



EUROPEAN CENTRAL BANK

EUROSYSTEM

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

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on Wednesday and Thursday, 11-12 December 2019

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

Financial market developments

Mr Cœuré reviewed the latest financial market developments. Since the Governing Council's previous monetary policy meeting on 23-24 October 2019, there had been signs of increased optimism among market participants. Global bond yields had remained at some distance above the very low levels that had been observed towards the end of summer 2019. Global stock prices were at, or close to, historical highs. All in all, financial market participants were less pessimistic and were pricing in less additional accommodation by central banks than earlier in the year.

Global sovereign bond markets had been much quieter over the previous few weeks than they had been prior to the 23-24 October monetary policy meeting, when prospects of a breakthrough in the trade negotiations between the United States and China had pushed up ten-year US Treasury and German government bond yields. Since then, yields had moved broadly sideways, with German ten-year sovereign bond yields oscillating at around -30 basis points.

There were likely two main reasons why yields had not continued on an upward trajectory. First, the outlook remained less favourable than at the start of 2019 and there was still no breakthrough in the resolution of the two major risk factors currently facing the global economy, i.e. the imposition of tariffs and Brexit. Second, monetary policy easing by major central banks, including the ECB, had put persistent downward pressure on yields.

Since September 2019 expectations of a further easing of monetary policy in the euro area had undergone a reversal, which had affected the entire forward interest rate curve. There were currently only limited expectations of a further cut in the ECB's deposit facility rate over the following 12 months. At the same time, the prospect of a tightening had also remained far out in the future, with a first full 10 basis point hike not priced in until the end of 2022.

Mr Cœuré also provided an update on the progress and impact of the two-tier system of reserve remuneration. The share of banks' unused allowances had dropped sharply after the implementation of the Governing Council's decision on the two-tier system. Many banks had been fast to make full use of their allowances, in part through cross-border borrowing in money markets, which was also reflected in trading volumes.

The impact on unsecured short-term money market rates, such as the €STR, had been very limited. The occasional spikes in €STR volatility were attributed to other factors unrelated to the two-tier system. At the same time, there had been a notable initial increase in repurchase agreement market rates in some jurisdictions in response to the launch of the tiering system, but it had not been persistent.

Global equity prices had increased measurably as the prospects of a breakthrough in trade negotiations had improved. The EURO STOXX50 index had gone up by 2% since the Governing Council's monetary policy meeting on 23-24 October 2019 and the S&P 500 by almost 5%, hitting a new all-time high. At first sight, stock

and bond market developments seemed to be somewhat out of sync. However, stock markets were currently being driven by short-term factors, including the recent drop in risk aversion, while earnings expectations suggested that both stock and bond market investors remained very cautious about the medium-term growth and inflation outlook.

The near-term global outlook had possibly been supported by the substantial easing of financial conditions in some emerging markets on the back of a reversal in portfolio flows. Since the start of 2019, investors had resumed channelling funds into emerging bond markets despite the ongoing trade tensions and broader uncertainty in financial markets.

The effective exchange rate of the euro had also continued to move broadly sideways, reflecting, among other things, very limited movements against the US dollar. The notable exception to these broadly stable exchange rate developments was the pound sterling, which had risen by 9% since mid-August 2019, when the risk of a no-deal Brexit had peaked.

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

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

Regarding the external environment, the pace of global activity had remained subdued. The projected annual growth rate of global activity excluding the euro area stood at 2.9% in 2019, its lowest level since 2008-09. Nonetheless there were signs of a stabilisation in the outlook for global GDP. Compared with the September 2019 ECB staff projections, growth in global activity had been revised down though, reflecting less dynamic activity in some emerging markets.

News regarding trade growth had been mixed, while uncertainty remained elevated. In some emerging economies there were tentative signs that growth was stabilising, thanks in part to fiscal support. However, this reflected domestic activity in particular and did not necessarily imply an upward revision to imports. Risks to global trade hence also remained on the downside.

Global financial conditions had eased moderately since the Governing Council's previous monetary policy meeting in October. In particular, global equity prices had continued to rise on account of improved risk sentiment, amid a retrenchment of safe-haven flows. Oil prices had increased by 10.7% since the October meeting on the back of tighter oil supply following the OPEC+ extension of production cuts. The euro had depreciated somewhat both against the US dollar and in nominal effective terms.

