ECB: Determination to act after holidays

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July 2019

- **The ECB kept rates unchanged but reintroduced the easing bias on rates, requested studies on further measures and, importantly, started talking about a symmetric inflation aim**
- **Draghi is worried about inflation and the macro outlook of manufacturing**
- **We expect a change in forward guidance, lower depo rates and a tiered depo system in September**
- **The probability of further QE has increased, but we still think the ECB will not adopt it yet**

After the dovish tone that the ECB has shown recently (Draghi at Sintra, recent meetings and comments by officials), **the focus today was to what extent was the ECB going to materialize those dovish signs**. We were expecting a change in the guidance to "present or lower levels" of rates, a modification in the forward guidance (contingent on an inflation measure instead of time-dependent) and more signals of a depo rate cut and a tiered depo system. Markets were even more dovish, pricing in a depo cut as soon as today with 50% probability and more clear signs of further QE.

On several of these issues, the ECB has not disappointed: **it has reintroduced in the statement that policy rates will remain at "present or lower levels"**, opening the door for rate cuts soon. It has not modified its forward guidance yet, but Mr Draghi has made clear they will address that in September. Moreover, **the ECB has asked its Staff to study ways to provide further easing**, which is the usual formula used when it is ready to act. The request is for the menu that Draghi offered at Sintra, **including the change in forward guidance, lowering interest rates together with a tiered system to mitigate side-effects of negative rates, and resuming QE**.

Moreover, **the ECB has introduced references to the "symmetry of the inflation aim", a way of introducing a further dovish bias** by recognizing that will tolerate more easily inflation rates above 2% -when we reach that point.

When asked about unanimity, Mr Draghi clarified that **there was a "convergence of views" rather than unanimity** among ECB governing council members, clarifying that there were different nuances of views on parts of package.

On the macro outlook, Mr Draghi gave **mixed signals** reflecting the very different of manufacturing and other sectors. He showed doubts about the recovery of the Eurozone's economy in the second half of the year. "Outlook is getting worse and worse. And **it's getting worse and worse in those countries where manufacturing is very important**." (Germany and Italy). In contrast, he tried to soften this message pointing that there are **signs of resilience in services, consumption and in the labor market**. All in all risks surrounding the growth outlook remain tilted to the downside, but **Draghi stressed that the probability of a recession remains low**.

On the inflation outlook, Draghi acknowledged repeatedly that they are worried as it has been persistently below expectations **("we don't like it")**. A novelty he mentioned is that **inflation expectations are low** not only according to market-based measures but **now also according to the Survey professional Forecasters** (to be published tomorrow), adding that this survey had been stable for a long time.

Fiscal policy was also a recurrent issue during the press conference. Draghi said that **fiscal policy will be necessary if the situation deteriorates further** in those countries with idiosyncratic shocks (meaning clearly Germany), but also in the Eurozone as a whole.

Overall, today's statement and press conference was one of those examples of pre-announcement of upcoming measures. **It seems quite clear now that a depo cut will be decided soon (we expect it for September now) together with a tiered system**. **Forward guidance will also be changed** (no longer calendar-based). **We still think that further QE measures will not be approved in September**, given the lack of unanimity, and the need to keep a **second bullet** in case it is needed (Draghi recognized during the press conference that the effectiveness of further QE is debatable). **But its probability has no doubt increased.**

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,

~~Vilnius, 6 June~~Frankfurt am Main, 25 July 2019

INTRODUCTORY STATEMENT

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. ~~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~~ We will now report on the outcome of today's meeting of the Governing Council~~. We will now report on the outcome of our meeting~~, 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 ~~now~~ expect them to remain at their present or lower levels at least through the first half of 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%~~our aim over the medium term.

~~Second, we~~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.

~~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~~underlined the need for a highly accommodative stance of monetary policy ~~stance and to the sustained convergence of~~ for a prolonged period of time, as 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~~ rates, both realised and projected, have been persistently below levels that are ~~below, but close to, 2% over~~in line with its aim. Accordingly, if the medium ~~term. Despite the somewhat better than expected data~~-term inflation outlook continues to fall short of our aim, the Governing Council is determined to act, in line with its commitment to symmetry in the inflation aim. It therefore stands ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner.

In this context, we have tasked the relevant Eurosystem Committees with examining options, including ways to reinforce our forward guidance on policy rates, mitigating measures, such as the design of a tiered system for ~~the first quarter, the most recent~~reserve remuneration, and options for the size and composition of potential new net asset purchases.

