EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

Mario DRAGHI
President

Mr Domènec Ruiz Devesa
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 26 September 2019

L/MD/19/334

Re: Your letter (QZ-039)

Honourable Member of the European Parliament, dear Mr Devesa,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, former Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 30 July 2019.

The ECB Governing Council's decision to end net asset purchases in December 2018 followed a thorough review of the outlook for inflation based on the stringent criteria that the Governing Council had articulated to assess progress towards a sustained adjustment in the path of inflation towards rates below, but close to, 2% in the medium term. In June 2018, the Governing Council judged that such progress had been substantial and that the underlying strength of the euro area economy and the continuing ample degree of monetary accommodation provided grounds to be confident that the sustained convergence of inflation towards the Governing Council's aim would continue in the period ahead, and would be maintained even after a gradual winding-down of our net asset purchases. Accordingly, it anticipated that, subject to incoming data confirming the medium-term inflation outlook, net purchases would be reduced until the end of 2018 and then end.

At the same time, the Governing Council recognised the need to maintain an ample degree of monetary accommodation to ensure that the sustained convergence contained in our inflation projections would be reflected in the actual evolution of inflation. It therefore reinforced its forward guidance on the policy rates by stating that the key ECB interest rates were expected "to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path". It also stressed its readiness to "adjust

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all of its instruments as appropriate to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner".

Over the course of the current year, global headwinds have continued to weigh on the euro area outlook. The prolonged presence of uncertainties related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets have been leaving their mark on economic sentiment. The weaker economic momentum has contributed to inflationary pressures remaining muted and indicators of inflation expectations declining. Inflation rates, both realised and projected, have been persistently below the Governing Council's aim, reinforcing the need for a highly accommodative stance of monetary policy for a prolonged period of time. For example, in December last year, when net asset purchases under the asset purchase programme (APP) came to an end, the projected inflation rate for 2021 was 1.8%. In the most recent projection exercise, conducted in September 2019, it had fallen to 1.5%.

Thus, when the Governing Council met earlier this month, it was confronted with a more protracted weakness in euro area economic activity, the persistence of prominent downside risks to the economic outlook and muted inflationary pressures, resulting in a continued shortfall of medium-term inflation with respect to its aim. The Governing Council hence decided on a package of monetary policy measures to support the convergence of inflation towards its medium-term inflation aim, which includes the following elements:

- The interest rate on the deposit facility has been reduced by 10 basis points, to -0.50%. The Governing Council now 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.

- Net asset purchases will be restarted under the APP at a monthly pace of €20 billion as from 1 November. These purchases are expected to run for as long as necessary to reinforce the accommodative impact of the ECB policy rates, and to end shortly before the Governing Council starts raising the key ECB interest rates. Reinvestments of the principal payments from maturing securities purchased under the APP will continue, in full, for an extended period of time past the date when the Governing Council starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

- The modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) will be changed to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. Specifically, the Governing Council eliminated the 10-basis point spread over the key policy rates contained in the

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pricing of the operations announced in June. The interest rate in each operation will now be set at the level of the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeds a benchmark, the rate applied in TLTRO III operations will be lower, and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation. The maturity of the operations will be extended from two to three years.

- Finally, the Governing Council decided to introduce a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate, so as to mitigate the adverse effects that negative interest rates might have on banks' lending behaviour by affecting their profitability.

This comprehensive package of monetary policy decisions will provide substantial monetary stimulus to ensure that financial conditions remain very favourable and support the euro area expansion, the ongoing build-up of domestic price pressures and, thus, the sustained convergence of inflation towards the Governing Council's medium-term aim. The Governing Council continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

Yours sincerely,

[signed]

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