The End of Quantitative Easing and the Market Implication

European Central Bank

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What was Quantitative Easing?

•Policy of targeting a quantity of reserves in excess of that required for day to day money operations

•Excess total largely symbolic

•Liquidity itself does not increase by quantity of excess reserves

Aims of Quantitative Easing

- Reinforce zero interest rate policy
- Anchor long-term yields
- Create financial market stability
- Improve investor confidence
- Help eradicate deflation expectations

Structural changes to money market since QE introduced

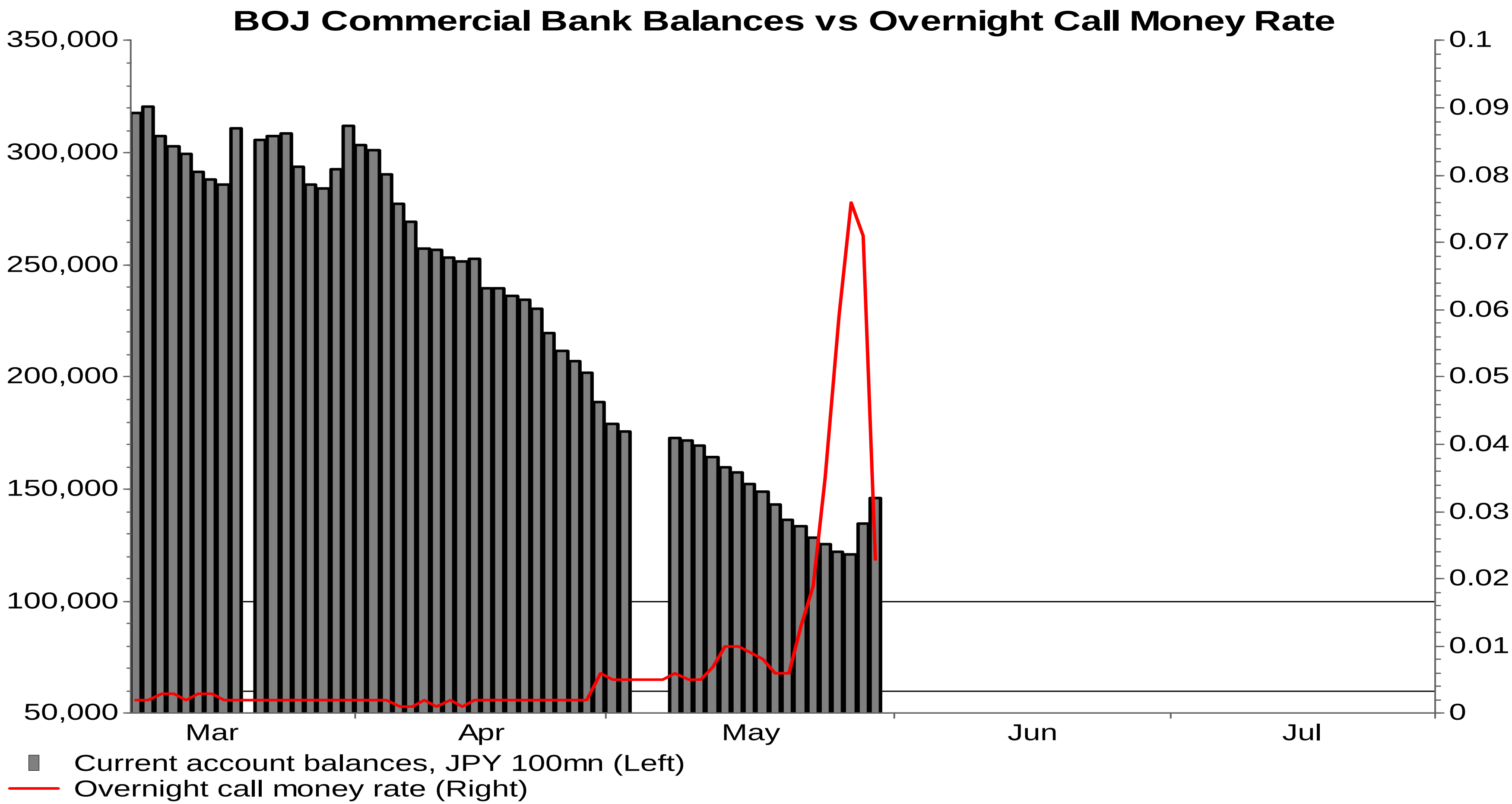
- Banking sector consolidation
- Changes in banks’ balance sheets
- Introduction of RTGS
- Termination of deposit guarantee

Preparation For Ending Quantitative Easing

- Activate interbank money market
- Reactivate credit lines
- Reassess counterparty risk
- Assess need for intraday liquidity

A new framework for the conduct of monetary policy

- Clarify price stability
- Examining economic activity and prices
  - 1-2 year outlook
  - Longer-term outlook
- Outlining the current view on monetary policy
  - ‘The Outlook for Economic Activity and Prices’



- Introduced March 2001
- Maintained at target range of JPY 30-35 trillion from January 2004 to March 2006

- Recent current account balance total of JPY 12.1 trillion lowest level since range of JPY 10-15 trillion in place in October 2002
- Reserve requirement estimated to be between JPY 6-8 trillion

