

# **ECB MONETARY POLICY**

## **Past, present and future**

**Óscar Arce**

DG Economics, Statistics and Research. Banco de España

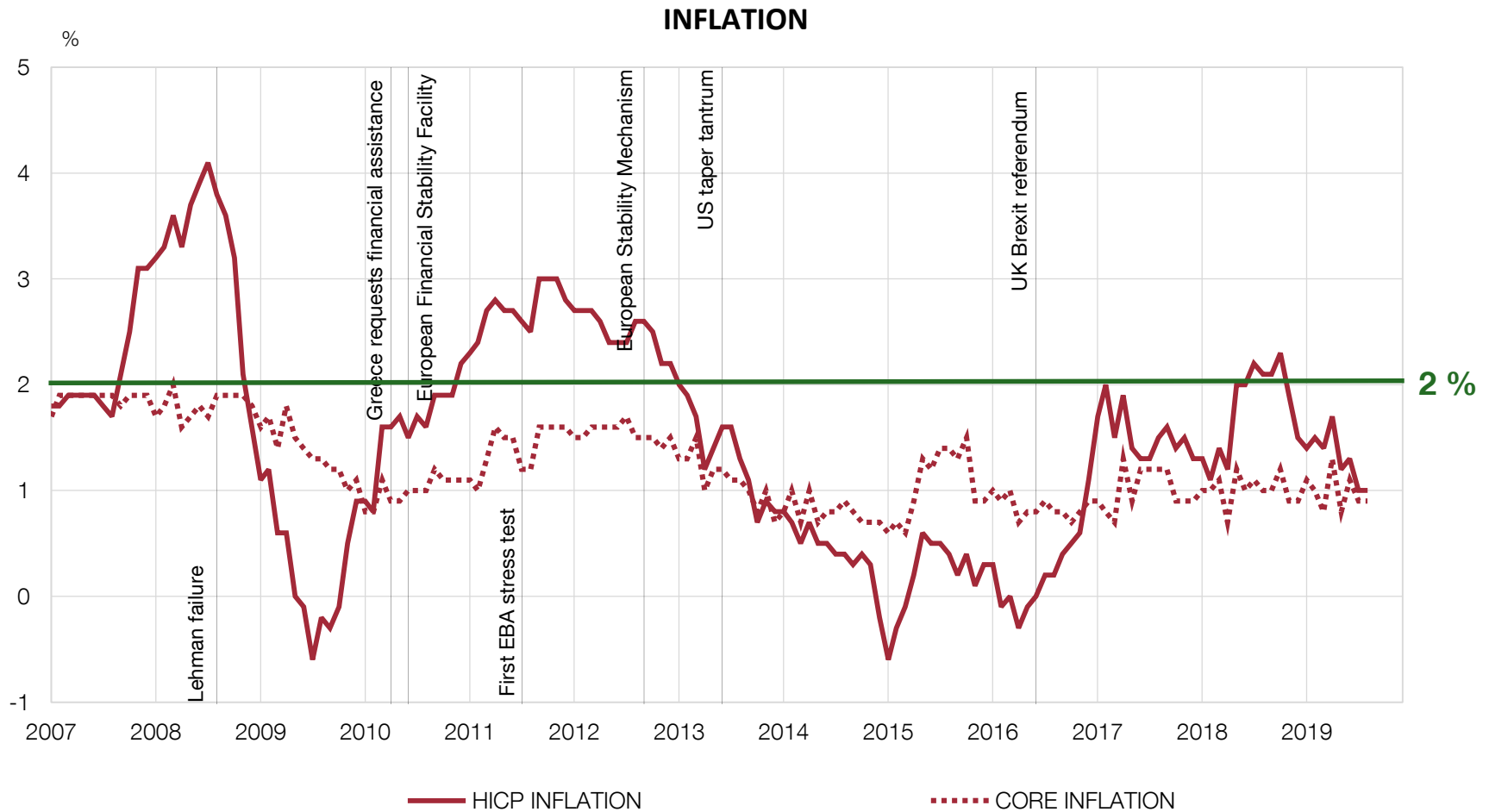
XV MEETING OF MONETARY POLICY MANAGERS

CEMLA-BCRD, Santo Domingo, República Dominicana

26-27 September 2019



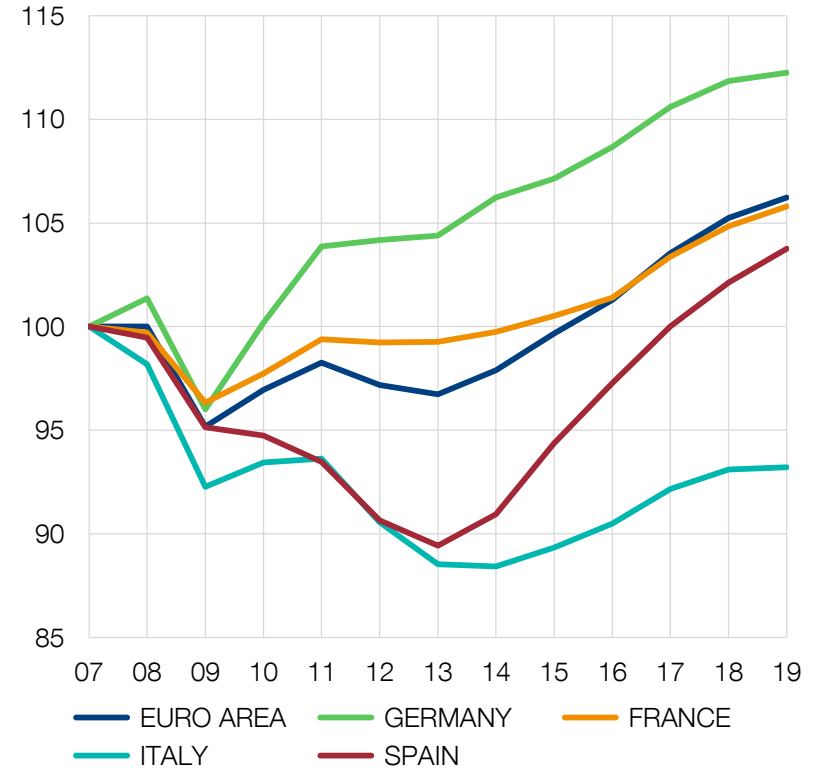
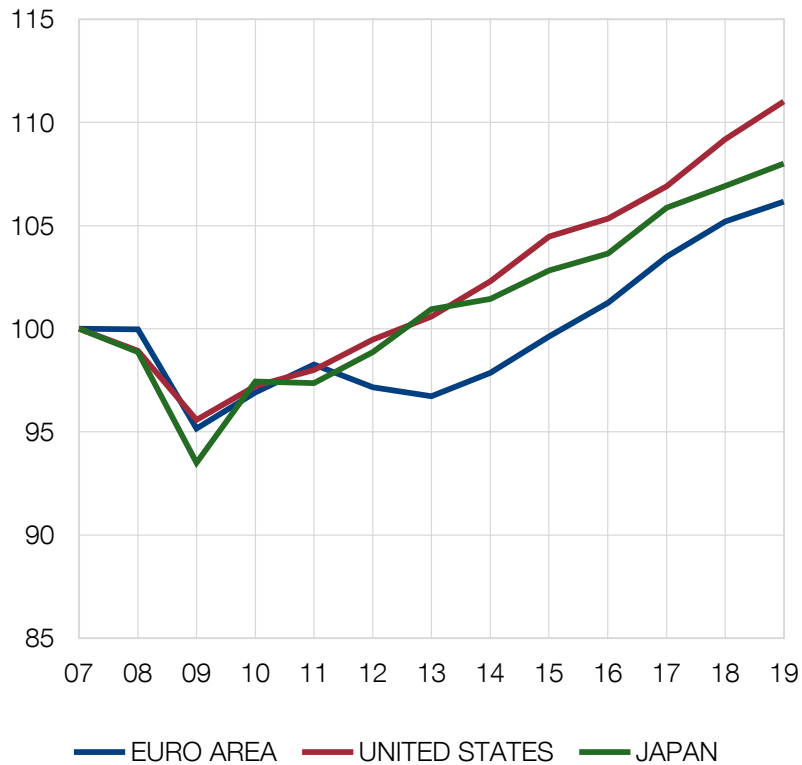
# THE EURO AREA HAS WITNESSED DISINFLATIONARY PRESSURES SINCE 2013



