

European Department

Unconventional Monetary Policy and CESEE



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Unconventional Monetary Policy can be used when interest rates are very low



UMP includes wide array of policies

- Restoring the **financial intermediation**:
 - Liquidity provisions
 - Outright purchases of private and public assets

- **Monetary accommodation** at zero lower bound:
 - Purchases of government bonds
 - Forward guidance

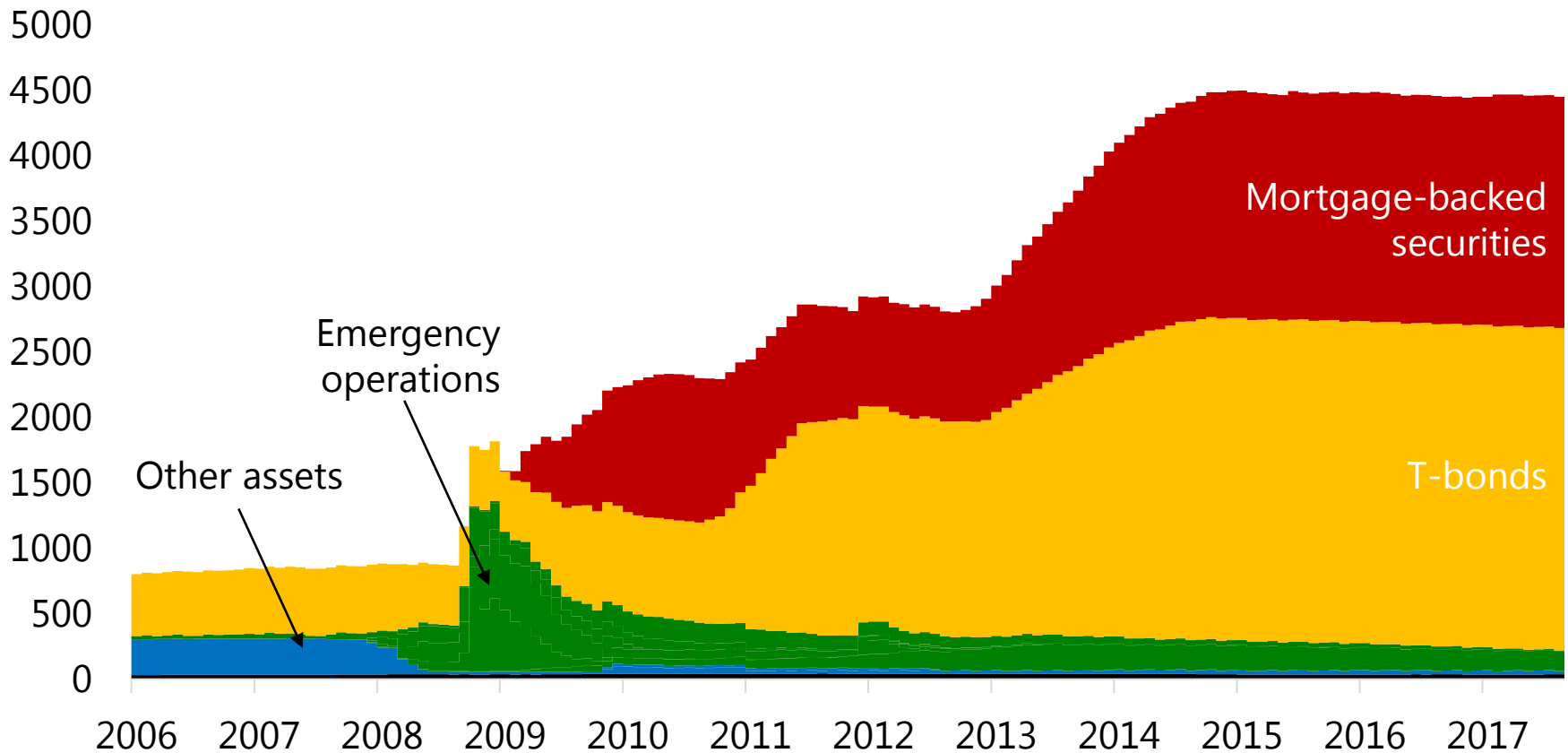
International Monetary Fund, 2013,

“Unconventional Monetary Policies—Recent Experience and Prospects.”

In the US, UMP mainly comprised of buying T-bonds and MBS



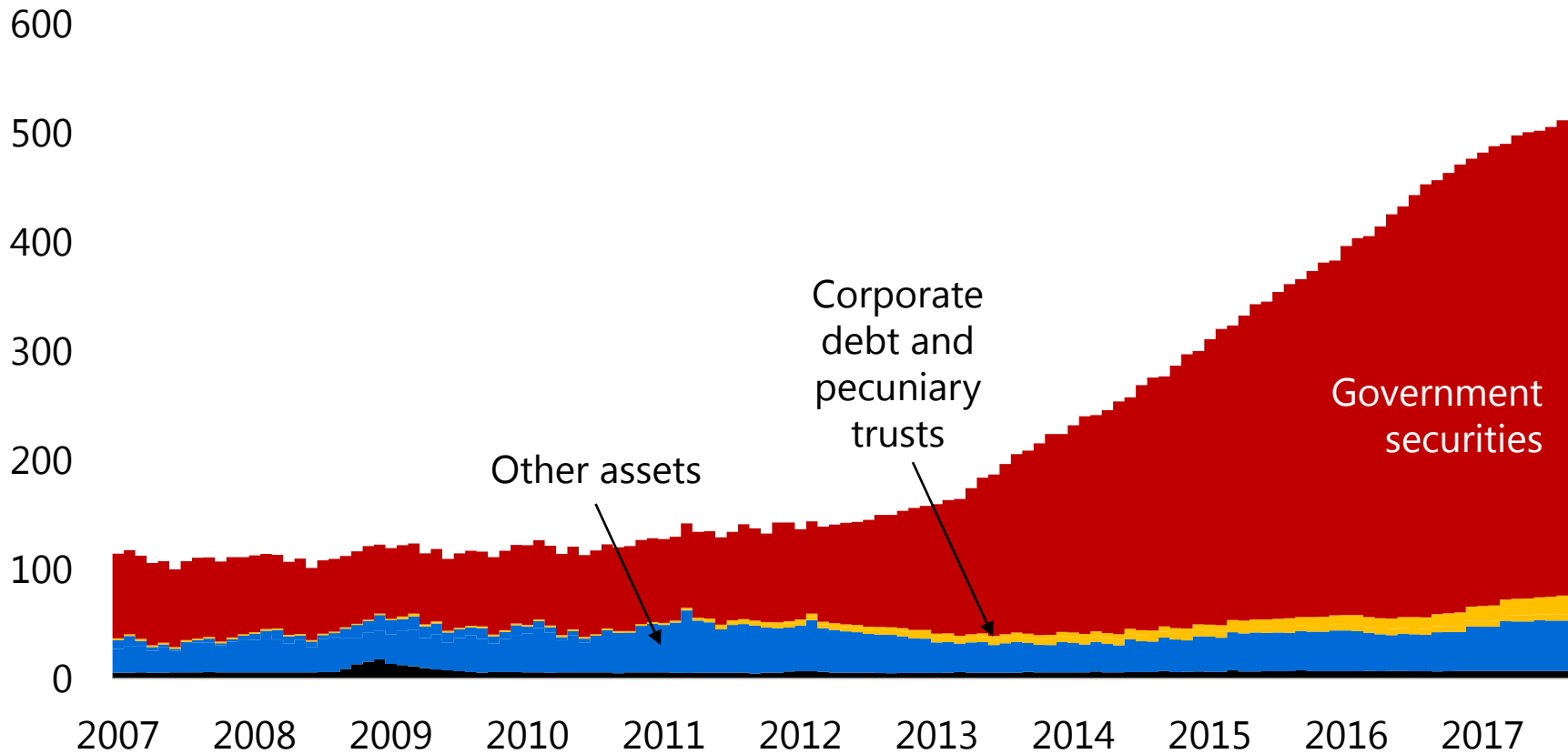
Balance Sheet of Federal Reserve
(USD billion)



Bank of Japan has been buying mostly government securities



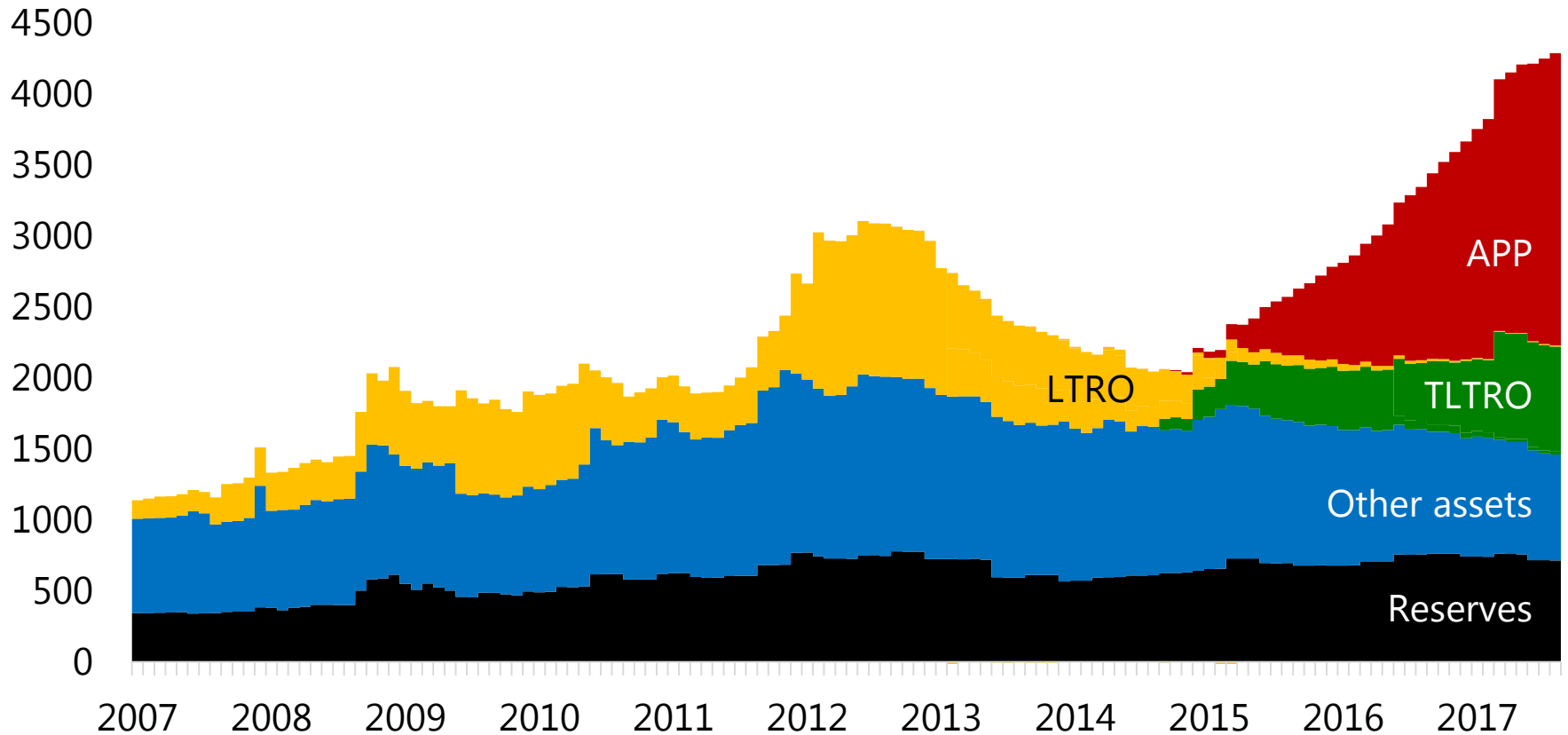
Balance Sheet of Bank of Japan
(JPY trillion)



