EUROPEAN CENTRAL BANK

EUROSYSTEM

The Eurosystem response to the pandemic crisis

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Key messages

- ➢The COVID crisis challenged central banks, already experienced in dealing with financial crises, to respond to a health crisis within their mandate

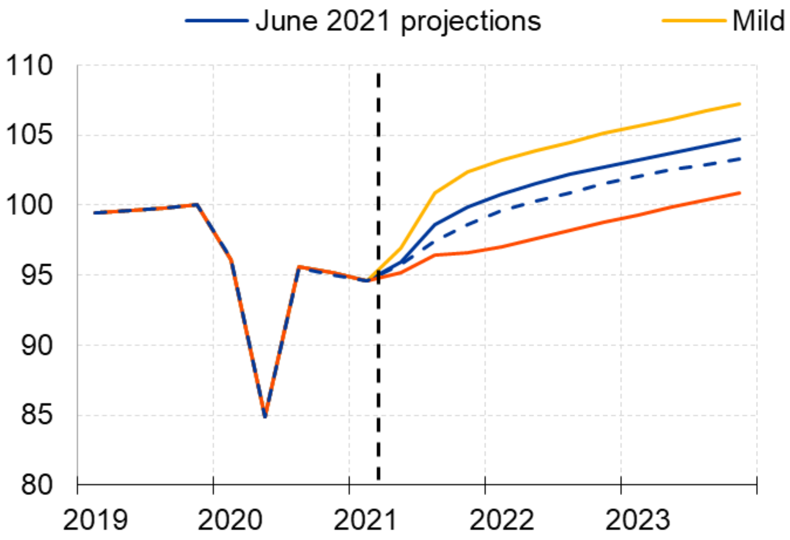
- ➢The Eurosystem rolled out measures using different and complementary channels targeting bank lending and broader financing conditions, market distress and disruptions in the provision of liquidity in foreign currency

- ➢Broader policy mix was comprehensive: The EU launched its first shared fiscal response in history while government guarantees as well as supervisory and regulatory measures complemented monetary policy measures to support the financing of the real economy

Responding to the most severe recession in post-war history

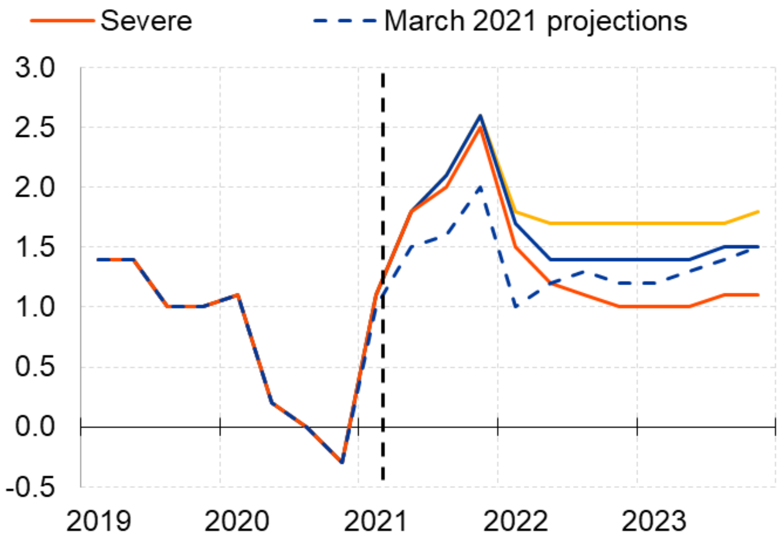
Scenarios for real GDP in the euro area

(chain-linked volumes, 2019Q4=100)



