ECB: Doubling down (almost)

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- **The ECB expanded the PEPP asset-buying program by €600 billion to €1.35 billion and until at least mid-21**
- **Significant downward revision of GDP and inflation projections**
- **Sharp contraction seems to bottom-out, but not enough to avoid an unprecedented recession while risks are to the downside**

The ECB packed quite a punch today as it boosted its COVID-19 response strategy with a larger than expected expansion of its QE purchases under the Pandemic Emergency Purchase Program (PEPP), by €600 bn, to a total of €1350 bn and extended the purchase horizon to at least the end of June 2021. The latest addition takes asset purchases under all active programs to a little more than €1.7 trillion. The move was largely anticipated, even though the size surprised by its magnitude, given that the current purchase run-rate of about €30 bn per week would have exhausted its initial €750 bn PEPP capacity by October. Furthermore, the ECB confirmed plans to reinvest the maturing principal payments from securities under the PEPP until at least the end of 2022 and would ensure that the future rolloff of PEPP portfolio doesn't interfere with the appropriate monetary stance. Meanwhile, as expected, key benchmark interest rates were left unchanged as also the corresponding policy guidance alongside conditions for LTROs or the tiering system, putting to rest some speculation that the ECB may adjust the later two.

ECB Chief Lagarde in her post policy conference call insisted that the PEPP remained ECB's instrument of choice to effectively fight the pandemic impact on the market and economy even as it stands ready to adjust all of its instruments, as appropriate. Lagarde reckoned that the PEPP expansion serves dual roles, 1) as a backstop function, intended to deal with short term market stress, the risk of market fragmentation, and improve the transmission of monetary policy and 2) underpinning ECB's monetary policy stance, in particular, achieving the HICP inflation mandate of sufficiently close to, but below, 2%. Lagarde acknowledged that the stance is more relevant than the transmission at the moment and that the purpose of getting back to the pre-covid inflation path is what has motivated today's PEPP expansion and all other actions combined. In this context, she asserted that the PEPP's three-pronged flexibility - across time, across asset classes and across jurisdictions - has played a crucial role in diffusing liquidity concerns and market stress across the Euro area, reviving the regions' corporate and commercial paper bond markets as well as mitigating the ongoing risk of fragmentation across Euro area.

Meanwhile, offering a glimpse of the challenges that lie ahead, the ECB's updated forecasts envisage an unprecedented contraction in 1H20 and a partial recovery from 2H20 in the baseline scenario, in line with expectations. The sharp decline in real GDP and the associated increase in the economic slack lead to a significant downward revision in inflation over the forecast horizon that leads the ECB to step up the flexibility of the PEPP.

On activity, the updated Staff forecasts a further decline of 13% QoQ in 2Q20 (-3.8% in 1Q20) before rebounding from 3Q20 as the containment measures ease further. As a result, GDP is expected to contract -8.7% in 2020 and to rebound by 5.2% in 2021 and by 3.3% in 2022 (GDP level around 4% below its level expected in March forecasts). The weaker demand expected in the medium term will put downward pressure on inflation which will be only partially offset by upward pressures due to supply constraints. Core inflation has been revised significantly down to remain slightly below 1% over the forecast horizon (0.8% in 2020, 0.7% in 2021 and 0.9% in 2022, revised down by 0.6pp in 2022), while the fall in energy prices could push headline inflation down to 0.3% in 2020 before increasing at a more gradual rate than previously projected to 0.8% in 2021 and 1.3% in 2022 (revised down by 0.3pp). On top of this, the ECB is also worried about the decline in inflation expectations, despite the longer-term indicators having been less affected. This baseline scenario assumes only partial success in containing the virus, with some resurgence in infections over the coming quarters until a vaccine is available by mid-2021. The risks are to the downside and uncertainty is very high.