Turning to the euro area, in the December 2019 Eurosystem staff projections, real GDP growth was almost unrevised compared with the September 2019 ECB staff projections: real GDP was expected to increase by 1.1% in 2020, 1.4% in 2021 and 1.4% in 2022. The risks surrounding the euro area growth outlook remained tilted to the downside but had become somewhat less pronounced. While the growth outlook remained muted in the near term, a moderate recovery was expected later on, reflecting the assumption of some dissipation of global headwinds, which would allow the fundamentals supporting growth to regain traction.

Since the last Governing Council meeting, economic news, as perceived by market participants, had become less negative. Overall, business surveys since mid-September suggested a stabilisation in output growth at moderate rates. The weakness in the manufacturing sector continued, although the Purchasing Managers' Index (PMI) on euro area manufacturing output, which had been in contraction territory since February 2019, recorded a slight rebound to 47.4 in November 2019. At the same time, spillovers to the rest of the economy remained contained. Economic sentiment in the services sector, albeit declining, remained slightly above its long-run average, while construction, retail trade and consumer confidence continued to stand clearly above their 1999-2019 averages.

Private consumption continued to be supported by higher labour income, which remained the main driver of real disposable income. Looking ahead, real disposable income and private consumption growth were expected to remain solid, albeit declining somewhat on account of weakening employment dynamics. At the same time, some near-term moderation in housing investment was suggested by a range of indicators, including residential investment, construction confidence and building construction production. Business investment growth was expected to weaken further in the near term, given the fall in industrial production and the rise in uncertainty about manufacturing activity, which was contributing to investment being postponed.

As regards developments in euro area labour markets, sectoral indicators pointed to a further moderation in labour market conditions, largely driven by the manufacturing sector. National accounts data for the third quarter showed that employment growth had declined to 0.1% (in quarter-on-quarter terms), from 0.2% in the second quarter of 2019 and from 0.3% in the first. The PMI on employment had edged up in November to 51.8, remaining in contractionary territory for manufacturing and in expansionary territory for services and construction.

National accounts statistics confirmed persistent weakness in euro area exports of goods and services in the third quarter of 2019. Extra-euro area exports of goods had been stable as the negative contribution from Asia was offset by the positive contribution from the United States, while intra-euro area trade had proved weaker, especially in intermediate goods.

Turning to price developments, according to Eurostat's flash estimate, annual HICP inflation had increased from 0.7% in October to 1.0% in November, mainly reflecting higher services and food price inflation. HICP inflation excluding energy and food had increased from 1.1% in October to 1.3% in November. Measures of underlying inflation remained generally subdued, although there were some indications of a mild increase, which was in line with previous projections.

In the December 2019 Eurosystem staff projections, HICP inflation was projected to be 1.1% in 2020, 1.4% in 2021 and 1.6% in 2022, reaching 1.7% at the end of the projection horizon. Projections for headline inflation as well as for HICP inflation excluding food and energy were broadly unrevised. This reflected the interplay between, on the one hand, upward pressures from a weaker exchange rate and higher oil prices, and, on the other hand, weaker global prices and staff taking a cautious view on domestic price dynamics.

In addition, certain indicators of underlying inflation had also been heavily affected by statistical effects in package holiday prices in the euro area's largest economy. Some indicators that excluded this component

suggested a very gradual but notable upward slope in the path of underlying inflation over recent years. At the same time, other measures showed a less convincing upward trajectory. Moreover, as HICP inflation only partially reflected changes in housing-related costs inflation measures would likely be higher currently if the cost of owner-occupied housing was accounted for.

Wage growth remained resilient but stronger labour cost pressures had been largely absorbed by profit margins. Annual growth in compensation per employee declined to 2.1% in the third quarter of 2019, down from 2.2% in the second quarter and 2.3% in the first, although it remained close to its long-term average (2.1%) and substantially above its low of 1.1% in the second quarter of 2016. At the same time, profit margin growth, following its significant weakening in 2018 on account of the slowdown in economic activity, had started to recover tentatively but remained negative in the third quarter of 2019. The recent slowdown in foreign and domestic demand had particularly affected activity in the industrial sector, where unit profit growth was highly correlated with the business cycle, and less so services activity, for which the correlation tended to be somewhat lower.

