BRIEFING

ECON in Focus

The ECB's Monetary Policy Response to the COVID-19 Crisis

The European Central Bank's (ECB's) Governing Council took the main decisions on monetary policy measures to address the economic fallout of the COVID-19 pandemic during its regular meeting on 12 March 2020 and during an extraordinary meeting on 18 March 2020. These meetings [1] yielded an extensive set of measures which are described below.

In a series of blog posts, the ECB sought to further clarify the rationale of the recent monetary policy decisions. Following the 12 March meeting, Philip Lane, Member of the Executive Board, provided additional details on the economic analysis underpinning the decisions taken in the meeting. Similarly, President Christine Lagarde further explained the 18 March decisions. Finally, in a joint blog post, Luis de Guindos, ECB Vice-President, and Isabel Schnabel, Member of the Executive Board, specifically described the reasoning behind the expansion of eligibility under the corporate sector purchase programme (CSPP) to non-financial commercial papers.

After repeated pleas for an ambitious and coordinated fiscal policy response, President Lagarde issued on 9 April a strong call for "full alignment of fiscal and monetary policies".

The severity of the crisis has forced the ECB to shift attention away from its monetary policy strategy review, initially planned to be completed before the end of 2020. The Governing Council decided to postpone the conclusion of the review to mid-2021 [2].

On 30 March 2020, the Chair and political group coordinators of the European Parliament's Committee on Economic and Monetary Affairs (ECON) held a meeting with ECB President Christine Lagarde [3].

Interest rate policy

The two Governing Council meetings in March have left the **key interest rates unchanged**:

- Main refinancing operations (MRO): 0.00% (since March 2016);
- Marginal lending facility: 0.25% (since March 2016);
- Deposit facility: -0.50% (since September 2019).

Forward guidance on key interest rates also remained unchanged, as articulated in the September 2019 Governing Council decision when the calendar-based element was dropped and forward-guidance became purely state-contingent.

> *"The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics."*

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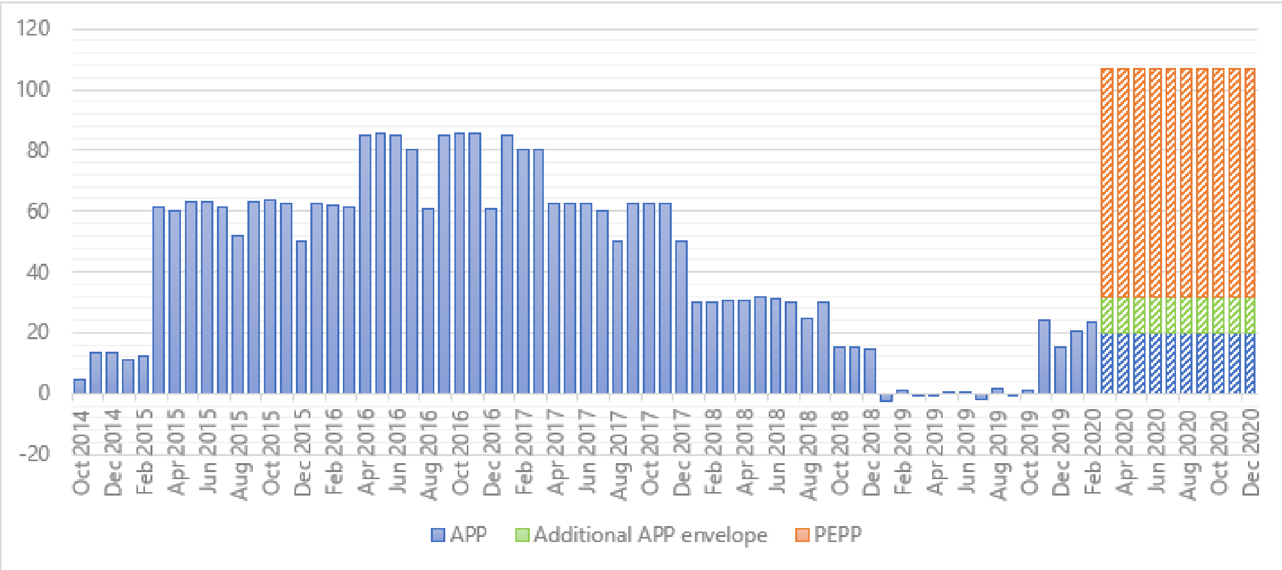
Despite not having changed key short-term interest rates like other central banks such as the Federal Reserve and the Bank of England (see Annex), the ECB has effectively reduced long-term funding costs through adjustments to the third series of targeted longer-term refinancing operations (TLTRO III).

