Central Banks

ECB: A package of measures to meet the second wave of Covid

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- The central bank approves an expansion of the PEPP, TLTROs III and easing of collateral rules
- No changes in the APP program, the tiering system for deposit rates or key interest rates
- Growth is revised up in 2020 and down in 2021, in line with recent data and evolution of Covid. Uncertainty remains high, but downside risks are less pronounced
- Further recalibration of measures (different amount of PEPP or lower interest rates) are not ruled out

The big question mark before the meeting was to see the size of the pre-announced package of measures, and the ECB action was broadly in line with what we were expecting (somewhat to the lower bound) announcing a package of further accommodative measures. Moreover, the central bank reaffirmed its readiness to adjust its instruments further if needed (as risks remain tilted to the downside). In detail, the package of monetary policy measures includes:

- First, the pandemic emergency purchase programme (PEPP) has been expanded by EUR500bn to EUR1.85tn while purchases have been extended until March 2022, longer than expected. Likewise, PEPP reinvestment will last until December 2023.
- Second, the terms of liquidity operations TLTROs III have also been recalibrated. The considerably more favourable conditions -a negative rate of up to -1% for these liquidity measures- will last until June 2022. However, this favourable cost will only be available for counterparties whose eligible net lending between 1 October 2020 and 31 December 2021 reaches the lending performance threshold (positive net lending). Moreover, three more TLTROs have been approved in 2021 with a 3-year maturity each, and the borrowing allowance has been raised from 50% to 55% of eligible loans.
- Additionally, four additional pandemic emergency longer-term refinancing operations (PELTROs) will be conducted in 2021, while extending the easing of the collateral rules until June 2022.
- Finally, the Eurosystem repo facility for central banks (EUREP) and all the temporary swap and repo lines with non-euro area central banks have also been extended until March 2022.

All this comes with no change in the standard QE program, the APP, which will continue at a monthly pace of €20bn, in the tiering system (the share of deposits in the central bank exempted of negative rates) nor in the key interest rates.

The main objective remains to maintain the favourable financing conditions for longer across the board (according to Ms Lagarde, until herd immunity to COVID-19 is reached, around the end of 2021). To this end, Ms. Lagarde put an special emphasis on the flexibility of these measures, in particular about the PEPP (in terms of purchases of assets, maturities and jurisdictions), stating that they can be expanded further if and when needed, but that the PEPP might not be used in full if the outlook improves.

In addition, when she was asked if interest rate cuts were discussed, Ms Lagarde said that all instruments remain in the toolbox to be used if necessary. On the exchange rate, she maintained the usual ECB's line that it is not a target, but that its recent growth has put downward pressure on prices and, therefore, they will continue to monitor it closely.

Regarding the updated macroeconomic forecasts, the economic outlook continues to remain uncertain and risks are tilted to the downside, but less pronounced than before. Though the second wave of Covid was expected, its depth and duration had been worse than expected, with a particularly large impact on the services sector. As a consequence, while recognizing the better-than-expected data for 3Q20, the ECB is now expecting a negative quarterly GDP growth in 4Q20 of -2.2% QoQ, revising the 2020 growth from -8% to -7.3%. A slower recovery of 3.9% is anticipated for 2021 (previously 5%), but it will not be until 2022 when the recovery speeds up at 4.2% (previously 3.2%) as herd immunity is reached by the end of 2021. Growth for 2023 is expected at 2.1%. Meanwhile, inflation remains "disappointingly low". However, both the expansionary fiscal and monetary policies will allow a gradual recovery of the demand and investment, which, alongside the fading of the base effect coming from energy prices and Germany's VAT cut, will lead to a slight surge in inflation, counteracting the downward pressures from a high exchange rate. Even so, inflation forces are not there yet and the expectations remain very low at 1% in 2021, 2.2% in 2022 and 1.4% in 2023.

Overall, the measures taken today are in line with expectations: more PEPP by EUR500bn, more TLTROs, easier conditions and no lower rates, with the exception of the increase in the tiering multiplier that we were also expecting and has eventually not been changed. The revision of the projections also goes in the logical direction (up in 2020 due to the better-than-expected data, worse in 2021 due to the second wave), as well as the recognition that the negative pandemic risks are lower than before, thanks to the vaccines.

