A 2

Eurosystem monetary policy

Eurosystem

more than

€1.85 trillion

– the total envelope of the ECB's new pandemic emergency purchase programme (PEPP)

€5.5 trillion

– the total liquidity provided by the Eurosystem

€1.8 trillion

– the amount allotted in TLTRO III operations, representing a historical high for the TLTRO series

A 2

Eurosystem monetary policy

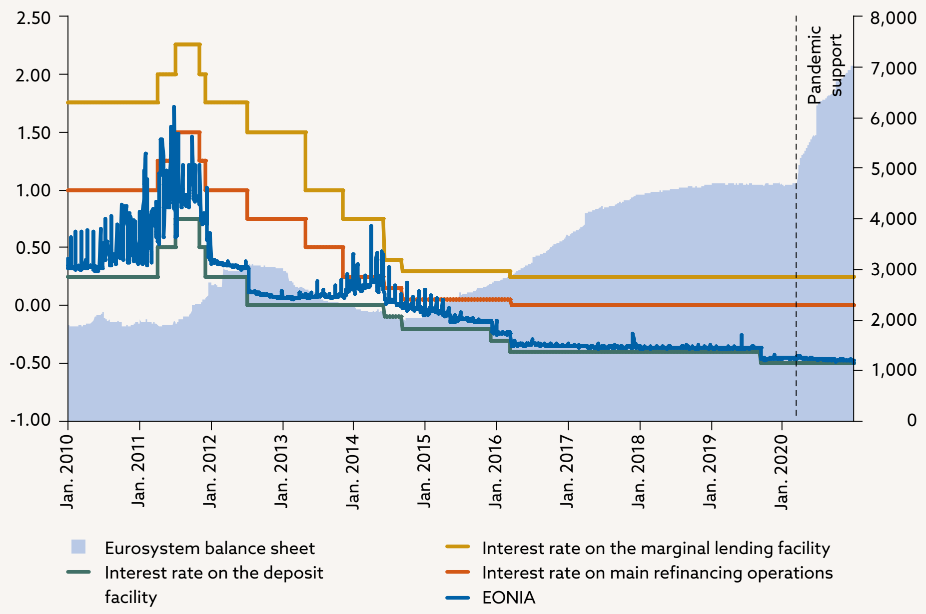
The scale and nature of the pandemic shock in 2020 demanded an extraordinary monetary policy response. A comprehensive package of measures was introduced, supplementing the existing automatic stabilisers of prolonged low interest rates, forward guidance and the asset purchase programme (APP)

In 2020 the Eurosystem continued to maintain an accommodative monetary policy stance and, in the light of the continued subdued inflation outlook, was resolved to keep this stance for a prolonged period of time. The accommodative monetary conditions were grounded on standard monetary policy instruments, namely low key interest rates: 0.00% for main refinancing operations, 0.25% for the marginal lending facility, and -0.50% for the deposit facility. In order to support the monetary policy transmission mechanism in an environment of negative interest rates, the Eurosystem continued in 2020 to implement the two-tier system for reserve remuneration that it had introduced in October 2019. Accommodative monetary conditions continued to be maintained mainly through non-standard instruments, specifically through targeted longer-term refinancing operations (TLTROs) and through APP purchases made at a monthly pace of €20 billion. Forward guidance remained an important part of the monetary policy toolkit in 2020, with the ECB's Governing Council using this instrument to indicate its intentions regarding the future path of policy rates, the expected duration of the asset purchase programme, and the reinvestment horizon. The Governing Council employed forward guidance not only to shape expectations about short-term interest rate developments, but also in regard to the outlook for longer-term rates. In January 2020 the Governing Council decided to launch a review of the ECB's monetary policy strategy (see Box 1 for more details).

The continuing convergence of inflation towards its target level was interrupted in early 2020 by the economic shock and accompanying financial market volatility triggered by the spread of the COVID-19 pandemic. The ECB responded to the new crisis with monetary policy measures that had the following aims: to stabilise financial markets; to preserve the flow of credit by ensuring favourable financing conditions for all sectors and jurisdictions; and to neutralise the pandemic-related downside risks to the inflation path[1]. Through monetary policy interventions, the Eurosystem provided the euro area banking sector with a considerable volume of new liquidity, resulting in the size of the Eurosystem's balance sheet reaching a historical high of €6.8 trillion in 2020. Of that total, monetary policy assets accounted for 83%.

