
Lecture 17: Unconventional Monetary Policy

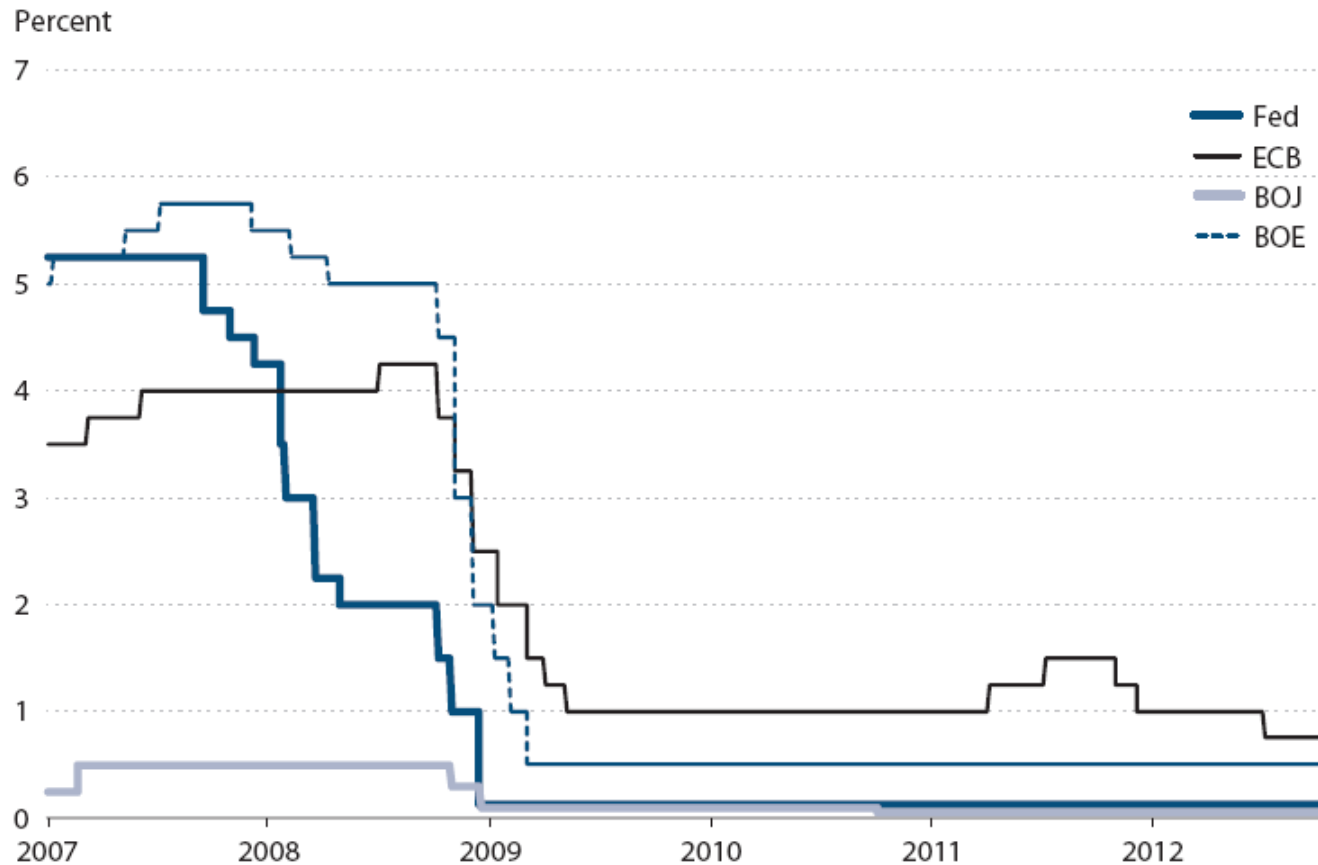
Dr. Runchana Pongsaparn
28 April 2013

Conventional and Unconventional Monetary Policy*

- In general, unconventional measures can be defined as those policies that directly target the cost and availability of external finance to banks, households and non-financial companies.
- Why implement unconventional policy measures?
 - Cutting interest rate is no longer possible (zero-bound constraint)
 - Monetary policy transmission process is significantly impaired
 - After the collapse of Lehman Brothers, market liquidity dried up leading to a sharp rise in market interest rate.
- Need to bear in mind the risk of hindering the functioning of markets

* Keynote lecture by Mr Lorenzo Bini Smaghi, Member of the Executive Board of the European Central Bank, at the International Center for Monetary and Banking Studies (ICMB), Geneva, 28 April 2009

Fed, ECB, BOJ, and BOE Main Policy Rates



NOTE: The main policy rates for the Fed, ECB, BOJ, and BOE are, respectively, the federal funds target rate, the main refinancing operations fixed/minimum bid rate, the uncollateralized overnight call rate, and the official Bank rate.

