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EUROSYSTEM

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Account of the monetary policy meeting of the Governing Council of the European Central Bank

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1. Review of financial, economic and monetary developments and policy options

Financial market developments

Ms Schnabel reviewed the financial market developments since the Governing Council's previous regular monetary policy meeting on 11-12 March 2020. Although the general risk-off mood had subsided and market liquidity was progressively improving, financial markets continued to show signs of fragility, mainly along four key dimensions.

First, most euro area sovereign bond spreads had widened relative to German benchmark bonds, irrespective of their credit rating. In some jurisdictions, bond spreads had temporarily returned to, or even risen above, the levels observed before the announcement of the pandemic emergency purchase programme (PEPP), compounded by expectations of increased issuance needs and the high prevailing uncertainty surrounding the economic and financial fallout from the crisis. There were also signs that liquidity premia had likely exacerbated the upward pressure on term premia resulting from increased issuance needs. Bid-ask spreads remained well above normal levels in many jurisdictions.

In this environment, there was evidence that the PEPP had established itself as an important anchor of stability for euro area bond markets beyond the initial effects of the announcement. High investor demand had been observed for sovereign bond auctions with, at times, historic bid-to-cover ratios. Even though the yield premium for some issuances had been considerable, the Eurosystem purchases were helping to preserve the smooth transmission of monetary policy across all parts of the euro area.

Second, although the PEPP had contributed to easing financial conditions and to stimulating issuance, concerns over the outlook for corporate profitability implied that financial conditions for firms and banks remained tighter than before the outbreak of the coronavirus (COVID-19) pandemic. Investment-grade issuers currently faced spreads which were around twice as high as before the crisis, in part reflecting expectations of a notable increase in credit rating downgrades. The number of "fallen angel" bonds was increasing, while downgrades of high-yield issuers were already much more prominent. Corporate default rates could increase measurably over the next twelve months.

Third, although global stock markets had partly recovered the losses seen in late February and early March 2020 – the Euro Stoxx 50 index had risen by more than 20% since the PEPP announcement – there were signs that the significant remaining uncertainty surrounding the economic outlook continued to pose risks to current valuations. While expectations regarding short-term earnings growth over the next 12 months had declined substantially, longer-term earnings expectations had remained surprisingly resilient so far. Either investors were sanguine about the long-term repercussions of the crisis and expected a V-shaped recovery with no protracted effects on growth, or they were finding it difficult to price in the impact on growth and earnings from the COVID-19 pandemic. The amount of tail risk priced into the market, as reflected in option prices, suggested that the latter hypothesis could not be ruled out. At the same time, investors were less sanguine about the earnings prospects of banks. The total Euro Stoxx Banks index had fallen by around 50%, with the extent of losses on euro area bank shares not very different from that on US banks.

Fourth, market-based funding conditions for banks were tightening in unsecured money markets, as could be observed from the increase over the past few weeks in the spread between the three-month EURIBOR and OIS rates, which had recently reached the widest level seen since 2012. These developments were likely to reflect, at least in part, remaining strains in the commercial paper market. New commercial paper issuance had remained limited to the shortest maturities owing to the withdrawal of some traditional buyers, most notably money market funds and corporations, in response to the deteriorating liquidity situation.

However, current and future Eurosystem liquidity-providing operations, in combination with the collateral easing package, offered immediate relief from higher market-based funding costs, thereby safeguarding monetary policy transmission and keeping the bank lending channel open. In this environment, the new series of targeted longer-term refinancing operations (TLTRO III) was highly attractive for a large part of the euro area banking sector, and market participants had doubled their expectations regarding take-up over recent weeks, to around €1.1 trillion in total. At the same time, expectations of further adjustments in the ECB's key policy rates had subsided in recent weeks as the OIS forward curve had shifted up notably. Market-based measures of interest rate expectations were consistent with survey evidence, signalling no significant expectations of further cuts in the deposit facility rate.

The global environment and economic and monetary developments in the euro area

Mr Lane reviewed the global environment and recent economic and monetary developments in the euro area.

Regarding the external environment, survey data signalled a sharp and deep economic downturn. The Purchasing Managers' Index (PMI) pointed to a sharp contraction in global activity in the first half of 2020, which was likely to be more pronounced than the trough observed during the great financial crisis. The global composite output PMI excluding the euro area had declined sharply from 52 in January to 45 in February, and further to 41 in March – with services being affected more strongly than manufacturing. Driven by supply chain disruptions and a massive demand shock, global trade was estimated to have fallen sharply as signalled, for example, by the substantial drop in the PMI for new manufacturing orders. Production disruptions had spread and were likely to weigh on global trade for some time to come.

