

ARTICLES

THE ECB'S MONETARY POLICY STANCE DURING THE FINANCIAL CRISIS



The ECB's assessment of its monetary policy stance is essential for the preparation of its monetary policy decisions. That assessment aims to determine whether monetary policy is contributing to economic, financial and monetary developments in a way that maintains price stability over the medium term. It is one of the important inputs that are examined by the Governing Council of the ECB when deciding on its monetary policy.

The ECB's response to the intensification of the financial crisis in the autumn of 2008 is a good illustration of this process – from the assessment of the monetary policy stance to the decision to adjust it, followed by the signalling and implementation of the appropriate stance. The ECB's broad-based and medium-term-oriented monetary policy strategy has guided the design and implementation of the monetary policy stance during the crisis. Specifically, maintaining price stability over the medium term has required the rapid lowering of the key ECB interest rates, as well as non-standard measures to ensure their effective transmission to the economy, with a view to tackling the financial crisis and cushioning its impact on the real economy. Thus, the ECB has embarked on a policy of enhanced credit support. These exceptional measures are of a temporary nature and will be phased out gradually, progressively and in a timely manner when financial conditions improve or if these measures begin to pose risks to the ECB's primary objective of maintaining price stability.

I INTRODUCTION

Good decisions rely on comprehensive information, sound analysis and good judgement. Central banks' decisions rely on an assessment of their monetary policy stance. That stance can be defined as the contribution made by monetary policy to economic, financial and monetary developments. Monetary policy actions affect the setting of market interest rates and prices in the economy through various channels, thereby influencing economic activity and/or inflation in a process known as "monetary policy transmission". Thus, the assessment of the monetary policy stance can be defined as determining whether the contribution made by monetary policy actions is appropriate in view of the central bank's objectives. It is on the basis of its assessment of the monetary policy stance that a central bank calibrates its actions.

In the case of the ECB, the primary objective, as assigned by the Treaty on the Functioning of the European Union, is to maintain price stability. Thus, the Governing Council of the ECB assesses whether the impact that monetary policy is having on the economy and ultimately price stability – i.e. its monetary policy stance – is appropriate in order to achieve its primary objective, taking into account all the

factors that affect the medium-term inflation outlook. The stance deemed appropriate at the previous monetary policy meeting may require adjustment, with new information having become available. The Governing Council then decides on the monetary policy course that will realign its stance with the price stability objective.

The severity of the financial crisis since the autumn of 2008 and its spillover to the real economy, together with the resulting high levels of uncertainty, have complicated both the assessment of risks to price stability and the way in which monetary policy is able to influence the euro area economy in order to ensure price stability. In such circumstances, the maintenance of price stability over the medium term has required both the rapid lowering of the key ECB interest rates and the introduction of temporary measures to ensure their effective transmission to the economy, with a view to tackling the financial crisis and cushioning its impact on the real economy. As economic and financial conditions have now improved, not all exceptional measures are needed to the same extent as in the past. Indeed, continuing them could even have adverse economic and financial effects.

Against this background, this article describes the way in which the ECB has assessed,

signalled and implemented the monetary policy stance in the context of the recent financial crisis. Section 2 describes the ECB's assessment of the monetary policy stance in normal times, and Section 3 shows how the financial crisis has complicated both the assessment of that stance and the signalling and implementation of the desired stance. Section 4 discusses the need for the progressive, gradual and timely phasing-out of the extraordinary measures adopted in response to the crisis against the background of the assessment of the monetary policy stance. Section 5 concludes.

2 THE MONETARY POLICY STANCE IN NORMAL TIMES

2.1 THE ECB'S MONETARY POLICY DECISIONS ARE BASED ON AN ASSESSMENT OF ITS STANCE

With the monetary policy stance defined as the contribution made by monetary policy to economic, financial and monetary developments, the assessment of that stance involves looking at whether this contribution is in line with the central bank's objective. In the case of the ECB, therefore, this assessment involves two elements: i) the formation of a view on the medium-term inflation outlook, and risks to price stability in particular; and ii) the identification of the contribution that monetary policy (i.e. its current and, given transmission lags, past conduct) makes to the euro area economy and the maintenance of price stability.