SOURCE: Fed, ECB, BOJ, and BOE.

Source: Fawley and Neely (2013)

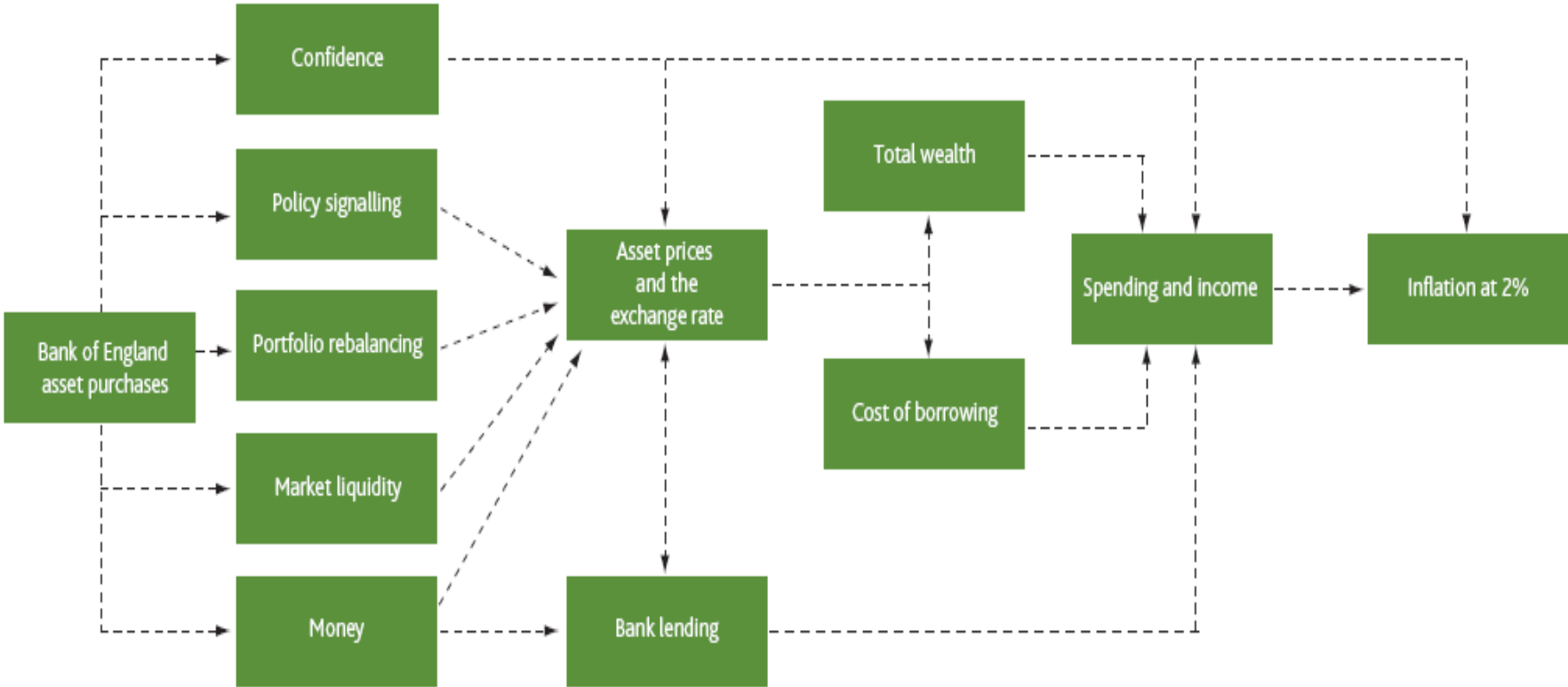
How are unconventional measures implemented?

