



The ECB's Monetary Policy Implementation and the Future Operational Framework

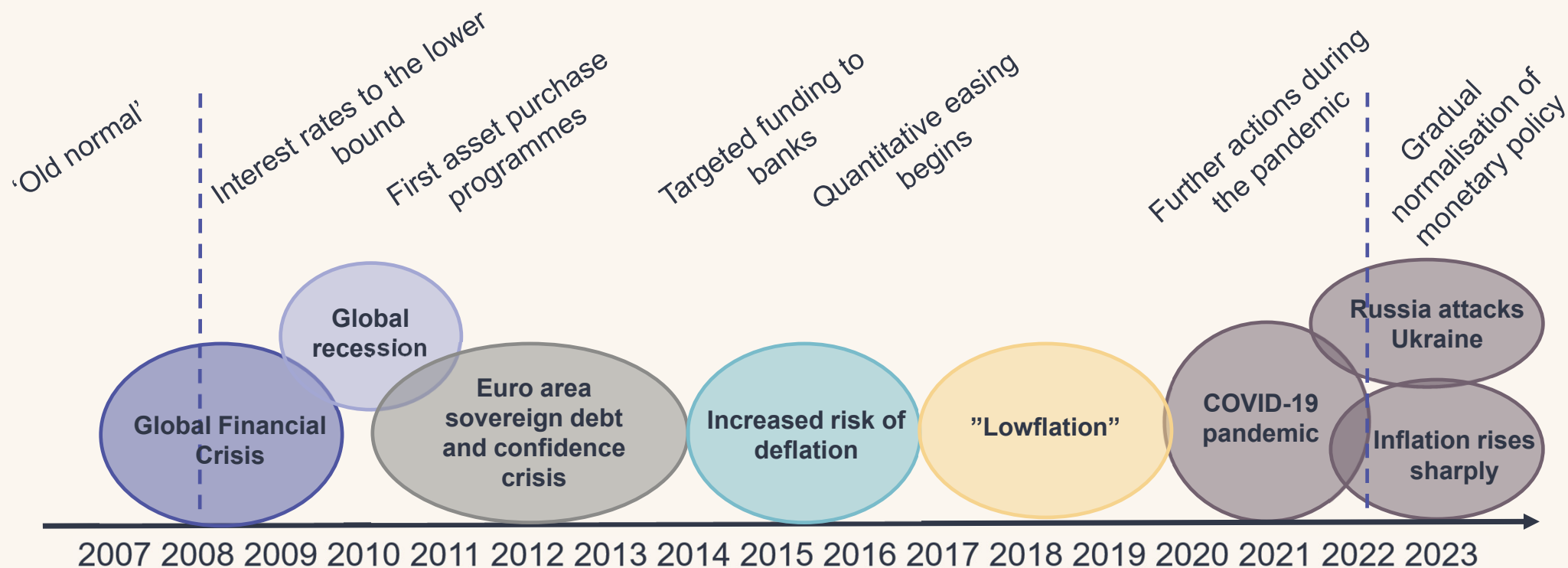
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Topics for today

- Eurosystem balance sheet has grown in recent years but is now contracting – time to assess how to steer rates in the future
- Why should markets care about the operational framework of the Eurosystem?
- Thoughts on issues that should be considered when designing a new operational framework for the Eurosystem