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, ~~29 October~~10 December 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 resurgence in coronavirus (COVID-19) infections presents renewed challenges~~While the rebound of economic activity in the third quarter was stronger than expected and the prospects for the roll-out of vaccines are encouraging, the pandemic continues to pose serious risks to public health and ~~the growth prospects of~~to 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 over the summer months. The rise in~~ The resurgence in COVID-19 cases and the associated ~~intensification of~~ containment measures ~~is weighing on~~ are significantly restricting euro area economic activity, ~~constituting a clear deterioration in the near-term outlook. In fact, while~~which is expected to have contracted in the fourth quarter of 2020. While activity in the manufacturing sector ~~has continued to recover, activity in the~~ continues to hold up well, services ~~sector has been slowing visibly. Although fiscal policy measures are supporting households and firms, consumers are cautious in the light of the pandemic and its ramifications for employment and earnings. Moreover, weaker balance sheets and increased uncertainty about the economic outlook are weighing on business investment. Headline inflation~~ activity is being ~~dampened by low energy prices and muted underlying price pressures~~severely curbed by the increase in infection rates and the new restrictions on social interaction and mobility. Inflation remains very low in the context of weak demand and significant slack in labour and product markets. Overall, the incoming data and our staff projections suggest a more pronounced near-term impact of the pandemic on the economy and a more protracted weakness in inflation than previously envisaged.

~~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~~In view of the economic fallout from the resurgence of the pandemic, today the Governing Council recalibrated its monetary policy instruments as follows:

First, the Governing Council 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 ~~percent~~per cent within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.
~~We will continue our purchases under the~~ Second, we decided to increase the envelope of the pandemic emergency purchase programme (PEPP) ~~with a total envelope of €1,350~~by €500 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~~ to a total of €1,850 billion. We also extended the horizon for net ~~asset~~ purchases under the PEPP ~~until~~to at least the end of ~~June 2021 and, in~~March 2022. In any case, we will conduct net purchases until the Governing Council judges that the coronavirus crisis phase is over. ~~We will reinvest the~~

We will conduct our purchases under the PEPP to preserve favourable financing conditions over this extended period. We will purchase flexibly according to market conditions and with a view to preventing a tightening of financing conditions that is inconsistent with countering the downward impact of the pandemic on the projected path of inflation. In addition, the flexibility of purchases over time, across asset classes and among jurisdictions will continue to support the smooth transmission of monetary policy. If favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The extension of our PEPP purchases over a longer horizon reflects the prolonged fallout from the pandemic for the economy and inflation. It allows for a continuous market presence and more durable support from our monetary stimulus. Preserving favourable financing conditions over the pandemic period will help to reduce uncertainty and bolster confidence, thereby encouraging consumer spending and business investment, and, ultimately, underpinning the economic recovery and helping to offset the downward impact of the pandemic on the projected path of inflation.

We also decided to extend the reinvestment of principal payments from maturing securities purchased under the PEPP until at least the end of ~~2022~~2023. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

~~Net~~Third, the Governing Council decided to further recalibrate the conditions of the third series of targeted longer-term refinancing operations (TLTRO III). Specifically, we decided to extend the period over which considerably more favourable terms will apply by twelve months, to June 2022. We will also conduct three additional operations between June and December 2021. Moreover, we decided to raise the total amount that counterparties will be entitled to borrow in TLTRO III operations from 50 per cent to 55 per cent of their stock of eligible loans. In order to provide an incentive for banks to sustain the current level of bank lending, the recalibrated TLTRO III borrowing conditions will be made available only to banks that achieve a new lending performance target. The extension of the pandemic-related low interest rate period under TLTRO III, the addition of more operations and the increase in the amount that can potentially be borrowed will preserve the very attractive funding conditions for banks. This will help to ensure that they can continue to offer favourable lending conditions and have ample liquidity to extend loans to households and firms.
Fourth, we decided to extend to June 2022 the duration of the set of collateral easing measures adopted by the Governing Council on 7 and 22 April 2020. The extension of these measures will continue to ensure that banks can make full use of the Eurosystem's liquidity operations, most notably the recalibrated TLTROs. The Governing Council will reassess the collateral easing measures before June 2022, ensuring that Eurosystem counterparties' participation in TLTRO III operations is not adversely affected.

