# Account of the monetary policy meeting

## of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 11-12 September 2019

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

### Financial market developments

Mr Cœuré reviewed the financial market developments since the Governing Council's previous monetary policy meeting on 24-25 July 2019. Global financial markets had undergone a strong correction over the summer, which bore a close resemblance to the episode observed during the spring. The principal catalyst on both occasions was an intensification of global trade tensions.

The yield on the ten-year German government bond had declined by around 35 basis points, compared with the day before the July meeting, to -71 basis points. The ten-year US Treasury yield had fallen by around 50 basis points.

Mr Cœuré highlighted three key aspects to help interpret these developments. The first related to the response of real interest rates, which was different from the spring episode. The large decline in real rates in August could be interpreted as a sign that market participants were becoming increasingly concerned about the cumulative impact of the sequence of trade shocks on the global economy.

The second point was whether there were signs of an effective lower bound gradually inducing non-linearity in the market reaction to shocks. Although the starting level of the ten-year German government bond yield prior to the August correction had been much lower than in the spring, and was already in deep negative territory, the order of magnitude of the decline had been similar in both episodes. There were no signs in this regard of downward rigidities in long-term rates that could relate to the effective lower bound. The EONIA forward curve had also continued to shift lower during August, pricing in a cumulative cut of almost 40 basis points in the rate on the ECB's deposit facility by early 2021. However, lower money market trading volumes for longer tenors suggested that the conviction about cuts significantly deeper into negative territory was not broad-based and uncertainty over the future path of short-term policy rates remained elevated.

The third aspect related to possible changes in portfolio rebalancing in response to the increase in the share of bonds that were trading at negative levels. A first development related to recent movements in the spread between the ten-year German Bund and the overnight index swap (OIS) rate, which until recently had been a reliable gauge of scarcity effects in the Bund cash market. However, since mid-July, there had been a notable reversal in the spread, despite growing scarcity in the cash market, to levels last seen towards the end of 2016. Market intelligence suggested that the reversal might primarily be related to hedging activities that were increasingly being conducted in the swap market rather than in the cash bond market. The second novelty in asset price responses was a flattening of the very long end of the yield curve, as evidenced by the narrower yield spread between 10-year and 30-year German government bonds. In August, for the first time, the entire German sovereign yield curve had moved into negative territory. The third novelty related to the marked and persistent rise in the price of gold, which coincided with the sharp increase in the share of bonds that were trading at negative levels.

Moving to the equity markets, the impact of the renewed trade tensions in August had been visible particularly in emerging markets. In the euro area and in the United States, the impact had been much more muted, with the decline in bond yields partly offsetting the rise in the equity risk premium.

As regards foreign exchange markets, the weakening of emerging market currencies contributed to a mild appreciation of the euro in nominal effective terms.

## 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, survey data pointed to subdued activity in the third quarter. Services, although weakening, had continued to support growth, while manufacturing activity had decelerated further. Trade tensions had sparked a risk-off sentiment, especially in emerging market economies. In the United States, economic activity was slowing – most clearly evidenced in investment – but remained solid. In China, the slowdown in economic activity was accentuated by new tariffs, while in Japan the growth momentum was set to decelerate and inflation remained subdued. In the United Kingdom, the risk of a no-deal Brexit was increasing, while economic activity had stalled. Overall, risks to global activity and trade remained on the downside.

Oil prices had dropped by 8% in August. As regards exchange rates, since the Governing Council's July monetary policy meeting the euro had been essentially flat, depreciating by -1.2% in bilateral terms against the US dollar but appreciating by 0.7% in nominal effective terms.

Turning to the euro area, information available since the July monetary policy meeting signalled a more protracted weakness in euro area growth dynamics, mainly driven by the external sector. Eurostat's second release of 6 September put real GDP growth in the second quarter of 2019 at 0.2% in quarter-on-quarter terms. With regard to developments in the third quarter so far, while the Economic Sentiment Indicator and the Purchasing Managers' Index had edged up in August, taking July and August together they had, on average, been lower than in the second quarter, suggesting a continuation of subdued growth. As regards sectoral developments, the exceptional divergence between manufacturing and services had persisted, reflecting the trade shock that the euro area currently faced, which predominantly affected the manufacturing sector.

Domestic demand had, on the whole, remained resilient and continued to be underpinned by a solid labour market, household confidence, improving balance sheets and policy stimulus. Real private consumption had expanded by 0.2% in the second quarter of 2019, following an exceptionally strong increase of 0.4% in the first quarter. Households continued to signal optimism about their future financial situation. In line with this, retail trade had continued to grow at an overall robust pace. Regarding housing investment, growth was expected to remain supported both from a demand and a supply-side perspective. Business investment had been slowing since early 2018 and the latest indicators suggested a continuation of subdued business investment in the short term. As regards the labour market, employment had grown by 0.2% in quarter-on-quarter terms in the second quarter of 2019, down from 0.4% in the first quarter. Looking ahead, the PMI employment component pointed to a further moderation in employment growth.

