



EUROPEAN CENTRAL BANK

EUROSYSTEM

“Extraordinary times
require extraordinary
action”:
The ECB and European
response to Covid19

CEMLA Central Banking
Operations Meeting
September 2 to 4 2020

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Overview

- 1 The ECB and European response: building blocks
- 2 The ECB and European response: effectiveness and market impact
- 3 Lessons learned and risks ahead

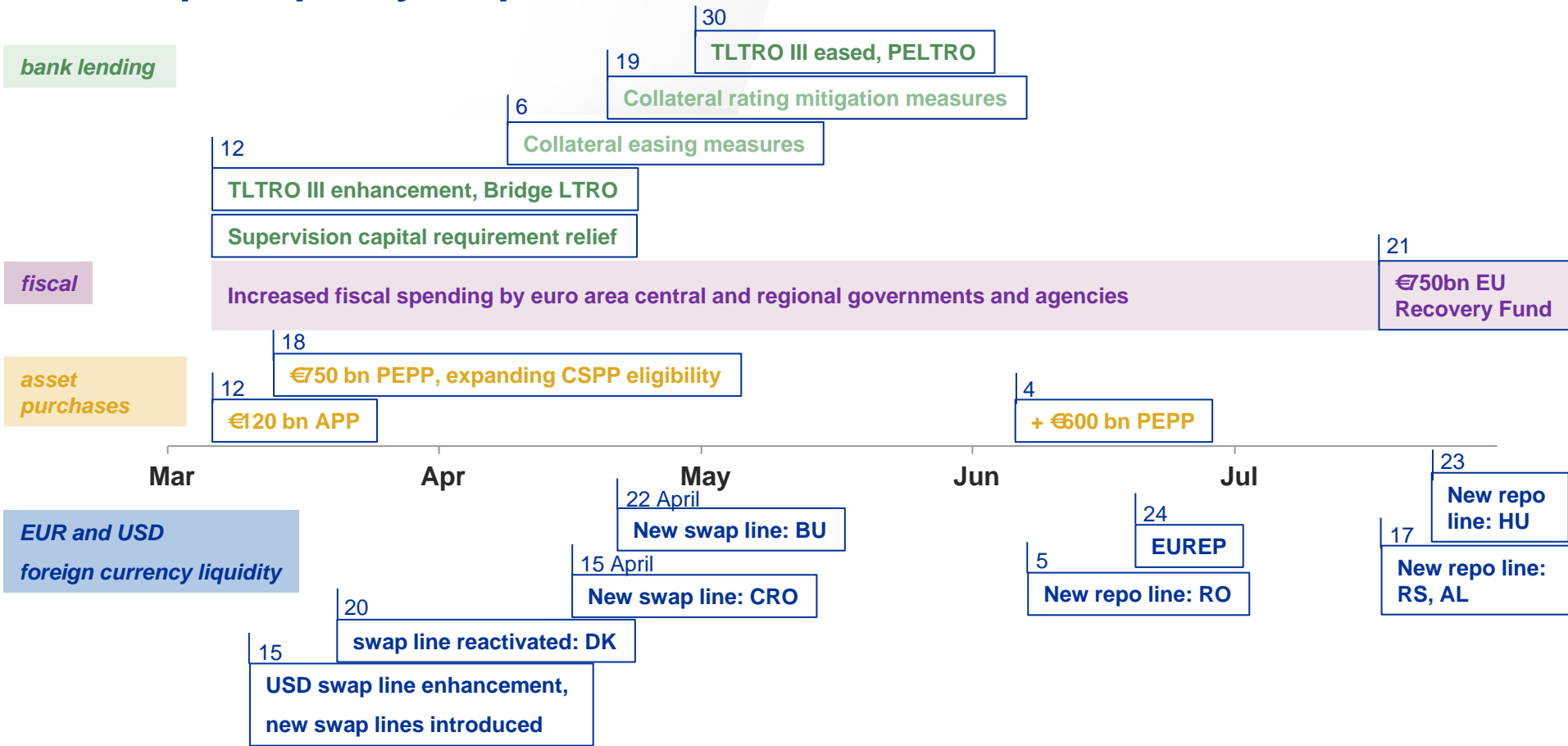
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Key messages








- The COVID crisis challenged central banks, otherwise experienced in dealing with financial crises, to respond to a health crisis
- The Eurosystem rolled out measures targeting different channels including bank lending conditions, market distress and the provision of foreign currency
- Efforts were aggravated by operationally challenging working conditions in the form of split teams
- The EU launched its first shared fiscal response in history

