EUROPEAN CENTRAL BANK
EUROSYSTEM

Meeting of 10-11 March 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, 10-11 March 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 20-21 January 2021.

Sovereign yield curves across advanced economies had steepened, while new coronavirus (COVID-19) cases had fallen, the pace of vaccination had accelerated and a large fiscal stimulus programme in the United States was expected to be soon put into law. The measurable rise in commodity prices had added to upward pressure on long-term nominal bond yields. The increase in long-term bond yields had been more muted in the euro area than in other advanced economies. The euro area GDP-weighted yield curve remained considerably flatter than throughout most of the years preceding the COVID-19 pandemic and it had largely the same shape and location as observed just before the outbreak of the pandemic. Moreover, sovereign spreads had remained resilient, even narrowing in some jurisdictions. Accordingly, the increase in yields reflected primarily a rise in the euro area risk-free rate.

A decomposition of the ten-year overnight index swap rate indicated that investors had hardly changed their views on the expected future path of short-term rates. Recent yield increases had instead reflected, by and large, rising term premia. As the increase in term premia coincided with a notable rise in inflation swap rates, it was likely that the inflation risk premium had become larger as investors had started reappraising the balance of risk around the inflation outlook. An increase in the inflation risk premium at the current juncture suggested that investors no longer only saw downside risks around the future inflation outlook as they had done for most of 2020.

Real ten-year risk-free interest rates had fluctuated over time but had fallen back close to the levels prevailing around the 9-10 December 2020 Governing Council meeting. They were currently some 120 basis points below their average since 2008. Real short and medium-term rates had been insulated from the recent bond market sell-off and had continued to hit new historical lows in recent weeks.

Credit markets had remained resilient to the increase in bond market volatility and in risk-free rates, which suggested that investors remained fundamentally positioned for higher growth. Credit spreads across all rating classes, and in particular for high-yield bonds, had continued to narrow over the past few weeks supported by a visible recovery in realised earnings. Changes in the corporate default outlook mirrored expectations of a significantly improved growth outlook, contributing to favourable valuations in credit markets.

In stock markets, the EURO STOXX 50 index had further extended its gains, gradually approaching pre-pandemic levels. ECB staff analysis suggested that the rise in risk-free rates and the deterioration in the short-term earnings outlook due to the prolongation of containment measures had pulled stock prices lower in recent weeks. However, the combination of better long-term earnings expectations on the back of vaccination roll-outs and the associated improvement in risk sentiment had more than offset this drag on stock prices. Yet, in some economies, the rise in risk-free rates had increased risks to asset valuations, which remained predicated on expectations of an extended period of low interest rates.

Developments in emerging markets provided further evidence of investors so far having been able and willing to absorb the rise in risk-free rates. In February, portfolio inflows into emerging markets had continued at a robust pace, although they had started to reverse during the week ahead of the current meeting.

Finally, in foreign exchange markets, expectations of higher US growth and a less accommodative US monetary policy had put upward pressure on the nominal effective exchange rate of the US dollar and also on the US dollar exchange rate against the euro. At the same time, risk sentiment continued to put some downward pressure on the US dollar on the back of hopes that a resolution of the pandemic and spillover effects from US fiscal policy would kick start and nurture a strong global cyclical upswing.

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, there was an upgrade of the outlook as a result of a combination of ongoing vaccinations, learning effects on how to live with the pandemic and the additional fiscal stimulus in the United States. In the March 2021 ECB staff macroeconomic projections for the euro area, global activity and trade had been revised up over the projection horizon after the global economy bounced back during the second half of 2020 at a faster pace than envisaged. Based on the latest Purchasing Managers' Index (PMI), output in services had particularly improved of late. Global trade was not yet back to pre-crisis levels and the pace of trade expansion had stalled at the turn of the year, with trade in services continuing to be a drag on overall trade owing to limitations on travel and tourism. Since the Governing Council's January monetary policy meeting, oil prices had risen by 23% and had climbed to USD 67.8 per barrel, close to pre-pandemic levels. In terms of the exchange rate, the euro had depreciated against the US dollar (-2.0%) but remained broadly stable in nominal effective terms (-0.3%).