Amid considerable volatility, global financial conditions had remained broadly unchanged in advanced economies since the Governing Council's monetary policy meeting on 11-12 March, but had tightened significantly compared with mid-February when the coronavirus had started to spread globally. Since that meeting oil prices had fallen by approximately 50% to below USD 20 per barrel, primarily due to the sudden collapse in demand owing to the coronavirus pandemic. The euro had weakened considerably against the US dollar but had depreciated only marginally in nominal effective terms since the 11-12 March monetary policy meeting.

Turning to the euro area, the latest economic indicators and survey results covering the period since the coronavirus spread to the euro area showed an unprecedented decline, pointing to a significant contraction in economic activity and to rapidly deteriorating labour markets. The coronavirus pandemic and the associated containment measures had severely affected the manufacturing and services sectors, taking a toll on the productive capacity of the euro area economy and on domestic demand. In the first quarter of 2020, which was only partially affected by the spread of the coronavirus, euro area real GDP had decreased by 3.8%, quarter on quarter, reflecting the impact of the lockdown measures in the final weeks of the quarter. The sharp downturn in economic activity in April suggested that the impact was likely to be more severe in the second quarter. Looking beyond the immediate disruption stemming from the coronavirus pandemic, euro area growth was expected to resume as the containment measures were gradually lifted, supported by favourable financing conditions, the euro area fiscal stance and a resumption of global activity.

Given the high level of uncertainty regarding the evolution of the pandemic, it was difficult to predict the likely extent and duration of the imminent recession and the subsequent recovery. However, without pre-empting the forthcoming Eurosystem staff macroeconomic projections for the euro area, which would be published in June, growth scenarios produced by ECB staff suggested that euro area GDP could fall by between 5% and 12% this year, followed by a recovery and normalisation of growth in subsequent years. The extent of the contraction and the recovery would depend crucially on the duration and the success of the containment measures, the extent to which supply capacity and domestic demand were permanently affected and the success of policies in mitigating the adverse impact on incomes and employment.

Turning to euro area price developments, annual HICP inflation had decreased from 0.7% in March to 0.4% in April, largely driven by lower energy price inflation, but also by slightly lower HICP inflation excluding energy and food. On the basis of the sharp decline in current and futures prices for oil, headline inflation was likely to decline considerably further over the coming months and was expected to bottom out around June. The sharp downturn in economic activity was expected to have a downward impact on underlying inflation. However, the medium-term implications of the coronavirus pandemic for inflation were surrounded by high uncertainty, given that downward pressures linked to weaker demand could be partially offset by upward pressures related to more lasting damage to the supply side.

Market-based indicators of longer-term inflation expectations had remained at depressed levels. While survey-based indicators of inflation expectations had declined for the short and medium term, indicators of longer-term expectations had been less affected.

Regarding euro area financial conditions, the short end of the EONIA forward curve had remained broadly unchanged since 21 February, when international financial market turmoil had begun on the back of the global spread of the coronavirus. Overall, therefore, euro area long-term risk-free rates had remained broadly unchanged over this period. Stock prices had decreased substantially following the global spread of the coronavirus, despite some recent improvement in sentiment. With respect to financing conditions for non-financial corporations, there had been some limited tightening of financing costs and concerns over the availability of external financing.

Turning to money and credit developments, broad money (M3) growth had increased to 7.5% in March 2020, from 5.5% in February. Money growth reflected bank credit creation for the private sector, which was being driven to a large extent by drawing on credit lines, and low opportunity costs of holding M3 relative to other financial instruments, while heightened economic uncertainty appeared to have triggered a shift towards monetary holdings, likely for precautionary reasons. In this environment, the narrow monetary aggregate M1, encompassing the most liquid forms of money, continued to be the main contributor to broad money growth.