In the euro area: (Targeted) Long-Term Refinancing Operations were followed by Asset Purchase Program



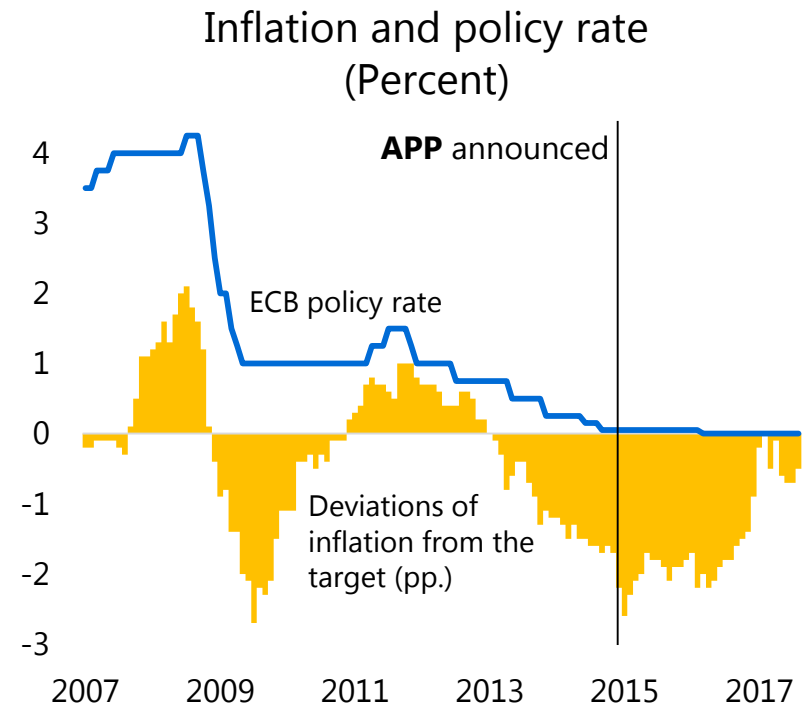
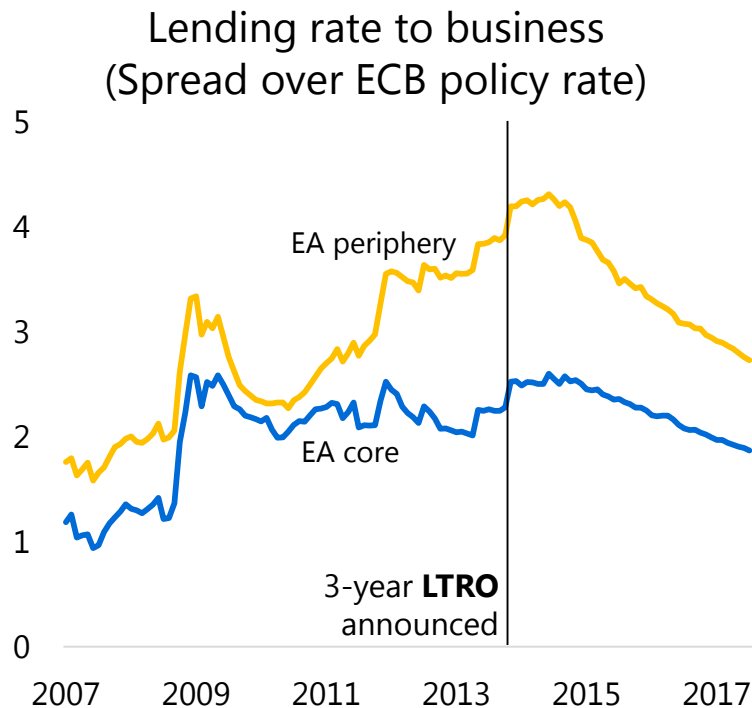
Balance Sheet of Eurosystem
(EUR billion)



UMP in Europe came in two stages



- LTRO - after euro area crisis intensified
- APP - when inflation remained stubbornly low



What spillovers could be expected to other countries?



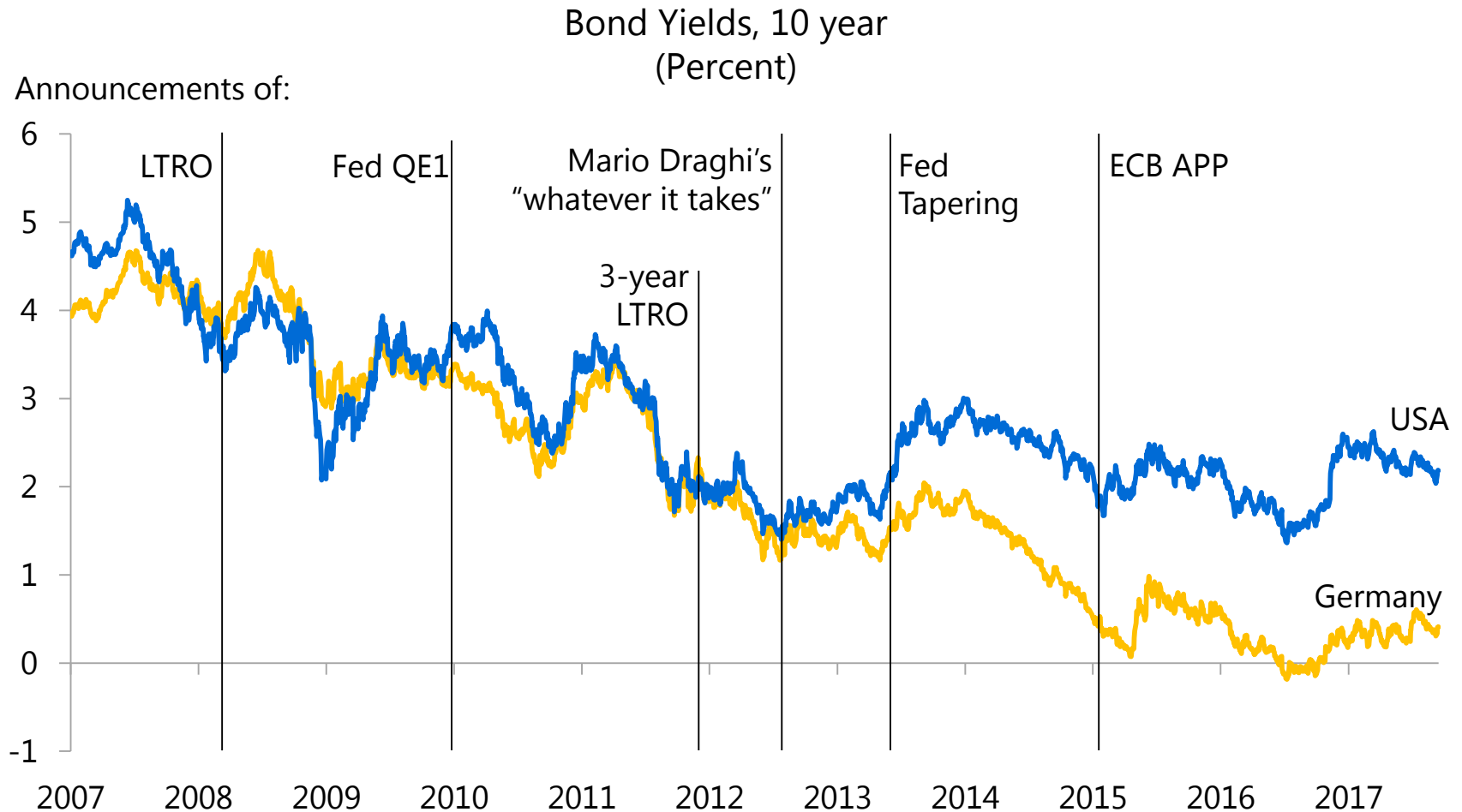
Positive spillovers:

- Lower global interest rates
- Reductions in risk premia
- Stronger growth in advanced countries

Negative spillovers:

- Capital inflows to emerging countries
- Appreciation of exchange rates
- Excessive risk seeking
- Too low interest rates

