



Back to the old normal?

Monetary policy implementation in a landscape of rising interest rates
and a shrinking Eurosystem balance sheet

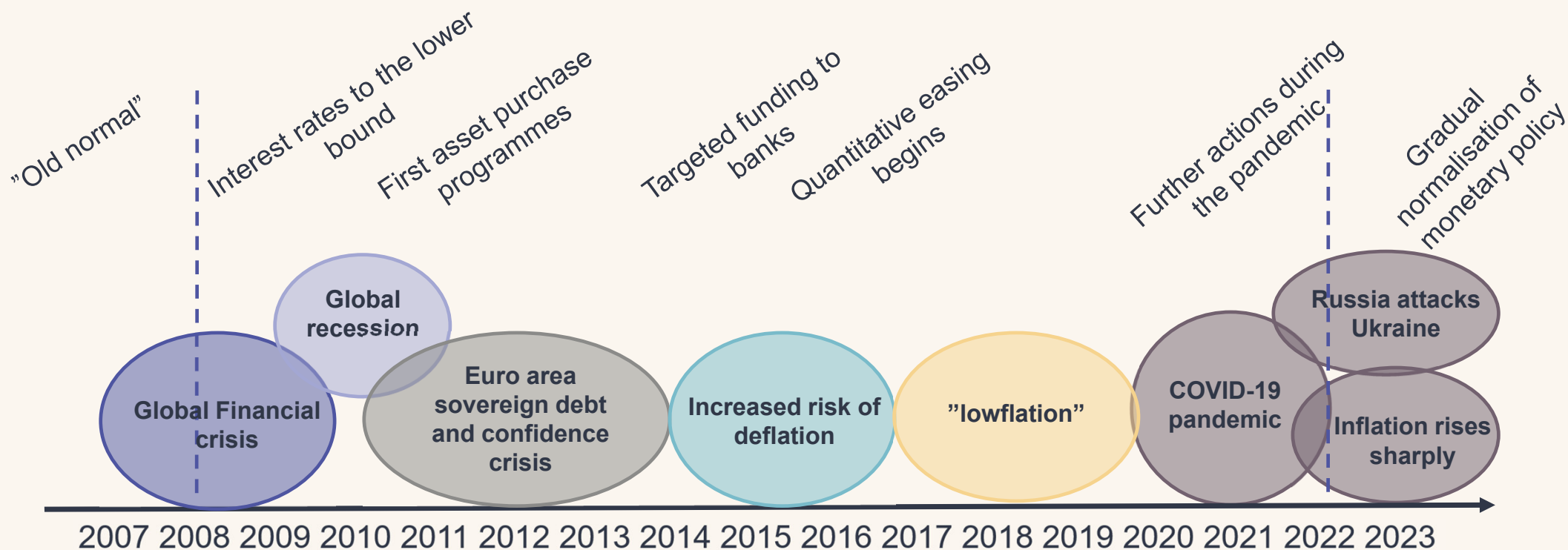
Bank of Finland Bulletin press conference 29 August 2023

