ECB WATCH: Considerable package without depo cut

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- **The ECB approves a substantial package of liquidity and QE support, but is contained in its forward guidance**
- **Depo rates were kept unchanged, failing to meet market's expectations**
- **Very strong call for an ambitious and coordinated fiscal response**

The ECB announced a comprehensive package focused on new liquidity and additional asset purchases measures to support households and firms facing increasing uncertainty.

First, the ECB introduced new weekly LTRO auctions from next Monday until June 2020 to bridge financing schemes for banks until the fourth auction of TLTROIII takes place. All operations will have a fixed interest rate at the average deposit facility rate over the life of the operation (i.e. -0.5%). Second, the ECB enhanced TLTROIII measures, as the maximum amount to be borrowed has been raised from 30% to 50% of eligible loans without operation limits and the lending benchmark has been reduced from an increase of 2.5% to 0%. In addition, conditions are now more favourable as interest rates were lowered by 25bp below the standard MRO operations, or below the depo rate if banks reached the lending benchmark. Third, the ECB announced an additional €120bn to the QE programme until the end of the year with no fixed amount per month (currently at €20bn per month).

The ECB did not cut the depo rate despite market expectations, while it made a strong call for a substantial and coordinated fiscal response in Europe.

At the press conference the main issues focused on the impact of coronavirus on the economy and the convenience of today's monetary policy decisions.

On coronavirus, it is seen as a "severe shock but still temporary in nature" if the right policies are taken, i.e. a rebound is expected in the second half of the year, but the exact timing is very uncertain while risks are clearly tilted to the downside. The ECB staff projections predate the virus outbreak, Lagarde warned. This implies that the announced 0.8% of GDP growth for 2020 has a significant downward bias (the projections for 2021 and 2022 are 1.3% and 1.4%, respectively). Regarding inflation, there are some downward pressures related to the strong fall in oil prices and a negative demand shock but could offset by upward pressures steaming from potential supply disruptions. Inflation is expected to slow significantly in the coming months, probably more than envisaged in the update forecast of 1.1% in 2020 (1.4% in 2021, 1.6% in 2022).

Regarding monetary policy measures, Lagarde defended the convenience of today's "targeted" decisions to face the current risks related to liquidity problems, credit slowdown and credit spread. She only talked about the use of all available tools in a flexible manner (ie. some flexibility on asset purchases around the capital key or larger corporate bond purchases), but she avoided to cite bolder action (such as the OMT programme).

In contrast to this relative moderation on monetary policy measures, Lagarde took the opportunity to make a very strong call for an ambitious and coordinated fiscal policy. The ECB considers that the risk surrounding the economic outlook should be tackled by fiscal authorities. Fiscal policy should take the lead “first and foremost”, encouraging European policy makers to take bold and coordinated action at the next Eurogroup (policy measures already committed, 0.25% of Eurozone GDP) is not enough.

All in all, the package delivered today by the ECB is adequate -liquidity and QE measures- but in the absence of a closely coordinated action with fiscal policy it is not enough to tackle the current risks. This could explain the continuation of a very negative market reaction. The ECB has to be ready to step up measures in case further risks materialize, and on this the ECB sounded somewhat contained. Overall, it is very important authorities continue with closely coordinated monetary, fiscal and supervisory measures.

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).

Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB,

Frankfurt am Main, ~~23 January~~12 March 2020

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.

~~Based on our regular economic and monetary analyses, we decided to keep the **key ECB interest rates** unchanged.~~Since our last Governing Council meeting in late January, the spread of the coronavirus (COVID-19) has been a major shock to the growth prospects of the global and euro area economies and has heightened market volatility. Even if ultimately temporary in nature, it will have a significant impact on economic activity. In particular, it will slow down production as a result of disrupted supply chains and reduce domestic and foreign demand, especially through the adverse impact of the necessary containment measures. In addition, the heightened uncertainty negatively affects expenditure plans and their financing.

