ECB Watch: ECB on a wait and see stance

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- **There was no discussion on any change in the QE recalibration**
- **The ECB seems more confident on the economic expansion**
- **Significant upward revision of staff's growth forecasts**

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 reiterated that APP will run since January 2018 at a monthly pace of EUR30bn until September 18, or beyond, if necessary. Dovish bias was retained as the central bank remains stick to its pledge to keep interest rates unchanged until well past the horizon of the net asset purchases. Along the same lines, the Governing Council (GC) continues to stand ready to increase the APP in terms of size and/or duration."

Regarding the ECB staff projections, stronger economic growth in 2H17, robust domestic fundamentals and improving global demand have led the ECB to raise growth forecasts significantly, by 0.2pp in 2017 (to 2.4%), 0.5pp to 2.3% in 2018 and 0.2pp to 1.9% in 2019. For 2020, they expect growth to moderate further to 1.7%. Risks to this growth scenario remain broadly balanced. Regarding inflation, they have also revised up the projections for 2018 (by 0.2pp to 1.4%) driven by the recent increase in oil prices (around 17% and 10% above the assumption incorporated in September projections), but they continue to expect a very gradual increase over the forecast horizon, projecting a 1.5% annual inflation rate for 2019 and 1.7% for 2020. Behind these projections lies the better economic performance, which should further reduce slack and underpin the ECB's confidence in achieving the inflation target over the medium term. It is worth noting that despite core inflation have been revised downward for 2018, mainly due to recent negative surprise, the staff expects it to increase gradually to 1.5% in 2019 and 1.8% in 2020. Despite this upbeat outlook, Mr. Draghi stressed that the extension of the APP program next year remains appropriate to achieve the inflation target, as domestic price pressures remain muted, and that they will continue to monitor wage growth in coming months, looking for signs of sustainability in the upward trend of core inflation.

During the Q&A, part of the attention was focused on the QE recalibration and Mr Draghi declined to give any details. According to recent comments from ECB members and to October's monetary policy meeting minutes it is well known that there has been a lively debate on the decision to keep the APP programme open-ended within the GC. On this issue, Mr Draghi said that they did not discuss about it at this meeting, but that at October meeting a vast majority was in favour of the open ended feature. Besides, he also stated that there was no discussion on cutting the direct link between inflation and bond purchases. Nonetheless, he acknowledged that as economic expansion gains further strength the component of coming from the forward guidance of interest rates will gain further importance.

In sum, the ECB left monetary policy unchanged, as expected, and it refused to give further details on the QE recalibration and the future of the exit strategy. Certainly, the ECB is not in a hurry to signal the end of QE, but sooner or later the central bank should be ready to adjust its policy stance.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in grey 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, ~~26 October~~14 December 2017
INTRODUCTORY STATEMENT

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 President of the Eurogroup, Mr Dijsselbloem, and by the Commission Vice-President, Mr Dombrovskis.

Based on our regular economic and monetary analyses, ~~today we conducted a thorough assessment of~~we decided to keep the ~~outlook for inflation, the risks surrounding this outlook and our monetary policy stance. As a result, the Governing Council took the following decisions in pursuit of its price stability objective.~~

~~First, the~~ key ECB interest rates ~~were kept~~ unchanged ~~and we~~. We continue to expect them to remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases.

~~Second, as regards~~ Regarding non-standard monetary policy measures, we ~~will~~ confirm that from January 2018 we intend to continue to make net asset purchases under the asset purchase programme (APP~~) at the current monthly pace of €60 billion until the end of December 2017. From January 2018 our net asset purchases are intended to continue~~), at a monthly pace of €30 billion, until the end of September 2018, 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. 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 the APP in terms of size and/or duration.

~~Third, the~~ The Eurosystem will reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary. This will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance.

~~And fourth, we also decided to continue to conduct 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 2019.~~

~~Today's~~Our monetary policy decisions ~~were taken to preserve~~have preserved the very favourable financing conditions that are still needed for a sustained return of inflation rates towards levels that are below, but close to, 2%. The ~~recalibration of~~ incoming information, including our ~~asset purchases reflects growing~~new staff projections, indicates a strong pace of economic expansion and a significant improvement in the growth outlook. The strong cyclical momentum and the significant reduction of economic slack give grounds for greater confidence ~~in the gradual convergence of~~ that inflation ~~rates~~will converge towards our inflation aim~~, on account of the increasingly robust and broad-based economic expansion, an uptick in measures of underlying inflation and the continued effective pass-through of our policy measures to the financing conditions of the real economy.~~. At the same time, domestic price pressures ~~are still~~remain muted overall and ~~the economic outlook and the path of inflation remain conditional on continued support from monetary policy. Therefore, an~~have yet to show convincing signs of a sustained upward trend. An ample degree of monetary stimulus therefore remains necessary for underlying inflation pressures to continue to build up and support headline inflation developments over the medium term. This continued monetary support is provided by the additional net asset purchases that we decided on at our October monetary policy meeting, by the sizeable stock of acquired assets and the forthcoming reinvestments, and by our forward guidance on interest rates.

