Governing Council
European Central Bank
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ECB Pandemic Emergency Purchase Programme PEPP - Impact on European pension funds and the role of the ECB to support balanced growth, full employment and sustainable development of EU economies

Dear Members of the Governing Council

The primary objective of the ESCB is to maintain price stability. However, in addition the legislation requires that "without prejudice to the objective of price stability, it shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union" (Article 2, Protocol (No 4) on The Statute of the European System Of Central Banks and of the European Central Bank and TFEU article 127 and TFEU article 282.2). The reference to Article 3 of the Treaty on European Union is essential as it defines the Union's aims, which include, among others, work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress as well as that It shall promote economic, social and territorial cohesion, and solidarity among Member States.

Thus, the duty of the ESCB is to support balanced growth, full employment and sustainable development of EU economies, not just the Eurozone economies. The basic aims of the EU need to be taken into consideration in considering the actions of the ECB.

The ECB announced recently (30 April) that it is fully prepared to increase the size of the Pandemic Emergency Purchase Programme (PEPP), and adjust its composition, by as much as necessary and for as long as needed. Accordingly, the Governing Council of the ECB has (5 May) stressed that the ECB remains fully committed to doing everything necessary within its mandate to ensure that inflation rises to levels consistent with its medium-term aim and that the monetary policy action taken in pursuit of the objective of maintaining price stability is transmitted to all parts of the economy and to all jurisdictions of the Europozone (EZ).

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As the European umbrella organisation representing pensions in Europe[1], we believe and agree that the main contribution the ECB can make to improving Europeans' welfare is, indeed, to maintain price stability. If the rate of inflation is low and stable, the situation is consistent with price stability.

Pension funds are concerned about too high inflation, as it could jeopardize an adequate (real) old age pension by diminishing the purchasing power. On the other hand, pension funds are also concerned about deflation, as it often goes hand in hand with very low interest rates which are challenging to pension funds' coverage ratios and make benefits (annuities) more expensive.

Stability in economy and financial markets, which also unconventional monetary policy can support, is important to pension funds as long-term investors tend to buy and hold most investments. Low economic growth/recession leads to lower returns (and therefore pensions), and swings in asset valuations can lead to pension funds having the need to rebalance their investment portfolios, which can create unnecessary trading costs to the detriment of the pension scheme members and beneficiaries.

In addition to monetary policy it is important that the ECB considers the economic impact its actions have and supports EU economies. Healthy economy and full employment are vital for pension funds in Europe.

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The European pension funds have seen that the ECB unconventional monetary policy, including the PEPP, has had effects in several areas – with various positive and negative side effects. Pension funds have profited from it for instance via higher returns on some of their investments. On the other hand, unconventional monetary policy has also led to lower funding ratios for defined benefit (DB) pension schemes, and as a consequence, some sponsors and members have felt the burden of higher contributions and lower pension accrual (for both DB and defined contribution (DC) pension schemes).

The PEPP has contributed to improving liquidity conditions and pricing behaviour in EZ sovereign bond markets, which are central to policy transmission as they form the basis for pricing other assets in the economy. Just before the announcement of the PEPP on 18 March, GDP-weighted 10-year euro area sovereign bond yields were around 70 basis points higher than before the outbreak of the pandemic. Even German Bund yields had risen by around 20 basis points over that same period. The announcement of the PEPP helped break this dynamic and partly reversed the steepening of the curve. It also reduced the fragmentation that had become increasingly visible as the pandemic spread at a

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[1] PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. PensionsEurope has 24 member associations in 17 EU Member States and 4 other European countries. PensionsEurope member organisations cover different types of workplace pensions for over 110 million people. Through its Member Associations PensionsEurope represents more than € 4 trillion of assets managed for future pension payments.

different pace and intensity across the EZ. Everywhere in the EZ, spreads relative to German Bunds fell measurably upon the PEPP announcement.

EZ pension funds investing in EZ sovereign bonds have benefited from the effects of the PEPP by experiencing gains in their bond holdings arising from dropping interest rates and the increase in bonds' prices. However, the situation for pension funds in non-EZ EU Member States (non-EZ MSs) has been slightly different. The evolution (since 18 March) of the spreads of sovereign bonds of several non-EZ MSs has shown that tensions have remained significant, even though some spillover effects of the PEPP are expected across non-EZ MSs.

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We have considered what the ECB readiness to adjust the composition of the PEPP, by as much as necessary and for as long as needed, could mean in practice. An extension of the scope of the PEPP to the purchase of non-EZ sovereign bonds would not only have positive stabilising effects in non-EZ MSs in general, but also on the investments of pension funds, which in those countries invest remarkable part of their assets in sovereign bonds. The increasing tensions in the financial markets of non-EZ MSs result in a continuous drop in sovereign bonds' prices which decreases the values of pension funds' bond holdings.

The extension would provide monetary stimulus to non-EZ MSs and further ease monetary and financial conditions, making access to finance more affordable for governments, firms and households in these countries. Those would support investment and consumption, healthier economies, and would ultimately contribute to the objective of the price stability in non-EZ MSs.

Adopting the euro requires extensive preparations. In particular, it requires economic and legal convergence, such as: complying with the debt and deficit criteria outlined by the Stability and Growth Pact, keeping inflation and long-term governmental interest rates below certain reference values, stabilising their currency's exchange rate versus the euro by participating in the European Exchange Rate Mechanism (ERM2), and ensuring that their national laws comply with the ECB statute, ESCB statute and articles 130+131 of the Treaty on the Functioning of the EU.

The extension of the PEPP to non-EZ MSs could start with the MSs, which are expected to join the EZ soon. We have noted that over the past few years some non-EZ MSs have made particularly good progress in many areas to join the EZ. Importantly, Bulgaria, Croatia and Romania are committed to joining the EZ respectively already by 2022-23, 2023 and 2024. Their NCBs are part of the ECB system and they have already their own contributions to the ECB'S capital.

Recently the governments of Croatia and Bulgaria have reaffirmed their strong commitment with a pre-defined action plan towards ERM2 and adoption of the single currency despite the consequences of the COVID-19 crisis. In both countries, the plan includes nineteen measures defined in close cooperation with ECB and EC and covers six areas: banking supervision and collaboration with the ECB, macro-prudential framework, anti-money laundering, statistics, public sector governance and reducing the financial and administrative burden. Both countries have already achieved significant progress in the fulfilment of their respective plan.

Such reform efforts towards a more robust financial sector, stronger institutions and public governance and more efficient economic structures will contribute to the successful participation of Croatia and Bulgaria in ERM2. Both countries would simultaneously join ERM2 and the Banking Union. They will therefore also participate in the Single Resolution Mechanism and would have to start contributing and financing the Single EU mechanism for banking resolution.

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Pensions funds are committed to continue to do the best from their side to get the EU out from the current crisis. As long-term investors, they play an important role in the long-term financing of the EU's real economy and thereby contributing to jobs and growth in Europe.

We thank you in advance for taking into consideration our thoughts and we remain at your disposal should you have any questions or need any further information.

Yours sincerely

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