QE: WHAT IS IT, WHY AND WHAT WILL IT DO?

Society of Actuaries in Ireland

Rossa White, NTMA Chief Economist, February 23rd 2015

QE

1. What is it?

Before QE: stylised financial system

ECB		**Commercial Bank**	
Assets	Liabilities	Assets	Liabilities
Existing claims	Existing money	Government bonds Agencies (e.g. ESM) ABS Covered bonds	Deposits etc.

After QE: stylised financial system

ECB		Commercial Bank	
Assets	Liabilities	Assets	Liabilities
Existing claims	Existing money	Money	Deposits etc.
Government bonds Agencies (e.g. ESM) ABS Covered bonds	Reserves (money)		

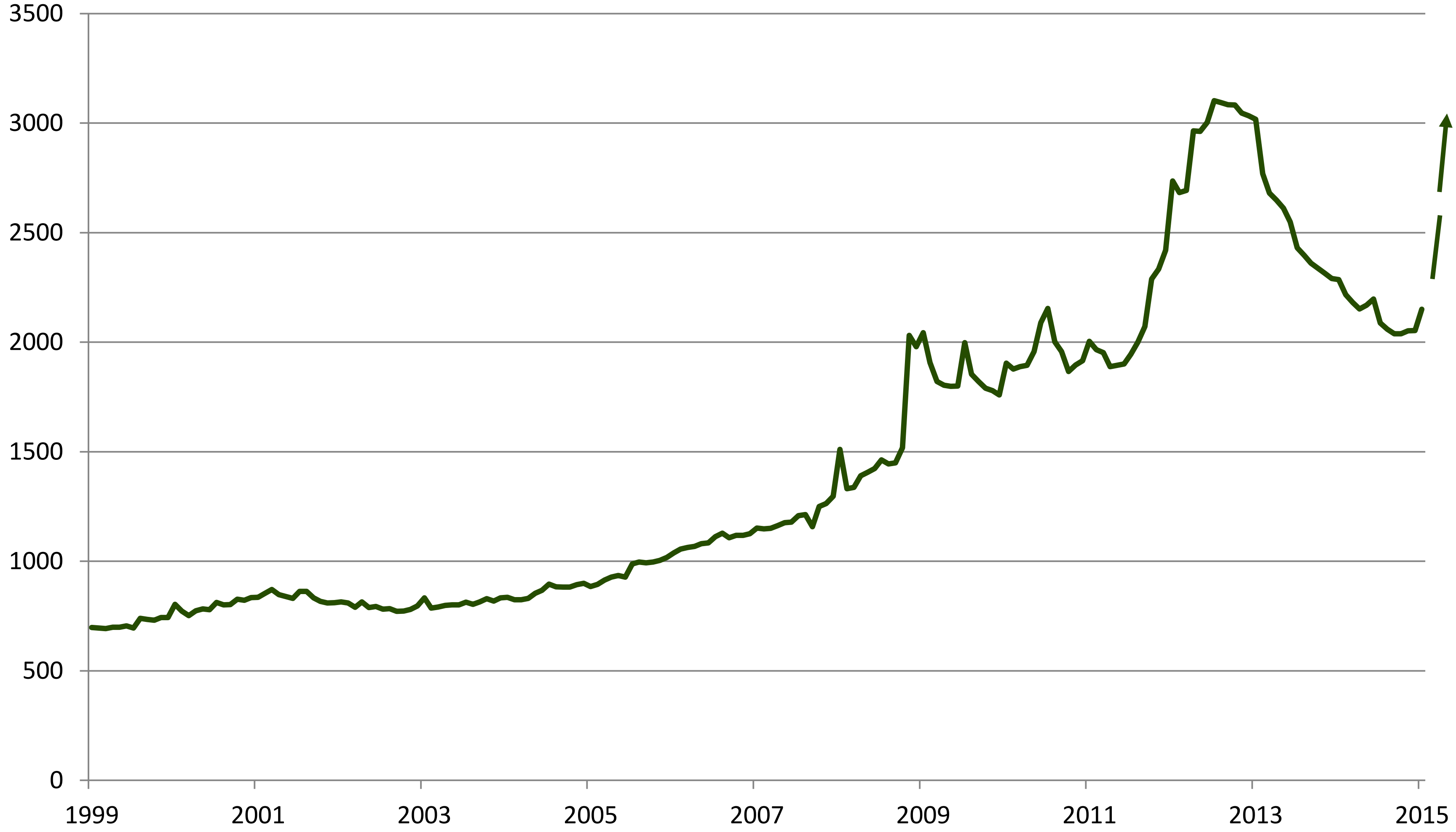
What will the bank do with this? Lend it out? Leave it on deposit with ECB? Re-invest it in risky assets?

