



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB Public

Ulrich Bindseil
DG Market Operations
ECB

(Views expressed in this presentation are not necessarily the ones of the ECB)

Short vs. Long-term investments - What will capital markets deliver?

An ECB Market Operations perspective

ECMI, 23 November 2017
Brussels

ECB - public

The maturity and liquidity transformation problem

- Euro area: EUR 58 trillion of real assets; EUR 33 billion are financed
- Financial assets = financial liabilities = EUR 128 trillion

Q2, 2017		In trillion of EUR				
		HH	NFCs	Publ sect	Fin Corp	Total
Assets		55	40	13	77	186
<i>Financial assets</i>		23	23	5	77	128
<i>Real assets</i>		32	17	8	1	58
Financial Liabilities		7	33	13	75	128
Net worth		48	8	1	2	58
(Net financial position ROW: 0.4 billion liability)						

The maturity and liquidity transformation problem

Real assets in economic projects are illiquid and depreciate over many years: The real sectors, in particular NFCs (also governments; households as mortgage borrowers) want to run only a limited duration mismatch and take only limited liquidity risks.

Household want to hold (besides their pension savings) assets which are liquid and have little (ideally no) market and liquidity risks.

The financial system aims at delivering required transformation:

- **Pension/insurance:** offer products with high long-term expected return, low risk
- **Banks** deliver maturity and liquidity transformation
- **Capital markets** aim at (long term) transparent and liquid funding instruments

Delivering financial transformation is risky => Regulation wants to reduce systemic risks, while not unduly preventing maturity/liquidity transformation at benefit of society.

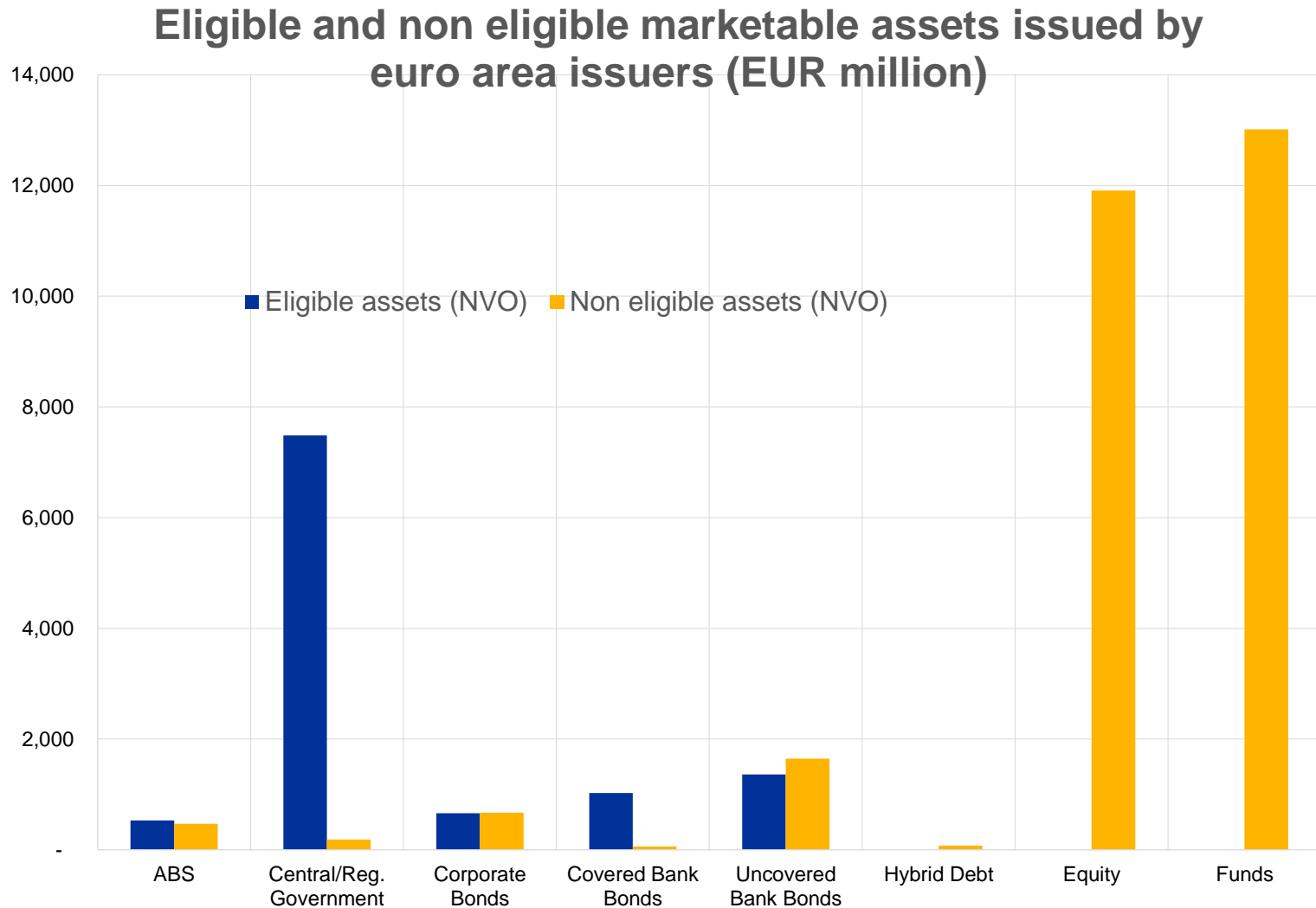
- **Importance of efficient capital markets to:**
 - Realise growth potential of the euro area economy;
 - Contribute to financial sustainability
 - Foster diversity of founding opportunities for corporates;
 - Provide attractive financial investments
 - Support transmission of monetary policy

ECB market operations perspective

- Asset and funding liquidity are essential in determining the ability of the financial system to intermediate and to provide liquidity and maturity transformation
- CB collateral framework and way banks can access central bank credit is important to asset and funding liquidity;
- Asset purchase programme, if in place, will impact on asset price behaviour and liquidity. By exchanging long duration, imperfectly liquid and somewhat credit risky assets against risk free and perfectly liquid ones, it cheapens funding of real economy and stimulates (long term) investment
- If implemented unfavourably, central bank operations could however also distort markets, create volatility, impair liquidity

- **Eurosystem collateral framework** allows banks to convert eligible securities into central bank money and has played a key role
 - protecting Eurosystem from losses
 - in implementation of monetary policy since 1999, and
 - in stabilising financial markets and institutions during financial crisis
- How the Eurosystem collateral framework has been designed with the aim also to support the efficient functioning of financial markets is explained in:
- <http://www.ecb.europa.eu/pub/pdf/scpops/ecb.op189.en.pdf>
- A model how central bank credit operations and the collateral framework impact on ability of the banking system to undertake maturity transformation, and what role asset liquidity plays, is explained further in:
- https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049792

Eligible and non-eligible capital market instruments



Source: ECB;
Universe of eligible marketable assets as of 31 October 2017
Hybrid debt includes convertible bonds, contingent convertible bonds and bonds with warrants attached.