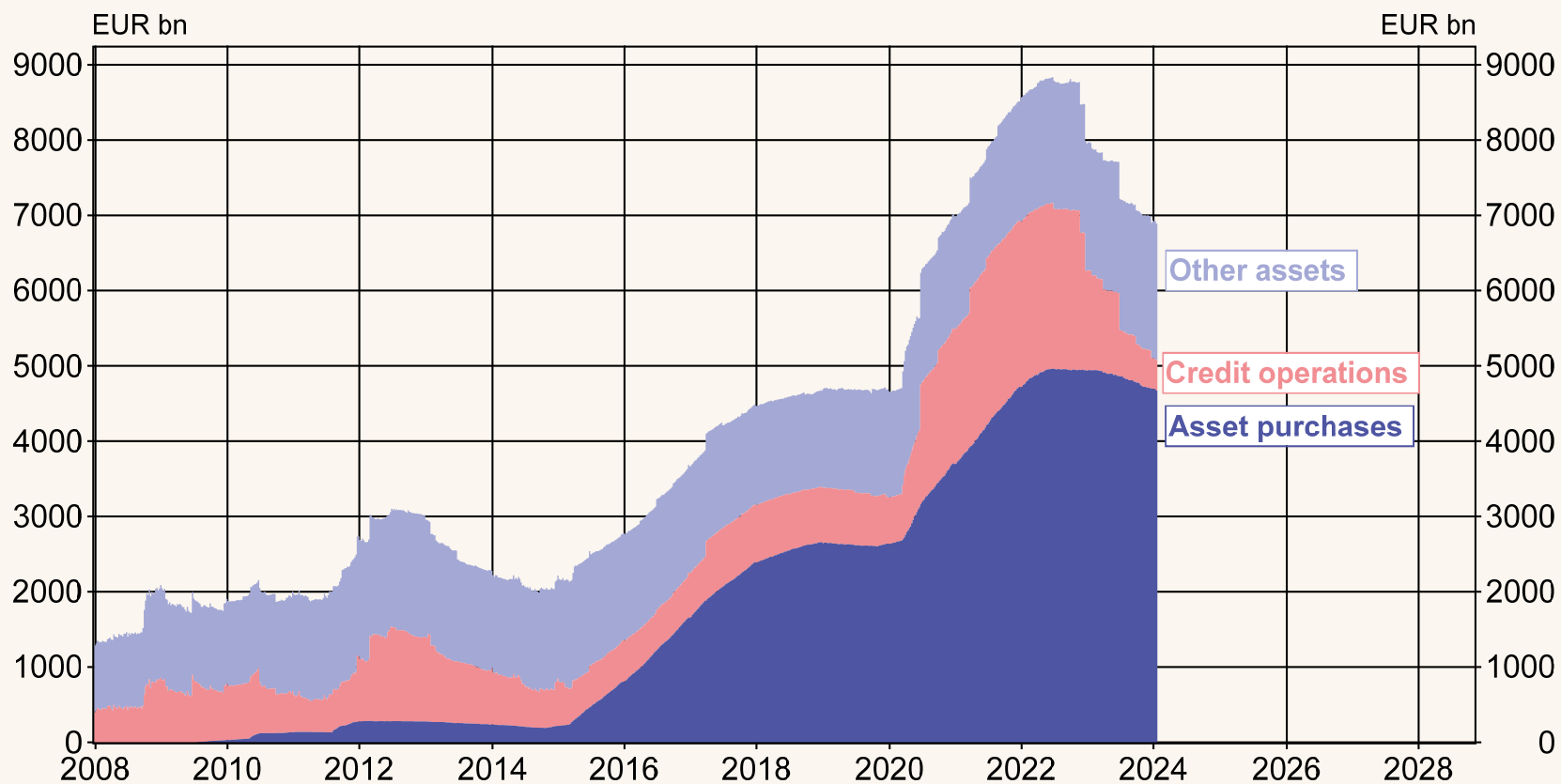
Economic and financial crises impact monetary policy implementation



Source: Bank of Finland.

