EUROPEAN CENTRAL BANK

EUROSYSTEM

9 April 2020

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

held in Frankfurt am Main

on Wednesday and Thursday, 11-12 March 2020

……………………………………………..…….

Christine Lagarde

President of the European Central Bank

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

Financial market developments

Ms Schnabel reviewed the latest financial market developments, focusing on the implications of the coronavirus (COVID-19) pandemic from three different perspectives: a contextual perspective, a policy perspective and a stability perspective.

First, from a contextual perspective, stock markets had corrected sharply and equity market volatility had spiked. The S&P 500 volatility index (VIX) had risen above the levels seen during the height of the sovereign debt crisis. On Monday, 9 March 2020 equity markets had experienced the sharpest one-day sell-off since the global financial crisis. However, the severity of the sell-off needed to be assessed in the broader market context in which it had taken place. Specifically, over the course of the second half of 2019, equity market valuations had risen notably and, in some places, had been pricing in an outlook for the global economy that had become increasingly more optimistic than leading indicators of economic activity suggested. This risk-on mood in financial markets had, in turn, implied a higher risk of a more pronounced correction should sentiment change. Such a scenario was currently materialising.

Second, from a policy perspective, the severity of the anticipated economic consequences of the coronavirus pandemic had already led to wide-ranging policy actions by several central banks, including the Federal Reserve System. In other jurisdictions, including the euro area, expectations of policy easing had risen markedly. In particular, there had been a notable downward shift and an inversion of the EONIA forward curve. Survey data, however, signalled more limited expectations of further interest rate cuts. The changes in policy rates, as well as expectations of further easing, had amplified price movements seen in global sovereign bond markets. The ten-year US Treasury yield had, for the first time in history, fallen below the 1% level. The yield of the ten-year German government benchmark bond, at currently -75 basis points, was also very close to its historical trough recorded in late summer 2019.

Third, from a stability perspective, implied volatility had increased sharply across asset classes, and market liquidity in both private and public credit markets had tightened since the coronavirus started to spread more quickly beyond China. Some first signs of tighter funding conditions for banks had been observed both in the euro area and the United States. The Libor-OIS spread and the foreign exchange swap basis had both widened. Moreover, euro area banks had underperformed the broader euro area equity market since the outbreak of the coronavirus, with bank stocks down by over 30% since 20 February 2020. The price-to-book ratios of euro area banks had fallen to new historical lows.

Stressed market conditions, rising risk aversion and flight-to-safety dynamics had also left a notable footprint in euro area sovereign bond markets, where spreads had widened by between 40 basis points and 130 basis points. In credit markets, spreads for financial institutions were up by some 30 basis points, with a more limited widening for investment grade non-financial corporation bonds of around 20 basis points, which likely also reflected the mitigating effect of the corporate sector purchase programme (CSPP). High-yield bond spreads had widened by 200 basis points, both in the euro area and in the United States. Sovereign spreads in emerging markets had also increased measurably over the past few weeks, by around 160 basis points. This widening had offset the previous marked easing in financial conditions observed in 2019.

In commodity markets, the recent oil price movements had reflected two largely separate events. Until last week, the broader repercussions of heightened uncertainty, related to the economic and financial impact of the coronavirus, had led to a drop of around 20% in oil prices. This fall had later been exacerbated by the breakdown of the talks between the Organization of the Petroleum Exporting Countries (OPEC) and Russia on the coordination of oil production targets. Taken together, oil prices were down by 38% since 20 February 2020. Long-term market-based inflation expectations had fallen alongside oil prices.

Finally, in foreign exchange markets, with the outbreak of the coronavirus in China in mid-January 2020, the US dollar had begun a period of marked appreciation against all currencies, including the euro. In mid-February 2020 the euro had briefly fallen to its lowest level against the US dollar in nearly three years. Since late February 2020 the US dollar had been volatile against major currencies, which likely also reflected the impact of changes in monetary policy expectations.

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

Mr Lane reviewed the global environment and economic and monetary developments in the euro area since the Governing Council's January monetary policy meeting. The review was based on the limited data available to date. It was clear that the coronavirus pandemic was a major shock to the economy, whose impact was challenging to assess based on the available information. Thus incoming data needed to be carefully monitored on a continuous basis in the period ahead.

Regarding the external environment, global indicators at the turn of the year had been pointing to a stabilisation in activity. Trade indicators had even shown some improvement, as trade-related uncertainty had declined following the trade deal between the United States and China. These developments had then been reversed by the outbreak of the coronavirus, with manufacturing output in China plunging in February and negative spillovers from China to the rest of the Asia-Pacific region.

Turning to global financial conditions, market sentiment towards risky assets had declined strongly, amid a flight to safety. Accordingly, global equity prices had fallen strongly across advanced and emerging market economies, leading to a tightening in financial conditions.

Since the January Governing Council meeting oil prices had fallen strongly by 43%, on account of uncertainty surrounding the spread of the coronavirus and discord among OPEC+ countries. The euro had, overall, strengthened somewhat both against the US dollar and in nominal effective terms.

