CENTRAL BANKS

# The ECB delivers a strong QE

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- The ECB approves a large, open-ended QE programme (EUR 60 bn per month, including private and public assets, until Sept2016 or until inflation follows an adequate path)
- Other positive aspects will the inclusion of long maturities (2 to 30 years), no senior status for the ECB and asset purchases according to the capital key
- Risk sharing of government bond purchases will be very limited, potentially sending the wrong signal in terms of fragmentation

As widely expected, at today's monetary policy meeting the ECB announced the future purchase of government bonds (QE). The program is bigger than expected: it will amount to purchases of EUR 60 bn a month (including the existing CBPP and ABSPP). Moreover, the ECB also reduced the rate of the six TLTROs in existence by removing the 10bp spread over the MRO rate in the first two TLTROs. Regarding standard measures, the central banks left the key policy rate unchanged at 0.05% (together with maintaining interest rates on the marginal lending facility and the deposit facility). Mr. Draghi justified the program by pointing to the persistence of weaker-than-expected inflation, stating that the degree of current monetary accommodation was insufficient to address the risk of too-prolonged a period of low inflation. Mr Draghi clarified that the Governing Council (GC) had been "unanimous in stating that the asset purchase programme is a true monetary policy tool in a legal sense". On the inflation outlook, the GC will continue to closely monitor medium-term risks, yet stating that after today's measures, the expect that downside risks to economic outlook should diminish.

At the press conference, the attention was focused on the on details of the new "Expanded Asset Purchase Program" (see)

- **The program will be open ended.** It will start in March 2015 and is "intended" to continue at least until September 2016, conducted until the ECB sees an inflation path consistent with their objective (i.e. inflation below, but close to 2%).
- **The amount of the purchases is larger than expected**. The ECB will carry out monthly purchases that will amount to EUR 60bn (which includes the purchases under the CBPP and ABSPP, currently running at about €13 billion a month). Additional purchases will mostly consist of government bonds, but the ECB will also buy bonds issued by agencies and European institutions. In this context, the total program could surpass EUR 1,100 bn. Purchases of government bonds will amount to around EUR 900bn, an amount well above expectations (we expected government bond purchases of around EUR20-25bn per month until December 2016, adding up to EUR 500-600 bn).
- **The range of maturities purchased will be broader than expected**. The ECB will buy securities that must have a minimum remaining maturity of two years and a maximum remaining maturity of 30 years (vs. market expectations between 3 and 10 years). Draghi said they are ready to buy bonds even with negative yields.

- **Limited risk sharing**. The ECB opted for a risk-sharing mechanism in which the potential losses of only 20% of its purchases would be mutualized among sovereigns (this includes the purchase of securities issued by European institutions, which add to 12% of the additional purchases). In terms of signalling, the optimal design would have been full risk sharing. The fact that risks are not fully shared may create uncertainty and can be seen as a step back.
- According to the principle of “descentralized implementation”, **purchases will be based on the Eurosystem NCBs´shares in the ECB´s capital key**. This implementation was widely expected, as the ECB had already applied it in the SMP (securities market program).
- As expected, the ECB will opt out of its senior-creditor status, accepting the same treatment as private investors (**pari passu**).
- **Purchases will be subject to an issue limit**, as expected. The ECB may buy up to 25% of any bond issue, or 33% of the marketable debt of any issuer. These limits “ensure that the application of collective action clauses for a bondholder decision is not obstructed.”
- Regarding eligibility criteria, the ECB will purchase euro-denominated securities with investment-grade rating. For countries under financial assistance programs, Mr Draghi said that they will be subject to “additional eligibility criteria.”

**General assessment**: The program announced today should be very effective as a pure monetary policy tool that combats low inflation, keeping long term rates low, fostering risk-taking, and weighing on a depreciated euro. But an unintended consequence of this measure could be an increase in fragmentation. It would have been much better if they had opted for implementing QE with full risk sharing.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in red and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE)

Mario Draghi, President of the ECB,
Frankfurt am Main, ~~4 December 2014~~22 January 2015

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to ~~the first~~ our press conference ~~in our new premises.~~. Let me wish you all a Happy New Year. I would also like to take this opportunity to welcome Lithuania as the nineteenth country to adopt the euro as its currency. Accordingly, Mr Vasiliauskas, the Chairman of the Board of Lietuvos bankas, became a member of the Governing Council on 1 January 2015. The accession of Lithuania to the euro area on 1 January 2015 triggered a system under which NCB governors take turns holding voting rights on the Governing Council. The details on this rotation system are available on the ECB's website. We will now report on the outcome of today's meeting of the Governing Council, which was also attended by the Commission Vice-President, Mr Dombrovskis.