European policy response to the health crisis: timeline and channels



European crisis support: building blocks

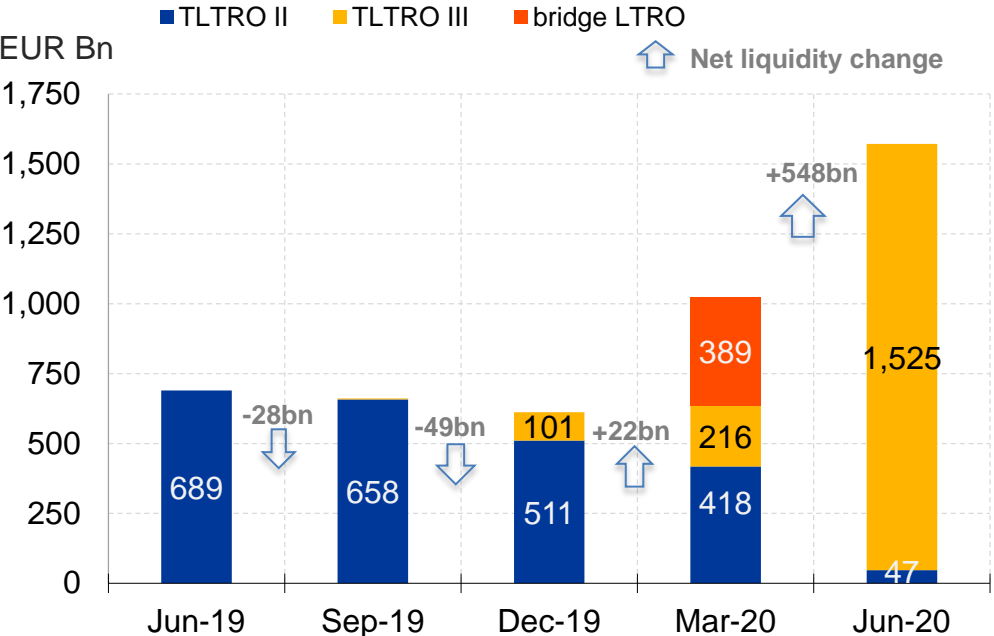
pct. of 2019 EA GDP / EURbn

Today's focus:	1. Lending operations	11% / 1,331 (outstanding amount today)	
	2. Collateral measures	9% / 1,000 (increase of mobilised collateral between March and July 2020)	
	3. Swaps & Repurchase operations	1% / 129 (outstanding amount at the peak of the crisis)	
	4. Asset Purchases	APP: 1% / 120 until Dec-20 PEPP: 11% / 1,350 until Jun-21	
	5. Expansionary fiscal stance by governments	c. 9% / 1,000 until Dec-20 (increase in EA net issuance for 2020E)	
	6. EU crisis support: SURE & RRF	RRF: 6% / 750 until Dec-26 SURE: 1% / 100 until Dec-22	
	7. Supervisory measures	Capital measures: 1% / 120 Dividend distribution: 0.2% / 30	

TLTRO III.4 allotted the largest operation in ECB history: EUR 1.3 trillion, 742 banks, EUR 548 net liquidity injection

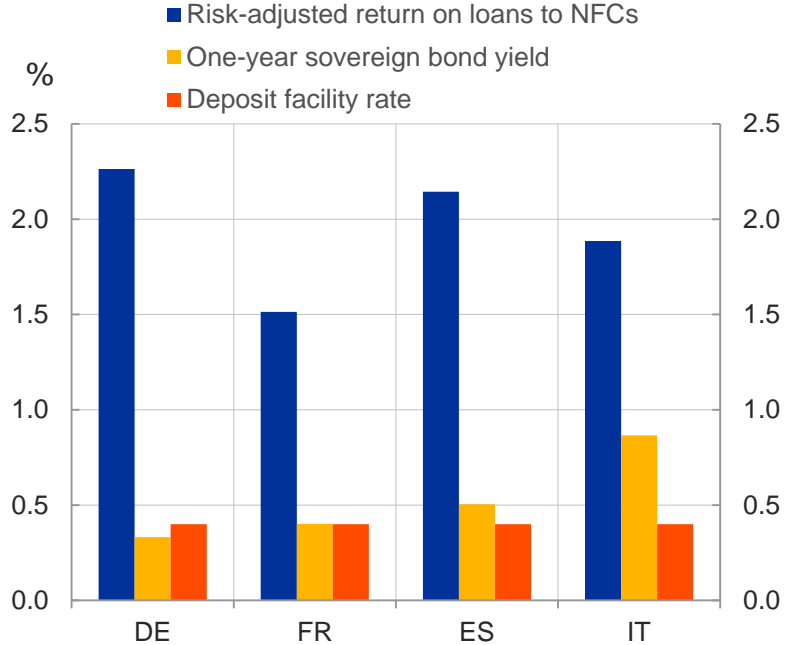


Evolution of outstanding amounts for selected credit operation



Sources: ECB calculation, LMN, SMA. Notes: the net liquidity effect includes TLTRO III.4 allotment, maturing operations (bridge LTRO and TLTRO-I.1) and early repayments (TLTRO-II.2-4).

Risk adjusted return on loans to NFCs compared to selected alternatives



Source: ECB and ECB calculations. Notes: Risk-adjusted return on loans (lending rate net of expected losses and capital requirements); monthly average of daily observations in June 2020 for sovereign bonds; all variables are expressed in deviation from a TLTRO-III.4 rate of -0.9% (-1% from June 2020 to June 2021, -0.5% until September 2021). Last Observation: May 2020 for lending rates, 30 June 2020 for sovereign bonds.

