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, 28-29 October 2020

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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 September 2020.

Financial markets had been driven by two opposing forces. On one side, reduced risks of a contested presidential election in the United States and expectations of a large fiscal stimulus programme under a potential Biden presidency had boosted risk sentiment and revived the reflation trade. On the other side, renewed lockdown measures in different countries on the back of a surge in new coronavirus (COVID-19) cases, especially in the euro area, were increasingly reflected in asset price valuations.

Unlike in spring, however, so far there had been no widespread flight into safe-haven assets. Instead, euro area sovereign bond spreads had compressed further and corporate bond spreads had remained stable. Equity markets, where policy support was least direct, had experienced a marked correction. Risk premia in euro area equity markets had increased and were estimated to have pulled euro area stock prices down by nearly 10% since the Governing Council's previous monetary policy meeting, although this decline had been partly mitigated by a rise in short-term earnings growth expectations.

In the United States, stock markets had increased by 5% since opinion polls started to point to a victory for the Democratic Party in the presidential election on 3 November 2020. Improved risk sentiment had also put renewed downward pressure on the US dollar, with positioning data pointing to risks of further US dollar depreciation. In bond markets, heightened expectations of fiscal stimulus in the United States had led to a notable steepening of the US Treasury curve, also reflecting rising inflation expectations.

In the euro area, by contrast, inflation expectations had trended lower since the Governing Council's previous monetary policy meeting, thereby also putting downward pressure on yields. The euro area risk-free curve was close to its flattest ever level, while the euro area GDP-weighted sovereign yield curve had shifted down further since the September monetary policy meeting. The curve was now measurably below the pre-pandemic level and firmly in negative territory up to the ten-year maturity. There was not a single euro area country that was not benefiting from negative yields, in most cases extending out to the three-year maturity.

The degree of accommodation currently embedded in euro area sovereign bond markets was practically unprecedented since the global financial crisis, both in its scale and its breadth across countries. The dispersion across euro area ten-year sovereign yields was at its pre-pandemic level, which itself had been far below the levels observed in previous years due to the substantial convergence in bond spreads in those countries that had been hit hardest by the sovereign debt crisis.

Market participants had pointed to three main reasons to explain why the spreads had fallen further. The first reason related to risk sentiment. There had been a strong negative correlation between euro area sovereign spreads and US stock price developments in the weeks before the current meeting. The second reason related

to expectations of further monetary policy support by the ECB. The third reason related to the first successful bond issuance under the European Commission's temporary programme of Support to mitigate Unemployment Risk in an Emergency (SURE), which had met with unprecedented demand. This provided tangible evidence of how the common European response to the crisis had helped to alleviate pressure on euro area sovereign funding and hence financing conditions. Therefore, contrary to the early phase of the crisis, the joint fiscal and monetary policy responses in the euro area had succeeded in providing firm protection against the risks of fragmentation and of an unwarranted tightening of financial conditions.

This was also clearly visible in corporate bond markets. In recent weeks, corporate credit spreads had largely resisted upward pressures despite a deteriorating growth outlook. The resilience in corporate bond markets likely also reflected the fact that firms had built up significant liquidity buffers over the past several months, limiting the extent to which they would have to rely on external credit in the event of a renewed collapse in business activity. At present, euro area firms' cash coverage was nearly four times higher than at the height of the global financial crisis.

Finally, growing excess liquidity was increasingly putting downward pressure on the term money market and commercial paper rates. Since early October 2020, the three-month EURIBOR had traded below the deposit facility rate, and corporates could issue three-month commercial paper at rates close to the deposit facility rate, providing an important liquidity backstop for corporates, with rates falling even faster at longer tenors.

All in all, financial market conditions remained very favourable across market segments, but vulnerabilities remained in the face of the exceptionally high uncertainty surrounding the future evolution of the pandemic-related crisis.