Turning to the euro area, the latest indicators suggested a considerable worsening of the near-term growth outlook. The disruption of supply chains was impeding production plans in the manufacturing sector, while necessary containment measures against the further spread of the coronavirus were adversely affecting economic activity.

This was only partly reflected in the March 2020 ECB staff macroeconomic projections for the euro area, as their data cut-off date predated the rapid spread of the coronavirus to the euro area. Before the outbreak of the coronavirus, euro area real GDP growth had moderated to 0.1%, quarter on quarter, in the fourth quarter of 2019, following growth of 0.3% in the third quarter. This easing mainly reflected the ongoing weakness in the euro area manufacturing sector and reduced investment growth.

The March ECB staff projections foresaw annual real GDP increasing by 0.8% in 2020, 1.3% in 2021 and 1.4% in 2022. In particular, the projections foresaw very muted growth in the first half of 2020, followed by an improvement in the second half of the year. Compared with the December 2019 Eurosystem staff projections, the outlook for real GDP growth had been revised down notably for 2020 and slightly for 2021, on account of the potential economic impact of the coronavirus outbreak. Overall, the projections needed to be treated with caution in the light of the substantial uncertainty related to the spread of the coronavirus and the necessity, duration and impact of the measures that had been adopted to counter it.

The risks surrounding the euro area growth outlook were clearly on the downside. In addition to the previously identified risks related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, the spread of the coronavirus added a new and substantial source of downside risk to the growth outlook.

Turning to inflation, euro area annual HICP inflation had decreased to 1.2% in February 2020, from 1.4% in January, according to Eurostat's flash estimate. On the basis of the sharp decline in current and futures prices for oil, headline inflation was likely to decline considerably over the months ahead. Indicators of inflation expectations had fallen and measures of underlying inflation remained generally muted.

While labour cost pressures had remained resilient amid tighter labour markets, the weaker growth momentum was delaying their pass-through to inflation. Over the medium term, the increase in inflation would be supported by the Governing Council's monetary policy measures and – looking through the coronavirus shock in the nearer term – the anticipated recovery in euro area growth dynamics.

The March ECB staff projections foresaw annual HICP inflation at 1.1% in 2020, 1.4% in 2021 and 1.6% in 2022. Compared with the December 2019 Eurosystem staff projections, the outlook for HICP inflation was broadly unrevised over the projection horizon. The implications of the coronavirus for inflation were surrounded by high uncertainty, given that downward pressures linked to weaker demand might be offset by upward pressures related to supply disruptions. However, the sharp decline in oil prices presented significant downside risks to the short-term inflation outlook.

Market-based indicators of longer-term inflation expectations had fallen to a new all-time low, with the euro area five-year forward inflation-linked swap rate five years ahead standing at 0.92% on 10 March 2020.

With respect to euro area financial conditions, the EONIA forward curve, which had been flat over short to medium-term maturities at the time of the January meeting, had inverted significantly, hinting at market expectations of imminent rate cuts. In addition, both the euro area ten-year overnight index swap (OIS) rate and the ten-year US Treasury yield had fallen strongly. Equity prices of financial and non-financial companies had also undergone a sharp correction.

Taken together, euro area financial conditions had tightened since the January 2020 monetary policy meeting and stood close to the levels observed in early 2019, as the accommodative effects of lower risk-free rates only partially offset the decline in euro area stock prices and the euro's appreciation.

Turning to money and credit developments, the annual growth rate of M3 had stood at 5.2% in January 2020, having moderated somewhat from its recent peak. Money growth continued to reflect ongoing bank credit creation for the private sector and low opportunity costs of holding M3 relative to other financial instruments. The narrow monetary aggregate M1 continued to be the main contributor to broad money growth. Loans to the private sector had continued to expand. The annual growth rate of loans to households had picked up slightly to 3.7% in January 2020, from 3.6% in December 2019. The annual growth rate of loans to non-financial corporations remained unchanged at 3.2% in January, confirming the moderation seen since autumn 2019 and likely reflecting the typically lagged reaction to the past weakening in the economy.

Turning to fiscal policies, the euro area fiscal stance was foreseen in the March ECB staff projections as being mildly expansionary in 2020-21 and broadly neutral in 2022. This, however, did not include the planned fiscal measures for cushioning the economic impact of the coronavirus.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that the spread of the coronavirus was a major shock to the world and the euro area economies, with severe near-term implications for aggregate expenditure levels and supply chains. The disruption of supply chains was impeding production plans in the manufacturing sector, while the necessary containment measures against the further spread of the coronavirus were adversely affecting activity in the services sector, notably related to transport, travel and recreational services. The March ECB staff projection baseline scenario already reflected a 0.3-percentage point decline in projected GDP growth in 2020 owing to the coronavirus. However, this was unlikely to capture the full impact on the euro area. In a risk scenario, the projections suggested that the negative impact on euro area output could become substantially larger, ranging from 0.6 to 0.9 percentage points depending on the models used. If lockdown measures were implemented more broadly and for a longer time period, a substantial recession could be envisaged.