- Direct quantitative easing
- Direct credit easing
- Indirect (or endogenous) quantitative/credit easing

Direct quantitative easing

- **QE describes any policy that unusually increases the magnitude of central bank liabilities—currency and bank reserves—particularly at the zero bound (Fawley and Neely, 2013)**
- **Usually focused on buying longer-term government bonds from banks**
 - **When long-term government bonds are purchased, the yields on privately issued securities are expected to decline in parallel with those on government bonds**
 - **If long-term interest rates were to fall, this would stimulate longer-term investments and hence aggregate demand, thereby supporting price stability**
- **Examples:**
 - **The Bank of Japan's policy between 2001 and 2006**
 - **The Fed's QE1 (Nov 08-Mar 10) and QE2 (Nov 10)**
 - **BOE Mar 09 – Jan 10**
- **Limitations:**
 - **Increase in monetary base does not necessarily lead to easier monetary condition**
 - **Risk of accumulating significant losses for the central bank if bond prices fall**

Figure 1 QE transmission channels



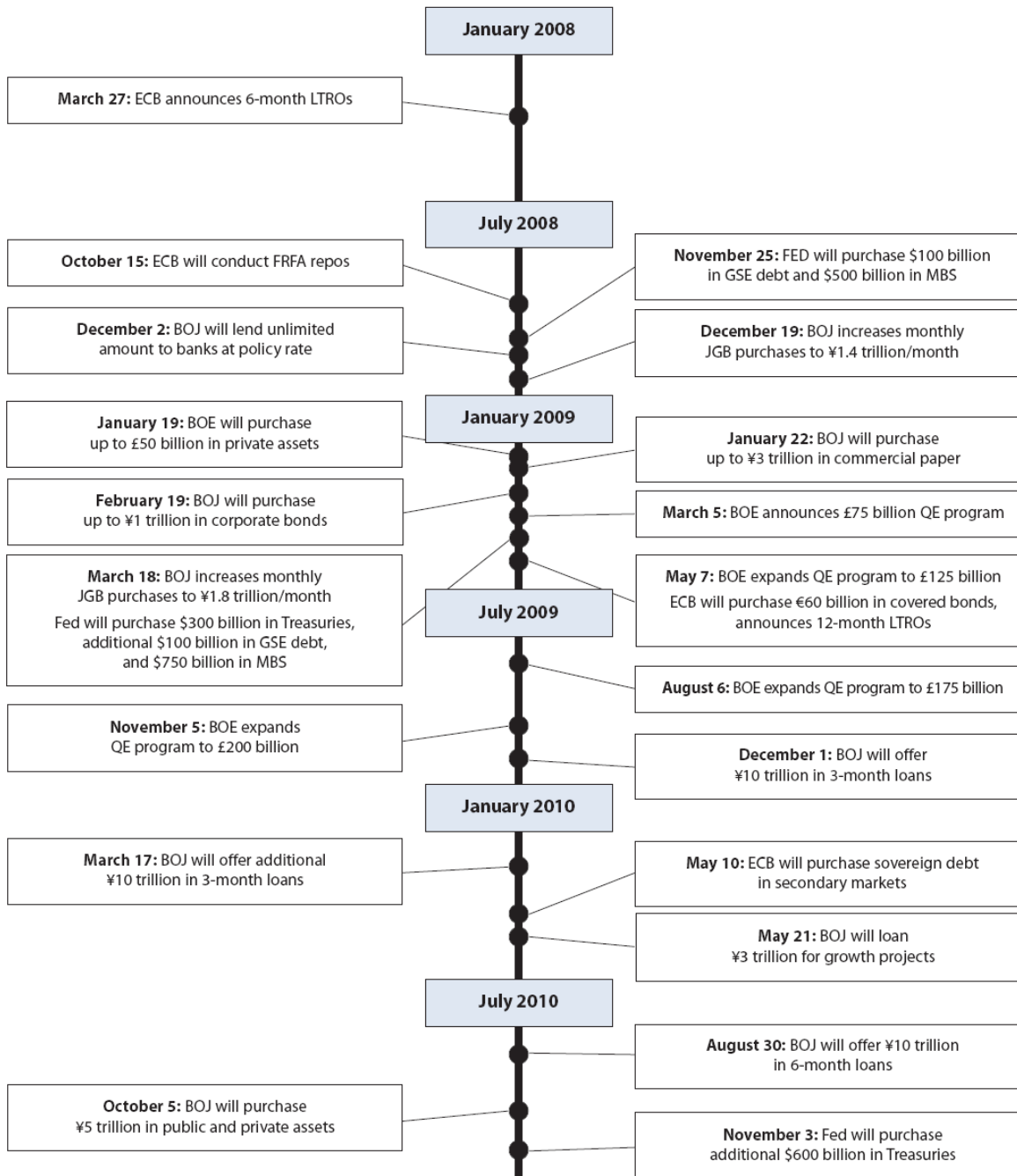
Source: Bank of England Quarterly Bulletin (Q3 2011)