Governments and all other policy institutions are called upon to take timely and targeted actions to address the public health challenge of containing the spread of the coronavirus and mitigate its economic impact. In particular, an ambitious and coordinated fiscal policy response is required to support businesses and workers at risk. The Governing Council strongly supports the commitment of euro area governments and the European Institutions to joint and coordinated policy action in response to the repercussions of the spread of the coronavirus. We also welcome the decisions taken by the ECB's Supervisory Board, which are detailed in a separate press release published earlier today.

In line with our mandate, the Governing Council is determined to support households and firms in the face of the current economic disruptions and heightened uncertainty. Accordingly, we decided on a comprehensive package of monetary policy measures. Together with the substantial monetary policy stimulus already in place, these measures will support liquidity and funding conditions for households, businesses and banks and will help to preserve the smooth provision of credit to the real economy.

First, we decided to conduct, temporarily, additional longer-term refinancing operations (LTROs) to provide immediate liquidity support to the euro area financial system. Although we do not see material signs of strains in money markets or liquidity shortages in the banking system, these operations will provide an effective backstop in case of need. They will be carried out through a fixed rate tender procedure with full allotment, with an interest rate that is equal to the average rate on the deposit facility. The LTROs will provide liquidity at favourable terms to bridge the period until the TLTRO III operation in June 2020.

Second, the Governing Council decided to apply considerably more favourable terms during the period from June 2020 to June 2021 to all TLTRO III operations outstanding during that same time. These operations will support bank lending to those affected most by the spread of the coronavirus, in particular small and medium-sized enterprises. Throughout this period, the interest rate on these TLTRO III operations will be 25 basis points below the average rate applied in the Eurosystem's main refinancing operations. For counterparties that maintain their levels of credit provision, the rate applied in these operations will be lower, and, over the period ending in June 2021, can be as low as 25 basis points below the average interest rate on the deposit facility. Moreover, the maximum total amount that counterparties will henceforth be entitled to borrow in TLTRO III operations is raised to 50% of their stock of eligible loans as at 28 February 2019. In this context, the

Governing Council will mandate the Eurosystem committees to investigate collateral easing measures to ensure that counterparties continue to be able to make full use of our funding support.
Third, we decided to add a temporary envelope of additional net asset purchases of €120 billion until the end of the year, ensuring a strong contribution from the private sector purchase programmes. In combination with the existing asset purchase programme (APP), this will support favourable financing conditions for the real economy in times of heightened uncertainty. We continue to expect net asset purchases 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.
In addition, 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% within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

~~We will continue to make net purchases under our asset purchase programme (APP) at a monthly pace of €20 billion. We expect them 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.

~~Today the Governing Council also decided to launch a review of the ECB's monetary policy strategy.~~ Further details ~~about~~on the ~~scope and timetable~~precise terms of ~~the review~~our new operations will be published in ~~a~~dedicated press ~~release today~~releases this afternoon at 15:30 CET.

~~The incoming data since our last meeting are in line with our baseline scenario of ongoing, but moderate, growth of the euro area economy. In particular, the weakness in the manufacturing sector remains a drag on euro area growth momentum. However, ongoing, albeit decelerating, employment growth and increasing wages continue to support the resilience of the euro area economy. While inflation developments remain subdued overall, there are some signs of a moderate increase in underlying inflation in line with expectations.~~

~~The unfolding monetary policy measures are underpinning favourable financing conditions for all sectors of the economy. In particular, easier borrowing conditions for firms and households are supporting consumer spending and business investment. This will sustain the euro area expansion, the build-up of domestic price pressures and, thus, the robust convergence of inflation to our medium-term aim.~~
~~At the same time, in the light of the continued subdued inflation outlook, monetary policy has to remain highly accommodative for a prolonged period of time to support underlying inflation pressures and headline inflation developments over the medium term. We will, therefore, closely monitor inflation developments and the impact of the unfolding monetary policy measures on the economy. Our forward guidance will ensure that financial conditions adjust in accordance with changes to the inflation outlook. In any case, the Governing Council continues to stand~~In view of current developments, the Governing Council will continue to monitor closely the implications of the spread of the coronavirus for the economy, for medium-term inflation and for the transmission of its monetary policy. The Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

