EUROPEAN CENTRAL BANK

EUROSYSTEM

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

held in Frankfurt am Main

on Wednesday and Thursday, 15-16 July 2020

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President of the European Central Bank

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 3-4 June 2020.

In both advanced and emerging market economies, financial conditions were approaching pre-pandemic levels at a slowing but steady pace, as also reflected in the strong recovery in global stock markets. In the euro area sovereign bond markets, pre-pandemic funding conditions had by and large been restored. Market-based measures of inflation expectations had also recovered further, albeit from very low levels, and risk premia on short-term funding for both banks and corporates had continued to decline.

Optimism in financial markets had, however, gone hand in hand with surging coronavirus (COVID-19) cases in the United States and many emerging market economies, raising fears of a broader relapse in containing the spread of the virus. This divergence between the evolution of the pandemic and developments in financial markets, together with high uncertainty about the ultimate shape and pace of the economic recovery and the resurgence of global trade tensions, raised questions regarding the robustness and resilience of current investor sentiment.

So far, market intelligence pointed to three main stabilising factors. The first related to changes in the expected policy response to contain the spread of COVID-19. Many market participants now expected the policy response to a further spreading of the virus to rely more heavily on less invasive and geographically more targeted restrictions on economic activity. The second factor related to investor positioning. Although stock prices had rallied since about mid-March 2020, assets under management in equity funds domiciled in the euro area remained below their pre-pandemic values. Continued inflows into money market funds suggested that many investors still preferred to keep liquid and cash-like positions. Monetary policy was the third factor that had likely contributed to preventing an increase in risk premia. By expanding and extending the pandemic emergency purchase programme (PEPP) at its meeting on 3-4 June, and by clarifying the horizon of the reinvestment period, the Governing Council had signalled that monetary policy would remain a supporting factor throughout the crisis. The announcement of the PEPP and its extension also seemed to have arrested the fall in market-based measures of medium-term inflation expectations.

At the same time, current financial conditions still critically hinged on EU leaders delivering on the high expectations that had built up regarding the European recovery fund. Consequently, the signals coming out of the European Council meeting on 17-18 July 2020 would be very important for investors.

The stabilising effects of the PEPP were being complemented by the significant take-up in the fourth operation of the third series of targeted longer-term refinancing operations (TLTRO III). Excess liquidity was projected to rise to new record levels over the next two years, which had likely contributed to the further easing in short-term unsecured funding conditions for banks and firms. The three-month EURIBOR, a critical benchmark for lending to firms, had returned to pre-pandemic levels and commercial paper rates, both for financial and non-financial firms, had fallen further. Traditional commercial paper investors, such as money market funds, were coming back to the market, especially at shorter maturities, which had contributed to restoring orderly market conditions. At the same time, rising excess liquidity would not necessarily increase the burden on banks overall, relative to the situation prevailing at the end of last year, owing to the offsetting effects of the generous conditions of the TLTROs.

The significant take-up of liquidity in the latest TLTRO III operation, together with the impact of the PEPP expansion and extension on forward premia and future overnight interest rates, had also affected the EONIA forward curve, which had shifted downwards since the Governing Council's previous monetary policy meeting. Expectations of further adjustments to the key ECB interest rates seemed limited, however, as also confirmed by survey evidence.

Overall, the evidence was increasing that the policy response in the euro area, with monetary policy and fiscal policy complementing each other, had succeeded in easing financial conditions and restoring confidence in a recovery of the euro area economy. This positive development was also increasingly reflected in the external value of the euro. Since about mid-May 2020 when the recovery fund proposal had taken shape, the euro had appreciated broadly against a wide basket of both advanced and emerging economy currencies, likely reflecting the removal of tail risks and the comparatively successful containment of the coronavirus in Europe.

