CENTRAL BANKS

The ECB acts despite marginal changes in projections

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- The ECB cut the deposit facility rate to a record low of -0.3%, extended the QE programme for six months and strengthened its forward guidance, including reinvestment of principal payments of maturing bonds.
- The Staff revised its projections only slightly downwards, which hardly justifies today's decisions.
- Markets reacted strongly as they expected further measures

As widely expected, the ECB acted. As regards non-standard measures, the central bank decided at today's monetary policy meeting: i) to cut the deposit facility rate by 10bp to -0.30%, a historical low; ii) to extend the asset purchase programme (APP) until at least March 2017; iii) to broaden the range of assets purchased (regional and local governments); in an effort to reinforce its forward guidance, iv) to reinvest the principal payments on the securities purchased under the APP as they mature, for as long as necessary, and finally v) to extend the FRFA (fixed rate tender procedures with full allotment) at least until the end of 2017. Mr. Draghi said that today´s decision was not unanimous, which seems natural given that the change of the economic outlook since the summer has been marginal, as some Governing Council (GC) members probably argued. But he highlighted that a large majority was in favour of the package. The tone remained dovish; the easing bias was retained as the central bank reiterated its willingness to act further if needed. On the inflation outlook, downside risks persist and the GC will continue to closely monitor the evolution of inflation rates. The risks on the economic outlook relate in particular to uncertainties around the global economy as well as to broader geopolitical risks.

At the press conference, the attention was focused on the new measures announced. The central bank decided:

- **To cut the deposit rate.** The GC cut the deposit facility rate by 10bp to -0.30%, a historical low. The GC maintained both the main refinancing rate at 0.05% and the marginal lending at 0.30%, thus leaving an asymmetric corridor for interest rates. Markets had been discounting a larger cut. Mr. Draghi said that the deposit rate cut "vastly improves policy transmission" and explained that the central bank had left the MRO (the main refinancing rate) unchanged because market rates follow the deposit rate. He declined to confirm whether the deposit rate is at lower bound (he mentioned that it was "adequate").

- **To extend the APP.** The GC decided to extend the APP until the end of March 2017 (a further six months) or beyond, if necessary, at the current monthly pace of EUR60bn (which remained untouched, against the expectations of some analysts and market participants). The central bank made it clear that this extension will be conditional, in any case until there is a sustained adjustment in the path of inflation consistent with the aim of achieving inflation rates below, but close to, 2% over the medium term.

- **To broaden the range of assets purchased under the APP.** The central bank decided to include euro-denominated marketable debt instruments issued by regional and local governments located in the euro area.

- **To reinforce its forward guidance by:**
  - **Reinvesting the principal payments on the securities purchased under the APP as they mature, for as long as necessary.** Mr. Draghi stressed that this "is quite an important measure", with the aim of maintaining the degree of monetary accommodation and favourable conditions for liquidity for a long time. He added that "the technical details will be communicated in due time."
  - **To extend the FRFA.** The ECB decided to continue "conducting the main refinancing operations and three-month longer-term refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the last reserve maintenance period of 2017".

Mr. Draghi made it clear that these modifications to the programme (the extension of the horizon, the re-investment of principal debt maturing and the broadening of the assets purchased) would be sufficient to achieve the ECB's objective, but he stressed that the current programme is flexible and can always be adjusted. In this regard, he said that the technical parameters of the programme will be reviewed again in the spring next year.

In response to the question of why the central bank was not doing more (markets had expected further measures) and if the current measures have not been enough to achieve its price stability objective, Mr. Draghi took the opportunity to defend the measures taken today, stating that the GC "want to consolidate something that has been a success."

The Staff forecasts remained barely unchanged in December and hardly justify today's decisions. Further stimulus seems to stem from the stronger external headwinds experienced by mid-year that could hinder the ECB's inflation target through lower oil prices and a more appreciated euro.

