Central Banks

ECB: The ECB amps up PEPP purchases to check yield rise

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- **The ECB will step up purchases under the PEPP program during the next quarter**
- **The central bank's immediate focus is on keeping financial conditions favourable**
- **The staff projections for GDP growth have been maintained broadly unchanged which do not incorporate yet the latest US stimulus package**
- **We consider that the PEPP envelope is large enough to comfortably increase purchases over the next quarter without the ECB having to increase the PEPP envelope**

The ECB, as expected, left its key benchmark interest rates and broader policy guidance unchanged today, but surprised boldly by announcing a significant step up of asset purchases under the PEPP program next quarter, as compared to that in the first months of the year. The consensus driven decision was a clear response to the recent undesirable increase in Euro Area bond yields, led, in part, by higher inflation expectations in the US.

Elaborating on the new move, the ECB chief, Lagarde, made clear that it was not any kind of yield curve control. She refused to quantify the monthly increase in PEPP purchases. Furthermore, she tempered expectations of an immediate significant increase in PEPP purchases on a weekly basis, stating that the ECB preferred a longer, quarterly horizon, to assess changes in its PEPP purchases. In essence, the ECB would assess the favorability of financing conditions (the "compass") by looking, on a quarterly basis, at inflation (the anchor), so as to determine the magnitude of increase in PEPP purchases. Echoing ECB's Chief Economist, Philip Lane's, recent rhetoric, Lagarde emphasised the role of a holistic and multifaceted approach towards assessing financial conditions, which would involve looking at several upstream and downstream indicators, rather than based on a single aggregate synthetic measure.

On the state of the economy, the ECB expects Euro Area real GDP growth to contract again in the current quarter in the wake of continued economic weakness driven by the persistence of pandemic and associated containment measures. That said, gradual relaxation of containment measures and vaccination alongside favorable financial conditions and expansionary fiscal stance and demand recovery are expected to aid economic recovery over the course of this year. In this context, ECB's updated macroeconomic forecasts suggest that risks have become more balanced, although they remain tilted to the downside in the near term as mutations and the vaccine rollout continue to be a large source of uncertainty. The new lockdown measures have proved to have a lower negative impact on the economy due to learning effects, as it was reflected in the better-than-expected data for 4Q20. Still, as containment measures were extended in early this year, a new decline in activity of -0.4% QoQ is projected for 1Q21, followed by a stronger recovery as vaccinations ramp up. In general, macroeconomic projections remain broadly unchanged, with a growth of 4% in 2021 (previously 3.9%) and 4.1% in 2022 (previously 4.2%), while reaching the pre-crisis levels in the second quarter of 2022, one quarter earlier than previously expected. For 2023, growth will moderate to 2.1%. Meanwhile, inflation has picked up on account of transitory and technical factors along with increasing energy prices, but inflationary pressures remain subdued due to weak demand and significant slack in labor. As a consequence, inflation has been revised upwards for 2021 to 1.5%, and it is expected to peak at 2% in the last quarter of the year, but they will look through that as it will only be temporary. From there on, it is still

forecasted to remain well below its target, at 1.2% in 2022 and 1.4% in 2023. Crucially, these forecasts do not incorporate, yet, the latest US stimulus package (which put an upward bias to both growth and inflation and will be taken into account in June's forecasts), although the Staff estimates that it will have a mild impact on the Eurozone economy, with a 0.3pp increase in real GDP and a 0.15pp in inflation over the forecast horizon. Overall, this outlook reflects a very accommodative monetary and fiscal stance, with Mrs. Lagarde highlighting the importance of the NGEU and the recent extension of fiscal waivers until 2023, while the Stability and Growth Pact should be reviewed once the pandemic is over, to make it simpler among other reforms. Finally, the ECB also reiterated that it will monitor carefully the development of the Euro exchange rate given its impact on outlook for price stability and its impact on economic activity.

All said, in our view, in the face of recent volatility and upward moves in long rates, the ECB wants to ensure, with today's announcement, a calmer situation over the next three months, which, in effect, would still be a difficult period for Europe in terms of both, the pandemic induced growth risks and the lingering doubts over inflation outlook. We consider that the PEPP envelope is large enough to comfortably increase purchases over the next quarter without the ECB having to increase the amount of the program before March 2022. The ECB has so far spent €0.9 trillion of the 1.85 trn earmarked under PEPP.

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, ~~21 January~~11 March 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~~the meeting of the Governing Council, which was also attended by the Commission Executive Vice-President, Mr Dombrovskis.

