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Committee on Economic and Monetary Affairs: Monetary Dialogue Preparatory Meeting

# Limits in terms of eligible collateral and policy risks of an extension of the ECB's quantitative easing programme

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# General assessment

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- QE program extended to run until (at least) March 2017
  - Change in limits and criteria (not surprisingly) sufficient, but further extension would call for another adjustment
  - Modest positive impact, risks increase further
    - » Very modest impact on economic activity and inflation
    - » More-of-the-same may turn into new risk quality
  - Non-monetary nature of problems in distressed EMU-MS
    - » Structural discrepancies
    - » Rigid labor markets
    - » Debt overhang and non-performing loans
- ⇒ **More QE not the appropriate answer to EMU's challenges**

# PSPP feasibility study (top 10 countries)

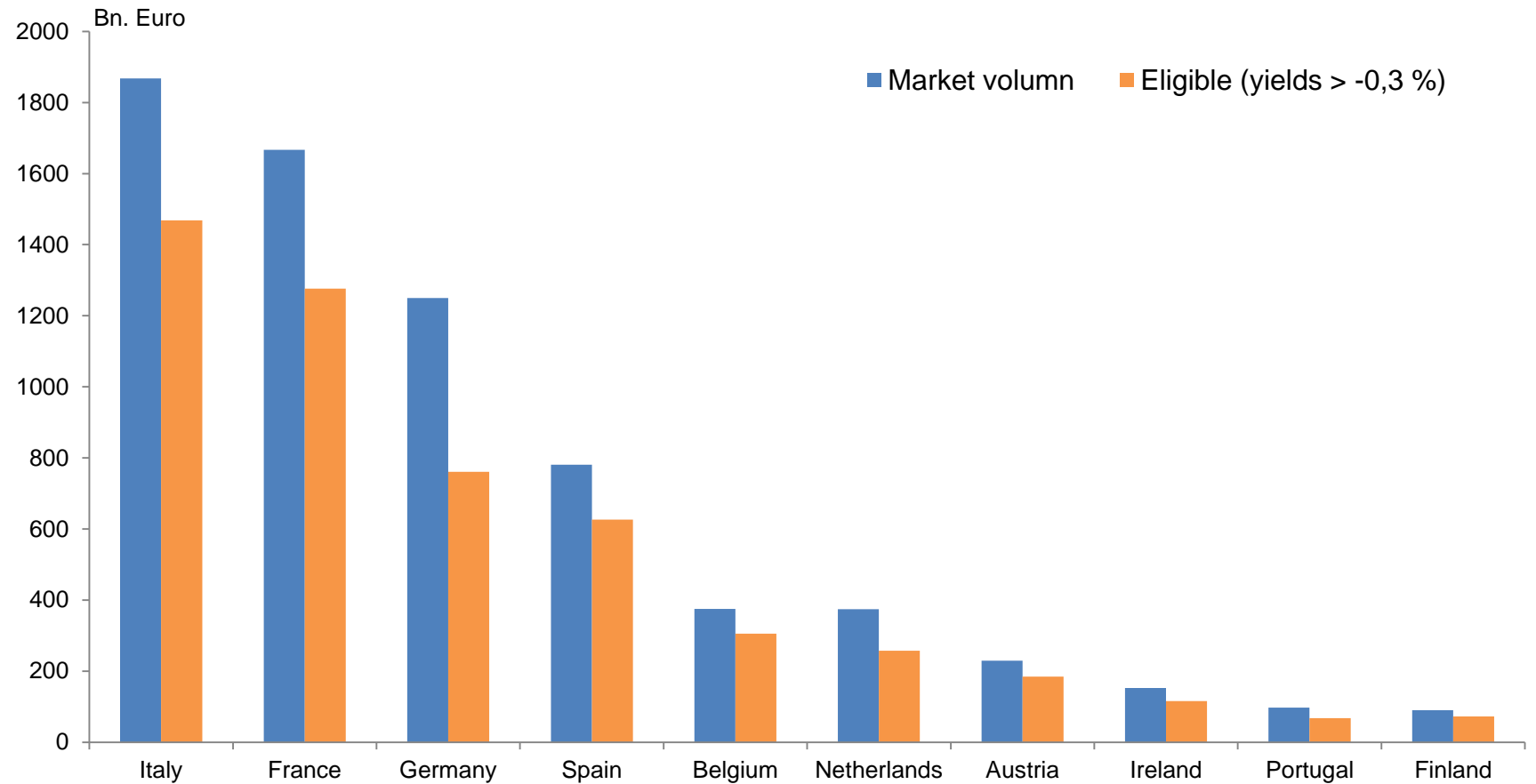
Data source: Claeys et al. 2015, ECB, IfW calculations

