

**Helena Adegas**

Banco de Portugal

Head of Markets and Reserve  
Management Department

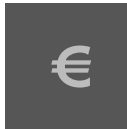
# Monetary Policy and Fragmentation

13<sup>th</sup> ECB Central Banking Seminar | Monetary Policy in the Euro Area  
5 July 2019

# Overview



Fragmentation in the euro area



The singleness of an heterogeneous currency area



Monetary policy measures toolkit



Lessons learnt



Which monetary policy framework in the future?

# Overview



## Fragmentation in the euro area



The singleness of an heterogeneous currency area



Monetary policy measures toolkit



Lessons learnt



Which monetary policy framework in the future?

# Fragmentation in the euro area

## 1. The markets functioning perspective



It is a **divergence** in certain economic indicators (mainly prices or quantities) ...



... either **within a group** of economic agents with similar characteristics or between **different groups** of economic agents ...



... which cannot be explained by endogenous factors only.



Such differences might result from **environmental, infrastructural or institutional** factors.

Source: Eurosystem Monitoring Working Group

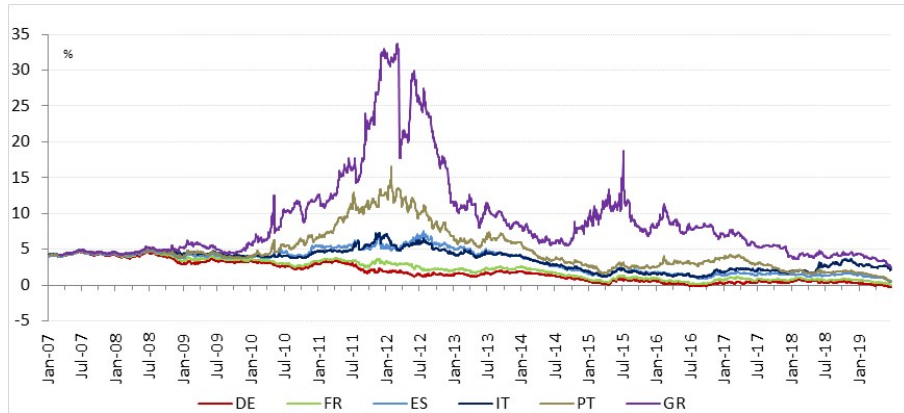
## 2. The monetary policy transmission perspective

It is the **lack of full tradability of central bank reserves** across borders which cannot be explained by technical (e.g. access to the central banks' standing facilities) or fundamental (e.g. counterparty credit risk) factors.

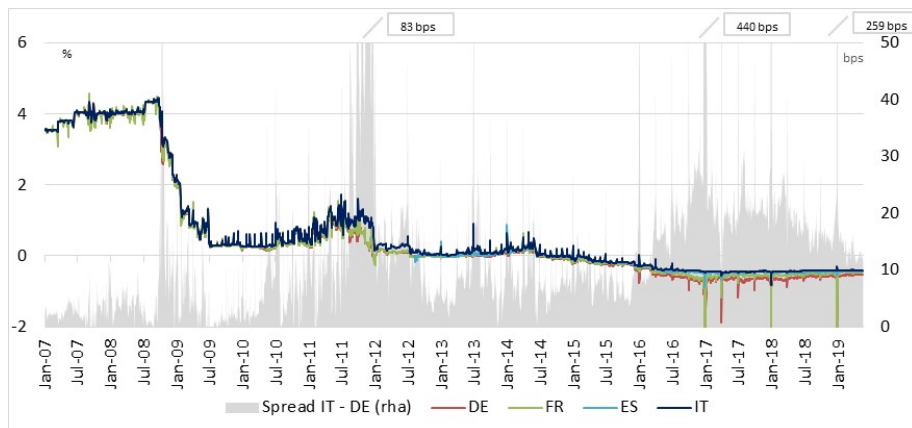
Source: Eisenschmidt *et al.* (2018)