Direct credit easing

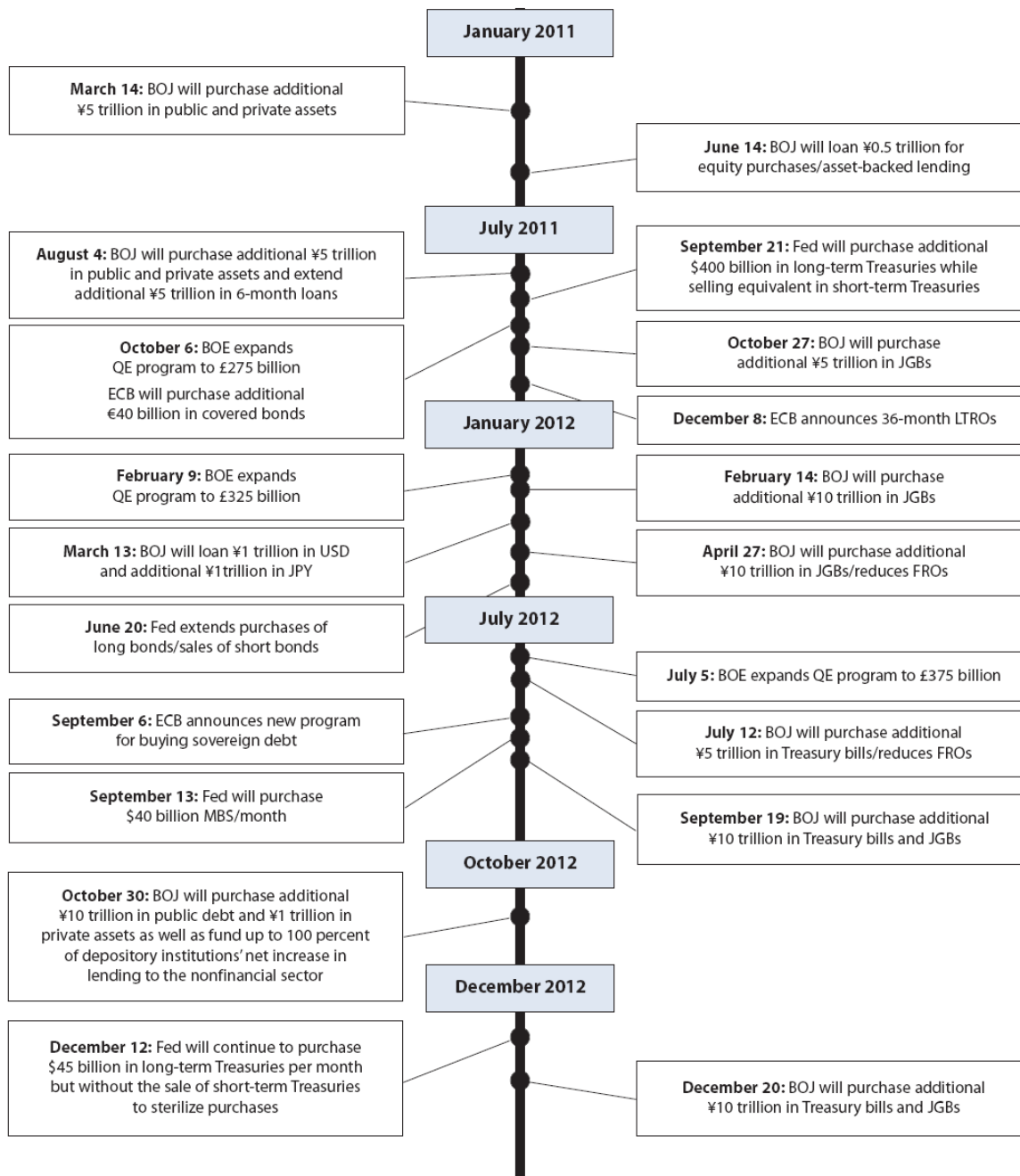
- **Directly addresses liquidity shortages and spreads in certain (wholesale) market segments through the purchase of commercial paper, corporate bonds and asset-backed securities**
 - **Outright purchases of privately issued securities affect the risk profile of the central bank's balance sheet**
 - **policy-makers need to carefully assess the eligibility of all assets on account of the implications they could have for the risk exposure of the central bank's balance sheet**
- **Examples:**
 - **The Fed since Dec 07: Commercial Paper Funding Facility, Purchase of GSE-Backed Asset-Backed Securities**
- **Limitations:**
 - **Outright purchases of privately issued securities need to be carefully planned to avoid allocative distortions in terms of industries, firms or regions**
 - **Given the limited depth of corporate bond markets in many economies, purchases of privately issued securities be difficult**