Turning to the euro area economy, growth in the last quarter of 2020 had been stronger than expected, but the ongoing restrictions would have a negative impact on growth in the first quarter – and perhaps also the second quarter – of 2021. Based on the March 2021 staff projections, real GDP would recover to exceed its pre-crisis level (of the fourth quarter of 2019) in the second quarter of 2022 and continue to increase at a robust rate thereafter. However, the recovery was expected to vary across the different GDP components and to rely quite heavily on fiscal support over the next two years.

Zooming in on the latest economic developments, containment measures had had to remain stricter in the first quarter of 2021 than previously expected, holding back the near-term recovery but not really changing the overall path. Based on the latest PMIs for February, the divergence in manufacturing and services growth dynamics was expected to continue.

Household savings continued to mirror pandemic-driven consumption dynamics. Savings seemed to have been accumulated mostly by older households, who typically had a lower propensity to consume out of income and wealth. They were therefore less likely to spend their savings as soon as lockdown measures were relaxed. By contrast, the younger population had seen a bigger deterioration in their financial situation, with low-skilled services and jobs particularly hit by the pandemic. Linked to recent delays in vaccination campaigns, households expected normal activities to resume with some delay.

Investment remained quite resilient overall. Data for the production of capital goods gave encouraging signals about ongoing business investment. The resilience in capital goods production was also supported by foreign demand. Housing investment was expected to remain subdued in the near term.

Trade had weakened at the turn of the year, driven mainly by weak intra-euro area exports, notwithstanding continued growth in extra-euro area exports. Leading indicators for manufacturing exports had continued to rise based on improvements in both shipping and survey indicators available for February.

Labour markets remained resilient on the back of strong fiscal support but some indicators pointed to vulnerabilities further ahead. Overall, survey indicators of employment perceptions had risen somewhat, indicating an expansion for the first time since the onset of the pandemic, but developments remained uneven across countries and sectors. The low-tech services sectors were those most adversely affected by the second and third waves of the pandemic. With the tightened restrictions, the importance of job retention schemes had increased again in recent months.

Turning to nominal developments, the short-term inflation outlook for 2021 had been revised up in the March 2021 ECB staff projections, while the inflation path embedded in the December 2020 Eurosystem staff projections was broadly confirmed for the outer years of the projection horizon. The projected profile of inflation in the Harmonised Index of Consumer Prices (HICP) was quite volatile, mainly as a result of energy prices. HICP inflation was expected to jump from 0.3% in 2020 to 1.5% in 2021, before falling back to 1.2% in 2022, and to increase again to 1.4% in 2023. The profile for HICP inflation excluding energy and food (HICPX) had shifted up somewhat, showing a gradual increase from 0.7% in 2020 to 1.3% in 2023.

Zooming in on recent developments, headline inflation had increased sharply to stand at 0.9% in January and February, after four consecutive months at -0.3%. The unchanged rate in February 2021 was the result of less negative energy inflation being offset by a decline in HICPX inflation to 1.1% in February (from 1.4% in January), which was substantially higher than the 0.2% recorded in the last four months of 2020.

The recent upswing in headline inflation reflected a number of factors, including less negative energy inflation, the end of the temporary VAT rate reduction in Germany, changes in sales patterns (timing and volumes) in some countries and the stronger than usual changes in HICP weights for 2021. Linked to the tightening of containment measures, the share of price imputations in the HICP increased further in January. The overall impact of price imputations on the change in HICP inflation remained unclear, adding to the high uncertainty as to whether the recent pick-up in inflation signalled genuinely increasing price pressures.

Key wage measures, based on national accounts data such as compensation per employee or compensation per hour, continued to be strongly affected by the effects of job retention schemes. Relatively strong growth in unit labour costs had continued to contribute positively to developments in the GDP deflator, counterbalancing the effects of lower contributions from profit margins. As a result, the GDP deflator had risen slightly from 1.0% in the third quarter to 1.1% in the fourth quarter of 2020.

As regards inflation expectations, the ECB’s Survey of Professional Forecasters (SPF) for the first quarter of 2021 had recorded an upward revision of short and medium-term inflation expectations, while longer-term inflation expectations had increased only very slightly. Market-based measures of inflation expectations stood somewhat above the levels observed around the Governing Council’s January monetary policy meeting, with the five-year forward inflation-linked swap rate five years ahead standing at 1.42% on 8 March 2021, compared with 1.32% on 19 January.

