

Meeting of 9-10 June 2021

Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 9-10 June 2021

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 monetary policy meeting on 21-22 April 2021.

The nominal euro area ten-year GDP-weighted sovereign bond yield had increased by around 5 basis points, while short to medium-term yields had remained broadly unchanged. Taking into account also broader developments since the Governing Council's 10-11 March meeting, a mild steepening of the yield curve could be observed – a typical phenomenon of an economy on the verge of recovery. Long-term US Treasury yields, meanwhile, had remained largely unchanged over the same period.

Market intelligence pointed to two key drivers behind the diverging yield developments in the euro area and the United States. The first factor related to the pace of vaccination, which had been accelerating in all major euro area countries. As a result, the euro area was now expected to close most of the vaccination gap with the United States by the start of the summer. A high proportion of vaccinations had also strengthened investor confidence in the resilience of the euro area recovery.

The second, and related, factor concerned the dynamics of the reopening, which had been considerably faster and economically stronger than most analysts had expected. The data for the euro area in recent weeks had persistently surprised market analysts to the upside. Model-based evidence confirmed that positive macroeconomic shocks had been a key factor driving euro area risk-free yields since the

Governing Council's 10-11 March meeting. This stood in sharp contrast to the period before the March meeting, when spillovers from outside the euro area had been the main driving force.

Firming expectations about a strong euro area recovery had led investors to materially upgrade their required inflation compensation across the entire maturity spectrum. Markets now expected annual inflation in two years' time – once adjusted for the still negative inflation risk premium – to be at almost 1.7%, well above the level seen before the pandemic. Option prices suggested that markets were pricing almost a one-in-four chance that euro area inflation over the next five years would average more than 2%. Consequently, changes in inflation compensation had remained the sole driver of developments in nominal risk-free rates in recent weeks. Real long-term overnight index swap (OIS) rates, by contrast, had remained below the levels that prevailed when, in December 2020, the Governing Council had pledged to preserve favourable financing conditions.

At the same time, there had been a notable and persistent increase in the spread of the ten-year GDP-weighted sovereign bond yield over the risk-free OIS rate. What distinguished the recent widening of the spread from many previous episodes was the fact that it had occurred across all euro area sovereigns, including the safest ones. Corporate bond spreads, by contrast, had remained resilient. It was likely that significant liquidity buffers, an improving growth and credit outlook, as well as expectations of continued fiscal policy support had jointly contributed to keeping spreads stable at, or close to, pre-pandemic levels.

Recent developments had been accompanied by a marginal upward shift in the euro overnight index average (EONIA) forward OIS curve, which now indicated a slightly earlier time for policy rate lift-off. However, both the limited size of the shift and survey evidence suggested that genuine lift-off expectations had not changed significantly in recent months. The nominal effective exchange rate of the euro had also remained broadly unchanged in recent months, masking diverging bilateral exchange rate developments that mirrored, by and large, the different pace with which the recovery from the crisis was proceeding around the globe.

Finally, recent stock market developments suggested that the renewed rise in long-term rates continued to be seen by investors as a harbinger of a robust and resilient expansion. The EURO STOXX 50 Index had risen by 8% since the Governing Council's meeting on 10-11 March. Upward revisions to long-term earnings expectations had pushed equity valuations in the euro area higher. Countries that were expected to benefit more from the reopening of the economy and a faster pace of vaccination had recently outperformed others. At the sectoral level, euro area banking had been the best-performing sector for the year to date, benefiting from an improving domestic economy, rising bond yields and cheap funding costs through the targeted longer-term refinancing operations (TLTROs). However, despite improved market sentiment, euro area bank valuations remained depressed in historical and international comparison.

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

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

As regards the external environment, progress in overcoming the pandemic, especially in advanced economies, was reflected in developments in Purchasing Managers' Indices (PMIs) as leading indicators of economic activity. Manufacturing PMIs had recovered quickly but had also stabilised more recently, partly on account of bottlenecks in production. At the same time, there had been a very significant and sharp increase in the global services output PMI. The recovery in global trade had so far been very strong, which reflected a close link between trade and manufacturing.

Oil prices had risen since the Governing Council's April monetary policy meeting (+7.7%) and also relative to the assumptions embedded in the June Eurosystem staff macroeconomic projections for the euro area at the cut-off date (+3.9%). In US dollar terms, oil prices were now broadly back at their pre-pandemic levels. Also since the April meeting, the euro had appreciated slightly against the US dollar but was broadly unchanged in nominal effective terms – although it was quite elevated when compared with its spring 2020 level.

