ECB Preview: July 2020

Contents

Details:

Monetary policy decision: 12:45BST/13:45CET, Thursday 16 July 2020

Press conference: 13:30BST/14:30CET, Thursday 16 July 2020

Expected links:

Monetary Policy Decisions:
https://www.ecb.europa.eu/press/govcdec/mopo/2020/html/index.en.html

Interest Rate Announcements:
https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html

ECB Press Conference Video:
https://www.ecb.europa.eu/press/tvservices/webcast/html/webcast_pc_youtube.en.html

Bloomberg: MEDI <Go>

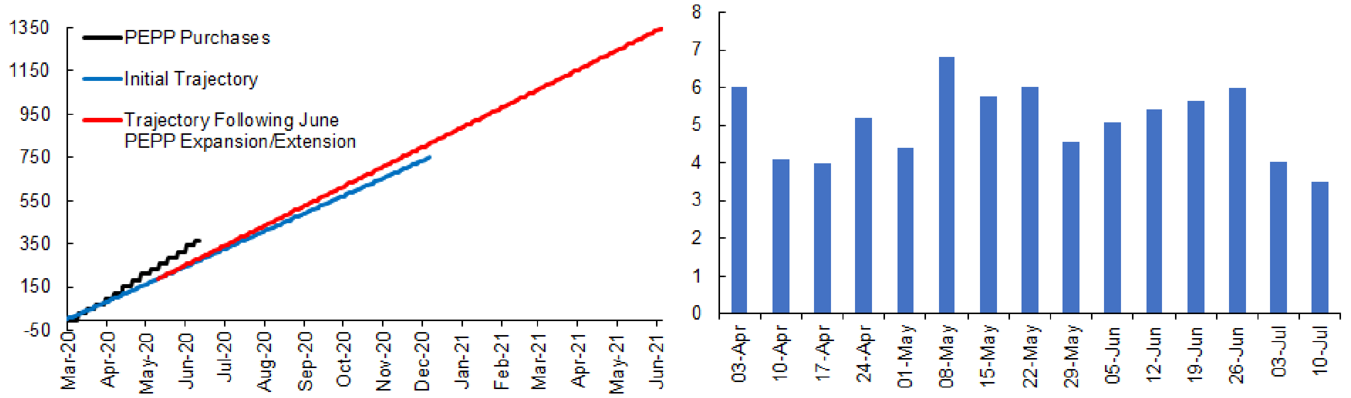
MNI Point of View (POV)

ECB On Autopilot As The List of Questions Grow

- No change in policy is expected at this week’s meeting.
- Dovish surprise: Including ‘fallen angels’ to the list of eligible PEPP securities.
- Hawkish surprise: A particularly optimistic assessment of recent economic data releases.
- Fundamental questions will emerge on how the ECB handles economic uncertainty and the evolution of PEPP (potential ceiling, lifespan and capital key deviations).

To get straight to the conclusion, the ECB is almost certain to keep policy unchanged at the July monetary policy meeting. Having over-delivered with a EUR600bn expansion to the PEPP envelope at the June meeting, and with strong demand for the more favourable TLTRO-III (E1,308bn), the bar for additional policy action in the immediate term is relatively high. Even technical adjustments such as raising the deposit tiering multiple, or including ‘fallen angels’ into the universe of eligible PEPP securities, are likely to be reserved for potential future use if fragmentation risks return. Both of these measures would be a positive surprise for the July meeting. In addition, although some ECB members have talked about the PEPP envelope not being fully utilised, it is too premature to make this judgement and the ECB will instead continue to assert that it stands ready to adjust all policy tools as necessary.

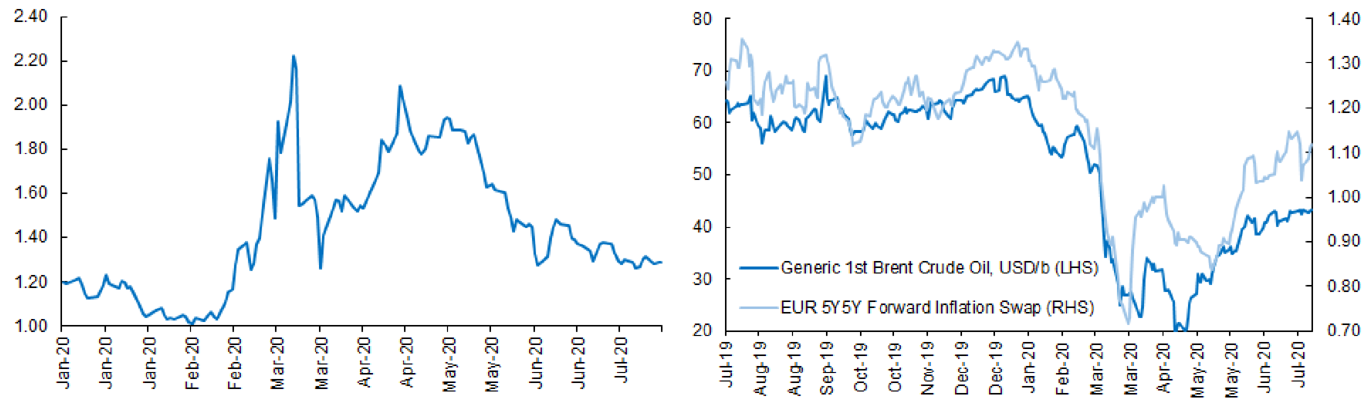
PEPP Trajectory, EURbn (LHS) & Daily PEPP Purchase Rate, EURbn/Day (RHS)



Source: MNI, Bloomberg, ECB

Economic and financial market developments since the last meeting certainly do not warrant another monetary blitz at this stage. Data for May/June have shown a broad bottoming of economic activity, while acute financial market stress has subsided as reflected in EGB periphery-core spread compression. The oil price rally and modest bounce in market-based measures of inflation expectations complete the picture of improving risk sentiment.

GDP-Weighted Periphery-Core EGB Spread (LHS) & EUR 5Y5Y Forward Inflation Swap Vs Oil (RHS)



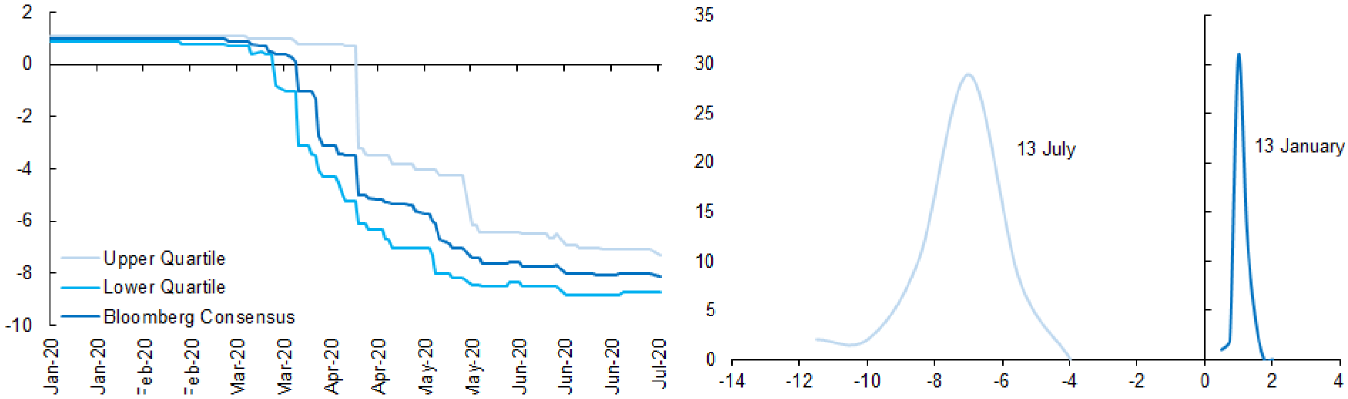
SOURCE: MNI, Bloomberg, Eurostat

Although this week's meeting is seen as a non-event policy-wise, there is still plenty for markets to chew over. The two areas that warrant particular attention are how the ECB will handle economic uncertainty going forward and the evolution of PEPP.

