ECB: Change of climate

Sonsoles Castillo / Agustín García / Miguel Jiménez
January 2020

- **No changes in rates nor in the main stance of monetary policy.**
- **The statement notes a mild increase in underlying inflation and a slightly less negative balance of risks thanks to the US-China trade agreement**
- **The ECB launched its strategic review for 2020, which took most of the time in the press conference, with special emphasis on climate change**

Today's ECB statement saw very minor changes in the key paragraphs related to monetary policy. Rates will remain "at their present or lower levels until we have seen the inflation outlook robustly converge to…" the objective, "... and such convergence has been consistently reflected in underlying inflation dynamics" which was one of the novelties of the September meeting. Equally, QE is maintained at €20bn per month "for as long as necessary" and to end shortly before they start raising rates.

Very marginal changes can be noted in the assessment of the current situation of moderate growth, weak manufacturing and ongoing, "but decelerating", employment growth and increasing wages. Signs of a "moderate increase" in underlying inflation are confirmed, while inflation expectations remain at low levels but have "recently either stabilised or ticked up slightly" (this is a novelty). The Bank Lending Survey for 4Q19, recently released, reveals still favourable credit supply conditions.

On the risks surrounding the outlook, there is now recognition that the uncertainty regarding international trade has receded, very much in line with the recent US-China agreement. Lagarde was also asked about the risks of a trade war between the US and the EU after some tweets coming from the US, a risk which she dismissed with a positive reading of the recent meeting between President Trump and European Commission President Von der Leyen.

On the Swedish exit from negative rates, which could potentially set a precedent for ECB policy, she read the return to zero as normal after a positive experience and took care to insist that every area has its idiosyncrasies. Also on deposit rates, when asked on the experience with the tiering system for remuneration of deposits, she said it had been very positive so far and there is currently no discussion within the GC of changing the current 6x multiplier to define the limit of exempted deposits.
Again, there was also a strong call for fiscal cooperation from fiscal policy to reinforce the impact of monetary policy accommodation. Ms Lagarde said there are two (not mentioned) countries currently with margin to expand who are taking significant measures, though the positive fiscal stimulus was qualified as moderate.

The lack of relevant news on monetary policy (which is likely to persist all through the rest of the year if no major shocks hit the economic outlook) provided much room in the press conference to the Strategic Review (SR) of its monetary policy framework that the ECB officially launched today with a short statement, and during the press conference there were many questions referred to climate change and its particular role on the strategy. Lagarde put some emphasis on the implications of sustainable development for financial stability. She also mentioned some of the channels through which the ECB already takes into account climate change, recognizing that the key point will be how it affects the purchases of corporate bonds within the APP programme (though she did not provide any specifics).

Interestingly, there were a couple of questions on how the ECB will deal with the potential uncertainty created by a discussion on a new monetary policy framework while applying the current one (markets may speculate on policy changes related to new formulation of target, for instance). To that, Lagarde could only reply that they will continue working with the current principles and rules.
While the ECB is widely expected to remain on hold over the year (during the SR) and beyond, it is very likely that this tension between the current objective and stance and future changes will be recurrent during the rest of the year..

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).

Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB,

Frankfurt am Main, ~~12 December 2019~~23 January 2020

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. ~~Today is the first time that I have had the privilege and pleasure of chairing the monetary policy~~ We will now report on the outcome of today's meeting of the Governing Council ~~of the ECB. I am delighted to proceed now with reporting on the outcome of our meeting, together with the Vice-President. The Governing Council meeting was also attended by the Commission Executive Vice-President, Mr Dombrovskis~~.

Based on our regular economic and monetary analyses, we decided to keep the **key ECB interest rates** unchanged. We expect 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.

~~On 1 November we restarted~~We will continue to make net purchases under our asset purchase programme (APP) at a monthly pace of €20 billion. 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.

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.

Today the Governing Council also decided to launch a review of the ECB's monetary policy strategy. Further details about the scope and timetable of the review will be published in a press release today at 15:30 CET.

The incoming data since ~~the~~our last ~~Governing Council~~ meeting ~~in late October point to continued muted~~are in line with our baseline scenario of ongoing, but moderate, growth of the euro area economy. In particular, the weakness in the manufacturing sector remains a drag on euro area growth momentum. However, ongoing, albeit decelerating, employment growth and increasing wages continue to support the resilience of the euro area economy. While inflation ~~pressures and weak euro area growth dynamics, although~~developments remain subdued overall, there are some ~~initial~~ signs of ~~stabilisation in the growth slowdown and of a mild~~a moderate increase in underlying inflation in line with ~~previous~~ expectations. ~~Ongoing employment growth and increasing wages continue to underpin the resilience of the euro area economy.~~

The ~~comprehensive package of~~unfolding monetary policy measures ~~that the Governing Council decided in September provides substantial monetary stimulus, which ensures~~are underpinning favourable financing conditions for all sectors of the economy. In particular, easier borrowing conditions for firms and households are ~~underpinning~~supporting consumer spending and business investment. This will ~~support~~sustain the euro area expansion, the ~~ongoing~~ build-up of domestic price pressures and, thus, the robust convergence of inflation to our medium-term aim.

