Summary of recent ECB monetary policy decisions

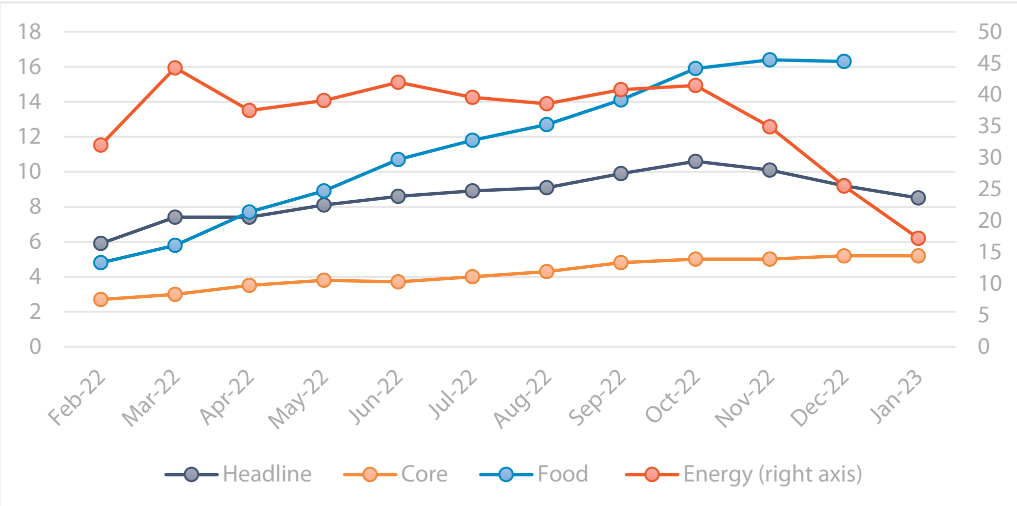
This briefing provides a recap of the key monetary policy decisions taken by the European Central Bank's (ECB's) Governing Council between December 2022 and February 2023, as complementary information to the briefing provided after the November 2022 Monetary Dialogue with the ECB President.

Background

In December 2022, the euro area headline harmonised index of consumer prices (HICP) inflation stood at 9.2% and the estimated inflation for January 2023 is 8.5%. The headline HICP inflation rate in the euro area has been gradually decreasing from its peak of 10.6% in October, reflecting mainly a steady drop in energy prices. Nevertheless, core inflation, i.e. excluding energy and food, has slightly increased in December, reaching 5.2% and it is estimated to have remained unchanged in January.

In Figure 1, euro area headline and core inflation is presented, alongside energy and food inflation. Since October 2022, annual energy inflation has been in a steady decline going from 41.5% to 17.2% in January 2023. Headline HICP inflation follows a similar pattern. On the other hand, food inflation, which has been greatly affected by the Russian invasion of Ukraine and the disruption in global supply chains, has been rising constantly in the past year, even reaching 16.2% in December 2022. Finally, in the past year, core inflation has been increasing moderately and has remained close to 5% since September 2022.

Figure 1: Euro area inflation: headline, core, food and energy (in %)



Source: ECB and Eurostat Notes: The numbers provided for January 2023 are based on the estimated values of the Eurostat Flash Estimate and the observed values can be diverging.

Economic Governance and EMU Scrutiny Unit (EGOV)
Authors: Giacomo LOI, Vasileios PSARRAS, Drazen RAKIC
Directorate-General for Internal Policies
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The coupling of monetary and fiscal policy in tackling inflation remains a key area of focus. During the announcement of the latest monetary policy decisions on 2 February 2023, ECB President Christine Lagarde called on euro area governments to start phasing out fiscal measures introduced to ease the impact of the energy crisis among fears that such fiscal stimulus could further fuel medium-term inflationary pressures. President Lagarde identified the softening of the energy crisis as a justification for rolling-back these measures, which could otherwise lead to a further build-up of price pressure requiring further tightening of monetary policy. In addition, she called for fiscal policies that can expand the euro area's supply capacity in the energy sector and contribute to a reduction in the inflationary pressure in the medium-term.

The main decisions of the 15 December 2022 and 2 February 2023 meetings of the Governing Council are summarised below. The next monetary policy meeting of the Governing Council (with macroeconomic projections) is scheduled for 16 March 2023. The upcoming Monetary Dialogue between the ECON Committee and ECB President Christine Lagarde will take place on 20 March 2023.

