Box 7. The monetary policy stances of the major central banks and of those in the region in 2020

Faced with the prospects of an unprecedented economic crisis, but also with a sizeable increase in global financial market volatility, central banks in developed countries and those in the region stepped in with a particularly prompt and forceful response to the outbreak of the COVID-19 pandemic. They resorted to the entire monetary policy toolkit, with a view to mitigating the adverse economic impact of the pandemic, as well as for supporting the smooth functioning of financial markets and the flow of credit to the real economy. Therefore, aside from substantial and/or successive cuts in interest rates and the provision of liquidity via traditional instruments, the central banks' response, decided *inter alia* on an emergency basis, included the large-scale resort – in some cases, even for the first time ever – to unconventional monetary policy tools, such as purchasing financial assets and granting long-term loans to credit institutions.

The European Central Bank responded promptly to the outbreak of the pandemic crisis, adopting in the 12 March meeting a package of measures meant to preserve ample liquidity conditions in the banking system and protect the flow of credit to the real economy, but also to safeguard the accommodative monetary policy stance by averting a procyclical tightening of financing conditions in the economy. Against this background, it was decided: (i) to conduct additional longer-term refinancing operations (LTROs) at an interest rate equal to the deposit facility rate, (ii) to apply more favourable terms to the targeted longer-term refinancing operations (TLTRO III) outstanding during the period from June 2020 to June 2021, via lowering the related interest rate by 0.25 percentage points[1] and raising the maximum total amount that counterparties were entitled to borrow, as well as (iii) to add a temporary envelope of additional net asset purchases of EUR 120 billion to the asset purchase programme (APP) until the end of the year.

In view of the abrupt deterioration of economic developments, but especially of those on the financial market following the 12 March meeting, the Governing Council adopted shortly (on 18 March) a new package of measures. This was aimed at countering the risks posed by the pandemic shock to the outlook for economic growth, to the monetary policy transmission mechanism and, ultimately, to the overriding price stability objective. Thus, the ECB launched a temporary asset purchase programme – the pandemic emergency purchase programme (PEPP), with an overall envelope of EUR 750 billion, designed to run until year-end –, expanded the range of eligible assets under the corporate sector purchase programme (CSPP) to include short-term debt securities issued by non-financial corporations, and eased the collateral framework by accepting claims related to the financing of the corporate sector[2].

[1] Under certain circumstances, it could be as low as 25 basis points below the average deposit facility rate during the programme period (at the time of the decision, the deposit facility rate was -0.50 percent).

[2] This package was complemented by a series of decisions taken in April on easing the collateral framework, for the purpose of improving financing conditions of the euro area economy.

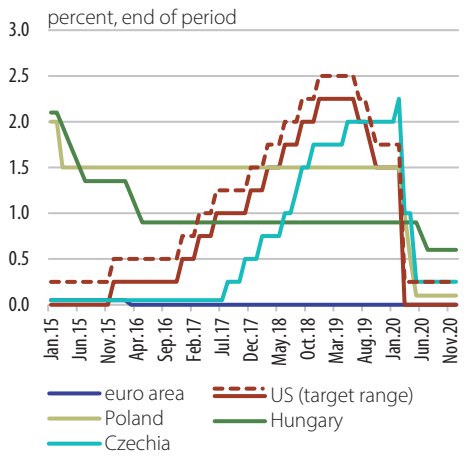
Table A. Macroeconomic developments and monetary policy stance in advanced economies and in the region

