CENTRAL BANKS

Further action likely in September

Sonsoles Castillo / Maria Martinez

- The ECB has left the monetary policy stance unchanged
- The ECB needs more time to reassess the degree of policy accommodation
- Unrelated to monetary policy, Draghi opens the possibility of a “public backstop” for NPL’s

As expected, at today’s monetary policy meeting there were no changes in the ECB´s policy stance, as the central bank left the key policy rate unchanged at 0.0% and the deposit rate at -0.4%, while confirming that interest rates will remain at current levels or lower for an extended period of time. Regarding non-standard measures, the ECB maintained the monthly asset purchases at EUR80 billion until the end of March 2017, or beyond, if necessary. However, Mr Draghi left the door open for additional easing in coming months. He repeated that the bank “is ready, willing and able to act if needed”. On the economic outlook, risks remain tilted to the downside as uncertainties related to the global economy (including Brexit) and geopolitical risks persist.

At the press conference, attention was focused on the aftermath of Brexit. In the statement, the central bank stressed the resilience of financial markets following the referendum. In particular, the statement points out that “the announced readiness of central banks to provide liquidity if needed, and our accommodative monetary policy measures, as well as our robust regulatory and supervisory framework, have all helped to keep market stress contained. Financing conditions remain highly supportive." However, Mr Draghi recognised that Brexit is a risk that has materialised, and it is a downside risk.

Against this background, the dovish tone was retained, reiterating that the GC will continue to monitor economic and financial market developments very closely (“very” is new) in order to safeguard the pass-through of its accommodative policy to the real economy. In this regard, Mr Draghi stated that the central bank will be in a better position in coming months to assess how uncertainties could affect inflation and growth, as they will have more information, including new staff projections in September.

In the Q&A, when he was asked about what instruments the ECB was considering, he said that they did not discuss any specific measure, but he insisted they could readapt its programmes, as they have done in the past. Mr Draghi refused to give any hints on the choice of any particular measure. We consider that the extension of the asset purchase programme (APP) until at least September 2017, combined with some changes in the QE is the most likely scenario to cope with increasing risks for the euro zone. In this regard, we consider a fine tuning of the APP (such as increasing the issuer limits for bonds without CACs) more likely before any change in capital key (political decision).

The banking situation was also discussed. Several questions were posed on the significant falls in equity prices of euro zone banks following Brexit. Mr Draghi stated that this is a significant concern for policy makers as lower equity prices would imply higher cost of capital and, hence, a potential decrease in lending, impairing the transmission of monetary policy. Regarding the problem of non-performing loans in some parts of the European banking sector, Mr Draghi recognised the need to address the problem and suggested the idea of a public backstop for banks under exceptional circumstances.

All in all, we consider it very likely that the ECB will take some further measures in September, but not radical ones. While Draghi gave no clear hints on the choice of any particular measure, an extension of the APP could be one of the preferred options combined with fine tuning of the parameters.

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,
~~Ewald Nowotny, Governor of Oesterreichische Nationalbank, Vienna, 2 June~~Frankfurt am Main, 21 July 2016

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. ~~I would like to thank Governor Nowotny 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, we decided to keep the **key ECB interest rates** unchanged. We continue to expect them to remain at present or lower levels for an extended period of time, and well past the horizon of our net asset purchases. Regarding **non-standard monetary policy measures**, we confirm that the monthly asset purchases of €80 billion are 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 inflation aim.~~ As a next step, on 8 June we will start making purchases under our **corporate sector purchase programme (CSPP)**. Moreover, starting on 22 June, we will conduct the first operation in our new series of **targeted longer-term refinancing operations**. Further information on implementation aspects of the CSPP will be released after the press conference on the ECB's website.~~

~~The comprehensive package of decisions taken~~Today we discussed developments since our last monetary policy meeting in early ~~March underpins the momentum~~June. Following the UK referendum on EU membership, our assessment is that euro area financial markets have weathered the spike in uncertainty and volatility with encouraging resilience. The announced readiness of central banks to provide liquidity, if needed, and our accommodative monetary policy measures, as well as a robust regulatory and supervisory framework, have all helped to keep market stress contained. Financing conditions remain highly supportive, which contributes to a strengthening in credit creation. They continue to support our baseline scenario of ~~the euro area's~~an ongoing economic recovery and ~~fosters the return of~~ an increase in inflation ~~to levels below, but close to, 2%. In particular, our measures continue to ease~~rates.

At the same time, given prevailing uncertainties, the ~~cost of credit and contribute to a strengthening in credit creation. The~~ Governing Council will continue to monitor economic ~~recovery is gradually proceeding. Additional stimulus,~~

~~beyond~~and financial market developments very closely and to safeguard the ~~impetus already taken into account, is expected from the monetary policy measures still to be implemented and will contribute to further rebalancing the risks~~ pass-through of its accommodative monetary policy to the ~~outlook for growth and~~ real economy. Over the coming months, when we have more information, including new staff projections, we will be in a better position to reassess the underlying macroeconomic conditions, the most likely paths of inflation~~. In the current context, it is crucial to ensure that the very low inflation environment does not become entrenched in second-round effects on wage and price setting. The Governing Council will closely monitor the evolution of the outlook for price stability and, if~~ and growth, and the distribution of risks around those paths. If warranted to achieve its objective, the Governing Council will act by using all the instruments available within its mandate.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~5~~6%, quarter on quarter, in the first quarter of 2016, after 0.~~3~~4% in the last quarter of 2015. Growth continues to be supported by domestic demand, while ~~being dampened by weak exports. The latest~~export growth has remained modest. Incoming data point to ongoing growth in the second quarter of 2016, though ~~possibly~~ at a lower rate than in the first quarter. Looking ahead, we continue to expect the economic recovery to proceed at a moderate ~~but steady~~ pace. Domestic demand remains supported by the pass-through of our monetary policy measures to the real economy. Favourable financing conditions and improvements in corporate profitability continue to promote a recovery in investment. ~~Moreover, sustained~~Sustained employment gains, which are also benefiting from past structural reforms, and still relatively low oil prices provide additional support for households' real disposable income and thus for private consumption. In addition, the fiscal stance in the euro area is ~~slightly~~expected to be mildly expansionary~~. However,~~ in 2016 and to turn broadly neutral in 2017 and 2018.