Developments in loans to the private sector had also been shaped by the impact of the coronavirus crisis. The annual growth rate of loans to households had stood at 3.4% in March 2020, after 3.7% in February, while the annual growth rate of loans to non-financial corporations had stood at 5.4% in March, after 3.0% in February. These developments were also clearly visible in the results of the euro area bank lending survey for the first quarter of 2020, which indicated a surge in firms' demand for loans and for drawing on credit lines to meet liquidity needs for working capital, while financing needs for fixed investment had declined. Demand for loans to households for house purchase had increased less than in the previous quarter. Credit standards for loans to firms had tightened slightly, while credit standards for loans to households had tightened more strongly. In both cases, this was related to the deterioration in the economic outlook and a decline in the creditworthiness of firms and households. At the same time, banks expected an easing of credit standards for loans to firms in the second quarter of 2020.

The euro area fiscal stance was assessed to have become strongly expansionary as euro area countries had announced significant fiscal measures to cushion the economic effects of the coronavirus pandemic. Transfers to firms and households constituted the largest part of the packages of measures.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that the European and world economies were currently experiencing an extraordinary and severe economic contraction. Public healthcare measures to contain the spread of the coronavirus had halted many economic activities across the globe. The assessment of the most likely economic developments had been rendered more difficult than usual by the exceptionally high level of uncertainty. Scenario analysis was the best approach and the work of the ECB's staff indicated that even a deep recession of around 5% in 2020 now appeared to be a benign outcome, with more severe scenarios projecting a contraction of up to 12% in GDP. At the same time, as the containment measures were gradually lifted, the Governing Council could expect a significant recovery in economic activity, although its speed and scale remained highly uncertain.

The uncertainty about the duration of the pandemic and the economic consequences of the containment measures had resulted in turbulent financial market developments. There had been a sharp repricing of risk across asset categories and a generalised tightening of financial conditions. At the same time, the results of the latest euro area bank lending survey showed only a very mild net tightening of credit standards for firms. This tightening was significantly less pronounced than the tightening seen at the time of the financial and sovereign debt crises between 2008 and 2012, which was a sign that the ECB's measures (together with the announcement in many countries of public credit guarantees and other support for firms and households) had so far largely protected bank-based credit flows.

Inflation had declined as a result of the sharp fall in oil prices and the drop in services sector inflation. Market-based measures of longer-term inflation expectations had remained at very depressed levels, after recording new historical lows. Even though survey-based indicators of inflation expectations had also declined for the short and medium term, they had remained stable for the longer term.

While monetary policy could not anticipate the point at which the economy would reopen, it could make sure that all the necessary conditions for a rebound were in place, in line with the easing of the containment measures. In particular, monetary policy measures had helped to sustain the flow of credit to households and firms (especially small and medium-sized enterprises – SMEs) and to maintain favourable financing conditions that benefited all sectors and jurisdictions.

In addition to the Governing Council's credit easing measures, the successful implementation of the PEPP – including its flexibility across jurisdictions throughout the duration of the programme – was critical in delivering the favourable financial conditions that were necessary to support the economy, in view of the severe risks both to the monetary policy transmission mechanism and to the outlook for the euro area posed by the coronavirus pandemic.

The rapidly evolving situation needed to be reflected in an adjustment to the Governing Council's monetary policy stance. Both the tail risks associated with the present macro-financial crisis and its scale were assessed to have deteriorated substantially since the monetary policy meetings on 11-12 March and on 18 March.

The TLTRO III programme complemented the accommodative impact of the ECB's other monetary policy measures, notably the asset purchase programmes. TLTRO III maintained the bank-based monetary transmission mechanism, funnelling the monetary easing associated with negative interest rates to those sectors that relied on access to bank credit. Accordingly, in finalising the revised design of the TLTRO III programme, Mr Lane proposed recalibrating the TLTRO III pricing. In particular, the interest rate on TLTRO III operations during the period from June 2020 to June 2021 would be reduced to 50 basis points below the average interest rate on the main refinancing operations prevailing over the same period. Moreover, for counterparties whose eligible net lending reached the lending performance threshold, the interest rate over the period from June 2020 to June 2021 would be lowered to 50 basis points below the average deposit facility rate prevailing over the same period.

Mr Lane also proposed offering a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) to support the liquidity conditions in the euro area financial system and contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop. The PELTROs would consist of seven additional refinancing operations commencing in May 2020 and maturing in a staggered sequence between July 2021 and September 2021 in line with the duration of the collateral easing measures. The operations would be carried out as fixed rate tender procedures with full allotment, with an interest rate that was 25 basis points below the average rate on the Eurosystem's main refinancing operations prevailing over the life of each PELTRO.

Together with the substantial monetary policy stimulus already in place, these measures would support liquidity and funding conditions and would help to preserve the smooth provision of credit to the real economy.

