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Committee on Economic and Monetary Affairs: Monetary Dialogue Preparatory Meeting

Extending QE: Additional risks for financial stability?

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- No game changer, but “more of the same for longer”
 - Qualitative risk assessment only
- ⇒ **Time dimension is crucial
(risk accumulation for longer)**

Allocative distortions escape the radar of macro-management

- Macroeconomic rationale of QE
 - » Reducing capital market rates
 - » Stimulating aggregate demand (credit creation, devaluation)

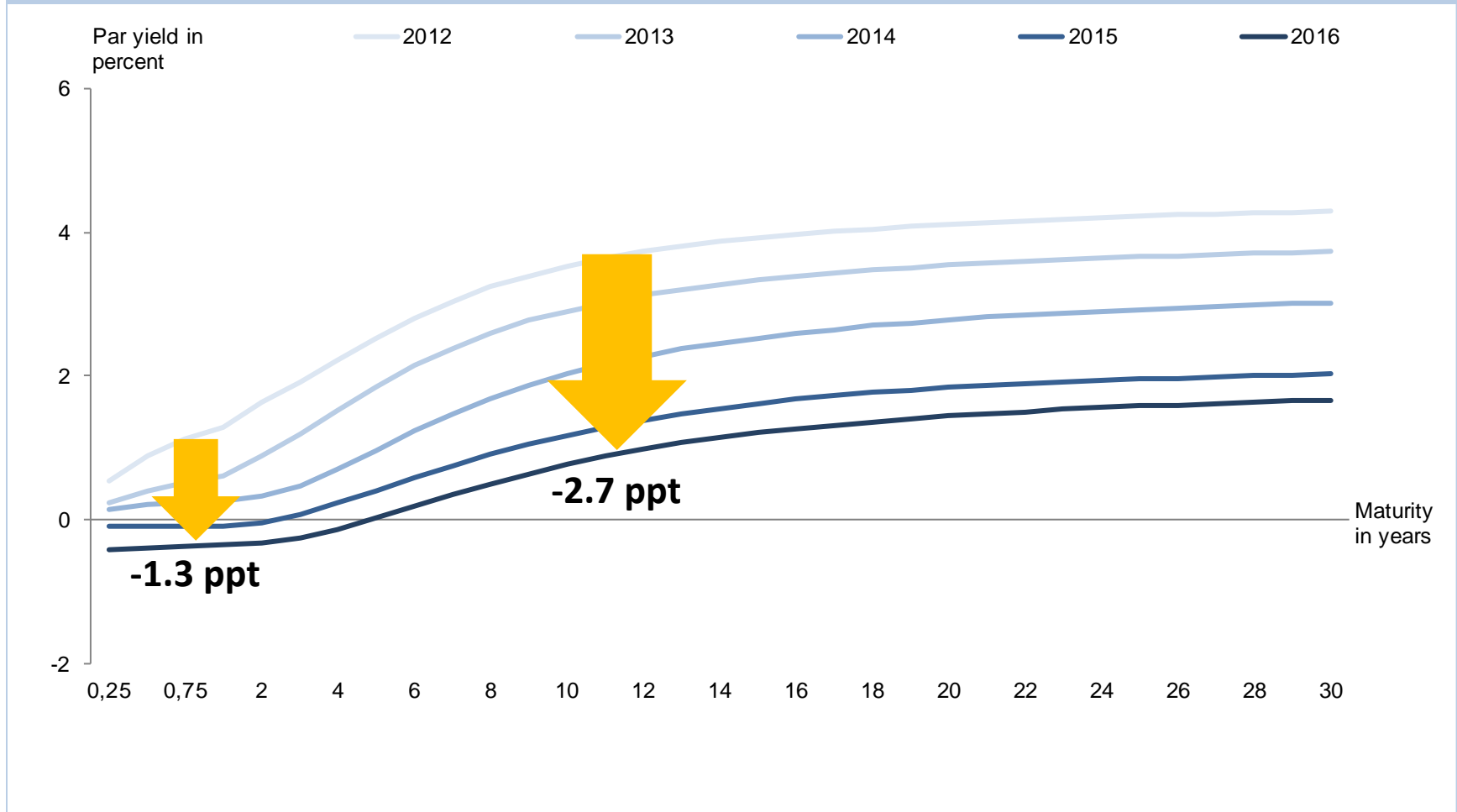
- Allocative role of interest
 - » Level of interest affects relative prices
(interest component depends on temporal distance to consumption)
 - » Relative prices shape production structures
 - » Capital stock skewed towards longer durations