- **APP (“QE”) a non-conventional monetary policy tool activated to achieve price stability mandate in a context of:**
 - Short term interest rates (the standard monetary policy tool) constrained by effective lower bound to interest rates;
 - Low natural interest rates (“low r^* ”) due to low potential growth and debt overhang issues from financial crisis that are only gradually repaired.
- **Without forceful easing measures (APP, TLTRO, NIRP), (expected) inflation was expected to decline further, implying risk ineffectiveness of monetary policy**
- **Eurosystem was successful in preventing this**
- **For more than three years: growth > potential growth => output gap closing; downward trend of inflation reversed; unemployment falling; debt overhang issues gradually addressed**

Experience of the private sector parts of the APP

	ABSPP	CBPP3	CSPP
Objectives / motivation	<ul style="list-style-type: none"> provide credit to real economy; help lenders diversify funding Contribute to revitalisation of a sustainable securitisation in euro area 	<ul style="list-style-type: none"> facilitate credit provision by banks to the real economy support financing conditions in the euro area 	<ul style="list-style-type: none"> strengthen pass-through of Eurosystem's APP to financing conditions of real economy; provide further monetary policy accommodation
Eligible Universe	Mon. pol. eligible ABS (subject to DD assessment)	Mon. pol. eligible CBs for own use & multi-cédulas	Non-financial and financial corporate securities (excluding unsecured bank bonds)
Minimum rating	CQS3	CQS3	CQS3
Maturity	All	All	6 months – 30 years
Issue Limit	70%*	70%*/**	33%/70%*/**
Issuer limit	No	Yes**	Yes*
Purchases	1 ^{ary} & 2 ^{ary} market	1 ^{ary} & 2 ^{ary} market	1 ^{ary} & 2 ^{ary} market (no 1 ^{ary} for public sector corporates)
Implementation	6 NCBs	NCBs and ECB	6 NCBs
Securities lending	Authorised	Yes	Yes

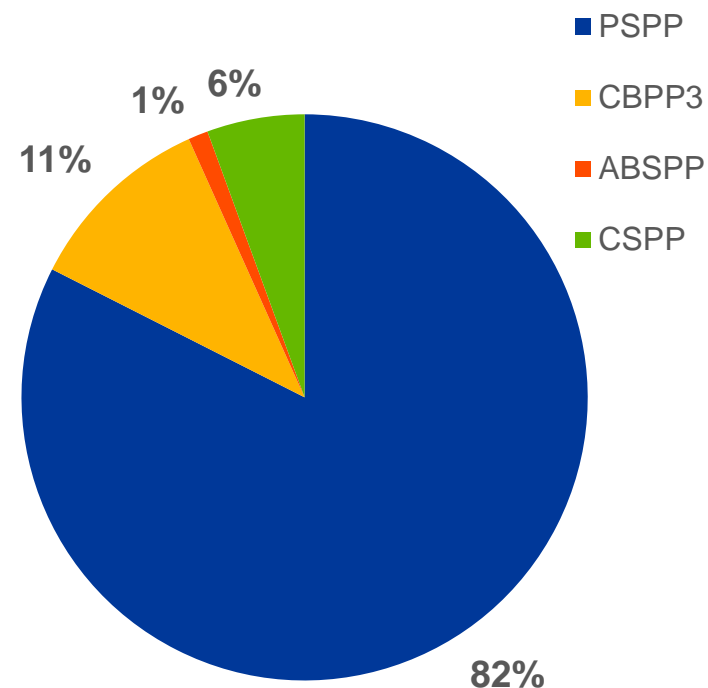
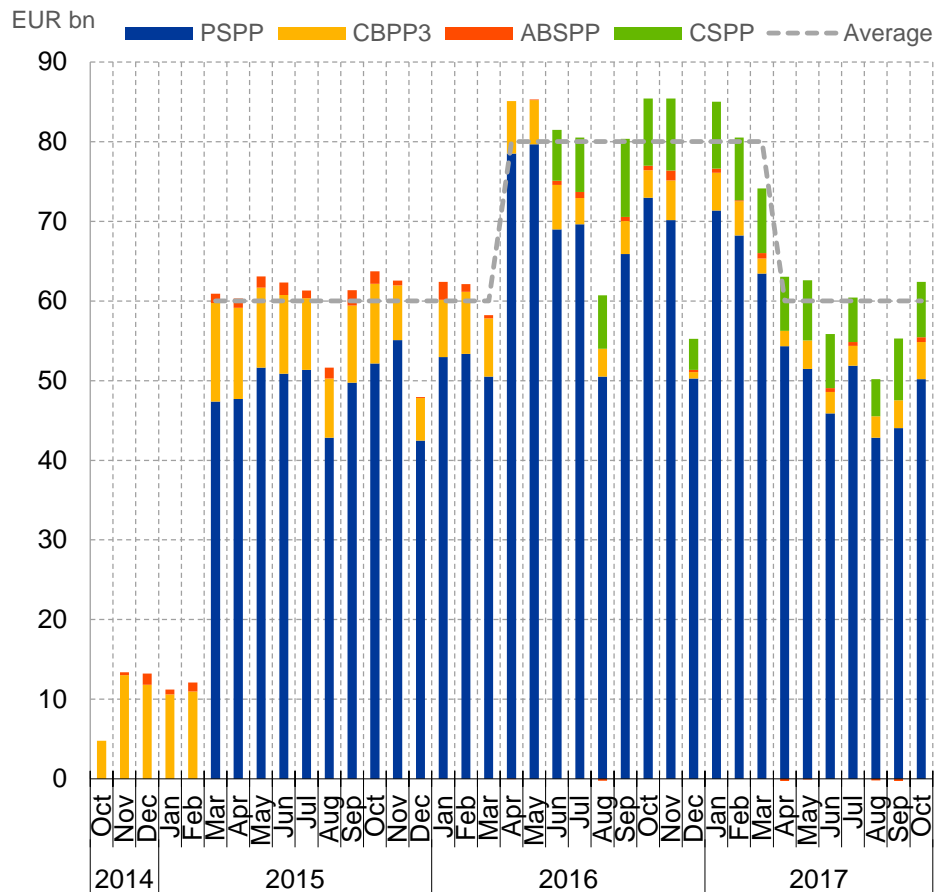
* Specific conditions for programme countries apply