These developments were also reflected in the September 2019 ECB staff macroeconomic projections for the euro area, which projected real GDP growth at 1.1% in 2019, 1.2% in 2020 and 1.4% in 2021. Compared with the June 2019 Eurosystem staff projections, real GDP growth had been revised down by 0.1 percentage points for 2019 and by 0.2 percentage points for 2020, while it was unrevised for 2021. The revisions were mainly on account of weaker external demand, which was somewhat cushioned by the impact of lower energy prices and the easing of financial conditions. Over the medium term, the baseline assumed a gradual dissipation of global headwinds, allowing fundamental factors supporting the euro area expansion to regain traction. The outlook was supported by the ECB's very accommodative monetary policy stance, improving labour markets and relatively robust wage growth and net worth, as well as by declining unemployment, rising profits, a loosening fiscal stance and a recovery in foreign demand. Nevertheless, GDP growth was expected to slow towards the end of the projection horizon, as declining capacity utilisation, a prolonged period of low business confidence and the expiration of tax incentives adversely affected investment. Moreover, labour supply constraints restricted employment growth. Projections from other institutions and the private sector were in line with the September 2019 ECB staff projections.

Turning to euro area price developments, according to Eurostat's flash estimate of 30 August, both annual headline HICP inflation and HICP inflation excluding food and energy had moved sideways in July, at 1.0% and 0.9% respectively. Measures of underlying inflation remained muted and indicators of inflation expectations were stagnating. Wage growth remained solid, increasing at rates around long-term averages. Compensation per employee had increased by 2.1% in annual terms in the second quarter of 2019, while compensation per hour had increased by 2.2%. Negotiated wage growth continued to stand above its 2018 level in the first half of 2019.

Since the first quarter of 2018, unit labour cost growth had risen strongly. Between the first quarter of 2018 and the second quarter of 2019 it had more than doubled, increasing from 1.0% to 2.1%. This reflected the decline in labour productivity growth over the same period, in turn a reflection of the resilience of the labour market in the face of slowing GDP growth. Strengthening unit labour cost pressures had so far been largely absorbed by profit margins.

In the September ECB staff projections, HICP inflation had been revised down over the whole projection horizon and was projected to reach 1.5% in 2021. The downward revision of inflation was due to lower energy prices, but also reflected the subdued nature of inflation dynamics.

Since the Governing Council's July monetary policy meeting, medium to longer-term euro area market-based measures of inflation expectations had largely stabilised at low levels. Despite the fall, recent developments constituted a moderation in a downward trend that had started in the autumn of 2018.

In terms of euro area financial conditions, a further notable decline in euro area risk-free rates across maturities had taken place since the Governing Council's July monetary policy meeting. The EONIA forward curve had inverted further at short horizons. In addition, both the euro area ten-year OIS rate and the ten-year US Treasury yield had fallen. Since the July meeting, euro area equity prices had also declined somewhat, mainly on account of risk premia, but their fall had been cushioned by lower discount rates. Taken together, the easing trend in financial conditions had come to a halt, while financing conditions for non-financial corporations (NFCs) had remained very favourable.

Turning to money and credit developments, the annual growth rate of broad money (M3) had risen to 5.2% in July, after 4.5% in June and 4.8% in May, despite a fading annual contribution from the asset purchase programme (APP) and a slowdown in economic activity. This resilience continued to reflect portfolio considerations, driven by declines in the yields of non-monetary assets, which decreased the opportunity cost of holding M3 and led money holders to increase the share of M3 holdings in their financial portfolios. From a counterpart perspective, this was mirrored in further monetary inflows from outside the euro area, which reflected a recovery in foreign investor demand for euro area assets. Bank funding costs continued to be favourable, mainly driven by the decline in bank bond yields. The cost of borrowing from banks for firms and households had fallen to new record lows. The annual growth rate of loans to NFCs remained stable at 3.9% in July, only somewhat below its September 2018 peak of 4.3%. The annual growth rate of loans to households had continued its gradual increase, rising to 3.4% in July.

As regards fiscal policy, the euro area fiscal stance – as measured by the change in the cyclically adjusted primary balance – was projected to be mildly expansionary over the period 2019-21. The negative impact of the stance on the headline budget balance over 2019-21 was largely offset by savings in interest payments.

## Monetary policy considerations and policy options

Summing up, Mr Lane remarked that, since the Governing Council's July monetary policy meeting, risk-free interest rates had declined notably, a partial reversal in the last week notwithstanding. At the same time, the easing potential from rates declining due to a deterioration in the macroeconomic outlook and to revised calculations of the equilibrium real interest rate might be limited. Equities had only declined moderately, as the lower discount rates had cushioned the impact of higher equity risk premia. Bank lending conditions for firms and households continued to be very favourable.

The most recent data indicated a more extended slowdown in the euro area economy than previously expected. In particular, the weakness of international trade and prolonged global uncertainties continued to weigh, especially on the manufacturing sector. The September 2019 ECB staff projections had further marked down the real GDP growth outlook in 2019 and 2020, mainly owing to the weaker global environment.

