ECB: Confident but ready to calibrate

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September 10 2020

- **The ECB kept monetary policy unchanged, as expected. Extension of the PEPP was not discussed**
- **The Governing Council showed some concern over the implications of euro appreciation for inflation, but with the usual language that they do not target the euro**
- **The strategy review by the ECB will proceed as expected and will be published in the second half of 2021**

The ECB sprang no surprises in its first monetary policy meeting since the summer break, **leaving its emergence bond buying program as well as its record low interest rates unchanged, in line with broader market expectations**. Further, marginal revisions to its macro projections since the June update did not warrant any meaningful changes to ECB's very accommodative policy guidance. On the euro dollar exchange rate, which had taken the spotlight ahead of today's policy, given its marked strengthening since the March lows and ECB Chief Economist Philip Lane's warning against undue currency strength, President Lagarde provided a conventional ECB response. While she acknowledged **that the Governing Council discussed the appreciation of the Euro and will carefully monitor the exchange rate going forward, she also asserted that the ECB does not target the exchange rate.** That said, the Governing Council will carefully assess incoming information, including developments in the exchange rate, with regard to its implications for the medium-term inflation outlook. The Euro hit a 1 week high of $1.1902 (+0.7%) on the relative soft remark, although still well below the recent high of 1.20.

The **ECB's assessment of the state of the Euro Area economy and ongoing recovery was broadly in line with expectations**, with the recovery in its early stages and remaining uneven across sectors and jurisdictions and the balance of risks remaining skewed to the downside, with a highly uncertain outlook. While it acknowledged the strong recovery since May, it saw a weaker momentum in services in August. Furthermore, it warned that actual and expected job and income losses and uncertainty continued to weigh on spending and investment and this, in turn, alongside precautionary household savings, was weighing on consumer spending. On the investment front, ECB cautioned that weak business prospects and high uncertainty are a key impediment, while weakness in the global economy is hampering foreign demand for Euro Area goods and services.

On the brighter side, the ECB stressed the expected rebound in Q3 as containment measures are eased further, supported by favorable financial conditions and supportive fiscal stance and resumption in global activity, although it warned that uncertainty about the overall scale and speed of the rebound remains high. **The updated ECB's forecasts for both growth and inflation remain broadly unchanged, although Mrs Lagarde highlighted that deflationary risks have receded over the last three months**. On activity, GDP growth has been revised slightly upward to -8% in 2020 (from -8.7) driven by the marginally lower-than-expected contraction in 2Q20. Incoming data points to a strong rebound in activity in 3Q20 (8.4% QoQ), supported by the improvement in the manufacturing sector that contrasts with slowing momentum in services. There are **no changes in the key assumption of a partial success in containing the virus** until a medical solution becomes available by mid-2021, so GDP growth forecasts were broadly unchanged at 5% (from 5.2%) in 2021 and 3.2% (from 3.3%) in 2022. **Risks to the economic outlook remain tilted to the downside** related with the evolution of the pandemic and potential measure to contain it.

On consumer prices, recent inflation figures, both headline and core measures, were in line with the ECB's projections and **headline inflation is expected to remain in negative territory in the remainder of the year before returning to positive figures in early 2021, while core inflation could slow further in coming months.** The inflation outturn in August (which unexpectedly moved to negative territory) was mainly driven by previous collapse of oil prices, but also the appreciation of the euro, the temporary reduction in the VAT rate in Germany along with the postponement of summer sales in some countries. When asked, Mrs Lagarde did not seem particularly worried about deflationary pressures. But disinflationary effects are expected to be broad-based across the services and goods sectors, as demand remains weak, while continued upward cost pressures related to supply side limitations are expected to partly offset these effects. The **projection for headline inflation remained unchanged for 2020 (slowing to 0.3%), but it is projected to increase in 2021 (1% from 0.8%) and 2022 (unchanged at 1.3%) as oil prices are assumed to pick up and demand should recover**, despite diminishing upward pressures from adverse supply effects linked to the pandemic and despite the appreciation of the euro. **Core inflation projections were revised slightly upwards by 0.2pp in both 2021 and 2022** to 0.9% and 1%, respectively.

