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The ECB's monetary policy: Mandate, strategy and implementation

The Future of Money

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The views expressed in this presentation are those of the presenter and do not necessarily reflect those of the ECB or the Eurosystem

Overview

Article 127 of the Treaty on the Functioning of the European Union :

The primary objective of the ESCB [Eurosystem] shall be to maintain **price stability**.

Without prejudice to the objective of **price stability**, the **ESCB** shall support the **general economic policies** in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union.“

The ECB's strategy: a quantitative definition of price stability

HICP inflation and price stability
(annual percent change)

Source: Eurostat, ECB computations.
Latest observation: October 2018.

What is price stability?

"The Governing Council aims to maintain **inflation rates** at levels **below, but close to, 2%** over the **medium term**."

Why "below, but close to, 2%"?

- **Below 2%:**
  - Economic and social benefits of price stability
- **But close to 2%:**
  - Lower bound on nominal interest rates

The ECB’s strategy: two pillars

A prominent role for **monetary analysis** in the ECB’s strategy

Governing Council takes monetary policy decisions based on a comprehensive assessment of the risks to price stability

Economic analysis

Analysis of economic dynamics and shocks

Cross-checking

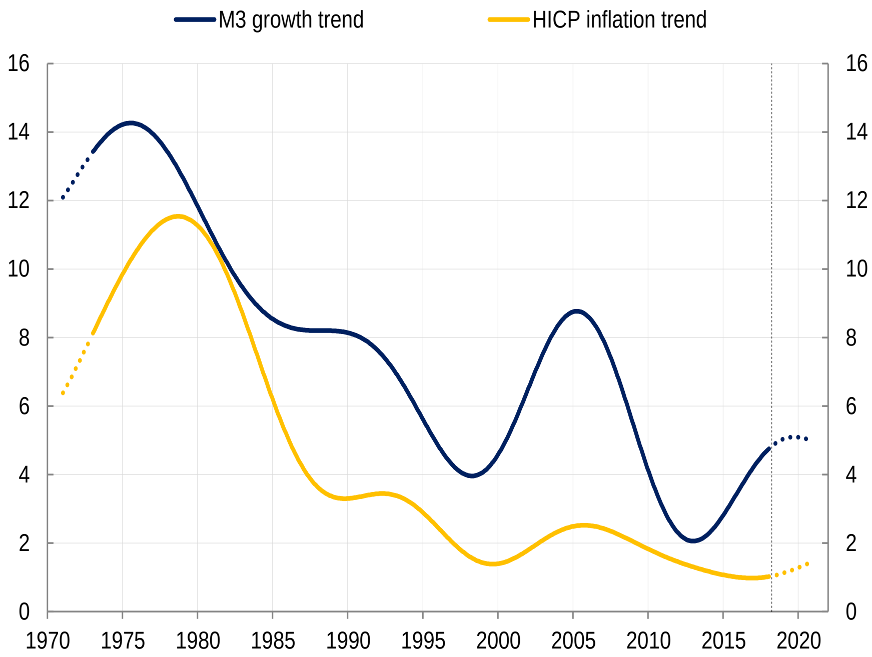
Monetary analysis

Analysis of monetary trends

Full set of information

Monetary trends for assessing risks to price stability over the medium to longer term

M3 and consumer price inflation
(annualised quarter-on-quarter percentage changes; deviation from mean)



Sources: ECB, ECB calculations. Includes March 2018 ECB staff projections.

Money is a good **leading indicator** for **inflation.**

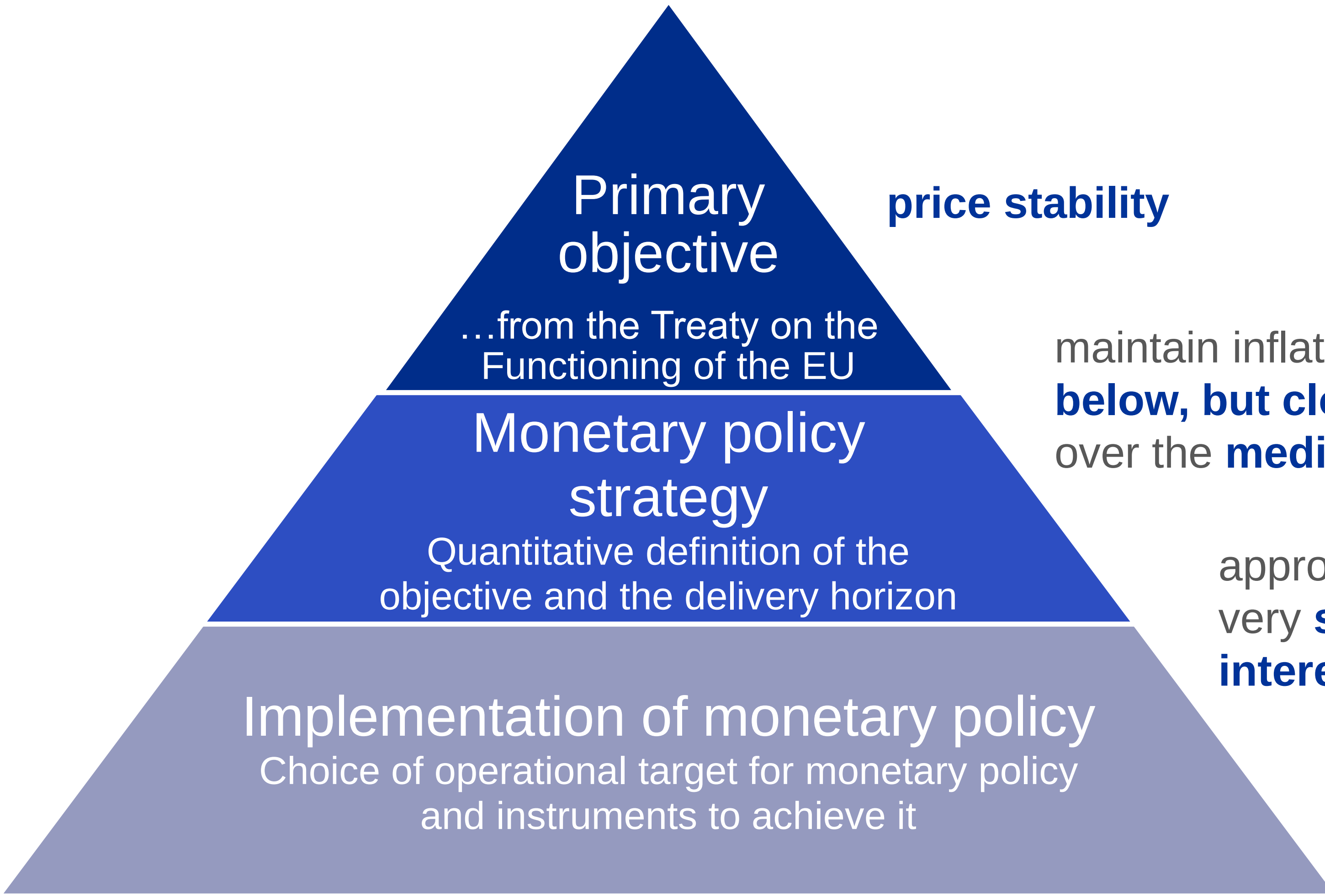
There is a robust **long-run relationship** between money growth and inflation.

