CENTRAL BANKS

ECB closer to a neutral balance of risks

María Martínez / Juan Navarro

- There was neither a discussion on the exit strategy nor clear hints of an early shift in the policy stance
- But risks to growth are more balanced (though still downwards)
- We expect some changes in forward guidance in June

As expected, at today's monetary policy meeting there were no changes in the ECB's monetary policy stance, as the central bank left key policy rates unchanged and confirmed that the monthly asset purchases of €60 billion are intended to run until the end of December 2017 (or beyond if necessary). The dovish stance remains in place as the ECB states that they stand ready to act if needed, reaffirming that policy rates are still expected to remain "at present or lower levels for an extended period of time, and well past the horizon of (the ECB's) net asset purchases". During the press conference, Mr Draghi highlighted the agreement of the Governing Council (GC) on the appropriateness of the current monetary policy stance, as they do not discuss the need of changes.

The main piece of news was on the economic outlook, as risks are moving to a more balance configuration, but remain tilted to the downside.

The balance of risks regarding economic outlook is evolving. The ECB has agreed that now risks to growth are closer to be balanced. "The risks surrounding the euro area growth outlook, while moving towards a more balanced configuration, are still tilted to the downside and relate predominantly to global factors." Draghi recognize that there were different views in the GC on this change as "some members had a more sanguine view on the economic situation", while "others believed that assessment did not need change." Moreover, the central bank also made slight changes on the judgment on the euro area recovery from "somewhat stronger" to "stronger", "the euro area economy is becoming increasingly solid and that downside risks have further diminished". Meanwhile, Mr Draghi made clear that the assessment of the inflation outlook has not suffered any modification. "Underlying inflation pressures continue to remain subdued and have yet to show a convincing upward trend."

During the Q&A, Draghi stated that the GC neither discussed the exit strategy nor any change in its forward guidance. He highlighted that there is no reason to deviate from the current monetary policy path, and hence there is no need to discuss the sequencing of the exit now. He also took the opportunity to remind the audience that tools implemented until now are powerful, stressing that side effects of negative rates have been limited.

Draghi did not give any hints on the next measures to be taken in the short term. He maintained a cautious mood regarding any change in the ECB guidance or in the monetary policy stance. However, the central bank's assessment is "in a process, in evolution" in light of economic conditions. Thus, in line with our growth and inflation projections, we would expect a gradual reassessment on the forward guidance, probably starting in June. It is likely that the ECB will adopt a neutral balance of risks on growth and on interest rates (removing the current downward bias), although maintaining a very cautious tone.

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, ~~9 March~~27 April 2017

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 ~~we will continue to make purchases under the asset purchase programme (APP) at the current monthly pace of €80 billion until the end of this month and that, from April 2017,~~ our net asset purchases ~~are intended to continue~~, at ~~a~~the new monthly pace of €60 billion, are intended to run until the end of December 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. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the ~~APP~~asset purchase programme.

Our monetary policy measures have continued to preserve the very favourable financing conditions that are necessary to secure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term. ~~Their ongoing pass-through to the borrowing conditions for firms and households benefits credit creation and supports the steadily firming recovery of the euro area economy. Sentiment indicators suggest~~Incoming data since our meeting in early March confirm that the cyclical recovery ~~may be gaining momentum. Headline inflation has again increased, largely on account of rising energy and food price inflation. However~~of the euro area economy is becoming increasingly solid and that downside risks have further diminished. At the same time, underlying inflation pressures continue to remain subdued~~. The Governing Council will continue~~ and have yet to show a convincing upward trend. Moreover, the ongoing volatility in headline inflation underlines the need to look through ~~changes~~transient developments in HICP inflation ~~if judged to be transient and to~~, which have no implication for the medium-term outlook for price stability.

A very substantial degree of monetary accommodation is still needed for underlying inflation pressures to build up and support headline inflation in the medium term. If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, we stand ready to increase our asset purchase programme in terms of size and/or duration.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~4~~5%, quarter on quarter, in the fourth quarter of 2016, following a ~~similar pace of~~ growth rate of 0.4% in the third quarter. Incoming data, notably survey results, ~~increase~~bolster our confidence that the ongoing economic expansion will continue to firm and broaden. The pass-through of our monetary policy measures is supporting domestic demand and facilitates the ongoing deleveraging process. The recovery in investment continues to ~~be promoted by~~benefit from very favourable financing conditions and improvements in corporate profitability. ~~Moreover, rising employment~~Employment gains, which ~~is~~are also benefiting from past ~~structural~~labour market reforms, ~~is having a positive impact on households'~~are supporting real disposable income~~, thereby providing support for~~ and private consumption. ~~Also, there are~~ Moreover, the signs of a ~~somewhat~~ stronger global recovery and increasing global trade~~.~~ suggest that foreign demand should increasingly add to the overall resilience of the economic expansion in the euro area. However, economic growth ~~in the euro area is expected~~continues to be dampened by a sluggish pace of implementation of structural reforms~~ and~~, in particular in product markets, and by remaining balance sheet adjustment needs in a number of sectors. The risks surrounding the euro area growth outlook, while moving towards a more balanced configuration, are still tilted to the downside and relate predominantly to global factors.