Interpreting incoming data will prove particularly challenging given the unprecedented and asymmetric nature of the economic shock from Covid-19. Gauging economic conditions (current and future) is particularly problematic given the lack of historical precedent for national lockdowns, lingering unknowns with respect to a potential second wave and timeline for an approved vaccine, as well as uncertainty over how the economy will react when temporary income-protection schemes expire later in the year.

For the ECB, economic uncertainty runs deeper than the difficulties in mapping the recovery path. Since the June meeting, President Lagarde and Isabel Schnabel have argued that the pandemic will trigger profound structural changes to the economy, particularly in the form of digitisation and restructured supply chains. Schnabel has also warned that fundamental differences in the efficiency of resource allocation (compounded by the asymmetric impact of the pandemic itself on different industries and economies) could trigger divergent recovery paths.

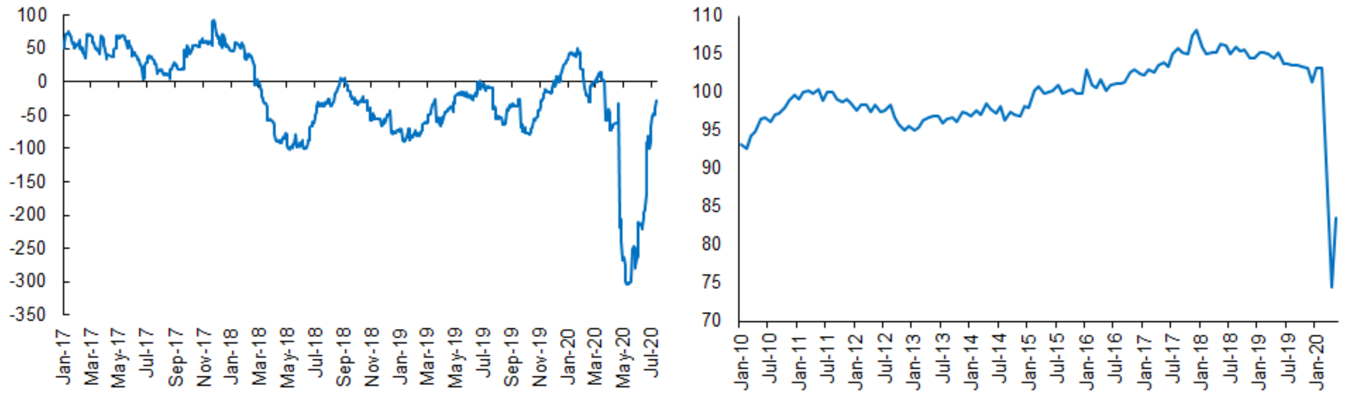
Eurozone 2020 GDP Consensus Forecast (LHS) & Distribution of Forecasts (RHS)



Source: MNI, Bloomberg

Despite this rather bleak assessment, recent economic data has surprised significantly to the upside. This has undermined scepticism in the equity rally (which could yet prove closer to anticipating the shape of the recovery than the analyst community) and has led some policymakers to float the idea of a potentially milder recession than initially feared. Certainly, a string of significant positive data surprises could make it more difficult to maintain such a strong conviction on prolonged weakness and fundamental economic restructuring.

Eurozone Economic Surprise Index (LHS) & Eurozone Industrial Production Index (RHS)



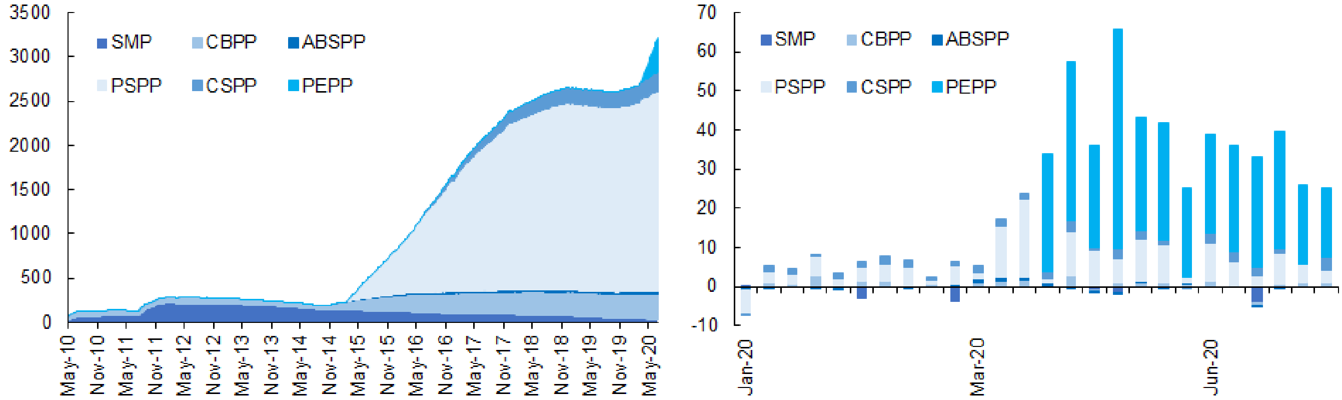
SOURCE:MNI, Bloomberg, Citi

Some commentators have suggested that the ECB could strike a more optimistic note on the economy as soon as this week's policy meeting, but given the lack of visibility on the recovery path this would seem premature at this stage. Growth rates may have rebounded sharply, but the lower base as a result of lost output means that in level-terms the picture is still quite bleak. As such, we would consider a hawkish assessment of recent data to be a positive surprise for the July meeting. We expect questions on the ECB's interpretation of incoming data to feature heavily in upcoming press conferences and media interviews. The ECB, for its part, is likely to rely heavily on scenario analysis going forward to navigate through the recovery.

PEPP will undoubtedly continue to attract a plethora of questions. These will continue to focus on the assets eligible for purchase, reinvestment policy and the possibility of further expansion/extension. We also wonder whether there is scope for PEPP (or a similar tool) to become a semi-permanent (or perhaps recurring) feature of the ECB toolkit and how deviations from the capital key will be corrected in the future.