Board Member Tuomas Välimäki
Bank of Finland

Key messages

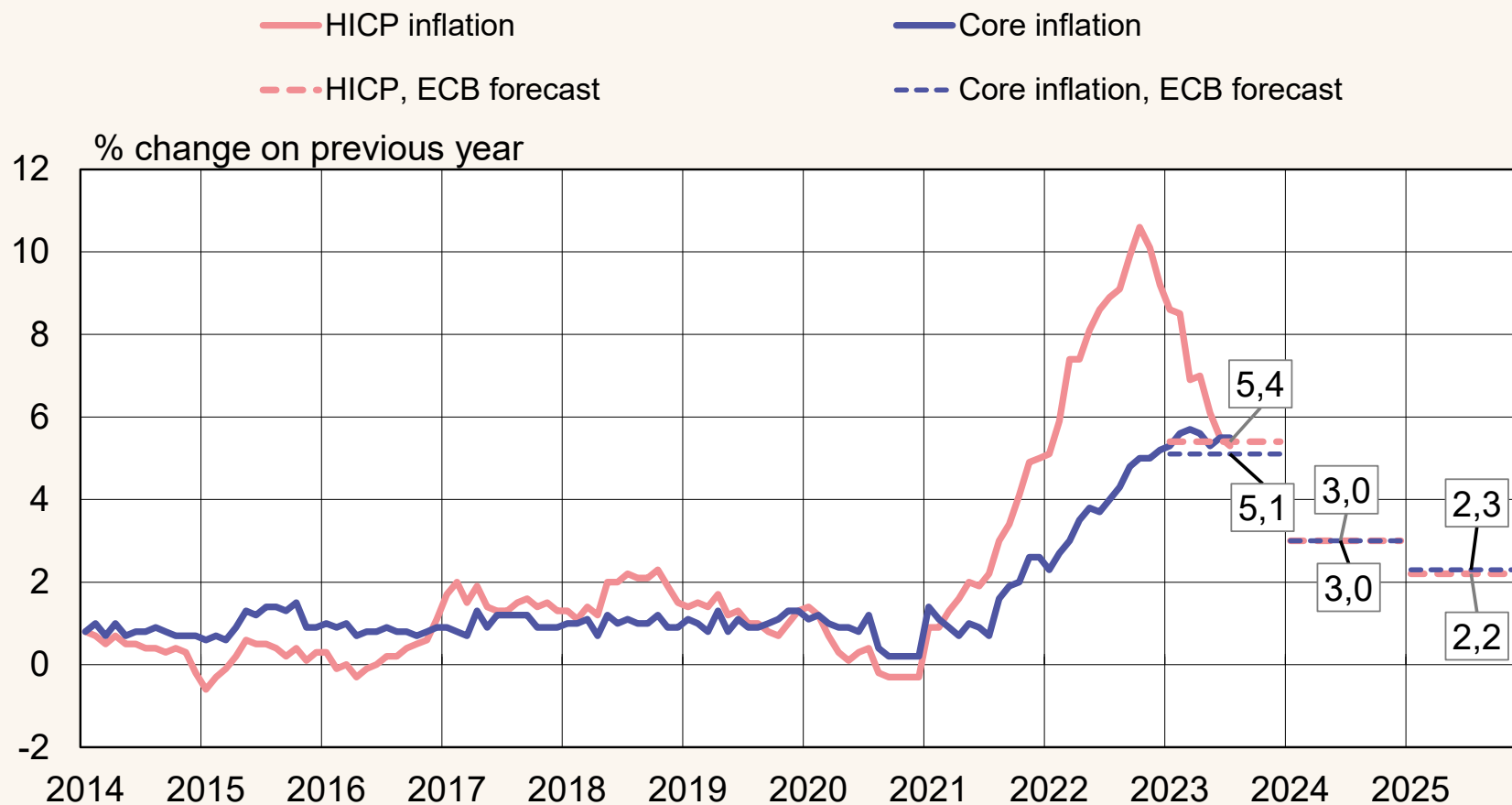
- Interest rates have returned to the focus of monetary policy
 - ECB's deposit facility rate the most important tool to steer rates.
- Eurosystem's balance sheet contracting gradually and predictably
 - ECB however stands ready to react to harmful market tensions.
- Now is the right time to weigh options for future monetary policy implementation
 - How to take into account factors related to financial stability and climate change without eroding the ability to steer interest rates?

Monetary policy environment coloured by crises



Source: Bank of Finland.

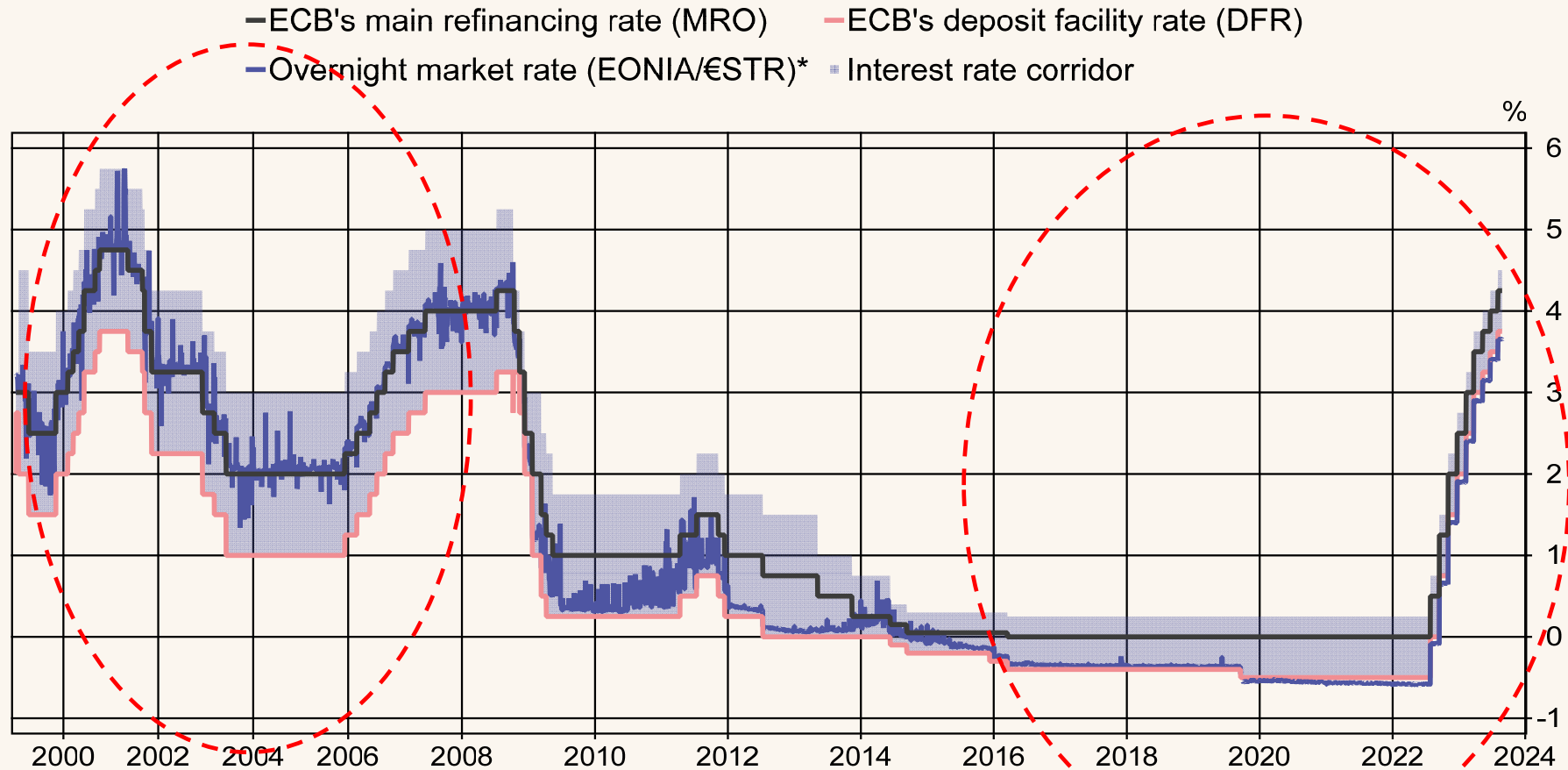
Inflation spiked above 10 %, receding slowly