Monetary analysis focuses on extracting the signal (the appropriate **underlying rate of monetary expansion**) that is relevant for **identifying risks to price stability.**

Overview

Eurosystem monetary policy implementation

The Eurosystem’s **operational target** and how it is met



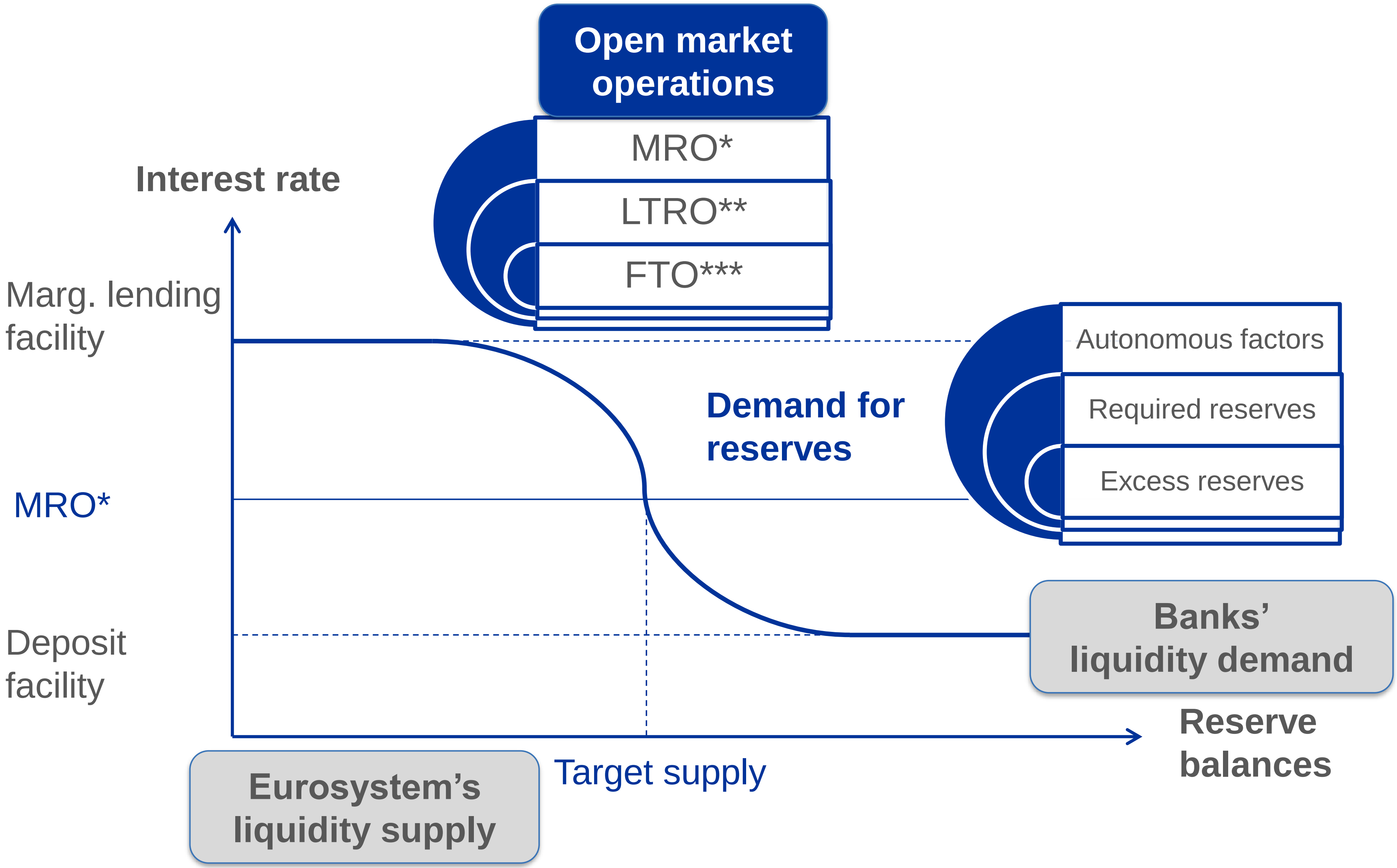
price stability

maintain inflation rate **below, but close to, 2%** over the **medium term**

appropriate level of very **short-term interest rates**

standard and **unconventional** tools

Steering liquidity in an interest-rate corridor