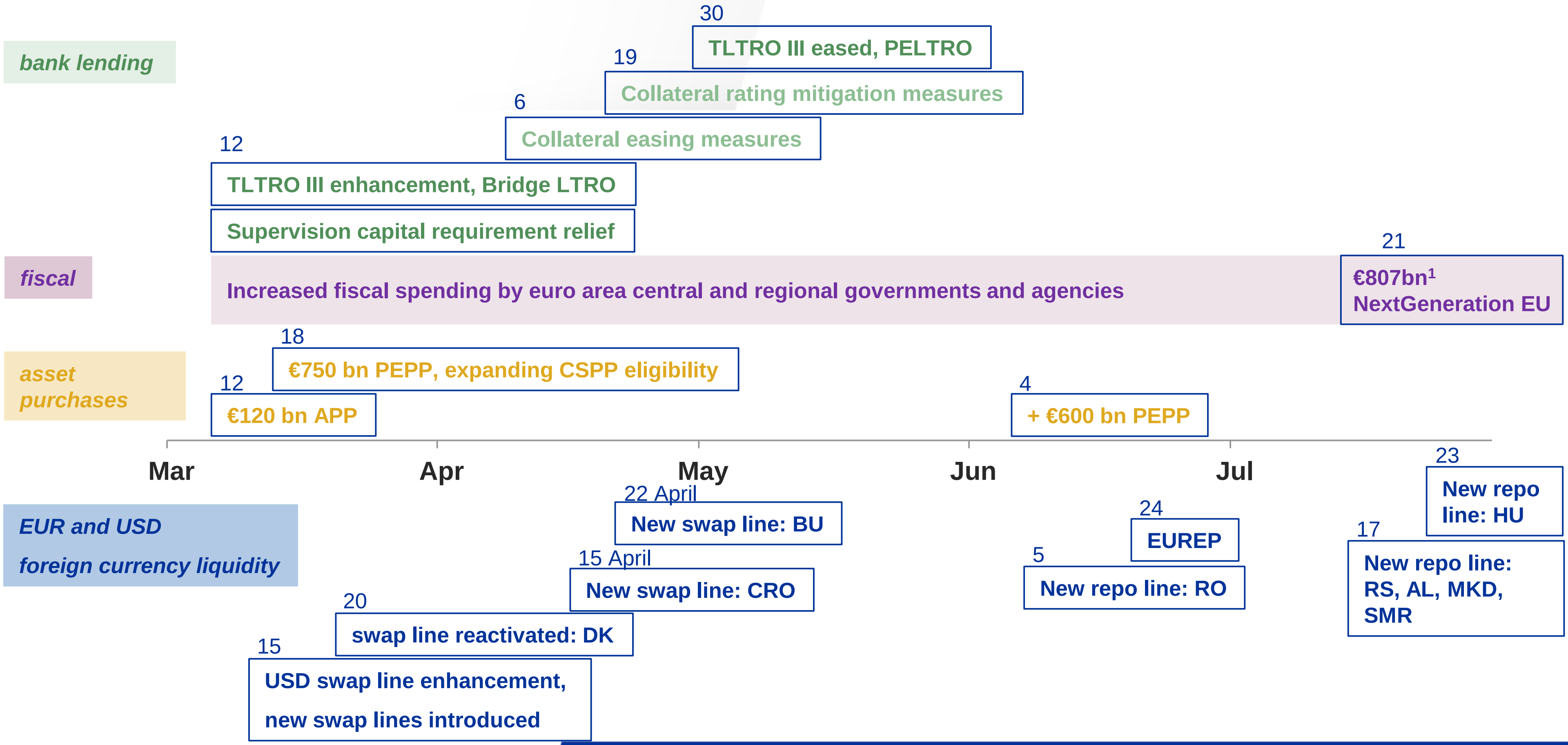
Scenarios for HICP inflation in the euro area

(annual percentage changes)



Note: Data for real GDP are seasonally and working day adjusted. The vertical line indicates the start of the projection horizon. Historical data may differ from the latest Eurostat publications due to data releases after the cut-off date for the projections.

European policy response to the health crisis: timeline and channels (i)



Source: ECB
Notes:
1. €750 bn in 2018 prices.

