Meeting of 9-10 September 2020

Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 9-10 September 2020

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 15-16 July 2020.

The functioning of euro area financial markets had, by and large, been restored. Stress symptoms had largely dissipated and liquidity had returned to the market. The Composite Indicator of Systemic Stress (CISS) remained only marginally higher than before the coronavirus (COVID-19) period, with the difference primarily being driven by still elevated volatility, particularly in stock markets.

Financial conditions had also improved broadly in the euro area. The GDP-weighted government bond curve had shifted further down and had returned to its pre-crisis level. Large parts of the curve were again in negative territory and very close to the lowest level ever recorded. Government bond spreads too had reached, or were close to, their pre-crisis levels and investment-grade corporate bond spreads had fallen by nearly 20 basis points since the Governing Council's previous monetary policy meeting. High-yield bond spreads had even fallen by nearly 50 basis points.

One factor that might explain the general resilience of financial markets was the growing divergence between the number of COVID-19 fatalities, which remained stable at low levels, and the number of new infections, which had more than tripled since the beginning of August 2020. Many market participants believed that this divergence – if it were to persist – would lower the risk of widespread lockdowns, resulting in less of a downside risk to economic activity.

It was notable that there was a growing dispersion in the extent of easing of financial conditions across advanced economies, with the euro area lagging behind. The dispersion could largely be explained by two factors, namely developments in global stock markets and shifts in exchange rates.

Even after the developments of the past few days, the Standard & Poor's 500 stock market index was still up by around 50% from its mid-March 2020 trough and remained above pre-crisis levels. Chinese stocks were also trading well above pre-pandemic levels. In the euro area, by contrast, stock prices had increased by only around 32% since mid-March 2020 and remained well below pre-crisis levels.

Idiosyncratic factors could partially explain these divergences. One factor was the sectoral composition of stock markets as, despite the recent correction, the technology sector continued to benefit most from the pandemic. Technology stocks had a larger weight in the United States than in the euro area. A second factor was the fall in equity risk premia that had contributed substantially to the rise in valuations in the United States. In the euro area, the reversal in risk premia had been slower.

Differences in portfolio rebalancing might have contributed to the divergence in risk premia. Over the summer real interest rates had declined notably faster in the United States than in the euro area. Real ten-year US Treasury yields were currently close to historical lows and, for the first time since 2013, were lower than equivalent yields in the euro area. Empirical evidence suggested that a marginal increase in inflation expectations tended to raise stock valuations, and this effect was considerably greater when real rates were in negative territory. Negative real yields also reduced the opportunity cost of holding a zero-coupon asset such as gold, which helped explain in part why gold prices had increased so strongly over the course of this year.

Furthermore, declining real rates were also likely to have accelerated the depreciation of the US dollar. The euro nominal effective exchange rate had been on an upward trend since the crisis had struck, driven to a large extent by the euro's appreciation against the US dollar. Thus far the euro had appreciated by some 7% against the US dollar from its pre-pandemic level. Investors tended to reduce their holdings of US dollar-denominated debt securities when break-even inflation rates increased, and this effect was also stronger when real rates were in negative territory.

More specifically, model-based analysis identified two main drivers behind the recent shifts in exchange rates. The first and most important one was the substantial improvement in global risk sentiment, i.e. the reversal of previous safe-haven flows into the United States. The decisive policy actions taken by euro area governments to fight the crisis had likely contributed to the improvement in risk sentiment. A second driver was likely related to monetary policies implemented in the United States and the euro area, in part reflecting differences in conventional policy space before the pandemic. Looking ahead, market positioning remained tilted towards further euro appreciation, with net speculative US dollar positions against advanced economy currencies, including the euro, remaining sizeable.

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 widespread collapse of activity in the second quarter had been followed by a significant rebound – but not yet a full recovery of the economy, as gaps remained. Such a pattern of developments was seen around the world. Global trade had posted a double-digit decline in the second quarter. In line with global activity, trade had also been recovering recently. While, by and large, risks to global activity and trade remained on the downside, there were also some upside risks.

Financial conditions had continued to ease in advanced and emerging economies since the Governing Council's July monetary policy meeting. One important factor behind the rally in global risk assets was related to positive global macroeconomic surprises – as reflected in the Citigroup Economic Surprise Index for advanced economies, which stood at an all-time high. In addition, risk sentiment had improved.

In particular, investors and forecasters had become more optimistic about the prospects for the early availability of a vaccine.

Since the July monetary policy meeting the recovery in oil prices seemed to have stalled, with prices declining by 9.0% – driven by a combination of decelerating demand growth and higher supply. The euro had continued to appreciate against the US dollar (+3.8%) and in nominal effective terms (+1.7%) against a trade-weighted basket of 42 currencies. The appreciation of the euro resulted, in part, from the broad weakness of the US dollar.