As we highlight below (see *ECB Communication: The Detail*), the ECB has emphatically endorsed the PEPP, which is rightly seen as the most powerful tool at its disposable. The ability to frontload the programme and target purchases has provided the flexibility needed to tackle the asymmetry of the Covid shock and quell fragmentation risks. Although the ECB has made clear that PEPP is its primary policy tool during this crisis, it has also stressed that this is temporary. However, there are several reasons to suggest that PEPP could stick around far longer than the currently envisaged.

ECB Asset Purchases, EURbn (LHS) & Weekly Changes, EURbn (RHS)



Source: MNI, Bloomberg,ECB

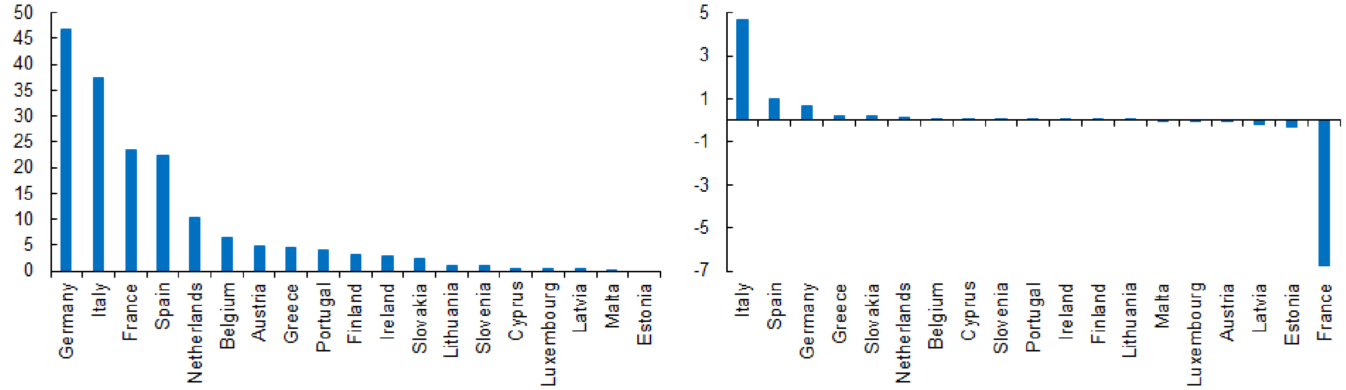
First, PEPP has levelled the playing field for the ECB with respect to its peers. Central banks operating in other developed markets have had much greater flexibility in targeting asset purchases since the financial crisis, whereas the ECB has been constrained by the capital key, issue(r) limits and political opposition. Viewed through this lens, PEPP is closer to the more 'traditional' QE programmes deployed by other major central banks.

Second, despite President Lagarde's recent enthusing over an apparent coordination of monetary and fiscal policy, in reality fiscal policy cannot be relied upon to share the burden of reviving economic activity. While this is certainly the case in most economies where governments and central banks do not always sing from the same song sheet (although during this crisis monetary and fiscal policy has been well coordinated) , the eurozone faces the additional constraint of 19 different governments with divergent views on appropriate fiscal policy,, which can impede coordination. As our recent MNI Exclusive highlights (see *MNI EXCLUSIVE: EU Covid Fund Compromise "Absurd" – Frugal Source*, 13 July), there remains deep divisions within the bloc over the European recovery fund that could lead to significant compromises for the so-called frugal states to the detriment of the regional recovery. Even if an ambitious and targeted recovery fund is agreed, the dependability of euro area fiscal policy in the future will remain uncertain. As such, an expanded and more flexible toolkit offers the ECB the best chance of managing future economic shocks.

Third, the ECB appears to have fended off the recent German constitutional court ruling on the legality of the PSPP. Both the German Finance Minister Olaf Scholz and the German parliament have endorsed the ECB's bond buying programme, which could prove a watershed moment given the longstanding political opposition within Germany to QE. The ECB will not adopt a *carte blanche* approach to monetary policy, but it may be more emboldened in the future when devising and calibrating new monetary policy tools.

Fourth, the ECB has stated that PEPP will continue to be used until the coronavirus crisis phase is deemed over (see ECB Communication: The Detail). This is one of the most interesting developments to emerge in recent communication among ECB members. There is no indication yet of how the ECB would eventually reach this determination. The crisis could be considered 'over' once there is a sustained period in which no more official deaths or infections are recorded, when the reproductive rate is sufficiently low, when there is an approved vaccine, or once the economic impacts of the Covid crisis have subsided. The ECB has stated that its longer-standing purchase programmes will continue to be used to tackle the pre-Covid disinflationary pressures, while the PEPP will explicitly be used to combat the impacts posed by the coronavirus fallout. If future staff analysis shows persistent economic damage arising from the Covid crisis, it is conceivable that this could be cited as a reason for keeping PEPP in the toolbox for the foreseeable future. We certainly expect the ECB to receive a lot of questions on how it will determine when the coronavirus crisis phase is over and how the PEPP will be adjusted.

PEPP Purchases, EURbn (LHS) & % Deviation From Capital Key (RHS)



Source: MNI, Bloomberg, ECB

Finally, we would highlight the capital key deviation under PEPP that is also like to attract considerable attention going forward. So far this deviation has been most significant for Italy (over-buying) and France (under-buying). Although PEPP has the inbuilt flexibility to deviate in this manner, the ECB has indicated that the capital key will continue to guide purchases over time. When these deviations are corrected and under what conditions will become a focus for markets (Isabel Schnabel has suggested the rebalancing could occur during the reinvestment phase). Under the current programme parameters, purchases will continue until June 2021 and maturing securities reinvested until the end of 2022. The ECB has stated that the programme was extended in this way to prevent the programme expiration from undermining the fragile recovery. In a similar vein it is unlikely that the ECB would want to avoid a rapid rebalancing to correct capital key deviations and would instead prefer to engineer a smooth adjustment.

mni Central Bank Watch - ECB

MNI ECB Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
HICP	% y/y	0.3	0.7	↓	1.3	↓					-1.66
Core Inflation	% y/y	0.8	1.0	↓	1.3	↓					-1.37
Oil Prices	$	41.2	22.7	↑	66.0	↓					-0.24
5y/5y Inflation Swap	%	1.09	0.96	↑	1.33	↓					0.07
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Eurozone PMI (Comp)	Index	48.5	29.7	↑	50.9	↓					0.01
Industrial Production	% y/y	-28.0	-2.1	↓	-1.6	↓					-2.24
Business Climate Indicator	Index	-2.26	-0.26	↓	-0.28	↓					-1.24
Consumer Confidence	Index	-14.7	-11.6	↓	-8.1	↓					-0.44
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Narrow Money (M1)	% y/y	12.5	8.1	↑	8.3	↑					2.89
Broad Money (M3)	% y/y	8.9	5.5	↑	5.6	↑					1.61
Loans to Non-Fin Corps	% y/y	6.7	2.4	↑	2.6	↑					1.63
Loans to Households	% y/y	3.3	3.9	↓	3.3	⇒					-0.40
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	-5.1	2.6	↓	2.5	↓					-1.11
Unemployment Rate	%	7.4	7.2	↑	7.4	⇒					0.78
Labour Costs (Quarterly)	% y/y	3.4	2.7	↑	2.6	↑					2.28
Employment (Quarterly)	% y/y	0.4	1.2	↓	1.5	↓					-2.16
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3292	2787	↑	3745	↓					-0.45
Bund Yield	%	-0.43	-0.47	↑	-0.19	↓					-0.08
10y BTP Spreads	%	167.2	199.4	↓	159.7	↑					0.23
EUR TWI	Index	122.86	120.83	↑	120.03	↑					1.81

Source: MNI, Bloomberg

Summary of Analyst Views

- There is broad consensus in expecting no change at this week's ECB meeting.
- Some analysts highlight the possibility of an increase in the tiering multiple or inclusion of 'fallen angels in the list of eligible purchase securities, but both are seen more likely to occur at a later date.