Based on our regular economic and monetary analyses, we conducted a thorough reassessment of the outlook for price developments and of the monetary stimulus achieved. As a result, the Governing Council took the following decisions:

First, it decided to launch an **expanded asset purchase programme**, encompassing the existing purchase programmes for asset-backed securities and covered bonds. Under this expanded programme, the combined monthly purchases of public and private sector securities will amount to €60 billion. They are intended to be carried out until end-September 2016 and will in any case be conducted until we see a sustained adjustment in the path of inflation which is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term. In March 2015 the Eurosystem will start to purchase euro-denominated investment-grade securities issued by euro area governments and agencies and European institutions in the secondary market. The purchases of securities issued by euro area governments and agencies will be based on the Eurosystem NCBs' shares in the ECB's capital key. Some additional eligibility criteria will be applied in the case of countries under an EU/IMF adjustment programme.

Second, the Governing Council decided to change the pricing of the six remaining **targeted longer-term refinancing operations** (TLTROs). Accordingly , the interest rate applicable to future TLTRO operations will be equal to the rate on the Eurosystem's main refinancing operations prevailing at the time when each TLTRO is conducted, thereby removing the 10 basis point spread over the MRO rate that applied to the first two TLTROs.

Third, in line with our forward guidance, we decided to keep the **key ECB interest rates** unchanged.

As regards the additional asset purchases, the Governing Council retains control over all the design features of the programme and the ECB will coordinate the purchases, thereby safeguarding the singleness of the Eurosystem's monetary policy. The Eurosystem will make use of decentralised implementation to mobilise its resources. With regard to the sharing of hypothetical losses, the Governing Council decided that purchases of securities of European institutions (which will be 12% of the additional asset purchases, and which will be purchased by NCBs) will be subject to loss sharing. The rest of the NCBs' additional asset purchases will not be subject to loss sharing. The ECB will hold 8% of the additional asset purchases. This implies that 20% of the additional asset purchases will be subject to a regime of risk sharing.

Separate press releases with more detailed information on the expanded asset purchase programme and the pricing of the TLTROs will be published this afternoon at 3.30 p.m.

Today's monetary policy decision on additional asset purchases was taken to counter two unfavourable developments. First, inflation dynamics have continued to be weaker than expected. While the sharp fall in oil prices over recent months remains the dominant factor driving current headline inflation, the potential for second-round effects on wage and pricesetting has increased and could adversely affect medium-term price developments. This assessment is underpinned by a further fall in market-based measures of inflation expectations over all horizons and the fact that most indicators of actual or expected inflation stand at, or close to, their historical lows. At the same time, economic slack in the euro area remains sizeable and money and credit developments continue to be subdued. Second, while the monetary policy measures adopted between June and September last year resulted in a material improvement in terms of financial market prices, this was not the case for the quantitative results. As a consequence, the prevailing degree of monetary accommodation was insufficient to adequately address heightened risks of too prolonged a period of low inflation. Thus, today the adoption of further balance sheet measures has become warranted to achieve our price stability objective, given that the key ECB interest rates have reached their lower bound.

~~Based on our regular economic and monetary analyses, and in line with our forward guidance, we decided to keep the **key ECB interest rates** unchanged. As regards our **non-standard monetary policy measures**, we have started purchasing covered bonds and asset-backed securities. These purchase programmes will last for at least two years. Next week, we will conduct the second targeted longer-term refinancing operation, to be followed by six further operations until June 2016. Taken together, our measures will have a sizeable impact on our balance sheet, which is intended to move towards the dimensions it had at the beginning of 2012.~~