Source: Eurostat. Last observation: 2019 August.

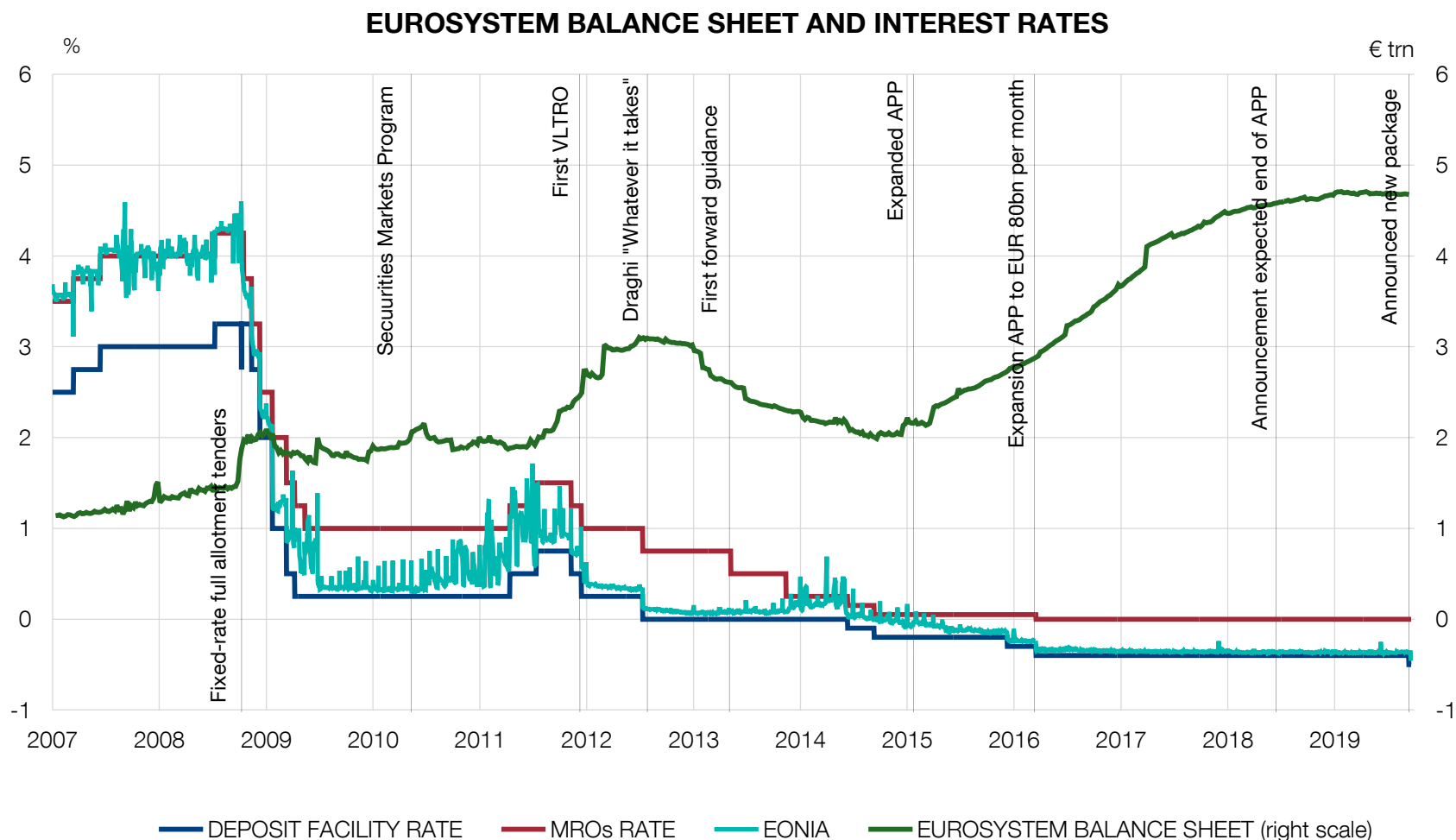
# PER CAPITA GROWTH IN THE EURO AREA HAS BEEN DISAPPOINTING SINCE 2012, WITH RISING DIVERGENCES ACROSS MEMBERS

**GROWTH OF THE REAL GDP PER HEAD OF POPULATION  
(2010 prices; 2007=100)**



Sources: Datastream and European Commission

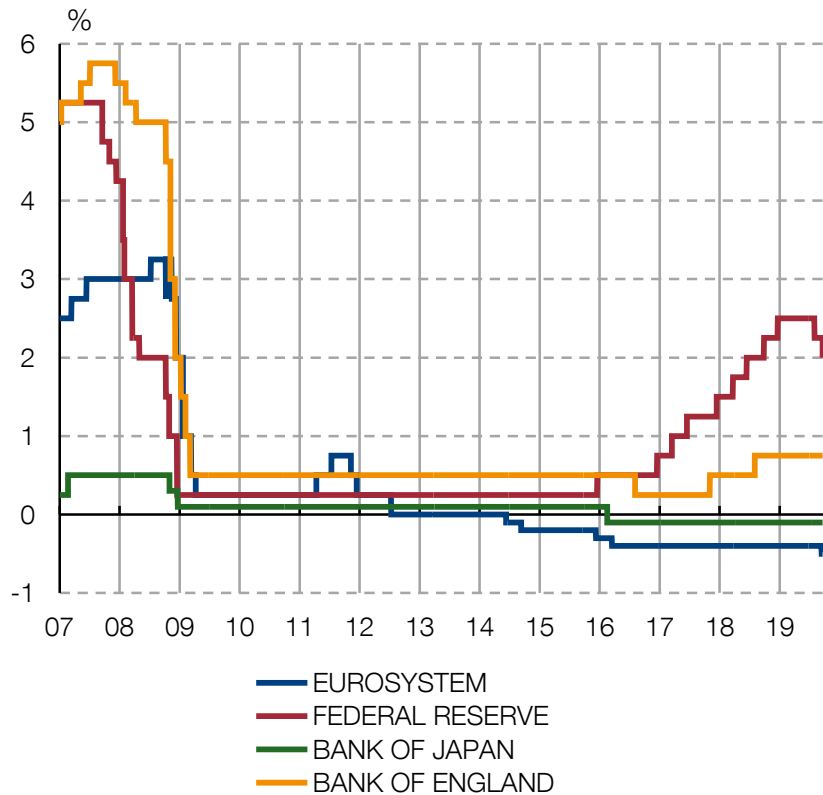
# OVER THE DIFFERENT PHASES OF THE CRISIS, THE ECB HAS DEPLOYED A PACKAGE OF MUTUALLY REINFORCING MEASURES