After QE: real economy money creation?

Commercial Bank		Firm X	
Assets	Liabilities	Assets	Liabilities
Loan to Firm X	Deposits etc.	Money	Loan from bank

This is how the new money could enter the real economy; similarly if you replace Firm X with Household Y

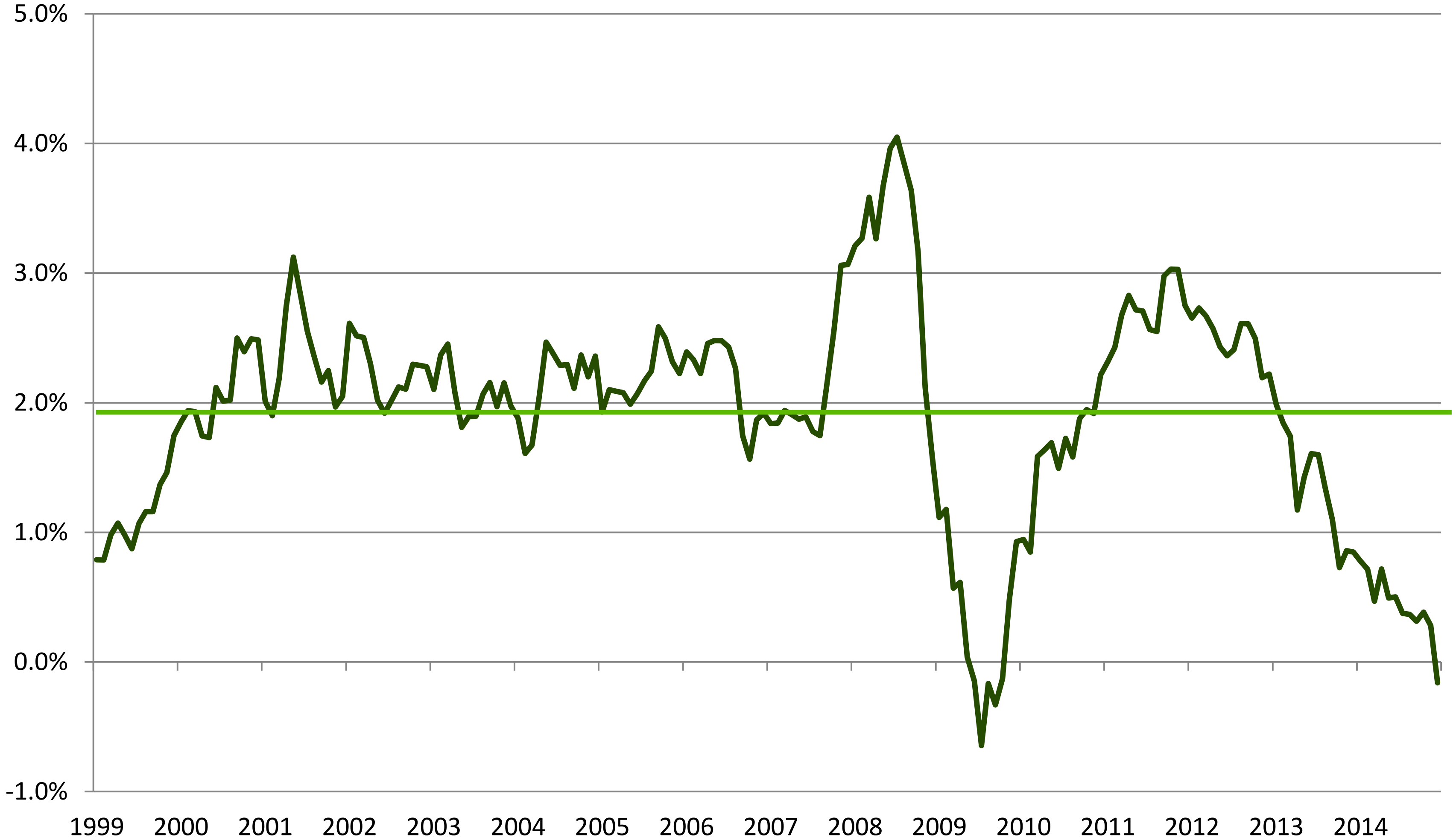
ECB balance sheet set to rise back towards €3 trillion?