European policy response to the health crisis: timeline and channels (ii)

bank lending

10
4 additional PELTROs;

TLTRO III: three more operations, period of favourable interest rates extended, borrowing allowance raised

fiscal

Increased fiscal spending by euro area central and regional governments and agencies

asset purchases

10
PEPP increased by €500 bn to €1,850 bn and extended to at least end-March 2022

11 – 10
Using PEPP's inbuilt flexibility: "significantly higher pace" than during the first months of the year (Apr decision: Q2 pace; Jun decision: Q3 pace)

Sep | Dec | Mar | Apr | Jun

EUR and USD

foreign currency liquidity

1
2nd reduction in frequency of 7-day USD

23
discontinue 84-day USD operations (as of 1 July 2021)

Source: ECB

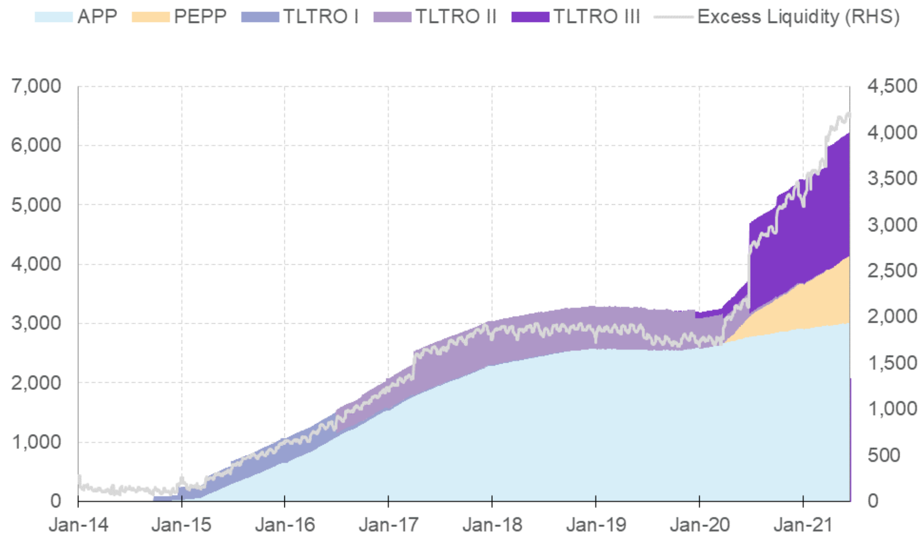
European crisis support: building blocks

	pct. of 2020 EA GDP / EURbn
1. Lending operations	**19%** / 2,107 (outstanding amount today)
2. Collateral measures	**10%** / 1,101 (increase mobilised collateral between March 2020 and May 2021)
3. Swaps & Repurchase operations	**1%** / 128 (outstanding amount at the peak of the crisis)
4. Asset Purchases	APP: **1%** / 120 until Dec-20 PEPP: **16%** / 1,850 until Mar-22
5. Expansionary fiscal stance by governments	c. **13%** / 1,458 until Dec-21 (incr. in EA net issuance 2020+21E)
6. EU crisis support: SURE & Next Generation EU	NextGeneration EU: **7%** / 807 until Dec-26 SURE: **1%** / 100 until mid-21
7. Supervisory measures	Capital - and liquidity measures and dividend distribution

Note: Guarantees and moratoria have also been an important aspect of European crisis support.

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

Liquidity providing instruments in euro bn



Sources: ECB. Last observation: 15 June 2021; Notes: standard operations such as the main refinancing operation and the three-month LTROs are excluded. Standard operations make up for less than 1% of the liquidity provision.

Collateral easing measures

	Measure	Timeframe	Implementation
Expansion of credit claims / increase of bank lending incentives	Removal of the minimum size threshold (of EUR 25,000) for credit claims	temporary	8 April 2020
	ACC – Increasing scope for accepting credit claims under the ACC frameworks by NCBs	temporary	NCB dependent
	ACCs – Accepting government COVID-19 guaranteed loans	temporary	NCB dependent
Increase of Eurosystem risk tolerance / countercyclical collateral availability	Increase of Eurosystem risk tolerance by proportionate reduction of all haircuts for all assets by 20%	temporary	20 April 2020
	Additional reduction of haircuts for non-marketable assets	permanent	20 April 2020
	Reduction of haircuts for individual credit claims in the general framework, individual ACCs and pools of ACCs	permanent	20 April 2020
	Increase of the concentration limit for unsecured bank bonds from 2.5% to 10%; allowing counterparties to mobilise higher volumes of unsecured bank bonds to alleviate pressure on money market funds and the commercial paper market	temporary	8 April 2020
Countering procyclicality of rating downgrades	Maintaining eligibility of marketable assets falling below rating threshold, with a floor at BB (for ABS with a floor at BB+)	temporary	18 May 2020
	Maintaining eligibility of ABS falling below rating threshold, with a floor at BB+	temporary	18 May 2020
Alleviating financing pressures and fragmentation	Acceptance of Greek sovereign bonds as collateral; alleviating pressures which had severely affected the Greek financial markets and reducing fragmentation of collateral accepted for Eurosystem credit operations with a view to enhancing the smooth functioning of the monetary policy transmission mechanism	temporary	20 April 2020