The ramifications on the economy had already been amplified by a tightening in financial conditions, especially through declining stock prices and rising yields in some asset classes. Even if limited so far, the appreciation of the euro added to the tightening of financial conditions and, if it proved to be more persistent, could be a further drag on the economy and inflation dynamics.

The overall magnitude and duration of the shock remained highly uncertain. While the baseline scenario was that the main economic impact was temporary, with a recovery in activity later this year, the spread of the coronavirus represented a substantial downside risk to the euro area growth outlook.

Inflation remained subdued and was set to decline considerably in the near term, following the recent sharp decline in oil prices. Measures of underlying inflation had moved sideways and market-based measures of inflation expectations had reached new historical lows. Staff projected the HICP to rise gradually, but the same uncertainty that applied to the growth outlook also applied to the inflation outlook.

A monetary policy response was required, both to preserve the monetary stance and to underpin the transmission mechanism of monetary policy. The response needed to have three elements: first, to safeguard liquidity conditions in the banking system; second, to protect the continued flow of credit to the real economy; and third, to prevent financing conditions for the economy from tightening in a pro-cyclical way. The effectiveness of monetary policy would be enhanced and reinforced by fiscal measures that supported those businesses and employees at risk and cushioned the impact of the shock on aggregate expenditure levels.

In the light of the significant risks of the economic repercussions of the coronavirus, Mr Lane proposed that the following decisions be taken at the current meeting:

First, to offer additional longer-term refinancing operations (LTROs) to provide immediate liquidity support to the euro area banking system at an interest rate equal to the average deposit facility rate over the life of the respective operation. While no signs of strains in money markets or liquidity shortages in the banking system were currently seen, the operations would provide an effective backstop in case of need. The additional LTROs would temporarily ease funding conditions for banks, in order to provide an effective bridge to the TLTRO III operation in June 2020.

Second, to apply considerably more favourable terms to all TLTRO III operations during the period from June 2020 to June 2021. In particular, the rate applied in these operations, over the period ending in June 2021, could be as low as 25 basis points below the average interest rate on the deposit facility over the same period, with the entry rate also lowered to 25 basis points below the average rate applied in the Eurosystem’s main refinancing operations (MROs). Furthermore, lending allowances would be temporarily raised from 30% to 50% of stocks of eligible loans. The operations would support bank lending to those sectors most affected by the coronavirus outbreak, especially small and medium-sized enterprises (SMEs). In addition, the Governing Council should ask the Eurosystem Committees to look into options to temporarily ease the collateral eligibility rules to ensure that counterparties would be able to make full use of the operations.

Third, to add a temporary envelope of additional net asset purchases amounting to €120 billion until the end of the year. During this period, the Governing Council would make full use of the flexibility embedded in the programme. In combination with the existing asset purchase programme (APP), the temporary envelope would support financing conditions more broadly and thereby also ease the interest rates that matter for the real economy. Moreover, the higher purchase pace would ensure that the Eurosystem showed a more robust presence in the market during times of heightened volatility, not least in the market for corporate bonds. By contributing to stability in the corporate bond market, the increase in net asset purchases would also reinforce the effectiveness of the TLTRO III programme in supporting SMEs. Increasing the volume of net asset purchases was also important in maintaining the consistency of the Governing Council’s policy reaction function by showing its agility in responding to major shifts in euro area financial conditions and to heightened risks to the economic and inflation outlook.

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

In view of the expected temporary nature of the shock, the easing of the monetary stance provided by the additional asset purchases and the considerable support for credit supply through the revised TLTRO III programme, the Governing Council should not reduce the deposit facility rate on this occasion. In particular, through the expectations component of bond yields, cuts in the short-term policy rate were more suited to setting the medium-term orientation of monetary policy than navigating a path through a temporary period of elevated uncertainty. At the same time, it was essential to maintain the option of future cuts in the policy rate in case warranted by a tightening in financial conditions or a threat to the ECB's medium-term inflation aim.

In its communication, the Governing Council needed to: (a) note that the latest indicators suggested a considerable worsening of the near-term growth outlook; (b) acknowledge that the economic consequences of the coronavirus were only partly reflected in the March staff macroeconomic projections, as their cut-off date predated the rapid spread of the coronavirus in the euro area; (c) highlight that there were substantial downside risks to the euro area outlook, since the spread of the coronavirus had added a new and substantial source of risk; (d) stress that, in view of current developments, the Governing Council would continue to monitor closely the consequences of the spreading coronavirus for the economy, for medium-term inflation and for the transmission of its monetary policy, and that it would stand ready to adjust all of its measures, as appropriate, to ensure that inflation moved towards its aim in a sustained manner; (e) welcome the commitment and readiness of euro area governments and European institutions to take joint policy action in the current situation, but reiterate the need for a more supportive and targeted fiscal stance in view of the weakened outlook and to safeguard against the further materialisation of downside risks.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members broadly shared the assessment of the outlook and risks for economic activity in the euro area provided by Mr Lane in his introduction. Euro area real GDP growth had moderated to 0.1% quarter on quarter in the fourth quarter of 2019, following growth of 0.3% in the previous quarter, reflecting mainly the ongoing weakness in the euro area manufacturing sector and slowing investment growth. However, this depicted the situation before the global outbreak of the coronavirus. While most indicators had remained robust or stronger than expected into February 2020, the latest information suggested a considerable worsening of the near-term growth outlook. The disruption of supply chains was impeding production plans in the manufacturing sector, while necessary measures to contain the further spread of the coronavirus were adversely affecting economic activity.