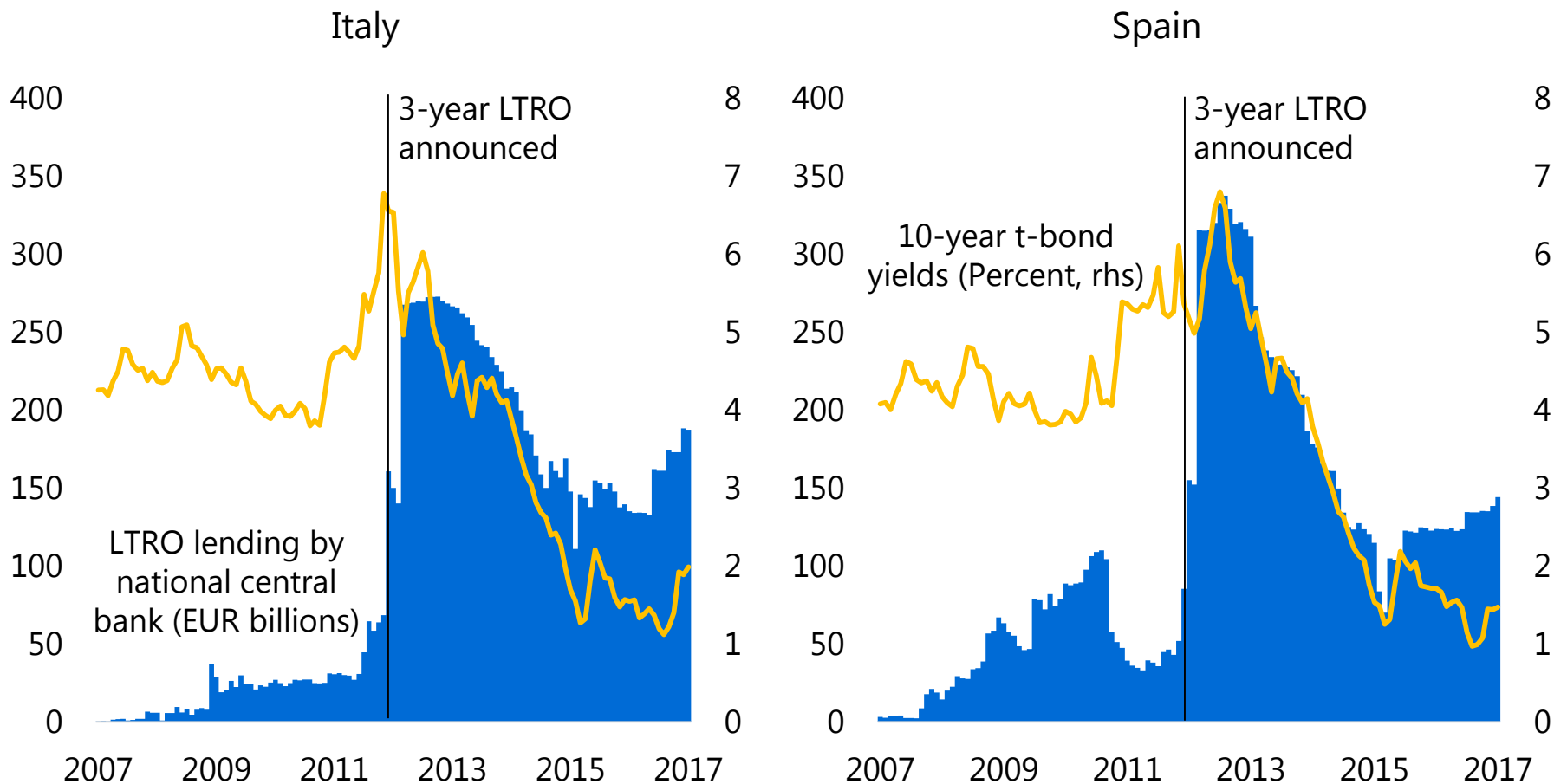
Long-term interest rates in advanced countries have come down



Risk premia fell, including in Italy and Spain



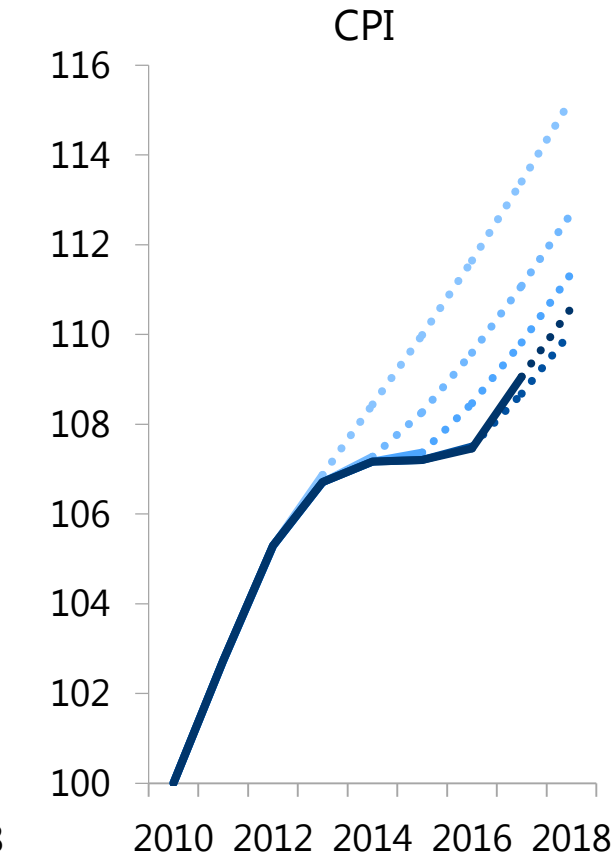
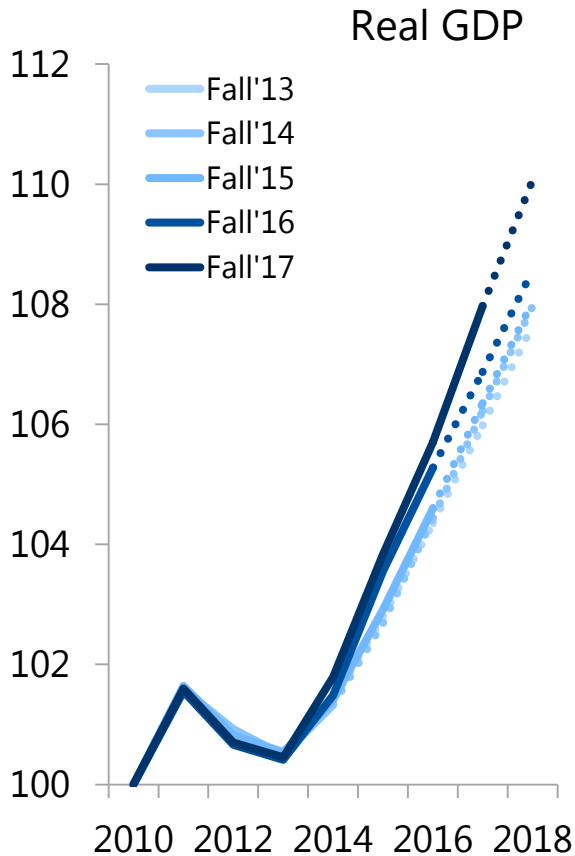
LTRO and Bond Yields



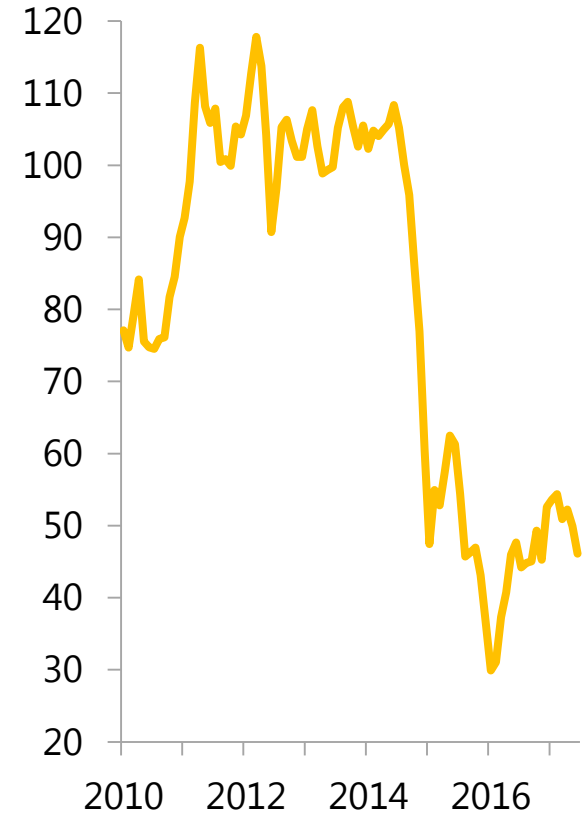
Since APP has started, growth in euro area has accelerated. Inflation has come in below expectations, the result of a sharp drop in oil prices.



Real GDP and CPI Forecasts in Euro Area by WEO vintage (2010=100)