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, developments in the global economy continued to be dominated by the COVID-19 pandemic. The global economy was showing signs of a recovery after a sharp downturn in the second quarter of 2020. As containment measures continued to ease across the world, the global composite output Purchasing Managers' Index (PMI) (excluding the euro area) had increased further in June and stood substantially higher than at the trough in April. The increase in June across almost all major advanced and emerging economies had been driven by a strong month-on-month improvement in services and, to a lesser extent, manufacturing. At the same time, the level of the global composite output PMI still pointed to a contraction in activity in June. Global trade was expected to recover after a steep fall in the second quarter.

Since the Governing Council's June monetary policy meeting, oil prices had increased by around 11%, to just over USD 42 per barrel, supported by a stronger than expected pick-up in demand for oil on the back of the easing of lockdown measures. Reductions in supply were also supporting a rebalancing in oil markets. The euro had appreciated somewhat against the US dollar and in nominal effective terms since the June monetary policy meeting.

Turning to the euro area, real GDP had decreased by 3.6%, quarter on quarter, in the first quarter of 2020 and was expected to have contracted even further overall in the second quarter – broadly in line with the baseline scenario of the June 2020 Eurosystem staff macroeconomic projections. Incoming data and survey results suggested that economic activity had improved significantly in May and June from its trough in April, alongside the ongoing containment of the virus and the associated easing of the lockdown measures. At the same time, economic indicators remained well below the levels recorded before the pandemic, and the recovery was in its early stages and remained uneven across sectors and jurisdictions. Euro area activity was expected to rebound in the third quarter as the containment measures were eased further, supported by favourable financing conditions, an expansionary fiscal stance and a resumption in global activity, although uncertainty about the overall speed and scale of the rebound remained high.

The COVID-19 pandemic and the resulting lockdown measures taken by governments had caused a collapse of consumption growth in the first quarter of 2020. At the same time, government transfers, which had counteracted the fall in the growth rate of firms' operating surplus and compensation of employees, had stabilised income growth in the first quarter of 2020, compared with the fourth quarter of 2019. This had led to a rise in savings, which were expected to have recorded a very strong further increase in the second quarter of 2020. Clear signs of a recovery in consumption had emerged since May, but spending remained far below pre-lockdown levels. Retail trade and new passenger car registrations had risen in May. Consumer confidence indicators available up to June suggested that consumption in May and June had increased strongly compared with April.

Turning to investment, euro area business investment was expected to have declined sharply in the second quarter. At the same time, recent survey data, such as production expectations and business confidence, signalled the start of a recovery in the third quarter of 2020, as projected in the June 2020 projections exercise. Euro area real residential investment was expected to have declined sharply in the second quarter of 2020 as a result of the lockdown measures, and was expected to recover only gradually.

Trade data, available up to March, showed that with respect to intra-euro area trade, intermediate goods had recorded the strongest impact as value chains within the euro area had become disrupted, but trade in capital goods, cars and fuels, as well as consumer goods, had also suffered. Partial data available for April highlighted that exports to all major economies had suffered severely.

As regards the labour market, government support schemes such as short-time work had helped to protect jobs, as reflected in the limited decrease in total employment and the limited increase in the unemployment rate. These schemes were also an important driver of the pronounced fall in average hours worked. Looking ahead, the effects of the pandemic on euro area labour markets could increase further. In this context, unemployment rate expectations had been revised in the ECB Survey of Professional Forecasters (SPF) in the direction of a later impact of the pandemic on the labour market and the unemployment rate was now expected to peak in 2021, rather than 2020. High-frequency indicators of job postings and hiring rates also pointed to a more severe impact of the COVID-19 pandemic on the euro area labour market.

Turning to euro area price developments, euro area HICP inflation had increased slightly to 0.3% in June, from 0.1% in May, according to Eurostat's flash estimate, reflecting mainly less negative energy price inflation. This had more than offset the decline in food price inflation and in HICP inflation excluding energy and food, which had declined from 0.9% in May to 0.8% in June. 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 decline again in the coming months before picking up in early 2021. Over the medium term, weaker demand was expected to put downward pressure on inflation, which would be only partially offset by upward pressures related to supply constraints.

