



EUROPEAN CENTRAL BANK

EUROSYSTEM

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

held in Frankfurt am Main

on Wednesday and Thursday, 20-21 January 2021

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

Financial market developments

Ms Schnabel reviewed the financial market developments since the Governing Council's previous monetary policy meeting on 9-10 December 2020.

New global coronavirus (COVID-19) infections had reached a record high in the previous week and the risk of more protracted containment measures was rising amid the emergence of more infectious mutations of the virus and a pace of vaccination that was proceeding more slowly than expected. Sentiment in financial markets, however, had improved noticeably at the start of the year, mainly reflecting expectations of additional fiscal stimulus in the United States, sparking reflation trades.

The US Treasury yield curve had steepened significantly, led by the long end, reflecting an increase in both inflation expectations and real rates. The euro area overnight index swap (OIS) curve, by contrast, remained close to its flattest historical level and had steepened only marginally over the past two weeks. The euro area GDP-weighted yield curve had also remained very close to the level observed at the time of the Governing Council's 9-10 December 2020 monetary policy meeting. However, stable nominal yields in the euro area masked opposing underlying developments. While medium to long-term inflation expectations had increased at the same pace as in the United States, real yields in the euro area had resisted upward pressure and had in fact declined to record low levels.

There had also been a repricing at the short end of the curve. Both in the United States and in the euro area, OIS forward curves had continued to shift upwards since the start of 2021, broadly reflecting higher interest rate expectations. Cross-asset price correlations were consistent with the view that the market was becoming more sanguine about the economic outlook despite the risk of strict lockdowns being extended further in the near future. Price and flow data on global equity markets suggested that a further improvement in risk sentiment and a recovery in long-term earnings expectations had so far outweighed any impact from the rise in risk-free rates. Global stock markets had posted further gains and the EURO STOXX 50 index was now close to reaching pre-COVID-19 pandemic levels. The recent price gains had also been backed by continued inflows into global equities. Assets under management in investment funds had increased by more than 10% since early November 2020.

At the same time, stock prices could eventually become vulnerable to a rise in real yields globally. The "excess CAPE yield", i.e. the inverse of the cyclically adjusted price/earnings ratio minus the real ten-year bond yield, continued to be high at present, meaning that investors had not necessarily lowered the premium they demanded for holding riskier assets. Nonetheless, a more sustained rise in real rates could rapidly lower the relative attractiveness of equities and thereby pose the risk of a more broad-based repricing. Such risks of price corrections were not evenly distributed across the equity universe. The distribution of the price/earnings

ratio across firms in the EURO STOXX 50 index was currently much wider than it had been on average over the past 20 years, also reflecting that the recovery remained highly uneven.

Credit markets had shown a similar resilience to the risk of higher rates. Corporate credit spreads in the euro area had continued to narrow marginally over the past few weeks. The arrival of vaccines and the recalibration of measures decided upon by the Governing Council in December 2020 had fostered a further compression of risk premia in this market segment to levels close to those prevailing before the COVID-19 pandemic.

In foreign exchange markets, rising US government bond yields had interrupted the depreciation trend in the US dollar that had gained further momentum after the Governing Council's previous monetary policy meeting. Since the Georgia run-off elections, the euro exchange rate versus the US dollar had dropped and had temporarily even fallen below the levels that had prevailed at the time of that monetary policy meeting. US real rates had been a key factor boosting global portfolio rebalancing and risk-taking. So to the extent that investors saw the risks surrounding these rates as increasingly skewed to the upside, an important driver behind recent exchange rate developments could lose steam.

Taken together, the recent financial market developments had left a broad-based positive mark on financial conditions in the euro area. Sovereign real yields had dropped, spreads had remained resilient, stock prices and inflation expectations had risen, and the euro exchange rate versus the US dollar had reversed its appreciation trend. This was a strong vote of confidence in the Governing Council's decision to focus on the duration of its policy support and on the preservation of favourable financing conditions to protect the current highly accommodative stance in an environment of continued high uncertainty.

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.

