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PRESS RELEASE

Effectiveness and transmission of the ECB's balance sheet policies

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This working paper examines the effects of the unconventional measures taken by the European Central Bank (ECB) between 2008 and 2013. An assessment of the macroeconomic effects of changes in the central bank's balance sheet is particularly pertinent, as the Governing Council of the ECB announced new unconventional monetary policy measures in the summer of 2014. In addition to its targeted refinancing operations with maturities of up to four years, the ECB has also launched covered bond and asset-backed securities purchase programmes. These measures aim being to bring the balance sheet back to early 2012 levels. Although it is premature to evaluate the macroeconomic impact of these measures, this paper does help to arrive at a picture of the impact on the euro-area economy of the envisaged balance sheet expansion.

The paper estimates a structural vector autoregressive model of the euro-area economy between 2008 and 2013, a period also marked by pronounced fluctuations in the central bank balance sheet. For much of this period, the central bank met all demand for liquidity, with changes in the size of the balance sheet being mainly driven by changes in the demand for central bank funding from banks rather than by new monetary policy measures. Any assessment of the impact of balance sheet measures on financial conditions and the macro economy should appropriately factor in that endogenous nature of central bank balance sheet developments. Against this background, the paper identifies exogenous changes in the size of the balance sheet by imposing a number of zero and sign restrictions on the impact of such balance sheet shocks on the macro economy and financial sector stress.

The time series of identified balance sheet shocks – and hence the identification scheme used – is plausible as it captures key decisions related to the ECB's balance sheet, such as the introduction of fixed-rate full allotment and the two three-year LTROs. Exogenous increases in the central bank balance sheet prompt more rapid growth of economic activity and rising inflation, although their impact is temporary. Moreover, the macroeconomic impact of unconventional monetary policy is qualitatively comparable to that of traditional interest-rate policy. Balance sheet measures can therefore help stabilise the macro economy, an interesting finding in the current low inflation environment which has pushed nominal policy rates to their floor.

In the period under review, the ECB's unconventional monetary policies were transmitted to the real economy by way of the financial markets and financial institutions: after expansionary balance sheet shocks, equity prices rise, long-term yields fall and spreads on European government bonds relative to German bunds narrowed. Banks also saw their CDS spreads fall, relaxed their credit conditions and lowered interest rates for new loans, prompting faster loan growth.

The paper highlights significant differences in the transmission of unconventional monetary policy in the different euro area countries. As it turns out, economic activity is growing faster in countries hit less hard by the financial crisis. This paradoxical finding can be interpreted from a different angle: the impact of unconventional monetary policy on GDP in the various countries shows a high correlation with bank capitalisation. After all, less solvent banks are less likely to swiftly turn central bank liquidity into new loans to the real economy. If further research corroborates this finding, this would bear out the importance of measures aimed at safeguarding and bolstering bank solvency. The successful completion of the ECB's comprehensive assessment and subsequent strengthening of bank capital positions should help guarantee a robust transmission of monetary policy measures, including those pertaining to the central bank balance sheet's size and composition.