** Combined Eurosystem holdings from monetary policy and investment portfolios

Development of APP purchases

APP monthly net purchases by programme

Breakdown of total holdings as of 31 October 2017



Total holdings: €2,180 trn*

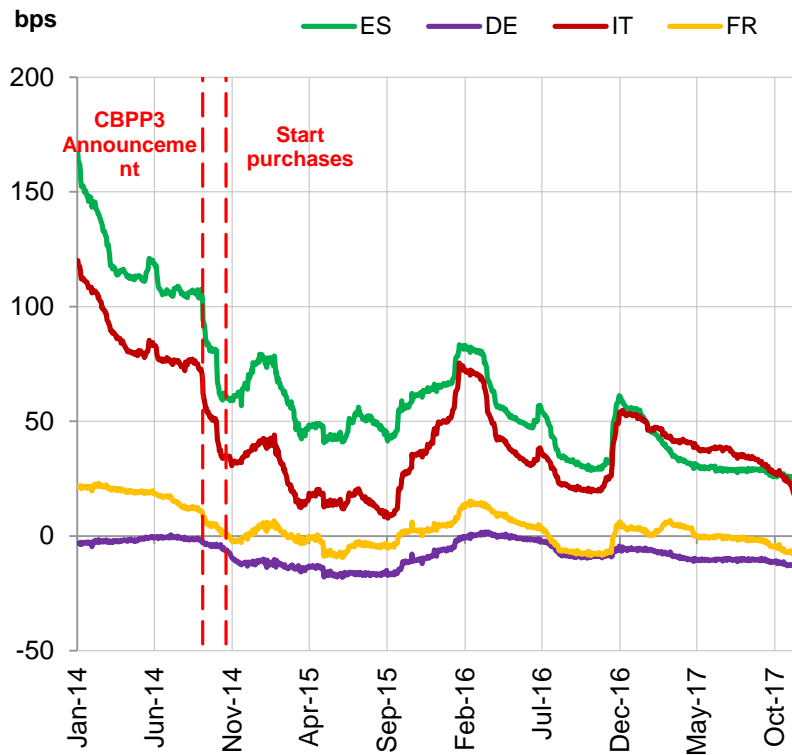
Source: ECB

*Note: at amortised cost

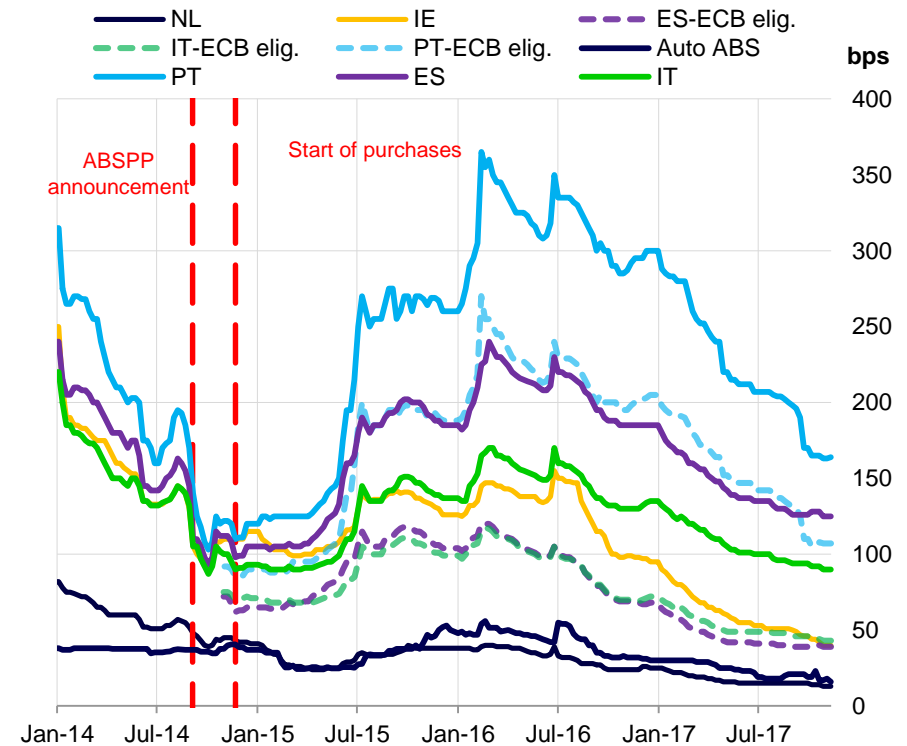
Since the start of the private sector purchase programmes, several positive developments can be highlighted:

1. Broad based spread tightening....

Covered bond asset swap spreads, per selected jurisdiction



ABS spread* developments

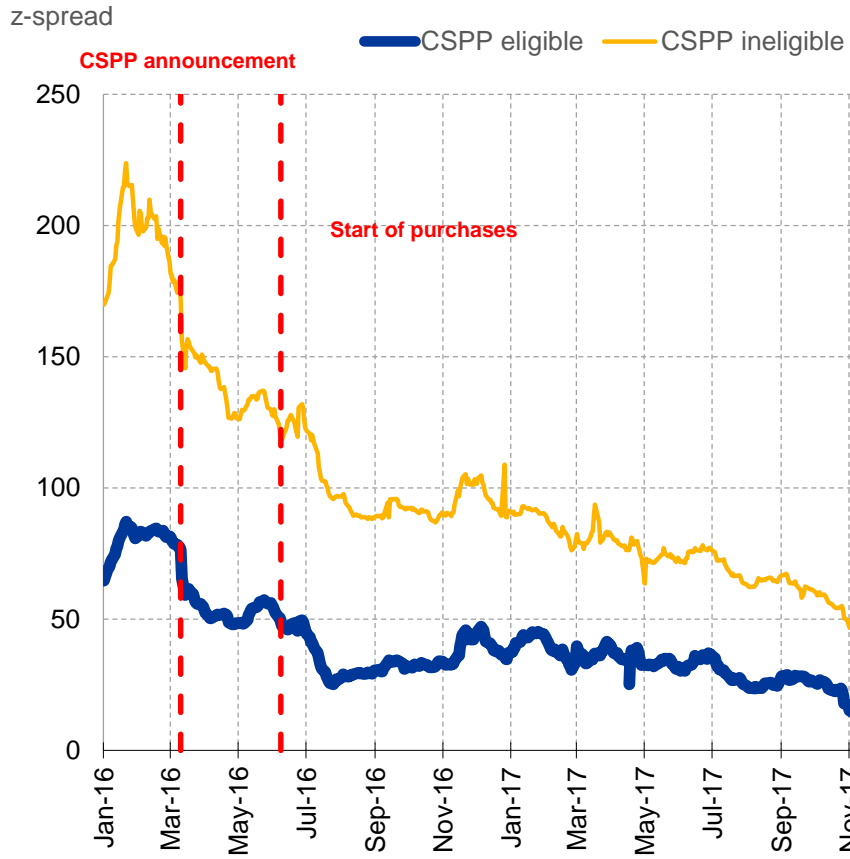


Sources and notes: iBoxx indices. Last observation: 08 November 2017.

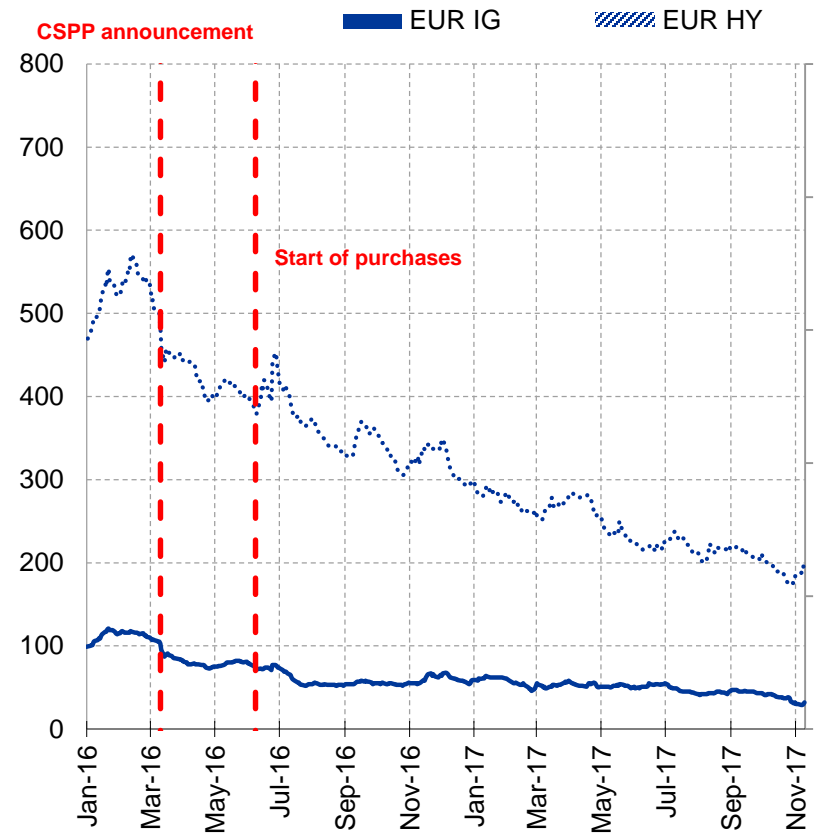
Sources: JP Morgan, Deutsche Bank Research and ECB calculations.
 *Note: Most spreads are over 3-month Euribor. Rating at issuance.
 Last observation: 10 November 2017.