- Spill-overs to financial system
 - » Temporal discrepancies in production sector affects systemic solvency
 - » Bank-based economies (like euro area) particularly fragile

⇒ **Capital gives money time to cause trouble (Garrison)**

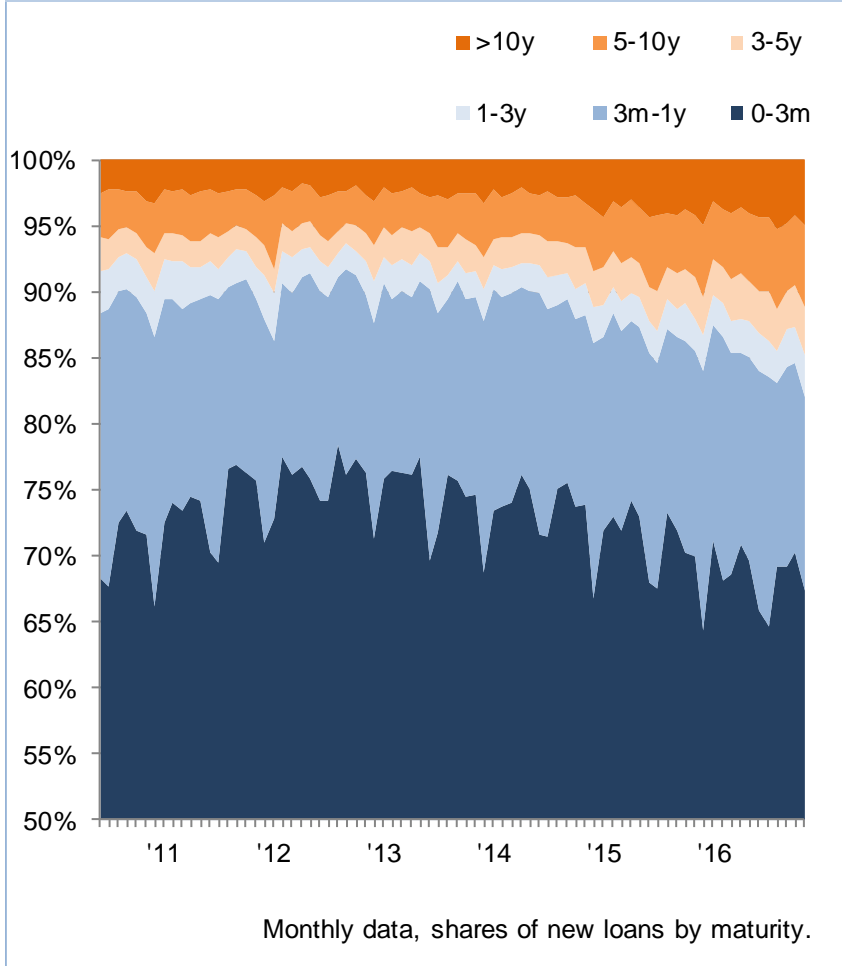
Flatter yield curves ...

