EUROPEAN CENTRAL BANK
EUROSYSTEM

MONETARY POLICY STATEMENT

Frankfurt am Main, 16 December 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 and the labour market is improving, helped by ample policy support. Growth is moderating but we expect activity to pick up again strongly in the course of next year. The latest pandemic wave and the Omicron variant have prompted some countries to re-introduce tighter restrictions. Energy prices have gone up significantly. And in some industries, there are shortages of materials, equipment and labour. These factors are restraining economic activity and are a headwind for the near-term outlook. However, although the public health crisis is still ongoing, many people have been vaccinated and booster campaigns have accelerated. Overall, society has become better at coping with the pandemic waves and resulting constraints. This has lessened the pandemic impact on the economy. Inflation has risen sharply owing to the surge in energy prices, and also because demand is outpacing constrained supply in some sectors. Inflation is expected to remain elevated in the near term, but should ease in the course of next year. The inflation outlook has been revised up, but inflation is still projected to settle below our two per cent target over the projection horizon.

We judge that the progress on economic recovery and towards our medium-term inflation target permits a step-by-step reduction in the pace of our asset purchases over the coming quarters. But monetary accommodation is still needed for inflation to stabilise at our two per cent inflation target over the medium term. In view of the current uncertainty, we need to maintain flexibility and optionality in the conduct of monetary policy. With this is mind, the Governing Council took the following decisions:

First, in the first quarter of 2022, we expect to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) at a lower pace than in the previous quarter. We will discontinue net asset purchases under the PEPP at the end of March 2022.

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Second, 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.

Third, 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 our monetary policy and made our efforts to achieve our 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.

Fourth, 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 our target over the medium term, we 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, we 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 our policy rates. We expect net purchases to end shortly before we start raising the key ECB interest rates.

We also confirmed the level of the key ECB interest rates and our forward guidance on the future path of policy rates. This is crucial for maintaining the appropriate degree of accommodation to stabilise inflation at our two per cent inflation target over the medium term.

We will continue to monitor bank funding conditions and ensure that the maturing of TLTRO III operations does not hamper the smooth transmission of our monetary policy. We will also regularly assess how targeted lending operations are contributing to our monetary policy stance. As announced, we expect the special conditions applicable under TLTRO III to end in June next year. We will also assess the appropriate calibration of our 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.

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 target over the medium term.

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

Economic activity

We expect the economic recovery to continue, driven by robust domestic demand. The labour market is improving, with more people having jobs and fewer in job retention schemes. This supports the prospect of rising household income and consumption. The savings built up during the pandemic will also support consumption. The current fiscal and monetary policy support, together with a continued global recovery, should support growth.

Economic activity has been moderating over the final quarter of the year and this slower growth is likely to extend into the early part of next year. We now expect output to exceed its pre-pandemic level in the first quarter of 2022.

To cope with the current pandemic wave, some euro area countries have reintroduced tighter containment measures. This could delay the recovery, especially in travel, tourism, hospitality and entertainment. The pandemic is weighing on consumer and business confidence and the spread of new virus variants is creating extra uncertainty. In addition, rising energy costs are a headwind for consumption.

Shortages of equipment, materials and labour in some sectors are hampering production of manufactured goods, causing delays in construction and slowing down the recovery in some parts of the service sector. These bottlenecks will still be with us for some time, but they should ease during 2022.

Looking ahead, we expect growth to rebound strongly over the course of 2022. Our new Eurosystem staff projections foresee annual real GDP growth at 5.1 per cent in 2021, 4.2 per cent in 2022, 2.9 per cent in 2023 and 1.6 per cent in 2024. Compared with our September staff projections, the outlook has been revised down for 2022 and up for 2023.

Targeted and growth-friendly fiscal measures 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.

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Inflation

Inflation increased further to 4.9 per cent in November. It will remain above two per cent for most of 2022. Inflation is expected to remain elevated in the near term, but we expect it to decline in the course of next year.

The upswing in inflation primarily reflects a sharp rise in prices for fuel, gas and electricity. In November, energy inflation accounted for more than half of headline inflation. Demand also continues to outpace constrained supply in certain sectors. The consequences are especially visible in the prices of durable goods and those consumer services that have recently reopened. Base effects related to the end of the VAT cut in Germany are still contributing to higher inflation, but only until the end of the year.

There is uncertainty as to how long it will take for these issues to resolve. But, in the course of 2022, we expect energy prices to stabilise, consumption patterns to normalise, and price pressures stemming from global supply bottlenecks to subside.

Over time, the gradual return of the economy to full capacity and further improvements in the labour market should support faster growth in wages. Market and survey-based measures of longer-term inflation expectations have remained broadly stable since our last monetary policy meeting in October. But overall, these have moved closer to two per cent in recent months. These factors will help underlying inflation to move up and bring headline inflation up to our target over the medium term.

Our new staff projections foresee annual inflation at 2.6 per cent in 2021, 3.2 per cent in 2022, 1.8 per cent in 2023, and 1.8 per cent in 2024 – significantly higher than in the previous projections in September. Inflation excluding food and energy is projected to average 1.4 per cent in 2021, 1.9 per cent in 2022, 1.7 per cent in 2023, and 1.8 per cent in 2024, also higher than in the September projections.

Risk assessment

We see the risks to the economic outlook as broadly balanced. Economic activity could outperform our expectations if consumers become more confident and save less than expected. By contrast, the recent worsening of the pandemic, including the spread of new variants, could be a more persistent drag on growth. The future path of energy prices and the pace at which supply bottlenecks are resolved are risks to the recovery and to the outlook for inflation. If price pressures feed through into higher than anticipated wage rises or the economy returns more quickly to full capacity, inflation could turn out to be higher.

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Financial and monetary conditions

Market interest rates have remained broadly stable since the October Governing Council meeting. Bank lending rates for firms and households remain at historically low levels. Overall, financing conditions for the economy remain favourable. Lending to firms is partly driven by short-term funding needs stemming from supply bottlenecks that increase their expenses for inventory and working capital. At the same time, corporate demand for loans remains moderate because of retained earnings and generous cash holdings, as well as high debt. Lending to households remains robust – driven by demand for mortgages.

Euro area banks have further strengthened their balance sheets thanks to higher capital ratios and fewer non-performing loans. Banks are now as profitable as they were before the pandemic. Bank funding conditions remain favourable overall.

In line with our new monetary policy strategy, twice a year the Governing Council assesses in-depth the interrelation between monetary policy and financial stability. An accommodative monetary policy underpins growth, which supports the balance sheets of companies and financial institutions, as well as preventing risks of market fragmentation. At the same time, the impact of accommodative monetary policy on property markets and financial markets warrants close monitoring as a number of medium-term vulnerabilities have intensified. Still, macroprudential policy remains the first line of defence in preserving financial stability and addressing medium-term vulnerabilities.

Conclusion

Summing up, the euro area economy continues to recover, despite a slowdown in the near term. The sharp increase in energy prices and demand outpacing constrained supply in some sectors are pushing up inflation. Inflation will remain above our target for most of 2022, but is likely to ease in the course of next year. At the same time, given the progress on economic recovery and towards our medium-term inflation target, we can discontinue net purchases under the PEPP in March. But monetary accommodation is still needed – including net purchases under the APP and our forward guidance on interest rates – for inflation to stabilise at our two per cent inflation target over the medium term.

We are now ready to take your questions.

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