The balance of risks remained tilted to the downside, largely on account of the prolonged presence of uncertainties related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets.

HICP inflation dynamics and developments in measures of underlying inflation remained muted, despite robust wage dynamics. The September projections entailed a downward revision of inflation over the projection horizon, with projected inflation reaching only 1.5% in 2021. This was, in part, related to lower energy prices, but also to the weaker growth environment. Both market and survey-based indicators of inflation expectations had stagnated at historical lows.

Overall, the Governing Council was confronted with a protracted slowdown in the euro area economy, persistent downside risks and an inflation outlook that continued to fall short of its medium-term inflation aim.

Taking a longer perspective, since December 2018 successive and significant downward revisions to the inflation outlook had been observed, bringing the 2021 inflation projection down from 1.8% to 1.5%. The further downgrade of the inflation outlook – despite the fact that the financial conditions embedded in the forecast already reflected substantial expectations for additional policy easing – meant that inflation was moving further away from levels that the Governing Council deemed consistent with its inflation aim and implied a further delay in inflation convergence.

Against this background, a comprehensive policy response was warranted to support the return to a sustained convergence path towards the Governing Council's medium-term inflation aim.

Mr Lane therefore proposed taking the following decisions at the current meeting. First, to lower the deposit facility rate by 10 basis points to -0.50%. Second, to adjust the forward guidance by stipulating that the key ECB interest rates would now be expected to remain at their present or lower levels until projected inflation was seen to converge to and stabilise around a level sufficiently close to, but below, 2% within the projection horizon, and such convergence had been consistently reflected in underlying inflation dynamics. Third, to restart net purchases under the APP at a monthly pace of €20 billion as from 1 November 2019. Moreover, net asset purchases should be expected to run for as long as necessary, to reinforce the accommodative impact of the ECB's policy rates, and to end shortly before the Governing Council started raising interest rates. Fourth, 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 the Governing Council started raising 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. Fifth, to change the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. The interest rate in each operation would be set at the level of the average rate for the Eurosystem's main refinancing operations (MROs) over the life of the respective TLTRO. For banks whose eligible net lending exceeded a benchmark, the applied rate in TLTRO III operations would be lower, and could be as low as the average deposit facility rate prevailing over the life of the operation. Moreover, the maturity of the operations would be prolonged from two to three years. Sixth, in order to safeguard the bank-based transmission of monetary policy, to introduce a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity would be exempt from the negative deposit facility rate.

This set of measures would provide monetary support through a range of mechanisms. Lowering the deposit facility rate – together with the reinforced forward guidance – would operate throughout the yield curve, especially in the short to medium-term segments. The strengthened state-dependent forward guidance would provide a clear signpost for rate expectations by linking the Governing Council's monetary policy to more stringent conditions for the inflation outlook. Moreover, forward guidance was especially effective under conditions of elevated uncertainty by facilitating smooth adjustment to the evolution of macroeconomic and financial conditions in both directions, with expectations about the future policy path responding in a stabilising manner to positive or negative news. According to the strengthened forward guidance, over the projection horizon projected inflation would not only need to converge to, but also stabilise around, levels "sufficiently close to, but below, 2%". The reference to such levels would signal that the Governing Council wanted to see projected inflation increase significantly from the current realised and projected inflation figures, which were well below levels considered to be in line with its aim. The Governing Council's guidance would remain forward-looking, in line with its strategy oriented towards the medium term. At the same time, the proposed guidance would contain safeguards against the risk of overreacting to transitory shocks to inflation, as well as against forecast and measurement errors, as it would be emphasised that convergence should be robust and that underlying inflation would have to increase to ensure that the pick-up in inflation was backed by a sustained build-up of domestic price pressures. Furthermore, by maintaining the easing bias on rates, the Governing Council would indicate that it still had room to cut rates further, if needed.

Resuming net purchases was an important complement to interest rate policy. In particular, the APP had a greater impact on longer-term rates, providing further support to the funding costs that mattered to businesses and households. Under the proposed formulation, the net purchase horizon dynamically adjusted to changes in the forward guidance on interest rates and thereby worked in the background to keep a lid on medium to longer-term interest rates. By adding to the stock of assets and reinvesting for longer, the Governing Council could postpone an undue tightening in term premia, which mechanically occurred as the APP's portfolio lost average duration. In addition, APP net purchases had strong signalling effects and wealth effects on the balance sheets of banks and other entities, and the APP tended to have a more powerful effect on the formation of inflation expectations by demonstrating the Governing Council's commitment to use all instruments in pursuit of its aim.

More generally, a two-track approach, whereby the Governing Council actively deployed both the short-term policy rate and net asset purchases, struck a balance by ensuring that it deployed mutually-reinforcing instruments in the most efficient manner, rather than relying excessively on any one instrument.

In relation to the reinvestment policy, the chained nature of the forward guidance meant that the revised forward guidance on policy rates would pass through to the horizon for maintaining the stock of purchased assets.