At the same time, in the light of the continued subdued inflation outlook, ~~the Governing Council reiterated the need for~~ monetary policy has to remain highly accommodative for a prolonged period of time to support underlying inflation pressures and headline inflation developments over the medium term. We will, therefore, closely monitor inflation developments and the impact of the unfolding monetary policy measures on the economy. Our 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.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP ~~growth was confirmed at~~increased by 0.~~2~~3%, quarter on quarter, in the third quarter of 2019, ~~unchanged from~~ following growth of 0.2% in the ~~previous~~second quarter. This pattern of moderate growth reflects the ongoing weakness of international trade in an environment of ~~persistent~~continued global uncertainties ~~continues to weigh on~~, which has particularly affected the euro area manufacturing sector and ~~is dampening~~has also dampened investment growth. At the same time, ~~incoming economic data and survey information, while remaining weak overall, point to some stabilisation in the slowdown of economic growth in the euro area.~~ the services and construction sectors remain more resilient, despite some moderation in the latter half of 2019. Incoming economic data and survey information point to some stabilisation in euro area growth dynamics, with near-term growth expected to be similar to rates observed in previous quarters. Looking ahead, the euro area expansion will continue to be supported by favourable financing conditions, further employment gains 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 December 2019 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.2% in 2019, 1.1% in 2020 and 1.4% in both 2021 and 2022. Compared with the September 2019 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised down slightly for 2020.~~

The risks surrounding the euro area growth outlook, related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets, remain tilted to the downside, but have become ~~somewhat~~ less pronounced as some of the uncertainty surrounding international trade is receding.

~~According to Eurostat's flash estimate,~~ Euro area annual HICP inflation increased ~~from 0.7~~to 1.3% in ~~October~~December 2019~~ to~~, from 1.0% in November, reflecting mainly higher ~~services and food~~energy price inflation. On the basis of current futures prices for oil, headline inflation is likely to ~~rise somewhat~~hover around current levels in the coming months. While indicators of inflation expectations ~~stand~~remain at low levels~~.~~, recently they have either stabilised or ticked up slightly. Measures of underlying inflation have remained generally muted, although there are ~~some~~further indications of a ~~mild~~moderate increase in line with previous expectations. While labour cost pressures have strengthened amid tighter labour markets, the weaker growth momentum is delaying their pass-through to inflation. Over the medium term, inflation is expected to increase, supported by our monetary policy measures, the ongoing economic expansion and solid wage growth.

~~This assessment is also broadly reflected in the December 2019 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.2% in 2019, 1.1% in 2020, 1.4% in 2021 and 1.6% in 2022. Compared with the September 2019 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised up slightly for 2020 and down slightly for 2021, mainly driven by the expected future path of energy prices.~~

Turning to the **monetary analysis**, broad money (M3) growth stood at 5.6% in ~~October~~November 2019, broadly unchanged ~~from the previous month~~since August. Sustained rates of broad money growth reflect ongoing bank credit creation for the private sector and low opportunity costs of holding M3 relative to other financial instruments. The narrow monetary aggregate M1 continues to be the main contributor to broad money growth on the components side.

The growth of loans to firms and households remained solid, benefiting from the ~~continued pass through of~~ongoing support provided by our accommodative monetary policy stance ~~to~~, which is reflected in very low bank lending rates. While the annual growth rate of loans to households remained unchanged from October, at 3.5% in November, the annual growth rate of loans to non-financial corporations ~~increased~~moderated to 3.4% in November, from 3.8% in October, ~~up from 3.6% in September~~likely reflecting some lagged reaction to the past weakening in the economy. These developments are also visible in the results of the euro area bank lending survey for the fourth quarter of 2019, which indicate weakening demand for loans to firms, while ~~the annual growth rate of loans to households continued on its gradual upward path, reaching 3.5% in October.~~demand for loans to households for house purchase continued to increase. However, credit standards for both loans to firms and loans to households for house purchase remained broadly unchanged, pointing to still favourable credit supply conditions. Overall, our accommodative monetary policy stance will help to safeguard very favourable bank lending conditions and will continue to support access to financing~~,~~ across all economic sectors and 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 robust 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 euro area fiscal stance is expected to ~~remain mildly expansionary in 2020, thus providing~~continue to provide some support to economic activity. In view of the ~~weakened~~weak economic outlook, the Governing Council welcomes the Eurogroup's call in December for differentiated fiscal responses and its readiness to coordinate. Governments with fiscal space should be ready to act in an effective and timely manner. In countries where public debt is high, governments need to pursue prudent policies and meet structural balance targets, which will create the conditions for automatic stabilisers to operate freely. All countries should 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.

Creating Opportunities

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