Interest rates

The ECB continues its path to bring inflation down to the 2% target. While between the last two recent ECB's Governing Council meetings the euro area has witnessed a decrease in headline inflation, it still remains well above 2%.

This has led the ECB to raise its three key interest rates interest rates, i.e. the deposit facility rate, the main refinancing operations (MRO) rate, and the marginal lending facility rate, in the last two meetings of its Governing Council. On 15 December 2022, it decided to increase the three interest rates by 50 basis points (bps), thus opting for a more modest raise compared to the previous 75 bps increases in September and October. On 2 February 2023, it furthered raised its key interest rates by 50 bps.

During the press conference on 2 February 2023 President Lagarde stated "*[Our] determination to reach 2% medium-term inflation should not be doubted, and our determination to raise rates sufficiently significantly in order to move into restrictive territory should not be doubted. Nor should be doubted the fact that, once we are in restrictive territory, we will want to stay there sufficiently long so that we can be confident that those rates will give us the return to the 2% medium-term inflation objective that we have*."

This is the fifth consecutive increase of the key ECB interest rates, which now stand at their highest points since November 2008.

On 2 February, the Governing Council announced a further increase in the coming meeting: "[*I*]*n view of the underlying inflation pressures, the Governing Council intends to raise interest rates by another 50 basis points at its next monetary policy meeting in March and it will then evaluate the subsequent path of its monetary policy*."

Table 1: Changes to the key ECB interest rates over the past three Governing Council meetings

Key ECB interest rates	Governing Council meetings		
	27 October	15 December	2 February
Deposit facility	1.5%	2%	2.5%
Main refinancing operations	2%	2.5%	3%
Marginal lending facility	2.25%	2.75%	3.25%

Source: ECB

Asset purchase programmes

Based on the consolidated financial statement of the Eurosystem as of 27 January 2023, the total number of securities held for monetary purposes stood at EUR 4.94 trillion, with the vast majority of these assets deriving from the temporary pandemic Emergency purchase programme (PEPP) and the standard asset purchase programme (APP).

While net asset purchases have ended under the PEPP (as of end-March 2022) and the APP (as of 1 July 2022), full reinvestment of principal repayments for maturing securities will continue until end-February 2023.

On 15 December 2022, the Governing Council formally announced that "[*t*]*he APP portfolio will decline at a measured and predictable pace, as the Eurosystem will not reinvest all of the principal payments from maturing securities. The decline will amount to €15 billion per month on average until the end of the second quarter of 2023 and its subsequent pace will be determined over time.*" This will be the ECB's first ever attempt to implement a balance sheet reduction operation through quantitative tightening.

The detailed modalities for reducing APP holdings were decided on 2 February 2023 by the Governing Council announcing that: "*[T]he monthly redemptions under the APP between March and June 2023 will exceed the decided average run-off pace of €15 billion per month. Partial reinvestments in excess of €15 billion per month will ensure that the Eurosystem maintains a continuous market presence under the APP over this period.*"

The APP consists of the public sector purchase programme (PSPP) and three private sector programmes (the asset-backed securities purchase programme [ABSPP], the third covered bond purchase programme [CBPP3] and the corporate sector purchase programme [CSPP]). Concerning the PSPP, the Governing Council has decided that reinvestment amounts will be *"allocated proportionally to the share of redemptions of each jurisdiction and across national and supranational issuers"*. For the remaining three private sector programmes, the Governing Council decided to focus on secondary market purchases during this period of partial reinvestment, while phasing out primary market reinvestments. As an exception, non-bank corporate issuers with a better climate performance and green corporate bonds will continue to be purchased in the primary market.

Furthermore, the Governing Council decided to implement a stronger tilting of its corporate bonds purchases towards issuers with a better climate performance during the partial reinvestment phase. This policy will be implemented according to the ECB climate action plan and without prejudice to the ECB's price stability objective.

Finally, the Governing Council does not for now intend to reduce the Eurosystem's holdings under the PEPP. Reinvestments of principal payments from maturing securities purchased under this programme are planned to continue until at least the end of 2024. The Governing Council will *"continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic"*.

Targeted longer-term refinancing operations (TLTROs)

The TLTRO III programme started in September 2019 with 10 quarterly operations having a maturity of three years. These operations provide financing to credit institutions, based on their loans to non-financial corporations and households. Initial conditions applicable under TLTRO III were eased on several occasions: in September 2019, and then in response to the COVID-19 pandemic in March, April and December 2020.