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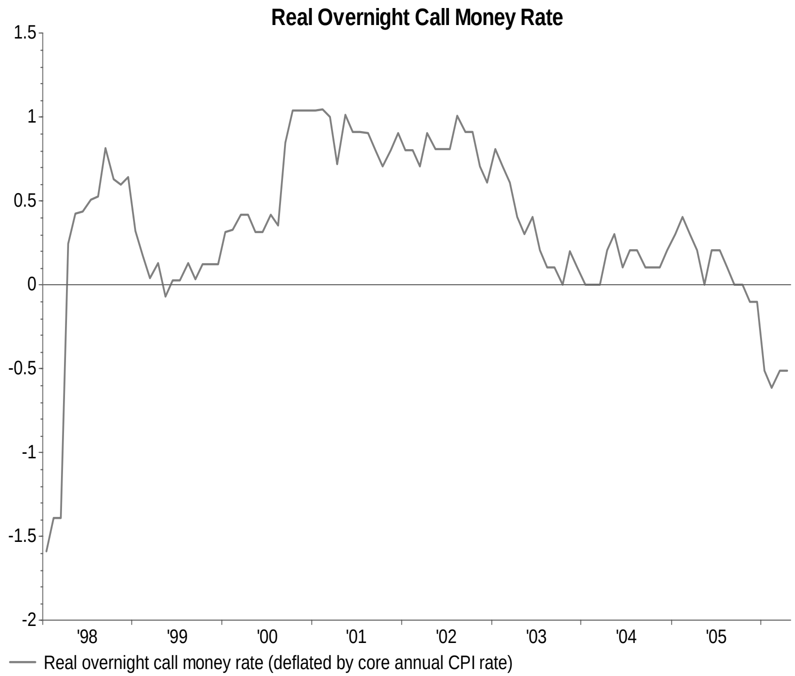
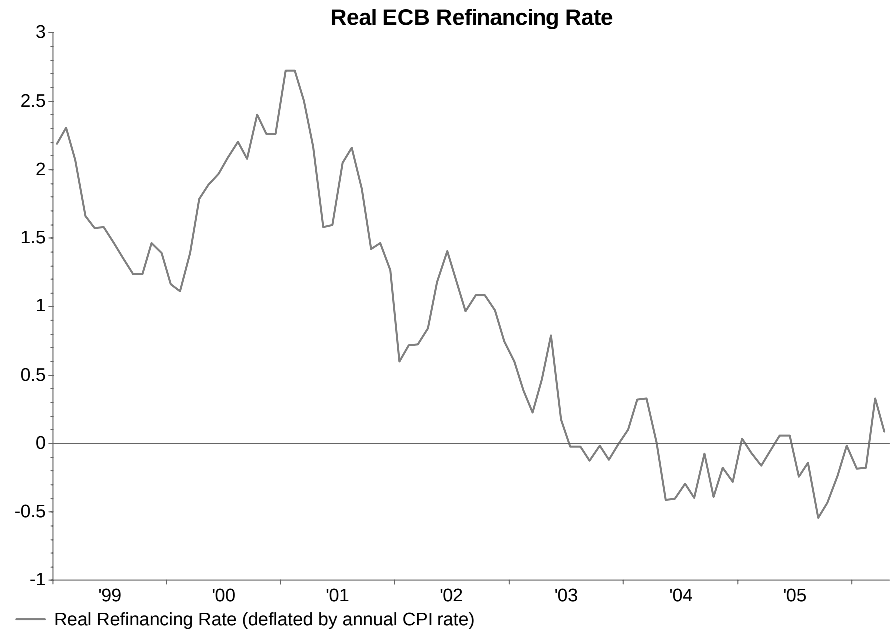
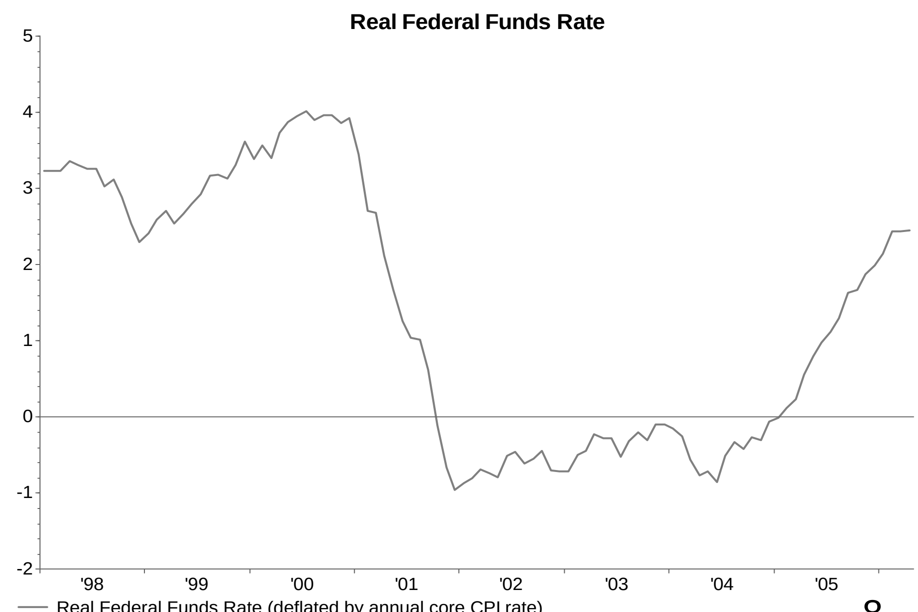