	Inflation target/ objective[b,c]	Annual inflation rate						Monetary policy rate[b,c]		Output gap[b,c]	General government balance, % of GDP**				Current account balance, % of GDP			
		2020 (average)	2020 (end of period)	Forecast*,b,c				Dec. 2019	Dec. 2020		2019	2020	Forecast*		2019	2020	Forecast*	
				2021 (average)	2022 (average)	2021 Q4	2022 Q4						2021	2022			2021	2022
Euro area	below, but close to 2%	0.3[a]	-0.3[c]	1.0	1.1	1.5	1.2	0	0	negative, narrowing	-0.6[a]	-7.2	-6.4[d]	-4.7[d]	2.3[d]	2.2	2.1[c]	1.9[c]
US	2%	1.2[f]	1.2[f]	1.8	1.9	-	-	1.50-1.75	0.00-0.25	negative, narrowing	-4.6[g]	-14.9	-8.6[g]	-6.1[g]	-2.2[d]	-3.1	-3.4[d]	-3.4[d]
Poland	2.5% ±1 pp	3.4[e]	2.4[e]	2.6	2.7	2.6	3.1	1.5	0.1	negative, narrowing	-0.7[a]	-7.0[a]	-4.2[d]	-3.0[d]	0.5[a]	3.6	1.5[d]	1.1[d]
Hungary	3% ±1 pp	3.3[e]	2.7[e]	3.5-3.6	2.9-3.0	-	-	0.9	0.6	negative, narrowing	-2.1[a]	-8.1[a]	(-6.5)-(-6.0)[b]	(-4.0)-(-3.0)[b]	-0.4[a]	0.1	(-0.4)-(-0.2)[b]	(-0.3)-(-0.1)[b]
Czechia	2% ±1 pp	3.2[e]	2.3[e]	2.3	2.0	2.2	2.0	2.00	0.25	negative, narrowing	0.3[a]	-6.2	-4.9[b]	-4.3[b]	0.3[a]	3.6	0.4[b]	0.3[b]

*) forecasted values refer to the latest central bank projections in 2020 and to the European Commission's autumn 2020 forecast respectively

**) budget deficit calculated according to the ESA 2010 methodology, except for US

Source: a) Eurostat, b) NCBs, c) ECB, d) European Commission (AMECO), e) national institutes of statistics, f) US Bureau of Economic Analysis, g) US Congressional Budget Office



Source: NCBs

Chart A
Monetary policy rate in the euro area, US and countries in the region

In turn, in the first part of March, the Fed narrowed abruptly the target range for the federal funds rate, lowering it in two hefty steps to 0.00-0.25 percent, from 1.50-1.75 percent (Table A; Chart A). Additionally, the Fed raised on 15 March the ceilings on holdings of Treasury securities and mortgage-backed securities (by at least USD 500 billion and USD 200 billion respectively), while in the following week it removed them altogether, undertaking to conduct purchases in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions. At the same time, the central bank announced an increase in the volume of overnight and term liquidity-providing operations and introduced new lending facilities worth up to USD 300 billion[3]. Moreover, at the beginning of April, the Fed launched a series of asset purchase programmes[4], as well as a Municipal Liquidity Facility (for states and local governments), worth up to USD 500 billion, to help manage cash flow stresses caused by the coronavirus pandemic, and raised to USD 850 billion the volume of several programmes introduced in March[5].

3 In particular, with a view to supporting big businesses, corporate bonds were to be purchased both on the primary market, via the Primary Market Corporate Credit Facility (PMCCF), and on the secondary one, through the Secondary Market Corporate Credit Facility (SMCCF). Households and firms would see the relaunch of the Term Asset-Backed Securities Loan Facility (TALF), which encourages the issuance of financial instruments backed by a wide range of loans, while support to mutual funds, firms and municipalities respectively was to be provided via the expansion of the Money Market Mutual Fund Liquidity Facility (MMLF) and of the Commercial Paper Funding Facility (CPFF). In addition, the Fed announced the establishment of a new programme aimed at facilitating SMEs' access to lending, i.e. the Main Street Business Lending Program.

4 Small Business Administration's Paycheck Protection Program (PPP), providing loans to participating financial institutions; Main Street Lending Program (MSLP), for buying SME loans worth up to USD 600 billion, so as to ensure the flow of credit to these entities.