Turning to the euro area, in the first quarter of 2021 the economy had experienced a consumption-led drop in GDP growth. Looser restrictions were expected to enable a rebound in activity as of the second quarter. At the sectoral level, manufacturing had been held back by supply-side constraints related to semiconductors and shipping, which in turn had weighed on first quarter output. In addition, the services sector had continued to be adversely affected by distancing measures and by a lack of demand. The hardest hit high-contact services, such as travel, accommodation and food, were still lagging, though clearly improving. The improving pandemic situation was reflected in strongly rising levels of confidence, as seen, for instance, in the Economic Sentiment Indicator and PMI data to May.

Regarding the components of GDP, consumer spending had decreased by 2.3% quarter on quarter in real terms in the first quarter of 2021. With households having gradually become more optimistic, consumption was expected to increase strongly in the second and third quarters of the year before levelling off. While the saving ratio was expected to fall, it was important to keep in mind that growth in household disposable income had been sustained by substantial public income support over recent quarters. As the economy recovered, labour income should again contribute more to growth in household income.

Investment had continued to support the economic recovery. Housing investment in the first quarter of the year had continued to grow, by 0.5% quarter on quarter, while firms had also flagged significant shortages of labour and materials, as well as a near-record lengthening of supplier delivery times. For

business investment, recent data indicated a rebound also in the second quarter of 2021, after a 0.4% quarter-on-quarter contraction in the first quarter.

Turning to euro area trade, order-based indicators signalled strong momentum, while the recovery in extra-euro area goods exports had slowed during the first months of the year. Euro area manufacturers had struggled to source semiconductors as a consequence of input shortages and were affected by disruptions in shipping.

Assessing labour market developments, hard indicators had continued to show weakness while soft indicators were signalling improvements. Employment was still about 2.2% below pre-pandemic levels and the latest employment figure for the first quarter of 2021 was -0.3% (quarter on quarter), on account of the contraction in real GDP in the fourth quarter of 2020 and the first quarter of 2021. While the unemployment rate reflected a slight improvement, broader measures of labour underutilisation had remained high. In line with the recovery in the economy, forward-looking employment indicators had turned positive.

The June staff projections included upward revisions to the level of economic activity. Real GDP was projected to grow by 4.6% in 2021 and 4.7% in 2022 (revised up by 0.6 percentage points for both years), and by 2.1% in 2023 (unchanged). Overall, the faster pace of the recovery was broad-based across demand components. To address the continued uncertainty surrounding the pandemic and its influence on economic developments, alternative mild and severe scenarios had been prepared once again, as part of the June projection exercise.

Turning to nominal developments, inflation in the Harmonised Index of Consumer Prices (HICP) had increased from 1.3% in March to 1.6% in April and 2.0% in May 2021, according to Eurostat's flash release. Positive energy-related base effects – linked to the strong fall in energy inflation in 2020 – had been dominating developments in headline inflation since February 2021. Meanwhile, the role of some temporary factors, such as seasonal sales or changes in HICP weights, had been waning in recent months.

HICP inflation excluding energy and food had broadly moved sideways between March and May 2021, at 0.9%, which was still somewhat below the level observed before the pandemic. Negotiated wage growth had decreased substantially to 1.4% in the first quarter of 2021, well below the 1.8% recorded, on average, in 2020. Compensation per employee and compensation per hour had continued to be strongly affected by job retention schemes. At the same time, the GDP deflator had increased from 1.3% in the fourth quarter of 2020 to 1.5% in the first quarter of 2021.

Pronounced rises in input costs (linked to surging commodity price inflation, substantial increases in shipping costs and supply shortages of some raw materials) had led to upward pressures at the early

stages of the pricing chain. However, so far, higher pipeline pressures for intermediate goods had fed through to later stages of the pricing chain only to a very limited extent. Euro area producer price inflation for non-food consumer goods – a key measure of pipeline pressures for non-energy industrial goods – had stood at 1.0% in April, up from 0.9% in March and 0.6% in February.

