CENTRAL BANKS

ECB kept monetary policy stance unchanged

Soncoles Castillo / Agustin García / Maria Martinez

- The ECB kept rates unchanged and reaffirmed the plan to run the APP to March 2017 or beyond if needed
- The GC did not discuss any measures at today´s meeting (including an extension of the APP)
- The GC tasked the relevant committees to evaluate the options that ensure a smooth implementation of its purchase programme
- The Staff barely changed its projections over the forecast horizon

At today's monetary policy meeting there were no changes in the ECB´s monetary policy stance, as the central bank left key interest rates unchanged and confirmed that the monthly asset purchases of €80 billion are intended to run until the end of March 2017, or beyond if necessary. Moreover, Mr Draghi highlighted that there was no discussion at today´s meeting on expanding the asset purchase programme (APP) or any other measure. Nevertheless, he reaffirmed the Governing Council (GC) unanimity in its commitment to continue with current stimulus measures until it sees a "sustained adjustment in the path of inflation consistent with its inflation aim." Moreover, he reiterated that the central bank is willing, and able to act if needed. The risks to the euro zone growth outlook remain tilted to the downside and relate mainly to the external environment.

At the press conference, attention was focused on why the ECB did not take more measures. Mr Draghi stressed that there was no need for extra stimulus for the time being, and he clarified that the GC did not discuss an extension of the APP or other measures. "The assessment was that for the time being the changes are not substantial as to warrant a decision to act." On its readiness to do more, he said that internal committees had been tasked with examining all possible monetary policy options to redesign the APP that ensure a smooth implementation of the programme. "The committees have full mandate. They will look at all the options that might be used to redesign the programme, and then of course we'll have a discussion in the Governing Council." Today's meeting had been expected at least to make some changes to the technical parameters to cope with the scarcity of bonds in some jurisdictions. Regarding this, Mr Draghi recognised that in recent months the universe of eligible bonds had clearly been restricted and that they had to make sure that the APP could be implemented with the "new constellation of interest rates."

The ECB's Staff macroeconomic projections barely changed over the forecast horizon. Available data so far point to the euro zone's remaining resilient to increasing global economic and political uncertainty. According to the ECB, non-standard measures along with mildly expansionary fiscal policy in 2016 and neutral in 2017-18 might underpin a moderate but steady recovery at the forecast horizon, while inflation should increase by year end and further in 2017-18. GDP growth was revised slightly upwards by 0.1pp to 1.7% in 2016 and downwards by 0.1pp to 1.6% in both 2017 and 2018, in line with our forecasts. Downside risks remain tilted to the downside and mostly stem from the external environment (subdued foreign demand and Brexit). The inflation forecast for 2016 remained unchanged at 0.2% in 2016, while it was revised marginally downwards by 0.1pp to 1.2% in 2017 and unchanged at 1.6% in 2017. The recent slight moderation in core inflation figures continues to be a source of concern, but Mr Draghi stressed the ECB's confidence in the effectiveness of the non-standard measures announced so far, which might support the Staff forecast of a sustainable increase in inflation from year end. For this reason, the ECB is assessing how to implement all measures or extend them otherwise.

Against this background, Mr Draghi took the opportunity to highlight that the current ECB measures have been very effective. In particular he said that “fragmentation is over”, credit spreads have largely disappeared, and he particularly emphasised that the transmission mechanism has never worked better.

All in all, we continue to expect the ECB to adjust the QE programme before the year end. While Draghi gave no clear hints as to the choice of any particular measure, an extension of the APP combined with some technical changes to cope with the scarcity of bonds in some jurisdictions is the most likely scenario to cope with lingering risks to the EZ recovery.

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, ~~21 July~~8 September 2016

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, 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.

Today, we ~~discussed developments~~assessed the economic and monetary data which had become available since our last ~~monetary policy~~ meeting ~~in early June. Following the UK referendum on EU membership, our assessment is that euro area financial markets have weathered~~ and discussed the ~~spike in uncertainty and volatility with encouraging~~new ECB staff macroeconomic projections. Overall, while the available evidence so far suggests resilience~~. The announced readiness~~ of ~~central banks~~the euro area economy to ~~provide liquidity, if needed, and our accommodative monetary policy measures, as well as a robust regulatory~~the continuing global economic 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~~ political uncertainty, our baseline scenario ~~of an ongoing~~remains subject to downside risks.