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

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

Regarding the external environment, the global economy had come back rapidly early in the third quarter, after the end of the lockdowns. Developments in the global composite output Purchasing Managers' Index (PMI), excluding the euro area, indicated that the recovery in activity was quite strong up to July but had flat-lined in September. Retail sales had recovered strongly around the world, while global consumer confidence had risen from its lowest level but still remained very weak. Turning to trade, high-frequency data pointed to a strong rebound in the third quarter of 2020 and early indications for the fourth quarter were also positive. Global financial conditions were broadly unchanged in both advanced and emerging economies.

Oil prices had increased slightly, by 1.8%, since the Governing Council's September monetary policy meeting, to stand at USD 39.8 per barrel on 26 October 2020, after trading in a narrow range. The euro had remained broadly stable against the US dollar (+0.4%), which continued to have a unique role in global trade, and in nominal effective terms (+0.2%) since the September meeting.

Turning to the euro area, output had rebounded strongly in the third quarter of 2020. At the same time, clear risks to GDP growth had emerged for the fourth quarter of 2020, linked primarily to the latest news about the plans for more severe lockdowns from November onwards.

The latest data supported the view that the recovery had been losing steam in the euro area. Industrial output had bounced back vigorously until August, when growth had decelerated to only 0.7% month on month. Retail sales had also softened in the summer months, and manufacturing and services PMIs for September and October suggested that the pace of recovery across the euro area had slowed.

Looking ahead, the outlook for services was gloomy, while industry appeared more resilient. Household savings were expected to remain high, but income support remained important for consumer confidence over the coming months in order to protect the economy. The outlook for business investment was depressed by weak demand, low revenues and low profitability.

Turning to euro area trade, exports and imports of goods had continued their recovery. Looking ahead, PMI new export orders signalled a continuation of the recovery in euro area goods exports, whereas the rebound in euro area services exports seemed to be fading, particularly in countries which relied heavily on tourism.

With respect to euro area labour markets, employment was expected to contract further and a large share of jobs were at risk. The PMI composite employment index had recovered strongly since spring, but remained below 50 in October. Since the start of the pandemic, the weakening in employment conditions had been particularly marked in labour-intensive sectors such as accommodation, food, transportation and warehousing. The euro area unemployment rate, which had increased from 7.2% in February to 8.1% in August, likely underestimated the ongoing adjustment in the euro area labour market.

Turning to nominal developments, HICP inflation fell to -0.3% in September, while HICP inflation excluding energy and food declined to a new low of 0.2% in September. The decrease in headline inflation, from -0.2% in August to -0.3% in September, reflected lower inflation not only for energy but also for non-energy industrial goods and services. Measures of underlying inflation were also weakening.

Regarding wage growth, euro area compensation per employee growth and compensation per hour growth had diverged strongly due to large changes in hours worked. Negotiated wage growth, which was not directly affected by changes in hours worked, had declined only gradually, with the few wage agreements that had been concluded over recent months pointing to lower wage increases.

Looking at survey-based longer-term inflation expectations, as reported in the latest ECB Survey of Professional Forecasters (SPF), inflation expectations five years ahead had remained broadly stable at around 1.6%-1.7%. Since the September monetary policy meeting, market-based indicators of longer-term inflation expectations had halted their recovery and remained broadly stable around their pre-pandemic levels. The five-year forward inflation-linked swap rate five years ahead stood at 1.16% on 26 October 2020.

As regards financial conditions in the euro area, the EONIA forward curve remained slightly inverted, but there were no firm expectations of an imminent rate cut. Longer-term risk-free rates remained broadly unchanged at low levels despite upward movements in US rates. Sovereign spreads had declined further amid expectations

of additional monetary and fiscal support. Risk asset markets were largely unchanged despite significant intra-period fluctuations and, overall, euro area financial conditions remained broadly stable.

Turning to money and credit, broad money (M3) growth remained buoyant, accelerating in September to 10.4% in annual terms. The strengthening of monetary dynamics since the start of the crisis had largely reflected precautionary motives. Domestic credit remained the main source of money creation.