At the same time, the Governing Council needed to continuously evaluate each of its measures, both individually and as a package, to assess whether they were still adequately calibrated and appropriately sized to provide the necessary degree of accommodation in this uncertain economic environment. At the June meeting, more information would be available, including new Eurosystem staff macroeconomic projections. At that point, the Governing Council would have to stand ready to adjust the PEPP and potentially other instruments if it saw that the scale of the stimulus was falling short of what was needed.

Regarding communication, it was proposed that the Governing Council should acknowledge that the available indicators suggested a very substantial contraction in economy activity in 2020, depending on the duration of the containment measures and the extent to which supply capacity and domestic demand were affected more permanently, and also on the combined success of fiscal, monetary and supervisory policies in mitigating the adverse impact on incomes and employment. It should be stressed that the decisive policy actions taken in mid-March had been effective in providing crucial support to the euro area economy and that, in view of the current rapidly evolving economic environment, the Governing Council would do everything necessary within its mandate to support all citizens of the euro area through this extremely challenging time. It was fully prepared to adjust all of its measures, as appropriate, to ensure that inflation moved towards its aim in a sustained manner, in particular signalling that it was fully prepared to increase the size of the PEPP and adjust its composition as much as necessary and for as long as needed. Finally, the measures taken by euro area governments and the European institutions to ensure sufficient healthcare sector resources and to provide support to affected companies, workers and households were to be welcomed, while reiterating the need for continued and ambitious efforts, notably through joint and coordinated policy action, to guard against downside risks and in support of the recovery.

2. Governing Council’s discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members broadly agreed with the assessment, provided by Mr Lane in his introduction, of the current economic situation in the euro area and of the risks to activity. Members agreed that the incoming data since the Governing Council’s monetary policy meetings on 11-12 March and on 18 March allowed for a better assessment of the impact of the crisis on the euro area economy. In particular, reference was made in the discussion to the GDP releases for the first quarter of 2020 in a number of countries, which had just been published together with the euro area data. Moreover, survey-based indicators for the euro area, covering both businesses and consumers, had fallen very sharply in March and April to stand at very low levels. It was now clear that the euro area economy was heading towards a decline in activity that was unprecedented in recent history. This could be demonstrated by comparing the scenarios for growth in the event of an intensification of the crisis presented in the March 2020 ECB staff projections with the various scenarios by ECB staff presented at the current meeting. It was clear that the June 2020 Eurosystem staff projections would be revised down significantly compared with the March 2020 ECB staff projections, and that the current situation could prove to be more disruptive than the global financial crisis. The point was made that the present situation was characterised by Knightian or "radical" uncertainty, implying unquantifiable risks.

Against this background, drawing on a range of scenarios was considered warranted in circumstances where the outlook for the euro area was subject to exceptional uncertainty. Members expressed appreciation for the scenario analysis conducted by ECB staff, while registering some reservations on the prospect of the scenarios becoming rapidly outdated in the light of evolving conditions. Although different views were expressed about these scenarios, it was generally considered that, of the three scenarios presented, the "mild" scenario was probably already too optimistic.

While it was agreed that in the ongoing projection round the economic outlook would have to be revised down drastically compared with the March ECB staff projections, it also had to be acknowledged that the extent and duration of the coronavirus pandemic could not be foreseen and the current crisis, which emanated from outside the economy, was very different from previous crises. The longer the lockdown measures were in place, the more serious the impact on activity and prices would be. At the same time, it was stressed that the economic effects of the pandemic would continue for a considerable period after the coronavirus was contained, as the decline in demand owing to precautionary motives or to income losses could be expected to weigh on economic activity, leading to a slow recovery. Attention was drawn to the fact that precautionary saving was already increasing and, if consumers did not regain confidence quickly after containment measures were lifted, there was a risk that demand would remain depressed. It was also to be expected that containment measures would stay in place for some time, at least until a vaccine was available. Uncertainty could also adversely affect investment behaviour. As demand was considered likely to recover only gradually, a swift V-shaped recovery could probably already be ruled out at this stage.

At the same time, the comment was made that it was too early to conclude that the "severe" scenario presented by ECB staff was the most likely. It was emphasised that the outlook and the strength of the recovery would depend critically on the actions of EU Member States and the European Union, and the strength of the overall policy response. It was also difficult to predict the extent to which entrepreneurial spirit and innovative thinking about how to conduct business in this new environment might emerge. In this context, it was also recalled that the largest shock to activity in the euro area would likely have been in April, and that in May there should be some improvement owing to a relaxation of some of the containment measures. Looking beyond the immediate disruption stemming from the coronavirus pandemic, euro area growth could be expected to resume as the containment measures were gradually lifted, supported by favourable financing conditions, the euro area fiscal stance and a resumption of global activity.