Asset purchase programmes

The Governing Council decisions of March 2020 have brought a substantial monetary stimulus through the ECB's asset purchase programmes. The agreed additional net purchases amount to 7.3% of euro area GDP[4]. Together with the existing EUR 20 billion monthly net purchases, they are set to increase the current stock of Eurosystem's asset holdings (accumulated since October 2014) by about 39% by the end of 2020[5]. Figure below puts into perspective the scale of net asset purchases planned for 2020, following the March decisions and taking into account the previously-agreed EUR 20 billion net asset purchases per month.

Eurosystem net asset purchases by month (EUR billion)



Note: October 2014-February 2020 based on actual data, March-December 2020 presented assuming an even monthly distribution of net asset purchases.

Source: Own graph based on ECB, History of cumulative purchase breakdowns under the APP.

1. Pandemic emergency purchase programme (PEPP)

Announced following the 18 March Governing Council meeting[6], the PEPP is a **new, temporary programme for public and private sector asset purchases with an envelope of EUR 750 billion**, set to run until the end of 2020. Its main stated aim is to counter risks to monetary policy transmission in the euro area caused by the coronavirus pandemic.

There is a substantial degree of flexibility embedded in the PEPP, allowing for "fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions". This means that there is neither a pre-committed monthly amount of net purchases nor a target in terms of type of assets. The ECB's capital key will guide, on a stock basis, net purchases under the PEPP. PEPP holdings will not be consolidated with the existing APP portfolios for the purpose of defining issue and issuer limits[7]. Compared with the existing asset purchase programme, a waiver of the eligibility criteria[8] for Greek government bonds was granted. The expansion of the corporate sector purchase programme to non-financial commercial papers decided on 18 March also applies to the PEPP.

The responsibility to set the pace and composition of monthly PEPP purchases was delegated by the Governing Council to the Executive Board of the ECB. The Eurosystem will report the aggregate book value of PEPP securities on a weekly basis as well as net and cumulative purchases on a monthly basis.

In the first two weeks of operation, the Eurosystem has purchased EUR 50.7 billion of assets under the PEPP[9].

2. Additional asset purchase programme (APP) envelope

On 12 March, the Governing Council decided to **increase the existing APP net purchases with an additional envelope of EUR 120 billion to be used by the end of 2020**.

The emphasis, similar to the PEPP, was put on flexibility based on "temporary fluctuations in the distribution of purchase flows both across asset classes and across countries", with purchases continuing to be guided by the ECB's capital key in the long run.

3. APP forward guidance

On 12 March, beyond the additional envelope, the Governing Council provided **forward guidance on the APP**, not departing from the September 2019 formulation:

> *"We continue to expect net asset purchases to run for as long as necessary to reinforce the accommodative impact of our policy rates, and to end shortly before we start raising the key ECB interest rates."*

On 18 March, **additional forward-looking elements** were included in the press release outlining the monetary policy decisions taken:

> *"The Governing Council is fully prepared to increase the size of its asset purchase programmes and adjust their composition, by as much as necessary and for as long as needed."*
>
> *"To the extent that some self-imposed limits might hamper action that the ECB is required to take in order to fulfil its mandate, the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks that we face."*

4. Corporate sector purchase programme (CSPP) eligibility criteria

On 18 March, the Governing Council decided to **expand the range of eligible assets under the CSPP** to non-financial commercial papers. This will also apply to purchases under the PEPP.

