CENTRAL BANKS

# The ECB will implement QE with some flexibility

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- The sovereign bond purchase programme will start next week
- The ECB reiterated that the programme is “intended” to continue at least until September 2016, and “beyond if necessary”.
- The updated macroeconomic projections show significant changes to the economic outlook stemming from better-than-expected data since December (lower oil prices and exchange rate), but also from the ECB´s confidence in the effectiveness of its new measures

At today’s monetary policy meeting, the ECB left the key policy rate unchanged at 0.05%. As regards non-standard measures, the central bank provided further details on the implementation of the public sector purchase program (PSPP), announced at the 22 January meeting. On general lines, the programme will be flexible in its implementation, in order to achieve the EUR60bn of monthly purchases combined of public and private sector securities. This flexibility paves the way to increase the ECB’s balance sheet by EUR1,100bn by the third quarter of 2016, as the ECB reiterated that the programme is “intended” to continue at least until September 2016, and beyond if necessary. (see) (see)

- i) The purchases under the PSPP will start on 9 March, and the ECB will publish on a weekly basis the aggregate book value of the securities bought. Moreover, the ECB will also publish on a monthly basis “the weighted average residual maturity by issuer residence, separating international organisations and multilateral development banks from other issuers, of its PSPP holdings.”
- ii) In its implementation, the ECB intention is to be market-neutral, making explicit its objective to interfere a little as possible in the market price formation mechanism.
- iii) As the last ECB meeting had already anticipated, the ECB will purchase government bonds with negative yields, but in today´s information it added that these purchases at negative yields are permissible only as long as the yield is not below the ECB’s deposit rate at time of purchase (currently at -0.2%).
- iv) The purchases will be based on the ECB´s capital key, however if any central bank cannot purchase sufficient government securities to fulfil its allocation in a certain month, the ECB will allow substitute purchases in order to permit the smooth implementation of the programme.
- v) Regarding the maturity breakdown of the purchases, in this aspect the ECB will also apply a certain flexibility as it will, in principle, be weighted by nominal outstanding amounts (ranging from 2 to 30 years), but considering the issue and issuer limits and also “potential distortions in certain maturity buckets.”
- vi) The ECB reiterated that it will buy on the secondary market so as to not violate Article 23 of the Maastricht Treaty, which prohibits primary market purchases (associated to monetary financing).

The updated staff macroeconomic projections show significant changes in the outlook for 2015-16, stemming from better-than-expected data since December, lower oil prices and exchange rate (partly reflecting the QE announcement in January). They also present, for the first time, forecasts for 2017.

The staff projections now assume oil prices to be around 30% and 25% lower in 2015 and 2016 respectively (at USD58.5 and USD66.8 a barrel, respectively, down from the USD85.6 and USD88.5 estimated three months ago) and the euro to remain about 9% more depreciated against the USD than in December (USD1.14 and USD1.13, from USD1.25 in both 2015 and 2016). As a result, GDP growth is revised upward by around 0.5pp in 2015 and 2016 to 1.5% and 1.9% respectively, and is expected to accelerate to 2.1% in 2017. Regarding inflation, the projections are revised down by 0.8pp in 2015 to 0% (because of lower oil prices) and slightly upward for 2016 to 1.5% from 1.3%, which is mainly due to the effect of non-standard measures. The projections envisage that inflation will increase again in 2017 to 1.8%, close to but below the 2% target. Core inflation projections remain virtually unchanged for 2015-16.

Mr Draghi highlighted the positive effects of the additional easing to the bank’s monetary policy stance, reiterating that these measures will contribute “to a sustained return of inflation towards a level below, but close to, 2%.” He stressed that the risks surrounding the economic outlook are tilted to the downside, but “have diminished following recent monetary policy decisions and the fall in oil prices”, and also pointed out the high uncertainty around 2017 figures that are conditional on the full implementation of the ECB’s measures. The ECB will continue to monitor the impact of all these factors on price performance, as well as the evolution of geopolitical developments.