The pandemic had triggered a major increase in non-financial corporate debt ratios in relation to gross operating surplus, both in gross terms and net of liquid assets. The increase in the gross debt ratio reflected both an increase in debt levels and the steep fall in activity, while net debt in absolute terms had declined slightly as firms accumulated large amounts of liquid assets that offset the increase in gross debt. External finance had recorded steep increases since the onset of the crisis, driven by both bank lending and corporate bond issuance. Bank lending rates remained very favourable, close to their historical lows. Direct market finance had been hit by the acute market turmoil in the initial phase of the crisis but had subsequently benefited from the pandemic emergency purchase programme (PEPP).

Policy support remained decisive for favourable credit conditions. A significant fraction of bank lending had been concentrated in those parts of the loan market that were benefiting from government guarantees, and the large and broad-based participation in the targeted longer-term refinancing operations (TLTROs), including the latest operation, had provided banks with significant funding cost relief.

The October bank lending survey signalled a tightening of credit standards, primarily related to a deterioration in banks' perceptions of the risks underlying the macroeconomic environment and borrowers' creditworthiness.

Regarding fiscal policies, the fiscal stance was expansionary in 2020 and the latest fiscal plans for 2021 foresaw larger support than previously expected. Fiscal plans for 2022 remained very uncertain, but the Next Generation EU (NGEU) programme could provide additional fiscal support for the economy.

Monetary policy considerations and policy options

Summing up, Mr Lane pointed out that, after a strong (albeit partial and uneven) rebound in economic activity over the summer months, the incoming data signalled that the euro area economic recovery was losing momentum relative to the previously projected recovery path. The rise in COVID-19 cases and the associated intensification of containment measures would restrict activity levels (especially in high-contact sectors), constituting a clear deterioration in the near-term outlook. High-frequency mobility indicators for transport, retail and recreation had started to weaken. Activity in the services sector was being hit the hardest, since it was most affected by the renewed restrictions on mobility and social interaction. Household consumption was expected to stay subdued, with the precautionary saving motive reinforced by the resurgence of the pandemic and its impact on employment and incomes. Weaker balance sheets and increased uncertainty about the economic outlook were weighing on business investment.

Headline inflation had declined from -0.2% in August to -0.3% in September, with inflation excluding energy and food decreasing from 0.4% to an all-time low of 0.2%. In terms of categories, the decline was being driven by

the extension of seasonal summer sales to non-summer items, a fall in travel-related prices and more negative energy inflation. While some of the factors weighing on inflation were likely to be transitory in nature, the persistence of weak demand implied more prolonged weakness in non-energy industrial goods inflation. Moreover, services inflation was expected to remain low, since the services sector was the most exposed to the ongoing intensification of containment measures. Accordingly, measures of underlying inflation were likely to remain subdued in the context of weak demand and significant slack in labour and product markets. Market-based indicators and survey-based measures of longer-term inflation expectations remained broadly unchanged at low levels.

On the basis of the downside inflation surprise and the current expected trajectory of energy prices, headline inflation would likely run below previous expectations and was currently expected to remain negative through early 2021, longer than in the September baseline projection.

After a long period of relatively benign conditions, in the most recent data financial markets were pricing a more pessimistic pandemic outlook.

The pace of monthly loan flows to firms had recently moderated and the results from the bank lending survey pointed to deteriorating credit conditions. In particular, after muted reactions in the earlier stages of the pandemic, credit standards on loans to firms had tightened in the third quarter of 2020. While banks indicated that their funding and balance sheet conditions remained supportive, higher risk perceptions were weighing on loan creation. The surveyed banks also reported a fall in loan demand from firms in the third quarter, reflecting a decline in emergency liquidity needs and weakening corporate investment. Accordingly, the amplification of adverse real-financial feedback loops remained a material risk and needed to be closely monitored.