Incoming information since the last Governing Council meeting in early June indicates that~~ global headwinds~~, while further employment gains and increasing wages continue to ~~weigh~~underpin the resilience of the economy, softening global growth dynamics and weak international trade are still weighing on the euro area outlook. ~~The~~Moreover, the prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism, and vulnerabilities in emerging markets, is ~~leaving its mark on~~dampening economic sentiment~~.~~

~~At~~, notably in the ~~same time, further employment gains~~manufacturing sector. In this environment, inflationary pressures remain muted and ~~increasing wages continue to underpin the resilience~~indicators of ~~the euro area economy and gradually rising~~ inflation~~. Today's policy measures~~ expectations have declined. Therefore, a significant degree of monetary stimulus continues to be necessary to ensure that financial conditions ~~will~~ remain very favourable~~, supporting~~ and support 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.~~

Let me now explain our assessment in greater detail, starting with the **economic analysis**. ~~Euro~~Following a rise of 0.2% in the fourth quarter of 2018, euro area real GDP ~~rose~~increased by 0.4%, quarter on quarter, in the first quarter of 2019~~, following an increase of 0.2% in the fourth quarter of 2018. However, incoming~~. Incoming economic data and survey information continue to point to somewhat ~~weaker~~slower growth in the second and third quarters of this year. This mainly reflects the ongoing weakness in international trade in an environment of prolonged global uncertainties, which are ~~weighing, in particular, on~~particularly affecting the euro area manufacturing sector. At the same time, activity levels in the ~~euro area~~ services and construction sectors are ~~showing resilience~~resilient and the labour market is ~~continuing to improve~~still improving. Looking ahead, the euro area expansion will continue to be supported by favourable financing conditions, further employment gains and rising wages, the mildly expansionary euro area fiscal stance~~, further employment gains and rising wages,~~ and the ongoing – albeit somewhat slower – 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~~reflecting the 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~~Euro area annual HICP inflation ~~was~~increased to 1.3% in June 2019, from 1.2 % in May~~ 2019, after 1.7% in April, reflecting mainly~~, as higher HICP inflation excluding food and energy more than offset lower energy~~ and services~~ price inflation. On the basis of current futures prices for oil, headline inflation is likely to decline over the coming months, before rising again towards the end of the year. Looking through the recent volatility due to temporary factors, measures of underlying inflation remain generally muted~~, but~~. Indicators of inflation expectations have declined. While labour cost pressures ~~continue to strengthen~~have strengthened and ~~broaden~~broadened amid high levels of capacity utilisation and tightening labour markets~~. Looking ahead,~~, the pass-through of cost pressures to inflation is taking longer than previously anticipated. Over the medium term underlying inflation is expected to increase~~ over the medium term~~, supported by our monetary policy measures, the ongoing economic expansion and 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 stood at 4.~~7~~5% in ~~April~~June 2019, after 4.~~6~~8% in ~~March~~May. Sustained rates of broad money growth reflect ongoing bank credit creation for the private sector and low opportunity costs of holding M3. The narrow monetary aggregate M1 continues to be the main contributor to broad money growth on the components side.

The annual growth rate of loans to non-financial corporations ~~increased to~~remained unchanged at 3.~~9~~8% in ~~April~~June 2019~~,~~. Notwithstanding some moderation from ~~3.6%~~the peak recorded in ~~March. Beyond short-term volatility~~September 2018, 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 observed over the course of 2018.~~continues to be robust. The annual growth rate of loans to households ~~stood~~also remained unchanged at 3.~~4~~3% in ~~April, compared with 3.3% in March~~June, continuing its gradual improvement. Overall, loan growth is still benefiting from historically low bank lending rates. The euro area bank lending survey for the second quarter of 2019 indicates that loan growth continued to be supported by increasing demand across all loan categories. At the same time, credit standards for loans to enterprises tightened in the second quarter amid concerns about the economic outlook, while they remained broadly unchanged for loans for house purchase.

~~The~~Our monetary policy measures ~~taken today~~, including the forthcoming new series of targeted longer-term refinancing operations (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, reduce structural unemployment and increase resilience. The 2019 country-specific recommendations should serve as the relevant signpost. Regarding **fiscal policies**, the mildly expansionary euro area fiscal stance 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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