CENTRAL BANKS

The ECB hints at further easing in March

Sonsoles Castillo / Maria Martinez

- The ECB will "review and possibly reconsider" its monetary policy stance at next meeting.
- The Governing Council (GC) was unanimous in today´s line of communication.
- The ECB has recognised that downside risks have increased to both inflation and economic growth since the December meeting.

As expected, at today's monetary policy meeting there were no changes in the ECB´s monetary policy stance, as the central bank left the key policy rate unchanged at 0.05% and the deposit rate at -0.3%. As regards non-standard measures, the ECB hinted at an easing by the central bank as early as March. In this way, the dovish tone was reinforced and the easing bias was strengthened as the ECB stated that it "will be necessary to review and possibly reconsider our monetary policy stance," coinciding with the new Staff macroeconomic projections. In particular, Mr Draghi said that the ECB has the "power, the determination and the willingness to act" while he stressed that the Governing Council (GC) was unanimous in today´s line of communication. In this context, the central bank left the door open to further rate cuts, as it stated that rates would stay at "present or lower levels for an extended period." On the economic and inflation outlook, the downside risks have increased.

Mr Draghi voiced his concern on the current outlook, stressing that the downside risks have increased to both inflation and economic growth since the December meeting. Since that monetary policy meeting, the global outlook has become increasingly challenging due to the combination of renewed financial tensions, heightened uncertainty about emerging markets and the sharp drop in commodity prices. On inflation, Mr Draghi highlighted that euro area inflation dynamics continue to be weaker than expected. "Inflation rates are currently expected to remain at very low or negative levels in the coming months and to pick up only later in 2016." This broadly coincides with our own assessment. In particular, he said that the central bank will monitor any second-round effects in order to avoid "a downward price spiral". On the recovery of the euro area´s economy, he said that it is expected to remain on track but it will continue to be dampened by the weakness in emerging economies and volatile financial markets.

At the press conference, part of the attention was focused on which way the ECB is ready to implement any further measures. Mr Draghi highlighted that the central bank will do everything necessary to meet the mandate. In particular, he stated that there are no limits to their actions within its mandate, emphasising that the ECB will put all the instruments in place for future use. Against this background, when he was asked about what instruments the ECB was considering, Mr Draghi said that the bank has plenty of instruments but he clarified that the ECB's experts are working "to ensure that all the technical conditions are in place to make the full range of policy options available for implementation". Mr Draghi refused to give any hints on the choice of any particular measure, although beyond an extension of (and some changes to) the asset purchase programme (APP), another deposit rate cut is also an option. In this regard, in the statement the central bank explicitly confirmed "ECB rates to remain at current levels or lower for an extended period of time." (the word "lower" was introduced into the statement for the first time, which opens the door for further deposit rate cuts).

Mr Draghi took the opportunity to highlight the positive effects of the measures which had been put in place since mid-2014, including those taken at December's monetary policy meeting. In particular, he noted that these actions have strengthened the euro area's resilience to global shocks, as well as having improved economic and financial conditions in the region.

All in all, after today´s meeting the ECB is expected to announce further measures in March. Although it is true that the early stages and the continuing fragility of the euro area's recovery warrant a highly accommodative monetary policy, there is not much available ammunition on the monetary front.

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

in black, wording common to both the current and previous statements, in red 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,
Vítor Constâncio, Vice-President of the ECB,
Frankfurt am Main, ~~3 December 2015~~21 January 2016

Ladies and gentlemen, ~~the~~first of all let me wish you a Happy New Year. 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 today conducted a thorough assessment of~~ and after the ~~strength and persistence of the factors that are currently slowing the return of inflation to levels below, but close to, 2% in the medium term and re-examined the degree of monetary accommodation. As a result, the Governing Council took the following decisions in the pursuit of its price stability objective:~~
~~First, as regards~~recalibration of our monetary policy measures last month, we decided to keep the **key ECB interest rates**~~, we decided to lower the interest rate on the deposit facility by 10 basis points to -0.30%. The interest rate on the main refinancing operations and the rate on the marginal lending facility will~~ unchanged and we expect them to remain ~~unchanged~~ at ~~their current~~present or lower levels for an extended period of ~~0.05% and 0.30% respectively.~~
~~Second, as regards~~time. Regarding our **non-standard monetary policy measures**, ~~we decided to extend the asset purchase programme (APP). The monthly purchases of €60 billion under the APP are now intended to run until the end of March 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term~~the asset purchases are proceeding smoothly and continue to have a favourable impact on the cost and availability of credit for firms and households.