Lagarde's post policy briefing echoed ECB's confidence - that the ECB feels it is 'in a good place at the moment' - in terms of its policy effectiveness in tackling the pandemic and its comfort with the state of existing policy measures already in place while keeping all options on the table. At the same time, the ECB chief called for patience, cautioning that monetary policy takes time to transmit and show its effects. On questions about the **possibility of further easing by the central bank, and in particular for the possibility to cut rates, Mrs. Lagarde has not discarded them, emphasizing the central bank's commitment to use/calibrate all instruments at their disposal** - this does not change the recent ECB language on the issue-. Lagarde re-emphasized the benefits of PEPP's flexibility across time, asset classes and jurisdiction, beyond its dual function of effectively addressing the risk of market fragmentation and impairment of monetary policy transmission as well as in easing monetary policy stance. Lagarde clarified that there was no discussion of another PEPP extension and that the ECB maintained its baseline to make full use of the PEPP envelope (currently at €1,350 billion) while remaining committed to calibrating all policy tools. In addition, Lagarde defended the effectiveness of TLTROs in easing tightening financial conditions, citing their high uptake and took comfort from banks' support in terms of forwarding lending through TLTROs. In this regard, Lagarde affirmed that the current two-tier system is effective, and has improved additional borrowing and lending activity in the interbank market, which is a sign of defragmentation. While the ECB has kept open the option of changing the remuneration rate and the multiplier overtime, it does not see the need to revisit right now. Meanwhile, Lagarde expressed the ECB's welcome to the approval of the NGEU which will provide substantial fiscal support and help enabling a more balanced recovery across the Euro Area.

As expected, the ECB faced questions about the Federal Reserve's Flexible Average Inflation Targeting Regime (FAIT) and the implications for the **ECB's strategic review.** Mrs Largarde made clear that the ECB does not react to the recent announcement by the Fed. They will continue with the expected pace of revision after the forced pause by the pandemic. Lagarde did not provide a release date, though mentioned that results are expected in the second half of 2021 and signalled that the focus will be on the "definition of price stability".

Finally, on the fiscal front, and ahead of the European Summit this week, the ECB President called upon political leaders to realise the importance of not wasting time and to signal a level of consensus and determination to support each other and work together.

Overall, today's meeting did not provide any surprises on the reaction by the ECB to the hottest topics post summer - the most recent inflation figures and especially the appreciation of the euro. **The ECB continues to be very cautious and dovish but does not seem to be ready to extend the PEPP for the moment, unless further risks on the pandemic and hence on the economy materialize.**

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).

PRESS CONFERENCE

Christine Lagarde, President of the ECB,
Luis de Guindos, Vice-President of the ECB,
Frankfurt am Main, ~~16 July~~10 September 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.

~~Incoming information~~The incoming data since our last monetary policy meeting in ~~early June signals~~July suggest a ~~resumption of euro area economic~~ strong rebound in activity broadly in line with previous expectations, although the level of activity remains well below the levels prevailing before the coronavirus (COVID-19) pandemic~~ and~~. While activity in the ~~outlook~~ manufacturing sector has continued to improve, momentum in the services sector has slowed somewhat recently. The strength of the recovery remains surrounded by significant uncertainty, as it continues to be highly ~~uncertain. Both high-frequency and survey indicators bottomed out in April and showed~~dependent on the future evolution of the pandemic and the success of containment policies. Euro area domestic demand has recorded a significant~~, though uneven and partial, recovery in May and June, alongside the ongoing containment of the virus and the associated easing of the lockdown measures. At the same time, actual and expected job and income losses and the exceptionally~~ recovery from low levels, although elevated uncertainty about the ~~evolution of the pandemic and the~~ economic outlook ~~continue~~continues to weigh on consumer spending and business investment. Headline inflation is being dampened by ~~lower~~low energy prices and weak price pressures ~~are expected to remain very~~ in the context of subdued ~~on account of the sharp decline in real GDP growth~~demand and ~~the associated~~ significant ~~increase in economic~~labour market slack.

Against this background, ample monetary stimulus remains necessary to support the economic recovery and to safeguard medium-term price stability. Therefore, we decided to reconfirm our ~~very~~ accommodative monetary policy stance.

We will 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.
We will continue our purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,350 billion. These purchases contribute to easing the overall monetary policy stance, thereby helping to offset the ~~pandemic-related~~ downward ~~shift in~~impact of the pandemic on the projected path of inflation. The purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions. This allows us to effectively stave off risks to the smooth transmission of monetary policy. We will conduct net asset purchases under the PEPP until at least the end of June 2021 and, in any case, until the Governing Council judges that the coronavirus crisis phase is over. We will reinvest the principal payments from maturing 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.

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 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.

We will also continue to provide ample liquidity through our refinancing operations. In particular, the latest operation in the third series of targeted longer-term refinancing operations (TLTRO III) has registered a very high take-up of funds, supporting bank lending to firms and households.