In the June staff projections, headline inflation was projected to average 1.9% in 2021 and to decline to 1.5% and 1.4% in 2022 and 2023 respectively. Compared with the March staff projections, the projection for HICP inflation had been revised up for 2021 and 2022 and was unchanged for 2023. HICP inflation excluding energy and food was projected to increase from 1.1% in 2021 to 1.3% in 2022 and 1.4% in 2023, revised up throughout the projection horizon due to upward effects from rising global inflationary pressures and more positive developments in slack.

Turning to market-based measures of inflation compensation, inflation-linked swap (ILS) rates had continued to recover, especially in shorter maturities. The one-year forward ILS rate one year ahead had increased by 23 basis points to 1.27% since the Governing Council's April monetary policy meeting, while the five-year forward ILS rate five years ahead had risen by 7 basis points to stand at 1.60%.

As regards financial conditions in the euro area, asset prices across financial markets had mirrored improvements in the economic outlook. Equity and corporate bond markets were reflecting an improving outlook for growth and near-term credit risk. Long-term risk-free rates and GDP-weighted sovereign bond yields had increased somewhat further since the March Governing Council monetary policy meeting and stood above their pre-pandemic levels.

Turning to monetary developments, annual M3 growth had declined to 9.2% in April from 10% in March. While the first four months of 2021 had seen a moderation in broad money growth, it had been driven by special factors. M3 growth had continued to be driven by Eurosystem purchases and, up to March, resilient lending to the private sector, which had supported the liquidity buffers of firms and the deposits of households. Bank lending to firms had seen net redemptions in April after the large positive inflow in March, which reflected the decision by some banks to frontload their lending to March to meet the lending benchmark for the TLTRO. The outflow in April might have also reflected decreased liquidity needs, as the sectors most affected by the pandemic showed signs of recovery. Bank lending rates to firms had increased in April, more than offsetting the decline observed in March.

Fiscal support had been scaled up further, especially for 2021, with a substantial additional stimulus since the March staff projections. A higher stimulus funded by the Next Generation EU (NGEU) programme was projected to provide significant growth support over the forecast horizon. According to the June fiscal projection, after the massive fiscal response to the pandemic crisis in 2020, the euro area budget deficit was projected to remain around 7% in 2021 and to decline to levels around 3% as of 2022.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that, while output had declined in the first quarter of 2021, forward-looking survey data indicated the start of a significant rebound in the second quarter. In particular, the services sector had started to reopen. The manufacturing sector remained strong, even if supply constraints and the uncertain prospects for some large emerging market economies were likely to pose headwinds. The pick-up in economic activity should accelerate in the third quarter, as a result of further progress in containing the pandemic and the associated easing of social distancing restrictions. Overall, based on the June staff projections, real GDP was expected to exceed its pre-pandemic level in the first quarter of 2022, one quarter earlier than envisaged in the March staff projections.

Risks surrounding the growth outlook were balanced. An even stronger recovery could be predicated on better developments in the epidemiological situation, a more vigorous rebound in consumption and a stronger than projected rebound in foreign demand. In contrast, downside risks still mainly related to a renewed deterioration in the pandemic, for instance due to the spread of more infectious coronavirus (COVID-19) variants, as well as to financial disruptions that could result from a surge in corporate insolvencies.

The increase in headline inflation, from 1.3% in March to 1.6% in April and 2.0% in May, was predominantly due to sizeable base effects in energy inflation. To a lesser extent, non-energy industrial goods inflation had also played a role. Pipeline pressures at the earlier stages of the pricing chain were intensifying, although there was no evidence so far that these were seeping through to inflation developments. Underlying inflationary pressures remained muted, especially as wage inflation was still weak. Owing to the reversal of last year's temporary VAT reduction in Germany, headline inflation was projected to pick up after the summer and to peak towards the end of the year, averaging 1.9% in 2021, before returning to more moderate rates of 1.5% in 2022 and 1.4% in 2023. The projected increase in core inflation, from 1.1% in 2021 to 1.3% in 2022 and 1.4% in 2023, reflected an upgrade on the March staff projections.

Long-term benchmark market interest rates had continued to increase, exerting some upward pressure on euro area sovereign bond yields. "Downstream" financing indicators, which capture the credit conditions facing households and firms, remained accommodative. Nonetheless, these could tighten in the months to come should the upward movement in long-term risk-free rates and sovereign bond yields prove sustained.