Average point estimates for longer-term inflation expectations in the Survey of Professional Forecasters had declined in each quarter of 2019 and stood at 1.67% in the fourth quarter of the year, down from 1.88% in the final quarter of 2018. Euro area market-based indicators of medium to longer-term inflation expectations had remained at low levels. Like other indicators, the five-year forward inflation-linked swap rate five years ahead, currently at 1.24%, continued to hover somewhat above the all-time low (of 1.12%) reached in early October 2019.

Turning to euro area financial conditions, the EONIA forward curve had shifted up further since the Governing Council's October monetary policy meeting, reflecting generally favourable risk sentiment owing to promising trade talks between the United States and China and a tentative stabilisation of the macroeconomic outlook. The forward curve now showed only a slight inversion, with its trough slightly above -0.5%. As term premia were now estimated to be close to zero – up from previously negative levels – “genuine” policy expectations had shifted by less than the forward curve suggested. At the same time, the estimated impact of the asset purchase programme (APP) on the compression of term premia in ten-year sovereign bonds remained sizeable.

Euro area equity prices had increased further for non-financial corporations since the October monetary policy meeting, while they remained largely unchanged for financial corporations. According to a dividend discount model, the increase in euro area non-financial equity prices was mainly driven by declines in the equity risk premium on the back of a perceived improvement in global risk sentiment. This was dampened by the ongoing decline in longer-term earnings expectations, which, however, showed some signs of stabilisation.

Turning to money and credit developments, the annual growth rate of broad money (M3) stood at 5.6% in October. This was almost entirely driven by annual M1 growth, with the decreasing opportunity cost of holding monetary assets being the main factor supporting robust broad money growth. From a counterpart perspective, credit to the private sector accounted for only about half of broad money creation, while net external monetary flows accounted for the other half.

Lending volumes continued to grow at a solid pace. The annual growth of bank loans to non-financial corporations was slightly below 4% in October, while that in credit to households reached 3.5% in October, with some differences across countries. The ECB's monetary policy measures continued to be passed through to bank lending rates. At the euro area level, the composite lending rate for non-financial corporations stabilised at 1.56% in October, while the cost of borrowing for households for house purchase stood at the historical low of 1.44%.

While a large part of banks' deposit funding, in particular retail deposits, remained floored at zero, the distribution of deposit rates to non-financial corporations continued to shift into negative territory in October 2019. At the same time, margin pressure was offset by the favourable developments in bank bond yields, despite recent increases. Moreover, while the net interest income earned by banks for each unit of their assets had been compressed, robust growth in intermediation volumes meant that the base for income generation was expanding. In addition, the two-tier reserve system was expected to reduce the cost for banks of holding excess liquidity.

The euro area fiscal stance was assessed as being expansionary over 2019-21, which would provide some support to demand conditions, and broadly neutral in 2022. The composition of fiscal expansion was tilted towards direct tax cuts and higher transfers. At the euro area level, the reduction in interest payments was estimated to offset around half of the budget effect of fiscal loosening.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that incoming data since the last monetary policy meeting pointed to continued weak but stabilising euro area growth dynamics. The ongoing weakness of international trade in an environment of persistent global uncertainties in combination with sector-specific domestic factors continued to weigh on the euro area manufacturing sector and was dampening investment. Private consumption remained resilient amid rising wages and favourable – albeit moderating – labour market developments. The December staff projections foresaw an increase in real GDP growth from 1.1% in 2020 (which was a slight downward revision) to 1.4% in both 2021 and 2022.

Although risks to the growth outlook remained tilted to the downside due to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, these risks had become somewhat less pronounced.

Bank lending conditions for firms and households had continued to improve, in a sign of continuing strong pass-through of monetary policy. In addition, equity prices had increased in line with improved market sentiment and the euro exchange rate had depreciated somewhat.