Collateral measures



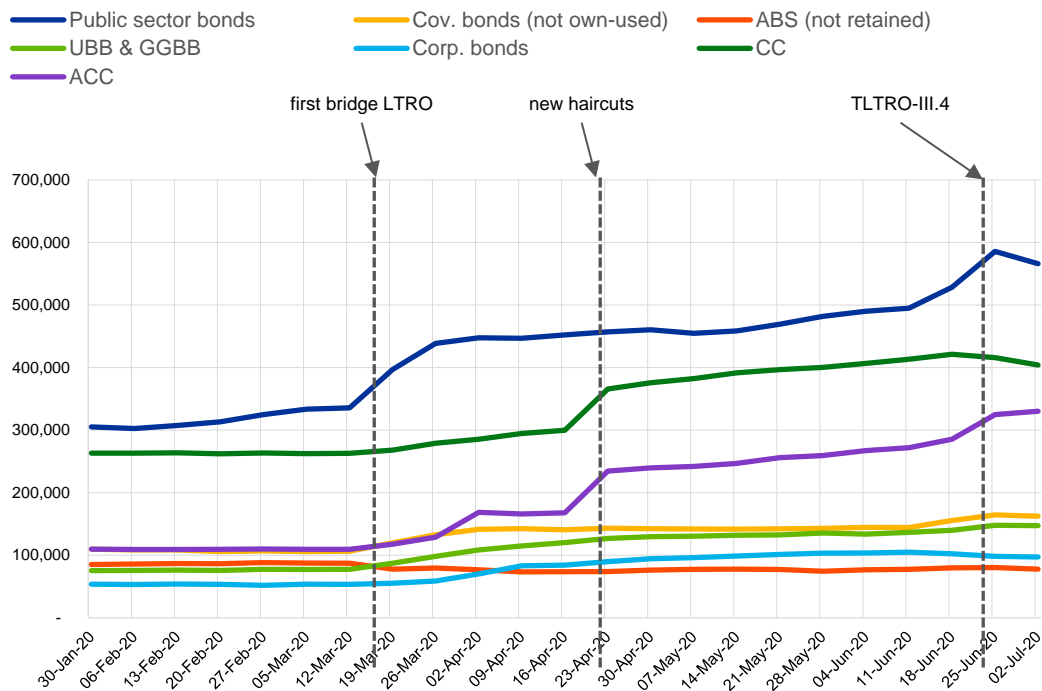
	Measure	Timeframe	Implementation
Measures targeted to credit claims	Removal of the minimum size threshold (of EUR 25,000) for credit claims	temporary	8 April
	ACC – Increasing scope for accepting credit claims under the ACC frameworks by NCBs	temporary	NCB dependent
Broad-based increase of Eurosystem risk tolerance	Proportionate reduction of all haircuts for all assets by a fixed factor of 20%	temporary	20 April
	Additional reduction of haircuts for non-marketable assets	permanent	20 April
	ACC – Reducing haircuts for ACC pools and individual credit claims	permanent	20 April
	Increase of the concentration limit for unsecured bank bonds from 2.5% to 10%	temporary	8 April
Minimum rating threshold	Grandfathering of eligibility of marketable assets (other than ABS) falling below rating threshold, with a floor at BB	temporary	18 May
	Grandfathering of eligibility of ABS falling below rating threshold, with a floor at BB+	temporary	18 May
Greek waiver	Acceptance of Greek sovereign bonds as collateral	temporary	20 April

Note: The ACC framework, in place since 2012, provides the possibility to National Central Banks (NCBs) to allow counterparties in their jurisdictions to use credit claims as collateral that are normally not eligible (e.g. due to lower credit quality or currency of denomination)

Collateral measures had strongest impact on credit claims (including ACCs)



Mobilized collateral (value after haircuts) for different asset categories (EUR Mill)



Source: ECB.



Asset purchase programmes provide sizeable support in a flexible manner

12 March: temporary €120 bn APP envelope added until year end¹

18 March: New temporary asset purchase programme, Pandemic emergency purchase programme (PEPP)

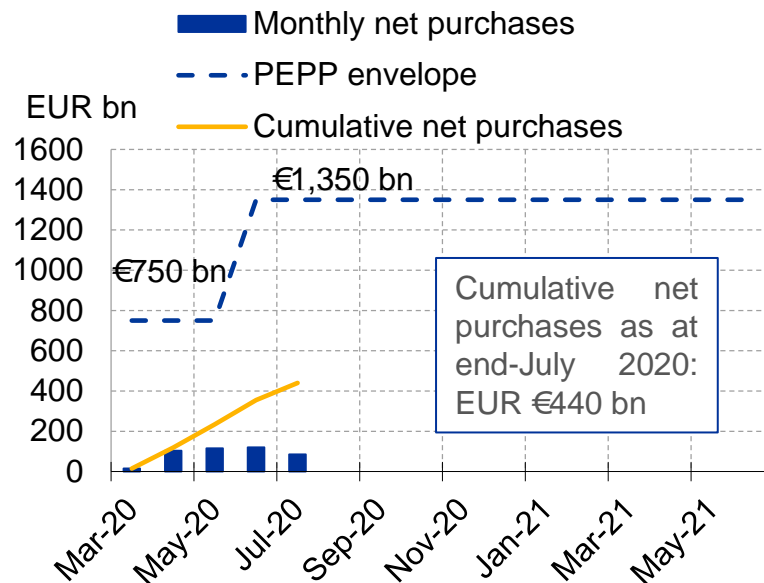
- **€750 bn** with net purchases until end of 2020
- **Inclusion of all asset categories eligible under the APP.** In addition: short-dated government securities (**bills**) and **commercial paper**. **Waiver** of the eligibility requirements **for Greek government securities**.
- **Purchases will be conducted in a flexible manner** to allow for fluctuations in distribution of purchases over time, across asset classes and among jurisdictions².

PEPP **expansion on 4 June: + €600 bn** net purchases until end of June 2021 (bringing total envelope to €1,350 bn). Reinvestments until at least end of 2022.

Notes:

1. The ECB's Asset Purchase Programme (APP) was initiated in mid-2014 to support the monetary policy transmission mechanism and provide the amount of policy accommodation needed to ensure price stability. APP cumulative net purchases stood at €2,920 bn as of as of end July-20.
2. For public sector securities, the benchmark allocation across jurisdictions will continue to be the capital key.

