OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

20 years of EMU, 10 years in crisis mode:
How may a future „new normal“ of monetary policy look like?

Peter Mooslechner
Former Executive Director and Member of the Governing Board
Oesterreichische Nationalbank

46th Economics Conference of the Oesterreichische Nationalbank
“European Economic and Monetary Union: The first and the next 20 years”
Vienna, May 2, 2019

Prologue:

The most simple EMU timeline: 2 decades completely different

The beginning: „10 golden years“

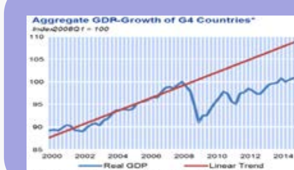
ECB

1999 - 2007

In crisis and in crisis mode…

ECB

2008 - now



Prologue:
The most simple EMU timeline: extended version

Preparatory Phase

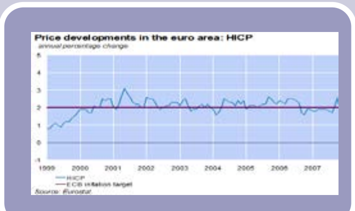
EMI

1994 - 1998

The beginning: „10 golden years“

ECB

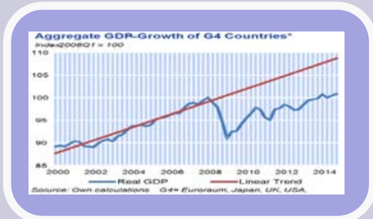
1999 - 2007



In crisis and in crisis mode…

ECB

2008 - now



The Future…

ECB

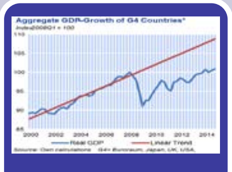
2019 - ????

Prologue:
Monetary policy exit as the pending challenge

In crisis and in crisis mode…

ECB

2008 - now



EXIT

The Future…

~~WHEN? and HOW?~~

WHERETO?

Prologue:

By the way: What do Europeans think about the future?

Study of Bertelsmann-Stiftung (2018): „Nostalgia provides stability in moments of uncertainty“

EUPINIONS SURVEY

Make Europe Great Again? Europeans view the past more positively than the present

It is popular to desire a supposedly better past: Donald Trump's promise to lead the US back to the top again took him to the White House. Brexit supporters have mobilized voters with memories of a time when the UK ruled the seas of the world. The latest issue of eupinions has studied how receptive Europeans are overall to the siren song of the "good old days."

FIGURE 1 **Who are the nostalgics?**

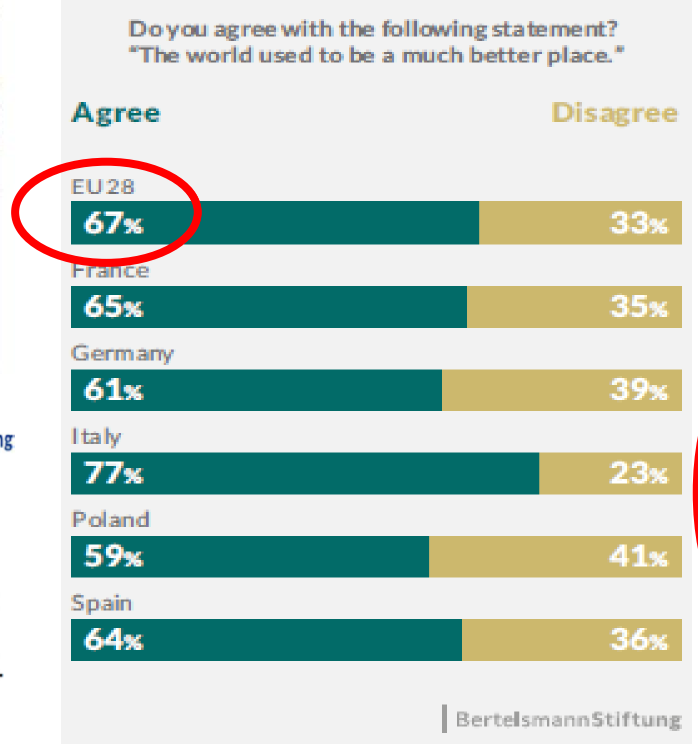
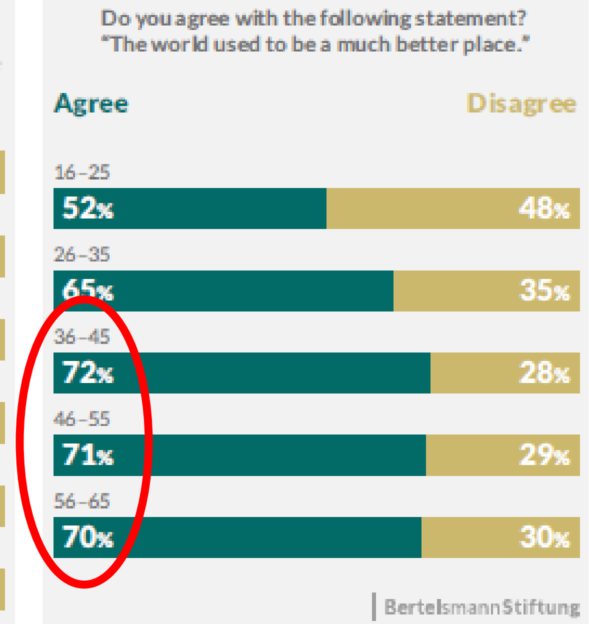
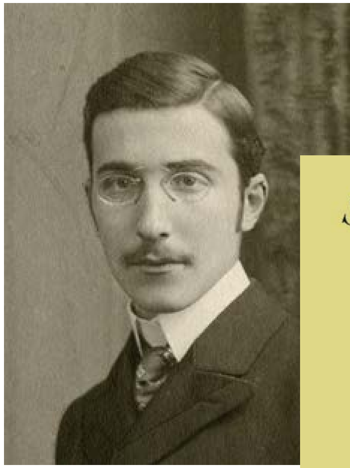


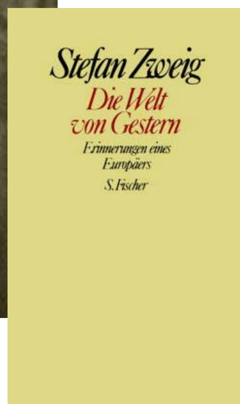
FIGURE 2 **EU28: Who are the nostalgics across age groups?**



Prologue:

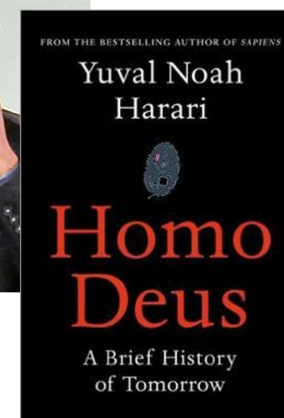
European expectations for the future: More „Stefan Zweig“ than „Yuval Harari“





Stefan Zweig: „The World of Yesterday – Memories of a European“ (1942)

„…to sum up the time of my childhood and youth before the First World War, I hope I can put it most succinctly by calling it the Golden Age of Security.“ (The World of Yesterday, 1942)



Yuval Noah Harari: „Homo Deus – A Brief History of Tomorrow“ (2016)

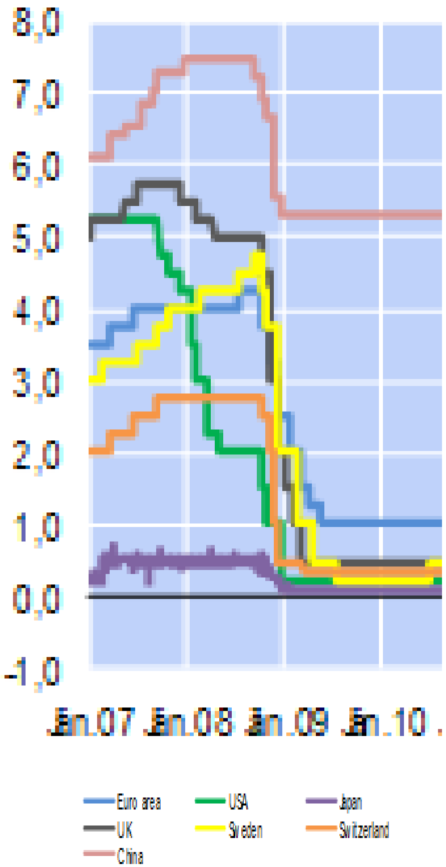
„We don‘t know how the world will look like in 2050, but we know for sure: It will be completely different from the one we are used to today.“ (Interview, March 2019)

Outline

- **Prologue: The most simple EMU timeline** ✓
- **How has monetary policy making changed in the course of the crisis?**
- **On the (forgotten) role of the preparatory phase**
- **What to expect for a future „new normal“ of monetary policy?**
- **(Any) Conclusions?**

I. HOW HAS MONETARY POLICY MAKING CHANGED IN THE COURSE OF THE CRISIS?

All (big) Central Banks have reacted to the crisis in a very similar way



In short:

…cut interest rates to the ZLB (or below)

…expanded their balance sheet by various intruments

ECB	Fed	BoJ
2008 - Fixed-rate full allotment - FRFA	2008 - Term-Auction Facility - TAF; Term Securities Lending Facility - TSLF	2008 - Securities Lending Facility - expansion
2008/2009/2011 - Long-term Refinancing Operations (6m, 1Y, 3Y) - LTRO	2008 - Primary Dealer Credit Facility - PDCF	2008 - Outright purchases JGBs
2009/2011/2014 - Covered Bonds Purchase Programme (s) - CBPP	2008 - Asset-Backed CP MMMF Liquidity Facility - AMLF (and MMIFF)	2008 - CP repo operations - expansion; Outright purchases CP
2012 - Outright Monetary Transactions (announcement) - OMT	2008 - Commercial Paper Funding Facility - CPFF	2008 - Special Funds-Supplying Operations to Facilitate Corp. Financing
2013 - Forward guidance	2009 - Term Asset-Backed Securities Loan Facility (ABS CMBS) - TALF	2009 - Outright purchases Corporate Bonds
2014 - Targeted Long-term Refinancing Operations - TLTROs	2009 - Liquidity to credit markets - consumer, small business CMBS - TALF	2010 - Asset Purchase Programme - APP
2014 - ABS and Covered Bond Purchase Programme - ABSPP, CBPP	2008/2010/2012 - Large-scale Asset Purchases - QE1, QE2, QE3 - LSAP	2012 - Loan Support Programme
2015 - Expanded Asset Purchase Programme - APP	2008/2011/2012/2014 - Forward guidance (qualitative and quantitative)	2013 - Quantitative and Qualitative Monetary Easing

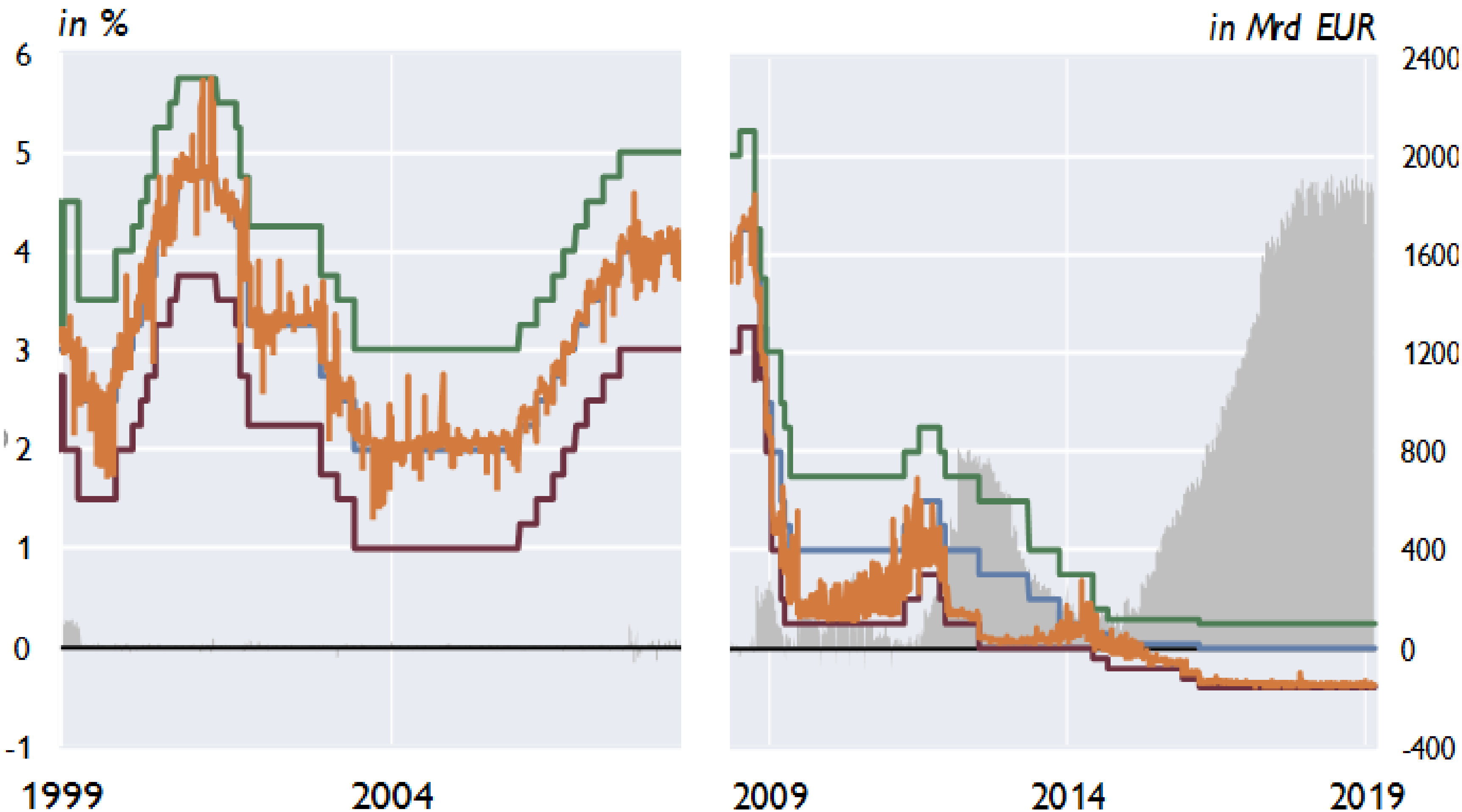
But: These reactions took place against a new economic background also…

…with very significant and lasting long-term changes in economic framework conditions like…

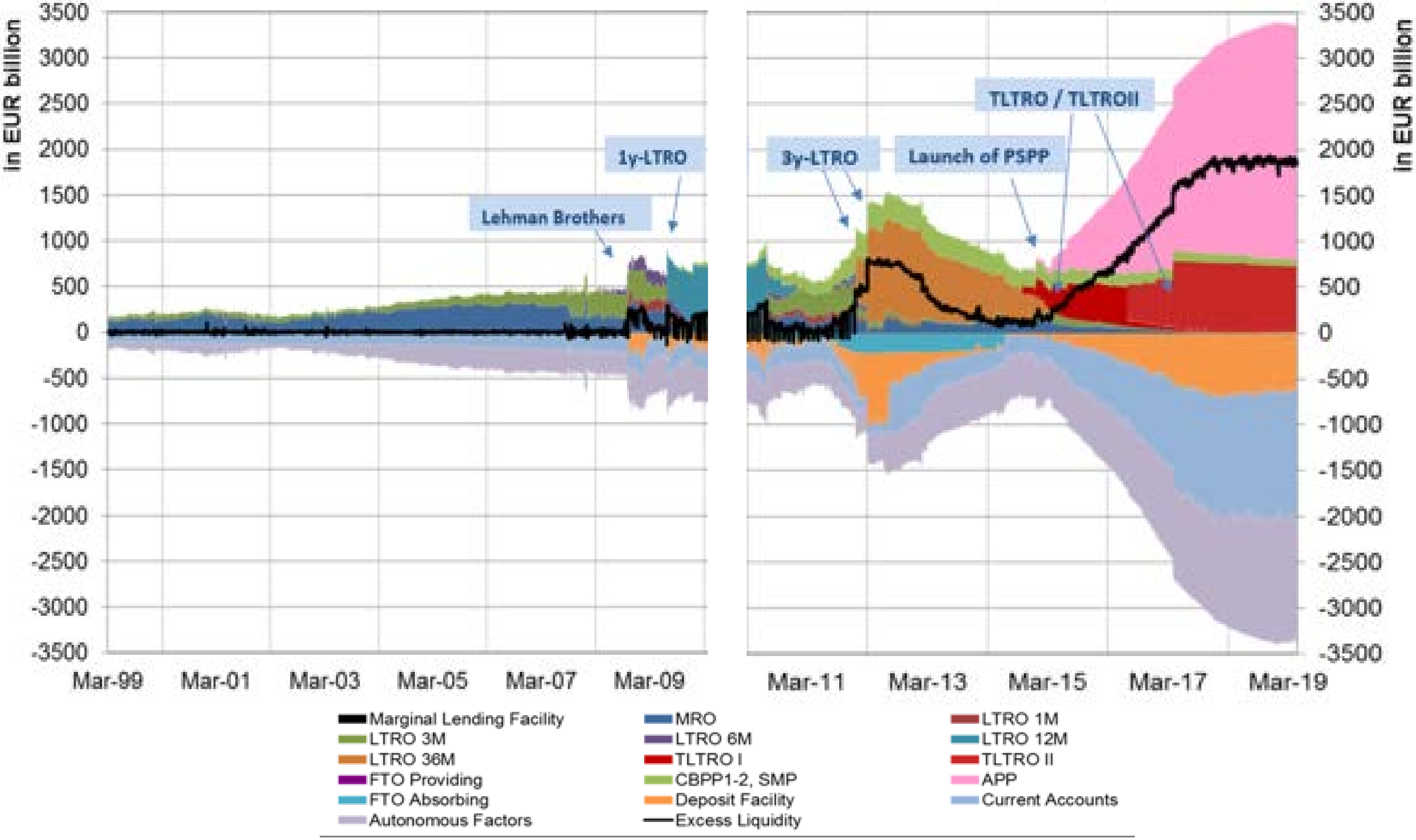
- structurally low inflation
- lower potential growth
- low interest rate environment
- globalization of financial markets
- increased financial market complexity
- higher systemic and contagion risk
- new regulatory environment
- …..