Commercial papers are, by definition, unsecured short-term (maturity up to 1 year) debt instruments used to meet short-term liabilities. In the euro area, the commercial paper market is dominated by financial institutions, although there has been an increase in recent years in issuance by non-financial corporations. The ECB detected deteriorating financing conditions for corporates emanating from the commercial paper market in the wake of the COVID-19 crisis, when the Governing Council decided to make this targeted change to the list of CSPP-eligible assets[10].

Long-term refinancing operations

The decisions of the 12 March and 18 March Governing Council meetings have brought substantial changes to the scale and conditions of the ECB's long-term refinancing operations.

1. Longer-term refinancing operations (LTROs)

On 12 March, the Governing Council has decided to conduct **additional LTROs on a temporary basis under a fixed-rate full allotment procedure**[11], providing banks with liquidity and acting as a backstop to any deterioration of money market conditions[12]. The interest rate will equal the average deposit facility rate. The aim is to bridge the gap until the fourth operation of the TLTRO III series in June 2020.

13 additional such LTRO operations are planned, all maturing on 24 June 2020, when the fourth operation of TLTRO III is scheduled to be settled. As of 15 April 2020, 5 of the 13 operations have been conducted, already providing EUR 257 billion of liquidity to the euro area financial system. Table below shows the schedule of these additional LTRO operations.

Schedule of additional LTRO operations decided on 12 March

Settlement date (indicative)	Maturity date	Allotted amount, EUR billion	Number of bidders
18 March 2020	24 June 2020	109.13	110
25 March 2020	24 June 2020	79.67	180
1 April 2020	24 June 2020	43.71	107
8 April 2020	24 June 2020	19.51	99
15 April 2020	24 June 2020	4.64	53
(22 April 2020)	24 June 2020		
(29 April 2020)	24 June 2020		
(6 May 2020)	24 June 2020		
(13 May 2020)	24 June 2020		
(20 May 2020)	24 June 2020		
(27 May 2020)	24 June 2020		
(3 June 2020)	24 June 2020		
(10 June 2020)	24 June 2020		

Source: Based on ECB announces measures to support bank liquidity conditions and money market activity and ECB, open market operations.

2. Targeted longer-term refinancing operations (TLTROs)

TLTRO III was first announced following the Governing Council meeting in March 2019[13]. Further operational details were unveiled in June 2019[14]. As part of a package of monetary policy measures adopted in September 2019, TLTRO III conditions were eased and interest rates reduced. These changes were applied to the first TLTRO III operation which was settled on 25 September 2019, and the second operation settled on 18 December 2019.

As part of the Governing Council's decisions of 12 March, **TLTRO III conditions were further eased, along with a reduction of applicable interest rates** (as low as -0.75%)[15]. The ECB estimates that these changes will result in more than a EUR 1 trillion increase in the possible volume of funds borrowed by banks[16]. Table below shows the key changes made to the initial TLTRO III conditions, both in September 2019 and March 2020.

Evolution of key TLTRO III conditions

	Initial conditions	September 2019 changes	March 2020 changes
Interest rate *(maximum rate reduction if above lending benchmark)*	MRO rate + 10bps *(as low as deposit facility rate + 10bps)*	MRO rate *(as low as deposit facility rate)*	MRO – 25bps (as low as deposit facility rate – 25bps, not lower than -0.75%)
Maximum rate reduction eligibility	2.5% above benchmark stock of eligible loans	*No change*	Reduced to 0% (no increase of benchmark stock of eligible loans needed)
Borrowing limit	Total: 30% of stock of eligible loans, reduced by any outstanding TLTRO II amount Each operation: 10% of stock of eligible loans	*No change*	Total: 50% of stock of eligible loans, reduced by any outstanding TLTRO II amount Each operation: limit removed
Maturity	2 years	3 years	*No change*
Early repayment	Not possible	Possible on a quarterly basis, starting two years after settlement of each operation	Starting one year after settlement of each operation (from September 2021)

Source: Based on relevant ECB press releases and decisions.

