

Asset Purchases Programmes and Financial Markets: Lessons from the Euro Area

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discussed by Michael Weber

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Unconventional Monetary Policy

- Conventional monetary policy constrained by ZLB
- Forward guidance less powerful in practice than in theory?
- Government purchases little effect on inflation expectations
- Large-scale asset purchases as alternative?

What we know I

The problem with QE is it works in practice but it doesn't work in theory.

Ben Bernanke (2014)

What we know II

- Gagnon, Raskin, Remache & Sack (2011)
 - Reduction in long-term interest rates
 - Also for assets not included
 - Through lower risk premia
 - No evidence on signalling channel

- Krishnamurthy & Vissing-Jorgensen (2012)
 - Signalling channel
 - Safe-assets channel
 - Inflation channel
 - MBS Channel
 - Credit risk channel

What we know III

- Importance of stock versus flow effects

D'Amico & King (2013)

- SMP, OMT, and LTROs lower government yields for GIIPS countries

Krishnamurthy, Nagel, & Vissing-Jorgensen (2015)

- Solicited refinancing channel

Kandrac & Schlusche (2015)

- Big effect of LSAP compared to forward guidance

Swanson (2016)

This Paper

- Analyze LSAP in the Eurozone
- Differences to literature: stable financial conditions, compressed yields
- Previous literature: lower effect in this environment
- Theoretical term structure model
- Extend Vayanos & Villa to allow for credit risk

Model Predictions

- Stock effects of asset purchases
- Local supply
- Duration channel
- Credit premium

Main Findings

- LSAP lowered yields across assets
- Stronger effect for longer maturities and higher credit risk
- Stronger for countries with higher yields

Who holds and sells?

- Model is extension of Vayanos & Villa (2009)
- Relies on market segmentation and risk-averse arbitrageurs
- In asset pricing, we typically assume deep pockets
 - BUT: slow moving capital
- Are arbitrageurs highly risk averse in times of distress?
- Who ultimately sells to the ECB?
- For Portugal: mainly local banks
- Is it possible to get data on holdings and sales to ECB?

Duration Channel

- Authors assume long bonds more sensitive to macro shocks
- Results in higher portfolio shares
- Higher impact on market price of risk
- Operation twist mechanically results in duration effect in model
- Similar mechanism for credit risk channel
- How does it differ from a term premium?
- Suggestion: provide direct evidence for channel at work
 - How do assets with similar duration/ credit risk respond?

Stock Effects

- Model implies central bank should only purchase longest maturity
- We don't see that in practice
- What are countervailing force?
- Liquidity?
- Supply?

Empirical Results: High-frequency Event Study

- Within-day reaction of yields for four countries
- Large drop, especially for Spain and Italy
- Conventional MP: larger response time for unscheduled news
- Is there overreaction and subsequent reversal?
- Variation within countries across maturities?

Empirical Results: Conventional Event Study

- One- and two-day changes in yields
- Control for macro news
- Many macro news contain noise
 - Use scaled changes (Guerkaynak, Sack, & Swanson (2005))
 - Revised releases (Gilbert (2011))

Additional Comments I

- Some channels are absent
 - “Whatever it takes channel”
 - Redenomination-risk channel
- Use different instruments to disentangle various channels
 - e.g., corporate debt for redenomination risk
- Welfare analysis: what are the (potential) costs?
 - Collateral trade: Crosignani, Faria-e-Castro, & Fonseca (2016)
 - Extend cross section of countries and instruments within countries
- How does liquidity, trade size, and turnover react?

Additional Comments II

- Is reaction across countries statistically different?
- Cross-sectional clustering in error terms, correct standard errors
- Preferred-habit model does not posit maturity
 - Exploit cross-sectional heterogeneity of ECB-targeted assets
- What drives difference in reaction AFTER CDS adjustment?
- Did market participants revise upwards inflation expectations?
 - Little evidence for household (D'Acunto, Hoang, & Weber (2016))
- What drives differences with findings in the US?
- Change σ to γ

Conclusion

- Great paper every one should read!
- Paper provides convincing new methodology
- Few minor quibbles to address empirically