In this context, the Staff projections include two alternative scenarios: (i) a mild scenario (temporary shock, fast and successful containment of the virus) in which GDP would decline by 5.9% in 2020, followed by a strong rebound in 2021 that revert the GDP fall by end 2022 and inflation at 1.7%; (ii) a severe scenario (strong resurgence of infections and more stringent lockdowns) in which GDP falls by 12.6%in 2020 and stands by end 2022 around 9.5% below its level in the March projections, with the inflation rate at only 0.9% in 2022.

On the polemic regarding the German Federal Constitutional Court's (GCC) recent ruling, Mrs Lagarde was conservative, trying not to ruffle any feathers but at the same time conveying, in no uncertain terms, that while ECB has taken note of the GCC ruling, it is confident that a good solution would be found which would in no way compromise ECB’s independence and the primacy of the EU law and the ECJ verdict.

Finally, on fiscal policy, ECB chief commended joint efforts to reinforce fiscal stimulus through the planned EU recovery fund alongside individual government initiatives and recommended targeted and temporary measures. However, at the same time, cautioned that it is still a proposal and needs parliament ratification, and furthermore should not be seen in isolation, in turn signaling the importance of fiscal-monetary combination to restore economic conditions.

All in all, we reckon that Mrs. Lagarde has not disappointed on the expectations generated in the past few weeks. The message from the ECB has been dovish enough, as the ECB reacts to the unprecedented contraction of the euro area economy with a substantial increase in the PEPP trying to avoid any problems until mid-2021, when the outlook will be much clearer. Not surprisingly, ECB’s bold and pre-emptive response and its commitment to stay active in the markets well into next year was well received by investors, narrowing European peripheral yield spreads, especially Italian (-15 bps), but also the Spanish, while giving legs to the Euro, whose status as a relevant international currency was proudly emphasized by the ECB chief today.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, ~~30 April~~4 June 2020

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. We will now report on the outcome of today's meeting of the Governing Council, which was also attended by the Commission Executive Vice-President, Mr Dombrovskis.

~~The euro area is facing an economic contraction of a magnitude and speed that are unprecedented in peacetime. Measures to contain the spread of the coronavirus (COVID-19) have largely halted economic activity in all the countries of the euro area and across the globe. Survey indicators for consumer and business sentiment have plunged, suggesting a sharp contraction in economic growth and a profound deterioration in labour market conditions. Given the high uncertainty surrounding the ultimate extent of the economic fallout, growth scenarios produced by ECB staff suggest that euro area GDP could fall by between 5% and 12% this year, depending crucially on the duration of the containment measures and the success of policies to mitigate the economic consequences for businesses and workers. As the containment measures are gradually lifted, these scenarios foresee a recovery in economic activity, although its speed and scale remain highly uncertain. Inflation has declined as a result of the sharp fall in oil prices and slightly lower HICP inflation excluding energy and food.~~

~~The decisive and targeted policy measures that we have taken since early March have provided crucial support to the euro area economy and especially to the sectors most exposed to the crisis. In particular, our measures are supporting liquidity conditions and helping to sustain the flow of credit to households and firms, especially small and medium-sized enterprises (SMEs), and to maintain favourable financing conditions for all sectors and jurisdictions.~~

~~We welcome the measures taken by euro area governments and the European institutions to ensure sufficient healthcare resources and to provide support to affected companies, workers and households. At the same time, continued and ambitious efforts are needed, notably through joint and coordinated policy action, to guard against downside risks and to underpin the recovery.~~

Incoming information confirms that the euro area economy is experiencing an unprecedented contraction. There has been an abrupt drop in economic activity as a result of the coronavirus (COVID-19) pandemic and the measures to contain it. Severe job and income losses and exceptionally elevated uncertainty about the economic outlook have led to a significant fall in consumer spending and investment. While survey data and real-time indicators for economic activity have shown some signs of a bottoming-out alongside the gradual easing of the containment measures, the improvement has so far been tepid compared with the speed at which the indicators plummeted in the preceding two months. The June Eurosystem staff macroeconomic projections see growth declining at an unprecedented pace in the second quarter of this year, before rebounding again in the second half, crucially helped by the sizeable support from fiscal and monetary policy. Nonetheless, the projections entail a substantial downward revision to both the level of economic activity and the inflation outlook over the whole projection horizon, though the baseline is surrounded by an exceptional degree of uncertainty. While headline inflation is suppressed by lower energy prices, price pressures are expected to remain subdued on account of the sharp decline in real GDP and the associated significant increase in economic slack.