Measures of underlying inflation remained generally subdued, although there were some indications of a mild increase, which was in line with previous projections. Indicators of both market-based and survey-based inflation expectations had remained at or near historical lows. Solid and broad-based wage growth was expected to continue, and the profile of a gradual pick-up in inflation remained largely unchanged compared with the September 2019 ECB staff projections. The December 2019 Eurosystem staff projections foresaw

inflation increasing from an average of 1.2% in 2019 to an average of 1.6% in 2022, reaching 1.7% at the end of the projection horizon.

Overall, the Governing Council was still faced with an inflation outlook that was below its medium-term aim, and inflation expectations continued to stand at low levels. Significant action had been taken to support the rise of inflation towards the medium-term aim. The Governing Council would, therefore, closely monitor inflation developments and the impact of the unfolding monetary policy measures on the economy. Its strengthened forward guidance would ensure that financial conditions adjusted in line with changes to the inflation outlook.

Against this background, Mr Lane proposed to keep the monetary policy stance unchanged at today's meeting. This would entail reiterating the forward guidance on policy interest rates, net asset purchases and reinvestments.

At the same time, in its communication the Governing Council needed to stress that it stood ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards the aim in a sustained manner, in line with its commitment to symmetry.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, Governing Council members broadly agreed with the assessment of the outlook for economic activity in the euro area provided by Mr Lane in his introduction. Incoming information since the Governing Council's monetary policy meeting in October pointed to continued weak euro area growth dynamics, although there were some signs of stabilisation. The ongoing weakness of international trade amid persistent global uncertainties continued to weigh on the euro area manufacturing sector and was dampening investment growth. At the same time, the services and construction sectors had remained resilient, despite some recent moderation, with employment growth and increasing wages continuing to underpin the euro area economy. This outlook was broadly reflected in the December 2019 Eurosystem staff projections. The outlook for real GDP growth had been revised down slightly for 2020 compared with the September 2019 ECB staff projections.

Regarding the outlook for the external environment, it was noted that the global outlook remained weak, with a further downward revision to the outlook for both global growth and trade in the December 2019 Eurosystem staff projections. This was illustrated by the fact that the latest projections now foresaw growth in global trade excluding the euro area of below 1% in 2020, compared with an increase of over 2% in the September 2019 ECB staff projections.

Members assessed the risks to the external environment as having remained on the downside overall, due to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, with reference being made to the persistence of uncertainties related to trade tensions and to the withdrawal of the United Kingdom from the EU. At the same time, it was suggested that sentiment in the United States seemed to have become more upbeat recently following indications that trade tensions between the United States and China were

diminishing. Positive developments in financial markets perhaps reflected the view that an escalation of trade disputes in the coming year had become less likely. However, it was also argued that the global geopolitical situation was not conducive to lowering uncertainty, at least in the short term, with reference also being made to developments at the World Trade Organisation that could impair its functioning for some time. Concern about the risks to trade was also linked to the very complex nature of global supply chains. It was emphasised that policies to rebuild confidence and reduce uncertainty were needed in relation to geopolitical tensions and trade conflicts.

Turning to euro area activity, members broadly agreed that recent economic data and survey information, while remaining weak overall, had also contained some more positive signs, pointing to a stabilisation in euro area growth. Real GDP growth had been confirmed to have increased by 0.2%, quarter on quarter, in the third quarter of 2019 – unchanged from the previous quarter. In the euro area's largest economy and in the euro area as a whole, real activity had been stronger than expected in the third quarter. In addition to some positive developments in recent survey data, the Citigroup surprise index was trending upwards and had been close to achieving positive values in recent weeks, while according to various models estimates of the probability of recession had declined significantly.

With regard to the risk of adverse spillovers from the ongoing weakness in manufacturing to sentiment and activity in other sectors of the economy, there appeared to be tentative indications that industrial production might bottom out before these spillovers became more generalised. At the same time, even though services sector activity had so far been resilient, it was argued that there was a need to remain cautious given the risk of spillovers across countries.

