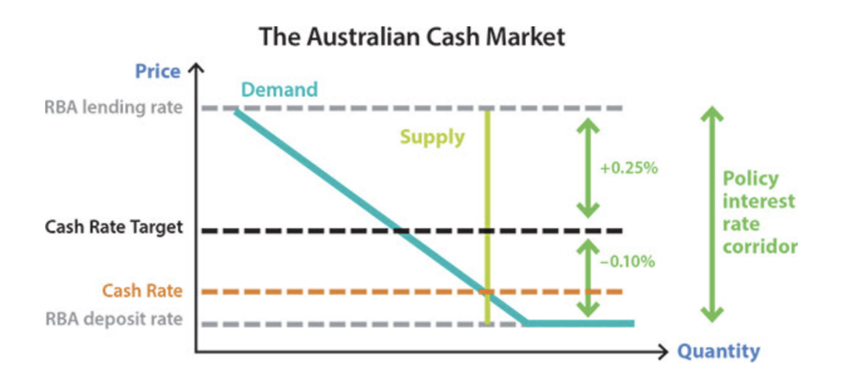
Content Review

(Monetary Policy)

Conventional Monetary Policy



Unconventional Monetary Policy

Forward Guidance

- Forward guidance relates to the central bank's communication of the 'stance' of monetary policy.
- It can be time based or state based.
- Under 'time-based guidance', the central bank commits to a stance of monetary policy until a specific point in time.
- Under 'state-based guidance', the central bank commits to a stance of monetary policy until a specific set of economic conditions are met.

Unconventional Monetary Policy

Quantitative Easing (Asset Purchases)

- Asset purchases involve the outright purchase of assets by the central bank from the private sector with the central bank paying for these assets by creating 'central bank reserves'.
- Typically, when a central bank undertakes asset purchases, it can either set a target for the **quantity** of assets it will purchase (at any price) or a target for the **price** of an asset.
- A quantity target for asset purchases is also known as quantitative easing (QE).
- A common theme has been the desire to lower interest rates on risk-free assets (such as government bonds) across different terms to maturity of those assets - that is, across the yield curve.

Unconventional Monetary Policy

Term Funding Facility

- Term funding facilities involve central banks providing low-cost, long-term funding to financial institutions at rates below the cost of most of their existing funding sources.
- They help lower the cost of longer-term funding for financial institutions and, in doing so, help lower the cost of long-term borrowing for households and businesses.
- Term funding facilities also incentivise financial institutions to lend to households and businesses.

Unconventional Monetary Policy

Negative Interest Rate

- Imply that instead of earning interest on money deposited in a bank, people would be charged by their bank to deposit money.
- Post-GFC, nominal interest rates (Euro, Japan, Switzerland, Sweden, Denmark) have been negative.
- Commercial banks face a crunch as they are unable to pass on negative interest rates to their depositors.