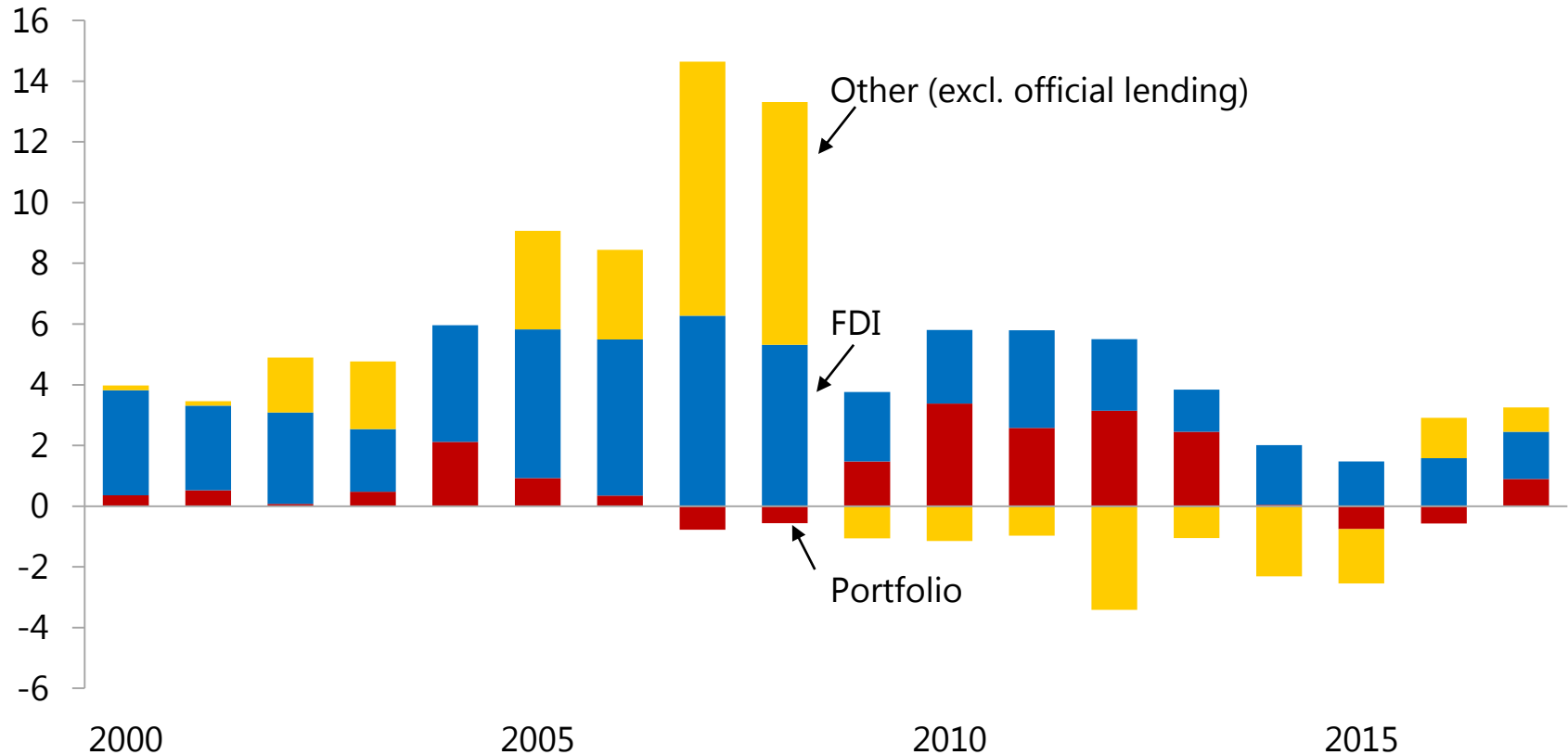
Average Crude Oil Prices (USD per barrel)



As regards capital inflows to CESEE, portfolio inflows were strong between 2009 and 13, albeit offset by bank outflows



Capital flows to CESEE*
(percent of trend GDP)

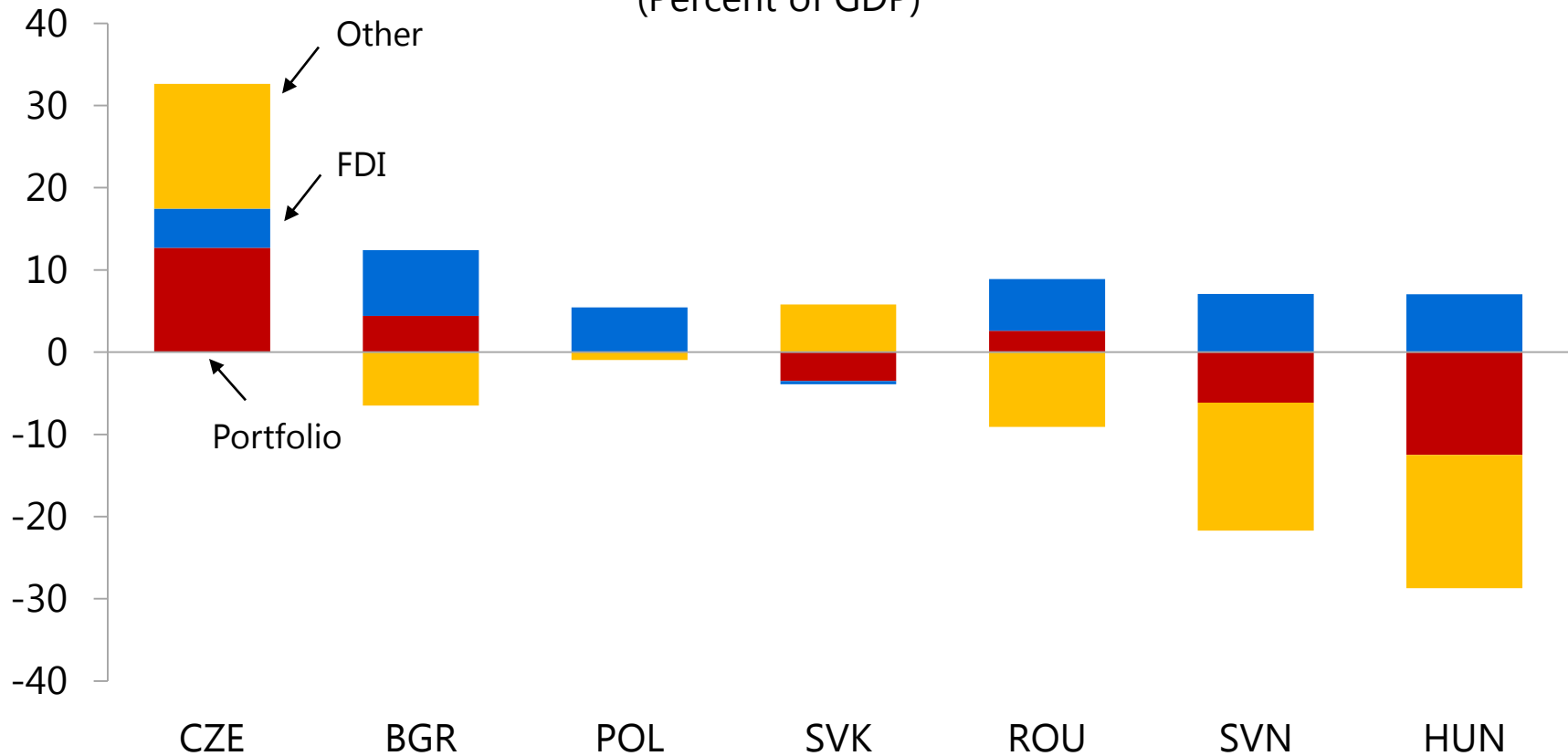


*Excluding Russia and Turkey.

In recent years, there have been no portfolio inflows to speak of, with exception of Czech Republic



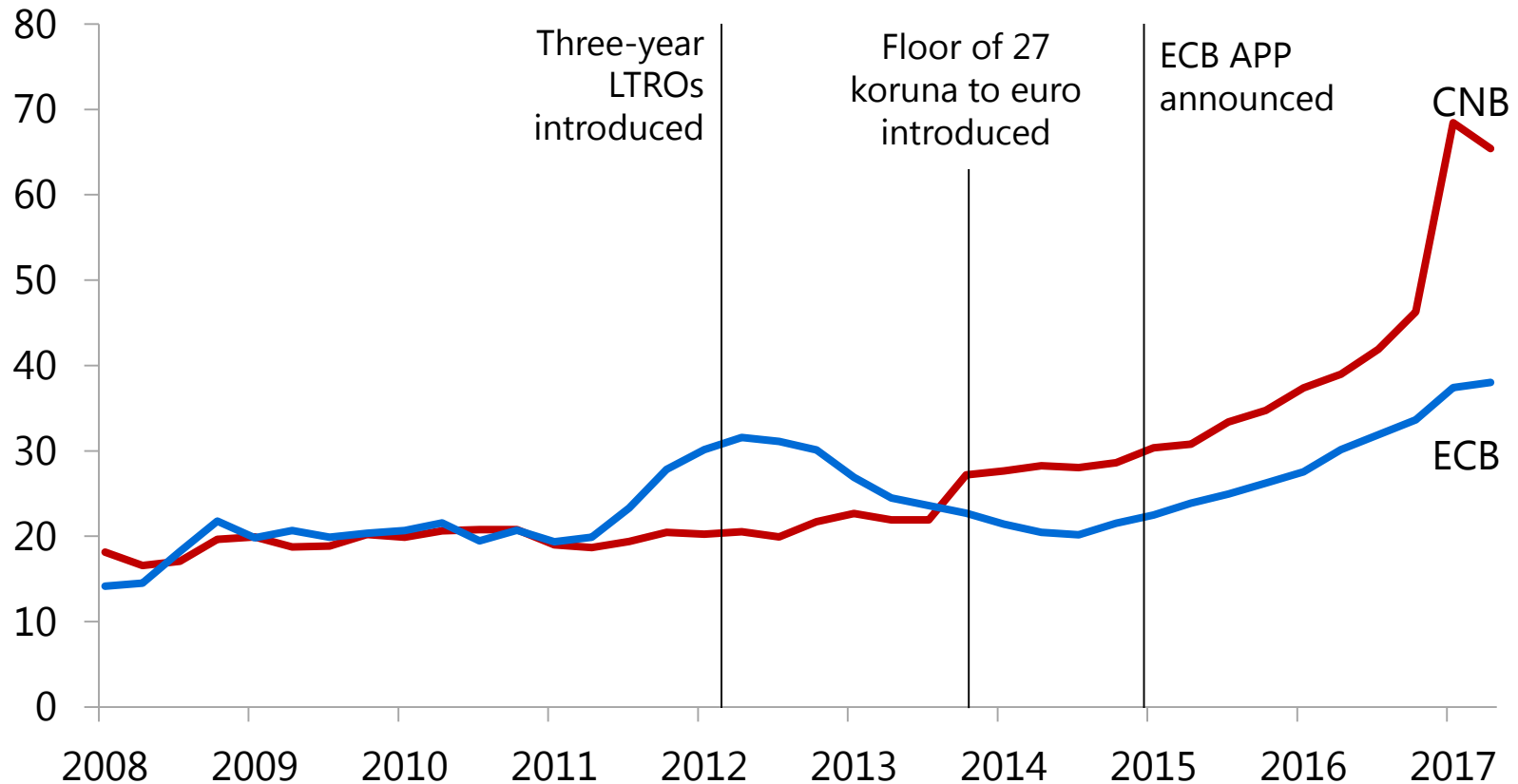
Cumulative Capital Inflows,
2014Q1:2017Q1
(Percent of GDP)



CNB massively intervened to prevent koruna appreciation



Central Bank Assets
(Percent of GDP)



So far, there is little evidence of UMP spillovers on real economy of non-EA countries

