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PRESS RELEASE

The ABC of quantitative easing
Or the basics of asset purchases by central banks
(Article for the June 2016 Economic Review)

On 22 January 2015, the European Central Bank (ECB) announced the launch of an “expanded asset purchase programme” whereby it intended to acquire securities from the euro area public and private sectors amounting to € 60 billion a month. On 10 March 2016 the monthly purchases were increased to € 80 billion and extended for the first time to include corporate bonds from the non-financial sector. This new policy, known as “quantitative easing” fundamentally altered the Eurosystem’s monetary policy by according a key role to its balance sheet.

“*What were the limits of “conventional” monetary policy that specifically motivated the central banks’ recourse to quantitative easing as a monetary policy instrument? What are the mechanisms whereby central bank asset purchases influence financing conditions in the economy? How is the exchange rate affected by purchases of securities? What are the implications of those purchases for the balance sheet of commercial banks or for public finances? “.* Those are the main questions that this article tries to answer, with a special focus on the euro area.

Recourse to asset purchases allows overcoming the limits of conventional monetary policy and contributes to safeguarding price stability

Large-scale purchases of long-term debt instruments by central banks form part of the “non-standard” monetary policy. Such a policy is particularly appropriate in a low inflation context, when the key interest rates are close to the floor and traditional monetary policy runs out of steam. However, its purpose is the same: to reduce real financing costs in order to stimulate economic activity and maintain price stability, the primary objective of monetary policy in the euro area.

Purchases of securities depress both financing costs and the exchange rate…

Central bank purchases of securities affect the various components of the real long-term interest rate either directly or in a more subtle way. By driving that rate down, they encourage consumption and investment, to the detriment of savings. They also tend to cause depreciation of the domestic currency and thus promote exports.

…and have an impact on the money supply and public finances.

Asset purchases inevitably give rise to an increase in the monetary base, essentially in the form of an expansion of the central bank reserves that the banking system holds. However, they do not necessarily trigger an equivalent increase in the money supply in the broad sense. For the time being, the central bank’s purchases of – mostly sovereign – securities have favourable implications for public finances, but that is not guaranteed in the longer term.

The “expanded asset purchase programme” adopted by the ECB contributed to further easing of monetary policy in the euro area.

In practice, the Eurosystem’s decision to launch an expanded asset purchase programme on 22 January 2015 brought a reduction in nominal interest rates on various segments of the financial markets. It also helped to stabilise inflation expectations in the euro area. Finally, the resulting decline in real yields was accompanied by a depreciation of the euro against the dollar. It appears thus that, apart from its theoretical effects, the Eurosystem’s asset purchase programme did indeed bring an additional easing of its monetary policy.

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