The monetary policy measures that we have taken since early March are providing crucial support to underpin the recovery of the euro area economy and to safeguard medium-term price stability. In particular, they support liquidity and funding conditions in the economy, help to sustain the flow of credit to households and firms, and contribute to maintaining favourable financing conditions for all sectors and jurisdictions. At the same time, in the current environment of elevated uncertainty~~ and significant economic slack~~, the Governing Council ~~remains fully committed~~will carefully assess incoming information, including developments in the exchange rate, with regard 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~~implications for the ~~economy and to all jurisdictions in the pursuit of our price stability mandate. The Governing Council, therefore,~~medium-term inflation outlook. It 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**. ~~Incoming data and survey results suggest that economic activity improved significantly in May and June from its trough in April, alongside the ongoing containment of the virus and the associated easing of the lockdown measures. At the same time, economic indicators remain well below the levels recorded before the pandemic, and the recovery is in its early stages and remains uneven across sectors and jurisdictions. After decreasing by 3.6%, quarter on quarter, in the first quarter of 2020, euro area real GDP is expected to have contracted even further overall in the second quarter, broadly in line with the June 2020 Eurosystem staff macroeconomic projections. Signs of a recovery in consumption have emerged, while there has also been a significant rebound in industrial output. At the same time, subdued labour market conditions and precautionary household saving are weighing on consumer spending. Weak business prospects and high uncertainty are dampening investment, while the weakness in the global economy is hampering foreign demand for euro area goods and services~~Euro area real GDP contracted by 11.8%, quarter on quarter, in the second quarter of 2020. Incoming data and survey results indicate a continued recovery of the euro area economy and point to a strong rebound in GDP growth in the third quarter. Alongside a significant rebound in industrial and services production, there are signs of a notable recovery in consumption. Recently, momentum has slowed in the services sector compared with the manufacturing sector, which is also visible in survey results for August. The increases in coronavirus infection rates during the summer months constitute headwinds to the short-term outlook. Looking ahead, a further sustained recovery remains highly dependent on the evolution of the pandemic and the success of containment policies. While the uncertainty related to the evolution of the pandemic will likely dampen the strength of the recovery in the labour market and in consumption and investment, the euro area economy should be supported by favourable financing conditions, an expansionary fiscal stance and a strengthening in global activity and demand.

~~Euro area activity~~This assessment is ~~expected to rebound~~broadly reflected in the ~~third quarter as the containment measures are eased further, supported by favourable financing conditions, an expansionary fiscal stance~~September 2020 ECB staff macroeconomic projections for the euro area. These projections foresee annual real GDP growth at -8.0% in 2020, 5.0% in 2021 and ~~a resumption in global activity, although~~3.2% in 2022. Compared with the June 2020 Eurosystem staff macroeconomic projections, the outlook for real GDP growth has been revised up for 2020 and is largely unchanged for 2021 and 2022.

Given the exceptional uncertainty ~~about the overall speed and scale of the rebound remains high. In general, the extent of the contraction and~~ currently surrounding the outlook, the ~~recovery~~projections include two alternative scenarios, which we will ~~depend crucially~~publish on ~~the duration and effectiveness of the containment measures, the success of policies to mitigate the adverse impact on incomes and employment, and the extent to which supply capacity and domestic demand are permanently affected.~~our website following this press conference. Overall, the ~~Governing Council assesses the~~ balance of risks to the euro area growth outlook is seen to remain on the downside. This assessment largely reflects the still uncertain economic and financial implications of the pandemic.

According to Eurostat's flash estimate, euro area annual HICP inflation ~~increased~~decreased to -0.~~3~~2% in ~~June~~August, from 0.~~1% in May, mainly reflecting less negative energy price inflation~~4% in July. On the basis of current and futures prices for oil and taking into account the temporary reduction in the German VAT rate, headline inflation is likely to ~~decline again in~~ remain negative over the coming months before ~~picking up~~turning positive again in early 2021. Moreover, in the near term price pressures will remain subdued owing to weak demand, lower wage pressures and the appreciation of the euro exchange rate, despite some upward price pressures related to supply constraints. Over the medium term, ~~weaker demand~~a recovery in demand, supported by accommodative monetary and fiscal policies, will put ~~downward~~upward pressure on inflation~~, which will be only partially offset by upward pressures related to supply constraints.~~ . Market-based indicators of longer-term inflation expectations have ~~continued to increase from the historical lows reached in mid-March, but overall remain at subdued~~ returned to their pre-pandemic levels~~. While~~, but still remain very subdued, while survey-based ~~indicators of inflation expectations have declined since the start of the pandemic, longer-term expectations have been less affected than short and medium-term expectations~~measures remain at low levels.

