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Article

"ECB announcements lift inflation expectations by overall 20-30 basis points": Seven questions to Malte Rieth

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Dr. Malte Rieth, Research Associate
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SEVEN QUESTIONS TO MALTE RIETH

»ECB announcements lift inflation expectations by overall 20–30 basis points«

1. Dr. Rieth, the European Central Bank (ECB) has initiated various bond purchase programs. What exactly is it hoping to achieve? First of all, the ECB wants to stabilize inflation and inflation expectations by purchasing bonds and assets, thus lowering interest rates—especially in the long run. Long-term interest rates are important for lending to households and businesses alike. The hope is that keeping interest rates low will lead to higher credit demand and activity. This should stimulate the economy and slowly raise inflation in the medium- to long-term.
2. Do the different ECB programs have different objectives? These programs do indeed have different objectives. At the height of the euro crisis, it was primarily a matter of holding the euro together and restoring the transmission mechanism of monetary policy. Programs from 2013 onward were aimed more at stabilizing lower inflation expectations in the wake of the decline in oil prices. That's why these programs focus specifically on stimulating inflation and inflation expectations.
3. Was the ECB able to raise inflation expectations with the most recent bond purchase programs? According to our calculations, these programs were successful. A term of roughly two years is the horizon the ECB has in mind when attempting to control inflation. Various announcements ensured that inflation expectations over the two-year horizon have risen by around 20 to 30 basis points when all the programs announced in the past two to three years are taken together.
4. How effective have these measures been? This is difficult to judge. You can, however, look at what impact they've had in other countries. For instance, other central banks, such as the US Federal Reserve or the Bank of England, carried out similar bond purchase

programs. We can conclude that the ECB's policies were not as effective in comparison. This is primarily due to the fact that the ECB implemented its programs after the central banks in the US and the UK, which announced and implemented their measures when interest rates were still considerably higher. This meant that the impact on interest rates and inflation expectations was greater than that of the ECB's measures.

5. What are the drawbacks of the bond purchase programs? The most common risk is that the measures could lead to asset price bubbles and that the money made available to the market by the ECB finds its way into other asset classes: into equity or housing, for example, or perhaps into certain sectors of the bond market. This could potentially lead to excesses, which might cause to become too high. If these bubbles then burst, it would cause further potential crises. But it does not look as if there will be massive excesses in euro area asset markets.
6. Should the ECB do more to increase inflation expectations? Looking at the ECB's own forecasts, it will have to do more. According to recent forecasts, the ECB expects inflation to remain below its target until and including 2018. This suggests the ECB will announce further expansionary measures this year, or next year at the latest.
7. What might these measures be? I think it is most likely they will extend the existing bond purchasing program, for example, by topping it up or by extending the term. It might also include certain finer adjustments making funding conditions for the banks and other financial institutions even more attractive.

Interview by Erich Wittenberg



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