Assessing the monetary policy stance in real time is always a challenging exercise. The assessment must take account of the uncertainty surrounding current and future economic conditions and the functioning of the economy, including the transmission of monetary policy itself. Given the uncertainty surrounding any such judgements in real time, the assessment must be broad-based and forward-looking, encompassing all the information relevant to the formation of a view on the risks to price stability in the medium term, including the potential

influence of monetary policy. The monetary policy strategy of the ECB ensures a broad-based and medium-term-oriented assessment of the monetary policy stance. In particular, the strategy has a two-pillar structure – comprising both an economic analysis and a monetary analysis – which provides two complementary perspectives on the determination of price developments.¹ The Governing Council decides on the appropriate monetary policy stance by cross-checking the indications regarding risks to price stability that stem from the economic analysis with those derived from the monetary analysis. In this cross-checking, all complementarities between the two pillars are exploited. Thus, the assessment of the monetary policy stance takes account of a broad range of economic, financial and monetary data, using a variety of models and analyses. An element of judgement, based on accumulated experience, is also essential.

This broad-based and medium-term-oriented assessment of the monetary policy stance ensures the robustness of policy decisions. It reduces the risk of policy error as a result of over-reliance either on a single forecast or model or on summary indicators of the monetary policy stance (such as indicators derived from natural interest rates, Taylor rules, and monetary and financing conditions indices). The approach adopted by the Governing Council ensures that all the information relevant for the assessment of future prices is used in a consistent and efficient manner, facilitating both the decision-making process and its communication.

2.2 SIGNALLING AND IMPLEMENTING THE DESIRED STANCE

In order to achieve the monetary policy stance that is appropriate for maintaining price stability over the medium term, the Governing Council first sets the key ECB interest rates. Under normal circumstances, these key rates are the

¹ See Chapter 3 of the special edition of the Monthly Bulletin (entitled "10th anniversary of the ECB") published in May 2008.

minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility, which form a corridor around the minimum bid rate. The Eurosystem then steers short-term market interest rates within this corridor, and normally towards the minimum bid rate, by means of its monetary policy operations. The transmission of monetary policy to the economy begins with these short-term interest rates and ultimately influences price developments. The ECB's communication supports the signalling and achievement of the desired stance.

SEPARATION BETWEEN MONETARY POLICY DECISIONS AND OPERATIONS

The overriding principle underlying the Eurosystem's operational framework for the implementation of the monetary policy stance is the concept of operational efficiency. The operational framework supports monetary policy's fulfilment of the ECB's price stability mandate by letting monetary policy decisions feed through as quickly and precisely as possible to short-term money market rates. It implies a dividing line between monetary policy decisions and the implementation of the desired stance through monetary policy operations. In line with the ECB's mandate, monetary policy decisions are geared towards the maintenance of price stability (and include, in particular, the setting of key ECB rates that signal the monetary policy stance). Following the monetary policy decisions, the monetary policy operations keep short-term money market interest rates in line with the level determined by monetary policy decisions. In normal times, the separation principle calls for the euro overnight index average (EONIA) to be very close to the main policy rate. In exceptional circumstances, when spreads in the money market (e.g. those between the euro interbank offered rate (EURIBOR) and the rates on overnight index swaps (OISs)) were abnormally high, the Governing Council decided to adopt a fixed-rate full-allotment approach in all refinancing operations. This has helped to offset anomalies in money market interest rate spreads and contributed to the EONIA fluctuating at levels closer to the deposit rate (see Section 3).

IMPLEMENTATION AND TRANSMISSION

The implementation of the monetary policy stance takes place via the Eurosystem's operational framework. Monetary policy operations mark the start of the transmission of the monetary policy stance by steering the marginal cost of banks' refinancing. Broadly speaking, the Eurosystem does so by allocating an amount of liquidity that allows euro area credit institutions to fulfil their liquidity needs at a price that is in line with the key interest rates set by monetary policy-makers. These liquidity needs comprise the liquidity necessary in order to accommodate the reserve requirements that the ECB imposes on credit institutions, as well as changes in factors which cannot be directly influenced by the Eurosystem, called "autonomous factors" (e.g. banknotes in circulation and government deposits held with the Eurosystem). More precisely, the ECB usually conducts its main refinancing operations as variable rate tender procedures for which the minimum bid rate applies.

Short-term money market interest rates such as the EONIA are normally steered in line with the minimum bid rate, following the allotment in the main refinancing operations of an amount of liquidity that allows credit institutions to smoothly fulfil their reserve requirements in the course of a maintenance period (which is a period of around a month). This allotment amount in the main refinancing operations takes into account not only liquidity needs resulting from "autonomous factors", but also liquidity supplied by means of other operations, normally longer-term refinancing operations. The interest rates on the ECB's standing facilities effectively limit the range of variation in overnight interest rates: the marginal lending facility allows credit institutions to receive ECB liquidity on an overnight basis, while the deposit facility allows them to deposit liquidity surpluses overnight.²

² The implementation of monetary policy both in normal times and in the various phases of the crisis is described in detail in the article entitled "The implementation of monetary policy since August 2007" in the July 2009 issue of the Monthly Bulletin.