As regards the external environment, members noted that there were clear downside risks to the ECB staff projections for global activity, given that these had been finalised in February, prior to the spread of the coronavirus beyond China and the subsequent reaction of the financial markets. It was highlighted that, in the March 2020 staff projections, the decline in activity in China incorporated in the baseline for the external environment was concentrated in the first quarter of the year and was followed by a rebound in the second quarter. However, a U-shaped recovery was now considered more likely than such a V-shaped recovery. Oil prices, which had fallen sharply, were seen as reflecting a fall in global demand for raw materials, as well as the failure of Saudi Arabia and Russia to agree on cuts in production.

More generally, in view of the global reach of the coronavirus pandemic in conjunction with remaining uncertainties regarding geopolitical factors, rising protectionism and vulnerabilities in emerging markets, members agreed that the risks to the external environment were clearly on the downside. In an environment of considerable uncertainty, the risk of adverse global spillovers was significant because of disruptions in global supply chains, a broader retrenchment in demand and heightened financial market volatility. In this context, international coordination was seen as particularly important. Reference was also made to the uncertainty about the outcome of the negotiations between the United Kingdom and the European Union on a future trade relationship, and to the ongoing refugee crisis and tensions on the EU border in Greece. The risk of an unwinding of globalisation and of global supply chains was highlighted as a possible consequence of the coronavirus pandemic.

Turning to euro area activity, members agreed that the spread of the coronavirus was a major shock to growth prospects and that the impact on the euro area economy could be severe, even if it was, in principle, temporary. The size of the impact would be determined, in particular, by the further spread of the coronavirus and the extent of the containment measures implemented. These containment measures, including the lockdown already in place in Italy, would adversely affect activity in the short run.

Members expressed their solidarity with the Italian people. It was considered more than likely that the recent developments seen in Italy would soon be repeated in many other countries. It was recalled that the outbreak had had relatively little impact on euro area data for January and February 2020, which supported the assessment that the impact would be seen more in the second quarter than in the first. However, it was also possible that the impact might extend beyond one or two quarters and it was important that governments did not mistake the relatively good data for the first few months of the year as a reason not to react strongly to the current situation. With governments prioritising public health issues over short-term economic concerns in order to contain the pandemic, it was argued that containment measures not only reduced economic activity sharply in the short run, but could also be expected to spread out the impact on the economy over time.

It was observed that the impact of the coronavirus pandemic was being felt particularly sharply in services sector activities, such as travel and tourism. Some doubt was expressed about the likelihood of lost output being recovered once growth picked up again in these sectors. It was felt that those forgoing travel or visits to the cinema or gym were unlikely to expand these activities after the crisis. It was also recalled that these services sector activities tended to be fairly labour-intensive, which suggested a more persistent impact, going beyond one or two quarters, on employment, wages and disposable income. In this context, the challenges faced by euro area SMEs, which could face cash-flow problems and liquidity constraints, were highlighted – notably with regard to financing and preserving working capital.

Against the background of the pandemic, it was emphasised that the outlook for the euro area was subject to an exceptionally high level of uncertainty and that the March ECB staff projections already appeared rather outdated, as they predated the rapid spread of the coronavirus in Europe. Given the extent of developments since the finalisation of the ECB staff projections, members viewed the scenarios prepared by ECB staff as especially relevant when considering a potential intensification of the coronavirus crisis beyond what was contained in the March 2020 baseline projection.

The “mild” scenario considered the implications of a more persistent outbreak of the coronavirus for China and the euro area. Building on this, a more “severe” scenario had also been considered by staff, which incorporated some additional shocks to financial markets and oil prices. In both of these scenarios, the epidemic in China extended into the second quarter of 2020 and the spread of the coronavirus to the euro area was assumed to accelerate significantly. The negative impact on euro area GDP under the mild scenario was estimated to be between 0.6 and 0.9 percentage points, compared with the ECB staff’s baseline projection, while in the severe scenario the negative impact was between 0.8 and 1.4 percentage points below the March 2020 projections. Neither of these scenarios incorporated either a monetary policy or a fiscal policy reaction. It was underlined that including such policy reactions could significantly mitigate the effects in both scenarios, notably in the event of timely and targeted fiscal measures.

Reference was also made to the OECD’s interim Economic Outlook, in which the euro area growth outlook for 2020 had similarly been revised down to 0.8% and which had also included several more adverse scenarios. Private sector forecasters were also in the process of revising down significantly their growth outlook for 2020.

