

# MONETARY POLICY AND ITS PERSPECTIVES IN ADVANCED ECONOMIES

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XI CENTRAL BANK OPERATIONS MEETING

CEMLA and Banco de México

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## SUMMARY

### 1. A global synchronized response of monetary policies to the pandemic

- Global monetary policy measures adopted in 2020
- Euro area: The forceful response of the ECB
- US: FED multiple actions
- Emerging Markets: unprecedented easing (focus on Latin America)

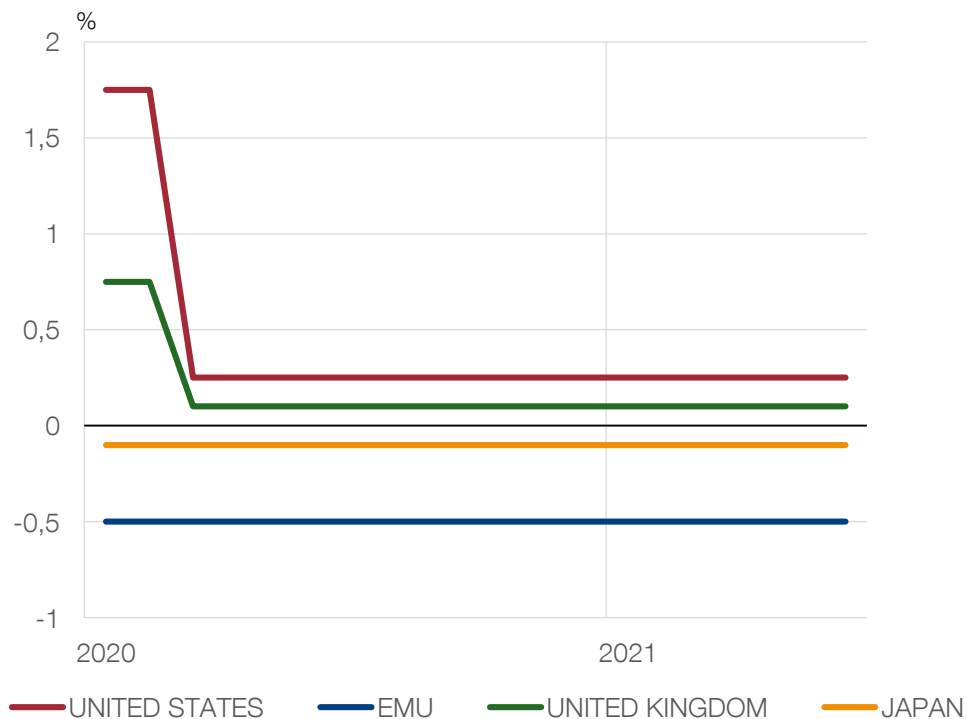
### 2. Uneven recovery and monetary policy challenges ahead

- Prospects for activity and inflation
- Euro area: ECB recent decisions
- US: FED strategy review and recent decisions
- Emerging Markets: turn of the cycle and spillovers from advanced economies policies

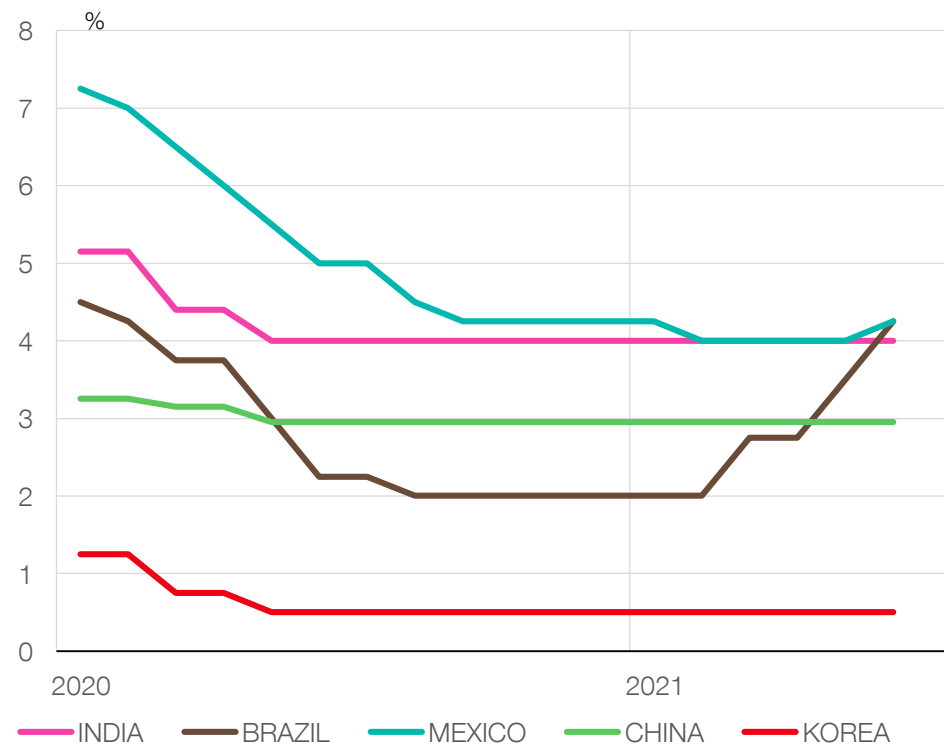
# GLOBAL RESPONSE OF MONETARY POLICIES TO THE PANDEMIC

- The monetary policy response to the pandemic during 2020 was widespread across geographies and with very diverse measures, including policy rate cuts...

POLICY RATES: ADVANCED ECONOMIES (\*)



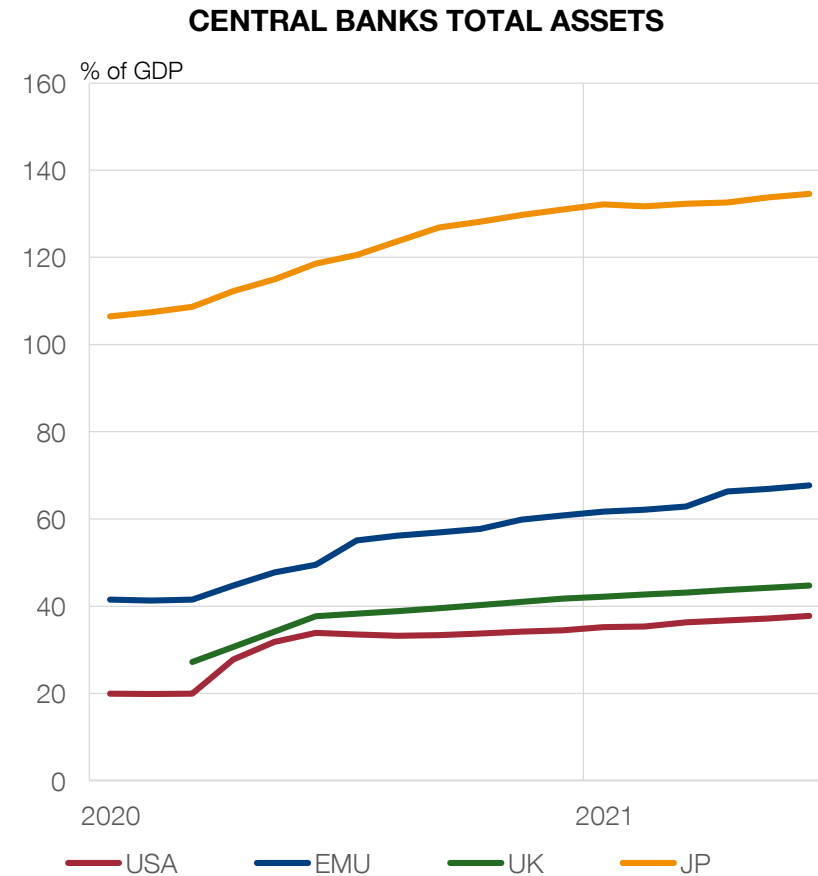
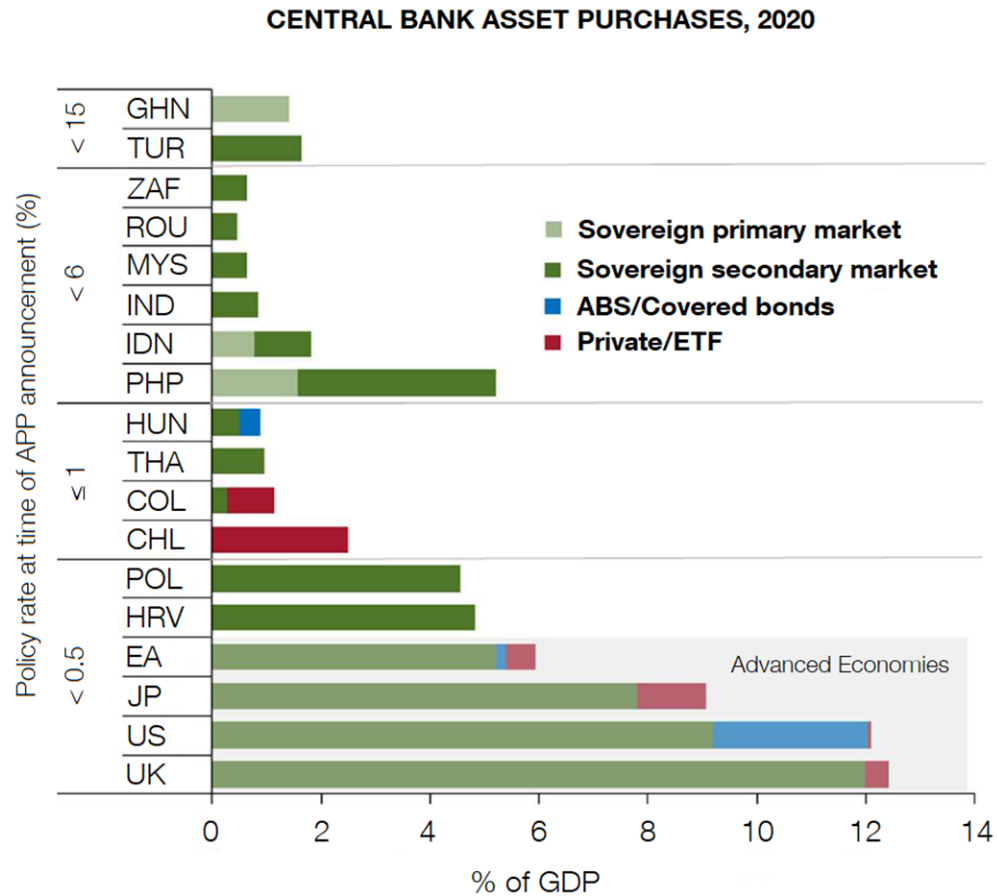
POLICY RATES: EMERGING MARKET ECONOMIES



(\*) For EMU, Deposit facility rate.  
Source: Refinitiv.

# GLOBAL RESPONSE OF MONETARY POLICIES TO THE PANDEMIC

- ...unconventional policy measures, such as asset purchase programs...

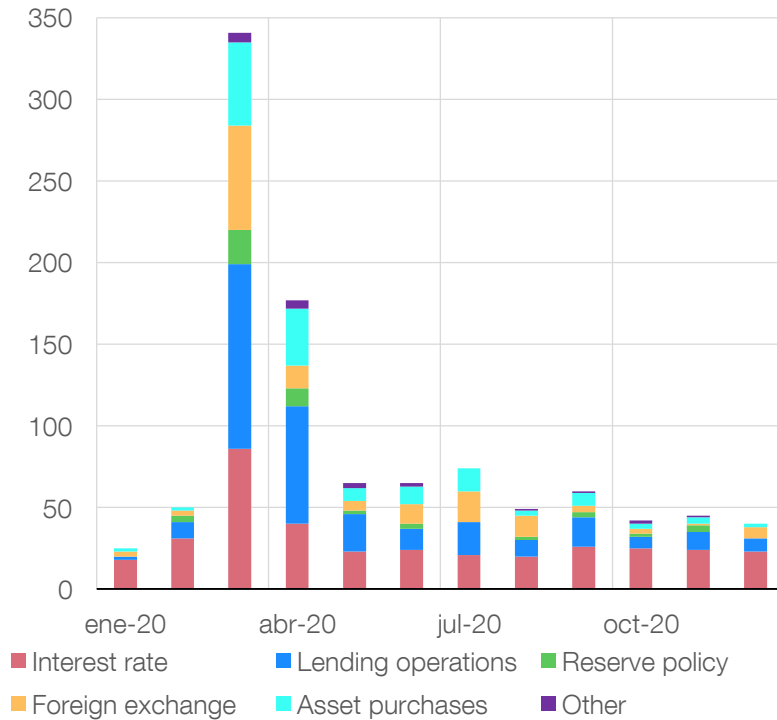


Sources: Refinitiv and IMF (2021) "Asset Purchases And Direct Financing: Some Guiding Principles For EMDEs During Covid-19 And Beyond". Data in lhs graph until August 2020.

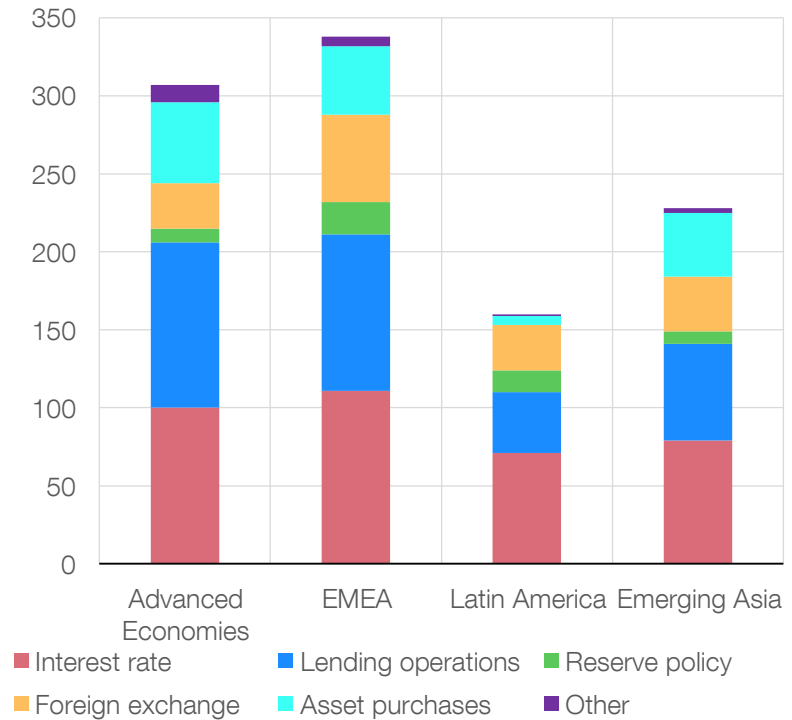
# THE RANGE OF MONETARY POLICY AND FINANCIAL MEASURES HAS BEEN VERY BROAD

- ...and other monetary and financial measures across the globe

**MONTHLY ANNOUNCEMENTS OF POLICIES BY CATEGORY**

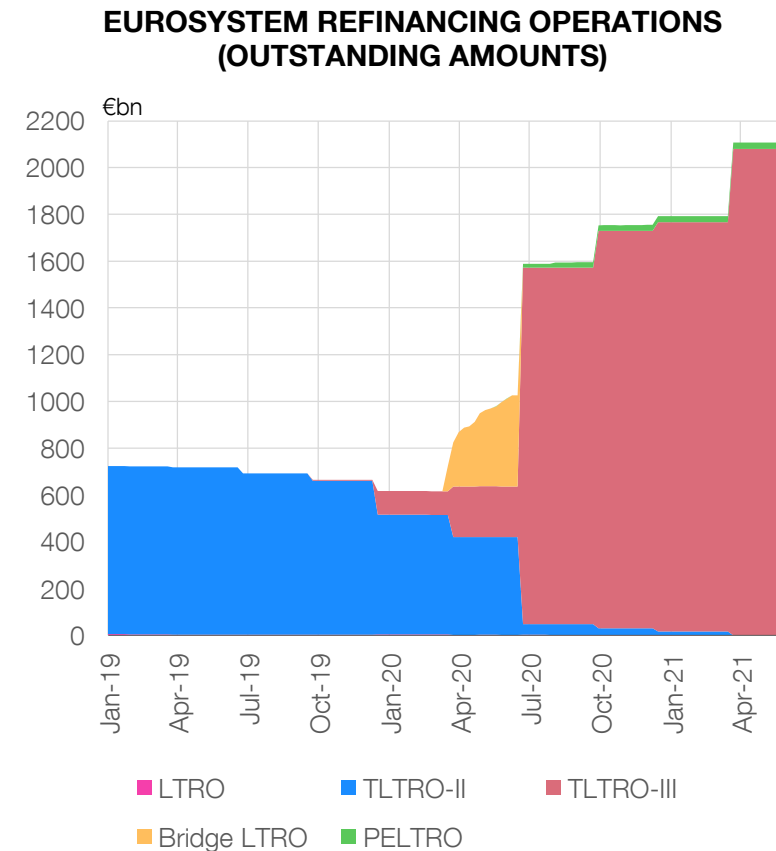
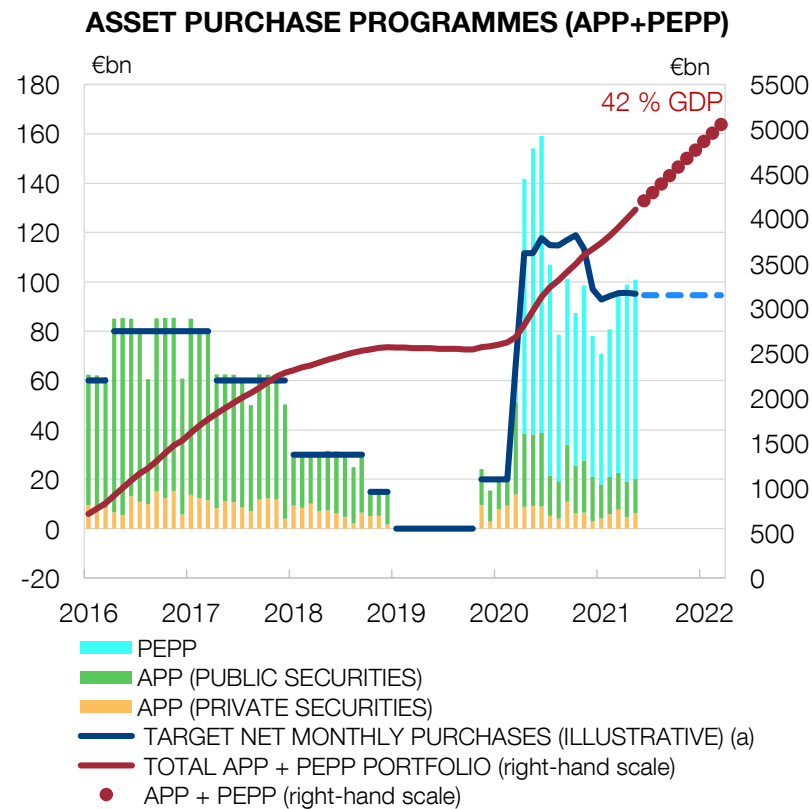