# Fragmentation in the euro area

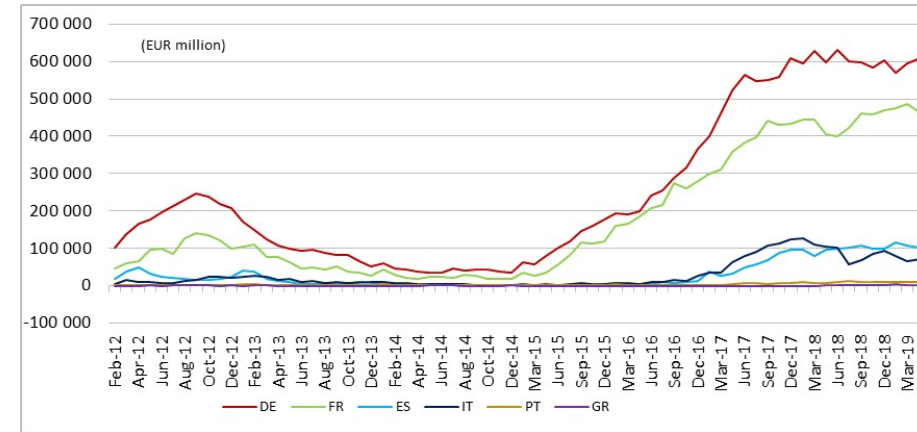
## 10-year government bond yields



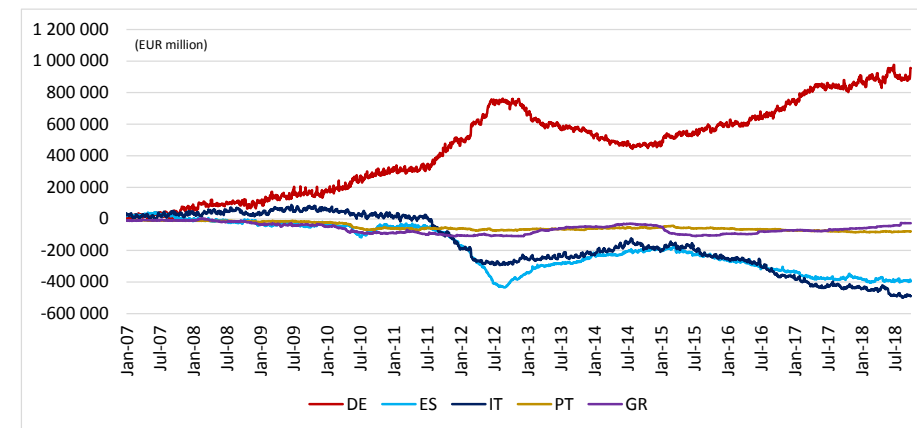
## Repo funds rates



## Excess liquidity



## TARGET balances



# Overview



Fragmentation in the euro area



**The singleness of an heterogeneous currency area**



Monetary policy measures toolkit



Lessons learnt



Which monetary policy framework in the future?

# How single can an heterogeneous currency area be?

FRBSF ECONOMIC LETTER  
2011-18 | June 13, 2011  
**Monetary Policy When One Size Does Not Fit All**

The Economist  
Topics Current edition More  
**Can one size fit all?**  
*The European Central Bank will face a tricky task setting monetary policy, partly because higher interest rates hit some economies harder than others*

S&P Global Ratings  
RatingsDirect®  
Economic Research:  
**Monetary Policy Normalization In The Eurozone: Will One Size Fit All?**

**The Single Monetary Policy of the European Central Bank: One Size Fits All**  
Otmar Issing\*  
*European Central Bank.*

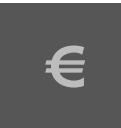
**One size fits all! A single monetary policy for the euro area**  
Speech by Otmar Issing, Member of the Executive Board of the ECB  
International Research Forum, Frankfurt am Main, 20 May 2005.