It was considered that even more attention than usual should be paid to differences across sectors, as some sectors were particularly exposed to the impact of social distancing measures. Moreover, although the coronavirus was a common shock that had severely affected all euro area jurisdictions, further discussion was needed about the impact on individual countries, which was likely to be heterogeneous (e.g. in the case of euro area countries with greater reliance on tourism).

Members expressed concern about the possibility of non-linear effects amplifying the effects of the coronavirus pandemic on activity, although these were difficult to quantify. In the discussion, reference was made in particular to the impact of the economic downturn on the liquidity and solvency situation of firms, the prospect of higher levels of non-performing loans and the consequences for the banking sector. The development of fiscal positions and concerns about rising public debt were also mentioned in this context, as well as the nexus between banks and sovereigns. However, it was suggested that the probability of such risks occurring would depend on the strength of the recovery in 2021, which would in turn depend on the policy responses. In particular, it was argued that the likelihood of a self-reinforcing downward spiral was contained owing to the stabilising effect of the far-reaching fiscal and monetary policy support measures that had been adopted by euro area governments and the ECB, as well as globally. In addition, it was remarked that, to the extent that timely, targeted and temporary measures were effective in addressing acute liquidity shortfalls, they should limit adverse longer-term implications for public and private debt sustainability.

Members also emphasised the possible impact of the pandemic on foreign trade, including the effect of changes in the future structure of global production, and the risks surrounding the speed and strength of the recovery in emerging market economies given their reliance on raw materials. There was a risk of being too optimistic about the recovery in these economies, and it was considered that they could be the source of a number of downside risks to the outlook to the real economy that should be closely monitored.

Regarding fiscal policies, members welcomed the measures taken by euro area governments and the European institutions to ensure sufficient healthcare resources and to provide support to affected companies, workers and households. At the same time, continuous and ambitious efforts were needed, notably through joint and coordinated policy action, to guard against downside risks and to underpin the recovery. An ambitious and coordinated fiscal stance was critical in view of the sharp correction in the euro area economy. Measures taken should, as much as possible, be targeted and temporary in nature in response to the pandemic emergency. The endorsement by the European Council of the Eurogroup agreement on the three safety nets for workers, businesses and sovereigns, amounting to a package worth €540 billion, was welcomed. At the same time, it was felt that further strong and timely efforts were urgently needed to prepare and support the recovery. In this regard, members welcomed the European Council agreement to work towards a recovery fund dedicated to dealing with the unprecedented crisis.

It was noted that euro area governments had implemented ambitious policy packages and that these packages were needed in the current circumstances to reduce the risk of what should be a temporary shock becoming a more permanent one. However, this would lead to a very significant increase in the financing needs of all euro area countries, which should, in principle, imply only a one-off increase in the debt-to-GDP ratio, but could also lead to higher financing needs for several years.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. Members agreed that the outlook for headline inflation in the short term had to be revised down, reflecting not only the reduction in oil prices but also the expectation of lower underlying inflation. It was argued that in 2020 the downward impact on prices of weaker demand would clearly be stronger than supply-side effects. However, in an exchange of views about the likely impact of the pandemic on the outlook for price developments in the medium to long term, it was emphasised that this would depend on a number of factors and could be considered more ambiguous, with the overall net effect depending on the balance between increasing slack and lower aggregate demand, and the possible long-term adverse impact on aggregate supply capacity. At the same time, it was possible that the pandemic could have a prolonged negative effect on demand, in which case the output gap might remain large, putting downward pressure on prices for some time to come. A remark was made that the negative effect of the pandemic on the supply side of the economy, and on potential growth, might even not lead to upward price pressures but to further negative demand effects, such as those associated with debt deflation.

However, it was also noted that inflation had in the past shown a high degree of persistence and there could be upward pressure on prices from the costs of containment measures and supply disruptions, as well as from a number of structural effects following the pandemic. These were seen to include the exit of firms from the market and associated changes in the degree of competition, lasting changes in supply chains and the location of production, and increasing emphasis on resilience, leading to higher buffers and inventories. There could also be tighter limits to production as the spatial distribution of global production changed.