A large part of the Q&A was dominated by Greece. Mr Draghi highlighted the central bank's commitment to support Greece. Yet to reinstate the waiver (admitting Greek bonds as collateral for monetary operations again) the country should first achieve a successful completion of the review. In response to a question about the possibility of raising the limit on Greece´s issuance of T-bills, he repeated that the ECB cannot directly or indirectly finance governments. Moreover, he added that "the ECB is a rule-based institution. It is not a political institution." Regarding the emergency liquidity assistance (ELA) for Greek banks, which until today amounted to EUR68.3bn, Mr Draghi said that the ECB had decided to raise these funds by EUR500mn.

All in all, the ECB again reinforced its intention to carry out an extended asset purchase programme until at least September 2016, providing it with some flexibility to reach its objective. The new projections and the assessment of risks are in line with those envisaged in our scenario. The pick-up of inflation in 2016 is somewhat faster than we had expected, though within a reasonable margin of error and consistent with the assumption made by the ECB – that QE measures are designed to redress inflation to close to 2% in the medium term.

**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, 22 January~~Nicosia, 5 March 2015

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference~~. Let me wish you all a Happy New Year.~~, here, in Nicosia. I would ~~also~~ like to ~~take this opportunity~~thank Governor Georghadji for her kind hospitality and to ~~welcome Lithuania as~~express our special gratitude to her staff for the ~~nineteenth country to adopt the euro as its currency. Accordingly, Mr Vasiliauskas, the Chairman~~excellent organisation of ~~the Board of Lietuvos bankas, became a member~~today's meeting of the Governing Council.

Based on ~~1 January 2015. The accession of Lithuania~~our regular economic and monetary analyses, and in line with our forward guidance, we decided 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.~~keep the **key ECB interest rates** unchanged. As regards **non-standard monetary policy measures**, the focus is now on implementation.

Following up on our decisions of 22 January 2015, we will, on 9 March 2015, start purchasing euro-denominated public sector securities in the secondary market. 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~~ also continue purchasing asset-backed securities and covered bonds~~. Under this expanded programme~~, which we started last year. As previously stated, the combined monthly purchases of public and private sector securities will amount to €60 billion. They are intended to be carried out until the end~~-~~ of 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~~Further information on certain implementation aspects of the public sector purchase programme will be released at 3.30 p.m. CET on the ECB's ~~capital key. Some additional eligibility criteria will be applied in the case of countries under an EU/IMF adjustment programme~~website.

~~Looking ahead, today's~~ We have already seen a significant number of positive effects from these monetary policy decisions. Financial market conditions and the cost of external finance for the private economy have eased further, also following our previous monetary policy measures. In particular, borrowing conditions for firms and households have improved considerably. Moreover, money and credit dynamics have been firming.

The substantial additional easing of our monetary policy stance supports and reinforces the emergence of more favourable developments for the euro area economy. In an environment of improving business and consumer sentiment, the transmission of our measures to the real economy will strengthen, contributing to a further improvement in the outlook for economic growth and a reduction in economic slack. Thereby, our measures will ~~decisively~~ contribute to a sustained return of inflation towards a level below, but close to, 2% over the medium term and underpin the firm anchoring of medium to long-term inflation expectations.~~ The sizeable increase in our balance sheet will further ease~~

Let me now explain our assessment in greater detail, starting with the **economic analysis**. According to Eurostat's flash estimate, real GDP in the euro area rose by 0.3%, quarter on quarter, in the last quarter of 2014, which was somewhat higher than previously expected. The latest economic data and, particularly, survey evidence available up to February point to some further improvements in economic activity at the beginning of this year. Looking ahead, we expect the economic recovery to broaden and strengthen gradually. The low level of the ~~monetary policy stance. In particular, financing conditions for firms and households in the euro area will continue to improve. Moreover, today's decisions will 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. Taken together, these factors~~ price of oil should ~~strengthen demand, increase capacity utilisation and support money and credit growth, and thereby contribute~~continue to ~~a return of inflation rates towards 2%.~~

~~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~~ leading to ongoing improvements in financial conditions~~ and~~, as well as by the progress made in fiscal consolidation and structural reforms. ~~Furthermore~~Moreover, demand for euro area exports should benefit from improvements in price competitiveness and from the global recovery. 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~~ various sectors and the rather slow pace of implementation of structural reforms.