QE

2. Why is it needed?

Euro area inflation well below target of “close to but below 2%” in the medium-term



Falling prices or deflation seen as a bad thing in textbook (rational!) economics, but not clear-cut

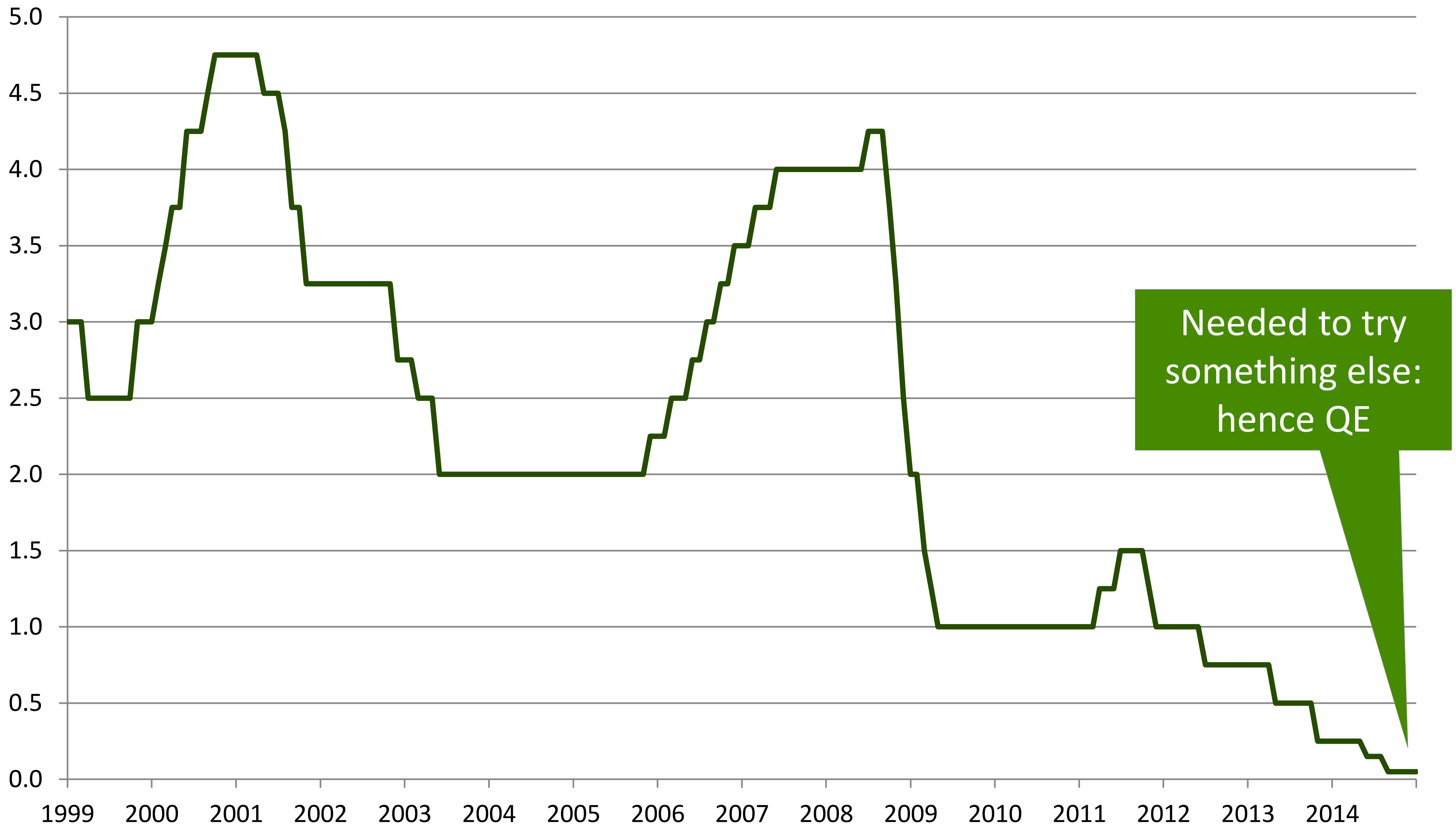
Cons

- May delay purchases
- Reduce Government revenue
- Lead to second-round effects of lower wages
- Raise real value of debt