PEPP envelope and monthly net purchases

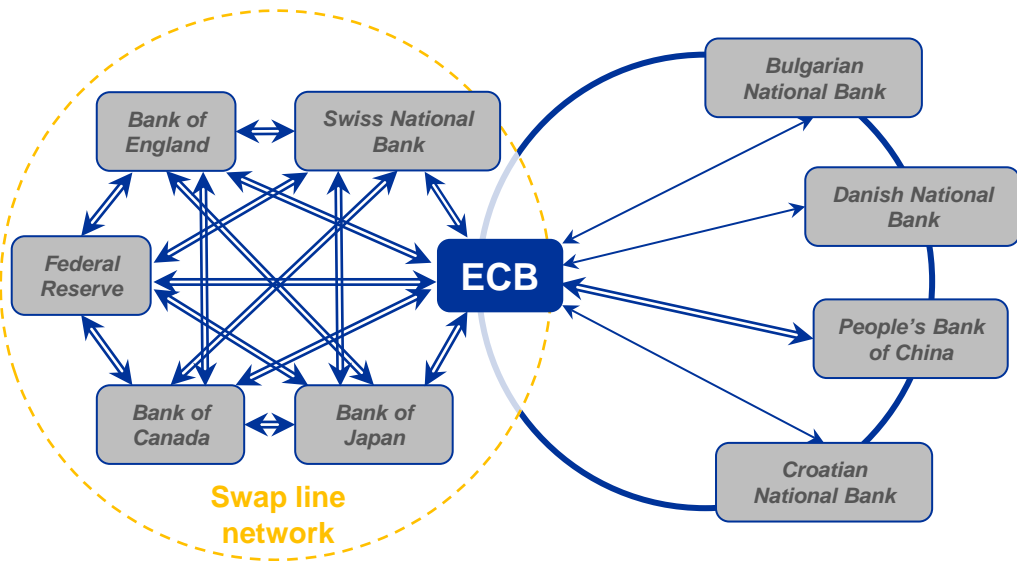


FX liquidity provision aims at improving euro area banks access to FX as well as providing euro liquidity to central banks outside the euro area



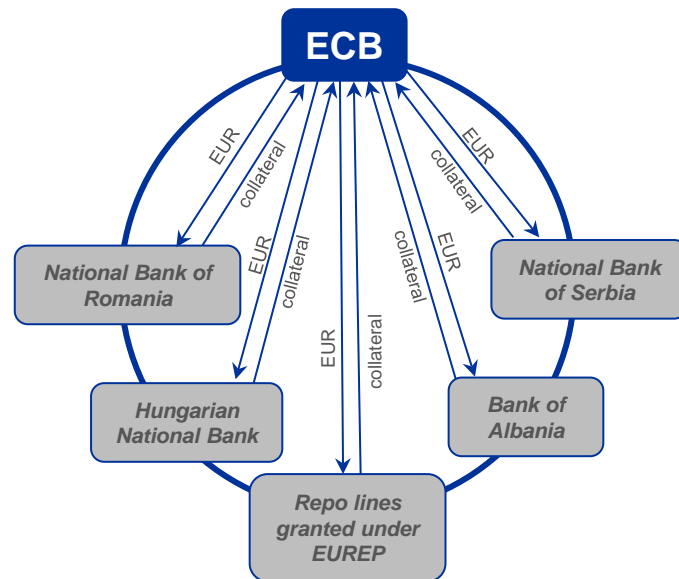
Swap lines

- ✓ ECB provides euro against currencies accepted by the ECB for swap line operations



Repo lines

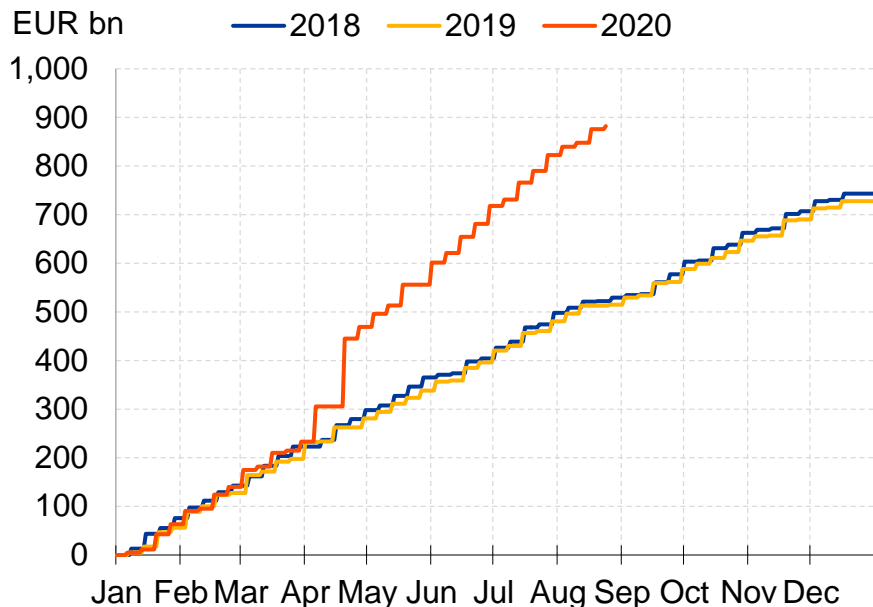
- ✓ ECB provides euro against adequate euro-denominated collateral accepted by the ECB



Euro area national fiscal stance strongly expansionary



Euro area cumulative government bond supply



Notes: Year-to-date gross issuance in central government bonds.
 Source: ECB Eligible Assets Database
 Last observation: 24 August 2020

Change in 2020E expected net issuance

(EURbn)	Pre-virus net supply estimate (Feb)	(+) Increase Feb v July estimate	July estimate
DE	-7	430	423
FR	60	167	227
IT	31	170	201
ES	29	107	136
NL	-6	92	86
AT	-2	3	1
FI	4	13	17
IE	-6	9	3
PT	0	23	23
Other EA	13	68	81
EA	117	1,082	1,199

Source: ECB estimates.

Notes: Net 2020E supply of bonds & bills as of July-20 ECB estimates for central and regional governments as well as agencies.

Strong political commitment to common European fiscal response (1/2)



The European Commission will issue bonds on behalf of the EU to finance SURE and RFF programmes. Investment Grade rating expected ([see appendix](#)).