The risk of tighter financing conditions needed to be seen against the still subdued outlook for inflation beyond the near term. At its meeting on 10-11 March, when confronted with a similar tightening in market interest rates against a backdrop of limited progress in the inflation outlook, the Governing Council had decided to significantly step up purchases under the pandemic emergency purchase programme (PEPP). The macroeconomic situation at the time of this meeting was more benign:

economic prospects were brightening, risks were receding and the projected pick-up in core inflation improved the robustness of the medium-term inflation outlook. At the same time, the negative pandemic shock to the projected inflation path had not been fully reversed. Also, if sustained, the rise in market rates could dampen the ongoing recovery and delay further progress in boosting inflation dynamics.

Against this background, Mr Lane proposed that the Governing Council should continue to conduct net asset purchases under the PEPP over the coming quarter at a significantly higher pace than during the first months of the year. A significantly higher pace of purchases under the PEPP remained necessary to help preserve the favourable financing conditions that were needed to offset the negative impact of the pandemic on inflation. This meant that asset purchases under the PEPP remained a proportionate monetary policy response to the risks to the ECB's inflation aim.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members generally agreed with the assessment of the current economic situation in the euro area and of the risks to activity provided by Mr Lane in his introduction. After the contraction in the first quarter of 2021, the latest data signalled a bounce-back in services activity and ongoing dynamism in manufacturing production. Economic activity was expected to accelerate in the second half of the year as further containment measures were lifted. At the same time, uncertainties remained, as the near-term economic outlook continued to depend on the course of the pandemic and on how the economy responded after reopening. Inflation had picked up over recent months, largely on account of base effects in energy inflation and other transitory factors. It was expected to rise further in the second half of the year, before declining as temporary factors faded out.

As regards the external environment, members largely shared the assessment provided by Mr Lane in his introduction that the global economic outlook was broadly unchanged. This concealed an upgrade to the outlook for advanced economies relative to that for emerging market economies, given the more rapid progress with vaccination programmes in the former and some new concerns about the pandemic in the latter. The stronger trade relationships between the euro area and other advanced economies implied that an unchanged global growth outlook was consistent with stronger euro area foreign demand. It was observed that, compared with progress in other major economies around the world, the economic recovery in the euro area was as yet lacking in robustness. At the same time, it was suggested that the inflationary pressures being experienced in some of these cyclically more advanced economies, notably the United States, could be a harbinger of developments in the euro area further down the road.

Turning to euro area developments, in the first quarter of the year euro area real GDP had declined further, by 0.3%, to stand 5.1% below its pre-pandemic level of the fourth quarter of 2019. Business and consumer surveys and high-frequency indicators pointed to a sizeable improvement in activity as of the second quarter. Over the medium term, the recovery in the euro area economy was expected to be buoyed by stronger global and domestic demand, with continued support from both monetary policy and fiscal policy.

Members generally agreed with both the baseline view for economic growth in the June staff projections and the upward revision as compared with the March staff projections. It was widely acknowledged that incoming information and data had been favourable and bolstered confidence in the expected economic recovery. It was underlined that there had been a string of positive surprises in the euro area since the March monetary policy meeting. Significant progress had been made on vaccination and the containment of the pandemic, with many restrictions in euro area countries being lifted. The point was made that the upward revisions to growth in the June staff projections looked modest compared with the recent improvements in some indicators. Moreover, activity in the first quarter of this year had turned out less negative than anticipated in the June projections. It was argued that this would still need to be factored into the outlook and would imply a faster closing of the output gap. However, it was remarked that projection errors for the first quarter were very heterogeneous across countries and that the outcome had been better than expected only in parts of the euro area.

At the same time, there were a number of reasons for caution. The recovery was still fragile and remained heavily dependent on the evolution of the pandemic and the assumption that the health crisis would be over after the summer. Reference was made to the uncertainty surrounding the emergence of new COVID-19 variants and the containment measures that these might necessitate. Moreover, it was suggested that positive surprises in incoming information had related more to soft data than to hard data, and it was noted that the June staff projections for growth in the second and third quarters of the year were above those of mechanical short-term forecasting tools. It was also stressed that the recovery remained heavily dependent on the support of fiscal policy measures and the very accommodative monetary policy stance.