.... with spill overs to non-eligible fixed income securities

Investment grade corporate bond z-spreads of CSPP eligible and non-eligible bonds



Corporate bond spreads in EUR denominated investment grade vs high yield sector

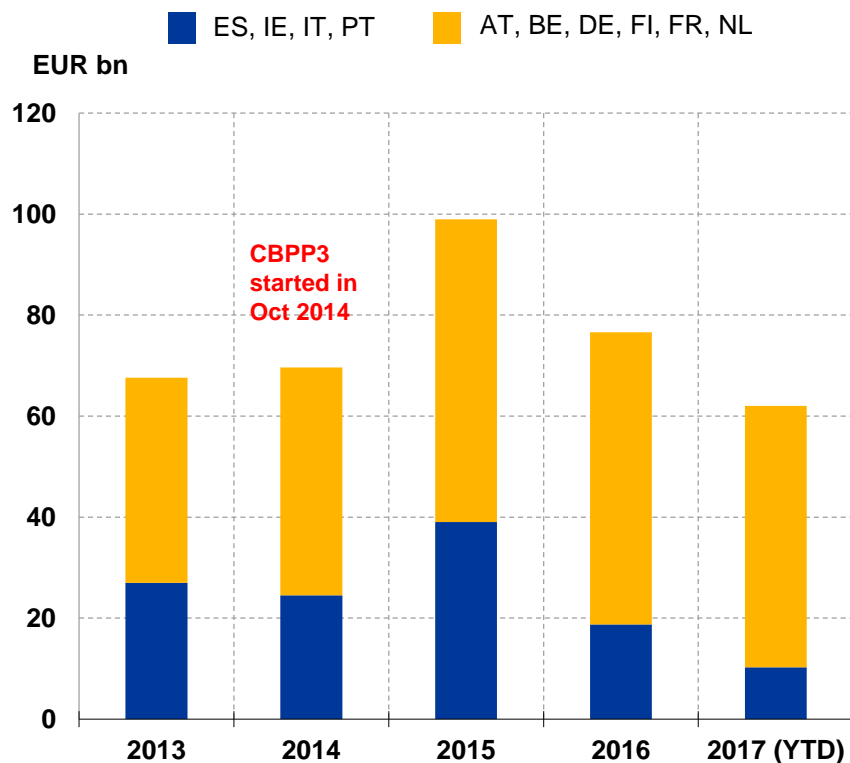


Sources and notes: ICE BAML EUR corporate bond index, ECB calculations. Last observation: 09 November 2017.

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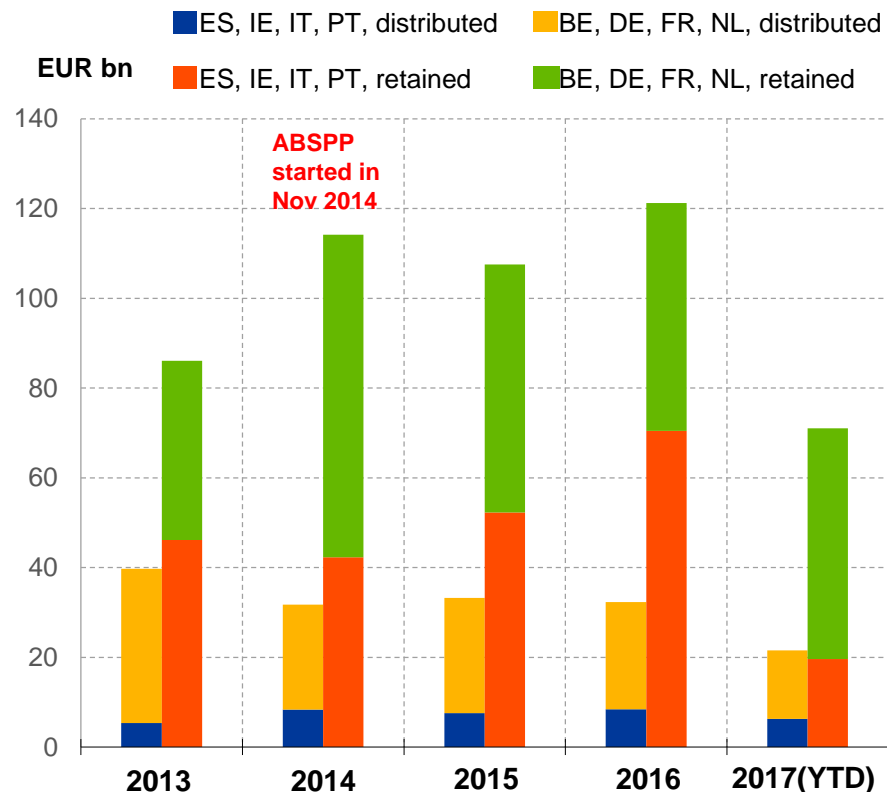
2. Issuance remained healthy or even picked up...

Covered bond issuance volumes



Source: Dealogic, ECB calculations. EUR-denominated benchmark size primary market issuances. Last observation: 10 November 2017.

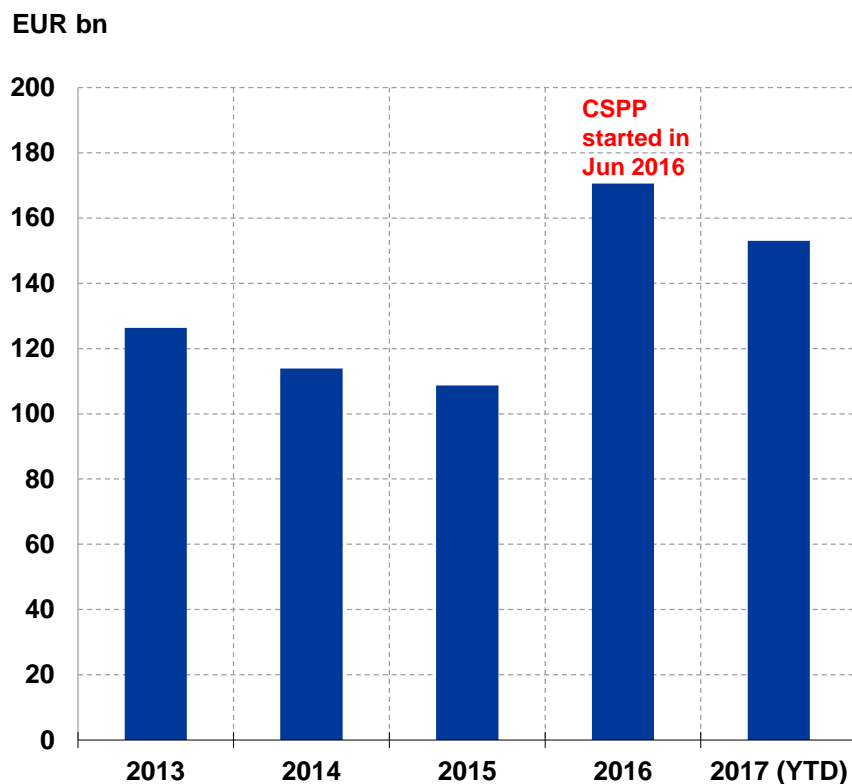
Asset-backed securities issuance volumes



Sources: JP Morgan and ECB calculation. Last observation: 10 November 2017.