Indirect (or endogenous) quantitative/credit easing

- **lending to banks at longer maturities, against collateral which includes assets whose markets are temporarily impaired**
 - This policy affects directly the yield curve over the horizon at which policy operations are conducted or committed to be conducted
 - The increase in the monetary base is determined endogenously by the banking system, based on banks' preference for liquidity and thus on the state of stress of the banking system
 - By enlarging the pool of the collateral accepted for the refinancing operations with the central bank, the financing conditions by banks to these sectors are facilitated, which should be reflected in the credit spreads that banks charge in particular to the corporate sector
- **Examples:**
 - **The ECB in Oct 08: a “fixed-rate full-allotment” procedure**
 - eligible counterparties in the euro area have had access to unlimited liquidity for periods ranging from one week up to six months at a fixed rate
 - expanding the list of assets eligible as collateral in Eurosystem refinancing operations



Fawley and Neely, 2013



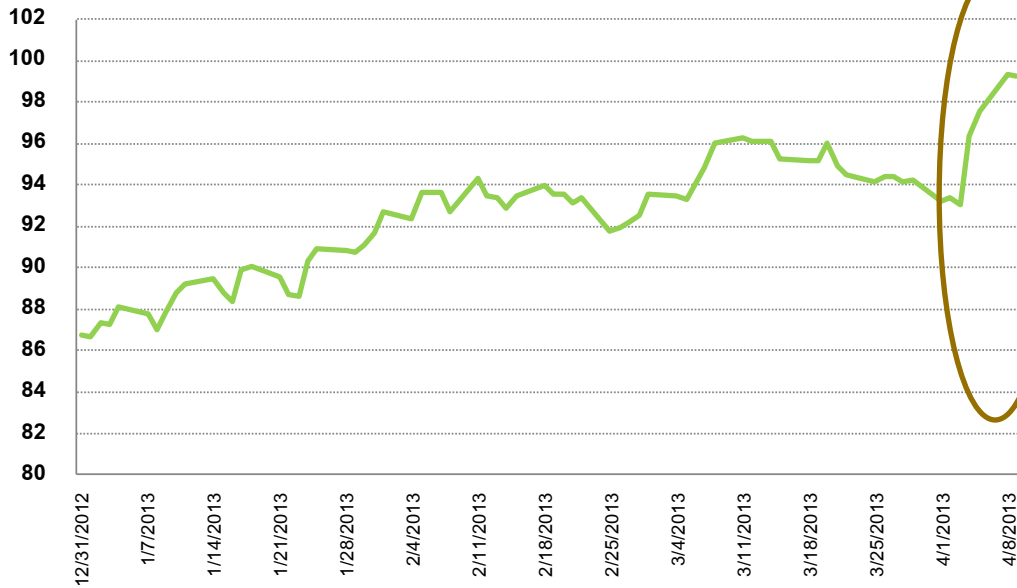
Fawley and Neely, 2013

BOJ announced Q-square Monetary Policy on 4 April 2013

- **Q-square refers to quantitative and qualitative monetary easing**
 - **It will double the monetary base and the amounts outstanding of Japanese government bonds (JGBs) in two years, and more than double the average remaining maturity of JGB purchases**
 - the main operating target for money market operations is changed from the uncollateralized overnight call rate to the monetary base.
 - The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.
 - With a view to encouraging a further decline in interest rates across the yield curve, the Bank will purchase JGBs so that their amount outstanding will increase at an annual pace of about 50 trillion yen.
 - In addition, JGBs with all maturities including 40-year bonds will be made eligible for purchase, and the average remaining maturity of the Bank's JGB purchases will be extended from slightly less than three years at present to about seven years.
- **Objective**
 - **The price stability target of 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI) at the earliest possible time, with a time horizon of about two years.**