In assessing the risks to growth, it was underlined that there had been a number of consecutive upward revisions to the growth outlook across recent projection rounds, despite the earlier assessment of downside risks. It was observed that the June baseline staff projections had turned out somewhere between the baseline and mild scenarios of the March staff projections. Also, it was noted that the GDP projections had been moving successively closer to the pre-pandemic trajectory and it was argued that, from that perspective, scarring effects seemed to be turning out less pronounced than had been initially feared. At the same time, it was cautioned that if the pandemic continued and restrictions remained in place, the outlook might be just as prone to downward revisions as it had previously been to upward

revisions. Moreover, in the June staff projections a number of previous upside risk factors were fully incorporated into the baseline, notably the impact associated with the US fiscal plans.

The behaviour of consumers in response to an easing of lockdown measures continued to be surrounded by uncertainty. On the one hand, it was argued that the assumption included in the June staff projections concerning the unwinding of accumulated forced savings might be too conservative. Even small additional releases of these savings could have large effects on consumption because of the amounts involved. Regarding possible additional upward risks to consumption, a question was raised on the role of wealth effects associated with the recent increases in house prices and equity prices. On the other hand, it was observed that, while the staff projections assumed only a small proportion of excess savings would be unwound by the end of the projection horizon, the projections were still predicated on the assumption of a very rapid normalisation of the saving ratio in the short term. It was recalled that excess savings had been accumulated mainly in richer households with lower propensities to consume and that there was large heterogeneity in such excess savings across euro area countries. A general question remained on the scale of pent-up demand and the extent to which excess savings could also be used for consumption rather than housing or other purposes, such as repaying debt.

It was observed that there had been no change to the staff projection for real GDP growth in 2023 and that the upward revision for 2022 was essentially due to carry-over effects from 2021, both of which suggested further upside risks beyond the short term. The point was also made that downside risks from financial amplification mechanisms, owing to corporate bankruptcies and associated pressures on banks, had diminished. However, it was noted that the economic recovery remained uneven across sectors and that an increase in insolvencies might yet come, especially among small and medium-sized enterprises (SMEs) and in the services sectors. It was suggested that uncertainties and risks remained in the final stretch of the recovery, related to the necessary resource reallocation typically associated with very deep recessions.

Overall, the risks surrounding the euro area growth outlook were seen as broadly balanced. On the one hand, an even stronger recovery could ensue if global demand picked up faster and household savings were reduced more quickly, once social and travel restrictions were lifted. On the other hand, the ongoing pandemic, including the spread of virus mutations, and its implications for economic and financial conditions continued to be sources of downside risk.

Regarding fiscal policies, an ambitious and coordinated fiscal stance was considered to remain crucial, as a premature withdrawal of fiscal support would risk weakening the recovery and amplifying longer-term scarring effects. National fiscal policies should thus continue to provide critical and timely support to the firms and households most exposed to the ongoing pandemic and the associated containment measures. At the same time, governments should ensure fiscal measures remained temporary and countercyclical, as well as sufficiently targeted in nature, to address vulnerabilities

effectively and to support a swift recovery in the euro area economy. The key role of the NGEU package was reiterated, with Member States called upon to deploy the funds productively and accompany these by productivity-enhancing structural policies. This would allow the NGEU programme to contribute to a faster, stronger and more uniform recovery and would increase economic resilience as well as the growth potential of Member States' economies. Such structural policies were particularly important in improving economic structures and institutions and in accelerating the green and digital transitions.

Members noted that the June staff projections contained substantial further fiscal loosening compared with the March staff projections. As a result, at present the fiscal stance in 2021 was expected to be similar to that in 2020, and the risk of "cliff-edge effects" was seen to be receding. While the continued importance of fiscal measures in supporting the economic recovery and tackling economic fragmentation was reiterated, concerns were expressed that fiscal consolidation might come too late rather than too early and that there was a risk of a substantial structural deterioration in fiscal deficits. Caution needed to be exercised in the interpretation of fiscal balances in the period ahead, as the crisis measures had been statistically recorded as structural spending. For the time being, it was generally considered that heterogeneity across countries in the timing and speed of economic recovery implied differentiated needs for targeted and temporary fiscal support. This suggested that calls for fiscal consolidation would need to be country-specific.