Measures of underlying inflation, which were largely only available up to May, had been weakening since February, with HICP inflation excluding energy and food showing the most pronounced decrease. That said, it needed to be kept in mind that these measures were still surrounded by high uncertainty as the share of imputed prices in the data was still considerable, especially for services.

Turning to wages, compensation per employee (CPE) growth had declined sharply in the first quarter of 2020 and was being heavily affected by wage supplementation policies. Annual CPE growth had decreased from 1.6% in the fourth quarter of 2019 to 0.3% in the first quarter of 2020, reflecting the initial impact of short-time work and temporary lay-off schemes towards the end of the first quarter, which had allowed workers to keep their employee status but had only partially offset remuneration losses. The impact of such schemes was also visible in annual growth in compensation per hour, which had increased to 3.1% in the first quarter of 2020, from 1.8% in the fourth quarter of 2019, owing to the sharp decline in actual hours worked per employee.

Looking ahead, survey-based measures of inflation expectations had declined. In the latest ECB SPF for the third quarter of 2020, HICP inflation expectations stood at 0.4% for 2020, 1.0% for 2021 and 1.3% for 2022. Longer-term HICP inflation expectations averaged 1.6% for 2025, compared with 1.7% for 2024 in the previous round. At the same time, market-based indicators of inflation expectations in the euro area had continued to recover since the June Governing Council meeting, but remained at subdued levels.

As regards fiscal policy, the euro area fiscal stance (net of the effect of automatic stabilisers) was assessed to be strongly expansionary in 2020. The national fiscal responses to the pandemic included state guarantees and equity injections, which were very heterogeneous across euro area countries. Most countries planned to withdraw the bulk of the expansionary discretionary measures in 2021, although automatic stabilisers would continue to operate. Additional sizeable national fiscal packages had recently been announced and the EU recovery instrument could also provide meaningful fiscal support in the period ahead.

Financial conditions in the euro area had overall remained largely unchanged since the Governing Council's June monetary policy meeting, but were tighter than before the crisis. The EONIA forward curve had become more inverted, implying that financial markets were pricing in low short-term rates for the time being. Overall, expectations were for no rate change for a considerable period. Longer-term risk-free rates had decreased in both the euro area and the United States since the June monetary policy meeting. While nominal long-term rates had edged down to a similar extent in both economies, the decrease in the real rate through an increase in the inflation component was significantly more pronounced in the United States. As a consequence, the long-standing gap between US and euro area real rates had essentially closed.

Turning to money and credit, broad money (M3) growth had increased to 8.9% in May 2020, from 8.2% in April. Strong money growth reflected bank credit creation, which continued to be driven to a large extent by the acute liquidity needs in the economy. Moreover, high economic uncertainty was triggering a shift towards money holdings for precautionary reasons. 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.

The dynamics of loans to firms had remained strong in May, driven by firms' operational financing needs, in an environment of compressed cash flows – but with substantial variation across countries. The annual growth rate of loans to non-financial corporations had risen further to 7.3% in May 2020, from 6.6% in April, reflecting firms' need to finance their ongoing expenditures and working capital. State guarantees played an important role in meeting the demand for loans by firms. However, the size, design and take-up of loans under state guarantee schemes differed significantly across countries. At the same time, the annual growth rate of loans to households had remained unchanged at 3.0% in May, after declining for two consecutive months, amid ongoing constraints on consumption.

Despite the severe decline in economic activity in the second quarter of 2020, credit standards on loans to firms remained broadly unchanged according to the results of the latest euro area bank lending survey. Monetary and fiscal policy measures played a major role in keeping credit standards favourable for loans to firms. For the third quarter of 2020, however, euro area banks expected a net tightening of credit standards on loans to firms, reflecting concerns about borrowers' creditworthiness and, in some countries, concerns about a foreseen end of state guarantee schemes. For loans to households for house purchase, credit standards had tightened in net terms in the second quarter of 2020, reflecting in particular a deterioration in households' income and employment prospects in the context of the pandemic.