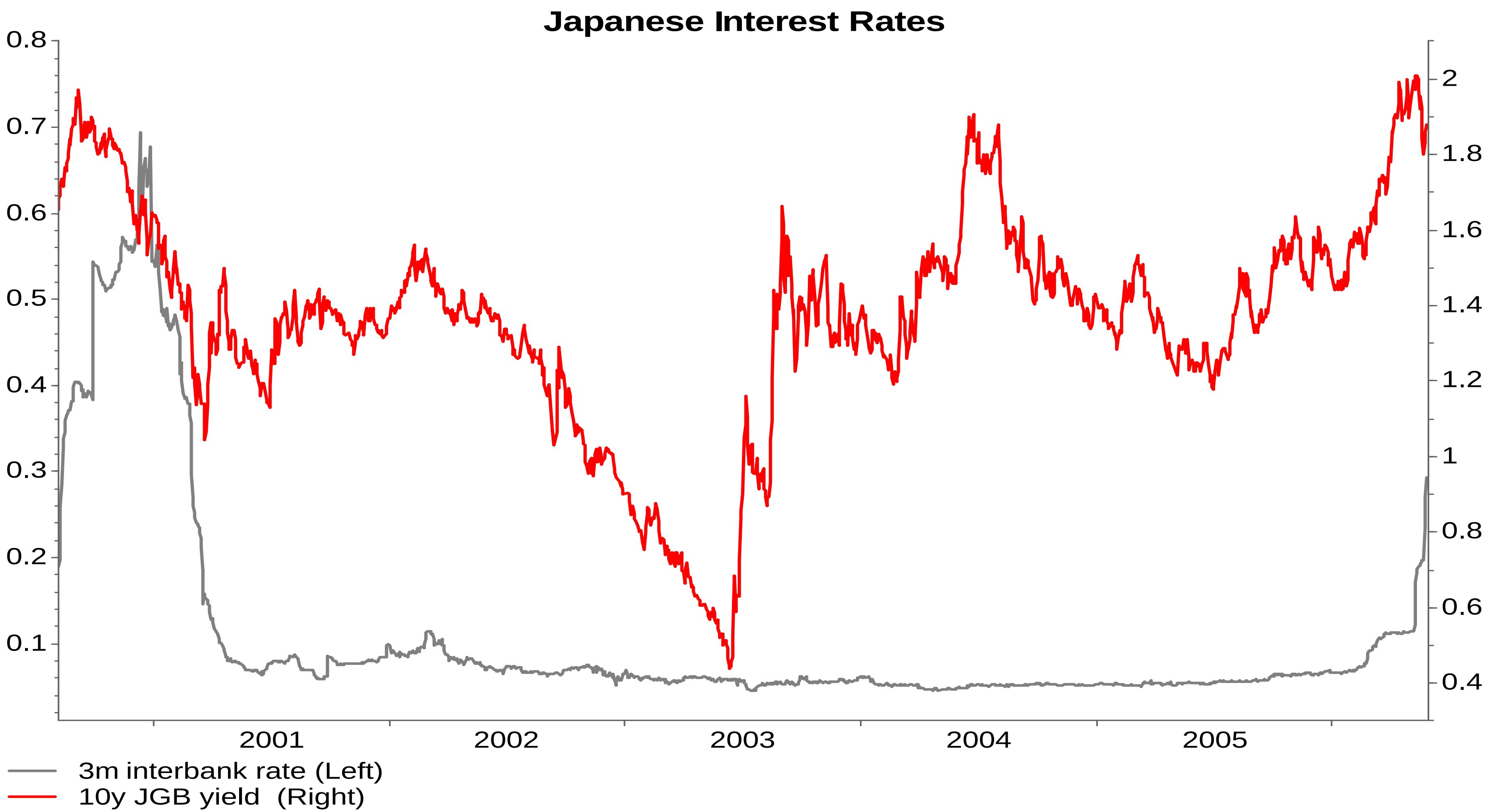


- •Governor Fukui - “period” of zero interest rates after end of QE
- •Real short-term rates falling as inflation increases
- •“Period” undefined but expected to be short



Reasons for monetary caution by BOJ

- Changes to money market structure
- GDP deflator, corporate services prices
- Potential slower global growth
- Global imbalance risk
- Crude oil price risk
- Internal political pressure
- Fiscal consolidation



- 10-yr yield spike causing MOF opposition to build
- Complicates fiscal consolidation