Turning to financial conditions in the euro area, there had been an increase in nominal [government bond] yields at the long end of the curve, an improvement in risk attitude, an increase in inflation-linked swap rates, a decline in sovereign bond risk premia and a slight depreciation of the euro. The sell-off in bond markets had been synchronised and broad-based across major advanced economies, pointing to an important global factor. Looking at corporate bond markets, default rates of high-yield issuers remained much lower than in past crisis episodes. Short-term earnings expectations had deteriorated across almost all sectors since the January monetary policy meeting. Indices of financial conditions assign different weights to developments in financial markets and their respective signals could therefore differ somewhat. While increases in long-term yields signalled some tightening in conditions, the strong stock market and the slight depreciation of the euro pointed to a loosening.

Regarding monetary developments, money growth continued to be strong − with broad money (M3) growing at an annual rate of 12.5% to January 2021 − amid a large footprint of Eurosystem asset purchases, which remained the largest source of money creation. The narrow monetary aggregate M1 remained the main contributor to broad money growth. Short-term monetary dynamics also remained strong. The monthly flow of January was weaker and largely driven by more volatile components. Growth in bank loans to non-financial corporations continued to moderate across countries, as reflected in monthly flows. The slowdown in the growth of lending reflected firms' substantial liquidity buffers but also the continued postponement of fixed investment and a perceived tightening of credit standards. Bank lending rates to firms remained close to historical lows, reflecting the continued pass-through of recent monetary policy accommodation. However, the decline in nominal rates in the euro area throughout 2020 had been counterbalanced by lower inflation expectations for much of this period, keeping real rates above pre-pandemic levels.

Turning to fiscal policies, according to the March 2021 projections, the 2020 budget deficit was expected to be smaller than foreseen in the December 2020 projections due to better economic developments and less need for support than previously expected. As partly anticipated, a sizeable additional stimulus was foreseen for 2021 in response to new lockdown measures. Nonetheless, the budget balance was projected to improve over the forecast horizon – from a deficit of 7.2% in 2020 to a deficit of 2.4% in 2023. This reflected not only a fiscal pull-back stemming from the winding-down of pandemic-related measures but also the reaction of automatic stabilisers and improvements linked to low interest rates.

Monetary policy considerations and policy options

Summing up, Mr Lane noted that, while the overall economic situation would improve throughout 2021, uncertainty in the euro area remained high, owing in particular to the persistently high rates of COVID-19 infection, the spread of virus mutations and the speed of vaccination campaigns. While the rebound in global demand and additional fiscal support measures were supporting global and domestic activity, the near-term economic outlook remained challenging.

Looking beyond the short-term weakness, euro area economic activity was expected to gain momentum in the course of the year. Over the medium term the recovery in the euro area economy should be supported by favourable financing conditions, an expansionary fiscal stance and a recovery in demand as containment measures were gradually lifted. Accordingly, the March 2021 staff projections foresaw growth rebounding to 4.0% in 2021 and to 4.1% in 2022, before stabilising at 2.1% in 2023.

The risks surrounding the euro area growth outlook over the medium term had become more balanced, although downside risks remained in the near term. On the one hand, better prospects for the global economy, which had been bolstered by the sizeable fiscal stimulus, and progress in vaccination campaigns were encouraging. 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.

According to Eurostat's flash estimate, headline inflation had risen sharply to 0.9% in January and February 2021 (from -0.3% in December 2020), mainly owing to an increase in energy price inflation and several idiosyncratic factors. At the same time, underlying price pressures remained subdued in the context of weak demand and significant slack in labour and product markets. Survey-based measures and market-based indicators of longer-term inflation expectations remained at low levels (compared with the Governing Council's inflation aim), although the market-based indicators had continued to rise gradually. Looking ahead, inflation was expected to increase temporarily, reaching 2.0% towards the end of the year. The March 2021 staff projections foresaw HICP inflation averaging 1.5% in 2021, 1.2% in 2022 and 1.4% in 2023.

The overriding theme in euro area and global financial markets had been the continued rise in longer-term risk-free interest rates and sovereign bond yields. In the overall context of a holistic and multifaceted approach to evaluating financing conditions (spanning the entire transmission chain of monetary policy), developments in risk-free interest rates and sovereign yields were particularly relevant. First, these market interest rates could be more directly influenced by the Governing Council's monetary policy measures, notably its asset purchases. Second, risk-free rates and sovereign yields were leading indicators for financing conditions at the later stages of transmission. These were the key benchmark rates used in the pricing of other capital market instruments – such as corporate and bank bonds – as well as the pricing of bank loans to households and firms. It followed that shocks originating in the risk-free and sovereign bond markets tended to trickle down the transmission chain and influence downstream indicators of financing conditions with a lag. Accordingly, developments in risk-free interest rates and sovereign bond yields, which were measurable in real time, could give warnings about potential developments in the later stages of the transmission chain with a lag.