Let me now explain our assessment in greater detail, starting with the economic analysis. ~~Euro area~~ The latest indicators suggest a considerable worsening of the near-term growth outlook. The disruption of supply chains is impeding production plans in the manufacturing sector, while necessary containment measures against the further spread of the coronavirus are adversely affecting economic activity. Before the coronavirus outbreak, euro area real GDP ~~increased by~~ growth moderated to 0.~~3~~1%, quarter on quarter, in the ~~third~~fourth quarter of 2019, following growth of 0.~~2~~3% in the ~~second~~third quarter. This ~~pattern of moderate growth reflects~~mainly reflected the ongoing weakness ~~of international trade in an environment of continued global uncertainties, which has particularly affected the~~ in the euro area manufacturing sector and ~~has also dampened~~slowing investment growth. ~~At the same time, the services and construction sectors remain more resilient, despite some moderation in the latter half of 2019. Incoming economic data and survey information point to some stabilisation in euro area growth dynamics, with near-term growth~~ Looking beyond the disruption stemming from the coronavirus, euro area growth is expected to ~~be similar to rates observed in previous quarters. Looking ahead, the euro area expansion will continue to be~~ regain traction over the medium term, supported by favourable financing conditions, ~~further employment gains in conjunction with rising wages,~~ the ~~mildly expansionary~~ euro area fiscal stance and the ~~ongoing – albeit somewhat slower – growth~~expected resumption in global activity.

This assessment is only partly reflected in the March 2020 ECB staff macroeconomic projections for the euro area, as their data cut-off date predates the most recent rapid spread of the coronavirus to the euro area. These projections foresee annual real GDP increasing by 0.8% in 2020, 1.3% in 2021 and 1.4% in 2022. In particular, the projections foresee very muted growth in the first half of 2020, followed by an improvement in the second half of the year. Compared with the December 2019 Eurosystem staff macroeconomic projections, the outlook for real GDP growth has been revised down notably for 2020 and slightly for 2021, on account of the potential economic impact of the coronavirus outbreak.
The risks surrounding the euro area growth outlook~~,~~ are clearly on the downside. In addition to the previously identified risks related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, ~~remain tilted~~the spread of the coronavirus adds a new and substantial source of downside risk to the ~~downside, but have become less pronounced as some of the uncertainty surrounding international trade is receding~~growth outlook.

~~Euro~~According to Eurostat's flash estimate, euro area annual HICP inflation ~~increased~~decreased to 1.~~3~~2% in ~~December 2019~~February 2020, from 1.~~0~~4% in ~~November, reflecting mainly higher energy price inflation~~January. On the basis of the sharp decline in current and futures prices for oil, headline inflation is likely to ~~hover around current levels in~~decline considerably over the coming months. ~~While indicators~~ Indicators of inflation expectations ~~remain at low levels, recently they have either stabilised or ticked up slightly. Measures~~have fallen and measures of underlying inflation ~~have remained~~ remain generally muted~~, although there are further indications of a moderate increase in line with previous expectations.~~. While labour cost pressures have ~~strengthened~~so far remained resilient amid tighter labour markets, the weaker growth momentum is delaying their pass-through to inflation. Over the medium term, the increase in inflation ~~is expected to increase,~~will be supported by our monetary policy measures~~, the ongoing economic expansion~~ and ~~solid wage~~the recovery in euro area growth dynamics.