The transmission of monetary policy to the real economy begins with those short-term money market interest rates. Ultimately, monetary policy influences price developments. Changes in money market interest rates are thus transmitted to bank lending rates. This affects variables such as money, credit growth and asset prices. These in turn, together with external factors, lead to changes in macroeconomic demand and supply, and ultimately changes in inflation.

THE ECB'S COMMUNICATION ON THE MONETARY POLICY STANCE

The ECB's communication policy forms an essential element of the transmission of monetary policy. The ECB's transparent communication contributes to the effective and efficient implementation of the monetary policy stance.

First, explaining the assessment of the monetary policy stance that underlies the decisions taken raises the general public's and the markets' awareness and understanding of the ECB's monetary policy decisions. In this respect, the two-pillar structure used in the assessment provides a systematic framework not only for internal decision-making (as indicated above), but also for external communication with the public. Using the same framework for internal and external purposes has helped the ECB to ensure that its monetary policy remains consistent, credible and effective.

A second, related point is that good communication helps private agents to understand the contribution that monetary policy is intended to make to economic and price developments over time. Indeed, to the extent that communication helps markets to better understand monetary policy responses to economic developments and shocks, it also assists them in anticipating the broad direction of monetary policy over the medium term. This implicit guidance tends to reinforce the predictability of policy developments over time. It affects expectations regarding the future path of interest rates, thereby making policy more effective.

Third, credible communication on the ECB's firm commitment to its objective serves to anchor inflation expectations, thereby facilitating the conduct of monetary policy.³ The ECB's readiness to act (its "credible alertness"), its steady-handed approach and its communication together facilitate the efficient use of its interest rate instrument.

Overall, communication explains the rationale underlying monetary policy decisions, guides expectations in a manner consistent with the assessment of the central bank and helps to anchor expectations in line with price stability. Thus, the ECB's communication is instrumental in the implementation of the desired stance, as it helps to align the understanding and expectations of the public and the markets with this desired stance and the ultimate price stability objective.

3 THE MONETARY POLICY STANCE DURING THE RECENT CRISIS

The financial crisis has complicated both the assessment determining the monetary policy stance that is appropriate for the maintenance of price stability and the signalling and implementation of that stance.⁴

3.1 ASSESSING THE MONETARY POLICY STANCE DURING THE CRISIS

AN ASSESSMENT IN THE PRESENCE OF HEIGHTENED UNCERTAINTY

Assessing the monetary policy stance is already challenging in normal times. It is even more

3 At the same time, this anchoring minimises costs in contractual relationships (by reducing inflation risk premia). More generally, by providing an anchor of stability in a world of economic fluctuation, the ECB should have a positive effect on the confidence of economic agents at times of uncertainty, possibly also allowing for a more sustainable and rapid correction of economic downturns. This anchoring of inflation expectations thereby fosters an environment which is conducive to sustainable economic growth and employment in the euro area.

4 For more details concerning the information in this section, see the speeches given by the President of the ECB on 13 July 2009 in Munich, on 22 August 2009 in Jackson Hole and on 4 September 2009 in Frankfurt am Main.

challenging when the economic situation is changing rapidly and there is a high degree of uncertainty. When the financial turmoil emerged, and especially when it intensified in the aftermath of the collapse of Lehman Brothers in September 2008, the assessment of the monetary policy stance had to be conducted in an environment of heightened uncertainty. Given the exceptional circumstances, regularities observed in normal times could not be relied upon when interpreting developments in many economic and financial variables. This meant that standard models and projections based on such regularities were less reliable than in the past.⁵ Uncertainty surrounded both the nature of the shocks affecting the euro area economy and the functioning of the economy itself. Notably, it was difficult to gauge in real time the nature and extent of financial developments and their spillover to the real economy. With confidence evaporating in the interbank market and the money market becoming dysfunctional, the transmission of monetary policy itself was disrupted. Indeed, in the euro area, the first phase of the transmission process relies to a large extent on intermediation within the banking sector. As a result, it was more difficult to gauge the two central elements of the stance assessment as described in Section 2.1, namely: i) the outlook for price stability over the medium term; and ii) the contribution that monetary policy ultimately makes to that outlook.