The monetary policy measures taken in response to the pandemic had been effective and efficient in stabilising financial markets and supporting financing conditions for households and businesses. However, the incoming data pointed to a more severe slowdown in growth momentum and a weakening of underlying inflation dynamics compared with the previously expected recovery path. Furthermore, other near-term risk events were looming, including geopolitical risks. In the current environment, the risks surrounding the euro area growth outlook were clearly tilted to the downside.

In the weeks to come, key information would be received. This included a new round of macroeconomic projections, which would allow a reassessment of the economic outlook and the balance of risks. Pending that information, Mr Lane proposed leaving the overall monetary policy stance unchanged and reconfirming the full set of existing monetary policy measures. At the same time, the Governing Council should clearly signal that on the basis of its updated assessment in December, it would recalibrate all of its instruments, as appropriate, to ensure that financing conditions remained favourable to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path, thereby fostering the convergence of inflation towards its aim in a sustained manner, in line with its commitment to symmetry.

In its communication, the Governing Council needed to: (a) stress that the incoming information signalled that the euro area economic recovery was losing momentum and that the rise in COVID-19 infections and the associated intensification of containment measures was weighing on economic activity, constituting a clear

deterioration in the near-term outlook; (b) emphasise that measures of underlying inflation were declining and that inflation pressures were expected to remain subdued on account of weak demand, lower wage pressures and the past appreciation of the euro; (c) underline that in the current environment of risks clearly tilted to the downside, the Governing Council would carefully assess the incoming information, including the dynamics of the pandemic and developments in the euro exchange rate, and that the new round of Eurosystem staff macroeconomic projections in December would allow a thorough reassessment of the economic outlook and the balance of risks; (d) highlight that on the basis of this updated assessment, the Governing Council would recalibrate its instruments, as appropriate, to ensure that financing conditions remained favourable to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path, thereby fostering the convergence of inflation towards its aim in a sustained manner, in line with its commitment to symmetry; and (e) emphasise that an ambitious and coordinated fiscal stance remained critical in view of the sharp contraction in the euro area economy and the reduction in private demand.

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 for activity provided by Mr Lane in his introduction. Incoming data and survey results signalled that the euro area economic recovery was losing momentum more rapidly than expected. Following a strong, but partial and uneven, rebound in the third quarter, the rise in COVID-19 cases and the associated intensification of containment measures was weighing on activity and constituted a clear deterioration in the near-term outlook. While activity in the manufacturing sector had continued to recover, activity in the services sector, which was most affected by the new restrictions on social activities and mobility, had been slowing visibly. Although fiscal policy measures were supporting households and firms, consumers were cautious in the light of the pandemic and its ramifications for employment and earnings. Moreover, weaker balance sheets and increased uncertainty about the economic outlook were weighing on business investment. Looking ahead, while the uncertainty related to the evolution of the pandemic was likely to dampen the strength of the recovery in the labour market and in consumption and investment, the euro area economy should continue to be supported by favourable financing conditions and an expansionary fiscal stance.

As regards the external environment, members broadly shared the assessment provided by Mr Lane in his introduction. Global activity had rebounded swiftly early in the third quarter and more strongly than expected. However, the momentum had slowed more recently and downside risks were related to increasing COVID-19 infection rates globally and to geopolitical factors. Since the Governing Council's September monetary policy meeting, the exchange rate of the euro had remained broadly stable both against the US dollar and in nominal effective terms.

Turning to euro area developments, members underlined that there had been both positive and negative news since the last monetary policy meeting. Euro area real GDP had contracted by 11.8%, quarter on quarter, in the

second quarter of 2020. However, following the trough in April 2020, the euro area economy had rebounded strongly in the third quarter, likely more than had been expected in the September ECB staff projections, making up a large part of the contraction in the first half of the year. However, the strength of the rebound might also have reflected that countries had eased containment measures too much too soon. Rising COVID-19 infection rates were seen as undermining confidence again and leading to additional containment measures, generating a loss in growth momentum in the fourth quarter earlier and at a faster pace than had been foreseen. Reference was made to the level of the composite output PMI, which had fallen below 50, and to the fact that the PMI for new business had fallen back even more strongly.

