

21 January 2021

RECOMMENDATIONS FOR THE ECB'S STRATEGIC REVIEW

KEY MESSAGES



1 European companies need predictable and stable conditions to conduct their business. We strongly support the ECB's mandate of guaranteeing price stability, and urge the ECB to explore ways to credibly get price developments back on a trajectory consistent with the ECB's objective.

2 When the ECB carries out asset purchases it is crucial that it is done with a view to maintaining market neutrality. As a non-political body the ECB should not be setting political priorities and goals that amount to effectively subsidizing certain types of investments and assets over others. The ECB must therefore forcefully reject calls to put priority in its purchases e.g. on SME-assets, or "green" private assets.

WHAT DOES BUSINESSEUROPE AIM FOR?



- *The ECB must explore ways to get price developments back on a trajectory consistent with the ECB's objective*
- *Asset purchases must be done with a view to maintaining market neutrality. Although e.g. "green" bonds, social bonds etc. should be eligible for purchase "on normal terms" the ECB should not unduly prioritize them.*



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The ECB is currently undertaking a comprehensive Strategic Review, its first since 2003. The review was formally commenced in February 2020 with a view to completing it by the end of the year, but due to the COVID-19 pandemic the time frame has been moved, so that it is not foreseen to run until mid-2021.

ECB MUST EXPLORE WAYS TO GET PRICE DEVELOPMENTS BACK ON A TRAJECTORY CONSISTENT WITH ITS MEDIUM-TERM OBJECTIVE

European companies need predictable and stable conditions to conduct their business. This includes among other factors stable price developments. We therefore reiterate our strong support to the ECB's mandate of guaranteeing price stability.

Clearly the past years have seen inflation at levels far below the objective. Very low inflation, and the threat of deflation, is a concern for European business. At macroeconomic level the sovereign debt crisis of the 2010's illustrated that the debt burden is hard for heavily-indebted countries to deal with in the context of inflation considerably below the expected target. At the level of individual companies, while too high inflation is damaging, ultra-low inflation can also be undesirable as it can obstruct the wage-adjustment mechanism in that companies can normally respond to downturns by keeping nominal wages fixed, allowing real wage to be adjusted downwards if necessary. Losing this possibility is particularly problematic in less flexible labour markets, which in international comparison is characteristic of many EU countries. In other words, the failure to maintain an inflation level around the desired level is harmful to European competitiveness and ability to respond to a downturn.

The ECB must therefore reaffirm its commitment to price stability in the medium run and explore ways to credibly get price developments back on a trajectory consistent with the ECB's objective.

In light of these significant deviations of actual inflation from the inflation target in the Euro Area, the ECB should carefully assess its monetary policy toolbox. Asset purchases, forward guidance, and yield curve controls have become important tools for central banks recently, including to some extent by the ECB, and the US Federal Reserve has recently adopted a symmetric medium-term inflation target. Closer analysis of lessons learned so far, and of the potential appropriateness of considering a similar modification to the ECB's inflation target, seems warranted. In the same vein the ECB has undertaken crisis-related deviations of its allocation rules for sovereign bond purchases, and whilst this seems



appropriate in this context a balanced approach should be maintained. Another recent development has been crisis-related deviations to banking regulation and supervision, and while a welcome development to help sustain the flow of liquidity to non-financial corporations and households these policy measures also warrant closer analysis.

In recent years the ECB has repeatedly called on member states to do more to support the recovery, instead of letting monetary policy be 'the only game in town'. It is important that the ECB continues to engage with member states, as effective fiscal policy and not least structural reforms are absolutely key to ensuring Europe's long-term prosperity and growth.

DEFLATIONARY MACROECONOMIC CONDITIONS INCREASE NEED TO FIND WAYS TO KEEP PRICE DEVELOPMENTS AT DESIRED LEVEL

The COVID-19 crisis has had perverse effects on price developments, as supply has been disrupted, many types of goods and items have become unavailable, and certain segments of the markets (including higher-end shops) have been under lockdowns, whilst others (such as online retailers) have experienced higher-than-usual sales. Whilst we caution against reading too much into current extraordinary circumstances, at the same time we cannot ignore the fact that price developments seem to diverge from rather than converge to the ECB's policy objective.