Monetary policy considerations and policy options

Summing up, Mr Lane pointed out that, after a steep fall in the first weeks of the second quarter, the incoming data signalled an increase in the level of euro area economic activity, which was broadly in line with the baseline scenario of the June Eurosystem staff projections. However, the breadth and scale of the recovery remained uneven and partial. Both high-frequency and survey indicators suggested that activity had bottomed out in April. In tandem with the ongoing containment of the virus and the easing of the lockdown measures, there were signs of an initial recovery in consumption, while there had been a significant rebound in industrial output in some countries.

However, a number of factors were holding back a more complete recovery. First, a resurgence in COVID-19 transmission rates in a number of major economies had led authorities to halt or reverse reopening plans, with a measurable impact on external demand for euro area exports. Second, surveys suggested that employment was lagging output, with actual and expected declines in employment and income, amid precautionary household saving, weighing on consumer spending. Third, exceptionally elevated uncertainty about the evolution of the pandemic and the economic outlook continued to dampen business investment.

HICP inflation had increased marginally in June but remained close to zero, while measures of underlying inflation had weakened somewhat, driven by lower price pressures in services and non-energy industrial goods. Since the June monetary policy meeting, market-based indicators of longer-term inflation expectations had continued to increase from their mid-March historical lows, but they remained at very depressed levels. Although survey-based indicators of longer-term inflation expectations remained well above market-based measures, the longer-term inflation expectations reported in the latest SPF had edged lower to 1.6%, from 1.7% in the previous round.

Euro area financial conditions had remained broadly stable since the June meeting, although significantly tighter than before the escalation of the pandemic. Moreover, while bank lending conditions remained favourable overall, the latest round of the bank lending survey signalled that banks expected a considerable net tightening of credit standards on loans to firms, in part related to the expected end of the state guarantee schemes.

The ECB’s monetary policy measures were gradually making their way through to the economy, providing crucial support to underpin the recovery of the euro area economy and helping to offset the pandemic-related downward shift in the projected path of inflation. At the same time, the outlook was surrounded by high uncertainty and subject to downside risks, related in particular to the prospects of the global economy and the emergence of potential real-financial feedback loops. In this environment, the Governing Council had to await further data to better assess the future path of the economy and the extent to which inflation was returning to its pre-crisis trajectory within the projection horizon.

Mr Lane therefore proposed leaving the overall monetary policy stance unchanged and reconfirming the full set of existing monetary policy measures. In addition, it was important to emphasise that, although economic activity was gaining momentum, there was no room for complacency. The extent of economic slack was extremely high, uncertainty remained elevated and market sentiment was exceptionally fragile. In this context, the outlook for economic activity and inflation embedded in the June staff projections was conditional on substantial monetary policy support, while any premature tightening of financial conditions could put the ongoing recovery at risk.

