



EUROPEAN CENTRAL BANK

EUROSYSTEM

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European Central Bank

# Policy Considerations on the Prolonged Period of Low Interest Rates: A Euro Area Perspective

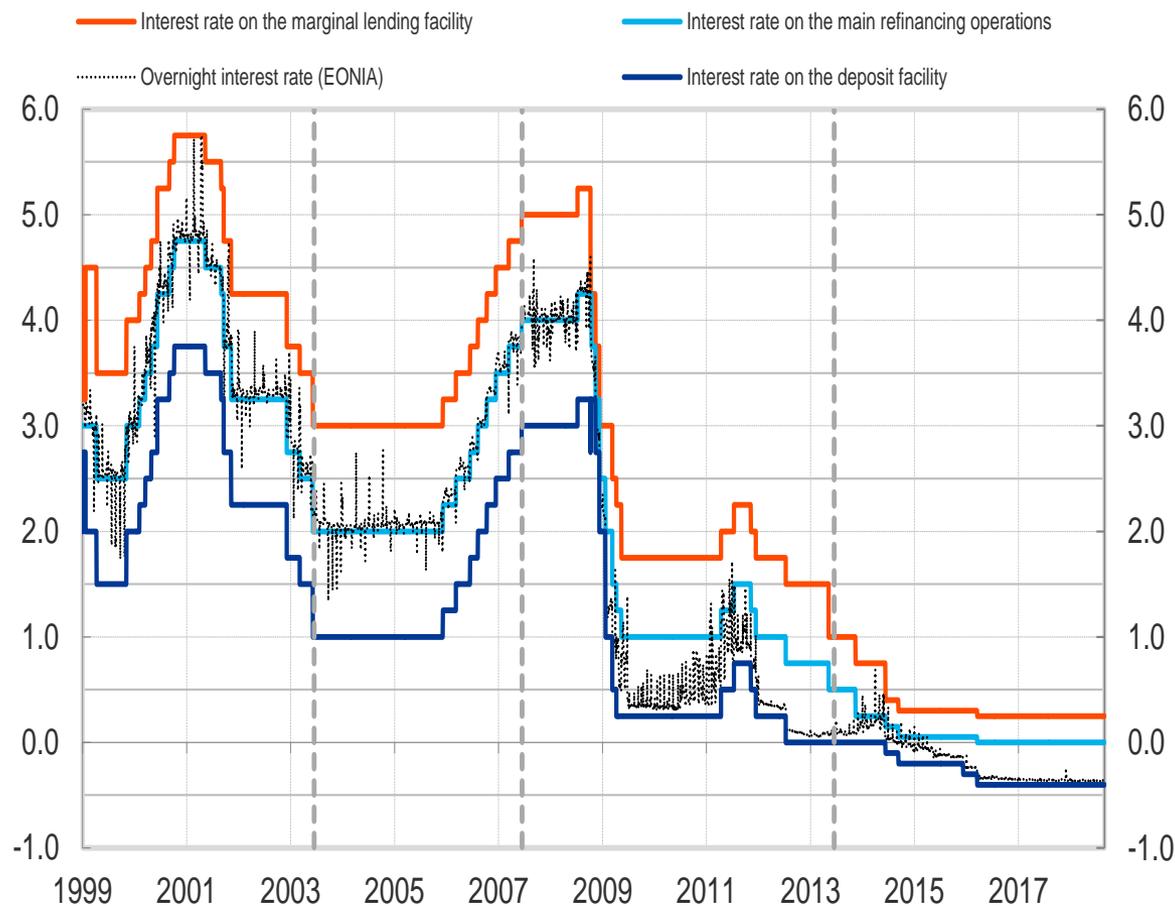
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Reserve Bank of Boston

**Disclaimer:** This talk falls in the ECB “quiet period”. Therefore the presentation and any remarks made in the discussion are exclusively backward-looking and should not be regarded as comments relating to current monetary policy issues. Any views expressed are the speaker’s own and should not be interpreted as views of the ECB or the Eurosystem.

# ECB interest rates “low” since the second quarter of 2009 or the third quarter of 2012

## Main ECB policy rates and EONIA (per cent)



Sources: ECB.