…resulted in
► significant changes in monetary policy implementation and operation

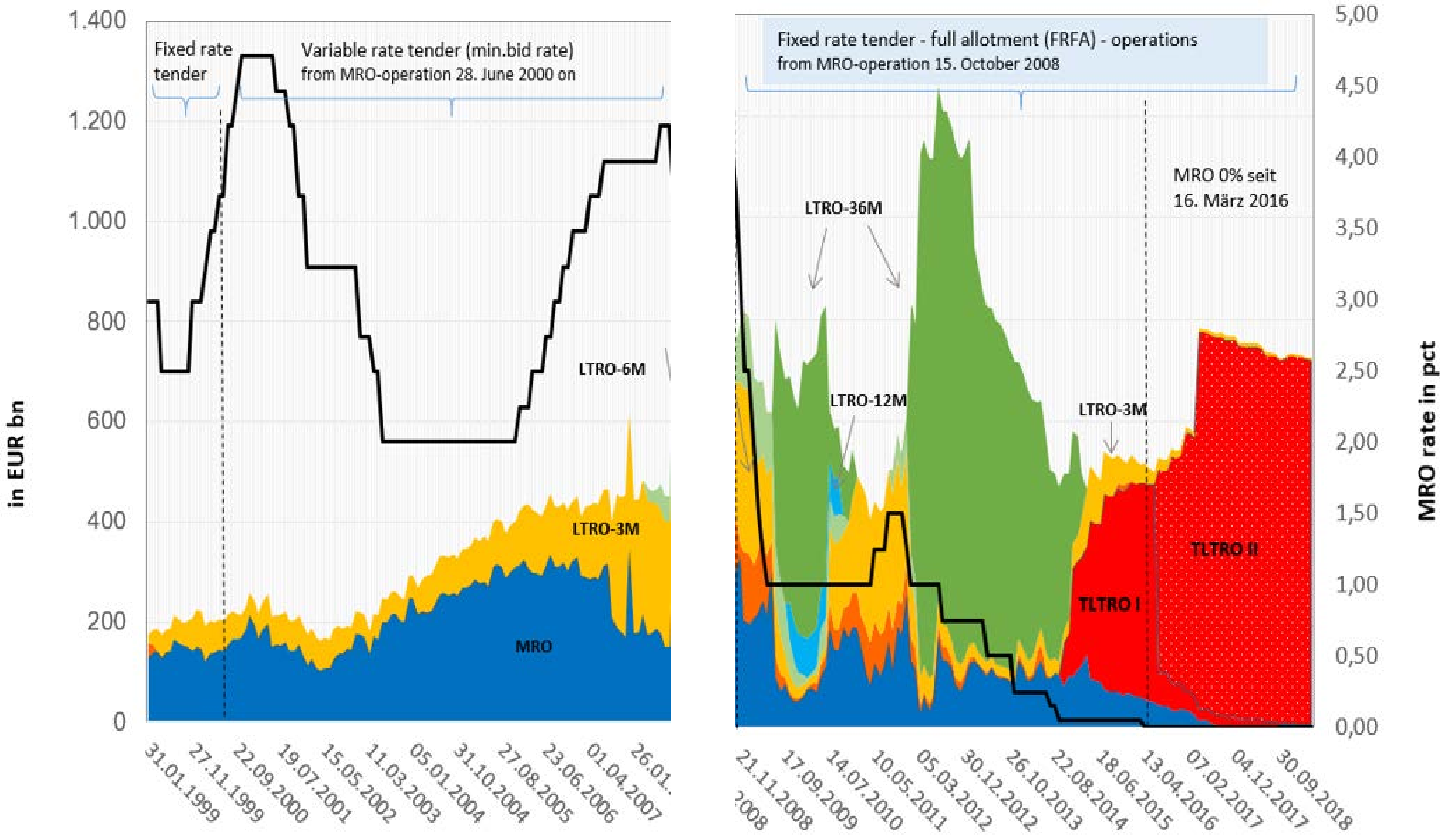
20 years of EMU in 4 pictures (I): ECB policy rates



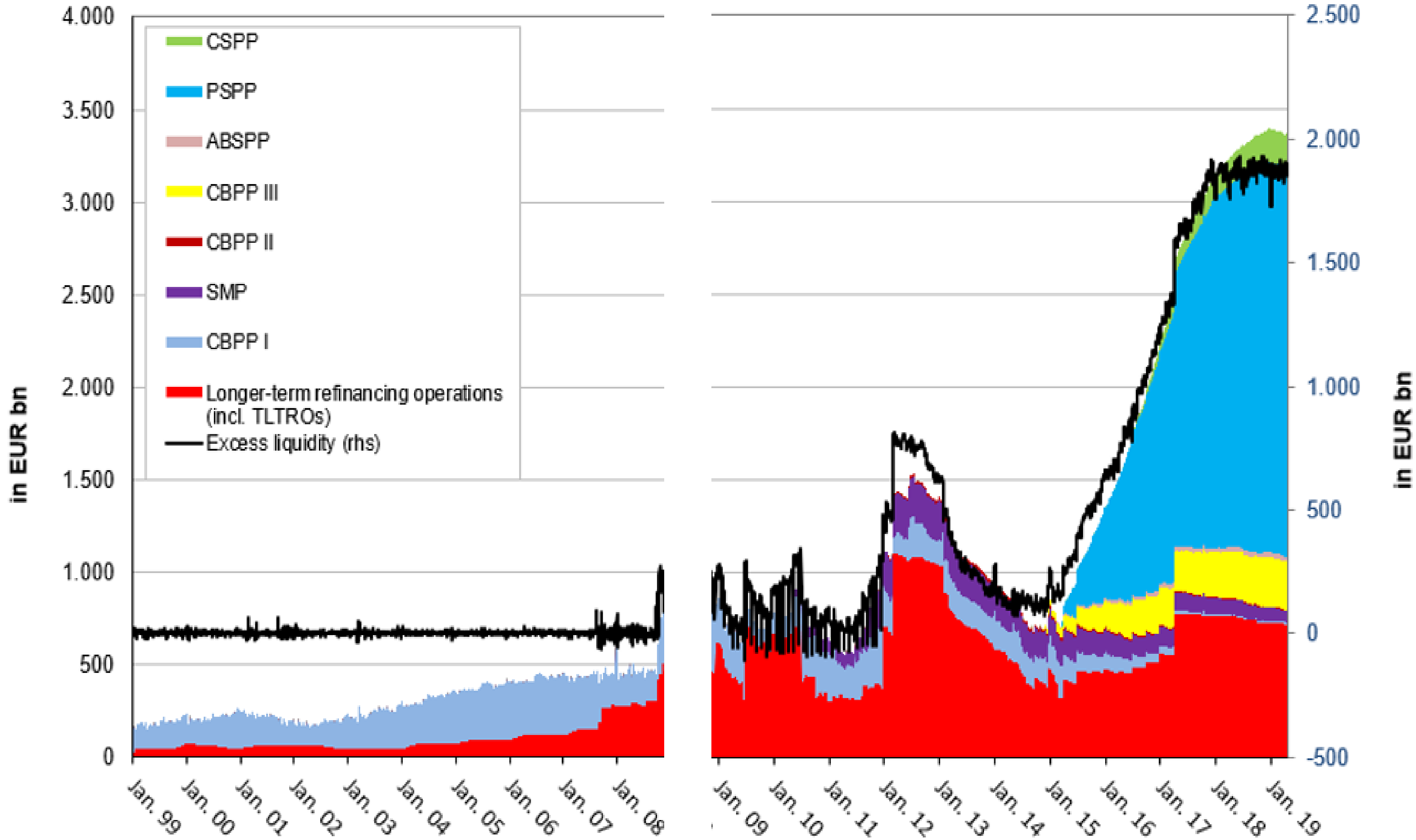
20 years of EMU in 4 pictures (II): ECB overall liquidity provision