~~Third,~~ Taking stock of the evidence available at the beginning of 2016, it is clear that the monetary policy measures that we ~~decided~~ have adopted since mid-2014 are working. As a result, developments in the real economy, credit provision and financing conditions have improved and have strengthened the euro area's resilience to~~-~~ recent global economic shocks. The decisions taken in early December to extend our monthly net asset purchases of €60 billion to at least the end of March 2017, and to reinvest the principal payments~~-~~ on ~~the~~maturing securities ~~purchased under the APP as they mature,~~ for as long as necessary~~. This~~, were fully appropriate. They will ~~contribute both to favourable~~ result in a significant addition of liquidity ~~conditions and to an appropriate~~to the banking system and will strengthen our forward guidance on interest rates.

Yet, as we start the new year, downside risks have increased again amid heightened uncertainty about emerging market economies' growth prospects, volatility in financial and commodity markets, and geopolitical risks. In this environment, euro area inflation dynamics also continue to be weaker than expected. It will therefore be necessary to review and possibly reconsider our monetary policy stance~~. The technical details will be communicated in due time~~ at our next meeting in early March, when the new staff macroeconomic projections become available which will also cover the year 2018. In the meantime, work will be carried out to ensure that all the technical conditions are in place to make the full range of policy options available for implementation, if needed.

~~Fourth, we decided to include, in the public sector purchase programme, **euro-denominated marketable debt instruments issued by regional and local governments located in the euro area** in the list of assets that are eligible for regular purchases by the respective national central banks.~~

~~Fifth, we decided to continue conducting the main refinancing operations and three-month longer-term refinancing operations as **fixed rate tender procedures with full allotment** for as long as necessary, and at least until the end of the last reserve maintenance period of 2017.~~

~~Today's decisions were taken in order to secure a return of inflation rates towards levels that are below, but close to, 2% and thereby to anchor medium-term inflation expectations. The latest staff projections incorporate the favourable financial market developments following our last monetary policy meeting. They still indicate continued downside risks to the inflation outlook and slightly weaker inflation dynamics than previously expected. This follows downward revisions in earlier projection exercises. The persistence of low inflation rates reflects sizeable economic slack weighing on domestic price pressures and headwinds from the external environment.~~

~~Our new measures will ensure accommodative financial conditions and further strengthen the substantial easing impact of the measures taken since June 2014, which have had significant positive effects on financing conditions, credit and the real economy. Today's decisions also reinforce the momentum of the euro area's economic recovery and strengthen its resilience against recent global economic shocks. The Governing Council will closely monitor the evolution in the outlook for price stability and, if warranted, is willing and able to act by using all the instruments available within its mandate in order to maintain an appropriate degree of monetary accommodation. In particular, the Governing Council recalls that the APP provides sufficient flexibility in terms of adjusting its size, composition and duration.~~

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP ~~increased by~~growth was confirmed at 0.3%, quarter on quarter, in the third quarter of 2015, ~~following~~supported mainly by private consumption, while being dampened by a ~~rise of 0.4% in the previous quarter, most likely on account of a continued positive~~negative contribution from ~~consumption alongside more muted developments in investment and~~net exports. The most recent survey indicators, available up to December, point to ongoing real GDP growth momentum in the ~~final~~fourth quarter of ~~the~~last year. Looking ahead, we expect the economic recovery to proceed. Domestic demand should be further supported by our monetary policy measures and their favourable impact on financial conditions, as well as by the earlier progress made with fiscal consolidation and structural reforms. Moreover, ~~low~~ the renewed fall in oil prices should provide additional support for households' real disposable income and corporate profitability and, therefore, for private consumption and investment. In addition, ~~government expenditure is likely to increase in some parts of~~the fiscal stance in the euro area is becoming slightly expansionary, reflecting in particular measures in support of refugees. However, the economic recovery in the euro area continues to be dampened by subdued growth prospects in emerging markets ~~and moderate global trade~~, volatile financial markets, the necessary balance sheet adjustments in a number of sectors and the sluggish pace of implementation of structural reforms.

~~This outlook is broadly reflected in the December 2015 Eurosystem staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.5% in 2015, 1.7% in 2016 and 1.9% in 2017. Compared with the September 2015 ECB staff macroeconomic projections, the prospects for real GDP growth are broadly unchanged.~~

The risks to the euro area growth outlook remain on the downside and relate in particular to the heightened uncertainties regarding developments in the global economy, as well as to broader geopolitical risks. These risks have the potential to weigh on global growth and foreign demand for euro area exports and on confidence more widely.

