CENTRAL BANKS

ECB strikes a dovish tone

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- The Staff revised downwards its projections for growth and inflation, driven by lower external demand. Moreover, renewed downside risks have emerged.
- The ECB takes advantage of the flexibility of the APP programme by increasing the initial issue share limit of 25% to 33%, and hints at further willingness to act.
- There was no discussion on expanding the APP.

As expected, at today's monetary policy meeting there were no changes in the ECB´s monetary policy stance, as the central bank left the key policy rate unchanged at 0.05%. As regards non-standard measures, the ECB raised the amount of any bond issue it could buy to 33% from 25% in its asset-buying programme. Mr Draghi stressed its commitment to the full implementation of the asset purchase programme (APP) and emphasised its willingness and ability to act if needed. However, Mr Draghi clarified that there was no discussion at today´s meeting on expanding the APP. Regarding the outlook for growth and inflation, the Governing Council (GC) highlighted that renewed downside risks have emerged, reflecting in particular the heightened uncertainties related to current developments in emerging economies and the most recent developments in oil prices.

The ECB Staff revised down both growth and inflation projections, driven by lower external demand – from emerging countries – and falling commodity prices. On activity, somewhat lower than expected growth in the second quarter (0.3% QoQ) combined with confidence surveys that suggest a stable recovery pace in the third quarter, and the loss of momentum in emerging economies led to a downward revision of GDP by 0.1pp in 2015 and 0.2pp in both 2016 and 2017, now at 1.4%, 1.7% and 1.8% respectively. In addition, renewed downside risks have emerged, stemming from the heightened uncertainty surrounding the performance of emerging economies, while Mr Draghi highlighted that "it is not yet clear whether the turmoil in those countries will have a long-lasting impact on the eurozone", especially throughout trade and confidence channels.

Regarding prices, inflation has remained relatively stable at 0.2% YoY since the previous Staff forecasts, as higher prices of non-energy industrial goods and food offset the fall in energy prices driven by the sharp fall of crude oil prices. Inflation is expected to remain very low in the coming months, due to significantly lower oil prices than previously expected (around -13% in 2015, -20% in 2016 and -17% in 2017) which should imply a smaller base effect by the end of this year and a slower increase in 2016 and 2017. Still, inflation will be supported by the economic recovery and the pass-through – mainly to non-industrial goods – of a weaker euro. As a result, inflation was revised down by 0.2pp, 0,4pp and 0.1pp in 2015, 2016 and 2017 to 0.1%, 1.1% and 1.7% respectively. Mr Draghi downplayed the potential for negative inflation rates in coming months, as low oil prices should only have a transitory effect, while core inflation projections remained unchanged. However, he stressed that taking into account the most recent developments in both oil prices and exchange rates, there are downside risks to the updated inflation projections.

At the press conference, Mr Draghi left the door open to do more if necessary. In particular, he underlined that the APP provides sufficient flexibility in terms of adjusting the size, composition and duration of the programme. Against this background, today the central bank announced a slight change in the APP; this modification could allow it to buy more of each individual bond issue, increasing the initial limit of 25% to 33% (subject to a case-by-case verification that this would not create a situation whereby the Eurosystem would have blocking minority power). Mr Draghi stated that this decision has the objective of providing a smooth implementation of the current programme, towards reaching the EUR60bn monthly target.

At this meeting, Greece had less attention than at the last one, as the third bailout deal had been agreed in July. However, Mr Draghi said that is it too early to take any decision on the restoration of the waiver for Greek government bonds, as Greece must meet some performance milestones in the coming months. He particularly stressed that a “strong ownership and consistent and significant implementation” of the programme remains key. Moreover, the ECB had lowered the ceiling of the ELA to Greek banks (from EUR89.7 bn to EUR89.1bn).

All in all, the message from the ECB has been more dovish than expected, which is quite supportive in the current climate of heightened uncertainty. The ECB again reinforced its intention to carry out the APP until the end of September 2016, or beyond if necessary, and underlined the possibility of making adjustments to the programme if needed. While uncertainty is high and risks remain on the downside, assuming that growth in China and major emerging markets stabilises (our baseline scenario) as does the turbulence in financial markets, we consider that the most likely scenario is for the ECB to remain on hold.

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,~~-~~

Vítor Constâncio, Vice-President of the ECB,~~-~~

Frankfurt am Main, 3 September~~16 July~~ 2015

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. We will now report on the outcome of today's meeting of the Governing Council. As usual, let me start with the decisions taken~~, which was also attended by the Commission Vice-President, Mr Dombrovskis~~.

Based on our regular economic and monetary analysis~~analyses~~, and in line with our forward guidance, the Governing Council~~we~~ decided to keep the **key ECB interest rates** ~~-~~unchanged.