Turning to the euro area economy, real GDP had contracted by 11.8%, quarter on quarter, in the second quarter of 2020. Incoming data and survey results pointed to a strong rebound in GDP growth in the third quarter – in line with short-term forecasts that included high-frequency data. Recently, momentum had slowed in the services sector compared with the manufacturing sector, which was also visible in survey results for August. Looking at the components of GDP in more detail, consumer spending had increased strongly since April, but its recovery remained far from complete. Survey data indicated that the perceived lack of demand was increasingly becoming a drag on investment – in particular business investment – in the second and third quarters of 2020.

In the labour market, the adjustment in employment and unemployment had been relatively sluggish. In part this reflected an increase in inactivity, which was likely linked to the suddenness of the loss of employment in March and April. Most of the adjustment in the labour market had stemmed from a decline in average hours worked, which mainly reflected the impact of job retention schemes. Looking ahead, although surveys and high-frequency indicators had improved recently, they still pointed to employment losses in the third quarter, despite the effect of the labour market policies in place.

Turning to euro area price developments, euro area annual HICP inflation had decreased from 0.4% in July to −0.2% in August (according to Eurostat's flash estimate). Overall, the latest readings of measures of underlying inflation pointed to a moderate weakening. Looking at inflation developments in recent months in more detail, energy inflation had continued to be a drag on euro area inflation, as oil prices were still at low levels, implying very negative year-on-year rates of energy inflation. However, it was notable that services inflation – which was much more closely linked to domestic developments and had a high wage content – had also declined further, falling from 1.2% in June to 0.9% in July and 0.7% in August.

On the basis of current and futures prices for oil and taking into account the temporary reduction in the German VAT rate, euro area headline inflation was likely to remain negative over the coming months before turning positive again in early 2021. Moreover, in the near term price pressures were expected to remain subdued owing to weak demand, lower wage pressures and the appreciation of the euro exchange rate, despite some upward price pressures related to supply constraints.

Turning to wage developments, the large take-up of the short-time work and temporary lay-off schemes had led to a strong divergence between growth in compensation per employee and growth in compensation per hour in the first and second quarters of 2020. Negotiated wage growth, allowing for one-off effects, had declined only moderately thus far but stood clearly below the levels reached in 2018 and 2019.

Market-based indicators of longer-term inflation expectations had returned to their pre-pandemic levels, but the increase had been much smaller than in the United States and they still remained at very subdued levels. Survey-based measures generally remained at low levels.

Turning to financial conditions in the euro area, the EONIA forward curve remained slightly inverted, but there were no firm expectations of a cut in the deposit facility rate. Longer-term risk-free rates remained at low levels amid a further decline in real rates. In sovereign debt markets, fragmentation had receded, which had led to a further narrowing of sovereign spreads. Markets for risky assets had remained broadly stable overall, while the easing trend in financial conditions had been halted by the appreciation of the euro.

Regarding money and credit, broad money (M3) growth had continued to rise, reaching 10.2% in July 2020, after 9.2% in June. Strong money growth reflected domestic credit creation and the ongoing asset purchases by the Eurosystem, as well as a heightened preference for liquidity in the money-holding sector. In this environment, the narrow monetary aggregate M1, encompassing the most liquid forms of money, continued to be the main contributor to broad money growth. Following strong increases during the early months of the pandemic, the annual growth rate of loans to non-financial corporations had remained broadly stable in July, standing at 7.0%. The annual growth rate of loans to households, which had stood at 3.0% in July, had remained stable since April 2020.

Turning to fiscal policies, the euro area fiscal stance was expected to be strongly expansionary in 2020, with most of the additional spending comprising transfers to firms and households. Additional expansionary fiscal measures could be expected over the coming months – by Member States but also in the context of the Next Generation EU (NGEU) programme.

Monetary policy considerations and policy options

Summing up, Mr Lane remarked that the incoming data indicated a strong rebound in activity, following the record decline in output of 11.8%, quarter on quarter, in the second quarter of 2020 and the cumulative decline of 15.1% in the first half of 2020. The speed of the rebound was broadly in line with the expected pace set out in the June 2020 projections. However, the recovery was asymmetric, being further advanced in the manufacturing sector than in the services sector. Moreover, momentum in the services sector had slowed somewhat recently. Consumer spending had increased, but accumulated savings remained high and households were likely to remain cautious, especially in the context of the expected deterioration in labour market conditions. The data suggested a partial recovery in euro area business investment, even though firms were likely to cancel or postpone investment plans in an environment of heightened uncertainty, spare capacity and weaker balance sheets.