20 years of EMU in 4 pictures (III): Structural changes in ECB tender operations

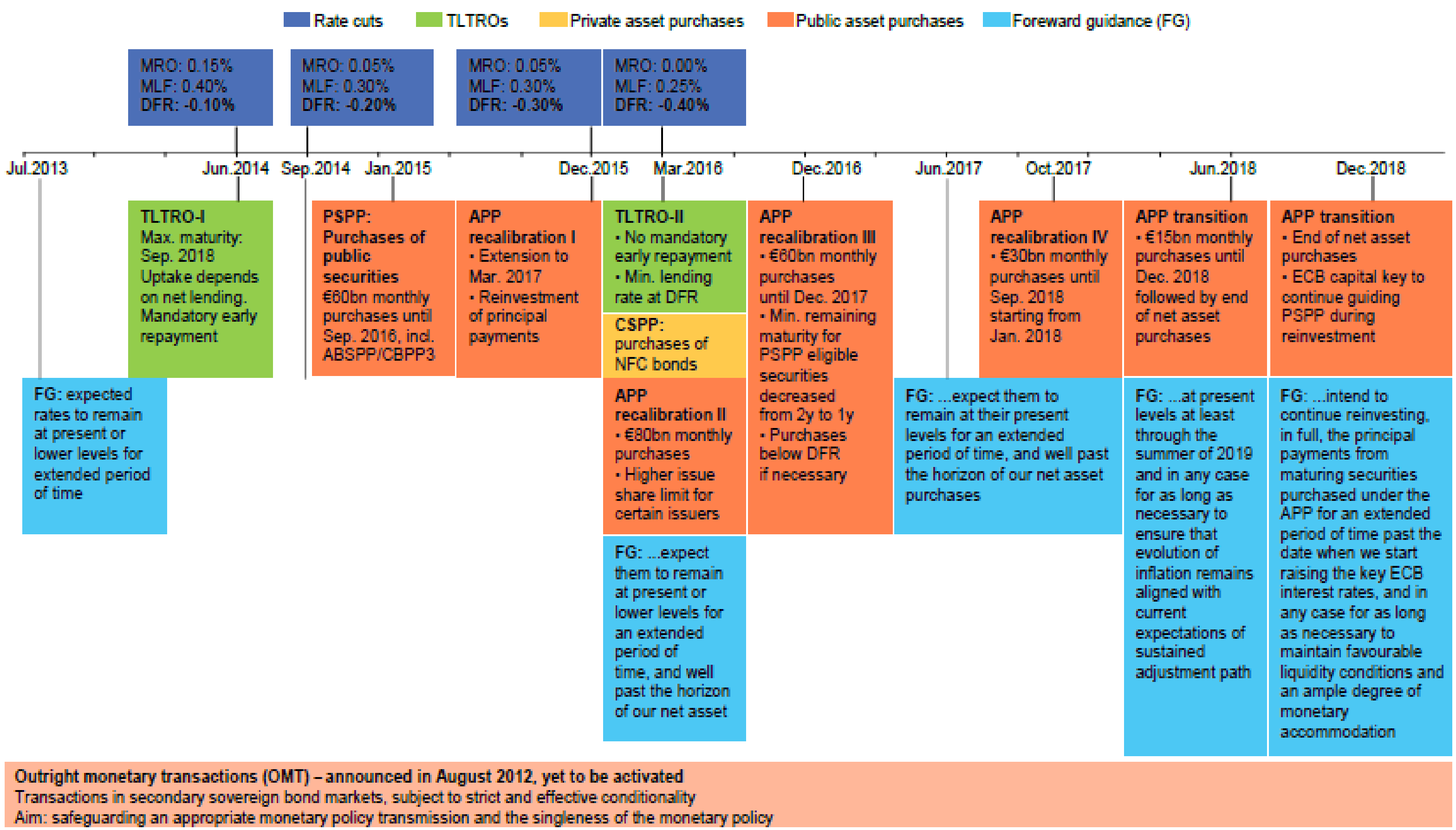


20 years of EMU in 4 pictures (IV): The (E)APP – Quantitative Easing ECB style



Reminder: Eurosystem portfolio of non-standard monetary policy measures

Road-map *ex post*



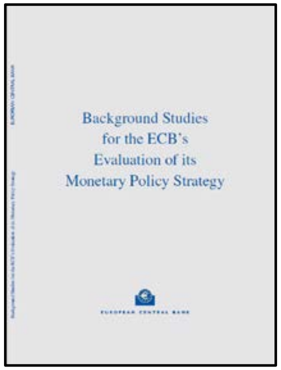
II. ON THE (FORGOTTEN) ROLE OF THE PREPARATORY PHASE

Determinants of the initial ECB„design“ and the evaluation of it‘s strategy in 2003…

ECB
= youngest Central Bank
= most modern „design“ of mandate and instruments

Some relevant factors at that time:

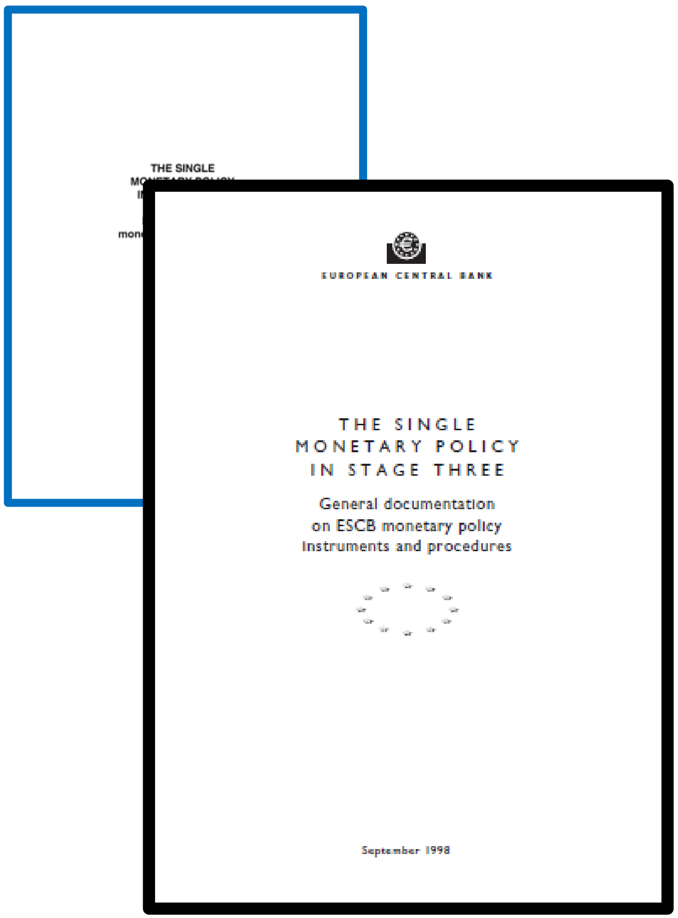
- **Bundesbank – model**
- **Modern academic thinking on Central Bank design (independence, price stability objective…)**
- **Exchange rate crises of 70s and 90s**
- **….**



Result of strategy review in 2003 reflected basic building blocks of „good“ monetary policy design before crisis:

- **Central Bank independence**
- **Price stability mandate**
- **Some sort of (flexible) inflation targeting (based on 2 pillars)**
- **Short-term interest rate setting**
- **Market-oriented policy implementation**

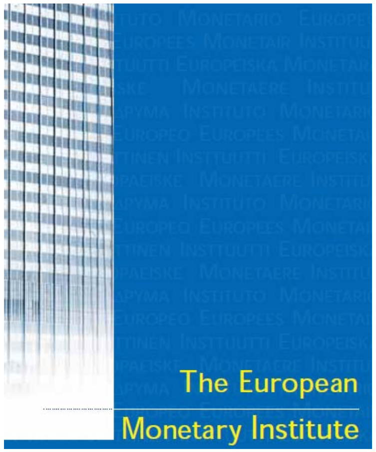
Principles of ECB monetary policy operations as defined in 1997/1998



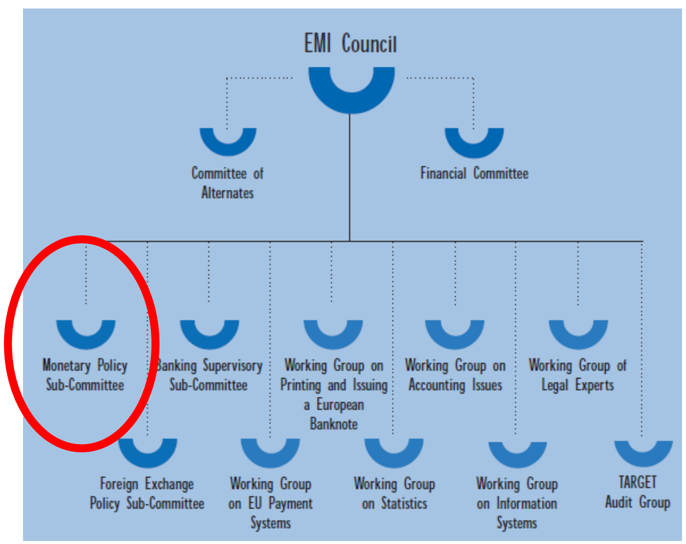
„.....the selection of the operational framework has been guided by the following general principles:

- ► conformity with market principles
- ► equal treatment
- ► simplicity and cost efficiency
- ► decentralisation
- ► continuity
- ► harmonisation
- ► and conformity with the setting of the ESCB's decision-making."