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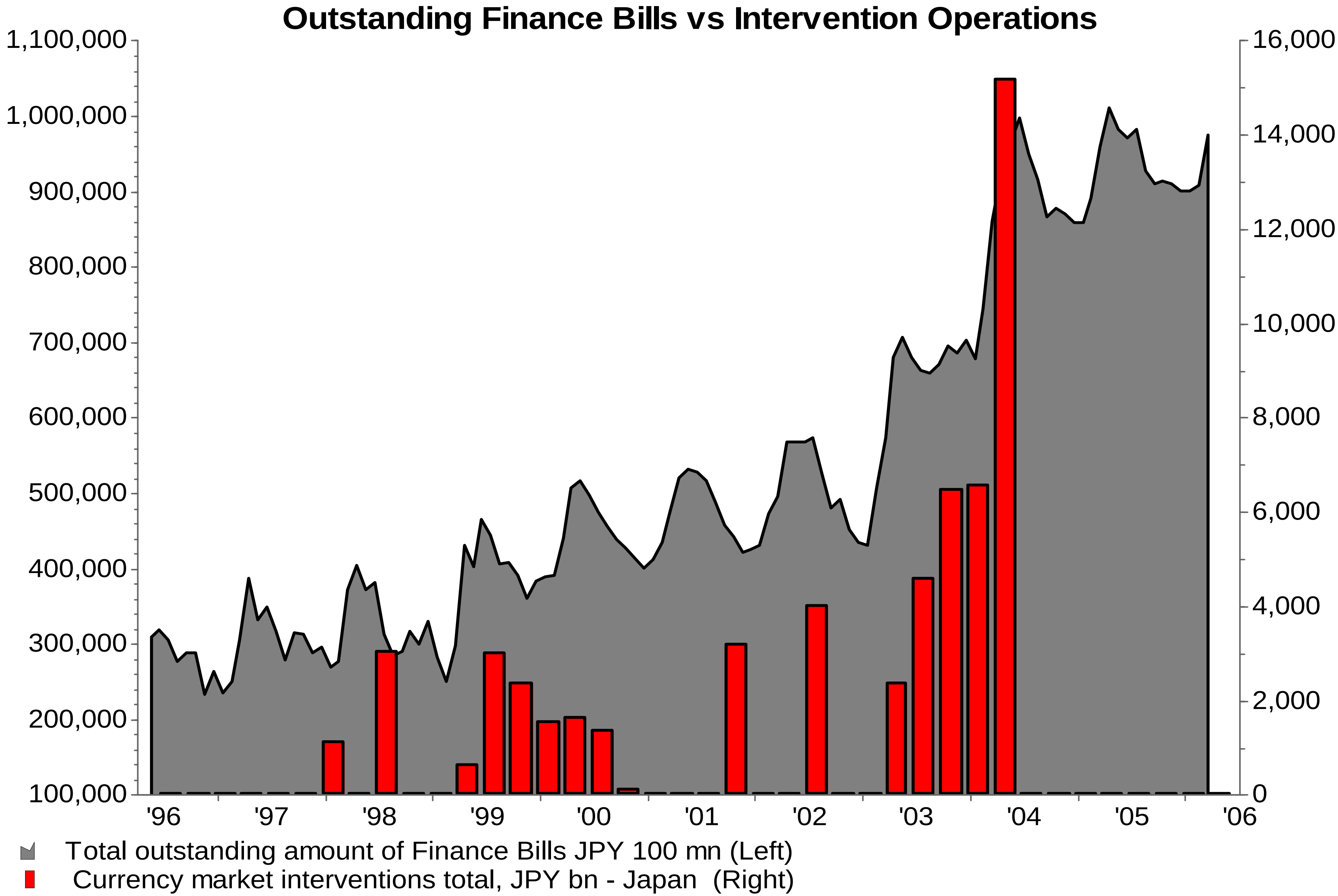

