# Christine Lagarde: ECB press conference - introductory statement

Introductory statement by Ms Christine Lagarde, President of the European Central Bank, and Mr Luis de Guindos, Vice-President of the European Central Bank, Frankfurt am Main, 28 October 2021.

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Good afternoon, the Vice-President and I welcome you to our press conference.

The euro area economy continues to recover strongly, although momentum has moderated to some extent. Consumers continue to be confident and their spending remains strong. But shortages of materials, equipment and labour are holding back production in some sectors. Inflation is rising, primarily because of the surge in energy prices but also as the recovery in demand is outpacing constrained supply. We foresee inflation rising further in the near term, but then declining in the course of next year.

Market interest rates have increased since our last meeting in early September. However, overall financing conditions currently remain favourable for firms, households and the public sector. Favourable financing conditions are essential for the economy to continue its recovery and to counter the negative impact of the pandemic on the inflation path.

We continue to judge that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the second and third quarters of this year.

We also confirmed our other measures, namely the level of the key ECB interest rates, our forward guidance on their likely future evolution, our purchases under the asset purchase programme (APP), our reinvestment policies and our longer-term refinancing operations, as detailed in the press release published at 13:45 today. We stand ready to adjust all of our instruments, as appropriate, to ensure that inflation stabilises at our two per cent target over the medium term.

I will now outline in more detail how we see the economy and inflation developing and will then talk about our assessment of financial and monetary conditions.

## Economic activity

The economy continued to grow strongly in the third quarter, even though momentum moderated to some extent. We still expect output to exceed its pre-pandemic level by the end of the year.

The grip of the pandemic on the economy has visibly weakened, with restrictions being lifted as a result of successful health measures and large numbers of people now vaccinated. This is supporting consumer spending, especially on entertainment, dining, travel and transportation. But higher energy prices may reduce purchasing power in the months to come.

The recovery in domestic and global demand is also supporting production and business investment. That said, shortages of materials, equipment and labour are holding back the manufacturing sector. Delivery times have lengthened considerably, and transport costs and energy prices have surged. These constraints are clouding the outlook for the coming quarters.

The labour market continues to improve. Unemployment has fallen and the number of people in job retention schemes is down significantly from the peak last year. This supports the prospect of higher incomes and increased spending. But, both the number of people in the labour force and the hours worked in the economy remain below their pre-pandemic levels.

To sustain the recovery, targeted and coordinated fiscal support should continue to complement monetary policy. This support will also help the economy adjust to the structural changes that are under way. An effective implementation of the Next Generation EU programme and the "Fit for 55" package will contribute to a stronger, greener and more even recovery across euro area countries.

## Inflation

Inflation increased to 3.4 per cent in September. We expect it to rise further this year. But while the current phase of higher inflation will last longer than originally expected, we expect inflation to decline in the course of next year.

The upswing in inflation largely reflects a combination of three factors. First, energy prices – especially for oil, gas and electricity – have risen sharply. In September, energy inflation accounted for about half of overall inflation. Second, prices are also going up because recovering demand related to the reopening of the economy is outpacing supply. These dynamics are especially visible in the prices of consumer services, as well as the prices of goods affected most strongly by supply shortages. And finally, base effects related to the end of the VAT cut in Germany are still contributing to higher inflation.

We expect the influence of all three factors to ease in the course of 2022 or to fall out of the year-on-year inflation calculation. As the recovery continues, the gradual return of the economy to full capacity will underpin a rise in wages over time. Market and survey-based measures of longer-term inflation expectations have moved closer to two per cent. These factors will support underlying inflation and the return of inflation to our target over the medium term.

## Risk assessment

The recovery continues to depend on the course of the pandemic and further progress with vaccinations. We see the risks to the economic outlook as broadly balanced. In the near term, supply bottlenecks and rising energy prices are the main risks to the pace of recovery and the outlook for inflation. If supply shortages and higher energy prices last longer, these could slow down the recovery. At the same time, if persistent bottlenecks feed through into higher than anticipated wage rises or the economy returns more quickly to full capacity, price pressures could become stronger. However, economic activity could outperform our expectations if consumers become more confident and save less than currently expected.

## Financial and monetary conditions

Growth and medium-term inflation dynamics still depend on favourable financing conditions for all sectors of the economy. Market interest rates have increased. Nevertheless, financing conditions for the economy remain favourable, not least because bank lending rates for firms and households remain at historically low levels. While there was a pick-up in September, lending to firms remains moderate. This continues to reflect the fact that firms generally need less external funding, since these have high cash holdings and are increasingly retaining their earnings. Lending to households remains strong, driven by demand for mortgages. Our most recent bank lending survey shows that credit conditions for firms stabilised and were supported – for the first time since 2018 – by a reduction in banks' risk perceptions. By contrast, banks are taking a slightly more cautious approach to housing loans and have tightened their lending standards for these loans accordingly. Bank balance sheets continue to be supported by favourable funding conditions and remain solid.

## Conclusion

Summing up, the euro area economy continues to recover strongly, although at a more moderate pace. Rising energy prices, the recovery in demand and supply bottlenecks are currently pushing up inflation. While inflation will take longer to decline than previously expected, we expect these factors to ease in the course of next year. We continue to foresee inflation in the medium term remaining below our two per cent target. Our policy measures, including our revised forward guidance on the key ECB interest rates, are crucial to helping the economy shift to a sustained recovery and, ultimately, to bringing inflation over the medium term to our target.

We are now ready to take your questions.