In its communication, the Governing Council needed to: (i) stress that the incoming information signalled a resumption of euro area economic activity, although the level of activity remained well below the level prevailing just before the onset of the pandemic and the outlook remained highly uncertain; (ii) emphasise that inflation pressures were expected to remain very subdued on account of the sharp decline in real GDP and the associated significant increase in economic slack; (iii) highlight that, in the current environment of elevated uncertainty and significant economic slack, ample monetary policy stimulus would remain necessary to support the economic recovery and to bring inflation back to its pre-crisis trajectory within the projection horizon; and (iv) reiterate that it would do everything necessary within its mandate and continued 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 situation in the euro area and the outlook provided by Mr Lane in his introduction. Incoming data and survey results suggested that economic activity had improved significantly in May and June from its trough in April, alongside the ongoing containment of the virus and the associated easing of the lockdown measures. At the same time, economic indicators remained well below the levels recorded before the pandemic, and the recovery was in its early stages and remained uneven across sectors and jurisdictions. After decreasing by 3.6%, quarter on quarter, in the first quarter of 2020, euro area real GDP was expected to have contracted even further in the second quarter taken as a whole, broadly in line with the baseline scenario in the June Eurosystem staff projections. Euro area activity was expected to rebound in the third quarter as containment measures were eased further, supported by favourable financing conditions, an expansionary fiscal stance and a resumption in global activity, although uncertainty about the overall speed and scale of the rebound remained high. In general, the extent of the contraction and the subsequent recovery would depend crucially on the duration and effectiveness of the containment measures, the success of policies to mitigate the adverse impact on incomes and employment, and the extent to which supply capacity and domestic demand were permanently affected. It was widely felt that, while uncertainty remained elevated, confidence in the baseline scenario of the June staff projections had increased on the whole.

As regards the external environment, members broadly shared the assessment provided by Mr Lane in his introduction. Global activity had rebounded towards the end of the second quarter, while global trade had remained very weak. It was emphasised that developments in world trade were a critical factor in the recovery of the euro area economy and that evidence of trade improving from depressed levels had yet to become stronger. The subdued trade dynamics were seen to affect both intra- and extra-euro area exports, and while the contribution of trade had thus far been broadly proportional to the overall decline in euro area real GDP, the export sector remained exposed to developments elsewhere in terms of the evolution of the COVID-19 pandemic and the policies adopted by trading partners. As the pandemic was affecting economies sequentially and to different degrees, this implied uneven recoveries and, at the global level, greater reliance on internal rather than external demand to support the recovery, and on domestic rather than global value chains.

On euro area activity, members widely acknowledged that the latest data were more positive and that in some cases the improvement had been stronger than previously expected. Based on recent data and survey information, mechanical estimates for euro area real GDP now pointed to somewhat less negative quarter-on-quarter growth in the second quarter of this year than suggested in the June staff projections, but also to lower than expected growth in the third quarter. When considering these mechanical estimates, it was cautioned that a “technical” rebound was to be expected after a period of substantial containment measures and that this did not answer the question of how steady the recovery would be in the period ahead. It was also observed that most of the upward surprises in the incoming data had come from surveys and that more forward-looking indicators, such as new orders and business expectations, had remained well below their average levels. At the same time, it was argued that the mechanical estimates for the second quarter were based on observed data, while little information was available as yet for the third quarter. Hence, it could not be ruled out that more favourable dynamics in the second quarter might carry over into the third quarter. It was generally underlined that, by the time of the September ECB staff projections, more information would be available for a reassessment of this profile and any implications for the medium-term outlook for activity.

Members reiterated that high uncertainty continued to surround the outlook for the euro area and that much of this uncertainty still related to the future course of the pandemic and the finding of a medical solution – both in the euro area and globally. The higher uncertainty after the outbreak of the pandemic remained visible in the flatter shape and fatter tails of probability distributions. At the same time, it was acknowledged that, on the whole, increased confidence could be placed in the baseline scenario of the June Eurosystem staff projections. The “severe scenario” described in the projections was now considered less likely, while more benign developments could also not be ruled out.

It was underlined that, while the baseline scenario had become more plausible, it remained surrounded by elevated risks. Upside risks related to the possibility that households would unwind the “forced savings” accumulated during the lockdown period, leading to some “catch-up effects” in consumption. Upside risks also related to the impact of the EU recovery fund and of the fiscal package launched in the largest euro area economy, to the extent that these had not been taken into account in the June staff projections. At the same time, members referred to various downside risks to the growth outlook, especially when looking beyond the short term. In addition to risks emanating from the external economy, reference was made to possible “cliff effects” occurring when various policy support measures expired, especially with respect to the labour market. This could lead to increases in outright unemployment instead of the decreases in hours worked per person seen thus far, and concerns were expressed that protracted periods of unemployment could lead to “hysteresis” effects. A second set of risks was considered to be associated with the business sector, where weak business prospects and high uncertainty were dampening investment. While policy measures had mitigated acute liquidity shortages to some extent, there was now an increasing risk of solvency problems in the period ahead, which could impede a strong economic recovery. In this context, references were made to the risk of negative real-financial feedback loops. All in all, members assessed the balance of risks to the euro area growth outlook to remain on the downside.