On activity, stronger domestic demand - supported by the accommodative monetary policy, some fiscal easing and low oil prices - offsets the weaker foreign demand which is now projected. As a result, GDP is projected to grow by 1.5% in 2015, 1.7% in 2016 and 1.9% in 2017 (implying an upward revision of +0.1pp in both 2015 and 2017 compared with September's projections). Downside risks are related to the uncertainties over developments in the global economy, along with broader geopolitical risks that could end up by weighing more widely on confidence.

Regarding prices, inflation was revised down slightly by 0.1pp in both 2016 and 2017 to 1% and 1.6% respectively, after an unchanged 0.1% expected for this year, mainly reflecting the lower oil prices. In particular, the futures of oil prices included in these forecasts are around 7% lower in 2016 and 6% in 2017, while the assumption on the exchange rate changed only marginally downwards. Despite low oil price figures, inflation should pick up as from next month, due to the base effect in energy prices after the sharp drops a year earlier. Core inflation is expected to increase only gradually over the forecast horizon (0.9% in 2015, 1.3% in 2016 and 1.6% in 2016), unchanged from three months ago. However, Mr. Draghi justified today's measures by stressing that risks continue tilted to the downside and that these slightly lower inflation projections follow downward revisions in earlier exercises. Draghi also mentioned that non-standard measures are working, with an estimated positive impact of around +0.5pp on inflation figures in 2016 and +0.3pp in 2017, and of 1pp on GDP in 2015-17. But external developments by mid-year have endangered the convergence of inflation to the target, and today's measures should offset these risks.

The ECB started 2015 by embarking on a larger-than-expected government bond purchase programme, with the aim of fighting the worsening of inflation expectations, and closes the year by announcing further measures. But the limited extent of the change in projections confirms our view that the current outlook did not require more aggressive monetary policy measures.

Markets reaction[1]: Although the ECB finally took further easing measures – as it had pre-announced in the October meeting – the first market reaction after the ECB meeting suggests that markets had been expected bolder measures than those announced today. On bond markets, the German 2Y bond soared (+14bp), while peripheral yields also jumped as the ECB did not increase the monthly purchase of sovereign bonds (Spain: +24bp, Italy: +24bp, Portugal: +22bp, Greece: +29bp), increasing the peripheral risk premia. Moreover, FX also reflected the financial markets' disappointment in today's ECB action. The euro appreciated abruptly against the main currencies, especially against USD (EUR: +2.72%). Equity markets dropped sharply across the board, mainly in Europe. The most EUR-dependent sectors (the industrial and export sectors) were the most punished after the abrupt appreciation of the euro (Euro Stoxx: +3.0%, IBEX 35: -1.9%, CAC: -3.0%, DAX: -2.9%, S&P 500: -0.1%).

[1] Update 17.30 CET 03 December, 2015

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,

~~Malta, 22 October~~Frankfurt am Main, 3 December 2015

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. ~~I would like to thank Governor Bonnici for his kind hospitality and express our special gratitude to his staff for the excellent organisation of~~ We will now report on the outcome of today's meeting of the Governing Council~~. We will now report on the outcome of our meeting~~, which was also attended by the Commission Vice-President, Mr Dombrovskis.

Based on our regular economic and monetary analyses, ~~and in line with our forward guidance, the Governing Council decided to keep the **key ECB interest rates** unchanged. As regards **non-standard monetary policy measures**, the asset purchases are proceeding smoothly and continue to have~~we today conducted a ~~favourable impact on the cost and availability~~thorough assessment of ~~credit for firms and households.~~

~~The Governing Council has been closely monitoring incoming information since our meeting in early September. While euro area domestic demand remains resilient, concerns over growth prospects in emerging markets and possible repercussions for the economy from developments in financial and commodity markets continue to signal downside risks to the outlook for growth and inflation. Most notably,~~ the strength and persistence of the factors that are currently slowing the return of inflation to levels below, but close to, 2% in the medium term ~~require thorough analysis. In this context,~~ and re-examined the degree of monetary ~~policy~~ accommodation. As a result, the Governing Council took the following decisions in the pursuit of its price stability objective:

First, as regards the **key ECB interest rates**, we decided to lower the interest rate on the deposit facility by 10 basis points to -0.30%. The interest rate on the main refinancing operations and the rate on the marginal lending facility will ~~need to be re-examined~~ remain unchanged at their current levels of 0.05% and 0.30% respectively.