The September ECB staff macroeconomic projections signalled that output would rebound in the third and fourth quarters by 8.4% and 3.1% respectively. Growth was foreseen to average −8.0%, 5.0% and 3.2% in 2020, 2021 and 2022 respectively. Only towards the end of the projection horizon was output projected to return to its pre-pandemic level.

Euro area HICP inflation had fallen to −0.2% in August, from 0.4% in July, according to Eurostat's flash estimate. Underlying this sharp decline was a fall in inflation excluding food and energy, which had declined from 1.2% to an all-time low of 0.4%. While temporary factors had distorted the August figure, underlying price pressures had likely weakened owing to subdued demand and significant labour market slack. Near-term price pressures were expected to remain subdued, in part owing to the recent appreciation of the euro exchange rate.

Since the July monetary policy meeting, market-based measures of longer-term inflation expectations had continued to recover from the historical lows reached in mid-March, but remained at very depressed levels. Survey-based measures remained well above market-based measures, but were still at historical lows. Close monitoring of inflation expectations remained warranted, since there was a clear risk that the negative shock to the path of inflation as a result of the pandemic could give rise to a renewed downward trend in inflation expectations.

In the near term the earlier collapse in oil prices and the temporary reduction in the VAT rate in Germany implied negative rates of euro area headline inflation for the rest of 2020. However, base effects in the energy component and, to a lesser extent, the reversal of the VAT rate cut in Germany, would generate a mechanical rebound in 2021. Inflation was expected to remain persistently low over the medium term, notwithstanding a gradual pick-up over the projection horizon.

The September ECB staff projections foresaw an increase in headline inflation from 0.3% in 2020 to 1.0% in 2021 and 1.3% in 2022. The unchanged projection for inflation in 2022 masked an upward revision to core inflation (reflecting the positive impact of monetary and fiscal policy measures). However, the scale of the upward revision to core inflation was muted by the appreciation of the euro. Headline inflation in 2022 did not increase, as the upward revision to core inflation was offset by the changed profile of the path of energy price inflation.

Valuations of risky assets had continued to recover across the globe, driven by a combination of positive data surprises and strong policy actions. In the euro area, the stock market had been resilient and bond spreads had declined. The composite financing costs for non-financial firms (including the cost of bank borrowing) had continued to decrease. There had been a marked appreciation of the euro exchange rate since July. While the appreciation to some extent reflected improvements in global risk sentiment, as well as euro area factors such as the NGEU recovery plan, it also reflected developments in monetary conditions in the euro area relative to the rest of the world.

The ECB's monetary policy measures were providing crucial support to the recovery of the euro area economy. The paths of both output and inflation would have been lower than foreseen in the September projections, had the ECB not recalibrated the pandemic emergency purchase programme (PEPP) in June. In addition, the third series of targeted longer-term refinancing operations (TLTRO III) had been a major force behind the declining path of bank lending rates.

The outlook remained surrounded by high uncertainty and the balance of risks continued to be tilted to the downside. While the NGEU recovery plan was a positive development, uncertainty about the evolution of the ongoing COVID-19 pandemic and the potential materialisation of adverse real-financial feedback loops called for vigilance. Over the coming months additional information would help to inform the direction of policy. This included tracking the underlying dynamics of the pandemic, developments in negotiations on the post-transition Brexit arrangements and decisions on fiscal plans.

Against this background, at the present meeting Mr Lane proposed to leave the overall monetary policy stance unchanged and to reconfirm the full set of existing monetary policy measures.

At the same time, there was no room for complacency. Inflation had been persistently below levels consistent with the Governing Council's inflation aim and inflation expectations remained close to their historical lows, amplifying risks to the anchoring of medium-term inflation expectations.

It followed that the Governing Council should monitor the incoming data very carefully with regard to their implications for the economy and the medium-term inflation outlook. It was important to stand ready to adjust all of the instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner, in line with the commitment to symmetry.

In its public communication the Governing Council needed to:

- stress that the incoming information continued to signal a strong resumption of euro area economic activity, broadly in line with previous expectations, although the recovery remained incomplete, uneven and subject to considerable uncertainty;
- emphasise that inflation pressures were expected to remain subdued on account of weak demand, lower wage pressures and the appreciation of the euro exchange rate;
- note that the unchanged projection for headline inflation in 2022 masked an upward revision to core inflation (reflecting the positive impact of monetary and fiscal policies, albeit muted by the appreciation of the euro) that was offset by the revised path of energy price inflation;
- reiterate that ample monetary policy stimulus would remain necessary to support the economic recovery and to offset the negative impact of the pandemic shock on the projected path of inflation;
- highlight that, in the current environment of elevated uncertainty, significant economic slack and increased exchange rate volatility, the Governing Council would monitor incoming information very carefully and continue to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner.

