



EUROPEAN CENTRAL BANK

EUROSYSTEM

# Dealing with uncertainty and monetary policy normalisation: challenges for financial markets

CEMLA XII Central  
Banking Operations  
meeting, June 2022

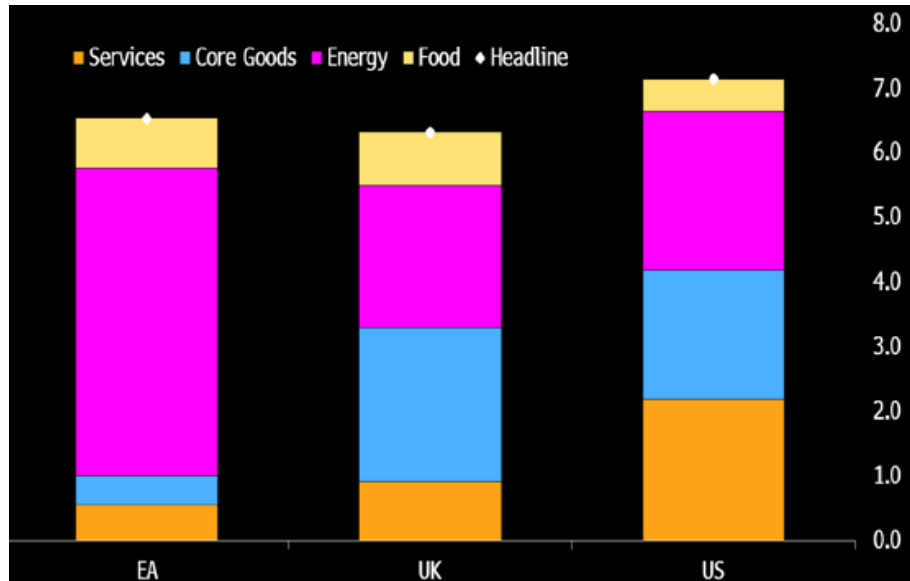
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# Inflation dynamics and market-based inflation expectations

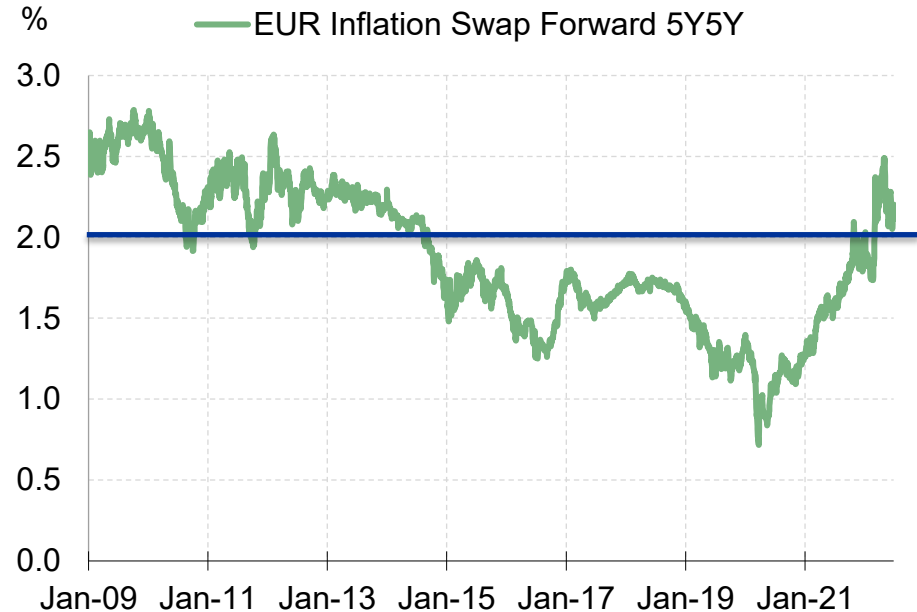
## Rise in inflation in the euro area is mostly driven by energy prices

(Contribution to change in inflation since January 21)