In line with ~~our~~its mandate, the Governing Council is determined to ~~continue to support households and firms in the face of the current economic disruption and heightened uncertainty, in order~~ ensure the necessary degree of monetary accommodation and a smooth transmission of monetary policy across sectors and countries. Accordingly, we decided on a set of monetary policy measures to support the economy during its gradual reopening and to safeguard medium-term price stability.

~~Accordingly~~First, the Governing Council decided ~~today~~ to ~~further ease the conditions on our targeted longer-term refinancing operations (TLTRO III). Specifically, we decided to reduce the interest rate on TLTRO III operations during the period from June 2020 to June 2021 to 50 basis points below the average interest rate on the Eurosystem's main refinancing operations prevailing over the same period. Moreover, for counterparties whose eligible net lending reaches the lending performance threshold, the interest rate over the period from June 2020 to June 2021 will now be 50 basis points below the average deposit facility rate prevailing over the same period.~~

~~We also decided on a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) to support liquidity conditions in the euro area financial system and contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop. The PELTROs consist of seven additional refinancing operations commencing in May 2020 and maturing in a staggered sequence between July and September 2021 in line with the duration of our collateral easing measures. They will be carried out as fixed rate tender procedures with full allotment, with an interest rate that is 25 basis points below the average rate on the main refinancing operations prevailing over the life of each PELTRO.~~

~~Further details on the amendments made to the terms of TLTRO III and on our new PELTROs will be published in dedicated press releases this afternoon at 15:30 CET.~~

~~Since the end of March we have been conducting purchases under our new~~increase the envelope for the pandemic emergency purchase programme (PEPP~~), which has an overall envelope of €750~~) by €600 billion~~, to ease the overall~~ to a total of €1,350 billion. In response to the pandemic-related downward revision to inflation over the projection horizon, the PEPP expansion will further ease the general monetary policy stance ~~and to counter the severe risks to the monetary policy transmission mechanism and the outlook~~, supporting funding conditions in the real economy, especially for ~~the euro area posed by the coronavirus pandemic. These~~businesses and households. The purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions. ~~We~~This allows us to effectively stave off risks to the smooth transmission of monetary policy.

Second, we decided to extend the horizon for net purchases under the PEPP to at least the end of June 2021. In any case, we will conduct net asset purchases under the PEPP until the Governing Council judges that the coronavirus crisis phase is over~~, but in any case until the end of this year.~~ .

~~Moreover~~Third, the Governing Council decided to reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2022. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

Fourth, net purchases under our asset purchase programme (APP) will continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year. We continue to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of our policy rates, and to end shortly before we start raising the key ECB interest rates.

~~We also~~Fifth, we intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when we start raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

~~In addition~~Sixth, we decided to keep the key ECB interest rates unchanged. We expect them to remain at their present or lower levels until we have seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

Together with the substantial monetary policy stimulus already in place, ~~these measures~~today's decisions will support liquidity and funding conditions ~~and~~ in the economy, help to ~~preserve~~sustain the ~~smooth provision~~flow of credit to ~~the real economy~~households and firms, and contribute to maintaining favourable financing conditions for all sectors and jurisdictions, in order to underpin the recovery of the economy from the coronavirus fallout. At the same time, in the current rapidly evolving economic environment, the Governing Council remains fully committed to doing everything necessary within its mandate to support all citizens of the euro area through this extremely challenging time. This applies first and foremost to our role in ensuring that our monetary policy is transmitted to all parts of the economy and to all jurisdictions in the pursuit of our price stability mandate. ~~We are, therefore, fully prepared to increase the size of the PEPP and adjust its composition, by as much as necessary and for as long as needed. In any case, the Governing Council stands~~The Governing Council, therefore, continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