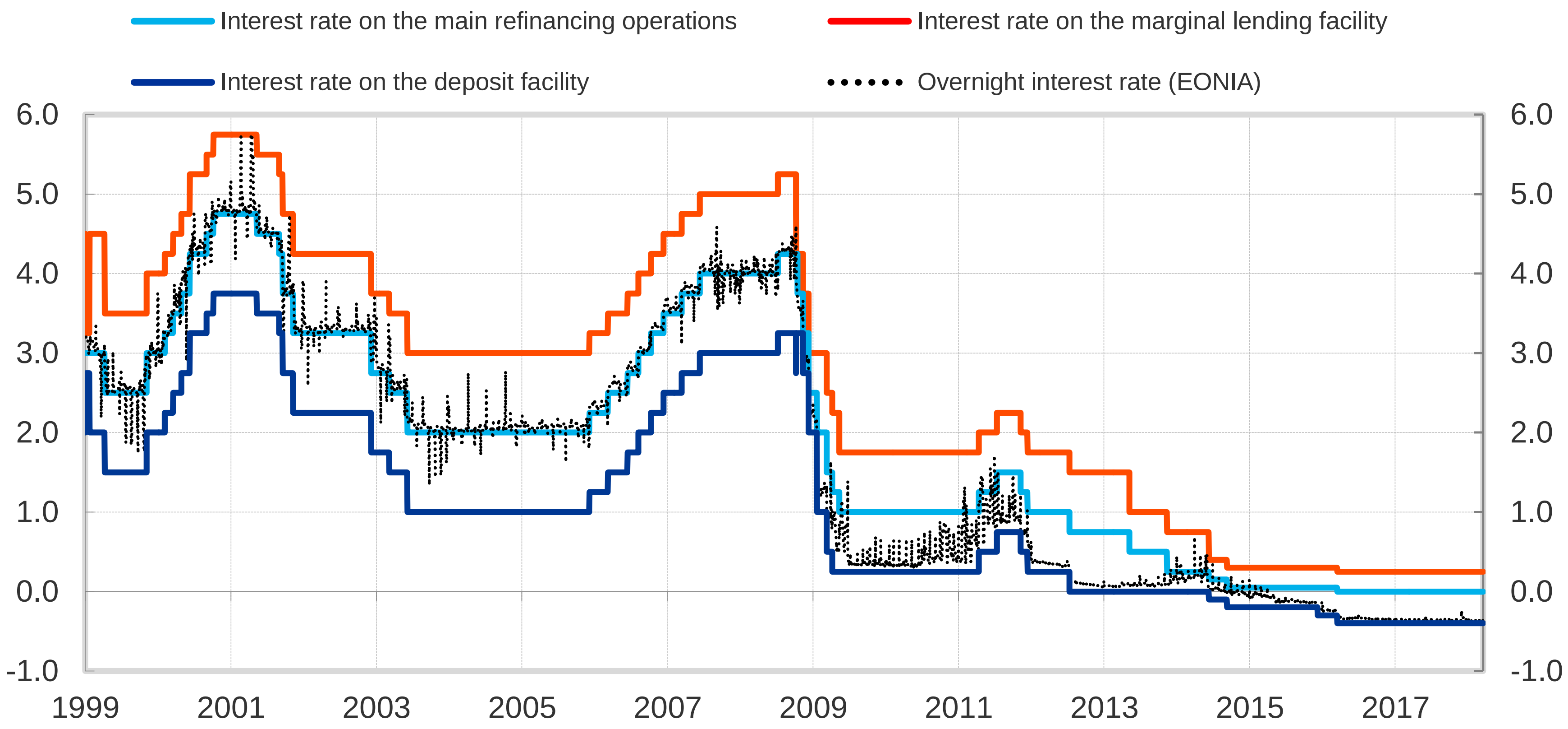


***Main Refinancing Operation, **Longer-term Refinancing Operation, ***Fine-tuning Operation**

Interest rates at the bottom of the corridor

ECB key interest rates and short-term market rate

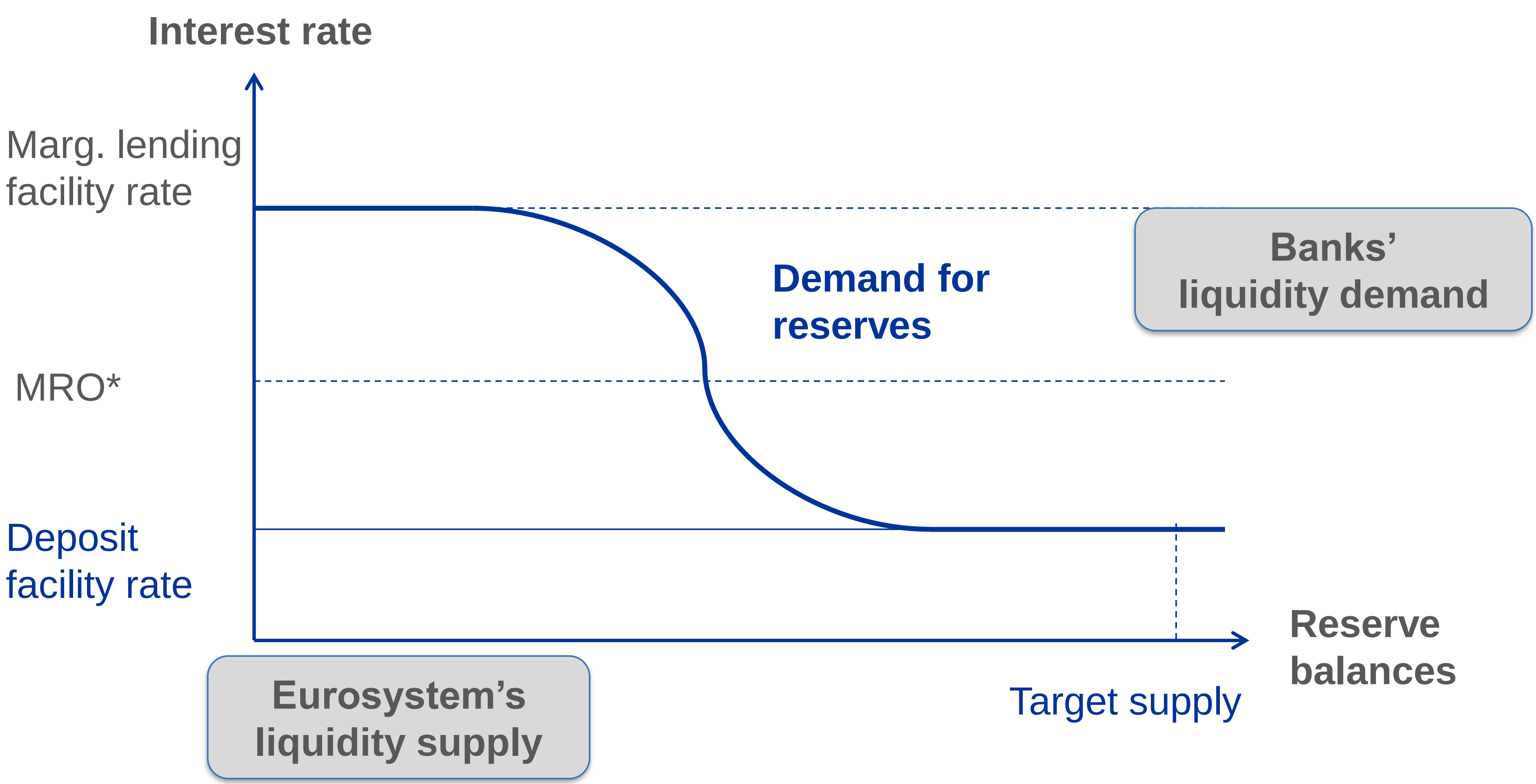
(percentages per annum)



Source: ECB.
Notes: "MLF" is the rate on the marginal lending facility, "DFR" is the rate on the deposit facility, "MRO" is the rate on the main refinancing operations and "EONIA" is the euro overnight unsecured interbank rate.
Latest observation: 11 March 2018