No data released so far had incorporated the recent announcements of further containment measures. As in March, the economic situation was once again changing rapidly. It could not be excluded that the euro area, or at least some countries, would experience a double-dip recession. The euro area economic outlook was seen to depend crucially on the effectiveness of administrative measures and the infection dynamics of the pandemic, with the magnitude and duration of a further downturn being very uncertain.

It was noted that the restrictions being implemented now tended to be more targeted than in the spring, either at regions or at sectors, and could therefore have a more limited effect on activity than earlier in the year. It was also remarked that the rate of infections appeared to be more relevant for economic activity than the stringency of containment measures, which varied considerably. Nevertheless, it was clear that while some sectors – such as manufacturing and construction – would be less affected in the euro area than had been the case in the more general lockdowns earlier in the year, others – such as entertainment and leisure or tourism – would be heavily affected by the new restrictions.

Members were of the view that in the period ahead containment measures could be expected to become more stringent and to last longer than previously anticipated. The winter months would be challenging in terms of limiting the spread of the virus and a sequence of temporary "circuit breaker" lockdowns might prove to be necessary. As a result, the growth trajectory could be bumpier than previously projected. At the same time, it was recalled that the economy had rebounded very strongly after the lockdowns in the first wave of the pandemic and that a similar dynamic recovery might be expected in the future. However, it was unclear whether the liquidity buffers that firms and households had built up in recent months would prove to be sufficient to withstand a renewed deterioration in the economy in the period ahead. The emergence of the second wave of the pandemic could lead to more widespread business closures in a number of sectors, for example retail trade. Moreover, the point was made that governments might be more prudent in easing containment measures after the experience of the summer months. As a result, growth figures for 2021 as a whole could be adversely affected.

Against this background, members argued that, looking ahead, it would be important to consider the possibility that the pandemic might have longer-lasting effects both on the demand side and on the supply side, reducing potential growth. Concerns were also expressed about the possibility of non-linear effects arising from financial amplification channels and about the impact of the pandemic on balance sheet positions of firms, households, banks and governments, particularly given the persistence of the crisis. Overall, it was emphasised that there was no clear trade-off between containment measures required to reduce the spread of the virus and the impact on the economy and it was recognised that, ultimately, concerns about the economy would remain until a vaccine

or effective treatment became widely available, which could take some time. In this context, members emphasised the role of both national and European fiscal policy in cushioning the impact on the economy of necessary containment measures. In particular, it was regarded as positive news that additional fiscal stimulus was being announced at the same time as new measures to contain the spread of the virus. These new fiscal measures clearly went beyond those assumed in the September staff projections.

Members exchanged views on the extent to which the latest developments were still broadly consistent with the baseline scenario in the September ECB staff projections, or whether revisions in the upcoming December Eurosystem staff projections were likely to result in the baseline being closer to the severe scenario included in the September projections. While the September baseline scenario had assumed some resurgence of the virus and the need for ongoing containment measures, recent developments were seen as constituting a clear downside risk to the projections. It was highlighted that uncertainty remained very high, as it had been throughout the year. However, by the time of the December monetary policy meeting, information would be available on major geopolitical developments – such as the result of the US presidential election and Brexit – as well as the initial evidence on the effectiveness of the new restrictions in containing the spread of the virus and their impact on the economy. Moreover, by that time, draft national budgetary plans and their assessment by the European Commission should also have become available, together with further indications on the prospective use of NGEU funds.

Overall, members considered the risks surrounding the growth outlook to be clearly tilted to the downside. This assessment largely reflected the recent resurgence in COVID-19 infections, the associated intensification of containment measures and the high uncertainty surrounding the timeline of the pandemic and the implications for economic and financial conditions.