Regarding fiscal policies, it was underlined that an ambitious and coordinated fiscal stance remained critical in view of the sharp contraction in the euro area economy. Measures taken in response to the pandemic emergency should, as far as possible, be targeted and temporary in nature. The three safety nets for workers, businesses and sovereigns, endorsed in April by the European Council and amounting to a package worth €540 billion, should – once fully operational – provide important funding support to EU Member States wishing to draw on it. However, looking ahead, further strong and timely efforts to support the recovery were needed. Members therefore strongly welcomed the European Commission’s “Next Generation EU” proposal, designed to support the regions and sectors hardest hit by the pandemic, to strengthen the Single Market and to build a lasting and prosperous recovery. It was considered paramount that European leaders quickly agreed on an ambitious package. Members noted that the quantitative impact that could be expected from the “Next

Generation EU" proposal depended on the time it would take to activate the funds and on how the funds would be spent.

With regard to price developments, members broadly agreed with the assessment presented by Mr Lane in his introduction. According to Eurostat's flash estimate, euro area annual HICP inflation had increased slightly to 0.3% in June, from 0.1% in May, mainly reflecting less negative energy price inflation. 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 decline again in the coming months before picking up in early 2021. Over the medium term, weaker demand would put downward pressure on inflation, which would be only partially offset by upward pressures related to supply constraints.

In their exchange of views, members highlighted a number of factors in the short-term inflation outlook. While oil price developments had led to a rebound in headline inflation, it was still close to zero and almost 30% of the items in the HICP basket had posted negative inflation rates. Moreover, underlying inflation was weak and would likely be well below 1% in the second half of 2020. It was warned that dynamics in underlying inflation, like those in economic activity, would only become clear once the temporary policy measures had expired. Current inflation developments also continued to be surrounded by uncertainty because the prices of some items in the HICP basket still needed to be imputed rather than collected. Attention was also drawn to the possibility that the reduction in the German VAT rate could temporarily push euro area headline inflation into negative territory and that such one-off effects would require appropriate communication.

As regards inflation expectations, market-based indicators of longer-term expectations had continued to increase from the historical lows recorded in mid-March but, overall, remained at subdued levels. While survey-based indicators of inflation expectations had declined since the start of the pandemic, longer-term expectations had been less affected than short and medium-term expectations. With respect to market indicators, it was observed that, while the risk-neutral probability of very low or negative inflation rates derived from five-year zero-coupon inflation options had decreased, it remained relatively high.

With regard to the monetary analysis, members broadly agreed with the assessment provided by Mr Lane in his introduction that strong money growth reflected bank credit creation, which continued to be driven to a large extent by acute liquidity needs in the economy. The annual growth rate of loans to non-financial corporations had risen further in May 2020, reflecting the needs of firms to finance their ongoing expenditures and working capital. Against this background, bank credit was seen as particularly important for small and medium-sized enterprises, which lacked access to market-based funding. It was remarked that monetary transmission through the banking sector had been effective, partly because the balance sheets of banks had been stronger at the start of the pandemic than before the financial crisis of 2008. The role of government guarantee schemes for loans was also highlighted as underpinning loan growth, with some concern expressed about possible future "cliff effects" as such programmes expired.