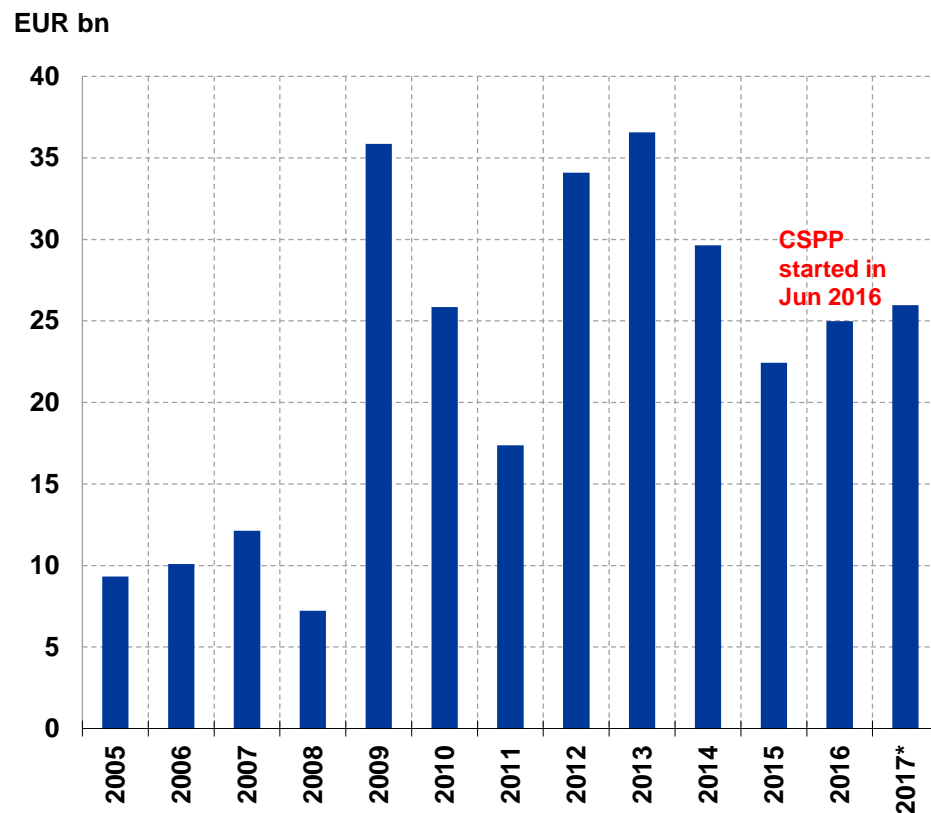
... however it is not yet evident that new or infrequent issuers are more active these days

Corporate bond issuance volumes



Sources: Dealogic, ECB calculations. EUR-denominated, investment grade primary market issuances. Last observation: 10 November 2017.

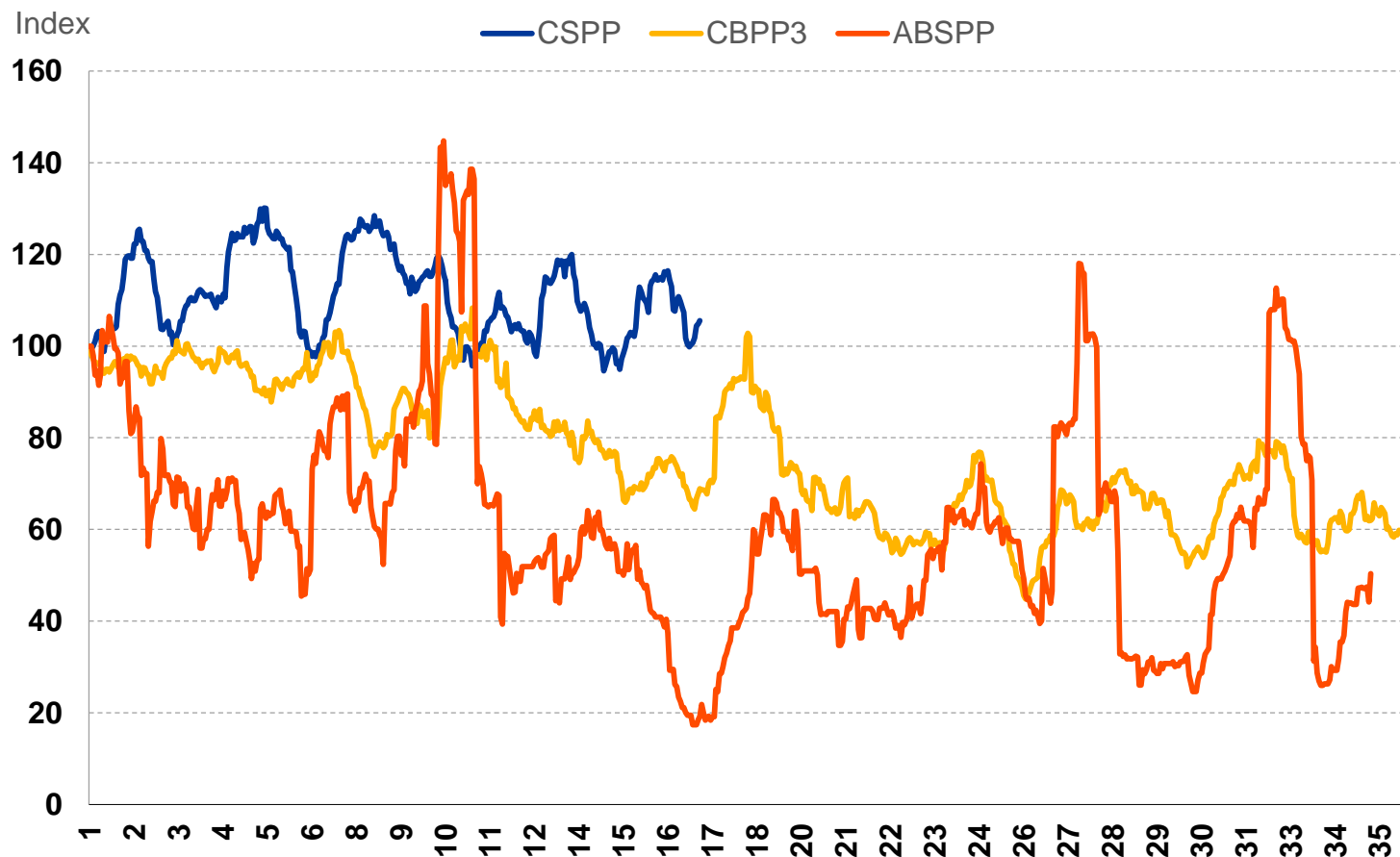
Bond issuance by infrequent euro area non-financial corporate bond issuers



Sources: Dealogic, ECB calculations. Data include all rated and non-rated euro area non-financial companies issuing in euro. Last observation: 10 November 2017.

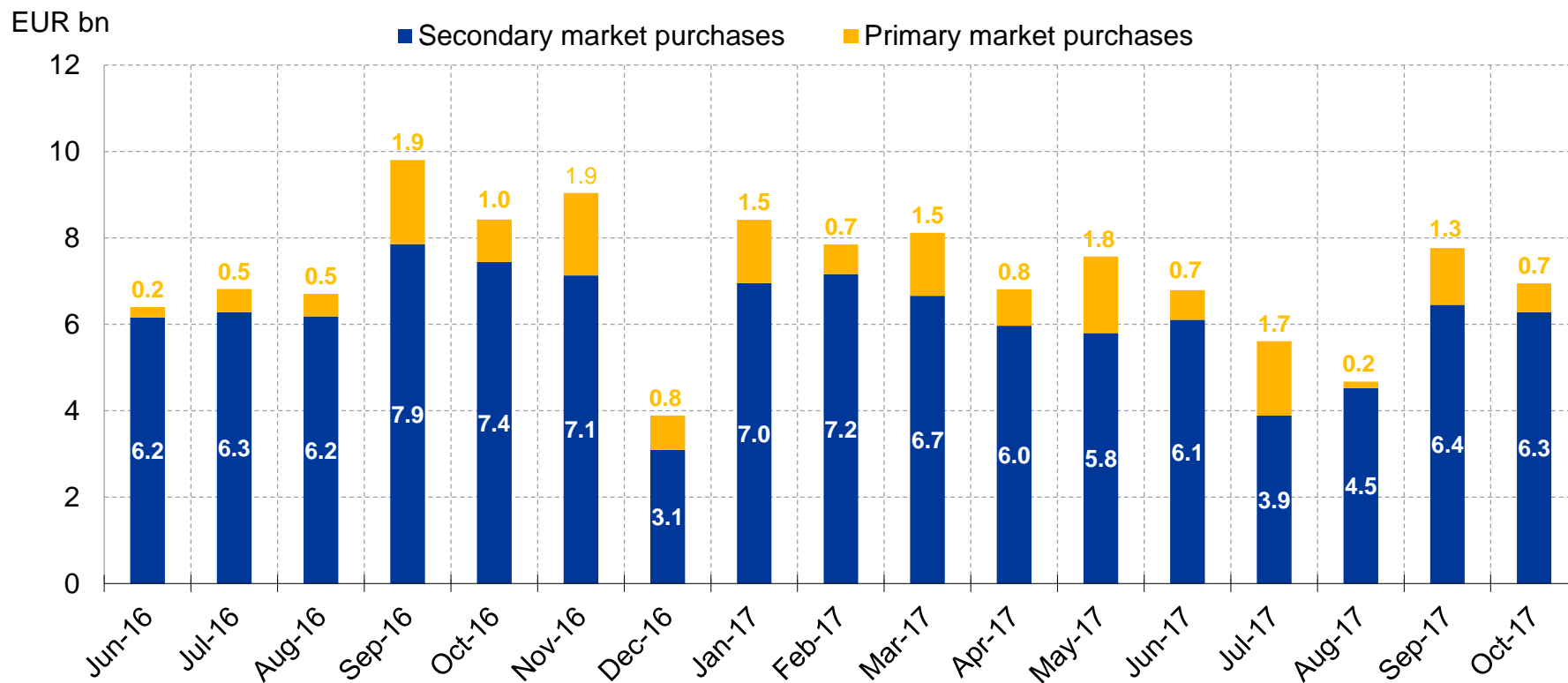
3. Liquidity picture is different across market segments