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 outlook for the euro area and the risks to activity provided by Mr Lane in his introduction. Incoming data and survey results indicated a continued recovery of the euro area economy and pointed to a strong rebound in GDP growth in the third quarter. At the same time, the level of activity remained well below the levels prevailing before the pandemic. Uncertainty related to the evolution of the pandemic would likely dampen the strength of the recovery in the labour market and in consumption and investment, but the euro area economy should be supported by favourable financing conditions, an expansionary fiscal stance and a strengthening in global activity and demand. This assessment was also broadly reflected in the September 2020 ECB staff macroeconomic projections for the euro area. Annual real GDP growth was projected to fall by 8% in 2020 and to increase by 5% in 2021 and 3.2% in 2022.

As regards the external environment, members broadly shared the assessment provided by Mr Lane in his introduction. It was noted that while there had been an upward revision to global activity and foreign demand for 2020 in the September projections, there had not been an upward revision to euro area trade, which could point to a small upside risk. However, there were also a number of downside risks – including the probability of a no-deal Brexit, which seemed to be increasing.

With respect to the recent volatility in the euro exchange rate, it was noted that developments in the nominal effective exchange rate were to some extent being driven by a broad-based improvement in risk sentiment and a reduction in "flight-to-safety" flows, in part reflecting more favourable developments in the euro area as well as weakness in the US dollar. Relative changes in the monetary policy in the United States and the euro area were also seen as an important driver. While it was noted that the nominal effective exchange rate of the euro was above the level recorded in 2018, it was suggested that it was the pace of the euro's appreciation, rather than the level of the exchange rate, that could become a concern. At the current stage, however, it was not clear how persistent recent movements in the exchange rate would be, with volatility being high and the potential for movements in both directions.

Members agreed that the incoming data for the euro area since the finalisation of the June 2020 Eurosystem staff projections had been broadly in line with previous expectations. The slump in activity in the second quarter had actually been somewhat less pronounced than feared and real GDP growth in the third quarter was likely to turn out higher than expected. There were indications that, in the absence of lockdowns, activity – and especially domestic consumption – would improve markedly in the third quarter, but the extent to which the pace of the recovery would be sustained throughout the rest of the year was less clear. Recently, momentum had slowed in the services sector compared with the manufacturing sector, which was also visible in the survey results for August. High-frequency indicators, such as data on labour mobility patterns, as well as the Purchasing Managers' Index for the services sector, were signalling more subdued activity and retail sales had lost some momentum. Weaker demand for services was also seen in lower services inflation.

While the pandemic was a common shock across euro area countries, references were made to the heterogeneity of developments in activity across countries, which could be attributed to differences in the evolution of the virus, to the containment measures and fiscal policy responses implemented in each country, and to the structure of each economy. These factors were considered likely to continue to cause divergence in the period ahead. In this context, NGEU funds were seen as important in helping to create a more level playing field, as the scope for national fiscal measures differed across countries.

In discussing the outlook for growth embedded in the September ECB staff projections, it was considered important to avoid being either unduly optimistic or unduly pessimistic. The June Eurosystem staff projections had been produced near the trough of the crisis. Since then there had been a noticeable improvement, with growth revised upwards for the second quarter of this year and for 2020 as a whole. The risk of the severe scenario outlined in June had receded. At the same time, it was emphasised that the September projections were broadly in line with the June projections only as a result of the policy measures that had been taken and without these measures the outlook for growth and inflation would have been much worse. It was also noted that real GDP and potential output were both foreseen to be lower at the end of the projection horizon than had been anticipated a year earlier, pointing to the prospect of permanent losses arising from the pandemic.

Members stressed that the degree of uncertainty remained exceptionally high. High economic uncertainty was seen to weigh on consumption, with the level of precautionary savings in particular being dependent on developments in household confidence. Lingering uncertainty surrounding the fallout from the pandemic could have the effect of keeping household savings elevated for some time. Given the uncertainty surrounding the outlook, the latest projections again included two alternative scenarios. The remark was made that the degree of uncertainty reflected in the gap at the end of the horizon between the level of GDP in the mild scenario and the level in the severe scenario was higher than in the June 2020 Eurosystem staff projections. However, the view was also expressed that confidence in the baseline scenario had increased notably compared with June and there was also increased confidence that governments would do what was needed to stabilise the economy in the event of future adverse shocks.

It was noted that while the baseline scenario assumed that the virus was largely under control, there was considerable uncertainty surrounding the future evolution of the pandemic and the development of a vaccine. It was argued that the severe scenario could not be entirely ruled out as there had been a new wave of infections, even if it had not so far been as lethal as the first wave. Many countries were now experiencing new outbreaks of the virus. In some parts of the euro area, the resurgence of the virus was assessed to be affecting the recovery and the probability that other countries would have further outbreaks was seen as very high. Alongside a resurgence of the virus, the winter months could be expected to be more challenging from a medical perspective. It was also underlined that it would take some time for a vaccine to become widely available and until that point concerns over the economy would remain.