ITS BROAD-BASED APPROACH HAS SERVED THE ECB PARTICULARLY WELL

The benefits of the ECB's broad-based two-pillar approach to the assessment of the monetary policy stance have been particularly visible during the financial crisis. To ensure the appropriate policy response, it is essential to look beyond volatility in economic and financial data and understand underlying developments. In the presence of such heightened uncertainty, the ECB's broad-based approach in its monetary policy strategy has allowed policy-makers to obtain a more comprehensive and accurate overall picture of underlying developments and the associated risks to price stability. In particular, the economic analysis has helped

the ECB to understand the impact that external factors (e.g. developments in oil prices and specific market segments such as the US sub-prime market) have on the euro area economy, as well as the links between the financial sphere and the real economy. The economic analysis has also helped the ECB to understand and anticipate the reversal of the inflationary trend associated with previous large increases in energy prices. This has avoided any possibility of the disinflation observed in 2009 being confused with outright deflation and triggering inappropriate policy reactions. The monetary analysis has helped to maintain a medium-term perspective, given the fundamental link between money and inflation over longer horizons. It has also helped to improve the understanding of developments in monetary aggregates, banks' balance sheets, money markets, asset prices and credit flows, which have been of crucial interest given the financial origins of the economic downturn.⁶

The picture of underlying developments included in the ECB's assessment of the monetary policy stance has, in turn, formed the basis for the interest rate decisions taken and the non-standard measures adopted. Notably, that understanding of the distortions affecting the transmission mechanism and the identification of the channels through which the financial turmoil could potentially spill over to the real economy have guided the design of the monetary policy action taken in order to contain these spillovers and the related risks to price stability over the medium term.

3.2 THE MONETARY POLICY RESPONSE

In the exceptional circumstances created by the financial crisis, the ECB's signalling and implementation of its monetary policy stance has involved not only interest rate decisions, but also non-standard measures.

5 See the article entitled "The latest euro area recession in a historical context" in the November 2009 issue of the Monthly Bulletin.

6 See the article entitled "Monetary analysis in an environment of financial turmoil" in the November 2009 issue of the Monthly Bulletin.

At the beginning of the financial turmoil, when access to liquidity in money markets became severely hampered in August 2007, the Eurosystem reacted swiftly to ensure that this did not lead to a major systemic financial crisis. It reacted mainly by amending the timing and maturity of its liquidity-providing operations to accommodate the funding needs of banks. In addition, it provided liquidity in foreign currencies. Following the collapse of Lehman Brothers, the turmoil escalated into a financial crisis, which rapidly spread to the global financial system and caused a severe downturn in the euro area economy, resulting in subdued inflationary pressures. In response to these developments, the Governing Council adopted a number of standard and non-standard measures. Thus, given the changes in the assessment of risks to price stability, the Governing Council cut the ECB's key interest rates by 325 basis points to 1%, a level not seen in the countries of the euro area since at least the Second World War.

As the functioning of the financial system – and the money market in particular – was severely hampered, the Governing Council adopted a number of non-standard measures to guard further against a systemic liquidity crisis in the euro area financial system, to support the transmission of its interest rate decisions and to enhance the flow of credit to households and corporations.

ENHANCED CREDIT SUPPORT

The ECB's "enhanced credit support" comprises non-standard measures that support financing conditions and credit flows above and beyond what could be achieved through reductions in key ECB interest rates alone.

This approach has been tailored to the financial structure of the euro area economy and the specific circumstances of the global financial crisis. It has focused on banks, as in the euro area banks are the primary source of financing for the real economy. Indeed, the bulk of the external financing of non-financial corporations comes from the banking sector. The banking sector is especially important when it comes to

providing financing to small and medium-sized enterprises, which in turn play a key role in the euro area economy. As regards the specific circumstances of the crisis, two factors have been particularly important. First, given the systemic liquidity threat posed by the crisis, the measures have focused on ensuring that banks have broad and deep access to central bank liquidity in these exceptional circumstances. Second, with euro area banks' access to foreign currency interbank markets severely impaired, the ECB has decided to provide liquidity to the euro area banking sector in US dollars in exchange for euro-denominated collateral. This is backed by the swap facility that the ECB has arranged with the US Federal Reserve.⁷ More specifically, the enhanced credit support comprises a set of five measures:

1. the provision to euro area banks of unlimited liquidity at a fixed rate in all refinancing operations against adequate collateral;
2. the lengthening of the maximum maturity of refinancing operations from three months prior to the crisis to one year;
3. the extension of the list of assets accepted as collateral;
4. the provision of liquidity in foreign currencies (notably US dollars); and
5. outright purchases in the covered bond market.