As regards the external environment, the global recovery continued towards the end of the year, although the slight fall in the global composite output Purchasing Managers' Index (PMI) to 53.5 in December signalled weakening momentum. Despite a surge in new COVID-19 infections, recent data and forecasts indicated an overall more optimistic outlook for global activity than previously expected, based on stronger economic growth in the United States, but also on strong economic data from China and the EU-UK trade deal. While the medium-term outlook was improving, rising COVID-19 cases and the resulting containment measures posed near-term headwinds to growth until vaccinations contained the pandemic, which was expected towards mid-2021.

Compared with the first wave of COVID-19 infections and containment measures in the spring of 2020, services had been affected less in November and December. Trade developments had also been more resilient during the new wave of the pandemic.

Oil prices had continued the recovery that started in spring 2020 and had increased by 15% since the Governing Council's December monetary policy meeting to above USD 55 per barrel, driven by higher demand as well as some factors limiting supply. At the same time, the euro had appreciated slightly, amid some volatility, against the US dollar (0.2%), but had depreciated slightly in effective terms (-0.2%), while

commodity prices for metals and food had risen sharply, supported by a strong rebound in commodity demand in the second half of 2020.

Turning to the euro area, the more restrictive and extended lockdowns were weighing on the short-term growth outlook.

The economic impact of the pandemic continued to affect services in particular, while manufacturing had remained resilient. According to the latest PMI data for December, activity in the services sector had continued to shrink, while manufacturing activity had continued to increase on the back of robust developments in global trade. The economic impact of the lockdowns seemed to have moderated compared with the first wave of the pandemic in spring 2020. According to the European Commission survey, confidence in the services sector was less subdued in most countries in the recent wave, likely reflecting the fact that the economy had adapted better to the restrictions.

Fiscal transfers had continued to buffer euro area households' disposable income in the second half of 2020, compensating for weak labour income. With many services unavailable during the lockdowns, consumers were forced to save, pushing up the household savings rate. In terms of the distribution, younger households were drawing more on their savings as their financial situation deteriorated, while older households were more able to save. Whether and when these savings would be used for consumption in the future was likely to affect the outlook for the euro area economy over the coming quarters.

With regard to labour market developments, the euro area unemployment rate had stood at 8.3% in November 2020, 0.1 percentage points lower than in October. Labour demand remained weak overall and the job market was providing only limited opportunities for those looking for new jobs. At the same time, job retention schemes (especially short-time work schemes) had contained unemployment and helped to stabilise household incomes.

Turning to nominal developments, HICP inflation and HICP inflation excluding food and energy (HICPX) remained at -0.3% and 0.2% respectively in December 2020.

Euro area inflation had fallen from pre-pandemic levels of above 1% and had remained persistently negative since August 2020, owing to developments not only in energy prices, but also in goods and services prices. A broad range of measures of underlying inflation had moved sideways, with measures excluding volatile items and indirect tax changes declining less since the beginning of the pandemic. Most of the decline in non-energy industrial goods inflation could be attributed to the weakness in clothing and footwear inflation, which could be expected to be corrected to some extent after the pandemic.

Negotiated wages had continued their broad sideways movement despite the large amounts of slack in the economy and the labour market, as many wage agreements had been concluded before the pandemic.

Looking ahead, headline inflation was likely to turn positive again in January 2021, and to increase further over the course of the year, with the phasing-out of the temporary cut in the German value-added tax (VAT) rate from January 2021 being one factor. HICP weights were expected to change substantially in 2021 as a result of the changes in consumption patterns during the pandemic, adding to the already elevated uncertainty surrounding the inflation outlook.

According to the Survey of Professional Forecasters (SPF) for the first quarter of 2021, inflation expectations were broadly unchanged. HICP inflation was expected to stand at 0.9% in 2021, 1.3% in 2022 and 1.5% in 2023. Looking further ahead, the SPF continued to expect headline inflation five years ahead to reach 1.7%. Market-based measures of longer-term inflation expectations had increased and the odds of very low inflation had declined.

Reviewing the latest developments in euro area financial conditions, the path of risk-free rates suggested that rate cut expectations were largely absent and long-term risk-free rates had increased. Risk assets had been stable and stood close to their pre-crisis levels.