Harmonization: A joint monetary policy framework as a necessary „cultural compromise“…



11 (initial) participants + Sweden, Greece, Denmark, UK



…created an encompassing set of policy instruments stemming from different traditions

Table 1

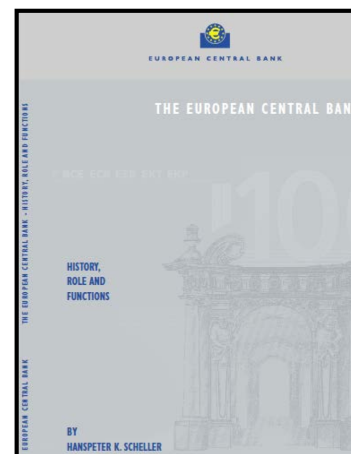
ESCB monetary policy operations

Monetary policy operations	Types of transactions: Provision of liquidity	Types of transactions: Absorption of liquidity	Maturity	Frequency	Procedure
OPEN MARKET OPERATIONS					
Main refinancing operations	• Reverse transactions	–	• Two weeks	• Weekly	• Standard tenders
Longer-term refinancing operations	• Reverse transactions	–	• Three months	• Monthly	• Standard tenders
Fine-tuning operations	• Reverse transactions • Foreign exchange swaps	• Foreign exchange swaps • Collection of fixed-term deposits • Reverse transactions	• Non-standardised	• Non-regular	• Quick tenders • Bilateral procedures
	• Outright purchases	• Outright sales	–	• Non-regular	• Bilateral procedures
Structural operations	• Reverse transactions	• Issuance of debt certificates	• Standardised/non-standardised	• Regular and non-regular	• Standard tenders
	• Outright purchases	• Outright sales	–	• Non-regular	• Bilateral procedures
STANDING FACILITIES					
The marginal lending facility	• Reverse transactions	–	• Overnight	• Access at the discretion of counterparties	
The deposit facility	–	• Deposits	• Overnight	• Access at the discretion of counterparties	

Outright purchases

Examples of „cultural differences:

- ▶ Minimum Reserve Requirements
- ▶ Acceptance of Credit Claims
- ▶ Outright transactions
- ▶ …..



III. WHAT TO EXPECT FOR A FUTURE „NEW NORMAL“ OF MONETARY POLICY?

Three areas of monetary policy to be looked at in more detail *(in 11 points)*

- **Interest rate policy:**
  From simple interest rate setting into negative territory and much more complex transmission

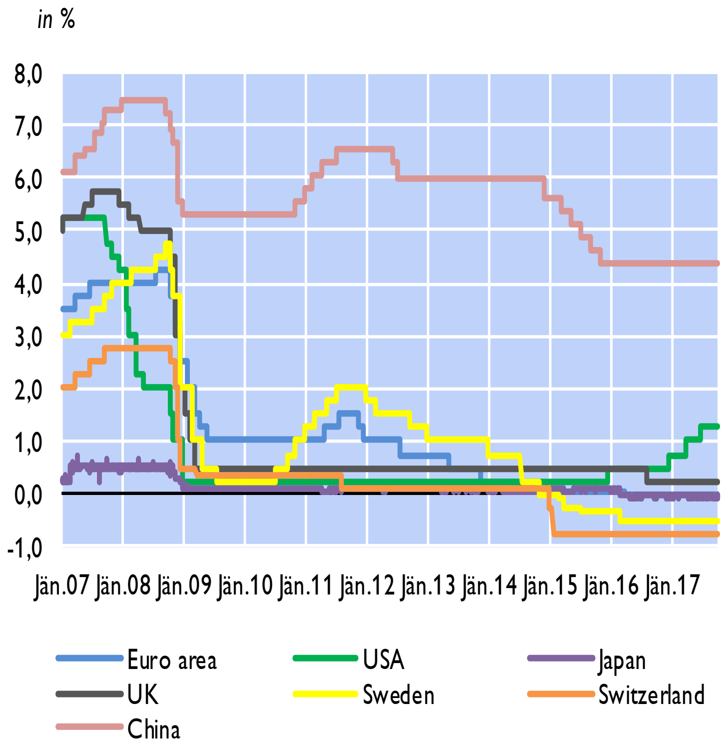
- **Liquidity provision:**
  From scarcity to (unlimited) balance sheet expansion

- **Forward guidance:**
  The (new) art of monetary policy making by expectation management

PRODUCT WARNING:
Each of the following slides would warrant a lecture of it‘s own

1. Interest rate policy: The Zero Lower Bound of (nominal) interest rates was newly defined

Monetary policy interest rates worldwide



Source: Macrobond.

Zero nominal rate

- Negative rates empower other monetary policy instruments

"Economic lower bound"

- Detrimental effects on the banking sector dominate
- Negative rates have both a one-off and a persistent impact
- Rate cuts cease to provide stimulus to the economy
- Depends on banking structures and competition

"Physical lower bound"

- Large-scale hoarding of cash

2. Interest rate policy: The simple textbook model of monetary policy no longer applies

Policy interest rate setting by the ECB

Marginal Lending Facility

Additional Overnight Liquidity at a higher (penalty) rate

Main Refinancing Operation (MRO)