Turning to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. According to Eurostat's flash release, euro area annual inflation had increased from 1.3% in March to 1.6% in April and 2.0% in May 2021. Headline inflation was likely to increase further towards the autumn, reflecting mainly the base effects of the reversal of the temporary VAT reduction in Germany. Inflation was expected to decline again at the start of next year as temporary factors faded out. Underlying price pressures were expected to increase somewhat this year owing to temporary supply constraints and the recovery in domestic demand. Nevertheless, price pressures were likely to remain subdued overall. This in part reflected low wage pressures, in the context of still significant economic slack, and the appreciation of the euro. Once the impact of the pandemic had begun to fade, the reduction in slack, supported by accommodative monetary and fiscal policies, would contribute to a gradual increase in underlying inflation over the medium term.

Members widely agreed on the importance of looking through the temporary increase in inflation in 2021. It was underlined that the increase in inflation to 2.0% in May had been larger than expected, but also that this had followed a long period of subdued price increases, and that this development had to be assessed from a medium-term perspective. The question was raised as to the extent to which the recent rise in input costs and the temporary supply constraints, such as for semiconductors, could be expected to feed through to consumer prices over time. Pipeline pressures emerging at the intermediate goods stage typically showed only a limited and sluggish pass-through to producer prices for final consumer

goods and from there to retail prices. At the same time, it was suggested that the current situation could be different from the past since companies had less scope for absorbing pipeline pressures in their margins, after a long period of subdued profits, while the marked pick-up in demand might offer an opportunity to adjust prices. A greater than usual pass-through to the final consumer stages might also be possible if households were prepared to pay higher prices in the light of ample savings accumulated involuntarily during the pandemic. Against this background, it was argued that there could be upside risks not only over the shorter term but also over the medium term.

It was suggested that a perception among the public that prices could rise more persistently could have an impact on the behaviour of households and companies in the period ahead. It had to be acknowledged that household purchasing power would suffer more than anticipated this year, and it was difficult to say how that would interact with wage negotiations. If second-round effects from higher oil prices and headline inflation fed into higher wages, it would help convergence with the Governing Council's inflation aim. However, it was argued that currently there was little evidence of mounting wage pressures. There was evidence of a labour scarcity in some sectors and the situation differed from country to country, but there was, overall, still a significant degree of slack in the labour market, and a large number of employees in job retention schemes still needed to be brought back into work. Moreover, it was recalled that, following labour market reforms, wage indexation had become much less prevalent than some years before.

In their discussion of the June staff projections, members noted that the projection of 1.4% for headline inflation in 2023 implied a medium-term figure that remained well below the Governing Council's inflation aim. The same held even for the mild scenario in the staff projections and for forecasts of other institutions. It was observed that the inflation forecasts of other institutions were broadly similar to those of the June projections, although their forecasts for economic growth were lower. It was pointed out that the inflation outlook would have been even lower without the substantial fiscal and monetary support in place. It was also mentioned that, in the June projections, the upward revision of underlying inflation to a rate above its longer-term average had been offset by a lower rate of change in energy prices. The staff projections, like several other forecasts and projections, were based on the assumption that oil prices would evolve along the path of their futures prices, implying a mechanical downward impact on energy price dynamics over the projection horizon, which in the context of the current projections implied a questionable decline in headline inflation between 2022 and 2023. It was also argued that, in a situation where governments were striving to meet climate change targets, it was likely that new measures would be required that might bring additional upside risks to price developments over a medium to longer-term horizon. For these reasons, projected inflation of only 1.4% in 2023 was widely seen as subject to upward risks.

With regard to recent developments in inflation expectations, members noted that survey-based measures of longer-term inflation expectations remained at subdued levels, while comparable market-based indicators of inflation compensation had continued to increase and now stood above pre-pandemic levels. The increase in inflation expectations was seen as a welcome development. It was argued that inflation expectations on the part of firms and households tended to be closely linked to the latest actual inflation readings, and this was helping boost inflation expectations given that realised inflation was likely to exceed 2% for some months. However, it was also pointed out that the higher levels of market-based indicators of inflation compensation mainly reflected an increase in risk premia rather than an upward shift in the anticipated path of inflation. Nonetheless, a reduction in hitherto negative risk premia was a first step towards normalisation, with economic agents starting to hedge against inflation risks rather than deflation risks.

With respect to the monetary analysis, members concurred with the assessment provided by Mr Lane in his introduction. The annual rate of growth in broad money (M3) had declined in March and April, partly owing to strong negative base effects and weaker developments in deposits that reflected reduced liquidity needs as the pandemic situation improved. At the same time, the Eurosystem's ongoing asset purchases remained the largest source of money creation. The annual growth rate of bank loans to the private sector had fallen in April, with volatility in loans to non-financial corporations reflecting some frontloading in loan creation in March relative to April, and loans to households recording solid monthly flows.