	25 % of eligible outstanding amount	Agencies	Regional governments	SMP	Sum	Planned purchases	Difference
<b>Italy</b>	367		6	76	297	200	<b>97</b>
<b>France</b>	319	23	29	0	372	230	<b>142</b>
<b>Germany</b>	190	33	56	0	279	293	<b>-14</b>
<b>Spain</b>	157	4	11	29	142	144	<b>-2</b>
<b>Belgium</b>	76		4	0	80	40	<b>40</b>
<b>Netherlands</b>	64		0	0	65	65	<b>0</b>
<b>Austria</b>	46		1	0	48	32	<b>15</b>
<b>Ireland</b>	29			10	19	18	<b>1</b>
<b>Portugal</b>	17		0	15	2	29	<b>-26</b>
<b>Finland</b>	18		1	0	19	21	<b>-2</b>

# Outstanding amount of debt securities (top 10 countries)

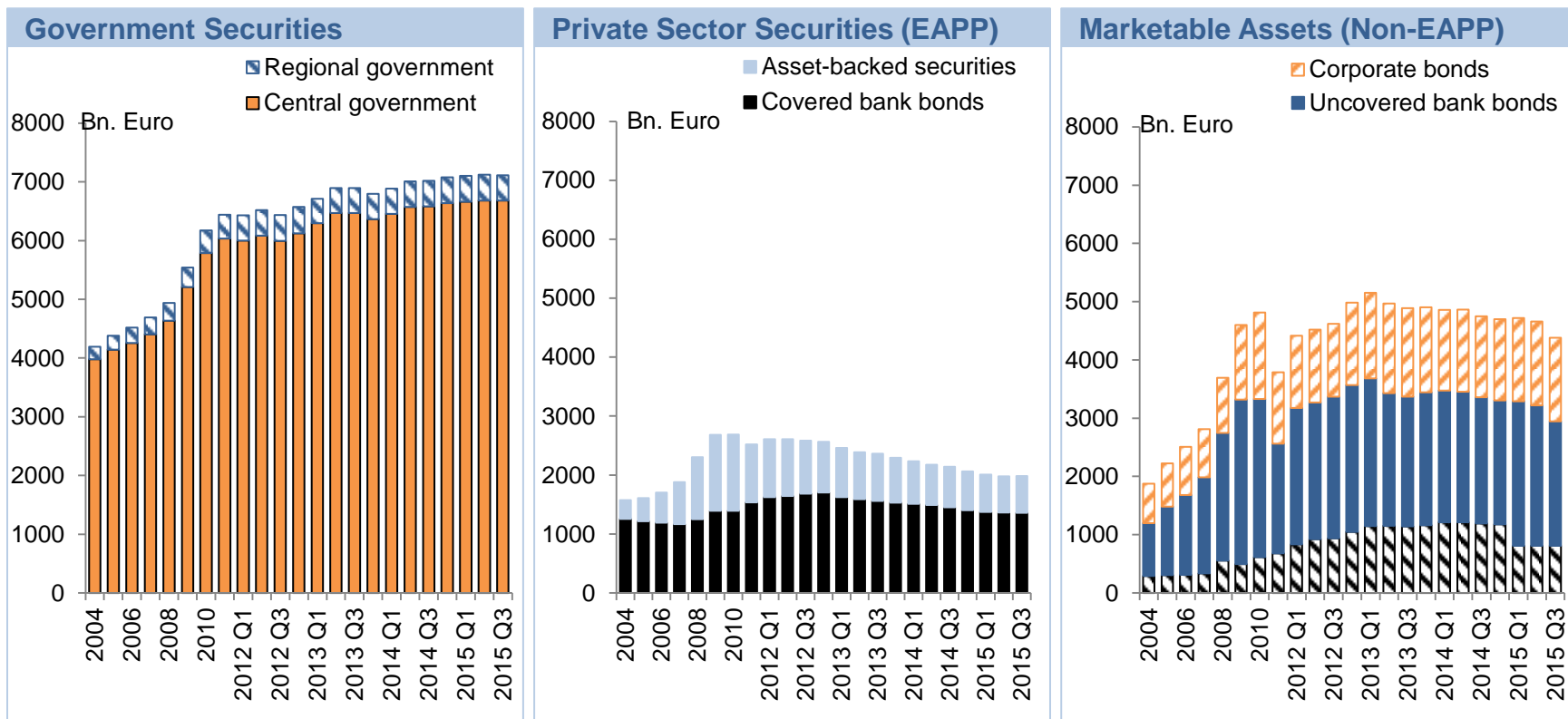
Data source: Allianz Global Investor QE Monitor, January 2016; IfW calculations.