A de-facto floor system because of asset purchases

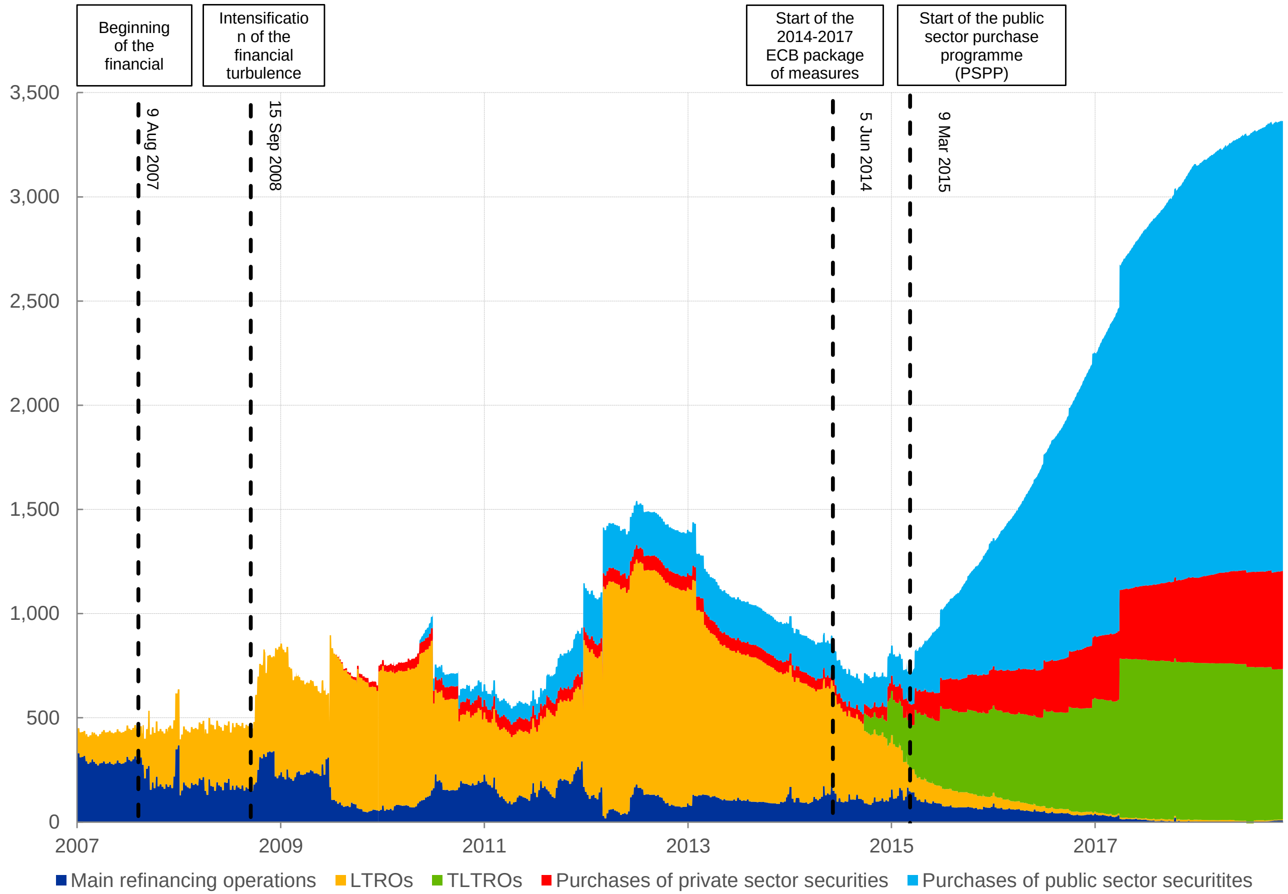
The deposit facility rate currently is the relevant policy rate



***Main Refinancing Operation**

Balance sheet expansion: TLTROs and Asset Purchase Programme

ECB monetary policy assets
(in billion €)



Source: ECB
Latest observation: 5 November 2018.

Overview

1	The ECB's mandate and strategy
2	Monetary policy implementation
3	**Transmission of monetary policy**
4	The effect of unconventional policies

Monopoly supplier of the monetary base

The Eurosystem is the **sole issuer** of **banknotes and bank reserves** in the euro area. This makes it the monopoly supplier of the monetary base, which consists of

- **currency** (banknotes and coins) in circulation,
- the **reserves** held by counterparties with the Eurosystem, and
- recourse by credit institutions to the Eurosystem’s **deposit facility**.

These items are **liabilities** in the **Eurosystem’s balance sheet**. Reserves can be broken down further into required and excess reserves.

Eurosystem simplified balance sheet

Assets	€ billions	Liabilities	€ billions
Gold and FX	696	Banknotes in circulation	1,197
Main refinancing operations	7	Liabilities related to monetary policy operations	1,986
Longer-term refinancing operations	726	Other liabilities	1,008
Securities held for monetary policy purposes	2,640		
Other assets in €	569	Capital, reserves and revaluation accounts	447
Total assets	**4,638**	**Total liabilities**	**4,638**

