

# Discussion

The response of Euro-area sovereign spreads to the  
ECB unconventional monetary policies  
by Hand Dewachter, Leonardo Iania and J-C Wijnandts

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The discussion should not be reported as representing the views of the European Central Bank (ECB).  
The views expressed are those of the discussant and do not necessarily reflect those of the ECB.

# What is the paper about?

- The effects of ECB's unconventional monetary policy on sovereign spreads is decomposed into various channels:
  - Signalling channel (short-rate expectation)
  - Portfolio rebalancing channel (term premium)
  - Fragmentation channel (expected average short-term spread)
  - Sovereign risk channel (risk premia for unexpected changes in the spread)

# The model

- Step 1 (Modeling the euro area OIS curve)
  - Arbitrage-free Nelson Siegel (AFNS) (Christensen-Diebold-Rudebusch 2011)
  - SR-AFNS (Christensen and Rudebusch 2015, Krippner 2012)
  
- Step 2 (Modeling the sovereign spread)
  - Two country specific factors (level and slope) are added (similar to Christensen, Lopez and Rudebusch 2014)
  - It is assumed that the country factors do not feedback to the OIS factors

# The main results

- The SR approach seems to matter for the decomposition of the OIS curve into premia and expectation components
  - Term premia at the 5 year maturity are considerably higher for the SR model
  - Results of the event study analysis seem to be similar for affine and SR models (except for the APP)
- SMP, (T)LTRO and OMT seem to have had an accommodative effect on the expected path of short-rate counterbalanced by increasing term premia
- UMP seems to affect sovereign spreads mainly via the risk component

# A few remarks/questions

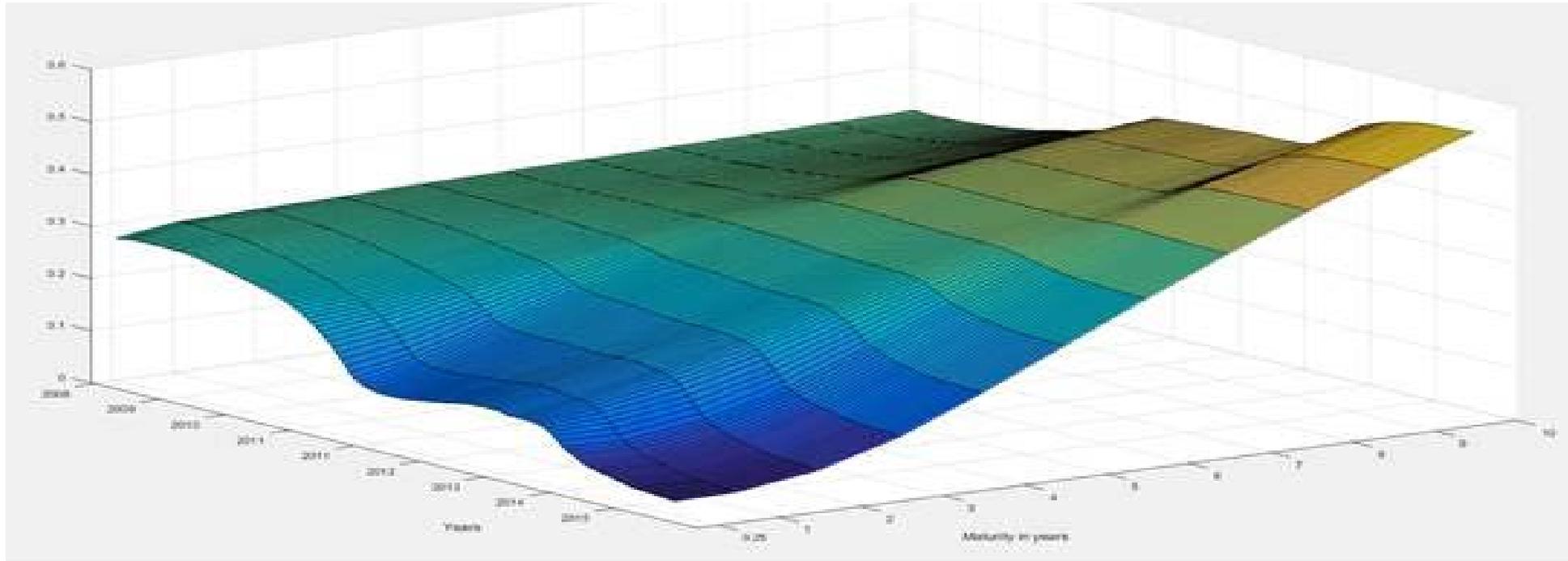
- Very important paper!
  - It is crucial for policy makers to understand the effects of UMP on the various components of the yield curve
- Do you really need a SR approach to assess the effects of UMP?
  - The UMP effects seem to be similar apart for the APP
- Why has FG no effect on the expected OIS path but reduces the country risk factor?
  - A “sign restriction” approach would assume the opposite
- Is a weekly frequency sufficient for event studies?
  - I’ll talk more on event studies in a second
- What about standard (interest rate) monetary policy?

