MONETARY POLICY STATEMENT

Frankfurt am Main, 28 October 2021

PRESS CONFERENCE

Christine Lagarde, President of the ECB,
Luis de Guindos, Vice-President of the ECB

Good afternoon, the Vice-President and I welcome you to our press conference.

The euro area economy continues to recover strongly, although momentum has moderated to some extent. Consumers continue to be confident and their spending remains strong. But shortages of materials, equipment and labour are holding back production in some sectors. Inflation is rising, primarily because of the surge in energy prices but also as the recovery in demand is outpacing constrained supply. We foresee inflation rising further in the near term, but then declining in the course of next year.

Market interest rates have increased since our last meeting in early September. However, overall financing conditions currently remain favourable for firms, households and the public sector. Favourable financing conditions are essential for the economy to continue its recovery and to counter the negative impact of the pandemic on the inflation path.

We continue to judge that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the second and third quarters of this year.

We also confirmed our other measures, namely the level of the key ECB interest rates, our forward guidance on their likely future evolution, our purchases under the asset purchase programme (APP), our reinvestment policies and our longer-term refinancing operations, as detailed in the press release published at 13:45 today. We stand ready to adjust all of our instruments, as appropriate, to ensure that inflation stabilises at our two per cent target over the medium term.

I will now outline in more detail how we see the economy and inflation developing and will then talk about our assessment of financial and monetary conditions.

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Economic activity

The economy continued to grow strongly in the third quarter, even though momentum moderated to some extent. We still expect output to exceed its pre-pandemic level by the end of the year.

The grip of the pandemic on the economy has visibly weakened, with restrictions being lifted as a result of successful health measures and large numbers of people now vaccinated. This is supporting consumer spending, especially on entertainment, dining, travel and transportation. But higher energy prices may reduce purchasing power in the months to come.

The recovery in domestic and global demand is also supporting production and business investment. That said, shortages of materials, equipment and labour are holding back the manufacturing sector. Delivery times have lengthened considerably, and transport costs and energy prices have surged. These constraints are clouding the outlook for the coming quarters.

The labour market continues to improve. Unemployment has fallen and the number of people in job retention schemes is down significantly from the peak last year. This supports the prospect of higher incomes and increased spending. But, both the number of people in the labour force and the hours worked in the economy remain below their pre-pandemic levels.

To sustain the recovery, targeted and coordinated fiscal support should continue to complement monetary policy. This support will also help the economy adjust to the structural changes that are under way. An effective implementation of the Next Generation EU programme and the “Fit for 55” package will contribute to a stronger, greener and more even recovery across euro area countries.

Inflation

Inflation increased to 3.4 per cent in September. We expect it to rise further this year. But while the current phase of higher inflation will last longer than originally expected, we expect inflation to decline in the course of next year.

The upswing in inflation largely reflects a combination of three factors. First, energy prices – especially for oil, gas and electricity – have risen sharply. In September, energy inflation accounted for about half of overall inflation. Second, prices are also going up because recovering demand related to the reopening of the economy is outpacing supply. These dynamics are especially visible in the prices of consumer services, as well as the prices of goods affected most strongly by supply shortages. And finally, base effects related to the end of the VAT cut in Germany are still contributing to higher inflation.

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We expect the influence of all three factors to ease in the course of 2022 or to fall out of the year-on-year inflation calculation. As the recovery continues, the gradual return of the economy to full capacity will underpin a rise in wages over time. Market and survey-based measures of longer-term inflation expectations have moved closer to two per cent. These factors will support underlying inflation and the return of inflation to our target over the medium term.

Risk assessment

The recovery continues to depend on the course of the pandemic and further progress with vaccinations. We see the risks to the economic outlook as broadly balanced. In the near term, supply bottlenecks and rising energy prices are the main risks to the pace of recovery and the outlook for inflation. If supply shortages and higher energy prices last longer, these could slow down the recovery. At the same time, if persistent bottlenecks feed through into higher than anticipated wage rises or the economy returns more quickly to full capacity, price pressures could become stronger. However, economic activity could outperform our expectations if consumers become more confident and save less than currently expected.

Financial and monetary conditions

Growth and medium-term inflation dynamics still depend on favourable financing conditions for all sectors of the economy. Market interest rates have increased. Nevertheless, financing conditions for the economy remain favourable, not least because bank lending rates for firms and households remain at historically low levels. While there was a pick-up in September, lending to firms remains moderate. This continues to reflect the fact that firms generally need less external funding, since these have high cash holdings and are increasingly retaining their earnings. Lending to households remains strong, driven by demand for mortgages. Our most recent bank lending survey shows that credit conditions for firms stabilised and were supported – for the first time since 2018 – by a reduction in banks' risk perceptions. By contrast, banks are taking a slightly more cautious approach to housing loans and have tightened their lending standards for these loans accordingly. Bank balance sheets continue to be supported by favourable funding conditions and remain solid.

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Conclusion

Summing up, the euro area economy continues to recover strongly, although at a more moderate pace. Rising energy prices, the recovery in demand and supply bottlenecks are currently pushing up inflation. While inflation will take longer to decline than previously expected, we expect these factors to ease in the course of next year. We continue to foresee inflation in the medium term remaining below our two per cent target. Our policy measures, including our revised forward guidance on the key ECB interest rates, are crucial to helping the economy shift to a sustained recovery and, ultimately, to bringing inflation over the medium term to our target.

We are now ready to take your questions.

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