Changes to the borrowing limits have been implemented in the third TLTRO III operation on 25 March 2020. Other changes will apply as of the fourth TLTRO III operation scheduled for 24 June 2020. Table below shows the indicative schedule of TLTRO III operations.

Indicative schedule of TLTRO III operations (as published in September 2019)

Settlement date (indicative)	Maturity date	Allotted amount, EUR billion	Number of bidders
25 September 2019	28 September 2022	3.4	28
18 December 2019	21 December 2022	97.72	122
25 March 2020	29 March 2023	114.98	114
(24 June 2020)	28 June 2023		
(30 September 2020)	27 September 2023		
(16 December 2020)	20 December 2023		
(24 March 2021)	27 March 2024		

Note: It is possible that the indicative calendar has changed following the March 2020 decisions, yet such information was not available at the time of writing.

Source: Based on Indicative calendar for the third series of targeted longer-term refinancing operations (TLTROs-III), as published in September 2019 and ECB, open market operations (website).

Collateral framework

The Eurosystem collateral framework plays a crucial role in the implementation of monetary policy in the euro area. Article 18 of the statute of the European System of Central Banks (ESCB) and the ECB states that credit shall be provided only against adequate collateral. The way in which the Eurosystem deals with collateral is based on a so-called "general" and "temporary" framework. The collateral framework has seen significant changes since 2008. An extensive account of the technical details and the evolution of the collateral framework is given in a 2017 ECB paper[17].

One particular element of the collateral framework is the "additional credit claims" (ACC)[18]. As part of temporary measures to increase collateral availability, the Governing Council announced in December 2011 that national central banks (NCBs) are allowed, on a temporary basis, to accept additional credit claims as collateral by having specific national credit claim eligibility criteria and risk control measures which differ from the general framework. The national eligibility criteria for such additional credit claims were first approved in February 2012[19]. In June 2019, the ACC frameworks were extended in their current format until the maturity date of the final TLTRO III operation in March 2023[20].

On 18 March 2020, in response to the COVID-19 crisis, the Governing Council announced the decision to include claims related to the financing of the corporate sector in the ACC framework[21].

On 7 April 2020, the Governing Council announced further details on the **package of temporary collateral easing measures**, which are substantial and going beyond only the ACC framework. The main temporary changes may be summarised as follows[22]:

- Temporary reduction of collateral valuation haircuts by 20% across the board, thus increasing the Eurosystem's level of risk tolerance.

- Temporary extension of the ACC framework:
  - Inclusion of government and public sector guaranteed loans to corporates, SMEs, self-employed individuals and households in the requirements on guarantees;
  - Extension of scope of acceptable credit assessment systems (e.g. acceptance of banks' own credit assessments from internal rating-based systems approved by supervisors);
  - Reduction of the loan level reporting requirements.

- Other temporary measures:
  - Lowering the level of the minimum size threshold for domestic credit claims to EUR 0 (from EUR 25 000);
  - Increase in the maximum share of unsecured debt instruments that can be used as collateral to 10% (from 2.5%);
  - Waiver of minimum credit quality requirements for Greek government bonds in order to accept them as collateral.

The temporary nature of these measures is tied to the duration of the PEPP, with a possibility of further extensions if needed.