In December, the Governing Council had pledged to preserve favourable financing conditions over the pandemic period and to prevent any tightening that was inconsistent with countering the negative pandemic shock to the projected inflation path. A sizeable and persistent rise in market interest rates that would prematurely tighten financing conditions for all sectors of the economy could challenge that commitment, especially in the context of a largely unchanged inflation outlook, as indicated by the March staff projections.

Based on a joint assessment of the favourability of current financing conditions and the inflation outlook, Mr Lane proposed that net purchases under the pandemic emergency purchase programme (PEPP) over the next quarter be conducted at a significantly higher pace than during the first few months of the year. This fulfilled the Governing Council's pledge to calibrate PEPP purchases, as appropriate, in order to preserve favourable financing conditions to help counter the negative pandemic shock to the projected path of inflation. The monthly purchase pace would continue to be implemented flexibly according to market conditions.

The Governing Council should review the purchase pace on a quarterly basis at its monetary policy meetings, based on joint assessments of financing conditions and the inflation outlook. If conditions were such that favourable financing conditions (in the context of the inflation outlook) could be preserved with a slower pace of purchases, the Governing Council could scale down the pace. Likewise, the Governing Council could always scale up the pace of purchases if that was required to preserve favourable financing conditions. Furthermore, the flexibility of purchases over time, across asset classes and among jurisdictions would continue to support the smooth transmission of monetary policy.

The proposed significant increase in the purchase pace under the PEPP constituted a proportionate response to the risks that rising market interest rates posed to broader financing conditions and, thus, ultimately to the price stability mandate. Sizeable and persistent shifts in market interest rates, if left unchecked, were likely to withdraw monetary stimulus prematurely at a time when preserving favourable financing conditions remained necessary to underpin economic activity and safeguard medium-term price stability. Flexibly implemented asset purchases were a suitable monetary policy instrument that remained more efficient than alternative tools for preserving favourable financing conditions in the current pandemic environment characterised by high uncertainty. Their benefits for achieving the ECB's price stability mandate also clearly outweighed any potential negative effects on other economic policy domains.

The Governing Council also needed to reiterate that 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. This needed to be underlined in public communication, alongside restating the established forward guidance on the ECB's key interest rates and asset purchase programmes.

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 the risks to economic activity provided by Mr Lane in his introduction. While the overall economic situation was seen to improve during 2021, uncertainty surrounding the near-term economic outlook remained, relating in particular to the dynamics of the pandemic and the speed of vaccination campaigns. The rebound in global demand and additional fiscal measures were supporting global and euro area activity, but persistently high COVID-19 infection rates, the spread of virus mutations and the associated extension and tightening of containment measures were weighing on euro area economic activity in the short term. Looking ahead, the ongoing vaccination campaigns, together with the envisaged gradual relaxation of containment measures, underpinned the expectation of a firm rebound in economic activity in the course of 2021. Inflation had picked up over recent months, mainly on account of some transitory factors and an increase in energy price inflation, but underlying price pressures remained subdued in the context of weak demand and significant slack in labour and product markets.

As regards the external environment, members broadly shared Mr Lane's assessment that the global economic recovery in 2020 had been faster than expected and that the outlook had improved in the context of ongoing vaccinations and learning effects on how to live with the pandemic. Attention was drawn to the fact that the additional US fiscal stimulus package (part of the Biden Administration's American Rescue Plan – the so-called "Biden plan") had not been factored into the March 2021 ECB staff projections, as the stimulus package had not been passed into legislation at the time the projections were finalised. This was seen to constitute an upside risk to the global and, consequently, euro area economic outlook as embedded in the staff projections. At the same time, the point was made that the impact of the Biden plan and the implications for the EUR/USD exchange rate depended on the type of open economy macro-model one had in mind and that spillovers were hard to quantify.