At the same time, the COVID-19 epidemic has also caused a substantial in global demand, what looks like a permanent destruction of human and physical capital, a drop in innovation and investments, which taken together will cause a drop in potential output over a short-to-medium time horizon. Moreover, in the medium-term, the macroeconomic fiscal effect of the COVID-19 pandemic will likely be deflationary and characterized by corporate deleveraging and balance-sheet repair.

The ECB needs to evaluate and pay close attention to these developments as they may cause permanent scarring of our economy, reduce the effectiveness of monetary policy, and generally weigh on monetary policy for the foreseeable future. There will be a need for a balanced approach that takes into account both the need to sustain the recovery and the need to tackle non-performing loans and overly weak balance sheets in the corporate sector.

ASSET PURCHASES MUST MAINTAIN MARKET NEUTRALITY AS CORNERSTONE

The asset purchase programmes launched by the ECB have been the center of a number of important discussions concerning among other issues the collateral framework, which diverges on a number of points from e.g. the central bank practices in the United States. The regulatory setup is important particularly in



times of crisis with liquidity in capital markets temporarily dropping, and its ramifications should be closely analyzed by the ECB as part of the ongoing review.

Moreover, the non-financial corporate sector has likely benefited from the environment of plenty liquidity at low interest rates. The emergence of a more liquid corporate bond market in the Euro Area is also a welcome development. However, low interest rates can also create problems for the financial sector as well as for non-financial asset management corporations, as they may struggle to find it difficult to achieve positive nominal returns on pension obligations and other assets. We believe these developments need further study in the ECB's ongoing review, particularly in light of the fact that we seem to be experiencing a longer-term trends towards falling returns on capital that puts increasing pressure on financial institutions.

We believe that acting to guarantee price stability also implies within the provisions of the EU treaties, a role for the ECB in preserving the integrity of the euro, which is of vital importance to the well-being of European businesses. Thus whilst the present round of asset purchases as well as the, as yet unused, Outright Monetary Transactions (OMT) tool are in place primarily to preserve the monetary transmission mechanism, we welcome the role they are also playing in supporting the integrity of the Euro.

However, when the ECB carries out asset purchases, it is crucial that it is done with a view to maintaining market neutrality. As a non-political body the ECB should not be setting political priorities and goals that amount to effectively subsidizing certain types of investments and assets over others. This requires the ECB to forcefully reject, in particular, calls to put priority in its purchases on SME-assets, or "green" private assets (however defined), although such bonds should be eligible for purchase "on normal terms" without such undue prioritizing as part of the ECB's general asset purchase programmes.

Public schemes exist that support such investments, including at EU level through the European Investment Bank and the EU budget (Multiannual Financial Framework). The ECB, however, should stay clear of such schemes that for a central bank would constitute an unfair and discriminatory practice.

DIGITALISATION AND DIGITAL EURO

We welcome the ECB's focus on cryptocurrency and cyber security as important areas that will require substantial attention in coming years. This work will also be important for European business as technological advancements make these issues ever more pertinent, and we look forward to exchanges in future. The ECB is also exploring the possibility of introducing a digital euro. We will respond to the currently ongoing public consultation in due course.



COMMUNICATION AND EXTERNAL RELATIONS

The ECB has rightly been focusing on making its work and decisions more accessible to a non-technical audience. This should continue and can be expanded. In particular, the ECB must continue to ensure that its decisions are communicated as clearly, transparently and as quickly as possible. Whilst the events of the COVID-19 crisis have created particular challenges, we must avoid a situation such as in the spring where details of an ECB decision (that Greek bonds would be eligible under the Pandemic Emergency Purchase Programme) emerged a few days after the decision had been made through the EU's Official Journal, rather than directly from ECB officials.

Closer engagements with both the financial and the non-financial private sector may help the ECB's forward guidance work better, and the ECB could explore opportunities for stepping up its engagement with business representatives e.g. through increased inclusion in formal events, conferences or similar fora to facilitate dialogue, both at European level and at the national level with exchanges between social partners and their respective national central banks.
