THE EUROPEAN CENTRAL BANK’S ASSET PURCHASE PROGRAMME: An early assessment

In 2015 the European Central Bank (ECB) joined several other central banks in implementing ‘quantitative easing’ (QE) through an expanded asset purchase programme (APP) aimed at addressing the risks of a too prolonged period of low inflation. New research to be presented at the annual congress of the European Economic Association in Geneva in August 2016 provides evidence suggesting that the APP was effective in easing further the stance of monetary policy in the euro area economy.

The study by Johannes Breckenfelder and colleagues first assesses empirically the effects of the APP on various asset prices. It documents that the programme produced significant effects on announcement, on 22 January 2015, and that such effects persisted for several months.

This evidence is consistent with two possible transmission channels of the APP: the reduction of duration risk and bank capital relief. The duration risk channel posits that by reducing private sector holdings of long-duration bonds – which are more exposed to interest rate risk – the central bank purchases should reduce risk and lead to a decline in yields. The evidence is consistent with this hypothesis: the fall in yields after the programme announcement is larger for longer maturity bonds.

The capital relief channel suggests that the higher prices of sovereign bonds induced by the APP should benefit banks through the ensuing increased valuation of their bonds holdings. The evidence is consistent with this channel: the equity prices of banks holding a larger portfolio share of government bonds benefited more from the increase in bond prices.

The empirical evidence is also consistent with the ‘signalling’ channel. After the announcement of the programme, market expectations of future short-term interest rates edged down, while inflation expectations tended to increase. The evidence also suggests that the introduction of the APP helped the ECB guide long-term inflation expectations closer to levels consistent with its price stability objective. The study refers to this effect as the ‘re-anchoring’ channel.

To evaluate the macroeconomic impact of the APP, the study relies on a general equilibrium model that incorporates the aforementioned transmission channels. Model-based results suggest that, compared with a counterfactual scenario without the APP, the purchases announced on 22 January 2015 contributed to support both inflation and output. The programme is estimated to be roughly comparable to a decrease in standard policy rates by 1 percentage point.

Three broad lessons can be drawn from the analysis in this study:

• First, for a given amount of assets purchased, macroeconomic benefits are larger, the higher the duration of the targeted assets.

• Second, explicit forward guidance as to the likely future date of ‘lift-off’ would be useful when implementing QE-type programmes to prevent unwarranted beliefs of an earlier lift-off of the nominal interest rate from its effective lower bound.
Third, communication is desirable as to the future evolution of asset purchases, including the conditions for their prolongation and the plans concerning the asset portfolio at the end of the purchasing period. From this perspective, the December 2015 Governing Council decision ‘to reinvest the principal payments on the securities purchased under the APP as they mature’ provided useful information.

The study concludes with a discussion of possible adverse effects of the APP on financial stability and the risk of capital losses for the ECB. The results suggest that financial stability risks due to the compression in spreads – which may reduce profits of financial institutions – were probably more than compensated by the capital relief channel.

Nevertheless, financial stability risks need to be carefully and continuously monitored. Risks of capital losses for the ECB should be prudently managed, but are less likely to materialise, the more the APP is successful in strengthening the economic recovery and ensuring a faster return towards inflation levels consistent with the ECB’s definition of price stability.

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