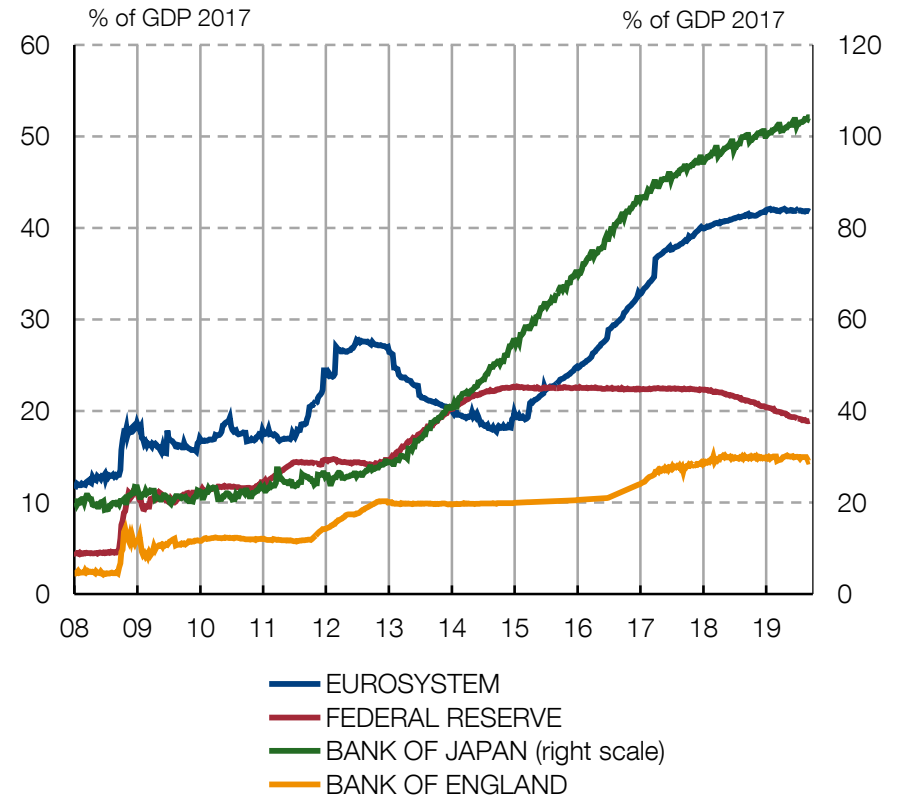
Source: European Central Bank. Last observation: Rates, 19 September 2019; Balance sheet: 12 September 2019.

# THE ECB'S MONETARY POLICY RESPONSE HAS BEEN COMPARABLE TO THAT IN OTHER LARGE ADVANCED ECONOMIES

## POLICY INTEREST RATES



## CENTRAL BANKS BALANCE SHEET

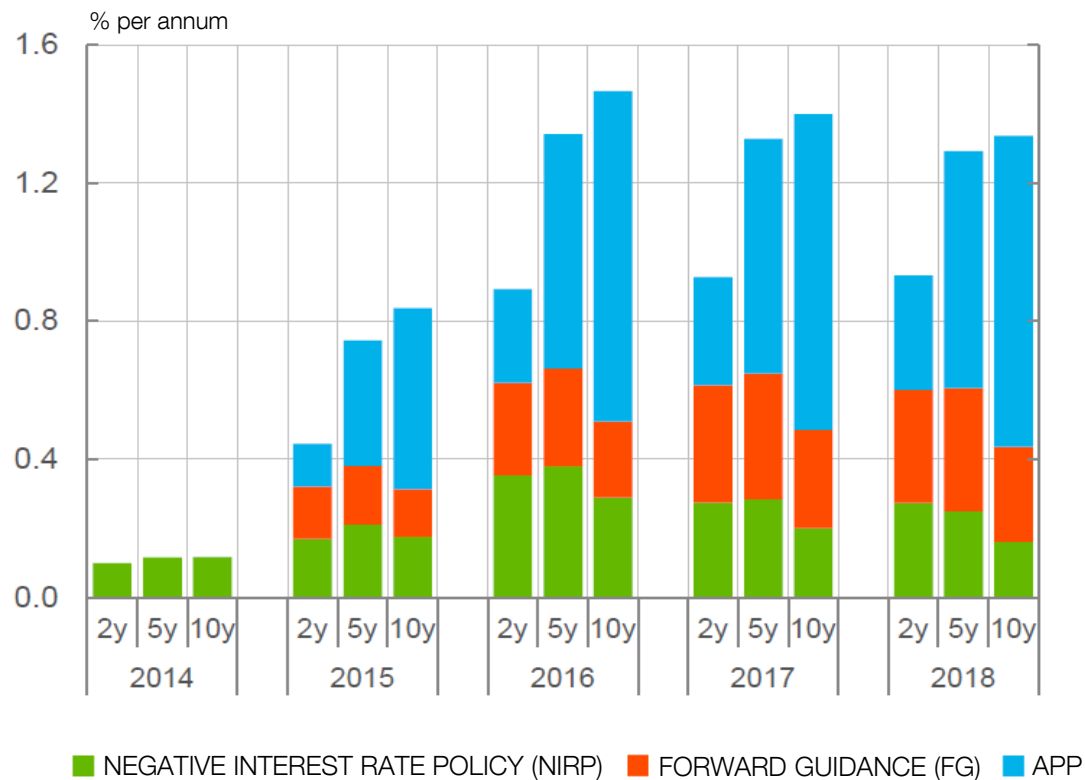


Sources: Datastream, European Central Bank and Banco de España.

