

ECB Monetary policy – More liquidity measures announced

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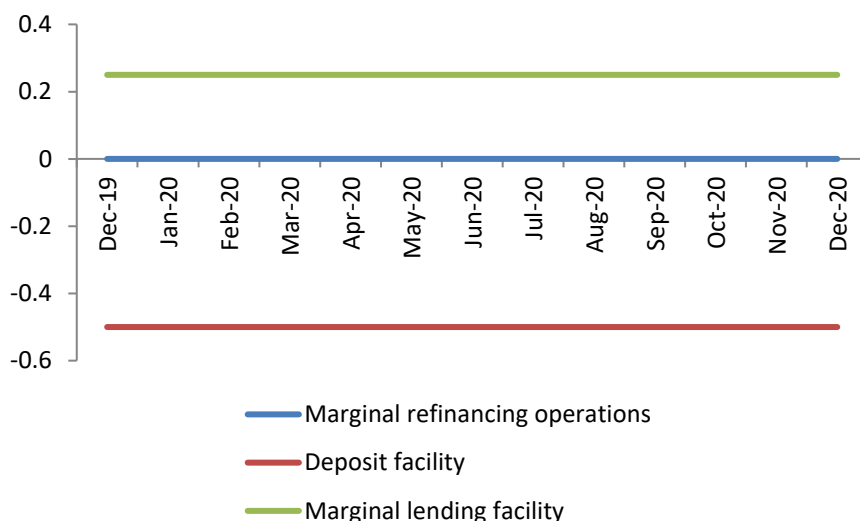
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The European Central Bank (ECB) kept the 3 key policy rates unchanged and decided to reconfirm its accommodative monetary policy stance in its latest monetary policy committee meeting. The biggest announcement of the ECB's monetary policy decision announced yesterday was the **increase in the pandemic emergency purchase programme (PEPP) by €500 bn to a total of €1,850 bn** and extended the time horizon of these net purchases atleast till the end of March 2022. Along with this, the ECB has announced a number of liquidity infusion measures and also extended the timeline of others in order to ensure favourable financing conditions over the pandemic period, supporting the flow of credit to all sectors, underpinning economic activity and safe-guarding price stability in the medium term.

The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0%, 0.25% and (-) 0.50% respectively. The ECB expects policy rates to remain at the present or lower levels until the inflation outlook robustly converges close to the 2% inflation target set by the ECB.

Chart 1: Movement in ECB policy rates(%)



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Source: ECB

Marginal refinancing operations rate is the pre-determined interest rate of lending to the banks against collateral on weekly basis

Deposit facility is the rate at which banks can make overnight deposits with the ECB

Marginal lending rate is the interest rate for overnight credit to the banks

Other key announcements in the policy

- Recalibration of conditions under Targeted Long Term Repo Operations (TLTRO III):** The ECB extended the period over which considerable more favorable terms will be applied till June 2022.

The counterparties will be entitled to borrow upto 55% of the stock of eligible loans compared with 50% norm which was set earlier.

- **Additional TLTRO III operations to be conducted between June and December 2021.**
- **Four additional pandemic emergency long term refinancing operations (PELTRO)** to be conducted in 2021 which will continue to provide an effective liquidity backstop.
- The set of collateral easing measures which were announced by the ECB in April 2020 will be extended to June 2022 in order to ensure the banks can make full use of Euro-system's liquidity operations.
- The net purchase under the asset purchase program (APP) will continue at a monthly pace of \$20 bn and this will continue as long as necessary.
- The Euro-system's repo facility for central banks and temporary swap lines and repo lines with non-euro area central banks to be extended until March 2022.

Assessment of the economy:

- The resurgence in coronavirus (COVID-19) infections and the associated containment measures are significantly restricting euro area economic activity. The second wave of the pandemic and the associated intensifications of containment measures observed since mid-October are expected to result in significant decline in economic activity.
- There was an improvement in economic activity in Q3-2020. GDP growth in the Euro zone fell **by 4.3% in Q3-2020** compared with a sharp decline of 14.7% in Q2-2020. Despite the rebound and encouraging prospects from the roll-out of the vaccine, high frequency data show that the economy is expected to contract in Q4-2020.
- The manufacturing sector activities continue to show resilience but the services sector is being severely curbed by the increase in infection rates and new restrictions.
- **ECB has projected annual real GDP growth at (-)7.3% in 2020, 3.9% in 2021, 4.2% in 2022 and 2.1% in 2023. The risks associated with the euro area growth outlook remains tilted to the downside.**
- **Euro area inflation** measured by the harmonized index of consumer prices (HICP) recorded deflation of (-)0.3% in each of the last 3 months till November 2020. **Annual inflation is projected at 0.2% in 2020, 1% in 2021, 1.1% in 2022 and 1.4% in 2023.**
- **Bank credit to the non-financial corporations** has plateaued and has fallen to 6.8% in October after 7.1% in September. This deceleration has been on account of abating emergency credit needs, weak investment and tighter credit conditions on loans to firms.

Market reactions

- European stocks (**Euro Stoxx fell by (-)0.2%, FTSE rose by 0.5% and CAC 40 Index rose by 0.05%**) ended mixed as the gains owing to ECB's stimulus announcement was outweighed by the losses on account of concerns surrounding the Brexit deal.
- **Euro** strengthened by 0.47% against the US Dollar ending at 1.21/\$after the ECB rolled out a number of stimulus measures to life the Eurozone from recession.