Euro area government yield curve

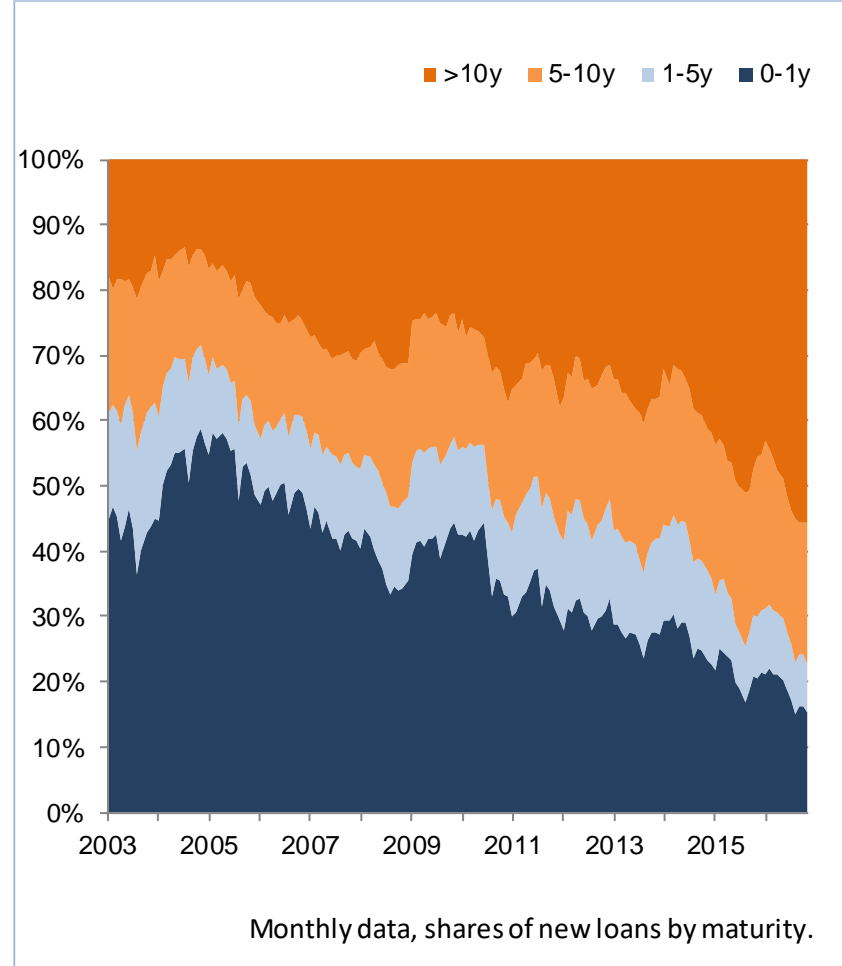


... trigger more aggressive maturity transformation

New loans by maturity, NFC

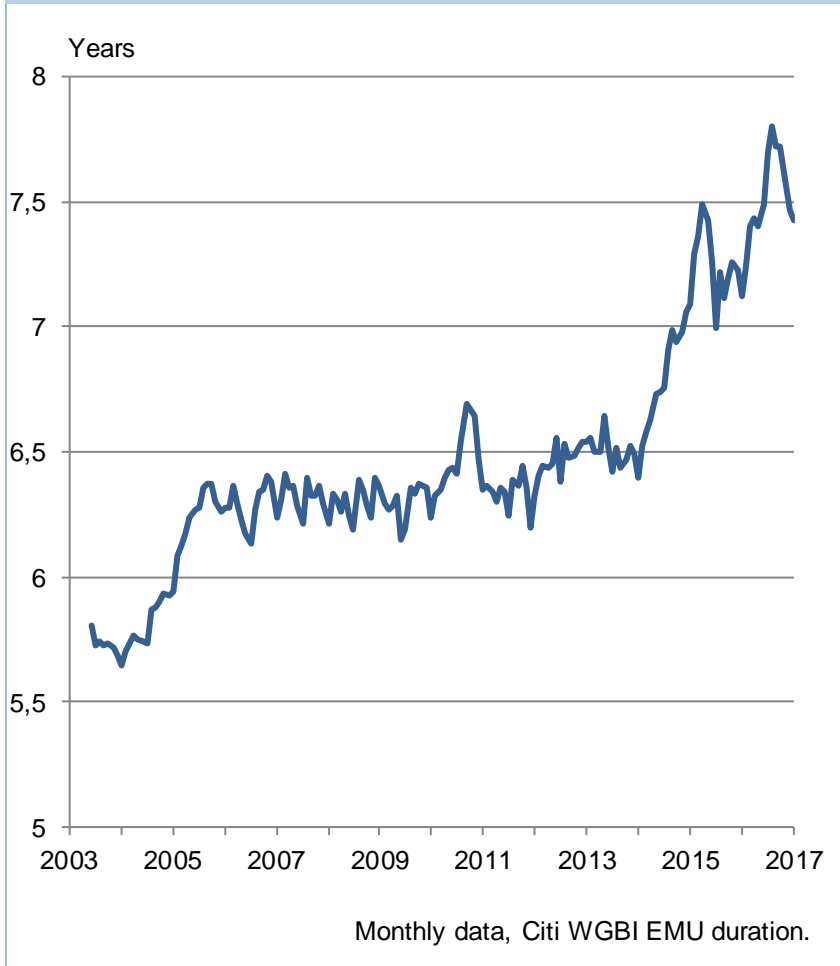


New loans by maturity, house purchases

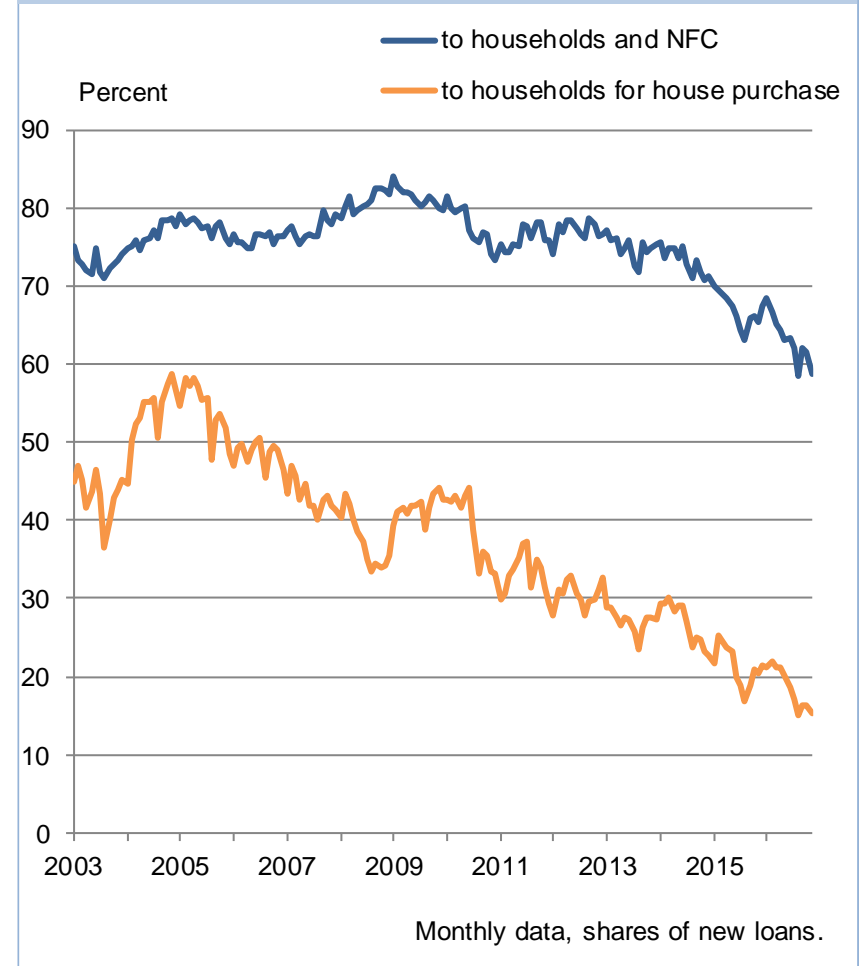


Governments and firms lock-in low rates

Government bond duration



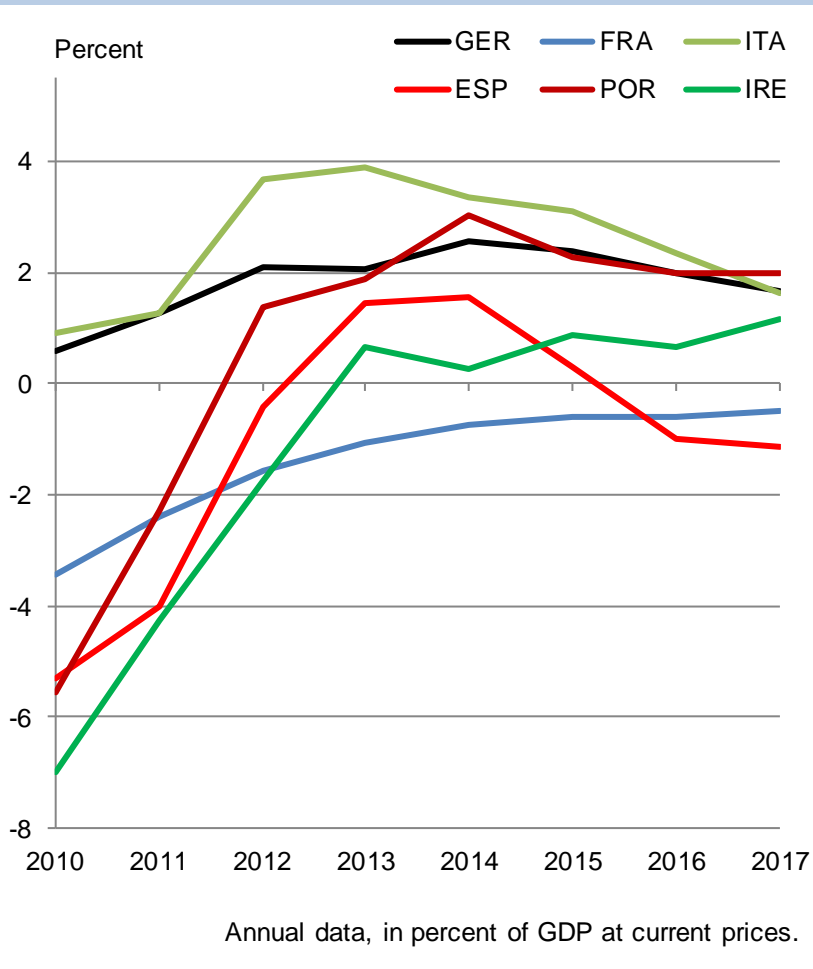
Variable rate loan shares



