EUROPEAN CENTRAL BANK

EUROSYSTEM

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COURTESY TRANSLATION

Christine LAGARDE
President

Mr Emmanouil Fragkos
Member of the European Parliament
European Parliament
60, rue Wiertz
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Frankfurt am Main, 19 June 2020

L/CL/20/166

Re: Your letter (QZ-027)

Honourable Member of the European Parliament, dear Mr Fragkos,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 15 April 2020.

The Governing Council of the ECB is fully committed to playing its role in supporting all citizens of the euro area through this extremely difficult time. We will do everything necessary within our mandate to help all sectors of the economy to cope with the current challenges, including small and medium-sized enterprises (SMEs).

The coronavirus (COVID-19) pandemic represents a severe and exceptional shock to the euro area economy. We are witnessing an unprecedented contraction of the euro area economy, which has severe implications for the incomes and prospects of firms and households.

In this situation, the continued access of SMEs to finance is of vital importance for sustaining the euro area economy. Hence, the ECB is monitoring very closely the implications of the economic fallout from the COVID-19 pandemic for the financing conditions of SMEs, in particular, and the transmission of its monetary policy in general. In this context, ECB staff have recently finished the analysis of the latest round of the joint ECB and European Commission Survey on the Access to Finance of Enterprises (SAFE), which provided fresh insights into the challenges posed to SMEs by the COVID-19 pandemic and the lockdowns enforced in several euro area countries. In particular, the analysis confirms a rapid deterioration in the economic environment related to COVID-19, with the deterioration in the economic outlook and in the financial situation of firms having a strong negative impact on the availability of finance. A report on the latest survey results was published on 8 May, which is earlier than usual.[1]

Reflecting our commitment, and to ensure that all sectors of the economy can benefit from easy financing conditions, the ECB is purchasing public and private sector bonds in large volumes via the pandemic emergency purchase programme (PEPP) to counter the severe risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the COVID-19 pandemic. This programme, with an envelope of €1,350 billion until at least the end of June 2021, comes on top of the temporary envelope of additional net asset purchases of €120 billion that was added to our regular asset purchase programme (APP). Our asset purchases have been extended to commercial paper, which is an important source of liquidity for firms. This provides them with additional support to manage their day-to-day cash flows and should help to avoid unnecessary lay-offs. Indeed, SAFE results show that the announcement of the PEPP contributed to attenuating the sharp decline in SMEs' confidence in access to external finance.

Moreover, we decided on targeted measures on a massive scale to make sure that liquidity gets through to those that need it most. Following our recent decisions, our targeted lending facility can provide up to around €3 trillion in liquidity to banks at a negative rate, which can be as low as -1.00%, the lowest rate the ECB has ever offered. These measures will encourage banks to also extend loans to micro-firms and the self-employed – who are typically first in line to face more restrictive conditions from banks – and refinance these loans by borrowing from the Eurosystem for up to three years at negative interest rates. In addition, we are also offering new long-term refinancing operations, called pandemic emergency longer-term refinancing operations (PELTROs), providing an additional source of longer-term funding for banks. These operations complement the targeted operations, thereby ensuring that ample central bank liquidity can reach all corners of the economy, including those typically serviced by smaller banks.

The ECB has also introduced a set of targeted collateral measures, with a special focus on smaller businesses, including the self-employed. Loans to companies and the self-employed which benefit from COVID-19 related guarantee schemes may be accepted by Eurosystem national central banks as collateral in our lending operations. This is again intended to ensure that access to bank credit for these borrowers remains available on favourable terms, as banks can mobilise these loans to borrow from the Eurosystem at the attractive conditions outlined above. We have also adopted temporary measures to mitigate the effect on collateral availability of possible rating downgrades resulting from the economic fallout from the COVID-19 pandemic.

Our monetary policy measures support the continued flow of credit to households and firms via the banking system, which is the main source of external finance for firms, especially smaller firms. The annual growth of loans to non-financial firms increased to 6.6% in April (from 5.5% in March), driven by drawdowns of credit

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[1] For more details, see Survey on the Access to Finance of Enterprises in the euro area – October 2019 to March 2020

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lines in response to the impact of the COVID-19 pandemic, substantial demand for new loans to cover ongoing payment obligations, precautionary borrowing to bridge potential liquidity shortfalls as well as public support measures, such as loan guarantees. In line with this, euro area banks reported a surge in demand for short-term bank loans, from both SMEs and large firms, in the euro area bank lending survey (BLS) for the first quarter of 2020, owing to firms' acute liquidity needs in the context of the COVID-19 pandemic. Euro area banks have also indicated only a contained net tightening of their lending standards for loans to euro area firms, which was significantly smaller than seen during the financial and sovereign debt crises. Importantly, in the first quarter, the tightening was broadly similar for loans to SMEs and to large firms. Developments in bank lending rates in April also show that the spread between the interest rates charged on very small loans – taken as a proxy for SME loans – and large loans has decreased. This signals that the support measures introduced by governments, supervisors and central banks are indeed helping to mitigate the effects of the COVID-19 pandemic on bank lending for both SMEs and large firms. Euro area banks have also indicated in the BLS that the ECB's asset purchase programmes and the third series of targeted longer-term refinancing operations (TLTRO III) have had a positive impact on their liquidity positions and market financing conditions. This, in turn, contributed to a favourable transmission of the ECB's monetary policy measures to bank lending conditions and lending volumes, as signalled by banks in the BLS.

In addition, ECB Banking Supervision has taken a number of measures to ensure that banks can continue performing their vital function of servicing the real economy. In particular, it has allowed banks to temporarily operate below the level of capital defined by the Pillar 2 guidance and encouraged them to fully use their capital buffers. This will allow banks to absorb losses in the deteriorated macroeconomic environment and to continue lending to customers, especially SMEs, severely hit by the crisis.

With regard to the distribution of bank profits, ECB Banking Supervision deems it vital to keep as much capital as possible within the banking sector at this stage. Therefore, it has recommended that, until at least October 2020, banks do not distribute dividends to shareholders for the 2019 and 2020 annual reporting periods, a recommendation that has been largely followed. Banks should also refrain from share buy-backs aimed at remunerating shareholders. Furthermore, on 8 June 2020, the European Systemic Risk Board (ESRB) recommended that relevant authorities request financial institutions to refrain from paying dividends, and from making certain other pay-outs, until 1 January 2021.

The measures we have taken since early March form a powerful package and are providing crucial support to the euro area economy, notably to those sectors most exposed to the crisis. At the same time, in the current rapidly evolving economic environment, we remain fully committed to doing everything necessary within our mandate to support all citizens of the euro area through this extremely challenging time. This applies first and foremost to our role in ensuring that our monetary policy is transmitted to all parts of the economy and to all jurisdictions in the pursuit of our price stability mandate. The Governing Council, therefore, continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

Yours sincerely,

[signed]

Christine Lagarde