Development of the average trade size (Indexed to 100 at the beginning of each programme)



Lessons learned from CSPP:

Keep flexibility at the heart of implementation by adapting purchases to market conditions...

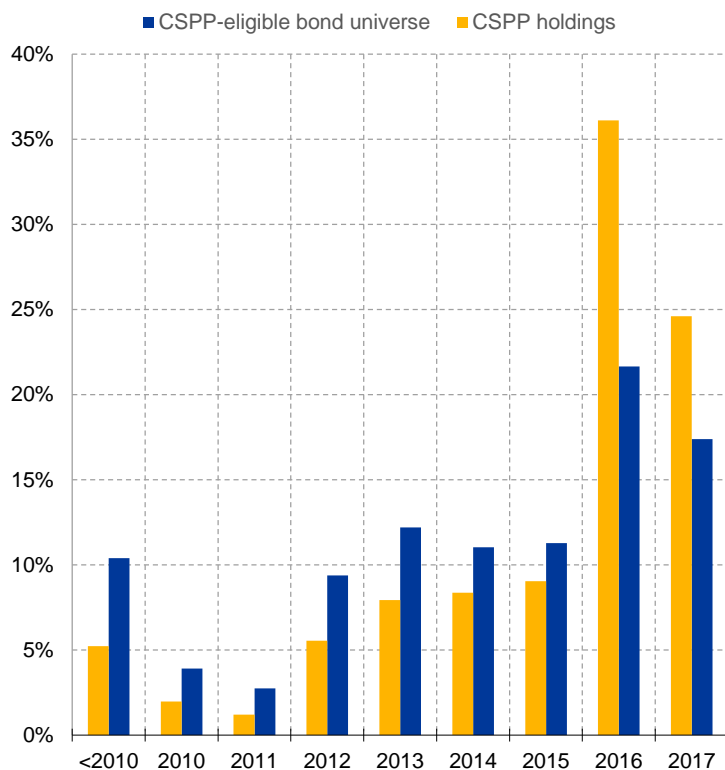


Sources: ECB Staff Calculations. Last observation: 31 October 2017
Data refers to net purchases..

Lessons learned from CSPP:

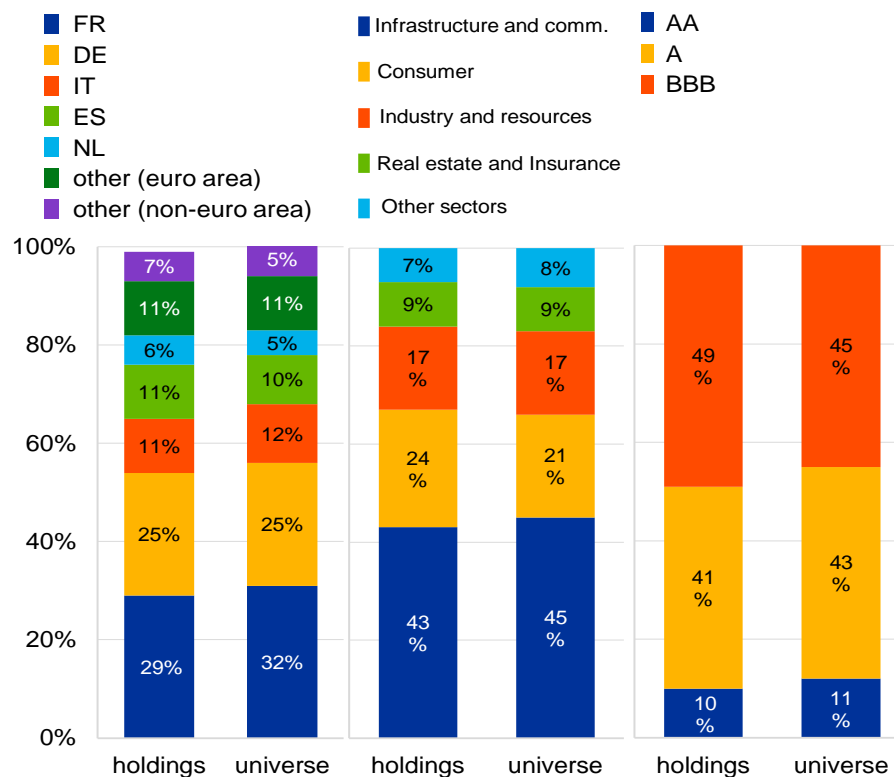
...and not aiming for a one to one replication of benchmark, rather keep market neutrality as a key feature

CSPP holdings according to the year of issuance of the bonds



Sources: ECB, Bloomberg. Distribution based on nominal amounts. Last observation: 9 November 2017.

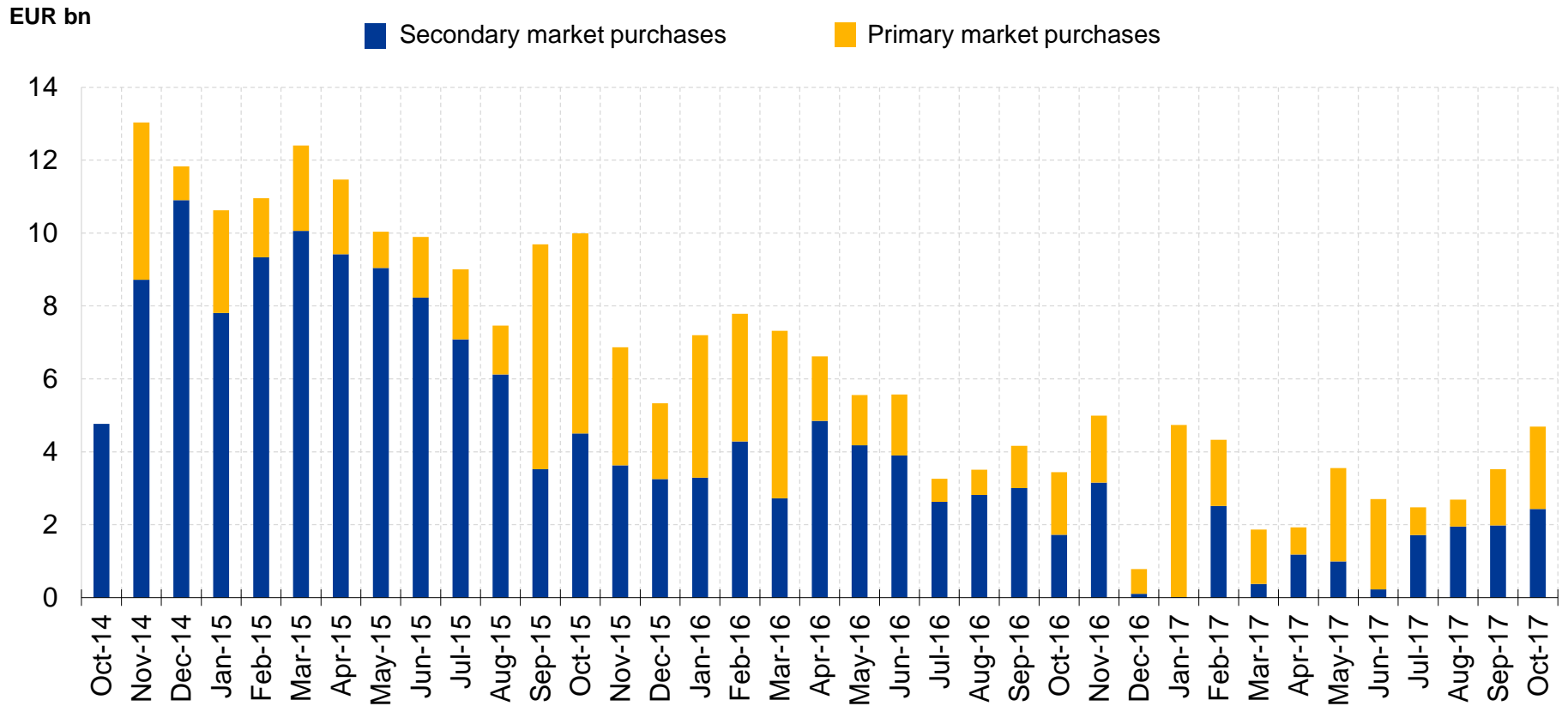
Country, sector and rating classification of CSPP holdings and CSPP-eligible bond universe