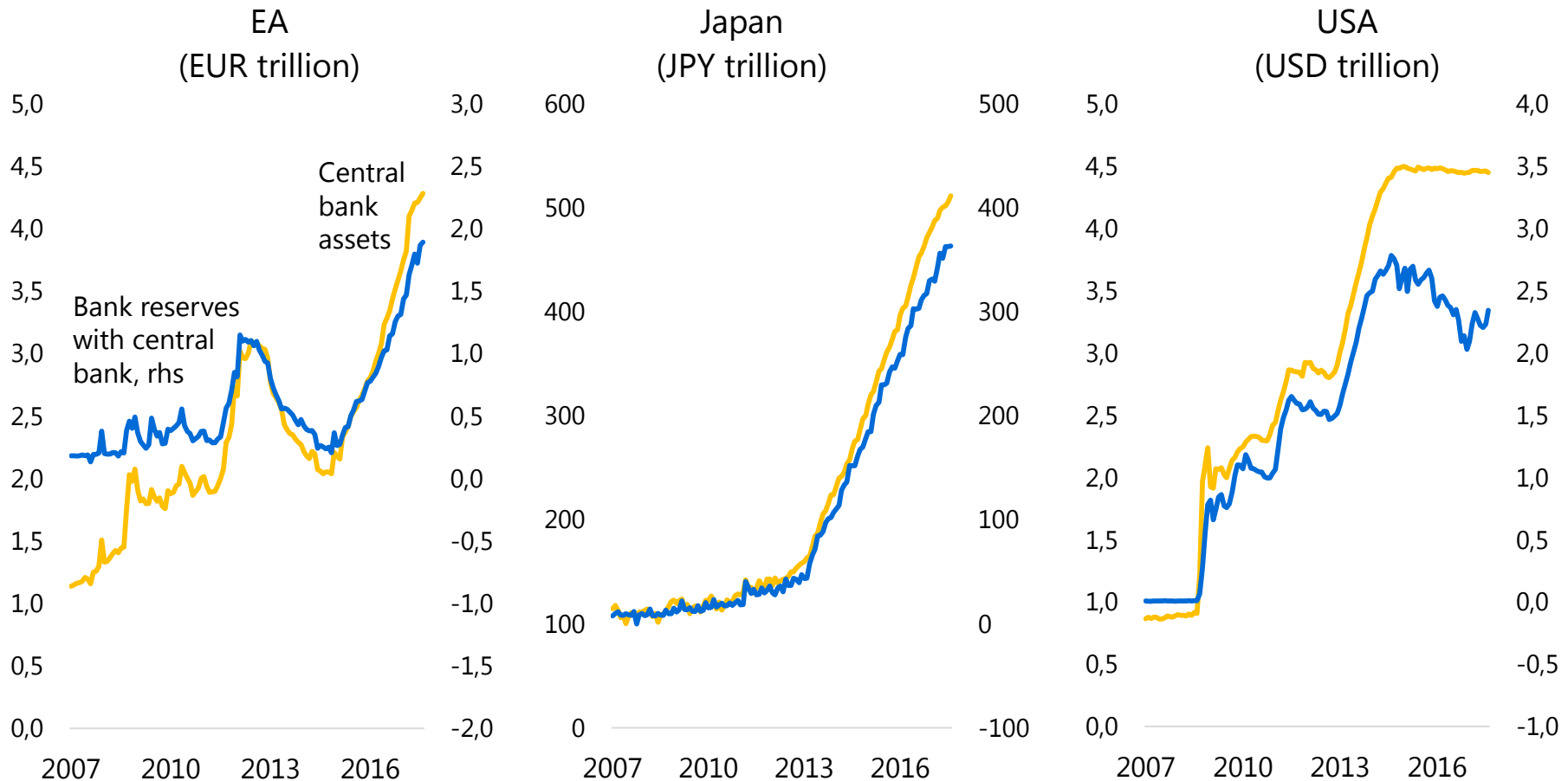


- Cross-Country Report on Spillovers found:
 - Strong correlation of bond yields,
 - Real appreciation,
 - Some capital inflows,as the adoption of APP approached

- Evidence of real sector spillovers appeared weak across applied methodologies

International Monetary Fund, 2016, "Cross-Country Report on Spillovers,"
IMF Country Report No. 16/212 (Washington).

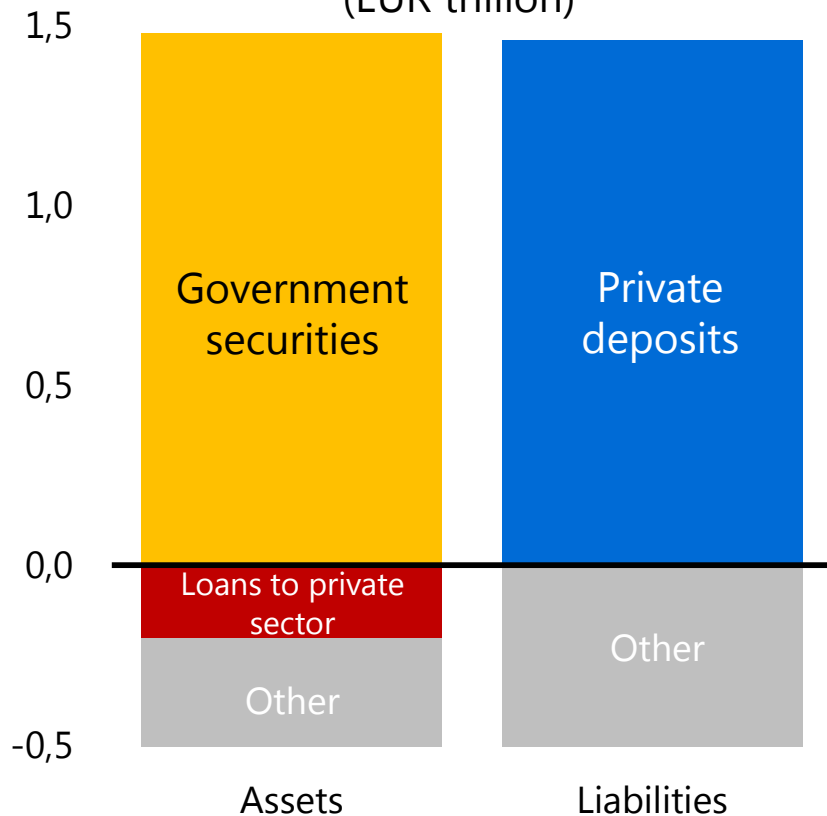
UMP resulted in ample liquidity of the banking sector



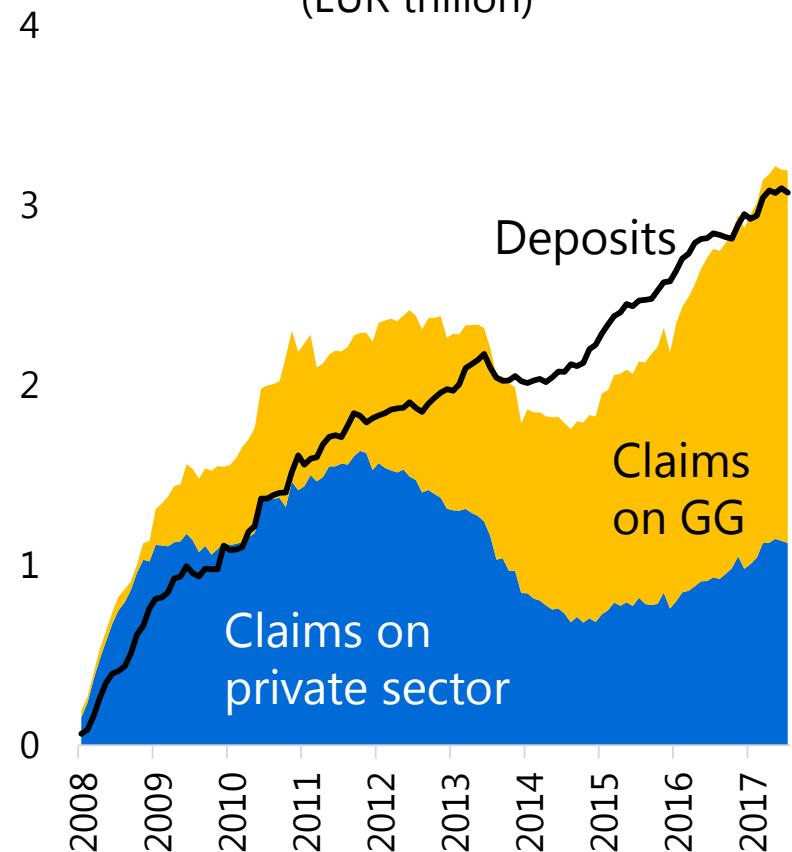
On *consolidated* basis, expansion of MFIs assets was mainly due to government bond purchases, although lending has picked up in recent years.



Change in Consolidated Balance Sheet of Euro Area MFIs, 2010-H1'2017 (EUR trillion)