- ECB decisions are driven by the mandate to **maintain price stability in the euro area** and as such, they **cannot be tailored to the specific needs of a single Member State**
- However, the ECB was able to **accommodate heterogeneity** when it threatened the transmission of monetary policy

# Overview



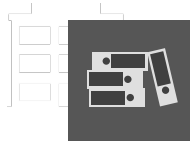
Fragmentation in the euro area



The singleness of an heterogeneous currency area



**Monetary policy measures toolkit**



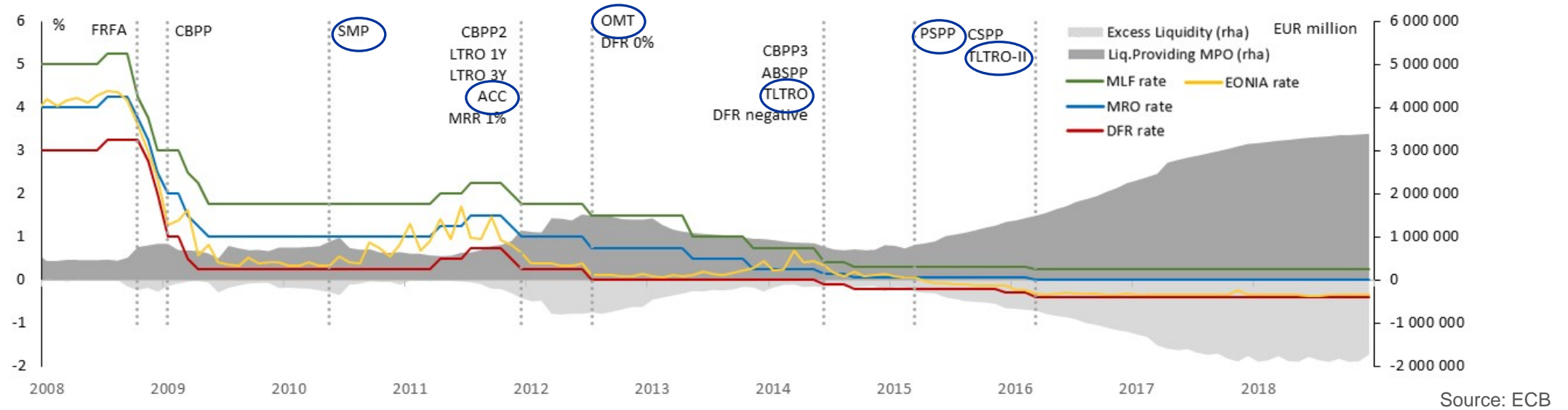
Lessons learnt



Which monetary policy framework in the future?



# Monetary policy measures



ACC

**Motivation:** to allow counterparties' access to new long term Monetary Policy Operations; to avoid collateral shortages by accommodating country specificities

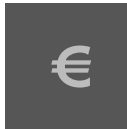
**Main Features:** individual and aggregated credit claims basis; higher flexibility in terms of probabilities of default; eligibility criteria and risk control measures established by NCB and approved by the Governing Council; non-loss sharing regime as the design is customized to address country needs

**Relevance:** 15% of the total assets mobilized in Portugal (7% in the Eurosystem); 30% of the collateral mobilized by Portuguese counterparties using ACC (14% in the Eurosystem)