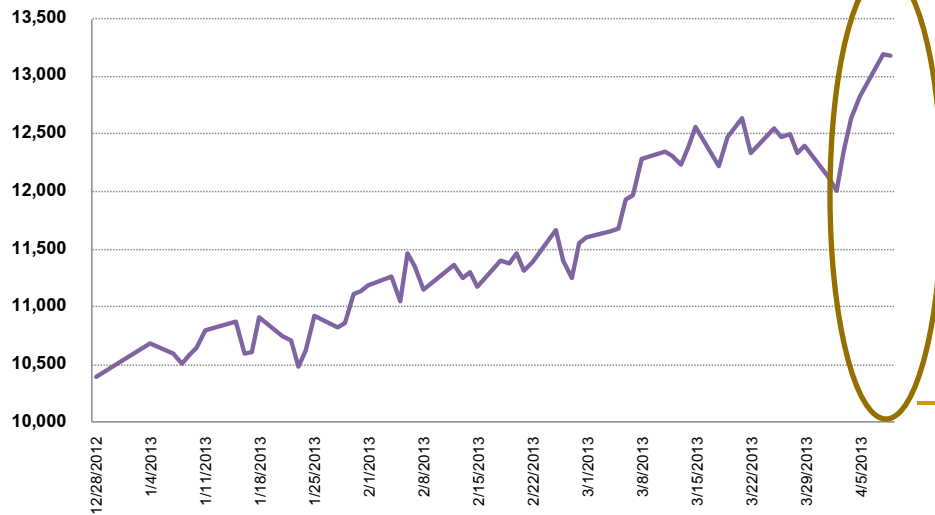
Impact of BOJ announcement

JPY movement

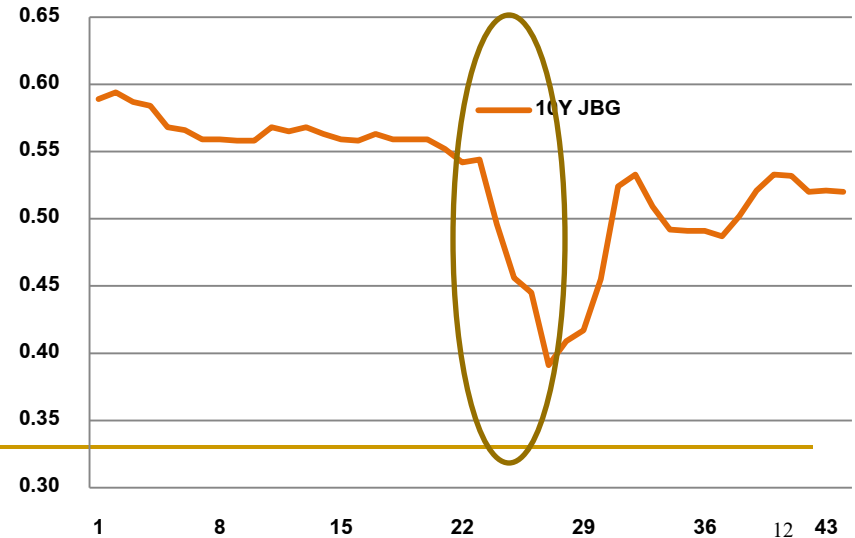


- JPY weakened
- Nikkei rallied
- 10y JGB yield declined

Nikkei 225

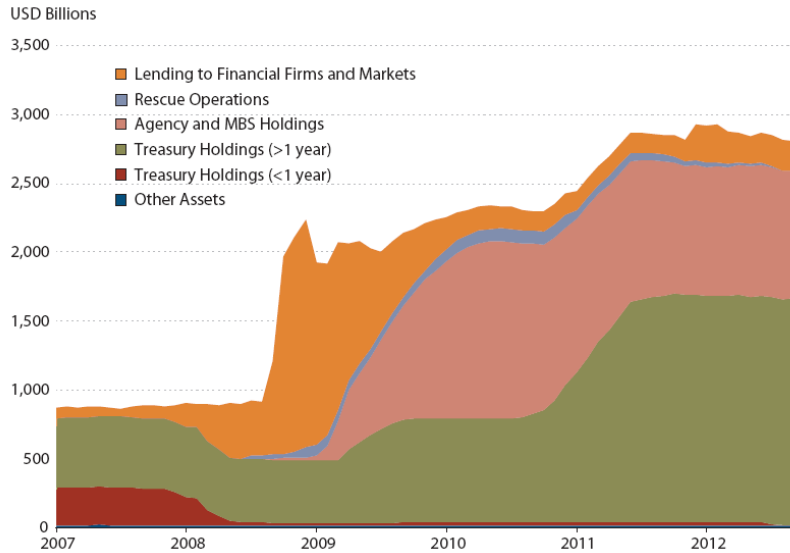


10Y JGB yield

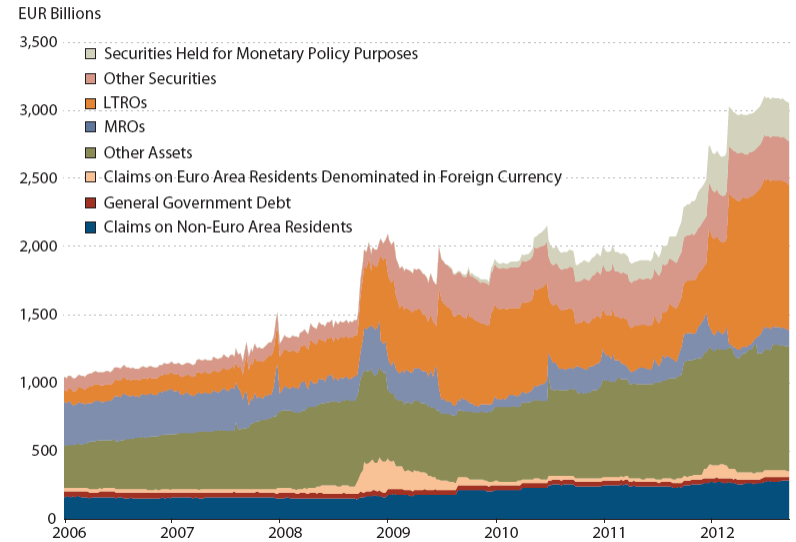