5 PMCCF, SMCCF and TALF.

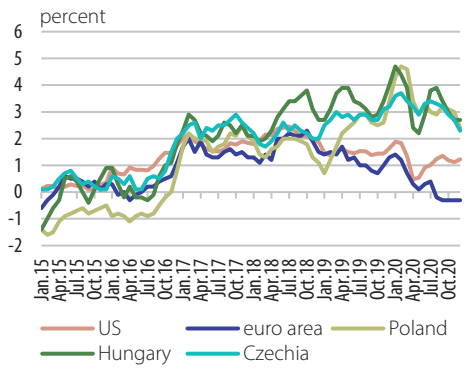
In the region, the Polish central bank carried out three policy rate cuts March through May, thus bringing the monetary policy rate down to a historical low of 0.10 percent, from 1.50 percent. At the same time, interest rates on standing facilities were lowered to 0 percent (deposit facility) and 0.50 percent (lending facility) respectively. Moreover, the central bank decided on liquidity provision to credit institutions via repos, the refinancing of loans granted by credit institutions to the non-financial sector, as well as on purchases of government securities and government-guaranteed debt securities in the secondary market. In addition, the required reserve ratio was reduced by 3 percentage points, to 0.5 percent.

The Czech National Bank (CNB) also lowered the policy rate in three steps in the period from March to May, to 0.25 percent from 2.25 percent; the deposit facility rate was thus brought down to 0.05 percent and the lending facility rate to 1.00 percent. At the same time, the central bank increased the frequency of tenders for two-week liquidity-providing repo operations[6], introduced liquidity-providing operations with three-month maturity, and broadened the range of eligible collateral to include mortgage bonds. Moreover, a time-limited[7] amendment of the CNB Act made it possible to introduce a short-term liquidity-providing instrument for non-bank financial institutions. All these measures were, however, introduced for precautionary reasons, the counterparties' recourse to these instruments being virtually non-existent.

In the case of the Hungarian central bank, the tailoring of the monetary policy stance in the immediate aftermath of the pandemic shock (March-May) was achieved by maintaining key rates unchanged (i.e. the base rate at 0.90 percent and the deposit rate at -0.05 percent), as well as by taking measures to provide forint and euro liquidity to credit institutions[8] and buy government securities on the secondary market, alongside the purchase of mortgage bonds on the primary and secondary markets. In April, the central bank decided, however, to make the interest rate corridor symmetrical (±0.95 percentage points around the base rate), raising the overnight and one-week collateralised lending rates to 1.85 percent (from 0.90 percent), with implications for interbank money market rates.

Subsequent to these decisions, there was increasing evidence of an unprecedented economic downturn in Q2, after a drastic weakening of economic activity in the previous months, under the major adverse impact of the coronavirus pandemic and of the restrictive measures to contain it. At the same time,

Chart B
Annual inflation rate in the euro area, US and countries in the region



Note: The annual inflation rate is calculated based on national CPI (Czechia, Hungary, Poland), HICP (euro area) and personal consumption expenditure index (US).

Source: Eurostat, national institutes of statistics, FRED

6 The CNB organised such tenders three times a week instead of the previous weekly frequency.

7 Until end-2021.

8 Extending the range of eligible collateral for monetary policy operations; conducting daily FX swap tenders with 1W maturity; supplementing the weekly tenders for operations with maturities ranging between 1 month and 12 months; introducing a fixed-rate lending facility with full allotment and maturities spanning three, six and twelve months and three and five years respectively; granting access to resident open-ended public mutual funds to lending operations with three, six and twelve-month maturities; no longer setting, as of 2020 Q2, target levels of liquidity mopped up via monetary policy instruments; exempting all eligible credit institutions from complying with reserve requirements starting with the March maintenance period.

the annual inflation rate witnessed a broad-based decline (Chart B), mainly amid the drop in oil prices, while the unemployment rate rose sharply in the US, but more slowly in the euro area and the countries in the region, due to governments' employment support programmes. Moreover, towards end-H1, central banks' forecasts on the level of economic activity and inflation developments were substantially revised downwards over the entire forecast horizon, while the recovery – as of H2 – of the economic decline was anticipated to be gradual.

