Quantitative easing ECB style – Is it working?

Tarek Buhagiar
University of Central Florida

ABSTRACT:

This paper investigates the ongoing results of the expanded Asset Purchase Program (APP) also referred as Quantitative Easing, or QE, adopted by the European Central Bank in response to the sluggish economic activity in Europe. This paper explores the effects of QE on European unemployment and GDP.

Keywords: Quantitative Easing, Credit Easing, Recession

INTRODUCTION

The European Central Bank (ECB) is the Central Bank of 19 of the 28 European countries who have adopted a single currency, the Euro. The Euro today is used by more than 337.5 million European citizens. The ECB is in charge of monetary policy in the Eurozone. Fiscal policy is left to each country with guidance set out by the Stability and Growth Pact (SGP). The recession that hit the United States in December, 2007 spread across the ocean into Europe. The now global recession was accentuated in Europe by the European sovereign debt crisis.

In an interview with Jeff Cox (2012) from CNBC, Nouriel Roubini, who predicted the collapse of the United States housing market, reported that a few European nations could lose market access to refinance their debts. According to Ferreiro, Gálvez, Gómez and González (2016), “until the year 2010, expansionary fiscal policies were a generalized phenomenon, leading to a marked increase of fiscal imbalances”. Raudla, Douglas, Randma-Liv and Savi (2015) stated that the recession resulted in “fiscal crises for governments across the Western world. Many European countries found themselves in the middle of sovereign debt crises.” Truger (2015) commented that most Euro countries were stuck with “austerity measures” because of the SGP to remedy the fiscal imbalance. Buhagiar (2013) called for a fiscal union in Europe to prevent an economic meltdown. An editorial in *The Economist* from June 9th, 2012 stated “not coming up with a solution guarantees an economic tragedy.” The solution, whether a fiscal union or some other cohesive solution among all Eurozone countries was too difficult to achieve. The European countries kept with varying degrees of commitment to the austerity measures in place. Without the fiscal union, the job of fighting the recession was left to the ECB.

EUROPEAN CENTRAL BANK AND QUANTITATIVE EASING

The main objective of the European Central Bank is to maintain price stability. According to the ECB’s own webpage, the ECB is also responsible for supervising credit institutions and contributing to the safety and soundness of the banking system and stability of the financial system within the European Union. The regular open market operations, according to the ECB’s website, consist of one-week liquidity providing operations in euro (main refinancing operations or MROs). Additionally, the ECB’s website states that because of the “intensification of the financial crisis in September 2008, the ECB has introduced a number of non-standard monetary policy measures that are unprecedented in nature, scope and magnitude with the aim to safeguard the primary objective of price stability and ensure an appropriate monetary policy transmission mechanism”.

One of these non-standard monetary policy operations is the Fixed-Rate Tender Full Allotment (FRFA) introduced starting on October 15, 2008 according to a remark by Jose Manuel Gonzalez-Paramo, one of the members of the Executive Board of the ECB (2011). This was the beginning of Quantitative Easing used by the ECB according to Fawley and Neely (2013). With an FRFA, the bids for loans are entirely satisfied, against satisfactory collateral. The FRFA was fully implemented on Long Term Refinancing Operations (LTROs) which, according to the Financial Times, started by providing “financing to Eurozone banks”. The Financial Times further states, “[u]ntil early 2008 the longest LTRO maturity was three month”. With an LTRO the Central Bank is “lending money at a very low interest rate to euro banks” according to Catherine Boyle (2012). Many banks used sovereign bonds for the loans' collaterals.

THE LAST RECESSION

According to the Centre for Economic Policy Research ([CPER], 2015), the entity that determines when recessions and expansions occur in euro area member countries, Europe entered the last recession in the third quarter of 2011, only 8 quarters after the end of the so called Global Recession; which in Europe started the first quarter of 2008. The last recession lasted six quarters, ending the first quarter of 2013.