Regarding fiscal policies, an ambitious and coordinated fiscal stance remained critical in view of the sharp contraction in the euro area economy. While fiscal measures taken in response to the pandemic emergency should, as much as possible, be targeted and temporary in nature, weak demand from firms and households and the heightened risk of a delayed recovery warranted continued support from national fiscal policies. The three safety nets endorsed by the European Council for workers, businesses and sovereigns provided important funding support in this context. The key role of the NGEU package was stressed, as well as the importance of it becoming operational without delay. Provided that the funds were deployed for productive public spending and accompanied by productivity-enhancing structural reforms, the NGEU programme would contribute to a faster, stronger and more uniform recovery and would thereby enhance resilience and the growth potential of EU Member States' economies, 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 HICP inflation had decreased to -0.3% in September 2020, from -0.2% in August, reflecting developments in the prices of energy, non-energy industrial goods and services. On the basis of oil price dynamics and taking into account the temporary reduction in German VAT, headline inflation was likely to remain negative until early 2021. Moreover, near-term price pressures would remain subdued owing to

weak demand, notably in the tourism and travel-related sectors, as well as to lower wage pressures and the appreciation of the euro. Once the impact of the pandemic faded, a recovery in demand, supported by accommodative monetary and fiscal policies, would put upward pressure on inflation over the medium term. Market-based indicators and survey-based measures of longer-term inflation expectations had remained broadly unchanged at low levels.

It was observed that headline inflation was now expected to be in negative territory for longer than had been foreseen in the September ECB staff projections. Moreover, it was highlighted that HICP inflation excluding energy and food had fallen to a new low of 0.2% in September, owing to lower non-energy industrial goods and services inflation. At the same time, there had also been a reduction in inflation in other items in the price index, which was considered a cause for concern. It was pointed out that 35% of all items were currently posting negative growth rates and underlying price pressures were also weak, raising concerns over a lasting impact. At the same time, it was underlined in this context that it was important to stress the temporary nature of the current inflation dynamics, partly owing to special factors such as exceptional patterns in seasonal sales and temporary tax reductions. Moreover, account should also be taken of changes in the consumption basket, which implied that inflation might actually be slightly higher than reported. The impact of the latest developments in growth and inflation on the medium-term outlook for inflation would have to be carefully evaluated in the December projections. However, the view was expressed that the probability that inflation rates would be closer to the severe scenario included in the September staff projections was increasing, even if no additional negative surprises were to materialise.

Regarding recent developments in inflation expectations, members noted that longer-term inflation expectations reported in the ECB's SPF were stable at 1.7%, while market-based indicators of inflation expectations had declined slightly, with the five-year forward inflation-linked swap rate five years ahead standing at 1.16%. It was pointed out that the SPF survey round for the fourth quarter of 2020 had been conducted at the beginning of October, before the resurgence of the pandemic and the widespread re-introduction of containment measures, and the results therefore needed to be treated with caution. It was considered important to ensure that the protracted period of lower inflation in the short run did not lead to lower medium and long-term inflation expectations.

With regard to the monetary analysis, members broadly agreed with the assessment provided by Mr Lane in his introduction that broad money (M3) growth continued to reflect domestic credit creation and the ongoing asset purchases by the Eurosystem. While monthly flows in loans to non-financial corporations had moderated in recent months amid a decline in emergency liquidity needs and subdued investment, bank lending to the private sector continued to be supported by government guarantees and monetary policy, particularly TLTRO III, which provided banks with sizeable funding cost relief. Bank lending rates continued to stand near historical lows.

TLTRO III was seen to provide continuous support to bank lending, as evidenced by the higher than expected take-up in the latest operation. The results of the euro area bank lending survey signalled a tightening of credit standards in the third quarter of 2020, mainly on account of the deterioration in banks' perceptions of the risks to the macroeconomic environment and borrowers' creditworthiness. According to the survey, banks' cost of funds and balance sheet situation had not contributed to the tightening, underscoring the positive impact of

monetary policy support on bank funding conditions. Looking ahead, banks reported that they expected a considerable net tightening of credit standards also in the fourth quarter of 2020. It was remarked, however, that the results of the bank lending survey should not be over-interpreted or overstated in view of the very substantial credit easing observed in the second quarter, underpinned by state-guaranteed lending. Moreover, further fiscal and supervisory policy support might be forthcoming in the fourth quarter.

