ECB: Holds fire, signals more stimulus in December

Sonsoles Castillo / Sumedh Deorukhkar / Miguel Jiménez / Maria Martinez

October 29 2020

- **The ECB kept all its main policy settings unchanged, in line with expectations**
- **It also conveyed a clear readiness to recalibrate all its policy instruments in December, or even inter-meeting, as warranted by a readjusted economic scenario**
- **There are clear downside risks for Q4 due to increase in virus contagions and consequent confinement measures**
- **On price stability, the ECB does not foresee deflation risks**
- **We expect now the ECB to announce a bold package by December, which would include another PEPP expansion, recalibration of liquidity provisions, and modification to the tiering system**

The ECB kept all its main policy settings unchanged today, including its key interest rates, the size and pace of the asset purchases under the PEPP and APP as well as TLTRO-III operational conditions. However, **it conveyed a clear readiness to recalibrate all its policy instruments in December (or even before, in an intermeeting)** given intensifying downside risks to the Euro Area economic outlook in the wake of recent increase in coronavirus contagions and the consequent approval of confinement measures across member states. Market participants had largely anticipated ECB's decision to hold its fire power in today's meeting while signalling more decisive policy changes action in December, when it updates its macroeconomic projections.

The ECB sounded a very cautionary tone. It highlighted the need to assess the pandemic dynamics, vaccine rollout prospects and exchange rate developments, while risks clearly remained tilted to the downside, especially in Q4, given the weakening growth momentum since September and a sharper downturn expected in November given the lockdown measures that have been announced in the past few days in several countries. **On the price stability front, the ECB does not foresee deflation risks** and attributes that current 'negative inflation' to one-off price changes, which it believes would reverse once demand recovery gains traction in the later half of next year on the back of continued policy support.

ECB's clear intentions to recalibrate its instruments in December drew most of the attention and questions during President Lagarde's accompanying press briefing. Mrs Lagarde highlighted the **unanimity across ECB's Governing Council Members to undertake such a recalibration exercise. Further, the ECB will examine all possible monetary policy tools at their disposal and ascertain what will be the optimal mix** (working on duration, attractiveness and effectiveness of each instrument) that will address the situation for maintaining favorable financing conditions to help the recovery and addressing the negative consequences from the pandemic on the inflation path. Ms Lagarde's mention that this recalibration will look at all of the ECB's instruments signals that, apart from non-standard policy measures, rate cuts are also not completely out of the cards.

All in all, **we expect the ECB to take a bold action in December.** It is difficult to foresee, in the coming weeks, a variation in the economic outlook and evolution of the pandemic that would change ECB's mind against such recalibration. While Lagarde gave no clear hints on the choice of any particular measure, she made it very clear that the ECB is ready to adopt a package of measures. In our view, **it means that the ECB will announce a package likely including another extension of PEPP, recalibration of liquidity provision and modifying the tiering system so as to ensure the optimal policy mix in a readjusted scenario.** We will wait to see the details of the discussion, which will be revealed in the minutes of the meeting, to be published on November 26. In terms of market reaction, ECB's pre-commitment to recalibrate in December pushed the DAX and bund futures higher while the Euro extended losses with a break below 1.17 against the USD (EURUSD -0.7% to 1.165).

