Central Banks

ECB: On hold, with focus on preserving favourable financing conditions

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- **January was a transition meeting for the ECB, with status quo on rates, stimulus program as well as policy guidance**
- **No hints of policy change in the near term, with the ECB ready to adjusts its instruments, if necessary, in either direction**
- **Will monitor FX very carefully**

As widely anticipated, the ECB maintained status quo today, holding all its policy settings unchanged, after having extended and expanded its accommodative measures last December.

The focus this time was on preserving favorable financing conditions, which according to President Lagarde serves as the compass, anchored by inflation, to ascertain the need for any potential two-way adjustments to ECB's policy measures. The stress was on flexibility to adjust all available instruments as needed, specifically the €1.85 bn pandemic emergency purchase program (PEPP). President Lagarde clarified persistently that while the PEPP envelope may not be fully used, it can also equally be recalibrated if required so as to maintain favorable financing conditions. The ECB's assessment of favourable financing conditions is driven by a holistic, multi-indicator approach, which includes bank lending, credit conditions, and corporate and sovereign yields.

On the Euro Area economic outlook, Mrs Lagarde stated that economic activity had evolved broadly in line with the ECB's December projections, despite the negative growth for Q4 2020 and the worse than expected outlook for Q1 2021. She stressed that there have been mixed developments in the Eurozone, characterized by the positives - 1) start of vaccinations, 2) the Brexit agreement, 3) the approval of NGEU, 4) manufacturing strength and 5) removal of US elections uncertainty, as well as the less positives - 1) the new virus strains and evolution of the pandemic, 2) very weak inflation outturns and less encouraging data on services PMI, retail sales, and mobility. That said, Mrs Lagarde struck a less than cautiously optimistic tone today, acknowledging that uncertainty remains high and the intensification of the pandemic poses some downside risks to the short-term economic outlook, in turn warranting ample monetary stimulus as well as ambitious and coordinated fiscal response. On the latter, she emphasized that fiscal policy needs to be targeted and temporary in nature.

Responding to concerns raised about the implications of a strengthening euro on inflation, Lagarde said that the ECB is monitoring the exchange rate very closely with all instruments on the table to be adjusted as needed. This suggests that we are not far from the FX level that could start to worry the ECB.

All in all, today's wait and watch policy meeting suggests that the ECB will stay put in the short to medium-run regarding monetary policy, in turn awaiting better clarity on the evolution of the pandemic and hence, on the shape of economic recovery and financial market conditions, while continuing to use the PEPP with high flexibility and focusing on preserving favourable financing conditions.

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).

1.1. Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB

Frankfurt am Main, ~~10 December 2020~~21 January 2021

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.

~~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 start of vaccination campaigns across the euro area is an important milestone in the resolution of the ongoing health crisis. Nonetheless, the pandemic continues to pose serious risks to public health and to the euro area and global economies. The ~~resurgence~~renewed surge in coronavirus (COVID-19~~ cases~~) infections and the ~~associated~~restrictive and prolonged containment measures ~~are significantly restricting~~imposed in many euro area countries are disrupting economic activity~~, which is expected to have contracted in the fourth quarter of 2020. While activity~~. Activity in the manufacturing sector continues to hold up well, but services sector activity is being severely curbed ~~by~~ , albeit to a lesser degree than during the first wave of the ~~increase~~pandemic in ~~infection rates and the new restrictions on social interaction~~early 2020. Output is likely to have contracted in the fourth quarter of 2020 and ~~mobility~~the intensification of the pandemic poses some downside risks to the short-term economic outlook. Inflation remains very low in the context of weak demand and significant slack in labour and product markets. Overall, the incoming data ~~and~~confirm our ~~staff projections suggest a more~~previous baseline assessment of a pronounced near-term impact of the pandemic on the economy and a ~~more~~ protracted weakness in inflation~~ than previously envisaged~~.

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

In this environment ample monetary stimulus remains essential to preserve favourable financing conditions over the pandemic period for all sectors of the economy. By helping to reduce uncertainty and bolster confidence, this will encourage consumer spending and business investment, underpinning economic activity and safeguarding medium-term price stability. Meanwhile, uncertainty remains high, including relating to the dynamics of the pandemic and the speed of vaccination campaigns. We will also continue to monitor developments in the exchange rate with regard to their possible implications for the medium-term inflation outlook. We 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.

Against this background, we decided to reconfirm our very accommodative monetary policy stance.

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 per cent within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

Second, we ~~decided to increase the envelope of the~~ will continue our purchases under the pandemic emergency purchase programme (PEPP) ~~by €500 billion to~~with a total envelope of €1,850 billion. We ~~also extended the horizon for~~will conduct net asset purchases under the PEPP ~~to~~until at least the end of March 2022~~. In~~ and, in any case, ~~we will conduct net purchases~~ until the Governing Council judges that the coronavirus crisis phase is over.

~~We will conduct our~~The purchases under the PEPP will be conducted to preserve favourable financing conditions over ~~this extended~~the pandemic 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~~We will continue to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2023. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

~~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~~Third, net purchases under our asset purchase programme (APP) will continue at a monthly pace of €20 billion. 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.