Impact of unconventional policies: Expanding CB's B/S

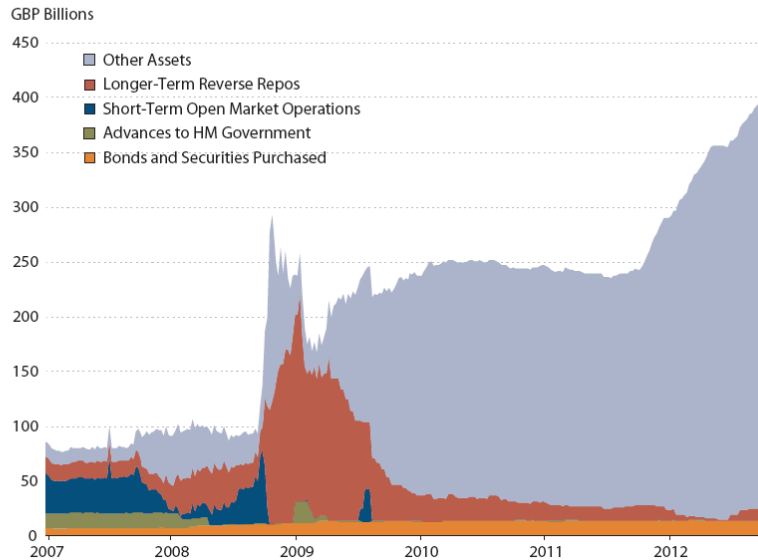
Federal Reserve Bank Assets



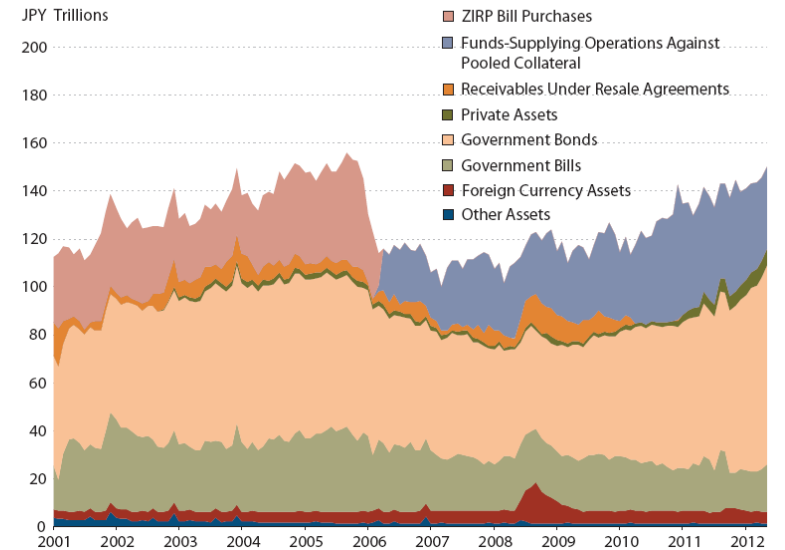
ECB Assets



BOE Assets



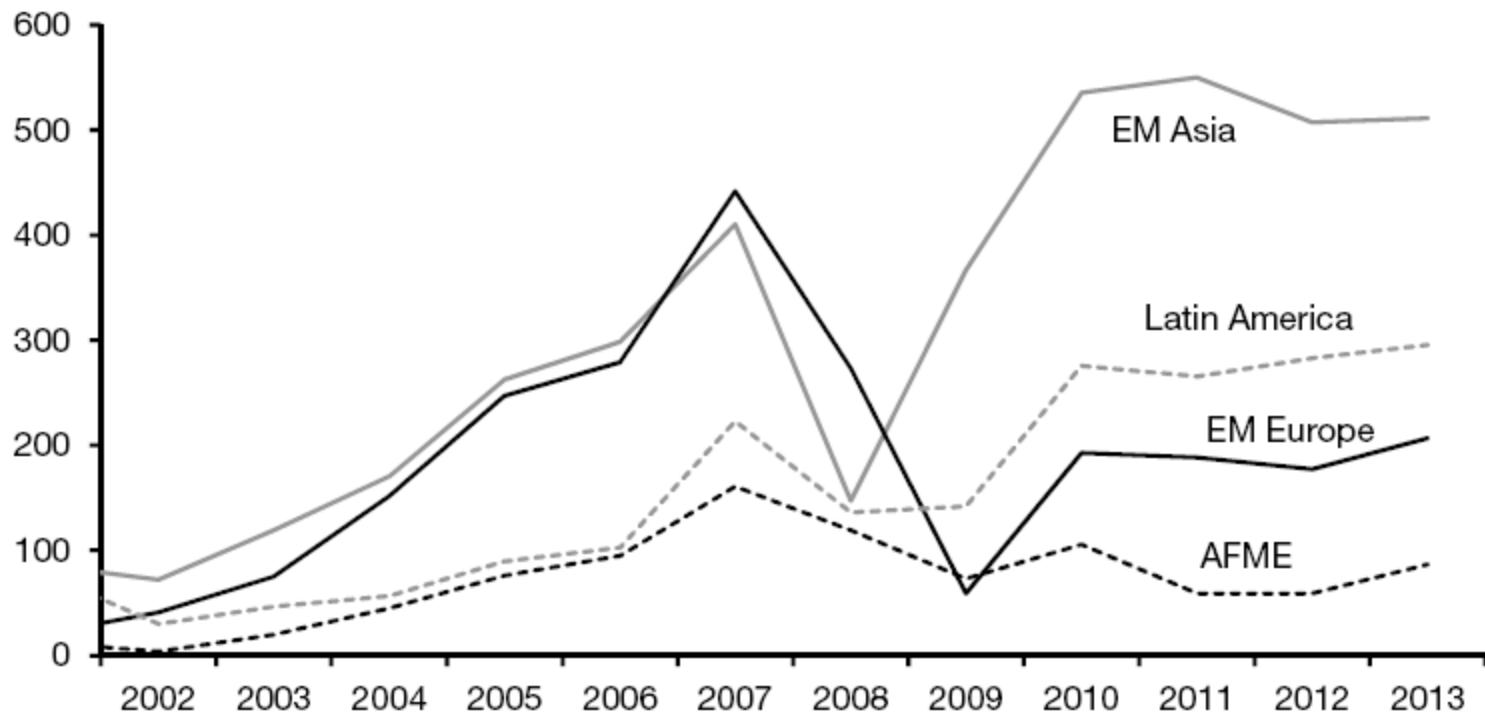
BOJ Assets



Source: Fawley and Neely (2013)

Impact of unconventional policies: Capital flows into Emerging Asia

Emerging Market Private Capital Inflows, Net
\$ billion



Source: IIF (2012)

References

- **Fawley and Neely (2013), 'Four Stories of Quantitative Easing', Federal Reserve Bank of St.Louis Review**
- **Bank of England (2011), Quarterly Bulletin, Q3 2011**
- **Bank of Japan (2013)**