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
• 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
BOJ Current Account Balance vs Finance Bill Rate

- BOJ current account balance, JPY trn (Left)
- Finance bill rate (Right)
3-Month Tibor Fixing Rate vs 3-Month Libor Fixing Rate

- Interbank rates BBA LIBOR 3 month, %, fixing - Japan
- Interbank rates TIBOR 3 month, %, fixing daily - Japan
Outlook for economic activity

Annual Real GDP

2.4 % in 2006
2.0 % in 2007
Non-Performing Loans vs Nikkei Bank Index

- NPL portfolio substantially reduced
- Confidence in banking sector restored
• Total debt JPY 774 trillion; 151% of GDP
• Government targeting primary balance by 2011
• Increased tax burden - Sales tax
  - Income tax
  - Inheritance tax
Japanese Consumer Prices (Annual)

Outlook for inflation

- Core annual inflation: 0.6% in 2006, 0.8% in 2007