Last observations: Rates, 19 Sep 2019; Balance sheet: Eurosystem, 12 Sep 2019; FED, 11 Sep 2019; BoJ, 09 Sep 2019; BoE,

# THESE MEASURES HAVE BEEN EFFECTIVE AT EASING FINANCIAL CONDITIONS, SUCH AS YIELD CURVES...

## UPWARD PRESSURES ON EURO AREA SOVEREIGN BOND YIELDS IN ABSENCE OF ECB'S NON-STANDARD MEASURES 2014-2018

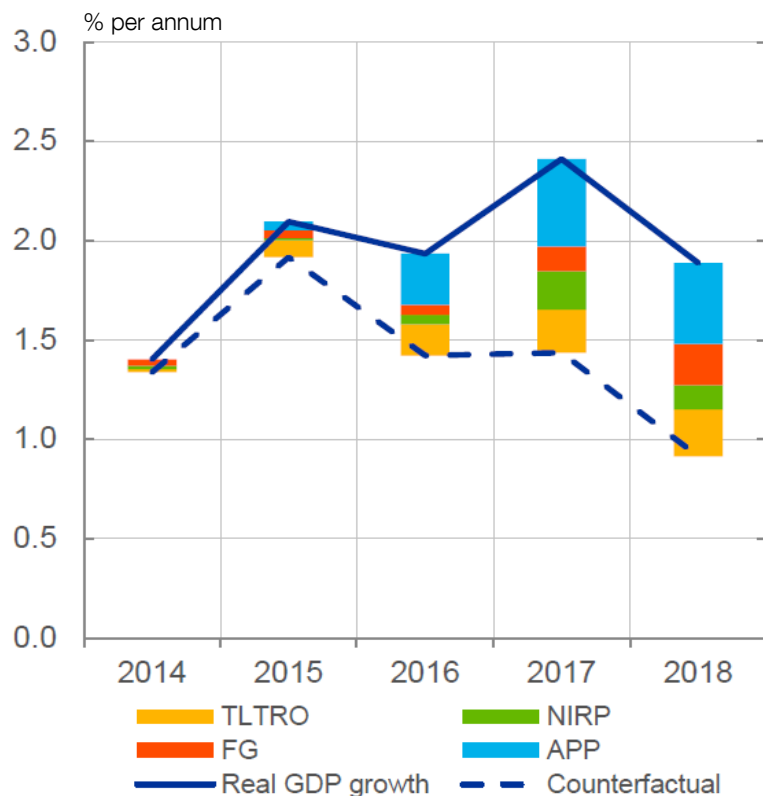


Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

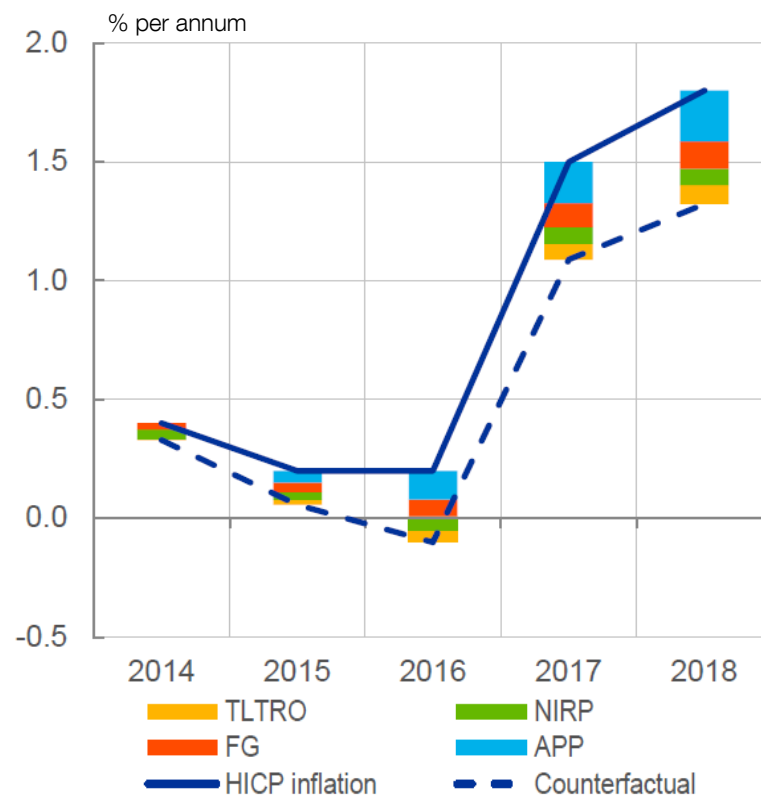
Notes: The chart shows the impact of ECB non-standard measures on the GDP-weighted aggregate of euro area sovereign bond yields.

# ...WHICH IN TURN HAVE STIMULATED GROWTH AND INFLATION OVER THE PERIOD 2014-2018

## CONTRIBUTION OF ECB NON-STANDARD MEASURES TO REAL GDP GROWTH 2014-2018



## CONTRIBUTION OF ECB NON-STANDARD MEASURES TO HICP INFLATION 2014-2018



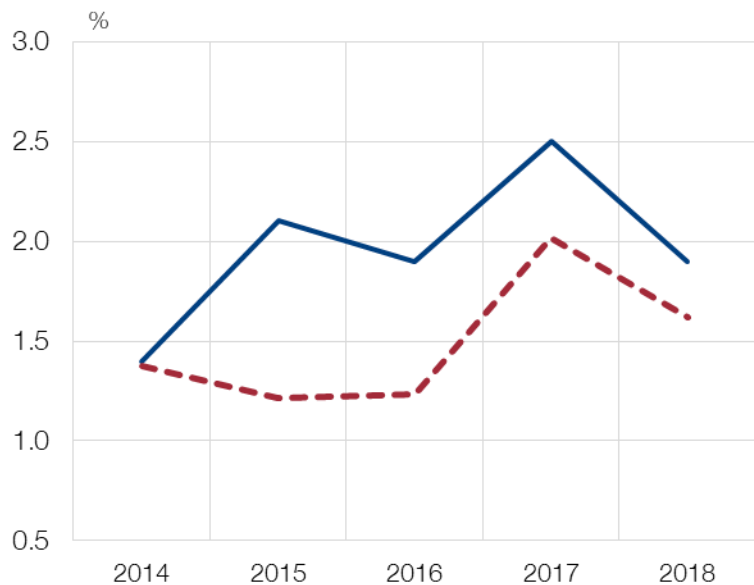
Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

Notes: The chart shows the impact of ECB non-standard measures on macro variables based on a macroeconomic model with financial variables conditioning on the yield curve impact shown in the previous slide.

# ANALYSIS BY BANCO DE ESPAÑA STAFF CONFIRMS THE EFFECTIVENESS OF ECB BALANCE-SHEET POLICIES (APP, TLTRO)

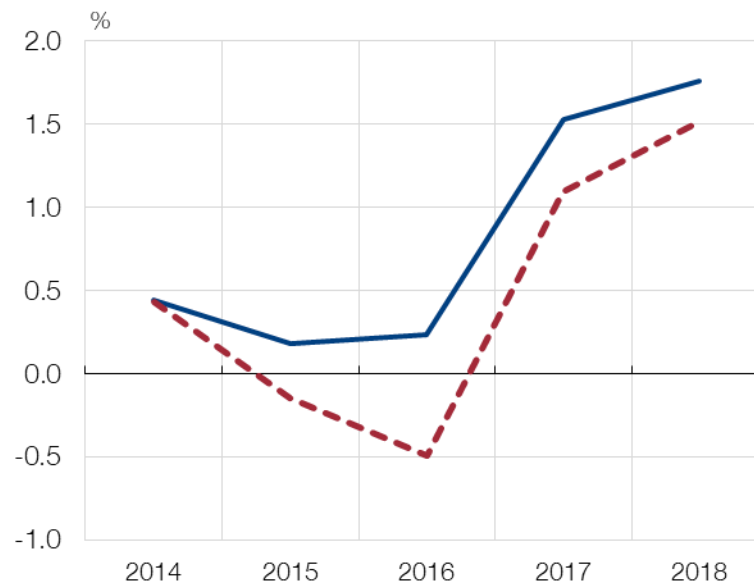
- Accumulated effects over the period 2015-18: **2.4%** for GDP, **1.8%** for HICP.