Our asset purchase programme continues to proceed smoothly. Regarding **non-standard monetary policy measures**, following the announced review of the public sector purchase programme's issue share limit after the first six months of purchases, the Governing Council decided to increase the issue share limit from the initial limit of 25% to 33%, subject to a case-by-case verification that this would not create a situation whereby the Eurosystem would have blocking minority power, in which case the issue share limit would remain at 25%.

Underlying our monetary policy assessment was a review of recent data, new staff macroeconomic projections and an interim evaluation of recent market fluctuations. The information available indicates a continued though somewhat weaker economic recovery and a slower increase in inflation rates compared with earlier expectations. More recently, renewed downside risks have emerged to the outlook for growth and inflation. However, owing to sharp fluctuations in financial and commodity markets, the Governing Council judged it premature to conclude~~the asset purchase programmes continue to proceed smoothly. As explained~~ on whether these developments could have a lasting impact on the outlook for prices and on the achievement of a sustainable path of inflation towards our medium-term aim, or whether they should be considered to be mainly transitory.

Accordingly, the Governing Council will closely monitor all relevant incoming information. It emphasises its willingness and ability to act, if warranted, by using all the instruments available within its mandate and, in particular, recalls that the asset purchase programme provides sufficient flexibility in terms of adjusting the size, composition and duration of the programme.

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In the meantime, we will fully implement~~previous occasions,~~ our monthly asset purchases of €60 billion. These purchases have a favourable impact on the cost and availability of credit for firms and households. They are intended to run until the end of September 2016, or beyond, if necessary, and, in any case, until we see a sustained adjustment in the path of inflation that is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term. ~~When carrying out its assessment, the Governing Council will follow its monetary policy strategy and concentrate on trends in inflation and the medium-term outlook for price stability.~~

~~All in all, the information that has become available since the Governing Council meeting in early June has been broadly in line with our expectations. Recent developments in financial markets, which partly reflect greater uncertainty, have not changed the Governing Council's assessment of a broadening of the euro area's economic recovery and a gradual increase in inflation rates over the coming years. The ECB's monetary policy stance remains accommodative and market-based inflation expectations have, on balance, stabilised or recovered further since our meeting in early June. The latest information also remains consistent with a continued pass-through of our monetary policy measures to the cost and availability of credit for firms and households. Our measures thereby continue to contribute to economic growth, a reduction in economic slack, and money and credit expansion. The full implementation of all our monetary policy measures will lead to a sustained return of inflation rates towards levels below, but close to, 2% in the medium term, and will underpin the firm anchoring of medium to long-term inflation expectations.~~

~~Looking ahead, we will continue to closely monitor the situation in financial markets, as well as the potential implications for the monetary policy stance and for the outlook for price stability. If any factors were to lead to an unwarranted tightening of monetary policy, or if the outlook for price stability were to materially change, the Governing Council would respond to such a situation by using all the instruments available within its mandate.~~

Let me now explain our assessment of the available information in greater detail, starting with the **economic analysis**. Real GDP in the euro area rose by 0.3% in the second quarter of 2015, which was somewhat lower than previously expected. The latest survey indicators point to a broadly similar pace of real GDP growth in the second half of this year. Overall, we expect the economic recovery to continue, albeit at a somewhat weaker pace than earlier expected, reflecting in particular the slowdown in emerging market economies, which is weighing on global growth and foreign demand for euro area exports.~~Euro area quarterly real GDP growth was confirmed at 0.4% in the first quarter of 2015, supported by contributions from private consumption and investment. The latest survey data, available up to June, remain consistent with a continuation of the moderate growth trend in the second quarter. Looking ahead, we expect the economic recovery to broaden further.~~ Domestic demand should be further supported by our monetary policy measures and their favourable impact on financial conditions, as well as by the progress made with fiscal consolidation and structural reforms. Moreover, the ~~recent~~ decline in oil prices should provide ~~additional~~ support for households' real disposable income and corporate profitability and, therefore, private consumption and investment. However,~~Furthermore, demand for euro area exports should benefit from improvements in price competitiveness. However, the ongoing slowdown in emerging market economies continues to weigh on the global outlook and~~ economic growth in the euro area is likely to continue to be dampened by the necessary balance sheet adjustments in a number of sectors and the sluggish pace of implementation of structural reforms.

This assessment is also broadly reflected in the September 2015 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.4% in 2015, 1.7% in 2016 and 1.8% in 2017. Compared with the June 2015 Eurosystem staff macroeconomic projections, the outlook for real GDP growth has been revised down, primarily due to lower external demand owing to weaker growth in emerging markets.