These measures focus on the banking sector, with the first four dealing with the provision of liquidity in euro and foreign currencies. The decision to purchase covered bonds outright was taken in order to support the covered bond market, which is a very important financial market in Europe and a primary source of financing for banks. This measure has fostered primary issuance and reduced the particularly elevated spreads in this market.

⁷ The ECB has also established swap facilities for Swiss francs and Swedish kronor.

These enhanced credit support measures constitute the ECB's approach to non-standard policy-making in the context of the recent financial crisis. They are not comparable with the US Federal Reserve's "credit easing" and the "quantitative easing" conducted by the Bank of Japan and the Bank of England. The major central banks of the world are all united in purpose, but they act in economies and institutional contexts that are very different. In the United States, for example, it is financial markets – and not banks – that are the primary source of external financing for firms. This explains why there is a much stronger focus on outright financial market purchases in the United States. In addition, differences in institutional arrangements may have an impact on the operational frameworks of central banks.

TEMPORARY LOOSENING OF THE CLOSE LINK BETWEEN POLICY AND MARKET INTEREST RATES

In these exceptional circumstances, the signalling of the monetary policy stance has become more complex. The close relationship that normally exists between the main refinancing rate and money market rates has taken on a different and more complex form. The decision to shift to a fixed rate tender procedure with full allotment in refinancing operations (rather than providing liquidity through competitive auctions) and the lengthening of the maximum maturity of operations to one year for a temporary – but extended – period have been necessary in order to mitigate the effects of the impaired functioning of the money market. Market participants' strong demand for liquidity, which has been fully accommodated by the Eurosystem, has caused overnight money market rates to fall significantly below the main refinancing rate and relatively close to the deposit rate. In this respect, the non-standard measures have temporarily led to a different relationship between monetary policy decisions and monetary policy operations. The new positioning of the overnight money market rate was considered acceptable in these exceptional

circumstances as a means of helping to offset the impaired functioning of the money market and, in particular, the abnormally high level of spreads on the term money market rates. In this context, the deposit rate has played a more prominent role than in the past with respect to the EONIA and other very short-term money market interest rates.

A STANCE GEARED TOWARDS PRICE STABILITY

Monetary policy's response to the financial crisis has been geared towards the achievement of the ECB's price stability objective. The firm anchoring of medium-term inflation expectations is essential in order to support sustainable growth and employment and contribute to financial stability.

The ECB's actions have supported both the banking sector's access to liquidity and the recovery of the euro area economy, thereby allowing the implementation of a monetary policy stance which is appropriate for maintaining price stability over the medium term. The measures adopted in response to the intensification of the financial crisis have contributed to the normalisation of economic and financial conditions. In particular, the measures implemented by the Eurosystem have supported credit flows to the economy through both supply factors (notably by alleviating funding pressures in the banking sector) and demand factors (owing to the very low level of interest rates). In addition, by emphasising its firm focus on the price stability objective and its readiness to act, and by acting accordingly, the ECB has presented itself as an anchor of stability in times of heightened uncertainty. This has been instrumental in fostering confidence in the context of the very weak economic activity foreseen in the short term. Throughout the crisis, medium to longer-term inflation expectations in the euro area have remained firmly anchored in line with the Governing Council's definition of price stability, with inflation rates below, but close to, 2% over the medium term.

4 THE PHASING-OUT OF NON-STANDARD MEASURES

The primary objective of price stability – which has led to monetary policy being implemented by means of both standard and non-standard measures in response to the subdued inflationary pressures observed during the financial crisis – also means that a return to a more normal monetary policy framework is a natural aim.

All of the non-standard measures adopted have been designed with their phasing-out in mind. Most of the measures unwind naturally in the absence of an explicit decision to prolong them. In addition, the ECB has the ability to act whenever it deems this necessary. In particular, the ECB's high degree of institutional independence means that it is unrestricted in its ability to implement the appropriate decisions, and the operational framework incorporates the necessary flexibility. In part as a result of the measures adopted by the ECB, financial conditions have first stabilised and then improved. The extraordinary conditions that led the Governing Council to adopt the non-standard measures will gradually fade away, and the extraordinary liquidity measures will not be needed to the same extent as in the past.