### CONTRIBUTION OF ECB BALANCE SHEET POLICIES TO REAL GDP GROWTH



— OBSERVED    - - - IN ABSENCE OF MEASURES

### CONTRIBUTION OF ECB BALANCE SHEET POLICIES TO HICP INFLATION



— OBSERVED    - - - IN ABSENCE OF MEASURES

Source: Banco de España. Estimated effects based on the model of Burriel and Galesi (2018).



# IN 2019, WE FACE AGAIN THE THREAT OF A DISANCHORING OF INFLATION EXPECTATIONS...

## FIVE-YEAR FORWARD BREAK-EVEN INFLATION RATE FIVE YEARS AHEAD

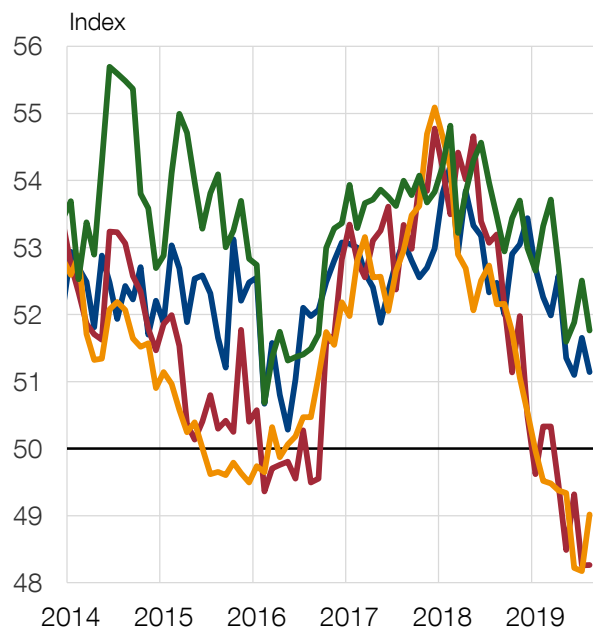


Sources: Thomson Reuters and Banco de España. Last observation: 19 September 2019.

# ... IN A CONTEXT OF DECELERATING GLOBAL GROWTH AND RISING RISKS

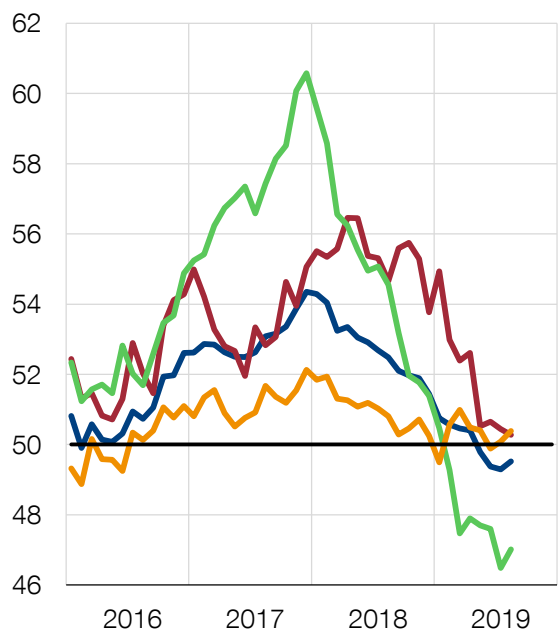
- The world economy slowed down in the second quarter and high-frequency indicators point to a continuation of this trend in the next months.
- World trade slowed down against a background of growing uncertainty over the trade policy of US and China.

### GLOBAL PMI



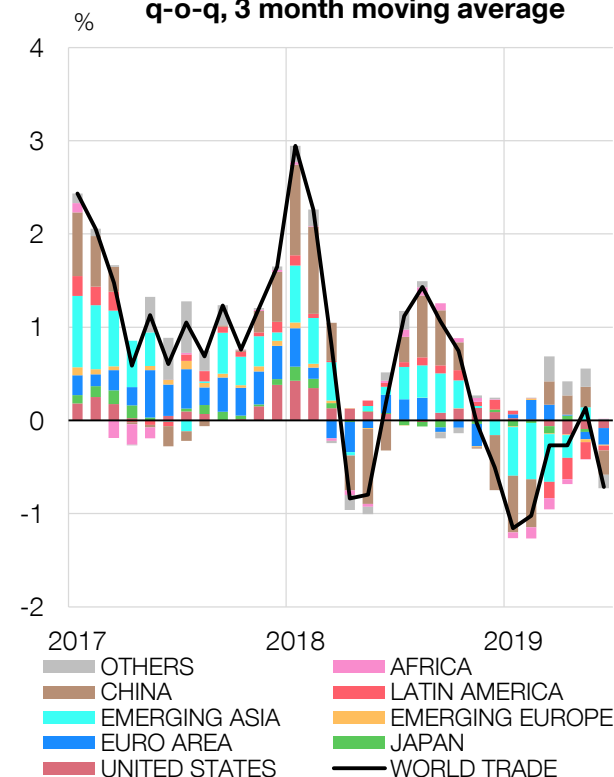
- MANUFACTURING. CONSUMER GOODS
- MANUFACTURING. INVESTMENTS GOODS
- MANUFACTURING. INTERMEDIATE GOODS
- SERVICES

### MANUFACTURING PMI



- GLOBAL
- EURO AREA
- UNITED STATES
- EMERGING

### WORLD TRADE GROWTH q-o-q, 3 month moving average



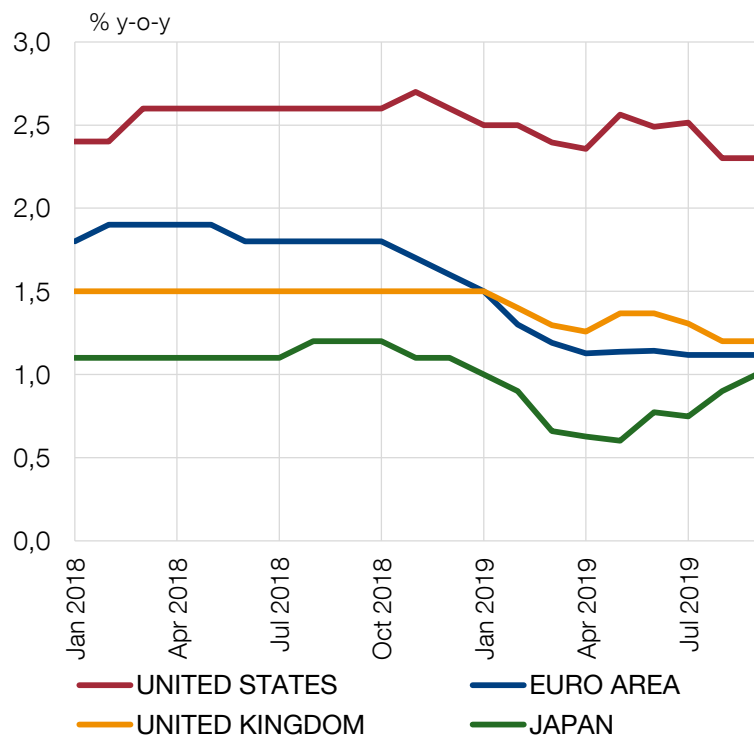
- OTHERS
- CHINA
- EMERGING ASIA
- EURO AREA
- UNITED STATES
- AFRICA
- LATIN AMERICA
- EMERGING EUROPE
- JAPAN
- WORLD TRADE

Sources: IHS Markit and CPB. Last observation: PMI, August 2019; Trade, June 2019.

