Central Banks

The ECB delivers on QE exit and gives strong guidance on rates

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- **The Asset Purchase Programme will end in December 2018.**
- **However, interest rates will remain on hold at least until the summer 2019, later than expected.**
- **Macro projections were revised in line with expectations: GDP down in 2018 to 2.1% and inflation up in 2018 and 2019 to 1.7%.**

At today´s meeting, the ECB unveiled very specific details of monetary policy normalization. As regards non-standard measures, the central bank decided **to reduce monthly asset purchase programme (APP) after September to €15 billion and ending the programme in December 2018.** No changes in the reinvestment of the principal of the securities purchased under the APP, i.e to be maintained for an extended period after the end of the net purchases, for as long as necessary.

Regarding standard measures, key interest rates were left unchanged, as expected, while **the ECB, unexpectedly, strengthened its forward guidance on rates announcing that "the key ECB interest rates to remain at their present levels at least through the summer of 2019** and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations of a sustained adjustment path," instead of its previous pledge to keep them unchanged until "well past" the horizon of the net asset purchases. **This way, the ECB has given priority to anchoring interest rates expectations to ensure that monetary conditions do not tighten, while losing some flexibility for the coming year.**

The ECB's assessment of the economic outlook remains broadly unchanged, but now it is more confident of the sustained upward trend in underlying inflation over the forecast horizon. This is supported by the solid and broad-based recovery, but also by the fact that inflation expectations remain well anchored despite the fact that markets have been pricing the end of the QE by year end for some time now.

The updated GDP growth forecasts are weaker in 2018 (-0.3 pp to 2.1%) due to the slowdown in the first quarter (partly because of temporary factors and the pause after very high growth in 2H17), but remain unchanged in 2019-20 (1.9% and 1.7%, respectively). Robust global demand and a more depreciated euro should offset the negative effect of higher oil prices on activity. However, these changes in oil prices and the exchange rate have led the ECB to revise its headline inflation forecasts upwards by 0.3 pp to 1.7% for both 2018 and 2019, while core inflation has also been revised slightly upwards by 0.1 pp in 2019 and 2020 to 1.6% and 1.9%, respectively. **Despite risks to economic growth being balanced,** according to the statement, Mr. Draghi highlighted the **"unquestionable increase" in global** (protectionism and geopolitical) and **domestic** (Italy) **uncertainty** in recent weeks, **so that monetary policy decisions will remain data-dependent over the coming months.**

Mr. Draghi said that **today's decisions were taken unanimously**, emphasizing that the Governing Council (GC) was unanimous about maintaining "optionality" on all parts of the decisions. **The tone remained dovish; the easing bias was retained as the central bank reiterated that it "stands ready to adjust all of its instruments** as appropriate to ensure that inflation continues to move towards the GC's inflation aim in a sustained manner." In particular, he took the opportunity to make clear that the APP is not disappearing, emphasizing that it will remain as a normal instrument of monetary policy. Moreover, the GC stressed that significant monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term.

Overall, the ECB has announced the end of the QE, as expected. However, the central bank also unexpectedly gave explicit rate path guidance, keeping rates steady at least through next summer. Against this background, we expect a delay in the hiking cycle relative to our previous scenario (by March 2019 the first depo hike and by June 2019 the first refi rate hike). In any case, today the ECB has taken another important step in the normalization process of its monetary policy.

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~~Luis de Guindos, Vice-President of the ECB,

~~Frankfurt am Main, 8 March~~Riga, 14 June 2018

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~~ I would like to thank Deputy Governor Razmusa for her kind hospitality and express our special gratitude to her staff for the excellent organisation of today's meeting of the Governing Council. We will now report on the outcome of our meeting.
~~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 their present levels for an extended period of time, and well past the horizon of our net asset purchases.~~

~~Regarding~~Since the start of our asset purchase programme (APP) in January 2015, the Governing Council has made net asset purchases under the APP conditional on the extent of progress towards a sustained adjustment in the path of inflation to levels below, but close to, 2% in the medium term. Today, the Governing Council undertook a careful review of the progress made, also taking into account the latest Eurosystem staff macroeconomic projections, measures of price and wage pressures, and uncertainties surrounding the inflation outlook.

