Central Banks

ECB: no decisions, but more dovish on the balance of risks

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- **The Governing Council is assessing the extent of the slowdown before discussing monetary policy measures**
- **The balance of risks has moved to the downside**
- **No modification in the policy or forward guidance, but the door is open for changes in the coming months**

The interest of this week's meeting was mostly seeing to what extent is the ECB worried about the current loss of growth momentum. **No decisions were expected and indeed the ECB maintained its monetary policy stance,** leaving key interest rates unchanged and reiterating that they expect them to remain "at their present levels at least through the summer of 2019, and in any case for as long as necessary." During the press conference **Draghi insisted that this forward guidance is time dependent *and* data dependent, implying that they may change it if the economy worsens further.**

In particular, there were many questions about the nature of the current slowdown and Draghi reiterated that now we have to check the persistence of the data -as part of the bad news is expected to be only temporary. On this issue, beyond some one-off factors in specific countries and sectors, slowing global demand (China) is also weighing on activity. In addition, the longer uncertainty on protectionism and *brexit* lasts, the more confidence deteriorates, and the **economic momentum could be lower than expected in the coming quarters**. However, Draghi emphasized that the **probability of a recession is low**.

The most important change in the statement came from the economic side as **the ECB changed the balance of risks on growth to the downside. In December the language on risks was less clear-cut (risks "moving" to the downside).**The persistence of uncertainties is related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility. **The dovish tone was retained** as the statement reiterated that an **"ample degree of monetary stimulus remains necessary" and it stands ready to adjust all of its instruments** (the full toolbox is available, according to Draghi's words) if needed.

Draghi said that there had been **unanimity within the Governing Council on the assessment of the situation,** but that they did not discuss (policy) implications of changing balance of risks. "Today's meeting was essentially devoted to an assessment".

When Mr Draghi was asked about the market **expectations on the first rate hike** - now pricing in mid-2020-, he replied that markets had understood the ECB's "reaction function". This suggests that **the central bank does not seem uncomfortable with market expectations.**

On the reinvestment of asset purchases, the policy remains also unchanged as the ECB retained that it remains in full, for an extended period of time past the date when we start raising the key ECB interest rates.

On the possibility of **another liquidity provision (LTRO), no decisions were taken either,** though several member of the GC had mentioned the topic during the meeting. **We continue to expect the ECB to announce a new round of LTROs by March or June 2019, in order to avoid a liquidity cliff.**

Overall, today's statement and press conference was one of those examples of a wait-and-see stance, but leaning to the dovish side (as we expected). In this way, **the ECB leaves the door open to altering its forward guidance on rates in the coming months and delaying its rate hikes.**

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

in grey, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE)

1.1. Mario Draghi, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, ~~13 December 2018~~24 January 2019

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 ~~of the Eurogroup~~, Mr ~~Centeno~~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 their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.

Regarding **non-standard monetary policy measures**, ~~our net purchases under the asset purchase programme (APP) will end in December 2018. At the same time, we are enhancing our forward guidance on reinvestment. Accordingly,~~ we intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the ~~APP~~asset purchase programme for an extended period of time past the date when we start raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