Under the circumstances, in mid-2020, the ECB and the Fed increased the degree of monetary policy accommodation. Specifically, the Governing Council decided in its June meeting to increase the envelope for the PEPP to a total of EUR 1,350 billion, to lengthen the horizon for net purchases under the PEPP until at least the end of June 2021 and to extend the reinvestment of principal payments from maturing securities purchased under the PEPP until at least the end of 2022. In the same month, the Fed expanded the volumes of purchases of Treasury securities and mortgage-backed securities to sustain smooth market functioning and consolidate the monetary policy transmission mechanism. Furthermore, the central bank decided to broaden the range of entities eligible to directly use its Municipal Liquidity Facility (MLF), to ease the terms of the Main Street Lending Program (MSLP), for facilitating SMEs' access to finance, as well as to extend until end-December 2020 (previously September 2020) the duration of the Secondary Market Corporate Credit Facility (SMCFF), which together with the Primary Market Corporate Credit Facility (PMCCF) totalled USD 750 billion[9].

At a regional level, the central banks' decisions were, however, mixed. Thus, the monetary authorities in Poland and Czechia decided in their June meetings to leave unchanged the monetary policy rates and the interest rates on standing facilities, while the Hungarian central bank lowered the base rate in two steps June through July, to 0.60 percent from 0.90 percent, but kept the deposit facility rate at -0.05 percent.

Subsequently-released statistical data and central banks' assessments pointed to the severe pandemic-induced contraction in Q2, but also to a strong – albeit partial – rebound in economic activity in the following quarter, thanks to fiscal and monetary policy support, and amid the relaxation of containment measures. The euro area annual inflation rate entered, however, negative territory in August, under the impact of the decline in fuel and services prices, as well as owing to subdued underlying inflationary pressures, but also as a result of the temporary VAT rate cut in Germany. Looking at the region, the annual inflation rate fluctuated, however, in the upper half of the variation band of the target (Poland, Hungary) or even above it (Czechia). Nevertheless, the second wave of the pandemic tending to spread worldwide – with a peak anticipated in autumn/winter – and the reintroduction of containment measures were likely to slow down or even reverse economic recovery in the near run, implying a delay in the closure of the negative output gap in all economies under review, and hence in the return of inflation in line with the target across the euro area and the US.

9 The facilities were aimed at purchasing corporate bonds on the primary and secondary markets.

Against this backdrop, the ECB's Governing Council signalled in October that it would recalibrate its policy instruments, as appropriate, at its next meeting in December 2020, once the economic outlook had been reassessed, based *inter alia* on the updated macroeconomic forecast. Year-end data and analyses pointed to the euro area annual inflation rate remaining negative during the final months of 2020 and the annual rate of underlying inflation standing still at a marginally positive level. They also indicated a likely contraction in economic activity in Q4, under the influence of the decline in the services sector, affected by the resurgence of the pandemic and the imposition of new restrictions, although less severe than those in spring. Moreover, there were downside risks to economic activity and inflation, their outlook worsening versus the September projection round. Thus, the gradual return of GDP to the pre-pandemic level was anticipated to occur only towards mid-2022, while the expected path of the annual inflation rate and that of the dynamics of its core component were again revised downwards, implying that inflation would run below the target over a longer-than-previously-anticipated period. At the same time, despite the imminent kick-off of the vaccination campaign, the mobility restrictions in place continued to pose risks to the European economy, even more serious ones in the short run than expected earlier, while the possibility of a no-deal Brexit materialising was also an issue.

In this context, the ECB decided in the meeting of 10 December 2020 to increase the envelope of the PEPP by EUR 500 billion to a total of EUR 1,850 billion, to lengthen the horizon for net purchases under the PEPP until at least March 2022 and to extend the reinvestment of principal payments from maturing securities purchased under the PEPP until at least the end of 2023. The future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. Moreover, the ECB decided to recalibrate the conditions of the third series of targeted longer-term refinancing operations (TLTRO III)[10]. At the same time, the Governing Council decided to extend the duration of the set of collateral easing measures until June 2022, so as to improve financing conditions of the euro area economy, and to offer four additional pandemic emergency longer-term refinancing operations (PELTROs) in 2021 to ensure the smooth functioning of the financial market. Finally, it was decided that net asset purchases under the APP would continue at a monthly pace of EUR 20 billion; they were expected to run for as long as necessary to reinforce the accommodative impact of the policy rates and to end shortly before the Governing Council starts raising the key ECB interest rates[11].