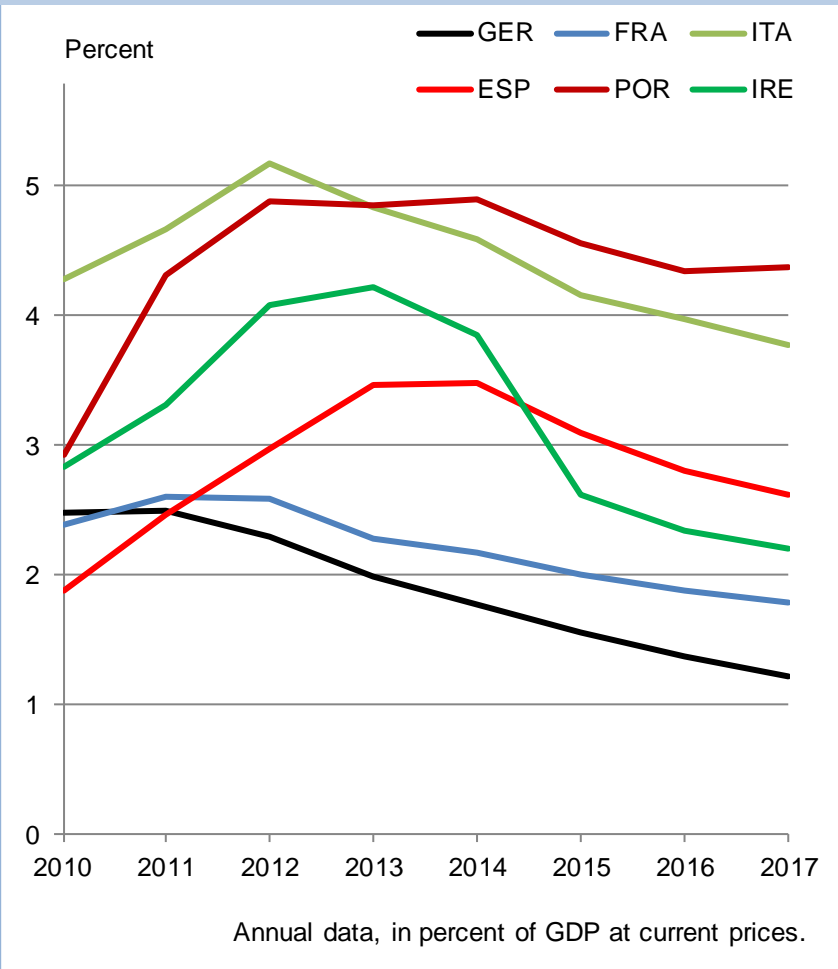
- Credit misallocation (structure, not level)
 - » Extension of credit by distressed banks to de facto insolvent firms
 - » “zombie banks” take a gamble for resurrection on “zombie firms”
 - Old, less productive firms stay in business
 - New, more productive firms face credit shortage
- ⇒ **Hampered structural change, no economic stimulus**

“Buying time” lets fiscal discipline and structural reform efforts wane

Structural Primary Balance



Interest payments



Summing up

- Time matters
- Allocative distortions escape the radar of macro-management
- Flatter yield curves trigger more aggressive maturity transformation
- Cheap credit hampers the liquidation of uncompetitive firms
- “Buying time” lets fiscal discipline and structural reform efforts wane

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