AT A GLANCE

Monetary Dialogue July 2018

ECB non-standard monetary measures, collateral constraints and potential risks for monetary policy

Background

MONETARY DIALOGUE

July 2018

The publications are prepared by Policy Department A of the European Parliament and are available in the relevant section (**Monetary Dialogue**) of the ECON Committee website.

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The great financial crisis and the subsequent adoption by the ECB of non-standard monetary policy measures led to a significant widening of the balance sheet of the Eurosystem (ECB and the national central banks of the euro area), reflecting the growing amount of assets accepted as collateral for refinancing the economy. These developments have sparked a debate on the implications and associated risks for monetary policy, including a potential shortage of collateral constraining the ability of the ECB to continue its Asset Purchase Programme for a prolonged period; delays in the adjustment path towards sustainable public finances in some Member States; an increased sensitivity of commercial banks' balance sheets to ECB's collateral policy through the valuation of the underlying assets. What are the risks associated to the current collateral policy of the ECB? Is there evidence that the broad range of eligible assets used as collateral has been accompanied by a deterioration of the credit risk in segments of the financial market?

For the July 2018 session of the Monetary Dialogue, the Committee on Economic and Monetary Affairs (ECON) of the European Parliament has asked monetary experts to analyse the risks and collateral constrains related to the ECB non-standard monetary measures. References to the relevant in-depth analyses are provided below.

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In-depth analyses of the July 2018 Monetary Dialogue

The effects and risks of ECB collateral framework changes by Christophe Blot, Jérôme Creel, Paul Hubert (Observatoire Français des Conjonctures Économiques)

During the crisis, the ECB modified its collateral framework to face increased liquidity needs of banks. This has taken two forms: the minimum required rating for different classes of assets has been reduced and the haircut associated to these assets has evolved conditional on the default risks of these assets. The benefits in terms of cushioning a liquidity crisis and enhancing monetary policy transmission have most probably exceeded the costs in terms of riskier central bank balance sheet and potential capital losses.

ECB non-standard monetary measures, collateral constraints and potential risks for monetary policy by Andrew Hughes Hallett (Copenhagen Business School, Frederiksberg, Denmark), Paul Fisher (Kings College London)

This paper takes a wide view of non-standard measures in difficult situations. It explores how, and to what extent, prudential metrics written into the new prudential and surveillance regulations can be used as policy instruments. The paper does not try to reach a judgment on which measures will work best. Instead it discusses how these policies work; why they depend on high quality collateral/assets; what happens if policymakers are driven to expand the bounds of "sufficient quality or liquidity"; how new credit risks arise and for whom. Some of these risks are quite subtle, implicit or indirect. But they all reduce the effectiveness of the measures in question (a transmission problem). As a result, they require larger interventions to reach certain target values (a feasibility question, given the side effects).

The ECB collateral policy beyond conventional monetary stimulus by Corrado Macchiarelli, Mara Monti (London School of Economics)

The importance of collateral as an instrument for monetary policy has increased in recent years not only in the light of the changes in the ECB's framework during the crisis but also due to the progressive replacement of the unsecured money market segment with the secured one in the euro area. Both aspects are set to have consequences for collateral availability and the scarcity of high-quality assets, particularly as these interact with non-standard monetary policy. The author concludes that collateral is vital to the well-functioning of money markets and the availability of beyond conventional monetary policy remains an important tool to deal with the issue of shortages of high-quality collateral at least in the short-term.

ECB non-standard policies and collateral constraints by Daniel Gros (Centre for European Policy Studies)

Collateral constitutes an indispensable lubricant for the financial system. Government bonds constitute the most important source of collateral, for use in inter-bank and repo transactions. But, the vast bond buying program of the ECB in the context of the Public Sector Purchase Programme has not led to any collateral scarcity. Banks tend to use less liquid assets as collateral with the ECB, but this does not mean necessarily more risk for the ECB for which liquidity is not important.

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