Turning to euro area developments, real GDP had declined by 0.7% in the fourth quarter of 2020 following the strong rebound observed in the third quarter. Incoming economic data, surveys and high-frequency indicators pointed to continued economic weakness in the first quarter of 2021 driven by the persistence of the pandemic and the associated containment measures. As a result, real GDP was likely to contract again in the first quarter, but was then expected to rebound firmly in the course of the year. Overall, members generally agreed with the baseline view for economic growth in the March 2021 staff projections and noted that it was broadly unchanged from the December 2020 Eurosystem staff projections. However, some nuances were expressed.

On the one hand, it was stressed that real GDP growth had been repeatedly underestimated in successive quarters over the past year, pointing to the economy being more resilient than expected. It was argued that, beyond the short term, there could be grounds for a more optimistic view than had been taken by ECB staff on the medium-term outlook if, for example, assumptions regarding the evolution of the saving ratio turned out to be too conservative. Other reasons for being more optimistic were the passing by the US Congress of the Biden plan, whose fiscal impulse would exert a positive effect on euro area economic growth, as shown in staff analysis, and stronger global trade and activity more broadly, together with greater confidence about the path beyond the pandemic emergency, compared with the situation in December.

On the other hand, it was noted that, compared with the December projections, the higher level of activity going forward was essentially reflecting a carry-over effect from past outturns. It was also noted that the projection for the first quarter of 2021 had been revised down and largely offset the better than expected outcome for the fourth quarter of 2020. Some caution was expressed that real GDP growth in the first quarter could be weaker than foreseen in the March projections, even though this might then be offset by a correspondingly stronger rebound in subsequent quarters.

Members underlined the uncertainty surrounding the near-term growth outlook. The baseline continued to depend on the evolution of the pandemic and while uncertainty had decreased, it still remained high. Reference was made to the slow pace of vaccination compared with other parts of the world. Questions were raised as to how realistic it was to assume that containment measures would be reduced as early as the second quarter and it was pointed out that, depending on the further evolution of the pandemic, weakness in activity might continue well into the second quarter and beyond.

Some concern was expressed that the true situation of the business and household sectors would only become apparent once the government support and guarantee schemes in response to the pandemic were phased out. This related, in particular, to the risk of insolvencies and their impact on bank balance sheets. The potential emergence of financial amplification loops would then also affect the medium-term economic outlook. It was also recalled that economic developments continued to be uneven across economic sectors, as the containment measures affected the services sector more adversely than the manufacturing sector.

With respect to the euro area household sector, reference was made to the assumption in the baseline of the staff projections that the saving ratio would gradually return to pre-crisis levels, but that there would be no substantial unwinding of the excess savings accumulated during the pandemic period. The point was made that this assumption might be too conservative and implied upside risks to growth if precautionary motives had played no significant role and the high amount of accumulated savings simply reflected a lack of spending opportunities. This pointed to considerable potential for pent-up demand being unleashed once containment measures were eased. At the same time, it was stressed that euro area countries were rather heterogeneous and that debt vulnerabilities, which to some extent predated the pandemic, had been exacerbated. Hence, it was conceivable that the saving ratio would remain higher than before, reflecting heightened caution and future deleveraging needs. Moreover, it was pointed out that there was still some risk that the unemployment rate would turn out to be higher than expected if jobs could not be preserved once the current job retention schemes expired.

In their assessment of the balance of risks, members re-emphasised the dichotomy between continued elevated risks to the outlook in the short term and more positive developments in the medium term. While the degree of uncertainty was still high, it was seen to have lessened compared with at the time of the December projections. It was noted that financial market dynamics suggested a rather positive outlook. It was pointed out that some downside risks seen as prevailing in December had meanwhile been taken into account in a downward revision to growth in the first quarter of 2021 and that others had become smaller as the vaccination process had got under way. In addition, there were factors such as the Biden plan fiscal package which implied clear upside risks to the staff projections. Hence, while the pandemic continued to imply downside risks, the balance of risk was now shifting and becoming more balanced, or possibly even starting to shift to the upside, having been on the downside at the time of the Governing Council's December monetary policy meeting and seen some improvement at the time of the 20-21 January meeting.

Overall, members judged that the risks surrounding the euro area growth outlook over the medium term had become more balanced, although downside risks remained in the near term. On the one hand, better prospects for global demand, which had been bolstered by the sizeable fiscal stimulus, and the progress in vaccination campaigns were encouraging. 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 still seen as critical in view of the sharp contraction in the euro area economy. To this end, continued support from national fiscal policies remained warranted given weak demand from firms and households due to the ongoing pandemic and the associated containment measures. At the same time, fiscal measures taken in response to the pandemic emergency should, as much as possible, remain temporary and targeted in nature to address vulnerabilities effectively and to support a swift recovery.