~~The start~~While the overall economic situation is expected to improve over 2021, there remains uncertainty surrounding the near-term economic outlook, relating in particular to the dynamics of the pandemic and the speed of vaccination campaigns~~ across the~~. The rebound in global demand and additional fiscal measures are supporting global and 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 renewed surge in~~ activity. But persistently high rates of coronavirus (COVID-19) ~~infections and~~ infection, the ~~restrictive~~spread of virus mutations, and ~~prolonged~~ the associated extension and tightening of containment measures ~~imposed in many euro area countries are disrupting economic activity. Activity~~are weighing on euro area economic activity in the short term. Looking ahead, the ongoing vaccination campaigns, together with the envisaged gradual relaxation of containment measures, underpin the expectation of a firm rebound in ~~the manufacturing sector continues to hold up well, but services sector activity is being severely curbed, albeit to a lesser degree than during the first wave of the pandemic~~economic activity in ~~early 2020. Output is likely to have contracted~~the course of 2021. Inflation has picked up over recent months mainly on account of some transitory factors and an increase in ~~the fourth quarter of 2020 and the intensification of the pandemic poses some downside risks to~~energy price inflation. At the ~~short-term economic outlook. Inflation remains very low~~same time, underlying price pressures remain subdued in the context of weak demand and significant slack in labour and product markets. ~~Overall, the incoming data confirm~~While our ~~previous baseline assessment of a pronounced near-term impact of the pandemic on the economy and a protracted weakness in inflation.~~

~~In this environment ample monetary stimulus~~latest staff projection exercise foresees a gradual increase in underlying inflation pressures, it confirms that the medium-term inflation outlook remains ~~essential to preserve~~broadly unchanged from the staff projections in December 2020 and below our inflation aim.

In these conditions, preserving favourable financing conditions over the pandemic period remains essential. Financing conditions are defined by a holistic and multifaceted set of indicators, spanning the entire transmission chain of monetary policy from risk-free interest rates and sovereign yields to corporate bond yields and bank credit conditions. Market interest rates have increased since the start of the year, which poses a risk to wider financing conditions. Banks use risk-free interest rates and sovereign bond

yields as key references for determining credit conditions. If sizeable and persistent, increases in these market interest rates, when left unchecked, could translate into a premature tightening of financing conditions for all sectors of the economy. ~~By helping~~This is undesirable at a time when preserving favourable financing conditions still remains necessary to reduce uncertainty and bolster confidence, ~~this will encourage consumer spending and business investment,~~thereby 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~~ the Governing Council decided ~~to reconfirm our very accommodative monetary policy stance.~~the following:

~~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~~First, we will continue ~~our~~to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion~~. We will conduct net asset purchases under the PEPP~~ until at least the end of March 2022 and, in any case, until the Governing Council judges that the coronavirus crisis phase is over. Based on a joint assessment of financing conditions and the inflation outlook, the Governing Council expects purchases under the PEPP over the next quarter to be conducted at a significantly higher pace than during the first months of this year.

~~The purchases under the PEPP will be conducted to preserve favourable financing conditions over 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.

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~~Second, 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.

Third, 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.

Finally, we will 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.

Preserving favourable financing conditions over the pandemic period for all sectors of the economy remains essential to underpin economic activity and safeguard medium-term price stability. We will also continue to monitor developments in the exchange rate with regard to their possible implications for the medium-term inflation outlook. We 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**. Following ~~a sharp contraction in the first half~~the strong rebound in growth in the third quarter of 2020, euro area real GDP ~~rebounded strongly and rose~~declined by ~~12.4~~0.7 per cent~~, quarter on quarter, in the third quarter, although remaining well~~ in the fourth quarter. Looking at the full year, real GDP is estimated to have contracted by 6.6 per cent in 2020, with the level of economic activity for the fourth quarter of the year standing 4.9 per cent below its pre-pandemic ~~levels.~~ level at the end of 2019.
Incoming economic data, surveys and high-frequency indicators ~~suggest that the resurgence~~point to continued economic weakness in the first quarter of 2021 driven by the persistence of the pandemic and the associated ~~intensification of~~ containment measures ~~have~~ . As a result, real GDP is likely ~~led to a decline in activity in the fourth quarter of 2020 and are also expected to weigh on activity~~ to contract again in the first quarter of ~~this year. In sum, this is broadly in line with the latest baseline of the December 2020 macroeconomic projections~~the year.

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

Looking ahead, the ~~roll-out~~ongoing vaccination campaigns, together with the gradual relaxation of ~~vaccines, which started in late December, allows for greater confidence in the resolution of the health crisis. However, it will take time until widespread immunity is achieved, and~~containment measures – barring any further adverse developments related to the pandemic ~~cannot be ruled out~~– underpin the expectation of a firm rebound in economic activity in the course of 2021. 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 gradually lifted ~~and uncertainty recedes~~.