As a result of this assessment, the Governing Council concluded that progress towards a sustained adjustment in inflation has been substantial so far. With longer-term inflation expectations well anchored, the underlying strength of the euro area economy and the continuing ample degree of monetary accommodation provide grounds to be confident that the sustained convergence of inflation towards our aim will continue in the period ahead, and will be maintained even after a gradual winding-down of our net asset purchases.

Accordingly, the Governing Council today made the following decisions:
First, as regards **non-standard monetary policy measures**, we ~~confirm that our~~will continue to make net ~~asset~~ purchases~~,~~ under the APP at the current monthly pace of €30 billion~~, are intended to run~~ until the end of September 2018~~, or beyond, if necessary, and in any case~~. We anticipate that, after September 2018, subject to incoming data confirming our medium-term inflation outlook, we will reduce the monthly pace of the net asset purchases to €15 billion until the ~~Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. The Eurosystem will continue to reinvest~~end of December 2018 and then end net purchases.

Second, we intend to maintain our policy of reinvesting the principal payments from maturing securities purchased under the ~~asset purchase programme~~ APP for an extended period of time after the end of ~~its~~our net asset purchases, and in any case for as long as necessary~~. This will contribute both to~~ to maintain favourable liquidity conditions and ~~to~~ an ~~appropriate~~ample degree of monetary ~~policy stance~~accommodation.
~~Incoming information, including our new staff projections, confirms the strong and broad-based growth momentum in the euro area economy, which is projected to expand in the near term at a somewhat faster pace than previously expected. This outlook for growth confirms our confidence that inflation will converge towards our inflation aim of~~ Third, we decided to keep the **key ECB interest rates** unchanged and we expect them to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path.

Today's monetary policy decisions maintain the current ample degree of monetary accommodation that will ensure the continued sustained convergence of inflation towards levels that are below, but close to, 2% over the medium term. ~~At the same time, measures of underlying inflation remain subdued and have yet to show convincing signs of a sustained upward trend. In this context, the Governing Council will continue to monitor developments in the exchange rate and financial conditions with regard to their possible implications for the inflation outlook. Overall, an ample degree of monetary~~ Significant monetary policy stimulus ~~remains necessary for underlying inflation pressures~~is still needed to ~~continue to build up and~~ support the further build-up of domestic price pressures and headline inflation developments over the medium term. This ~~continued monetary~~ support ~~is~~will continue to be provided by the net asset purchases until the end of the year, by the sizeable stock of acquired assets and the ~~forthcoming~~associated reinvestments, and by our enhanced forward guidance on the key ECB interest rates. In any event, the Governing Council stands ready to adjust all of its instruments as appropriate to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. ~~Real~~Quarterly real GDP ~~increased by~~ growth moderated to 0.~~6%,~~4% in the first quarter ~~on quarter, in the fourth quarter of 2017, after increasing by~~of 2018, following growth of 0.7% in the ~~third quarter. The latest economic data~~ previous quarters. This moderation reflects a pull-back from the very high levels of growth in 2017, compounded by an increase in uncertainty and some temporary and supply-side factors at both the domestic and the global level, as well as weaker impetus from external trade. The latest economic indicators and survey results ~~indicate continued strong~~are weaker, but remain consistent with ongoing solid and broad-based economic growth ~~momentum~~. Our monetary policy measures, which have facilitated the deleveraging process, continue to underpin domestic demand. Private consumption is supported by ~~rising~~ongoing employment gains, which ~~is also benefiting from~~, in turn, partly reflect past labour market reforms, and by growing household wealth. Business investment ~~continues to strengthen on~~is fostered by the ~~back of very~~ favourable financing conditions, rising corporate profitability and solid demand. Housing investment ~~has improved further over recent quarters.~~remains robust. In addition, the broad-based ~~global~~ expansion in global demand is expected to continue, thus providing impetus to euro area exports.

This assessment is broadly reflected in the ~~March~~June 2018 ~~ECB~~Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 2.~~4~~1% in 2018, 1.9% in 2019 and 1.7% in 2020. Compared with the ~~December 2017 Eurosystem~~March 2018 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised ~~up~~down for 2018 and remains unchanged for 2019 and 2020.

