

## Christine Lagarde: IMFC Statement

Statement by Ms Christine Lagarde, President of the European Central Bank, at the forty-second meeting of the International Monetary and Financial Committee, Virtual IMF Annual Meetings, Washington DC, 15 October 2020.

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The coronavirus (COVID-19) pandemic continues to be a truly global challenge. Countries all around the world are facing severe human and economic consequences. In the euro area, we have taken decisive action to mitigate the impact of the crisis, both at the national and European levels. However, a global challenge of this nature also requires global solutions and strong international cooperation.

At the global level, it will be crucial not to withdraw the policy support prematurely, including on both the monetary and fiscal sides, as reducing support too soon would risk delaying the economic rebound. At the same time, well-tailored structural measures facilitating the re-allocation of resources over time to more viable sectors will be instrumental in minimising permanent damage to our economies and thus key for medium-term growth and the inflation outlook.

### **Euro area developments and outlook**

Following the unprecedented fall in output in the first half of the year, economic indicators are pointing to a strong rebound in activity in the third quarter. This rebound is nevertheless uneven across sectors and regions, and a further sustained recovery remains highly dependent on how the pandemic will affect consumption, savings and investment decisions. While uncertainty about the path the pandemic will take is likely to dampen the strength of the recovery and affect the resilience of the labour market, the euro area economy will continue to be supported by very accommodative monetary and fiscal policies along with an expected gradual resumption in global activity. Inflation has been in negative territory since August, largely reflecting the sharp decline in energy prices earlier this year and the mid-year temporary cut in German VAT rates. These factors, combined with the impact of weak demand, downward pressure on wages and the euro's appreciation weighted on inflation although there was also some upward pressure related to supply constraints. On the basis of current and futures prices for oil and taking into account the temporary reduction in the German VAT rate, headline inflation is likely to remain negative over the coming months before turning positive again in early 2021. Over the medium term, a recovery in demand, supported by accommodative monetary and fiscal policies, will put upward pressure on inflation.

### **Monetary policy**

Since our last IMFC meeting in April, the ECB's Governing Council has taken further decisive monetary policy measures to support the economy during its gradual reopening and to safeguard medium-term price stability.

We recalibrated the pandemic emergency purchase programme (PEPP), increasing its size by €600 billion in June to a total of €1.35 trillion, and extending its duration until at least the end of June 2021 and, in any case, until the Governing Council judges that the coronavirus crisis phase is over. Moreover, we decided to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2022. The PEPP purchases aim to ensure the smooth transmission of our monetary policy across all sectors and euro area jurisdictions and to ease the overall monetary policy stance, helping to offset the downward impact of the pandemic on the projected path of inflation.

In addition, we further eased the terms and conditions for accessing central bank liquidity under

our third targeted longer-term refinancing operations programme (TLTRO III) to strengthen the incentives for banks to continue lending to the real economy. This was accompanied by an easing of collateral requirements to ensure that banks can make full use of these operations. For a year, banks will be able to borrow at negative rates, which can be as low as  $-1\%$ , on the condition that they lend to the economy. Largely in response to this recalibration, we have seen a very high take-up in our operations by banks, which has translated to a continued flow of credit to households and firms and kept lending rates at historic low levels. Moreover, we decided to conduct a new series of seven pandemic emergency longer-term refinancing operations (PELTROs) to provide liquidity support to the euro area financial system and help to preserve the smooth functioning of money markets by providing an effective backstop following the expiry of the bridge longer-term refinancing operations (LTROs) conducted since March 2020.

Overall, the monetary policy measures we have taken since early March are providing crucial support to the economy, supporting access to financing, including for those most affected by the spread of the pandemic, and contributing to maintaining favourable financing conditions for all sectors and jurisdictions.

In the current environment of elevated uncertainty, the Governing Council will carefully assess all incoming information, including developments in the exchange rate, with regard to its implications for the medium-term inflation outlook. We continue to stand ready to adjust all of our instruments, as appropriate, to ensure that inflation moves towards our inflation aim in a sustained manner, in line with our commitment to symmetry.

Moreover, the ECB's strategy review, which was delayed because of the pandemic, has resumed recently and will be an important focus for our work over the next year.