On aggregate, credit conditions were judged to have remained supportive. The risk of a premature tightening of bank lending conditions was seen as being mitigated by a continued sizeable degree of policy support. Bank profitability was improving, allowing banks to prepare for credit defaults and to use their balance sheet capacity in terms of capital and liquidity buffers for new lending. It was noted that some tightening in bank lending rates, as included in the baseline projection, was to be expected when support measures were phased out, and credit risk was likely to increase. An increase in bankruptcies in the corporate sector could be expected later this year, and cliff-edge effects could not be ruled out, notably for SMEs. However, it was underlined that an increase in insolvencies would come from artificially subdued levels. A view was expressed that, overall, risks of financial amplification effects or credit supply constraints affecting firms and banks were diminishing. At the same time, credit demand could slow as firms and households ran down precautionary liquidity buffers that they had built up during the pandemic, which might moderate a tightening of bank lending rates.

Monetary policy stance and policy considerations

Turning to the assessment of euro area financing and financial conditions, members generally agreed that, despite the increase in nominal risk-free rates, euro area financing conditions had remained

accommodative and continued to support the recovery. The recent rise in nominal yields was seen as having been partly driven by the improving economic outlook, which was accompanied by an increase in inflation compensation, whereas real rates, which were considered to matter most for financing conditions, had fallen to new record lows or remained at very favourable levels. Downstream indicators of nominal financing conditions were assessed as favourable, too, with bank lending rates still near historical lows despite a recent rebound. Attention was drawn to the role of global factors in driving yield increases, with yields having stabilised in the United States since the Governing Council's April monetary policy meeting. The concern was voiced that a sustained rise in market rates could translate into a tightening of broader financing conditions that were relevant for the wider economy, thereby reinforcing vulnerabilities in the sectors most affected by the crisis. At the same time, it was noted that stock and residential property prices had become even more buoyant than in December 2020, when the PEPP was last expanded substantially. It was reiterated that preserving favourable financing conditions over the pandemic period remained essential to reduce uncertainty and bolster confidence, thereby underpinning economic activity and safeguarding medium-term price stability.

Members expressed broad agreement with Mr Lane's proposal to reconfirm the very accommodative monetary policy stance and to leave the ECB's monetary policy configuration unchanged, including the proposal to continue net purchases under the PEPP over the next quarter at a significantly higher pace than during the first months of the year. Although the medium-term outlook had improved, the June staff projections still saw inflation falling short of the pre-pandemic projected path at the policy-relevant horizon and did not show a robust convergence towards a level below, but close to, 2%. In this environment, monetary policy had to look through temporary short-term developments in inflation and focus on the medium-term outlook.

While it seemed appropriate that the improved outlook should be reflected in the Governing Council's policy stance, financing conditions were assessed as too fragile to allow a meaningful reduction in the pace of purchases without risking a disorderly rise in yields. It was stressed that the recovery was at an early stage and lacked robustness, as it depended heavily on policy support. Moreover, the projected path for the economy was subject to significant uncertainties and risks. An undue tightening of financing conditions at the current juncture could jeopardise the ongoing economic recovery and the outlook for inflation. A noticeable slowing of the pace of purchases for the next quarter was therefore seen as inappropriate at the current juncture. Concern was expressed that any change in net purchases not based on a clear improvement in the medium-term inflation outlook would lead to an unwarranted tightening of financing and financial conditions and cast doubt on the Governing Council's resolve to bring inflation back to its aim. In this context, a remark was made that, in view of the persistent inflation shortfall projected in the June staff projections, even an increase in asset purchases as the main monetary policy instrument could be justified at present. It had also to be considered that the lower bound on interest rates was still constraining the available monetary policy space, which meant caution

was required in relation to a tightening of the policy stance. A steady course was therefore warranted to maintain the monetary accommodation needed to underpin the economic recovery and to contribute to the sustained convergence of inflation towards the Governing Council's aim in the medium term.