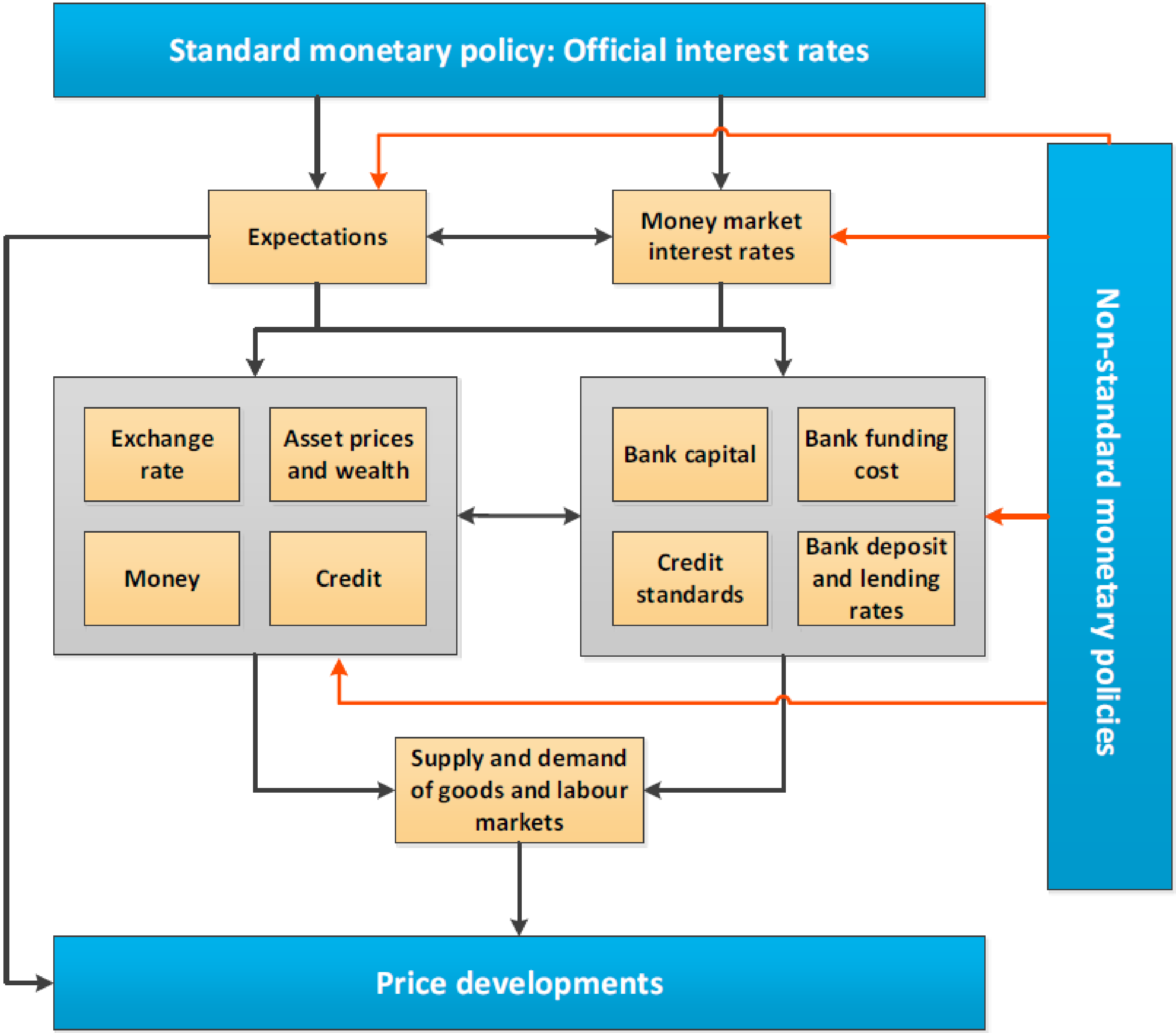
Consolidated financial statement of the Eurosystem as at 16 November 2018

Definition of monetary aggregates

Monetary aggregates comprise **monetary liabilities** of Monetary Financial Institutions (**MFIs**) and **central government** (post office, treasury, etc.) vis-à-vis **non-MFI euro area residents** excluding central government.

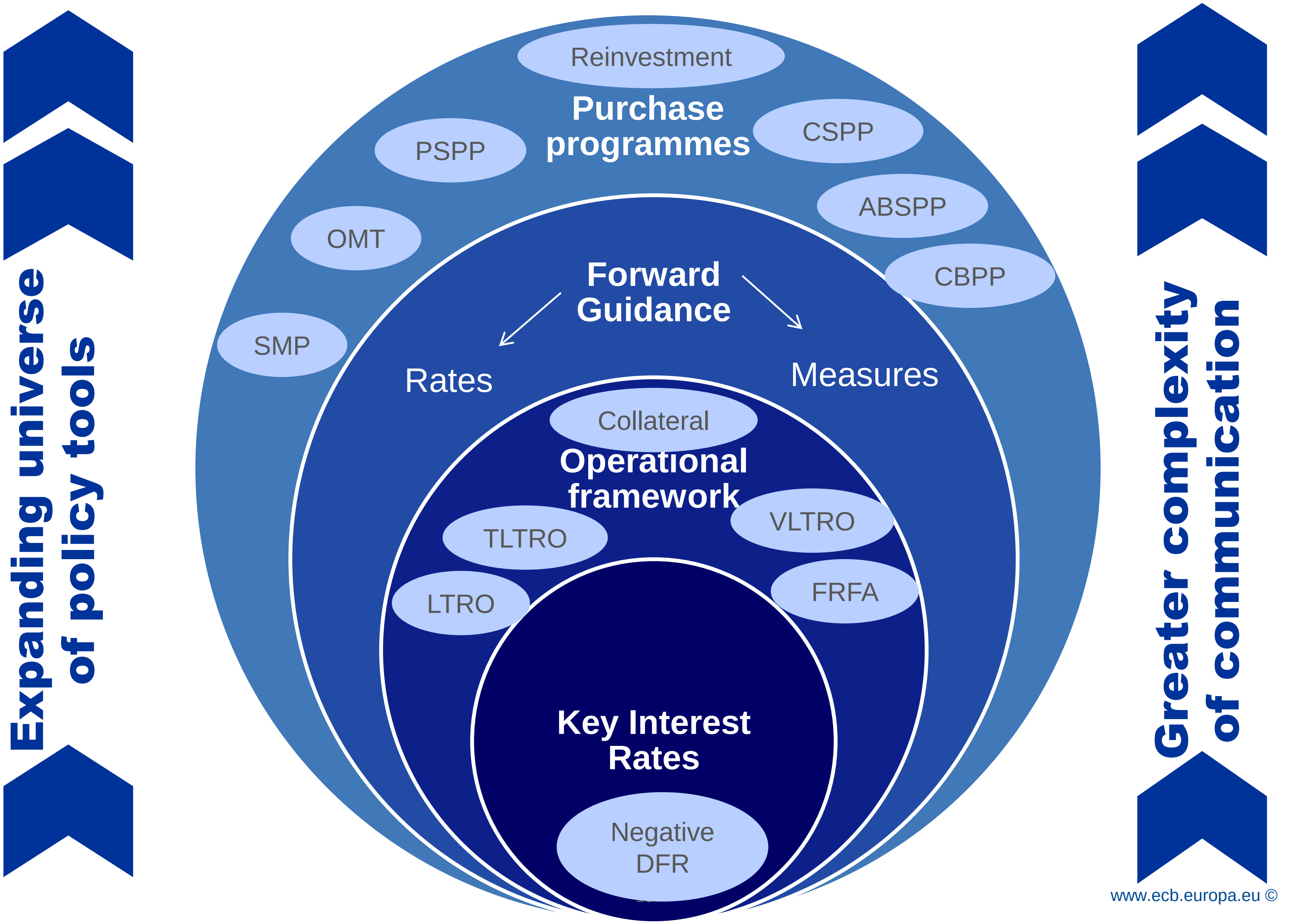
- **M1** is the sum of **currency in circulation** and **overnight deposits**;
- **M2** is the sum of **M1**, **deposits** with an agreed **maturity of up to two years** and **deposits redeemable at** notice of **up to three months**; and
- **M3** is the sum of **M2**, **repurchase agreements**, **money market fund** shares/units and **debt securities** with a **maturity of up to two years**.

