

What central banks still have left: our comprehensive guide

Global central banks have already thrown a lot at the emerging coronavirus crisis. We take a look at the tools policymakers still have available



Japan's Finance Minister, Taro Aso with the ECB's Christine Lagarde and the Fed's Jerome Powell, pictured in 2018

Federal Reserve

Rate cut space: Rates have already been cut to 0-0.25%

Negative rates: Not seen as an appropriate response - Powell said this on 15 March. That's for three reasons. Firstly, the legal documents state banks using the deposit facility "may receive earnings". There is no mention of paying money to the Fed so this would need legal clarification and possibly a law change. Secondly, the experience of negative rates in Europe and Japan doesn't suggest it is particularly successful. It may, in fact, be more damaging for the financial sector and a drag on activity. Finally, US money market funds' legislation make it difficult to enact. Money market funds invest in high-quality short term securities – their goal is stable net asset value with income paid out as dividends – nearly \$4trillion is invested in them. Negative interest rates would "break the buck" and contravene rule Rule 2a-7 of the 1940 Investment Company Act. Should a fund see its net asset value fall below \$1 regulators may force the fund into liquidation.

Quantitative easing: The Federal Reserve has announced \$700bn of QE "over coming months"

with \$500bn allocated to Treasury securities and \$200bn to MBS. At present the Federal Reserve's balance sheet size is equivalent to around 18% of GDP, having peaked at 25% of GDP in 2015. We would estimate that to get back to 25% of GDP the Fed could probably announce another \$900bn of asset purchases although the Fed could choose to expand further – the US is already running a fiscal deficit of 5% of GDP with a very strong probability this will increase significantly. As such supply will not be a constraint.

New or other tools: The Commercial paper purchase programme has now been reinstated. Businesses use commercial paper for short term funding needs but, given strains in the financial system, liquidity had dried up and borrowing costs spiked. The result had been that businesses were resorting to drawing down credit facilities within their banking group. This facility should make it far easier for businesses to roll over their maturing commercial paper obligations and hopefully give investors the confidence to return.

Helicopter money? While supported by several Democrats and the “Yang Gang”, it is not an option being seriously considered within government at this stage given the arsenal of options still available. The focus instead is on fiscal support for key industries and expansion of unemployment and healthcare benefits which can be more specifically targeted at the most vulnerable people. Giving everyone \$1,000 is fine, but if you are not allowed to go to a restaurant or book a flight it isn't going to help the most impacted parts of the economy.

Federal Reserve covered by James Knightley

European Central Bank

Rate cut space: The deposit rate could be cut further, combined with changes to the tiering system to keep the pressure on banks unchanged. Even the ECB hawks have mentioned rate cuts as possible steps in case the economic situation worsens. Currently, -70bp seems to be the lower bound for the deposit rate but tiering would allow the ECB to go even lower. Introduction of the dual-rate targeted longer-term refinancing operations (TLTROs) also provides room for further cuts

Existing unconventional policy space: The latest announcement of a QE ‘envelope’ of 120bn euro until the end of the year allows the ECB to frontload the purchases. Currently, the ECB purchases 20bn euro per month, with the 120bn euro coming on top. In the heyday of QE, the ECB purchased 80bn euros per month.

To return to similar levels, the ECB would probably have to shift more towards corporate bonds or even bank bonds. The ECB would also have to cross or change some of its own red lines like the issuer's limit and the capital key. The issuer limit, in particular, was one of the reasons for the European Court of Justice ruling that the ECB had stayed within the limits of its mandate when starting QE. In the current situation, we would expect the ECB to temporarily cross the red lines.

New/other tools: The ECB could buy stocks/ETFs, buy perpetual bonds from governments, or repurpose the TLTROs as a kind of helicopter money, by linking them to banks transferring money to retail customer accounts.

European Central Bank covered by Carsten Brzeski



Source: Shutterstock

ECB President Lagarde still has the option to lower the deposit rate further, or tweak the parameters of the quantitative easing programme

□ People's Bank of China

Extremely unlikely: Negative rates, or even low-interest rates (e.g. the 7-day reverse repo at 1%)

Unlikely: Cut the retail deposit benchmark rate, which is now 1Y at 1.5%. This would mark a backward step in the interest rate liberalisation process, and it would be unnecessary to help banks to reduce their interest costs in this way. This is a popular topic nowadays.

Likely: PBoC can work with the banking regulator, CBIRC (the China Banking and Insurance Regulatory Commission), to reduce the capital ratio of banks that have lent to inclusive finance, e.g. a formula capital reduction as a function of inclusive finance

Extremely likely (our base case): A deferred rate cut of 10bps in April (we expected it in March) as a targeted RRR cut suppressed interbank rates, which will reduce banks' interest expense if they lend out more inclusive finance. Further targeted RRR cuts in April or May are possible if global demand continues to weaken

PBoC is covered by Iris Pang

□ Bank of Japan

Rate cut space: Governor Kuroda says that he can cut the current -0.1% policy rate, but that now is not the time. Most people believe there is no further rate cut space, as it's not clear negative rates aren't doing more harm than good – especially to banks.

Existing unconventional policy space: Expanding QE is possible but difficult. The BoJ already owns more than 50% of the entire Japanese Government Bond (JGB) market. The ceiling on ETF purchases of JPY12tr could be raised, but it is a ceiling, not a target or a floor, so it's non-binding. The bond yield target of zero could be lowered further, but it has the same problem as negative rates – it may be doing more harm than good.