Sources: Eurostat and ECB.

32426@YKHIkontrib(2)en

Deposit facility rate has become the main instrument for monetary policy

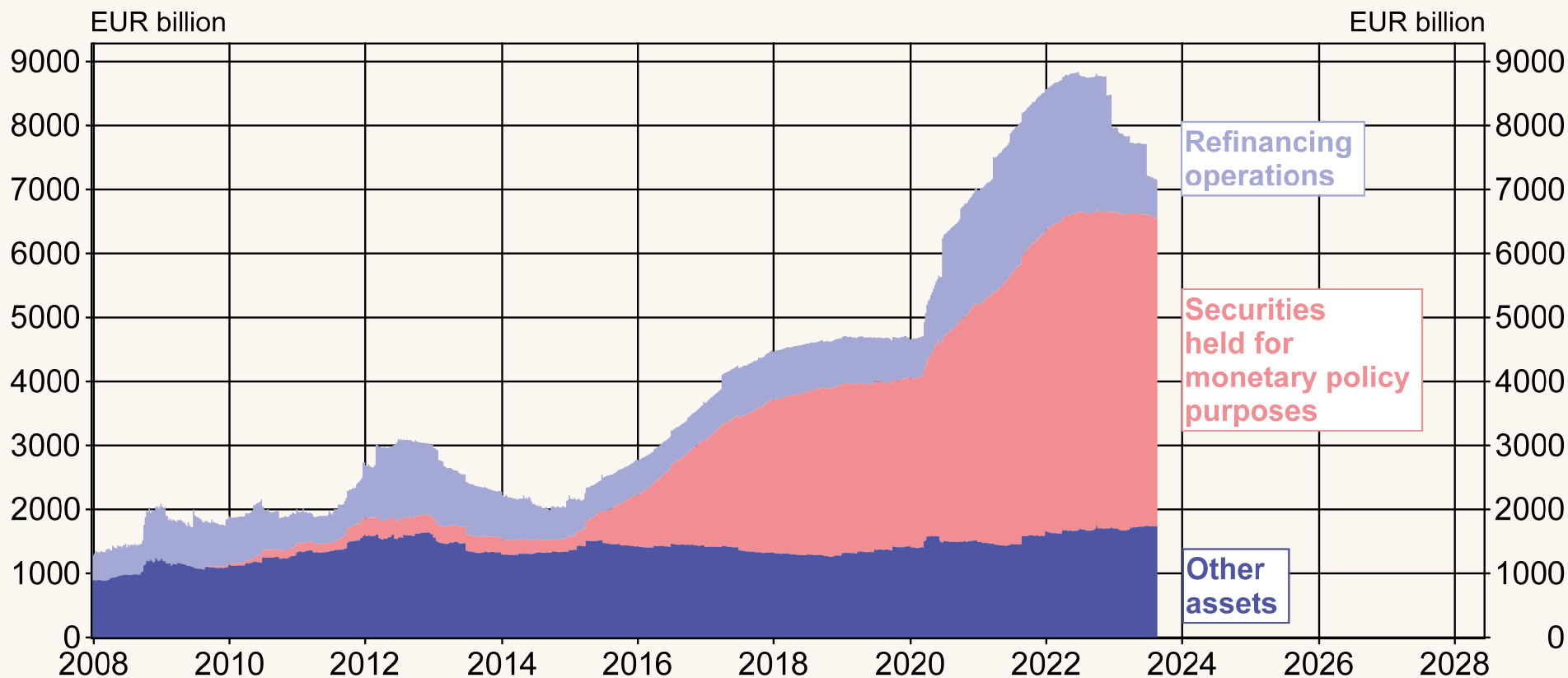


Sources: Macrobond, ECB, Bloomberg.

*€STR replaced EONIA as the main overnight benchmark rate for the euro area in October 2019.