A more positive assessment regarding the future pattern of private consumption was based on the view that people would learn to live with the virus. There was now also greater confidence that governments could prevent their health systems being overwhelmed and that they could contain the spread of the virus without a full lockdown and the ensuing severe harm to the economy. Reference was also made to the large stock of accumulated household savings, which could be drawn down more quickly than foreseen in the staff projections and underpin a rebound in consumption growth in the coming years.

An upside risk to growth and to the labour market was seen as emanating from fiscal policy, as several governments had decided on, or were currently discussing, additional measures that were not incorporated in the current projections. It was noted that the labour market had been shielded from the slump in activity through the use of labour market support schemes and governments had shown their willingness to extend these schemes where necessary. There was also a more determined approach to the crisis at the European level and the September baseline did not include the additional expenditure that could be expected from the NGEU programme. Generally, it was felt that more time was needed to better understand the possible impact, including the timing, of fiscal stimulus at the domestic and European levels. It was widely underlined that fiscal support was critical, should arrive as early as possible and should not be withdrawn too soon. At the same time, debt sustainability considerations meant that it was important for fiscal expansion to be temporary and well targeted, in particular aimed at improving productivity and sustainable economic growth.

Reference was also made to the risk of debt deflation in the period ahead, given the increase in private and public sector indebtedness, and concern was expressed about possible "cliff effects" as fiscal and supervisory measures came to an end, with the risk of financial amplification associated with increasing insolvencies and higher non-performing loans, notably in the non-financial corporate sector. While adverse financial amplification effects had to some extent been included in the September staff projections with regard to bank lending rates, the swift rebound in business investment foreseen in the baseline might appear optimistic, in part in view of the strong preference of firms for liquidity. However, it was also noted that the emerging risk of insolvencies could be addressed by governments, with shortfalls in liquidity and capital being dealt with through existing government programmes.

Overall, the balance of risks to the euro area growth outlook was seen to remain on the downside. This assessment largely reflected the still uncertain economic and financial implications of the pandemic.

Regarding fiscal policies, there was wide agreement that an ambitious and coordinated fiscal stance remained critical in view of the sharp contraction in the euro area economy. Fiscal measures taken in response to the pandemic emergency should as much as possible be targeted and temporary in nature. The three safety nets endorsed by the European Council for workers, businesses and sovereigns, amounting to €540 billion, provided important funding support in this context. The members of the Governing Council also strongly welcomed the NGEU package of €750 billion, which had the potential to significantly support the regions and sectors hardest hit by the pandemic, strengthen the Single Market and build a lasting and prosperous recovery.

Members emphasised that in order for the NGEU package to fully achieve its potential, it would need to be firmly rooted in sound structural policies conceived and implemented at the national level in order to ensure strong ownership. Well-designed structural policies could contribute to a faster, stronger and more uniform recovery from the crisis, thereby supporting the effectiveness of monetary policy in the euro area. Targeted structural policies were particularly important to revitalise euro area economies, with a focus on boosting investment in priority areas such as the green and digital transitions.

With regard to price developments, there was broad agreement with the assessment presented by Mr Lane in his introduction. According to Eurostat's flash estimate, euro area annual HICP inflation had decreased to −0.2% in August 2020, after 0.4% in July, reflecting lower contributions from the food, non-energy industrial goods and services components. On the basis of current and futures prices for oil, and taking into account the temporary reduction in the German VAT rate, headline inflation was likely to remain negative over the coming months before turning positive again in early 2021. Moreover, in the near term price pressures would remain subdued owing to weak demand, lower wage pressures and the appreciation of the euro exchange rate, despite some upward price pressures related to supply constraints. Over the medium term a recovery in demand, supported by accommodative monetary and fiscal policies, would put upward pressure on inflation.

This assessment was broadly reflected in the September 2020 ECB staff macroeconomic projections for the euro area. Annual HICP inflation was projected to be 0.3% in 2020, 1.0% in 2021 and 1.3% in 2022. The unchanged projection for inflation in 2022 masked an upward revision to inflation excluding energy and food – in part reflecting the positive impact of the monetary and fiscal policy measures – which was largely offset by the revised path of energy prices.

Members noted that although the inflation outlook was largely unchanged relative to the baseline in the June projections, this was in large part due to the policy measures taken, which were responsible for an upward revision to underlying inflation, and the outlook would have been weaker in the absence of these measures. Moreover, it was underlined that inflation remained below the Governing Council's aim over the projection horizon, notwithstanding ample policy support.

