Central Banks

ECB: More dovishness in several fronts

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- **The ECB strengthened its forward guidance on rates, with no rate hikes at least through the first half of 2020**
- **The ECB opens the possibility to further easing if needed**
- **The final conditions of TLTRO-III were quite favourable**
- **Slightly downward revision on growth due to more protracted uncertainty**

The main interest of this month's meeting was to see to what extent the ECB maintained or reinforced its dovish tone in view of enhanced trade tensions and the Fed openness to cut rates, and to know the final terms of TLTRO-III. And **the central bank exceeded expectations of dovishness. By unanimity, the forward guidance on rates was delayed for six months, and interest rates will remain on hold until at least through the first half of 2020** in response to the increase and persistence of global uncertainty (i.e. threat of protectionism and Brexit). This delay was foreseeable, but the decision was not expected as early as today. Moreover, **the central bank reaffirmed its readiness to act in case of adverse contingencies**. In particular, Mr Draghi openly recognized that all possible measures have been debated, including lower deposit rates, restarting the asset purchase program (APP) or further extension in the forward guidance.

Regarding the details of the new series of quarterly targeted longer-term refinancing operations (TLTRO III), the main points were the following:

- **Design:** These operations were designed to serve as a backstop, as Mr Draghi stated that banks will have funding pressure to comply with regulatory requirements as well as the need to pay back the previous rounds, and the intention is that these operations will mitigate future cliff effects. Moreover, he explicitly said that these operations are also designed to minimize the possibility of carry trade and focus on productive lending.
- **Cost:** interest rate will be set at 10 basis points above the average MRO rate over the life of each operation. For counterparties exceeding their lending benchmark a lower interest rate will apply, which can be as low as the average deposit facility rate plus 10 basis points. This is a slightly lower than expected cost at the beginning (we and many other analysts expected MRO minus 20 bps).
- **Borrowing capacity:** Counterparties are entitled to borrow up to a total of 30% of the stock of eligible loans as at 28 February 2019 (the same as in TLTRO II, including loans to non-financial corporations and households but excluding loans for house purchases). However, as expected, to this quantity it should be deducted TLTRO-II amounts. In addition, the amount that counterparties can borrow in each of the seven operations will be limited to, at most, 10% of their eligible stock. TLTRO III operations cannot be repaid before maturity (unlike TLTRO-II). With this decision the ECB ensures a smoother repayment of those new operations.

On the economic outlook, **incoming data so far is not bad but Draghi stressed that the uncertainty is now higher and more protracted** than expected in March (especially on trade tensions, but also on Brexit and vulnerabilities in EM), **which could drive to more moderate growth in coming quarters**

and has lead the ECB to be ready to act if necessary. This is reflected in the Staff Projections of a slight upward revision of GDP growth for 2019 (+0.1pp to 1.2%), but downwards for 2020 (-0.2pp to 1.4%) and 2021 (-0.1pp to 1.4%). **Risks to this scenario remain tilted to the downside**. Inflations forecasts remain broadly unchanged, as the **ECB remain confidence on the expected upward trend in core inflation** (1.1% in 2019, 1.4% in 2020 and 1.6% in 2021) supported by accommodative monetary policy and tighter labour markets. The ECB does not see signs of de-anchoring inflation expectations, though Draghi acknowledged concerns about lower markets' prospects.

All in all, the message from the **ECB has been more dovish than expected**, as the ECB reacted to the increasing and prolonged uncertainty with a combination of a delay in the rate hikes and opening the door for further easing.

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

in black, 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, 10 April~~Vilnius, 6 June 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~~ I would like to thank Chairman of the Board Vasiliauskas for his kind hospitality and express our special gratitude to his 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 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 ~~end~~first half of ~~2019~~2020, 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.

~~We~~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 Governing Council~~Third, regarding the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III), we decided that the interest rate in each operation will be set at a level that is 10 basis points above the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeds a benchmark, the rate applied in TLTRO III will be lower, and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation plus 10 basis points.

A press release with further details of the terms of TLTRO III will be published at 15:30 CET today.

The Governing Council also assessed that, at this point in time, the positive contribution of negative interest rates to the accommodative monetary policy stance and to the sustained convergence of inflation is not undermined by possible side effects on bank-based intermediation. However, we will continue to monitor carefully the bank-based transmission channel of monetary policy and the case for mitigating measures.

Today's monetary policy decisions were taken to provide the monetary accommodation necessary for inflation to remain on a sustained path towards levels that are below, but close to, 2% over the medium term. Despite the somewhat better than expected data for the first quarter, the most recent information indicates that global headwinds continue to weigh on the euro area outlook. The prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets, is leaving its mark on economic sentiment.

At the same time, further employment gains and increasing wages continue to underpin the resilience of the euro area economy and gradually rising inflation. Today's policy measures ensure that financial conditions will remain very favourable, supporting the euro area expansion, the ongoing build-up of domestic price pressures and, thus, headline inflation developments over the medium term. Looking ahead, the Governing Council is determined to act in case of adverse contingencies and also 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.

