Central Banks

A faster tapering than expected

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- **More hawkish tone after announcing the end of PEPP in March 2022 and a lower-than-expected increase of the APP**
- **Lower rates under TLTROIII will end in June 2022, with a reassessment of the tier multiplier**
- **GDP is revised marginally downwards in 2022 and upwards in 2023. Strong upward revision for inflation in 2022 but reverting clearly below 2% in the medium term**
- **Flexibility will continue to be key, and PEPP may be resumed should pandemic conditions deteriorate**

The ECB announced the **end of the pandemic bond purchasing program,** PEPP, for **March 2022**, as it was expected, and **approved several measures to soothe the cliff-edge** that this measure implies, such as an extension of the reinvestment period of PEPP purchases and an increase of net purchases under the standard QE program (APP) for the second and third quarters of 2022. The special period for liquidity operations (TLTROIII) in which entities could benefit up to -100bps favourable rate will end in June 2022, to mitigate the impact of this expiry on banks the ECB will assess the calibration of the tier multiplier. Yet, the commitment to adapt all current measures in any direction, if needed, continues.

PEPP purchases will be conducted at a slower pace during 1Q22 and will end in March, as expected, and despite the rumors that this decision could be postponed until more evidence of the impact of the Omicron strain was available. Still, a new package of measures will ease the potential cliff-edge effects that could come with this.

First, **the reinvestment of PEPP purchases will be extended by one year to end 2024**, and this reinvestment **will be flexible in asset classes and jurisdictions**. Special emphasis was put on the fact that **Greek bonds will be included** now. Second, **APP purchases are increased to a monthly amount of €40bn in 2Q22 and to €30bn in 3Q22**, t**o then revert to the current €20bn afterwards**. This implies €90bn more for APP above the current purchases to substitute for the expiration of PEPP, which is below what we were expecting. Third, TLTROIII special period under which entities could benefit from an interest rate of up to -1% will end in June 2022, but this will come along with a calibration of the tier multiplier in order to alleviate cost for banks in an environment of increasing liquidity. The ECB also stressed that all these measures continue to be flexible, and that the PEPP could be resumed to counter negative shocks of market fragmentation related to the pandemic.

Regarding the updated macroeconomic outlook, President Lagarde said that the economy continues recovering while the labour market keeps improving, but energy prices, bottlenecks and the pandemic will lead to a slowdown in the near term. The GDP projections have been adjusted marginally downwards for 2022, but with a significant deceleration in 4Q21 (0.2% QoQ from 2.2% by mid-year) and 1Q22 (0.4% QoQ), and upwards for 2023 (5.1% in 2021 with a downward revisión of 0.1pp; 4.2% in 2022, down 0.4pp; 2.9% in 2023, up 0.8pp and 1.6% in 2024).

Inflation is revised upwards to 3.2% in 2022, but with a sharp moderation expected during the year (1.9% in 4Q22, from 4.6% in 4Q21) due to the stabilization of energy prices, the ease of bottlenecks and the fade out of base effects, and reverting to below 2% afterwards (2.6% in 2021, 3.2% in 2022 and 1.8% in 2023 and 2024). In their analysis, they attribute most of the recent surprise to energy prices and do not see any second round effects on wages for the moment, though the projections incorporate higher wages (especially due to minimum wages in 2022). The risks of inflation are tilted to the upside not only because pressures from energy prices and bottlenecks may persist longer than expected, but also from stronger demand.

Overall, the ECB was relatively hawkish as the main instrument to smooth the suppression of PEPP, APP, received less money than expected, while the measures on liquidity also imply some hardening. Moreover, the pace of APP purchases for 2022 seems now settled and implies that tapering of QE has started. The stress on flexibility and the readiness to reopen PEPP if needed is a welcome measure, but not enough to compensate for it. On the key issue of medium term inflation projections, they remain on the soft side.

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).