This assessment is broadly reflected in the September 2020 ECB staff macroeconomic projections for the euro area, which foresee annual inflation at 0.3% in 2020, 1.0% in 2021 and 1.3% in 2022. Compared with the June 2020 Eurosystem staff macroeconomic projections, the outlook for inflation is unchanged for 2020, has been revised up for 2021, and is unchanged for 2022. The unchanged projection for inflation in 2022 masks an upward revision to inflation excluding energy and food – in part reflecting the positive impact of the monetary and fiscal policy measures – which was largely offset by the revised path of energy prices.
Turning to the **monetary analysis**, broad money (M3) growth ~~increased to 8.9% in May 2020, from 8~~continued to rise, reaching 10.2% in ~~April.~~July 2020, after 9.2% in June. Strong money growth reflects ~~bank~~domestic credit creation~~, which continues to be driven to~~ and the ongoing asset purchases by the Eurosystem, as well as precautionary considerations which foster a ~~large extent by the acute~~heightened preference for liquidity ~~needs in the economy. Moreover, high economic uncertainty is triggering a shift towards~~in the money ~~holdings for precautionary reasons~~-holding sector. 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 continued to be shaped by the impact of the coronavirus on economic activity. ~~The annual growth rate of loans to non-financial corporations rose further to 7.3% in May 2020, from 6.6% in April, reflecting firms' need to finance their ongoing expenditures and working capital in the context of still anaemic revenues. At the same time, the annual growth rate of loans to households remained unchanged at 3.0% in May, after declining for two consecutive months, amid ongoing constraints on consumption~~Following strong increases in the early months of the pandemic, the annual growth rate of loans to non-financial corporations remained broadly stable in July, standing at 7.0%, compared with 7.1% in June. High rates of corporate loan growth continue to mirror elevated liquidity needs of firms to finance their ongoing expenditures and working capital and to further build liquidity buffers, although the rebound in economic activity has resulted in some recovery in their revenues. The annual growth rate of loans to households also remained stable at 3.0% in July – the same rate as observed since April 2020. Growth in loans to the private sector continues to benefit from historically low bank lending rates.

~~The results of the euro area bank lending survey for the second quarter of 2020 provide further insights into these developments. With regard to firms, they show a continued strong upward impact of the pandemic on demand for loans, largely driven by emergency liquidity needs, while financing needs for fixed investment declined. Credit standards on loans to firms remained broadly unchanged. The tightening impact of the deterioration in the economic outlook and the associated decline in the creditworthiness of firms was broadly offset by the easing effects of policy measures, particularly the ECB's liquidity-support measures and government guarantees on loans. However, looking ahead, banks expect a net tightening of credit standards on loans to firms, in part related to the expected end of the state guarantee schemes. With regard to loans to households, credit standards tightened, reflecting in particular a deterioration in households' income and employment prospects in the context of the pandemic.~~

Overall, our policy measures, together with the measures adopted by national governments and European institutions, will continue to support access to financing, including for those most affected by the ramifications of the 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 remains critical, in view of the sharp contraction in the euro area economy. ~~Measures~~Fiscal measures taken in response to the pandemic emergency should as much as possible be targeted and temporary in nature. The three safety nets endorsed by the European Council for workers, businesses and sovereigns, amounting to a ~~package worth~~total of €540 billion, provide important funding support in this context. ~~At the same time, the~~ The Governing Council ~~urges further strong and timely efforts to prepare and support the recovery. We therefore~~also strongly ~~welcome~~welcomes the ~~European Commission's~~ Next Generation EU ~~proposal~~package of €750 billion, which ~~is dedicated~~has the potential to ~~supporting~~significantly support the regions and sectors hardest hit by the pandemic, ~~to strengthening~~strengthen the

Single Market and ~~to building~~build a lasting and prosperous recovery~~. It is important for the European leaders to quickly agree on an ambitious package~~.

In order to fully reach its ~~full~~ potential, the ~~European Union's Recovery and Resilience Facility~~package will need to be firmly rooted in sound **structural policies** conceived and implemented at the national level. Well-designed structural policies could contribute to a faster, stronger and more uniform recovery from the crisis, thereby supporting the effectiveness of monetary policy in the euro area. Targeted structural policies are particularly important to ~~rejuvenate~~revitalise our economies, with a focus on ~~accelerating~~boosting investment in priority areas such as the green and digital transitions.

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