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)

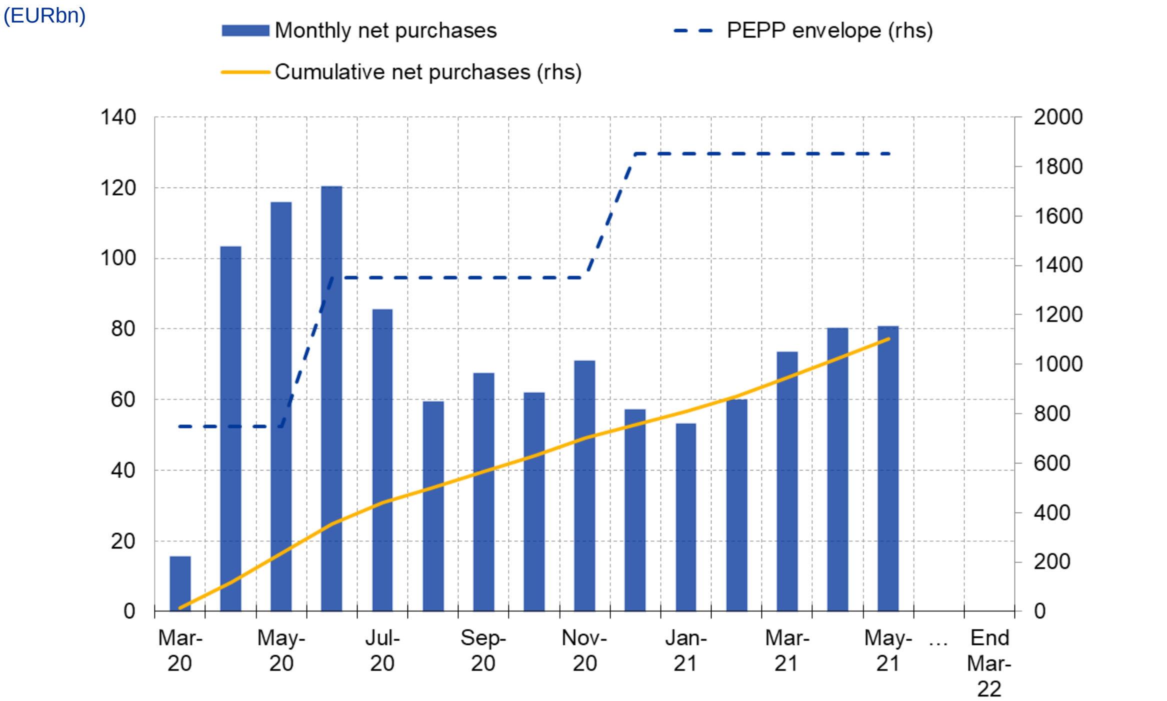
Asset purchase programmes provide sizeable support in a flexible manner

- The pandemic emergency purchase programme (PEPP) was introduced on 18 March 2020 alongside the APP[1], as *"a new temporary asset purchase programme of private and public sector securities to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the outbreak and escalating diffusion of the coronavirus, COVID-19".*
- Designed to play a **dual role**: contributing to **market stabilisation** and enabling an easing in the **monetary policy stance**, helping to offset the downward impact of the pandemic on the projected path of inflation.
- As of December 2020, the PEPP envelope equals **€1,850 billion** until **at least end-March 2022**. **Purchases will be conducted flexibly to preserve favourable financing conditions:**
  - **Joint assessment of financing conditions and the inflation outlook**: if favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full; equally, the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation
  - "**Holistic and multifaceted**" approach: a broad-based spectrum of indicators considered, covering the whole gamut of transmission from upstream stages (including risk-free curve and the sovereign curves) to downstream effects on bank-based intermediation. Moreover, the approach incorporates the necessary granularity to detect movements in specific market segments in a timely manner.