# A few more general remarks

- Are 3-factor models adequate in times of UMP?
- The problems of event studies in times of UMP
- What is the risk of changing sovereign spread if the sovereign spread is determined by many factors that vary over time?

# Potential problems with the AFNS close to the zero bound

Loading structure of the 1<sup>st</sup> PC of the euro area OIS curve  
(Jan 2006 to Dec 2015)

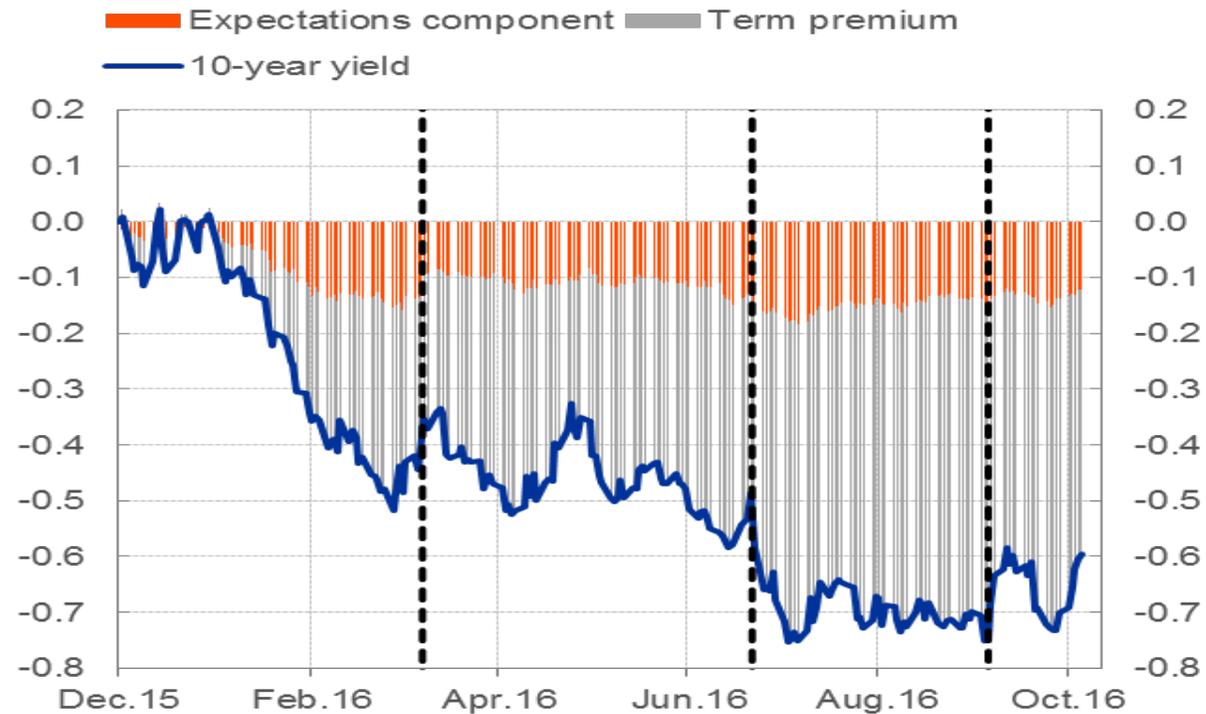


Does a SR approach help?

Krippner 2015 suggests to use a 2-factor approach also for SR models

# Potential problems with event studies in times of UMP

Decomposition of EA 10Y OIS yield change since 3 December 2015



Was there no effect on the path of the expected short-rate (signalling channel) in March 2016?

What about expectations building up?

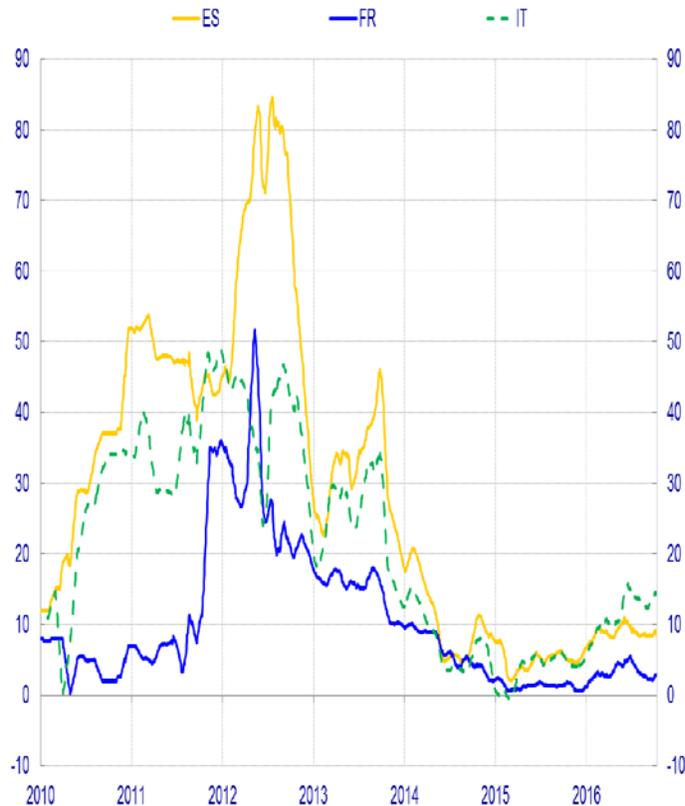
Sources: Thomson Reuters and ECB calculations.