~~In the coming months, our measures will further ease the monetary policy stance more broadly, support our forward guidance on the key ECB interest rates and reinforce the fact that there are significant and increasing differences in the monetary policy cycle between major advanced economies. However, the latest euro area macroeconomic projections indicate lower inflation, accompanied by weaker real GDP growth and subdued monetary dynamics.~~

~~In this context, early next year the Governing Council will reassess the monetary stimulus achieved, the expansion of the balance sheet and the outlook for price developments. We will also evaluate the broader impact of recent oil price developments on medium-term inflation trends in the euro area. Should it become necessary to further address risks of too prolonged a period of low inflation, the Governing Council remains unanimous in its commitment to using additional unconventional instruments within its mandate. This would imply altering early next year the size, pace and composition of our measures. In response to the request of the Governing Council, ECB staff and the relevant Eurosystem committees have stepped up the technical preparations for further measures, which could, if needed, be implemented in a timely manner. All of our monetary policy measures are geared towards underpinning the firm anchoring of medium to long-term inflation expectations, in line with our aim of achieving inflation rates below, but close to, 2%, and contribute to a return of inflation rates towards that level.~~

~~Let me now explain our assessment in greater detail, starting with the **economic analysis**. Real GDP in the euro area rose by 0.2%, quarter on quarter, in the third quarter of this year. This was in line with earlier indications of a weakening in the euro area's growth momentum, leading to a downward revision of the outlook for euro area real GDP growth in the most recent forecasts. The latest data and survey evidence up to November confirm this picture of a weaker growth profile in the period ahead. At the same time, the outlook for a modest economic recovery remains in place. On the one hand, domestic~~Let me now explain our assessment in greater detail, starting with the **economic analysis**. Real GDP in the euro area rose by 0.2%, quarter on quarter, in the third quarter of 2014. The latest data and survey evidence point to continued moderate growth at the turn of the year. Looking ahead, recent declines in oil prices have strengthened the basis for the economic recovery to gain momentum. Lower oil prices should support households' real disposable income and corporate profitability. Domestic demand should also be further supported by our monetary policy measures, the ongoing improvements in financial conditions~~,~~ and the progress made in fiscal consolidation and structural reforms~~, and significantly lower energy prices supporting real disposable income~~. Furthermore, demand for exports should benefit from the global recovery. ~~On the other hand, the~~ However, the euro area recovery is likely to continue to be dampened by high unemployment, sizeable unutilised capacity, and the necessary balance sheet adjustments in the public and private sectors.

~~These elements are reflected in the December 2014 Eurosystem staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 0.8% in 2014, 1.0% in 2015 and 1.5% in 2016. Compared with the September 2014 ECB staff macroeconomic projections, the projections for real GDP growth have been revised substantially downwards. Downward revisions were made to the projections for both domestic demand and net exports.~~

~~The risks surrounding the economic outlook for the euro area are on the downside. In particular, the weak euro area growth momentum, alongside high geopolitical risks, has the potential to dampen confidence and especially private investment. In addition, insufficient progress in structural reforms in euro area countries constitutes a key downward risk to the economic outlook.~~

~~According to Eurostat's flash estimate, euro area annual HICP inflation was 0.3% in November 2014, after 0.4% in October. Compared with the previous month, this mainly reflects a stronger fall in energy price inflation and a somewhat lower annual increase in services prices. Taking into account the current environment of very low rates of inflation, it will~~

~~be important to assess the broader impact of recent oil price developments on medium-term inflation trends and to avoid spillovers to inflation expectations and wage formation.~~

~~Against the background of recent oil price developments, it is crucial to recall that forecasts and projections are based on technical assumptions, especially for oil prices and exchange rates. On the basis of information available in mid-November, at the time the December 2014 Eurosystem staff macroeconomic projections for the euro area were finalised, annual HICP inflation was foreseen to reach 0.5% in 2014, 0.7% in 2015 and 1.3% in 2016. In comparison with the September 2014 ECB staff macroeconomic projections, they have been revised significantly downwards. These revisions reflect mainly lower oil prices in euro terms and the impact of the downwardly revised outlook for growth, but they do not yet incorporate the fall in oil prices over the past few weeks following the cut-off date for the projections. Over the coming months, annual HICP inflation rates could experience renewed downward movements, given the recent further decline in oil prices.~~