Barclays

- The ECB is expected to remain on hold this week in order to assess the effectiveness of the policy package announced in June.
- However, it is possible that the tiering multiple is increased given the higher excess liquidity. Although, Barclays believes that this is more likely by September at the earliest.
- An expansion of eligible assets, including 'fallen angels' is unlikely given the recent stabilisation of financial conditions in the euro area.

Berenberg

- The June PEPP increase has bought the ECB some time and so it may not need to think about a further increase for at least six months.
- After a second increase of EUR500bn later this year, the ECB could announce a further increase 6-9 months after that and possibly do the same again a further 6-9 months later. In total the ECB could purchase a further EUR0.8-1.6trn of assets under PEPP or the APP on top of what has already been committed to.

Commerzbank

- With the eurozone economy recovering, the ECB is unlikely to adjust monetary policy at this week's meeting.
- Given the stabilisation of financial markets, there is no immediate urgency to consider purchases of 'fallen angels'.

Danske

- No new monetary policy measures are expected at the July meeting.
- Given the recent improvement in confidence indicators, the ECB is expected to strike a cautiously optimistic tone at this week's meeting.
- The ECB will also indicate that the full PEPP envelope may not be used.
- A further expansion of PEPP is not expected unless financial fragmentation risks return. Therefore, the ECB is expected to slow down its daily PEPP operations quite markedly from the current purchase rate.
- Although markets continue to price in a rate cut by the ECB, Danske do not expect another cut.
- An increase in the tiering multiple to 10x is expected later this year.

Goldman Sachs

- No additional policy changes are expected at the July meeting following the June policy package.
- However, the ECB is expected to strike a relatively more optimistic note on the economic outlook.
- Despite recent comments suggesting that the full PEPP envelope may be used, the ECB will stress that purchases under PEPP will continue until projected inflation has returned to the pre-Covid path.
- Given the subdued outlook for inflation, GS expect the full EUR1.35trn PEPP envelope to be used and expect purchases to run until June 2021.
- While the GC is likely to have debated the inclusion of high-yield debt in the list of eligible assets under PEPP, a decision on this is unlikely at the July meeting.
- Similarly, while there is scope for increasing the tiering multiple, the GC will also hold this policy in reserve.

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HSBC

- No change in asset purchases or policy rates is expected at the July meeting.
- There is a chance that the ECB announces at this meeting that it will purchase 'fallen angels', particularly if the ECB's Bank Lending Survey shows rising concern on the flow of credit to firms.
- HSBC believe that another PEPP expansion in September is unwarranted unless there is significant market pressure or a second coronavirus wave and return to lockdowns. This is partly because HSBC believes that an upward revision to inflation is more likely than a downward one.
- A QE expansion is expected in order to prevent a cliff-edge when PEPP expires in June 2021. An increase in APP from EUR20bn to EUR40bn is expected to be announced in December and running from January.

ING

- The ECB will be taking stock at this week's meeting and will not be taking any further action for now.

JPM

- The ECB is likely to pause at this week's GC meeting.
- Economic activity has picked up faster than expected and previous policy easing has calmed financial markets. There are still further TLTRO tenders to come and a significant volume of PEPP purchases to be carried out.
- Nonetheless, it is possible that the ECB could make some adjustments to TLTROs and the tiering multiplier.
- JPM continue to expect the ECB to expand the PEPP by another EUR750bn, which will be announced in Q420 alongside additional TLTRO innovations.

Morgan Stanley

- Given the PEPP increase and large TLTRO take-up in June, there is no immediate need for the ECB to ease monetary policy further at the July meeting.
- With the ECB not expecting the eurozone economy to return to pre-Covid conditions before 2022 and with inflation well below target, the ECB will continue easing for an extended period. Morgan Stanley continues to expect a EUR400bn PEPP top-up in 2021.
- Although there is an argument to be made for raising the tiering multiple to limit the impact of negative deposit rates on the banking sector, the favourable TLTRO terms mitigate some of this impact. In addition, while it is possible that the ECB could buy 'fallen angels' it is only likely to do so in a period of heightened market stress.

Natixis

- The ECB will take a breather at this week's meeting and not adjust monetary policy.
- Whether a further increase in PEPP will be announced at some point will depend on 1) the deterioration of government balance sheets in the coming quarters and 2) thee development of private sector savings.

Nomura

- Given the recent sizeable policy interventions, the ECB will now pause and monitor economic and financial market conditions before deciding to adjust policy again.
- Nomura note that at the current purchase rate, the PEPP envelope would be used by March next year. Given that the ECB has stated the programme will run until mid-2021, this implies some degree of tapering. Otherwise, a further expansion of the programme would be required.
- There may be questions during the press conference on the PEPP redemption policy, 'fallen angels', the run-rate of PEPP purchases and the use of the capital key in relation to PEPP.

Nordea

- There is no immediate need for the ECB deliver further monetary stimulus at this week's meeting.
- There was strong take-up of TLTRO-III in June and there is substantial PEPP ammunition still left.
- There is a risk that President Lagarde will sound overly-optimistic during the press conference and hint that the pace of bond purchases may be slower in the future.

- The 33% issuer limit of the PSPP will need to be addressed soon. Shifting to the PEPP, which does not have such a limit, would not be difficult to do. However, the ECB is likely to delay a decision as long as possible given the recent legal issues.

RBC
- It is unlikely that the ECB will alter monetary policy this week given that the PEPP was expanded in June.
- RBC have argued for an increase in the tiering multiplier this year. While this may be premature for the July meeting, it cannot be ruled out entirely.

SEB
- No new policy measures are expected at the July meeting, but an increase in the tiering multiplier is likely later this year.
- If Europe can avoid major new lockdown measures through the remainder of the year then the ECB is likely to stay put in H2.

Scotiabank
- No immediate change in monetary policy, with the ECB instead likely to wait until later in the year before considering an expanding stimulus.
- Forecast guidance may be meaningful.

Swedbank
- The ECB will keep monetary policy unchanged at this week's meeting, but will reiterate that all of the pandemic policies will continue to be used when necessary.

TD Securities
- No major policy announcements are expected at this week's meeting given that the June meeting effectively set policy for next year.
- TD looks for a more upbeat tone from the ECB given the content of recent policymaker comments.
- There now appears to be a floor under 2020 GDP downgrades and financial conditions have continued to improve. However, Lagarde will not want to push too far on the optimism given the considerable uncertainty around the economic outlook.

