ECB MONETARY POLICY
Past, present and future

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THE EURO AREA HAS WITNESSED DISINFLATIONARY PRESSURES SINCE 2013

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

Sources: Datastream and European Commission
OVER THE DIFFERENT PHASES OF THE CRISIS, THE ECB HAS DEPLOYED A PACKAGE OF MUTUALLY REINFORCING MEASURES

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

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...


Notes: The chart shows the impact of ECB non-standard measures on the GDP-weighted aggregate of euro area sovereign bond yields.
CONTRIBUTION OF ECB NON-STANDARD MEASURES TO REAL GDP GROWTH
2014-2018

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


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.

![Graph showing contribution of ECB balance sheet policies to real GDP growth and HICP inflation.](image)

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

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

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.

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

Source: Banco de España.
BREXIT: UNCERTAINTY PERSISTS AS OCTOBER 31ST 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

Source: IMF WEO, April 2019.
TURKEY HAS BOTTOMED OUT AND ECONOMIC CONDITIONS ARE GRADUALLY IMPROVING, BUT DOMESTIC RISKS PERSIST

Note: the weight of Turkey in Euro Area exports is around 2.5%
Sources: Central Bank of Turkey and Turkish Statistical Institute.
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 1st 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
• 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
• 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.

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