The results of the euro area bank lending survey indicated that banks expected a net tightening of credit standards on loans to firms in the third quarter of 2020, which signalled risks that the recent strong credit growth would not be sustained. Concerns were voiced about the emergence of real-financial feedback loops, in particular in the interaction between non-financial corporations and banks, notably if government guarantee schemes were withdrawn too early. It was also noted that credit standards for loans to households had tightened in the second quarter, reflecting primarily a deterioration in households' income and employment prospects in the context of the pandemic. At the same time, it was argued that the expected net tightening of credit standards should not be over-interpreted against the background of the earlier considerable easing that had resulted from supportive policy measures.

It was seen as necessary to monitor the transmission of monetary policy carefully, as the availability and cost of financing, notably through the banking channel, might become strained, which could adversely affect household consumption and business investment. The point was made that the effects of the pandemic on corporate balance sheets would only become evident over time since the pandemic was not yet under control globally and its full effects had still to materialise. An increase in non-performing loans and corporate insolvencies as a result of the pandemic could affect bank balance sheets and impair monetary transmission through the banking sector, which could also give rise to financial stability risks. In this context it was stressed that, while monetary policy was able to provide liquidity and support favourable lending conditions, it was up to fiscal policy to deal with solvency problems that could emerge in the financial and corporate sectors in the wake of the coronavirus shock.

Monetary policy stance and policy considerations

With regard to the monetary policy stance, members shared the assessments provided by Ms Schnabel and Mr Lane in their introductions. While financial market conditions had continued to normalise since the June monetary policy meeting, they remained tighter and more fragile than before the pandemic, with some fragmentation in financial markets still evident. There had been further gains in equity markets and narrower bond spreads had been partly offset by an appreciation of the euro. It was underlined that monetary and fiscal policy measures, as well as the Governing Council's stated willingness to stand ready to do more, had brought about a considerable improvement in financial conditions since the height of the coronavirus crisis. This improvement was considered to be especially noteworthy, as it had taken place against the backdrop of a significant increase in fiscal deficits and rising public and private debt levels. At the same time, the calmness of financial markets was considered to rest on the expected continuation of the supportive policy measures. It was also cautioned that the recent positive market developments were not fully backed by economic data and might be based on overly optimistic expectations about the European Council's recovery package and about progress on developing a vaccine.

Members agreed that a highly accommodative monetary policy stance continued to be appropriate on account of the subdued medium-term outlook for price stability, characterised by inflation expectations standing near historical lows and significant economic slack. It was emphasised that the Governing Council's monetary policy had been effective in easing financial conditions from the tighter levels seen following the coronavirus shock and that part of the stimulus was still to be transmitted to the real economy over the coming months. Careful monitoring was warranted. At the same time, uncertainty about the economic outlook remained elevated. Against this background, the current monetary policy stance was seen as adequate and a recalibration was not deemed necessary at the current juncture.

Accordingly, 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. While financial markets were calmer than at the peak of the pandemic crisis and incoming data signalled short-term activity that was broadly in line with the baseline scenario in the June macroeconomic projections, the situation remained fragile and risks were still on the downside. In particular, the risk of a persistent increase in the unemployment rate and uncertainty about the extent to which the corporate sector could face solvency issues were highlighted. Uncertainty continued to be elevated and the outlook for inflation remained subdued, underscoring the view that there was no room for complacency. While the prevailing uncertainty called for the present configuration of the monetary policy instruments to be kept in place at the current meeting, it was underlined that more information would be available in the autumn. A number of temporary fiscal measures were likely to expire then, and businesses would be more directly exposed to the impact of the pandemic shock.

With regard to the PEPP, the flexibility of the programme was highlighted as a key element of its effectiveness and efficiency in supporting the transmission of monetary policy over time and across asset classes and jurisdictions. It was also recalled that, while flexibility in the implementation of the PEPP was essential to successfully ease market conditions in times of stress, the capital key provided the benchmark for the allocation of purchases.