Chart 12: Key ECB interest rates and the Eurosystem balance sheet (percentages; EUR millions)

Sources: ECB, Bloomberg, and NBS.



The Governing Council's initial monetary policy response to the COVID-19 pandemic came in March 2020, when it decided first to modify existing instruments and then to launch a new temporary asset purchase programme of private and public sector securities, called the pandemic emergency purchase programme (PEPP). Then in April, the Governing Council unveiled a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs). One important modification of the monetary policy toolkit was the enlargement of the pool of collateral eligible for use in Eurosystem operations. In June 2020 the Governing Council decided to set up a new backstop facility, called the Eurosystem repo facility for central banks (EUREP), to provide precautionary euro repo lines to central banks outside the euro area. The reason for providing euro liquidity to these central banks was to ensure the smooth transmission of ECB monetary policy by reducing the risk of fire sales of euro-denominated assets. Having regard to the impact of the pandemic, the Governing Council recalibrated its pandemic-related measures in April, June and December so that they would continue contributing to the preservation of favourable financing conditions.

[1] Philip R. Lane, Member of the Executive Board of the ECB, "Monetary policy in a pandemic: ensuring favourable financing conditions", speech at the Economics Department and IM-TCD, Trinity College Dublin, 26 November 2020.

As regards monetary policy operations allotted through tenders, the bulk of the funds taken up by the banking sector in 2020 were provided through non-standard targeted and non-targeted operations with favourable interest conditions. The aim of the operations was to ensure bank lending to the entities hardest hit by the coronavirus pandemic.

Since the standard weekly main refinancing operations (MROs) and three-month longer-term refinancing operations (LTROs) remained subject to standard interest conditions, demand in these operations fell to minimal levels in 2020. The banking sector continued to make far more use of non-standard refinancing operations, to which the Governing Council in 2020 started applying a negative interest rate for the first time. The largest take-up continued to be seen in the third series of targeted longer-term refinancing operations (TLTRO III), which experienced a surge in demand after the Governing Council decided to reduce the interest rate on these operations to a negative level[2] for the period from June 2020 to June 2021. The modification was intended to support bank lending to those affected most by the spread of the coronavirus, in particular small and medium-sized enterprises and households. In the fourth TLTRO III operation, conducted in June 2020, the take-up of €1.3 trillion represented a historical high for a Eurosystem tender operation. In order to provide immediate liquidity support to the financial system during the period from March to June, prior to the fourth TLTRO III operation, the Governing Council decided to conduct, temporarily, new bridge LTROs, which also carried a negative interest rate. Last but not least, the Governing Council decided at the end of April on a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs), designed to support liquidity conditions in the euro area financial system and to contribute to preserving the smooth functioning of money markets. These operations were also subject to a negative interest rate and they registered the second highest take-up among the Eurosystem's tender operations, which, however, was significantly below the take-up of TLTRO III operations. The overall liquidity provided by the Eurosystem to the euro area banking sector in 2020 amounted €1.8 trillion, almost three times higher than the corresponding figure for 2019.

[2] In March 2020 the Governing Council decided that during the period from June 2020 to June 2021, the interest rate on TLTRO III operations would be 25 basis points below the average rate applied in the Eurosystem's main refinancing operations. For counterparties that maintain their levels of credit provision, the rate applied over that period can be as low as 25 basis points below the average interest rate on the deposit facility. These conditions were further eased in April, when it was decided to increase both of those reductions to 50 basis points. In December the Governing Council decided that the period over which these more favourable terms apply would be extended to June 2022 and that three additional operations would be conducted between June and December 2021.

In line with the coordinated efforts of the world's major central banks to make liquidity provision more effective, the ECB in 2020 increased the frequency of its tender operations in US dollars. The greater availability of dollar liquidity in the euro area financial market – evident from the high take-up of these operations, particularly in the first half of the year – helped ensure that financial conditions also stabilised in this segment of the European financial market.

In 2020, the significant easing of monetary policy and the application of more favourable financing conditions in the real economy were also ensured through the asset purchase programme (APP) and the new pandemic emergency purchase programme (PEPP).