New or other tools: BoJ now offering loans in exchange for corporate debt, and this could be

broadened to a wider asset array. They could write off some of government debt holdings – effectively monetising the debt by the back door (covert helicopter money).

Bank of Japan is covered by Robert Carnell

□ Bank of England

Rate cut space: Room for a partial rate cut, most likely taking rates from 0.25% to 0.1%.

Negative rates: Ruled out for the time being – the Bank believes the lower bound is just above zero.

Quantitative easing: The next obvious step would be to step-up the buying of government and corporate bond purchases – the BoE's existing holdings currently stand at £435bn and 10bn respectively. The Bank has room to comfortably increase holdings of gilts by £100bn or more – the BoE would then hold around a third of the market, although given the government's debt issuance plans, net supply after QE would likely still be positive. For comparison, the Bank increased gilt holdings by £60bn following the 2016 Brexit referendum.

Bank of England is covered by James Smith



New Bank of England Governor Andrew Bailey is likely to unveil further stimulus in coming days

□ Bank of Canada

Rate cut space: Rates have been cut to 0.75%, and we fully expect them to be cut to 0.25% - the same as the post-GFC lows. The next scheduled meeting is April 15, but they could move more swiftly.

Negative rates: More likely than in the US, but it is still a remote possibility. Governor Stephen Poloz (who steps down June 2nd) stated in 2015 that "the bank is now confident that Canadian financial markets could also function in a negative interest rate environment". However, after last week's rate cut to 0.75% he said he "doesn't like the idea of negative rates that much", adding

they are “very unlikely to be needed”.

Existing unconventional policy space: The BoC did not implement QE during the Global Financial Crisis, but could be open to it. Officials have stated it is a tool that could be used, but at this stage, the BoC still has conventional ammunition and the hope will be it won't be needed.

New/other tools: In conjunction with the Federal government the BoC announced that it would buy C\$500mn of mortgage bonds per week and accept a wider range of securities in its term repo operations. It also announced it would acquire securities directly linked to corporate credit lines in an effort to ease market tensions. All of these can, of course, be expanded if required

Bank of Canada is covered by James Knightley

☐ Reserve Bank of Australia

Rate cut space: No further rate cut space available – 25bp has been ruled as the effective lower bound, and negative rates have been ruled out.

Existing unconventional policy space: QE is possible, and there's talk about large scale bond purchases, possibly as soon as this Thursday. Total outstanding bond supply is only AUD630bn, so AUD5bn per month would be equivalent to 10% of outstanding stock over one year.

New or other tools: Purchase of bank paper is a possibility

RBA is covered by Robert Carnell

☐ Reserve Bank of New Zealand

Rate cut space: The official cash rate sits at 0.25%, so there is still some room for cutting rates. Negative rates not ruled out

Existing unconventional policy space: Preparing for large scale bond purchase programme by the May meeting. Total outstanding bond supply only NZD40bn, about 50% of which is owned by foreigners. A monthly total of NZD2bn per month might deliver 10% of total purchases annually.

New or other tools: Governor Orr has also talked about buying Swaps

RBNZ is covered by Robert Carnell

☐ Riksbank

Rate cut space: The Riksbank increased the repo rate to zero back in December, in a move which was motivated by a desire to prevent negative rates becoming a more permanent state of affairs. That means policymakers will be wary about going into negative territory again so soon, but ultimately having already been as low as -0.5% before, repo rate cuts shouldn't be ruled out.

Existing unconventional policy space: The Riksbank currently owns SEK340bn of government bonds and has already committed to expanding purchases by “up to” SEK300bn, although this also includes municipal and covered bonds. That is already quite a large package and could see the

Riksbank owning quite a large share of the market by the end.

Other tools: Policymakers have already allowed banks to borrow an “unlimited” amount of money on a three-month basis, and have widened the type of assets that can be considered as collateral.

Riksbank is covered by James Smith

□ Norges Bank

Rate cut space: Norges Bank has already implemented a rate cut, but at 1%, the policy rate has much greater scope to be cut than elsewhere. The latest rate projection from the emergency meeting in mid-March pencilled in another 25bp cut later in the year. But with things moving fast and with other global central banks unleashing large packages, we would expect Norges Bank to go further. We wouldn't be surprised to see rates go lower – potentially to 0.5% initially, which would match the low of 2016-18. However, a move to zero is also entirely possible.

Unconventional policy space: Back in October 2019, [Governor Olsen outlined](#) a number of reasons why he didn't think quantitative easing was a viable option for Norway. As he put it, the Norwegian market is dominated by short-term, floating loans, which QE would have little influence on. He also noted the size of the Norwegian government bond market is relatively small. We, therefore, think policy rates will remain the main tool in the meantime.

Norges Bank is covered by James Smith

□ Swiss National Bank

Rate cut space: Our base case is that the SNB would prefer to keep its rate unchanged at its current level (-0.75%) for as long as possible, continuing to intervene in the foreign exchange market when it deems necessary. However, a rate cut cannot be completely ruled out, it is a very close call and SNB officials has already said several times that the lower limit of the rates has not been reached.

Other tools: The SNB is already intervening on the foreign exchange markets to avoid the Swiss franc appreciating too much. It will probably continue to intervene in the foreign exchange market in the future, but it cannot do so indefinitely, especially because the US Treasury has put Switzerland on the "currency manipulators" watch list. An excessive increase in the reserves held by the SNB could lead to Switzerland being classified as a currency manipulator and subject to sanctions by the United States.

Unconventional policy space: Legally, the SNB could also embark on a formal QE by buying Swiss Confederation debt on the secondary market.

SNB is covered by Charlotte de Montpellier

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

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