**POLICY ANNOUNCEMENTS BY REGION**



Sources: BIS WP #934

# EURO AREA: ECB ASSET PURCHASES (NOTABLY UNDER PEPP) AND REFINANCING OPERATIONS (NOTABLY TLTRO-III) PREVENTED A TIGHTENING OF EURO AREA FINANCING CONDITIONS

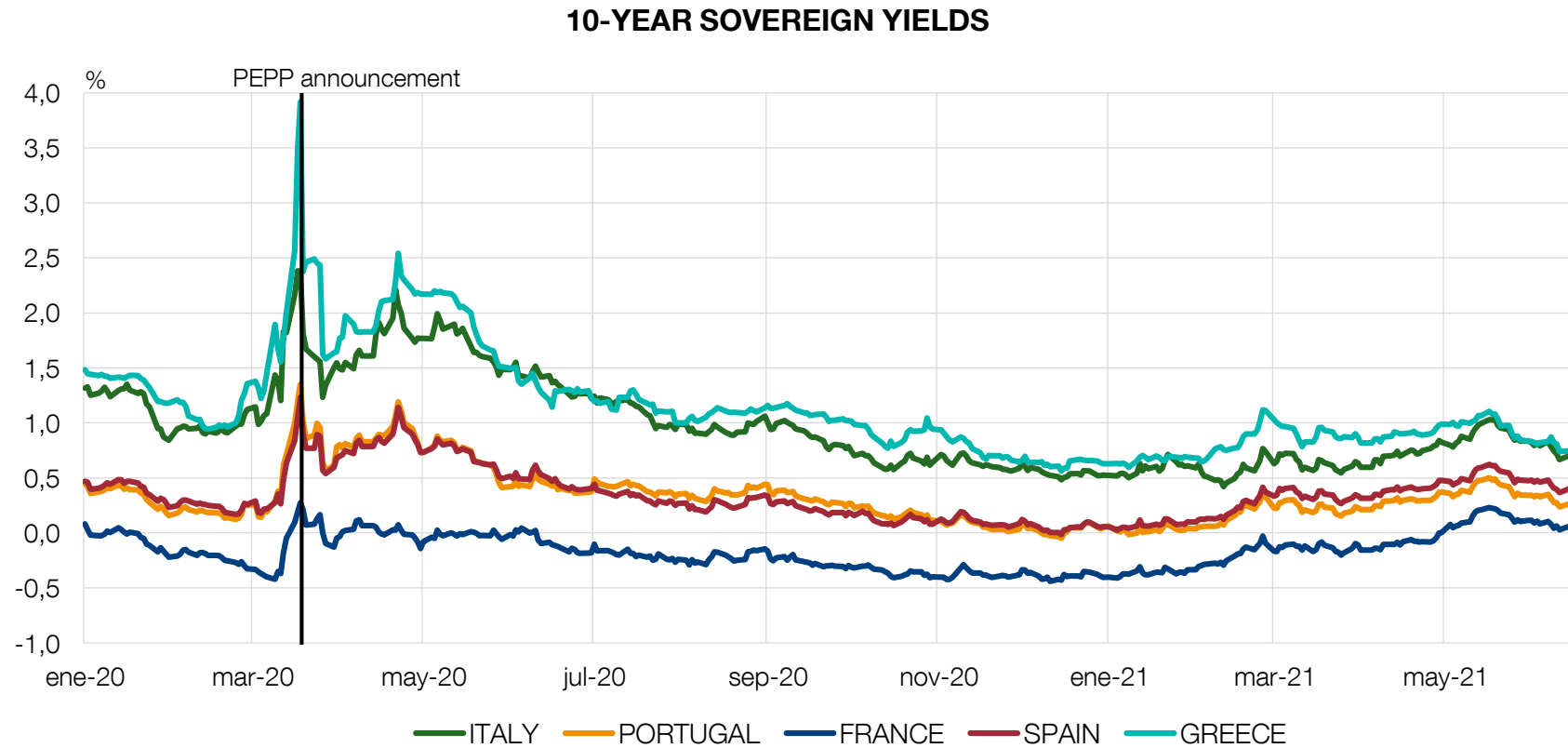


Source: ECB. Latest observation: 04/06/2021

Sources: ECB and Refinitiv Datastream. Latest observation: May 2021.

(a) The monthly net purchase target as from June 2021 (dashed blue line) includes, in addition to the €20 bn per month approved on 12 September 2019, the unused portion of the current PEPP envelope (€1.85 tr), assuming, for illustrative purposes, that purchases will be distributed uniformly until March 2022 and that the PEPP envelope will be fully used (in practice, purchases may be distributed flexibly over time and the envelope may not be used in full).

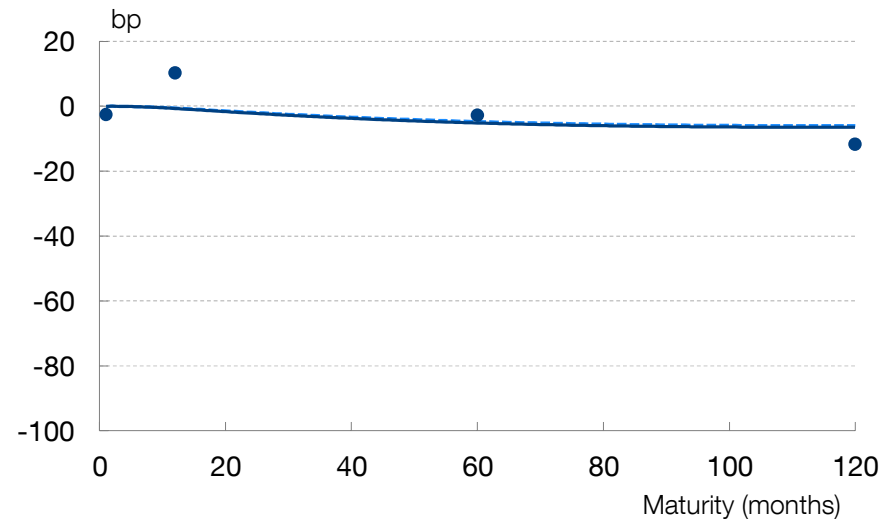
# EURO AREA: THE FLEXIBILITY IN THE DISTRIBUTION OF PEPP PURCHASES OVER TIME AND ACROSS JURISDICTIONS WAS IMPORTANT TO ADDRESS FINANCIAL FRAGMENTATION RISK...



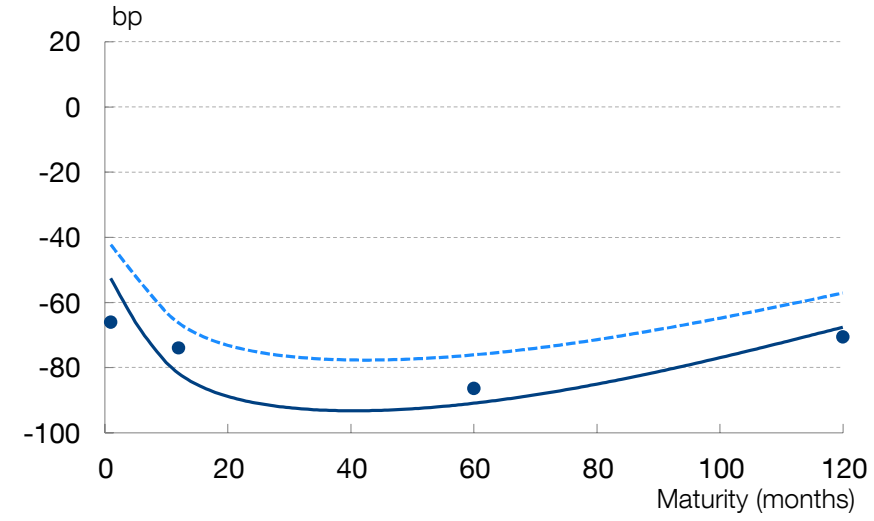
Source: Refinitiv Datastream. Latest observation: 18/06/2021

## Impact of the PEPP announcement on yields (18-20 March 2020)

**GERMANY: SHIFT IN THE YIELD CURVE**



**ITALY: SHIFT IN THE YIELD CURVE**



--- FIXED PURCHASES MODEL    — FLEXIBLE PURCHASES MODEL    ● OBSERVED IMPACT OF THE PEPP

Sources: Banco de España and Refinitiv Datastream.

a. The observed impact of the announcement of the PEPP is calculated as the difference between the zero-coupon yield curve as at the close of 20 March and the one as at the close of 18 March 2020 (PEPP was announced at 23:45 on 18 March 2020). The theoretical impact is calculated using Costain, Nuño and Thomas' (2021) structural yield curve model, assuming that, at the time of the announcement, investors know the volume and the time and country distribution of public sector bond purchases. "Flexible purchases" replicates observed ones, while "fixed purchases" consider the counterfactual case in which the distribution of purchases across countries follows the ECB capital key and is uniform over time.

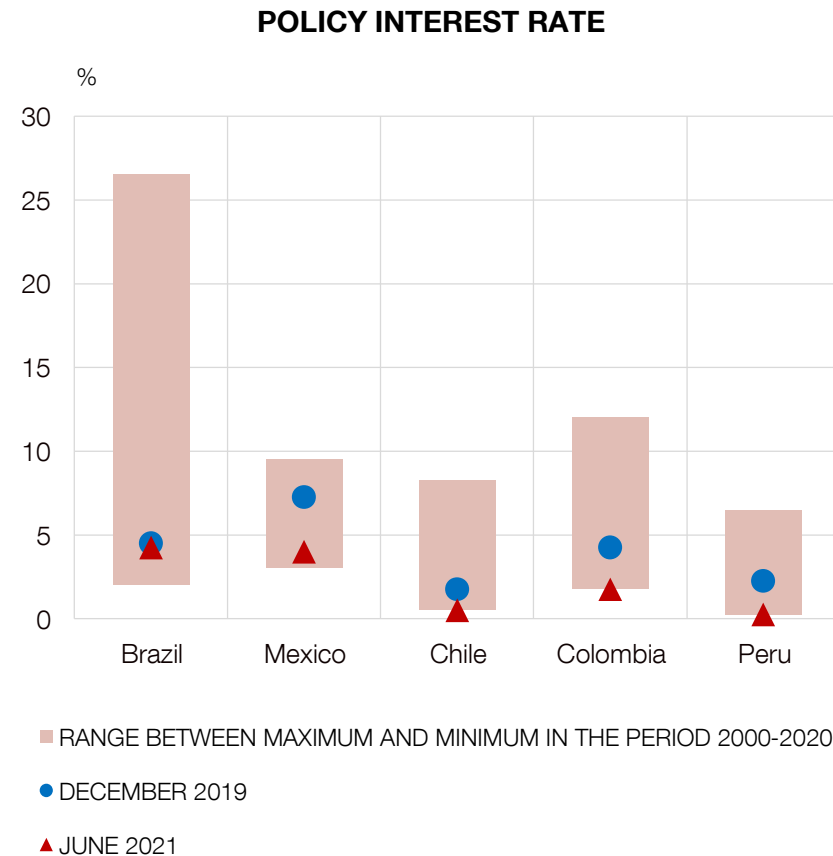
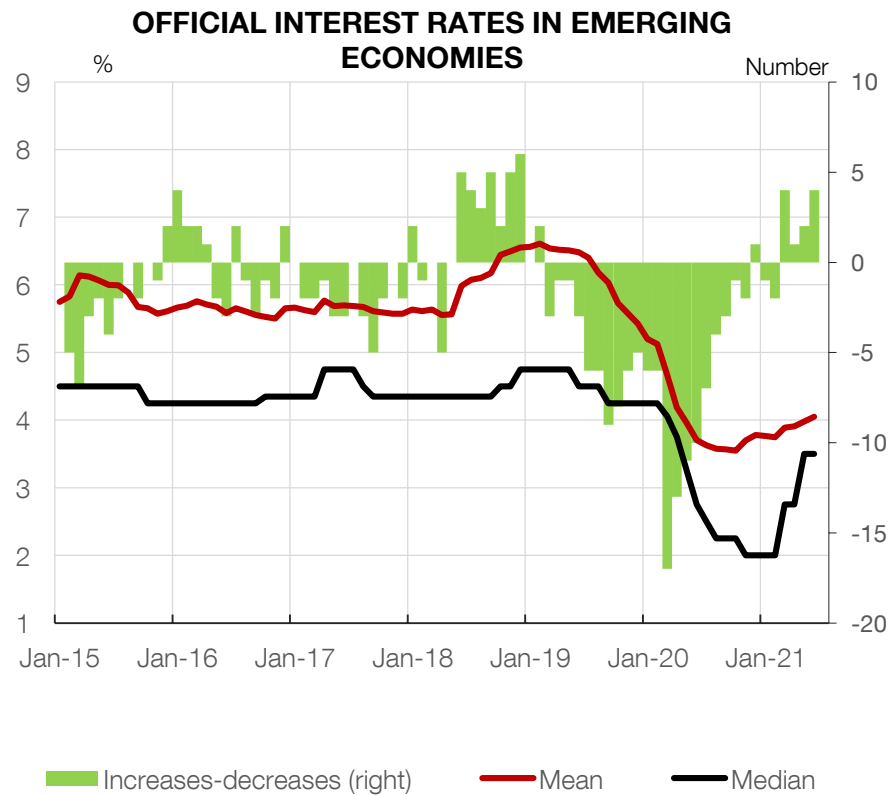


# US: THE FEDERAL RESERVE RESPONDED SWIFTLY AND WITH A RANGE OF POLICY ACTIONS TO ADDRESS THE WIDESPREAD DISRUPTIONS ACROSS FINANCIAL MARKETS

	Announced Size Limit (bns \$)	Outstanding 16 June 2021 (bns \$)	Peak (bns \$)	Treasury equity (bns \$)	Expiration date
Commercial Paper Funding Facility (CPFF)	-	0.0	4.3	10	Mar-2021
Corporate Credit Facility	750	12.8	14.3	75	Dec-2020
Main Street Lending Program	600	13.6	16.5	75	Dec-2020
Paycheck Protection Program Liquidity Facility (PPPLF)	-	86.6	87.1	100% guarantee	Mar-2021
Term Asset-Backed Securities Loan Facility (TALF)	100	1.6	3.7	10	Dec-2020
Primary Dealer Credit Facility (PDCF)	-	0.0	33.4	-	Mar-2021
Money Market Mutual Fund Liquidity Facility (MMLF)	-	0.0	53.2	10	Mar-2021
Municipal Liquidity Facility (MLF)	500	5.4	6.4	35	Dec-2020
Term Repo Operations	1,000	0.0	132.4	-	Feb-2021
ON Repo Operations	500	0.0	343.0	-	-
Central Bank Liquidity Swaps	Temporary: 30 - 60	0.5	448.9	-	Temporary: Sep-2021
Intraday credit	-	0.6	50.8	-	-
Securities (Treasuries and MBS)	Unlimited	8,064	-	-	