Second, as regards **non-standard monetary policy measures**, we decided to extend the asset purchase programme (APP). The monthly purchases of €60 billion under the APP are now intended to run until the end of March 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained

adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term.
Third, we decided to **reinvest the principal payments** on the securities purchased under the APP as they mature, for as long as necessary. This will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance. The technical details will be communicated in due time.
Fourth, we decided to include, in the public sector purchase programme, **euro-denominated marketable debt instruments issued by regional and local governments located in the euro area** in the list of assets that are eligible for regular purchases by the respective national central banks.
Fifth, we decided to continue conducting the main refinancing operations and three-month longer-term refinancing operations as **fixed rate tender procedures with full allotment** for as long as necessary, and at least until the end of the last reserve maintenance period of 2017.

Today's decisions were taken in order to secure a return of inflation rates towards levels that are below, but close to, 2% and thereby to anchor medium-term inflation expectations. The latest staff projections incorporate the favourable financial market developments following our ~~December~~last monetary policy meeting~~, when the~~. They still indicate continued downside risks to the inflation outlook and slightly weaker inflation dynamics than previously expected. This follows downward revisions in earlier projection exercises. The persistence of low inflation rates reflects sizeable economic slack weighing on domestic price pressures and headwinds from the external environment.

Our new ~~Eurosystem staff macroeconomic projections will be available. The Governing Council~~ measures will ensure accommodative financial conditions and further strengthen the substantial easing impact of the measures taken since June 2014, which have had significant positive effects on financing conditions, credit and the real economy. Today's decisions also reinforce the momentum of the euro area's economic recovery and strengthen its resilience against recent global economic shocks. The Governing Council will closely monitor the evolution in the outlook for price stability and, if warranted, is willing and able to act by using all the instruments available within its mandate ~~if warranted~~ in order to maintain an appropriate degree of monetary accommodation. In particular, the Governing Council recalls that the ~~asset purchase programme~~APP provides sufficient flexibility in terms of adjusting its size, composition and duration~~. In the meantime, we will continue to fully implement the monthly asset purchases of €60 billion. These purchases 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~~.
Let me now explain our assessment ~~of the available information~~ in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~4~~3%, quarter on quarter, in the ~~second~~third quarter of 2015, following a rise of 0.~~5~~4% in the previous quarter~~. The outcome for the second quarter reflected~~, most likely on account of a continued positive ~~contributions~~contribution from ~~both domestic demand~~consumption alongside more muted developments in investment and ~~net~~ exports. The most recent survey indicators point to ~~a broadly similar pace of~~ongoing real GDP growth in the ~~third~~final quarter of the year. ~~Overall~~Looking ahead, we expect the economic recovery to ~~continue, albeit dampened, in particular, by weaker than~~

~~expected foreign demand~~proceed. Domestic demand should be further supported by our monetary policy measures and their favourable impact on financial conditions, as well as by the earlier progress made with fiscal consolidation and structural reforms. Moreover, ~~the decline in~~low oil prices should provide support for households' real disposable income and corporate profitability and, therefore, private consumption and investment. In addition, government expenditure is likely to increase in some parts of the euro area, reflecting measures in support of refugees. However, the economic recovery in ~~domestic demand in~~ the euro area continues to be ~~hampered~~dampened by subdued growth prospects in emerging markets and moderate global trade, the necessary balance sheet adjustments in a number of sectors and the sluggish pace of implementation of structural reforms.

This outlook is broadly reflected in the December 2015 Eurosystem staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.5% in 2015, 1.7% in 2016 and 1.9% in 2017. Compared with the September 2015 ECB staff macroeconomic projections, the prospects for real GDP growth are broadly unchanged.