In March 2020 the Governing Council introduced a temporary envelope of additional net asset purchases of €120 billion until the end of the year, so extending the existing APP envelope of €20 billion per month. Later in March, as the diffusion of the coronavirus pandemic escalated and posed increasingly serious risks to the monetary policy transmission mechanism, the Governing Council decided to launch a new pandemic emergency purchase programme (PEPP), which initially had an envelope of €750 billion and was to run at least until the end of 2020. PEPP purchases included all the asset categories eligible under the existing APP, including bonds issued by euro area sovereigns and international organisations located in the euro area, covered bonds, corporate bonds, and asset-backed securities. In addition, the PEPP included a waiver of the eligibility requirements for securities issued by the Greek Government. In the light of market needs, it was also decided to expand the eligibility of non-financial commercial paper to include securities with a remaining maturity of at least 28 days. The PEPP's implementation was calibrated in accordance with the programme's dual function: firstly, to stabilise the market and ensure smooth policy transmission, and, secondly, to ease the monetary policy stance. The PEPP purchases were conducted in a flexible manner over time, across asset classes and among jurisdictions. As under the APP, the majority of assets purchased under the PEPP were government bonds. For PEPP purchases, the benchmark allocation across jurisdictions continued to be the percentage share of each national central bank in the ECB's total capital (the capital key). The flexibility of PEPP purchases allowed for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions. In June 2020, responding to the pandemic-related downward revision of projected inflation, the Governing Council decided to increase the PEPP envelope by €600 billion, to a total of €1,350 billion, and to extend the horizon for net purchases under the PEPP to at least the end of June 2021. In December 2020, in view of the economic fallout from the resurgence of the pandemic, the Governing Council decided to increase the PEPP envelope by a further €500 billion, to a total of €1,850 billion, and to extend the programme's horizon to at least the end of March 2022. At the same time, the Governing Council made clear that, depending on market conditions, the PEPP envelope need not be used in full or it may be increased.

Chart 13: Eurosystem tender operations (EUR millions)

Sources: ECB, and NBS.

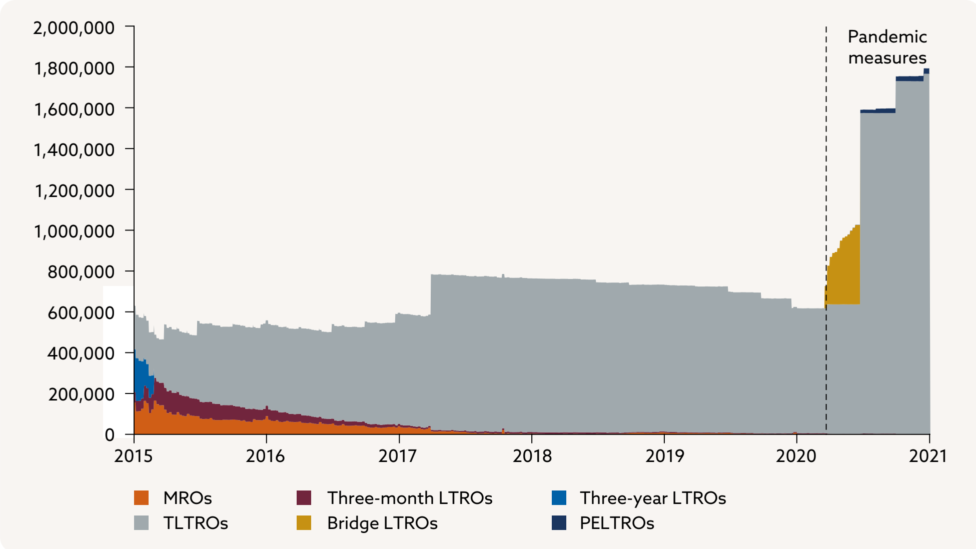
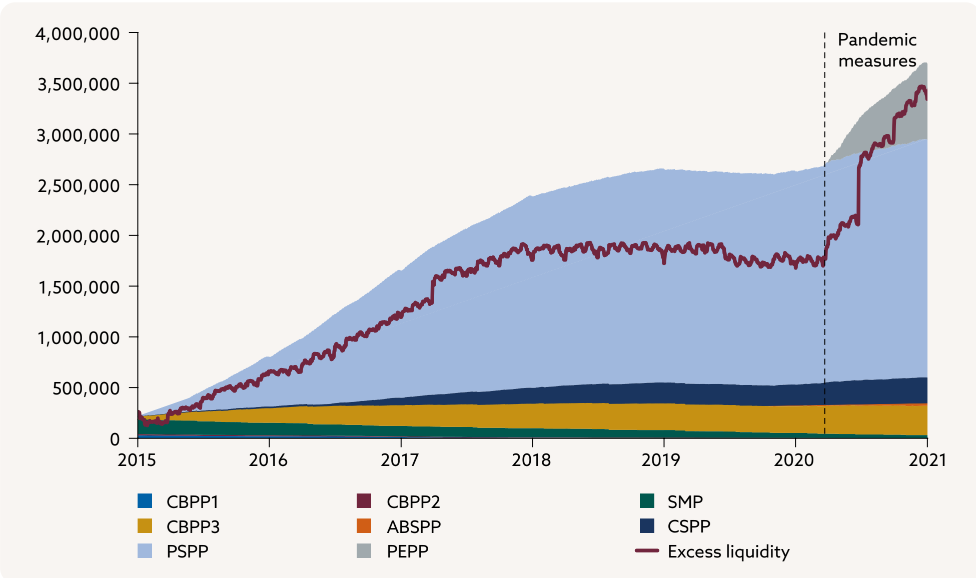