Money, credit and banks are central in monetary transmission process



Overview

Unconventional policies took many forms



Three-pronged approach to monetary policy easing

- **Credit Easing**
  Longer-term loans to banks with incentive mechanisms to ensure an effective pass-through to households and firms (e.g. "Targeted Longer-Term Refinancing Operations" - TLTROs)

- **Forward Guidance**

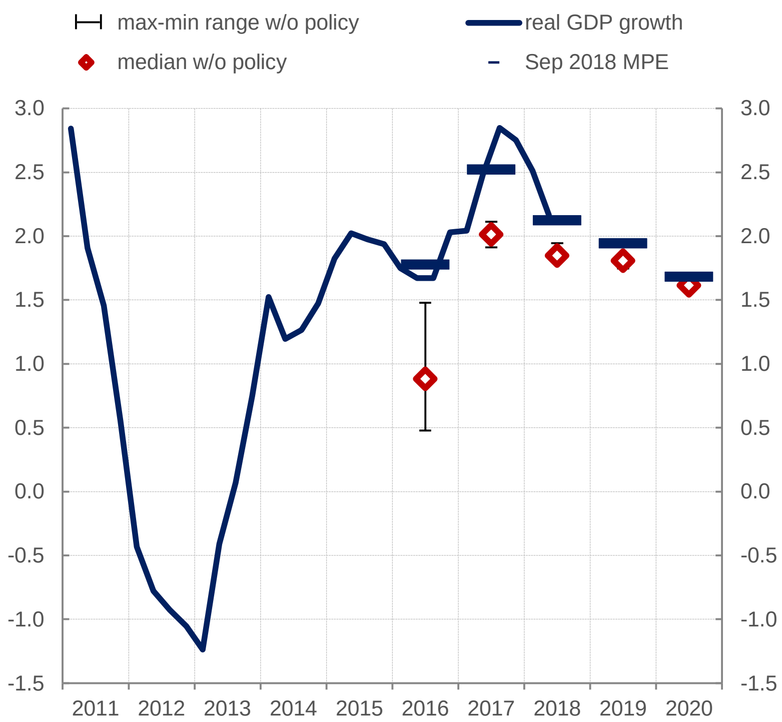
  Signaling the future course of monetary policy action (e.g. "…we decided to keep the key ECB interest rates unchanged. *We continue to expect them to remain at their present levels at least through the summer of 2019*, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.")

- **Asset Purchase Programme**

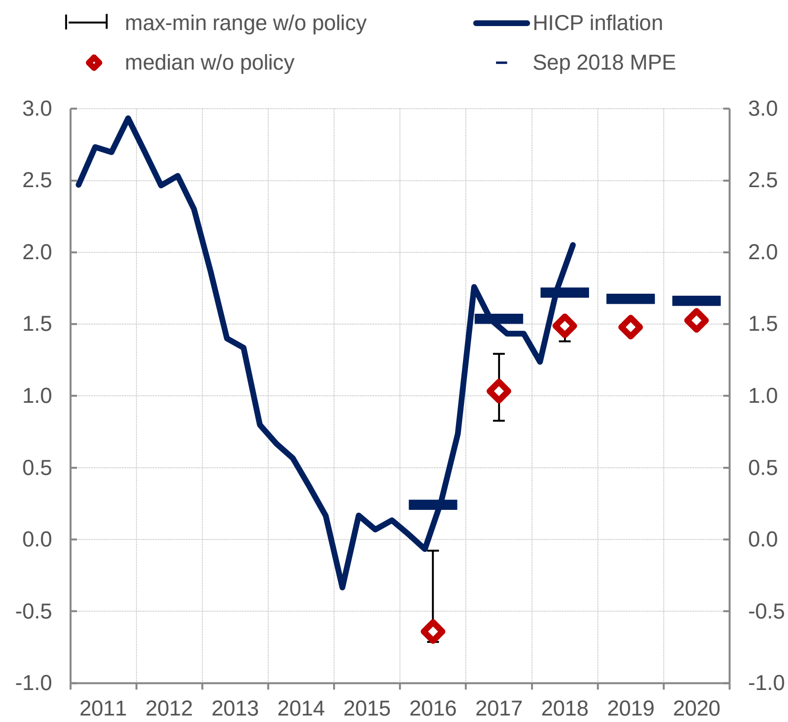
  Purchases of private and public securities to lower risk-free interest rates, compress risk premia across financial assets and encourage portfolio rebalancing towards lending to households and firms

The macroeconomic impact of NIRP, TLTRO and APP has been material

HICP inflation: actual, baseline projection and counterfactual without policy contribution
(year on year percentage change)



Real GDP growth: actual, baseline projection and counterfactual without policy contribution
(year on year percentage change)



Source: ECB computations.
Notes: HICP inflation and real GDP growth are based on the September 2018 MPE; the median and range reflect estimates of HICP inflation and real GDP growth over the projection horizon in the absence of monetary policy support.
Latest observation: 2018Q3 for HICP and 2018Q2 for GDP.

Thank you

The ECB's unconventional measures since June 2014

Rate cuts | TLTROs | Private asset purchases | Public asset purchases | Forward guidance (FG)

Jul.2013 | Jun.2014 | Sep.2014 | Jan.2015 | Dec.2015 | Mar.2016 | Dec.2016 | Oct.2017 | Jun.2018

Jun.2014

MRO: 0.15%
MLF: 0.40%
DFR: -0.10%

TLTRO-I Max. maturity: Sep. 2018 Uptake depends on net lending. Mandatory early repayment

Sep.2014

MRO: 0.05%
MLF: 0.30%
DFR: -0.20%

ABSPP-CBPP: Purchases of ABS and bank covered bonds

Jul.2013

FG: expected rates to remain at present or lower levels for extended period of time

Jan.2015

PSPP: Purchases of public securities €60bn monthly purchases until Sep. 2016, incl. ABSPP/CBPP3

Dec.2015

MRO: 0.05%
MLF: 0.30%
DFR: -0.30%

APP recalibration I
- Extension to Mar. 2017
- Reinvestment of principal payments

Mar.2016

MRO: 0.00%
MLF: 0.25%
DFR: -0.40%

TLTRO-II
- No mandatory early repayment
- Min. lending rate at DFR

CSPP: Purchases of NFC bonds

APP recalibration II
- €80bn monthly purchases
- Higher issue share limit for certain issuers

FG: ...and well past the horizon of our net asset purchases

Dec.2016

APP recalibration III
- €60bn monthly purchases until Dec. 2017
- Min. remaining maturity for PSPP eligible securities decreased from 2y to 1y
- Purchases below DFR if necessary

Oct.2017

APP recalibration IV
- €30bn monthly purchases until Sep. 2018 starting from Jan. 2018

