Central Banks

Draghi reacts in all fronts

Sonsoles Castillo / Agustín García / Miguel Jiménez / María Martínez

- **The ECB strengthened its forward guidance on rates, with no rate hikes at least through the end of 2019**
- **They also launched a new series of TLTROs, with partial details revealed and more liquidity than expected**
- **Significant downward growth revision in 2019, but minor changes in the medium term. Despite the revision, risks remain tilted to the downside**

After recent dovish comments of ECB members of the Governing Council (GC), today all the eyes were on the possibility that the ECB could made changes in the forward guidance on rates and on a potential announcement of further liquidity measures. And **the ECB has not disappointed: it will keep interest rates on hold until at least the end of this year and has announced another series of auctions of long-term liquidity.** The dovish tone was retained as the statement reiterated that the GC stands ready to adjust all of its instruments, as appropriate, to ensure sustainable convergence towards the inflation target. **Mr Draghi stressed that this package of measures are "adding accommodation" to its accommodative policy stance and the decision was taken by unanimity.** But there there was debate within the GC as several members proposed extending the calendar of forward guidance to March 2020 and other members discussed consequences of "low for longer" rates on banks.

Regarding the new round of TLTROs, the program consists of **seven two-years targeted longer-term refinancing operations (TLTRO III),** on a quarterly basis **starting in September 2019. The amount of loans that can be borrowed is sizeable**: 30% of outstanding eligible loans as of 28 February 2019, e.g. September 2018 ~€1.7tr although probably minus the €740bn borrowed in TLTROs II (more details will be communicated by the ECB in "due course"). It will be key how the ample potential take-up materializes in specific countries and entities, once the details are published. Nonetheless, **the cost of these funds will be less favourable than the current TLTROII – as we expected, without benefiting from negative rates- as the rate is indexed to the interest rate on the main refinancing operations (MROs) over the life of each operation.** If the ECB hikes the main refinancing rate during the life of the operation, the cost could be higher than 0%. Together with this measure, the ECB took the logical decision to **extend the full allotment fixed-rate procedure as long as necessary**, and at least until the end of the reserve maintenance period starting in March 2021.

On the economic outlook, the ECB mentions that the slowdown in international demand along with some country and sector specific factors have resulted in weaker-than-expected growth since mid-2018 that seems to extend into this year. As a result, the **GDP growth forecast was revised sharply downwards by 0.6pp to 1.1% in 2019**, but the revision was **much more moderate for 2020**, by 0.1pp, to 1.6% and it remained unchanged for 2021 at 1.5%, which implies that a reacceleration is still expected at some point during 2019. But, in contrast, Draghi highlighted also that the **balance of risks remains tilted to the downside despite the downward revision, as today's ECB's decisions cannot solve global headwinds** (Brexit, protectionism, emerging market vulnerabilities or the slowdown in China and the US), which are the main ones hitting the Eurozone. Altogether, this slower expansion, along with the limited pass-through of higher nominal wages, has also led to a **downward revision for underlying**

inflation forecasts by around 0.2pp over the forecast horizon (1.2% in 2019, 1.4% in 2020 and 1.6% in 2021). Despite the markedly downward revision, Mr. Draghi stressed that the **probability of both a recession and de-anchoring inflation expectations is still very low**.

All in all, **the message from the ECB has been more dovish than expected**, as the ECB reacted to the gloomier picture of the Eurozone economy with a combination of a delay in the rate hikes, significant cut in projections and a further TLTRO package that -though many details are lacking- provides more liquidity than expected.

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)

Mario Draghi, President of the ECB,

Luis de Guindos, Vice-President of the ECB,

Frankfurt am Main, ~~24 January~~7 March 2019

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 Commission Vice-President, Mr~~.~~ Dombrovskis.

Based on our regular economic and monetary analyses, we have conducted a thorough assessment of the economic and inflation outlook, also taking into account the latest staff macroeconomic projections for the euro area. As a result, the Governing Council took the following decisions in the pursuit of its price stability objective. First, we decided to keep the **key ECB interest rates** unchanged. We ~~continue to~~now expect them to remain at their present levels at least through the ~~summer~~end 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**~~Second, we intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the 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.

~~The incoming information has continued~~Third, we decided to launch a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), starting in September 2019 and ending in March 2021, each with a maturity of two years. These new operations will help to preserve favourable bank lending conditions and the smooth transmission of monetary policy. Under TLTRO-III, counterparties will be ~~weaker than expected~~entitled to borrow up to 30% of the stock of eligible loans as at 28 February 2019 at a rate indexed to the interest rate on ~~account of softer external demand and~~ the main refinancing operations over the life of each operation. Like the outstanding TLTRO programme, TLTRO-III will feature built-in incentives for credit conditions to remain favourable. Further details on the precise terms of TLTRO-III will be communicated in due course.

Fourth, we will continue conducting our lending operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021.