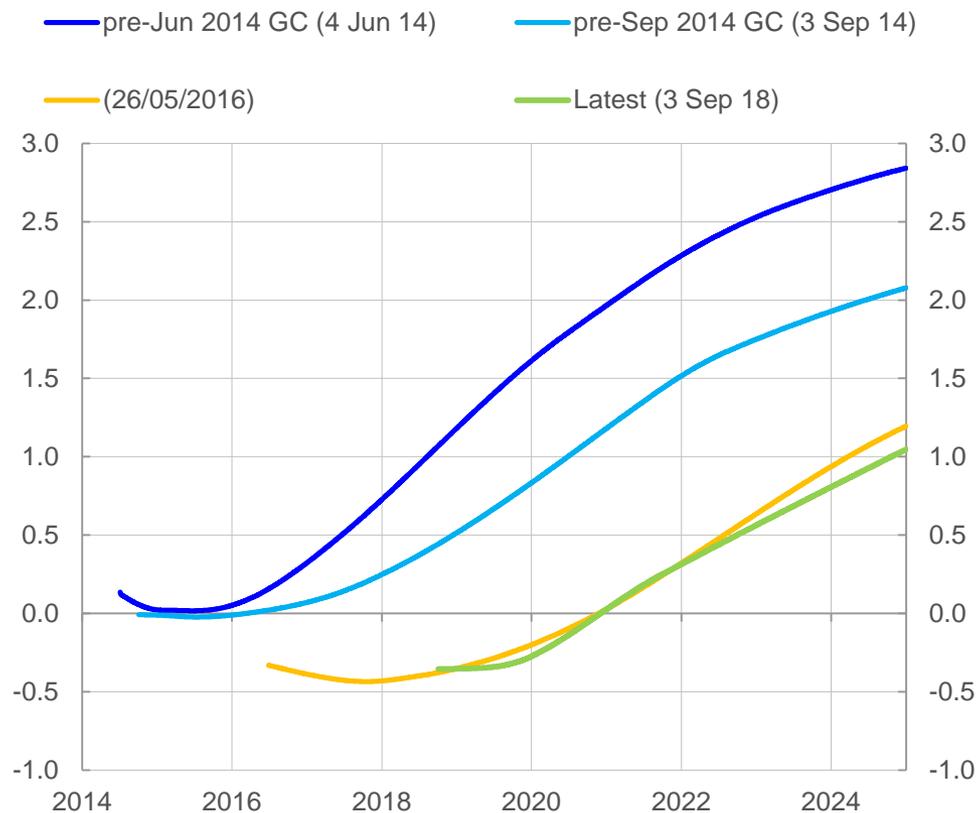
- Overall 6 to 9 years, depending on what is regarded as “low”
- Consequence of financial and sovereign debt crises
- Negative component since June 2014: deposit facility rate (DFR) moved from 0 to -40 basis points
- Due to ample liquidity policy, overnight rate close to DFR
- NB: other measures!

# Outline

- 1) Rationale for and transmission of negative ECB policy rates
- 2) Financial stability implications of low rates in the euro area
- 3) International monetary policy spillovers in the low rate environment