Liquidity Provision to Banks for a Predefined Period of Time at the MRO-Rate

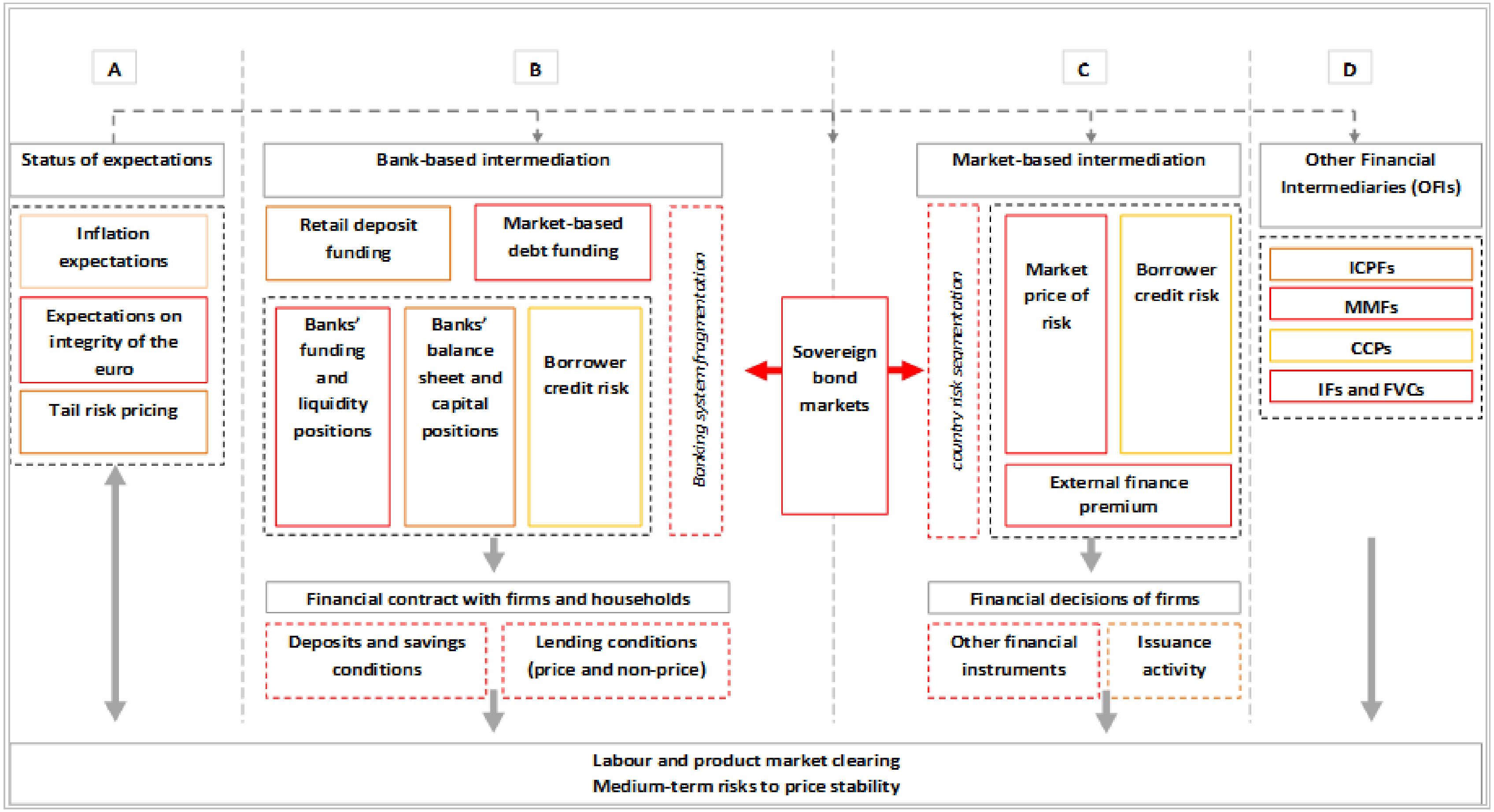
Deposit Facility

Depositing liquidity with the Eurosystem at a lower rate

Liquidity provided against good collateral (eg securities) only

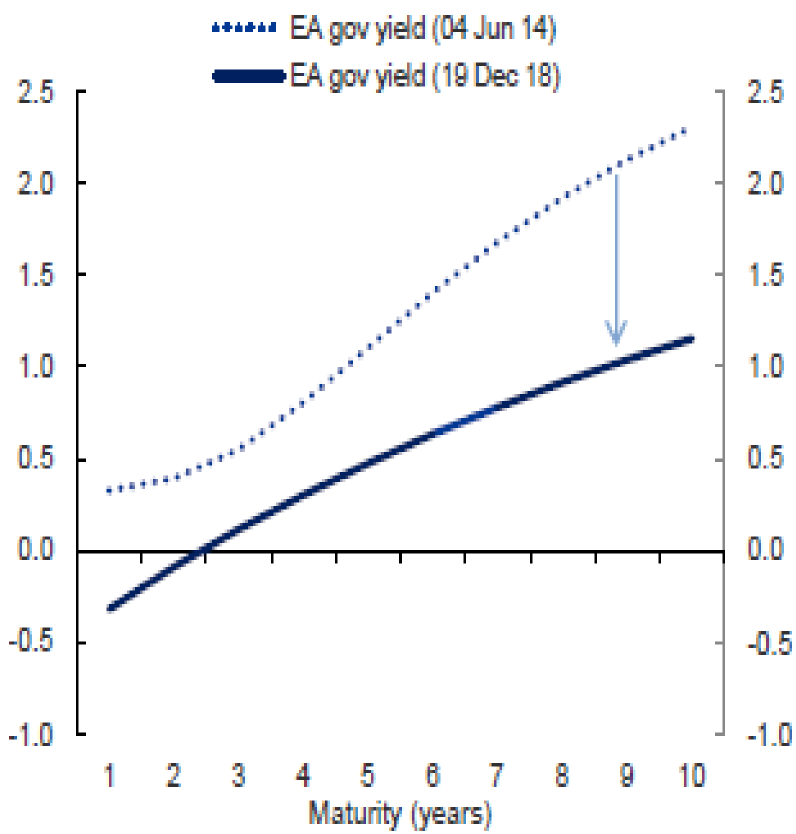
Amount of liquidity provision and MRO-rate determine money market rates

3. Interest rate policy: Today's reality is characterized by a much more complex monetary transmission mechanism

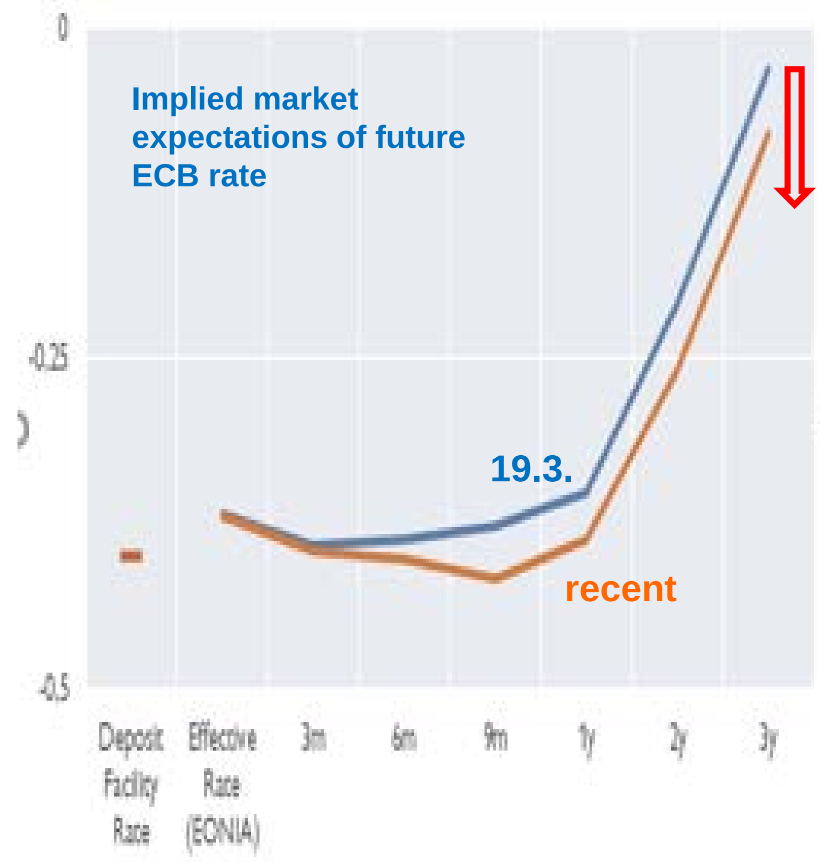


ØNB

4. Interest rate policy: steering the entire term structure of the yield curve has become an accepted and important tool



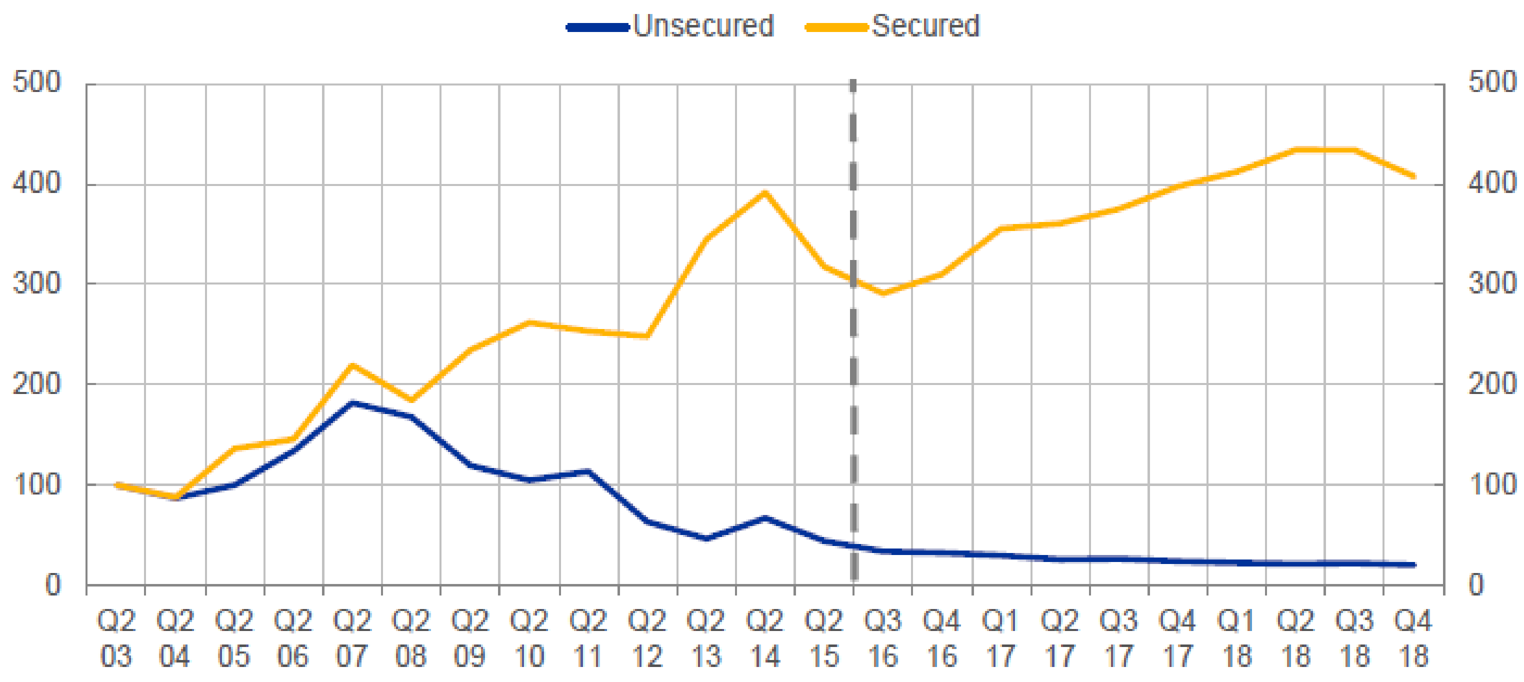
Sources: Bloomberg, ECB, ECB calculations.