In discussing the December 2019 Eurosystem staff projections, it was highlighted that this was the first projection exercise for some time in which there had not been a significant downward revision to the euro area growth outlook. These projections could be interpreted as confirming the narrative contained in the previous projection exercise and increasing the Governing Council's confidence in the baseline. At the same time, it was acknowledged that the downward revision to foreign demand over the projection horizon had been offset by the prospect of stronger domestic demand, which had benefited from the additional monetary policy accommodation introduced in September as well as some extra fiscal stimulus. It was emphasised that the comprehensive package of policy measures that the Governing Council had decided in September was supporting the euro area expansion, the ongoing build-up of domestic price pressures and thus the robust convergence of inflation to its medium-term aim. However, it was also stressed that in order to reap the full benefits from the ECB's monetary policy measures, other policy areas needed to contribute decisively to raising the longer-term growth potential, supporting aggregate demand at the current juncture and reducing vulnerabilities.

The risks surrounding the euro area growth outlook, related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, were assessed as remaining tilted to the downside, but having become somewhat less pronounced.

Regarding fiscal policy, the mildly expansionary euro area fiscal stance in 2020 was seen as providing some support to economic activity. However, in view of the weak economic outlook, members welcomed the Eurogroup's call for differentiated fiscal responses and its readiness to coordinate. It was emphasised that

governments with fiscal space should be ready to act in an effective and timely manner, while governments in countries where public debt was high needed to pursue prudent policies and meet structural balance targets. This would create the conditions for automatic stabilisers to operate freely. Also all countries should redouble their efforts to achieve a more growth-friendly composition of public finances.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. According to Eurostat's flash estimate, euro area annual HICP inflation had been 1.0% in November 2019, compared with 0.7% in October, mainly reflecting higher services and food price inflation. On the basis of current futures prices for oil, headline inflation was likely to rise somewhat in the coming months. Although measures of underlying inflation had generally remained muted, there were indications of a mild increase in line with previous expectations. While labour cost pressures had strengthened due to tighter labour markets, the weaker growth momentum was delaying their pass-through to inflation. Over the medium term inflation was expected to increase, supported by the ECB's monetary policy measures, the ongoing economic expansion and solid wage growth.

This assessment was also broadly reflected in the December 2019 Eurosystem staff projections. Compared with the September 2019 ECB staff projections, the outlook for HICP inflation had been revised up slightly for 2020 and down slightly for 2021, mainly driven by the expected future path of energy prices.

In discussing the inflation outlook in the December 2019 Eurosystem staff projections, members acknowledged the absence of major revisions and considered that the latest projections provided broad confirmation of the path for inflation in the previous projections exercise. It was noted that, excluding volatile package holiday prices in the euro area's largest economy, there had been a solid upward movement in underlying inflation, supported by high capacity utilisation levels, rising energy commodity prices and tight labour markets. It was also observed that staff had adopted a more cautious approach to developments in profit margins over the projection horizon, which were now assumed to recover more gradually, while the impact of the ECB's monetary policy measures on growth and inflation contained in the December 2019 staff projections was seen as being rather conservative compared with a range of estimates from different models.

Members also noted, however, that even though the latest inflation projections had not been revised down further, there had previously been substantial downward revisions to the inflation outlook over the past year. HICP inflation in 2021 was expected to be only 1.4% in the current projection exercise compared with 1.8% in the December 2018 staff projections. Moreover, the comment was made that previous forecast errors for inflation were not fully explained by domestic and international factors and it was suggested that further efforts should be made to try to better understand the reasons behind the unexplained weakness in inflation.

Regarding the impact of the cost of owner-occupied housing on inflation measures it was pointed out that while the effect of including this factor was generally procyclical and increased the volatility of inflation, it could also help to explain the perception of higher inflation in some countries where housing market developments had been relatively strong.

There was also some discussion about how climate-related policies, including the European Commission's Green Deal package, should be taken into account in the projection exercises, with members contending that there was a need to step up efforts to understand the economic consequences of climate change. It was

highlighted that while policies designed to mitigate the impact of climate change could be expected to have an impact on growth and inflation in the coming years, the implications for the projections would need to be analysed carefully. In particular, it was argued that while such policies could be considered a negative supply shock, the response to climate change could also lead to significantly higher investment, while the impact on oil and energy prices was uncertain.