### **Euro area banking sector developments and financial stability issues**

The euro area financial sector has shown resilience so far, due to the measures taken following the financial crisis and the fiscal, prudential and monetary policy response that played a key role in maintaining credit supply and preventing a large increase in corporate and household defaults. However, financial stability risks in the euro area remain elevated, as vulnerabilities in the non-financial sector have increased owing to weak earnings and rising indebtedness. Euro area bank profitability has continued to decline, and is expected to remain very weak, with credit losses set to increase. This is reflected in the low market valuations of euro area banks and has added to structural challenges, such as overcapacity and limited revenue diversification. Nevertheless, euro area banks currently have sufficiently robust capital and liquidity buffers to absorb losses and support lending to the real economy. The ECB and the national micro- and macroprudential authorities deployed extraordinary measures to limit the consequences of the pandemic, acting in a countercyclical manner. The ECB encouraged banks to use their capital and liquidity buffers for lending purposes and loss absorption.

We also continue to closely monitor risks in the non-bank financial sector. During the market turmoil in March, some investment funds and money market funds experienced significant liquidity stress, which exposed pre-existing vulnerabilities. Liquidity strains in the non-bank financial sector amplified the market sell-off and threatened to spill over to the broader financial system and, potentially, to the real economy. Monetary policy actions taken by the ECB and other central banks around the world in the pursuit of their respective mandates helped improve market conditions during this period. But this episode highlighted that the resilience of the non-bank financial sector needs to be strengthened through regulatory reforms, which should also reflect macroprudential perspectives. This is especially important given the growing role of non-bank financial institutions in financing the real economy and their interlinkages with the rest of the financial system.

### **Europe's response to the coronavirus shock**

Europe's fiscal policy response to the coronavirus shock has been crucial in cushioning the immediate impact of the crisis on Member States' economies. National fiscal policy measures continue to be the first line of defence to secure employment and safeguard the survival of productive firms. These emergency measures should be as targeted and temporary as possible. The three safety nets agreed at the European level complement national efforts, with up to €540 billion of additional funding support being made available for workers, companies and sovereigns. An ambitious and coordinated euro area fiscal stance remains critical to support the recovery. The recovery fund (under the "Next Generation EU" umbrella) agreed by the European Council in July will provide much-needed further macroeconomic support and build a ramp towards a modern, green and digital European economy. It will be important to ensure that the European funding for the recovery is used in a timely manner and in a way that enhances long-term growth and resilience and supports common EU objectives.

### **International crisis response**

As national authorities have been taking the necessary steps to fight the pandemic, global cooperation and resource-sharing across nations continue to be vital. Addressing international trade disruptions, preserving trade openness and ensuring universal access to vaccines and treatments will be of paramount importance for a durable global economic recovery.

Further international efforts will be needed to counter the consequences of the pandemic and maintain a well-functioning international monetary system. The ECB supports the crisis response measures taken by the IMF. We continue to be open to exploring a possible new special drawing rights (SDR) allocation for all IMF members. We welcome progress on implementing the agreed reforms to double the New Arrangements to Borrow and the new round of Bilateral Borrowing Agreements on 1 January 2021. Still, the IMF resources need to be kept under close review. Given high debt levels worldwide, we are also broadly supportive of the IMF's comprehensive work agenda on debt issues.

During the first phase of the pandemic shock, major central banks, including the ECB, took coordinated action to enhance the provision of US dollar liquidity. In addition, the ECB agreed to bilateral euro swap and repo line arrangements with some EU and EU neighbouring countries' central banks. It also established a new precautionary backstop facility (EUREP) under which euro liquidity can be provided against high quality euro-denominated collateral to a broader set of central banks. By ensuring that euro liquidity is available to counterparties outside the euro area, the Eurosystem's swap and repo agreements help prevent euro liquidity shortages from becoming financial stability risks, and support the use of the euro in global financial and commercial transactions. Taken together, these measures contribute to the smooth transmission of monetary policy in the euro area and thereby help the ECB to fulfil its price stability objective.

The international community will have to cooperate more closely, and learn from each other with respect to the effectiveness of the various policy measures introduced. The current pandemic also provides a crucial opportunity to build a more resilient future, with greater focus on mitigating climate change and fostering digitalisation and inclusion. We welcome the plans to further integrate climate change-related issues into IMF surveillance. At the ECB, as part of our strategy review, we will examine the risks posed by climate change and how these risks feed into the monetary policy framework. Likewise, the international community has to work together to enhance cross-border payment systems to make them faster, cheaper and more inclusive, and to address the opportunities and challenges of the digitalisation of finance. At the ECB, discussions have started on whether to issue a digital euro to make our currency fit for the digital age. A digital euro would be a complement to, not a substitute for, cash.