~~28 October~~16 December 2021

The Governing Council ~~continues to judge~~judges that the progress on economic recovery and towards its medium-term inflation target permits a step-by-step reduction in the pace of its asset purchases over the coming quarters. But monetary accommodation is still needed for inflation to stabilise at the 2% inflation target over the medium term. In view of the current uncertainty, the Governing Council needs to maintain flexibility and optionality in the conduct of monetary policy. With this is mind, the Governing Council took the following decisions:

1.1. Pandemic emergency purchase programme (PEPP)

~~favourable financing conditions can be maintained with a moderately lower pace of~~In the first quarter of 2022, the Governing Council expects to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) at a lower pace than in the ~~second and third quarters of this year~~previous quarter. It will discontinue net asset purchases under the PEPP at the end of March 2022.

The Governing Council decided to extend the reinvestment horizon for the PEPP. It now intends to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2024. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

The pandemic has shown that, under stressed conditions, flexibility in the design and conduct of asset purchases has helped to counter the impaired transmission of monetary policy and made efforts to achieve the Governing Council's goal more effective. Within our mandate, under stressed conditions, flexibility will remain an element of monetary policy whenever threats to monetary policy transmission jeopardise the attainment of price stability. In particular, in the event of renewed market fragmentation related to the pandemic, PEPP reinvestments can be adjusted flexibly across time, asset classes and jurisdictions at any time. This could include purchasing bonds issued by the Hellenic Republic over and above rollovers of redemptions in order to avoid an interruption of purchases in that jurisdiction, which could impair the transmission of monetary policy to the Greek economy while it is still recovering from the fallout of the pandemic. Net purchases under the PEPP could also be resumed, if necessary, to counter negative shocks related to the pandemic.

1.2. Asset purchase programme (APP)

~~confirmed~~In line with a step-by-step reduction in asset purchases and to ensure that the monetary policy stance remains consistent with inflation stabilising at its ~~other measures, namely the level of~~ target over the medium term, the Governing Council decided on a monthly net purchase pace of €40 billion in the second quarter and €30 billion in the third quarter under the asset purchase programme (APP). From October 2022 onwards, the Governing Council will maintain net asset purchases under the APP at a monthly pace of €20 billion for as long as necessary to reinforce the accommodative impact of its policy rates. The Governing Council expects net purchases to end shortly before it starts raising the key ECB interest rates~~, its forward guidance on their likely future evolution, its purchases under the asset purchase programme (APP), its reinvestment policies and its longer-term refinancing operations. Specifically:~~.

The Governing Council also intends 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 it starts 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.

~~1.1.~~1.3. Key ECB interest rates

The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.50% respectively.

In support of its symmetric ~~two per cent~~2% inflation target and in line with its monetary policy strategy, the Governing Council expects the key ECB interest rates to remain at their present or lower levels until it sees inflation reaching ~~two per cent~~2% well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at ~~two per cent~~2% over the medium term. This may also imply a transitory period in which inflation is moderately above target.

~~1.2.~~1.1. ~~Asset purchase programme (APP)~~

~~Net purchases under the APP will continue at a monthly pace of €20 billion. The Governing Council continues to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates.~~

~~The Governing Council also intends 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 it starts 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.~~

~~1.3.1.1. Pandemic emergency purchase programme (PEPP)~~

~~The Governing Council will continue to conduct net asset purchases under the PEPP with a total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over.~~

~~The Governing Council continues to judge that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the PEPP than in the second and third quarters of this year.~~

~~The Governing Council 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 Governing Council 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.~~

1.4. Refinancing operations

~~The Governing Council will continue to provide ample liquidity through its refinancing operations. In particular, the 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.~~

The Governing Council will continue to monitor bank funding conditions and ensure that the maturing of TLTRO III operations does not hamper the smooth transmission of its monetary policy. The Governing Council will also regularly assess how targeted lending operations are contributing to its monetary policy stance. As announced, it expects the special conditions applicable under TLTRO III to end in June next year. The Governing Council will also assess the appropriate calibration of its two-tier system for reserve remuneration so that the negative interest rate policy does not limit banks' intermediation capacity in an environment of ample excess liquidity.

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The Governing Council stands ready to adjust all of its instruments, as appropriate and in either direction, to ensure that inflation stabilises at its ~~two per cent~~2% target over the medium term.

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