As regards longer-term inflation expectations, members noted that while market-based measures of longer-term expectations had stabilised, the ECB's September monetary policy measures had not yet had any visible positive effect, with longer-term inflation expectations continuing to stand at historically low levels and clearly below the ECB's inflation aim. In terms of market-based measures of longer-term inflation expectations, the five-year forward inflation-linked swap rate five years ahead currently stood at 1.24%, while in terms of survey-based measures, longer-term inflation expectations stood at 1.7% for the fourth quarter of 2019 in the Survey of Professional Forecasters (SPF). However, it was pointed out that most of the gap between survey-based and market-based measures of longer-term inflation expectations disappeared when adjusting for estimates of liquidity and risk premia, and that the risk of deflation was low. Moreover, a remark was made that the point estimates provided by SPF participants were still at levels consistent with the Governing Council's inflation aim and that, according to most available indicators, the degree to which longer-term inflation expectations were anchored had remained unchanged recently. At the same time, the previous declines in many of the indicators suggested close monitoring was warranted.

With regard to the monetary analysis, members broadly shared the assessment provided by Mr Lane in his introduction that money and credit developments remained robust overall. The sustained rates of broad money growth reflected ongoing bank credit creation for the private sector and low opportunity costs of holding M3. Continued robust growth of money was also seen as evidence for the ongoing transmission of monetary policy, given that the monetary aggregates had continued to expand despite the pause in net asset purchases between the beginning of the year and their resumption on 1 November.

The solid growth of loans to firms and households had benefited from the continued improvement in bank lending conditions, which was seen as a sign of the ongoing pass-through of the accommodative monetary policy stance to the borrowing conditions for the real economy. The accommodative monetary policy stance was seen as safeguarding very favourable bank lending conditions and as continuing to support access to financing across all economic sectors. The bank lending channel of monetary policy was seen to be functioning well, as also evidenced by the euro area bank lending survey and the continued translation of favourable market funding conditions into easier borrowing conditions for firms and households.

At the same time, some cross-country heterogeneity in the pass-through to lending rates was visible, as competitive pressures in the banking industry differed across countries. Similarly, it was noted that the extent to which banks were passing on the ECB's monetary policy to bank deposit rates varied considerably. This was seen to be due to differences in legal frameworks, market practices, funding needs and competitive pressures across the banking systems of euro area countries. Moreover, the potential financial stability implications of the current monetary policy environment were seen to merit close monitoring.

Monetary policy stance and policy considerations

With regard to the monetary policy stance, members widely shared the assessment provided by Mr Lane in his introduction. The incoming data since the last Governing Council meeting in late October pointed to continued weakness in euro area growth dynamics, although there were some initial signs of stabilisation in the growth slowdown. Inflation developments had remained subdued overall, although there were some indications of a slight increase in measures of underlying inflation in line with previous expectations.

Members expressed confidence that the monetary policy measures would provide the necessary monetary stimulus to support the stabilisation of economic growth – compensating to a large degree for the negative impulse from global factors – and the recovery of inflation towards the Governing Council's aim. The September monetary policy measures had contributed to an overall substantial easing in financial conditions, preserving much of the easing that had occurred via anticipation effects since the summer. Perceptions of receding uncertainties, mainly related to the trade dispute between the United States and China, had led to some upward movement in risk-free interest rates and yields in the corporate and sovereign bond markets since the October monetary policy meeting. The more positive market sentiment had also supported equity prices and the euro had depreciated somewhat.

The point was made that the upward adjustment in the yield curve observed since September showed that markets were responding to changes in the data, outlook and risks, in line with the Governing Council's state-dependent forward guidance. This ran counter to perceptions of circularity between market expectations and the ECB's policy decisions. At the same time, it was highlighted that real interest rates remained at very low levels across the entire maturity spectrum, which was seen as confirmation of the effectiveness of the ECB's policy measures in underpinning very favourable financing conditions. The continued pass-through of the monetary accommodation to improving loan dynamics and lower bank lending rates was also underlined. This was providing support to firms and households for financing consumption and investment.