1. The ECB's Asset Purchase Programme (APP) was initiated in mid-2014.

PEPP: flexibility across time

PEPP envelope and monthly net purchases

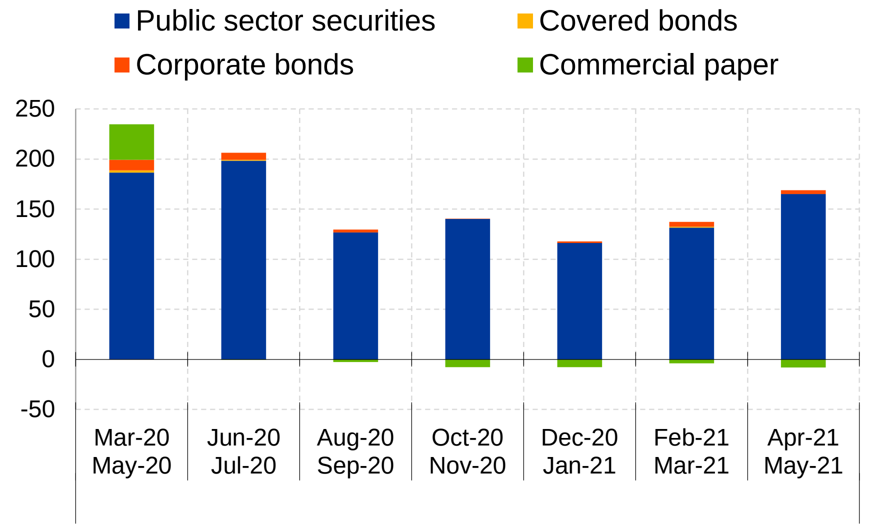


Source: ECB website.
Last update: 31 May 2021

PEPP: flexibility across asset classes and jurisdictions

PEPP net purchases by asset class

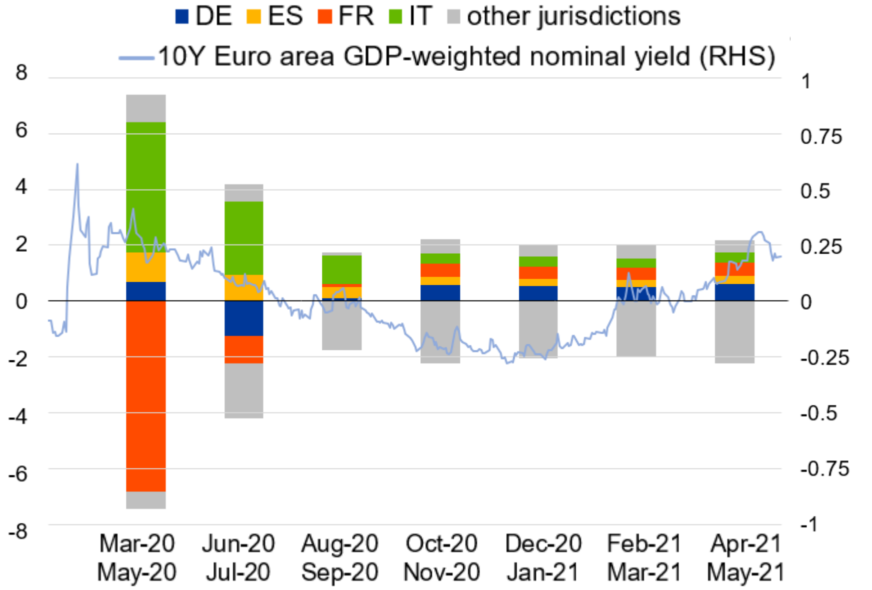
(EURbn)