The key role of the Next Generation EU package and the importance of it becoming operational without delay were underlined. Member States were called upon to ensure a timely ratification of the Own Resources Decision, to finalise their recovery and resilience plans promptly and to deploy the funds for productive public spending, accompanied by productivity-enhancing structural policies. This would allow the Next Generation EU programme to contribute to a faster, stronger and more uniform recovery and would increase economic resilience and the growth potential of Member States' economies, thereby supporting the effectiveness of monetary policy in the euro area. Such structural policies were particularly important in addressing long-standing structural and institutional weaknesses and in accelerating the green and digital transitions. Against this background, it was argued that in considering the fiscal stimulus in the United States, one should not overlook that more fiscal stimulus was in the pipeline also in euro area countries and that the disbursements of the Next Generation EU recovery fund were still to come.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. Euro area annual HICP inflation had increased sharply, standing at 0.9% in January and February 2021 after -0.3% in December 2020. The upswing in headline inflation reflected a number of idiosyncratic factors, such as the end of the temporary VAT rate reduction in Germany, delayed sales periods in some euro area countries and the impact of the stronger than usual changes in HICP weights for 2021, as well as higher energy price inflation. On the basis of current oil futures prices, headline inflation was likely to increase further in the coming months, but some volatility was to be expected. These factors could be expected to fade out of annual inflation rates early next year. Underlying price pressures were expected to increase somewhat this year due to current supply constraints and the recovery in domestic demand, although pressures were expected to remain subdued overall, also reflecting low wage pressures and the past appreciation of the euro. Once the impact of the pandemic was fading, the unwinding of the high level of slack, supported by accommodative fiscal and monetary policies, would contribute to a gradual increase in inflation over the medium term.

According to the March 2021 ECB staff projections, the outlook for inflation had been revised up for 2021 and 2022, largely due to temporary factors and higher energy price inflation, while it was unchanged for 2023. While the projections foresaw a gradual increase in underlying inflation pressures, they confirmed that the medium-term inflation outlook remained broadly unchanged from the Eurosystem staff projections in December 2020 and below the Governing Council's inflation aim.

In discussing the inflation outlook, members generally agreed that the large upward surprise in the latest HICP data and the upward revision to headline inflation for 2021 in the March 2021 ECB staff projections were mainly due to temporary factors which could be expected to fade away. At the same time, it was observed that there had been a small upward surprise in the latest HICP data also after accounting for the temporary factors.

It was highlighted that the medium-term outlook for headline inflation in the March 2021 ECB staff projections was broadly unchanged from the December 2020 Eurosystem staff projections and thus remained well below the Governing Council's inflation aim and below the projections prevailing just before the onset of the pandemic. At the same time, it was recalled that spillovers from the Biden plan fiscal package to the euro area had not been taken into account in the current inflation projections, but would lead to an upward impact when doing so in subsequent projections.

As regards inflation expectations, survey-based measures and market-based indicators of longer-term inflation expectations had remained at subdued levels, although the market-based indicators were continuing to rise gradually. It was noted that part of this upward trend might reflect “imported” inflation expectations from outside the euro area, but also that long-term inflation expectations had risen more strongly in the euro area than in the United States since the beginning of the year.

Members also considered the implications that the expected temporary increase in headline inflation to around 2% later in 2021 could have on inflation expectations. On the one hand, it was suggested that there could be an upward impact if inflation expectations were backward looking. On the other hand, it was pointed out that economic agents would likely look through the temporary rise in inflation. However, it was also reported that contacts with businesses pointed to a perception of higher inflation in a context of spikes in commodity prices, supply bottlenecks and rising production costs. This warranted a close monitoring of producer price developments going forward.

Turning to the monetary analysis, members concurred with the assessment provided by Mr Lane in his introduction. Strong money growth had continued to be supported by the ongoing asset purchases of the Eurosystem, which remained the largest source of money creation. Developments in loans to the private sector had been characterised by somewhat weaker lending to non-financial corporations and resilient lending to households. A question was raised regarding the information content of money growth for medium-term inflation at a time when secular forces still seemed to be holding down the natural rate of interest and the Phillips curve relationship appeared to have weakened. Attention was drawn to the potential consequences of the prolonged pandemic crisis for the liquidity and solvency of non-financial corporations, which could eventually result in higher defaults, especially when public support and moratoria expired. Reference was also made to the tightening of credit conditions expected by banks, according to the latest bank lending survey. The prospect of increasing non-performing loans in the banking sector bore a risk of creating financial amplification loops, which ultimately could also cloud the medium-term economic outlook and give rise to financial stability risks.