ECB balance sheet expanded at the effective lower bound and as a response to crises

Eurosystem assets

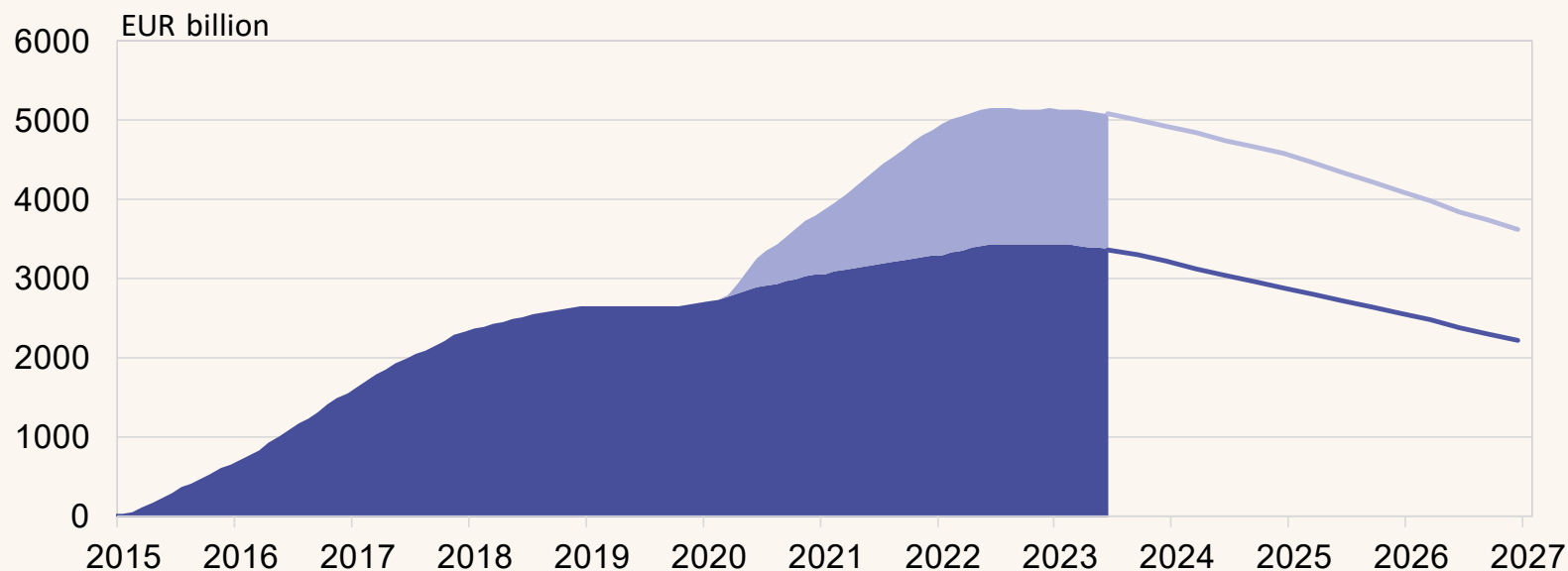


Sources: ECB, Macrobond

Eurosystem securities holdings are gradually decreasing

Eurosystem purchase programme holdings

■ APP ■ PEPP — APP expectations* — PEPP expectations*



*Expectations are median expectations from the Survey of Monetary Analysts.