Reference was also made in the discussion to the problem of measuring inflation accurately in the current circumstances, taking into account changes in the composition of purchases of goods, as well as the impaired ability to collect price data and uncertainty about how prices would be imputed in the absence of actual price data. All of this would make it more difficult to assess, with any precision, the situation with respect to inflation.

In discussing recent developments in inflation expectations, members noted that short-term inflation expectations according to the ECB's Survey of Professional Forecasters (SPF) had been revised down sharply, to stand at 0.4% for 2020. At the same time, SPF inflation expectations for 2021 and 2022 had been revised down by much less, and survey-based longer-term inflation expectations had so far not been affected by the coronavirus crisis, remaining at 1.7% for headline inflation. Market-based indicators of inflation expectations remained at very low levels and had fallen further in the euro area, with the five-year forward inflation-linked swap rate five years ahead posting a new record low of 0.72%. The point was made that inflation expectations appeared to be reacting more to developments in actual inflation, which could be taken as an indicator that inflation expectations were becoming less well anchored. Moreover, inflation had remained below the ECB's inflation aim for an extended period. It was highlighted that, since the start of the coronavirus pandemic, the likelihood of inflation being below zero, or below 1%, according to option-implied probabilities, had increased substantially, pointing to a significant risk of deflation or very low inflation in the coming years.

With regard to the monetary analysis, members broadly concurred with the assessment, provided by Mr Lane in his introduction, that the increase in broad money growth mostly reflected a rise in loans to non-financial corporations that was driven to a large extent by drawing on credit lines. These developments were also clearly visible in the results of the euro area bank lending survey for the first quarter of 2020, which indicated a surge in firms' demand for loans and for drawing on credit lines to meet liquidity needs for working capital, while financing needs for fixed investment had declined. The latest results of the bank lending survey also showed only a very mild net tightening of credit standards for firms, whereas interim results from the survey on the access to finance of enterprises (SAFE) suggested that SMEs had registered a significant deterioration in their access to external finance owing to the unfavourable evolution of their own financial prospects. It was stressed that, while increased lending was a welcome development, it raised the level of risk-weighted assets on banks' balance sheets and lowered capital ratios, which could induce banks to restrict lending eventually. In that context, public loan guarantees were seen as a crucial element in maintaining credit flows to firms and households.

Monetary policy stance and policy considerations

With regard to the monetary policy stance, members shared the view that financial market developments had been volatile since the Governing Council's previous regular monetary policy meeting in March, with a sharp repricing of risk across asset categories, especially around mid-March, which had been partly reversed subsequently as described by Ms Schnabel in her introduction. Financial conditions had tightened overall since the outbreak of the pandemic despite the measures taken by the Governing Council, whereas it was felt that, in the light of the darkened outlook, an easing would have been appropriate. Liquidity premia had remained elevated across jurisdictions and term funding markets for banks had still not fully reopened. Concerns were also voiced about the increasing spread between the EURIBOR and OIS rates, as the EURIBOR represented an important benchmark for pricing loans. Although equity prices had recovered recently, it was remarked that this improvement was not grounded in improved fundamentals. Attention was also drawn to the risk of higher real interest rates if expected inflation continued to decline.

The view was widely shared that the Governing Council's monetary policy measures taken in March, and reinforced by decisions taken on the collateral framework in April, had provided forceful monetary accommodation in a rapidly evolving environment and succeeded in safeguarding the ECB's monetary policy stance and effective monetary policy transmission across the euro area, which included countering unwarranted increases in risk premia. At the same time, it was cautioned that undue risks of fragmentation could re-emerge with a further worsening of the economic outlook. It was underlined that past experience showed that a loss of confidence in financial markets had to be avoided and pre-emptive action was preferable. Financial amplification mechanisms, such as those triggered by illiquid corporations or banks, could affect the real economy in a non-linear way and increase deflationary risks. At the same time, it was cautioned that monetary policy was not able to address these problems on its own and that fiscal policy also needed to play an essential role. Overall, it was felt that the longer the crisis endured, the more the risk of financial amplification effects would increase.

Members agreed that the rapidly evolving situation had to be reflected in a further adjustment to the Governing Council's monetary policy stance as both the scale and the associated tail risks of the macro-financial crisis had grown substantially since the March monetary policy meetings. Against this background, members broadly supported the monetary policy measures proposed by Mr Lane in his introduction, namely, first, to recalibrate the TLTRO III pricing by reducing the interest rate on TLTRO III operations during the period from June 2020 to June 2021, and second, to offer a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) to support liquidity conditions in the euro area financial system and contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop.