UBS
- Following the policy package announced in June, the ECB is in 'wait and see' mode.
- Nonetheless, there is a good chance that the ECB will adjust the details of the two-tiered deposit rate.
- Given that Klaas Knot and Isabel Schnabel recently suggested that the ECB may not fully utilise the PEPP, there are likely to be questions on this possibility during the press conference.
- UBS are not convinced that the current EUR1,350bn PEPP envelope will last until mid-2021, but that the ECB will not decide on an increase in extension before Q420.
- The deposit rate is expected to remain unchanged at -0.50% for the foreseeable future.

UniCredit
- The ECB will be in wait and see mode at this week's meeting with no change in policy expected.
- The GC may even believe that short-term risks are tilted to the upside following Isabel Schnabel's comments that the recession could be milder than initially expected, and Philip Lane's suggestion that the rise in oil prices could prevent inflation falling as much as projected in June.
- Unless growth and inflation surprise strongly to the upside in the coming months, a further expansion of PEPP is likely and probably before the end of the year.
- The ECB will unlikely feel the need to purchase 'fallen angels' right now and will prefer to keep its powder drive in case financial conditions deteriorate again.

ECB COMMUNICATION: THE DETAIL

Although the German Constitutional Court (GCC) ruling on the PSPP had cast a shadow over future ECB asset purchases, it did not prevent the GC from over-delivering at the June meeting with a EUR600bn expansion of the PEPP envelope. ECB members continued to assert that the European Court of Justice has exclusive jurisdiction over the ECB, the central bank only answers to the ECJ and the European Parliament, and that the ECJ previously ruled in December 2018 that the ECB was acting within its price stability mandate.

However, the ECB clearly needed to address the GCC ruling without directly responding to the German court and jeopardising its independence. Policymakers repeatedly asserted the proportionality of ECB asset purchases and their appropriateness in the current environment.

ECB President **Christine Lagarde** addressed this issue on **June 8** during a hearing at the Committee on Economic and Monetary Affairs of the European Parliament:

> "..the ECB has to, of course, constantly evaluate whether its policy measures achieve their intended purpose. This assessment also includes analysing potential side effects of the measures considered and determining whether alternative instruments might be more efficient in attaining the objective. In my first hearing before this Committee in September 2019, I referred to this assessment as a "cost-benefit analysis".
>
> More generally, the ECB continually monitors the proportionality of its instruments. Such assessments are conducted regularly, as reflected in the monetary policy accounts, in speeches, and not least in the regular exchanges with the European Parliament such as the one today. The ECB's strategy review will also play an important part in these ongoing efforts."

Isabel Schnabel further opined on **27 June:**

> "All in all, the benefits of our measures clearly outweigh their costs. For the average saver, the additional losses arising from our new policy measures are very small. And there are no signs so far that the monetary policy response to this crisis has meaningfully affected governments' budgetary discipline and created moral hazard.
>
> This means that the measures taken by the ECB in response to the crisis broke out have been necessary, suitable and proportionate to ensure price stability in the euro area."

Although the GCC could make a similar ruling in the future (perhaps against the new PEPP, which is explicitly deviating from the capital key, at least in the short term), the current ruling seems to have been quashed after German Finance Minister Olf Scholz and the German parliament declared that the ECB has fulfilled the court's requirements. The Bundesbank is now expected to continue purchasing government bonds, nullifying the August 5 deadline set by the GCC.

Moving on the economic outlook for the euro area, ECB members have offered a particularly bleak assessment, even after the June policy package was announced. It is not just the expectation that the Covid-19 crisis will hit medium-term growth and inflation, but that the pandemic could trigger major structural changes to the economy, as **Isabel Schnabel** noted on June 10:

> "Evidence is increasingly pointing towards a protracted impact of the crisis on both demand and supply conditions in the euro area and beyond."
>
> "In effect, both the nature of the shock and the length of the ensuing downturn make it likely that the economy will experience important structural shifts"

"…product and labour markets in the euro area still remain too rigid to accommodate the required shift in resources in a swift manner, risking permanent damage to the economy."

"…the speed and extent of capital and labour reallocation is likely to differ across euro area economies, depending on the sectoral composition and the quality of labour market institutions. Such differences, if left unaddressed, risk increasing heterogeneity and fragmentation, further complicating the conduct of the common monetary policy."

These sentiments were mirrored by **Christine Lagarde** on **13 June**:

"It is becoming increasingly clear that the crisis will restructure our economies in fundamental ways. In the manufacturing sector, we are likely to see a push to make supply chains more resilient, which will likely lead to a greater focus on "proximity", i.e. on-shoring of production and reinforcing of strategic value chains.

In the services sectors, by contrast, the pandemic is likely to shift the economy towards more "distancing" via more digitalisation.

We are already seeing this transition accelerate as retail trade gravitates towards e-commerce, services that we previously thought were "non-tradeable" start being traded online, and more remote working becomes possible."

And again, by **Isabel Schnabel** on **27 June 2020:**

"The changes to our economy induced by the pandemic are therefore in all likelihood not only temporary, but structural**.** Global value chains are already being put to the test, productivity in many service sectors may be permanently affected, and certain industries will probably never return to their pre-crisis levels."

While broadly sticking to the script that the recovery will be fragile and drawn out, with heightened uncertainty, members are acknowledging the recent pickup in activity. **Isabel Schnabel** noted on **July 7**:

"In recent weeks some confidence indicators have come in positive, which suggests that the recession could turn out somewhat milder than expected. But overall we are in the range of our baseline scenario."

Furthermore, **Luis de Guindos** stated on **July 8**:

"The outlook is a little bit brighter than it was only two months ago,"

And that he was:

"having perhaps a little bit more optimism with respect to the drop in the second quarter and the recovery in the third and the fourth."

What has become abundantly clear in recent months is the predominance of the PEPP in the ECB's toolbox. Although policymakers continue to assert that this tool has a limited shelf life and will only be deployed to combat the economic impacts of Covid-19, it is clearly the most powerful resource that the ECB has at its disposal. As **Isabel Schnabel** noted on **June 10**:

"The evidence around the PEPP announcement suggests that the normalised impact of a € 500 billion purchase envelope may be almost twice as large as under our regular asset purchase programme (APP)

Philip Lane further hammered home this point on **24 June**:

"Notably, the recently-announced expansion in the PEPP has been associated with a further improvement in the transmission mechanism. These developments show that the PEPP has been very effective against the widening of risk premia, consistent with evidence that monetary policy measures designed to release balance sheet constraints for firms and financial intermediaries tend to be particularly effective in conditions of elevated market stress."

> "The PEPP and the scaling-up of the asset purchase programme are estimated to reduce the ten-year sovereign term premium by almost 45 basis points (Chart 7). This adds to the nearly 100 basis point compression in the term premium that is attributable to the sizeable stock of assets purchased under the APP in recent years and the September 2019 recalibration of the APP."

In addition to the clearly emphatic assessment of the PEPP's efficacy, another interesting development to emerge in the ECB's communication has been the connection between the PEPP's lifespan and the evolution of the coronavirus crisis. Referencing the June PEPP increase, **Isabel Schnabel** stressed on **June 10** that the Governing Council had decided to:

> "…extend the horizon of net purchases under the PEPP to at least the end of June 2021, or in any case until the Governing Council judges that the coronavirus crisis phase is over."