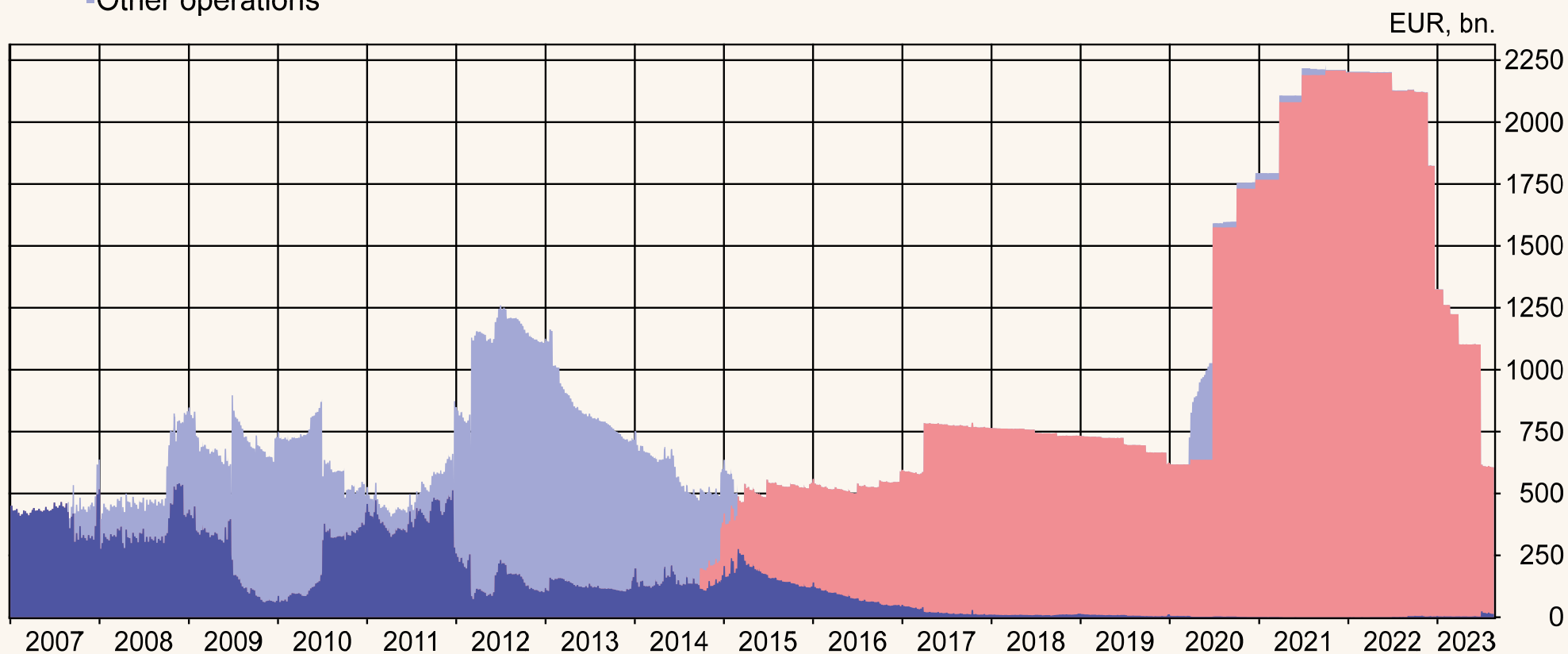
APP and PEPP do not include SMP, CBPP1 or CBPP2 programmes

Source: ECB

29.8.2023/ © Bank of Finland

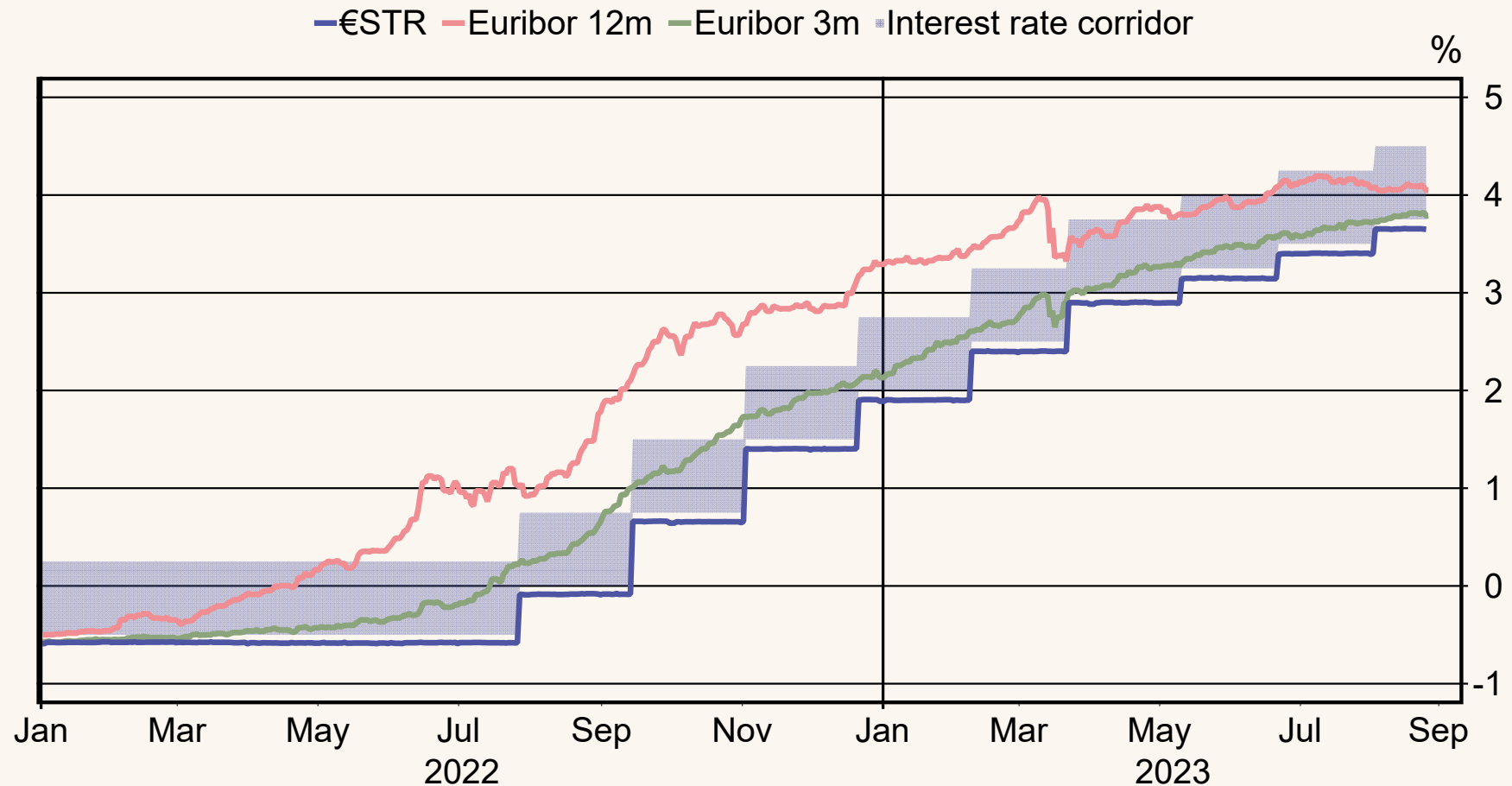
Central bank credit operations have returned to pre-pandemic levels