Banks that fulfilled lending benchmarks could borrow at interest rates as low as 50 basis points below the deposit facility rate (not lower than 1%) during the "special interest rate period" between June 2020 and June 2022, and from June 2022 until November 2022 at the deposit facility rate. In October 2022 the ECB

Governing Council took important steps to further normalise monetary policy and restrain the TLTROs favourable conditions. The Governing Council decided that "*[s]tarting from 23 November 2022 and until the maturity date or early repayment date of each respective outstanding TLTRO-III, the interest rate should be indexed to the average applicable key ECB interest rates over this period, as opposed to the life of each respective TLTRO-III.*"

The weekly financial statements of the Eurosystem of 27 January 2023 indicate that the total outstanding amount of longer-term refinancing operations (LTROs) is equal to EUR 1.26 billion, with the majority of this amount referring to TLTRO III. In Table 2, the initially allotted amount of each operation is shown as well as the outstanding amount of each operation for December and January. The last two columns show data related to the early repayment of TLTRO III.3-10 for December and January, and the maturity of the TLTRO III.2 operation. Based on the results of the December 2022 Survey of Monetary Analysts, the December early repayment surpassed significantly the median expected value of EUR 311 billion, while the January early repayment was almost half of the median expected value of EUR 130 billion.

Because of the introduction of the three additional early repayments and their significant impact on the Eurosystem balance sheet, the ECB Governing Council "*[w]ill regularly assess how targeted lending operations are contributing to its monetary policy stance.*"

Table 2: Overview of TLTRO III operations outstanding amounts and early repayments

TLTRO III	Maturity date	Allotted amount (EUR bn)	Outstanding amount (EUR bn)		Repayment (EUR bn)	
			December 2022	January 2023	21 December 2022	25 January 2023
1	28/09/2022	3.40	0	0	0	0
2	21/12/2022	97.72	0	0	51.91	0
3	29/03/2023	114.98	39.12	35.05	36.36	4.07
4	28/06/2023	1,308.40	631.23	579	350.6	52.23
5	27/09/2023	174.46	94.44	92.01	42.98	2.43
6	20/12/2023	50.41	46.49	46.2	0.54	0.29
7	27/03/2024	330.50	293.69	290.48	6.47	3.21
8	26/06/2024	109.83	77.01	76.78	8.63	0.23
9	25/09/2024	97.57	91.18	91.13	0.65	0.05
10	18/12/2024	51.97	44.5	44.27	1.24	0.23
Total		**2,339.25**	**1,317.66**	**1,254.92**	**499.38**	**62.74**

Source: ECB Statistical Data Warehouse.

Other central banks

Major central banks such as the Federal Reserve (Fed) in the United States and the Bank of England (BoE) in the United Kingdom (UK) have also been normalising their monetary policies.

In its last two meetings, the BoE's Monetary Policy Committee (MPC) decided to increase the bank rate by 50 bps. As shown in Table 3, the current bank rate of the BoE stands at 4%. In February 2022, the BoE started the runoff phase by allowing maturing bonds to roll off the balance sheet. The active sales phase started on 1 November 2022, after being delayed from early October due to turmoil in government bond markets. The MPC's aim is to reduce the Bank of England's holdings of UK government bonds by GBP 80 billion over a 12-month period from September (to GBP 758 billion) and to completely unwind its stock of corporate bonds by the end of 2023. On 12 January 2023, the MPC had been informed that the BoE had completed its sales of its temporary holdings of UK government bonds purchased in autumn 2022 on financial stability grounds.

Contrary to the ECB's Governing Council and the BoE's MPC, the Federal Open Market Committee (FOMC) decided to increase its federal funds rate only by 25 bps in its most recent meeting, bringing the current federal funds rate range to 4.5-4.75%. Fed Chair Jerome Powell pointed out that *"[I]t is a good thing that the disinflation that we have seen so far has not come at the expense of a weaker labour market."* In line with previously announced plans, the FOMC reiterated its commitment to continue reducing its holdings of Treasury securities by USD 60 billion per month, and agency mortgage-backed securities (MBS) by USD 35 billion per month.

Table 3: Evolution of key interest rates, Federal Reserve and Bank of England

Major central banks	November	December	February
Federal funds target rate (Federal Reserve)	3.75-4%	4.25-4.5%	4.5-4.75%
Bank rate (Bank of England)	3%	3.5%	4%

Source: Federal Reserve Bank of New York, Bank of England

Contact: egov@ep.europa.eu

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