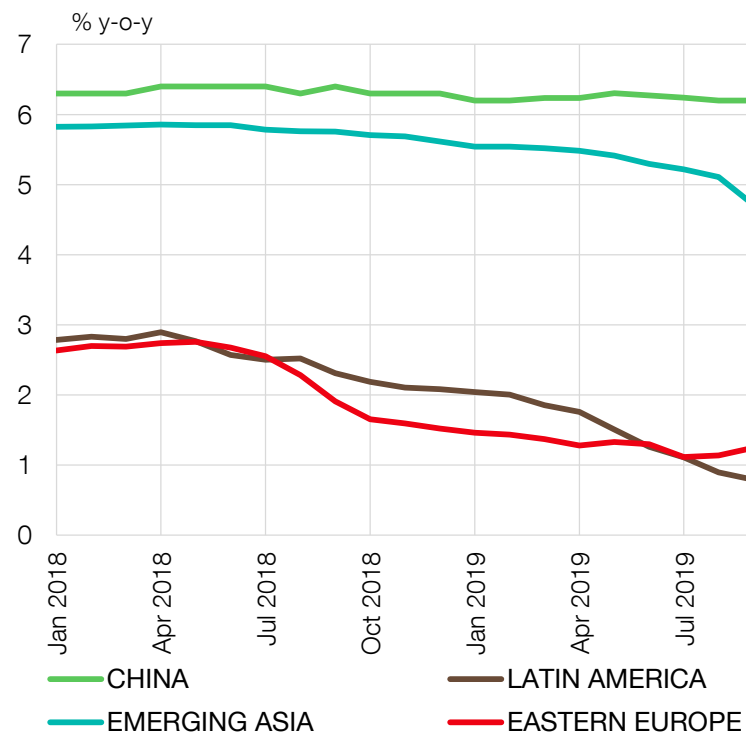
# ... IN A CONTEXT OF DECELERATING GLOBAL GROWTH

- Generalized and recurrent downward revisions for growth, in 2019, for both advanced and emerging economies.

### GDP PROJECTIONS FOR 2019 DEVELOPED ECONOMIES



### GDP PROJECTIONS FOR 2019 EMERGING ECONOMIES

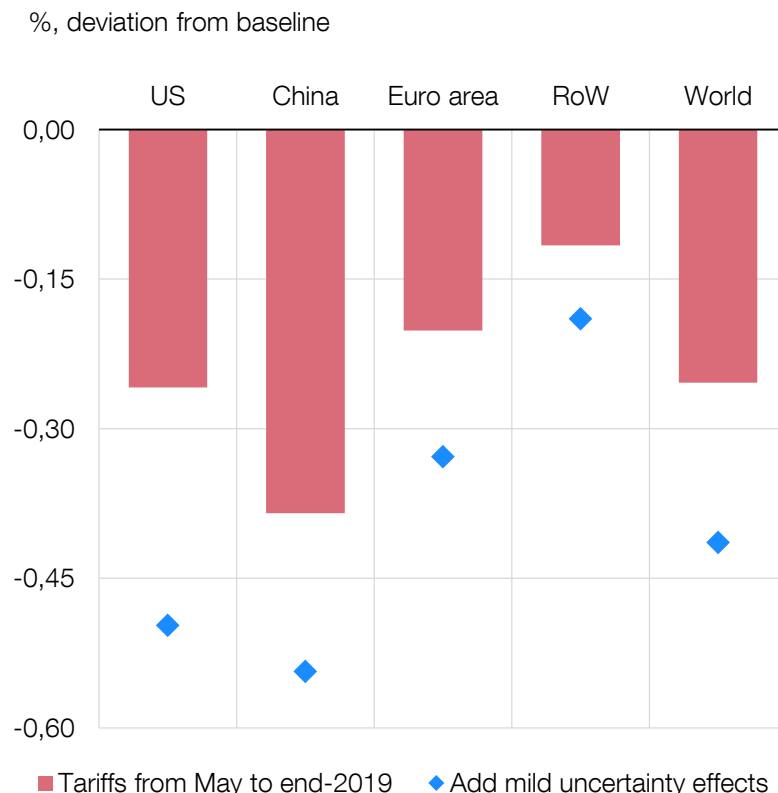


Source: Consensus. Last observation: September 2019, except Emerging Asia excluding China (August 2019) and Eastern Europe (August 2019)

# US-CHINA TRADE CONFLICT: THE EFFECTS ON THE GLOBAL ECONOMY ARE ALREADY MATERIALIZING

- The escalation of trade tensions between China and the US entered a new phase in May 2019
- The increase in protectionism appears to be significantly affecting global economic activity through a variety of channels...
  - ...both direct (Demand, prices of goods)
  - ...and indirect (Confidence, risk aversion)
- We estimated the impact on the global economy using the NiGEM macroeconometric model
  - For the euro area, the impact on GDP is roughly -0.2%, reflecting its high degree of trade openness, rendering it more vulnerable to the fall in global activity
  - Impact of uncertainty difficult to gauge