Jun.2018

APP transition
- €15bn monthly purchases until Dec. 2018 followed by end of net asset purchases

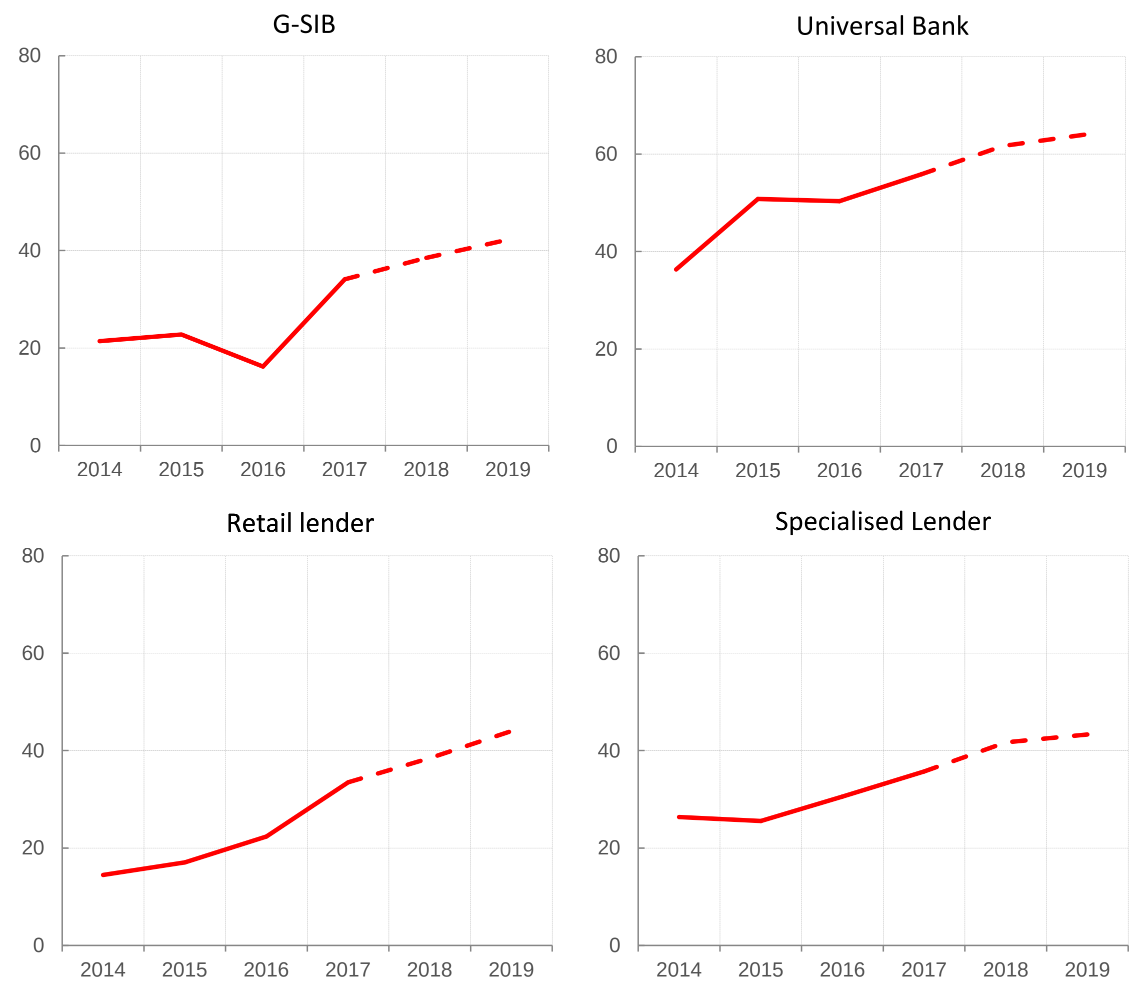
FG: ...at present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that evolution of inflation remains aligned with current expectations of sustained adjustment path

Outright monetary transactions (OMT) – announced in August 2012, yet to be activated
Transactions in secondary sovereign bond markets, subject to strict and effective conditionality
Aim: safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy

Recovery in profitability for all categories of banks

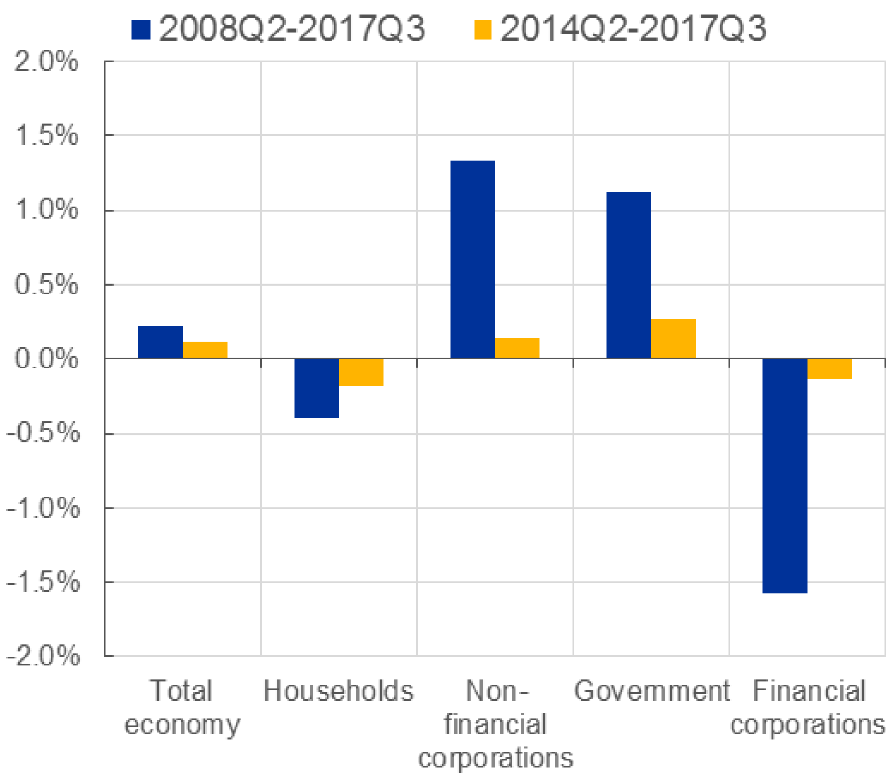
Cumulated change in ROA across bank business model

(basis points)