The risks to the euro area growth outlook remain on the downside, reflecting in particular the heightened uncertainties related to the external environment. Notably, current developments in emerging market economies have the potential to further affect global growth adversely via trade~~The downside risks surrounding the economic outlook for the euro area have generally been contained as a result of our monetary policy decisions, as well as oil price and exchange rate developments.~~

~~Inflation bottomed out at the beginning of the year~~ and confidence effects.

~~has moved back into positive territory in recent months.~~ According to Eurostat's flash estimate~~Eurostat~~, euro area annual HICP inflation was 0.2% in August~~June~~ 2015, unchanged~~slightly down~~ from June and July. Compared with the previous month, this reflects a further decline in energy price inflation, compensated for by higher price increases for food and industrial goods.~~0.3% in May.~~ On the basis of the information available and current oil futures prices, annual HICP inflation rates will~~is expected to~~ remain very low in the near term. Annual HICP inflation is expected to ~~months ahead and to~~ rise towards the end of the year, also on account of base effects associated with the fall in oil prices in late 2014. Inflation rates are foreseen to pick up further during 2016 and 2017, supported~~Supported~~ by the expected economic recovery, the pass-through~~impact~~ of past declines in the ~~lower~~ euro exchange rate and the assumption ~~embedded in oil futures markets~~ of somewhat higher oil prices in the years ahead as currently reflected in oil futures markets. However, this increase in annual~~,~~ inflation rates is currently~~are~~ expected to materialise somewhat more slowly than anticipated thus far~~pick up further during 2016 and 2017~~.

This assessment is also broadly reflected in the September 2015 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 0.1% in 2015, 1.1% in 2016 and 1.7% in 2017. In comparison with the June 2015 Eurosystem staff macroeconomic projections, the outlook for HICP inflation has been revised down, largely owing to lower oil prices. Taking into account the most recent developments in oil prices and recent exchange rates, there are downside risks to the September staff inflation projections.

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

Turning to the **monetary analysis**, recent data confirm robust growth in broad money (M3). The annual growth rate of M3 was 5.3~~0~~% in July~~May~~ 2015, compared with 4.9~~5.3~~% in June~~April~~. Annual growth in M3 continues to be increasingly~~strongly~~ supported by its most liquid components, with the narrow monetary aggregate M1 growing at an annual rate of 12.1% in July, compared with 11.7% in June~~11.2% in May~~.

Loan dynamics continued to improve. The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) increased to 0.9% in July, up from 0.2% in June, continuing its gradual recovery since the beginning of 2014.~~1% in May, up from -0.1% in April, continuing its gradual recovery from a trough of -3.2% in February 2014. This is consistent with the positive evidence from the bank lending survey for the second quarter of 2015. Banks reported a continued net easing of credit standards on loans to enterprises which was stronger than expected in the previous survey round. Net demand for loans to enterprises increased further, supported by demand for credit related to fixed investment. Fragmentation in terms of credit demand in individual countries decreased and the targeted longer-term refinancing operations helped to improve the terms and conditions for credit supply.~~ Despite these improvements, the dynamics of loans to non-financial corporations remain subdued. They continue 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) increased to 1.9~~4~~% in July~~May~~ 2015, after 1.7~~3~~% in June~~April~~. Overall, the monetary policy measures we have put in place since June 2014 provide clear support for improvements both in borrowing conditions for firms and households and in credit flows across the euro area.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis indicates~~confirms~~ the need to ~~maintain a steady monetary policy course,~~ firmly implement~~implementing~~ the Governing Council's monetary policy decisions~~. The full implementation of all our monetary policy measures will provide the necessary support to the economic recovery in the euro area~~ and to monitor closely all relevant incoming information as concerns their impact on~~lead to a sustained return of inflation rates towards levels below, but close to, 2% in~~ the medium~~-~~term outlook for price stability.

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 reap the full benefits from our monetary policy measures, other policy areas must contribute decisively. Given continued high structural unemployment and low potential output growth in the euro area, the ongoing cyclical recovery should be supported by effective **structural policies**. Further ~~In particular, in order to increase investment, boost job creation and raise productivity, both the implementation of~~ product and labour market reforms, ~~and~~ and particularly actions to improve the business environment, including an adequate public infrastructure, are vital to increase productive investment, boost job creation and raise productivity. The~~ for firms need to gain momentum in several countries. A~~ swift and effective implementation of these reforms, in an environment of accommodative monetary policy, will not only lead to higher sustainable economic growth in the euro area but will also raise expectations of permanently higher incomes and accelerate the benefits of reforms, thereby making the euro area more resilient to global shocks.~~.~~ **Fiscal policies** should support the economic recovery while remaining in compliance with the Stability and Growth Pact. Full and consistent implementation of the Pact is crucial~~key~~ for confidence in our fiscal framework.

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