## TRADE CONFLICT ESCALATION: GDP IMPACT IN Q4 2021

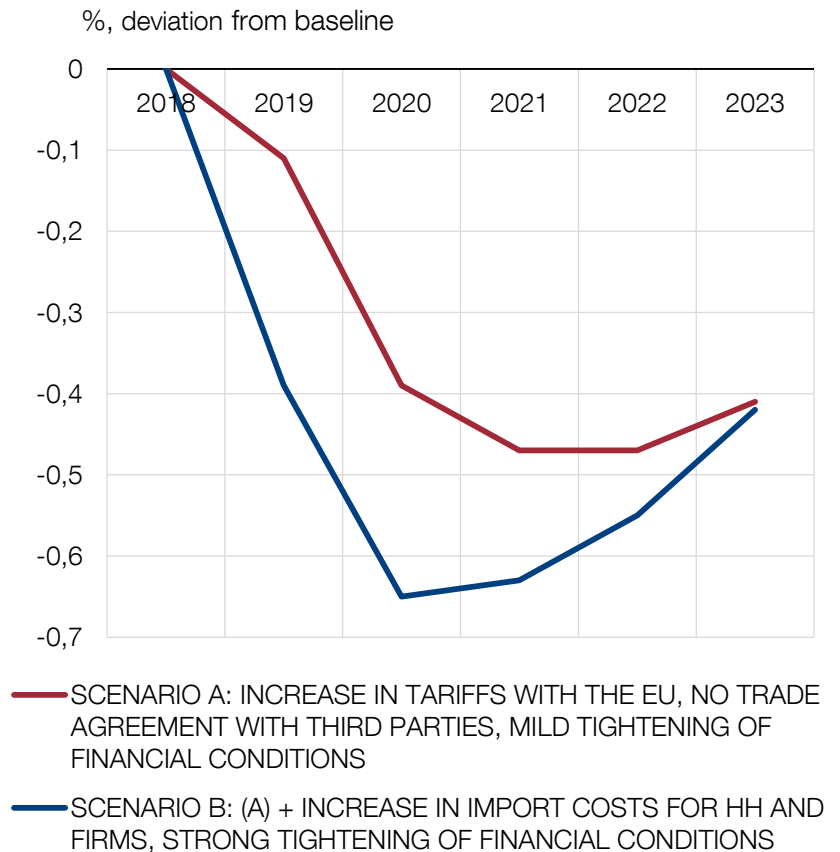


Source: Banco de España.

# BREXIT: UNCERTAINTY PERSISTS AS OCTOBER 31<sup>ST</sup> APPROACHES

- The UK economy has deteriorated further on account of heightened uncertainty about how and when it will leave the EU...
- The arrival of the new Cabinet in July increased the likelihood of a no-deal scenario
- Despite some legal actions taken by the other parties in UK Parliament to deter a no-deal beyond October 31st, the timing and the outcome of such measures are still largely uncertain
- In the last weeks, on the other hand, the UK Government appears to have become more prone to reaching an agreement.
- ...all of the former notwithstanding, a no-deal path would have a noticeable negative impact in the euro area economy

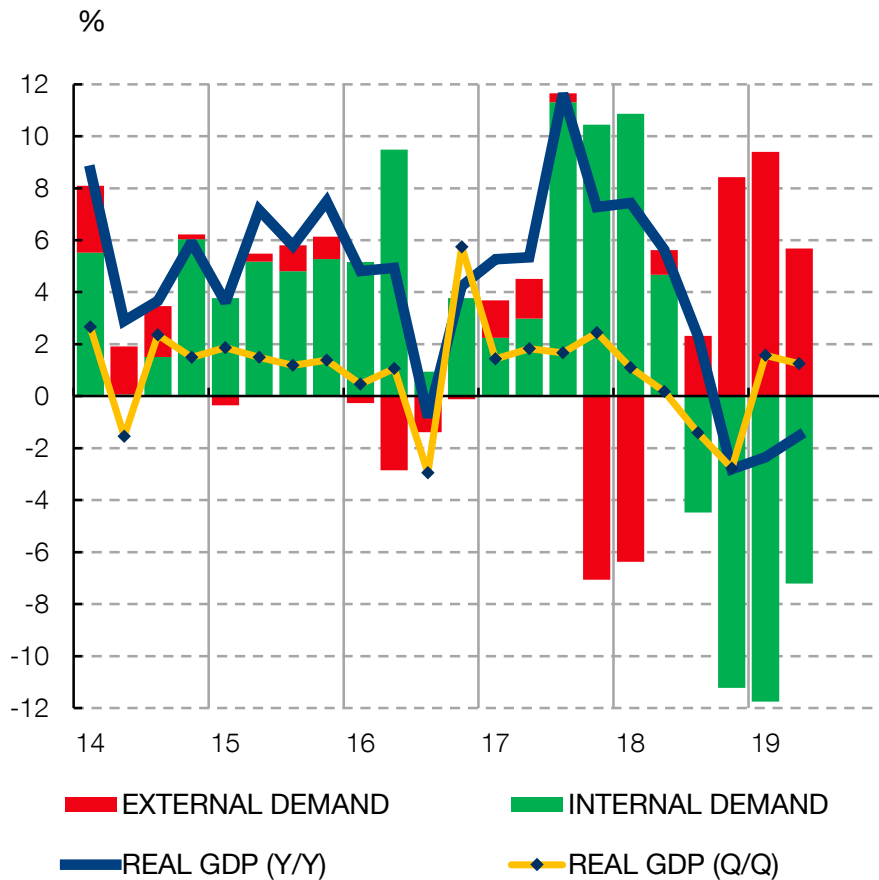
## EU: GDP IMPACT OF NO-DEAL BREXIT



Source: IMF WEO, April 2019.

# TURKEY HAS BOTTOMED OUT AND ECONOMIC CONDITIONS ARE GRADUALLY IMPROVING, BUT DOMESTIC RISKS PERSIST

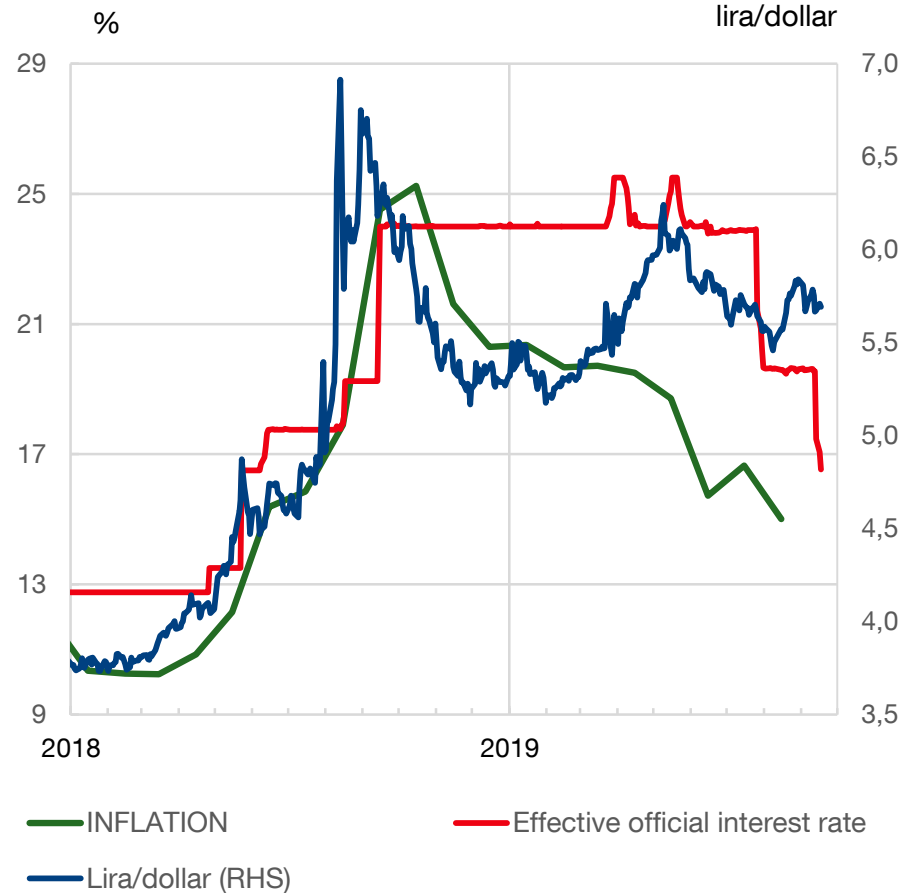
## GDP GROWTH RATE AND CONTRIBUTIONS



Note: the weight of Turkey in Euro Area exports is around 2.5%

Sources: Central Bank of Turkey and Turkish Statistical Institute.

