Analysis

Implementation of monetary policy purchase programmes at the Bank of Finland

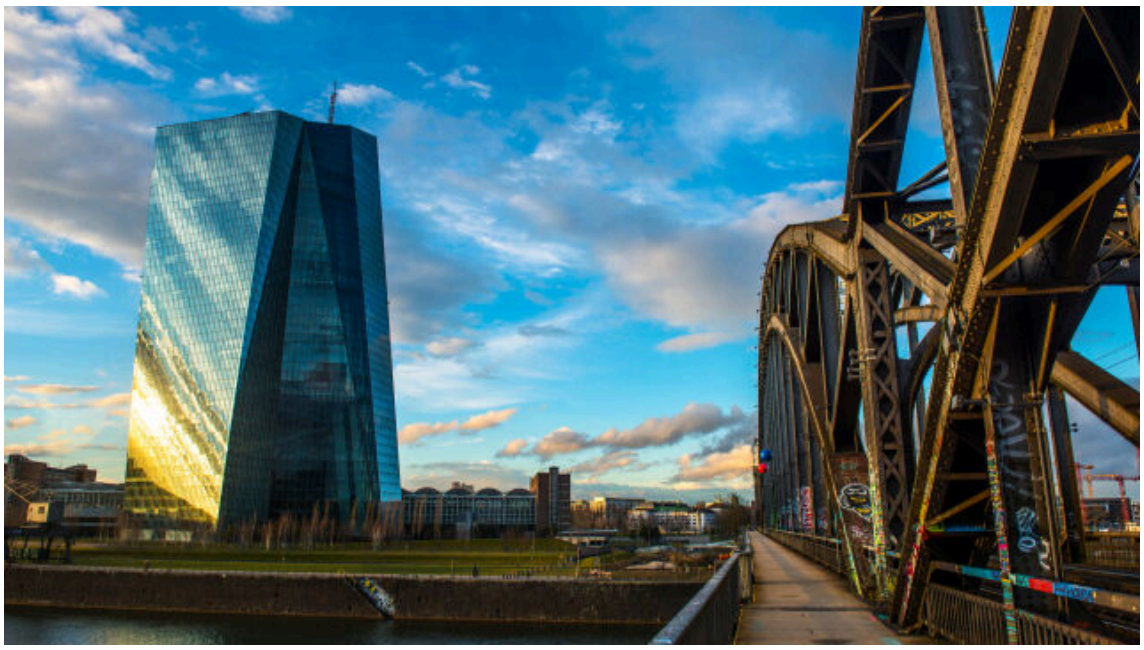
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The expanded asset purchase programme was introduced in 2015, when Eurosystem interest rates began to reach their lowest threshold. Bond purchase programmes have become one of the most significant approaches to monetary policy. This article explains how the Bank of Finland itself implements monetary policy purchase programmes within the Eurosystem.



Purchase programmes within the Eurosystem are decentralised

The European Central Bank launched its expanded asset purchase programme (EAPP) in 2015, with the aim of fulfilling its price stability mandate and addressing the risks of too prolonged a period of low inflation. In spring 2020, the economy was hit hard by the coronavirus pandemic, and the ECB took new, dramatic steps to stabilise both the economy and the financial markets (blog: ECB's monetary policy measures during the coronavirus pandemic). The Bank of Finland participates in the implementation of monetary policy purchase programmes within the Eurosystem. Purchases of public or private sector bonds are made under the various programmes. On 31 July 2020, the balance sheet value of securities acquired for monetary policy purposes stood at EUR 56.9 billion.

The Governing Council of the European Central Bank makes decisions on the purchase programmes, the technical details being finalised by various committees within the Eurosystem, on which the Bank of Finland is also represented. The ECB itself has responsibility for coordinating the purchases. The persons in Frankfurt involved in carrying out these tasks include Bank of Finland personnel. The purchase programmes are, however, mainly implemented by the national central banks.[1] At the Bank of Finland, four portfolio managers are involved in such purchases.

Besides portfolio management, the Bank of Finland is also engaged in securities payment and settlement, and, before any purchase goes ahead, it conducts an analysis of the eligibility of the issuer and the bond in question. This is a way to ensure that the bond meets the criteria for the Eurosystem purchase programme. Furthermore, the bonds purchased for the Bank of Finland's balance sheet and their issuers are monitored in order to anticipate risk.