Notes: Decomposition based on an ATSM (Affine term structure model) fitted to the euro area OIS curve. The estimation method follows Joslin, Singleton and Zhu (2011). Vertical lines denote the 10 March GovC meeting, the 24 June 2016 UK referendum outcome and the last GovC meeting (08 September), respectively. Last observation is 07 October 2016.

# What is behind the sovereign spreads?

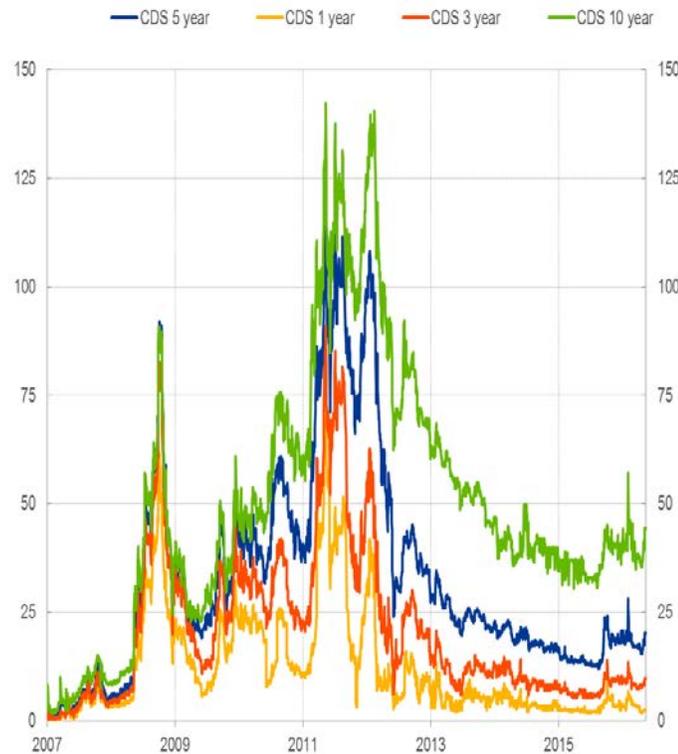
Is it fragmentation? Of course yes, but what is behind it?

### Redenomination risk



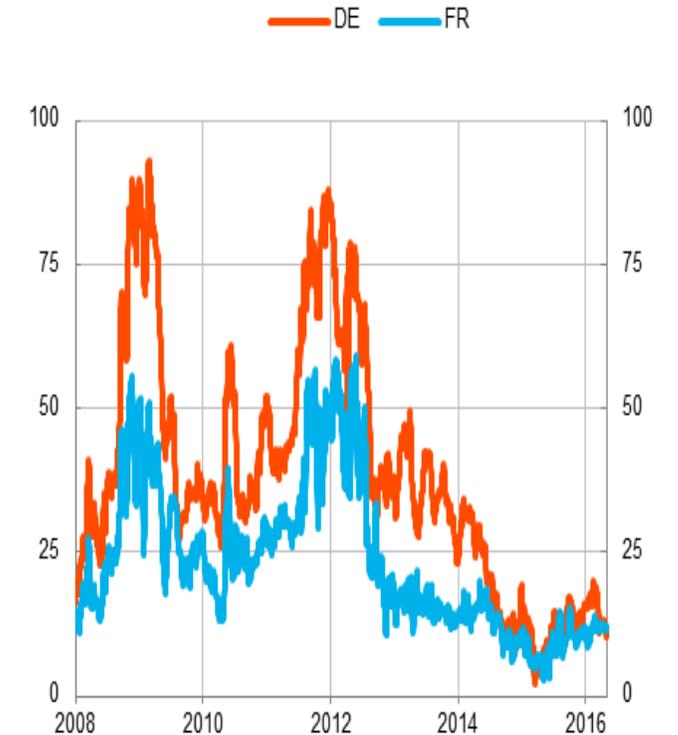
Sources: Thomson Reuters and ECB calculations.  
Notes: Estimated redenomination risk based on CDS denominated in US dollar and euro.

### Credit risk: German CDS spreads



Sources: Thomson Reuters

### Liquidity risk



Sources: Thomson Reuters and ECB calculations.  
Notes: KfW – Bund yield (5y) for DE and Cades – OATs (Obligations Assimilables du Trésor) yield (5y) for FR

# Conclusion

- Very interesting paper! Please read it!
- The current version of the paper is too “dense”
  - Do you really need a SR approach for assessing the impact of UMP?
- Is the decomposition of the sovereign spread into level and risk component not too ambitious?
  - The sovereign spread is determined by many factors with changing importance over time