Consequently, the Governing Council decided at its meeting on 3 December 2009 to gradually phase out those non-standard measures that were no longer needed, beginning in the first quarter of 2010, while continuing with some other components. In particular, the number and frequency of longer-term refinancing operations is gradually being scaled back. The last one-year operation was conducted in December 2009, one final six-month operation will be conducted in March 2010, and the number of three-month operations is being reduced as of the first quarter of 2010.

The decision to initiate the gradual phasing-out of these measures reflects, as indicated, the improvements observed in financial conditions. Money markets are performing better, and the

past reductions in the ECB's key policy rates are increasingly being reflected in the interest rates on bank loans to households and corporations, indicating that the transmission process is broadly functioning. In such an environment, the gradual phasing-out of some non-standard measures is not expected to have a negative impact on financing conditions.

At the same time, the timing of the decision to begin phasing out those measures reflects the fact that there would have been an increased risk of adverse side effects had all measures been extended in the current circumstances. Improvements in financial conditions allow banks to begin performing part of their "normal" role in the money market, thereby reducing the intermediation role of the Eurosystem. Keeping all of the non-standard measures in place when they are no longer needed could induce distortions such as excessive reliance on exceptional central bank liquidity and associated moral hazard problems. In addition, the continuation of all elements of the enhanced credit support in the context of improving financial conditions could result in weak financial incentives to restructure banks' balance sheets and delay the necessary adjustments. In the presence of accommodative interest rates, excess liquidity could also lead to excessive risk-taking.

The decision to phase out some of the non-standard measures reflects the gradual approach that the ECB has adopted. These initial steps allow account to be taken of the way in which financial conditions and financial market participants react to the ECB taking on a smaller role as a money market intermediary. In addition, the continued high degree of uncertainty and the ECB's steady-handedness argue in favour of a gradual approach.

In particular, the fact that non-standard measures have begun to be phased out does not mean the discontinuation of enhanced credit support. The Eurosystem will continue to provide liquidity to the banking system at very favourable conditions. At the same time, the economy is continuing to benefit from the

gradual pass-through of past decreases in key ECB interest rates. Against the background of improving financial and economic conditions, the phasing-out of non-standard measures should not necessarily imply a tightening of the monetary policy stance.

Looking to the future, the gradual phasing-out of non-standard measures will allow a gradual return to a more standard implementation of monetary policy. The main refinancing rate should regain its key role in the signalling and implementation of the monetary policy stance – and, in turn, in the assessment of the monetary policy stance itself. This would allow a full return to the clear distinction between monetary policy decisions and their implementation. This will facilitate the implementation of monetary policy, as it enables monetary policy decisions to feed through as quickly and precisely as possible to short-term money market rates as the first stage of the transmission process. It should be noted that the operational framework is flexible, allowing control over interest rates even without the phasing-out of non-standard measures. From a forward-looking perspective, extraordinary liquidity measures that are not needed to the same extent as before will gradually and progressively be phased out at the appropriate time. In order to effectively counter any threat to price stability over the medium to longer term, relevant measures will be phased out when necessary. In this way, the Governing Council will continue to ensure the firm anchoring of medium-term inflation expectations.

5 CONCLUSION

The ECB assesses the monetary policy stance by adopting a broad-based, forward-looking approach. The benefits of applying this approach have been particularly visible during the financial crisis. In particular, it has allowed policy-makers to obtain a meaningful assessment of underlying developments and associated risks to price stability in an environment marked by a high level of uncertainty. The outlook for price

stability has changed fundamentally in the course of the crisis. The ECB has responded to this change by strongly and rapidly lowering its key interest rates. In addition, dysfunctional money markets have weakened the ability of monetary policy to influence this outlook by means of interest rate decisions alone. Thus, with a view to supporting the effective transmission of monetary policy and cushioning the impact on the real economy and the medium-term inflation outlook, the ECB has adopted a number of non-standard measures. The ECB's enhanced credit support has aimed to ensure the flow of credit to households and corporations.

Because of their exceptional nature, these non-standard measures have to be gradually phased out once the situation in financial markets normalises and the transmission of monetary policy begins to function normally again. Keeping these measures in place for too long would lead to distortions and would not provide the banking sector with appropriate incentives conducive to sustainable economic growth and stable price developments in the longer term. At the same time, the effects of the sizeable policy interest rate cuts and the enhanced credit support will continue to feed through to the economy even after the phasing-out of the non-standard measures has begun.