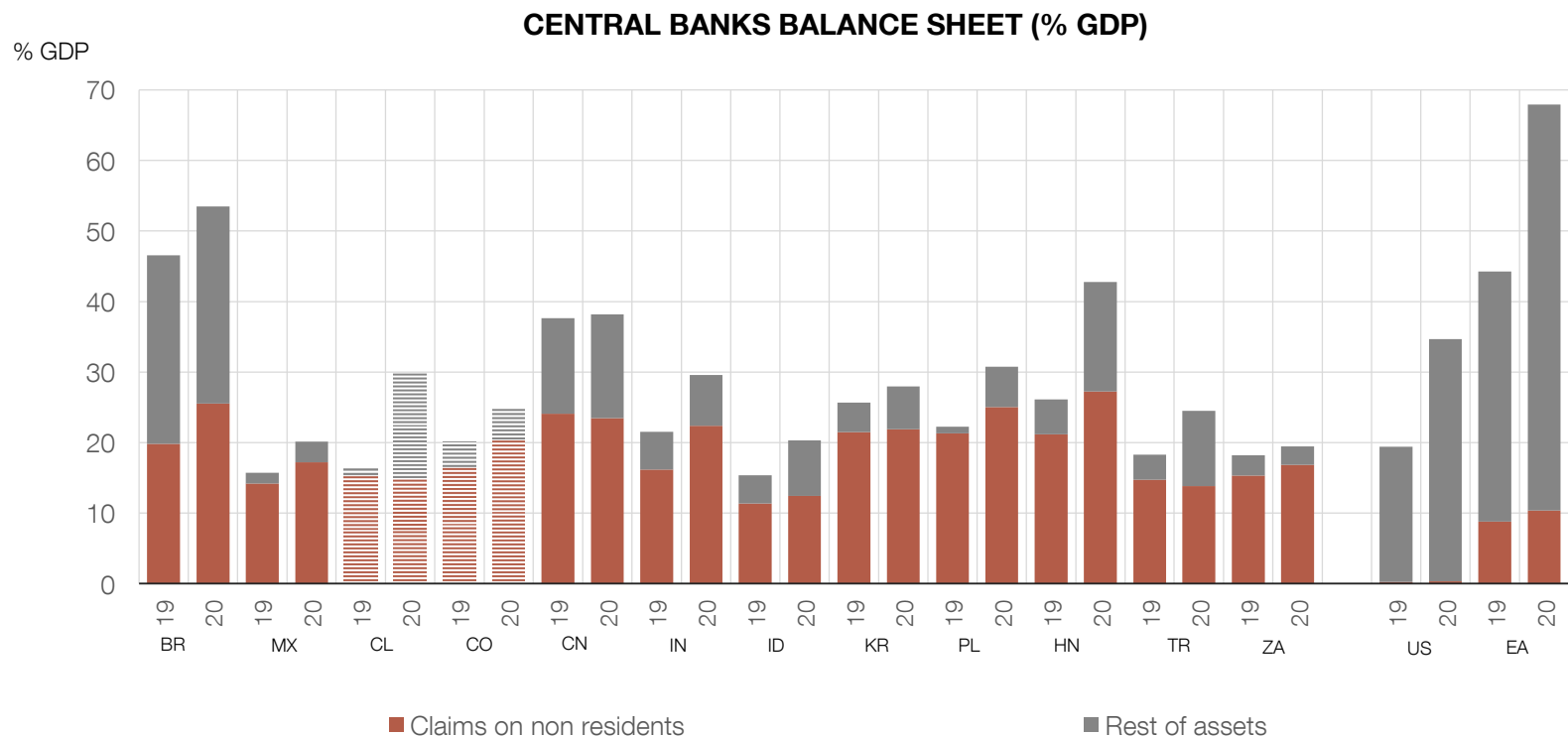
Source: Banco de España calculations based on Federal Reserve, “Factors Affecting Reserve Balances—H.4.1,” various dates.

- Unprecedented monetary policy easing -jointly with fiscal expansion, financial-support measures, FX interventions and liquidity and credit support programs – favored also by strong support from advanced economies. In Latin America official interest rates reached historical lows in some countries



# EMERGING MARKETS ECONOMIES: ASSET PURCHASE PROGRAMS

- Many countries made use of asset purchase programs for the first time, which were quite effective in keeping favorable financing conditions
- APPs in EMEs, more modest size than in advanced economies, were adopted before reaching the ELB and basically to reduce market volatility



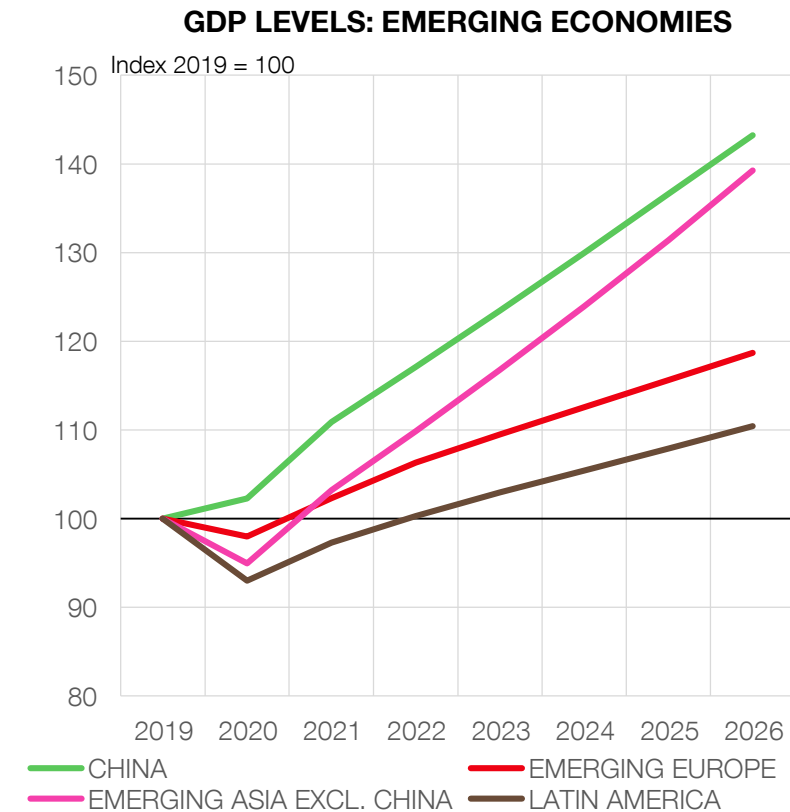
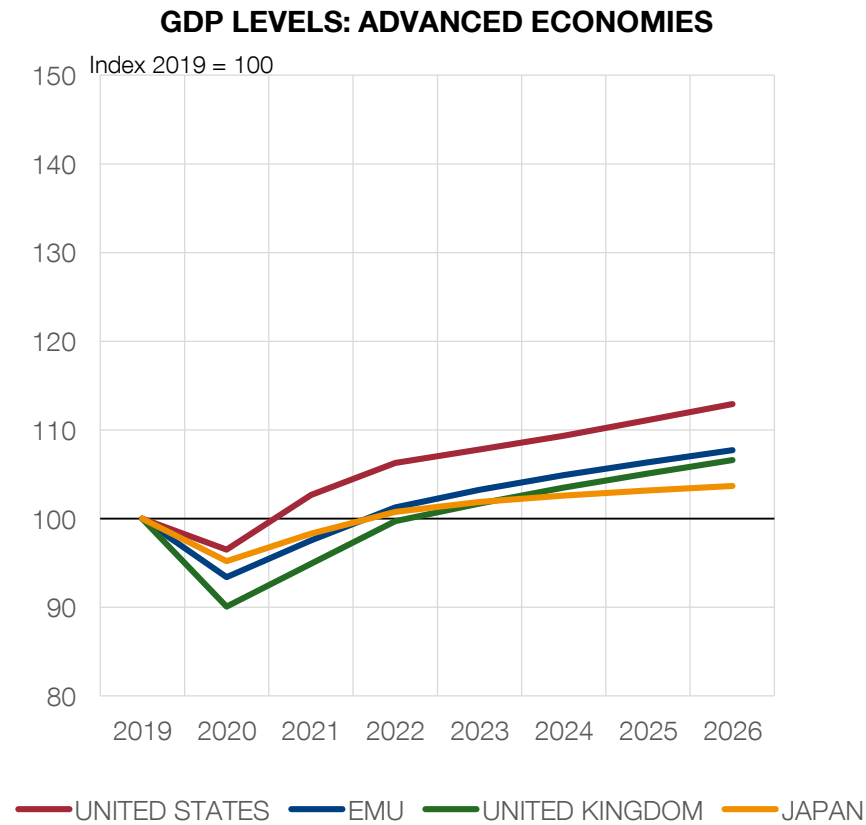
Note: Chile and Colombia (shaded in the graph) were the only two Latin American countries where APPs with quantified targets were announced. Brazil changed the Central Bank Law to allow asset purchases but finally did not announce any purchase. Mexico increased the amount of CB's open markets operations.

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# UNEVEN RECOVERY OF ADVANCED AND EMERGING MARKET ECONOMIES

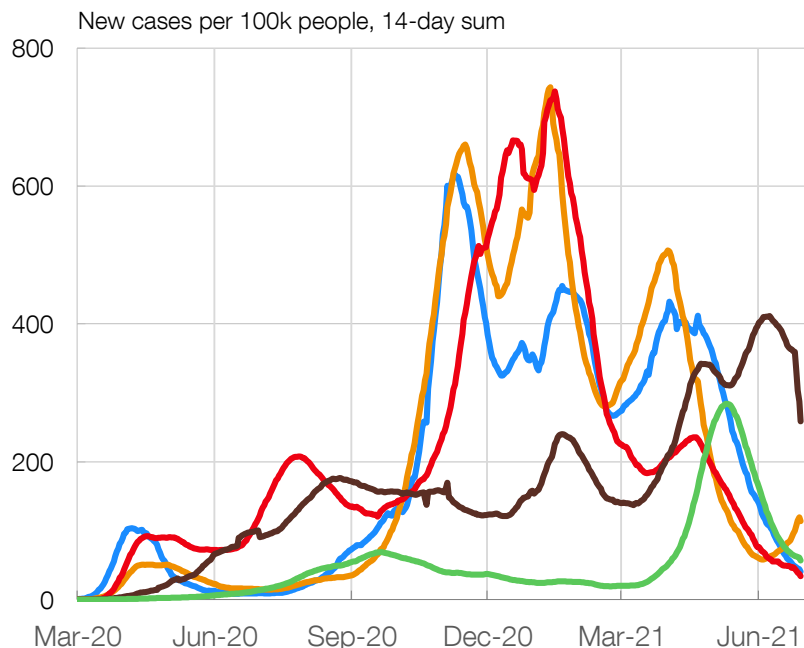
- The US and some emerging market regions (Asia, Eastern Europe) will reach 2019-GDP levels by 2021. The euro area and Japan would recover those levels in 2022, and the UK and LATAM in 2023
- An asynchronous recovery with a faster normalization on economic policies in advanced economies (especially in the US) could adversely impact EMEs



Source: IMF WEO April 2021

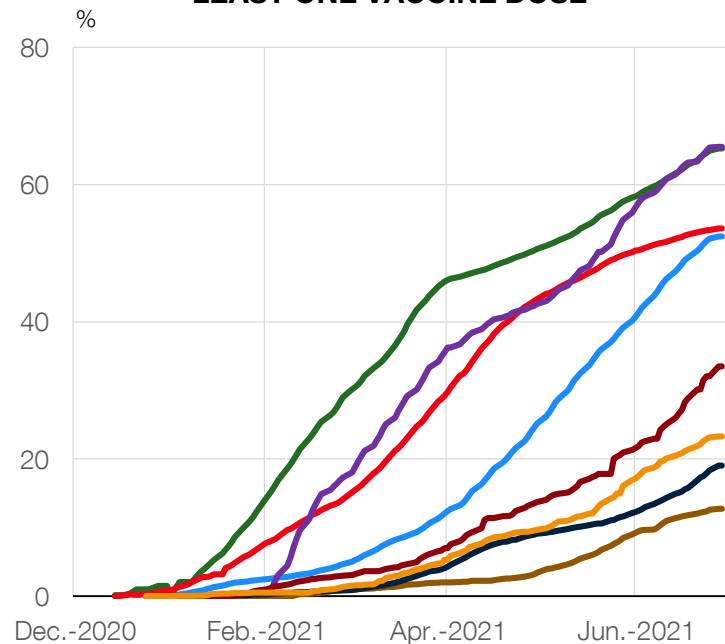
# VACCINATION HAS RECENTLY STEPPED UP, BUT EMES ARE LAGGING BEHIND...

## 14-DAY CUMULATIVE INCIDENCE



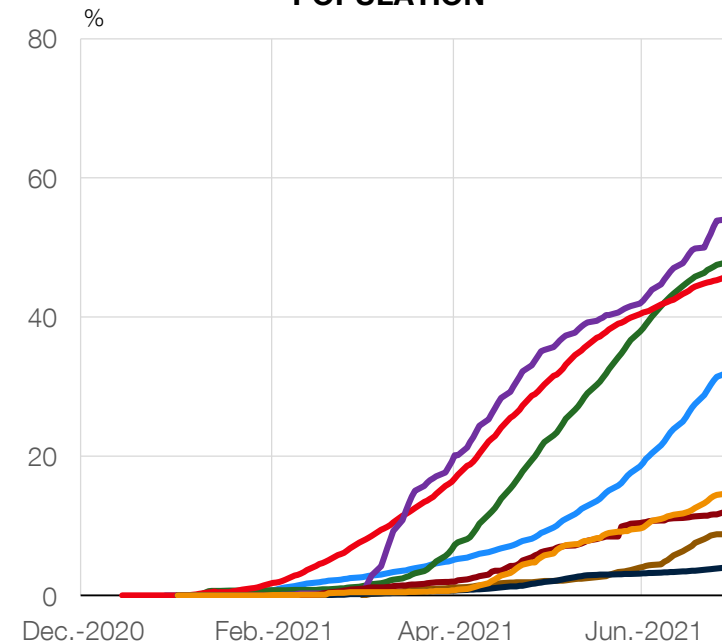
- EURO AREA
- NORTH AMERICA
- ASIA (EXCL. CHINA)
- REST OF EUROPE
- SOUTH AMERICA