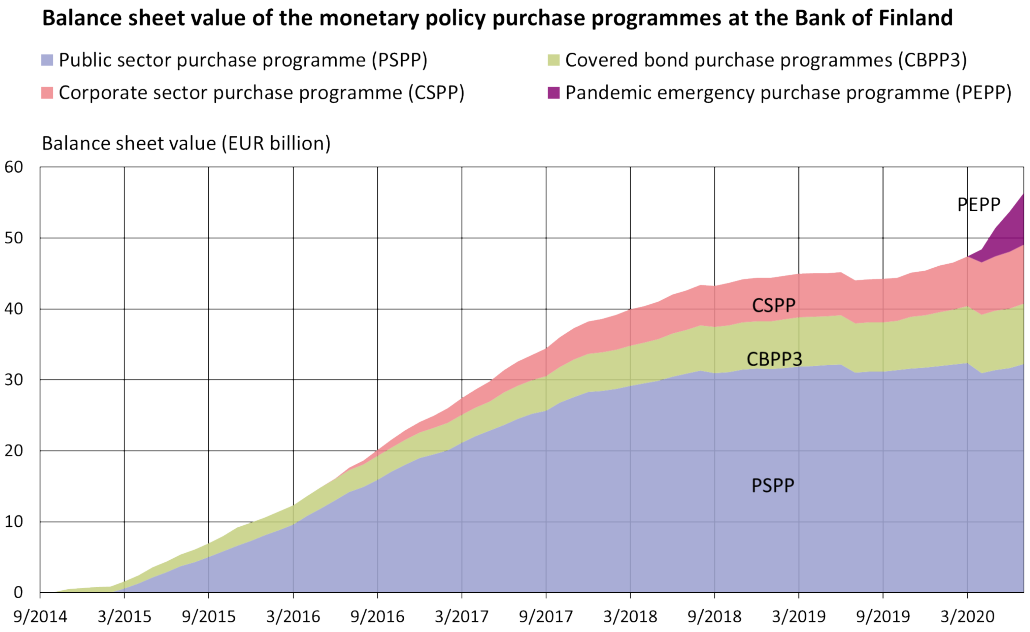
Net purchases were recommenced when the outlook for inflation weakened

The purchase programmes allow the Eurosystem to boost liquidity in the financial system and lower interest rates on the bond markets. This eases the cost burden for companies, banks, governments and, ultimately, for households too. In 2018, the outlook for inflation in the euro area showed a favourable trend and expansion of the monetary policy investment portfolio, i.e. net purchases, was terminated. The purchase programmes then moved to a reinvestment phase for the bonds already bought, where the purchases only covered the value of maturing bonds. When in autumn 2019 the economy flagged, net purchases were recommenced to a value of EUR 20 billion per month.

In March 2020, the coronavirus pandemic seriously harmed the economy and tightened financing conditions. When the outlook for inflation grew even worse, the ECB decided to increase the amount for net purchases by EUR 120 billion by the end of the year. When the crisis deepened at the end of March, a new pandemic emergency purchase programme (PEPP) was launched, with an initial envelope of EUR 750 billion until the end of the year. Later it was decided that the programme would be extended until the end of June 2021 and that the maximum amount for purchases would be raised by EUR 600 billion to EUR 1,350 billion.

The chart below shows the reinvestment phase covering the period 2018–19 on the Bank of Finland's balance sheet. Clearly, the balance sheet value of securities barely grew at all. However, the net purchase amounts for the PEPP purchase programme launched at the end of March 2020 have shown a marked upward trend each month, and holdings by the end of July stood at EUR 7.3 billion on the Bank's balance sheet.

Chart 1.



Source: Bank of Finland's balance sheet.
25 Aug 2020
bofbulletin.fi

Finnish Government bonds worth tens of millions of euros are being bought each day

Finnish Government bonds account for most of the holdings of EUR 32.2 billion in the public sector purchase programme. The programme also includes bonds issued by MuniFin, Finnvera and

the Employment Fund. Central banks in the Eurosystem may not finance the public sector, so all the purchases are made on the secondary markets.

The sellers are mainly primary dealer banks for bonds issued by the State Treasury. There are 14 of these. In the current year, purchases were conducted with 24 banks, so other banks are also active on this market. It is important to have a large number of counterparties in order to obtain the best price and be able to monitor market liquidity.

The Bank of Finland endeavours to purchase Finnish public sector bonds as neutrally as possible along the yield curve, although purchases below the ECB's overnight deposit rate are only made when strictly necessary. A neutral, prudent and steady approach to purchasing promotes smooth market operations. The purchases tend to be of those bonds available on the market at the time, where possible avoiding those in short supply. The smooth functioning of the bond markets is also enhanced by lending investors bonds held under the purchase programmes.

