



TOPICAL RESEARCH AND HIGHLIGHTS

MONETARY POLICY MEASURES IN
THE EURO AREA AND THE UNITED STATES
RELATED TO THE COVID-19 PANDEMIC

(PUBLISHED IN 'ECONOMIC REVIEW',
VOL. 1/2020)



BULGARIAN NATIONAL BANK

Monetary Policy Measures in the Euro Area and the United States Related to the Covid-19 Pandemic

Measures to curb the spread of the new coronavirus, SARS-COV-2, have caused an unprecedented global economic crisis with a strong decline in GDP and dramatically increased uncertainty about short- and medium-term prospects. Output slowed down strongly in major world economic regions as a result of disruptions in supply chains, weaker domestic and external demand and severely worsened prospects to economic growth. March saw global financing conditions for governments, banks, corporations and households rapidly and strongly deteriorated, which worsened their liquidity and created conditions for disrupting financial stability. Therefore, the major central banks, including the US Federal Reserve System and the ECB launched rapid and wide-ranging monetary policy measures. This box is aimed to summarise major monetary policy changes in the euro area and the United States between March and mid-May 2020.

ECB Monetary Policy Measures

The ECB Governing Council adopted step by step a package of monetary policy measures in response of the emerging COVID-19 crisis, with reference interest rates remaining unchanged. These measures can be broken down into three major groups: 1) refinancing operations; 2) lowering the quality of assets accepted as collateral in refinancing operations; and 3) asset purchase programmes. The measures were aimed at maintaining the liquidity and financing conditions for governments, banks, households and corporations in the euro area.

The first measure of group one was announced by a Governing Council decision of 12 March¹. It foresaw conducting weakly longer-term refinancing operations (LTRO) of temporary nature intended to provide liquidity support to the euro area banking system. The interest rate applied to these operations is the average interest rate on the deposit facility. These operations will mature on 24 June 2020, thereby ensuring liquidity for the euro area financial system for the period until the next LTRO III operation in June 2020.

On 30 April the ECB Governing Council announced a new series of longer-term refinancing operations in the context of emergency situation, called pandemic emergency longer-term refinancing operations (PELTROs). The programme includes seven additional refinancing operations commencing in May 2020 and maturing in a staggered sequence between July 2021 and September 2021. The interest rate was set at 25 basis points below the average interest rate on main refinancing operations.

On 12 March the ECB Governing Council launched also measures in support of lending and refinancing of households and corporations improving the terms and conditions on targeted longer-term refinancing operations (TLTRO III) for the period from June 2020 to June 2021. The interest rate on these operations was initially lowered to 25 basis points below the average interest rate on main refinancing operations and consequently (by a decision of 30 April) to 50 basis points below the average interest rate on main refinancing operations. For banks lending under a preliminary set threshold the interest rate on these operations was initially reduced to 25 basis points below the average interest rate on the deposit facility and consequently (by a decision of 30 April) to 50 basis points below the average interest rate on the deposit facility. The maximum total amount of funds to be borrowed in TLTRO III operations was raised.

In addition to the expanded volume and lower interest rates on refinancing operations collateral quality requirements for participation in these operations were eased.² On 7 April the ECB Governing Council allowed the use of Greek government bonds and credit claims as collateral in refinancing operations, lowering the collateral valuation haircut on credit operations by 20 per cent. On 22 April the ECB announced³ that until September 2021 the quality requirements for eligible collateral used in refinancing operations would be eased in cases of possible rating downgrades resulting from the economic fallout from the pandemic.

¹ See <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200312~8d3aec3ff2.en.html>

² See <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200407~2472a8ccda.en.html>

³ See https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200422_1~95e0f62a2b.en.html

The third group of measures included an expansion of the net purchases of assets by the Eurosystem under the asset purchase programme, (APP) and the launch of a new temporary asset purchase programme. On 12 March the amount of net purchases under APP was raised by EUR 120 billion until the end of 2020. It was stated that this would increase the contribution from the private sector asset purchase programmes. Reinvestments of the principal payments from maturing securities purchased under the asset purchase programme will continue, in full, for an extended period of time past the date when the ECB Governing Council starts raising the key interest rates. In addition, on 18 March the scope of assets eligible for purchase under the corporate sector purchase programme (CSPP) was expanded.

After the 18 March extraordinary meeting the ECB Governing Council announced⁴ the launch of a new temporary purchase programme of private and public sector securities called Pandemic Emergency Purchase Programme (PEPP). Purchases under the programme will amount to EUR 750 billion and will be conducted until the end of 2020 including all the asset categories eligible under the asset purchase programme (APP). The new PEPP will be implemented in a flexible manner and it will allow for temporary fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions. The limits of maximum purchased securities issued by one issuer or one issue applied to PSPP shall not apply to PEPP.⁵ The principle of allocating purchases according to the capital key of the national central banks in the ECB capital remained in force. Under the new programme purchases of securities issued by the Greek government were allowed. After the 30 April meeting the ECB Governing Council announced that it was fully prepared to increase the size of the PEPP and adjust the composition, volume and duration of the programme.