At the same time, headwinds to the economic recovery in the euro area ~~continues to be dampened by~~include the outcome of the UK referendum and other geopolitical uncertainties, subdued growth prospects in emerging markets, the necessary balance sheet adjustments in a number of sectors and a sluggish pace of implementation of structural reforms. Against this background, the risks to the euro area growth outlook remain tilted to the downside.

~~This outlook is broadly reflected in the June 2016 Eurosystem staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.6% in 2016 and 1.7% in 2017 and 2018. Compared with the March 2016 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised up for 2016 and has remained broadly unchanged for 2017 and 2018.~~

~~The risks to the euro area growth outlook remain tilted to the downside, but the balance of risks has improved on the back of the monetary policy measures taken and the stimulus still in the pipeline. Downside risks continue to relate to developments in the global economy, to the upcoming British referendum and to other geopolitical risks.~~

According to ~~Eurostat's flash estimate~~Eurostat, euro area annual HICP inflation in ~~May~~June 2016 was ~~-~~0.1%, up from -0.~~2~~1% in ~~April~~May, mainly reflecting higher energy and services price inflation.~~-~~ Looking ahead, on the basis of current futures prices for oil, inflation rates are likely to remain very low ~~or negative~~ in the next few months before ~~picking~~starting to pick up later in~~ the second half of~~ 2016, in large part owing to base effects in the annual rate of change of energy prices. Supported by our monetary policy measures and the expected economic recovery, inflation rates should ~~recover~~increase further in 2017 and 2018.

~~This broad pattern is also reflected in the June 2016 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 0.2% in 2016, 1.3% in 2017 and 1.6% in 2018. In comparison with the March 2016 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised slightly up for 2016, reflecting recent oil price increases, and has remained unchanged for 2017 and 2018.~~

Turning to the **monetary analysis**, broad money (M3) continued to ~~grow~~increase at a robust pace in ~~April~~May 2016, with its annual rate of growth standing at 4.~~6~~9%, after ~~5.0~~4.6% in ~~March~~April. As in previous months, annual growth in M3 ~~is~~was mainly supported by its most liquid components, with the narrow monetary aggregate M1 ~~growing~~expanding at an annual rate of 9.1% in May, after 9.7% in April~~, after 10.1% in March~~.

Loan dynamics followed 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) ~~stood at~~increased to 1.~~2~~4% in ~~April~~May 2016, compared with 1.~~1~~2% in ~~March~~April. Developments in loans to enterprises continue to reflect the lagged relationship with the business cycle, credit risk 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) remained broadly stable at 1.6% in May, after 1.5% in April~~, after 1.6% in March~~.

The euro area bank lending survey for the second quarter of 2016 indicates further improvements in loan supply conditions for loans to enterprises and households and a continued increase in loan demand across all loan categories. Furthermore, banks continued to report that the targeted longer-term refinancing operations had contributed to more favourable terms and conditions on loans.

The monetary policy measures in place since June 2014 have ~~clearly~~significantly improved borrowing conditions for firms and households, as well as credit flows across the euro area. The comprehensive package of new monetary policy measures adopted in March this year underpins the ongoing upturn in loan growth, thereby supporting the recovery of the real economy. In the light of the prevailing uncertainties, it is essential that the bank lending channel continues to function well.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis confirmed the need to preserve an appropriate degree of monetary accommodation in order to secure a return of inflation rates towards levels that are below, but close to, 2% without undue delay.

Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance supports economic activity. As emphasised repeatedly by the Governing Council, and as again strongly echoed in both European and international policy discussions, in order to reap the full benefits from our monetary policy measures, other policy areas must contribute much more decisively, both at the national and at the European ~~levels. **Structural policies** are essential, given continued high~~level. The implementation of **structural reforms** needs to be substantially stepped up to reduce structural unemployment and ~~low~~boost potential output growth in the euro area. Structural reforms are necessary in all euro area countries, although specific reform needs differ across the individual economies. ~~At this stage, the~~The focus should be on actions to raise productivity and improve the business environment, including the provision of an adequate public infrastructure, which are vital to increase investment and boost job creation. The enhancement of current investment initiatives, including the extension of the Juncker plan, ~~and~~ progress on the capital markets union and reforms that will improve the resolution of non-performing loans will also contribute positively to this objective. In an environment of accommodative monetary policy, the swift and effective implementation of structural reforms, in line with the 2016 country-specific recommendations recently ~~published~~approved by the European ~~Commission~~Council, will not only lead to higher sustainable economic growth in the euro area but will also make the euro area more resilient to global shocks. **Fiscal policies** should also support the economic recovery, while remaining in compliance with the fiscal rules of the European Union. Full and consistent implementation of the Stability and Growth Pact over time and across countries is crucial to maintain confidence in the fiscal framework. At the same time, all countries should strive for a more growth-friendly composition of fiscal policies.

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