Eurosystem balance sheet has grown significantly

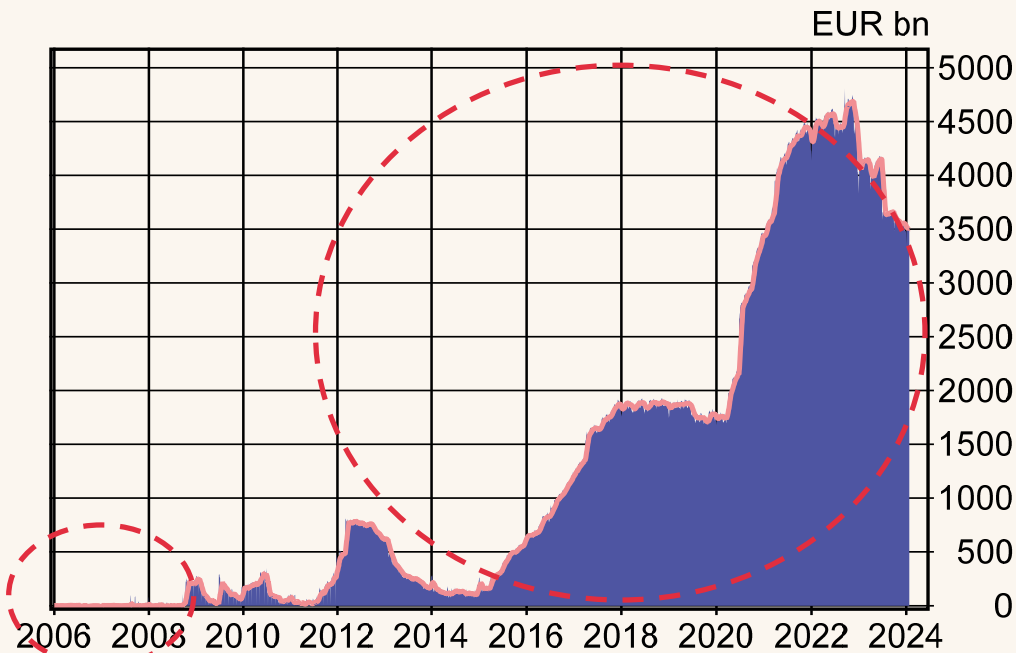
Eurosystem assets



Sources: ECB and Macrobond.

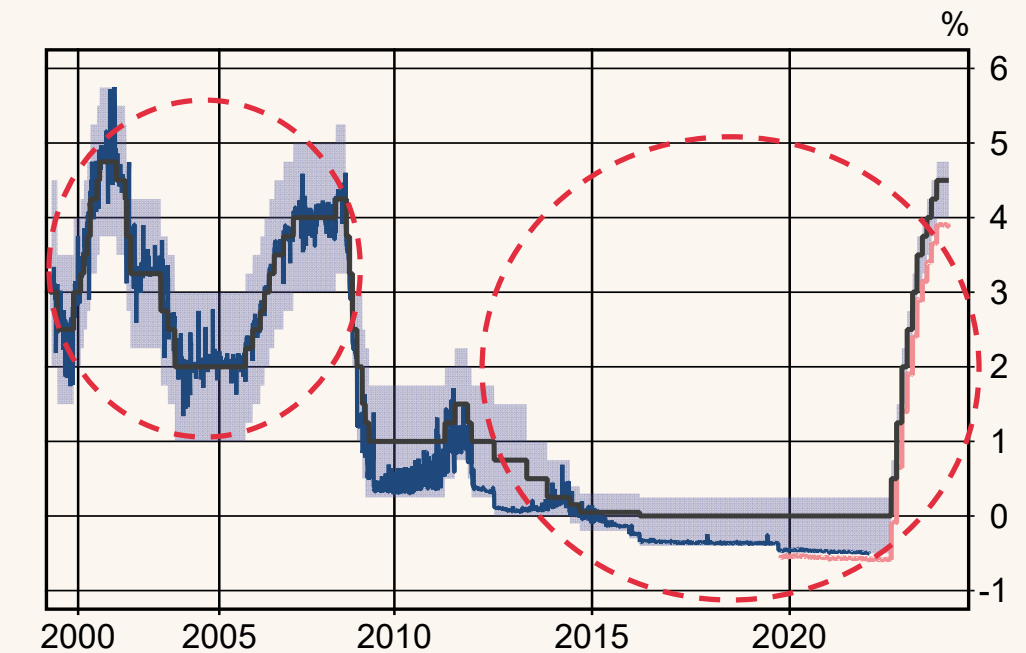
Banking sector shifted from scarce to abundant reserves, turning the deposit facility rate into the policy rate

— 1m MA ■ Excess liquidity



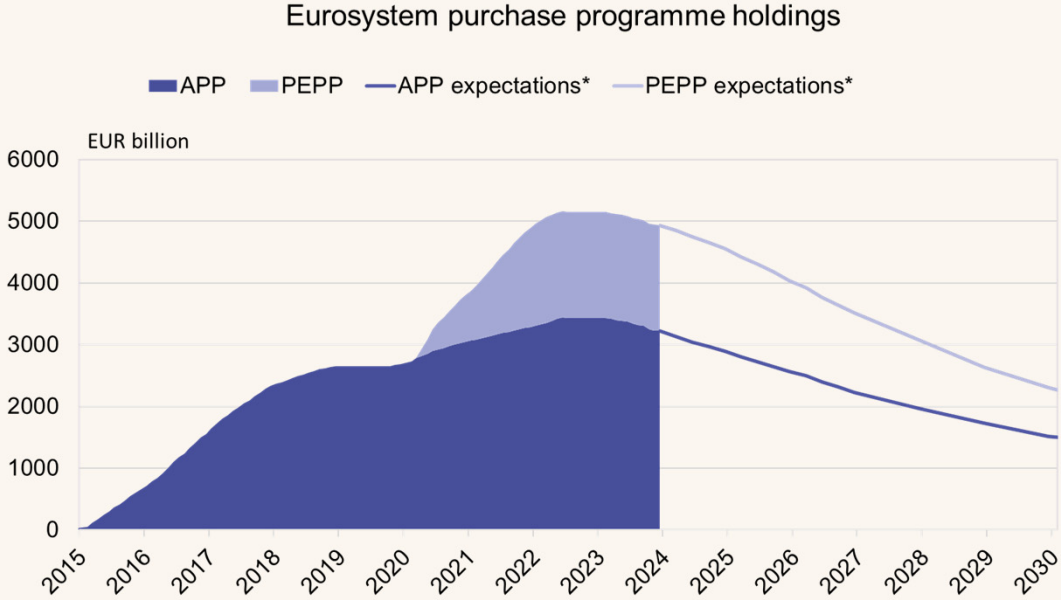
Sources: ECB/Bloomberg.