Sources: ECB, Bloomberg. Distribution based on nominal amounts. CSPP holdings as of end of Q3 2017.

Lessons learned from CBPP3:

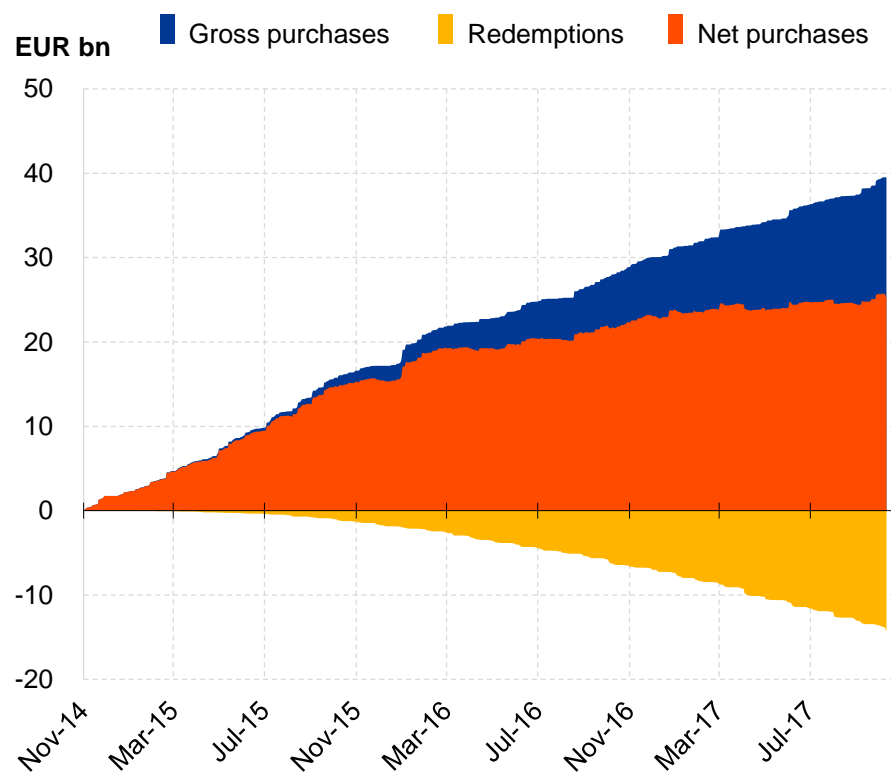
Adapt purchases across time, including to primary market activity ...



Sources : ECB. Purchases at amortised cost in EUR billion. Secondary market figures reported net of redemptions. Last observation 31 October 2017. Data refers to net purchases.

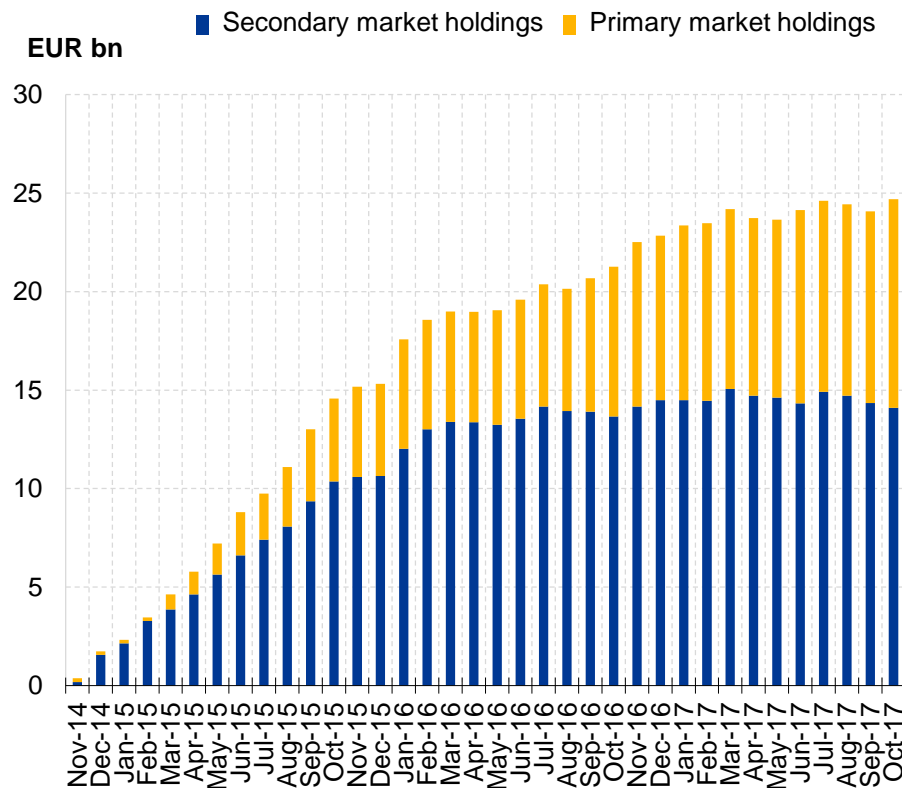
Lessons learned from ABSPP: Net purchases are increasing at slower pace due to redemptions, leading to a higher share of primary market transactions