## SHARE OF POPULATION WHO RECEIVED AT LEAST ONE VACCINE DOSE



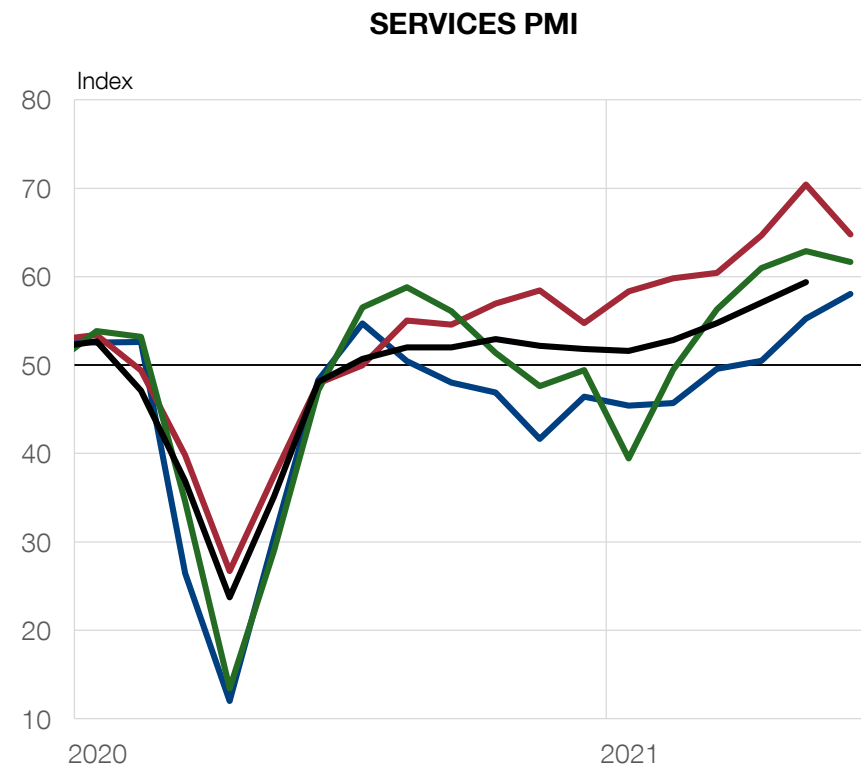
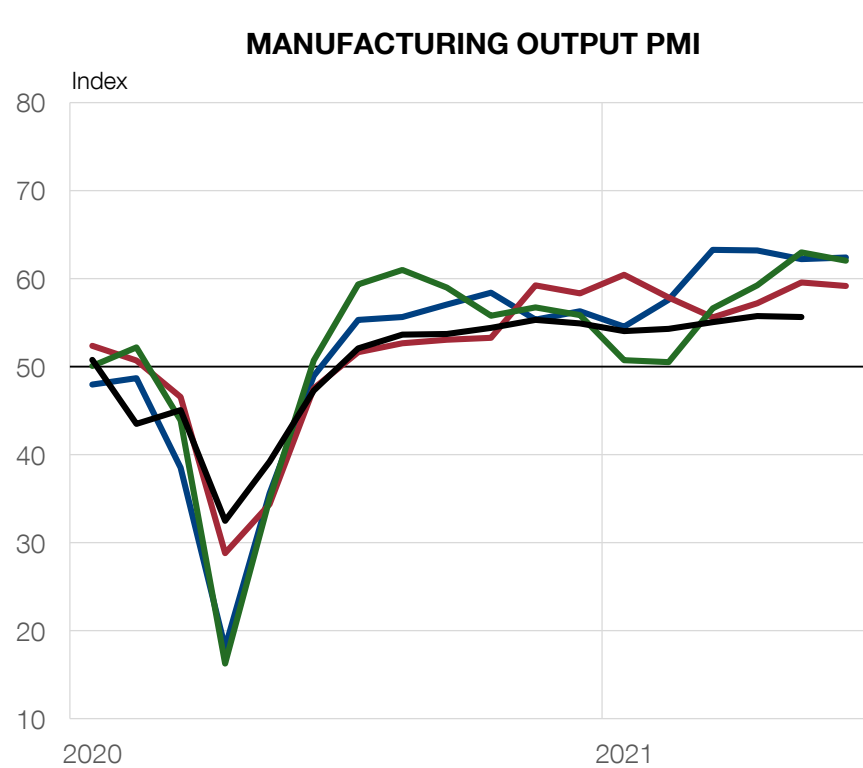
- EURO AREA
- UNITED KINGDOM
- UNITED STATES
- PERU
- CHILE
- INDIA
- BRAZIL
- MEXICO

## SHARE OF FULLY VACCINATED POPULATION



Source: Johns Hopkins Coronavirus Resource Center.

# FASTER VACCINATION IN ADVANCED ECONOMIES IS IMPROVING ECONOMIC INDICATORS IN 2Q21...



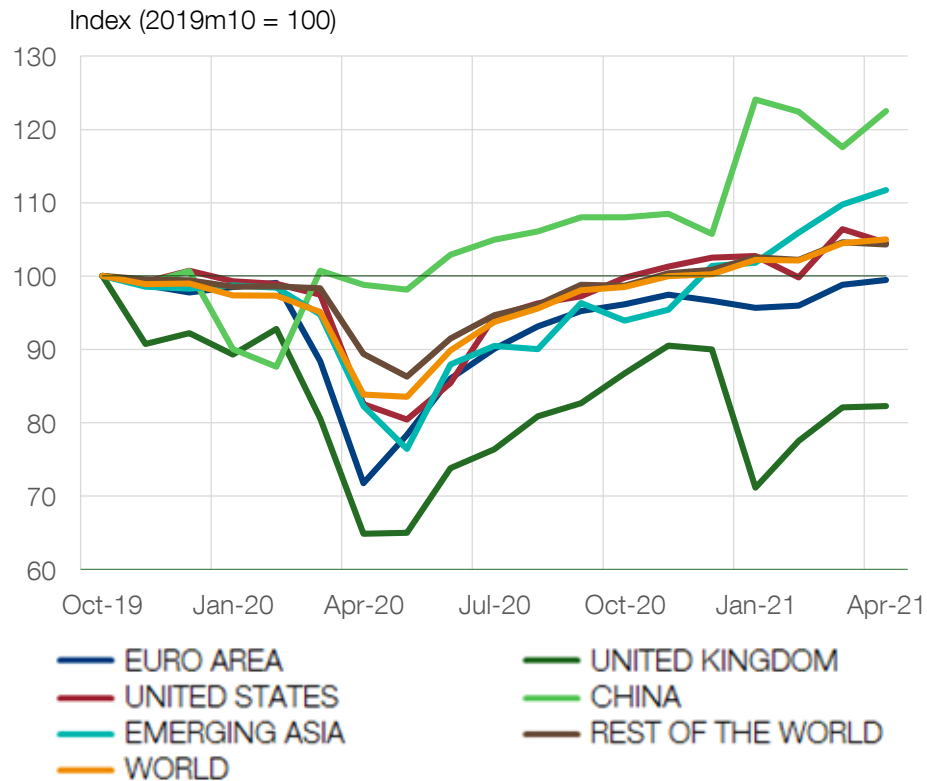
— UNITED STATES — UNITED KINGDOM — EURO AREA — GLOBAL

Source: IHS Markit.

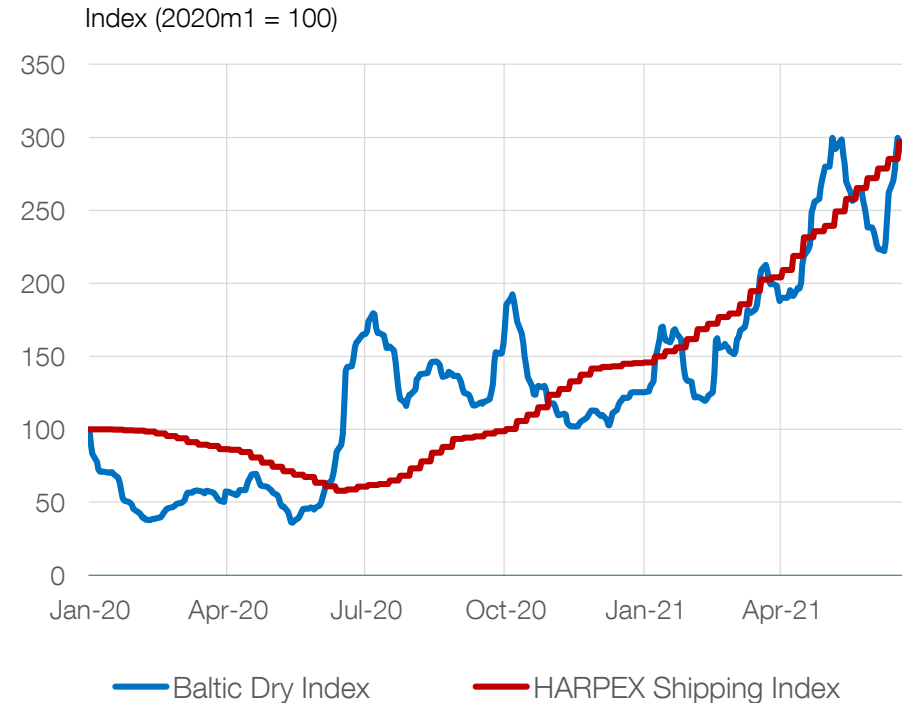
## ...AND WORLD TRADE IS PICKING UP AMID INCREASING SHIPPING COSTS

- In April, the global trade volume rose 0.5% month-on-month, while the ascending trend in shipping costs persists

### TRADE FLOWS BY AREA



### MARITIME FREIGHT COST INDICATORS

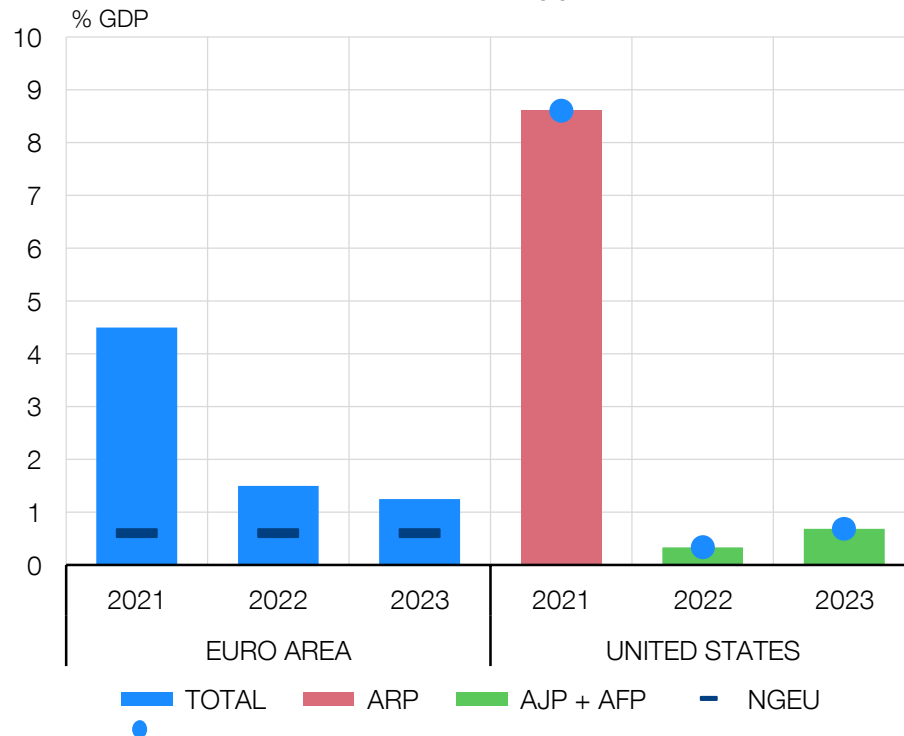


Sources: CPB and Datastream.

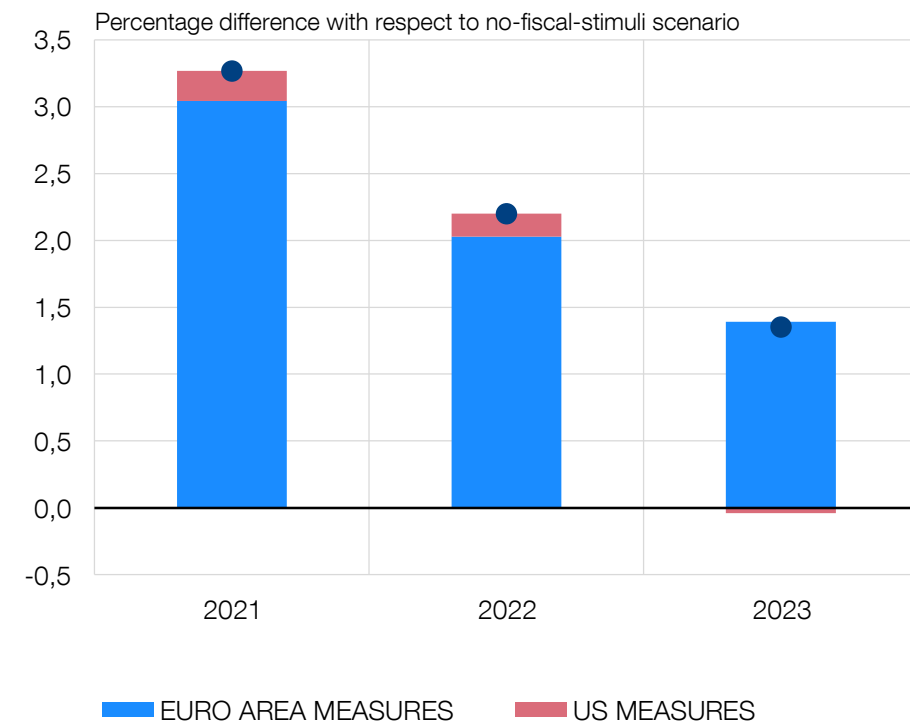


- The fiscal impulse hinges considerably on investment, especially so from 2022 onwards, owing to measures financed by NGEU in the Euro area and the AJP in the US

DISCRETIONARY FISCAL STIMULUS MEASURES IN THE EURO AREA AND THE US (a)



IMPACT OF FISCAL MEASURES ON EURO AREA GDP (b)



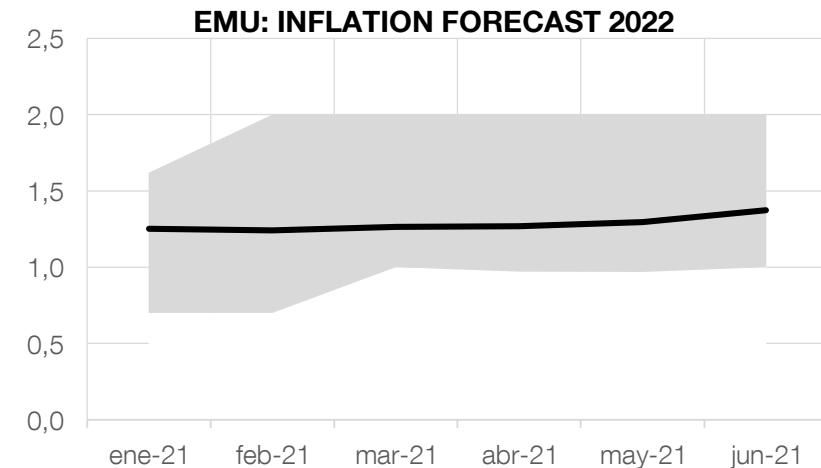
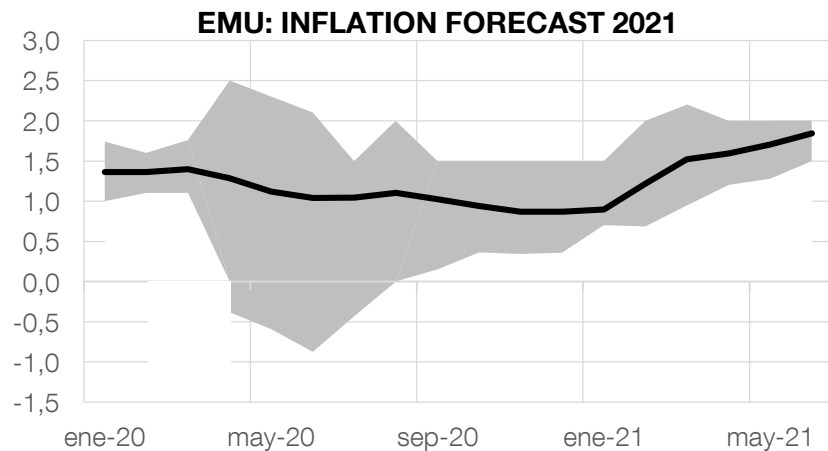
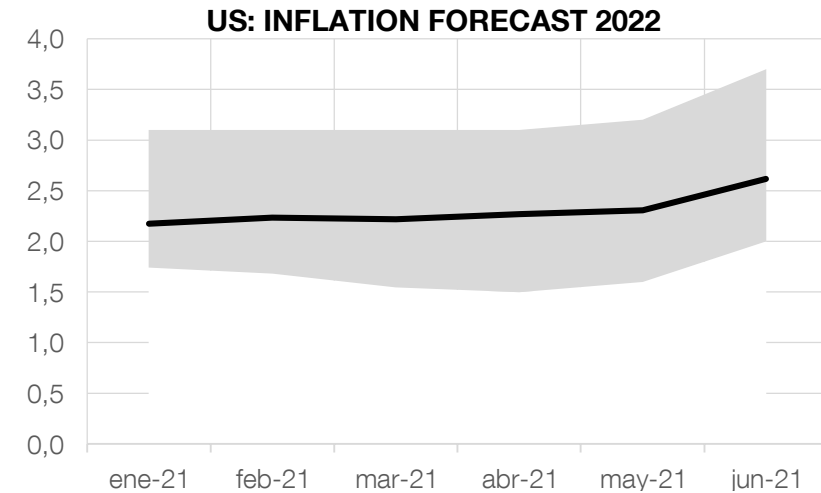
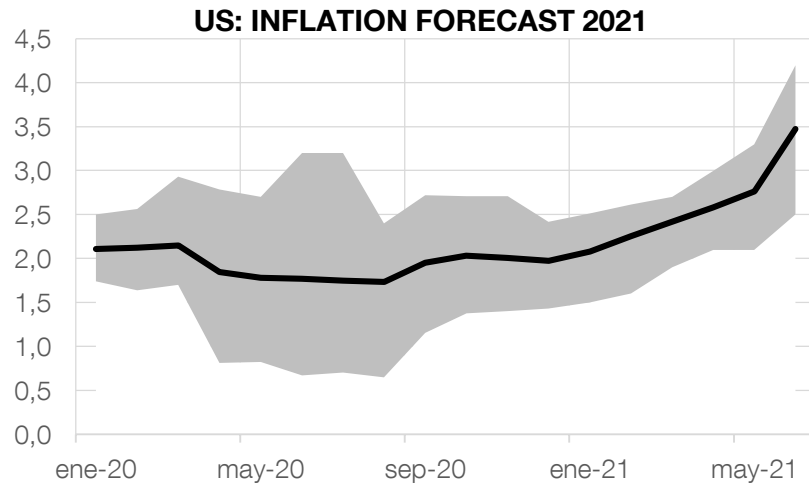
Sources: Banco de España and Eurosystem with data from the Committee for a Responsible Federal Budget, the Congressional Budget Office, the White House, the Tax Policy Center, the Tax Foundation and the Penn Wharton Budget Model.