Let me now explain our assessment in greater detail, starting with the economic analysis. The economic expansion in the euro area ~~continues to be solid and broad-based. Real~~ continued in the third quarter of 2017, when real GDP increased by 0.~~7%,~~6% quarter on quarter, ~~in the second quarter of 2017,~~ after 0.~~6~~7% in the ~~first~~second quarter. The latest data and survey results point to ~~unabated~~solid and broad-based growth momentum ~~in the second half of this year.~~. Our monetary policy measures, which have facilitated the deleveraging process ~~and~~, continue to support domestic demand. Private consumption is underpinned by ~~rising~~ongoing employment gains, which ~~is~~are also benefiting from past labour market reforms, and by ~~increasing~~rising household wealth. ~~The upswing in business~~Business investment continues to ~~benefit from~~ strengthen on the back of very favourable financing conditions~~ and improvements in~~ , rising corporate profitability~~. Construction~~ and strengthening demand. Housing investment has also ~~strengthened.~~risen further over recent quarters. In addition, euro area exports are being supported by the broad-based global ~~recovery is supporting euro area exports~~expansion.

This assessment is broadly reflected in the December 2017 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 2.4% in 2017, 2.3% in 2018, 1.9% in 2019 and 1.7% in 2020. Compared with the September 2017 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised up substantially.

Risks surrounding the euro area growth outlook remain broadly balanced. On the one hand, the strong cyclical momentum, ~~as evidenced in recent~~ underpinned by continued positive developments in sentiment indicators, could lead to further positive growth surprises in the near term. On the other hand, downside risks continue to relate primarily to global factors and developments in foreign exchange markets.

~~Euro~~According to Eurostat's flash estimate, euro area annual HICP inflation ~~remained unchanged at~~was 1.5% in ~~September~~November, up from 1.4% in October. At the same time, measures of underlying inflation have moderated somewhat recently, in part owing to special factors. Looking ahead, on the basis of current futures prices for oil, annual rates of headline inflation are likely to ~~temporarily decline towards~~ moderate in the ~~turn of the year~~coming months, mainly reflecting base effects in energy prices~~. At the same time, measures of underlying inflation have ticked up moderately since early 2017, but have yet to show more convincing signs of a sustained upward trend. Wage growth has increased somewhat, but domestic cost pressures still remain subdued overall.~~, before increasing again. Underlying inflation ~~in the euro area~~ is expected ~~to continue~~ to rise gradually over the medium term, supported by our monetary policy measures, the continuing economic expansion, the corresponding ~~gradual~~ absorption of economic slack and rising wage growth.

This assessment is also broadly reflected in the December 2017 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.5% in 2017, 1.4% in 2018, 1.5% in 2019 and 1.7% in 2020. Compared with the September 2017 ECB staff macroeconomic projections, the outlook for headline HICP inflation has been revised up, mainly reflecting higher oil and food prices.

Turning to the monetary analysis, broad money (M3) continues to expand at a robust pace, with an annual rate of growth of 5.~~1~~0% in October 2017, from 5.2% in September~~ 2017, after 5.0% in August. As in previous months, annual growth in M3 was mainly supported by its~~, reflecting the impact of the ECB's monetary policy measures and the low opportunity cost of holding the most liquid ~~components, with~~deposits. Accordingly, the narrow monetary aggregate M1 continued to be the main contributor to broad money growth, expanding at an annual rate of 9.~~7~~4% in October, after 9.8% in September~~ 2017, up from 9.5% in August~~.

The recovery in the growth of loans to the private sector observed since the beginning of 2014 is proceeding. The annual growth rate of loans to non-financial corporations increased to 2.~~5~~9% in ~~September~~October 2017, after 2.4% in ~~August~~September, while the annual growth rate of loans to households remained stable at 2.7%.~~ The euro area bank lending survey for the third quarter of 2017 indicates that net loan demand has continued to increase for all loan categories. Credit standards have further eased for loans to households, while they remained broadly unchanged for loans to enterprises. Banks' overall terms and conditions on new loans have continued to ease for all categories of loans.~~

The pass-through of the monetary policy measures put in place since June 2014 continues to significantly support borrowing conditions for firms and households, access to financing – notably for small and medium-sized enterprises – and 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 ~~to recalibrate the policy instruments to ensure the~~for an ample degree of monetary accommodation~~ necessary~~ to secure a sustained return of inflation rates towards levels that are below, but close to, 2%.

In order to reap the full benefits from our monetary policy measures, other policy areas must contribute decisively to strengthening the longer-term growth potential and reducing vulnerabilities. The implementation of structural reforms in all euro area countries needs to be substantially stepped up to increase resilience, reduce structural unemployment and boost euro area productivity and growth potential. ~~Regarding fiscal policies, all~~Regarding fiscal policies, the increasingly solid and broad-based expansion strengthens the case for rebuilding fiscal buffers. This is particularly important in countries where government debt remains high. All countries would benefit from intensifying efforts towards achieving a more growth-friendly composition of public finances. A full, transparent and consistent implementation of the Stability and Growth Pact and of the macroeconomic imbalance procedure over time and across countries remains essential to increase the resilience of the euro area economy. Strengthening Economic and Monetary Union remains a priority. The Governing Council welcomes the ongoing discussions on completing the banking union and the capital markets union, and on further enhancing the institutional architecture of our Economic and Monetary Union.

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