This assessment is broadly reflected in the baseline scenario of the March 2021 ECB staff macroeconomic projections for the euro area. These projections foresee annual real GDP growth at 4.0 per cent in 2021, 4.1 per cent in 2022 and 2.1 per cent in 2023. Compared with the December 2020 Eurosystem staff macroeconomic projections, the outlook for economic activity is broadly unchanged.

Overall, the risks surrounding the euro area growth outlook ~~remain tilted to the~~over the medium term have become more balanced, although downside ~~but less pronounced. The news about the~~ risks remain in the near term. On the one hand, better prospects for ~~the~~ global ~~economy,~~demand, bolstered by the ~~agreement on future EU-UK relations~~sizeable fiscal stimulus, and the ~~start of~~progress in vaccination campaigns ~~is~~are encouraging~~, but~~. On the other hand, the ongoing pandemic, including the spread of virus mutations, and its implications for economic and financial conditions continue to be sources of downside risk.

Euro area annual inflation ~~remained unchanged at~~ increased sharply to 0.9 per cent in January and February 2021, up from -0.3 per cent in December. The upswing in headline inflation reflects a number of idiosyncratic factors, such as the end of the temporary VAT rate reduction in Germany, delayed sales periods in some euro area countries and the impact of the stronger than usual

changes in HICP weights for 2021, as well as higher energy price inflation. On the basis of current ~~energy price dynamics~~oil futures prices, headline inflation is likely to increase in the coming months, ~~also supported by the end of the temporary VAT reduction in Germany. However, underlying~~but some volatility is expected throughout the year reflecting the changing dynamics of the factors currently pushing inflation up. These factors can be expected to fade out of annual inflation rates early next year. Underlying price pressures are expected to increase somewhat this year due to current supply constraints and the recovery in domestic demand, although pressures are expected to remain subdued ~~owing to weak demand, notably in the tourism and travel-related sectors, as well as to~~overall, also reflecting low wage pressures and the past appreciation of the euro~~ exchange rate.~~. Once the impact of the pandemic fades, ~~a recovery in demand~~the unwinding of the high level of slack, supported by accommodative fiscal and monetary policies, will ~~put upward pressure on~~contribute to a gradual increase in inflation over the medium term. Survey-based measures and market-based indicators of longer-term inflation expectations remain at ~~low~~subdued levels, although market-based indicators ~~of inflation expectations have increased slightly~~have continued their gradual increase.

This assessment is broadly reflected in the baseline scenario of the March 2021 ECB staff macroeconomic projections for the euro area, which foresees annual inflation at 1.5 per cent in 2021, 1.2 per cent in 2022 and 1.4 per cent in 2023. Compared with the December 2020 Eurosystem staff macroeconomic projections, the outlook for inflation has been revised up for 2021 and 2022, largely due to temporary factors and higher energy price inflation, while it is unchanged for 2023.

Turning to the **monetary analysis**, the annual growth rate of broad money (M3) ~~increased to~~stood at 12.5 per cent in January 2021, after 12.4 per cent in December and 11.0 per cent in November 2020~~, from 10.5 per cent in October, reflecting a continued increase in deposit holdings~~. Strong money growth continued to be supported by the ongoing asset purchases by the Eurosystem, which remain the largest source of money creation. ~~In the context of~~The narrow monetary aggregate M1 has remained the main contributor to broad money growth, consistent with 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 has remained the main contributor to broad money growth~~.
Developments in loans to the private sector were characterised by ~~moderate~~somewhat weaker lending to non-financial corporations and resilient lending to households. The monthly lending flow to non-financial corporations ~~remained very modest in November, continuing the pattern~~continued the moderation observed since the end of the summer. At the same time, the annual growth rate remained broadly unchanged, at ~~6.9~~7.0 per cent, after 7.1 per cent in December, still reflecting the very strong increase in lending in the first half of the year. The annual growth rate of loans to households remained broadly stable at 3.0 per cent in January, after 3.1 per cent in ~~November~~December, amid a ~~sizeable~~solid 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 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 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. To this end, ~~continued~~ support from national fiscal policies ~~is warranted~~should continue given weak demand from firms and households relating to the ~~worsening of the~~ongoing pandemic and the ~~intensification of~~associated containment measures. At the same time, fiscal measures taken in response to the pandemic emergency should, as much as possible, remain ~~targeted and~~ temporary and targeted in nature to address vulnerabilities effectively and to support a swift recovery. The three safety nets endorsed by the European Council for workers, businesses and governments provide important funding support.

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~~ ensure a timely ratification ~~process~~of the Own Resources Decision, 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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