- Monetary Policy Decisions
    - 9 June 2011 – Interest rates on the main refinancing operations and the interest rates on the marginal lending facility and deposit facility remain unchanged at 1.25%, 2.00%, and 0.50% respectively. Jean-Clause Trichet, President of the ECB, in a press release about fiscal policies, stated that many countries needed to correct their excessive deficits.
    - 7 July 2011 - The interest rate on refinancing operations and marginal facility and deposit facility raised by 25 basis points.
    - 4 August 2011 to 6 October 2011- The interest rate on refinancing operations and marginal facility and deposit facility unchanged from the previous meeting.
    - 3 November 2011 - The interest rate on refinancing operations and marginal facility and deposit facility decreased by 25 basis points. This was the first press release with Mario Draghi at the helm of the ECB.
    - 8 December 2011 - The interest rate on refinancing operations and marginal facility and deposit facility decreased by 25 basis points. The ECB also decided to expand the length of the LTORs operations to 36 months and reduced the rating threshold for collaterals. In the fiscal policy remark the ECB stated that countries needed to correct their excessive deficits.
    - 12 January 2012 to 6 June 2012 - The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. In the June press conference, the ECB stated it decided to continue FRFAs for as long as necessary.
    - 5 July 2012 - The interest rate on refinancing operations and marginal facility and deposit facility decreased by 25 basis points to 0.75%, 1.50% and 0.00% respectively.
    - 2 August 2012 - The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meeting. In its press release the ECB stated that it was observing exceptionally high risk premia in government bond prices in several countries due to the fears of the reversibility of the euro. The ECB reemphasized the position that the euro is irreversible and reinstated that policy-makers in the euro area need to push with fiscal consolidation.
    - 6 September 2012 - The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. However, the Governing Council decided to undertake Outright Monetary Transactions (OMTs) in secondary markets for sovereign bonds. According to the Free

Exchange (2012), the ECB started to buy sovereign bonds from to one to three year maturity "because the ECB's ability to set interest rates for the euro zone as a whole has broken down". This made the ECB the de facto lender of last resort for countries in the Euro zone.

- 4 October 2012. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. The ECB reinstated that the ECB is "within our mandate to maintain price stability over the medium term; we act independently in determining monetary policy; and the euro is irreversible". The ECB called for structural reforms for the euro area countries and sound fiscal policies. The ECB also called for a strengthening of the bank resilience without which there would not be a normalization of all funding channels in the Euro Area.
- 8 November 2012. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. Euro Area GDP contracted by 0.2% in the second quarter of 2012. The annual growth rate of loans in the private sector kept declining.
- 6 December 2012. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings.
- 10 January 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. The annual growth rate of loans in the private sector kept being weak. The ECB kept calling for further structural reforms in the countries of the Euro Area.
- 7 February 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. Euro Area GDP contracted by 0.1% in the third quarter of 2012.
- 7 March 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. The forecast for Euro Area GDP is bleak for the fourth quarter of 2012.
- 4 April 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. The annual growth rate of loans in the private sector kept being weak. Euro Area GDP contracted by 0.6% in the fourth quarter of 2012.
- 2 May 2013. The interest rate on refinancing operations decreased by 25 basis points at 0.5%. The interest rates on marginal facility decreased by 50 basis points at 1.0% and kept deposit facility at 0.00%. The ECB decided to continue conducting main refinancing operations (MROs) for as long as necessary. It also decided to conduct the three-month longer –term refinancing operations (LTROs) until the second quarter of 2014. Also, "the Governing Council decided to start consultations with other European institutions on initiatives to promote a functioning market for asset-backed securities collateralised by loans to non-financial corporations".
- 6 June 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings.
- 4 July 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. Euro Area Real GDP declined by 0.3% in the first quarter of 2013. The ECB states that "Since the

summer of 2012 substantial progress has been made in improving the funding situation of banks and, in particular, in strengthening the domestic deposit base in a number of stressed countries. This has contributed to reducing reliance on Eurosystem funding, as reflected in the ongoing repayments of the three-year longer-term refinancing operations (LTROs). In order to ensure an adequate transmission of monetary policy to the financing conditions in euro area countries, it is essential that the fragmentation of Euro Area credit markets continues to decline further and that the resilience of banks is strengthened where needed".

- 1 August – 5 September 2013. The interest rate on refinancing operations and marginal facility and deposit facility was unchanged from the previous meetings. Real GDP rose by 0.3% in the second quarter of 2013.

EMPIRICAL RECESSION RESULTS

At the end of the recession in October, 2013, the following conditions were in place:

- Unemployment rate, Euro Area 19 countries: 12% (Eurostat, 2016)
- GDP: 0% for the 3rd quarter 2013 - Euro Area 19 countries: (Statistical Data Warehouse, 2016)
- Inflation - Moving 12 months average rate of change – Euro Area 19 countries: 1.6% (Statistical Data Warehouse, 2016)

The level of unemployment during the recession passed from 10.2% in the third quarter of 2011 to 12% in the third quarter of 2013, an 18% increase. The total output declined by 1.5% ([CPER], 2015). Comparing these numbers to the previous recession, the impact on unemployment of the previous recession was greater. The recession of first quarter 2008 – to second quarter 2009, unemployment went from 7.2% to 9.7%. This was an increase of 2.5 percentage points – a 35% increase. The total decline in output was an enormous 5.5 % ([CPER], 2010).