Source: ECB website.
Notes: The chart on the left hand side shows total PEPP purchases for all asset classes
Last update: 31 May 2021

Deviations from Eurosystem Capital Key (public sector)

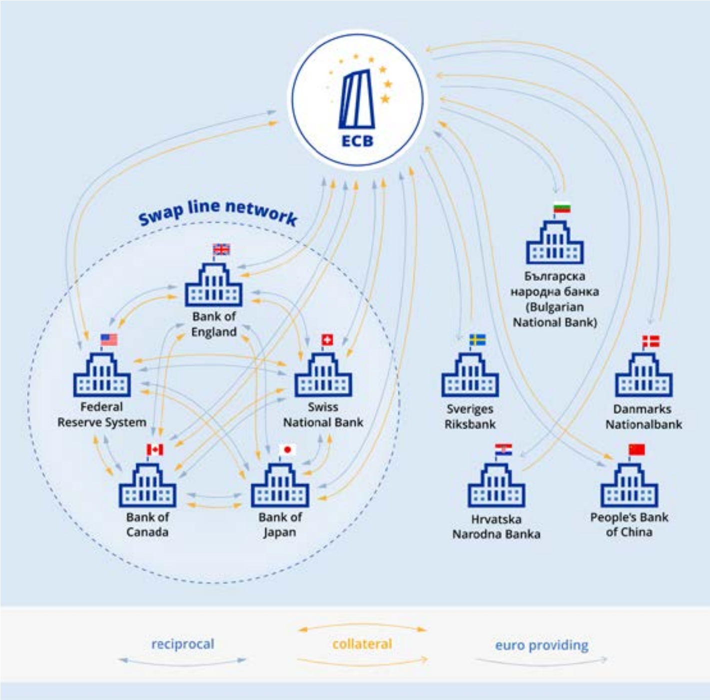
(LHS: p.p.; RHS: %)



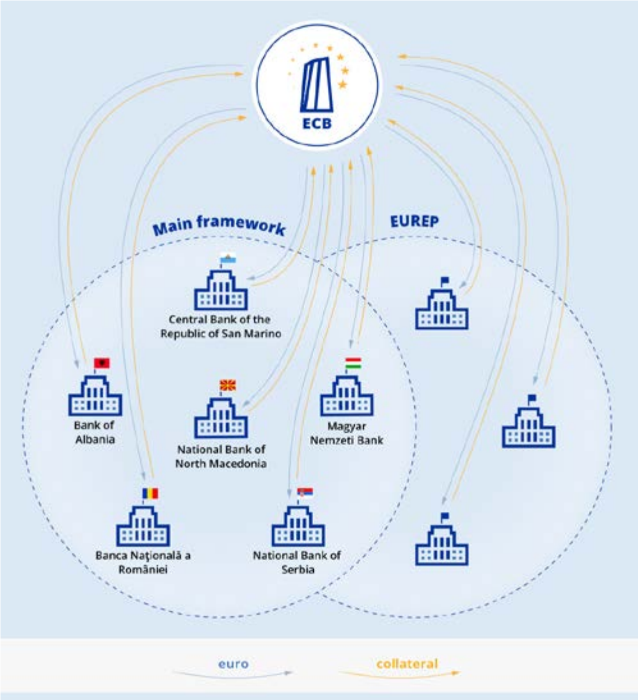
Source: ECB website, ECB calculations.
Notes: Capital key deviations for public sector purchases calculated in bi-monthly flow terms.
Last update: 31 May 2021

FX liquidity provision aims at alleviating tensions in international funding markets