The argument was made that the inflation outlook in the September staff projections appeared too optimistic. The situation in the labour market could be expected to lead to weaker wage pressures over time. Moreover, Phillips curve estimates, in particular those incorporating the output gap or using total hours worked rather than the unemployment gap, tended to show lower inflation compared with the September baseline. Inflation pressures were very low in some services sectors, and certain services sectors, such as hospitality, would probably experience a more gradual recovery than previously thought. The pick-up in inflation to 1.3% in 2022 could also be considered optimistic against the background of the sharp decline in activity and high uncertainty. The projected inflation profile also reflected an increase in oil prices as embodied in futures markets, which depended on adherence to the recent agreement by OPEC to cut production.

At the same time, it was noted that the upward impact on growth of further fiscal measures, which were not yet incorporated in the projections, would imply a smaller output gap, which would normally translate into a better inflation outlook. It was underlined that uncertainty surrounding inflation was exceptionally high at present. The relationship between slack and inflation was being heavily distorted by the lockdowns and specific factors that were at play during the pandemic, including uncertainty about the pandemic's impact on the supply side and on potential growth. It was suggested that the relative impact of negative shocks to demand and supply could be investigated in more depth by analysing sectoral developments. While activity in sectors such as hospitality and tourism was not likely to recover soon, in other sectors, such as IT or online commerce, there had even been a positive demand shock.

Given the openness of the euro area economy, members considered that a further appreciation of the exchange rate constituted a risk to both growth and inflation. It was recalled that a significant impact of the exchange rate appreciation on euro area inflation had been included in the September 2020 ECB staff projections. The argument was made that ultimately the impact of a one-off adjustment of the exchange rate would be seen in the level of prices rather than in the rate of inflation. Moreover, the economic impact would also depend on the underlying causes of the exchange rate movement, which were difficult to reliably disentangle.

In discussing recent developments in inflation expectations, members noted that longer-term inflation expectations, as reported in the ECB's Survey of Professional Forecasters, had fallen to 1.6%, the lowest level since the start of Economic and Monetary Union. At the same time, market-based indicators of inflation expectations had continued to recover, with the five-year forward inflation-linked swap rate five years ahead presently standing at 1.19%. The comment was made that inflation expectations appeared to have stabilised overall and, although uncertainty about the inflation outlook remained high, markets were beginning to price out the risk of deflation. At the same time, it was highlighted that inflation expectations were still too low and that even though the risk of deflation was decreasing, it remained non-negligible. It was argued that the moderate improvement in inflation expectations was mostly due to the monetary policy decisions taken in June and that the prospect of a further appreciation of the exchange rate implied downside risks to inflation.

With regard to the monetary analysis, members broadly agreed with the assessment provided by Mr Lane in his introduction. Broad money (M3) growth had continued to rise, reflecting domestic credit creation and the ongoing asset purchases by the Eurosystem, as well as precautionary motives which fostered a heightened preference for liquidity in the money-holding sector. Bank lending to the private sector continued to be supported by the measures taken by the supervisory, fiscal and monetary policy authorities, including the latest TLTRO III operation. Bank lending conditions remained very favourable, with lending rates continuing to stand at historical lows. High rates of corporate loan growth continued to mirror elevated liquidity needs of firms to finance their ongoing expenditures, such as wage payments and working capital, and to further build liquidity buffers. While the rebound in economic activity had resulted in some recovery in firms' revenues and a shift in loan demand towards longer-term loans, the uncertainty over the economic outlook was likely to cast a shadow over future loan demand. In fact, it was pointed out that banks also expected some slowing of firms' future loan demand, as highlighted in the most recent bank lending survey for the euro area.

The uncertainty surrounding the economic outlook was seen to pose a potential challenge to the transmission of monetary policy through the banking sector, which had to be monitored carefully. In this context, the crucial role of government guarantee schemes in underpinning bank loan provision to the real economy was stressed, as was the need to avoid "cliff effects". The point was made that the full effects of the pandemic had yet to become evident in corporate balance sheets. Possible financial vulnerabilities in the corporate sector could, in turn, have adverse repercussions for bank balance sheets and thereby had the potential to impair monetary policy transmission and give rise to financial stability risks. In particular, in the absence of further regulatory relief regarding the classification of loans as non-performing, a surge in corporate insolvencies resulting from the pandemic could lead to an increase in non-performing loans on bank balance sheets, especially as governments were likely to start withdrawing some of the support provided, such as debt moratoria or loan guarantees. Weakened bank balance sheets associated with rising firm indebtedness and defaults could, in turn, lead banks to charge higher lending rates to their customers and to cut back on new loans even though bank lending rates were currently still at historically low levels.