Turning to money and credit developments, money growth had been buoyant, with the annual growth of M3 increasing from 10.5% in October 2020 to 11.0% in November. Eurosystem asset purchases remained the main source of money creation, while the contribution of bank credit to the private sector had continued to moderate.

The annual growth of loans to euro area non-financial corporations was still affected by the strong expansion of loans in the spring of 2020 and was broadly unchanged at 6.9% in November, while short-term loan dynamics had continued to weaken, driven by both demand factors and supply factors. The annual growth of loans to euro area households had remained broadly unchanged at 3.1% in November.

Based on the January 2021 bank lending survey (BLS) for the euro area, credit standards for loans to firms had tightened in the fourth quarter of 2020, driven by banks' heightened risk perceptions and concerns about borrowers' creditworthiness. Banks expected a further tightening of credit standards for firms in the first quarter of 2021, reflecting continued uncertainty about the development of the pandemic and its effects on the credit risk of borrowers. Credit standards for loans to households for house purchase had continued to tighten in the fourth quarter of 2020, but less so than in the previous two quarters. Nominal costs of debt financing for non-financial corporations had been broadly unchanged in December, at historically low levels.

Turning to fiscal policies, the fiscal support planned for 2021 was sizeable, but would possibly be extended depending on the development of the pandemic against the background of strengthened and extended COVID-19-related restrictions. From 2021 the Next Generation EU (NGEU) package was expected to provide a strong contribution, particularly to public investment, if ambitious government plans were fulfilled.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that the launch of vaccination campaigns across the euro area was an important milestone in the resolution of the ongoing health crisis. However, the near-term outlook was challenging on account of the renewed surge in infections, the emergence of virus mutations and the more restrictive containment measures imposed in many euro area countries over the past few months. The high-frequency data and incoming survey indicators for the fourth quarter of 2020 and the initial weeks of 2021 signalled a significant weakening in the services sector, albeit to a lesser degree than during the first wave of the pandemic in spring 2020. Activity in the manufacturing sector had continued its recovery, supported by

foreign demand. Output was likely to have contracted in the fourth quarter of 2020 and the intensification of the pandemic posed some downside risks to output in the first quarter of 2021.

Looking beyond the first quarter, there were reasons for cautious optimism about the prospect of a recovery in the course of 2021. In addition to the roll-out of vaccination campaigns, there were signs of an improvement in the global economic outlook. Furthermore, the EU-UK trade deal was a positive development compared with the December 2020 Eurosystem staff macroeconomic projections. At the same time, uncertainty remained high, especially relating to the dynamics of the pandemic and the timely implementation of vaccination campaigns.

Inflation remained subdued amid weak demand and significant slack in labour and product markets, with HICP and HICPX inflation unchanged in December at -0.3% and 0.2% respectively. Although headline inflation was likely to increase in the coming months on the basis of current energy price dynamics and supported in part by the end of the temporary VAT reduction in Germany, underlying price pressures were expected to remain muted owing to weak demand – notably in the tourism and travel-related sectors – as well as to low wage pressures and the appreciation of the euro. Survey-based measures and market-based indicators of longer-term inflation expectations remained at low levels, although there had been a slight pick-up in market-based indicators of inflation expectations.

Financial market sentiment had remained positive, underpinned by ample fiscal and monetary policy support and amid global reflation hopes that had been fuelled by expectations of substantial US fiscal stimulus. In currency markets, developments in the euro exchange rate should continue to be monitored with regard to their possible implications for the medium-term inflation outlook.

In broad terms, financing conditions in the euro area were generally supportive for both the bond market and bank lending. Nonetheless, it was important to monitor the recent increase in nominal risk-free rates, which could be attributed to the spillover from the more substantial increase in US yields. Looking ahead, assessing the impact of upward pressure on nominal yields on the favourability of financing conditions would be an important task in the context of future updates to the inflation outlook. In assessing the favourability of financing conditions, it would also be important to bear in mind the continued net tightening of credit standards that had been reported in the January BLS.

Ample monetary policy support remained essential. The comprehensive policy package announced in December would contribute to preserving favourable financing conditions over the pandemic period. This would help to reduce uncertainty and bolster confidence, encouraging consumer spending and business investment, underpinning economic activity and safeguarding medium-term price stability.