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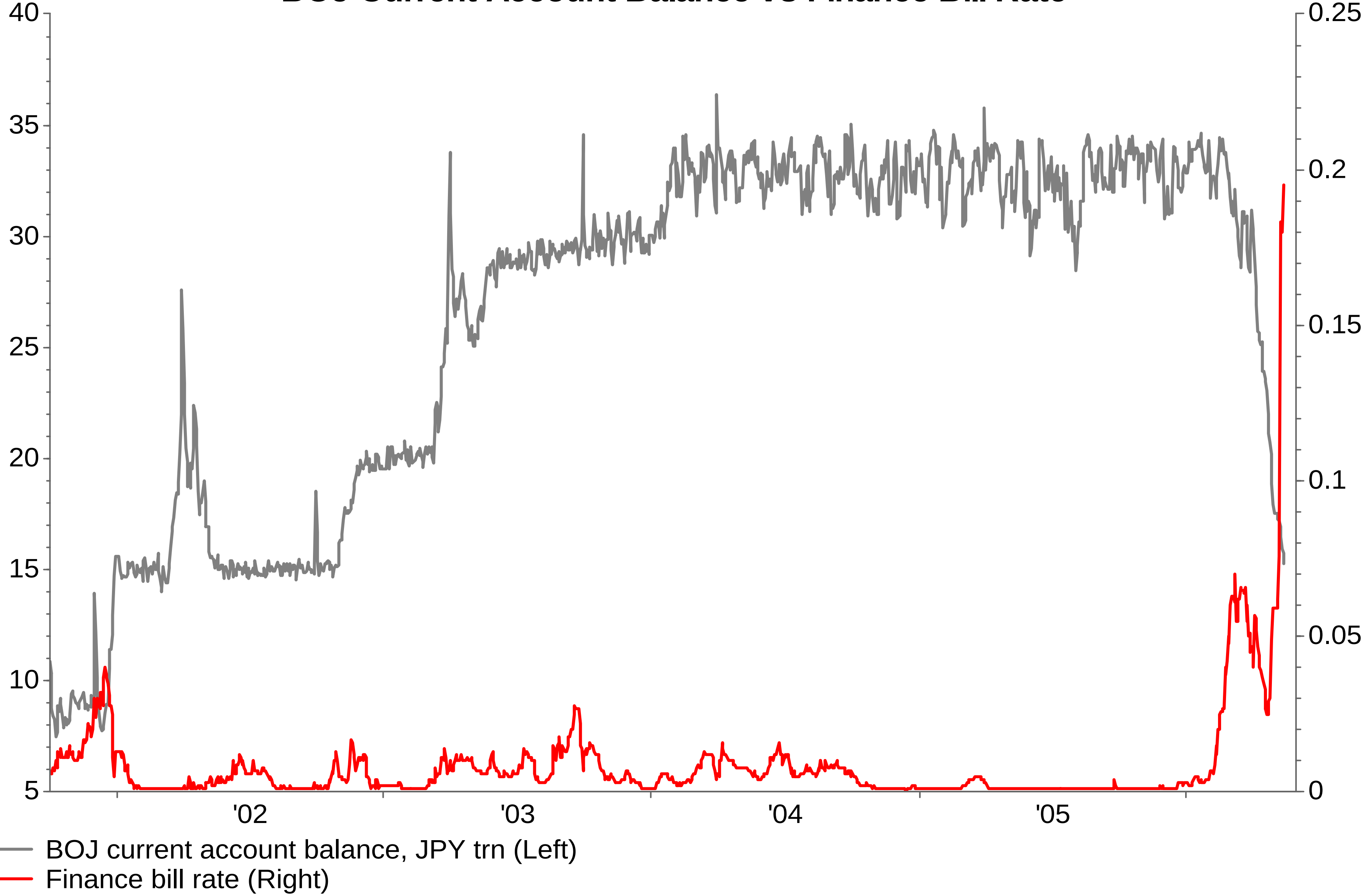