Chart 14: Eurosystem monetary policy portfolio (EUR millions)

Sources: ECB, and NBS.



At the end of 2020 APP and PEPP holdings amounted to €2.9 trillion and €755 billion respectively, almost €3.7 trillion in total. The PEPP holdings were at about the size of the programme's originally announced envelope. Of the total liquidity provided by the Eurosystem in 2020, amounting to €5.5 trillion, asset purchases accounted for 67% and tender operations for 33%. The day-to-day fine-tuning of banking sector liquidity is ensured through the marginal lending facility and deposit facility, i.e. standing facilities. Owing to the enormous liquidity surplus in the European banking sector in 2020, the marginal lending facility was used in very limited amounts.

On the other hand, banks continued to reduce their liquidity surplus via recourse to the deposit facility, the average use of which amounted to €500 billion.

The primary challenge in 2020 was a health one. At the same time, however, the Eurosystem's monetary policy helped to ensure significant financial market stabilisation and to preserve favourable financing conditions for households, firms and governments.

Chart 15: EURIBOR rates

Sources: Bloomberg, and NBS.

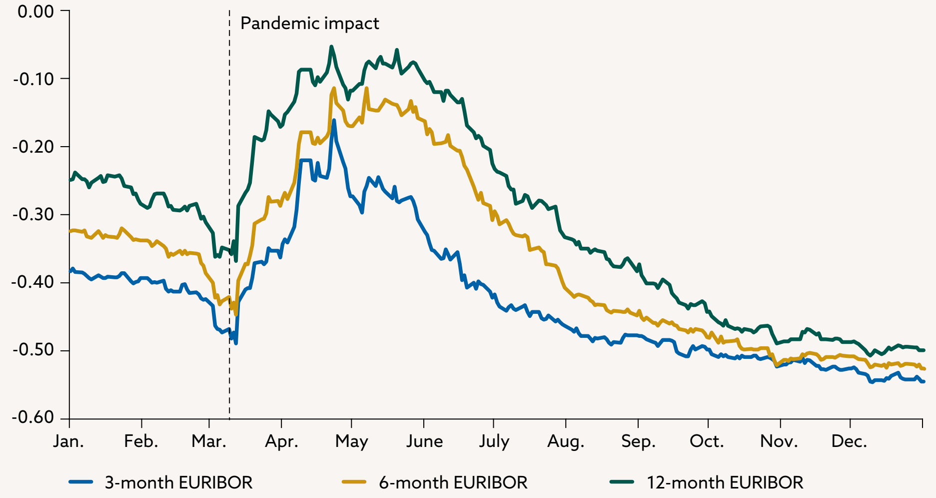
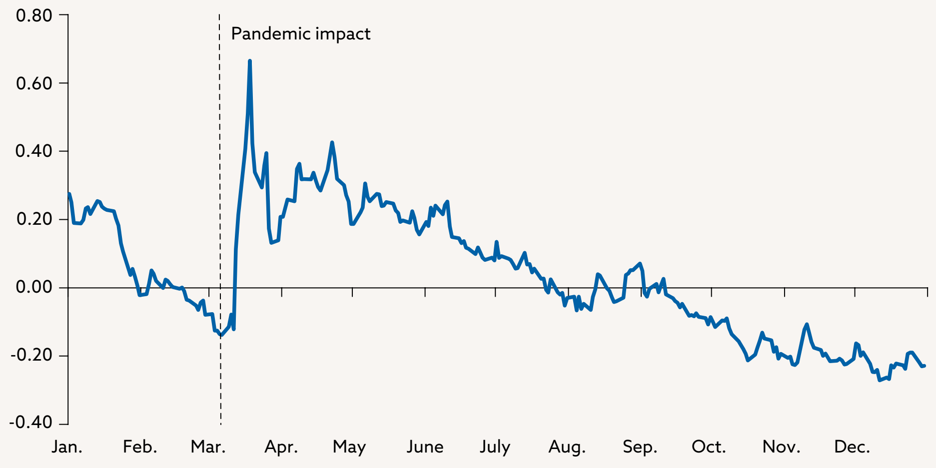