Source: Bloomberg  
Notes: Chart dated as of April 2022

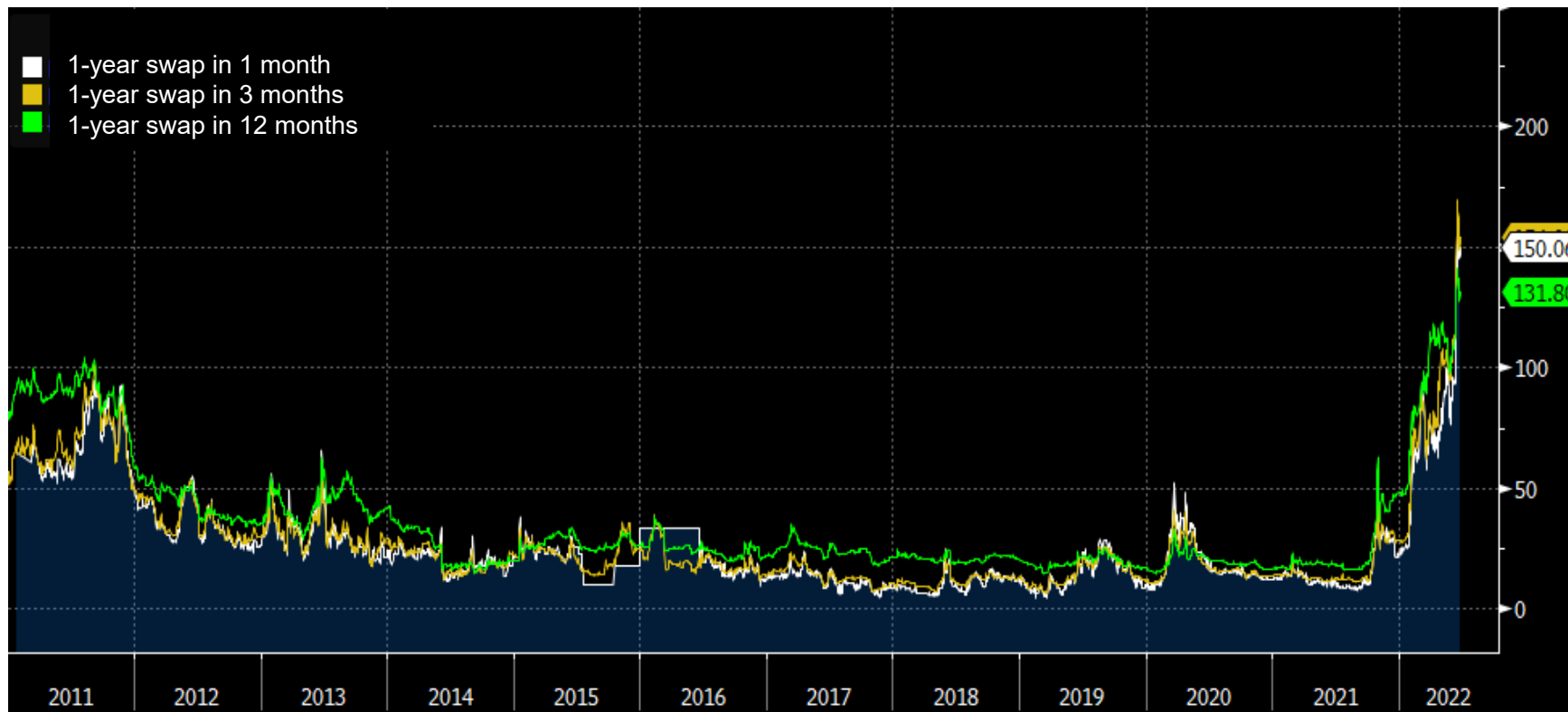
## Market-based inflation expectations moved higher, but remain anchored