SURE: temporary Support to mitigate Unemployment Risks in an Emergency

- **Size:** €100 bn loans granted on favourable terms from the EU to Member States (backed by €25 bn of voluntarily guarantees by Member States).
- First time common instrument to combat unemployment shocks in the EU.
- **Adopted** on 19 May 2020 by the Council.
- **Purpose:** To address sudden increases in public spending directly related to employment preservation (short-term work schemes etc.).

RRF: Recovery and Resilience Facility

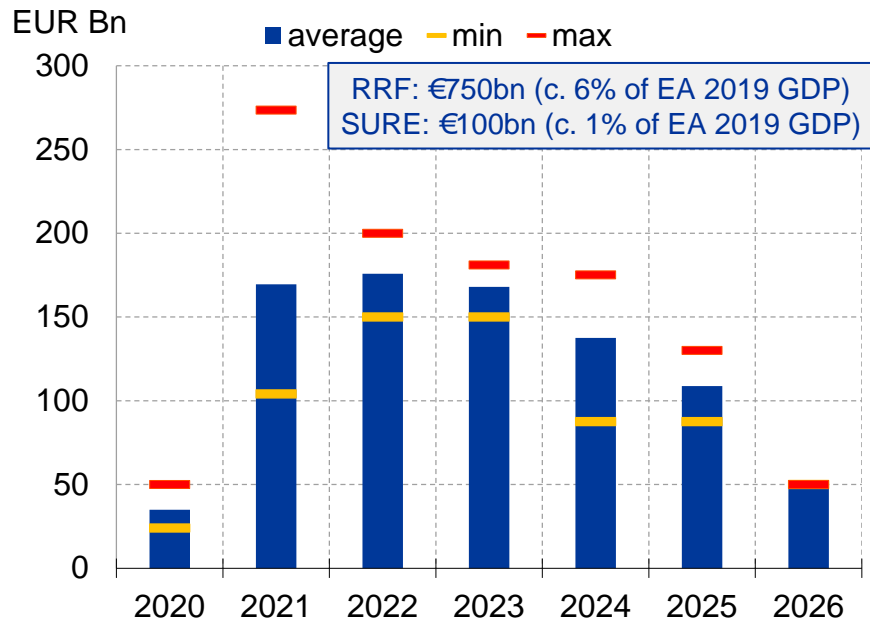
- **Size:** €750 bn, embedded in the European Semester
- Will boost the financial firepower of the EU budget by enabling the EU budget to raise additional financing on the financial markets → increase in safe assets.
- **Agreed** on 21 July 2020 following many months of EU negotiations. The proposal from the EU followed a €500 bn Franco-German proposal in May.
- **Purpose:** Financial support to both public investments and reforms, €310 bn in grants and up to €250 bn in loans.



Strong political commitment to common European fiscal response (2/2)



SURE and RRF issuance trajectory



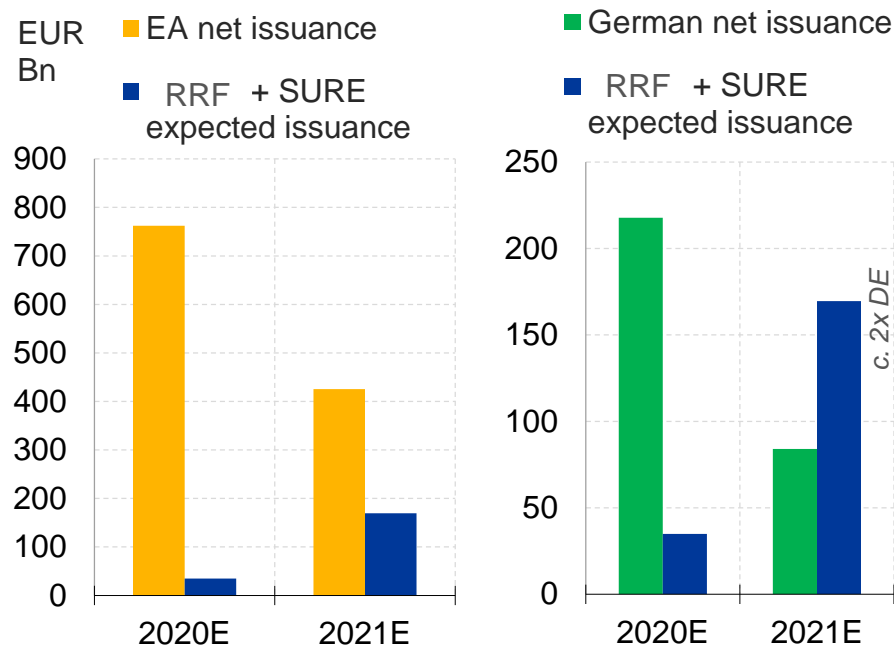
Source: Expected issuance calculated based on recent counterparty estimates.