The point was made that heightened uncertainty surrounding the second wave of the pandemic and the associated containment measures could pose renewed risks to the transmission of monetary policy through the banking sector, which required close monitoring. Financial vulnerabilities in the corporate sector, in particular, could have negative ramifications for banks' balance sheets and give rise to adverse real-financial feedback loops. Against this backdrop, concerns were expressed about a likely increase in non-performing loans and a heterogeneous impact of the pandemic on the banking sector across countries. It was noted that recent equity price developments suggested that markets might have started pricing in the adverse impact on the banking system of the resurgence in COVID-19 infections, as evidenced by the underperformance of financial sector share prices. In this context, it was recalled that low profitability in the banking sector and the erosion of net interest margins presented ongoing challenges for euro area banks. The view was expressed that fiscal initiatives to address non-performing loans and ensure an adequately capitalised banking sector should be encouraged, while monetary policy was playing its part in supporting favourable financing conditions and ample liquidity in the banking sector.

Monetary policy stance and policy considerations

With regard to financial conditions, members widely shared the assessments provided by Ms Schnabel and Mr Lane in their introductions. It was noted that euro area financial markets had been relatively calm, with financial conditions – including exchange rate developments – being broadly stable and financing conditions for banks, households and firms remaining very favourable. The relatively muted reaction of markets to the second wave of the pandemic was seen as evidence of the effectiveness of the ECB's monetary policy measures in containing tail risks, including the risk of market fragmentation. At the same time, markets were seen to remain fragile and could face a correction in pricing – for example in the event of a no-deal Brexit, a further worsening of the pandemic or if an agreement on the disbursement of funds under the NGEU plan was delayed.

At the current juncture, members viewed the monetary policy stance as highly accommodative and appropriate. It was stressed that monetary policy had to aim to preserve favourable financing conditions in the future in order to support economic activity. Against this backdrop, members supported the proposal by Mr Lane to leave the overall monetary policy stance unchanged and to reconfirm the full set of existing monetary policy instruments. Furthermore, members widely agreed that, given the sharper slowdown in growth momentum and the weakening of underlying inflation dynamics compared with what had previously been expected, as well as the deterioration in the balance of risks, it would be warranted to recalibrate the monetary policy instruments in December. It was noted that taking monetary policy decisions in December would be consistent with prevailing market expectations. However, it was also stressed that the Governing Council was in a position to act at any time, if needed. At the same time, it was underlined that more than half of the PEPP envelope was still available

to conduct ongoing purchases in a flexible manner in case of renewed market turbulence. By the time of the December meeting, updated staff projections would be available and a clearer picture of the dynamics of the pandemic and prospects of a vaccine might have emerged, together with more information on the fiscal policy responses in the euro area.

With regard to the monetary policy measures taken since early March, members widely agreed that they were helping to preserve favourable financing conditions for all sectors and jurisdictions across the euro area, thereby providing crucial support to underpin economic activity and to safeguard medium-term price stability. The TLTROs were seen to be providing funding to banks at favourable rates and contributing to low interest rates for bank lending, and had so far successfully averted a credit crunch. The PEPP was proving successful in stabilising market conditions and reducing fragmentation, as well as easing the monetary policy stance. It was remarked that the flexibility embedded in the PEPP was essential to its continued success.

While the existing monetary policy instruments were viewed as effective, questions were raised about possible non-linearities, side effects and “diminishing returns” in an environment of high uncertainty and very favourable financial conditions. With markets having stabilised since the introduction of the pandemic-related monetary policy measures in March, it was noted that additional asset purchases might not have the same impact on financial conditions and real economic activity as they had had earlier in the year.