(a) The fiscal stimulus for each year is represented. ARP (American Rescue Plan); AJP (American Jobs Plan); AFP (America Families Plan).

(b) In-house estimations. The Euro area impact is estimated using a standard multiplier while the US figures stem from simulations using the NiGEM model.

# INFLATION PROJECTIONS HAVE INCREASED IN RECENT MONTHS

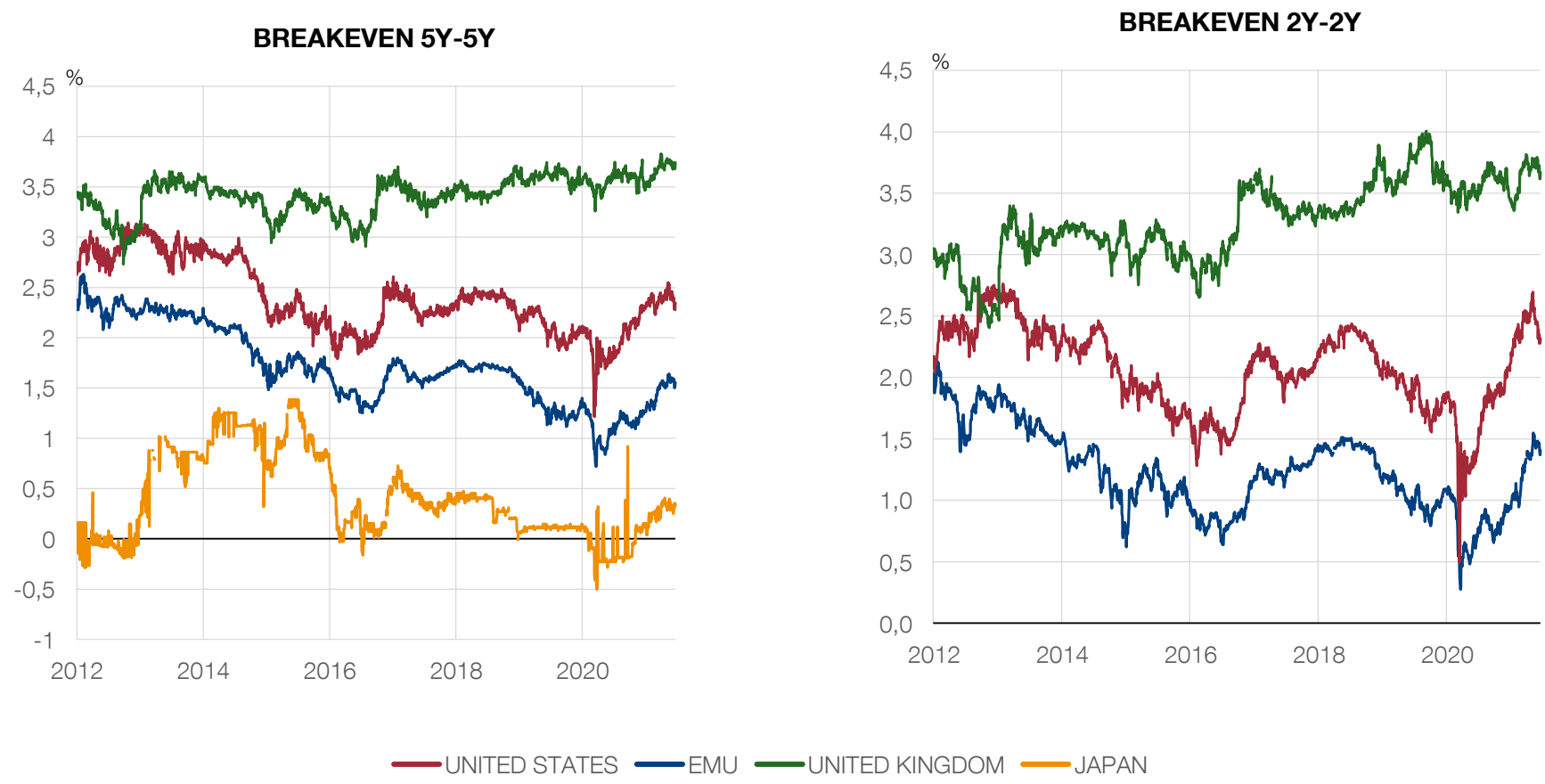
- **Inflation forecasts for 2021 have increased worldwide. In advanced economies the revisions are particularly noticeable in the US. This increase is considered as mostly transitory**



Source: Consensus Forecast

# INFLATION EXPECTATIONS HAVE ALSO INCREASED BUT REMAIN WELL ANCHORED

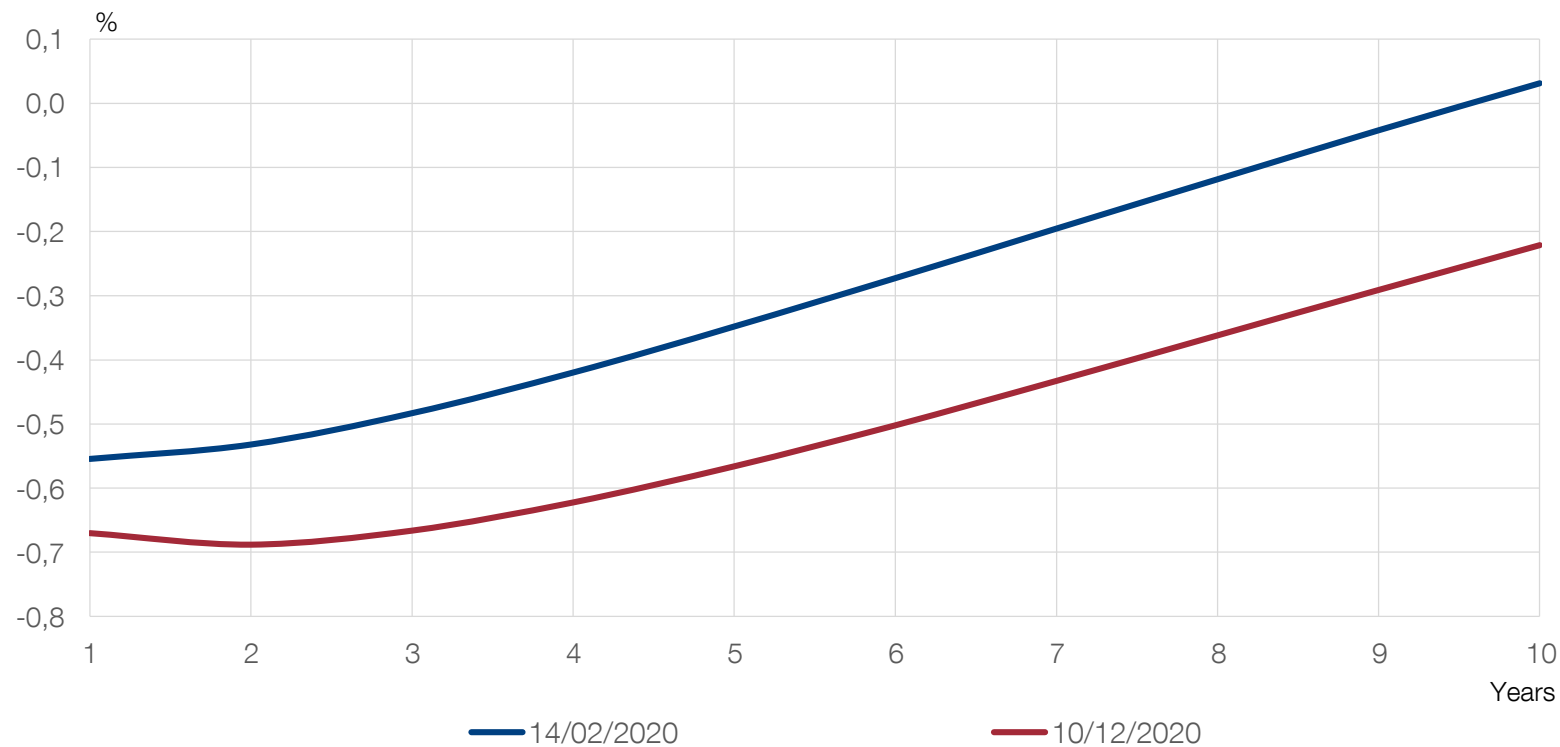
- Despite short-term concerns, market expectations remained relatively well anchored in the long run



Sources: Bloomberg, Barclays

# EURO AREA: IN DECEMBER 2020, THE ECB ANNOUNCED THAT PEPP PURCHASES WOULD BE CONDUCTED FLEXIBLY WITH THE OBJECTIVE OF MAINTAINING FAVOURABLE FINANCING CONDITIONS

## SOVEREIGN YIELD CURVE. EMU (a)



Sources: Refinitiv Datastream and ECB.

(a) GDP-weighted sovereign yield of Big-4 (Germany, France, Italy, Spain).

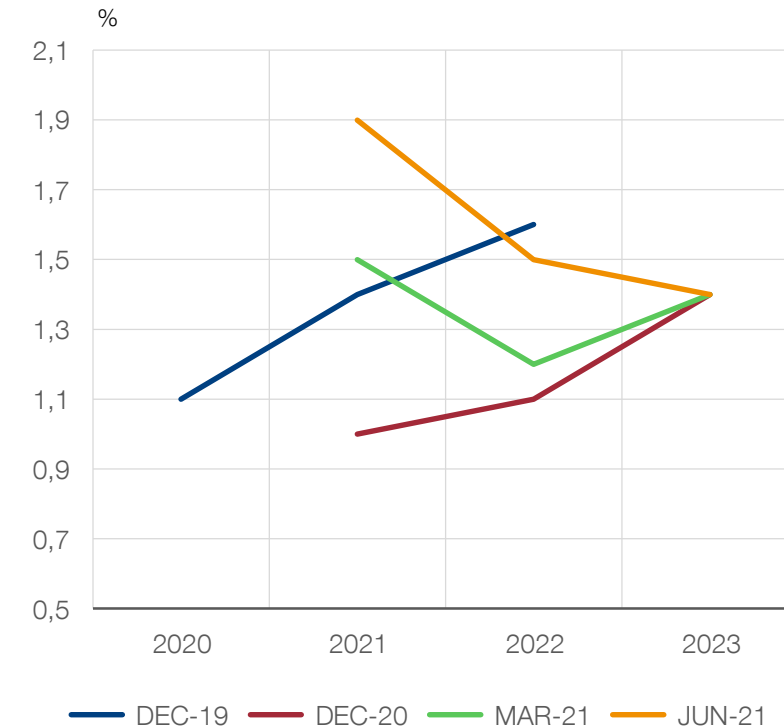
# EURO AREA: IN MARCH, AMIDST TIGHTER FINANCING CONDITIONS AND NO IMPROVEMENT IN THE MEDIUM-TERM INFLATION OUTLOOK, THE ECB DECIDED TO INCREASE THE PACE OF PEPP PURCHASES

- In June, after jointly analyzing financing conditions and the inflation outlook, the ECB decided to maintain the enhanced pace of PEPP purchases

10-YEAR OIS AND SOVEREIGN YIELDS. EMU



ECB/EUROSISTEM PROJECTIONS OF EURO AREA INFLATION



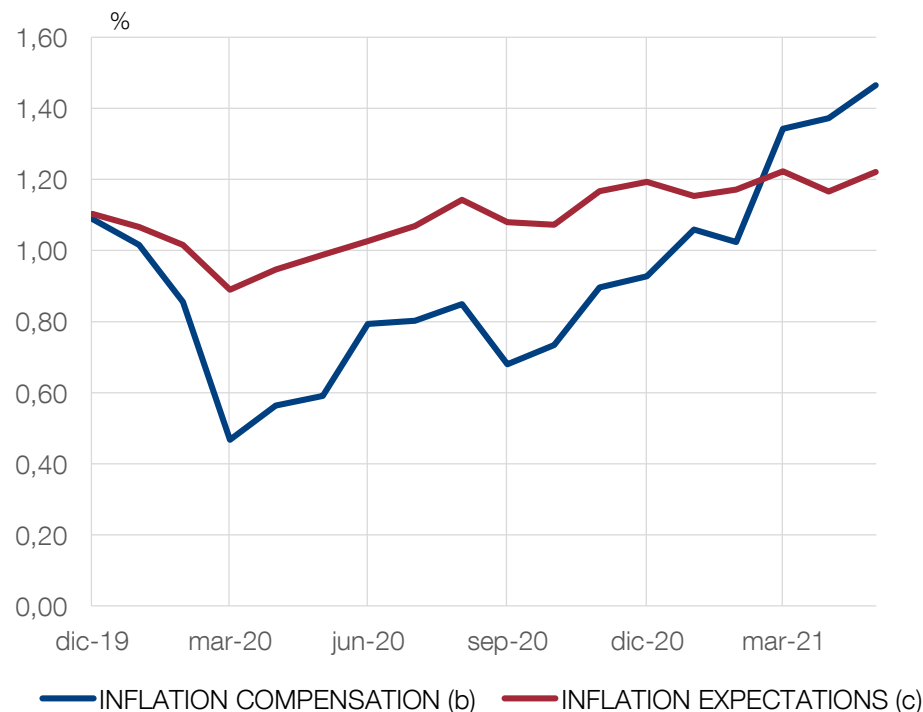
Sources: Refinitiv Datastream and ECB. Latest observation: 18/06/2021.  
 (a) GDP-weighted 10y sovereign yield of Big-4 (Germany, France, Italy, Spain).

Source: ECB.

# EURO AREA: MARKET-BASED MEASURES OF INFLATION EXPECTATIONS HAVE INCREASED NOTABLY, BUT THIS LARGELY REFLECTS RISING INFLATION RISK PREMIA

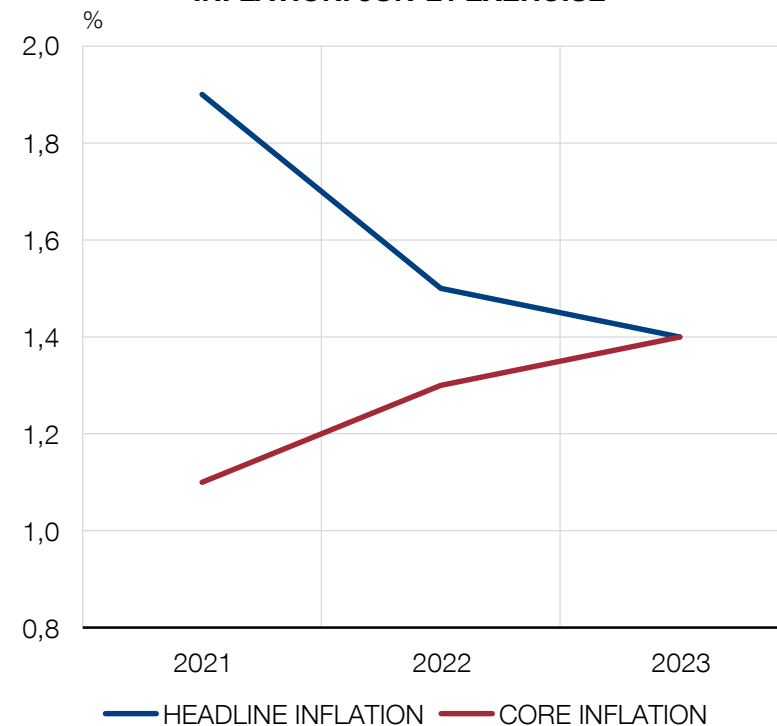
- Model-based analysis suggests that “genuine” inflation expectations have increased only moderately
- Some inflationary pressures in the short term, the medium-term inflation outlook remains well below 2 percent

**INFLATION COMPENSATION AND INFLATION EXPECTATIONS. EMU (a)**



Source: Refinitiv Datastream and own calculations.  
 Latest observation: May 2021.  
 (a) Inflation-Linked Swaps two years in two years implicit forward.  
 (b) Calculated with observed Inflation-Linked Swaps.  
 (c) Calculated with an affine model of Inflation-Linked Swaps.