Sources: ECB, Bloomberg

# Uncertainty permeates through financial markets (1)

## Implied volatility on money markets at highest level since 2011



# Uncertainty permeates through financial markets (2)

## Implied Volatility of Bund future also spiked at record level



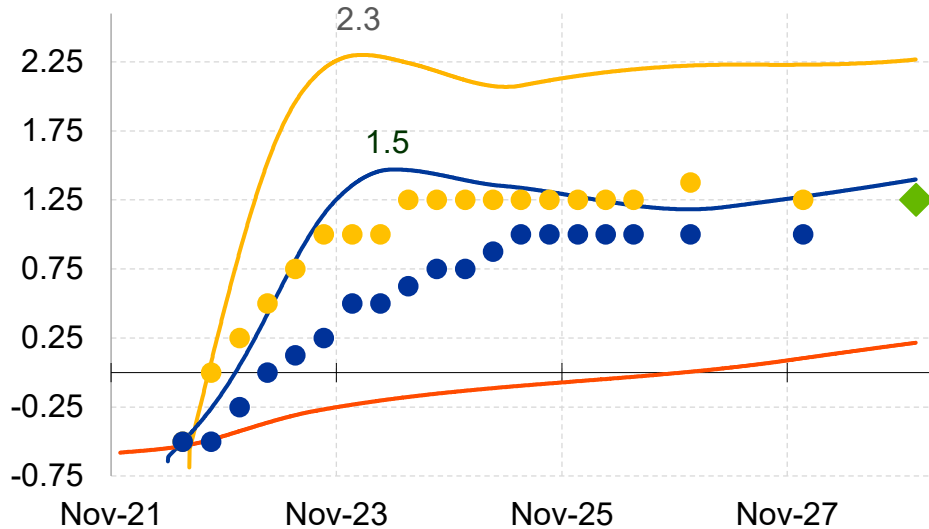
Source: Bloomberg

# Policy rate expectations in the euro area since 10 Nov 2021

## EUR OIS forward curve and SMA median expectations

(percentage per annum)

- 22-Jun-22
- 13-Apr (Pre GovC)
- 10-Nov (MOC ESCB)
- SMA - JUN22 - MEDIAN
- SMA - APR22 - MEDIAN
- ◆ SMA - long run



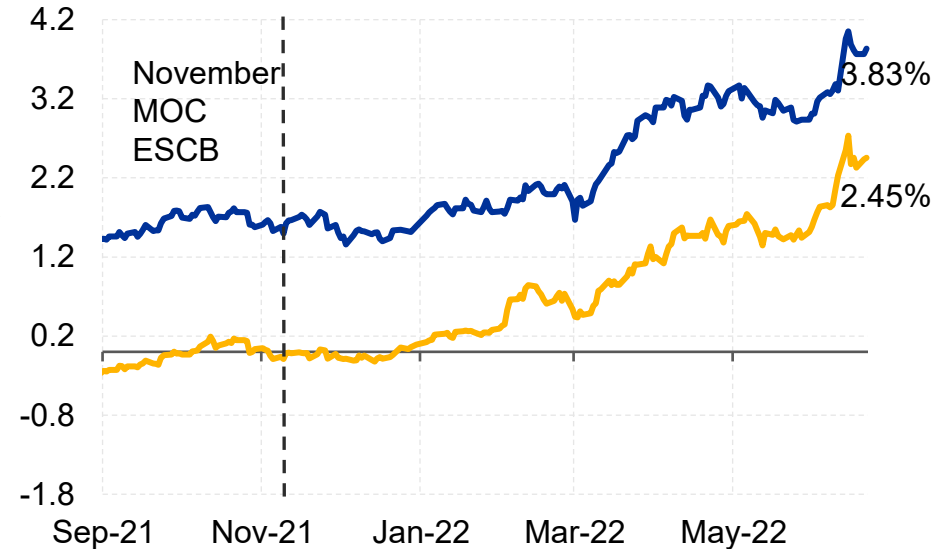
Sources: Bloomberg and ECB.