Because of the current pandemic, the state's need for financing has increased. The same is true of other countries in the euro area, and the PEPP purchase programme has kept financing conditions accommodative, despite the additional availability of funds. The coronavirus crisis has also meant that the Eurosystem has eased the restrictions on this new purchasing programme, which has made it easier to implement. This allows purchases to be conducted where needed, to ensure that the accommodative monetary policy proceeds effectively.

Banks receive affordable financing against mortgage collateral

The monetary policy purchases of bank-issued bonds focus on covered bonds. The collateral used for these in Finland is typically mortgages. In its credit operations, the Eurosystem does not provide the banking sector with financing without a guarantee, and so no purchases are made of unsecured bank bonds. The Bank of Finland only buys covered bonds issued by Finnish banks. OP Financial Group and Nordea are the largest mortgage lenders, accounting for around 70% of mortgage finance and, hence, a large number of the securities purchased.

The Bank of Finland also purchases covered bonds on the primary markets. Finnish banks issue an average of seven covered bonds totalling EUR 250–1,000 million every year. A significant number of the covered bonds under the purchase programme are acquired on the primary markets.

The ECB also provides banks with financing via other operations, of which the most important at present is the TLTRO III programme. The availability of cheap central bank financing has made banks less interested in issuing covered bonds. This has caused liquidity to weaken in recent times

on the covered bond markets, and new issuances have become something of a rarity.

The Bank of Finland specialises in the purchase of corporate bonds

The Bank of Finland is one of six national central banks within the Eurosystem to conduct corporate sector monetary policy purchases on behalf of the Eurosystem as a whole. It has long experience of corporate bonds in its own investing activities, and this expertise has now been explored in the context of the Eurosystem. The Bank of Finland buys corporate bonds on the Finnish, Irish and Austrian markets and those of the Baltic States. It works closely with the central banks of these countries, and purchases are made on both the primary and secondary markets.

Under the corporate sector purchase programme, the Bank of Finland holds corporate bonds issued by 44 companies. Every year the Bank has participated in between five and ten issues on the primary markets, although it has mainly achieved its purchase goals with daily secondary market purchases.

Corporate bonds have been purchased from such Finnish companies as Elisa, Fortum, Kojamo, Nokia, Sampo, Stora Enso and Teollisuuden Voima. The companies in Ireland from which the Bank has purchased bonds include ESB Finance, Fresenius, Kerry and Ryanair. In Austria, bonds have been acquired from OMV and Telekom Austria, and, among the Baltic States, Eesti Energia, for example.

There are risks attached to holdings under the purchase programmes. Some, such as those associated with Finnish public sector bonds, are the responsibility of each national central bank. However, the risks with corporate and covered bonds are shared across the Eurosystem. For example, if a single company were to incur a loss of a EUR 1 billion in respect of the Eurosystem, the Bank of Finland would record a loss of EUR 18 million based on the capital key. As a counterweight to the risks, though, the returns on holdings are also shared, except for public sector holdings.

This year the Eurosystem also purchased commercial papers

The pandemic that broke out in spring 2020 hampered financing conditions, and it was hard for companies to acquire market funding. Commercial papers with an initial maturity of less than one year were rapidly maturing, and their refinancing was a cause for concern. At the end of March, the Eurosystem began to purchase commercial papers under the financial pandemic emergency purchase programme (PEPP), which calmed the situation.

To be eligible for the monetary policy purchase programmes, commercial papers must fulfil the Eurosystem's criteria for collateral. The main criteria are adequate creditworthiness, a stock exchange listing and book-entry form. Finland has a viable commercial paper market that nevertheless fails to meet these criteria. The Bank of Finland operates on this market within the framework of its own investment activities.[2]

All the same, for Finnish companies, the commercial papers included in the ECB's purchase programme are still an opportunity to access a greater supply of funding. Companies with a good credit rating can establish an ECP (Eurocommercial Paper) issuance programme, under which they can issue commercial papers that are eligible for the purchase programmes. Alternatively, Finland's domestic market could also satisfy the Eurosystem's criteria for collateral as far as companies with a high credit rating are concerned, provided the issue is in book-entry form and listed on the stock market.

Notes

1. The ECB accounts for 10% and the national central banks 90% of the purchases in the purchase programmes. ↑
2. More can be read about buying Finnish commercial papers on Jarno Ilves's blog (in Finnish): Suomen Pankki käynnisti toimintansa yritystodistusmarkkinoilla (The Bank of Finland enters the commercial paper market), at https://www.eurojatalous.fi/fi/2020/1/suomen-pankki-kaynnisti-toimintansa-yritystodistusmarkkinoilla/. ↑

Keywords

bonds, commercial papers, COVID-19, government debp, monetary policy