Monetary policy, exchange rates and capital flows

Washington D.C.,
3 November 2017
Euro area recorded large net portfolio outflows since the launch of the APP

Breakdown of euro area net portfolio investment flows
(EUR bn; twelve-month moving sums)

Source: ECB.
Notes: A positive (negative) number indicates net outflows (inflows) from (into) the euro area. Equity includes investment fund shares. APP stands for Asset Purchase Programme. The latest observation is for April 2017.
Exchange rate more closely connected to short-term interest rate differential

USD/EUR and 2-year interest rate differential
(lhs: %; rhs: USD/EUR)

USD/EUR and 10-year interest rate differential
(lhs: %; rhs: USD/EUR)

Sources: Haver Analytics and ECB staff calculations.
Last observation: 27/10/2017.
Decomposition of long-term yields helps uncover exchange rate relationship

**USD/EUR and 10-year interest rate differential**  
(*lhs: %; rhs: USD/EUR*)

![Graph showing the USD/EUR and 10-year interest rate differential](image)

**USD/EUR and expectations component of 10-year yields**  
(*lhs: %; rhs: USD/EUR*)

![Graph showing the USD/EUR and expectations component of 10-year yields](image)

Sources: Haver Analytics and ECB staff calculations.  
Last observation: 31/12/2014.

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Last observation: 31/12/2014.
Evidence of increased euro area bond market spill-over into US Treasury market

**Estimated long-term bond yield spillovers**

(% contribution to variance of other economy’s bond yield)

- Spillovers from German Bunds to US Treasuries
- Spillovers from US Treasuries to German Bunds

**10-year term premia estimates:**

US vs. euro area

(%) 

**Sources:** Federal Reserve Bank of New York, ECB and ECB calculations.

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Risk premium shocks put downward pressure on US dollar in H1/2014

Historical decomposition of euro exchange rate against the US dollar
(percentage quarterly contributions, not cumulated)

Source: ECB staff calculations.
Notes: Estimates are based on a quarterly BVAR model of the USD/EUR exchange rate, relative euro area - US GDP, relative euro area - US CPI and relative shadow interest rates, identified via sign restrictions and estimated over the period 1999Q1-2017Q3.
Latest observation: Q3 2017 (proxied by July data and nowcast estimates of GDP).
Estimated spillovers through different yield curve components between the euro area and the US
(average % contribution to variance in other economy’s long-term bond yield)

Sources: Haver and ECB calculations.
Most recent disconnect characterised by close co-movement with relative term premia

USD/EUR and expectations component of 10-year yields
(lhs: %; rhs: USD/EUR)

USD/EUR and term premia differential
(lhs: %; rhs: USD/EUR; monthly data)

Sources: Federal Reserve Bank of New York and ECB calculations.