- All of the above to lead to debt-deflationary spiral

Pros

- Lower prices raise real incomes
- Falling oil prices are good because demand is inelastic
- Competitiveness gains help boost exports and raise GDP
- Prices have fallen periodically (esp. in 1800s); and better quality goods mask true drop in CPI

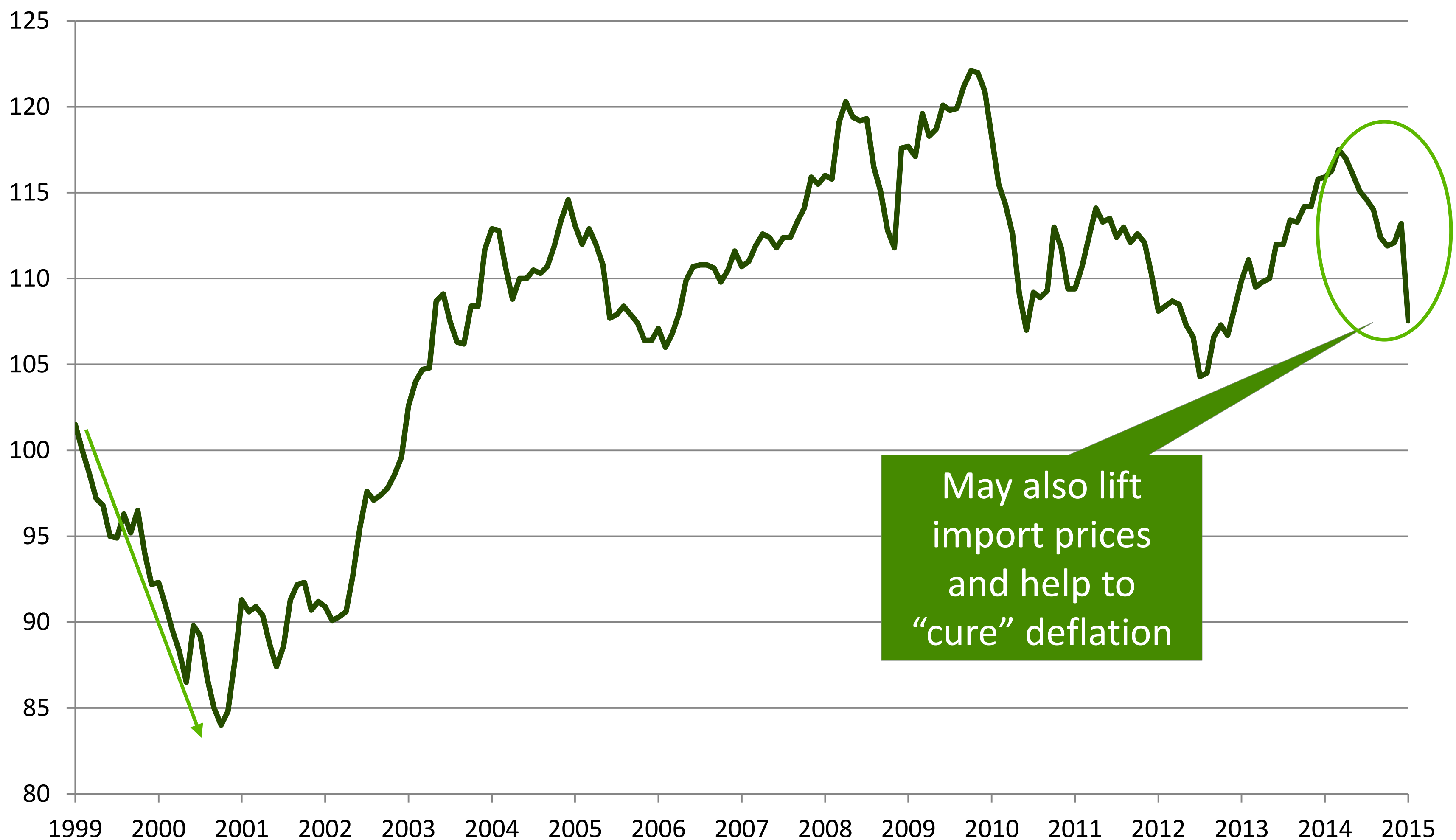
ECB overnight rate at zero bound, so plan A is over