— ECB MRO rate — €STR — EONIA ■ Interest rate corridor



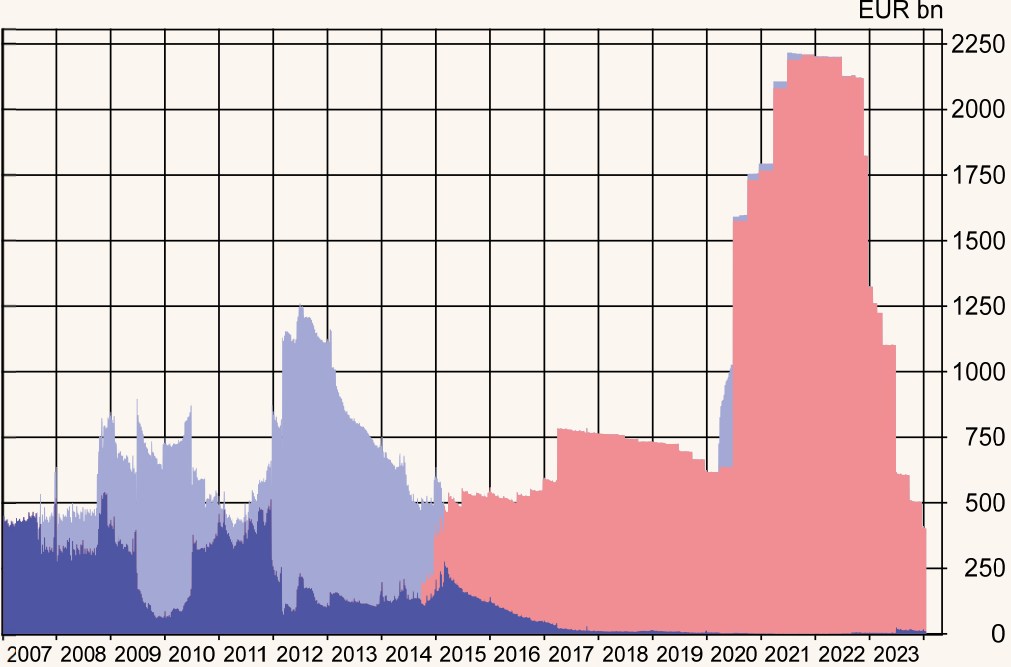
Sources: ECB and Macrobond.

Asset holdings and credit operations on a downward path



*Expectations are median expectations from the Survey of Monetary Analysts (December 2023).
 APP and PEPP do not include SMP, CBPP1 or CBPP2 programmes
 Source: ECB

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



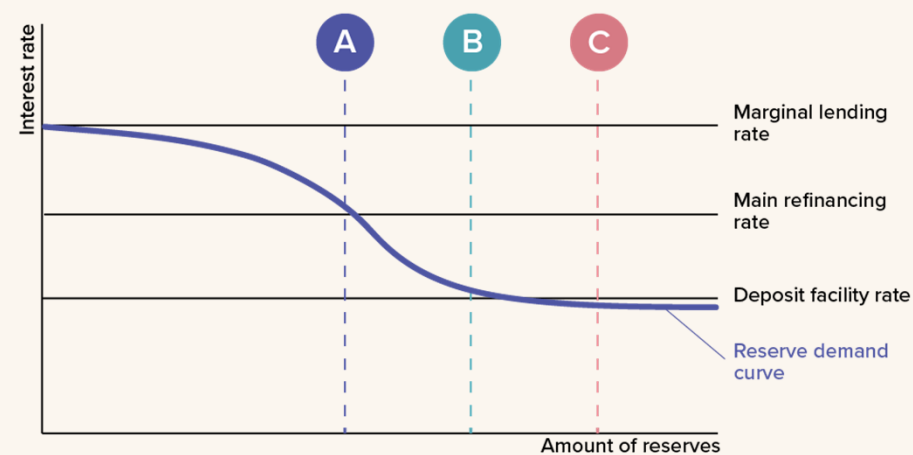
Source: Macrobond, ECB, Bank of Finland.