Today's monetary policy decisions were taken to ensure that inflation remains on a sustained path towards levels that are below, but close to, 2% over the medium term. While there are signs that some ~~country and sector-specific~~of the idiosyncratic domestic factors~~.~~ dampening growth are starting to fade, the weakening in economic data points to a sizeable moderation in the pace of the economic expansion that will extend into the current year. The persistence of uncertainties ~~in particular relating~~related to geopolitical factors~~ and~~, the threat of protectionism ~~is~~

~~weighing~~and vulnerabilities in emerging markets appears to be leaving marks on economic sentiment. Moreover, underlying inflation continues to be muted. The weaker economic momentum is slowing the adjustment of inflation towards our aim. 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 in the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term. Significant monetary policy stimulus remains essential to~~Today's decisions will support the further build-up of domestic price pressures and headline inflation developments over the medium term. ~~This will~~Significant monetary policy stimulus will continue to be provided by our forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of acquired assets~~.~~ and the new series of TLTROs. 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~~fourth quarter of 2018, following growth of 0.~~4~~1% in the ~~previous two quarters.~~third quarter. Incoming data have continued to be ~~weaker than expected as a result of a~~weak, in particular in the manufacturing sector, reflecting the slowdown in external demand compounded by some country and sector-specific factors. ~~While the~~The impact of ~~some of~~ these factors is ~~expected to fade,~~turning out to be somewhat longer-lasting, which suggests that the near-term growth ~~momentum is likely to~~outlook will be weaker than previously anticipated. Looking ahead, the effect of these adverse factors is expected to unwind. The euro area expansion will continue to be supported by favourable financing conditions, further employment gains and rising wages, ~~lower energy prices,~~ and the ongoing – albeit somewhat slower – expansion in global activity.

This assessment is broadly reflected in the March 2019 ECB staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.1% in 2019, 1.6% in 2020 and 1.5% in 2021. Compared with the December 2018 Eurosystem staff macroeconomic projections, the outlook for real GDP growth has been revised down substantially in 2019 and slightly in 2020.

The risks surrounding the euro area growth outlook ~~have moved~~are still tilted to the downside, on account of~~-~~ the persistence of uncertainties related to geopolitical factors~~ and~~, the threat of protectionism~~,~~ and vulnerabilities in emerging markets~~ and financial market volatility~~.

~~Euro~~According to Eurostat's flash estimate, euro area annual HICP inflation ~~declined to~~was 1.~~6~~5% in ~~December 2018, from~~February 2019, after 1.~~9~~4% in ~~November~~January, reflecting ~~mainly lower~~somewhat higher energy and food price inflation. On the basis of current futures prices for oil, headline inflation is likely to ~~decline further over the coming months.~~remain at around current levels before declining towards the end of year. Measures of underlying inflation remain generally muted, but labour cost pressures ~~are continuing to strengthen and broaden~~have strengthened and broadened amid high levels of capacity utilisation and tightening labour markets. 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 March 2019 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.2% in 2019, 1.5% in 2020 and 1.6% in 2021. Compared with the December 2018 Eurosystem staff macroeconomic projections, the outlook for HICP inflation has been revised down across the projection horizon, reflecting in particular the more subdued near-term growth outlook.

Turning to the **monetary analysis**, broad money (M3) growth ~~moderated~~decreased to 3.~~7~~8% in ~~November~~January 2019, from 4.1% in December 2018~~, after 3.9% in October~~. M3 growth continues to be backed by bank credit creation, notwithstanding a recent moderation in credit dynamics. The narrow monetary aggregate M1 remained the main contributor to broad money growth.

The annual growth rate of loans to non-financial corporations ~~stood at 4.0~~declined to 3.3% in ~~November 2018, after~~January 2019, from 3.9% in ~~October~~December 2018, reflecting a base effect but also, in some countries, the typical lagged reaction to the slowdown in economic activity, while the annual growth rate of loans to households remained ~~broadly unchanged at 3.3%. The euro area bank lending survey for the fourth quarter of 2018 suggests that overall bank lending conditions remained~~at 3.2%. Borrowing conditions for firms and households are still favourable, ~~following an extended period of net easing, and demand for bank credit continued to rise, thereby underpinning loan growth.~~

~~The pass-through of~~as the monetary policy measures put in place since June 2014 ~~continues~~continue 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~~. The policy measures decided today, and in particular the new series of TLTROs, will help to ensure that bank lending conditions remain favourable going forward.

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 view of the overall limited implementation of the 2018 country-specific recommendations, as recently communicated by the European Commission. Regarding **fiscal policies**, the mildly expansionary euro area fiscal stance and the operation of automatic stabilisers are providing support to economic activity. At the same time, countries where government debt is high ~~and for which full adherence to the Stability and Growth Pact is critical for safeguarding sound fiscal positions.~~need to continue rebuilding fiscal buffers. All countries should continue to increase efforts to achieve a more growth-friendly composition of public finances. Likewise, the transparent and consistent implementation of the ~~EU's~~European Union'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.

We are now at your disposal for questions.

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