Central Banks

ECB: Reaffirming March's assessment and commitment

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- **Near term economic risks still to the downside but seem more balanced over the medium term**
- **Scaling back PEPP purchases? would be "premature"**
- **Fall of 2021 is the deadline to deliver on the Strategy Review**

The ECB's policy meeting today lived up to its intermediate status, reaffirming the governing council's assessment for the Euro Area macro economic outlook put forth in the previous policy meeting in March. As such, the ECB left all its monetary policy settings as well as forward guidance unchanged, with President Lagarde striking a note of cautious optimism over the medium term outlook while being cognizant of near term downside risks and underlying uncertainty.

Reassuringly, the ECB expects economic recovery to gain traction over the course of 2021, despite the possible contraction in the first quarter. In this respect, Ms Lagarde sounded slightly more optimistic when talking about recent indicators, than over the past meeting. The risks, however, are still tilted to the downside in the near term even as medium term risks are seen as much more balanced, which is in line with the broad-based view that the Eurozone economy is set to accelerate over the second half of the year.

On the pandemic emergency purchase programme (PEPP), the ECB reiterated that it will maintain asset purchases at a significantly higher pace during this quarter than during the first two months of the year. Mrs Lagarde highlighted that the intensity of the purchases doesn't depend on a specific date, but rather is based on the state of prevailing financing conditions as well as the inflation outlook. Hence, the ECB will determine the pace of purchases on the basis of these two elements, which, in Lagarde's words, are "quite complicated in their own respect, each of them". Mrs Lagarde pushed back against any suggestion on whether the ECB is thinking about scaling back stimulus, describing the idea as "premature". She made a clear distinction between the Fed (and other central banks such as the Bank of Canada that has announced tapering), stating that "we are not on the same page as the US". As such, any determination concerning the pace of purchases of PEPP would be entirely data depending.

The effectiveness of TLTRO III operations was emphasized, particularly the high take-up of funds at the latest operation, in which institutions asked for €330.5 billion (figure that exceeded market expectations). She also highlighted that they are playing a critically important role in facilitating banks' lending operations.

Meanwhile, the ECB disclosed that it is well into the 2nd half of the review of its monetary policy strategy (Strategy Review) and is looking at multiple proposals, views and recommendations. The central bank is committed to deliver on its deadline for release before the fall of 2021, although Mrs Lagarde tempered expectations of an earlier than expected release, noting that there is still some work that has to be done.

All in all, today's monetary policy meeting reconfirms ECB's March assessment. It provides more credence to the view that medium term risks have become more balanced, which could pave the way for a normalization of PEPP purchases path back to 1Q21 levels of around €60 billion after this year's June meeting. In a snapshot, the ECB awaits better clarity on the evolution of the pandemic and thereby, on the shape of the economic recovery and financial market conditions, while continuing to use the PEPP with high flexibility so as to preserve 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, ~~11 March~~22 April 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 the meeting of the Governing Council~~, which was also attended by the Commission Executive Vice-President, Mr Dombrovskis~~.

While the ~~overall economic situation is expected to improve over 2021, there remains uncertainty surrounding~~recovery in global demand and the sizeable fiscal stimulus are supporting global and euro area activity, the near-term economic outlook~~, relating in particular to the dynamics~~ remains clouded by uncertainty about the resurgence of the pandemic and the ~~speed~~roll-out of vaccination campaigns. ~~The rebound in global demand and additional fiscal measures are supporting global and euro area activity. But persistently~~Persistently high rates of coronavirus (COVID-19) infection~~, the spread of virus mutations,~~ and the associated extension and tightening of containment measures ~~are weighing on euro area~~continue to constrain economic activity in the short term. Looking ahead, ~~the ongoing~~ progress with vaccination campaigns~~, together with~~ and the envisaged gradual relaxation of containment measures~~,~~ underpin the expectation of a firm rebound in economic activity in the course of 2021. Inflation has picked up over recent months ~~mainly~~ on account of some ~~transitory~~idiosyncratic and temporary factors and an increase in energy price inflation. At the same time, underlying price pressures remain subdued in the context of ~~weak demand and significant slack in labour and product markets. While our latest staff projection exercise foresees a gradual increase in underlying inflation pressures, it confirms that the medium-term inflation outlook remains broadly unchanged from the staff projections in December 2020 and below our inflation aim~~significant economic slack and still weak demand.

~~In these conditions, preserving~~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. This is undesirable at a time when preserving favourable financing conditions still remains necessary~~ to reduce uncertainty and bolster confidence, thereby underpinning economic activity and safeguarding medium-term price stability.

Euro area financing conditions have remained broadly stable recently after the increase in market interest rates earlier in the year, but risks to wider financing conditions remain. Against this background, the Governing Council decided ~~the following:~~to reconfirm its very accommodative monetary policy stance.

We will keep the key ECB interest rates unchanged. We expect them to remain at their present or lower levels until we have seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2 per cent within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

~~First, we~~We will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion 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~~Since the incoming information confirmed the joint assessment of financing conditions and the inflation outlook carried out at the March monetary policy meeting, the Governing Council expects purchases under the PEPP over the ~~next~~current quarter to continue to be conducted at a significantly higher pace than during the first months of ~~this~~the year.

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.

~~Second, net~~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~~the latest operation in the third series of targeted longer-term refinancing operations (TLTRO III) ~~remains an attractive source~~has registered a high take-up of funds. The funding ~~for banks,~~obtained through TLTRO III plays a crucial role in supporting bank lending to firms and households.