The proposed amendments to the TLTRO III parameters were considered to be well suited to enhancing the accommodative stance of monetary policy. It was widely felt that the attractive pricing of TLTRO III operations – in conjunction with government guarantees to banks – helped to provide incentives to maintain lending at a time when banks were facing challenges to reach their lending benchmarks and also counteracted pressures on bank lending rates resulting from recent increases in the EURIBOR. At the same time, a concern was expressed that lowering the minimum rate in the TLTRO III operations to 50 basis points below the deposit facility rate could open up the possibility for banks to obtain funds in the TLTRO III operations and then deposit them at the deposit facility rate instead of increasing their lending to the private sector.

Members welcomed the proposal to conduct a new series of non-targeted longer-term refinancing operations to address the pandemic emergency. These PELTROs would consist of seven additional refinancing operations commencing in May 2020 and maturing in a staggered sequence between July 2021 and September 2021, in line with the duration of the Governing Council's collateral easing measures. The provision of term funding without the operational complexity associated with TLTRO III was seen as important in providing funding for banks at attractive conditions and in helping to preserve the smooth functioning of money markets.

Overall, with a broad range of measures already in place, the Governing Council's monetary policy response was considered to have been suitable and forceful so far and, including the additional measures under consideration, was providing ample liquidity to banks and appropriate monetary stimulus to all sectors of the euro area economy.

Looking ahead, and in the light of the high uncertainty surrounding the economic and inflation outlook as shown in the scenarios prepared by ECB staff, it was stressed that the ECB needed to stand ready to adjust its monetary policy stance as appropriate and also to ensure the functioning of transmission across the euro area. This was widely seen to include ensuring favourable financing conditions and addressing downside risks to price stability in the euro area as a whole, including those resulting from negative real-financial feedback loops, as well as preventing fragmentation. The policy measures taken in response to the crisis, most notably the PEPP, had been essential and had limited the likelihood of a self-reinforcing downward spiral.

Although the announcement of the PEPP had been followed by a decrease in sovereign bond yields, it was observed that a reversal had taken place subsequently and some yields were currently higher than before the start of the crisis. National governments had announced ambitious fiscal packages that would entail a significant increase in financing needs for all euro area countries for several years. Members widely agreed that, to make the most effective use of the PEPP and to support financing conditions that were consistent with the Governing Council's policy aim, purchases under the PEPP should use all the flexibility that was built into the programme to ward off severe risks to the smooth functioning of monetary transmission.

The concern was voiced that large-scale interventions in sovereign bond markets could give rise to the risk of "fiscal dominance" and that the programme had to be executed carefully in order not to encourage irresponsible behaviour on the part of governments. However, it was also underlined that this was by no means a justification for the Governing Council not to fulfil its price stability mandate and support monetary policy transmission. This included addressing self-fulfilling redenomination risk and fragmentation in the event that these risks were to rise. In this context, it was remarked that the PEPP, like the asset purchase programme (APP), worked by extracting duration risk from asset markets, with the objective of preserving financing conditions that were consistent with a return of inflation towards levels in line with the ECB's medium-term inflation aim. To ensure compatibility with the ECB's mandate, it was underlined that price stability always needed to be kept to the fore, while government debt issuance and the evolution of structural deficits had to be monitored closely.

With respect to communication, members broadly agreed with the elements put forward by Mr Lane in his introduction. It was stressed that the decisive policy actions taken in mid-March had been effective in providing crucial support to the euro area economy. Moreover, the Governing Council stood ready to adjust all of its measures, as appropriate, to ensure that inflation moved towards its aim in a sustained manner. It was fully prepared to increase the size of the PEPP and adjust its composition, and potentially its other instruments, if, in the light of information that became available before its June meeting, it judged that the scale of the stimulus was falling short of what was needed.

The Governing Council highlighted its willingness to adapt its tools and to implement them forcefully as needed and continued to stand ready to take bold, innovative action to safeguard the smooth functioning of the transmission mechanism and the integrity of Monetary Union, aiming to support the economic recovery and delivering on the ECB’s medium-term price stability objective. In this context it was deemed important to stress the flexibility of PEPP implementation.