Turning to the other elements of the proposal, a more attractive TLTRO III pricing would support bank funding conditions in an environment of weak growth. This would ensure that banks would continue to offer favourable lending conditions to firms and households, which would ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. Prolonging the maturity to three years would better align the operations with the typical maturity of bank-based financing of investment projects, thereby enhancing the support that TLTRO III provided to the financing of the real economy.

Finally, a two-tier system for reserve remuneration would help preserve the positive effects of the Governing Council's negative rate policy on the economy by mitigating the direct cost for banks of holding excess reserves, thereby contributing to the safeguarding of the bank-based transmission mechanism of the monetary policy.

In summary, the proposed range of measures complemented and reinforced one another and constituted a powerful package to provide substantial monetary stimulus that would ensure that financial conditions remained very favourable and would support euro area growth, the ongoing build-up of domestic price pressures and the sustained convergence of inflation to the Governing Council's medium-term inflation aim. At the same time, the Governing Council should reiterate the need for a highly accommodative stance of monetary policy for a prolonged period of time and its readiness to adjust all its instruments, as appropriate, to ensure that inflation moved towards levels close to, but below, 2% in a sustained manner, in line with the Governing Council's commitment to symmetry in its inflation aim.

Mr Cœuré elaborated on the details of a possible two-tier system for the remuneration of excess liquidity and the proposed modifications to the TLTRO III parameters. An "exempt tier" would be introduced, with a multiplier of 6 to be applied to the level of credit institutions' minimum reserve requirements, to be remunerated at 0% and applicable to reserve holdings in excess of minimum reserve requirements held on current accounts with the Eurosystem. Turning to the proposed modifications to the price and maturity conditions of TLTRO III, the Governing Council was invited to decide to set the interest rate at the level of the average rate applied in the Eurosystem's MROs over the life of the respective TLTRO III operation, to prolong the maturity of operations from two to three years from their respective settlement dates and to provide an option for counterparties to repay the amounts borrowed voluntarily before maturity, at a quarterly frequency starting two years after the settlement of each operation. Furthermore, Mr Cœuré indicated that the prolongation of the maturity of the TLTRO III operations implied that the additional credit claims frameworks were automatically extended until the end of March 2024. In addition, Mr Cœuré recalled that, in October 2017, it had been decided that the interest rate in three-month longer-term refinancing operations (LTROs) would remain at the average rate of the MROs over the life of the respective operations covering the period until the last maintenance period of 2019, which should now be extended at least until the end of the reserve maintenance period starting in March 2021. Separately, a proposal was also made to allow purchases of assets with yields below the deposit facility rate under the private sector programmes of the APP, to the extent necessary, with the decision reflecting changes in market interest rates relative to the deposit facility rate.

## 2. Governing Council's discussion and monetary policy decisions

### Economic and monetary analyses

With regard to the economic analysis, members broadly shared the assessment of the outlook for economic activity in the euro area provided by Mr Lane in his introduction. Incoming information since the Governing Council's July monetary policy meeting indicated a more protracted weakness in the euro area economy than previously expected. The slowdown in growth mainly reflected the prevailing weakness of international trade in an environment of prolonged global uncertainties, which were particularly affecting the manufacturing sector. At the same time, the services and construction sectors showed ongoing resilience and a number of factors continued to support the euro area economic expansion, including favourable financing conditions, further employment gains and rising wage growth, the mildly expansionary euro area fiscal stance and the continued – albeit somewhat slower – growth in global activity. This assessment was broadly reflected in the September ECB staff projections.

In the discussion on the outlook and risks for the external environment, it was noted that, while global activity and trade were projected to recover gradually over the medium term, there had been a further downward revision to the outlook for both global growth and trade in the latest ECB staff projections. Members assessed the risks to the external environment to have remained on the downside on account of the prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets. In particular, reference was made to prevailing uncertainties related to trade tensions and Brexit.

Turning to euro area activity, members generally concurred that the recent data had been weaker than expected and that the euro area slowdown was now expected to be more protracted. Real GDP was confirmed to have increased by 0.2%, quarter on quarter, in the second quarter of 2019, following growth of 0.4% in the first quarter, while incoming economic data and survey information pointed to moderate, but positive, growth in the third quarter of the year. The downward revisions to the growth projections in the September ECB staff projections were generally considered to have been warranted, as they largely reflected disappointing data. The point was made that the revised baseline for growth and inflation should continue to be considered the most likely scenario, while significant downside risks remained.

Perceptions about the outlook differed somewhat, with several members arguing that, despite the revisions, the baseline scenario in the latest ECB staff projections was still too optimistic in the light of the prevailing uncertainties. At the same time, it was highlighted that, while the rebound in euro area growth was delayed, growth was still expected to recover from its current weakness over the projection horizon. The observation was also made that the euro area economy was operating at close to full capacity, in line with the projections. It was argued that the current slowdown in the euro area was the consequence of asymmetric shocks related to the external environment or to domestic factors, whose impact was largely concentrated in two of the largest euro area countries, primarily owing to weakness in the manufacturing sector. Reference was also made to the possibility of upside, as well as downside, risks; for example, if the ongoing trade tensions were to be resolved more quickly than expected.