~~This assessment is broadly reflected in the March 2017 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.8% in 2017, by 1.7% in 2018 and by 1.6% in 2019. Compared with the December 2016 Eurosystem staff macroeconomic projections, the outlook for real GDP growth~~ Headline inflation has been ~~revised upwards slightly in 2017 and 2018. The risks surrounding the euro area growth outlook have become less pronounced, but remain tilted to the downside and relate predominantly to global factors.According to Eurostat's flash estimate~~recovering from the very low levels seen in 2016, largely owing to higher energy price increases. After reaching 2.0% in February 2017, euro area annual HICP inflation ~~increased further to 2.0% in February, up from 1.8% in January 2017 and 1.1% in December 2016.~~stood at 1.5% in March. This reflected mainly ~~a strong increase in annual~~lower energy and unprocessed food price inflation, ~~with no signs yet of a convincing upward trend in~~ but also a decline in services price inflation. Looking ahead, on the basis of current futures prices for oil, headline inflation is likely to increase in April and thereafter to hover around current levels until the end of this year. However, as unutilised resources are still weighing on domestic wage and price formation, measures of underlying inflation~~. Headline inflation is likely to remain at levels close to 2% in the coming months, largely reflecting movements in the annual rate of change of energy prices. Measures of underlying inflation, however, have remained~~ remain low and are expected to rise only gradually over the medium term, supported by our monetary policy measures, the expected continuing economic recovery and the corresponding gradual absorption of slack.

~~This pattern is also reflected in the March 2017 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.7% in 2017, 1.6% in 2018 and 1.7% in 2019. By comparison with the December 2016 Eurosystem staff macroeconomic projections, the outlook for headline HICP inflation has been revised upwards significantly for 2017 and slightly for 2018, while remaining unchanged for 2019. The staff projections are conditional on the full implementation of all our monetary policy measures.~~

Turning to the **monetary analysis**, broad money (M3) continues to expand at a robust pace, with an annual rate of growth of 4.~~9~~7% in ~~January~~February 2017, after ~~5.0~~4.8% in ~~December 2016~~January. 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 8.4% in ~~January~~February 2017, ~~after 8.8% in December 2016~~unchanged from the previous month.

~~Loan dynamics followed the path of gradual~~ The recovery in loan growth to the private sector observed since the beginning of 2014~~.~~ is proceeding. The annual growth rate of loans to non-financial corporations ~~was~~declined to 2.0% in February 2017, from 2.3% in ~~January 2017, as in~~ the previous month~~. The~~, while the annual growth rate of loans to households ~~was 2.~~remained broadly stable at 2~~% in January 2017, after 2.0% in December 2016. Although developments in~~.3% in February. At the same time, the euro area bank ~~credit continue to reflect the lagged relationship with the business cycle, credit risk~~lending survey for the first quarter of 2017 indicates that net loan demand has increased and ~~the ongoing adjustment of financial and non-financial sector balance sheets,~~bank lending conditions have further eased across all loan categories. The pass-through of the monetary policy measures put in place since June 2014 ~~are~~continues to significantly ~~supporting~~support borrowing conditions for firms and households and ~~thereby~~ 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 confirmed the need for a continued very substantial degree of monetary accommodation to secure a sustained return of inflation rates towards levels that are below, but close to, 2% without undue delay.

In order to reap the full benefits from our monetary policy measures, other policy areas must contribute much more decisively to strengthening economic growth. The implementation of **structural reforms** needs to be substantially stepped up to increase resilience, reduce structural unemployment and boost ~~potential output growth. Against the background of overall limited implementation of country-specific recommendations in 2016, greater reform effort is necessary in all euro area countries in 2017.~~productivity and potential output growth. Regarding **fiscal policies**, all countries should intensify efforts towards achieving a more growth-friendly composition of public finances. A full and consistent implementation of the Stability and Growth Pact and of the macroeconomic imbalances procedure over time and across countries remains crucial to ~~ensure confidence in the EU's governance framework~~enhance the resilience of the euro area economy.

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