ABSPP – Cumulative purchases and redemptions



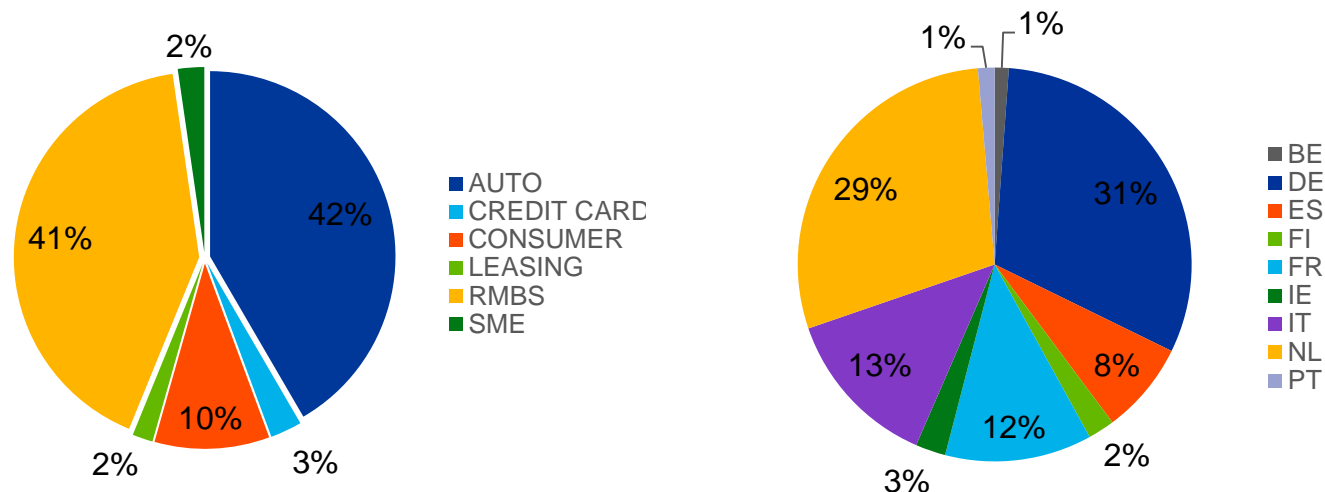
Sources: Intex and ECB calculations.
Last observation: 10 November 2017.

ABSPP – Cumulative net purchases* in primary and secondary market



Sources : ECB website. End of month book value at amortised cost, in EUR billion. Previous month's figures subject to revision. Figures reported net of redemptions.

Euro area ABS new issuance since the start of the programme

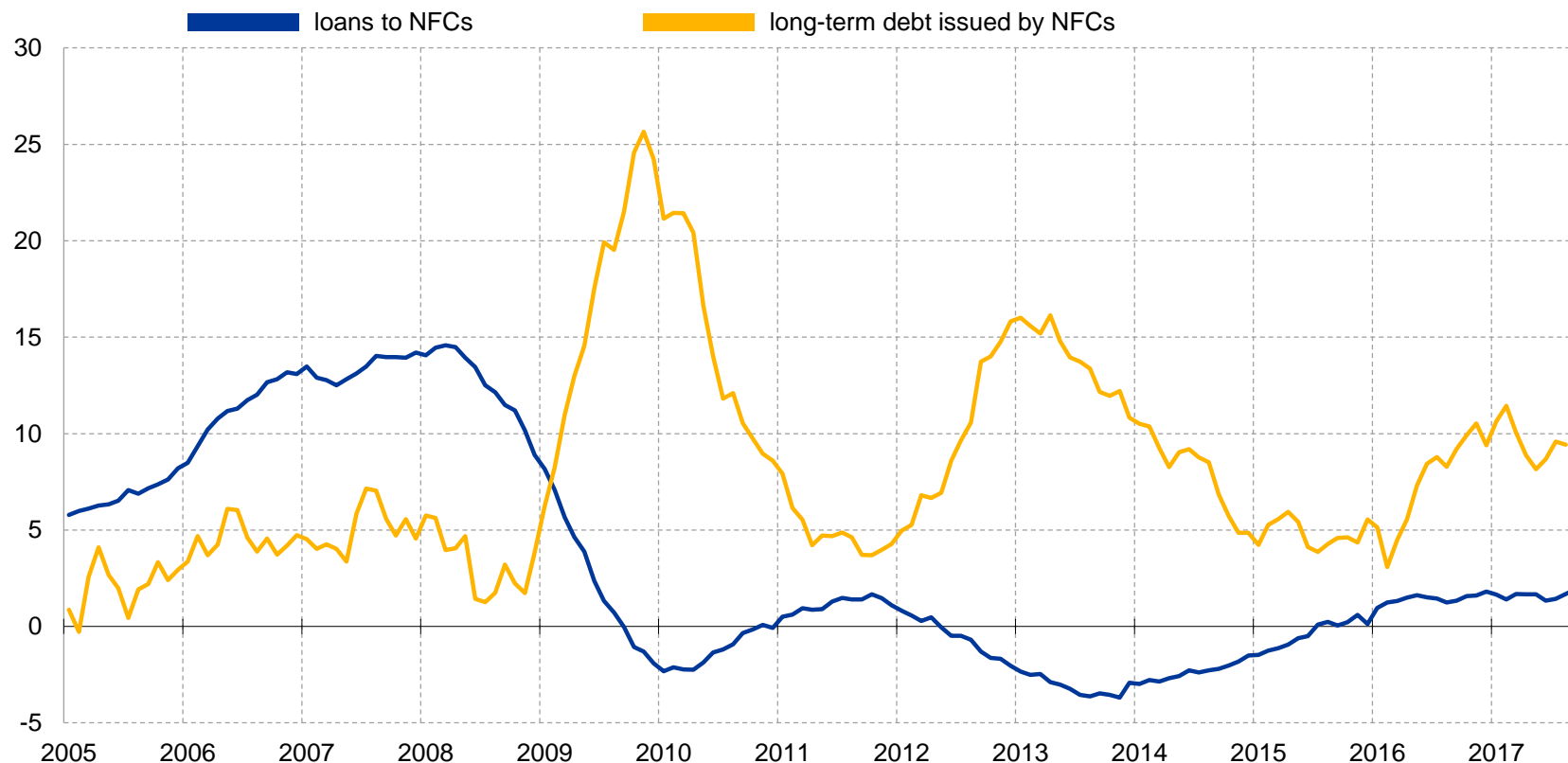


- EU ABS issuance remains at low levels, at about EUR 35 bn/year, but:
 - good investor demand in recent issuances
 - more broad-based issuance by jurisdictions and originators:
 - two Portuguese SME ABS and one Auto ABS
 - broad-based issuance in Italy in terms of type of ABS, incl. RMBS and SME ABS
 - some revitalisation in Spain, with some Auto ABS and RMBS
 - consolidation/regular issuance in Netherlands (RMBS) and Germany (Auto ABS)
 - first public RMBS issuances in Ireland & France since the financial crisis
 - Final ABS regulatory framework on STS (simple, transparent and standardised) and amended capital requirements regulation (CRR) voted in October 2017. Legislation enter into force in Q1 2018; will apply Jan 2019 => Part of CMU

4. Evidence of easing in credit conditions

Sources of financing for euro area non-financial companies (NFCs)

(y-o-y growth, %)



Source: ECB

Note: The data include debt issuance and loans denominated in euro to all euro area NFCs covered by the ECB securities statistics and statistics from MFIs (monetary financing institutions). Last observation: September 2017.

Latest ECB monetary policy decisions

- 1) Key interest rates unchanged [*“will remain at their present levels for an extended period of time...”*]
 - MRO at 0.00%; MLF at 0.25%; DFR at -0.40%
- 2) APP will continue until end Sep 2018 [*“or beyond, if necessary...”*] at a monthly pace of EUR 30 bn from January 2018
- 3) Reinvestment of the principal payments from maturing securities purchased under the APP will continue after the end of net asset purchases
- 4) Private sector programs will remain “sizable”
- 5) Reinvestment modalities in net purchase phase: PSPP: same jurisdiction; private sector programs: flexible
- 6) FRFA procedure extended for MRO and 3-month LTRO. At least until the end of the last reserve maintenance period of 2019.

APP redemptions profile and reinvestment policy

- Projected APP redemptions surpass EUR 100 bn in 2018; ECB started publishing estimated APP redemptions data over rolling 12-month horizon.
- Eurosystem will continue reinvesting maturing securities purchased under APP for extended period of time after net purchases => absence of cliff effects
- Therefore, no particular volatility expected looking forward relating to APP path
- But of course factors causing volatility in past may apply again

APP past and projected redemptions for 12 months