However, a number of considerations were also advanced to suggest that the revised growth outlook might be too optimistic. The argument was made that the export weakness could over time be expected to spill over to domestic demand and to the services sector of the economy, and there were already some indications of the slowdown in exports affecting labour market developments. The slowdown could also be considered rather general and of a global nature, affecting a number of large economies, as opposed to reflecting specific asymmetric shocks. Moreover, the assumptions underlying the September ECB staff projections were seen as relatively favourable because the projections were based on an orderly Brexit – while the probability of a disorderly Brexit had recently increased – and assumed a resolution of trade tensions over time. Both of these assumptions could be considered optimistic. In addition, it was noted that the baseline did not contain some trade measures that had been announced since the finalisation of the projection exercise.

The risks surrounding the euro area growth outlook were generally assessed by members to be still tilted to the downside on account of the prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets.

In an exchange of views about fiscal policy, members considered that the mildly expansionary euro area fiscal stance was providing some support to economic activity. However, in view of the weaker economic outlook and the continued prominence of downside risks, it was emphasised that governments with fiscal space should act in an effective and timely manner. In countries where public debt was high, governments needed to pursue prudent policies that would create conditions for automatic stabilisers to operate freely, while all countries should reinforce their efforts to achieve a more growth-friendly composition of public finances.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. According to Eurostat’s flash estimate, euro area annual HICP inflation was 1.0% in August 2019, unchanged from July, with lower energy price inflation being offset by higher food price inflation. The rate of HICP inflation excluding food and energy was also unchanged. On the basis of current futures prices for oil and owing to base effects, annual headline inflation was likely to decline before rising again towards the end of the year. Measures of underlying inflation remained generally muted and indicators of inflation expectations stood at low levels. While labour cost pressures had strengthened and broadened amid high levels of capacity utilisation and tightening labour markets, their pass-through to inflation was taking longer than previously anticipated. Over the medium term, underlying inflation was expected to increase, supported by the ECB’s monetary policy measures, the ongoing economic expansion and robust wage growth. This assessment was also broadly reflected in the September ECB staff projections, which had been revised down over the whole horizon, reflecting lower energy prices and the weaker growth environment.

It was noted that both headline and underlying inflation were currently being dampened by a change in the statistical treatment of package holidays in the euro area’s largest economy, a factor which would fade in coming months. Looking ahead, members acknowledged the implications for the medium-term inflation outlook arising from the downward revisions to the growth outlook. Underlying inflation, as measured by the HICP excluding food and energy, was still expected by staff to pick up over the projection horizon but had been revised down compared with the June 2019 Eurosystem staff projections. Attention was drawn to the fact that the revised growth outlook implied less upward pressure on domestic inflation dynamics. Looking through the volatility of energy prices, there had been a downward revision to the inflation outlook at the end of the horizon, with the projected measures of underlying inflation and headline inflation only expected to reach 1.5% in 2021, at the end of the projection horizon.

Members underlined that wage growth continued to be solid and in line with long-term averages. However, the transmission of higher wages to consumer price inflation in the medium term might have become more uncertain given the revised growth outlook, with some doubts being expressed about whether profit margins would increase – as assumed in the projections – as economic activity recovered.

As regards longer-term inflation expectations, members noted that, since the Governing Council's July monetary policy meeting, market-based measures of longer-term expectations had stabilised, albeit at historically low levels and well below the ECB's inflation aim. Concern was expressed about the longer-term downward trend observed in inflation expectations, which was evident in both market-based and survey-based measures. Market-based inflation expectations, as measured by the five-year forward inflation-linked swap rate five years ahead, currently stood at 1.23%, while longer-term survey-based inflation expectations stood at 1.7% in the Survey of Professional Forecasters for the third quarter of 2019. Concerns were also expressed about the increased probability of inflation outcomes between zero and 1%, as derived from option prices.

Caution was urged, however, against placing too much emphasis on developments in longer-term, market-based measures of inflation, which were subject to liquidity and risk premia. In particular, the gap between survey-based measures and market-based measures could also be explained by a negative risk premium, although it was remarked that the negative risk premium could itself be a concern if it reflected hedging by market participants against outcomes of very low inflation or deflation. Moreover, a remark was made that financial market participants were not responsible for setting relevant prices in the real economy, and that there was not a full understanding of how actual price-setting behaviour at the firm level would be affected by expectations of general aggregate price developments, as opposed to microeconomic determinants. It was suggested that a deeper analysis of inflation expectations be undertaken, amid increased concerns about the risk of an unanchoring of inflation expectations.

Regarding the monetary analysis, members widely shared the assessment provided by Mr Lane in his introduction. Sustained rates of broad money growth reflected ongoing bank credit creation for the private sector and low opportunity costs of holding M3. The narrow monetary aggregate M1 continued to be the main contributor to broad money growth on the components side. Members also agreed that the ECB's monetary policy measures continued to support loan growth and, ultimately, activity and inflation. Overall, loan growth was still benefiting from historically low bank lending rates. Bank lending conditions for firms and households continued to be very favourable.