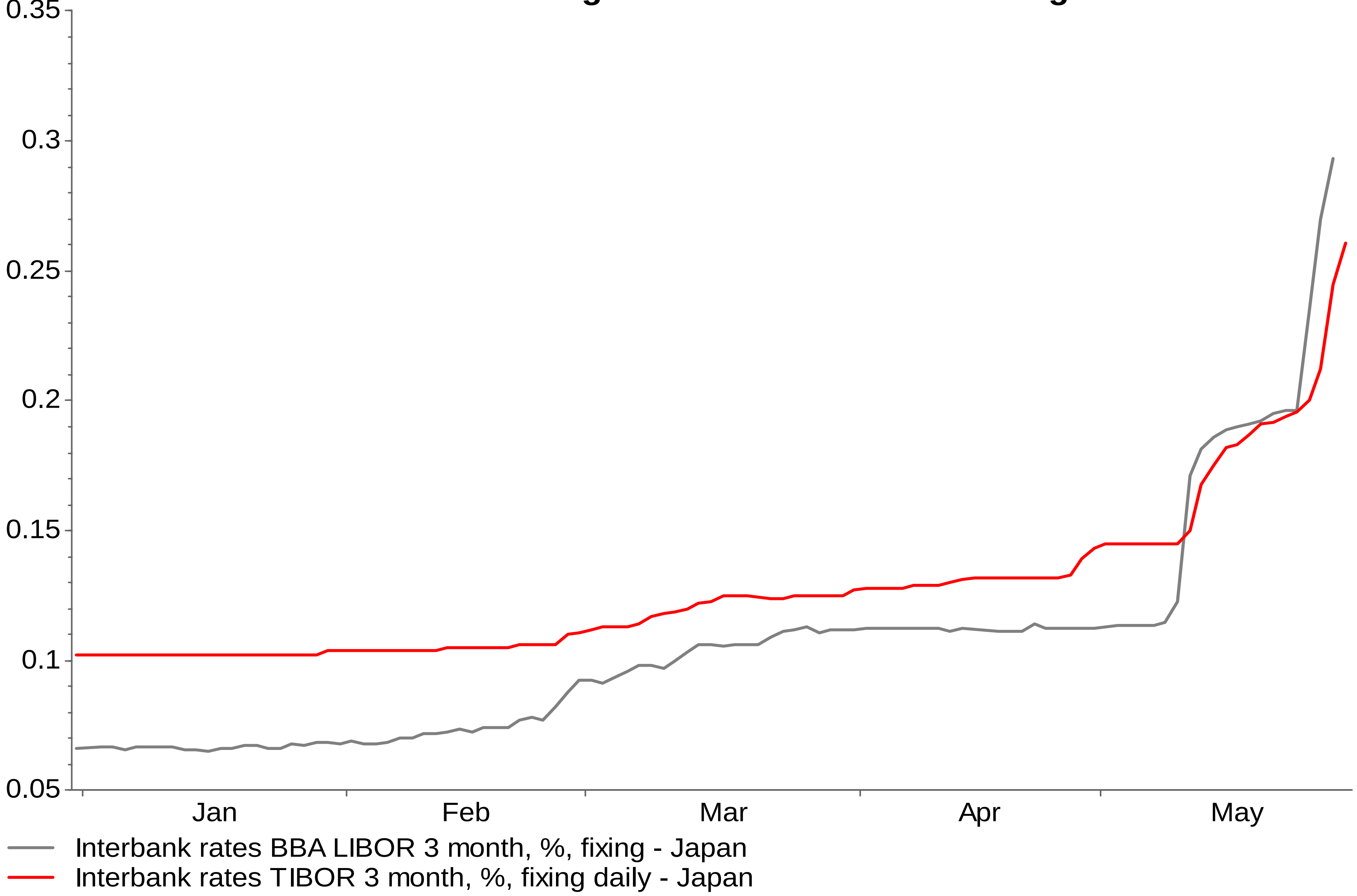
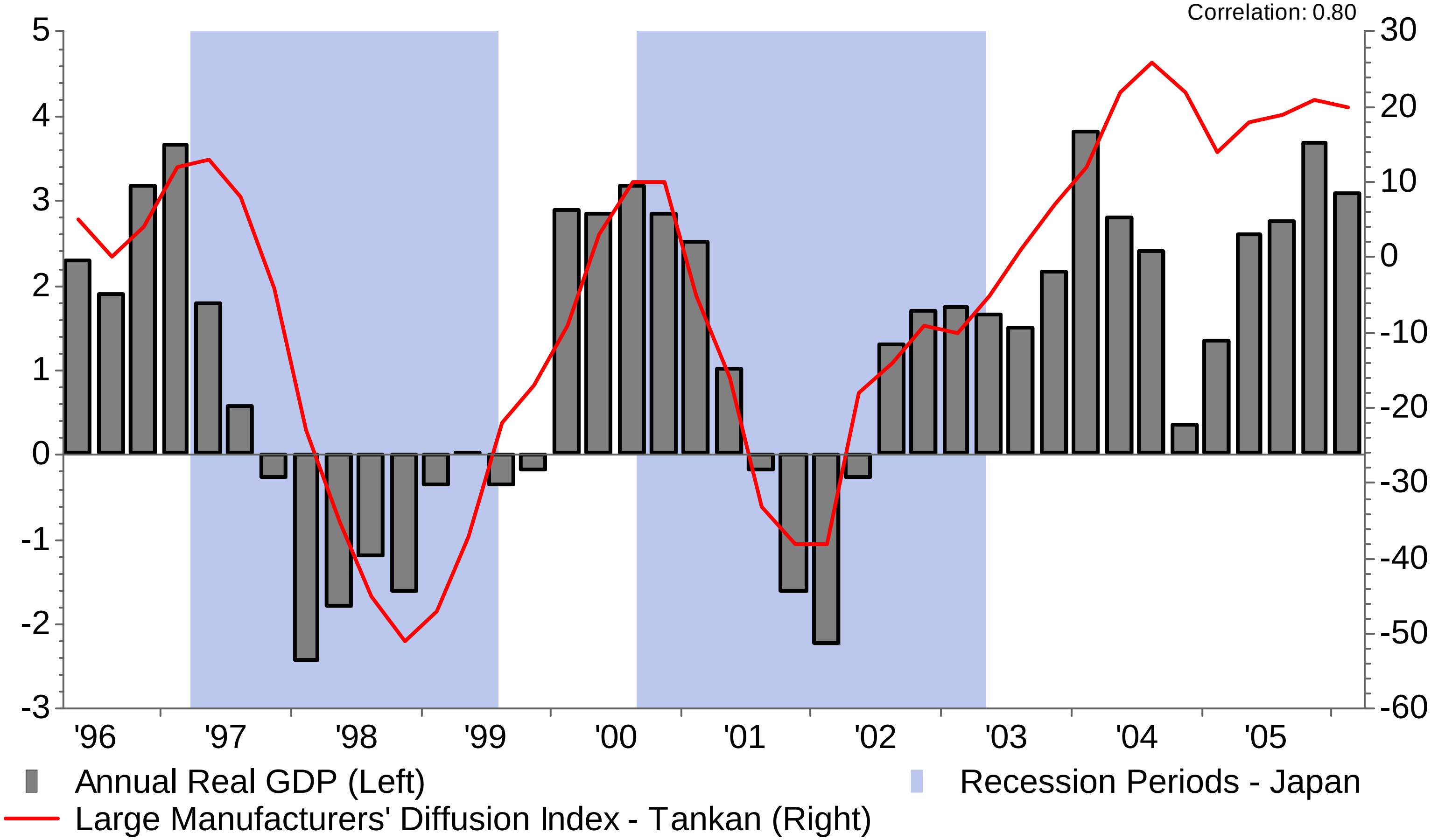
BOJ Current Account Balance vs Finance Bill Rate