# Deposit facility rate reductions below zero flattened the risk-free yield curve and shifted it down

## EONIA forward curves before and after ECB rate reductions below zero (percentage points)

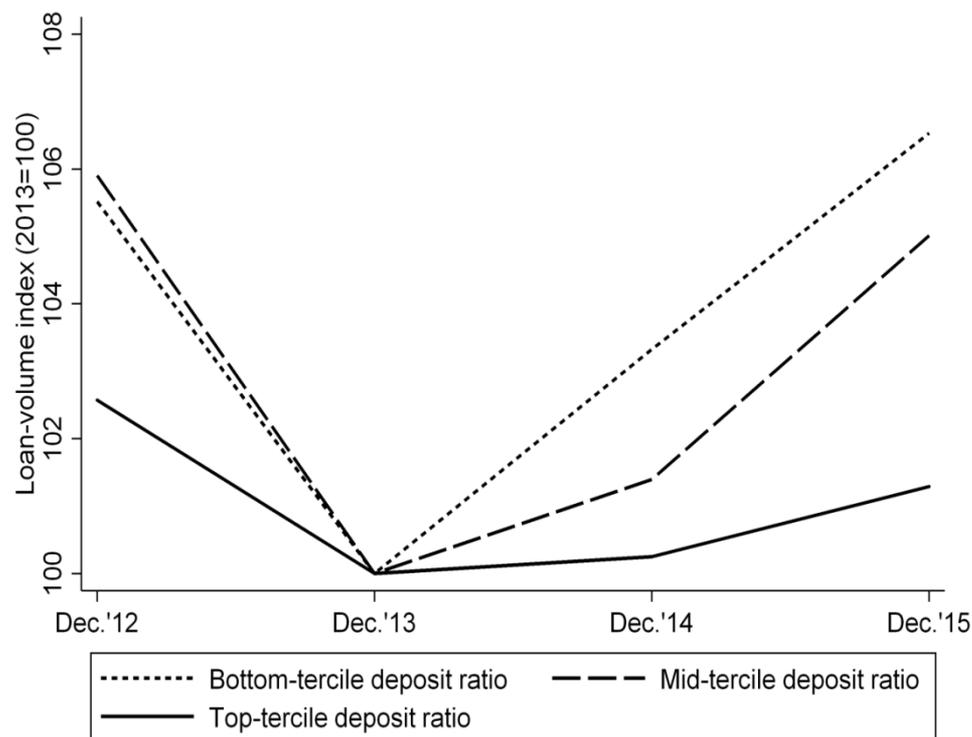


Notes: Forward curve is estimated using spot Overnight Index Swap (EONIA) rates.  
Sources: Thomson Reuters and ECB calculations.

- Disinflationary forces after sov. debt crisis (mid-2013 and on)
- Three-pronged easing strategy:
  - Negative interest rate policy (NIRP)
  - Targeted longer-term ref. operations
  - Various asset purchase programs
- NIRP removes non-negativity constraint on future expected short rates
- Charge on cash hoarding triggers portfolio shifts towards long-term bonds compressing term premium
- Movements as broadly predicted in novel yield curve models (Lemke and Vladu 2017)
- Imply stimulating effects on investment and consumption

# The policy also contributed to higher lending of banks relying less on deposit funding

Total bank lending before and after ECB rate reductions below zero (by deposit ratios)



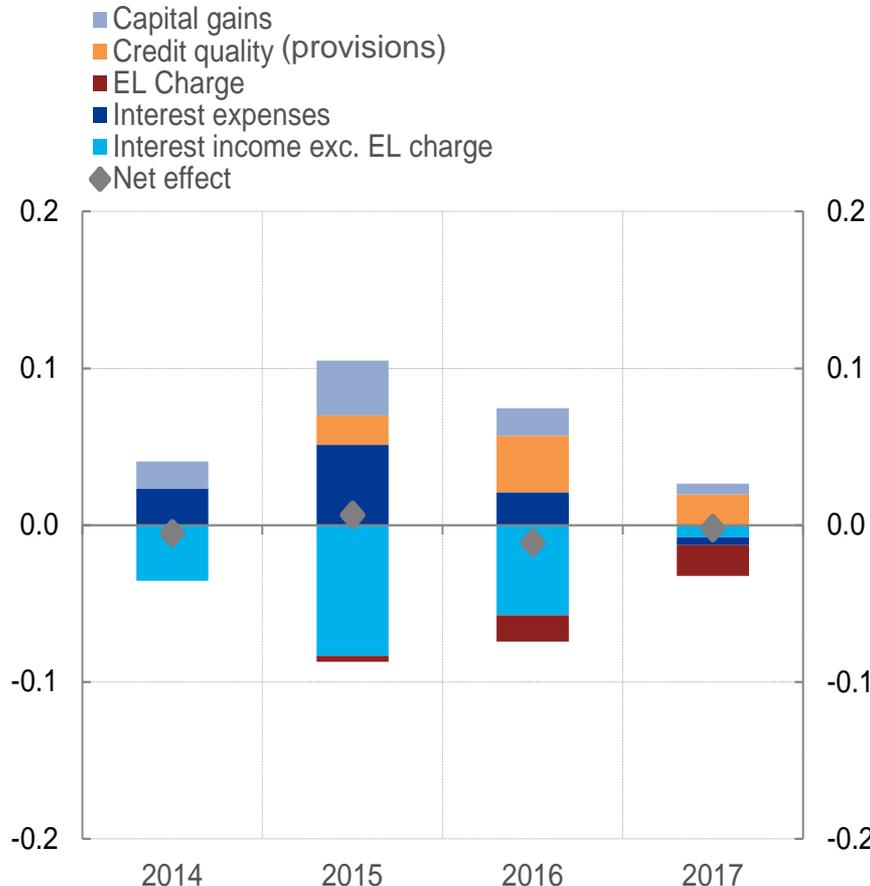
*Notes:* Annual total loan volumes (end of year) indexed to 2013 levels for 70 large euro area banks. Bank sample is split in tertiles of deposit ratios, which are defined as total deposits divided by total assets in 2013.