The risks surrounding the euro area growth outlook ~~are assessed as~~remain broadly balanced. ~~On the one hand, the prevailing positive cyclical momentum could lead to stronger growth in the near term. On the other hand, downside risks continue to relate primarily~~Nevertheless, uncertainties related to global factors, including ~~rising~~the threat of increased protectionism ~~and developments in foreign exchange and other~~, have become more prominent. Moreover, the risk of persistent heightened financial ~~markets~~market volatility warrants monitoring.

According to Eurostat's flash estimate, euro area annual HICP inflation ~~decreased~~increased to 1.~~2~~9% in ~~February~~May 2018, from 1.~~3~~2% in ~~January~~April. This reflected ~~mainly negative base effects in unprocessed~~higher contributions from energy, food and services price inflation. ~~Looking ahead, on~~On the basis of current futures prices for oil, annual rates of headline inflation are likely to hover around ~~1.5%~~the current level for the remainder of the year. ~~Measures~~While measures of underlying inflation remain ~~subdued overall. Looking forward~~generally muted, they have been increasing from earlier lows. Domestic cost pressures are strengthening amid high levels of capacity utilisation, tightening labour markets and rising wages. Uncertainty around the inflation outlook is receding. Looking ahead, underlying inflation is expected to ~~rise~~pick up towards the end of the year and thereafter to increase gradually over the medium term, supported by our monetary policy measures, the continuing economic expansion, the corresponding absorption of economic slack and rising wage growth.

This assessment is also broadly reflected in the ~~March~~June 2018 ~~ECB~~Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.~~4~~7% in 2018, ~~1.4% in~~ 2019 and ~~1.7% in~~ 2020. Compared with the ~~December 2017 Eurosystem~~March 2018 ECB staff macroeconomic projections, the outlook for headline HICP inflation has been revised ~~down slightly~~up notably for ~~2019~~2018 and ~~remains unchanged for 2018 and 2020~~2019, mainly reflecting higher oil prices.

Turning to the **monetary analysis**, broad money (M3) ~~continues to expand at a robust pace, with an annual rate of~~ growth ~~of 4.6~~stood at 3.9% in April 2018, after 3.7% in March and 4.3% in ~~January 2018, unchanged from~~February. While the ~~previous month, reflecting~~slower momentum in M3 dynamics over recent months mainly reflects the reduction in the monthly net asset purchases since the beginning of the year, M3 growth continues to be supported by the impact of the ECB's monetary policy measures and the low opportunity cost of holding the most liquid deposits. Accordingly, the narrow monetary aggregate M1 remained the main contributor to broad money growth, ~~continuing to expand at a solid annual rate~~although its annual growth rate has receded in recent months from the high rates previously observed.

The recovery in the growth of loans to the private sector observed since the beginning of 2014 is ~~progressing~~proceeding. The annual growth rate of loans to non-financial corporations ~~strengthened to~~ stood at 3.~~4~~3% in ~~January~~April 2018, ~~after 3.1% in December 2017, while~~unchanged from the previous month, and the annual growth rate of loans to households also remained ~~unchanged~~stable, at 2.9%.

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~~ and credit flows across the euro area. This is also reflected in the results of the latest Survey on the Access to Finance of Enterprises in the euro area, which indicates that small and medium-sized enterprises in particular benefited from improved access to financing.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis confirmed that today's monetary policy decisions will ensure the ~~need for an~~ ample degree of monetary accommodation ~~to secure a~~necessary for the continued sustained ~~return~~convergence of inflation ~~rates~~ towards levels that are below, but close to, 2% over the medium term.

In order to reap the full benefits from our monetary policy measures, other policy areas must contribute more decisively to raising the longer-term growth potential and reducing vulnerabilities. The implementation of **structural reforms** in euro area countries needs to be substantially stepped up to increase resilience, reduce structural unemployment and boost euro area productivity and growth potential. ~~Against the background of overall limited implementation of the 2017 country-specific recommendations, as communicated by the European Commission yesterday, greater reform effort is necessary in the euro area countries. Regarding **fiscal policies**, the increasingly solid and~~Regarding **fiscal policies**, the ongoing broad-based expansion calls 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. ~~Deepening~~Improving the functioning of Economic and Monetary Union remains a priority. The Governing Council urges specific and decisive steps to complete the banking union and the capital markets union.

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