Notes: SMA median results from June and April surveys. The numbers in the plot area show the terminal rate as priced in the market at the respective point in time. Latest observation: 22 June 2022

## Market pricing of terminal rate

(percentage per annum)

- Euro area
- US



Sources: ECB, ECB calculations, Morgan Stanley, Bloomberg

Notes: The terminal rate for the euro area is derived from the euro OIS forward curve by capturing the first local peak within a five-year horizon for each observation. The terminal rate for the US is an estimate calculated by Morgan Stanley. Latest observation: 22 June 2022

# Policy normalisation in the euro area

## ***Normalisation approach***

June 2022 Monetary Policy Statement: *“Throughout this process, the Governing Council will maintain optionality, data-dependence, gradualism and flexibility in the conduct of monetary policy.”*

- ***Flexibility***
- ***Optionality***
- ***Data-dependence***
- ***Gradualism***
- ***Consistent with:***
  - ❑ *Sequencing (between end of net asset purchases and lift-off)*
  - ❑ *Forward guidance defined in the aftermath of the strategy review*

# Decision to end PEPP net asset purchases and keep flexibility

## ***On 16 December 2021 the Governing Council decided ...***

- *To discontinue net asset purchases under the PEPP at the end of March 2022*
- *To extend the reinvestment horizon for the PEPP until at least the end of 2024*
- *To adjust flexibly PEPP reinvestments across time, asset classes and jurisdictions at any time, in the event of renewed market fragmentation related to the pandemic*
- *To continue purchasing Greek government bonds over and above rollovers of redemptions to avoid an interruption of purchases which could impair the transmission of monetary policy to the Greek economy*

# Phasing out of pandemic-related collateral easing measures

***On 23 March 2022, the Governing Council decided on timeline to gradually phase out package of temporary pandemic collateral easing measures***

- Measures introduced in April 2020 will be gradually phased out in three steps between July 2022 and March 2024.
- The step-wise phasing out will lead to a gradual restoration of the Eurosystem's pre-pandemic risk tolerance, while avoiding collateral availability cliff-effects.
- ECB will continue to waive the minimum credit quality requirement for Greek government bonds (GGBs), allowing national central banks (NCBs) to accept them as collateral, in line with the continued eligibility of GGBs in the pandemic emergency purchase programme (PEPP).



# Decision to end APP net asset purchases

## ***On 9 June 2022, the Governing Council decided ...***

- *to end net asset purchases under its asset purchase programme (APP) as of 1 July 2022;*
- *that it intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates and, in any case, for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance.*

# Outlining a path to lift-off and beyond

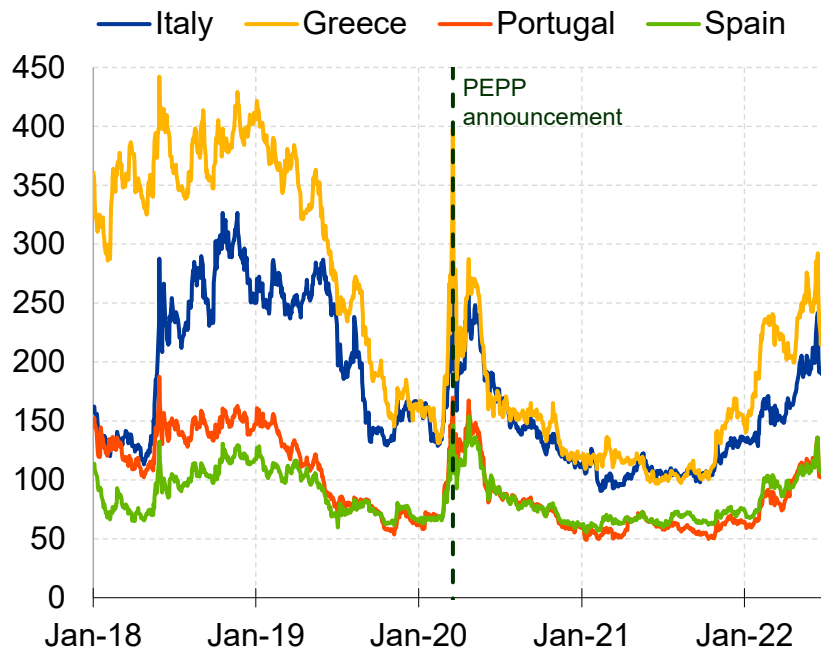
***On 9 June 2022, the Governing Council outlined a series of steps towards rate normalisation:***