The risks to the euro area growth outlook ~~remain on the downside, reflecting~~relate in particular to the heightened uncertainties regarding developments in ~~emerging market economies, which~~the global economy as well as to broader geopolitical risks. These risks have the potential to ~~further~~ weigh on global growth and foreign demand for euro area exports~~. Increased uncertainty has recently manifested itself in financial market developments, which may have negative repercussions for euro area domestic demand~~ and on confidence more widely.

According to ~~Eurostat~~Eurostat's flash estimate, euro area annual HICP inflation was ~~-~~0.1% in ~~September~~November 2015, ~~down~~unchanged from ~~0.1% in August. Compared with the previous month, this mainly reflects a further decline in energy price inflation.~~October but lower than expected. This reflected somewhat weaker price increases in services and industrial goods, mainly compensated for by a less negative contribution from energy prices. On the basis of the information available and current oil futures prices, annual HICP inflation rates ~~will remain very low in the near term. Annual HICP inflation is~~are expected to rise at the turn of the year, ~~also~~mainly on account of base effects associated with the fall in oil prices in late 2014. ~~Inflation~~During 2016 and 2017, inflation rates are foreseen to pick up further~~ during 2016 and 2017~~, supported by our previous monetary policy measures – and supplemented by those announced today – the expected economic recovery, and the pass-through of past declines in the euro exchange rate~~ and the assumption of somewhat higher oil prices in the years ahead as currently reflected in oil futures markets. However, there are risks stemming from the economic outlook and from financial and commodity market developments which could further slow down the gradual increase in inflation rates towards levels closer to 2%. These risks are being closely monitored by the~~ . The Governing Council will closely monitor the evolution of inflation rates over the period ahead.

This broad pattern is also reflected in the December 2015 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 0.1% in 2015, 1.0% in 2016 and 1.6% in 2017. In comparison with the September 2015 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised down slightly.

Turning to the **monetary analysis**, recent data confirm solid growth in broad money (M3), ~~notwithstanding a decline in~~with the annual ~~growth~~ rate of growth of M3 ~~to 4.8% in August 2015 from~~increasing to 5.3% in ~~July~~October 2015 from 4.9% in September. Annual growth in M3 continues to be mainly supported by its most liquid components, with the narrow monetary aggregate M1 growing at an annual rate of 11.~~4~~8% in ~~August~~October, after ~~12.2~~11.7% in ~~July~~September.

Loan dynamics continued ~~to improve~~the path of gradual recovery observed since the beginning of 2014. The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) increased to 0.~~4~~6% in ~~August~~October, up from 0.~~3~~1% in ~~July, pursuing its gradual recovery since the beginning of 2014~~September. Despite these improvements, developments in loans to enterprises 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.~~0~~2% in ~~August 2015~~October, compared with ~~0.9~~1.1% in ~~July. The euro area bank lending survey for the third quarter of 2015 confirms the increase in demand for bank loans, supported by the general level of interest rates, financing needs for investment purposes and housing market prospects. In addition, credit standards eased further on loans to enterprises, notably due to increasing competitive pressures in retail banking, while tightening somewhat on loans to households for house purchase.~~September. Overall, the monetary policy measures ~~we have put~~ in place since June 2014 ~~provide clear support for improvements both in~~have clearly improved borrowing conditions for both 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 the need to firmly implement the Governing Council's monetary policy decisions and to monitor closely all relevant incoming information as concerns their impact on the medium-term outlook for price stability.~~confirmed the need for further monetary stimulus in order to secure a return of inflation rates towards levels that are below, but close to, 2%.

Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance supports 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. In particular, actions to improve the business environment, including the provision of an adequate public infrastructure, are vital to increase productive investment, boost job creation and raise productivity. The swift and effective implementation of **structural 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~~beneficial effects 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 ~~EU's~~ fiscal rules of the European Union. Full and consistent implementation of the Stability and Growth Pact is crucial for confidence in our fiscal framework. At the same time, all countries should strive for a more growth-friendly composition of fiscal policies.

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