Swap lines



Repo lines

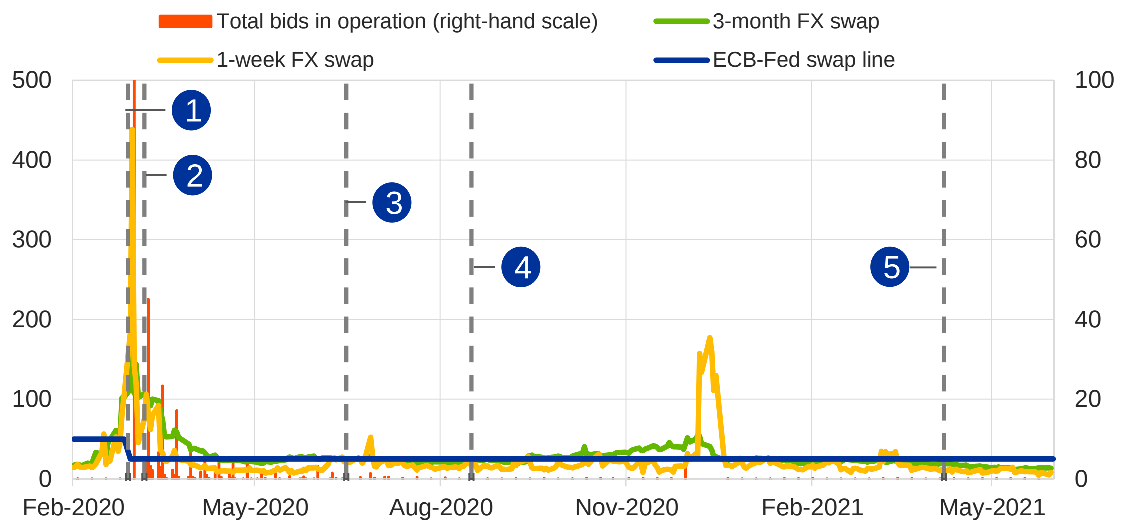


Sources: ECB.
Notes: Illustration of the agreements in place as at March 2021. For the current list of agreements under the ECB's main framework see [ECB website](). Swap lines: ECB provides euro against foreign currencies accepted as collateral. Under reciprocal swap lines, the ECB may also receive foreign currency providing euro as collateral. Repo lines: ECB provides euro against adequate euro-denominated collateral accepted by the ECB.

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

USD funding costs during the COVID-19 crisis

(left-hand scale – basis points; right-hand scale – USD billion)



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, lowering pricing to OIS+25 bps (15-Mar). 2: Coordinated expansion of USD swap lines - increasing the frequency of USD operations from weekly to daily (23-Mar). 3: Adjustment of USD swap lines - decreasing the frequency of USD operations from daily to 3 times per week (01-Jul). 4: Adjustment of USD swap lines - decreasing the frequency of USD operations from 3 times to once per week (01-Sept). 5: Adjustment of USD swap lines - discontinuation of 84-day operation as of 1 July 2021 (23-Apr). Last observation: 14 June 2021.

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

The European Commission is issuing bonds on behalf of the EU in the following programmes to finance the recovery:

NextGenerationEU: a game changer in the capital markets

- **New temporary recovery instrument with financial firepower of around €800 billion between now and end-2026 → material increase in euro area safe assets** (curve: bills + bonds up to 31-year maturity)
- **Purpose**: financial support to public investments and reforms (€407.5 billion available for grants; €386 billion for loans)
- **Largest Green Bond Scheme in the world:** objective is to issue 30% as green bonds (up to €250 bn)
- **Agreed** on 21 July 2020 following many months of EU negotiations
- **Issuance strategy**: funding approach will be similar to those of sovereign issuers (primary dealer network, combination of auctions and syndications). Semi-annual issuance programme expected in Q3 2021
- **Inaugural issuance on 15 June:** raised €20 billion via a 10Y bond. Largest-ever institutional bond issuance in Europe, the largest-ever institutional single tranche transaction and the largest amount the EU has raised in a single transaction