The Fed maintained the target range of the federal funds rate at 0.00-0.25 percent in the second part of 2020, reiterating its commitment to further increase its holdings of Treasury securities and mortgage-backed securities at least at the

[10] This implied extending the period over which more favourable terms would apply by twelve months, to June 2022, conducting three additional operations with a three-year maturity between June and December 2021, raising the total amount that counterparties would be entitled to borrow in TLTRO III operations from 50 percent to 55 percent of their stock of eligible loans as at 28 February 2019. In order to provide an incentive for banks to sustain lending, the recalibrated TLTRO III borrowing conditions would be made available only to banks that achieve a new lending performance target.

[11] Furthermore, the ECB reiterated that it would continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

pace up to that time, to support the seamless functioning of the financial market. The monetary policy decisions during that period were taken in the context in which the annual inflation rate had started to pick up in the latter half of the year from the lower readings recorded in spring, but remained below 2 percent, while the target level was anticipated to be slightly exceeded as of 2023, amid preserving the accommodative nature of monetary policy.

In the second part of the year, the Fed completed its monetary policy strategy review warranted by transformations of the economy over the past decade. The comprehensive process, launched in 2019, materialised in redefining the central bank's dual mandate goals. In particular, in the context of the revised framework, the maximum level of employment is defined as a broad-based and inclusive goal, and monetary policy decisions are based on assessments of the shortfalls of employment from its maximum level (instead of both-way deviations in the previous approach). As for price stability, the 2 percent level of the longer-term quantitative goal was kept in place, but what changed was the manner to fulfil it, the central bank now seeking to achieve inflation that averages 2 percent over time. In line with this approach, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time (flexible average inflation targeting).

In the region, the Czech central bank kept the monetary policy rate unchanged during H2, as the annual inflation rate was anticipated to go down into the tolerance band at the onset of 2021 and then run in line with the midpoint of the target until the end of the forecast horizon, *inter alia* amid some base effects. At the same time, headwinds from the resurgence of the pandemic weighed on the more sizeable recovery of economic activity, which was anticipated to remain below the pre-pandemic level even at end-2022. Moreover, the forecast was marked by heightened uncertainties, related especially to the second pandemic wave and the potential extension of the associated restrictive measures.

The Polish central bank also preserved the parameters of the monetary policy instruments in the second part of the year. In terms of the decisions taken, relevance was attached to the signs of a resurgence of the pandemic and the potential implications for the recovery of economic activity in 2020 Q4, as well as to the prospects for the output gap to remain negative throughout 2021. Furthermore, the annual inflation rate was expected to decline in 2021 close to the midpoint of the target – amid the disinflationary effects of aggregate demand, some base effects and the likely increase in the supply of certain agricultural products –, after having tended to stay at relatively high readings during 2020, in the upper half of the fluctuation band of the target, driven by the rise in companies' operational costs owing to the pandemic, by the administered price hikes and the depreciation of the zloty.

In turn, the Hungarian central bank maintained the status-quo of monetary policy coordinates August through December, as the annual inflation rate followed a fluctuating path during 2020, reaching the upper bound of the variation band

of the target in the summer months; in 2021 Q2 it was expected to climb in the vicinity of 4 percent, under the impact of exogenous factors (higher excise duty on tobacco products and some base effects), before declining to the midpoint of the target, amid disinflationary pressures associated with the moderate dynamics of domestic demand and of economic activity abroad. Major drivers of the decisions were also the slow-in-coming recovery of the economic downturn due to the pandemic wave in autumn-winter, together with the associated restrictions, as well as the risks to the inflation forecast stemming from changes in investor sentiment towards emerging economies.