In this context, it was remarked that bank stock prices had been continuously declining, with low bank valuations being evident in very low price-to-book ratios. While banks had increased their provisions in view of higher expected losses, the point was made that low bank valuations could reflect a weak profitability outlook as well as doubts among investors about the quality of bank balance sheets and the adequacy of the level of provisions given expected increases in firm defaults and bankruptcies. It was also cautioned that sovereign exposures of banks had risen again since the start of the crisis, giving rise to renewed concerns about the tight nexus between banks and sovereigns. Overall, it was important to monitor the transmission of monetary policy carefully, to ensure that the liquidity injected was directed towards funding the real economy and to avoid unduly fuelling financial asset prices and reinforcing the bank-sovereign nexus.

Monetary policy stance and policy considerations

With regard to financial conditions and the monetary policy stance, members broadly shared the assessments provided by Ms Schnabel and Mr Lane in their introductions. While financial market conditions had continued to normalise since the July monetary policy meeting, with valuations of risky assets across the globe continuing to recover, the easing trend in financial conditions had been partly counteracted by the appreciation of the euro. Euro area sovereign and corporate bond yield spreads had narrowed further, while equity prices, notwithstanding some weakening in bank stocks, had remained resilient overall on the back of favourable global risk sentiment and supportive monetary and fiscal policies. It was, however, cautioned that although low equity valuations in some sectors reflected investor expectations of an extended impact of the pandemic, overall stock prices still appeared to be highly valued, for example when looking at measures such as cyclically adjusted price-to-earnings ratios. This pointed to the possibility of volatility or corrections in stock markets in the period ahead, as seen in US stock markets in the days preceding the September Governing Council meeting. At the same time, since the July Governing Council meeting the euro exchange rate had appreciated significantly against almost all advanced and emerging market currencies, reflecting in part positive risk sentiment towards the euro area, which was also supported by the agreement on the NGEU plan as well as relative monetary policy configurations in major jurisdictions. In this context, the risk of a further euro appreciation was seen as partly linked to market perceptions of the scope for further changes in monetary policy in different jurisdictions. Against this background, it was considered important to avoid complacency and the perception among investors that the direction of exchange rate movements was a one-way bet.

Members widely agreed with the assessment presented by Mr Lane that ample stimulus remained necessary to support the economic recovery and to safeguard medium-term price stability. While the incoming data since the last Governing Council meeting had been positive overall, suggesting a strong resumption of euro area activity broadly in line with previous expectations, risks continued to be tilted to the downside and the strength of the recovery remained surrounded by significant uncertainty. In this environment, inflation pressures were expected to remain subdued on account of weak demand, lower wage pressures and the recent appreciation of the euro exchange rate.

Against that background, members agreed with the proposal by Mr Lane to leave the overall monetary policy stance unchanged and to reconfirm the current configuration of existing monetary policy instruments. In the prevailing environment of high uncertainty, keeping a steady hand with respect to monetary policy was seen as most appropriate. At the same time, the case was made for keeping a "free hand" in view of the elevated uncertainty, underpinning the need to carefully assess all incoming information, including the euro exchange rate, and to maintain flexibility in taking appropriate policy action if and when needed. Over the coming weeks more data would become available, which would provide improved visibility about how the various forces at play would influence the medium-term inflation outlook. In this regard, the underlying dynamics of the pandemic, developments in negotiations on the post-transition Brexit arrangement, the outcome of the US presidential election and decisions on fiscal plans at the individual country level as well as at the euro area level had to be closely monitored.

Members widely agreed that the ECB's monetary policy measures were providing crucial support for the recovery of the euro area economy and underlying inflation pressures. It was underlined that the inflation and growth outlook would have been significantly worse had the Governing Council not taken its decisive action since the outbreak of the coronavirus crisis. The configuration of monetary policy was supporting the flow of credit to households and businesses and contributing to accommodative funding conditions in all parts of the economy. In this regard, the TLTROs continued to underpin the declining path of bank lending rates and were supporting bank credit provision to households and businesses.

With regard to the two objectives of the PEPP, it was underlined that the PEPP had been successful in stabilising financial market conditions in the euro area. In the light of normalising market conditions and subsiding risks of fragmentation, it was highlighted that the role of the PEPP in easing the monetary policy stance had taken centre stage. In conjunction with the ongoing asset purchases under the asset purchase programme (APP), the PEPP purchases were providing significant monetary stimulus, helping to re-anchor inflation to the path that had been projected before the outbreak of the pandemic. In this context, it was nonetheless stressed that, notwithstanding the positive contribution of monetary policy to underlying inflation dynamics, the baseline scenario in the September projections still foresaw inflation remaining well below the pre-crisis path over the projection horizon. On the basis of the current information, the PEPP envelope would likely have to be used in full to provide the necessary accommodation to offset the downward impact of the pandemic on the path of inflation, which was also in line with prevailing market expectations. It was seen as important to remain firm on previous announcements regarding the overall PEPP envelope, which underpinned the Governing Council's commitment to bring inflation back to levels in line with its aim. At the same time, the point was made that the pace of monthly purchases could be reduced as tensions in financial markets subsided. This would allow buffers to be built up in case market turbulence and fragmentation were to re-emerge.