~~The Governing Council will continue to closely monitor the risks to the outlook for price developments over the medium term. In this context, we will focus in particular on the possible repercussions of dampened growth dynamics, geopolitical developments, exchange rate and energy price developments, and the pass-through of our monetary policy measures. We will be particularly vigilant as regards the broader impact of recent oil price developments on medium-term inflation trends in the euro area.~~

~~Turning to the **monetary analysis**, data for October 2014 support the assessment of subdued underlying growth in broad money (M3), with the annual growth rate standing at 2.5% in October, unchanged from September.~~The risks surrounding the economic outlook for the euro area remain on the downside, but should have diminished after today's monetary policy decisions and the continued fall in oil prices over recent weeks.

According to Eurostat, euro area annual HICP inflation was -0.2% in December 2014, after 0.3% in November. This decline mainly reflects a sharp fall in energy price inflation and, to a lesser extent, a decline in the annual rate of change in food prices. On the basis of current information and prevailing futures prices for oil, annual HICP inflation is expected to remain very low or negative in the months ahead. Such low inflation rates are unavoidable in the short term, given the recent very sharp fall in oil prices and assuming that no significant correction will take place in the next few months. Supported by our monetary policy measures, the expected recovery in demand and the assumption of a gradual increase in oil prices in the period ahead, inflation rates are expected to increase gradually later in 2015 and in 2016.

The Governing Council will continue to closely monitor the risks to the outlook for price developments over the medium term. In this context, we will focus in particular on geopolitical developments, exchange rate and energy price developments, and the pass-through of our monetary policy measures.

Turning to the **monetary analysis**, recent data indicate a pick-up in underlying growth in broad money (M3), although it remains at low levels. The annual growth rate of M3 increased to 3.1% in November 2014, up from 2.5% in October and a trough of 0.8% in April 2014. Annual growth in M3 continues to be supported by its most liquid components, with the narrow monetary aggregate M1 growing at an annual rate of 6.~~2~~9% in ~~October~~November.

The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) ~~was~~ remained weak at -1.3% in November 2014, compared with -1.6% in October, ~~after -1.8% in September, showing a~~ while continuing its gradual recovery from a trough of -3.2% in February 2014. On average over recent months, net redemptions have moderated from the historically high levels recorded a year ago~~. Lending~~ and net lending flows turned slightly positive in November. In this respect, the January 2015 bank lending survey indicates a further net easing of credit standards in the fourth quarter of 2014, with cross-country disparities decreasing in parallel with an increase in net demand for loans across all loan categories. Banks expect that these dynamics will continue in early 2015. Despite these improvements, lending to non-financial corporations remains weak and continues to reflect the lagged relationship with the business cycle, credit risk, credit supply factors and the ongoing adjustment of financial and non-financial sector balance sheets. The annual growth rate of loans to households (adjusted for loan sales and securitisation) was 0.7% in November, after 0.6% in October~~, after 0.5% in September. The~~. Our monetary policy measures ~~in place and the completion of the ECB's comprehensive assessment~~ should support a further ~~stabilisation of~~improvement in credit flows.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis ~~confirms~~confirmed the need ~~to closely monitor the risks to the outlook~~ for ~~price developments over the medium term and to be prepared to provide~~ further monetary policy accommodation~~, if needed~~. All our monetary policy measures should provide support to the euro area recovery and bring inflation rates closer to levels below, but close to, 2%.

Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance contributes to supporting economic activity. However, in order to ~~strengthen~~increase investment activity, boost job creation and raise productivity growth, other policy areas need to contribute decisively. In particular, the determined implementation of **product and labour market reforms** as well as actions to improve the business environment for firms ~~need~~needs to gain momentum in several countries. It is crucial that structural reforms be implemented swiftly, credibly and effectively as this will not only increase the future sustainable growth of the euro area, but will also raise expectations of higher incomes and encourage firms to increase investment today and bring forward the economic recovery. **Fiscal ~~policies~~policies** should support the economic recovery, while ensuring debt sustainability in compliance with the Stability and Growth Pact, which remains the anchor for confidence. All countries should use the available scope for a more growth-friendly composition of fiscal policies. ~~The Investment Plan for Europe which the European Commission announced on 26 November 2014 will also support the recovery.~~

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