*Sources:* Heider et al. (2018), Figure 6, using SNL Financial data.

- Banks with low deposit-to-asset ratios benefited from funding advantages
- Extended lending relative to high deposit-ratio banks (Heider et al. 2018)
- Led to net lending increase in the aggregate (Demiralp et al. in progress)
- Potential “reversal rate” (Brunnermeier and Koby 2018) not reached
- NB: Accompanying TLTRO-2 pricing
- But initial capital gains on securities portfolios offset over time by reductions in net interest margins

# Bank stability implications: positive profitability effects have offset any negative ones so far

Simulated deviations of banks' return on assets from a no policy scenario (all monetary policy measures, p.p.)

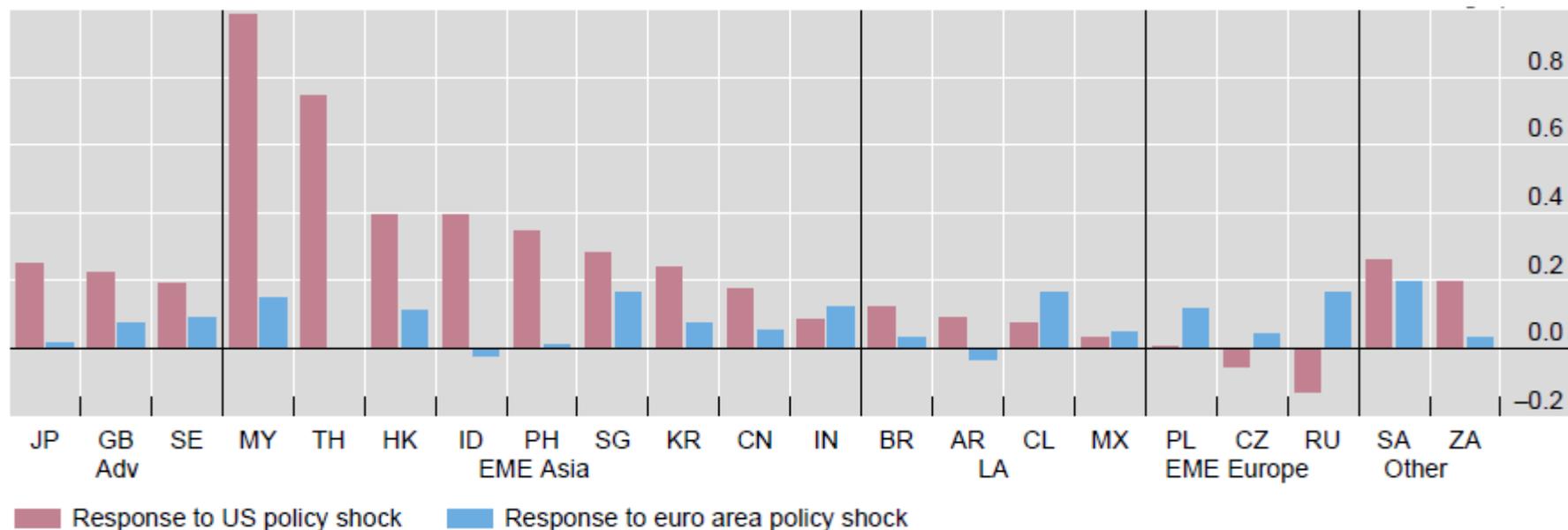


- NB: Sizeable differences across countries and individual banks
- ECB Banking Supervision's SREP stress tests found that most European banks could weather a 200 bp interest rate shock (ECB 2017)
- Many other dimensions than banks (ESRB 2016, CGFS 2018):
  - Profitability and solvency of life insurers and pensions funds
  - Search for yield (real estate, fixed income)
  - Accelerated transition to market-based financial structure

Notes: Capital gains based on data on a consolidated basis for 68 euro area banking groups included in the list of significant institutions under direct ECB supervision and in the 2014 EU-wide stress test. Other estimates based on aggregate banking statistics. Euro area aggregate calculated as average of the countries included in the sample, using the ECB's consolidated banking data for weighting. NII stands for net interest income and EL for excess liquidity.  
Sources: Altavilla et al. (2018).

# Spillovers of US unconventional monetary policy more global and euro area spillovers more regional

Estimated cumulative effects of a 25 basis point reduction in shadow overnight rates on consumer price inflation rates (percentage points)



Notes: Based on a global vector error correction model estimated for 24 major advanced and emerging economies between October 2008 and June 2014.  
Sources: Chen et al. (2017), Graph IV.3.