Time to reconsider future control of interest rates

- Although reserves will remain abundant for the next few years, we must be ready when this is no longer the case
 - The ECB Governing Council is currently reviewing the operational framework, with an aim to concluding the review by spring 2024
- Markets need guidance on the new framework, as Eurosystem balance sheet size and composition affect several market segments
 - **Bond markets:** Eurosystem footprint in different segments
 - Implications for **ESG** assets: climate criteria
 - **Money markets:** collateral framework, rate steering mechanism

Alternatives for controlling market rates

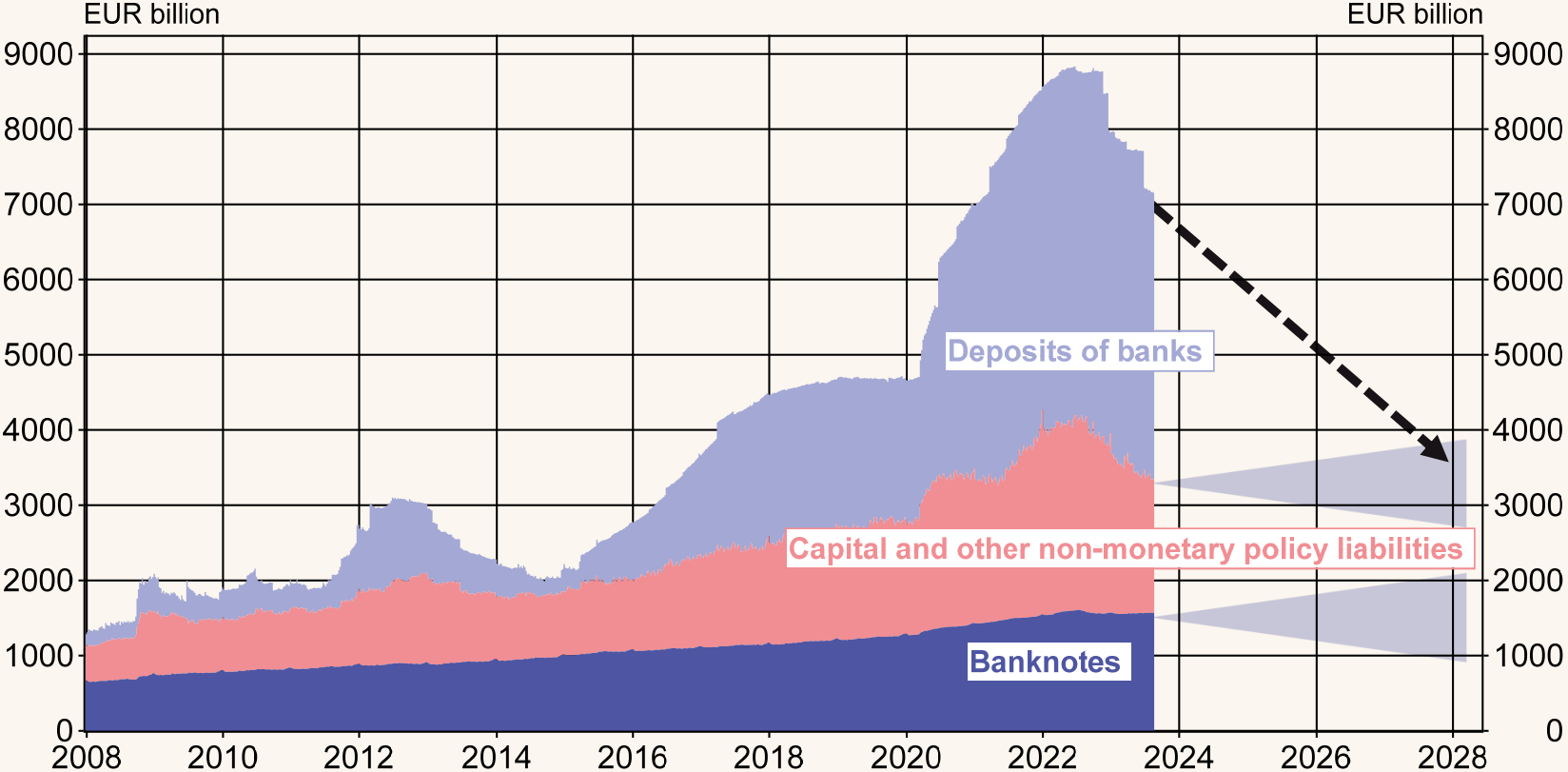
- Central banks have chosen different alternatives to control rates
 - **Fed**: a supply-driven floor system
 - **BoE**: a demand-driven floor system
 - **Riksbank**: a (narrow) corridor system
- The operational framework must be
 - Efficient in controlling rates
 - Robust to uncertain and volatile reserve demand
 - Robust to changes in the economic environment
 - Acknowledge special characteristics of the euro area
- **Main trade-off**: rate control vs. market footprint