Against this background, members discussed the possibility of a recession in the euro area, acknowledging that the risk had increased significantly. On the one hand, it was argued that recent forecasts did not take into account the very rapid deterioration in economic conditions in Europe and that it would be difficult, if not impossible, to avoid a recession. Accordingly, perhaps the question was rather how deep the recession would be and whether the recovery would be only moderate for a prolonged period. On the other hand, it was emphasised that the outlook depended critically on the strength of the policy response. In this context it was underlined that the situation called for joint action and close coordination in the euro area, between monetary and fiscal policy as well as macroprudential policy and supervision, and that cooperation was needed both at the national level and with European institutions.

While the magnitude of the downward revision to growth in the short term was very uncertain, the direction was very clear. However, the need for revisions to the growth and inflation outlook in the medium term was considered more of an open question, depending not only on the future course of the coronavirus pandemic itself and the policy responses, but also on the persistence of the effects on demand and supply conditions. In terms of the consequences for the supply side, it was noted that there were serious risks of a large-scale destruction of productive capacity and a partial dismantling of global supply chains more generally. Whereas monetary policy was primarily concerned with the weakness of aggregate demand, there was now also an acute risk to the supply side in the medium to longer term. It was important to ensure that a temporary demand and supply shock did not lead to a fully fledged macroeconomic and financial crisis if disruptions in production and cash flows, compounded by liquidity and financing constraints, triggered balance sheet problems in the corporate and banking sectors. Such a scenario could lead to long-run damage to the supply side of the economy and to substantial hysteresis effects. The situation therefore had to be monitored closely and everything possible should be done in all policy domains to ensure that permanent damage was contained.

Members concluded that the risks surrounding the euro area growth outlook were clearly on the downside. In addition to the previously identified risks related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, the spread of the coronavirus had added a new and substantial source of downside risk to the growth outlook.

Regarding fiscal policies, an ambitious and coordinated fiscal stance was now needed in view of the weakened outlook and to safeguard against the materialisation of downside risks. It was emphasised that the Governing Council welcomed the measures already taken by several governments to ensure sufficient health sector resources and to provide support to affected companies and employees. In particular, measures such as providing credit guarantees were needed to complement and reinforce the ECB's monetary policy measures. It was also underlined that the Governing Council welcomed the commitment of the euro area governments and European institutions to act without delay, strongly and collectively, in response to the repercussions of the further spread of the coronavirus. There was broad agreement that fiscal policy had to play a leading role, with temporary, timely and targeted measures.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. According to Eurostat, euro area annual HICP inflation was 1.2% in February 2020, compared with 1.4% in January. On the basis of the sharp decline in spot and futures prices for oil, headline inflation was likely to decline considerably over the coming months. Indicators of inflation expectations had fallen and measures of underlying inflation remained generally muted. While labour cost pressures had so far remained steady amid tighter labour markets, the weaker growth momentum was delaying their pass-through to inflation. In the exchange of views about the implications of the coronavirus outbreak for the outlook for inflation, a number of factors were stressed. In particular, a clear distinction had to be made between the short-term and the medium-term impact. There was also a need to distinguish between the relative importance of shocks to demand and shocks to supply, as they could be expected to have different implications for price developments.

It was observed that the pandemic, which had initially been viewed as primarily a global supply-side shock, was being propagated to demand and was intensifying in Europe, reducing activity across most sectors of the economy. Demand would be negatively affected as a result of job losses and any reduction in household income growth, as well as the impact of increased uncertainty on confidence and investment. It was argued that, in the short term, the shortfall in demand could be expected to outweigh any supply-side effects. In the mild scenario produced by ECB staff, the downward impact on inflation in 2020 was assumed to be around 0.2 percentage points, while the impact in a severe scenario was expected to be between 0.4 and 0.8 percentage points.

There was uncertainty about the need to revise the outlook for inflation in the medium term, which was the policy-relevant horizon for the ECB's price stability objective. On the one hand, the temporary nature of the downturn suggested that there might be limited need for revisions to the medium-term outlook for inflation, although the assessment was subject to unusually high uncertainty. On the other hand, the picture of broadly unrevised inflation in the medium term could be questioned, in view of the recent sharp decline in oil prices and the possibility that a more persistent effect on demand would materialise. It was also to be hoped that the coronavirus crisis would not have a lasting adverse effect on attitudes to consumer expenditure, although this was possible in the case of large shocks. The point was made that the ultimate medium-term implications were not independent of short-term events and that the magnitude and duration of the shock's impact would in turn depend on the course of the pandemic and the policy reaction to it.

Regarding longer-term inflation expectations, members noted that market-based inflation expectations in both the euro area and the United States had fallen. For the euro area, the five-year forward inflation-linked swap rate five years ahead had declined to a record low of 0.95%. At the same time, it was suggested that the importance of market-based measures should not be over-emphasised, as recent developments reflected market tensions and a flight to safety. Such measures should thus be regarded as an imperfect indicator of future inflation developments.