# Overview



Fragmentation in the euro area



The singleness of an heterogeneous currency area



Monetary policy measures toolkit

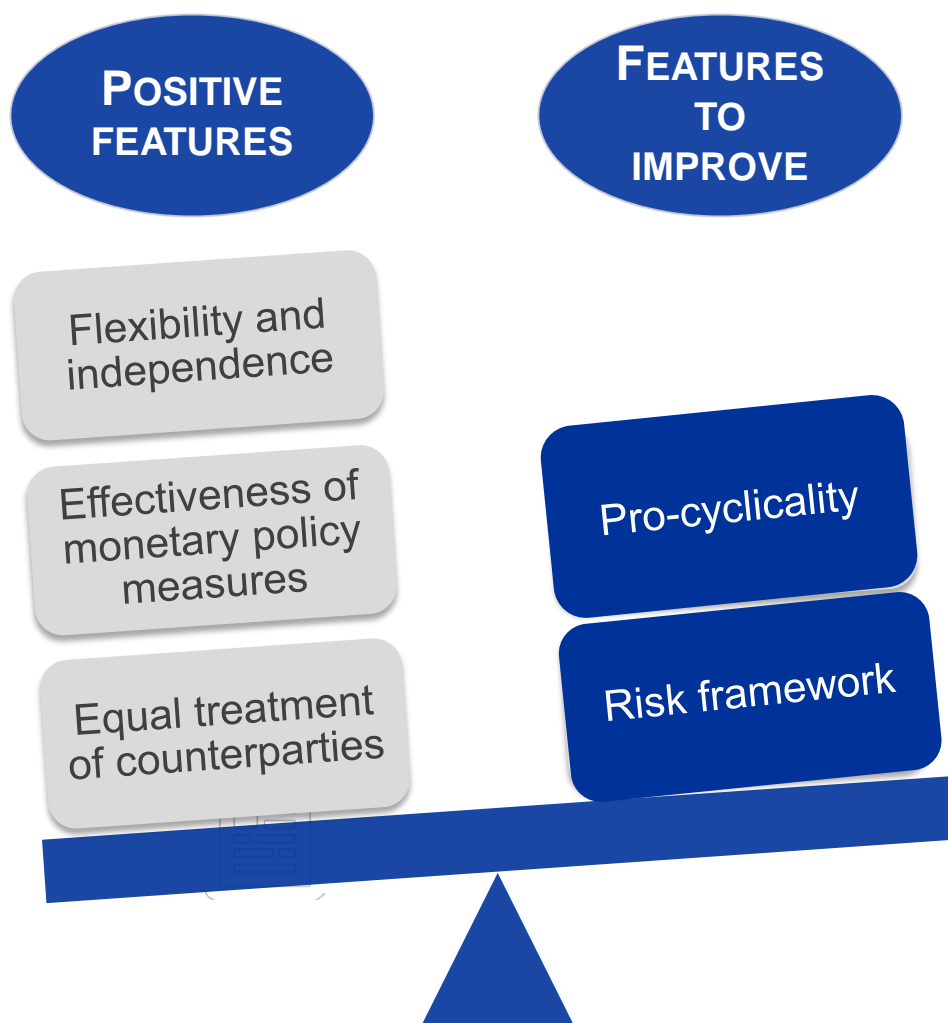


**Lessons learnt**



Which monetary policy framework in the future?

# Lessons learnt



## Potentially pro-cyclical elements of the framework:

- ✓ Deleveraging => downward pressure on prices => decline in **banks' capital** => impact on counterparties eligibility
- ✓ External **ratings** => impact on collateral eligibility, haircuts and valuation

Frameworks were adapted to **support the counter-cyclical** Monetary Policy stance: widening of collateral, while respecting the risk equivalence principle

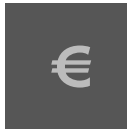
## Risk management issues:

- ✓ **Counterparties** => Develop early warning indicators to **enhance due diligence**
- ✓ **Collateral** => Increase consistency of the framework (privilege further the **risk sharing**) and **reassess the reliance on external ratings**

# Overview



Fragmentation in the euro area



The singleness of an heterogeneous currency area



Monetary policy measures toolkit



Lessons learnt



**Which monetary policy framework in the future?**

# Which future monetary policy framework might minimize fragmentation?

## OPERATIONS



- Credit operations that support the steering of short-term rates
- Long-term credit operations and outright purchases in the toolbox
- Respond to liquidity demand arising from uncertain factors

## COUNTERPARTIES



- Broad counterparty framework
- Improved information exchange with the supervisor

## COLLATERAL



- Extended and diversified collateral framework
- Single collateral layer

**Helena Adegas**

Banco de Portugal

Head of Markets and Reserve  
Management Department

# Monetary Policy and Fragmentation

13<sup>th</sup> ECB Central Banking Seminar | Monetary Policy in the Euro Area  
5 July 2019