Unconventional Monetary Policy and CESEE

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Unconventional Monetary Policy can be used when interest rates are very low

UMP includes wide array of policies

- Restoring the **financial intermediation**:
  - Liquidity provisions
  - Outright purchases of private and public assets

- **Monetary accommodation** at zero lower bound:
  - Purchases of government bonds
  - Forward guidance

International Monetary Fund, 2013, “Unconventional Monetary Policies—Recent Experience and Prospects.”
In the US, UMP mainly comprised of buying T-bonds and MBS
Bank of Japan has been buying mostly government securities
In the euro area: (Targeted) Long-Term Refinancing Operations were followed by Asset Purchase Program.
UMP in Europe came in two stages

- LTRO - after euro area crisis intensified
- APP - when inflation remained stubbornly low
What spillovers could be expected to other countries?

Positive spillovers:
- Lower global interest rates
- Reductions in risk premia
- Stronger growth in advanced countries

Negative spillovers:
- Capital inflows to emerging countries
- Appreciation of exchange rates
- Excessive risk seeking
- Too low interest rates
Long-term interest rates in advanced countries have come down

Announcements of:
- LTRO
- Fed QE1
- Mario Draghi’s “whatever it takes”
- 3-year LTRO
- Fed Tapering
- ECB APP

Bond Yields, 10 year (Percent)
Risk premia fell, including in Italy and Spain

LTRO and Bond Yields

Italy

Spain

Source: Bruegel database of Eurosystem lending operations
Since APP has started, growth in euro area has accelerated. Inflation has come in below expectations, the result of a sharp drop in oil prices.
As regards capital inflows to CESEE, portfolio inflows were strong between 2009 and 13, albeit offset by bank outflows.

*Excluding Russia and Turkey.
In recent years, there have been no portfolio inflows to speak of, with exception of Czech Republic.
CNB massively intervened to prevent koruna appreciation
So far, there is little evidence of UMP spillovers on real economy of non-EA countries

- Cross-Country Report on Spillovers found:
  - Strong correlation of bond yields,
  - Real appreciation,
  - Some capital inflows, as the adoption of APP approached

- Evidence of real sector spillovers appeared weak across applied methodologies

UMP resulted in ample liquidity of the banking sector

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**EA (EUR trillion)**

- Central bank assets
- Bank reserves with central bank, rhs

**Japan (JPY trillion)**

**USA (USD trillion)**

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On *consolidated* basis, expansion of MFIs assets was mainly due to government bond purchases, although lending has picked up in recent years.
So far, impact of UMP on CESEE seems to have been modest. But could loose monetary policy in advanced countries become a problem going forward?

Overnight Interest Rate Swap vs Reference Rates at various maturity
(Percent, 19 September 2017)
Labor markets in CESEE are tightening rapidly

Cumulative changes in unemployment rate
(2008Q1=0, seasonally adjusted)
While inflation remains moderate, wage growth has picked up.
Will unemployment continue to surprise on the downside?

Unemployment rate forecasts by WEO vintage (percent)

Poland

Hungary

Spring 2014
Fall 2014
Spring 2015
Fall 2015
Spring 2016
Fall 2016
Spring 2017
Fall 2017
This might particularly be a problem for countries with fixed exchange rate or euro

- Countries with floating exchange rate can tighten monetary conditions - a combination of higher interest rates and nominal exchange rate appreciation
- Countries with fixed exchange rate do not have this option
- As inflation accelerates real interest rates will drop
In floaters, nominal exchange rate appreciation can help keep real interest rate steady.
As a result, volatility of GDP and inflation is lower.

Average real GDP growth (Percent)

Average CPI inflation (Percent)

High exchange rate flexibility

Low exchange rate flexibility
Fiscal policy may also need to play a role to prevent overheating.
Thank you