## Monetary policy stance and policy considerations

With regard to the monetary policy stance, members widely shared the assessment provided by Mr Lane in his introduction. Since the Governing Council's monetary policy meeting in July, risk-free interest rates had declined, partly in anticipation of additional monetary policy stimulus but also in response to a worsening macroeconomic outlook. It was noted that substantial anticipation effects of future policy measures seemed to be embodied in market expectations of the path of interest rates and thus, to some extent, were already reflected in the projections. However, despite the fact that financial conditions embedded in the projections already reflected substantial expectations of further policy easing, projected inflation was moving further away from levels deemed consistent with the Governing Council's inflation aim. At the same time, it was also cautioned that the Governing Council should not try to accommodate market expectations but should base its decisions on its own assessment. In addition, an argument was put forward that, in an environment of high uncertainty, to exceed market expectations might be counterproductive, as this might be viewed as signalling a worse outlook than embedded in the forecasts.

All members agreed that a further easing of the monetary policy stance was warranted to support the return to sustained convergence to the Governing Council's inflation aim. The September staff projections had further revised down the real GDP growth outlook for 2019 and 2020, mainly owing to the weaker global environment, and inflationary pressures had remained muted. At the same time, the point was made that the monetary policy response should be proportional to the contingency faced. In this respect, it was noted that, despite the downward revision in the projections, some of the fundamental driving forces for a pick-up as foreseen in the baseline scenario were still in place and deflation risks were absent at the current juncture. Monetary transmission was functioning well, with long-term yields at historical lows both for the euro area and across countries.

Members expressed broad agreement with most of the monetary policy proposals made by Mr Lane in his introduction as part of a comprehensive package. Most members saw a package, i.e. a combination of instruments with significant complementarities and synergies, on the whole as the appropriate approach in a situation where individual policy measures were facing some limitations and the impact of each measure on its own was uncertain and difficult to assess. In the light of the continued shortfall of realised and projected inflation from the Governing Council's medium-term aim and the risk of an unanchoring of inflation expectations, it was seen as important for the Governing Council to demonstrate its determination and capacity to act, in line with its reaction function, by adjusting all of its instruments, as appropriate, to achieve its inflation aim. In this context, all measures – including restarting net asset purchases and introducing a two-tier system for the remuneration of reserves – were seen as having important signalling effects that would be further enhanced by the proposed changes to the Governing Council's forward guidance.

At the same time, a number of reservations were expressed about individual elements of the proposed policy package. Although the rationale for a comprehensive package was widely shared, members assessed the case for specific elements differently, with some measures seen as substitutes rather than complements, giving rise to trade-offs between elements of the package, for instance between the liquidity-providing measures and the proposed two-tier system.

A large majority of members agreed to change the modalities of the new series of quarterly TLTROs (TLTRO III), as proposed by Mr Lane and Mr Cœuré. Removing the spread of 10 basis points vis-à-vis the key ECB interest rates and extending the maturity from two to three years was seen as effective to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. In this context, the Governing Council also took note of the proposed extension of the additional credit claims framework until the end of March 2024 and agreed to fix the interest rate in the three-month LTROs at the average rate of the main refinancing operations over the life of the respective LTRO, at least until the end of the reserve maintenance period starting in March 2021.

Regarding forward guidance on APP reinvestment, all members concurred with Mr Lane's proposal 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 the Governing Council started raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Members generally agreed with the proposal to enhance the state-based component of the Governing Council's forward guidance on interest rates, although a few members saw value in keeping the date-based element of forward guidance and shifting it further out into the future. The enhanced state-contingent forward guidance was considered a core element of the package, conveying the Governing Council's intention with respect to its main policy instrument – the key policy rates – to which its other measures were tied, such as the proposed guidance on the net asset purchases and the reinvestments of principal payments. The proposed forward guidance was seen as crucial to providing adequate monetary accommodation, by anchoring inflation expectations at the ECB's medium-term inflation aim, to making the "lift-off" date for interest rates state-dependent and to anchoring expectations sufficiently far out in the future, as warranted in the present circumstances.

It was widely felt that the forward guidance needed to be formulated carefully so as to be sufficiently stringent, while not being unduly precise or complex, in order to be credible and to avoid introducing uncertainty into the expectations of markets and the general public. Accordingly, it was seen as natural to build on, and remain broadly consistent with, previous communication on a sustained adjustment in the path of inflation, namely related to convergence, confidence and resilience in attaining the Governing Council's aim of inflation below, but close to, 2% over the medium term. Merit was seen in underlining the symmetry of the Governing Council's inflation aim in qualitative terms, without pre-empting a future review of the ECB's strategy.

Some initial support was expressed for basing the forward guidance on a quantitative benchmark of both projected and realised inflation in order to provide greater clarity on the inflation aim. On the other hand, it was questioned whether more clarity in numerical terms would actually enhance the effectiveness of the forward guidance, in view of the subdued inflation record in recent years. Linking the Governing Council's forward guidance to the ECB staff projections was seen as prone to circularity, although the point was also made that inflation-targeting central banks typically conditioned their policy on their own projections. All in all, a reference to robust convergence and a broad qualitative formulation in terms of the overall inflation outlook were considered preferable.

