Central Banks

A steady-handed ECB looks moderately optimistic

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June 10 2021

- **The ECB renews pledge to keep PEPP purchases at ”a significantly higher pace” for next quarter than in Q1**
- **Sees risks as now being ‘broadly balanced’, instead of ‘tilted to the downside’**
- **Sees a more optimistic macro outlook while inflation projections have been revised slightly upwards**

Today’s policy meeting saw the ECB leave its rates unchanged while maintaining the current pace of PEPP purchases, but delivered a moderately positive assessment of the evolving economic situation. This despite an acknowledgement of the underlying uncertainties posed by the pandemic.

Most importantly, the ECB now sees risks to growth as being ‘broadly balanced’, an upgrade from its April assessment that risks were tilted to the downside, and driven by prospects of an even stronger recovery, predicated on brighter prospects for global demand and a faster-than-anticipated reduction in household savings once social and travel restrictions are lifted. That said, President Lagarde maintained a dovish tone in the post policy conference, highlighting that the pandemic remained a source of downside risks and that the ECB stands ready to adjust all of its instruments if needed.

Regarding the macroeconomic projections, the ECB is now more optimistic than in March. Although the containment measures are being tighter than expected in this first half of the year, the fall in GDP has been contained in the first quarter thanks to learning effects and a strong growth is expected in the second quarter. A faster relaxation of the restrictions during the second half of the year along with a strong global demand led the ECB to revise upwards its growth forecasts for 2021 and 2022 to 4.6% (from 4% in March) and to 4.7% (from 4.1%), while leaving the 2023 growth unchanged at 2.1%. More importantly, Mrs Lagarde also asserted that risks to the growth outlook are now broadly balanced, which is the first time we hear this since 2018. The ECB staff also revised up its inflation projections driven mainly by upward effects from higher oil prices, but also somewhat more positive developments in measures of slack than envisaged in March. Inflation will increase further in the short-term due to temporary factors, such as base effects coming from energy prices and the reversal of Germany’s VAT cut. Nonetheless, they remain contained at 1.9% in 2021 (from 1.5% in March), to later moderate in 2022 at 1.5% (from 1.2%) and 1.4% in 2023, still far from ECB’s target. The unwinding of high levels of slack will also contribute to a higher core inflation, which was slightly revised upwards (+0.1% each year over the forecast horizon) to still moderate levels and will be closely monitored. Finally, Mrs. Largarde also took advantage of a question from the press to make clear that the US and the Eurozone are in very different economic situations in terms of the size of fiscal stimulus, the point of the recovery and the starting point of inflation.

On the PEPP, the ECB decided to maintain the current pace of PEPP purchases at 80bn euros per month (vs. Euro 60bn euros per month in 1Q21), and as such “significantly higher than at the beginning of the year”. Mrs Lagarde made clear that the decision was broadly supported by the Governing Council, meaning that while there was unanimous support for the statement on the PEPP, there was a debate on the analytical aspects of the use of instruments. It was emphasized that there was no debate on the exit policy, with Lagarde making clear that it was “too early, and premature to discuss [...]”. ECB’s guard on the prospects of normalization stem from its concerns over potential tightening of financial conditions going forward in the wake of recent increase in market rates. This, it fears, could pose a risk to the inflation outlook and the ongoing economic recovery. In particular, it was mentioned during the Q&A that there is a bit of tightening in financing conditions with a potential pass-through to the corporate sector. Nonetheless, Mrs Lagarde stressed that for households, financing conditions remain very favourable.

All in all, the message from the ECB today has come in line with expectations, as it left the monetary policy unchanged, with no mention of tapering, but perceived risks to the outlook as balanced, while still maintaining a very cautious tone overall. Regarding the normalization process, we expect the ECB to open the door to a slow pace of PEPP asset purchases in September.

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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).

Frankfurt am Main, ~~22 April~~10 June 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~~After the ~~recovery~~contraction in ~~global demand and~~ the ~~sizeable fiscal stimulus are supporting global and~~ first quarter of the year, the euro area ~~activity, the near-term economic outlook remains clouded by uncertainty about the resurgence of the~~ economy is gradually reopening as the pandemic situation improves and ~~the roll-out of~~ vaccination campaigns~~. Persistently high rates of coronavirus (COVID-19) infection and the associated extension and tightening of containment measures continue to constrain~~ make significant progress. The latest data signal a bounce-back in services activity and ongoing dynamism in manufacturing production. We expect economic activity ~~in the short term. Looking ahead, progress with vaccination campaigns and the envisaged gradual relaxation of containment measures underpin the expectation of a firm rebound in economic activity~~to accelerate in the ~~course of 2021.~~second half of this year as further containment measures are lifted. A pick-up in consumer spending, strong global demand and accommodative fiscal and monetary policies will lend crucial support to the recovery. At the same time, uncertainties remain, as the near-term economic outlook continues to depend on the course of the pandemic and on how the economy responds after reopening. Inflation has picked up over recent months, largely on account of ~~some idiosyncratic and temporary~~base effects, transitory factors and an increase in energy ~~price inflation. At the same time,~~ prices. It is expected to rise further in the second half of the year, before declining as temporary factors fade out. Our new staff projections point to a gradual increase in underlying ~~price~~inflation pressures throughout the projection horizon, although the pressures remain subdued in the context of still significant economic slack ~~and still weak demand~~that will only be absorbed gradually over the projection horizon. Headline inflation is expected to remain below our aim over the projection horizon.