It was remarked that the introduction of the two-tier system for reserve remuneration had proceeded very smoothly and had worked as intended. It had relieved banks from part of their costs of holding excess liquidity, while at the same time preserving money market rates at low levels. It had also encouraged additional borrowing and lending activity in the money market, including cross-border trades, which had led to a more homogenous distribution of liquidity across countries, as also evidenced in the decline in TARGET2 balances. At the same time, it was pointed out that the tiering-induced cross-border trading had been almost entirely based on secured money market transactions, while unsecured transactions had remained largely domestic. This suggested that the euro area money market continued to display some degree of fragmentation.

While it appeared that the take-up in the operation under way as part of the new series of targeted longer-term refinancing operations (TLTRO III) would turn out to be somewhat lower than expected, it was seen as contributing to preserving favourable bank lending conditions. This lower take-up was attributed to banks' desire to minimise exposures towards the year-end and the better distribution of liquidity through money markets as a result of the tiering system for reserve remuneration. It was cautioned that the take-up in the present operation should not be over-interpreted, but be assessed together with the take-up in future operations, and that the overall success of TLTRO III should only be judged at the end of the programme.

Against this background, members widely agreed with the proposal by Mr Lane to keep the monetary policy stance unchanged, with a steady hand being warranted for monetary policy. This would entail reiterating the Governing Council's forward guidance on policy interest rates, net asset purchases and reinvestments of principal payments. The present monetary policy stimulus appeared fully appropriate, lending substantial support to growth and inflation developments. While vigilance on the efficacy of the policy measures and the appropriateness of the monetary policy stance was called for, it was highlighted that the measures should be given time to exert their full impact on the euro area economy.

Faced with a subdued inflation outlook, which was largely unchanged from September, members reiterated the need for a highly accommodative monetary policy stance for a prolonged period of time. Projected inflation was generally seen to remain some distance from the Governing Council's inflation aim, while market-based measures of inflation expectations had stagnated at historically low levels and downside risks to the growth outlook continued to prevail, despite having become somewhat less pronounced. In this environment, monetary policy needed to remain highly expansionary. Members highlighted the crucial role of the Governing Council's forward guidance in providing monetary accommodation, with the strengthened state-based forward guidance decided at the September monetary policy meeting being seen as providing a degree of "automatic stabilisation" in response to changes in macroeconomic conditions. Tying the likely path of policy interest rates more clearly to inflation prospects ensured that financial conditions would adjust in accordance with the evolving state of the economy and the outlook for inflation.

Looking ahead, there was broad agreement on the need to carefully monitor the incoming data and the evolution of risks, while continuing to evaluate the pass-through of the September policy measures. In any case, it remained vital for the Governing Council to be prepared to act by adjusting all of its instruments, as appropriate, to ensure that inflation moved towards the aim in a sustained manner, in line with the Governing Council's commitment to symmetry.

At the same time, some members highlighted the need to be attentive to the possible side effects of the present monetary policy measures, which merited close monitoring in the period ahead. It was suggested that the liquidity created by the Eurosystem needed to be tracked carefully regarding its impact on bank intermediation and asset markets – namely equities, housing and real estate – as well as capital outflows outside Europe in a search for yield. Some concern was also voiced with regard to the potential impact of negative interest rates on euro area households, with savings and consumption dynamics also requiring close monitoring.

Nonetheless, confidence was expressed that policy rates had not yet reached the so-called reversal rate. Thus far there was ample evidence that credit conditions in the euro area had continued to improve, with rising credit volumes and declining borrowing rates for firms and households providing support to their consumption and investment plans. Moreover, while the negative interest rate environment was dampening banks' net interest income, the overall effects on bank profitability had remained positive. This related in particular to capital gains from banks' sales of securities to the Eurosystem and lower provisions for loan impairment, with the overall macroeconomic environment having improved in part as a consequence of the accommodative monetary policy stance.

In this context, it was recalled that macroprudential policies were the first line of defence for addressing risks and side effects, as they could be tailored to the issues identified. To some extent, the implementation of monetary policy could also be adjusted to reduce unwanted side effects, with the introduction of the two-tier system for excess reserve remuneration being seen as a case in point.