- Regular open market operations (MRO + LTRO)
- Targeted longer-term refinancing operations (TLTRO)
- Other operations



Source: Macrobond, ECB, Bank of Finland.

Rate hikes have been transmitted well to money market rates

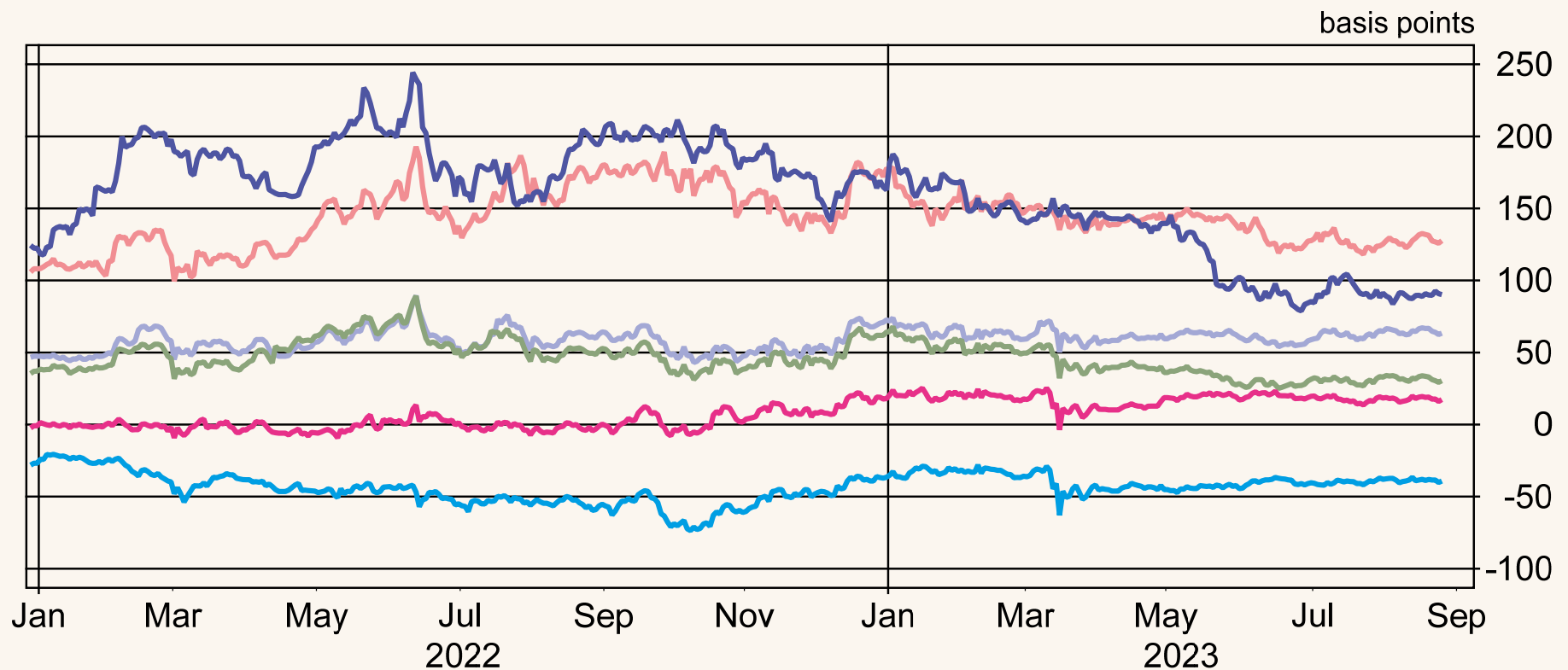


Sources: Macrobond, Bloomberg.