It was emphasised that, in the present environment, monetary policy in part operated by facilitating fiscal expansion through keeping financing costs affordable, and both policy domains were working “hand in hand”. It also had to be acknowledged, however, that an accommodative monetary policy stance could create the temptation for governments to enter into commitments that were difficult to undo and thereby increase expenditure beyond what was necessary to deal with the pandemic, exacerbating structural deficits and damaging the long-term sustainability of public finances.

As regards communication, members widely agreed with the proposals made by Mr Lane in his introduction. The Governing Council needed to signal that it stood ready to act with all the flexibility that was embodied in its pandemic emergency monetary policy tools, while also stressing its determination to act and signalling its willingness to adjust all instruments, if needed. It was stressed that any sign of complacency – even inadvertent – could be detrimental in the present circumstances.

While there was wide agreement on the need to signal the necessity of recalibrating the ECB’s monetary policy instruments at the December monetary policy meeting, it was cautioned that the Governing Council should not pre-commit itself to specific policy actions.

In its communication the Governing Council needed to highlight that the downside risks to the baseline scenario of the September projections had clearly increased, shifting the balance of risks further downwards, and that the Governing Council was carefully evaluating the worsening of the pandemic and the associated intensification of government containment measures with regard to their implications for the near-term outlook. Therefore, there was broad agreement that the Governing Council should communicate that, on the basis of this updated assessment, it would recalibrate its instruments, as appropriate, to ensure that financing conditions remained favourable to support the economic recovery, counteracting the negative impact of the pandemic on the

projected inflation path and thereby fostering the convergence of inflation towards the Governing Council's aim in a sustained manner, in line with its commitment to symmetry.

Finally, there was broad agreement among members to emphasise that an ambitious and coordinated fiscal stance remained critical and was the most effective policy in the current situation to deal with the effects of the pandemic and the associated containment measures. In its communication the Governing Council should strongly welcome the NGEU package and encourage the EU institutions to approve this package swiftly in order to activate it in a timely manner to support the regions and sectors hardest hit by the pandemic. In this context, it could be emphasised that monetary policy was removing obstacles to the expansion of fiscal policy by supporting favourable financing conditions and the proper functioning of financial markets. In this way fiscal and monetary policy reinforced each other in the current circumstances, with monetary policy increasing its own effectiveness by empowering fiscal policy and fostering confidence.

Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, upon a proposal by the President, who ascertained that the decisions and proposed communication were supported by all members, the Governing Council took the following monetary policy decisions:

(1) 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.

(2) The Governing Council would continue its purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,350 billion. These purchases contributed to easing the overall monetary policy stance, thereby helping to offset the downward impact of the pandemic on the projected path of inflation. The purchases would continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions. This allowed the Governing Council to effectively stave off risks to the smooth transmission of monetary policy. The Governing Council would conduct net asset purchases under the PEPP until at least the end of June 2021 and, in any case, until it judged that the coronavirus crisis phase was over. The Governing Council would reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2022. In any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance.

(3) Net purchases under the asset purchase programme (APP) would continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year. 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 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.

(4) The Governing Council would also 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 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 29 October 2020

Press release

Monetary policy decisions

Meeting of the ECB's Governing Council, 28-29 October 2020

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Centeno

Mr Hernández de Cos

Mr Herodotou

Mr Holzmann

Mr Kazāks

Mr Kažimír

Mr Knot

Mr Lane

Mr Makhlouf*

Mr Mersch

Mr Müller*

Mr Panetta

Mr Rehn

Mr Reinesch

Ms Schnabel

Mr Stournaras

Mr Vasiliauskas

Mr Vasle

Mr Vella

Mr Villeroy de Galhau

Mr Visco

Mr Weidmann*

Mr Wunsch*

* Members not holding a voting right in October 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 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 Odór

Mr Pattipeilohy

Mr Rutkaste

Mr Tavlas

Mr Välimäki

Other ECB staff

Mr Bracke, Deputy 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, 14 January 2021.