Overall, the risks surrounding the euro area growth outlook remained tilted to the downside but had become less pronounced. The news about the global economy, the agreement on future EU-UK relations and the launch of vaccination campaigns was encouraging. However, the ongoing pandemic and its implications for economic and financial conditions continued to be sources of downside risk.

Against this background, Mr Lane proposed that the Governing Council should reconfirm its existing monetary policy measures.

In its communication, the Governing Council needed to: (i) highlight that the incoming data confirmed the December baseline assessment of a pronounced near-term impact of the pandemic on the economy and a protracted weakness in inflation; (ii) emphasise that ample monetary stimulus remained essential to preserve favourable financing conditions over the pandemic period for all sectors of the economy; (iii) stress that this would help to reduce uncertainty and bolster confidence, which would encourage consumer spending and business investment, underpin economic activity and safeguard medium-term price stability; (iv) reiterate that it would purchase flexibly under the PEPP, according to market conditions and with a view to preventing a tightening of financing conditions that was inconsistent with countering the downward impact of the pandemic on the projected path of inflation; and (v) reiterate that it continued to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner, in line with the commitment to symmetry.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members generally agreed with the assessment of the current economic situation in the euro area and the risks to activity provided by Mr Lane in his introduction. Overall, the incoming data confirmed the previous baseline assessment of a pronounced near-term impact of the pandemic on the economy and a protracted weakness in inflation.

As regards the external environment, members also broadly shared the assessment provided by Mr Lane in his introduction, that there were signs of an improvement in the global economic outlook. In particular, attention was drawn to positive news on the evolution of trade and growth in China and other Asian economies; to the additional US fiscal stimulus package and the final results of the US elections, which could lead to substantial further fiscal stimulus; and to the successful conclusion of an EU-UK trade agreement. On the geopolitical front, it appeared that there was less uncertainty on the whole. At the same time, the pandemic and the ongoing public health crisis continued to pose serious risks to the global economy.

Turning to euro area developments, following a sharp contraction in the first half of 2020 euro area real GDP had rebounded strongly, rising by 12.4%, quarter on quarter, in the third quarter, although remaining well below pre-pandemic levels. Members considered that incoming economic data, surveys and high-frequency indicators suggested that the resurgence of the pandemic and the associated intensification of containment measures had likely led to a decline in activity in the fourth quarter of 2020, although this was less pronounced than had been envisaged in the December 2020 Eurosystem staff macroeconomic projections. Conversely, the recent intensification of the pandemic was expected to weigh more heavily on activity in the first quarter of 2021 than had been foreseen earlier. However, taking the two quarters together, developments remained broadly in line with the December baseline projection overall. It was also recalled that an extension of the containment measures beyond the fourth quarter of 2020 had been incorporated into the December staff projections. However, it was highlighted that in response to the increase in cases of infection further measures

had been taken, or had been announced, in many euro area countries, which had led to tighter restrictions than had been anticipated in the December projections.

Moreover, it was argued that the fast rebound in growth foreseen in the December staff projections might be too optimistic, with growth in the second quarter of 2021 possibly at risk from extended lockdowns. In addition, vaccination roll-outs were proving to be slow and concern was also expressed about the possible impact of the spread of new, more virulent, mutations of the virus, which had proliferated following the December holiday period. At the same time, it was noted that the economic costs of containment measures were now lower than in spring 2020, as the measures were more targeted and firms had learned to better adjust to the restrictions. In addition, it was emphasised that although containment measures were stricter, governments were also providing more fiscal support, which would cushion the short-term impact of tighter restrictions. While the delay in the vaccination roll-outs relative to earlier expectations was likely to contribute to longer-lasting restrictions, this could be attributed mainly to logistics and was seen as affecting the time frame, rather than changing the picture substantially.

It was underlined that economic developments continued to be uneven across sectors, with the services sector being more adversely affected by the new restrictions on social interaction and mobility than the industrial sector. There was also heterogeneity across euro area countries. Although fiscal policy measures were continuing to support households and firms, consumers were seen as remaining cautious in the light of the pandemic and its impact on employment and earnings. However, reference was also made to the high level of accumulated household savings and the potential pent-up demand, which would contribute to a swift rebound in consumption once containment measures were eased. At the same time, weaker corporate balance sheets and uncertainty about the economic outlook were seen to be still weighing on business investment.