The tightening of monetary policy has been transmitted smoothly across the entire euro area

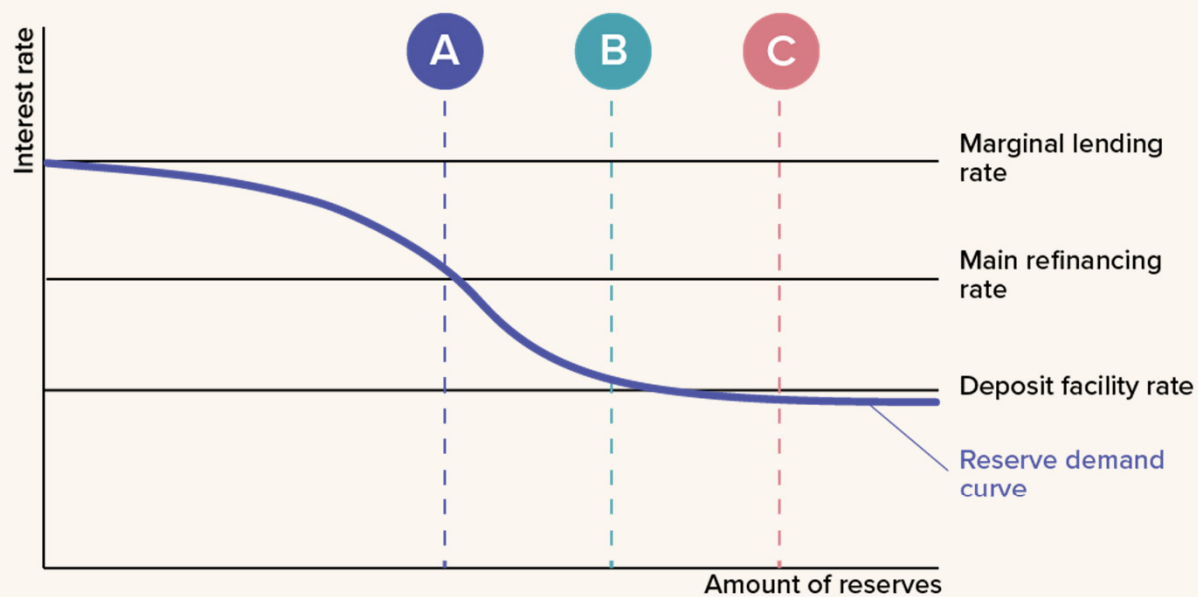
10-year OIS spreads of selected euro area government bonds

—Finland —Germany —Greece —Portugal —Spain —Italy



Sources: Macrobond, Bloomberg.

Monetary policy implementation in the future



A

By holding the supply of reserves scarce, market interest rates can be steered to the middle of the interest rate corridor.

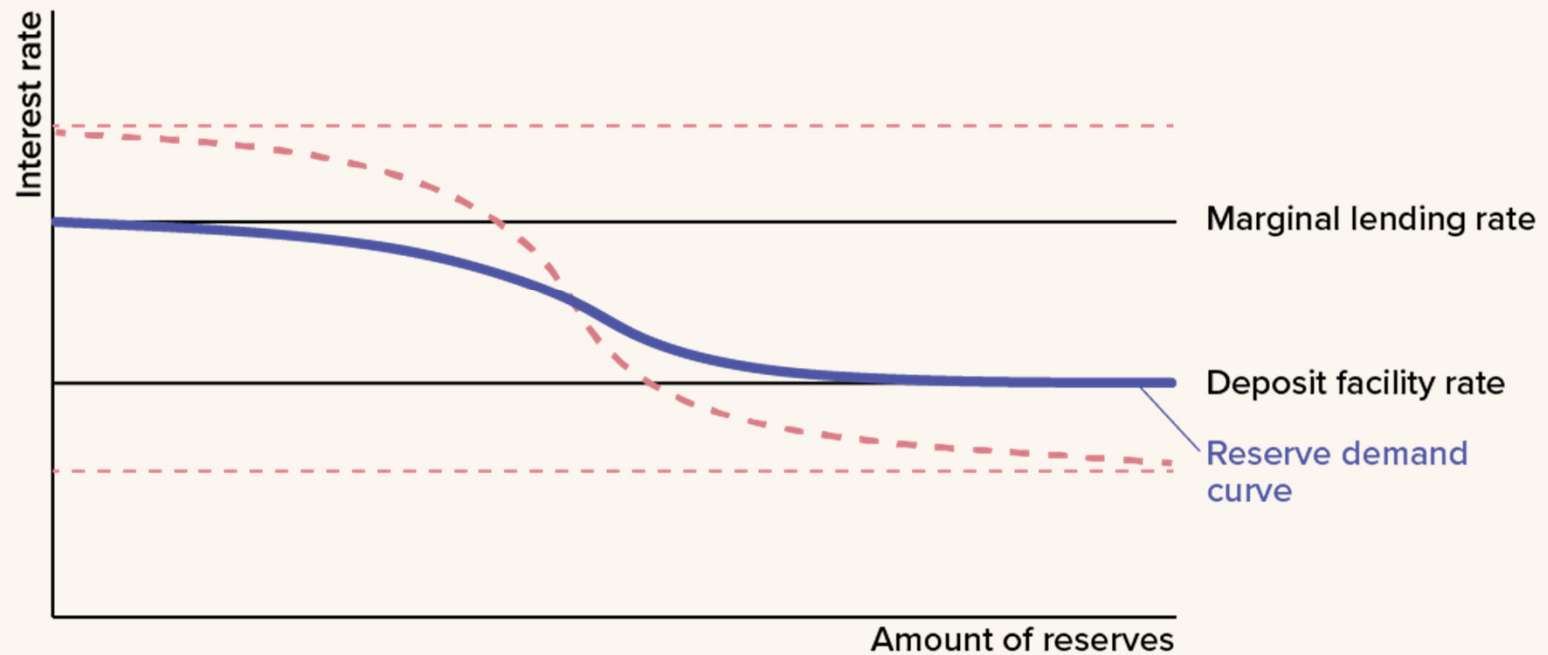
B

By offering ample reserves, market interest rates start to drop to the bottom of the interest rate corridor.