Philip Lane echoed these remarks on **June 11**

> "… we will conduct net asset purchases under the PEPP until we judge that the coronavirus crisis phase is over."

However, for the time being we do not know how the ECB will judge when the coronavirus crisis is over. This could be taken to mean when there are no more reported coronavirus deaths, no more coronavirus cases, a sufficiently low reproduction rate, an approved vaccine, or when the economic impacts of the coronavirus crisis are deemed to have dissipated. Questions on this point could arise in the press conference at the July ECB meeting. In any case, future communication on how the ECB will arrive at an assessment of when the crisis is over will be closely scrutinised.

There is also an explicit recognition that the ECB will effectively need to backstop eurozone sovereign bond markets given the large volume of Covid-19-related issuance in the pipeline. **Isabel Schnabel** stated on **10 June**:

> "By removing duration risk from the market, PEPP reduces the bond free-float ratio –the share of bonds that need to be held by private price-sensitive investors relative to total bond supply (see left chart on Slide 8).
>
> In the absence of our new measures, this ratio would have gradually increased on the back of the large coronavirus-induced increase in debt issuance, thereby putting upward pressure on bond yields."

Other interesting facets of the PEPP include the deviation from the capital key, which Isabel Schnabel explicitly acknowledged on 27 June:

> "… conditional on market conditions at the time, we could eventually reduce past deviations from the capital key, using, for example, the reinvestment phase of the PEPP."

There have been a few instances of communication which has raised some doubts about whether the ECB will fully utilise the PEPP. **Fabio Panetta** stated on **16 June**:'

> "At the moment, there is still a lot of uncertainty around how the public health and economic situation will develop. It would have been unwise to go for the "full monty" –using our firepower to a larger extent – without a clearer picture."

Yves Mersch was even more explicit on **25 June:**

> "We would not need to make use of the full PEPP envelope if the Governing Council were to assess that market tensions had eased sufficiently."

As was **Isabel Schnabel** on **30 June:**

> "One shouldn't think of a linear pace that is going to be continued until the end of the program,"

> "There is also not necessarily a need to use the full envelope."
>
> "At the moment we feel very comfortable with the envelope we have,"
>
> "If the outlook is very much improved, we are going to react to that."

Finally, despite the focus on the PEPP and PETRLO, the issue of negative policy rates and whether they can be further pushed into the red keeps coming up. **Isabel Schanbel** addressed this in a Twitter Q&A on **9 June**:

> "Currently, we consider asset purchases to be a more effective and efficient tool, also taking potential side effects into account. But our experience with negative interest rates has been positive, and lowering interest rates remains an option for the future."

In comparison to the policy tools used to combat the impacts of Covid-19, **Isabel Schnabel** also noted on **27 June**:

> "…ECB staff has analysed how far we would have had to cut our main policy rate – the rate on deposits that banks hold overnight at the ECB – in the current situation in order to achieve the same impact on inflation as with the additional asset purchases that we have decided upon since March.
>
> The results show that we would have had to cut the interest rate on the deposit facility by more than a full percentage point to around -1.7% – from currently -0.5% – to achieve the same effect on inflation (Slide 7, left)."

ECB Inter-Meeting Communication

Date	Time	ECB Member	Location	Event/Topic
08/06/2020	14:45	Christine Lagarde		ECB's Lagarde in European Parliament Hearing. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200608~4225ba8a1b.en.html
09/06/2020	09:00	Olli Rehn	Helsinki	Speech on Eurozone monetary policy
09/06/2020		Isabel Schnabel	Online	Twitter Q&A. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200609~f2fdf135ec.en.html https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200609~f2fdf135ec.en.html
10/06/2020	08:00	Madis Müller	Tallinn	Speech on the Eurozone Economic Outlook
10/06/2020	08:30	Peter Kažimír	Bratislava	Press Conference on Revised Economic Forecasts
10/06/2020	12:00	Isabel Schnabel	Online	Participation in online seminar hosted by the Florence School of Banking and Finance. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200610~a16c903e5c.en.html
10/06/2020	12:00	Klaas Knot	Dutch parliament	Speech to parliament about the Dutch financial system

10/06/2020	14:30	Luis de Guindos	Online	Keynote address to the IIEA, discussing the Eurozone economic outlook and the extraordinary measures taken by the ECB. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200610_1~64efe479b2.en.html
11/06/2020		Philip R. Lane		Interview with Il Sole 24 Ore conducted on June 8. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200611~ec8ed4779b.en.html
12/06/2020	12:00	Pierre Wunsch	Online	Participation in webinar
13/06/2020		Christine Lagarde	Online	The Path Out of Uncertainty". Remarks made via videoconference at the inaugural session of the Italian National Consultation. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200613~890270bad1.en.html
14/06/2020		Luis de Guindos		Interview with ABC conducted on June 9. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200614~717384384f.en.html
16/06/2020	15:00	Ignazio Visco	Online	Speech on monetary policy during the health crsisi
16/06/2020		Fabio Panetta		Interview with Le Monde. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200616~2fdb438ac4.en.html
18/06/2020	17:00	Robert Holzmann	Online	ECB's Holzmann Speaks at Virtual Finance Seminar
22/06/2020		Luis de Guindos		Interview with Der Spiegel conducted on June 15. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200622~3bd6510157.en.html
22/06/2020	13:00	Jens Weidmann	Frankfurt	Speech at the Frankfurt Finance Summit 2020: "The Current Crisis and the Challenges It Poses For Econoic and Monetary Policy"
22/06/2020	15:15	Luis de Guindos	Frankfurt	"Financial Stability and the Pandemic Crisis" speech at the Frankfurt Finance Summit 2020. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200622~422531a969.en.html
22/06/2020	17:30	Philip R. Lane	Online	Speech for the COVID-19 webinar series hosted by the Bendheim Center for Finance at Princeont University. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200622_1~b8e6d3cf24.en.pdf?f179582fdd878f51108519135806eecb
23/06/2020	08:00	Pablo Hernandez de Cos	Spain Parliament	Testimony before Spain's Commission for Social and Economic Reconstruction
24/06/2020	08:00	Philip R. Lane	Online	Speech for the "Food for Thought" webinar series organised by Frankfurt Main Finance. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200624~d102335222.en.html