Making forward guidance conditional on inflation convergence being reflected consistently in the observed underlying inflation dynamics, as well as in the inflation outlook, was seen as helping to clarify that some momentum should be visible and verifiable in the data on actual inflation, while not implying a departure from the forward-looking nature and medium-term orientation of the ECB's monetary policy strategy. In addition, the notion of robust convergence was seen to underline the message that the Governing Council's inflation aim should not be regarded as a cap for inflation, thereby confirming the symmetry of the inflation aim. In this context, it was argued that the proposed formulation could move market expectations of the "lift-off" date too far into the future. All in all, the adopted formulation on state-dependent forward guidance was viewed as remaining consistent with the ECB's current monetary policy strategy, as it neither redefined the policy aim nor pre-empted a strategy review that might take place later.

A clear majority of members agreed with Mr Lane's proposal to restart net purchases under the APP at a monthly pace of €20 billion as from 1 November, to continue them for as long as necessary to reinforce the accommodative impact of policy rates and to end them shortly before the key ECB interest rates were to be raised. The APP was seen as a necessary component of the policy package, as it had been shown by ECB staff analysis to be effective in supporting activity and inflation. The mere reinvestment of principal payments from maturing securities was seen as insufficient to prevent a loss of duration on the ECB's balance sheet or to underpin the low yields currently observed, or even to engender a further compression of term premia. Concern was expressed that not delivering sufficient stimulus, including through the APP, might trigger a reversal of the current favourable financial conditions. By contrast, restarting net purchases would provide a strong signal of the Governing Council's determination and willingness to act in the light of the current subdued inflation outlook and the potential risk of an unanchoring of inflation expectations. Moreover, an argument was made that the room for further compression of term premia had not necessarily been completely used up. In this context, forceful and pre-emptive monetary policy action was considered important, which called for a comprehensive package that included a resumption of net asset purchases.

A number of members assessed the case for renewed net asset purchases as not sufficiently strong, either because they deemed them to be a less efficient instrument, given the prevailing compression of term premia, or because they deemed them to be an instrument of last resort which should only be deployed in the event of more severe contingencies and which was not warranted in the light of the current outlook, where a package not including net purchases could be considered adequate. Current financial conditions were seen as already being very favourable, in particular with bonds of very long maturities trading at negative yields. The point was also made that the Governing Council's decisions should be based on the effectiveness of the measures rather than on signalling effects vis-à-vis markets. Some concerns were voiced about a potential decline in the efficiency of the portfolio rebalancing channel and potential adverse side effects on financial intermediation – including by banks and by insurance companies and pension funds – related to a flattening at the long end of the yield curve and heightened financial stability risks.

A remark was made that an open-ended announcement of renewed net asset purchases could give rise to demands by market participants for higher monthly purchase amounts, at least in the absence of convincing evidence of an improving inflation outlook. This would exhaust the purchasable universe and call into question the programme limits, which were considered important to ensure that the boundary between monetary policy and fiscal policy was not blurred. Effects from any potential limit changes on market functioning and bond scarcity would also need to be considered. However, it was noted that, at €20 billion per month, the pace of purchases was far less than in earlier phases of the programme, while the current expansionary stance of fiscal policy would allow the Governing Council to continue purchases under the current limits for a significant period of time. Hence, it was felt that a discussion of the limits could wait until the issue became more pressing.

A very large majority of members agreed with Mr Lane's proposal to lower the rate on the deposit facility by 10 basis points to -0.50%, which – together with the reinforced forward guidance – would act on the whole yield curve, especially in the short to medium-term segments, complementing the effects of net asset purchases on the long end of the curve. In this way, the measure would address the high level of short-term uncertainties that currently prevailed and help preserve very favourable financial conditions. While a few members expressed a readiness to consider lowering the rate on the deposit facility by 20 basis points at the current meeting, in particular as part of a package that would exclude net asset purchases, other members felt unable to support a cut of 10 basis points, as they were concerned about the possibility of increasingly adverse side effects from additional rate cuts.

A majority of members went along with the proposed introduction of a two-tier system for reserve remuneration as part of the overall policy package. With an exempt tier of six times the level of the minimum reserve requirements of institutions subject to such requirements, a two-tier system would help to preserve the positive effects of the negative rate policy on the economy by mitigating the direct cost for banks of holding excess reserves, thereby contributing to the safeguarding of the bank-based transmission mechanism of the Governing Council's monetary policy. The two-tier system would support the ability of banks to extend loans to their customers on favourable terms and help to preserve the incentives for banks to pass through the stimulus provided by negative rates on their reserves. Furthermore, it would corroborate the Governing Council's forward guidance that interest rates could be lower than the current levels.