~~Preserving~~These measures help to preserve favourable financing conditions ~~over the pandemic period~~ for all sectors of the economy ~~remains essential to~~and thereby 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 the strong rebound in growth in the third quarter of 2020, euro~~Euro area real GDP declined by 0.7 per cent in the fourth quarter~~. Looking at the full year, real GDP is estimated~~ of 2020 to ~~have contracted by 6.6 per cent in 2020, with the level of economic activity for the fourth quarter of the year standing~~stand 4.9 per cent below its pre-pandemic level ~~at the end of 2019~~one year earlier. Incoming economic data, surveys and high-frequency indicators suggest that economic activity may have contracted again in the first quarter of this year, but point to a resumption of growth in the second quarter.
~~Incoming economic data,~~Business surveys ~~and high-frequency indicators point to continued economic weakness in~~indicate that the ~~first quarter of 2021 driven by~~ manufacturing sector continues to recover, supported by solid global demand. At the ~~persistence of the pandemic and the associated containment measures. As a result, real GDP is likely to contract again in the first quarter of the year.~~

~~Economic developments continue to be uneven across countries and sectors, with the services sector being more adversely affected by the~~same time, restrictions on mobility and social interaction ~~and mobility than~~still limit activity in the ~~industrial~~services sector, ~~which is recovering more quickly. Although fiscal~~although there are signs of a bottoming-out. Fiscal policy measures ~~are supporting~~continue to support households and firms, but consumers remain cautious in ~~the light~~view of the pandemic and its impact on employment and earnings. ~~Moreover,~~Despite weaker corporate balance sheets and elevated uncertainty about the economic outlook ~~are still weighing on~~, business investment has shown resilience.

Looking ahead, the ~~ongoing~~ progress with vaccination campaigns, ~~together with the~~which should allow for a gradual relaxation of containment measures ~~– barring any further adverse developments related to the pandemic – underpin the expectation of~~, should pave the way for a firm rebound in economic activity in the course of 2021. Over the medium term~~,~~ the recovery of the euro area economy ~~should be~~ is expected to be driven by a recovery in domestic and global demand, supported by favourable financing conditions~~, an expansionary fiscal stance and a recovery in demand as containment measures are gradually lifted~~ and fiscal stimulus.

~~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, while the risks surrounding the euro area growth outlook over the ~~medium~~near term ~~have become more balanced, although~~continue to be on the downside, medium-term risks remain ~~in the near term.~~more balanced. On the one hand, better prospects for global demand~~,~~ – bolstered by the sizeable fiscal stimulus~~,~~ – and the progress ~~in~~with vaccination campaigns are encouraging. 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 increased ~~sharply~~ to ~~0.9 per cent~~1.3% in ~~January and February~~March 2021, ~~up~~ from ~~-~~0.~~3 per cent~~9% in ~~December. The upswing~~February, on account of a strong increase 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 oil futures prices, headline~~ that reflected both a sizeable upward base effect and a month-on-month increase. This increase more than offset decreases in food price inflation and in HICP inflation excluding energy and food. Headline inflation is likely to increase further in the coming months, but some volatility is expected throughout the year reflecting the changing dynamics of ~~the~~idiosyncratic and temporary 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~~, owing to ~~current~~short-term supply constraints and the recovery in domestic demand, although ~~pressures are expected to~~they remain subdued overall, ~~also~~in part reflecting low wage pressures, in the context of economic slack, and the ~~past~~ appreciation of the euro exchange rate. Once the impact of the pandemic fades, the unwinding of the high level of slack, supported by accommodative fiscal and monetary policies, will 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 subdued levels, although market-based indicators 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) stood at 12.3 per cent in February 2021, after 12.5 per cent in January~~ 2021, after 12.4 per cent in December and 11.0 per cent in November 2020.~~. Strong money growth continued to be supported by the ongoing asset purchases by the Eurosystem, ~~which remain~~as the largest source of money creation. 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.
~~Developments in loans to the private sector were characterised by somewhat weaker lending to non-financial corporations and resilient lending to households. The monthly lending flow to non-financial corporations continued the moderation observed since the end of the summer. At the same time, the annual growth rate remained broadly unchanged, at 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 December, amid a solid positive monthly flow.~~

Overall, lending to the private sector remained broadly unchanged. The monthly lending flow to non-financial corporations showed a modest pick-up in February compared with the previous month. This was also reflected in a slightly higher annual growth rate of 7.1 per cent, after 6.9 per cent in January. Monthly lending flows to households continued to be solid with the annual growth rate of loans to households remaining unchanged at 3.0 per cent in February. The latest euro area bank lending survey for the first quarter of 2021 reports a moderate tightening of credit standards for loans to firms, following more significant tightening in the previous two quarters. Heightened risk perceptions among banks were again the main contributor to the tightening, although their impact was less pronounced than in previous survey rounds. Surveyed banks also reported a renewed fall in demand for loans to firms, mainly driven by a continued decline in demand for financing for fixed investment. With regard to lending to households, the survey indicated lower demand for loans for house purchase, while the credit standards for these loans eased slightly, supported by competition among lenders.

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~~crucial, as premature withdrawal of fiscal support would risk delaying the ~~sharp contraction in~~recovery and amplifying the ~~euro area economy. To this end, support from national~~longer-term scarring effects. National fiscal policies should thus continue ~~given weak demand from~~ to provide critical and timely support to the firms and households ~~relating~~most exposed to the ongoing pandemic and the associated containment measures. At the same time, fiscal measures taken in response to the pandemic emergency should, as much as possible, remain temporary and targeted in nature to address vulnerabilities effectively and to support a swift recovery~~.~~ of the euro area economy. The three safety nets endorsed by the European Council for workers, businesses and governments provide important funding support.

The Governing Council ~~recognises~~reiterates the key role of the Next Generation EU package and ~~stresses~~ the ~~importance~~urgency of it becoming operational without delay. It calls on Member States to ensure a timely ratification 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~~improving economic structures and institutions and in accelerating the green and digital transitions.

Creating Opportunities

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