## Outstanding Government Debt



# Further expanding the QE program

Data source: ECB



- **More public securities**

- » Reducing interest rates
- » Higher per issue/issuer limits

⇒ **Government financing?**

- **More private securities**

- » ABS, covered bonds
- » Corporate/uncovered bonds

⇒ **Limited volumes, risks (haircuts)**

# Effectiveness of QE in the Euro Area

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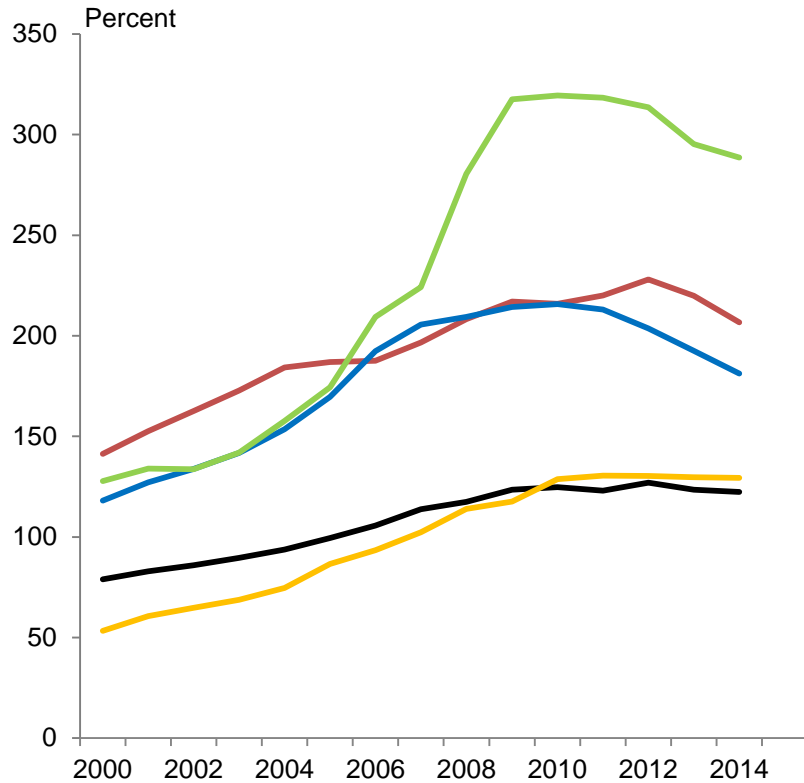
- As QE operates via purchases in securities markets, the financing conditions in the more bank-based euro area economies may respond less strongly (already vast surplus liquidity, but hampered credit channel).
  - More pronounced structural and political problems in the euro area dampen the impact of monetary stimulus in general.
  - The various euro area member states differ significantly in their economic situations, making joint monetary policy for the whole euro area more difficult.
- ⇒ **Modest impact on economic activity and inflation**