Abbreviations:

SURE: Support to mitigate Unemployment Risks in an Emergency

RRF: Recovery and Resilience Facility

2021 contribution expected to be sizeable



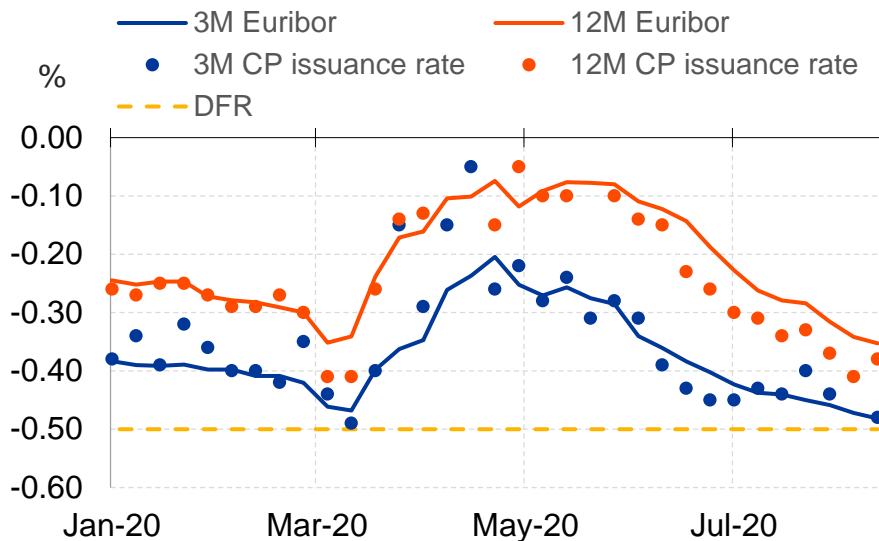
Source: ECB estimates for EA net bond issuance by Central Governments. RRF and SURE estimated based on recent counterparty estimates.

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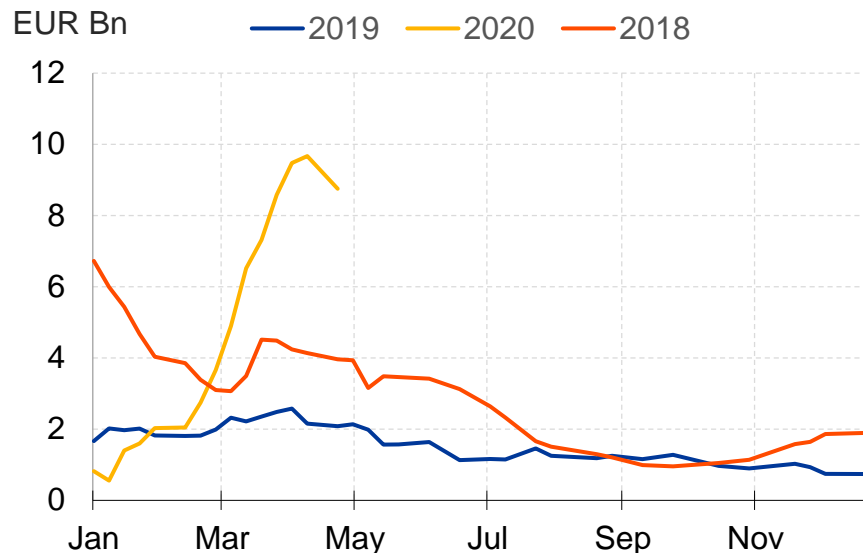
Bank funding conditions and bank risk premia normalised gradually; issuance patterns suggest there is still a preference for short duration

CP and EURIBOR rate for selected maturities



Source: BdF data (NEU CP). A1 rated Financial issuers
Last observation: 21 August 2020

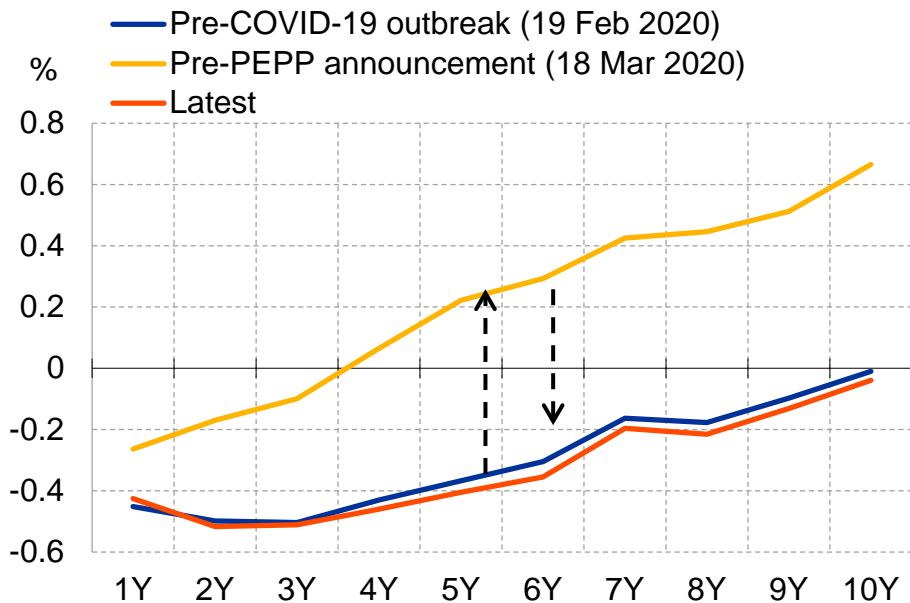
Commercial paper issuance in maturities up to one-month



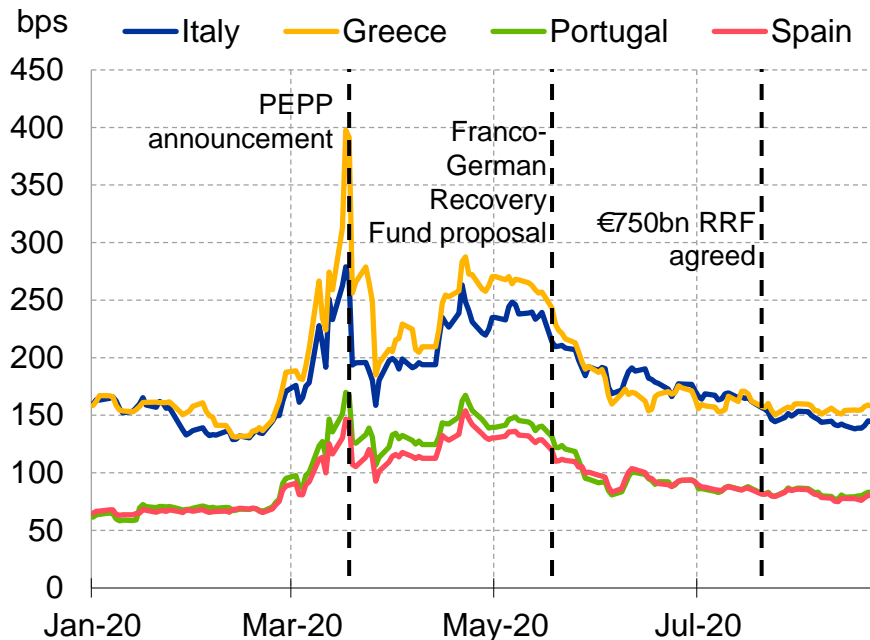
Source: BdF data (NEU CP). Financial issuers, all ratings, five week moving average