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**President Lagarde, thank you very much for taking my questions. I was wondering, because the markets were – well, everybody was anticipating that this meeting was all about inflation, so what have you been discussing, and what was on top of your agenda? Was there at least a slightly different assessment to the nature of inflation, given that inflation is at a 30-year high now for the eurozone.**

**My second question would be on the market expectation about the rate hike. Economists were saying that the market has not fully absorbed your new forward guidance. Perhaps you can tell us more about it and why the market is wrong to expect a rate hike already by next year.**

Lagarde: Thank you very much. Actually, we talked about inflation, inflation, inflation. That has been a topic that has occupied a lot of our time and a lot of our debates. We went I think in-depth into analysing the factors that are driving inflation. We looked at, obviously, what is happening now, which is clearly of concern, particularly to citizens of Europe, but we also looked at the medium-term outlook that we have. I think I would summarise those factors driving inflation, as we see it at the moment, in two key categories. One is related to pandemic and recovery, and the other one is related to energy. If you look at the one that is related to recovery and the post-pandemic period, we are seeing shortages. We're seeing shortages in equipment; we're seeing shortages in labour, and that has to do with the fact that the rebound of demand, the decompressed demand, if you will, is not exactly connected with the supply, and we have this supply-demand disconnection.

The second, as I said, is energy, and on that front we have drivers of the energy prices that have to do with the recovery, that have to do with the demand, but also other factors having to do with inventory, with the wind, with maintenance in Norway, with demand in China, with the supply by Russia. All elements that actually are contributing to the high energy prices that we are facing at the moment. Those are the three key buckets that are causing inflation as we discussed it today and yesterday afternoon. Now, there is a third category, which is very much related to the base effects, and I would put first and foremost, obviously, the German VAT, which is going to continue to impact our inflation numbers until the end of this year, but which will disappear as of 1 January. So that's one category base effect that will fade as of the beginning of the year. We also believe that the other two buckets that I have just discussed with you, that is recovery-related and pandemic consequences on the one hand, energy prices on the other hand. We have every reason to believe that they are going to gradually fade over the course of 2022. I'm happy to discuss further, but there might be other questions on these particular matters.

We did talk a lot about those, and we did a lot of soul-searching to actually test our analysis, and we are confident that this analysis of the temporality of those two categories is actually correct, and will lead to a decline over the course of '22. Now, granted, it will take a little longer than what we had expected, and the bottlenecks will gradually be sorted out, but it will take a bit longer. On the energy front, we also believe that it's in the course of '22 that we will see a decline in – at least a stabilisation, if not a decline of energy prices. So that was predominantly what we discussed with members of the Governing Council this morning and yesterday. We also, obviously, looked at the financial conditions that prevail at the moment in order to arrive at our monetary policy decisions, but inflation took a lot of our time, and it takes quite a bit of the space of the monetary policy statement that you have in front of you.

I would, by the way, add that our analysis certainly does not support that the conditions of our forward guidance are satisfied at the time of lift-off, as expected by markets, nor any time soon thereafter. So you asked me about this market expectations regarding lift-offs, and we look at all of that, but we really very deeply looked and tested our analysis of the drivers of inflation, and we are confident that our anticipation and our analysis is actually correct.

**President Lagarde, you and many of your colleagues have pushed back against the idea that you need to tighten policy in response to the inflation spike that we're seeing, but many of your global counterparts have in fact started doing so. So could you explain in what ways the eurozone's underlying inflation dynamics are fundamentally different to those that we see in other advanced economies, or do you think that other central banks might be overreacting to the rise in prices?**

**Secondly, on the PEPP pace, you decided in September to slow your PEPP purchases to a moderate slower pace in the fourth quarter, but we haven't actually seen that in any of the weekly data so far this month. So does this have to do with countering the effects of policy-tightening expectations, or how should we read this data?**

Lagarde: Well, let me start with the latter part of your question, which has to do with our PEPP purchases, and the decision that we made and that we reiterated this morning at our monetary policy meeting to slow the pace of purchase as compared with the second and third quarter of 2021. This has in fact been the case. This is what happened in September; this is what was decided for October; and this is the view that we have taken this morning, as well. So slow down in the pace of purchases, which is, as I said last time around, this is not tapering; this is calibrating appropriately on the basis of the commitment that we made back in December last year to look at a combination of the financing conditions to determine that they are favourable, and look at what the inflation outlook is. We came to the conclusion, yet again, this morning, that on the basis of both financing conditions that are favourable, particularly at the level of corporates and households, where interest rates are at an historically low level, and there seems to be plenty of supply of lending available. When we looked at the inflation outlook we concluded that the same assessment was appropriate this time around.

Now, you asked me to compare with other central banks. First of all, I think that comparisons, for good reasons, are odious, simply because we are not talking about the same economies. The outlook is different, the level of inflation that they have is different. Some of them are either at or above target already, including in the inflation outlook, and that fully justifies that they adopt different approaches. Some of those central banks are in commodity producers and exporters economies, and that also justified particularly approaches. So clearly, the euro area is a very large market economy. It is not a small open-market economy. It has to decide on the basis of data what the monetary policy should be in order to deliver on our mandate, which is price stability. I can assure you that we are fully committed to our 2% inflation in the medium term. That is our target. We have affirmed it in July. We are absolutely determined to deliver on that target, but we have to do that on the basis of data. We have to be patient; we have to be persistent as to our policy going forward, and that is particularly so at the effective lower bound where we are, as we have indicated in our strategy review recently.