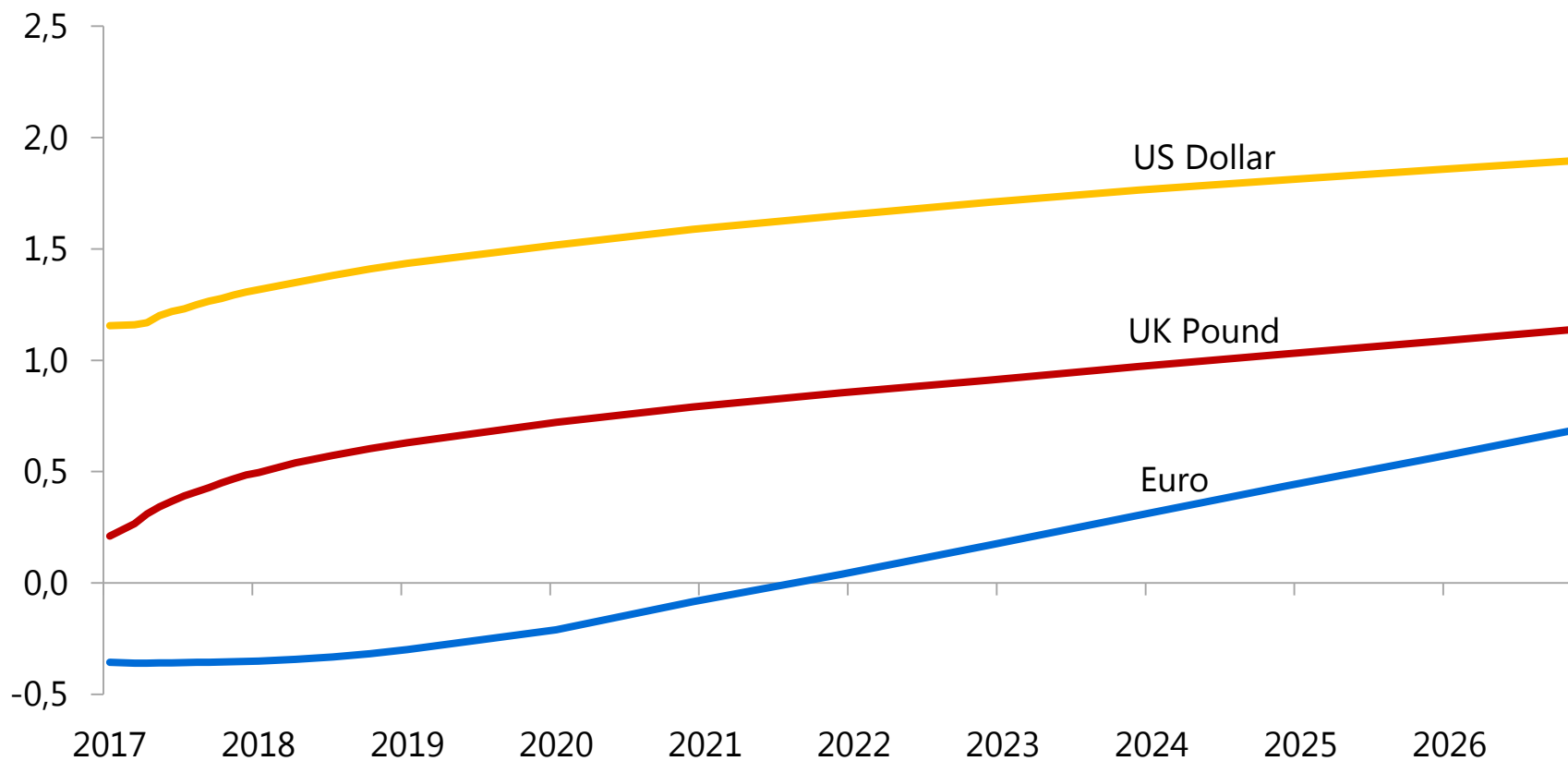
Cumulative Change in Consolidated Balance Sheet of EA MFIs since 2008 (EUR trillion)



So far, impact of UMP on CESEE seems to have been modest. But could loose monetary policy in advanced countries become a problem going forward?



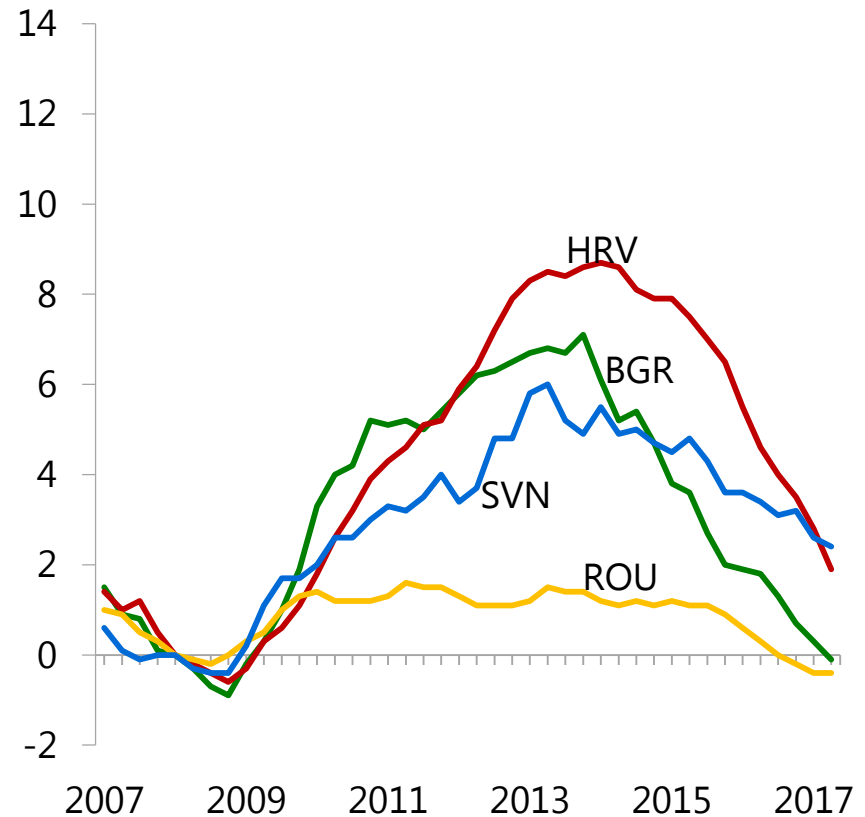
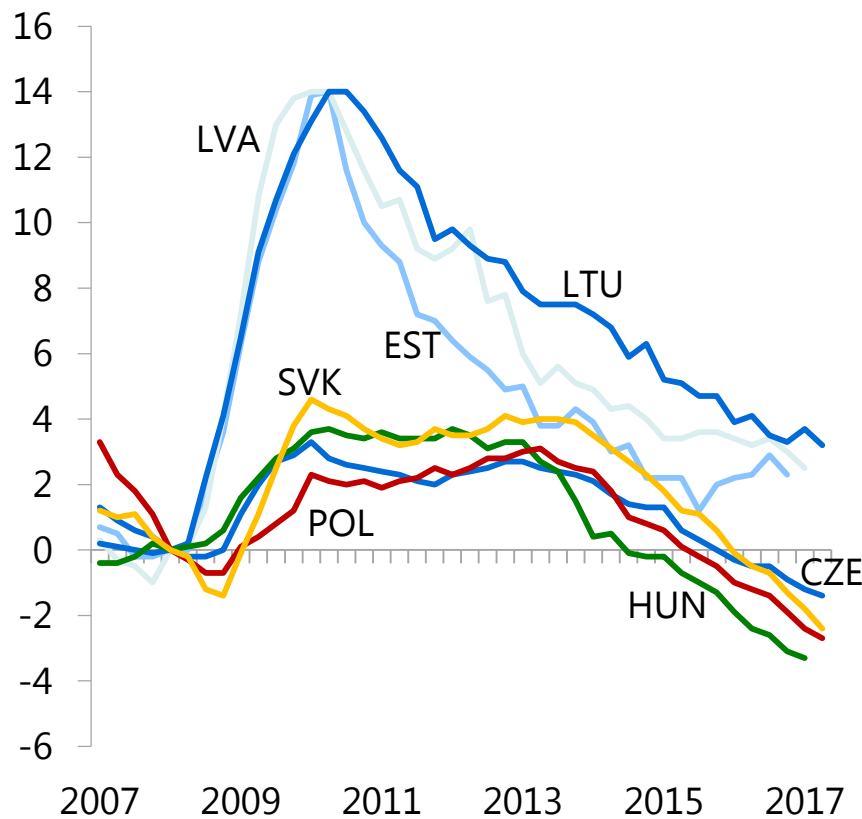
Overnight Interest Rate Swap vs Reference Rates at various maturity
(Percent, 19 September 2017)



Labor markets in CESEE are tightening rapidly



Cumulative changes in unemployment rate
(2008Q1=0, seasonally adjusted)

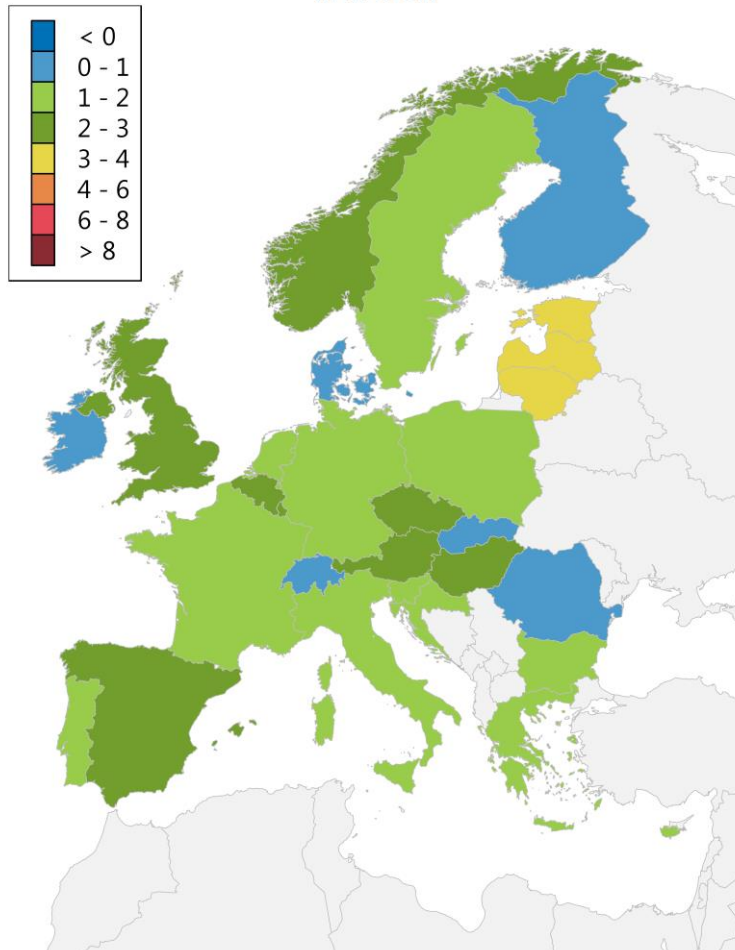


While inflation remains moderate, wage growth has picked up.