Monetary policy stance and policy considerations

With regard to the assessment of financial and financing conditions, there was broad agreement among members that financing conditions were to be assessed on the basis of a holistic and multifaceted set of indicators covering the entire chain of monetary policy transmission. Longer-term risk-free interest rates and sovereign bond yields in the euro area had increased since the Governing Council’s early December meeting. This reflected, in part, spillovers from US bond yield increases on the back of the expected US fiscal stimulus, as well as rising commodity prices and improved growth prospects globally, as new global COVID-19 infections had declined and vaccination campaigns were proceeding. Although a better economic outlook in the United States also entailed positive demand effects for the euro area, it was observed that the optimism prevailing on financial markets, reflected in "reflation trades", seemed not to be shared by businesses and households, which had generally maintained a cautious stance.

At the same time, the view was held that the increase observed in sovereign yields had remained contained and to some extent decoupled from developments in the United States. Moreover, financing conditions for the non-financial private sector had remained very favourable overall, also on account of ample monetary policy support. In this context, the important role of both the PEPP and the supportive communication by the President and Governing Council members were underlined, which had helped to dampen the increase in euro area yields and contributed to the partial decoupling in the face of the global bond market sell-off.

It was also noted that these increases had taken place from very low levels and that other indicators of financing conditions, such as lending rates for non-financial companies and households, as well as sovereign spreads and credit spreads, remained highly accommodative. However, it was also argued that, while a holistic and multifaceted approach to assessing the favourability of financing conditions along the entire transmission chain of monetary policy was deemed appropriate, special attention needed to be paid to sovereign yields and risk-free interest rates, which played a key role for financing conditions at the later stages of the transmission chain. In this context, it was remarked that a rise in risk-free interest rates and GDP-weighted sovereign yields needed to be pronounced and persistent in order to exert a material impact on broader financing conditions. The role of the targeted longer-term refinancing operations, which could shield banks somewhat from possible increases in market-based funding costs, was also underlined.

Members concurred with Mr Lane that ample monetary stimulus remained necessary to preserve favourable financing conditions over the pandemic period in order to ensure a sustained convergence of inflation towards the Governing Council's aim. It was emphasised that the assessment of financing conditions and the inflation outlook had to be undertaken jointly and that the assessment of favourable financing conditions would have to evolve over time. The focus of the Governing Council's December decisions had been on countering an unwarranted and premature tightening of financing conditions, rather than preserving any particular level. A possible misperception that the Governing Council was engaging in a form of implicit yield curve control had to be avoided. However, the view was also expressed that, as long as the medium-term inflation outlook remained unsatisfactory, the Governing Council needed to preserve financing conditions close to the favourable levels observed in December to bring inflation back to the projected pre-pandemic path. Any material tightening in financing conditions, irrespective of the underlying driver and origin, would delay the convergence of inflation to the

Governing Council's aim of below, but close to, 2% in the medium term. In this context, the view was held that the Governing Council had to look through the recent spike in inflation and focus instead on the continued shortfall of inflation from the Governing Council's aim. However, the point was also made that the financing conditions that had prevailed in December 2020, as well as the pre-pandemic staff projections for inflation, could become less relevant over time in the light of other shocks that had occurred in the intervening period.

Against this background, although the risks to the economic outlook for the euro area were becoming more balanced over the medium term, the recent tightening of financing conditions was generally seen as premature for the euro area, which was still in a weaker cyclical position than the United States. On the basis of the March staff projections, the euro area inflation and growth outlook had remained largely unchanged since the Governing Council's December meeting. This was widely seen to call for a continuing high degree of accommodation.

At the same time, it was underlined that, to assess the favourability of financing conditions, it was necessary to understand the underlying drivers of the rise in risk-free rates. Real yields in the euro area had not increased materially since December and had even declined at short maturities, indicating that the pick-up in nominal yields reflected almost entirely markets' reappraisal of the inflation outlook. Moreover, it was argued that higher real rates were not necessarily a cause for concern and should not trigger a policy intervention if they reflected higher growth prospects rather than higher real term premia. In this context, a remark was made that assessing developments in real interest rates was subject to uncertainty as regards the measurement of the relevant inflation expectations.