25/06/2020	12:30			ECB June Monetary Policy Meeting Account
25/06/2020	13:30	Isabel Schnabel	Frankfurt	Welcome remarks at the virtual Bond Market Contact Group conference. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200625_1~28520b4408.en.pdf?cc7de3280ffe67fb6406735d145b842f
25/06/2020	15:30	Yves Mersch & Klaas Knot		Participation in a panel discussion for the Reinventing Bretton Woods webinar series "The World Economy Transformed". https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200625~5eee0165a7.en.html
26/06/2020	08:00	Christine Lagarde	Online	Speech at Online Summit
27/06/2020	10:05	Isabel Schnabel		Participation in a pnel discussion at the virtual Petersberger Sommer-Dialog. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200627~6009be389f.en.html
29/06/2020	13:00	Gabriel Makhlouf	Online	Speech at a Bruegel online event: 'The Need For Market-Based Finance After COVID-19'
30/06/2020	12:00	Isabel Schnabel		Speech at IIF event
30/06/2020	16:00	Luis de Guindos	Online	Participation in a virtual series "Perspectives on the Pandemic" organised by the National Association for Business Economics.
01/07/2020		Luis de Guindos		Interview with La Stampa. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200701~601bc1b5ff.en.html
01/07/2020		Philip R. Lane		Interview with Reuters. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200701_1~3fdbba5640.en.html
01/07/2020		Isabel Schnabel		Interview with NRC Handelsblad. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200707~94b5970eb4.en.html
01/07/2020	08:45	Fabio Panetta	Online	Speech at a Capital Markets webinar organised by the EIB and ESM. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200701.en.html
01/07/2020	10:00	Pablo Hernandez de Cos		"El impacto del Covid-19 en la economia espanola" speech, as part of the "Lideres en directo" conference series, organised by the Consejo General de Economistas.
01/07/2020	13:10	Christine Lagarde	Online	Pre-recorded remarks for a virtual roundtable on "Rebirthing the Global Economy to Deliver Sustainable Development" organised by the UN.
02/07/2020	14:00	Yves Mersch	Online	Participation in Salzburg Global webinar: "What Future For The European Union In The Aftermath of The German ECB Ruling?"

				https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200702~87ce377373.en.html
02/07/2020	18:00	Isabel Schnabel	Online	"The ECB's monetary policy during the coronavirus crisis – necessary, suitable and proportionate" presentation at the Berlin Economic Roundtable. https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200702_1~977101f696.en.pdf?9d8f2f095d607386840fa45fc1ec0636
03/07/2020	13:00	Klaas Knot		Speech at the Bloomberg EU Policy Series Event
04/07/2020	11:40	Christine Lagarde	Online	Participation in the session "Mettre en oeuvre un modele alternatif de croissance" for the Rencontres Economiques d'Aix-en-Provence.
07/07/2020		Fabio Panetta	Online	"Unleashing the euro's untapped potential at global level" introductory remarks at a meeting with members of the European Parliament.
08/07/2020		Christine Lagarde		Interview with Financial Times. https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200708~8418847210.en.html
08/07/2020	15:00	Luis de Guindos	Online	Speech at a webinar organised by CEAPI
09/07/2020	11:00	Pablo Hernandez de Cos		Participation in the presentation of the Real Instituto Elcano's Report: "¿Recuperacion o metamorfosis? Analisis y recomendaciones para el plan de transformacion economica de Espana".
13/07/2020		Fabio Panetta		"Pursuing a successful path towards euro area accession". Introductory remarks at a meeting of the Euro Accession Countries Working Group of the Committee on Economic and Monetary Affairs of the European Parliament https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200713~ecca67c570.en.html
13/07/2020		Isabel Schnabel		Interview with ARD "plusminus" conducted on 8 July https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200713~67f858ce55.en.html

MNI Policy Team

MNI PREVIEW: ECB Set To Hold In "Wait And See" Approach

--After June Move, Time And Data Offer Breathing Space

By Luke Heighton

FRANKFURT (MNI) - The European Central Bank is set to keep monetary policy unchanged Thursday, with the Governing Council likely to adopt a cautious "wait and see" approach after better-than-expected data releases, while stressing that it remains ready to act in the event of further pandemic disruption.

Increases to the EUR1.35 trillion Pandemic Emergency Purchasing Programme are unlikely, the ECB having bought itself time to assess the depth and the spread of the damage done by the coronavirus. Recent assertions from the Executive Board and Council members that the package may not be needed in full should be treated with scepticism, though further efforts to signal to markets that they should not become too used to large PEPP increases are possible.

A tweak to the tiering multiplier in the targeted longer-term refinancing operations is possible, although any discussion of including junk bonds in the ECB's asset purchases is very much on the backburner. Recent strong TLTRO uptake should reassure the ECB it is under no pressure to act immediately. However, governors remain watchful for any signs of further tightening of financial conditions, and any sudden changes in bond spreads.

The ECB and the Bundesbank have put to bed, for now at least, any concerns over the German Constitutional Court's ruling on its public sector purchasing programme.

--MOVING AHEAD

Having come through what it is hoped will be the first and only 'hot' phase of the crisis, Governing Council consensus is running high, though some points of contention remain. The almost pessimistic tone so far adopted by the ECB regarding the eurozone's recovery prospects stands in contrast to the comparative optimism of some of its more hawkish members and suggests a robust discussion of the size and duration of PEPP lies in store.

There is also room for disagreement over precisely what PEPP is for - as highlighted in remarks by Executive Board member Isabel Schnabel.

First announced primarily as a safeguard of the monetary policy transmission mechanism, by calming financial markets and heading off fragmentation, the ECB now suggests it is a means to help return inflation towards target.

Other points of contention remain. What degree of deviation from the capital key is tolerable? To what extent can this be offset through reinvestments? How does one judge when the crisis is over? How sustainable are current issuer limits?

--CLARITY

None of these questions is likely to be answered this week, but the need for greater clarity could be highlighted by a renewed emphasis on the ECB's monetary policy strategy review.

With deflation is still a greater perceived threat than inflation, downside risks and the uncertain outlook will remain the focus. A 'two-speed' European recovery, coupled with the customary call for an effective fiscal

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response, will also be on the agenda.

Once again, the press conference will provide the fireworks, and with reference to fiscal policy, there will be interest in whether President Christine Lagarde is as forthright in offering advice to specific national governments perceived to be blocking progress as some colleagues have been of late.

MNI EXCLUSIVE: EU Covid Fund Compromise "Absurd"-Frugal Source 13 July 2020

--Senior Frugal Four Source Calls Compromise Proposal No Basis For Deal --Source: Draft EU Summit Conclusions 'Absurd'
--Sources: Dates For Further EU Summit By End Of July Quietly Being Pencilled In

By David Thomas

BRUSSELS(MNI) - Proposed amendments to the European Commission's EUR750 billion 'Next Generation' proposal for the EU's recovery from Covid-19 are window-dressing which fail to address concerns over the size and composition of the fund, a senior source from one of the so-called "Frugal Four" countries told MNI, as some officials in Brussels began to talk informally about the need for another summit following the July 17-18 meeting to clinch a deal.

A compromise plan put forward by the presidency of the EU Council on Friday is insufficient, and the Netherlands, Austria, Denmark and Sweden will continue their fight to reduce the size of the fund, the source said.

"I have seen (EU summit) draft conclusions and they are absurd. They are 64 pages long and describe in detail the (earlier) proposal of the Commission. No way can this be the basis of a deal. It's more like a provocation," the source said.

--LETTER

In a letter to the Dutch Parliament on Monday, the country's finance and foreign ministers insist that they will demand a cut in the size of the proposed package. The ministers take particular issue with the EUR190 billion 'top up' which would come in addition to a EUR560 billion Recovery and Resilience Fund. The Commission and Council propose that top up money be disbursed via traditional programmes in the EU's 2021-2027 budget, such as cohesion funding and farm spending.

In line with the Frugals' earlier call for a more temporary fund based on loans to member states, the letter pushes for an approach more clearly targeted at combating the impact from Covid.

"The government also considers it undesirable to finance current expenditure from the EU budget with loans and is critical of this construction," the letter states.