PEPP highly effective to mitigate fragmentation in bond markets, further stabilization from EU RRF announcement

Euro area GDP-weighted yield curve



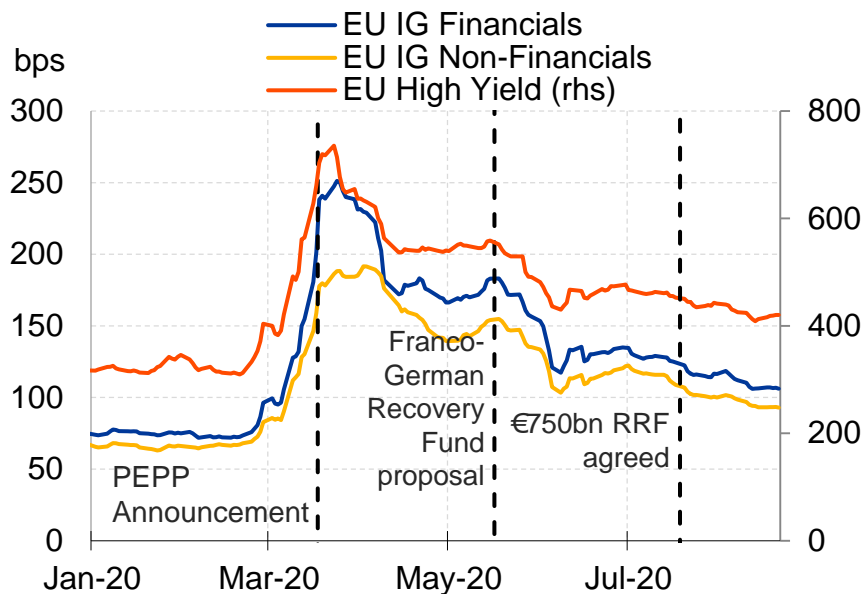
10-year government bond spreads vs. Germany



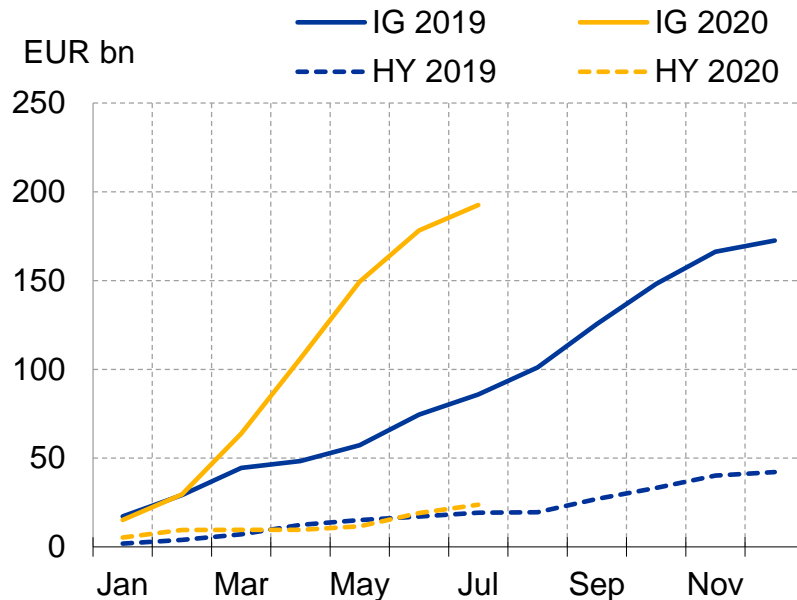
Source: Bloomberg, ECB calculations
Last observation: 21 August 2020

PEPP contributed to the stabilization of corporate yields even with the heavy supply in IG

Euro area corporate bond credit spreads



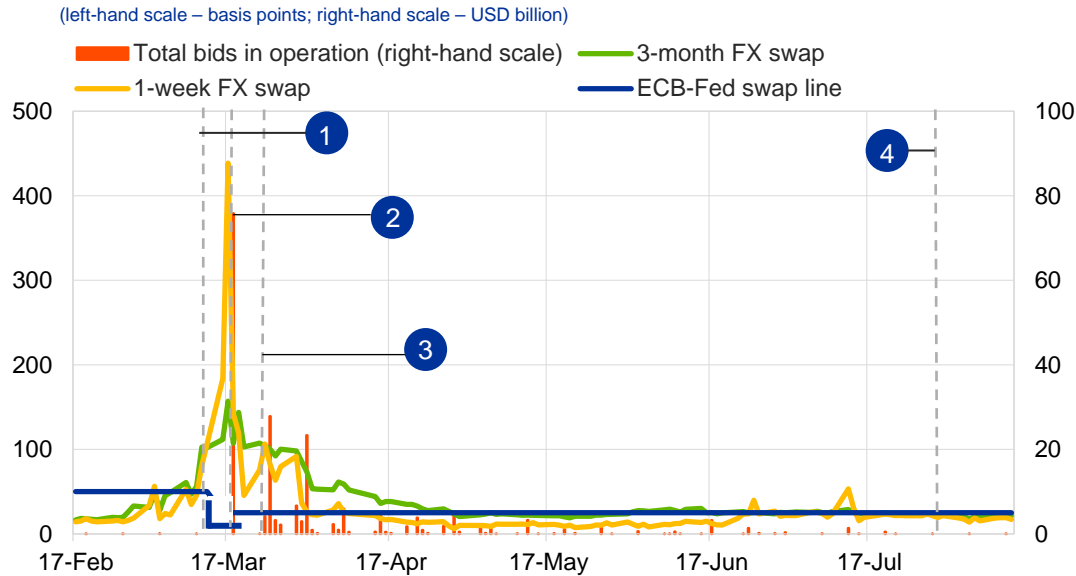
Corporate issuance (euro) activity in 2020