3-Month Tibor Fixing Rate vs 3-Month Libor Fixing Rate



Real GDP vs Tankan



Outlook for economic activity

Annual Real GDP	2.4 % in 2006
	2.0 % in 2007

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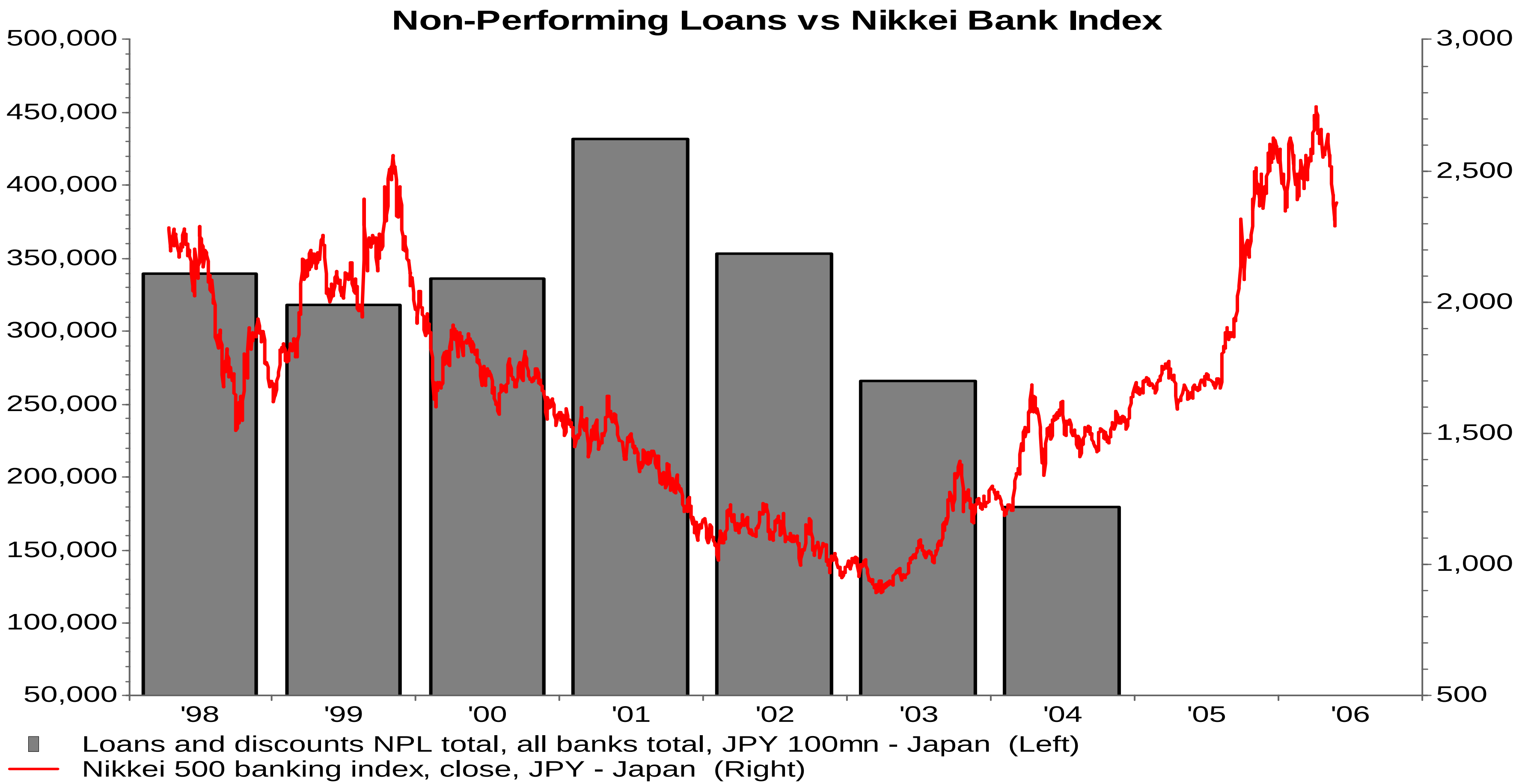

- NPL portfolio substantially reduced
- Confidence in banking sector restored

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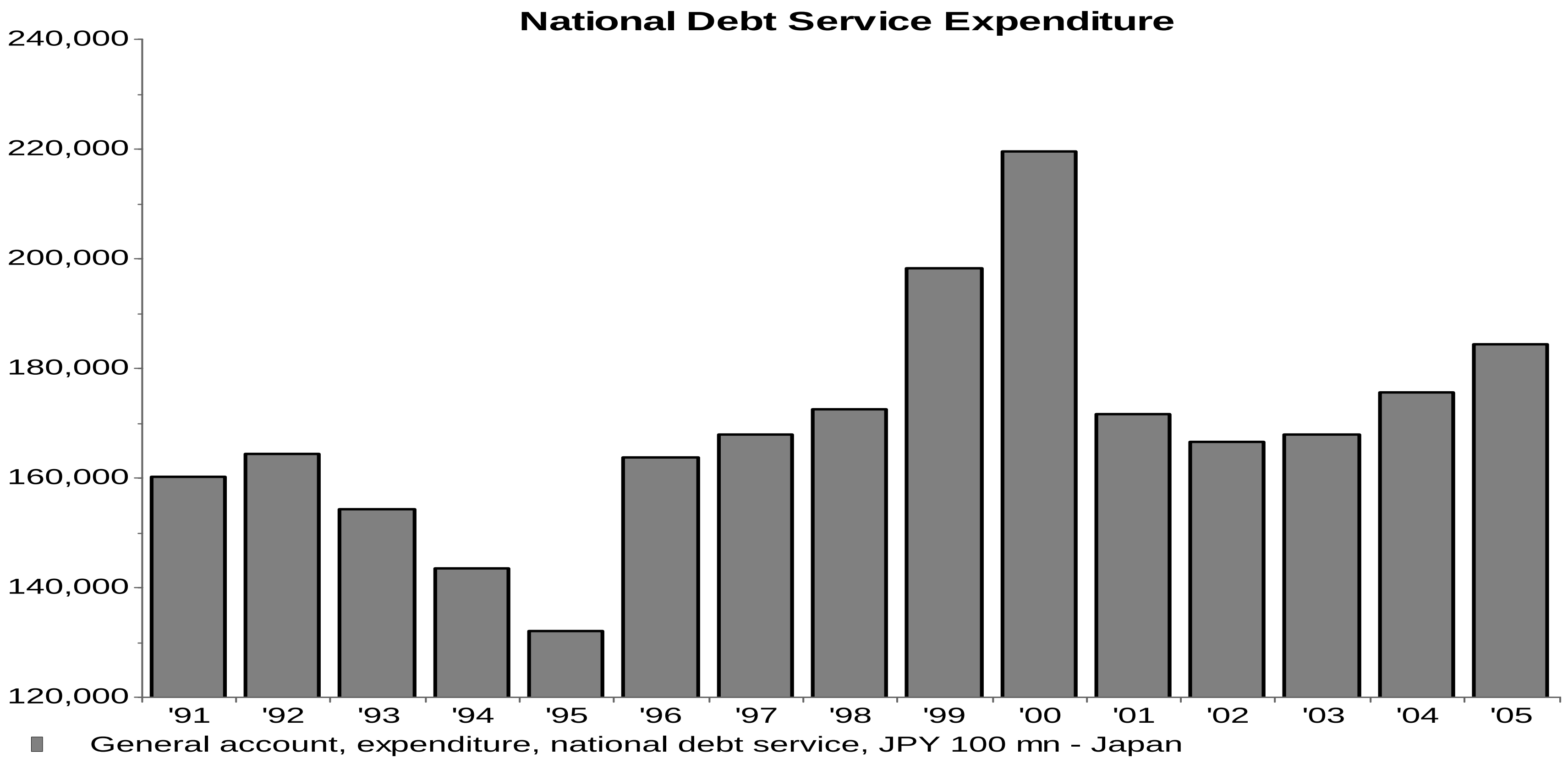