~~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.~~This assessment is also broadly reflected in the March 2015 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.5% in 2015, 1.9% in 2016 and 2.1% in 2017. Compared with the December 2014 Eurosystem staff macroeconomic projections, the projections for real GDP growth in 2015 and 2016 have been revised upwards, reflecting the favourable impact of lower oil prices, the weaker effective exchange rate of the euro and the impact of the ECB's recent monetary policy measures.

The risks surrounding the economic outlook for the euro area remain on the downside but have diminished following recent monetary policy decisions and the fall in oil prices.

According to Eurostat's flash estimate, euro area annual HICP inflation was -0.3 % in February 2015, after -0.6% in January. The negative outcomes largely reflect the impact of the significant fall in oil prices since July 2014. 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~~Supported by the favourable impact of our 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~~,~~ on aggregate demand, the impact of the ~~expected recovery in demand~~lower euro exchange rate and the assumption of ~~a gradual increase in~~ somewhat higher oil prices in the ~~period~~years ahead, inflation rates are expected to ~~increase~~start increasing gradually later in 2015~~ and in 2016~~.

This assessment is also broadly reflected in the March 2015 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 0.0% in 2015, 1.5% in 2016 and 1.8% in 2017. In comparison with the December 2014 Eurosystem staff macroeconomic projections, the inflation projection for 2015 has been revised downwards, mainly reflecting the fall in oil prices. In contrast, the inflation projection for 2016 has been revised slightly upwards, also reflecting the expected impact of our recent monetary policy measures.

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 pass-through of our monetary policy measures, geopolitical developments, and 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.~~When discussing the economic outlook and the new projections, the Governing Council acknowledged that the staff projections are conditional on the full implementation of all our policy measures. Moreover, the March staff projections extend the horizon to 2017. In this context, the Governing Council again stressed that the degree of forecast uncertainty tends to increase with the length of the projection horizon.

Turning to the **monetary analysis**, recent data confirm the gradual increase in underlying growth in broad money (M3). The annual growth rate of M3 increased to 4.1% in January 2015, up from 3.8% in December 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.~~9.0% in ~~November~~January.

The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) ~~remained weak at -1.3% in November 2014, compared with -1.6~~was -0.9% in ~~October, while~~ January 2015, after -1.1% in December 2014, 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 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~~The three-month cumulated net lending flows were positive in January for the second consecutive month, compared with sizeable net redemptions still recorded a year ago. Despite these improvements, the dynamics of 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~~remain subdued and continue~~s~~ 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~~increased further to 0.~~7~~9% in ~~November~~January 2015, after 0.~~6~~8% in ~~October.~~December 2014. Our recent monetary policy measures should support a further 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 ~~confirmed the need for further monetary policy accommodation. All~~confirms the appropriateness of the Governing Council's recent decisions. The determined implementation of all our monetary policy measures ~~should~~ will provide support to the euro area recovery and bring inflation rates ~~closer to~~towards levels below, but close to, 2~~%~~% in the medium term.

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 ~~increase investment activity, boost job creation and raise productivity growth~~reap the full benefits from our monetary policy measures, other policy areas need to contribute decisively. Given high structural unemployment and low potential output growth in the euro area, a cyclical recovery along the lines of the March ECB staff projections is no grounds for complacency. In particular, in order to increase investment, boost job creation and raise productivity, both the ~~determined~~decisive implementation of **product and labour market reforms** ~~as well as~~ and actions to improve the business environment for firms need~~s~~ 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~~, bringing forward the economic recovery. **Fiscal policies** should support the economic recovery~~,~~ while ~~ensuring debt sustainability~~remaining in compliance with the Stability and Growth Pact~~, which remains~~. Full and consistent implementation of the ~~anchor~~Stability and Growth Pact is key for confidence~~.~~ ~~All countries should use the available scope for a more growth-friendly composition of fiscal policies~~ in our fiscal framework. In view of the necessity to step up structural reform efforts in a number of countries, it is also important that the macroeconomic imbalance procedure is implemented effectively in order to address the excessive imbalances as identified in individual Member States.

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