5. Interest rate policy: Structural liquidity surplus has established the floor system of interest rate setting

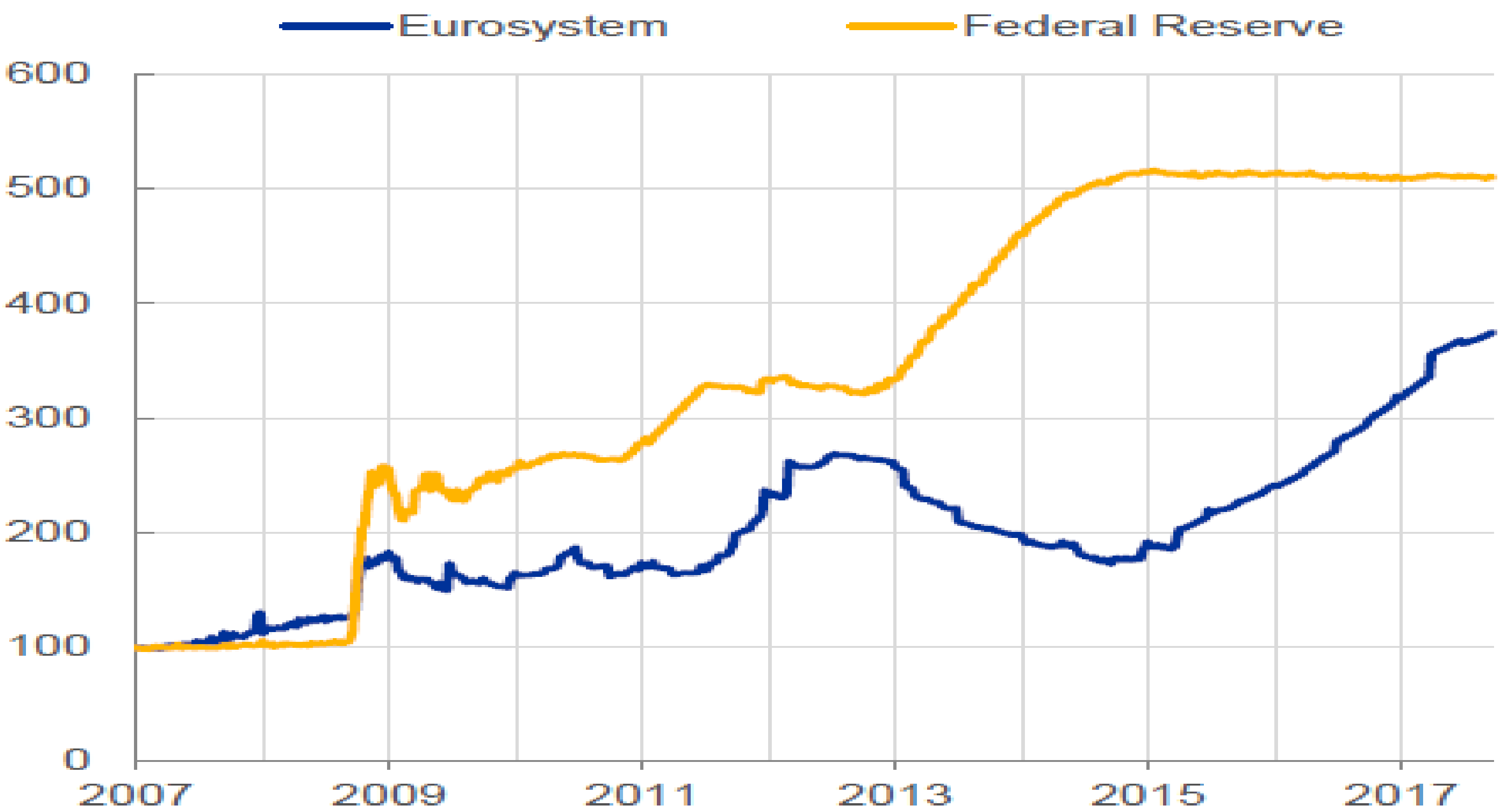
6. Liquidity provision: From peak liquidity to permanent high central bank liquidity volume

Turnover in selected money market segments
(index: total volume in 2003Q2 = 100)

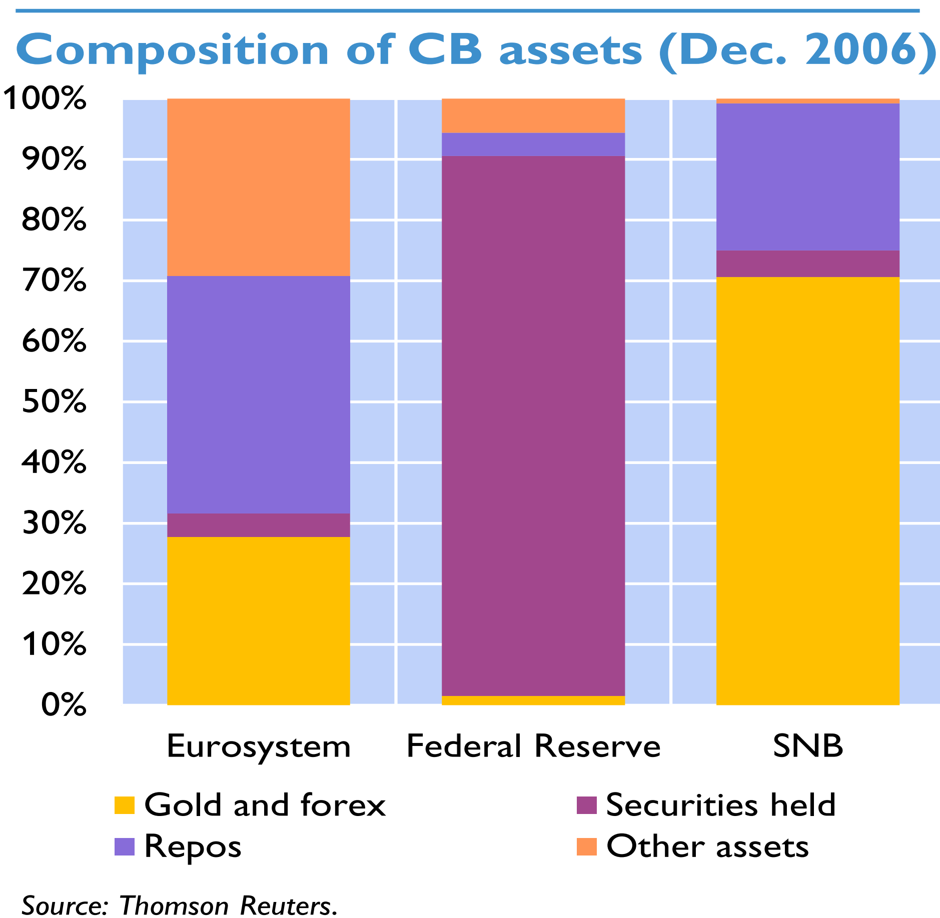


Sources: ECB Euro Money Market Survey (until 2015Q2) and money market statistical reporting (MMSR, as of 2016Q3).

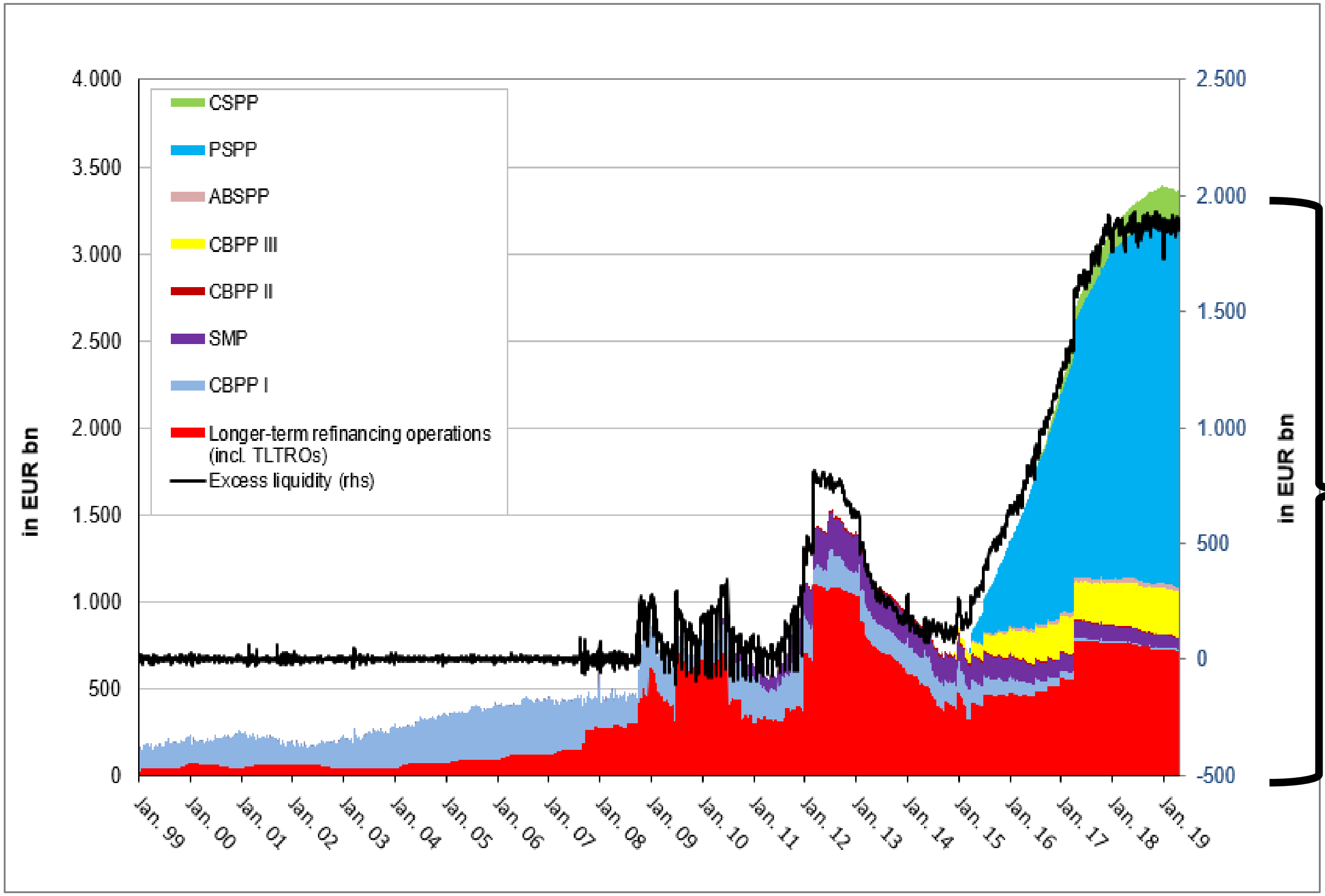
7. Liquidity provision: Balance sheet size has become an equally accepted monetary policy instrument