On communication, members broadly agreed with the proposals put forward by Mr Lane in his introduction. It needed to be emphasised that overall the incoming data remained weak, but had signalled some stabilisation of the euro area economy. It had to be pointed out that risks remained tilted to the downside, although they had become somewhat less pronounced. With regard to monetary policy, the need for patience and perseverance needed to be stressed. On the one hand, it needed to be highlighted that the measures decided in September had been effective and were reaching the economy, although more time was needed for their full effects on economic outcomes to unfold. On the other hand, it needed to be emphasised that the baseline scenario for growth and inflation continued to be predicated on a highly accommodative monetary policy stance for a prolonged period of time. Therefore, steady handed communication was needed in order to preserve the very favourable financial conditions to support a robust convergence of inflation towards the Governing Council's inflation aim.

Likewise, it was felt that the Governing Council needed to reiterate its commitment to achieving its inflation aim. In this regard, the important role of the Governing Council's state-dependent forward guidance needed to be highlighted, as it might not have been fully appreciated by market participants and ECB observers. It needed to be stressed that the forward guidance formulation – by tightly linking the likely future path of policy rates to an inflation outlook that was sufficiently close to, but below, 2%, as well as a consistent rise in observed underlying inflation – ensured that financial conditions would adjust in accordance with changes to the inflation outlook.

At the same time, it was seen as important to stress that the Governing Council was attentive to potential side effects of its monetary policy measures. While the present monetary policy configuration was fully appropriate, it needed to be emphasised that the analysis and monitoring of side effects was part and parcel of the Governing Council's ongoing monetary policy assessment.

Furthermore, it was necessary to reiterate that other policymakers needed to contribute more decisively to supporting the euro area economy, contributing to further stabilisation and building confidence, as well as alleviating uncertainties relating to trade and geopolitical tensions that were holding back a more dynamic expansion of the economy. In particular, fiscal policy, notably that of governments with fiscal space, had to play a more prominent role in stabilising economic conditions in view of the weakened economic outlook. In this context, the Governing Council welcomed the Eurogroup's recent call for differentiated fiscal responses and its readiness to coordinate.

Finally, it was also suggested that some broad guidance be communicated about the forthcoming strategy review, including the likely timeline, although it was generally seen as advisable to refrain from public discussions on the strategy prior to the envisaged launch of the review by the Governing Council early in 2020.

Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, upon a proposal by the President, the Governing Council decided that 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 saw 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.

On 1 November net purchases had been restarted under the Governing Council's asset purchase programme (APP) at a monthly pace of €20 billion. The Governing Council expected them 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 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.

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

Introductory statement

<https://www.ecb.europa.eu/press/pressconf/2019/html/ecb.is191212~c9e1a6ab3e.en.html>

Press release

<https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp191212~06d84240ae.en.html>

Meeting of the ECB's Governing Council, 11-12 December 2019

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Cœuré

Mr Costa

Mr Hernández de Cos

Mr Herodotou*

Mr Holzmann

Mr Kažimír

Mr Knot

Mr Lane

Mr Makhlouf

Mr Mersch

Mr Müller

Mr Rehn

Mr Reinesch

Mr Rimšēvičs *

Mr Stournaras

Mr Vasiliauskas *

Mr Vasle

Mr Vella

Mr Villeroy de Galhau

Mr Visco

Mr Weidmann*

Mr Wunsch

* Members not holding a voting right in December 2019 under Article 10.2 of the ESCB Statute.

Other attendees

Mr Dombrovskis, Commission Executive Vice-President**

Mr Teixeira, Secretary, Director General Secretariat

Mr Smets, Secretary for monetary policy, Director General Economics

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

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

Accompanying persons

Mr Alves

Mr Arce

Mr Aucremanne

Mr Bradeško

Ms Buch

Mr Demarco

Ms Donnery

Mr Gaiotti

Ms Goulard

Mr Haber

Mr Kaasik

Mr Kuodis

Mr Kyriacou

Mr Lünnemann

Mr Odór

Mr Pattipeilohy

Mr Rutkaste

Mr Tavlás

Mr Välimäki

Other ECB staff

Ms Graeff, Director General Communications

Mr Straub, Counsellor to the President

Ms Holthausen, Deputy 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, 20 February 2020