C

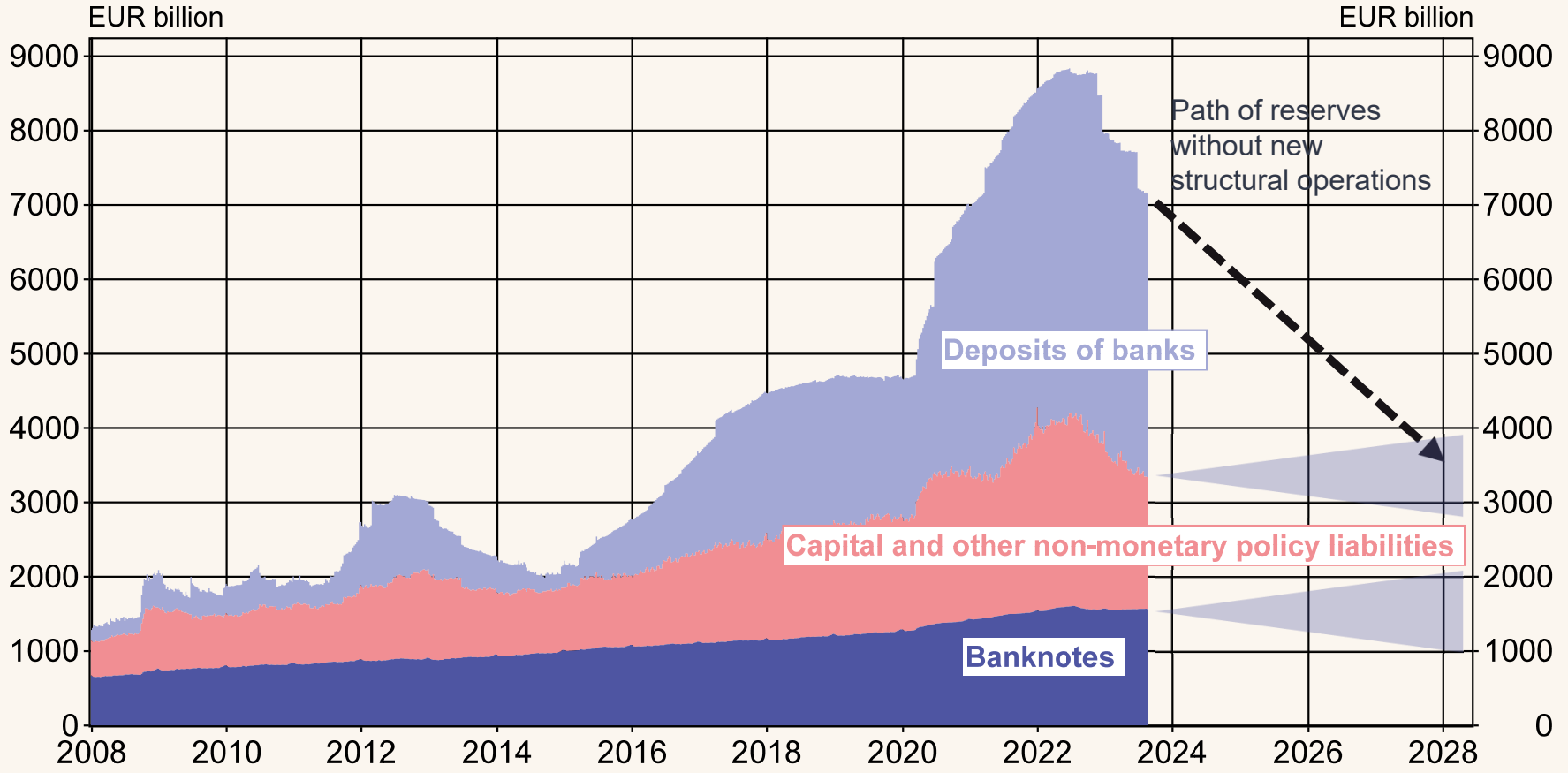
With abundant reserves market interest rates are at the bottom of the interest rate corridor or even below it.

Narrow interest rate corridor limits volatility in money market rates



Increase in liabilities may create a need for structural operations

Eurosystem liabilities



Sources: ECB, Macrobond.

Conclusions



The ECB's key interest rates are again prominent in monetary policy. The most important of these is the deposit facility rate.



The Eurosystem's balance sheet is shrinking gradually and predictably.



The time is right to review how the ECB controls interest rates and how it will take climate change into account.



Thank you!

e-mail: tuomas.valimaki@bof.fi

Twitter: [@TuomasValimaki](https://twitter.com/TuomasValimaki)

bof.fi