SINCE THE RECESSION

The European Central Bank policies did not accomplish all they were set out to achieve. However, they result are not all negative. On one hand, quantitative easing policies "have not led to an increase in consumption" according to Levren (2016). On the other hand, it appears that as of November, 2016, the economy has stabilized. As of November, 2016:

- Unemployment rate: 9.8% Euro Area 19 countries: (Eurostat, 2016)
- GDP: 0.3% for the 3rd, Euro Area 19 countries: (Statistical Data Warehouse, 2016)
- Inflation - Moving 12 months' average rate of change – Euro Area 19 countries: 0.2% (Statistical Data Warehouse, 2016)

TRENDS AND CONCLUSIONS:

The unemployment rate trend confirms that Europe seems to be improving, and since the ECB pledge is "whatever it takes", according to *The Economist* print edition December, 2016 Quantitative Easing might not end anytime soon. In fact, during a press conference on December

8th, 2016 Mario Draghi, president of the European Central Bank, suggests that the program of Quantitative Easing is still in place and the ECB has no plan to stop any time soon (December, 2016), unless there are clear improvements in the Euro Area.

REFERENCES

Boyle, Catherine (2012, February 29). Retrieved June 12, 2016 from http://www.cnbc.com/id/46567837

Buhagiar, Tarek (2013, February 2013). Fiscal union or bust. Research in Business and Economics Journal. Volume 7, 2013

Centre for Economic Policy Research (CEPR), Euro Business Cycle Dating Committee (2010, October 4) Retrieved July 19, 2016, from http://cepr.org/Data/Dating/Dating-Committee-Findings-04-Oct-2010.pdf

Centre for Economic Policy Research (CEPR), Euro Business Cycle Dating Committee (2015, October 1) Retrieved June 18, 2016, from http://cepr.org/Data/Dating/Dating-Committee-Findings-01-Oct-2015.pdf?_ga=1.123736202.1010498112.1464989168

Cox, Jeff (2012, May 9). Interview with Nouriel Roubini, CNBC. Retrieved May 9, 2012 from http://www.cnbc.com/id/47356500/Global_Economy_Faces_a_Perfect_Storm_in_2013_Roubini

European Central Bank. Press release: Monetary policy decisions. Retrieved June 24, 2016 from https://www.ecb.europa.eu/press/pr/activities/mopo/html/index.en.html

European Central Bank. Asset purchase programmes. Retrieved June 3, 2016 from https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html

European Central Bank.Presss Conference – December 8th 2016 Retrieved January 3, 2017 from https://www.youtube.com/watch?v=VKQJp5DwqPk

Eurostat. Retrieved June 18, 2016, from http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics

Fawley, B. W., & Neely, C. J. (2013). Four stories of quantitative easing. Review - Federal Reserve Bank of St.Louis, 95(1), 51-88. Retrieved from https://login.ezproxy.net.ucf.edu/login?url=http://search.proquest.com.ezproxy.net.ucf.edu/docview/1271598640?accountid=10003

Ferreiro, J., Gálvez, C., Gómez, C., & González, A. (2016). Bank rescues and fiscal policy in the european union during the great recession. Panoeconomicus, 63(2), 211-230. doi:http://dx.doi.org.ezproxy.net.ucf.edu/10.2298/PAN1602211F

Free exchange (The Economist) – The ECB's new bond purchase programme. Not too little, possible too late (September 6 2012). Retrieved June 10, 2016. http://www.economist.com/blogs/freeexchange/2012/09/ecbs-new-bond-purchase-programme

Gonzalez-Paramo (October 21, 2011). The ECB's monetary policy during the crisis. Closing speech at the Tenth Economic Policy Conference, Málaga, 21 October 2011. Retrieved June 6, 2016 from https://www.ecb.europa.eu/press/key/date/2011/html/sp111021_1.en.html

Lerven, F. (2016). Quantitative Easing in the Eurozone: A One-Year Assessment. Intereconomics/Review Of European Economic Policy, 51(4), 237-242. doi:http://dx.doi.org.ezproxy.net.ucf.edu/10.1007/s10272-016-0608-9

Print Edition Finance and Economics (The Economist) – The European Central Bank's quantitative-easing options. (December 8th 2016) Retrieved January 8, 2017.

http://www.economist.com/news/finance-and-economics/21711322-ecbs-willingness-do-whatever-it-takes-helps-explain-markets-uneasy
Raudla, R., Douglas, J. W., Randma-Liiv, T., & Savi, R. (2015). The Impact of Fiscal Crisis on Decision-Making Processes in European Governments: Dynamics of a Centralization Cascade. *Public Administration Review*, *75*(6), 842-852.
Statistical Data Warehouse – European Central Bank. Retrieved July 6, 2016 from http://sdw.ecb.europa.eu/
Truger, Achim. 2015. "The Fiscal Compact, Cyclical Adjustment and the Remaining Leeway for Expansionary Fiscal Policies in the Euro Area." Panoeconomicus, 62(2): 157-175.