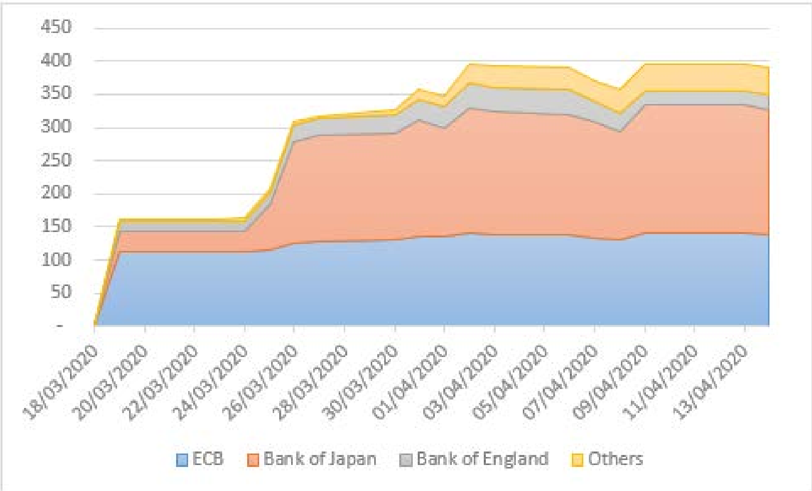
Apart from these temporary measures, the Governing Council also decided to permanently reduce collateral haircuts on non-marketable assets[23] by 20%. For such assets, this applies on top of the temporary haircut reduction.

Currency swap lines

Swap lines are arrangements between central banks to exchange currency in order to maintain foreign currency liquidity when markets are distorted. The necessity of such arrangements became particularly pronounced in the aftermath of the global financial crisis, when the ECB entered into swap arrangements with central banks from a number of jurisdictions. In October 2013, the Bank of Canada, the Bank of England, the Bank of Japan, the ECB, the Federal Reserve, and the Swiss National Bank agreed to replace existing temporary bilateral liquidity swap lines with standing arrangements[24].

On 15 March 2020, the above-mentioned **6 central banks jointly decided to enhance the provision of global USD liquidity** through their existing standing arrangements by: a) lowering the pricing of USD swap operations (to USD overnight index swap rate + 25bps), and b) adding weekly USD operations with 84-day maturity (in addition to existing weekly 1-week maturity operations). On 20 March, **these arrangements were further enhanced** by changing the frequency of the existing 1-week maturity operations from weekly to daily, while continuing with the new 84-day maturity operations[25]. Figure below shows the take-up of USD currency liquidity swaps.

USD liquidity swaps, amounts outstanding (USD billion)



Source: Own graph based on Federal Reserve Bank of New York, Central Bank Liquidity Swap Operations. Accessed on 15 April 2020.

In addition, on 20 March, the **ECB and Danmarks Nationalbank have reactivated a currency swap arrangement** and increased the maximum amount to be borrowed by Danmarks Nationalbank from EUR 12 billion to EUR 24 billion, in order to provide euro liquidity to Danish banks[26].

On 15 April, the **ECB and the Croatian National Bank agreed to set up a precautionary swap line**, to remain at least until the end of 2020. The Croatian National Bank will be able borrow a maximum of EUR 2 billion from the ECB in exchange for Croatian kuna[27].

ANNEX: Key monetary policy measures taken by the Bank of England and the Federal Reserve in response to the COVID-19 crisis