~~While~~The incoming information has ~~been~~continued to be weaker than expected~~, reflecting~~ on account of softer external demand ~~but also~~and some country and sector-specific factors~~,~~. The persistence of uncertainties in particular relating to geopolitical factors and the ~~underlying strength of domestic demand continues~~threat of protectionism is weighing on economic sentiment. At the same time, supportive financing conditions, favourable labour market dynamics and rising wage growth continue to underpin the euro area expansion and gradually rising inflation pressures. This supports our confidence ~~that~~in the continued sustained convergence of inflation to ~~our aim will proceed and will be maintained even after~~levels that are below, but close to, 2% over the ~~end of our net asset purchases. At the same time, uncertainties related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility remain prominent.~~medium term. Significant monetary policy stimulus ~~is still needed~~remains essential to support the further build-up of domestic price pressures and headline inflation developments over the medium term. ~~Our~~This will be provided by our forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of acquired assets~~, continues to provide the necessary degree of monetary accommodation for the sustained convergence of inflation to our aim.~~. 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**. Euro area real GDP increased by 0.2%, quarter on quarter, in the third quarter of 2018, following growth of 0.4% in the previous two quarters. ~~The latest~~Incoming data ~~and survey results~~ have ~~been~~continued to be weaker than expected~~, reflecting~~ as a ~~diminishing contribution from~~ result of a slowdown in external demand ~~and~~compounded by some country and sector-specific factors. While the impact of some of these factors ~~are likely to unwind, this may suggest some slower~~ is expected to fade, the near-term growth momentum is likely to be weaker than previously anticipated. Looking ahead~~. At the same time, domestic demand, also backed by our accommodative monetary policy stance, continues to underpin the economic expansion in~~, the euro area~~. The strength of the labour market, as reflected in ongoing~~ expansion will continue to be supported by favourable financing conditions, further employment gains and rising wages, ~~still supports private consumption. Moreover, business investment is benefiting from domestic demand, favourable financing conditions and improving balance sheets. Residential investment remains robust. In addition, the~~lower energy prices, and the ongoing – albeit somewhat slower – expansion in global activity ~~is still expected to continue, supporting euro area exports, although at a slower pace~~.

~~This assessment is broadly reflected in the December 2018 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.9% in 2018, 1.7% in 2019, 1.7% in 2020 and 1.5% in 2021. Compared with the September 2018 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised slightly down in 2018 and 2019.~~

The risks surrounding the euro area growth outlook ~~can still be assessed as broadly balanced. However, the balance of risks is moving~~have moved to the downside ~~owing to~~on account of the persistence of uncertainties related to geopolitical factors~~,~~ and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility.

~~According to Eurostat's flash estimate, euro~~Euro area annual HICP inflation declined to ~~2.0~~1.6% in December 2018, from 1.9% in November~~ 2018, from 2.2% in October~~, reflecting mainly ~~a decline in~~lower energy price inflation. On the basis of current futures prices for oil, headline inflation is likely to ~~decrease~~decline further over the coming months. Measures of underlying inflation remain generally muted, but ~~domestic~~labour cost pressures are continuing to strengthen and broaden amid high levels of capacity utilisation and tightening labour markets~~, which is pushing up wage growth.~~. Looking ahead, underlying inflation is expected to increase over the medium term, supported by our monetary policy measures, the ongoing economic expansion and rising wage growth.

~~This assessment is also broadly reflected in the December 2018 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.8% in 2018, 1.6% in 2019, 1.7% in 2020 and 1.8% in 2021. Compared with the September 2018 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised slightly up for 2018 and down for 2019.~~

Turning to the **monetary analysis**, broad money (M3) growth ~~stood at~~moderated to 3.~~9~~7% in ~~October~~November 2018, after 3.~~6% in September. Apart from some volatility in monthly flows,~~9% in October. M3 growth continues to be ~~supported~~backed by bank credit creation. The narrow monetary aggregate M1 remained the main contributor to broad money growth.

~~In line with the upward trend observed since the beginning of 2014, the growth of loans to the private sector continues to support the economic expansion.~~ The annual growth rate of loans to non-financial corporations stood at 4.0% in November 2018, after 3.9% in October~~ 2018, after 4.3% in September~~, while the annual growth rate of loans to households remained broadly unchanged at 3.~~2%.~~ 3%. The euro area bank lending survey for the fourth quarter of 2018 suggests that overall bank lending conditions remained favourable, following an extended period of net easing, and demand for bank credit continued to rise, thereby underpinning loan growth.

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 – in particular 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 that an ample degree of monetary accommodation is still necessary for the continued sustained convergence of inflation to 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. Regarding **fiscal policies**, the Governing Council reiterates the need for rebuilding fiscal buffers. This is particularly important in countries where government debt is high and for which full adherence to the Stability and Growth Pact is critical for safeguarding sound fiscal positions. Likewise, the transparent and consistent implementation of the EU's fiscal and economic governance framework over time and across countries remains essential to bolster the resilience of the euro area economy. Improving the functioning of Economic and Monetary Union remains a priority. The Governing Council welcomes the ongoing work and urges further specific and decisive steps to complete the banking union and the capital markets union.

~~Further information on the technical parameters of the reinvestments will be released at 15:30 CET on the ECB's website.~~

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