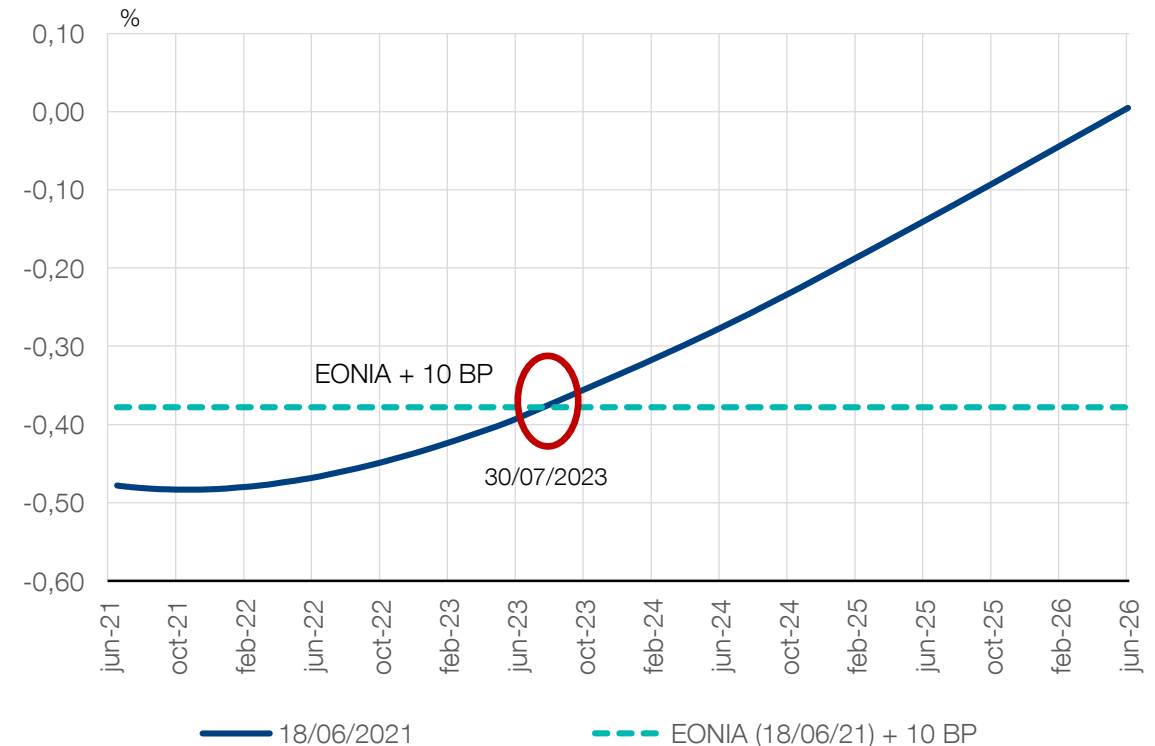
**ECB/EUROSISTEM PROJECTIONS OF EURO AREA INFLATION. JUN-21 EXERCISE**



Source: ECB.

- The Governing Council expects the **key ECB interest rates to remain at their present or lower levels** until it has seen the **inflation outlook robustly converge to a level sufficiently close to, but below, 2%** within its projection horizon, and such convergence has been **consistently reflected in underlying inflation dynamics**.
- Net purchases under the asset purchase programme (APP) will continue at a monthly pace of €20 billion. The Governing Council continues to expect **monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates**.
- The Governing Council also intends to **continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation**.

OIS FORWARD CURVE. EMU



Source: Refinitiv Datastream. Latest observation: 18/06/2021.

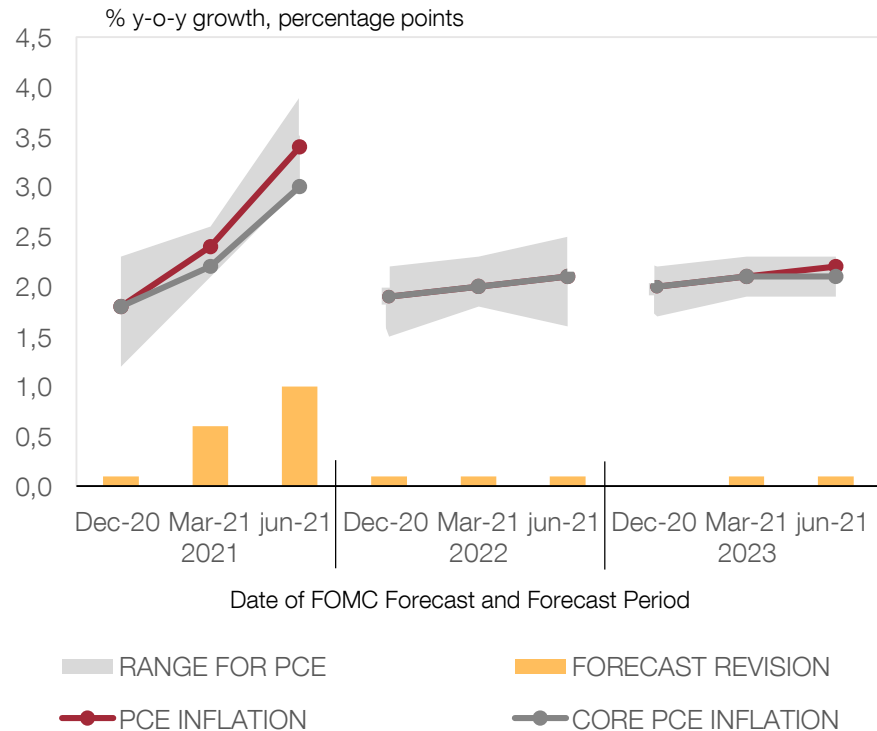
- In August 2020, the Fed announced several changes to its monetary policy strategy. The new monetary policy framework includes significant changes to both operating targets of the Fed's dual mandate – maximum employment and price stability

	OLD	NEW
EMPLOYMENT TARGET	<ul style="list-style-type: none"> <li>• Policy action to be taken in response to <i>deviations</i> of employment from maximum level</li> </ul>	<ul style="list-style-type: none"> <li>• Policy action to be taken in response to <i>shortfalls</i> of employment from maximum level</li> </ul>
INFLATION TARGET	<ul style="list-style-type: none"> <li>• Inflation should be 2% in the long run</li> </ul>	<ul style="list-style-type: none"> <li>• Inflation should <i>average</i> 2% in the long run, so the Fed will tolerate inflation above its target for a period of time to offset periods when inflation was below its target</li> </ul>



- Fed argues the inflation rise is transitory and concentrates on labor market weaknesses

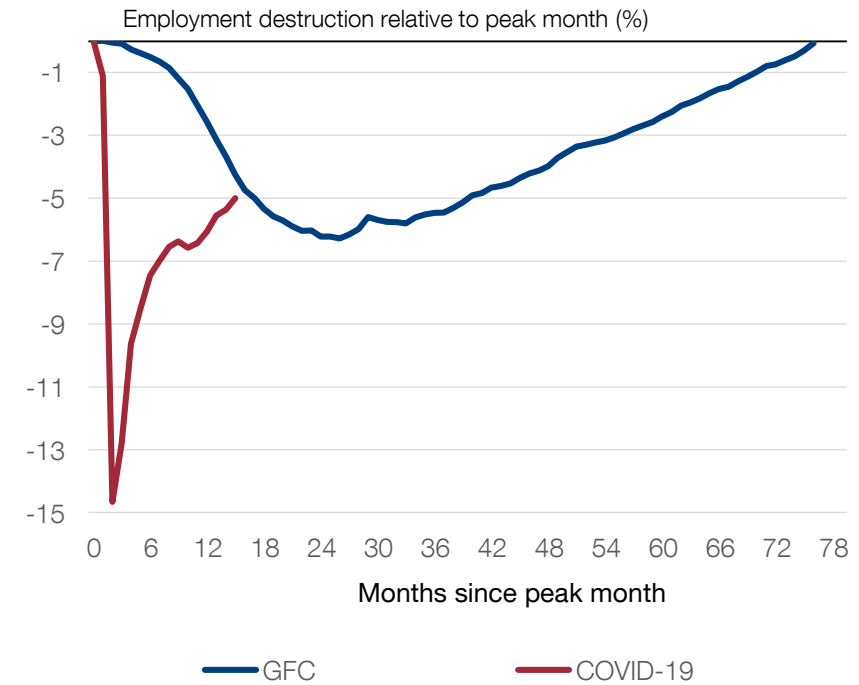
### FOMC INFLATION PROJECTION (MEDIAN, RANGE AND FORECAST REVISIONS)



Source: Federal Reserve.

Notes: "Range for PCE" refers to the forecast range of FOMC members for PCE inflation.

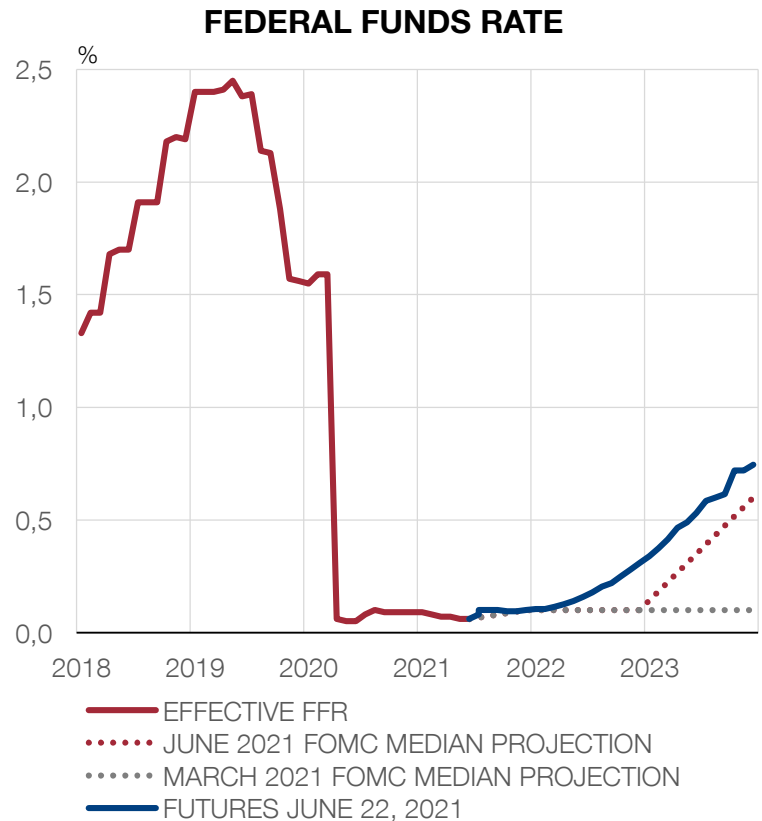
### EMPLOYMENT DESTRUCTION COVID-19 COMPARED TO GFC



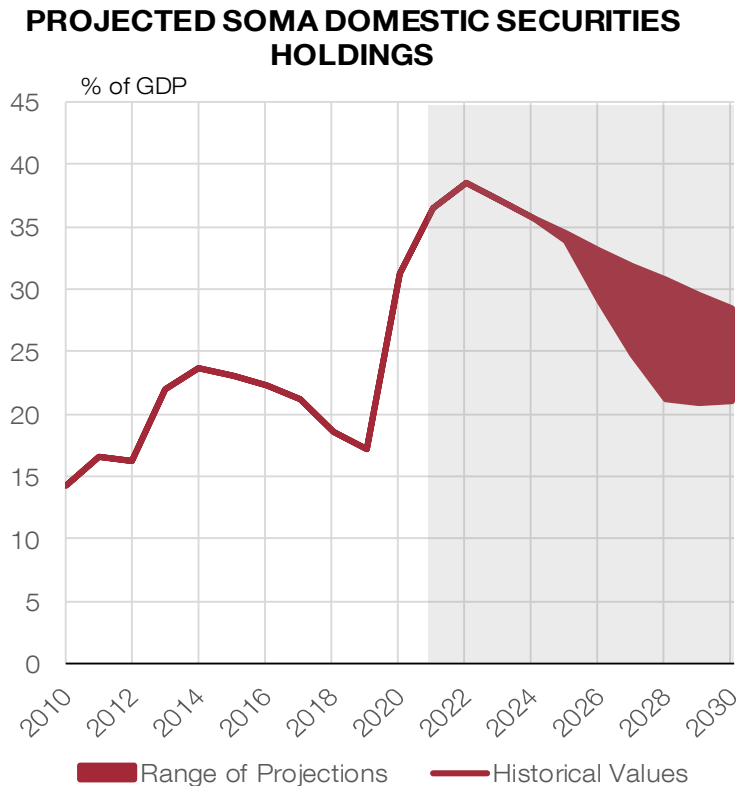
Source: BLS.

Notes: The peak months for the Global Financial Crisis (GFC) and Covid-19 are respectively, December 2007 and February 2020.

- The Federal Reserve now projects a sooner normalization of policy rates as a result of the spike in inflation in 2021. It has just started to talk about talking about tapering asset purchases



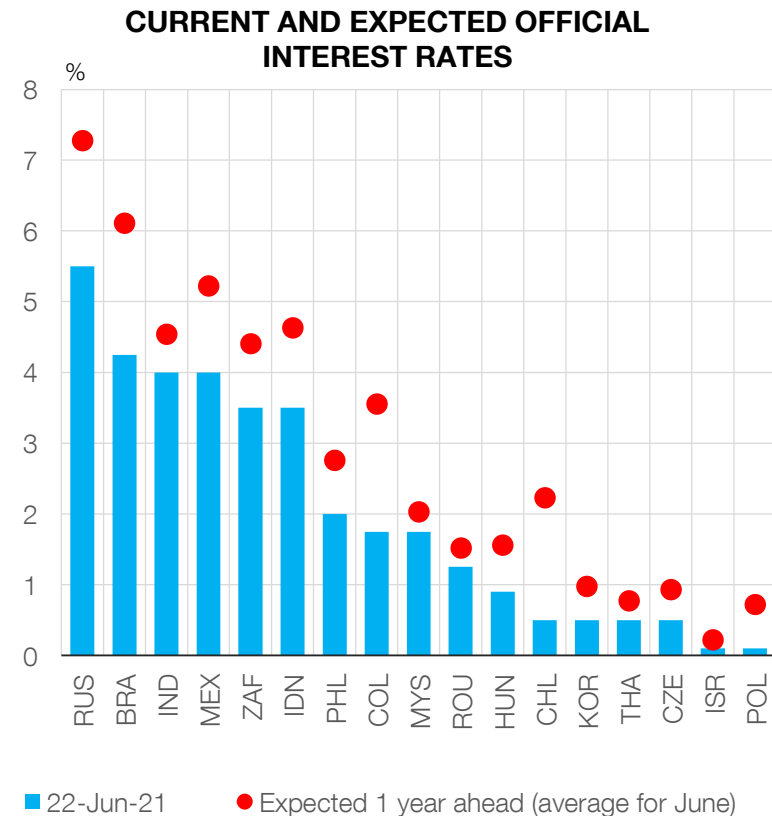
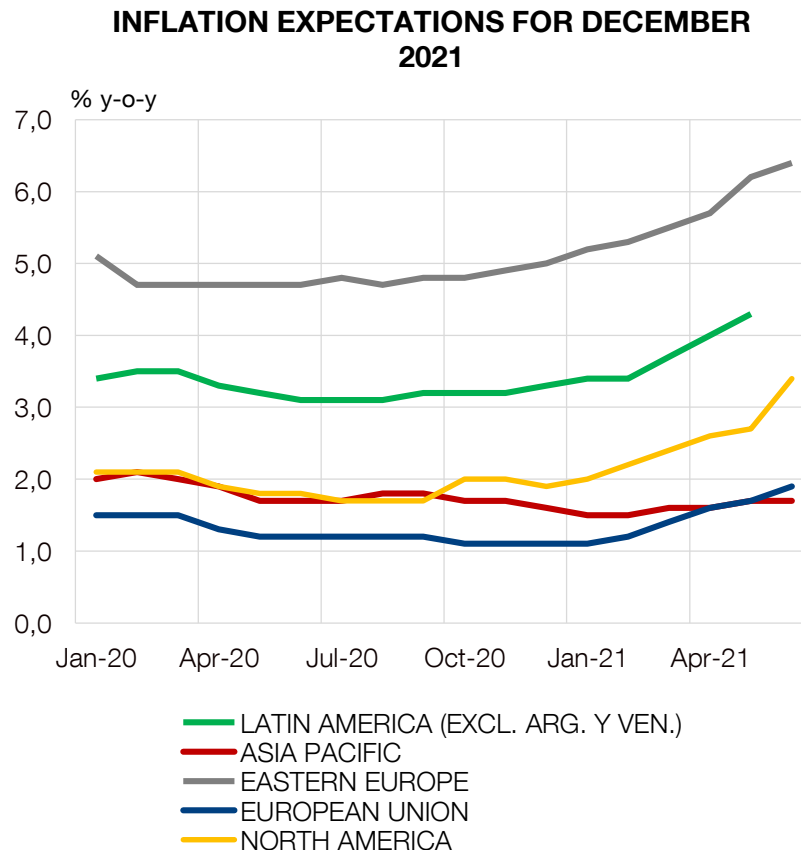
Source: Federal Reserve, Refinitiv.