Bank of England (BoE)[28]	
Instrument	Description
Bank Rate	In response to the COVID-19 crisis, the BoE has reduced its Bank Rate on two occasions (11 and 19 March), by a total of 65 bps, to 0.1% (lowest level in history).
Asset purchases	On 19 March, BoE's Monetary Policy Committee decided to expand the central bank's holding of UK government bonds and non-financial corporate bonds by GBP 200 billion.
Joint lending facility	On 17 March, the joint HM Treasury-BoE "Covid Corporate Financing Facility" was announced. The BoE will buy, in the primary market, commercial paper of up to 1-year maturity issued by companies "making a material contribution to the UK economy". The facility will operate for at least 12 months and will be financed with central bank reserves.
Ways and Means facility (monetary financing)	HM Treasury and the BoE agreed to temporarily extend the use of the so-called Ways and Means facility, which is the government's overdraft account with the BoE. This is aimed to provide additional liquidity to the government if needed, thus complementing market borrowing which is to remain the government's primary source of financing. Any drawings will be repaid as soon as possible before the end of the year.
Term Funding Scheme	On 11 March, the BoE announced the "Term Funding Scheme" offering 4-year funding priced "at or very close to" the Bank Rate for banks which increase lending, in particular to SMEs. The scheme will run for 12 months, starting on 15 April 2020.
Repo operations	BoE activated the "Contingent Term Repo Facility" (CTRF) with weekly 3-month repo operations, to run from 26 March until 2 April 2020. Operations are unlimited in size and the price is Bank Rate + 15bps. The CTRF was later extended until 30 April 2020, with the addition of weekly 1-month operations.
Currency swap lines	Together with 5 other central banks, the BoE agreed to further enhance the provision of USD liquidity via the standing liquidity swap line arrangements (see Section 5 above).

Federal Reserve[29]	
Instrument	Description
Federal Funds rate	Since the outbreak of the COVID-19 crisis, the Federal Reserve has reduced its overnight interbank lending rate (federal funds rate) on two occasions. On 3 March, the range was reduced from 1.5%-1.75% to 1%-1.25%. On 15 March, the range was further reduced to 0%-0.25%. Forward guidance: The Federal Open Market Committee (FOMC) "expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."
Asset purchases	On 23 March, the Federal Reserve announced it would purchase Treasury securities and mortgage-backed securities (MBS) issued by government agencies or government-sponsored

	enterprises (such as Fannie Mae and Freddie Mac) at an unprecedented rate of up to USD 125 billion each business day.
Reserve requirements	On 15 March, the Board of Governors of the Federal Reserve System has decided to eliminate reserve requirements for all depository institutions.
Repo operations	The Open Market Trading Desk at the Federal Reserve Bank of New York, which is tasked with executing open market operations on behalf of the Federal Reserve System, has continued to offer overnight and longer-term repos since September 2019 when rates in the repo market unexpectedly soared. In the wake of the COVID-19 crisis, the Desk has significantly scaled up its repo operations. In the operating period from 14 April through 13 May 2020, the Desk will run overnight (twice per day until 1 May, after that once per day), one-month (once per week) and three-month (once every two weeks) repo operations each limited to USD 500 billion.
Currency swap lines	On March 15, the Federal Reserve, in a coordinated action with 5 other central banks (see Section 5 above), reduced the cost of USD swap operations within the standing swap arrangements. On 19 March, temporary swap arrangements were established with nine additional central banks (Reserve Bank of Australia, Banco Central do Brasil, Danmarks Nationalbank, Bank of Korea, Banco de Mexico, Norges Bank, Reserve Bank of New Zealand, Monetary Authority of Singapore, and Sveriges Riksbank). On 31 March, the Federal Reserve created the "Foreign and International Monetary Authorities Repo Facility" with the aim to allow foreign central banks to temporarily swap Treasury securities for USD.
Emergency lending (lender of last resort)	As part of the response to the COVID-19 crisis, the Federal Reserve invoked its emergency lending authority to provide credit to non-financial institutions, states, municipalities and non-bank financial institutions. This authority was last used during the 2008 financial crisis and during the Great Depression before that. As part of the overall appropriation of USD 500 billion under the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act, the Treasury is required to invest USD 454 billion in programmes and facilities established by the Federal Reserve. As of 10 April, a total of 8 lending facilities were put in place, some revived and some newly created: • Commercial paper funding facility (CPFF) - no announced size limit; • Primary dealer credit facility (PDCF) - no announced size limit; • Money Market Mutual Fund Liquidity Facility (MMLF) - no announced size limit; • Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF) - USD 750 billion; • Term Asset-Backed Securities Loan Facility (TALF) - USD 100 billion; • Payroll Protection Program Lending Facility (PPPLF) - no announced size limit; • Main Street Lending Program (MSLP) - USD 600 billion; • Municipal Liquidity Facility (MLF) - USD 500 billion.