Let me now explain our assessment in greater detail, starting with the~~-~~ **economic analysis**. The latest economic indicators and survey results ~~covering the period since the coronavirus spread to the euro area have shown an unprecedented decline, pointing to~~confirm a ~~significant~~sharp contraction ~~in~~of the euro area ~~economic activity~~economy and ~~to~~ rapidly deteriorating labour ~~markets.~~market conditions. The coronavirus pandemic and the ~~associated~~necessary containment measures have severely affected both the manufacturing and services sectors, taking a toll on the productive capacity of the euro area economy and on domestic demand. In the first quarter of 2020, ~~which was~~when containment measures were only ~~partially affected by the spread of the coronavirus~~in place from mid-March in most countries, euro area real GDP decreased by 3.8%, quarter on quarter~~, reflecting the impact of the lockdown measures in the final weeks of the quarter. The sharp downturn in economic activity in April suggests that the impact is likely~~. Information from surveys, high-frequency indicators and incoming hard data all point to ~~be even more severe~~a further significant contraction of real GDP in the second quarter. ~~Looking beyond the immediate disruption stemming from the coronavirus pandemic~~Most recent indicators suggest some bottoming-out of the downturn in May as parts of the economy gradually reopen. Accordingly, euro area ~~growth~~activity is expected to ~~resume~~rebound in the third quarter as the containment measures are ~~gradually lifted~~eased further, supported by favourable financing conditions, ~~the euro area~~an expansionary fiscal stance and a resumption in global activity~~.~~, although the overall speed and scale of the rebound remains highly uncertain.

~~Given the highly uncertain duration of the pandemic, the likely extent and duration of the imminent recession and the subsequent recovery are difficult to predict. However, without pre-empting the forthcoming~~This assessment is also broadly reflected in the June 2020 Eurosystem staff macroeconomic projections~~, which will be published in June, growth scenarios produced by ECB staff suggest that~~ for the euro area. In the baseline scenario of the projections, annual real GDP ~~could fall by between 5% and 12% this year, followed by a recovery and normalisation of growth in subsequent years. The~~is expected to fall by 8.7% in 2020 and to rebound by 5.2% in 2021 and by 3.3% in 2022. Compared with the March 2020 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised substantially downwards by 9.5 percentage points in 2020 and revised upwards by 3.9 percentage points in 2021 and 1.9 percentage points in 2022.

Given the exceptional uncertainty currently surrounding the outlook, the projections also include two alternative scenarios, which we will publish on our website following this press conference. In general, the extent of the contraction and the recovery will depend crucially on the duration and the ~~success~~effectiveness of the containment measures, ~~how far supply capacity and domestic demand are permanently affected, and the~~ the success of policies ~~in mitigating~~to mitigate the adverse impact on incomes and employment~~.~~, and the extent to which supply capacity and domestic demand are permanently affected. Overall, the Governing Council sees the balance of risks around the baseline projection to the downside.

According to Eurostat's flash estimate, euro area annual HICP inflation decreased ~~from~~to 0.~~7~~1% in ~~March to~~May, down from 0.~~4~~3% in April, ~~largely driven by~~ mainly on account of lower energy price inflation~~, but also slightly lower HICP inflation excluding energy and food.~~. On the basis of ~~the sharp decline in~~ current and futures prices for oil, headline inflation is likely to decline ~~considerably~~somewhat further over the coming months~~. The sharp downturn in economic activity is expected to lead to negative effects on underlying inflation over the coming months. However,~~ and to remain subdued until the end of the year. Over the medium~~-~~ term~~ implications of the coronavirus pandemic for inflation are surrounded by high uncertainty, given that downward pressures linked to~~, weaker demand ~~may be~~will put downward pressure on inflation, which will be only partially offset by upward pressures related to supply ~~disruptions~~constraints. Market-based indicators of longer-term inflation expectations have remained at depressed levels. ~~Even though~~While survey-based indicators of inflation expectations have declined over the short and medium term, longer-term expectations have been less affected.