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, ~~10 September~~29 October 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 ~~incoming data since our last monetary policy meeting~~resurgence in ~~July suggest~~coronavirus (COVID-19) infections presents renewed challenges to public health and the growth prospects of the euro area and global economies. Incoming information signals that the euro area economic recovery is losing momentum more rapidly than expected, after a strong, yet partial and uneven, rebound in economic activity ~~broadly in line with previous expectations, although the level of~~ over the summer months. The rise in COVID-19 cases and the associated intensification of containment measures is weighing on activity ~~remains well below the levels prevailing before the coronavirus (COVID-19) pandemic. While~~, constituting a clear deterioration in the near-term outlook. In fact, while activity in the manufacturing sector has continued to ~~improve, momentum~~ recover, activity in the services sector has ~~slowed somewhat recently. The strength of the recovery remains surrounded by significant uncertainty, as it continues to be highly dependent on the future evolution~~been slowing visibly. Although fiscal policy measures are supporting households and firms, consumers are cautious in the light of the pandemic and ~~the success of containment policies. Euro area domestic demand has recorded a significant recovery from low levels, although elevated~~its ramifications for employment and earnings. Moreover, weaker balance sheets and increased uncertainty about the economic outlook ~~continues to weigh~~are weighing on ~~consumer spending and~~ business investment. Headline inflation is being dampened by low energy prices and ~~weak~~ muted underlying price pressures in the context of ~~subdued~~weak demand and significant slack in labour ~~market slack~~and product markets.

~~Against this background, ample monetary stimulus remains necessary to support the economic recovery and to safeguard medium-term price stability. Therefore~~The monetary policy measures that we have taken since early March are helping to preserve favourable financing conditions for all sectors and jurisdictions across the euro area, thereby providing crucial support to underpin economic activity and to safeguard medium-term price stability. At the same time, in the current environment of risks clearly tilted to the downside, the Governing Council will carefully assess the incoming information, including the dynamics of the pandemic, prospects for a rollout of vaccines and developments in the exchange rate. The new round of Eurosystem staff macroeconomic projections in December will allow a thorough reassessment of the economic outlook and the balance of risks. On the basis of this updated assessment, the Governing Council will recalibrate its instruments, as appropriate, to respond to the unfolding situation and to ensure that financing conditions remain favourable to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path. This will foster the convergence of inflation towards its aim in a sustained manner, in line with its commitment to symmetry.

In the meantime, we decided to reconfirm our 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~~%~~ percent 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 downward 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~~our third series of targeted longer-term refinancing operations (TLTRO III) ~~has registered a very high take-up~~remains an attractive source of ~~funds~~funding for banks, 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, 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. 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**. Euro area real GDP contracted by 11.8~~%,~~ percent, quarter on quarter, in the second quarter of 2020. ~~Incoming data and survey results indicate a continued recovery of the~~ Following the trough in April 2020, the euro area economy ~~and point to a strong rebound in GDP growth~~rebounded strongly in the third quarter~~. Alongside a significant rebound~~, making up about half of the contraction in ~~industrial and services production, there are signs~~the first half 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 year. The ~~increases~~significant surge in coronavirus infection rates ~~during~~and the associated intensification of containment measures since the summer ~~months~~ constitute clear headwinds to the short-term outlook. In fact, recent hard data, survey results and high-frequency indicators point to a significant softening in economic activity in the final quarter of the year. Moreover, economic developments continue to be uneven across sectors. In particular, activity in the services sector is slowing again as it is the sector most affected by the new restrictions on social activities and mobility. Looking ahead, ~~a further sustained recovery remains highly dependent on the evolution of the pandemic and the success of containment policies. While~~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 continue to be supported by favourable financing conditions~~,~~ and an expansionary fiscal stance ~~and a strengthening in global activity and demand~~.

~~This assessment is broadly reflected in the September 2020 ECB staff macroeconomic projections for the~~ Overall, the risks surrounding the euro area~~. These projections foresee annual real GDP~~ growth ~~at -8.0% in 2020, 5.0% in 2021 and 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 currently surrounding the outlook, the projections include two alternative scenarios, which we will publish on our website following this press conference. Overall, the balance of risks~~ are clearly tilted to the ~~euro area growth outlook is seen to remain on the~~ downside. This ~~assessment~~ largely reflects the ~~still~~recent resurgence in COVID-19 infections, the associated intensification of containment measures and a highly uncertain timeline of the pandemic and its implications for economic and financial ~~implications of the pandemic~~conditions.