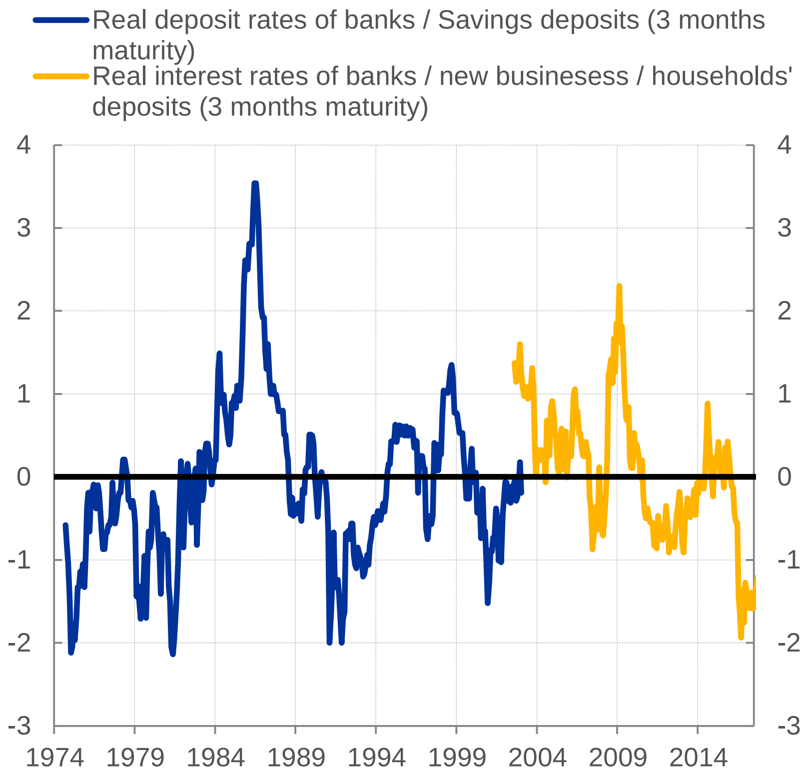
Source: ECB calculations. Note: The charts report the changes in return on assets (ROA) by bank business model historically observed in 2014-2017Q4 (red solid line) and projected ROA (red dashed line). Projections are based on a dynamic panel VAR model that uses individual balance sheet data from the iBSI dataset matched with Supervisory and SNL data. The variables included in the model are: ROA, lending rates to NFPS, deposit rates, NPLs, real GDP growth, inflation rate and interest rates with a remaining maturity of 2-, 5-, and 10-years. The baseline is constructed as a conditional forecast where the ROA of individual banks are projected for the next 3-year horizon conditional on the interest rates and macroeconomic outlook consistent with the September 17 MPE .

Changes in net interest income by sector
(percent of GDP)



Source: ECB.
Note: The chart reflects the changes from Q2-2008 to Q3-2017, and from Q2-2014 to Q3-2017, in the 4-quarter moving average of net interest income. To exclude the impact of variations in the stocks of assets/liabilities on net interest income, the changes computed by applying the asset and liability rates of return on the notional asset and liability stocks in Q1-2008 and Q1-2014, respectively. Changes in net interest income are expressed as percentages of GDP, with GDP fixed at the respective starting points.

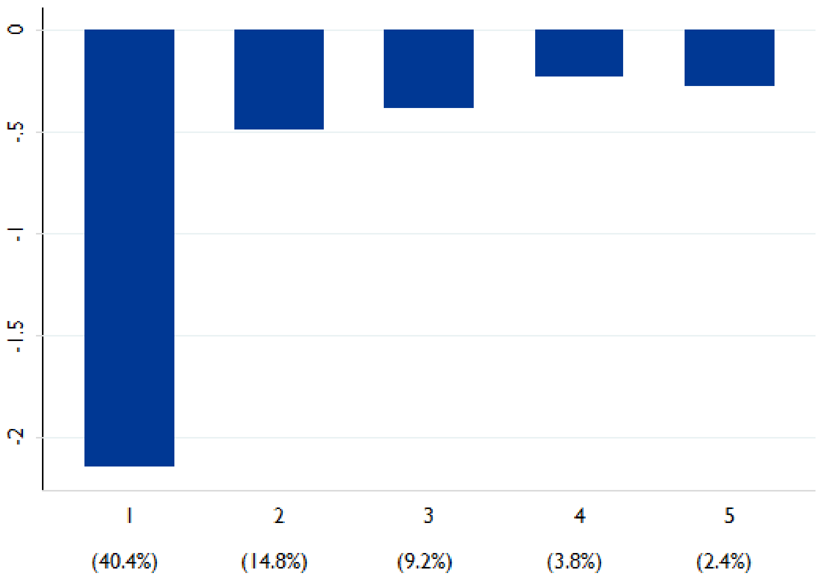
Real term deposit rates in Germany
(percent)



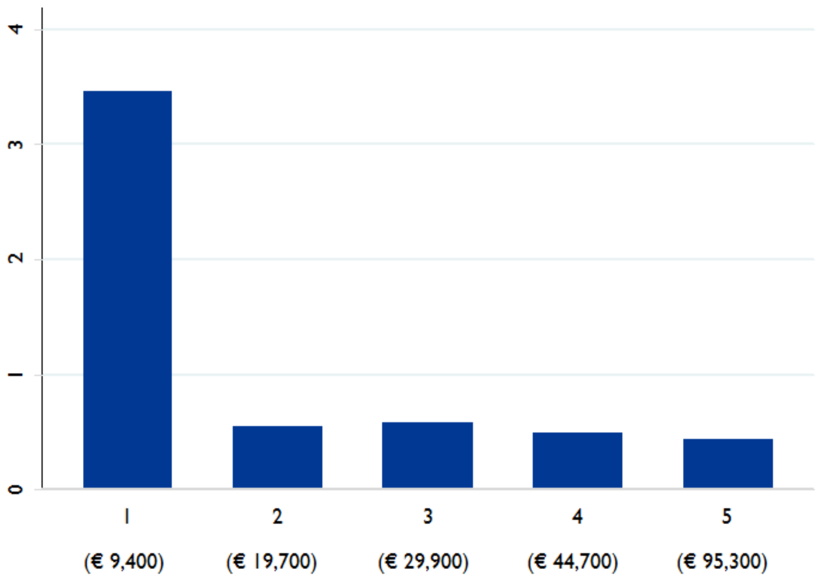
Source: Deutsche Bundesbank.
Latest observation: February 2018.

APP effects are strongly skewed toward low-income households

Estimated APP impact on unemployment rate by income quintile
(percentage points)



Estimated APP impact on mean income by income quintile
(percent)



Sources: Lenza and Slacalek (2018).
Note: The numbers in brackets on the RHS chart show levels of mean gross household income 4 quarters after the impact of APP. Euro area aggregates are calculated as the total for the four large countries: Germany, Spain, France and Italy.