QE

3. What will it do?

Trade-weighted euro beginning to drop: its depreciation has lifted exports and the overall economy before



US risky assets have soared since QE began; bond yields decline on Fed buying and low inflation

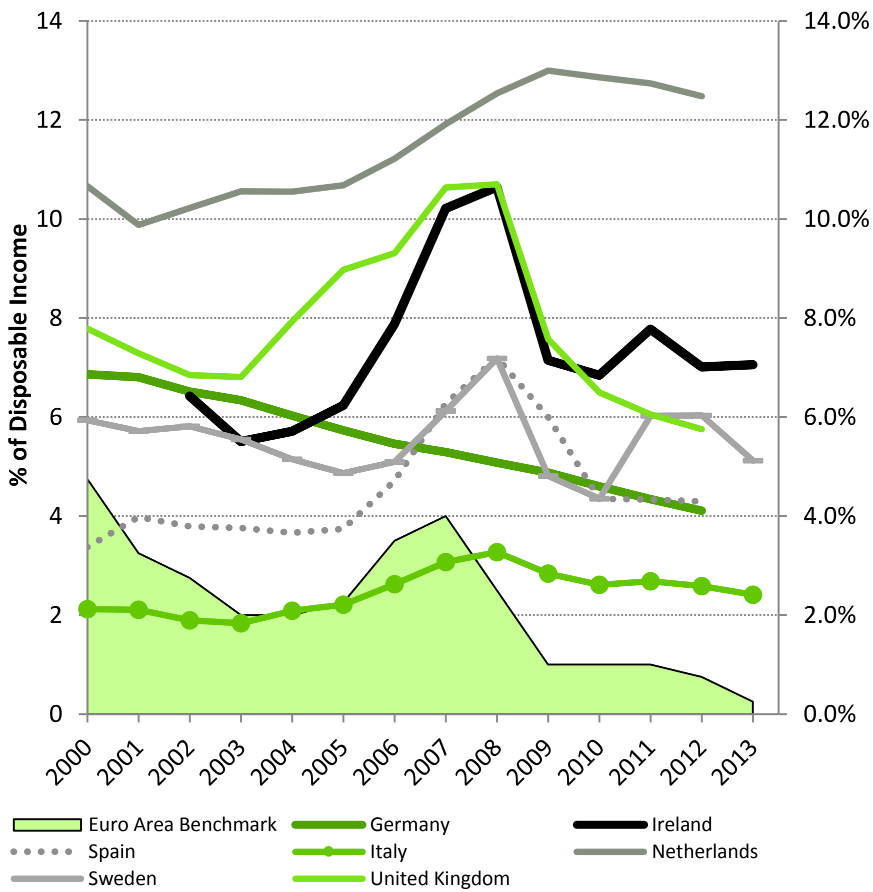