- Total debt JPY 774 trillion; 151% of GDP
- Government targeting primary balance by 2011
- Increased tax burden - Sales tax
  - Income tax
  - Inheritance tax

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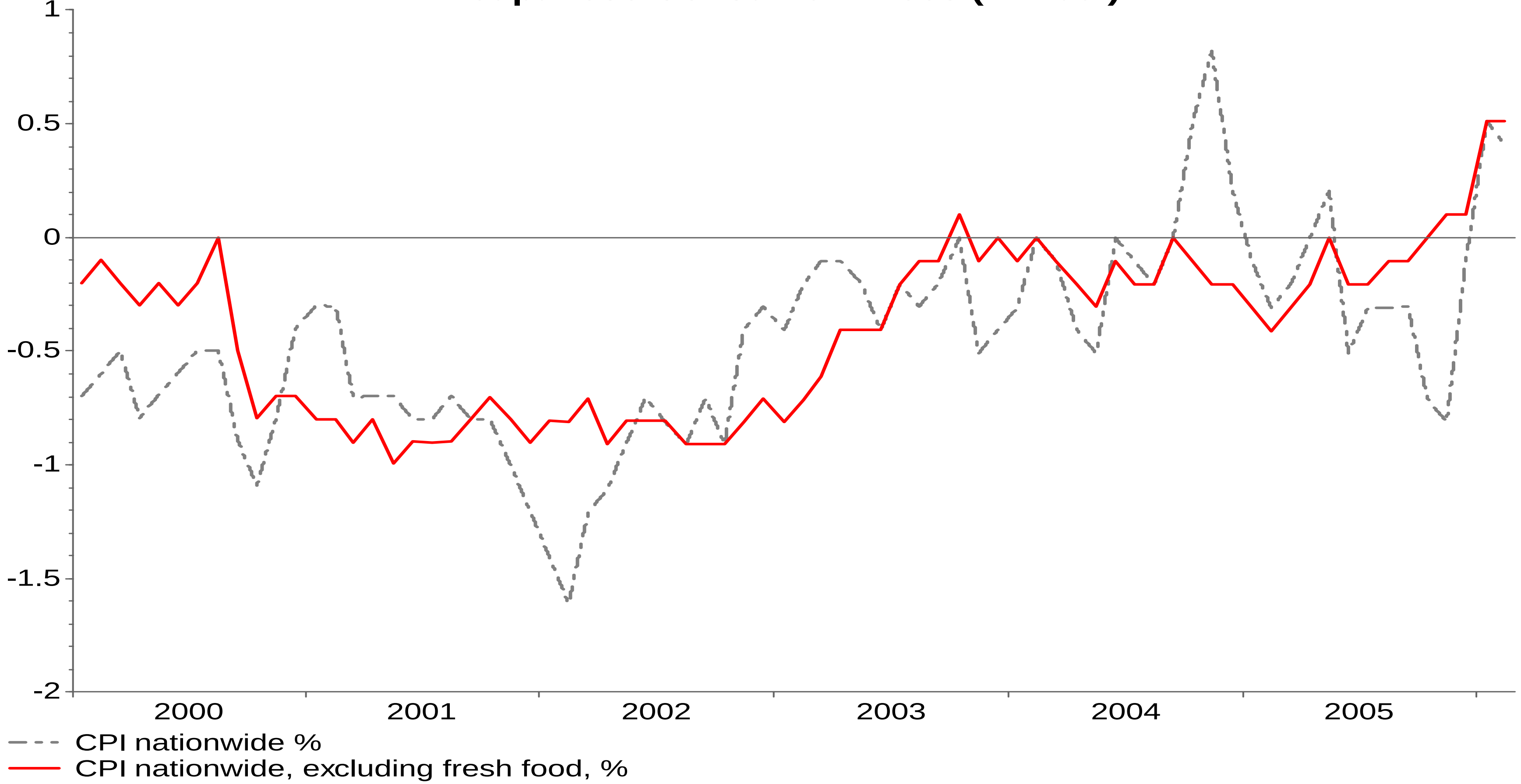
Japanese Consumer Prices (Annual)



Outlook for inflation

Core annual inflation	0.6% in 2006
	0.8% in 2007

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