- Spillovers of expansionary policies tend to be positive (despite depreciation)
- In most studies Fed effects stronger than ECB effects, except in Europe
- But evolving literature...

# Spillovers have triggered a debate about the value of international monetary policy coordination

- Some have argued that the capital flows triggered by extraordinary monetary policies of major advanced economies and exits from them are too heavy for emerging market economies to keep control of their domestic macro conditions and financial stability (e.g. Rajan 2014)
- But formal monetary policy coordination is complicated given the domestic mandates of central banks (e.g. Draghi 2016)
- Recent studies by the Fed and the IMF suggest that actions by major central banks account only for a relatively small fraction of global financial volatility and capital flows (Powell 2018)
- A “realistic” approach:
  - Transparent diagnoses of the root causes of the challenges facing different economies
  - Shared commitment to found domestic monetary (and other) policies on these diagnoses
  - As clear as possible communication of the policy strategy to meet the challenges, to align expectations and to avoid market disruption
  - Further developing the (prudential, fiscal and international) policy frameworks that help to ensure domestic resilience

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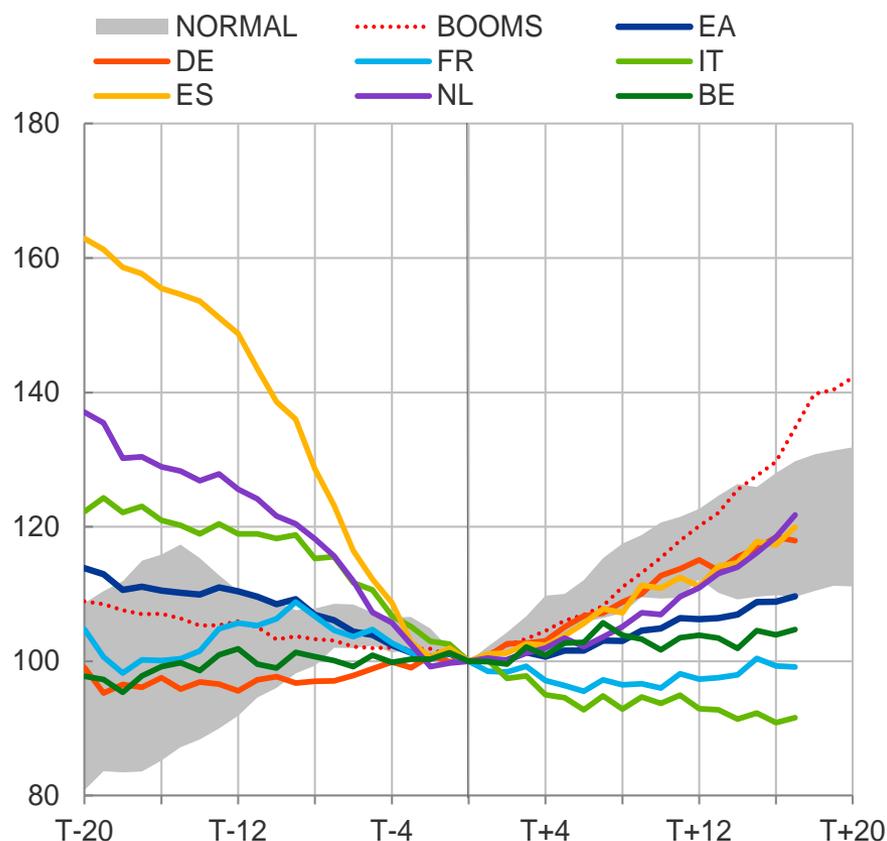
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# Annex

# Property price developments are within (or below) regular ranges and below historical boom dynamics

Post-crisis real house prices compared to boom periods and normal ranges (Q4 2013 and historical troughs normalised to 100)



- No general property bubble in the euro area
- A few countries and/or large cities have nevertheless high property price growth now
- In some countries risks may be particularly pronounced in commercial real estate
- A number of prudential policy actions have been taken in those cases

*Notes:* Real house price indexes based on residential property price and consumer price indexes of euro area countries between 1975Q1 and 2018Q1. Identification of troughs and peaks following Harding and Pagan (2002). Red dotted line refers to the median for all upswings covered in the fourth quartile (historical “booms”). Grey area refers to the range of all upswings covered in the second and third quartile (historically “normal” upswings).

*Sources:* BIS, ECB, Fed Dallas, OECD and ECB calculations.