The ECB’s policy response to the COVID-19 crisis*

Isabel Schnabel
Member of the Executive Board

*This is a partly amended version of a presentation given at an online seminar hosted by the Florence School of Banking & Finance on 10 June 2020.
Systemic stress in financial markets gradually receding

CISS indicator

Source: ECB Working Paper No. 1426. Note: CISS stands for Composite Indicator of Systemic Stress (0=No Stress, 1=High Stress). It aggregates stress symptoms across money, bond, equity and foreign exchange markets and is computed from time-varying correlations among individual asset returns.
Last observation: 22/06/2020.
COVID-19 likely to leave lasting scars on euro area economy

Eurosistem staff projections

Real GDP (index: 2019Q4 = 100)

Source: ECB.

HICP inflation (year-on year)

Source: ECB.
PEPP effective in easing financial conditions by removing duration risk

Euro area GDP-weighted yield curve

Impact of asset purchases on free-float ratio of the four largest EA countries (percentage points)


Source: ECB. Notes: The figure shows the compression of a free-float measure (based on the ratio of bond holdings of price-sensitive investors to total bond equivalents, as in Eser et al. 2019) induced over time by the successive vintages of the APP and the PEPP.
Strong portfolio rebalancing effects unleashed by negative rates

“Footprint” of policy rate cuts across maturity: standard rate cut vs. DFR cut in negative territory

Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem and Yiangou (2019). Notes: Term structure refers to OIS. The changes are normalized to a 10 bps decline of the OIS rate at the maturity where the measure exerts the maximum impact, namely 1-year for the standard rate cut and 5-years for the DFR cut.
TLTRO III mitigates tighter market-based funding conditions

Euro area bank funding conditions

- **Unsecured**
- **Secured (rhs)**

ECB liquidity-providing operations

- **TLTRO II**
- **Additional LTRO**
- **TLTRO III**
- **TLTRO III.4**

Net liquidity injection: € 548.5 bn
Total take-up: € 1308 bn

Source: Bloomberg. Note: Unsecured refers to Iboxx EUR Financials and Secured to Iboxx EUR Covered indices.

Source: ECB. Notes: TLTRO III refers to the sum of TLTRO III.1, III.2 and III.3.
Asset purchases more effective in periods of market stress

Impact of asset purchases during low and high market stress: the US experience

Source: Motto, Rast and Ristiniemi (2020), mimeo.
Notes: Local projections on monthly sample (2008-2019). Low stress events refer to periods when the VIX is below 25. IRFs scaled to a 50bp decline in 10-year yield on impact. Markers denote point estimates, error bars 68% significance bands.
**PEPP: highly effective and mitigating fragmentation**

**GDP-weighted average sovereign yield elasticities**

<table>
<thead>
<tr>
<th></th>
<th>2-year yield</th>
<th>5-year yield</th>
<th>10-year yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSPP announcement</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>PEPP announcement</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>PSPP announcement</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>PEPP announcement</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
</tbody>
</table>

**Estimated impact of PEPP envelope on 10-year sovereign yields across the four largest EA countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Min-max range</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>DE</td>
<td>-100</td>
<td>-80</td>
</tr>
<tr>
<td>FR</td>
<td>-80</td>
<td>-60</td>
</tr>
<tr>
<td>ES</td>
<td>-60</td>
<td>-40</td>
</tr>
<tr>
<td>IT</td>
<td>-40</td>
<td>0</td>
</tr>
</tbody>
</table>

Sources: Refinitiv, ECB calculations. Notes: PEPP estimates derived from an event study based on a two-day window after 18 March. PSPP estimates based on Eser et al. (2019). Elasticities refer to the change in (GDP-weighted) yields of the Big4 EA countries in response to €500bn of sovereign bond purchases in the euro area. No reinvestment assumed.

Sources: Refinitiv, ECB calculations. Notes: The bigger impact corresponds to the 2-day reaction of yields to the PEPP announcement in March 2020. The smaller impact (upper part of the boxes) is based on the model by Eser et al. (2019) which uses PEPP-implied projected duration extraction to estimate the impact on GDP-weighted Big4 sovereign yields. This average yield impact is then distributed to country level by assuming the same relative impacts as for the event approach.
Declining rates on non-financial commercial paper, longer tenors supported by Eurosystem purchases

Commercial paper rates and Euribor

- 3M financial CP issuance rate
- 3M non-financial CP issuance rate
- 3M Euribor

Source: NEU Banque de France

Commercial paper: outstanding amounts by maturity

Thank you