On the monetary analysis, members broadly concurred with the assessment provided by Mr Lane in his introduction that monetary dynamics had moderated, due in part to decelerating bank lending to firms. The annual rate of M3 growth had stood at 5.2% in January 2020, having decreased somewhat from its recent peak. Money growth was reflecting ongoing bank credit creation for the private sector and low opportunity costs of holding M3 relative to other financial instruments. Loans to the private sector had continued to expand overall, while the annual growth rate of loans to non-financial corporations had remained unchanged at 3.2% in January, confirming the moderation seen since autumn 2019. It was noted that credit standards for SMEs had tightened somewhat and that their loan rejection rate had increased over the last four rounds of the survey on access to finance for enterprises.

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. Financial conditions and bank funding conditions in the euro area had tightened since the Governing Council's previous monetary policy meeting. Equity market valuations had dropped significantly in recent weeks, as also shown in the presentation by Ms Schnabel, although it was mentioned that part of the fall in asset prices could be seen as a correction of earlier overvaluation. While limited so far, the euro's recent appreciation added to the tightening of financial conditions, which – if it proved to be more persistent – could move inflation expectations further away from the Governing Council's aim. While the implications of the coronavirus pandemic pointed to a considerable worsening of the euro area growth outlook and increased downside risks in the near term, the implications for inflation were surrounded by high uncertainty in the light of supply disruptions and weaker demand.

Members agreed that a decisive monetary policy response was required in the present circumstances, both to preserve the monetary stance and to underpin the monetary transmission mechanism. Although the source of the shock was outside the realm of monetary policy and was to be primarily addressed by timely and targeted fiscal policies, a forceful package of monetary policy measures was seen as necessary. First, such a package would mitigate the threat of a liquidity and credit crunch further aggravating the situation in the real economy. Second, it would help counter self-fulfilling fear dynamics and renewed fragmentation in financial markets. In order to maximise the effectiveness of the monetary policy response, coordination with fiscal and supervisory policies was deemed essential.

As outlined by Mr Lane in his introduction, members agreed that a first element of the policy response was to safeguard ample liquidity in the banking system by ensuring banks' continued access to funding at attractive conditions as a necessary element to guard against a potential credit crunch. However, it was also argued that this was not sufficient to ensure that the liquidity made available to banks would be passed on to the end-users. It was pointed out that, whereas during the financial crisis of 2008 banks were at the heart of the problem, the current situation differed in the sense that problems would materialise first in the real economy and would subsequently be reflected in banks' balance sheets.

Members also agreed that the second element of the proposed policy response, namely to protect the continued flow of credit to the real economy, was of paramount importance. Under the current conditions, however, it was seen as more difficult to ensure that the liquidity provided via monetary policy operations reached those that were most in need, such as SMEs, as problems in the real economy risked impairing credit flows to businesses. Banks needed to be incentivised to provide credit to viable firms that were suffering from a reduction in cash flow because of the coronavirus pandemic. In this regard, it was underlined that commensurate action by governments and supervisors could support effective monetary transmission, for example via credit guarantees.

Agreement also prevailed with regard to the third element of the required monetary policy response, namely safeguarding the monetary policy stance by averting a procyclical tightening of financing conditions in the economy. However, it was cautioned that instruments affecting the monetary policy stance would only become fully effective once the spread of the coronavirus had been contained by other policies. At the same time, it was recalled that the ECB's monetary policy had been highly accommodative since the financial crisis. It was emphasised that, in order to maintain accommodative monetary conditions, the Governing Council needed to consider using all the tools at its disposal in a flexible way.

Against this background, all members agreed with the package of monetary policy measures proposed by Mr Lane in his introduction, namely: first, offering additional LTROs to provide immediate liquidity support to the euro area banking system at an interest rate equal to the deposit facility rate; second, applying more favourable terms to all TLTRO III operations during the period from June 2020 to June 2021; and, third, adding a temporary envelope of €120 billion to the volume of net asset purchases. Overall, the package was seen as appropriate to address the three elements of the proposed policy response, though some nuances were expressed with regard to individual components. Together with the substantial monetary policy stimulus already in place, these measures would support liquidity and funding conditions and help to preserve the smooth provision of credit to the real economy.

Members welcomed the proposed additional LTROs, which would immediately ease funding conditions for banks, thus providing an effective bridge to the TLTRO III operation in June 2020 that would be conducted at the proposed, more favourable terms. The first LTRO operation would be announced on 16 March 2020, allotted on 17 March 2020 and settled on 18 March 2020, with subsequent operations taking place weekly until 10 June 2020. All operations would mature on 24 June 2020, on which date they could be rolled over into the June TLTRO III operation. By offering funding at the deposit facility rate, the LTROs would allow banks to benefit from very favourable borrowing conditions immediately and, at the same time, offer them a high degree of flexibility at a low operational cost. This would provide a simple and effective backstop, in particular in combination with the full allotment of the operations, and ensure that banks were supplied with liquidity until the June TLTRO III operation, which required a longer lead time because of its operational complexity.