S&P 500 since US QE began

US 10-year treasury bond yields

Drop in currency boosts Irish exporters and households enjoy capped interest bills for longer

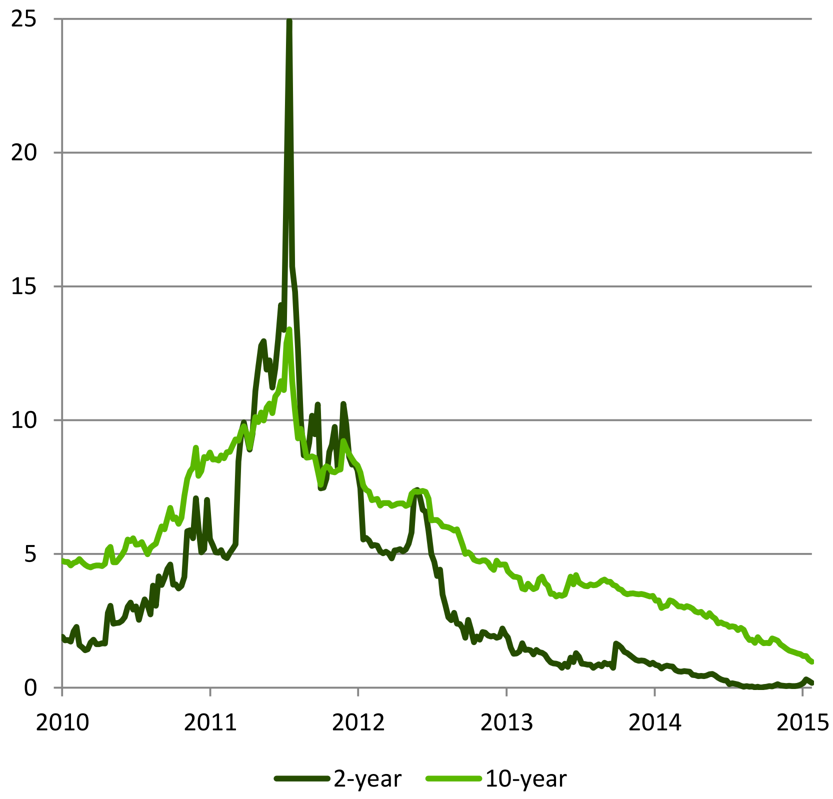
Ireland trade-weighted € (Jan 95=100)

Household interest burden (% DI)



