BANK FOR INTERNATIONAL SETTLEMENTS

Discussion of "The interest rate pass-through in the euro area before and during the sovereign debt crisis"

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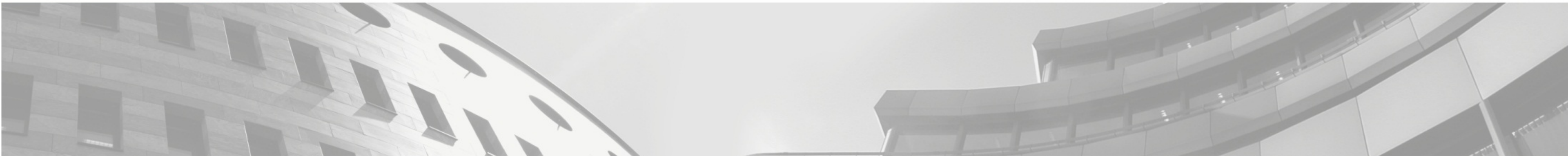
Frankfurt am Main, 6 October 2014



Policy relevance

- Investigate the transmission of monetary policy
  - Key for its effectiveness!

- Questions raised:
  - Has the transmission of monetary policy been impaired?
  - Where does the impairment lie?
  - Is the transmission homogeneous across countries?
  - How could the ECB provide further stimulus at the ZLB?

The ingredients of the paper

- **Measure of monetary policy at the ZLB**
  - EMS (Krippner 2014)
  - Shadow rate (Wu and Xia 2013)
  - *EM-DFM (Lombardi and Zhu 2014)*

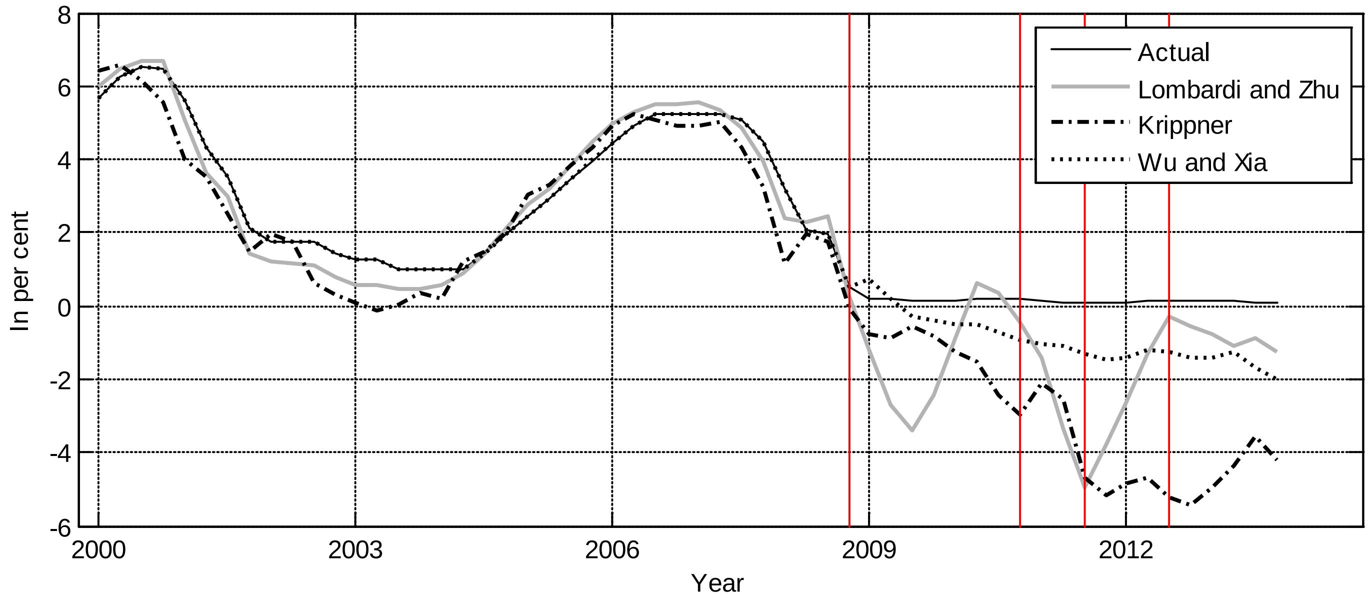
- **The components of the transmission**
  - *Illes and Lombardi (2013)*

- **Modelling the transmission**
  - *Gambacorta, Illes and Lombardi (forthcoming)*
  - *Illes, Lombardi and Mizen (forthcoming)*

Measuring monetary policy at the ZLB

Alternative estimates of the shadow federal funds rate[1]

In per cent | Graph 7



[1] The red vertical lines correspond to the dates of introduction of the major asset purchase programmes implemented by the Federal Reserve: LSAP1 (November 2008), LSAP2 (November 2010), MEP (September 2011) and LSAP3 (September 2012).

Sources: Federal Reserve, Krippner (2013a), Wu and Xia (2014), authors' calculations.

The transmission channel

$$(r_{retail} - r_{policy}) = (r_{retail} - r_{bank}) + (r_{bank} - r_{gov}) + (r_{gov} - r_{rf\_long}) + \mathrm{EMS}.$$

Do we really need EMS?

- NO, if you just look at the decomposition of the lending spread
  - Components as gauges of where the impairment to the transmission could be
- YES, if you want to compute the dynamic response to a monetary policy shock
  - Components as gauges of the reactivity to monetary impulse

The modelling choice

- Traditional approach: **cointegration**
  - Pass-through as the long-run coefficient
  - Speed of adjustment
  - But no identified shocks

- **FAVAR** is better suited to identify monetary shocks
  - But potential is not exploited fully
  - How do shocks feed to spreads through the factors?
  - What do factors capture?

- Are we comfortable with the identification strategy?

Cross-country evidence

- Divergence concentrated in sovereign spreads
  - Implies quite diverse bank funding costs
- Relatively homogeneous margins
  - In line with Illes, Lombardi and Mizen (forthcoming)

- Homogenous aggregate results?
  - We find much weaker response when looking at the lending spread rather than the margin