The argument was also made that the flexibility of the PEPP suggested that the net purchase envelope should be considered a ceiling rather than a target. The point was made that incoming data had surprised on the upside and some of the downside risks surrounding the outlook prevailing at the time of the Governing Council's June monetary policy meeting had receded, increasing the possibility that the envelope might not have to be deployed fully. At the same time, it was recalled that the PEPP had been designed to achieve the dual objective of addressing risks to the smooth transmission of monetary policy across the euro area and risks to medium-term price stability owing to the pandemic crisis. More specifically, it aimed to offset the pandemic-related downward shift in the projected path of inflation. Accordingly, under the baseline scenario in the June Eurosystem staff macroeconomic projections, and in the absence of any significant upside surprises to the medium-term inflation outlook, the current presumption was that the PEPP envelope would have to be used in full.

With regard to the TLTRO III programme, the point was made that the very strong take-up in the June 2020 operation was evidence of the programme's effectiveness in providing very favourable funding conditions for the banking sector, while the pass-through to lending to the real economy was seen as calling for close monitoring. Caution was seen as warranted given that government guarantee schemes appeared to be playing a key role in supporting bank lending at present, as evidenced by the latest bank lending survey. Against this background, further analysis was viewed as necessary to get a better picture of the use made of TLTRO III funds, including the extent to which the liquidity provided translated into lending to firms and households.

Looking ahead, additional information, including more hard data releases, new staff projections and news on fiscal measures, would become available by September. This would provide more clarity regarding the medium-term inflation outlook. At the same time, it was cautioned that in terms of the flow of information over the summer, it would be unusually difficult to extract signals about the medium-term prospects for the economy and the inflation path, as the scale of the initial bounceback in activity was not necessarily a good guide to the speed and robustness of the recovery. In any case, at its September meeting the Governing Council would be in a better position to reassess the monetary policy stance and its policy tools.

Monetary policy decisions and communication

Members agreed that, although the monetary policy stance was being left unchanged, communication was of particular importance at present. Arguments were made in support of a steady hand regarding communication, as market expectations appeared to be well aligned with the Governing Council's intentions. In this context, it was argued that some of the uncertainties prevailing at the time of the Governing Council's June monetary policy meeting had receded, while the balance of risks still remained on the downside. At the same time, it was generally felt that communication should aim to strike a balance between acknowledging the improvements in incoming data and stressing the remaining risks. In this regard, there was broad agreement to retain the present communication. Attention was also drawn to the need for clear communication on the impact of the reduction in the German VAT rate, which would temporarily weigh on euro area headline inflation.

Against the background of prevailing uncertainty, it was seen as important to reaffirm that the PEPP's flexibility would be used as needed, depending on market conditions, and that the Governing Council stood ready to act, with all of its instruments, as appropriate, to ensure the necessary degree of monetary accommodation. It was stressed that the Governing Council should make clear that the full PEPP envelope remained available. While it was underlined that the Governing Council should avoid creating new expectations of further monetary policy action, it should also emphasise that it had the tools and policy space to take further action if needed.

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 pandemic-related downward shift in 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 16 July 2020

Press release

Monetary policy decisions

Meeting of the ECB's Governing Council, 15-16 July 2020

Members

Ms Lagarde, President

Mr de Guindos, Vice-President

Mr Costa

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 July 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

Ms Goulard

Mr Haber

Mr Kaasik

Mr Kuodis

Mr Kyriacou

Mr Lünnemann

Mr Odór

Mr Rutkaste

Mr Sleijpen

Mr Tavlas

Mr Välimäki

Other ECB staff

Mr Bracke, Deputy Director General Communications

Mr Straub, Counsellor to the President

Ms Rahmouni-Rousseau, Director General Market Operations

Mr Sousa, Deputy Director General Economics

Mr Rostagno, Director General Monetary Policy

Release of the next monetary policy account foreseen on Thursday, 8 October 2020.