Members widely shared the view that the proposed changes to the TLTRO III operations would support bank lending to the firms affected most by the spread of the coronavirus, in particular SMEs. For the period from 24 June 2020 to 23 June 2021, the interest rate on all TLTRO III operations outstanding during that time would be 25 basis points below the average rate applied in the Eurosystem's MROs over the same period. For counterparties whose eligible net lending met the benchmark, the interest rate applied would be 25 basis points below the average interest rate on the deposit facility prevailing over the same period, and in any case not higher than -0.75%. The lending performance threshold for attaining the minimum interest rate would be lowered to 0%, from 2.5%. The maximum total amount that counterparties would be entitled to borrow would be raised from 30% to 50% of their stock of eligible loans. The limit on the amount of funds that could be borrowed in each operation would be removed.

The proposed amendments to the TLTRO III parameters were considered to be well suited to temporarily ease funding conditions for banks, supporting credit flows to affected sectors and avoiding a tightening in credit supply. These amendments effectively lowered interest rates in a ring-fenced way for eligible counterparties and provided a strong incentive to banks not to cut lending. Linking the favourable terms to banks' credit portfolios would incentivise banks not to cut credit at a time when the economy was in need. It was cautioned, however, that the reduction in the lending performance threshold to 0% might turn out to be insufficiently supportive if banks were forced to reduce their credit exposure because of supervisory concerns or market pressures, possibly resulting in a contraction of credit. Members widely agreed that it was important to further investigate options for better incentivising banks to expand their lending to SMEs.

In order to allow banks to make full use of the ECB's lending facilities, members widely welcomed Mr Lane's proposal to task the Eurosystem committees with studying ways to further broaden the collateral framework. Expanding the eligible collateral and reviewing the additional credit claims framework were seen as particularly important with regard to improving bank lending flows to SMEs.

Members generally agreed that the additional envelope for net asset purchases as part of the proposed policy package was essential to influence the level of the risk-free yield curve. In combination with the existing APP, an additional temporary envelope of €120 billion until the end of the year, with a strong contribution from the private sector purchase programmes, would support favourable financing conditions for the real economy in times of heightened uncertainty. Limiting the additional envelope to the current calendar year was deemed an appropriate response to a shock that was assessed as being temporary at this stage. The private sector purchases would provide a strong signal of support for favourable funding conditions in the corporate sector. A flexible expansion of APP net purchases was also seen as partially compensating for not cutting the deposit facility rate, with the public sector purchases helping to preserve a risk-free rate that served as a benchmark for pricing many other financial products. A remark was made that although the envelope of €120 billion seemed large, in the face of the disruptions that had been witnessed a larger volume would be justified. It was also remarked that an increase in the envelope of the APP could be seen as an appropriate way to support a coordinated policy response, as the Governing Council was urging policymakers to take decisive fiscal measures.

Overall, it was felt that adding more volume to the APP was preferable to another reduction in the deposit facility rate. Additional net purchases would support policy transmission to the long end of the risk-free yield curve and provide some form of backstop for public and private bond markets. However, some reservations were also expressed regarding the case for expanding the public sector purchase programme as a means of preserving or lowering the risk-free yield curve at a time when higher-rated government bond yields had fallen to record low levels in an environment of heightened risk aversion. It was also pointed out that, in normal circumstances, the relationship between the ECB's capital key and the risk-free yield curve was stable, whereas under the current conditions this relationship was distorted by a shift into safe assets, calling for temporary and tactical flexibility in the APP purchases to address liquidity issues arising from this flight to safety. It was argued that the provision of the additional envelope until the year-end would allow enough flexibility in the implementation of the purchases to temporarily target markets where conditions were particularly tight. While it was confirmed that the parameters guiding the APP remained in place, the timeline for the convergence of the ECB's sovereign bond holdings towards the capital key would allow some flexibility for purchases within the existing parameters.

The rationale for using additional asset purchases, in particular public sector purchases, as an instrument to ease the monetary policy stance was recalled, in line with the purpose of the expanded APP as conceived in 2015. In this context, it was remarked, however, that it was difficult to distinguish whether observed spreads were driven by an increase in credit risk or a lack of liquidity.

The view was widely shared that the present, very challenging circumstances called for a maximum degree of cohesion, consensus and unity in the Governing Council, notwithstanding different preferences with regard to the various monetary policy instruments under consideration.

In view of the expected temporary nature of the shock and the proposed measures, members agreed that it did not seem appropriate to lower the deposit facility rate on this occasion. While a few members expressed their willingness to consider a cut in the deposit facility rate at the current meeting, most members were of the view that increasing the APP would be more effective in lowering risk-free rates. At the same time, it was seen as important for the Governing Council to stress, in line with its current forward guidance, that rates could be lowered further if the Governing Council considered this to be appropriate.

Monetary policy decisions and communication

On communication, it was stressed that, in view of the current developments, the Governing Council would continue to monitor closely the consequences of the spread of the coronavirus for the economy, for medium-term inflation and for the transmission of monetary policy, and it would stand ready to adjust all of its measures, as appropriate, to ensure that inflation moved towards its aim in a sustained manner in line with its commitment to symmetry. Although the proposed measures were considered to be adequate for the time being, the view was held that, as the spread of the coronavirus continued to unfold, the Governing Council might be confronted with continued market pressures and expectations of further policy actions at its meetings for some time to come.