Chart 16: 10-year GDP-weighted yield on euro area government bonds

Sources: SDW ECB, and NBS.



BOX 1

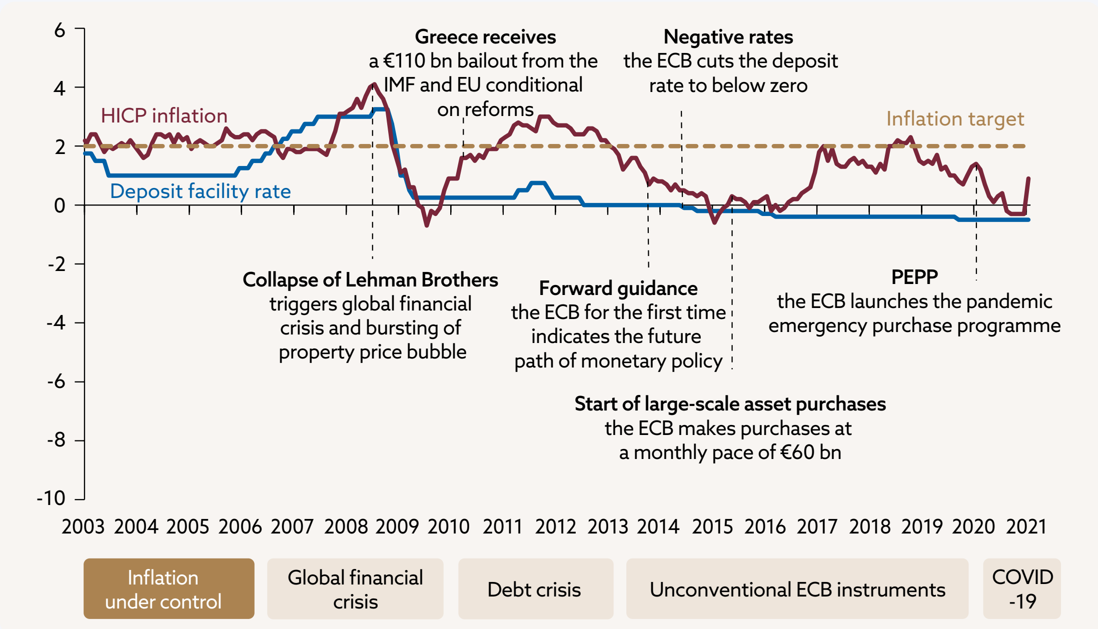
The ECB's monetary policy strategy review

The ECB's monetary policy strategy is about what objectives the ECB wants to achieve, and how it wants to achieve them, in order to fulfil its mandate to maintain price stability. That general primary mandate was given by EU citizens through the approval of the Treaty establishing the European Community. The strategy also helps the ECB communicate its objectives and intentions to the public.

The ECB last conducted a strategy review in 2003, since when the euro area economy has undergone profound changes. Policymakers faced new challenges in the form of the global financial crisis and its fallout, which included the debt crisis and lower economic growth. Declining trend growth amid decelerating productivity growth, an ageing population and the repercussions of the financial crisis put downward pressure on interest rates in the economy, making it harder for the ECB and other central banks to reduce interest rates in the event of a business cycle downturn.

As the economic damage faded and interest rates remained subdued, the ECB had to respond with several new unconventional instruments (Chart A). After a certain time since their introduction, it is necessary to take stock of these instruments, to assess to what extent they have supported, and are supporting, the fulfilment of strategic

Chart A: Key events and the introduction of new ECB instruments (EUR billions)



Source: SDW ECB.