In view of the better outlook for growth and inflation and the associated upside risks, it was, however, also argued that, to provide the same degree of accommodation, asset purchases should be scaled back somewhat. It was stressed that, as a matter of symmetry and consistency in decision-making, the improved outlook should be reflected in the pace of purchases. Financing conditions in the euro area were seen to be more favourable in June than they had been in March or December, implying an increasing degree of accommodation if the current purchase pace was maintained. Moreover, the improved outlook would also raise the natural interest rate, thereby effectively providing further accommodation. Reference was made to the Governing Council's established communication that, if economic developments were better than expected and favourable financing conditions could be maintained with asset purchase flows that did not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. In this context, it was recalled that the PEPP was an emergency programme with a limited time span. Concerns were also expressed about potential side effects if the highly accommodative monetary policy stance was maintained much longer because it might hinder structural change in the corporate sector and resource reallocation in the labour market. In addition, property price dynamics were accelerating.

Overall, most members expressed their readiness to join a broad consensus behind the proposal by Mr Lane. Hence, the Governing Council confirmed that it expected net asset purchases under the PEPP over the next quarter to continue to be conducted at a significantly higher pace than during the first months of the year. The Governing Council's commitment to preserve favourable financing conditions over the pandemic period and to prevent a tightening that was inconsistent with countering the downward impact of the pandemic on the projected inflation path was reiterated. Moreover, it was deemed essential that the Governing Council reaffirm its commitment to achieve its stated inflation aim.

It was underlined that the Governing Council's "reaction function" with respect to purchases under the PEPP would continue to rely on a joint assessment of financing conditions and the outlook for inflation over the medium term. It was reiterated that flexibility in the conduct of purchases was a cornerstone of the PEPP's purchase strategy. The broad parameters for PEPP purchases would continue to be decided by the Governing Council on the basis of a quarterly joint assessment of financing conditions and the inflation outlook. They would then be implemented by the Executive Board in a flexible manner according to market conditions, including seasonality, with a view to preventing a tightening of financing conditions that was inconsistent with countering the downward impact of the pandemic on the projected path of inflation.

Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, upon a proposal by the President, the Governing Council decided to confirm its very accommodative monetary policy stance:

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 would 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 judged that the coronavirus crisis phase was over. Based on a joint assessment of financing conditions and the inflation outlook, the Governing Council expected net purchases under the PEPP over the next quarter to continue to be conducted at a significantly higher pace than during the first months of the year.

The Governing Council would purchase flexibly according to market conditions and with a view to preventing a tightening of financing conditions that was 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 would continue to support the smooth transmission of monetary policy. If favourable financing conditions could be maintained with asset purchase flows that did not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope could be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The Governing Council would 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 would be managed to avoid interference with the appropriate monetary policy stance.

Net purchases under the APP would continue at a monthly pace of €20 billion. 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.

The Governing Council also intended 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 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.

Finally, the Governing Council would continue to provide ample liquidity through its refinancing operations. The funding obtained through the third series of targeted longer-term refinancing operations (TLTRO III) played a crucial role in supporting bank lending to firms and households.

The Governing Council 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.

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

[Introductory statement to the press conference of 10 June 2021](#)

Press release

[Monetary policy decisions](#)

Meeting of the ECB's Governing Council, 9-10 June 2021

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Centeno*

Mr Elderson

Mr Hernández de Cos

Mr Herodotou

Mr Holzmann*

Mr Kazāks

Mr Kažimír

Mr Knot

Mr Lane

Mr Makhlouf

Mr Müller
Mr Panetta
Mr Rehn
Mr Reinesch
Ms Schnabel
Mr Scicluna*
Mr Stournaras
Mr Šimkus
Mr Vasle
Mr Villeroy de Galhau
Mr Visco*
Mr Weidmann
Mr Wunsch

* Members not holding a voting right in June 2021 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 Aucremanne
Mr Bradeško
Mr Demarco
Ms Donnery
Mr Gaiotti

Ms Goulard
Mr Haber
Mr Kaasik
Mr Kuodis
Mr Kyriacou
Mr Lünnemann
Ms Mauderer
Mr Novo
Mr Ódor
Mr Rutkaste
Mr Sleijpen
Mr Tavlás
Mr Välimäki

Other ECB staff

Mr Proissl, Director General Communications
Mr Straub, Counsellor to the President
Ms Rahmouni-Rousseau, Director General Market Operations
Mr Rostagno, Director General Monetary Policy
Mr Sousa, Deputy Director General Economics

Release of the next monetary policy account foreseen on Thursday, 26 August 2021.