[1] The ECB published the accounts of these meetings: 12 March and 18 March.

[2] "ECB extends review of its monetary policy strategy until mid-2021", ECB Press Release, 2 April 2020.

[3] "ECON activities in regard to COVID-19", Announcement on the ECON Committee website.

[4] "Our response to the coronavirus emergency", blogpost by Christine Lagarde, President of the ECB, 19 March 2020.

[5] The Eurosystem's stock of APP bonds stood at EUR 2 732 billion at end-February 2020; The PEPP, the additional APP envelope and the previously-agreed net purchases of EUR 20 billion/month jointly amount to EUR 1 070 billion between March and December 2020.

[6] "ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP)", ECB Press Release, 18 March 2020.

[7] See Article 4, Decision (EU) 2020/440 of the European Central Bank 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

[8] See Article 3(2), Decision (EU) 2020/188 of the European Central Bank of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9).

[9] "Consolidated financial statement of the Eurosystem as at 10 April 2020" (Commentary), 15 April 2020.

[10] "The ECB's commercial paper purchases: A targeted response to the economic disturbances caused by COVID-19", blog post by Luis de Guindos, Vice-President of the ECB, and Isabel Schnabel, Member of the Executive Board of the ECB, 3 April 2020.

[11] Credit institutions' bids are fully satisfied at a fixed rate against eligible collateral.

[12] "ECB announces measures to support bank liquidity conditions and money market activity", ECB Press Release, 12 March 2020.

[13] Governing Council, monetary policy decisions, 7 March 2019.

[14] "ECB announces details of new targeted longer-term refinancing operations (TLTRO III)", ECB Press Release, 6 June 2019.

[15] "ECB announces easing of conditions for targeted longer-term refinancing operations (TLTRO III)", ECB Press Release, 12 March 2020.

[16] "The Monetary Policy Package: An Analytical Framework" blog post by Philip R. Lane, Member of the Executive Board of the ECB, 13 March 2020.

[17] Bindseil, U., Corsi, M., Sahel, B. and Visser, A. (2017). "The Eurosystem collateral framework explained". ECB Occasional Paper Series No 189 / May 2017.

[18] Credit claims are a distinct type of non-marketable assets.

[19] "ECB's Governing Council approves eligibility criteria for additional credit claims", ECB Press Release, 9 February 2012.

[20] "Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates)", June 2019.

[21] "ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP)", ECB Press Release, 18 March 2020.

[22] "ECB announces package of temporary collateral easing measures", ECB Press Release, 7 April 2020.

[23] Non-marketable assets include: (i) fixed-term deposits from eligible counterparties, (ii) credit claims, and (iii) non-marketable retail mortgage-backed debt instruments.

[24] "ECB establishes standing swap arrangements with other central banks", ECB Press Release, 31 October 2013.

[25] "Coordinated central bank action to further enhance the provision of US dollar liquidity", ECB Press Release, 20 March 2020.

[26] "ECB and Danmarks Nationalbank reactivate swap line to provide euro liquidity", ECB Press Release, 20 March 2020.

[27] "ECB and Hrvatska narodna banka set up swap line to provide euro liquidity", ECB Press Release, 15 April 2020.

[28] Sources: Bank of England website; "Policy Responses to COVID-19", International Monetary Fund.

[29] Sources: Labonte, M. (2020). "Federal Reserve: Monetary Policy Actions in Response to COVID-19". Congressional Research Service, 13 April; Labonte, M. (2020). "Federal Reserve: Emergency Lending in Response to COVID-19". Congressional Research Service, 10 April.

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