Members highlighted the dichotomy between risks to the short-term outlook and more positive developments in the medium term. The roll-out of vaccines, which had started in late December, allowed for greater confidence in the resolution of the health crisis. However, it would take time until widespread immunity was achieved, and further setbacks related to the pandemic could not be ruled out. So far the improvement in the macroeconomic outlook appeared to be driven more by external factors than by domestic factors, which was beneficial for the euro area as an open economy, particularly for the manufacturing sector. Looking ahead, the recovery of the euro area economy should be supported by favourable financing conditions, an expansionary fiscal stance and a recovery in demand as containment measures were lifted and uncertainty receded. However, reference was also made in the discussion to the continued risk of a cliff-edge effect from a premature removal of fiscal stimulus as well as from weaker corporate and banking sector balance sheets, given the risk of a surge in corporate insolvencies and non-performing loans.

Overall, members assessed that the risks surrounding the euro area growth outlook remained tilted to the downside but had become less pronounced compared with the situation in the autumn prior to the news on vaccines. Improved prospects for the global economy, the agreement on future EU-UK relations and the start of vaccination campaigns were encouraging, but the ongoing pandemic and its implications for economic and financial conditions continued to be sources of downside risk.

Regarding fiscal policies, an ambitious and coordinated fiscal stance was seen as remaining critical, in view of the sharp contraction in the euro area economy. To this end, continued support from national fiscal policies was warranted, given weak demand from firms and households related to the worsening of the pandemic and the intensification of containment measures. At the same time, it was emphasised that fiscal measures taken in response to the pandemic emergency should, as much as possible, remain targeted and temporary in nature.

There was also concern that although European leaders had agreed to deliver the largest support package ever financed by the EU budget, progress on implementation was slow and challenging. The key role of the Next Generation EU package was underlined, as was the importance of it becoming operational without delay. Member States were called upon to accelerate the ratification process, to finalise their recovery and resilience plans promptly and to deploy the funds for productive public spending, accompanied by productivity-enhancing structural policies. This would allow the Next Generation EU programme to contribute to a faster, stronger and more uniform recovery and would increase economic resilience and the growth potential of Member States' economies, thereby also supporting the effectiveness of monetary policy in the euro area. Such structural policies were particularly important in addressing long-standing structural and institutional weaknesses and in accelerating the green and digital transitions.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. Euro area annual inflation had remained unchanged at -0.3% in December. On the basis of current energy price dynamics, headline inflation was likely to increase in the coming months, in part supported by the end of the temporary VAT reduction in Germany. However, underlying price pressures were expected to remain subdued owing to weak demand, notably in the tourism and travel-related sectors, as well as to low wage pressures and the appreciation of the euro. Once the impact of the pandemic had faded, a recovery in demand, supported by accommodative fiscal and monetary policies, would put upward pressure on inflation over the medium term. Survey-based measures and market-based indicators of longer-term inflation expectations remained at low levels, although market-based indicators of inflation expectations had increased slightly.

In discussing recent inflation developments, members agreed that, while broadly in line with the December 2020 staff projections, headline inflation was at a very low level and in December underlying inflation had reached a historical low. Although stronger global demand and higher commodity prices would help to push up inflation, price pressures generally remained subdued so that achieving a robust convergence to the ECB's medium-term inflation aim remained a challenge, with favourable developments for the economy and inflation all being contingent on progress in curbing the spread of the pandemic.

It was emphasised that the medium-term outlook for inflation was surrounded by a high level of uncertainty, given the unprecedented pandemic situation and long-standing questions about changes in the underlying determinants of inflation. This elevated uncertainty was related not only to the strength of the post-pandemic economic recovery, but also to the relative importance of demand versus supply factors in different sectors of the economy and to questions about the strength of pass-through from financing conditions to inflation. In

addition, there continued to be acute measurement issues related to the relevant weights in the price indices during the pandemic period.