Source: Iboxx indices, Dealogic.
 Last observation: 21 August 2020 for LHS and end of July 2020 for RHS

Foreign currency liquidity provision was particularly effective in alleviating USD funding conditions for euro area banks

USD funding costs during the COVID-19 crisis



Source: MMSR, Bloomberg, ECB calculations.

Note: Spreads are calculated using transaction data expressed as a spread to market overnight index swap (OIS) rates. 1: Coordinated expansion of USD swap lines - introduction of USD operations with a longer maturity (15-Mar). 2: First operation with a 3-month maturity under expanded swap line, announcement of ECB's PEPP (18-Mar). 3: Coordinated expansion of USD swap lines - increasing the frequency of USD operations from weekly to daily (23-Mar). 4: Adjustment of USD swap lines - decreasing the frequency of USD operations from daily to 3 times per week (01-Jul).

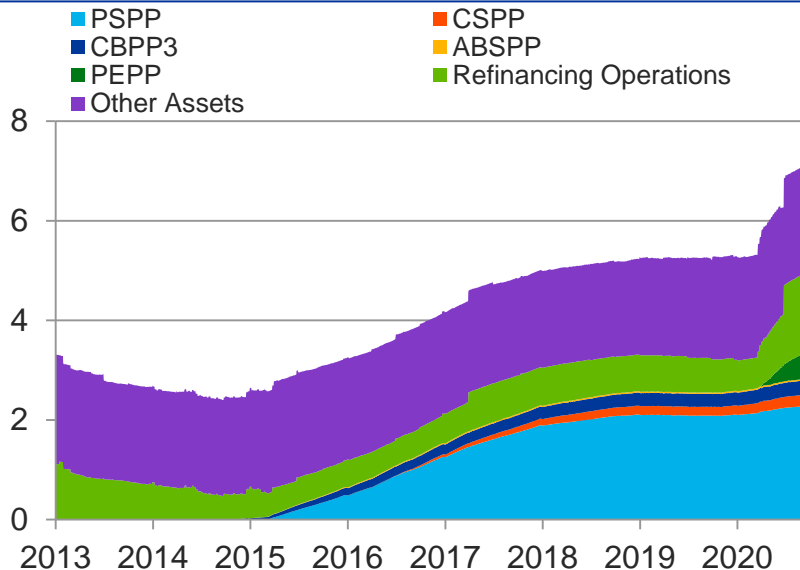
Last observation: 14 August 2020.

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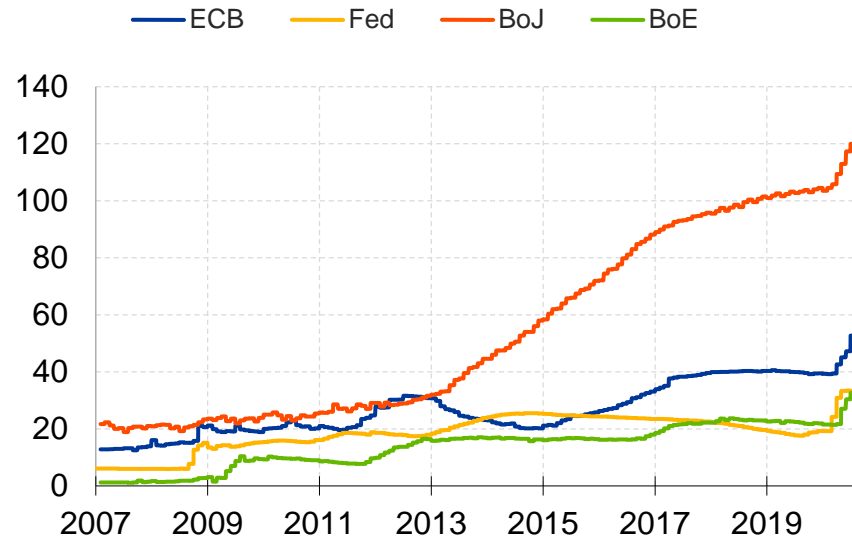
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Central banks balance sheets expanded to record high levels

ECB balance sheet breakdown in euro trillion



Balance sheet development comparison as a percentage of GDP



Source: ECB, Fed, BoJ, BoE

Lessons learned and risks ahead

- **Ensuring that comprehensive policy response succeeds not only in stabilizing market conditions, but also in preserving unimpeded flow of credit to the real economy**
- **Monitoring long-term impact of COVID on credit risk:** So far limited rating downgrades (governments, companies), but the more the health crisis persists, the more solvency concerns will arise, including for banking system
- **Keeping flexibility in calibrating central bank actions:** dependency on incoming data and market conditions
- **Maintaining fiscal support commensurate with the economic shock and for as long as needed**

Thank you