~~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~~will continue ~~conducting~~to provide ample liquidity through our ~~regular lending~~ refinancing 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~~. In particular, our third series of targeted longer-term ~~price stability. At the same time, uncertainty~~refinancing operations (TLTRO III) 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~~an attractive source of funding for banks, supporting bank lending to firms and households.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Following a sharp contraction in the first half of 2020, euro area real GDP rebounded strongly and rose by 12.~~5~~4 per cent, quarter on quarter, in the third quarter, although remaining well below pre-pandemic levels. ~~The second wave~~Incoming economic data, surveys and high-frequency indicators suggest that the resurgence of the pandemic and the associated intensification of containment measures ~~observed since mid-October are expected to result in a renewed significant~~have likely led to a decline in activity in the fourth quarter~~, although~~ of 2020 and are also expected to ~~a much lesser extent than observed~~weigh on activity in the ~~second~~first quarter of this year. In sum, this is broadly in line with the latest baseline of the December 2020 macroeconomic projections.

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

Looking ahead, the ~~news of prospective~~ roll-~~outs~~out of vaccines, which started in late December, 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~~and further ~~resurgences in infections, with challenges~~adverse developments related to ~~public health and economic prospects,~~the pandemic cannot be ruled out. Over the medium term, the recovery of the euro area economy should be supported by favourable financing conditions, 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 remain tilted to the downside~~,~~ but ~~have become~~ less pronounced. ~~While the~~The news about the prospects for ~~vaccine roll-outs in the near~~the global economy, the agreement on future EU-UK relations and the start of vaccination campaigns is encouraging, ~~downside risks remain related to the~~but the ongoing pandemic and its implications ~~of the pandemic~~ for economic and financial conditions continue to be sources of downside risk.

~~According to Eurostat's flash estimate, euro~~Euro area annual inflation remained unchanged at -0.3 per cent in ~~November~~December. On the basis of ~~oil~~current energy price dynamics ~~and taking into account the temporary reduction in the German VAT rate~~, headline inflation is likely to ~~remain negative until early 2021. Thereafter, it is expected to~~ increase ~~owing to~~in the coming months, also supported by the end of the temporary VAT reduction in Germany ~~and upward base effects in energy price inflation. At the same time~~. However, underlying price pressures are expected to remain subdued owing to weak demand, notably in the tourism and travel-related sectors, as well as to 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~~Survey-based measures and market-based indicators ~~and survey-based measures~~ of longer-term inflation expectations remain at low levels, although market-based indicators of inflation expectations have increased slightly.

~~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 rate of broad money (M3) ~~remained broadly unchanged at~~increased to 11.0 per cent in November 2020, from 10.5 per cent in October ~~2020.~~, reflecting a continued increase in deposit holdings. Strong money growth ~~has been~~continued to be supported by the ongoing asset purchases by the Eurosystem, which ~~have become~~remain the largest source of money creation. In the context of a still heightened preference for liquidity in the money-holding sector and a low opportunity cost of holding the most liquid forms of money, the narrow monetary aggregate M1 ~~continues to be~~has remained the main contributor to broad money growth.

~~The growth of lending~~Developments in loans to the private sector ~~has plateaued, while still recording higher growth rates than prior to the COVID-19 pandemic. Following strong increases in the early months of the pandemic, the annual growth rate of loans to~~ were characterised by moderate lending to non-financial corporations ~~fell~~and resilient lending to households. The monthly lending flow to ~~6.8 per cent~~non-financial corporations remained very modest in ~~October, after 7.1 per cent in September. This 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.~~November, continuing the pattern observed since the end of the summer. At the same time, the annual growth rate remained broadly unchanged, at 6.9 per cent, still reflecting the very strong increase in lending in the first half of the year. The annual growth rate of loans to households ~~stood~~remained broadly stable at 3.1 per cent in ~~October, unchanged~~November, amid a sizeable positive monthly flow.

The new bank lending survey for the fourth quarter of 2020 reports a tightening of credit standards on loans to firms. This tightening was mainly driven by heightened risk perceptions among banks, in a context of continued uncertainty about the economic recovery and concerns about borrower creditworthiness. Surveyed banks also reported a fall in loan demand from ~~September~~firms in the fourth quarter. The survey also indicated a further increase in net demand from households for loans for house purchase in the fourth quarter, even though credit standards continued to tighten.

Overall, our policy measures, together with the measures adopted by national governments and other European institutions, remain essential to support bank lending conditions and access to financing, 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 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. ~~Fiscal~~To this end, continued support from national fiscal policies is warranted given weak demand from firms and households relating to the worsening of the pandemic and the intensification of containment measures. At the same time, fiscal measures taken in response to the pandemic emergency should, as much as possible, ~~be~~remain 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~~governments 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. It calls on Member States to accelerate the ratification process, to finalise their recovery and resilience plans promptly and to deploy the funds for productive public spending, accompanied by productivity-enhancing **structural policies**. This would allow the Next Generation EU programme to contribute to a faster, stronger and more uniform recovery and 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 transitions.

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