~~Details on the precise terms of the new series of targeted longer-term refinancing operations (TLTROs) will be communicated at one of our forthcoming meetings. In particular, the pricing of the new TLTRO-III operations will take into account a thorough assessment of the bank-based transmission channel of monetary policy, as well as further developments in the economic outlook. In the context of our regular assessment, we will also consider whether the preservation of the favourable implications of negative interest rates for the economy requires the mitigation of their possible side effects, if any, on bank intermediation.~~

~~The information that has become available since the last Governing Council meeting in early March confirms slower growth momentum extending into the current year. While there are signs that some of the idiosyncratic domestic factors dampening growth are fading, global headwinds continue to weigh on euro area growth developments. The persistence of uncertainties, related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets, is leaving marks on economic sentiment. At the same time, further employment gains and rising wages continue to underpin the resilience of the domestic economy and gradually rising inflation pressures. However, an ample degree of monetary accommodation remains necessary to safeguard favourable financing conditions and support the economic expansion, and thus to ensure that inflation remains on a sustained path towards levels that are below, but close to, 2% over the medium term. Significant monetary policy stimulus is being 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.~~

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP rose by 0.~~2~~4%, quarter on quarter, in the ~~fourth~~first quarter of ~~2018~~2019, following an increase of 0.~~1~~2% in the ~~third~~fourth quarter~~. Incoming~~ of 2018. However, incoming economic data ~~continue~~and survey information point to ~~be weak, especially for the manufacturing sector, mainly on account of the slowdown in external demand, which has been compounded by some country and sector-specific factors. As the impact of these factors is turning out to be~~ somewhat ~~longer-lasting, the slower~~weaker growth ~~momentum is expected to extend into the current~~in the second and third quarters of this year. This reflects the ongoing weakness in international trade in an environment of prolonged global uncertainties, which are weighing, in particular, on the euro area manufacturing sector. At the same time, the euro area services and construction sectors are showing resilience and the labour market is continuing to improve. 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, the mildly expansionary euro area fiscal stance, further employment gains and rising wages, and the ongoing – albeit somewhat slower – ~~expansion~~growth in global activity.

This assessment is broadly reflected in the June 2019 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.2% in 2019, 1.4% in 2020 and 1.4% in 2021. Compared with the March 2019 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised up by 0.1 percentage points for 2019 and has been revised down by 0.2 percentage points for 2020 and by 0.1 percentage points for 2021.

The risks surrounding the euro area growth outlook remain tilted to the downside, on account of the ~~persistence~~prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism and vulnerabilities in emerging markets.

According to Eurostat's flash estimate, euro area annual HICP inflation was 1.~~4~~2% in ~~March~~May 2019, after 1.~~5~~7% in ~~February~~April, reflecting mainly ~~a decline in food,~~ lower energy and services ~~and non-energy industrial goods~~ price inflation. On the basis of current futures prices for oil, headline inflation is likely to decline over the coming months~~. Measures~~, before rising again towards the end of year. Looking through the recent volatility due to temporary factors, measures of underlying inflation remain generally muted, but labour cost pressures ~~have strengthened~~continue to strengthen and ~~broadened~~broaden 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~~stronger wage growth.

This assessment is also broadly reflected in the June 2019 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.3% in 2019, 1.4% in 2020 and 1.6% in 2021. Compared with the March 2019 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised up by 0.1 percentage points for 2019 and revised down by 0.1 percentage points for 2020.

Turning to the **monetary analysis**, broad money (M3) growth ~~increased to~~stood at 4.~~3~~7% in ~~February~~April 2019, ~~from 3.8~~after 4.6% in ~~January. Looking through some volatility in monthly flows, M3~~March. Sustained rates of broad money growth ~~continues to be backed by~~ reflect ongoing bank credit creation~~, notwithstanding a recent moderation in credit dynamics.~~ for the private sector and low opportunity costs of holding M3. The narrow monetary aggregate M1 ~~remained~~ continues to be the main contributor to broad money growth on the components side.

The annual growth rate of loans to non-financial corporations ~~rebounded~~increased to 3.~~7~~9% in ~~February~~April 2019, from 3.~~4~~6% in ~~January, reflecting mainly a base effect. Looking through~~March. Beyond short-term volatility, the annual growth rate of loans to non-financial corporations has moderated somewhat in recent months from its peak in September 2018, reflecting the typical lagged reaction to the slowdown in economic growth~~. At~~ observed over the ~~same time, the~~course of 2018. The annual growth rate of loans to households ~~remained broadly unchanged at~~ stood at 3.4% in April, compared with 3.3% in ~~February. The euro area bank lending survey for the first quarter of 2019 suggests that overall bank lending conditions remained favourable~~March, continuing its gradual improvement.

~~Our~~The monetary policy measures taken today, including ~~the new series of TLTROs that we announced in March~~TLTRO III, will help to safeguard favourable bank lending conditions and will continue to support access to financing, in particular for small and medium-sized enterprises.

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. The 2019 country-specific recommendations should serve as the relevant signpost. Regarding **fiscal policies**, the mildly expansionary euro area fiscal stance ~~and the operation of automatic stabilisers are~~is providing support to economic activity. At the same time, countries where government debt is high need to continue rebuilding fiscal buffers. All countries should reinforce their efforts to achieve a more growth-friendly composition of public finances. Likewise, the transparent and consistent implementation of the 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.

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