The commitment to joint policy action by euro area governments and the European institutions in the current situation was welcomed, and the need for a more supportive and targeted fiscal stance was reiterated in view of the weakened outlook and to safeguard against the further materialisation of downside risks. While monetary policy could effectively address liquidity constraints on financial markets, the limits to what monetary policy could do to address the immediate consequences of the coronavirus pandemic had to be acknowledged. The substantial downside risks to the euro area outlook had to be highlighted, since the spread of the coronavirus had added a new and substantial source of risk.

As regards forward guidance, it was emphasised that the Governing Council expected the key ECB interest rates to remain at their present or lower levels until the Governing Council had seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within the projection horizon, and such convergence had been consistently reflected in underlying inflation dynamics. The Governing Council also confirmed that it stood ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner.

Taking into account the foregoing discussion among the members, on a proposal from the President, the Governing Council decided on the following comprehensive package of monetary policy measures:

(1) Additional LTROs would be conducted, temporarily, to provide immediate liquidity support to the euro area financial system. Although the Governing Council did not see material signs of strains in money markets or liquidity shortages in the banking system, these operations would provide an effective backstop in case of need. They would be carried out through a fixed rate tender procedure with full allotment, with an interest rate that was equal to the average rate on the deposit facility. The LTROs would provide liquidity at favourable terms to bridge the period until the TLTRO III operation in June 2020.

(2) In TLTRO III, considerably more favourable terms would be applied during the period from June 2020 to June 2021 to all TLTRO III operations outstanding during that same time. These operations would support bank lending to those affected most by the spread of the coronavirus, in particular SMEs. Throughout this period, the interest rate on these TLTRO III operations would be 25 basis points below the average rate applied in the Eurosystem's MROs. For counterparties that maintained their levels of credit provision, the rate applied in these operations would be lower, and, over the period ending in June 2021, could be as low as 25 basis points below the average interest rate on the deposit facility. Moreover, the maximum total amount that counterparties would henceforth be entitled to borrow in TLTRO III operations would be raised to 50% of their stock of eligible loans as at 28 February 2019. In this context, the Governing Council would mandate the Eurosystem committees to investigate collateral easing measures to ensure that counterparties continued to be able to make full use of the funding support.

(3) A temporary envelope of additional net asset purchases of €120 billion would be added until the end of the year, ensuring a strong contribution from the private sector purchase programmes. In combination with the existing APP, this would support favourable financing conditions for the real economy in times of heightened uncertainty. The Governing Council continued to expect net asset purchases 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.

(4) The interest rate on the MROs 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.

(5) Reinvestments of the principal payments from maturing securities purchased under the APP would continue, in full, for an extended period of time past the date when the Governing Council started raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Further details on the precise terms of the new operations would be published in dedicated press releases at the end of the ECB's press conference.

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

Introductory statement

https://www.ecb.europa.eu/press/pressconf/2020/html/ecb.is200312~f857a21b6c.en.html

Press releases

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200312~8d3aec3ff2.en.html

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_2~06c32dabd1.en.html

https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_1~39db50b717.en.html

Meeting of the ECB's Governing Council, 11-12 March 2020

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Costa, via teleconference

Mr Hernández de Cos

Mr Herodotou, via teleconference

Mr Holzmann *

Mr Kazāks, via teleconference

Mr Kažimír

Mr Knot

Mr Lane

Mr Makhlouf

Mr Mersch

Mr Müller, via teleconference

Mr Panetta, via teleconference

Mr Rehn

Mr Reinesch *

Ms Schnabel

Mr Stournaras

Mr Vasiliauskas, via teleconference

Mr Vasle, via teleconference

Mr Vella *, via teleconference

Mr Villeroy de Galhau

Mr Visco *, via teleconference

Mr Weidmann

Mr Wunsch

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

Other attendees

Mr Dombrovskis, Commission Executive Vice-President **

Ms Senkovic, Secretary, Director General Secretariat

Mr Smets, Secretary for monetary policy, Director General Economics

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

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

Accompanying persons

Mr Alves

Mr Arce

Mr Aucremanne

Mr Bradeško, via teleconference

Ms Buch

Ms Cleanthous, via teleconference

Mr Demarco, via teleconference

Ms Donnery, via teleconference

Mr Filipozzi, via teleconference

Mr Gaiotti, via teleconference

Mr Kuodis, via teleconference

Mr Lünnemann

Mr Odór

Mr Pattipeilohy

Ms Ritzberger-Grünwald

Mr Rutkaste

Mr Tavlas

Mr Välimäki

Other ECB staff

Ms Graeff, Director General Communications

Mr Straub, Counsellor to the President

Ms Rahmouni-Rousseau, Director General Market Operations

Mr Rostagno, Director General Monetary Policy

Mr Sousa, Deputy Director General Economics

Release of the next monetary policy account foreseen on Thursday, 21 May 2020.