Fifth, the Governing Council also decided to offer four additional pandemic emergency longer-term refinancing operations (PELTROs) in 2021, which will continue to provide an effective liquidity backstop.

Sixth, 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 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, our third series of targeted longer-term refinancing operations (TLTRO III) remains an attractive source of funding for banks, supporting bank lending to firms and households.~~

Seventh, the Eurosystem repo facility for central banks (EUREP) and all temporary swap and repo lines with non-euro area central banks will be extended until March 2022.

Finally, we decided to continue conducting our regular lending operations as fixed rate tender procedures with full allotment at the prevailing conditions for as long as necessary.

Separate press releases with further details of the measures taken by the Governing Council will be published this afternoon at 15:30 CET.

The monetary policy measures taken today will contribute to preserving favourable financing conditions over the pandemic period, thereby supporting the flow of credit to all sectors of the economy, underpinning economic activity and safeguarding medium-term price stability. At the same time, uncertainty remains high, including with regard to the dynamics of the pandemic and the timing of vaccine roll-outs. We will also continue to monitor developments in the exchange rate with regard to their possible implications for the medium-term inflation outlook. We therefore continue to stand ready to adjust all of our instruments, as appropriate, to ensure that inflation moves towards our aim in a sustained manner, in line with our commitment to symmetry.
Let me now explain our assessment in greater detail, starting with the **economic analysis**. ~~Euro area~~ Following a sharp contraction in the first half of 2020, euro area real GDP ~~contracted by 11.8 percent~~rebounded strongly and rose by 12.5 per cent, quarter on quarter, in the ~~second~~third quarter ~~of 2020. Following the trough in April 2020, the euro area economy rebounded strongly in the third quarter, making up about half of the contraction in the first half of the year. The significant surge in coronavirus infection rates~~ , although remaining well below pre-pandemic levels. The second wave of the pandemic and the associated intensification of containment measures observed since ~~the summer constitute clear headwinds~~mid-October are expected to ~~the short-term outlook. In fact, recent hard data, survey results and high-frequency indicators point to a~~ result in a renewed significant ~~softening~~decline in ~~economic~~ activity in the ~~final~~fourth quarter, although to a much lesser extent than observed in the second quarter of ~~the~~this year. ~~Moreover, economic~~

Economic developments continue to be uneven across sectors~~. In particular,~~, with activity in the services sector ~~is slowing again as it is the sector most~~being more adversely affected by the new restrictions on social ~~activities and mobility.~~ interaction and mobility than activity in the industrial sector. Although fiscal policy measures are supporting households and firms, consumers remain cautious in the light of the pandemic and its ramifications for employment and earnings. Moreover, weaker balance sheets and uncertainty about the economic outlook are weighing on business investment.

Looking ahead, the news of prospective roll-outs of vaccines allows for greater confidence in the assumption of a gradual resolution of the health crisis. However, it will take time until widespread immunity is achieved, while ~~the uncertainty related to the evolution of the pandemic will likely dampen the strength of~~further resurgences in infections, with challenges to public health and economic prospects, cannot be ruled out. Over the medium term, the recovery ~~in the labour market and in consumption and investment,~~of the euro area economy should ~~continue to~~ be supported by favourable financing conditions~~ and~~, an expansionary fiscal stance and a recovery in demand as containment measures are lifted and uncertainty recedes.

This assessment is broadly reflected in the baseline scenario of the December 2020 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP growth at -7.3 per cent in 2020, 3.9 per cent in 2021, 4.2 per cent in 2022 and 2.1 per cent in 2023. Compared with the September 2020 ECB staff macroeconomic projections, the outlook for economic activity has been revised down in the short term, but is seen to broadly recover to the level projected in the September baseline scenario over the medium term.

Overall, the risks surrounding the euro area growth outlook ~~are clearly~~remain tilted to the downside~~. This largely reflects the recent resurgence in COVID-19 infections, the associated intensification of containment measures and a highly uncertain timeline of the pandemic and its implications for~~ , but have become less pronounced. While the news about the prospects for vaccine roll-outs in the near future is encouraging, downside risks remain related to the implications of the pandemic for economic and financial conditions.