Source: FRB New York.

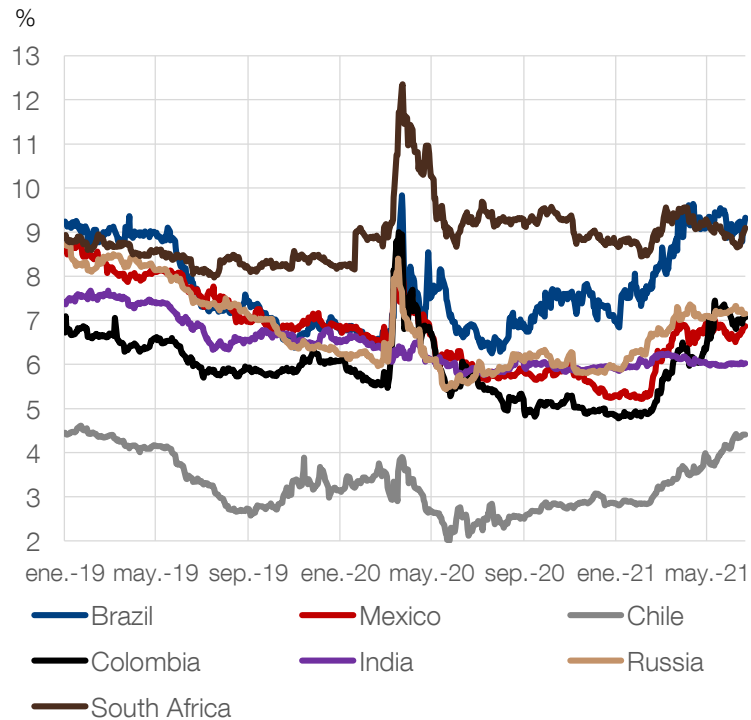
Notes: Figures are as of year-end. Figures for 2010-20 represent historical data; figures for 2021-30 are shaded and represent projections. The range after 2025 reflects outcomes for the portfolio between full reinvestment and full run-off. Assumptions for SOMA purchases, interest rates, length of the reinvestment phase, and the growth of key liabilities are based on the Survey of Primary Dealers and the Survey of Market Participants conducted by the New York Fed in March 2021. Projected figures are rounded.

- The spike in inflation and inflation expectations (and the rise in US 10y rates) led to halt the easing cycle in EMEs. Brazil, Mexico, Russia, Hungary, Czech Rep. have already raised policy rates
- Markets expect policy rate increases in almost all EMEs during this year



- Since February 2021 financial conditions have tightened in EMEs as a result of higher US long-term yields, with an increase in sovereign yields particularly in local currency

LONG TERM SOVEREIGN YIELDS

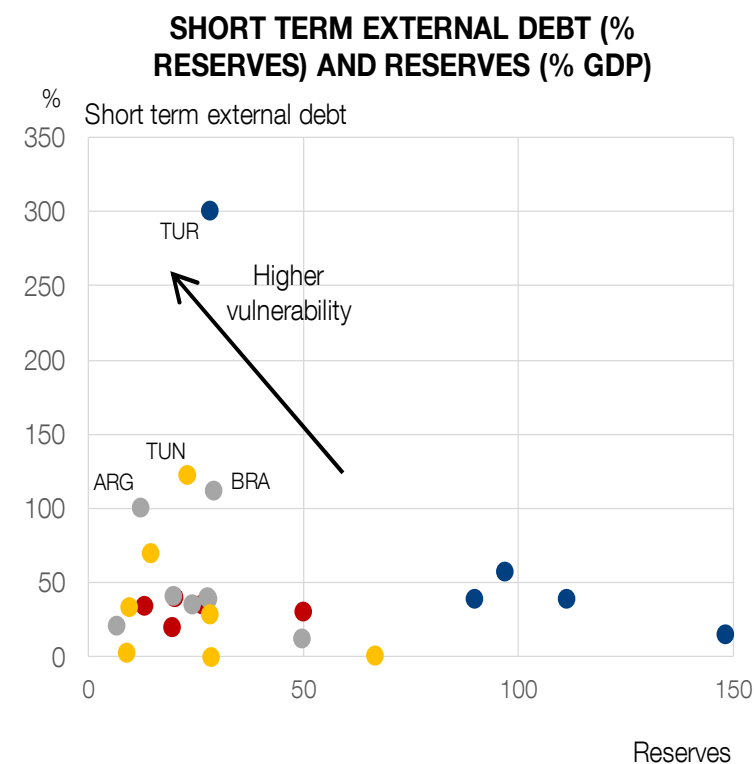
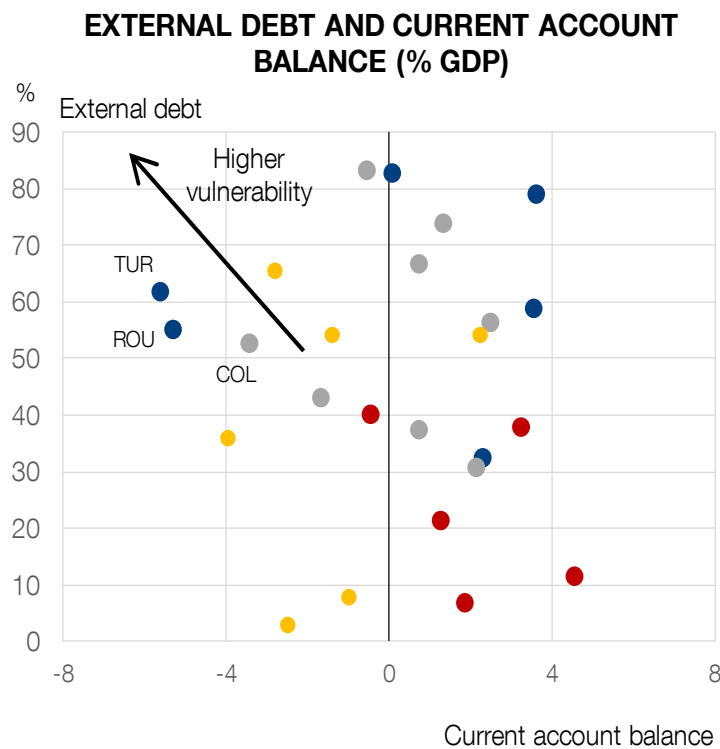
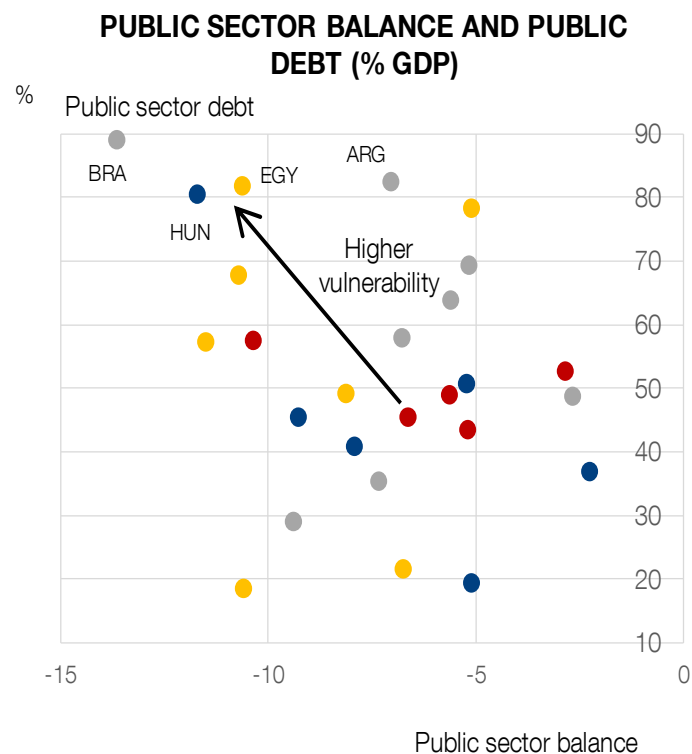


LOCAL CURRENCY YIELDS AND CAPITAL INFLOWS



# EMERGING MARKET ECONOMIES: RISKS FROM DOMESTIC VULNERABILITIES

- **Main vulnerabilities of EMEs are related to the fiscal position and elevated (public and private) debt levels. The external situation is in general more solid (with some exceptions: e.g. Turkey).**



● Eastern Europe ● Asia ● Latin America ● Africa and Middle East ● Eastern Europe ● Asia ● Latin America ● Africa and Middle East ● Eastern Europe ● Asia ● Latin America ● Africa and Middle East

- **Widespread bold initial monetary policy reaction, tailored to each jurisdiction's singularities**
- **Yet the initial condition, the impact of the crisis and the prospects down the road differ:**
  - **US:**

Pre-crisis period: normalization of monetary policy, with inflation outlook in line with objective

Near/medium term: Fast recovery and rising inflation; Fed narrative: inflation rise is transitory, focus on labor market weaknesses

Yet conditions could be conducive to a relatively early normalization of monetary policy
  - **EMU:**

Pre-crisis: long period of subdued inflation, persistently low inflation expectations

Near term/medium: Deeper impact of crisis, more gradual recovery, relatively muted inflation expectations
  - **EMEs:**

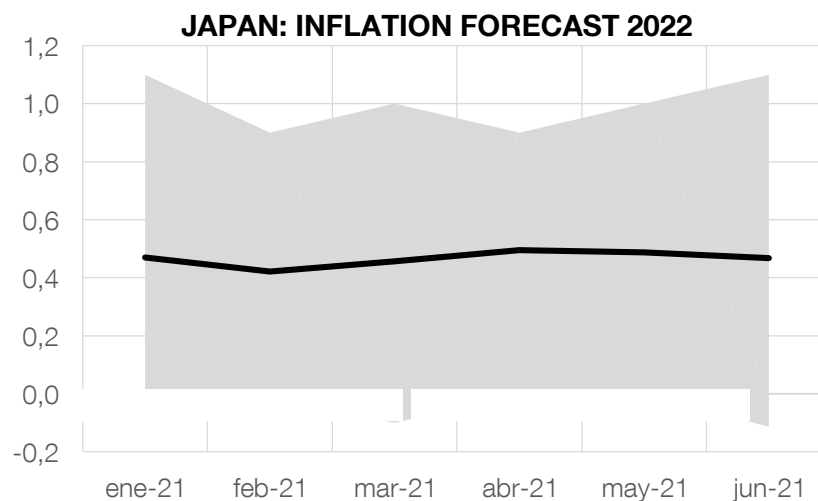
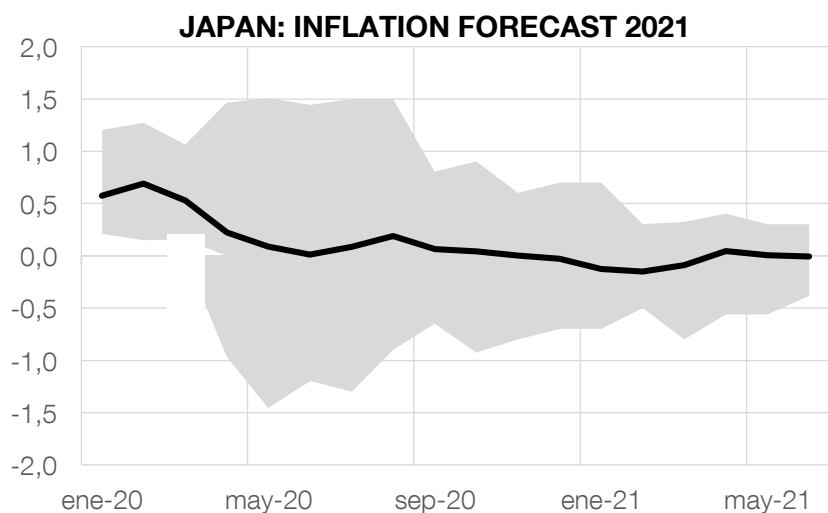
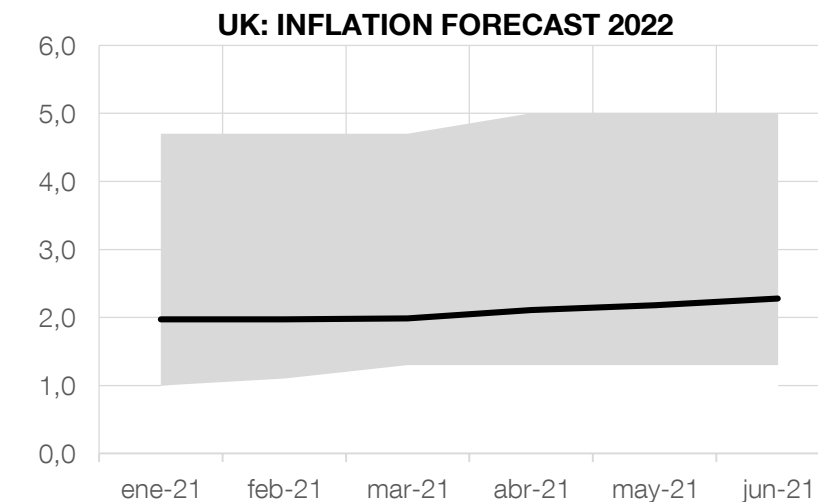
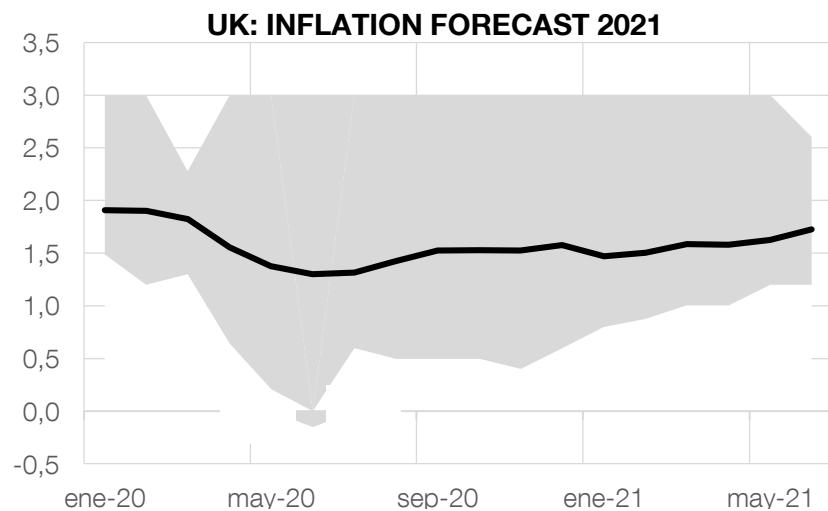
Heterogeneity in initial conditions, and uneven recovery (with Latam lagging)

External constraints and inflation expectations leading to partial normalization

Rebuilding policy space; risks of potential spillovers arising from eventual normalization of (mainly) US mon. policy

THANK YOU FOR YOUR ATTENTION

**Inflation forecasts for the UK in 2021 and in 2022 have increased slightly in the last months. However, inflation forecast for Japan have barely moved since the beginning of the year**