- *The three forward guidance conditions have been satisfied*
- *Accordingly, and in line with our policy sequencing, we intend to raise the key ECB interest rates by 25 basis points at our July monetary policy meeting*
- *Looking further ahead, we expect to raise the key ECB interest rates again in September. The calibration of this rate increase will depend on the updated medium-term inflation outlook. If the medium-term inflation outlook persists or deteriorates, a larger increment will be appropriate at our September meeting.*

# Widening of sovereign and credit spreads, uneven transmission

## Sovereign bond spreads

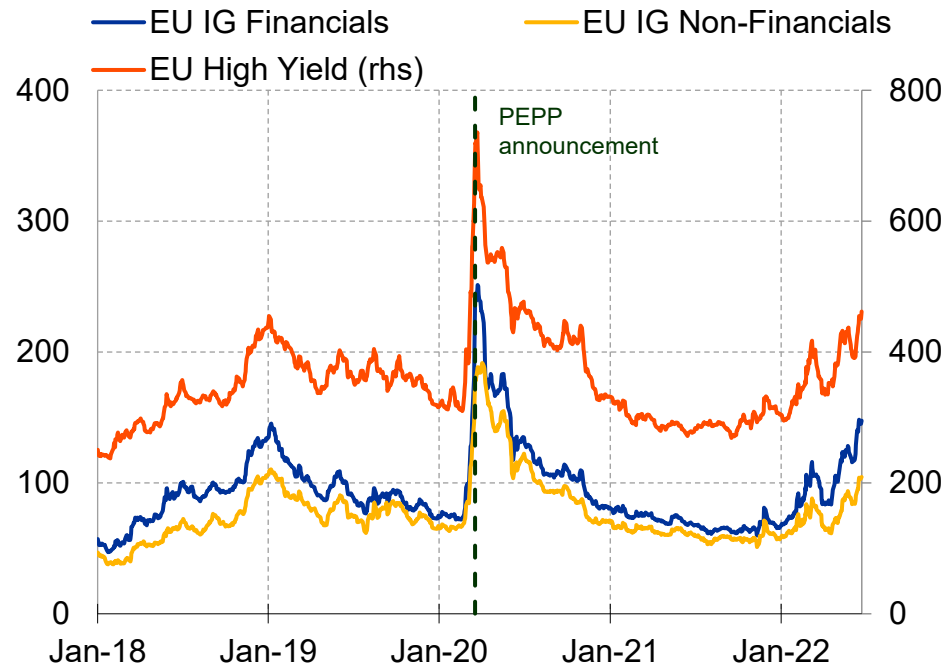
(basis points)



Source: Bloomberg.  
Latest observation: 22 June 2022.

## Corporate bond spreads

(basis points)



Source: iBoxx.  
Latest observation: 22 June 2022.

# Flexibility in PEPP redemptions & new anti-fragmentation instrument

***On 15 June 2022, Governing Council decided, at its ad-hoc meeting,...***

- To apply flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to preserving the functioning of the monetary policy transmission mechanism, a precondition for the ECB to be able to deliver on its price stability mandate.*
- To mandate the relevant Eurosystem Committees together with the ECB services to accelerate the completion of the design of a new anti-fragmentation instrument for consideration by the Governing Council.*

***Isabel Schnabel, United in diversity – Challenges for monetary policy in a currency union, speech 14 June: “Put simply, fragmentation reflects a sudden break in the relationship between sovereign yields and fundamentals, giving rise to non-linear and destabilising dynamics”***

# Medium-term challenges for markets and implementation

