EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC
COURTESY TRANSLATION

Mario DRAGHI
President

Mr Auke Zijlstra
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 2 May 2019
L/MD/19/139

Re: Your letter (QZ-025)

Honourable Member of the European Parliament, dear Mr Zijlstra,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 19 March 2019.

The ECB’s non-standard measures have made a considerable contribution to the euro area’s growth and inflation performance. By substantially easing financing conditions, they have supported lending to firms and households and, in turn, contributed to stronger real GDP growth, employment gains and higher inflation.

To avoid the reliance on a specific type of model that, as CPB research showed, might not give reliable estimates, ECB research has followed a much broader approach to assess the impact of the ECB’s non-standard measures, taking also into account the anticipation effects of monetary policy announcements. ECB and Eurosystem staff have made a concerted effort to quantify such effects using a broad set of state-of-the-art models, ranging from optimising general equilibrium structures which emphasise the forward-looking behaviour of economic agents to time series models that rely on identified co-movements across variables and are not forward-looking. The aim of that Eurosystem-wide exercise is to produce results that are as robust as possible and capture a variety of channels that theory suggests are activated when central banks conduct balance sheet policies. The models used are run regularly at the ECB, as well as at national central banks, and have been vetted by professional review, with many of them documented in major international macroeconomic journals. While the resulting estimates are surrounded by statistical uncertainty, they suggest that, taken together, the measures implemented since mid-2014 will have a total cumulative impact of around 1.9 percentage points on both real GDP growth and inflation in the euro area in the period from 2016 to 2020.[1]

By pursuing its primary objective of maintaining price stability over the medium term, as enshrined in the Treaty on the Functioning of the European Union, the ECB helps to preserve the value of savings. In fact, households – which, in addition to being savers, are also homeowners, employees, taxpayers and/or entrepreneurs – have benefited greatly from the positive impact that our measures have had on the euro area economy. Since May 2014, our measures have helped to bring about a significant decline in lending rates for households and non-financial corporations (which have fallen by around 110 and 130 basis points respectively), with lending rates now standing close to all-time lows. Meanwhile, the annual growth rate of loans to non-financial corporations stood at 3.7% in February 2019, up from -3.0% in May 2014, while that of loans to households rose from -0.1% to 3.3% over the same period. The unemployment rate in the euro area stood at 7.8% in February 2019, its lowest level since October 2008, while the number of people in employment increased by around 10.2 million between the second quarter of 2013 (when euro area employment bottomed out) and the fourth quarter of 2018.

The ECB and the national central banks of the Eurosystem maintain a comprehensive, forward-looking and pre-emptive risk management framework in order to identify and control balance sheet risks. The process used to control risks rests on four pillars: the identification of risks; the design of risk management strategies and policies; the operationally efficient implementation of such strategies and policies; and continuous monitoring of and reporting on financial risks. In particular, the Eurosystem's risk management framework encompasses controls designed to mitigate the credit risk stemming from direct exposure to the issuers of bonds purchased under the asset purchase programme and collateralised exposure to counterparties in refinancing operations.

In its refinancing operations, the Eurosystem only provides credit to financially sound counterparties in return for adequate collateral, as required by the Statute of the European System of Central Banks and of the European Central Bank. For this reason, the Eurosystem sets detailed minimum eligibility criteria and applies rigorous valuation haircuts in order to mitigate the risks associated with the asset classes accepted as collateral, which would be liquidated in the event of a counterparty default. Similarly, in the context of its asset purchases, the Eurosystem only buys assets that meet high credit quality requirements akin to those governing the acceptance of assets as collateral. In addition, it ensures diversification in its asset purchase portfolio by seeking to achieve market neutrality and setting issuer and issue share limits. This is complemented by due diligence procedures, risk-monitoring processes and additional risk management measures as required.

The Eurosystem continuously scrutinises the risks associated with all of its financial exposures, not only those relating to its asset purchases and collateralised refinancing operations. Financial risks are quantified

[1] For more details, see the article entitled "Taking stock of the Eurosystem's asset purchase programme after the end of net asset purchases" in the March 2019 issue of the ECB's Economic Bulletin (available here: https://www.ecb.europa.eu/pub/economic-bulletin/articles/2019/html/ecb.ebart201902_01~3049319b8d.en.html#toc1).

in detail and are regularly checked against the net equity base of the Eurosystem and that of each individual central bank, so as to evaluate the relevant loss absorption capacity and any potential deterioration thereof. Those risk monitoring and measurement processes are based on internally harmonised risk assessment methodologies and consolidated data spanning the whole of the Eurosystem's balance sheet. Levels of financial risk and the contributions of the various components of that risk are reported regularly, both for the Eurosystem as a whole and for each individual central bank (including the ECB). More detailed information about the Eurosystem's risk management framework and processes can be found in the ECB publication entitled "The financial risk management of the Eurosystem's monetary policy operations"[2].

Ultimately, the ECB manages the risks on its balance sheet with a view to ensuring its continued ability to maintain price stability in line with its mandate. Consequently, in order to cater for residual risks remaining after the application of the relevant risk control frameworks, the ECB also makes provision for risks relating to exchange rates, interest rates and the price of gold, in addition to credit risk.

Yours sincerely,
[signed]

Mario Draghi

[2] Available at https://www.ecb.europa.eu/pub/pdf/other/financial_risk_management_of_eurosystem_monetary_policy_operations_201507.en.pdf

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