# Debt overhang hampering credit channel

Data source: Bank for International Settlements, World Bank

## Gross Private Sector Debt

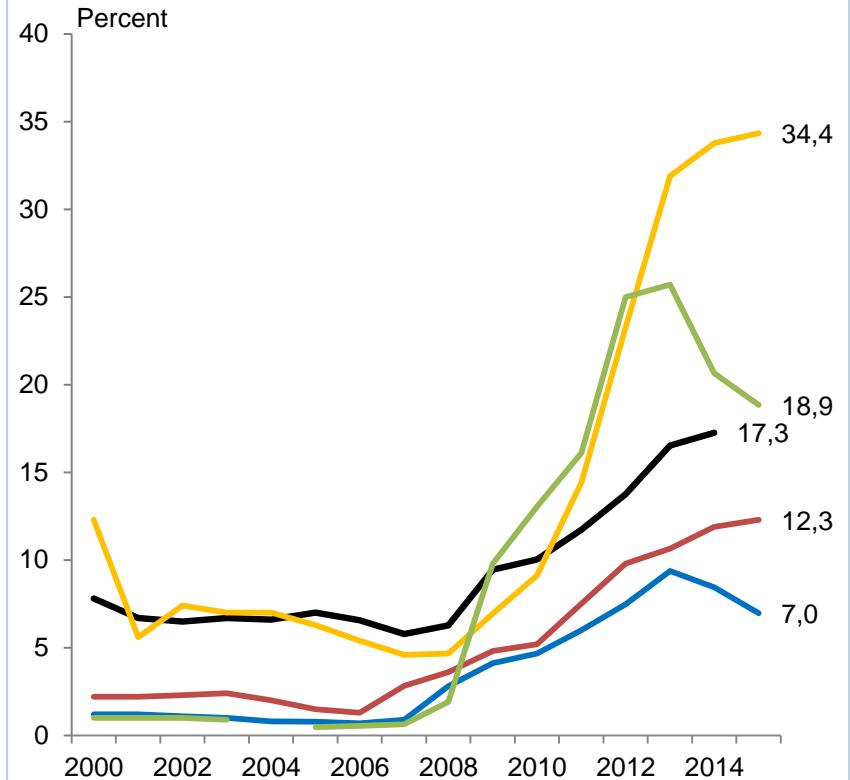
— Portugal — Italy — Spain — Greece — Ireland



Annual Data. In relation to nominal GDP.

## Non-Performing Loans

— Portugal — Italy — Spain — Greece — Ireland



Annual data. Share of total loans.

# (Radical) Policy instruments to enhance the effectiveness of QE

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- Buying risks upfront instead of lowering risk free yields
    - » More private sector securities
    - » Distortion of risk premia and related cost of capital
  - Targeting non-performing assets
    - » Monetary bail-out
    - » Turning the Eurosystem into a bad bank
  - Helicopter money
    - » Bypassing the credit channel to inflate the debt-overhang away
    - » Transforms the Eurosystem into a pure fiat money system
- ⇒ **Hardly in line with ECB's mandate, radical consequences**



# QE-related policy risks

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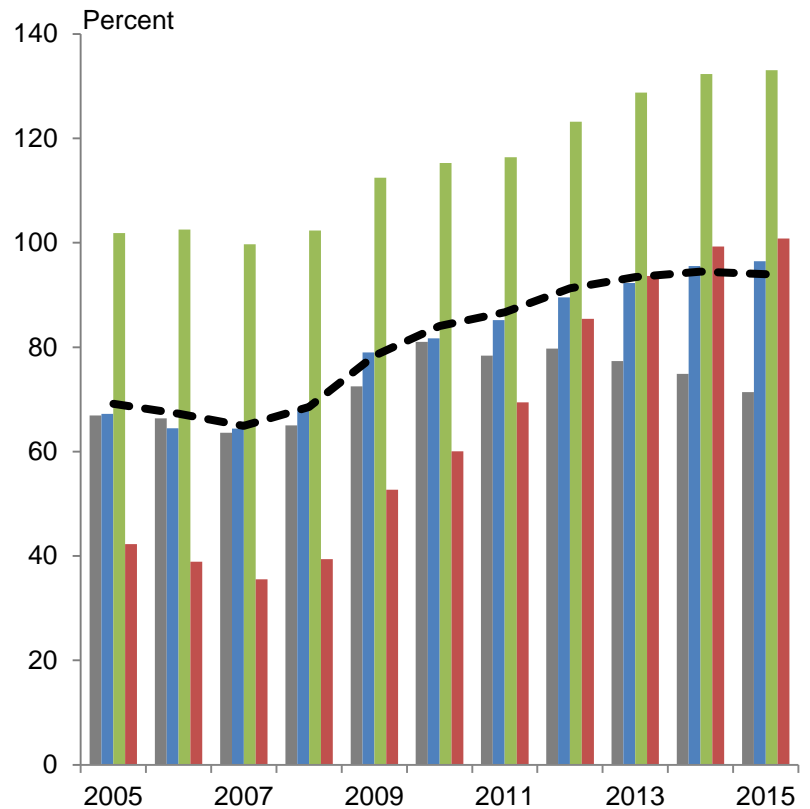
- Inflation targeting and policy communication
  - » (Necessarily) disappointing expectations
  - » Central bank reputation (overall monetary policy approach)
- Central bank independence and monetary financing
  - » Pending loss risks on Eurosystem's balance sheets
  - » Eurosystem becomes largest single creditor of European governments
- Systemic financial risks and misallocation of resources
  - » Asset price bubbles and systemic financial instability
  - » Misallocation of resources and zombification
- Disincentives for governments
  - » Structural reform policies
  - » Fiscal consolidation
- Distortions in foreign exchange markets (“currency wars”)