Monetary policy decisions and communication

Taking into account the foregoing discussion, upon a proposal by the President, the Governing Council took the following monetary policy decisions:

(1) The conditions on the targeted longer-term refinancing operations (TLTRO III) would be further eased. Specifically, the Governing Council decided to reduce the interest rate on TLTRO III operations during the period from June 2020 to June 2021 to 50 basis points below the average interest rate on the Eurosystem’s main refinancing operations prevailing over the same period. Moreover, for counterparties whose eligible net lending reached the lending performance threshold, the interest rate over the period from June 2020 to June 2021 would now be 50 basis points below the average deposit facility rate prevailing over the same period.

(2) A new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) would be conducted to support liquidity conditions in the euro area financial system and contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop. The PELTROs would consist of seven additional refinancing operations commencing in May 2020 and maturing in a staggered sequence between July and September 2021 in line with the duration of the collateral easing measures. They would be carried out as fixed rate tender procedures with full allotment, with an interest rate that was 25 basis points below the average rate on the main refinancing operations prevailing over the life of each PELTRO.

(3) Since the end of March, purchases had been conducted under the Governing Council’s new pandemic emergency purchase programme (PEPP), which had an overall envelope of €750 billion, to ease the overall monetary policy stance and to counter the severe risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the coronavirus pandemic. These purchases would continue to be conducted in a flexible manner over time, across asset classes and among

jurisdictions. The Governing Council would conduct net asset purchases under the PEPP until it judged that the coronavirus crisis phase was over, but in any case until the end of the year.

(4) Moreover, net purchases under the asset purchase programme (APP) would continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year. The Governing Council continued 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 started raising the key ECB interest rates.

(5) Reinvestments of the principal payments from maturing securities purchased under the APP would continue, in full, for an extended period of time past the date when the Governing Council started 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.

(6) The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged at 0.00%, 0.25% and -0.50% respectively. The Governing Council expected the key ECB interest rates to remain at their present or lower levels until it had seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence had been consistently reflected in underlying inflation dynamics.

The Governing Council was fully prepared to increase the size of the PEPP and adjust its composition, by as much as necessary and for as long as needed. In any case, it stood ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner, in line with its commitment to symmetry. Finally, the Governing Council took note that further details on the amendments made to the terms of TLTRO III and on the new PELTROs would be published in dedicated press releases at the end of the press conference.

The members of the Governing Council subsequently finalised the introductory statement, which the President and the Vice-President would, as usual, deliver at the press conference following the end of the current Governing Council meeting.

Introductory statement

https://www.ecb.europa.eu/press/pressconf/2020/html/ecb.is200430~ab3058e07f.en.html

Press releases

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200430~fa46f38486.en.html

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200430_1~477f400e39.en.html

Meeting of the ECB’s Governing Council, 29-30 April 2020

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Costa*

Mr Hernández de Cos

Mr Herodotou

Mr Holzmann*

Mr Kazāks

Mr Kažimír

Mr Knot*

Mr Lane

Mr Makhlouf

Mr Mersch

Mr Müller

Mr Panetta

Mr Rehn

Mr Reinesch

Ms Schnabel

Mr Stournaras

Mr Vasiliauskas

Mr Vasle

Mr Vella*

Mr Villeroy de Galhau

Mr Visco

Mr Weidmann

Mr Wunsch

* Members not holding a voting right in April 2020 under Article 10.2 of the ESCB Statute.

Other attendees

Mr Dombrovskis, Commission Executive Vice-President**

Ms Senkovic, Secretary, Director General Secretariat

Mr Smets, Secretary for monetary policy, Director General Economics

Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

** In accordance with Article 284 of the Treaty on the Functioning of the European Union.

Accompanying persons

Mr Alves

Mr Arce

Mr Aucremanne

Mr Bradeško

Ms Buch

Mr Demarco

Ms Donnery

Mr Gaiotti

Ms Goulard

Mr Haber

Mr Kaasik

Mr Kuodis

Mr Kyriacou

Mr Lünnemann

Mr Odór

Mr Rutkaste

Mr Sleijpen

Mr Tavlas

Mr Välimäki

Other ECB staff

Ms Graeff, Director General Communications

Mr Straub, Counsellor to the President

Ms Rahmouni-Rousseau, Director General Market Operations

Mr Sousa, Deputy Director General Economics

Mr Rostagno, Director General Monetary Policy

Release of the next monetary policy account foreseen on Thursday, 25 June 2020.