BBVA Research

Creating Opportunities

Arrivederci Mr Draghi ("never give up")

Sonsoles Castillo / Agustín García / Miguel Jiménez / María Martínez
October 2019

- **No hints of (nor questions on) policy changes in the near term**
- **Mr Draghi tries to convey the message that unity has returned to the ECB despite legitimate discrepancies within the Governing Council**
- **Further stress on the need to activate fiscal policy to complement monetary policy**

The focus of today's monetary policy meeting - **Draghi's last one as ECB President-** was marked by the divisions that broke up immediate before and after September's meeting, where a bold package of further accommodative measures was approved. **No decisions were expected and indeed the ECB maintained its monetary policy stance, leaving key interest rates and forward guidance unchanged.** During the press conference **Mr Draghi maintained his dovish tone**, mentioning that the central bank continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner.

On **economic activity,** Draghi said that the latest data confirm their previous assessment of a protracted weakness of the euro area growth dynamics. He mentioned that **new surveys and indicators continue to be relatively weak and justify the measures taken last month. The risks surrounding the growth outlook remain tilted to the downside**, and the main risk is a downturn in the economy, whether it is global or in the euro area. On the price performance, Mr Draghi stated that headline inflation is likely to decline slightly further driven by energy and food prices before rising again by the end of the year. He also stressed that while labor cost pressures have strengthened, the weaker growth momentum is delaying their pass-through to inflation.

On the important questions about the division within the Governing Council (GC) about the September easing package, Mr Draghi noticed that there are disaccords in all institutions, and there were also at the ECB in the past. **He insisted that the decisions taken at last meeting had majority support from the GC,** playing down reports and comments of disagreements within the central bank and mentioning **healing remarks from dissenters**; in particular, he mentioned that one of the dissenters called for unity, while another one said "bygones are bygones".

Mr. Draghi emphasized again a message on the need to activate fiscal policy if one wants to see higher rates sooner. Moreover, he stated that if fiscal stimulus is launched where there is room for it, the job of monetary policy will be done faster and easier. He signaled that the IMF has mentioned Germany specifically in the introduction of its last WEO. He also said, when asked about what is the key reform for the future of EMU, that a countercyclical, centralized fiscal capacity, with enough power, is necessary for the area.

On a specific **question about the limit of assets to purchase in its QE programme**, he confirmed that there is still debt to buy for quite some time and stressed out that calculations depend on assumptions about issuance. He also mentioned that such limits are self-imposed (suggesting they could be raised if necessary). On **negative interest rates**, he defended the idea that their positive impact on the economy more than compensates negative side effects.

Finally, **Mr Draghi took the opportunity to defend his legacy,** signalling that if there is one thing on what he is proud of then it is that **they have always pursued their mandate, "never give up."**

Overall, in a relatively relaxed press conference, Mr. Draghi provided a dovish tone, in line with his entire presidency **-** a central banker who began his term by lowering interest rates and who closed his mandate with a bold stimulus package-. **He did not give any hints about action to be taken in the short term, trying not to tie the hands of his successor, Mrs Lagarde.** We expect the ECB to remain on hold, monitoring the impact of the measures announced in September, in a scenario which has not changed much since the last meeting with an improvement of the Brexit outlook but with still weak data and with other global risks looming. If we add to that the split of the GC for the latest package, our baseline scenario for euro rates (another deposit rate cut in the short/medium term to -0.6%) seems less likely.

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, ~~12 September~~24 October 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, Mr Dombrovskis, and the incoming President, Ms Lagarde.

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 pursuit of its price stability objective.~~
~~First, as regards~~decided to keep the **key ECB interest rates**~~, we decided to lower the interest rate on the deposit facility by 10 basis points to -0.50%. The interest rate on the main refinancing operations and the rate on the marginal lending facility will remain~~ unchanged~~ at their current levels of 0.00% and 0.25% respectively.~~. We ~~now~~ expect ~~the key ECB interest rates~~them to remain at their present or lower levels until we have seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

~~Second, the Governing Council~~As decided ~~to~~at our last meeting in September, we will restart net purchases under ~~its~~our asset purchase programme (APP) at a monthly pace of €20 billion as from 1 November. We expect them to run for as long as necessary to reinforce the accommodative impact of our policy rates, and to end shortly before we start raising the key ECB interest rates.

~~Third, we~~We also intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP 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.