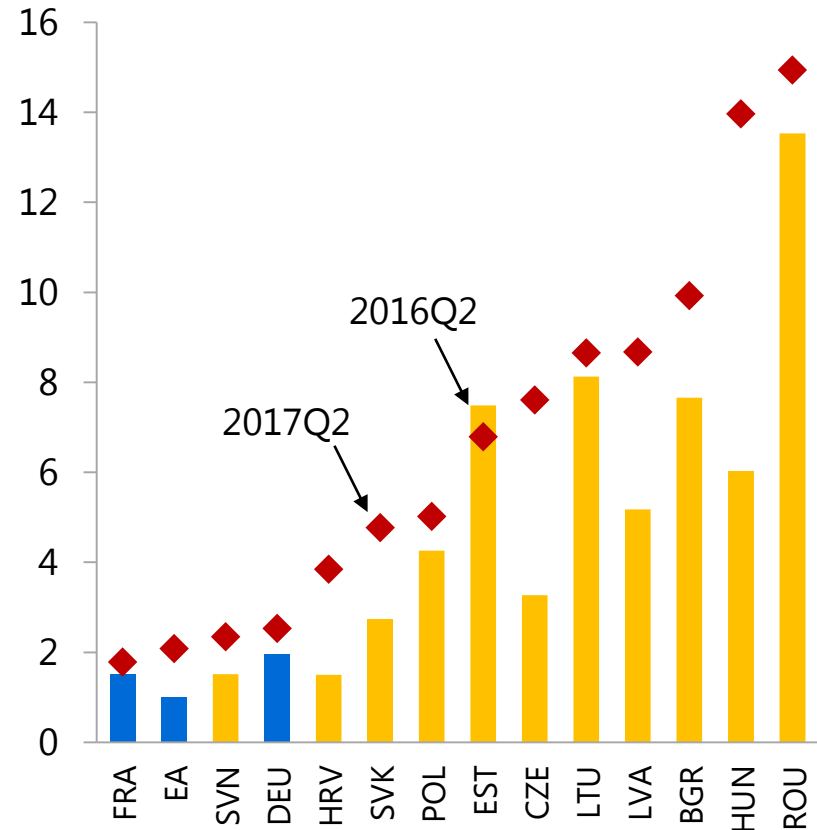


CPI Inflation in 2017Q2

(Y/Y, Percent)



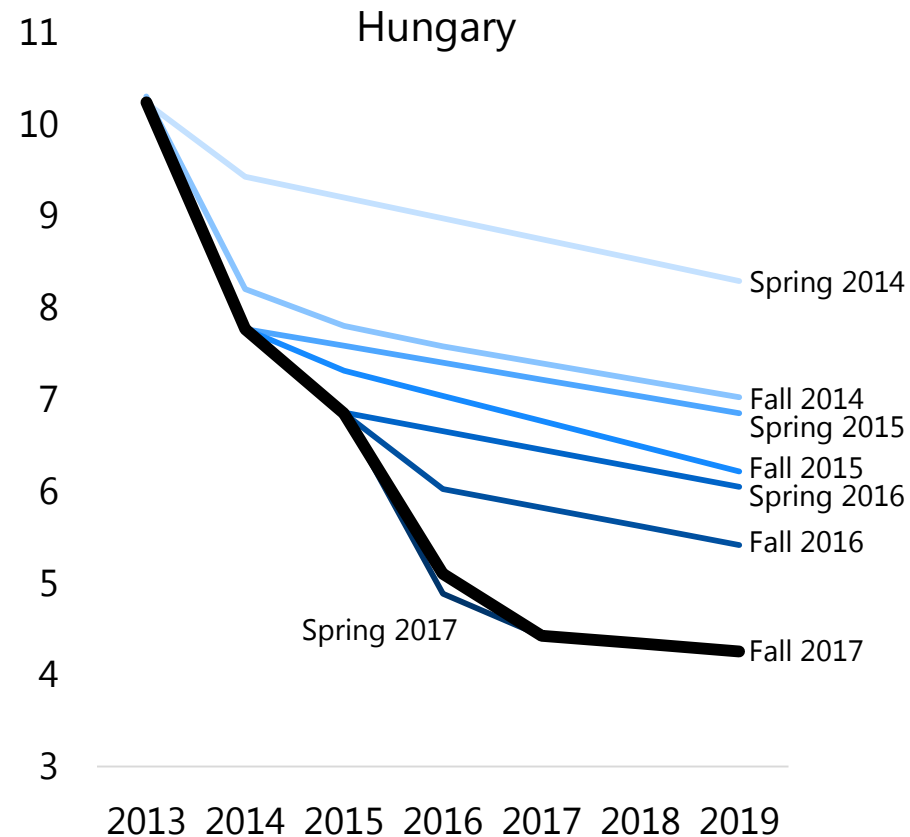
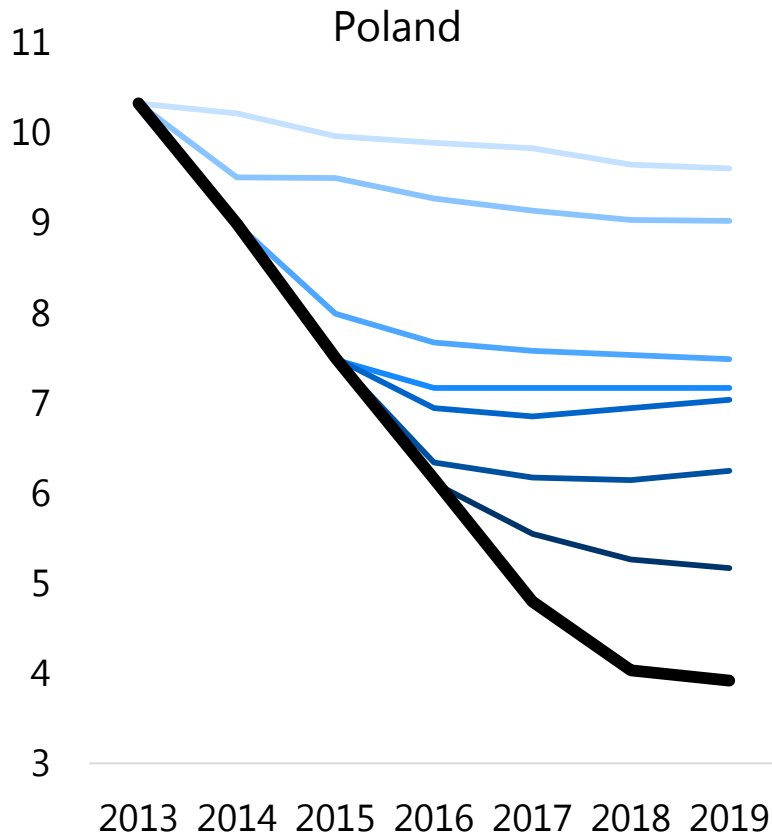
Wage Growth (Y/Y, percent)



Will unemployment continue to surprise on the downside?



Unemployment rate forecasts by WEO vintage
(percent)

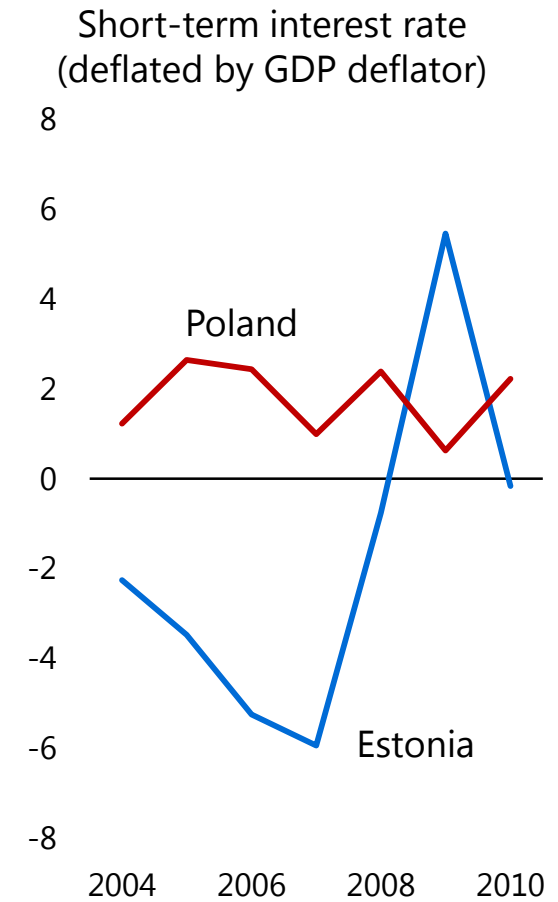
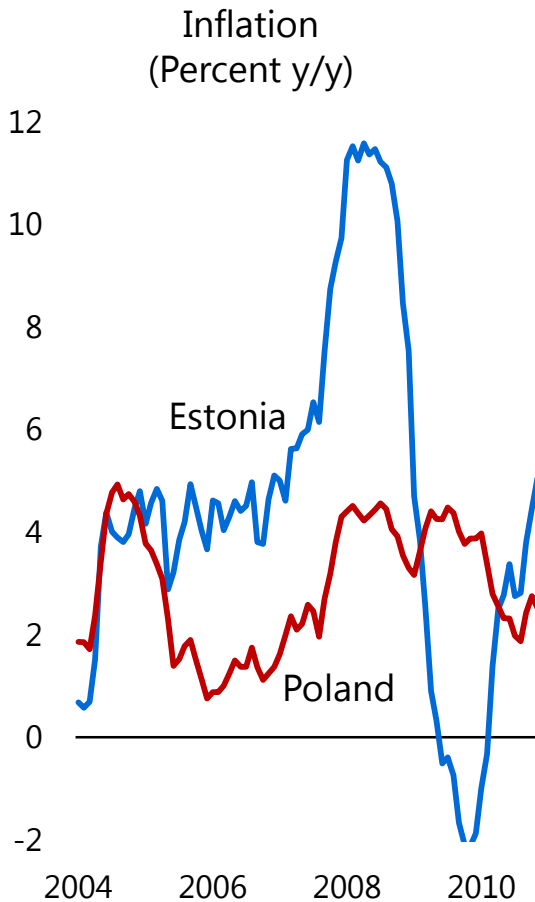
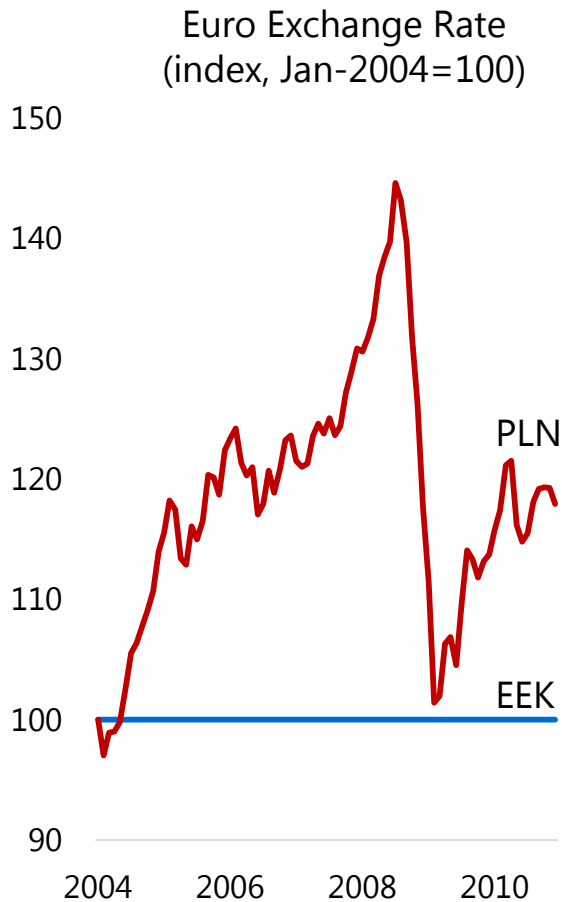