# Monetary financing

Data source: Eurostat, European Commission

## Gross Government Debt

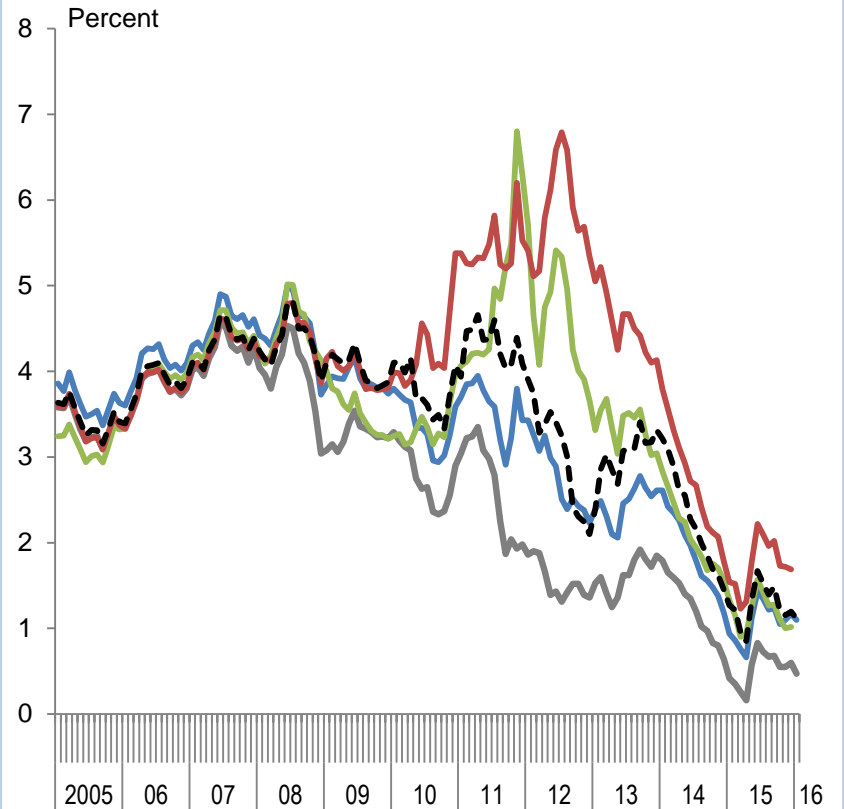
Germany France Italy Spain EMU



Annual Data. In relation to nominal GDP; EMU: Average.