The projected gradual recovery in inflation in the baseline scenario was seen to remain broadly valid, but it was highlighted that inflation was only projected to be 1.4% in 2023. At the same time, there appeared to be little risk of deflation at this juncture, with inflation expected to rise in the short term owing to higher energy prices and the reversal of a temporary tax reduction in one jurisdiction, together with the rapid recovery in activity expected after restrictions were lifted. It could also not be ruled out that in the course of 2021 inflation dynamics might be stronger than foreseen in the projections, at least temporarily, in the light of global developments and especially if there was a stronger than expected rebound in activity in the second half of the year. The point was made, however, that such a temporary boost to inflation should not be mistaken for a sustained increase, which was still likely to emerge only slowly.

Members reviewed the latest exchange rate developments, noting that the recent persistent trend appreciation of the euro had reversed since the start of 2021. Possible adverse implications of a further appreciation of the euro for the inflation outlook were reiterated. It was noted that the nominal effective exchange rate was at a historically high level and had already had a negative impact on inflation, although it was also highlighted that the impact of exchange rate movements on inflation might be overestimated in standard models.

Regarding recent developments in inflation expectations members noted that, according to the ECB's latest SPF, longer-term inflation expectations were unchanged, at 1.7%, while market-based indicators of inflation expectations had increased. The five-year forward inflation-linked swap rate five years ahead now stood at 1.32%, i.e. back at pre-pandemic levels. It was regarded as positive that the pandemic had barely affected longer-term inflation expectations and, given the adaptive nature of inflation expectations, it was argued that an increase in inflation could have a positive impact on inflation expectations in the future. It was also noted, however, that the increase in market-based measures in the euro area was mainly due to global factors.

Turning to the monetary analysis, members broadly agreed with the assessment provided by Mr Lane in his introduction. The annual growth rates of broad money (M3) and narrow money (M1) had been high in November, at 11.0% and 14.5%, respectively. It was highlighted that recent money growth had been mainly due to the Eurosystem's ongoing asset purchases, with monetary dynamics therefore driven more by developments on the asset side than on the liability side of the Eurosystem balance sheet.

Attention was drawn to the recent developments in loans to the private sector, which had been characterised by moderate lending to non-financial corporations and resilient lending to households. It was noted that, at 6.9%, the annual growth rate of lending to non-financial corporations appeared robust. However, this was mainly reflecting the very strong increase in lending in the first half of the year while the monthly lending flows had moderated since the end of the summer, which could translate into weak investment dynamics over time. However, it was also argued that firms had built up sizeable precautionary buffers and the recent slowdown in credit should not be interpreted as the start of a financial amplification cycle. At the same time, concerns were expressed about a possible deterioration in firms' financial positions looking ahead, as and when public support measures were phased out.

Views were exchanged on the interpretation of the results of the bank lending survey (BLS) for the fourth quarter of 2020, which reported a continued net tightening of credit standards on loans to firms. This tightening was mainly driven by heightened risk perceptions among banks, in a context of continued uncertainty about the economic recovery and concerns about borrower creditworthiness. It was underlined that in the perception of banks the recession seemed to be harming the creditworthiness of non-financial companies, as crisis-related bankruptcies could trigger a surge in non-performing loans (NPLs) when payment holidays and moratoria expired.

On the one hand, it was argued that the results of the BLS warranted careful monitoring as they could signal a further tightening ahead with corresponding negative consequences for credit flows and economic activity. In addition, the results highlighted the role of structural weaknesses in the euro area banking sector, such as overcapacity, high NPLs, low profitability and slow progress on digitalisation. On the other hand, it was recalled that reported credit standards had tightened much less than in previous crisis episodes, while state-guaranteed loans had led to a significant relaxation of credit standards in the second quarter and the recent tightening thus could be interpreted as a return to more normal conditions.