- 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.

Eurosystem balance sheet to stay larger than pre-GFC

Eurosystem liabilities



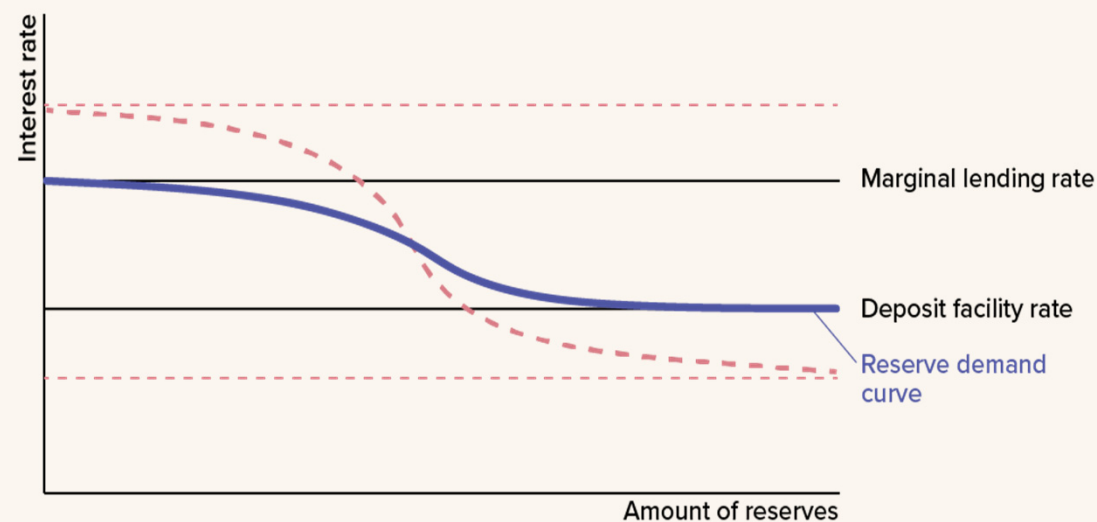
Sources: ECB, Macrobond.

Large structural liquidity deficit calls for a mix of instruments

- **A mix of structural instruments would**
 - Fulfil the large liquidity deficit; balance the trade-off between rate control and market footprint
 - Allow flexible response to market disruptions
- 1. Longer-term structural refinancing operations would**
 - Distribute liquidity efficiently to all banks
 - Provide information on banks' reserve demand
 - Facilitate liquidity transformation without distorting market prices (broad collateral & variable rate auctions)
- 2. A structural bond portfolio would**
 - Enable support for secondary objectives, such as the green transition

Controlling rates with short-term operations in a corridor system

- The rate steering credit operation should be **separate** from structural longer-term operations
 - **Fixed-rate full allotment** adjust supply to changes in demand and support financial stability
 - Optimal **width of the corridor** is an open question – maximal rate control if lending rate = deposit rate
 - To prevent excessive liquidity transformation and central bank footprint, the operation should be against a **narrower collateral set**
 - Key: **no stigma** in credit operation – banks should be encouraged to use CB facilities



On the Bank of England framework

- As QT proceeds, the BoE has introduced the **Short Term Repo (STR) with FRFA** to provide reserves to banks
- **To limit money market volatility**, the BoE has a corridor with zero-width: both borrowing and lending take place at the bank rate
- **To limit stigma** and precautionary reserve demand, the BoE encourages banks to use their liquidity facilities

Issues for discussion

- Your thoughts on the future operational framework of the ECB?
- What factors influence banks' demand for reserves going forward?
- Is it possible to return to a regime with scarce reserves?
- Will unsecured interbank markets ever come back? Can repo markets be a complete substitute for it?
- Thoughts on central banks' market footprint?



Thank you!

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