## Government Bond Yields (10-year)

Germany France Italy Spain EMU

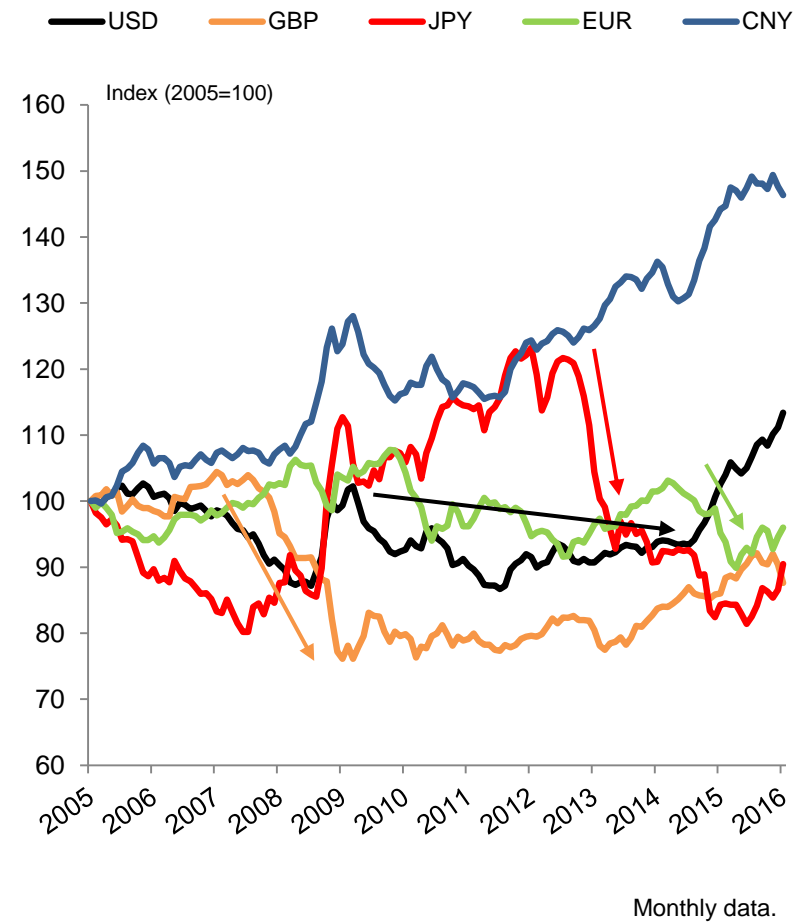


Monthly data. EMU: Average.

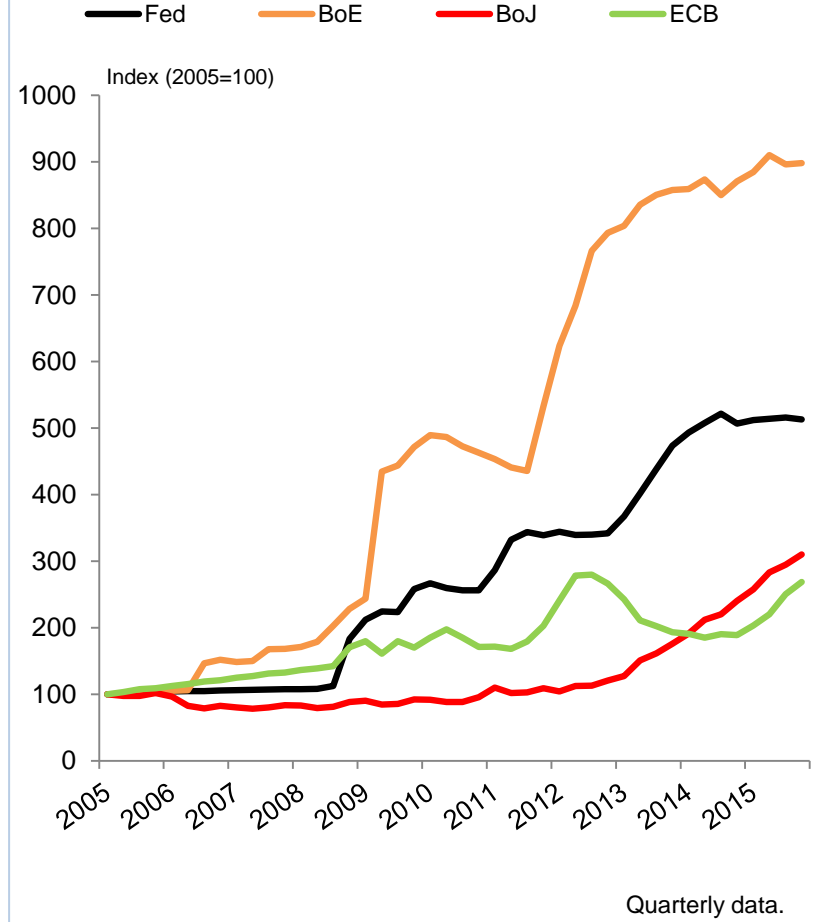
# Global QE

Data source: Thomson Reuters Datastream, IfW calculations

## Nominal effective exchange rates



## Monetary Base



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