In view of the Governing Council's commitment to maintaining favourable financing conditions, adopted at its early December meeting, there was broad consensus among members that the recent rises in risk-free rates and GDP-weighted sovereign yields required a scaling-up of the pace of purchases under the PEPP. Since longer-term sovereign yields figured prominently among the key variables used to evaluate financing conditions and were indicative of future changes in other components of financing conditions, a significant increase in the pace of PEPP purchases for the next three months was widely seen as warranted.

All in all, members expressed broad support for Mr Lane's proposal to conduct purchases under the PEPP over the next quarter at a significantly higher pace than during the first few months of the year. A significant increase in the purchase pace for the next three months was seen as warranted by the observed tightening of financing conditions and the lack of a material improvement in the growth and inflation outlook. The proposal was also deemed proportionate in the light of the ECB's mandate, balancing increased optimism about the medium-term outlook against the considerable uncertainty that still prevailed in the shorter term.

Consideration was given to the appropriate size of the increase in the pace of purchases. It was highlighted that, to give a clear message to markets on the Governing Council's "reaction function", the purchase volume needed to be increased significantly, as proposed by Mr Lane. This would send a strong signal that the Governing Council wanted to lean against the tightening of financing conditions. However, it was also argued that a more moderate increase in the pace would better reflect the assessment of more balanced risks to the outlook, also in the light of previous decisions when a similar pace had been chosen but economic conditions had been worse. Although risk-free rates and GDP-weighted sovereign bond yields had increased, it was observed that this had occurred mostly on account of higher expected inflation and a better outlook for the global economy. In this context, it was remarked that the Governing Council needed to avoid giving the impression of being overly focused on sovereign yields or reacting mechanically to a set of indicators of financing conditions. Moreover, the view was put forward, that the tightening might not be sizeable and persistent enough to affect broader financing conditions materially.

Overall, there was wide agreement that the purchase pace needed to take into account a joint assessment of the favourability of current financing conditions and the inflation outlook. Against this background, all members joined a broad consensus around the proposal put forward by Mr Lane, on the understanding that the total PEPP envelope was not being called into question in the current conditions and that the pace of purchases could be reduced in the future. In this context, the flexibility of purchases over time was seen as essential for reacting to changes in financing conditions as needed over time. The decision to accelerate the purchase pace significantly would show that the Governing Council was willing to use the flexibility of the programme, without changing the overall envelope or duration of the programme. The envelope could, however, be recalibrated if required in order to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation. Equally, 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. It was underlined that the flexibility embodied in the PEPP was symmetric, implying that the purchase pace could be increased and decreased according to market conditions.

Looking ahead, members agreed that the Governing Council would undertake a quarterly joint assessment of financing conditions and the inflation outlook in order to determine the pace of purchases needed to keep financing conditions favourable. At the same time, it was also deemed important that in the intervening period flexibility in the pace of purchases continued to be applied according to market conditions.

As regards communication, it was seen as essential that the Governing Council reiterated its commitment to stand 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. It was important to provide reassurance that the Governing Council would maintain an accommodative monetary policy for as long as necessary and saw no risk of overheating in the euro area in the present environment. Finally, in view of the sharp contraction of the euro area economy and the uneven recovery across sectors, it was deemed important to emphasise the need for continued support from fiscal policies to sustain the recovery.

Monetary policy decisions and communication

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

First, the Governing Council would continue to conduct net asset purchases under the pandemic emergency purchase programme (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 purchases under the PEPP over the next quarter 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.

Second, net purchases under the asset purchase programme (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.

Third, 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.

Finally, the Governing Council would continue to provide ample liquidity through its refinancing operations. In particular, the third series of targeted longer-term refinancing operations (TLTRO III) remained an attractive source of funding for banks, 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 11 March 2021]

Press release

[Monetary policy decisions]

Meeting of the ECB's Governing Council, 10-11 March 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 Vasiliauskas *

Mr Vasle

Mr Villeroy de Galhau

Mr Visco

Mr Weidmann *

Mr Wunsch

* Members not holding a voting right in March 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 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 Novo

Mr Ódor

Mr Rutkaste

Mr Sleijpen

Mr Tavlas

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 Friday, 14 May 2021