~~Fourth, we decided to change the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. The interest rate in each operation will now be set at the level of 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 operations will be lower, and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation. The maturity of the operations will be extended from two to three years.~~

~~Fifth, in order to support the bank-based transmission of monetary policy the Governing Council decided to introduce a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate.~~

~~Separate press releases with further details of the measures taken by the Governing Council will be published this afternoon at 15:30 CET.~~

The Governing Council reiterated the need for a highly accommodative stance of monetary policy for a prolonged period of time ~~and~~to support underlying inflation pressures and headline inflation developments over the medium term. In particular, the Governing Council's forward guidance will ensure that financial conditions adjust in accordance with changes to the inflation outlook. In any case, the Governing Council continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

~~Today's decisions were taken in response to the continued shortfall of inflation with respect to our aim. In fact,~~The incoming ~~information~~data since the last Governing Council meeting ~~indicates a more~~in early September confirm our previous assessment of a protracted weakness ~~of the~~in euro area ~~economy~~growth dynamics, the persistence of prominent downside risks and muted ~~inflationary~~inflation pressures. ~~This is reflected in the new staff projections, which show a further downgrade of the inflation outlook.~~

At the same time, ~~robust~~ongoing employment growth and increasing wages continue to underpin the resilience of the euro area economy. ~~With today's~~The comprehensive package of ~~monetary~~ policy ~~decisions,~~ measures that we ~~are providing~~decided at our last meeting provides substantial monetary stimulus, which will contribute to ~~ensure that financial~~a further easing in borrowing conditions ~~remain very favourable~~for firms and households. This will support the euro area expansion, the ongoing build-up of domestic price pressures and, thus, the sustained convergence of inflation to our medium-term inflation aim.
Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP ~~increased by~~growth was confirmed at 0.2%, quarter on quarter, in the second quarter of 2019, following a rise of 0.4% in the previous quarter. Incoming economic data and survey information continue to point to moderate but positive growth in the ~~third quarter~~second half of this year. This slowdown in growth mainly reflects the ~~prevailing~~ongoing weakness of international trade in an environment of ~~prolonged~~persistent global uncertainties, which ~~are particularly affecting~~continue to weigh on the euro area manufacturing sector and are dampening investment growth.

At the same time, the services and construction sectors ~~show ongoing resilience and the~~remain resilient, despite some moderation. The euro area expansion is ~~also~~ supported by favourable financing conditions, further employment gains ~~and~~in conjunction with rising wages, the mildly expansionary euro area fiscal stance and the ongoing – albeit somewhat slower – growth in global activity.

~~This assessment is broadly reflected in the September 2019 ECB staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.1% in 2019, 1.2% in 2020 and 1.4% in 2021. Compared with the June 2019 staff macroeconomic projections, the outlook for real GDP growth has been revised down for 2019 and 2020.~~

The risks surrounding the euro area growth outlook remain ~~tilted to~~on the downside. ~~These~~In particular, these risks ~~mainly~~ pertain to 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~~ decreased from 1.0% in August 2019~~, unchanged from July. Lower~~ to 0.8% in September, reflecting lower food and energy price inflation ~~was offset by higher food inflation, while the rate of HICP inflation excluding food and energy was unchanged.~~. On the basis of current futures prices for oil, headline inflation is likely to decline slightly further before rising again ~~towards~~at the end of the year. Measures of underlying inflation remained generally muted and indicators of inflation expectations stand at low levels. While labour cost pressures have strengthened ~~and broadened~~ amid ~~high levels of capacity~~

~~utilisation and tightening~~tighter labour markets, the weaker growth momentum is delaying their pass-through to inflation~~ is taking longer than previously anticipated.~~. Over the medium term~~ underlying~~ inflation is expected to increase, supported by our monetary policy measures, the ongoing economic expansion and robust wage growth.

~~This assessment is also broadly reflected in the September 2019 ECB staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.2% in 2019, 1.0% in 2020 and 1.5% in 2021. Compared with the June 2019 staff macroeconomic projections, the outlook for HICP inflation has been revised down over the whole projection horizon, reflecting lower energy prices and the weaker growth environment.~~

Turning to the **monetary analysis**, broad money (M3) growth increased to 5.~~2~~7% in ~~July~~August 2019, after ~~4.~~5.1% in ~~June~~July. 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 remained unchanged at 3.9% in July 2019.~~firms and households remained solid, benefiting from the continued pass-through of our accommodative monetary policy stance to bank lending rates. The annual growth rate of ~~overall~~ loans to non-financial corporations ~~continues to be solid, although short-term loans – which are more sensitive to the cycle – show signs of weakness. The~~ increased to 4.3% in August, from 4.0% in July 2019, while the annual growth rate of loans to households ~~stood~~remained unchanged at 3.4% in ~~July, after 3.3% in June, continuing its gradual improvement. Overall, loan growth is still benefiting from historically low bank lending rates.~~

~~The monetary policy measures we have taken today, including the more accommodative terms of~~ August. The euro area bank lending survey for the ~~new series~~third quarter of 2019 indicates a slight easing of ~~TLTROs,~~credit standards and increasing demand for loans to households, while demand for loans to firms remained broadly stable. Our accommodative monetary policy stance 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, supporting aggregate demand at the current juncture and reducing vulnerabilities. The implementation of **structural policies** in euro area countries needs to be substantially stepped up to 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 currently providing some support to economic activity. In view of the weakening economic outlook and the continued prominence of downside risks, governments with fiscal space should act in an effective and timely manner. In countries where public debt is high, governments need to pursue prudent policies ~~that~~and meet structural balance targets, which will create the conditions for automatic stabilisers to operate freely. All countries should ~~reinforce~~intensify 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.

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com