As a result of the monetary policy measures launched, including swap lines from the US Federal Reserve, the ECB balance sheet figure increased EUR 759 billion from the beginning of March until 8 May, exceeding Bank's balance sheet growth during the 2008 global financial crisis, when the balance sheet figure rose EUR 648 billion between September and December 2008.

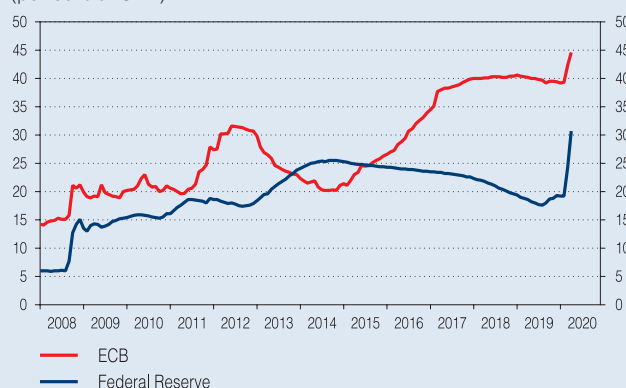
US Federal Reserve System Monetary Policy Measures

As a result of the spread of COVID-19 in the United States which posed serious risks to the US economy, the US Federal Reserve System initiated a number of measures to smooth the negative economic implications of the crisis. The measures launched by the US Federal Reserve can be broken down into three major groups: 1) measures related to traditional monetary policy tools; 2) programmes for providing US dollar liquidity outside the USA; and 3) programmes for providing liquidity and lending facilities to corporations, households and municipalities inside the USA.

The first measure launched by the FOMC after the unscheduled meetings was to lower the target range for the federal funds rate initially by 50 basis points (on 3 March) and later (on 15 March) by another 100 basis points 0.00–0.25 per cent. Furthermore, new measures were launched to stimulate the supply of liquidity by deposit institutions through cutting the Primary Credit Rate by 150 basis points to its historical low of 0.25 per cent. On 23 March a decision was made to change the framework of the asset purchase program, originally announced on 15 March at USD 700 billion⁶. The volumes under the programme became unlimited and purchases of commercial mortgage bonds were included to the purchases of US Treasury securities and residential mortgage bonds. In addition, the terms and conditions for repo operations conducted by the Federal Reserve Bank of New York were eased. Three extraordinary, two three-month and one one-

ECB and Federal Reserve Balance Sheets

(per cent of GDP)



Sources: the ECB; the Federal Reserve System.

⁴ See https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200422_1~95e0f62a2b.en.html

⁵ See <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020D0440&from=EN#d1e266-1-1>

⁶ The programme announced on 15 March 2020 provided for purchases of US Treasury securities and mortgage bonds with a minimum volume of purchases of USD 500 billion and USD 200 billion respectively.

month repo operations were conducted, each amounting to USD 500 billion.

The second group of measures, comprising part of the coordinated actions of large central banks, focused mainly on contractual terms on credit swap lines⁷ of the US Federal Reserve with other central banks. The measures announced on 15 March originally included an interest rate cut by 25 basis points to OIS + 25 basis points and an extension of the maturity of swap lines provided by the US Federal Reserve to 84 days. Initially, the measures were announced only for the European Central Bank, the Bank of England, the Bank of Japan, the Bank of Canada, and the Swiss National Bank. On 19 March another nine central banks⁸ were temporarily included for a period of not less than six months. On 20 March the frequency of operations with a seven-day maturity was increased from weekly to daily. As at 14 May the amount of the US Federal Reserves swap lines totalled USD 446.5 billion and were mainly used by the Bank of Japan (USD 224.2 billion) and the ECB (USD 143.1 billion).

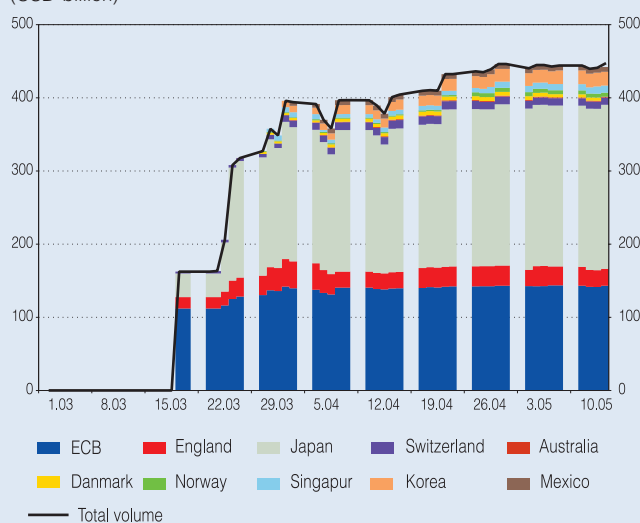
In addition to the measures for providing liquidity through swap lines, on 31 March an additional tool was launched to provide US dollar liquidity to central banks and international institutions (Foreign and International Monetary Authorities (FIMA) Repo Facility) with accounts at the Federal Reserve Bank by entering into repurchase agreements in US Treasury securities.