~~According to Eurostat's flash estimate, euro~~Euro area annual ~~HICP~~ inflation decreased to ~~-0.2%~~-0.3 percent in September, from -0.2 percent in August, ~~from 0.4% in July.~~reflecting developments in the prices of energy, non-energy industrial goods and services. On the basis of ~~current and futures prices for oil~~oil price dynamics and taking into account the temporary reduction in ~~the~~ German VAT ~~rate~~, headline inflation is likely to remain negative ~~over the coming months before turning positive again in~~ until early 2021. Moreover, ~~in the~~ near-term price pressures will remain subdued owing to weak demand, notably in the tourism and travel-related sectors, as well as to lower wage pressures and the appreciation of the euro exchange rate~~, despite some upward price pressures related to supply constraints. Over the medium term~~. Once the impact of the pandemic fades, a recovery in demand, supported by accommodative fiscal and monetary ~~and fiscal~~ policies, will put upward pressure on inflation~~.~~ over the medium term. Market-based indicators and survey-based measures of longer-term inflation expectations ~~have returned to their pre-pandemic levels, but still remain very subdued, while survey-based measures remain~~ remain broadly unchanged 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 ~~continued~~rose to ~~rise, reaching~~ 10.~~2%~~4 percent in ~~July~~September 2020, ~~after~~from 9.~~2%~~5 percent in ~~June~~August, thus remaining well above the levels recorded before the COVID-19 pandemic. Strong money growth ~~reflects~~continues to reflect domestic credit ~~creation~~expansion and the ongoing asset purchases by the Eurosystem, as well as precautionary considerations which foster a heightened preference for liquidity in the money-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~~COVID-19 pandemic on economic activity. 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.~~stood at 7.1 percent in September, unchanged from August. This, however, masks a moderation in recent monthly loan flows. The annual growth rate of loans to households edged up to 3.1 percent in September, from 3.0 percent in August. Growth in loans to the private sector continues to benefit from historically low bank lending rates.

According to our bank lending survey for the third quarter of 2020, credit conditions on loans to firms tightened. While banks indicated that their funding and balance sheet conditions remain supportive, higher risk perceptions could weigh on their attitude towards loan creation. Surveyed banks reported a fall in firms' loan demand in the third quarter, reflecting a decline in emergency liquidity needs and weakening corporate investment. The survey indicates an increase in households' net demand for loans in the third quarter, while also suggesting the intention to tighten credit standards for households.

Overall, our policy measures, together with the measures adopted by national governments and European institutions, ~~will continue~~remain essential 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~~to support economic activity and the robust convergence of inflation to levels that are below, but close to, 2~~%~~ percent 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~~. Fiscal~~ and the reduction in private demand. While fiscal measures taken in response to the pandemic emergency should, as much as possible, be targeted and temporary in nature~~.~~, weak demand from firms and households and the heightened risk of a delayed recovery warrant continued support from national fiscal policies. The three safety nets endorsed by the European Council for workers, businesses and sovereigns~~, amounting to a total of €540 billion,~~ provide important funding support in this context~~. The Governing Council also strongly welcomes the Next Generation EU package of €750 billion, which has the potential to significantly support the regions and sectors hardest hit by the pandemic, strengthen the Single Market and build a lasting and prosperous recovery~~.

~~In order to fully reach its potential,~~The Governing Council recognises the key role of the Next Generation EU package ~~will need to be firmly rooted in sound~~and stresses the importance of it becoming operational without delay. Provided the funds are deployed for productive public spending and accompanied by productivity-enhancing **structural policies** ~~conceived and implemented at the national level. Well-designed structural policies could~~ , Next Generation EU will contribute to a faster, stronger and more uniform recovery ~~from the crisis,~~ and will increase economic resilience and the growth potential of Member States' economies, thereby supporting the effectiveness of monetary policy in the euro area. ~~Targeted~~Such structural policies are particularly important ~~to revitalise our economies, with a focus on boosting investment~~in addressing long-standing structural and institutional weaknesses and in ~~priority areas such as~~accelerating the green and digital ~~transitions~~transition.

Creating Opportunities

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com