8. Liquidity provision: Historically very different operational traditions have become more and more similar



9. Liquidity provision: Significant longer maturity of Central Bank liquidity supply



Almost all long-term liquidity, less than 6 bn MRO

10. Forward guidance: Talking to the markets and creating monetary policy expectations

PRESS CONFERENCE

Mario Draghi, President of the ECB,
Luis de Guindos, Vice-President of the ECB,
Frankfurt am Main, 7 March 2019

INTRODUCTORY STATEMENT

on interest rates

First, we decided to keep the **key ECB interest rates** unchanged. We now expect them to remain at their present levels at least through the end 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.

on reinvestments

Second, we intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when we start 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.

on TLTRO - III

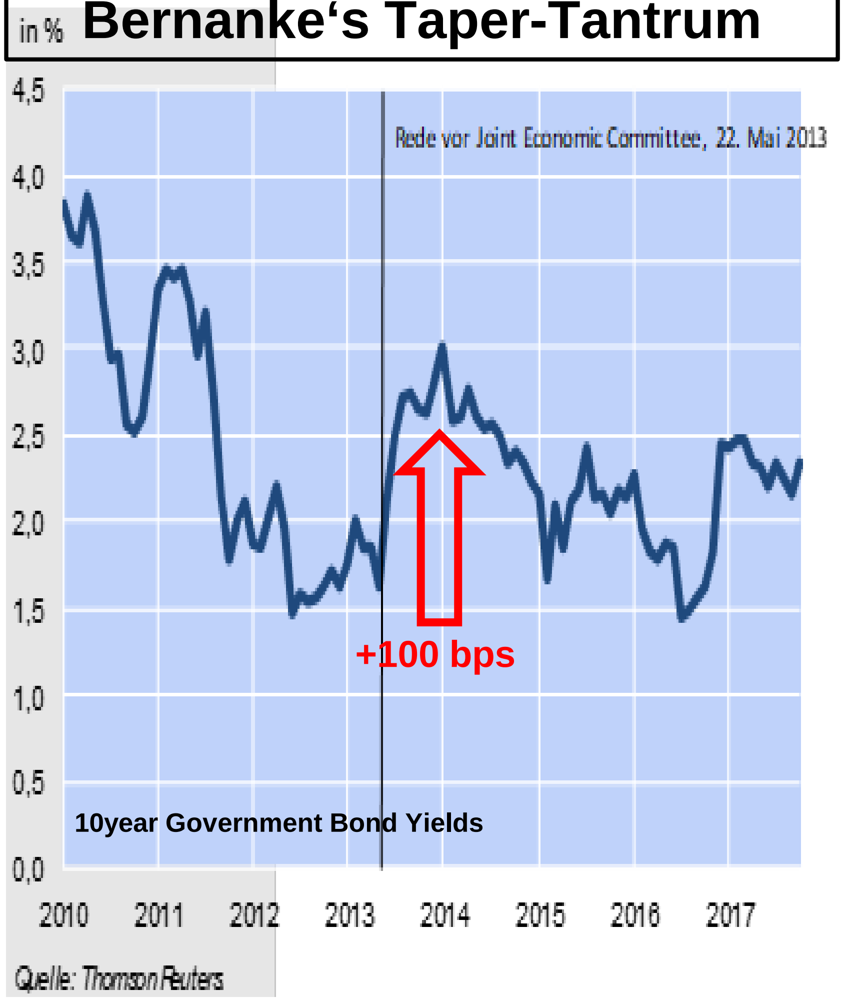
Third, we decided to launch a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), starting in September 2019 and ending in March 2021, each with a maturity of two years. These new operations will help to preserve favourable bank lending conditions and the smooth transmission of monetary policy. Under TLTRO-III, counterparties will be entitled to borrow up to 30% of the stock of eligible loans as at 28 February 2019 at a rate indexed to the interest rate on the main refinancing operations over the life of each operation. Like the outstanding TLTRO programme, TLTRO-III will feature built-in incentives for credit conditions to remain favourable. Further details on the precise terms of TLTRO-III will be communicated in due course.

on FRFA

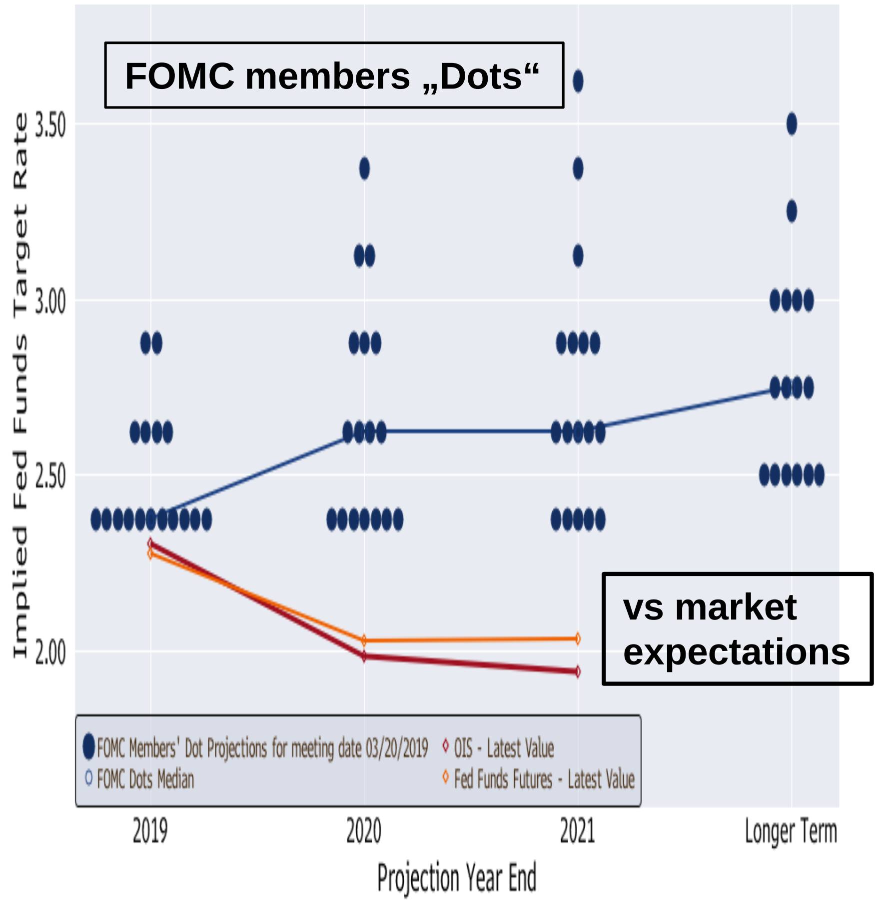
Fourth, we will continue conducting our lending operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021.

11. Forward guidance: How successful or how damaging may/will it be?

Bernanke's Taper-Tantrum



Fed vs market expectations



(ANY) CONCLUSIONS?

(Any) Conclusions?

- Like Harari I think any future „new normal“ will very likely look (very) different from that before the crisis
- I expect all the elements I have mentioned to stay with us and to be there also in a forthcoming definition of the „new normal“
- Of course, the intensity of their effective use will vary depending on the respective economic situation…
- …but these new instruments or approaches have not only become part of our toolkit, they will be regularly used if found necessary and appropriate
- However, WHEN we in fact will be able to approach this completely new „new normal“ still has to be seen….
- …unfortunately, even more than a decade after monetary policy went into crisis mode.

OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

20 years of EMU, 10 years in crisis mode:
How may a future „new normal“ of monetary policy look like?

Peter Mooslechner
Former Executive Director and Member of the Governing Board
Oesterreichische Nationalbank

46th Economics Conference of the Oesterreichische Nationalbank
“European Economic and Monetary Union: The first and the next 20 years”
Vienna, May 2, 2019