The scope of the third group of measures was the widest and included both a resumption of programmes applied during the financial crisis in 2008–2009 and establishment of entirely new programmes expanding significantly beneficiary groups of credit facility measures. On 17 March the Federal Reserve Board announced the establishment of a Primary Dealer Credit Facility (PDCF) and a Commercial Paper Funding Facility (CPFF). On 18 March a Money Market Mutual Fund Liquidity Facility (MMLF) was established. On 23 March the establishment of two new facilities was announced to support credit to large employers: the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance and the Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds on the secondary market. The establishment of tools for intervention in the corporate bonds market was a new and extraordinary measure launched by the US Federal Reserve System. The Term Asset-Backed Securities Loan Facility (TALF) was restored to support the flow of credit to consumers and businesses. The TALF enables also the issuance of asset-backed securities (ABS). The range of securities that can be purchased under the established MMLF and CPFF was widened.

On 9 April the Federal Reserve took additional actions to provide USD 2.3 trillion in the form of additional programmes and credit facilities established jointly with the US Department of Treasury. The measures included an expansion of the scope and an increase of the maximum amount under PMCCF and SMCCF to USD 750 billion. A new Main Street Lending Program was established⁹ to purchase loans of small and medium-sized businesses meeting the terms and conditions of the programme¹⁰ totalling USD 600 billion. The Main Street Lending Program consists of three separate facilities: Main Street New Loan Facility

US Federal Reserve Swap Lines

(USD billion)



Note: By 14 May 2020 the central banks of Canada, Brazil, New Zealand and Sweden did not use their swap lines.

Source: FBI of New York.

⁷ See <https://www.federalreserve.gov/newsevents/pressreleases/swap-lines-faqs.htm>

⁸ Central banks of Australia, Brazil, Denmark, Korea, Mexico, New Zealand, Norway, Singapore and Sweden.

⁹ See <https://www.federalreserve.gov/monetarypolicy/files/main-street-lending-faqs.pdf>

¹⁰ Loans under the Main Street Lending Program are intended to support small and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 pandemic by extending four-year loans to companies having 10,000 employees or fewer or revenue of USD 2.5 billion or less. The banks which have extended the loans should keep 5 per cent of them, whereas the remaining 95 per cent will be purchased by special purpose vehicles (SPV) under the Main Street Lending Program.

(MSNLF), Main Street Priority Loan Facility (MSPLF) and Main Street Expanded Loan Facility (MSELF). The first two facilities are intended to purchase new loans, while the third one is aimed at increasing the size of loans to small and medium-sized businesses which have been already disbursed. Furthermore, the US Federal Reserve established the Municipal Liquidity Facility to support state and local governments with funds totalling USD 500 billion. The facility will directly purchase short-term securities issued by US states and countries or cities with a population exceeding 1 million residents. The US Federal Reserve established also Paycheck Protection Program Liquidity Facility (PPPLF) intended to provide liquid funds to financial institutions offering loans under the Paycheck Protection Program.¹¹

Most of the measures approved by the US Federal Reserve System in March and in early April were subsequently changed in terms of their scope and size until mid-May. On 11 May the Federal Reserve of New York announced¹² that purchases of exchange-traded funds (ETF) would start on 12 May as part of the SMCCF. Concurrently, weekly volumes of unlimited purchases by the Federal Reserve of New York¹³ were reduced from USD 300 billion in the week ending 27 March to USD 30 billion in the week ending 22 May.

As a result of the monetary policy measures launched, the US Federal Reserve System balance sheet increased substantially from the beginning of March until 13 May by USD 2.8 trillion to USD 6.9 trillion, exceeding significantly the Bank's balance sheet growth during the 2008 global financial crisis, when the balance sheet figure rose USD 1.3 trillion between September and December 2008.

¹¹ See <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>

¹² See <https://www.newyorkfed.org/newsevents/news/markets/2020/20200511>

¹³ See <https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation/treasury-securities/treasury-securities-operational-details>

THE SCULPTURAL COMPOSITION BY KIRIL SHIVAROV DEPICTING HERMES AND DEMETER ON THE SOUTHERN FAÇADE OF THE BULGARIAN NATIONAL BANK BUILDING IS USED IN COVER DESIGN.