QE likely to make NTMA's funding job a little easier

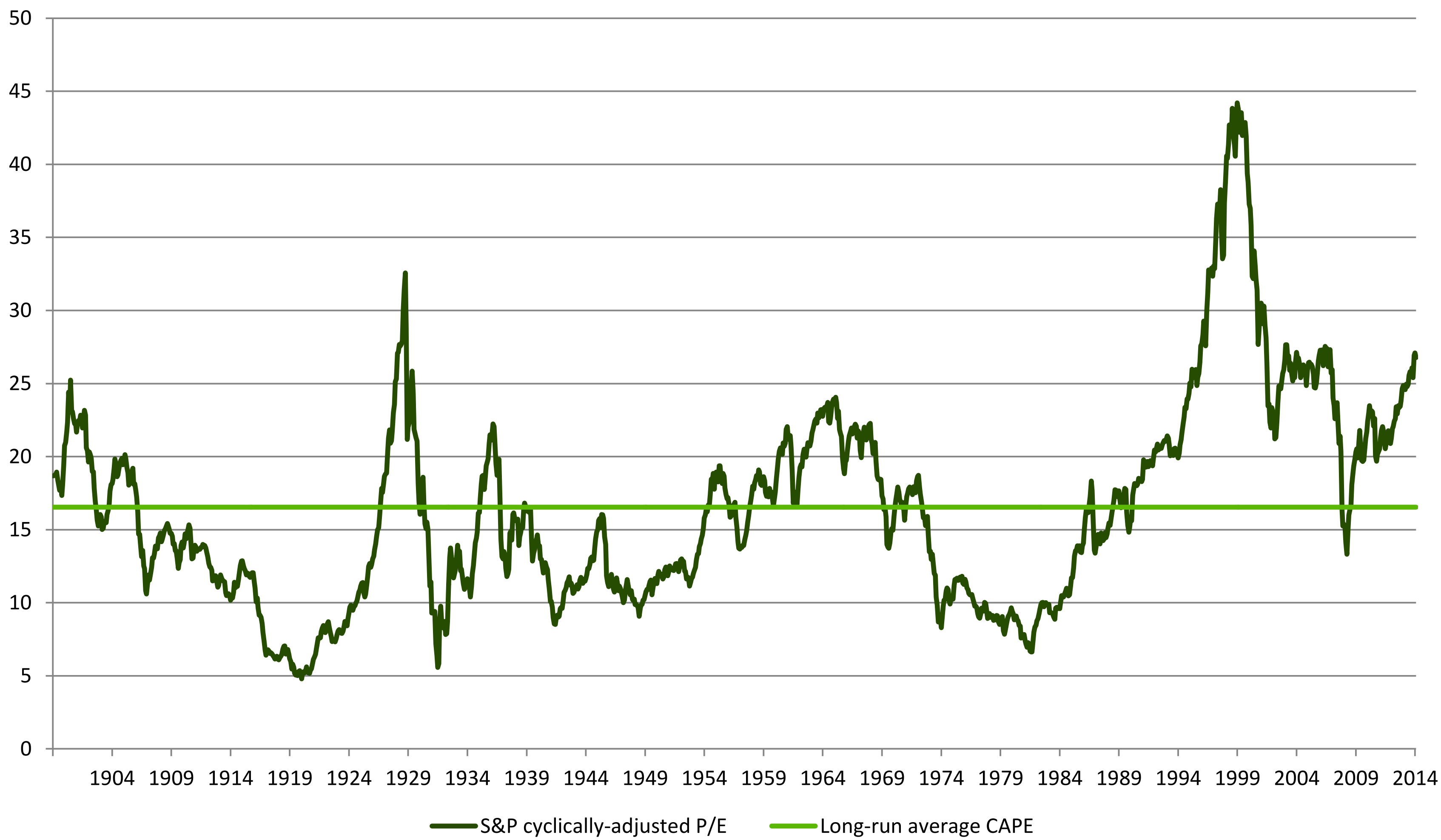
Ireland's bond yields (2 and 10 year %)



Potential impact on NTMA

- ECB may buy around €13bn of Irish bonds until September 2016
- Will hopefully keep a lid on Irish bond yields
- ECB will accumulate at least 10% of eligible stock and probably a lot more through secondary mkt.
- Refinancing should be easier
- Small fiscal benefit, depending on *yield* * amount bought (c.€100m)

US equities are expensive: didn't undershoot in 2009 thanks in part to QE "portfolio re-balancing" effect



Rising inequality is probably a by-product