This might particularly be a problem for countries with fixed exchange rate or euro



- Countries with floating exchange rate can tighten monetary conditions - a combination of higher interest rates and nominal exchange rate appreciation
- Countries with fixed exchange rate do not have this option
- As inflation accelerates real interest rates will drop

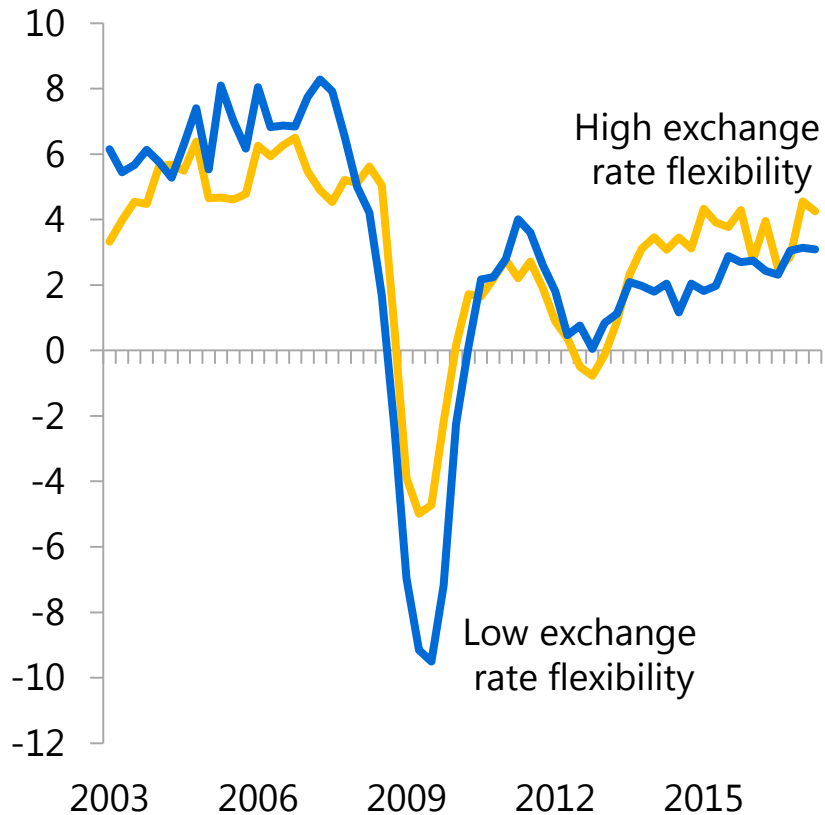
In floaters, nominal exchange rate appreciation can help keep real interest rate steady



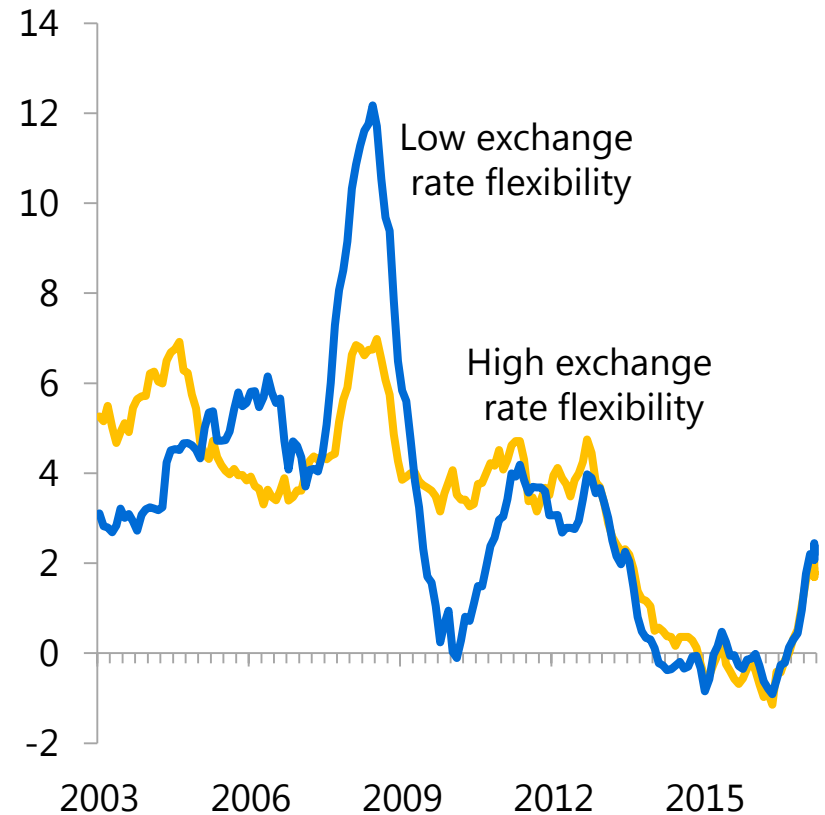
As a result, volatility of GDP and inflation is lower



Average real GDP growth
(Percent)



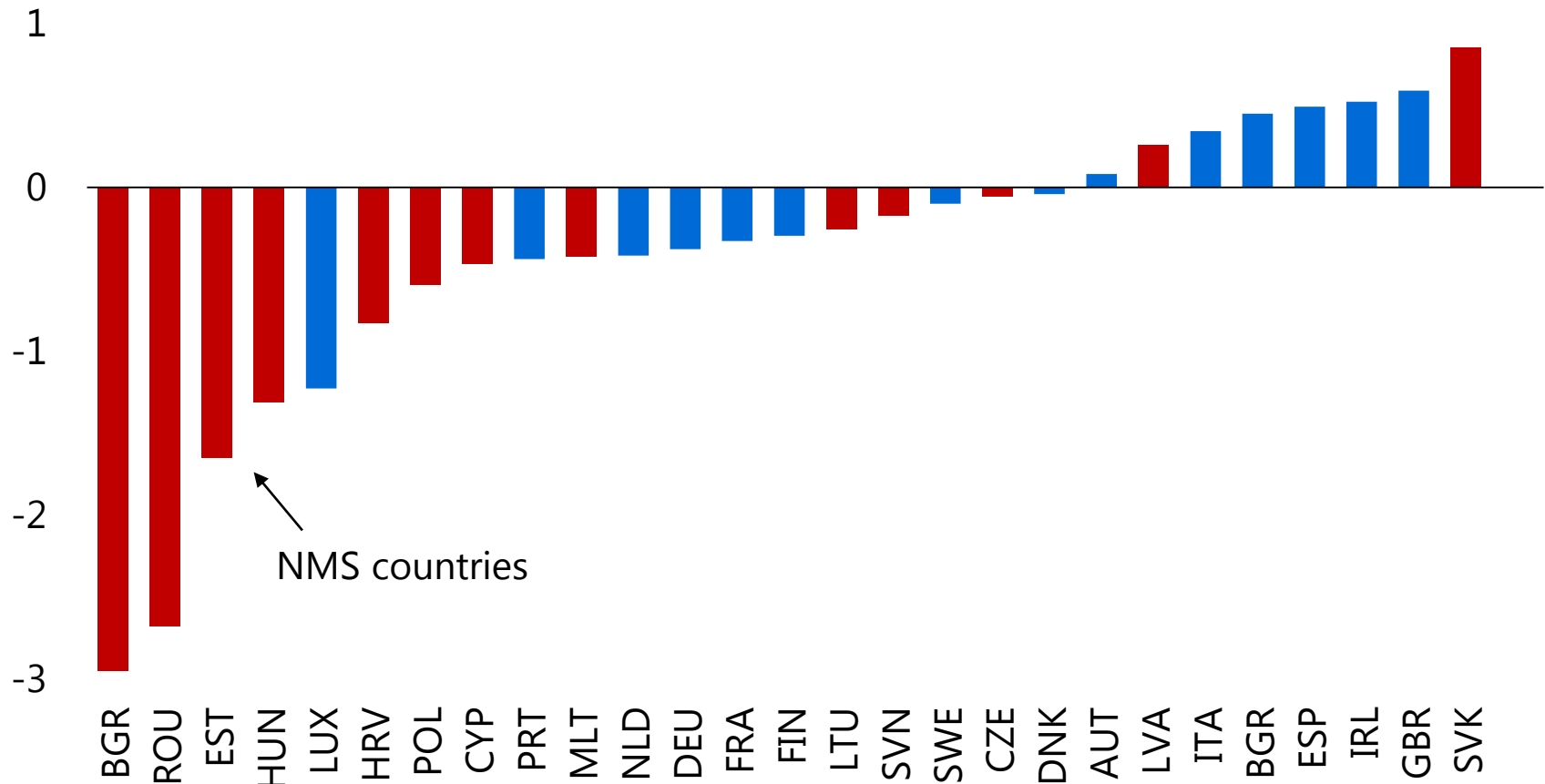
Average CPI inflation
(Percent)



Fiscal policy may also need to play a role to prevent overheating.



Change in Structural General Government Balance, 2016-18
(Percent of potential output)





Thank you