~~Euro~~According to Eurostat's flash estimate, euro area annual inflation ~~decreased to~~ remained unchanged at -0.3 ~~percent in September, from -0.2 percent in August, reflecting developments in the prices of energy, non-energy industrial goods and services.~~per cent in November. On the basis of oil price dynamics and taking into account the temporary reduction in the German VAT rate, headline inflation is likely to remain negative until early 2021. ~~Moreover, near-term~~Thereafter, it is expected to increase owing to the end of the temporary VAT reduction in Germany and upward base effects in energy price inflation. At the same time, underlying price pressures ~~will~~are expected to remain subdued owing to weak demand, notably in the tourism and travel-related sectors, as well as to ~~lower~~low wage pressures and the appreciation of the euro exchange rate. Once the impact of the pandemic fades, a recovery in demand, supported by accommodative fiscal and monetary policies, will put upward pressure on inflation over the medium term. Market-based indicators and survey-based measures of longer-term inflation expectations remain ~~broadly unchanged~~ at low levels.

This assessment is broadly reflected in the baseline scenario of the December 2020 Eurosystem staff macroeconomic projections for the euro area, which foresees annual inflation at 0.2 per cent in 2020, 1.0 per cent in 2021, 1.1 per cent in 2022 and 1.4 per cent in 2023. Compared with the September 2020 ECB staff macroeconomic projections, the outlook for inflation has been revised down for 2020 and 2022.

Turning to the monetary analysis, the annual growth of broad money (M3) ~~growth rose to~~remained broadly unchanged at 10.~~4 percent in September 2020, from 9.~~5 ~~percent in August, thus remaining well above the levels recorded before the COVID-19 pandemic.~~per cent in October 2020. Strong money growth ~~continues to reflect domestic credit expansion and the~~ has been supported by the ongoing asset purchases by the Eurosystem, ~~as well as precautionary considerations which foster a~~which have become the largest source of money creation. In the context of a still heightened preference for liquidity in the money-holding sector~~. In this environment, the narrow monetary aggregate M1, encompassing~~ and a low opportunity cost of holding the most liquid forms of money, the narrow monetary aggregate M1 continues to be the main contributor to broad money growth.

~~Developments in loans~~The growth of lending to the private sector ~~continued~~has plateaued, while still recording higher growth rates than prior to ~~be shaped by the impact of~~ the 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 ~~stood at~~ fell to 6.8 per cent in October, after 7.1 ~~percent~~per cent in September~~, unchanged from August.~~. This~~, however, masks a moderation in recent monthly loan flows.~~ deceleration has occurred in the context of abating emergency liquidity needs, weak investment and tighter credit conditions on loans to firms, as signalled by our bank lending survey for the euro area for the third quarter of 2020. The annual growth rate of loans to households ~~edged up to~~stood at 3.1 ~~percent in~~ per cent in October, unchanged from 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, remain essential to support bank lending conditions and access to financing, ~~including~~in particular 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 to support economic activity and the robust convergence of inflation to levels that are below, but close to, 2 ~~percent~~per cent 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~~ and the reduction in private demand. While fiscal~~. Fiscal measures taken in response to the pandemic emergency should, as much as possible, be targeted and temporary in nature. At the same time, weak demand from firms and households and the heightened risk of a delayed recovery in the light of the new lockdowns owing to the second wave of the pandemic warrant continued support from national fiscal policies. The three safety nets endorsed by the European Council for workers, businesses and sovereigns provide important funding support in this context.
The Governing Council recognises the key role of the Next Generation EU package and stresses the importance of it becoming operational without delay. ~~Provided~~It calls on Member States to deploy the funds ~~are deployed~~ for productive public spending~~ and~~,

accompanied by productivity-enhancing **structural policies**~~,~~. This would allow the Next Generation EU ~~will~~programme to contribute to a faster, stronger and more uniform recovery and ~~will~~would increase economic resilience and the growth potential of Member States' economies, thereby supporting the effectiveness of monetary policy in the euro area. Such structural policies are particularly important in addressing long-standing structural and institutional weaknesses and in accelerating the green and digital ~~transition~~transitions.

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