Preserving favourable financing conditions over the pandemic period remains essential to reduce uncertainty and bolster confidence, thereby underpinning economic activity and safeguarding medium-term price stability. ~~Euro area financing~~Financing conditions for firms and households have remained broadly stable ~~recently after the increase~~since our monetary policy meeting in March. However, market interest rates ~~earlier~~have increased further. While partly reflecting improved economic prospects, a sustained rise in ~~the year, but risks to~~ market rates could translate into a tightening of wider financing conditions ~~remain.~~ that are relevant for the entire economy. Such a tightening would be premature and would pose a risk to the ongoing economic recovery and the outlook for inflation.

Against this background, the Governing Council decided to ~~reconfirm~~confirm 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.

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. ~~Since the incoming information confirmed the~~Based on a joint assessment of financing conditions and the inflation outlook~~ carried out at the March monetary policy meeting~~, the Governing Council expects net purchases under the PEPP over the ~~current~~coming quarter to continue to be conducted at a significantly higher pace than during the first months of 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.

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.

Finally, we will continue to provide ample liquidity through our refinancing operations. ~~In particular, the latest operation in~~ The funding obtained through the third series of targeted longer-term refinancing operations (TLTRO III)~~ has registered a high take-up of funds. The funding obtained through TLTRO III~~ plays a crucial role in supporting bank lending to firms and households.

~~These~~Our measures help to preserve favourable financing conditions for all sectors of the economy~~ and thereby underpin~~, which is needed for a sustained economic ~~activity~~recovery and ~~safeguard medium-term~~for safeguarding 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**. ~~Euro~~In the first quarter of the year, euro area real GDP declined further, by 0.~~7~~3 per cent~~ in the fourth quarter of 2020~~, to stand ~~4.9~~5.1 per cent below its pre-pandemic level ~~one year earlier. Incoming economic data,~~of the fourth quarter of 2019. Business and consumer 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~~ sizeable improvement in activity in the second quarter of this year.
Business surveys indicate ~~that the manufacturing sector continues to recover~~a strong recovery in services activity as infection numbers decline, which will allow a gradual normalisation of high-contact activities. Manufacturing production remains robust, supported by solid global demand~~. At the same time, restrictions on mobility and social interaction still limit activity in the services sector~~, although ~~there are signs of a bottoming-out. Fiscal policy measures continue to support households and firms, but consumers remain cautious in view of the pandemic and its impact on employment and earnings. Despite~~supply-side bottlenecks could pose some headwinds for industrial activity in the near term. Indicators of consumer confidence are strengthening, suggesting a strong rebound in private consumption in the period ahead. Business investment shows resilience, despite weaker corporate balance sheets and ~~elevated uncertainty about the~~the still uncertain economic outlook~~, business investment has shown resilience~~.

~~Looking ahead, the~~ We expect growth to continue to improve strongly in the second half of 2021 as progress ~~with~~in vaccination campaigns~~, which should allow for a gradual~~ allows a further relaxation of containment measures~~, should pave the way for a firm rebound in economic activity in the course of 2021.~~. Over the medium term, the recovery ~~of~~in the euro area economy is expected to be ~~driven~~buoyed by ~~a recovery in~~ stronger global and domestic ~~and global~~ demand, ~~supported~~as well as by ~~favourable financing conditions~~ continued support from both monetary policy and fiscal ~~stimulus~~policy.

This assessment is broadly reflected in the baseline scenario of the June 2021 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP growth at 4.6 per cent in 2021, 4.7 per cent in 2022 and 2.1 per cent in 2023. Compared with the March 2021 ECB staff macroeconomic projections, the outlook for economic activity has been revised up for 2021 and 2022, while it is unchanged for 2023.