BOX 1

objectives. This should also help ensure that the ECB can respond as efficiently as possible to future challenges presented by globalisation, digitalisation, population ageing, and climate change.

The new strategy review that the ECB's Governing Council launched in January 2020 covers all aspects of monetary policy. There are five main issues:

1. what is meant by "price stability", that is, what rate of inflation should be aimed for;
2. the way to analyse how decisions affect the economy, specifically stakeholders like consumers, companies, markets and banks;
3. to what extent is it important to take account of other issues such as employment, climate change and financial stability;
4. the monetary policy instruments the ECB uses to achieve its objective;
5. how decisions are communicated to, and understood by, the public.

In order to deepen understanding of these key issues, the ECB has set up 13 work streams (see Figure 1). The work streams are actively using the expertise and analytical capacities of Eurosystem staff members from the ECB and national central banks, including Národná banka Slovenska, and are also receiving inputs from the various stakeholders: the public, the business sector, civil society organisations, etc.

Figure 1: The ECB's strategy review work streams

PRICE STABILITY

Price stability objective
Provides analysis on the ECB's numerical formulation of price stability and alternative approaches to achieving price stability.

Inflation measurement
Analyses the most accurate method of measuring inflation, and assesses potential measurement issues.

Inflation expectations
Analyses how inflation expectations are formed and deepens the understanding of their main drivers.

INSTRUMENTS AND OTHER DECISION-MAKING FACTORS

Macroprudential policy, monetary policy and financial stability
Contributes to the assessment of the interaction between macroprudential policies, financial stability and monetary policy.

Non-bank financial intermediation
Examines how the changing structure of the financial sector, in particular the growing role of non-banks, affects the conduct of monetary policy.

Eurosystem modelling
Assesses knowledge gaps in the main models used for monetary policy decision-making.

Employment
Studies how (un)employment affects the conduct and success of monetary policy.

Fiscal and monetary policy in a monetary union
Takes stock of the fiscal policy landscape in the euro area and assesses implications for monetary policy.

Monetary policy communication
Assesses the ECB's communication strategy in relation to monetary policy decisions and to the general public's understanding of the ECB.

FUTURE CHALLENGES

Climate change
Examines the risks posed by climate change and how these risks feed into the monetary policy framework.

Globalisation
Assesses the impact of globalisation on the transmission of monetary policy decisions to the economy and to inflation.

Digitalisation
Studies the implications of digitalisation for the functioning of the economy and for the conduct of monetary policy.

Productivity, innovation and technological progress
Assesses developments in productivity and technology, and analyses the implications of these developments for monetary policy.

BOX 1

An important prerequisite for the effectiveness of the ECB's monetary policy, is transparency – both in monetary policy decisions, and in the strategies that result in those decisions. In this vein, the first "ECB Listens" event was held in October 2020, as a way for the ECB to hear the views of citizens, firms, the academic community, and civil society organisations from across Europe.

The ECB has excellent communication with experts and financial markets; however, its decisions and tasks need to be better understood by the general public. The proposals made by participants at the ECB Listens event focused mainly on how to simplify communication with the general public and the importance of educating people about the basic functioning of monetary policy. A central bank that is closer to people helps to raise awareness as well as to prevent the spread of populism. In this regard, Národná banka Slovenska has already launched several projects, including, for example, the "5peňazí" financial education initiative and a regular publication about the background to monetary policy, called "Frankfurtské hárky" (Frankfurt Papers).

Events involving the direct participation of the broader public were also organised at the national level

In late 2020, for example, Národná banka Slovenska hosted an event called "NBS vás počúva" (NBS Listens), at which the NBS Governor Peter Kažimír, Deputy Governor Ľudovít Ódor, and Chief Economist Michal Horváth spoke about the current economic situation with representatives of the non-profit, business and public sectors. Among the key issues for the participants were the risks related to the pandemic crisis and to rising property prices. Another risk mentioned was the prolonged low interest rate environment in the light of households' overly conservative investment behaviour, which may result in them having a greater propensity to hoard cash than to invest. The participants also pointed out the importance of stable and predictable prices to the investment decisions of firms and households.

Because of the pandemic crisis, the review has been delayed and is now expected to be concluded in the second half of 2021. The objective is to ensure that the strategy is fit for purpose both now and in the future.