## EXCHANGE RATE, OFFICIAL INTEREST RATE AND INFLATION



# ECB MONETARY POLICY PACKAGE IN RESPONSE TO DETERIORATING GROWTH AND INFLATION OUTLOOK

The ECB adopted a comprehensive package of measures in its last policy meeting (12 September):

- 10 bps reduction of **deposit facility rate** (from -0.40% to -0.50%) with two-tier system
- Reinforced **state-contingent forward guidance**
- Reactivated **APP**: monthly 20 billion EUR starting from 1<sup>st</sup> of November and without a defined time limit
- Dropped the 10 bps spread on rate of **TLTROs** and extended the maturity from 2 to 3 years

# MONETARY POLICY GOING FORWARD: REVIEW OF MONETARY POLICY STRATEGIES

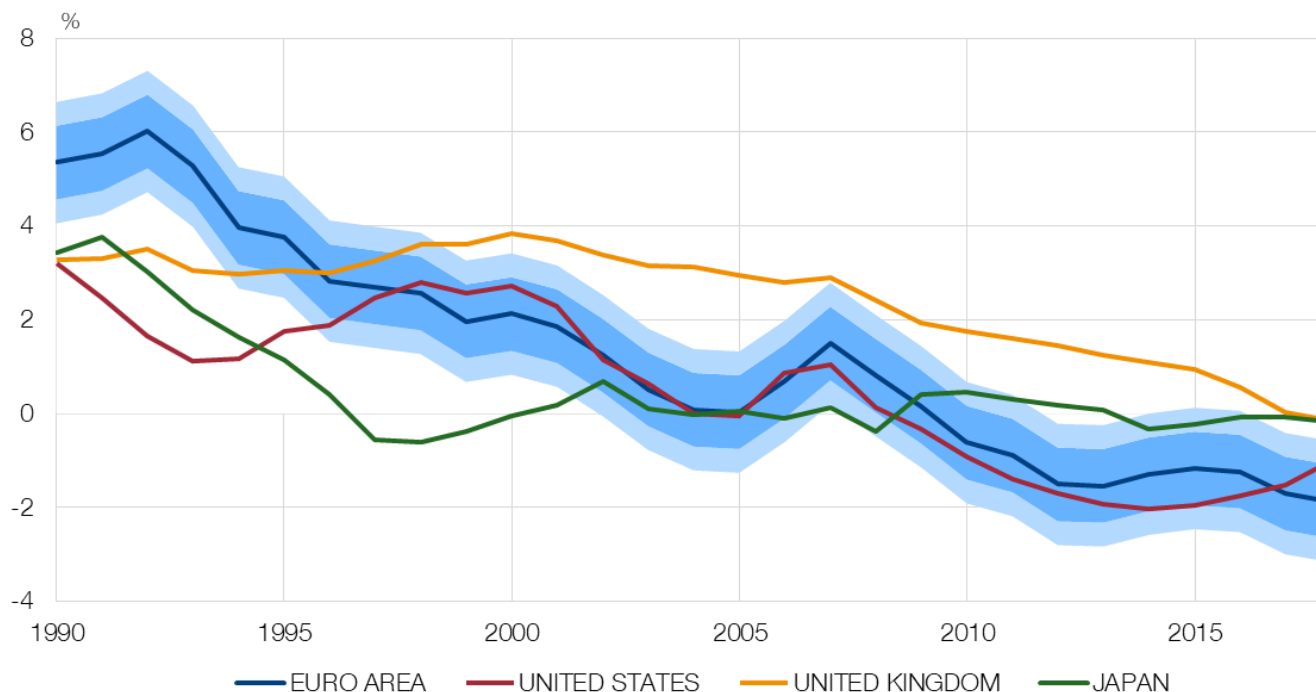
- Several major central banks are conducting reviews of their **monetary policy strategies**
- There is room for including **modification/clarification of the ECB's price stability definition**
  - Current inflation aim: ***“below, but close to, 2 percent”*** over the medium term
  - Possibility of introducing specific **point target** (e.g. 2 percent)...
  - ... with **symmetric** interpretation: both negative and positive (transitory) deviations
- Would allow to make state-contingent **forward guidance** more precise and effective



# MONETARY POLICY GOING FORWARD: AN ENVIRONMENT OF LOW NATURAL INTEREST RATES

- The **natural interest rate ( $r^*$ )** is a key determinant of policy interest rates
- Evidence of sustained **decline** in recent decades, reflecting different factors: **demographics** (e.g. Eggertsson & Mehrotra, 2014), **low productivity growth** (Gordon, 2015), **safe asset scarcity** (Caballero & Farhi, 2017), etc.

**NATURAL INTEREST RATE ESTIMATES FOR THE MAIN ADVANCED ECONOMIES**



SOURCE: *Banco de España Annual Report 2018*, based on the model of Fiorentini, Galesi, Pérez-Quirós and Sentana (2018). The bands for the euro area refer to confidence levels of 68% and 90%.

# MONETARY POLICY GOING FORWARD: AN ENVIRONMENT OF LOW NATURAL INTEREST RATES

- A low (and falling)  $r^*$  implies that the **effective lower bound (ELB)** may be more and more binding in the future
- If **reversal rate** (Brunnermeier & Koby 2018) higher than “switch-to-cash” ELB, conventional policy space may be even smaller
  - No conclusive evidence that we are already at the reversal rate...
  - ... but if rates remain negative for long this may end up hampering bank-based monetary transmission (e.g. Arce et al. 2018)
- In this environment, rethinking MP strategy becomes an valuable option:
  - Possibility of introducing “make up” strategies such as **average inflation targeting**
  - Would be consistent with **medium-term** orientation of inflation aim

# THE ROLE OF OTHER ECONOMIC POLICIES

- Monetary cannot be “only game in town”
  - **Completing Banking Union** is a priority for further deepening the monetary union and reducing vulnerabilities
  - Further **progress in the Capital Market Union** project is needed to boost private-sector risk-sharing channels
    - *capital markets contribute to soften more than 40% of an adverse shock in a particular US State, just 10% for euro area countries -*
  - Build a **common fiscal stabilization capacity** to smooth aggregate and country specific shocks (public risk-sharing)
  - Need for **countercyclical fiscal policy** in countries with fiscal space
  - Need for **structural reforms** that raise competition and increase the potential growth of the economy (Andrés, Arce and Thomas, 2017)
    - *Productivity growth in the euro area is low: between 2000-2018 total factor productivity in the US increased by near 12%, only 5,7 % in the euro area -*
  - Positive **synergies** from joint implementation of monetary, fiscal and structural policies (Arce, Hurtado and Thomas, 2016)

THANK YOU FOR YOUR ATTENTION