There was broad agreement among members that there was no room for complacency, as emphasised by Mr Lane in his introduction. There were key downside risks to the medium-term outlook for price stability, mainly related to the as yet uncertain economic and financial implications of the pandemic. Moreover, inflation had been persistently below levels consistent with the inflation aim and inflation expectations remained at subdued levels, which posed a risk to the perceived ability and determination of the ECB to deliver on its mandate. While there was an upward revision to inflation excluding energy and food in the latest staff projections, headline inflation was projected to be 1.3% in the final year of the projection horizon, thereby remaining below the projected pre-crisis path and some distance from levels in line with the Governing Council's inflation aim. In this environment, it was important for the Governing Council to underline its readiness to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner. While the PEPP was currently seen as the primary instrument for providing additional monetary policy accommodation, it was noted that further cuts in policy rates and changes to the conditions of the TLTROs were also part of the toolkit for providing additional monetary policy accommodation, if necessary.

As regards communication, there was wide agreement among members with the communication proposed by Mr Lane in his introduction. It needed to be highlighted that the current environment was surrounded by elevated uncertainty, which required the Governing Council to carefully assess all incoming information, including developments in the exchange rate, with regard to the implications for the medium-term inflation outlook. In this context, it needed to be emphasised that while the euro exchange rate was not a policy target for the ECB, the external value of the euro was an important determinant of inflation developments in the euro area. In this regard, the recent appreciation of the euro exchange rate had had a material impact on the inflation outlook in the September ECB staff projections.

There was broad agreement among members that in the current environment of elevated uncertainty the recent volatility in the exchange rate of the euro required careful monitoring with regard to its possible implications for the medium-term outlook for price stability. Reference was made to the language that had been used by the Governing Council on exchange rate volatility in 2017-18 and it was generally felt that the proposed communication was similar and appropriate at the current juncture.

It was stressed that the Governing Council had to be ready to adjust all of its instruments, as appropriate, to ensure that inflation moved towards its aim in a sustained manner. This also included reiterating the continued determination of the Governing Council to use the PEPP in a flexible manner in order to address the possible threat of market fragmentation and to preserve the smooth transmission of monetary policy. In addition, it needed to be emphasised that the monetary policy stance would remain accommodative and that the Governing Council would not tolerate an unwarranted tightening in financial conditions that would put the ECB's price stability mandate at risk.

In the context of the announcement by the US Federal Reserve System of a revised Statement on Longer-Run Goals and Monetary Policy Strategy, it was important to highlight that the ECB's strategy review had been delayed because of the COVID-19 pandemic and that it would resume shortly and would be an important focus of the Governing Council's work over the next year. It was also viewed as important to highlight that, without pre-empting the ongoing strategy review deliberations, the Governing Council was not constrained in taking the necessary policy action in the pursuit of the ECB's price stability mandate. In this context, it was also emphasised that the ECB's inflation aim was symmetrical and that the Governing Council would respond with the same determination to sustained downside deviations as to sustained upside deviations from the inflation aim.

Finally, it needed to be highlighted that fiscal policy continued to be critical to support the recovery of the euro area economy and to provide important funding support to those hardest hit by the pandemic. It was urged that fiscal support should not be withdrawn prematurely, but should be channelled towards enhancing productivity growth, fostering sustainable economic growth, bolstering innovation and strengthening the long-term growth potential of the euro area economy.

Monetary policy decisions and communication

Taking into account the foregoing discussion, upon a proposal by the President, 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 would contribute 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 latest operation in the third series of targeted longer-term refinancing operations (TLTRO III) had registered a very high take-up of funds, supporting bank lending to firms and households.

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

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

Introductory statement

Introductory statement to the press conference of 10 September 2020 English

Press release

Monetary policy decisions

Meeting of the ECB's Governing Council, 9-10 September 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 September 2020 under Article 10.2 of the ESCB Statute.

Other attendees

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

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

Accompanying persons

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

- Mr Lünnemann
- Mr Odór
- Mr Rutkaste
- Mr Sleijpen
- Mr Tavlas
- Mr Välimäki

Other ECB staff

- Mr Straub, Counsellor to the President
- Ms Rahmouni-Rousseau, Director General Market Operations
- Mr Rostagno, Director General Monetary Policy
- Mr Bracke, Deputy Director General Communications
- Mr Sousa, Deputy Director General Economics

Release of the next monetary policy account foreseen on Thursday, 26 November 2020.

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