Monetary policy stance and policy considerations

Members took note of the assessments of financial and financing conditions provided by Ms Schnabel and Mr Lane in their introductions, which had remained favourable since the Governing Council's meeting in December, also on account of the ECB's recalibrated monetary policy package, which had been well received by financial markets. Financial markets had remained calm, with several standard indicators of financial conditions signalling a degree of accommodation comparable to, or higher than, that prevailing at the start of the pandemic. Although euro area risk-free rates had risen slightly since the December meeting, sovereign and credit spreads had been resilient, bond market conditions had remained favourable – also for corporate bonds – and bank lending rates were close to their historical lows for both households and firms. When taking the increase in market-based inflation expectations into account, real yields were at historical lows. It was observed that expectations of substantial US fiscal support had led to a steepening of the US Treasury yield curve, which had only affected yields in the euro area to a limited extent, as a significant “decoupling” of yields could be observed.

Moreover, euro area stock prices had increased further since the December meeting, while the euro exchange rate was broadly stable amid some volatility. It was noted that staff analysis suggested that recent exchange rate developments had been driven less by policy shocks and more by global risk sentiment. Concerns were voiced, however, over developments in the exchange rate that might have negative implications for euro area financial conditions and, ultimately, consequences for the inflation outlook.

Members agreed that ample monetary stimulus remained essential to preserve favourable financing conditions over the pandemic period. Overall, the monetary policy stance was assessed to have remained very accommodative and to have helped preserve the favourable financing conditions that were necessary to counter the downward impact of the pandemic on the projected path of inflation. Recent financial market developments confirmed that the Governing Council's decision to focus on the extended duration of the

pandemic emergency measures, the preservation of favourable financing conditions and the flexibility of the PEPP had so far proven effective. The view was held that favourable financing conditions needed to prevail for some time in order to provide continued support to the flow of credit to all sectors of the economy and to counter possible macro-financial amplification effects.

Against this background it was recalled that the projected path of inflation in the December Eurosystem staff macroeconomic projections continued to be distant from the Governing Council's medium-term inflation aim. While the December package had been calibrated with the objective to counter the downward impact of the pandemic on the projected path of inflation, the view was held that the Governing Council should allow real interest rates to decline if financing conditions eased on account of an increase in inflation expectations. As the inflation outlook was falling significantly short of the Governing Council's aim, lower real yields would provide additional support for a faster return to price stability. At the same time, it was maintained that not every increase in nominal yields should be interpreted as an unwarranted tightening of financing conditions and trigger a corresponding policy response. It was noted that nominal yields were not an appropriate benchmark for assessing whether financing conditions remained favourable, as they could rise because of a better economic outlook and higher inflation expectations. What mattered from a monetary policy perspective was the evolution of real rates, which had declined to record low levels in recent weeks.

Overall, it was widely felt that the recalibration of instruments decided on in December remained appropriate and well-balanced, while all instruments needed to remain on the table, with due consideration of benefits and possible unintended side effects. It was also emphasised that a holistic approach was needed when defining the relevant range of financing conditions to be targeted in a broad and flexible manner, for all sectors of the economy, private and public. It should also comprise bank lending rates, as well as credit volumes and conditions for households and firms, take into account economic and market developments, and ultimately be anchored in the medium-term outlook for price stability.

All members agreed with Mr Lane's proposal to reconfirm the existing monetary policy measures. It was argued that monetary policy should keep a steady hand and that the measures that were put in place in December should be given time to take full effect. Moreover, the economic outlook was judged to be evolving broadly in line with the December Eurosystem staff projections, and the present configuration of monetary policy tools was deemed supportive and flexible enough to address the current situation. Overall, members also widely agreed that there was no room for complacency and that the Governing Council had to continue to stand ready and use all of its instruments, as appropriate, to ensure a robust convergence of inflation towards its aim.

Members agreed that the monetary measures in place, including those adopted since the onset of the pandemic, were effective and proportionate in supporting growth and inflation, and that the balance of the benefits and costs remained positive. The purchases under the PEPP contributed to preserving favourable financing conditions for all sectors, while the third series of targeted longer-term refinancing operations (TLTRO III) remained an attractive source of funding for banks, supporting bank lending to firms and households. The continued reinvestments of principal payments from maturing securities purchased under the

PEPP and the asset purchase programme (APP) were enhancing favourable financing conditions by signalling a continued presence of the Eurosystem in the markets over the pandemic period and beyond.