This assessment is also reflected in the June 2020 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation in the baseline scenario at 0.3% in 2020, 0.8% in 2021 and 1.3% in 2022. Compared with the March 2020 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised downwards by 0.8 percentage points in 2020, 0.6 percentage points in 2021 and 0.3 percentage points in 2022.

Turning to the **monetary analysis**, broad money (M3) growth increased to 8.3% in April 2020, from 7.5% in March~~ 2020, from 5.5% in February. Money~~. Strong money growth reflects bank credit creation~~ for the private sector~~, which is driven to a large extent by ~~drawing on credit lines, and low opportunity costs of holding M3 relative to other financial instruments, while heightened~~ the acute liquidity needs in the economy. Moreover, high economic uncertainty ~~appears to have triggered~~is triggering a shift towards ~~monetary~~money holdings~~, likely~~ for precautionary reasons. In this environment, the narrow monetary aggregate M1, encompassing the most liquid forms of money, continues to be the main contributor to broad money growth.

Developments in loans to the private sector ~~have also been~~continued to be shaped by the impact of the coronavirus~~.~~ on economic activity. The annual growth rate of loans to ~~households stood at 3.4% in March 2020, after 3.7% in February, while the annual growth rate of loans to~~ non-financial corporations ~~stood at 5.4% in March, after 3.0% in February. These developments are also clearly visible in the results of the euro area bank lending survey for the first quarter of 2020, which indicate a surge in~~rose further to 6.6% in April 2020, up from 5.5% in March, reflecting firms' ~~demand for loans~~need to finance their ongoing expenditures and ~~for drawing on credit lines to meet liquidity needs for~~ working capital~~, while financing needs for fixed investment declined. Demand for loans to households for house purchase increased less than in the previous quarter. Credit standards for loans to firms tightened slightly, while credit standards for loans to households tightened more strongly. In both cases, this was related to the deterioration in the economic outlook and a decline in the creditworthiness of firms and households.~~ in the context of rapidly declining revenues. At the same time, ~~banks expect an easing of credit standards for loans to firms in the second quarter of 2020.~~the annual growth rate of loans to households decreased to 3.0% in April, from 3.4% in March, amid consumption constraints due to the containment measures, declining confidence and a deteriorating labour market.

Our policy measures, in particular the ~~more~~very favourable terms for ~~TLTRO III~~our targeted longer-term refinancing operations ~~and the collateral easing measures,~~(TLTRO III), should encourage banks to extend loans to all private sector entities. Together with the~~ credit support~~ measures adopted by national governments and European institutions, they support ongoing access to financing, including for those most affected by the ramifications of the coronavirus pandemic.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis confirmed that an ample degree of monetary accommodation is necessary for the robust convergence of inflation to levels that are below, but close to, 2% over the medium term.

Regarding **fiscal policies**, an ambitious and coordinated fiscal stance ~~is~~remains critical, in view of the sharp contraction in the euro area economy. Measures taken should as much as possible be targeted and temporary in nature in response to the pandemic emergency. ~~We welcome the endorsement~~The three safety nets endorsed by the European Council ~~of the Eurogroup agreement on the three safety nets~~ for workers, businesses and sovereigns, amounting to a package worth €540 billion, provide important funding support in this context. At the same time, the Governing Council urges further strong and timely efforts to prepare and support the recovery. ~~In this regard, we~~We therefore strongly welcome the European ~~Council agreement to work towards establishing~~Commission's proposal for a recovery ~~fund~~plan dedicated to ~~dealing with this unprecedented crisis~~supporting the regions and sectors most severely hit by the pandemic, to strengthening the Single Market and to building a lasting and prosperous recovery.

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