The document welcomes some aspects of the compromise proposed by EU Council President Charles Michel, such as the pledge to end payments to member states within the lifetime of the next seven-year EU budget, efforts to address allocation concerns by updating the criteria for aid, and to involve governments more in decisions on how the aid is disbursed.

But the Dutch also demand stricter conditions on how money is disbursed and a 'decisive' role for member states in vetting whether required structural reforms have been accomplished and also that aid is spent on reforms which increase sustainable growth potential.

The EU Council Presidency says it is committed to pushing for an agreement this weekend. But there is informal talk among officials that another summit will be needed and dates for further leaders' meeting before the end of July are provisionally being pencilled in.

MNI SOURCES: ECB's EUR1.35 Trln PEPP Likely To Be Used In Full **9 July 2020**

--Talk Of Not Using PEPP Envelope Meant To Placate German Court
--Some Sources Sceptical Of PEPP's Temporary Nature

LONDON (MNI) - The European Central Bank's EUR1.35 trillion Pandemic Emergency Purchasing Programme envelope is likely to be used in full despite suggestions to the contrary, sources told MNI, with some expressing scepticism over the PEPP's "temporary" status and the extent to which reinvestment of principal payments could align it with the capital key.

Recent suggestions by Governing Council members that the PEPP's capacity might only be partially exploited were intended to underline the programme's "extraordinary nature" in light of the German Constitutional Court's May ruling questioning whether the ECB's Public Sector Purchasing Programme was proportional to the central bank's mission, one central bank source said. "We will use it all," said another, adding that the remarks were intended to dampen market expectations regarding another increase, while "making a proportionality point."

"It's still whatever it takes - that has not gone away. But sometimes you don't need as much," the source said. "PSPP and the programmes before that were more or less all announced as envelope programmes," said the first source. "The possibility that this time it may not be used fully - this is invented now."

--CAPITAL KEY

The PEPP's divergence from the capital key, according to which purchases of individual eurozone countries' bonds should align with the relative size of their economies, can be only "partially" addressed by reinvestment of principal of maturing securities, the official continued, although the degree of tolerance acceptable "can be discussed." The question of whether to raise issuer limits "has not been addressed yet; it cannot be addressed," the source added.

"The pandemic has made such limits outdated. Pre-Covid monetary rules, and thresholds are less and less valid," the source said. "We can transcend proportionality criteria if warranted and still operate within our mandate if such a move is necessary to guarantee the smooth transmission of monetary policy."

Purchases under PEPP are expected to be subdued during July and August, said a third eurosystem source, at around half the EUR200 billion level conducted of late, though "that will not be a policy signal."

While Executive Board member Isabel Schnabel has asserted that the "first objective of the PEPP is to counter the risks to the inflation outlook over the medium term," the source said that the facility's "stated objective" is to repair the transmission mechanism, although "also its use can be consistent with the aim to return inflation to its target."

--"TEMPORARY" PEPP

A fourth central bank official admitted to feeling "sceptical" as to the temporary nature of PEPP, and said it would be "unfortunate" were the timing of its winding-down to be conditional upon inflation stabilising towards the medium-term target of close to, but below 2%.

"Of course there is a danger that the temporary character of the PEPP might be stretched," the official said. Discussions within the Governing Council have been "intense" but "constructive," the official added, although "there might be a pretty good probability that total consensus might get some cracks in the future [...] there might be different opinions or attitudes on major decisions."

The first source also saw the PEPP's usage being extended in time.

"All instruments are temporary, but later on all turn out to be permanent [...]," the official said, "albeit it's not necessary to use all parts of the toolbox all the time."

Next week's meeting is unlikely to produce major policy decisions, sources agreed, with the scale of permanent economic damage and possible structural changes caused by the pandemic on the agenda over the coming months. It is too early to read much into surprisingly positive domestic data, they said, pointing to weakness in orders compounded by service sector stress.

--KEY ROLE FOR LANE

The pandemic response is being driven by Chief Economist Philip Lane and the Executive Board, several officials said. Lane's role has "improved considerably after the departure of [Mario] Draghi," the first explained. "I think he is probably the mastermind of those instruments at this stage. I think the vision as to how to conduct this business is more or less his own."

Schnabel is also "doing a good job and gaining in importance," said a former senior central banker with knowledge of current Governing Council workings. The former banker was less convinced of Lane's predominance, though admitting that the chief economist's more expansionary tendencies had gained ground under the current ECB presidency.

"The main difficulty is that the factual role of Lagarde is very unclear still," the former banker said, "She is doing a lot 'French style', outside the meeting in bilateral personal contacts. At the same time she seems very flexible during the meeting, not having a predefined objective or outcome in mind like Mario, and even changing her position in the course of the meeting."

An ECB spokeswoman declined to comment for this article.

MNI EXCLUSIVE: Eurozone Bad Bank Push Bogged Down, Sources Say **2 July 2020**

--Bad Bank Pushed By SSM's Enria, Blocked By SRB's Koenig

By David Thomas

BRUSSELS (MNI) - A drive for a eurozone bad bank is going nowhere, a senior European source told MNI, with other officials in Brussels and Italy pointing to fragmentation across the bloc's financial and capital markets as significant barriers to setting up a joint mechanism in response to an expected surge in bad loans.

The idea has been promoted by Andrea Enria, the European Central Bank's chief bank supervisor, the official said, adding that he has made little progress. Enria initially proposed a bad bank in 2017, when he was head of the European Banking Authority, but his attempt to revive the idea to deal with the wake of the Covid-19 crisis has met with public opposition from Single Resolution Board chief Elke Koenig, who fears it would deviate from policies favouring bail-ins rather than bailouts, as well as resistance from northern European countries. In June, Enria said it was too early to say whether a bad bank would be needed, but he acknowledged that it might be necessary to extend moratoria on loan repayments once they begin to expire in the autumn.

"Enria has been extremely proactive in trying to sell the idea of a bad bank with everyone and everywhere he can," the well-placed source said.

"Koenig and the SRB are vehemently opposed to any such thing and the idea has gained no traction within the ECB either."

--NPLs

Sources within the governing coalition of Italy, which already has a bad bank, AMCO, noted that nonperforming loans were set to jump throughout the eurozone, but that the lack of a unified capital market meant NPL disposal markets worked differently in different parts of the bloc.

"Some sort of public intervention/support must be on the table," one Italian coalition source told MNI. "Just like rules on state aid have been made more flexible at EU level, the same could happen for the treatment/disposal of post-Covid NPLs, no matter under which kind of form or entity."

"Perhaps, if mistrust among peers persists, the national way could be the best option as long as it's under some kind of authorised EU framework.".

The potential role of the eurozone's bailout fund, the European Stability Mechanism, in any bloc-wide bad bank might also be problematic for Italy, said a second coalition official, adding that it was unlikely Germany would agree to sharing the burden of other countries' bad loans.

Another Brussels source agreed that the bad bank drive had bogged down, in the face of the "immense fragmentation" of the EU banking industry in terms of legal, solvency and other issues.

Nonetheless, the source pointed to a likely spike in bad debt once a moratorium on loan payments is lifted. In Italy alone, EUR260 billion in loans would immediately be in jeopardy, the source said.

An ECB spokeswoman declined to provide a comment for this article.