The purchases under the PEPP would continue to be conducted flexibly according to market conditions to preserve favourable financing conditions over the pandemic period with a view to countering the downward impact of the pandemic on the projected path of inflation. In addition, the flexibility of purchases over time, across asset classes and among jurisdictions would continue to support the smooth transmission of monetary policy. In this regard, the dual role of the PEPP was stressed.

As regards communication, members broadly agreed with the elements proposed by Mr Lane in his introduction. On the one hand, it was deemed important to stress that the current inflation outlook remained disappointing with an inflation rate well below 2% in the baseline scenario. On the other hand, a balanced presentation of the outlook was called for, as some uncertainties regarding the international developments had been resolved in a more positive way than expected.

In this context, it had to be emphasised that the measures put in place were appropriate in view of the current outlook but were also designed to react flexibly and equally to either potentially less favourable developments or upside surprises. It was seen as essential to convey that the Governing Council was committed to maintaining a steady presence in the markets to ensure favourable financing conditions. Moreover, the point was made that the Governing Council needed to stress that there was no room for complacency. It was also felt that the Governing Council should reiterate its vigilance with regard to developments in the exchange rate and their implications for the inflation outlook. In addition, the Governing Council needed to state that it continued to stand ready to adjust all of its instruments, including the deposit facility rate (DFR), as appropriate, to ensure that inflation moved toward its aim in a sustained manner.

Finally, in view of the sharp contraction of the euro area economy it was deemed important for the Governing Council to emphasise the need for continued and ambitious fiscal policies to support the recovery.

Monetary policy decisions and communication

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

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

Second, the Governing Council would continue the purchases under the PEPP with a total envelope of €1,850 billion. The Governing Council would conduct net asset purchases under the PEPP until at least the end of March 2022 and, in any case, until it judged that the coronavirus crisis phase was over. The purchases under the PEPP would be conducted to preserve favourable financing conditions over the pandemic period. If favourable financing conditions could be maintained with asset purchase flows that did not exhaust the

envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope could be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The Governing Council would continue to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2023. In any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance.

Third, net purchases under the APP would continue at a monthly pace of €20 billion. The Governing Council continued to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it started raising the key ECB interest rates.

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

Finally, the Governing Council would continue to provide ample liquidity through its refinancing operations. In particular, the third series of targeted longer-term refinancing operations (TLTRO III) remained an attractive source of funding for banks, supporting bank lending to firms and households.

The Governing Council continued to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner, in line with its commitment to symmetry.

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

Introductory statement

[Introductory statement to the press conference of 21 January 2021](#)

Press releases

[Monetary policy decisions](#)

Meeting of the ECB's Governing Council, 20-21 January 2021

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Centeno

Mr Elderson

Mr Hernández de Cos
Mr Herodotou *
Mr Holzmann
Mr Kazāks *
Mr Kažimír
Mr Knot
Mr Lane
Mr Makhlouf
Mr Müller
Mr Panetta
Mr Rehn
Mr Reinesch
Ms Schnabel
Mr Scicluna
Mr Stourmaras *
Mr Vasiliauskas
Mr Vasle
Mr Villeroy de Galhau
Mr Visco *
Mr Weidmann
Mr Wunsch

* Members not holding a voting right in January 2021 under Article 10.2 of the ESCB Statute.

Other attendees

Mr Dombrovskis, Commission Executive Vice-President **
Ms Senkovic, Secretary, Director General Secretariat
Mr Smets, Secretary for monetary policy, Director General Economics
Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

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

Accompanying persons

Mr Arce
Mr Aucremanne
Mr Bradeško
Ms Buch
Mr Demarco
Ms Donnery
Mr Gaiotti

Ms Goulard

Mr Haber

Mr Kaasik

Mr Kuodis

Mr Kyriacou

Mr Lünnemann

Mr Novo

Mr Ódor

Mr Pattipeilohy

Ms Phelan

Mr Rutkaste

Mr Tavlás

Mr Välimäki

Other ECB staff

Mr Proissl, Director General Communications

Mr Straub, Counsellor to the President

Ms Rahmouni-Rousseau, Director General Market Operations

Mr Sousa, Deputy Director General Economics

Mr Rostagno, Director General Monetary Policy

Release of the next monetary policy account foreseen on Thursday, 8 April 2021.