Overall, ~~while~~we see the risks surrounding the euro area growth outlook ~~over the near term continue to be on the downside, medium-term risks remain more~~as broadly balanced. On the one hand, ~~better~~an even stronger recovery could be predicated on brighter prospects for global demand ~~– bolstered by the sizeable fiscal stimulus – and the progress with vaccination campaigns~~

~~are encouraging~~and a faster-than-anticipated reduction in household savings once social and travel restrictions have been lifted. 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~~ According to Eurostat's flash release, euro area annual inflation increased ~~to~~from 1.3~~%~~ per cent in March ~~2021, from 0.9%~~to 1.6 per cent in ~~February, on account of~~April and 2.0 per cent in May 2021. This rise was due mainly to a strong increase in energy price inflation ~~that reflected~~ , reflecting both ~~a~~ sizeable upward base ~~effect and a~~ effects as well as month-on-month increases, and, to a lesser extent, a slight increase~~. This increase more than offset decreases in food price~~ in non-energy industrial goods inflation ~~and in HICP inflation excluding energy and food.~~. Headline inflation is likely to increase further ~~in~~towards the ~~coming months, but some volatility~~autumn, reflecting mainly the reversal of the temporary VAT reduction in Germany. Inflation is expected ~~throughout the year reflecting the changing dynamics~~to decline again at the start of ~~idiosyncratic and~~next year as temporary factors~~. These factors can be expected to~~ fade out ~~of annual inflation rates early next year. Underlying~~and global energy prices moderate.

We expect underlying price pressures ~~are expected~~ to increase somewhat this year~~,~~ owing to ~~short-term~~temporary supply constraints and the recovery in domestic demand~~, although they~~. Nevertheless, the price pressures will likely remain subdued overall, in part reflecting low wage pressures, in the context of still significant economic slack, and the 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 and fiscal policies, will contribute to a gradual increase in underlying 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~~to increase.

This assessment is broadly reflected in the baseline scenario of the June 2021 Eurosystem staff macroeconomic projections for the euro area, which foresees annual inflation at 1.9 per cent in 2021, 1.5 per cent in 2022 and 1.4 per cent in 2023. Compared with the March 2021 ECB staff macroeconomic projections, the outlook for inflation has been revised up for 2021 and 2022, largely owing to temporary factors and higher energy price inflation. It is unchanged for 2023, as the increase in underlying inflation is largely counterbalanced by an expected decline in energy price inflation. HICP inflation excluding energy and food is projected to increase from 1.1 per cent in 2021 to 1.3 per cent in 2022 and 1.4 per cent in 2023, revised up throughout the projection horizon compared with the March 2021 projection exercise.

Turning to the **monetary analysis**, the annual growth rate of broad money (M3) ~~stood at~~ declined to 9.2 per cent in April 2021, from 10.0 per cent in March and 12.3 per cent in February ~~2021, after 12.5 per cent in January. Strong money~~. The deceleration in March and April was due partly to strong negative base effects as the large inflows in the initial phase of the pandemic crisis dropped out of the annual growth ~~continued to be supported by the~~statistics. It also reflects a moderation in shorter-term monetary dynamics, mainly originating from weaker developments in deposits by households and firms in April and lower liquidity needs as the pandemic situation improves. The ongoing asset purchases by the Eurosystem~~, as~~ continue to be the largest source of money creation. ~~The~~While also decelerating, the narrow monetary aggregate M1 has remained the main contributor to broad money growth~~,~~. Its strong contribution is 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.

~~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.~~The annual growth rate of loans to the private sector declined to 3.2 per cent in April, from 3.6 per cent in March and 4.5 per cent in February. This decline took place amid opposing dynamics in lending to non-financial corporations and to households. The annual growth rate of loans to non-financial corporations fell to 3.2 per cent in April, after 5.3 per cent in March and 7.0 per cent in February. The contraction reflects large negative base effects and some frontloading in loan creation in March relative to April. The annual growth rate of loans to households rose to 3.8 per cent in April, after 3.3 per cent in March and 3.0 per cent in February, supported by solid monthly flows and positive base effects.

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 crucial, as a premature withdrawal of fiscal support would risk ~~delaying~~weakening the recovery and amplifying the longer-term scarring effects. National fiscal policies should thus continue to provide critical and timely support to the firms and households 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 countercyclical, while ensuring that they are sufficiently targeted in nature to address vulnerabilities effectively and to support a swift recovery ~~of~~in 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 reiterates the key role of the Next Generation EU package~~ and the 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~~productively, 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~~as well as the growth potential of Member States' economies~~, thereby supporting~~. In doing so, the programme would support the effectiveness of monetary policy in the euro area. Such structural policies are particularly important in improving economic structures and institutions and in accelerating the green and digital transitions.

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