~~According to Eurostat's flash estimate, euro~~Euro area annual HICP inflation was 0.2% in December 2015, compared with 0.1% in November ~~2015, unchanged from October but~~ . The December outcome was lower than expected~~. This reflected somewhat weaker~~, mainly reflecting the renewed sharp decline in oil prices, as well as lower food price ~~increases in~~and services ~~and industrial goods, mainly compensated for by a less negative contribution from energy prices.~~price inflation. On the basis of ~~the information available and~~ current oil futures prices, which are well below the level observed a few weeks ago, the expected path of annual HICP inflation in 2016 is now significantly lower compared with the outlook in early December. Inflation rates are currently expected to ~~rise~~remain at ~~the turn of~~very low or negative levels in the ~~year, mainly on account of base effects associated with the fall in oil prices in late 2014. During 2016~~ coming months and ~~2017, inflation rates are foreseen~~ to pick up ~~further~~only later in 2016. Thereafter, supported by our ~~previous~~ monetary policy measures ~~–~~and ~~supplemented by those announced today –~~ the expected economic recovery, ~~and the pass-through of past declines in the euro exchange rate. The Governing Council will~~ inflation rates should continue to recover, but risks of second-round effects should be monitored closely ~~monitor the evolution of inflation rates over the period ahead.~~

~~This broad pattern is also reflected in the December 2015 Eurosystem staff macroeconomic projections for the euro area, which foresee annual~~ . A more comprehensive picture of the impact of oil prices and other external and domestic factors on the outlook for HICP inflation ~~at 0.1% in 2015, 1.0% in 2016 and 1.6% in 2017. In comparison with the September 2015~~will become available in the March 2016 ECB staff macroeconomic projections, ~~the outlook for HICP inflation has been revised down slightly~~which will also cover the year 2018.

Turning to the **monetary analysis**, recent data confirm solid growth in broad money (M3), with the annual rate of growth of M3 ~~increasing to~~standing at 5.1% in November 2015, after 5.3% in October ~~2015 from 4.9% in September~~. Annual growth in M3 continues to be mainly supported by its most liquid components, with the narrow monetary aggregate M1 growing at an annual rate of 11.2% in November, after 11.8% in October~~, after 11.7% in September~~.

Loan dynamics continued the path of gradual recovery observed since the beginning of 2014. The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) increased to 0.9% in November 2015, up from 0.6% in October~~, up from 0.1% in September. Despite these improvements, developments~~. Developments in loans to enterprises continue to reflect the lagged relationship with the business cycle, credit risk and the ongoing adjustment of financial and non-financial sector balance sheets. The annual growth rate of loans to households (adjusted for loan sales and securitisation) increased to 1.~~2~~4% in ~~October~~November, compared with 1.~~1~~2% in ~~September~~October.

The bank lending survey for the euro area for the fourth quarter of 2015 points to further improvements in demand for bank loans, supported by the low level of interest rates, financing needs for investment purposes and housing market prospects. Credit standards eased further on loans to enterprises, notably owing to increasing competitive pressures in retail banking, and reverted to a net easing on loans to households for house purchase. Overall, the monetary policy measures in place since June 2014 have clearly improved borrowing conditions for both firms and households~~ and~~, as well as credit flows across the euro area.

To sum up, a **cross-check** of the outcome of the economic analysis with the signals coming from the monetary analysis confirmed the ~~need for further~~effectiveness of the monetary ~~stimulus~~policy measures in place and the need to review and possibly reconsider our monetary policy stance at our next meeting in early March in order to secure a return of inflation rates towards levels~~ that are~~ below, but close to, 2%.

Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance supports economic activity. However, in order to reap the full benefits from our monetary policy measures, other policy areas must contribute decisively. Given continued high structural unemployment and low potential output growth in the euro area, the ongoing cyclical recovery should be supported by effective~~-~~ **structural policies**. In particular, actions to improve the business environment, including the provision of an adequate public infrastructure, are vital to increase productive investment, boost job creation and raise productivity. The swift and effective implementation of~~-~~ structural reforms, in an environment of accommodative monetary policy, will not only lead to higher sustainable economic growth in the euro area but will also raise expectations of permanently higher incomes and accelerate the beneficial effects of reforms, thereby making the euro area more resilient to global shocks. **Fiscal policies** should support the economic recovery, while remaining in compliance with the fiscal rules of the European Union. Full and consistent implementation of the Stability and Growth Pact is crucial ~~for~~to maintain confidence in ~~our~~the fiscal framework. At the same time, all countries should strive for a more growth-friendly composition of fiscal policies.

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