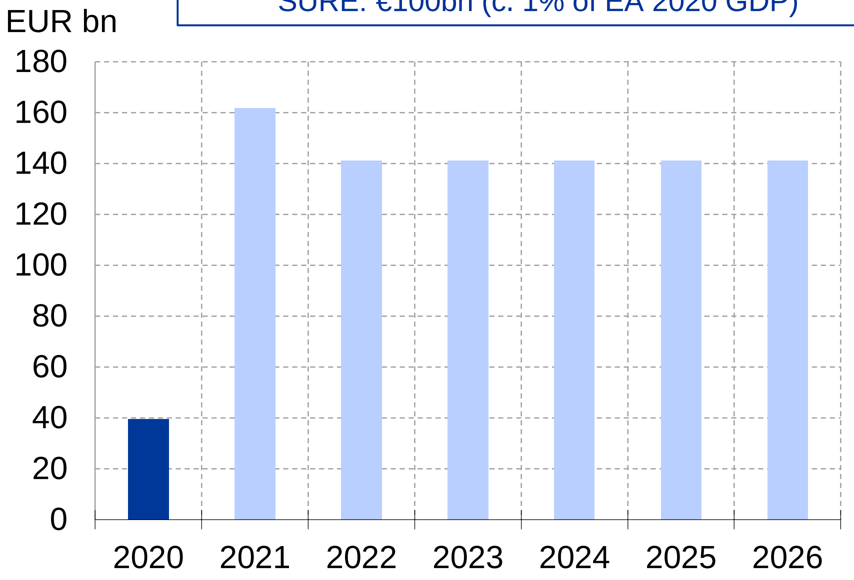
SURE: temporary Support to mitigate Unemployment Risks in an Emergency.
Size: €100 bn loans granted on favourable terms from the EU to Member States (adopted 19 May 2020).

Source: European Commission website.
NextGen EU: https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/gic_slides_08062021.pdf
SURE: https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/eu_en_04-2021_finalv2.pdf

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

Expected SURE and NextGeneration EU gross issuance

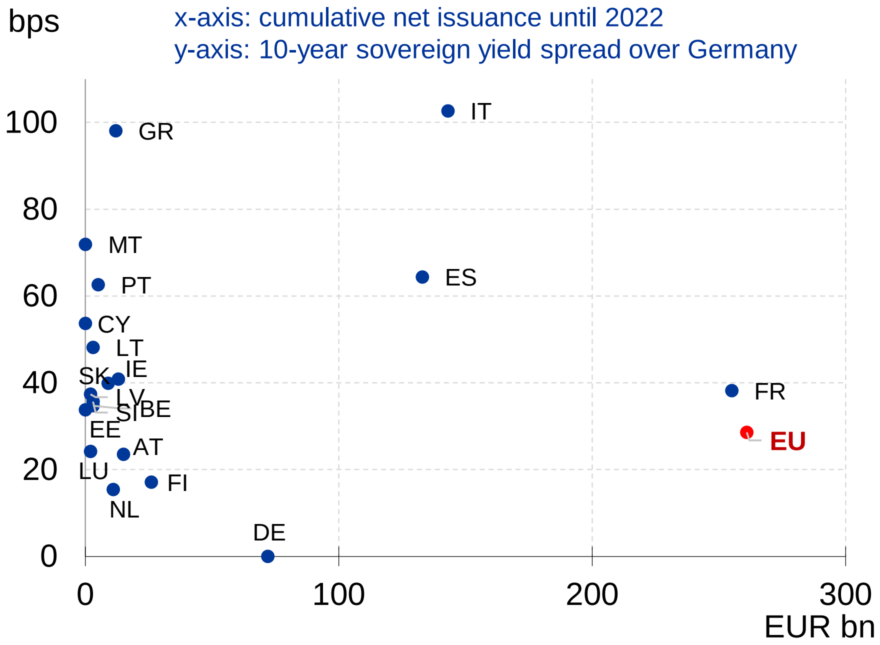
NextGeneration EU: €807bn (c. 7% of EA 2020 GDP)
SURE: €100bn (c. 1% of EA 2020 GDP)



Source: Expected issuance estimated based on investment research and public information from EU Commission.

10Y spread and expected net issuance until 2022

x-axis: cumulative net issuance until 2022
y-axis: 10-year sovereign yield spread over Germany



Source: ECB calculations.
Notes: net issuance of bonds issued by central and local governments and agencies between June 2021 and December 2022 (bills are excluded). EU includes all expected EU Supranational issuance. 10-year sovereign yield spreads over Germany.

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 longer the health crisis persists, the more solvency concerns will arise, including for the banking system

- **Keeping flexibility in calibrating central bank actions:** dependency on incoming data and market conditions

- Maintaining adequate **fiscal support in place in order to deal with the economic shock for as long as needed**