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ECB stimulus expanded and extended

Key take aways

- The ECB meeting today brought a new batch of monetary stimulus measures including an expansion and extension of the PEPP program.
- Market reaction was rather muted as the ECB's delivered package was broadly in line with expectations.
- Monetary policy support will remain accommodative for the time being, with its inflation target unlikely to be reached over its forecast period.

1. What happened?

After reiterating its commitment of a recalibration of its policy tools several times over the last few weeks, the ECB Governing Council today delivered a package of further monetary stimulus, as well as its regular macroeconomic projections.

The ECB decided to keep key policy rates unchanged although several other policy tools were adjusted. The overall volume of the Pandemic Emergency Purchase Programme (PEPP) was increased by EUR500bn to EUR1850bn, this being the fourth quantitative easing (QE) expansion during the last nine months. At the same time the investment horizon for net asset purchases under the PEPP was extended to at least the end of March 2022.

The third series of longer term refinancing operations (TLTROs) was also extended by 12 months to June 2022 while three additional operations are planned between June and December 2021. Besides this, the ECB decided to offer four additional pandemic emergency longer term refinancing operations (PELTROs) in 2021 to provide further incentives for banks to sustain their current level of lending to households and corporations. Eased collateral conditions for banks, introduced in April, will also be extended to June 2022.

In its new macroeconomic projections released today the ECB presents its first forecast for 2023 (real GDP: +2.1%, HICP: +1.4%). Furthermore, the ECB projects a less severe contraction in GDP growth in 2020 (-7.3%) than in its previous forecast released in September (-8.0%) while being less optimistic on 2021 (+3.9%, down from +5.0%) but more positive on 2022 (+4.2%, up from +3.2%). The inflation projection path includes a lower than previously forecasted HICP in 2020 (+0.2%, down from +0.3%) and in 2022 (+1.1% from +1.3%). The inflation rate projection for 2021 stayed the same at +1.0%.

The ECB again noted in its introductory statement that it will continue to monitor developments in the exchange rate and their possible implications for the inflation rate.

On the fiscal policy side, it seems there is potential for an agreement on the EU Budget and the EU Recovery Fund at the European Council taking place in Brussels today and tomorrow.

2. How did markets react?

As further stimulus measures were widely expected, the market reaction on the released details was rather muted. Equities fell slightly because of unrelated concerns regarding a new U.S. fiscal stimulus package (EuroStoxx 50: -0.1%). 10y German bund yields stayed flat at -0.60%. EUR/USD was slightly higher at 1.213 (+0.4%).

3. What does it mean for investors?

Despite encouraging news when it comes to vaccine roll-outs and the related potential light at the end of the pandemic tunnel, the ECB is still clearly concerned about the short-term economic outlook. As COVID-19 infection rates are still high or even accelerating in most Eurozone countries, restriction measures could remain in place longer than expected.

The near-term impact of the pandemic may therefore be worse than previously expected, and the ECB has demonstrated with its measures unveiled today that an ample degree of liquidity support is still necessary. The expansion and extension of the PEPP alongside the prolonged TLTRO reflect concerns about the negative effects from the pandemic on growth and inflation. As Christine Lagarde has stressed during the last few weeks, not only the level of financing conditions matters, but also the duration of policy support. The ECB has delivered on this point.

While the increase in the volume of asset purchases was widely expected, the commitment to make net asset purchases for at least nine months longer than previously announced can be interpreted as a dovish signal from the Governing Council. The ECB is once again underlining its commitment to keeping financial conditions supportive well beyond the end of the pandemic-induced economic contraction.

While longer term inflation expectations (5y5y) have risen to 1.24% due to the progress made regarding the approval of the first COVID-19 vaccines, they stay still well below the ECB target of "below, but close to, 2%". In its macroeconomic projections released today, the ECB lowered its inflation outlook for 2020 and 2022, and inflation will stay below its target range over the whole forecast period.

The cautious tone of the ECB's introductory statement (that the roll out of the vaccines could take time, and the short term outlook remains tilted to the downside) warrants a continued expansionary monetary policy stance for the coming months. As a consequence yields will stay low for longer with multiple implications for various asset classes in the Eurozone.

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Glossary

Bunds are longer-term bonds issued by the German government.

EUR is the currency code for the euro, the currency of the Eurozone.

The European Central Bank (ECB) is the central bank for the Eurozone.

The EuroStoxx 50 Index tracks the performance of blue-chip stocks in the Eurozone and includes the super-sector leaders in terms of market capitalization.

The Eurozone is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The Harmonised Index of Consumer Prices (HICP) is an approach to measuring consumer price inflation which has been standardised across EU countries.

The ECB's pandemic emergency purchase programme (PEPP) is a temporary asset purchase programmeof private and public sector securities in order to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by COVID-19 outbreak.

Quantitative easing (QE) is an unconventional monetary policy tool, in which a central bank conducts a broad-based asset purchases.

Targeted long-term refinancing operations (TLTROs) are used by the ECB to provide financing to Eurozone banks.

USD is the currency code for the U.S. Dollar.

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