A number of reservations were expressed about the monetary policy justification for a two-tier system. It was argued that, at the current juncture, monetary policy transmission channels seemed to be functioning well. In addition, banks would benefit from TLTRO III, which offered them very favourable lending conditions, and from a significant decline in bank bond yields. A remark was made that providing partial relief only to banks for the costs of negative rates raised potential distributional and communication challenges. Moreover, if a two-tier system were not calibrated properly, it could give rise to side effects and put upward pressure on market rates. It was argued, however, that other jurisdictions with negative interest rates had long since introduced exemption schemes. With regard to the design of the two-tier system, the proposed value of six times the minimum reserve requirements was generally supported, although a case was also made for having a smaller or a larger multiplier. In this context, it was argued that tying the exemption amount more directly to minimum reserve requirements by increasing the remuneration rate on these reserve holdings would be better targeted at transmission channels that were more fragile, would better alleviate potential upward pressure on market rates and would create less interaction with TLTRO III.

Deviating from the established frameworks of other central banks would, however, be more challenging to communicate, particularly since such remuneration on minimum reserves would be akin to the introduction of another policy rate.

In summary, the President concluded that all members agreed on the need to act in response to the continued shortfall of inflation with respect to the Governing Council's aim and that a clear majority of members supported the proposed measures, which complemented and reinforced one another, as a powerful package to provide substantial monetary stimulus, ensuring very favourable financial conditions and supporting the euro area economic expansion, the ongoing build-up of domestic price pressures and the sustained convergence of inflation to the Governing Council's medium-term inflation aim. Accordingly, the Governing Council reiterated the need for a highly accommodative stance of monetary policy for a prolonged period of time and 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 its commitment to symmetry.

Finally, all members agreed that, in view of the weakening economic outlook and the continued prominence of downside risks, governments with fiscal space should act in an effective and timely manner. In response to the significant risks related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets, policies other than monetary policy would be more effective and were better suited to address country-specific shocks. In this context, the Governing Council should communicate carefully so as not to create unrealistic expectations about the contingencies that monetary policy was able to address.

## Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, on a proposal from the President, the Governing Council took the following monetary policy decisions:

1. The interest rate on the deposit facility would be decreased by 10 basis points to -0.50%. The interest rate on the main refinancing operations and the rate on the marginal lending facility would remain unchanged at their current levels of 0.00% and 0.25% respectively. The Governing Council now expected the key ECB interest rates to remain at their present or lower levels until it saw the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence was consistently reflected in underlying inflation dynamics.

2. Net purchases would be restarted under the Governing Council's APP at a monthly pace of €20 billion as from 1 November. The Governing Council expected them to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it started raising the key ECB interest rates.

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

4. The modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) would be changed to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. The interest rate in each operation would now be set at the level of the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeded a benchmark, the rate applied in TLTRO III operations would be lower, and could be as low as the average interest rate on the deposit facility prevailing over the life of the operation. The maturity of the operations would be extended from two to three years.

5. In order to support the bank-based transmission of monetary policy, a two-tier system for reserve remuneration would be introduced, in which part of banks' holdings of excess liquidity would be exempt from the negative deposit facility rate.

Separate press releases with further details of the measures taken by the Governing Council would be published after the press conference.

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

Introductory statement

**https://www.ecb.europa.eu/press/pressconf/2019/html/ecb.is190912~658eb51d68.en.html** **English**

Press releases

**https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp190912~08de50b4d2.en.html**
**https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190912_1~b17f699a88.en.html**
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**https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190912_2~a0b47cd62a.en.html**

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

**Members**

- Mr Draghi, President
- Mr de Guindos, Vice-President
- Mr Cœuré
- Mr Costa
- Mr Hernández de Cos
- Mr Herodotou
- Mr Holzmann
- Mr Kažimír
- Mr Knot
- Mr Lane
- Ms Lautenschläger
- Mr Makhlouf*
- Mr Mersch
- Mr Müller*
- Mr Rehn
- Mr Reinesch
- Mr Rimšēvičs
- Mr Stournaras*
- Mr Vasiliauskas
- Mr Vasle
- Mr Vella

- Mr Villeroy de Galhau*
- Mr Visco
- Mr Weidmann
- Mr Wunsch

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

**Other attendees**

- Mr Smets, Secretary for monetary policy, Director General Economics
- Mr Stone, Deputy Secretary, DG Secretariat
- Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

**Accompanying persons**

- Mr Alves
- Mr Arce
- Mr Aucremanne
- Mr Bradeško
- Ms Buch
- Mr Demarco
- Ms Donnery
- Mr Gaiotti
- Mr Garnier
- Mr Haber
- Mr Kaasik
- Mr Kazāks

- Mr Kuodis
- Mr Kyriacou
- Mr Lünnemann
- Mr Odór
- Mr Pattipeilohy
- Mr Tavlas
- Mr Välimäki

**Other ECB staff**

- Ms Graeff, Director General Communications
- Mr Straub, Counsellor to the President
- Mr Bindseil, Director General Market Operations
- Mr Klöckers, Director General International & European Relations
- Mr Rostagno, Director General Monetary Policy
- Mr Sousa, Deputy Director General Economics
- Ms Valla, Deputy Director General Monetary Policy

Release of the next monetary policy account foreseen on Thursday, 21 November 2019.

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