Our comprehensive policy measures continue to ensure supportive financing conditions and underpin the momentum of the euro area economic recovery~~and an increase in~~. As a result, we continue to expect real GDP to grow at a moderate but steady pace and euro area inflation ~~rates~~to rise gradually over the coming months, in line with the path already implied in our June 2016 staff projections.

~~At the same time, given prevailing uncertainties, the~~The Governing Council will continue to monitor economic and financial market developments very closely~~ and to safeguard~~. We will preserve the ~~pass-through~~very substantial amount of ~~its accommodative~~ monetary ~~policy to the real economy. Over the coming months, when we have more information, including new~~support that is embedded in our staff projections~~, we will be in~~ and that is necessary to secure a ~~better position to reassess the underlying macroeconomic conditions, the most likely paths~~return of inflation ~~and growth, and the distribution of risks around those paths.~~to levels below, but close to, 2% over the medium term. If warranted~~ to achieve its objective, the Governing Council~~, we will act by using all the instruments available within ~~its mandate~~our mandate. Meanwhile, the Governing Council tasked the relevant committees to evaluate the options that ensure a smooth implementation of our purchase programme.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~6~~3%, quarter on quarter, in the second quarter of 2016, after 0.5% in the first quarter~~ of 2016, after 0.4% in the last quarter of 2015. Growth continues to be supported by domestic demand, while export growth has remained modest.~~. Incoming data point to ongoing growth in the ~~second~~third quarter of 2016, ~~though~~ at ~~a lower~~around the same rate ~~than~~as in the ~~first~~second 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 the demand outlook and in corporate profitability continue to promote a recovery in investment. 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 expected to be mildly expansionary in 2016 and to turn broadly neutral in 2017 and 2018.

~~At the same time, headwinds to~~ However, the economic recovery in the euro area ~~include the outcome of~~is expected to be dampened by still subdued foreign demand, partly related to the uncertainties following the UK referendum ~~and other geopolitical uncertainties, subdued growth prospects in emerging markets~~outcome, the necessary balance sheet adjustments in a number of sectors and a sluggish pace of implementation of structural reforms. ~~Against this background, the~~The risks to the euro area growth outlook remain tilted to the downside and relate mainly to the external environment.

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

According to ~~Eurostat~~Eurostat's flash estimate, euro area annual HICP inflation in ~~June~~August 2016 was 0.~~1%, up~~2%, unchanged from ~~-0.1% in May, mainly reflecting higher~~July. While annual energy ~~and~~ inflation continued to rise, services ~~price inflation.~~ and non-energy industrial goods inflation turned out to be slightly lower than in July. Looking ahead, on the basis of current oil futures prices~~ for oil~~, inflation rates are likely to remain ~~very~~ low ~~in~~over the next few months before starting to pick up ~~later in~~towards the end 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 increase further in 2017 and 2018.

This pattern is also reflected in the September 2016 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 0.2% in 2016, 1.2% in 2017 and 1.6% in 2018. In comparison with the June 2016 Eurosystem staff macroeconomic projections, the outlook for HICP inflation is broadly unchanged.

Turning to the **monetary analysis**, broad money (M3) continued to increase at a robust pace in ~~May~~July 2016, with its annual rate of growth standing at 4.~~9~~8%, after ~~4.6~~5.0% in ~~April~~June. As in previous months, annual growth in M3 was mainly supported by its most liquid components, with the narrow monetary aggregate M1 expanding at an annual rate of ~~9.1~~8.4% in ~~May~~July, after ~~9~~8.7% in ~~April~~June.

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)~~ increased to 1.~~4~~9% in ~~May~~July 2016, compared with 1.~~2~~7% in ~~April. Developments in~~ June. The annual growth rate of loans to ~~enterprises~~households remained stable at 1.8% in July. Although developments in bank credit 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~~, the monetary policy measures in place since June 2014 are increasingly filtering through to support borrowing conditions for firms and households and thereby credit flows across the euro area.

~~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 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~~the very substantial amount of monetary ~~accommodation~~support that is necessary 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 level. The implementation of **structural** ~~**reforms**~~~~needs~~**reforms** needs to be substantially stepped up to reduce structural unemployment and 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.~~. 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, 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 approved by the European 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~~remains crucial to ~~maintain~~ensure 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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