This assessment is only partly reflected in the March 2020 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.1% in 2020, 1.4% in 2021 and 1.6% in 2022. Compared with the December 2019 Eurosystem staff macroeconomic projections, the outlook for HICP inflation is broadly unrevised over the projection horizon. The implications of the coronavirus for inflation are surrounded by high uncertainty, given that downward pressures linked to weaker demand may be offset by upward pressures related to supply disruptions. The recent sharp decline in oil prices poses significant downside risks to the short-term inflation outlook.
Turning to the monetary analysis, broad money (M3) growth stood at 5.~~6% in November 2019, broadly unchanged since August. Sustained rates of broad money growth~~2% in January 2020, having moderated somewhat from its recent peak. Money growth continues to reflect ongoing bank credit creation for the private sector and low opportunity costs of holding M3 relative to other financial instruments. The narrow monetary aggregate M1 continues to be the main contributor to broad money growth~~ on the components side~~.

~~The growth of loans~~Loans to ~~firms and households remained solid, benefiting from~~ the ~~ongoing support provided by our accommodative monetary policy stance, which is reflected in very low bank lending rates. While the~~ private sector continued to expand. The annual growth rate of loans to households ~~remained unchanged from October, at 3.5~~picked up somewhat to 3.7% in January 2020, from 3.6% in ~~November,~~

~~the~~December 2019. The annual growth rate of loans to non-financial corporations ~~moderated to~~remained unchanged at 3.~~4~~2% in ~~November, from 3.8% in October,~~ January, confirming the moderation seen since autumn 2019 and likely reflecting ~~some~~the typically lagged reaction to the past weakening in the economy. ~~These developments are also visible in the results of the euro area bank lending survey for the fourth quarter of 2019, which indicate weakening demand for loans to firms, while demand for loans to households for house purchase continued to increase. However, credit standards for both loans to firms and loans to households for house purchase remained broadly unchanged, pointing to still favourable credit supply conditions.~~ Overall, our accommodative monetary policy stance, including the measures taken today, will ~~help to~~ safeguard ~~very~~ favourable bank lending conditions and will continue to support access to financing ~~across all economic sectors and~~, including for those affected most by the ramifications of the coronavirus and, in particular, for small and medium-sized enterprises.

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 ~~still~~ necessary for the ~~continued~~ robust convergence of inflation to levels that are below, but close to, 2% over the medium term.

~~In order to reap the full benefits from our monetary policy measures, other policy areas must contribute more decisively to raising the longer-term growth potential, supporting aggregate demand at the current juncture and reducing vulnerabilities. The implementation of **structural policies** in euro area countries needs to be substantially stepped up to boost euro area productivity and growth potential, reduce structural unemployment and increase resilience. The 2019 country-specific recommendations should serve as the relevant signpost. Regarding **fiscal policies**, the euro area fiscal stance is expected to continue to provide some support to economic activity. In view of the weak economic outlook, the Governing Council welcomes the Eurogroup's call in December for differentiated fiscal responses and its readiness to coordinate. Governments with fiscal space should be ready to act in an effective and timely manner. In countries where public debt is high, governments need to pursue prudent policies and meet structural balance targets, which will create the conditions for automatic stabilisers to operate freely. All countries should intensify their efforts to achieve a more growth-friendly composition of public finances.~~

~~Likewise, the transparent and consistent implementation of the European Union's fiscal and economic governance framework over time and across countries remains essential to bolster the resilience of the euro area economy. Improving the functioning of Economic and Monetary Union remains a priority. The Governing Council welcomes the ongoing work and urges further specific and decisive steps to complete the banking union and the capital markets union.~~

Regarding fiscal policies, an ambitious and coordinated fiscal stance is now needed in view of the weakened outlook and to safeguard against the further materialisation of downside risks. We welcome the measures already taken by several governments to ensure sufficient health sector resources and to provide support to affected companies and employees. In particular, measures such as providing credit guarantees are needed to complement and reinforce the monetary policy measures taken today. We welcome the commitment of the euro area governments and the European Institutions to act now, strongly, and together in response to the repercussions of the further spread of the coronavirus.

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