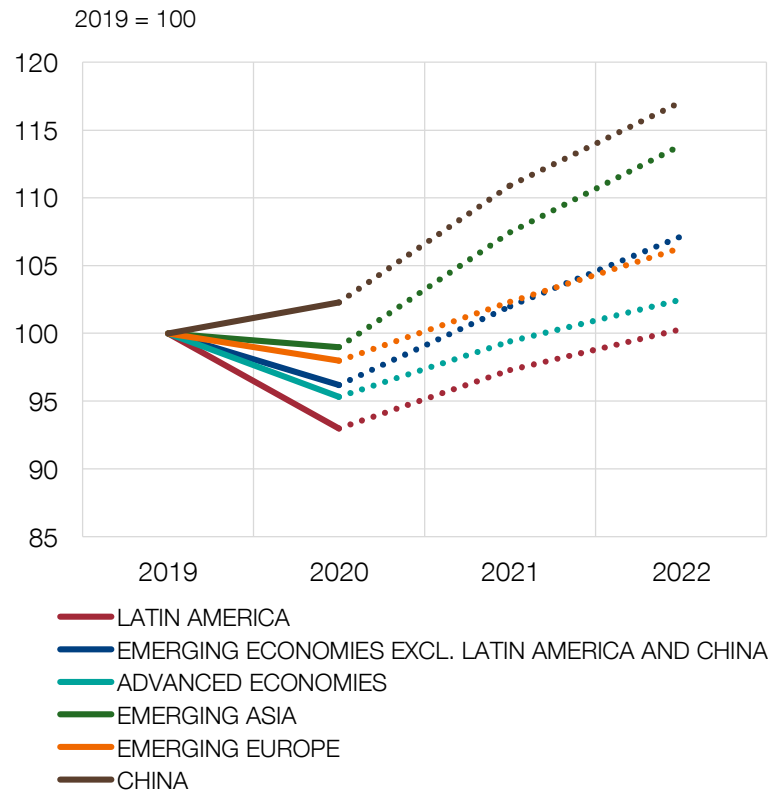


Source: Consensus Forecast

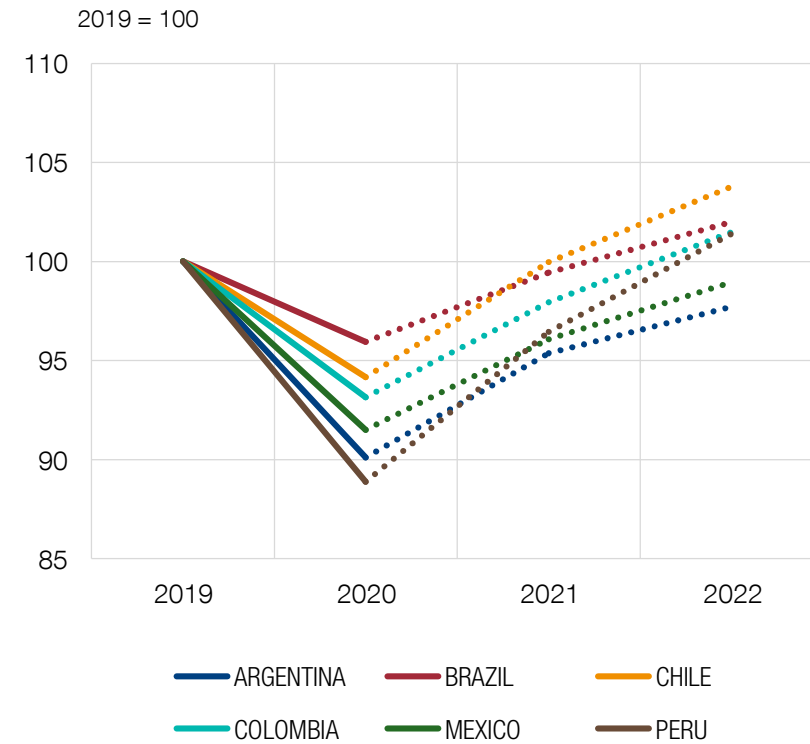


# ANNEX: AN ASYNCHRONOUS RECOVERY IN EMES WITH LATAM LAGGING BEHIND

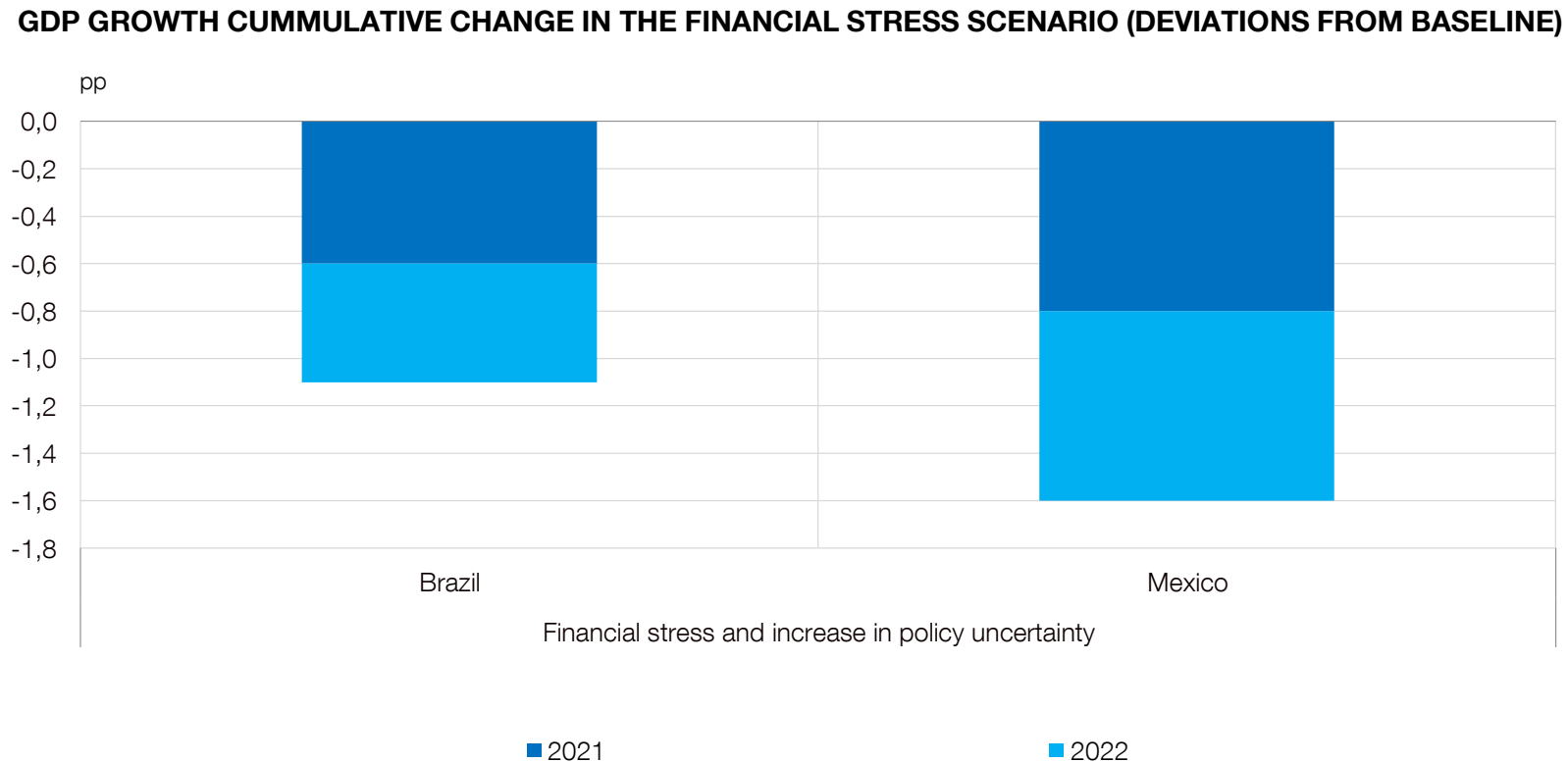
## GDP LEVEL BY AREA



## GDP LEVEL IN THE SIX MAIN LATIN AMERICA ECONOMIES

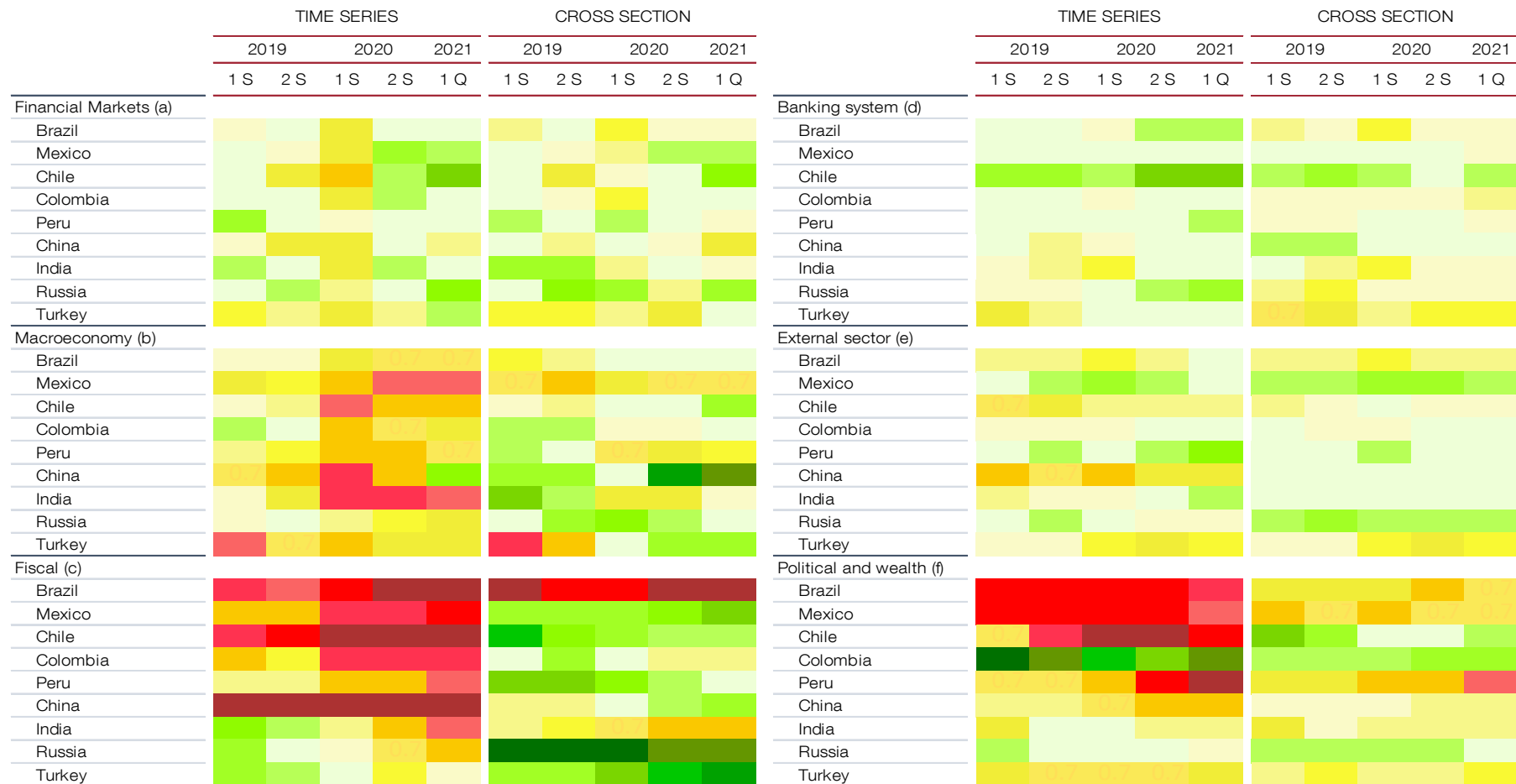


- **Estimated effects on Brazil and Mexico of a tightening of financial conditions:**



Source: Banco de España

# ANNEX: VULNERABILITY HEAT MAPS FOR THE MAIN EMES



a Sovereign spread (level and quarterly change), quarterly change of equity index and exchange rate vs USD.

b GDP, industrial production, inflation, GDP per capita.

c Public balance and public debt

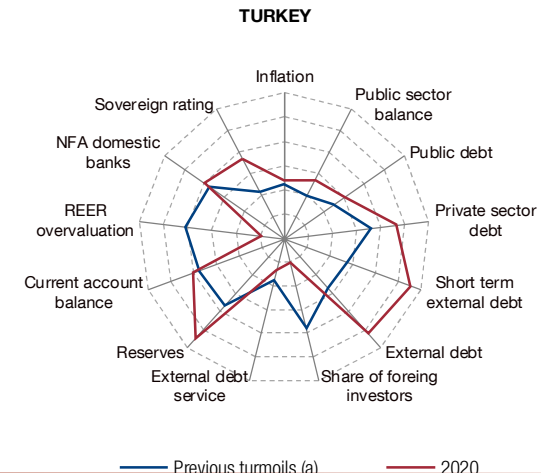
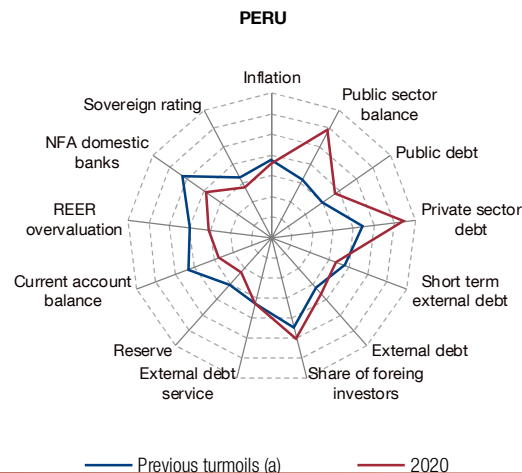
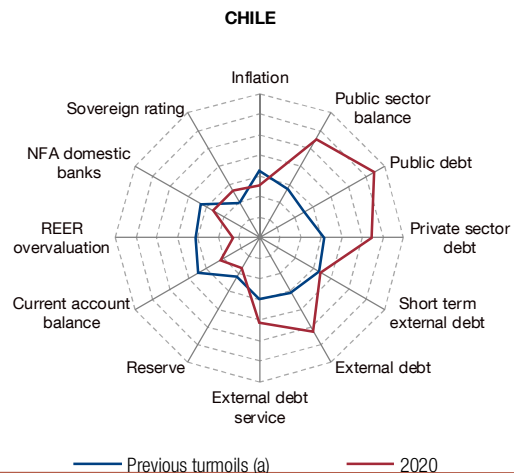
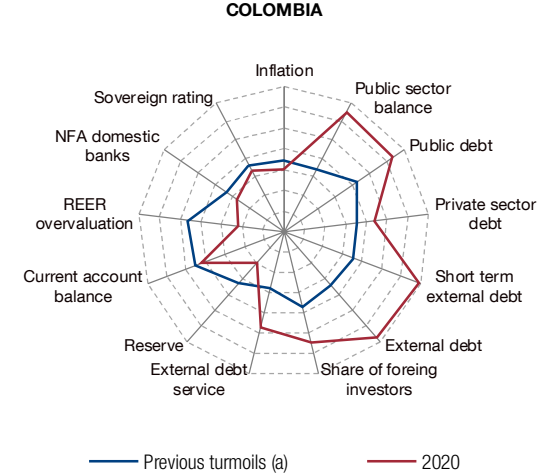
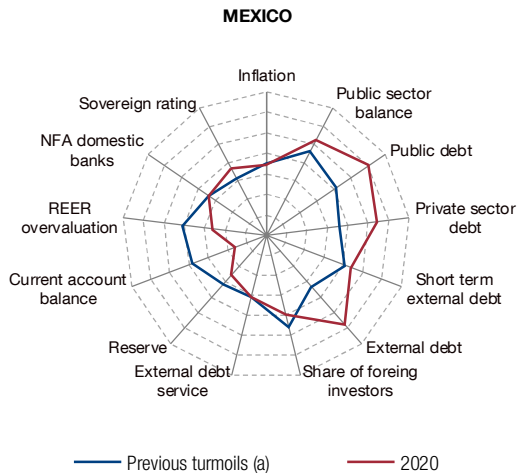
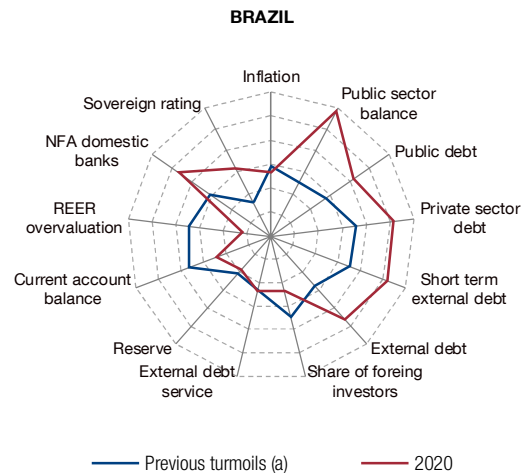
d Real change in credit and deposits, loan to deposit ratio, NPL, NFA domestic banks, banks equity index and external debt spread, BICRA, IHS Markit, interbank rate, intermediation margin

e Current account balance, FDI, portfolio inflows, external debt, short term external debt, external debt service, International Reserves.

Source: Banco de España

# ANNEX: COMPARISON OF VULNERABILITIES IN EMES (2020 VS HISTORY)

- Are EMEs in a better or worse vulnerability position in comparison with past turbulence times?
- In general, they show a better external position, lower exchange rate overvaluations and inflation. However, private and public debt levels are higher than in previous episodes.



Source: Banco de España