CENTRAL BANKS

ECB in a wait and see stance

Financial Scenarios Unit

- The ECB did not announce a target size for the private asset buying programmes
- The programmes will last for at least two years
- Pending eligibility criteria for guaranteed mezzanine tranches

As expected, at today's monetary policy meeting the ECB left the key policy rate unchanged at 0.05%, did not take additional steps on non-standard measures but revealed operational details of the asset-backed securities (ABSPP) and covered bonds purchase programmes (CBPP). Mr. Draghi reiterated the unanimity within the Governing Council (GC) in their willingness to use further unconventional monetary policy if needed. Moreover, he took the opportunity to highlight that the new measures will enhance the transmission of the monetary policy and also, they should ease the monetary policy stance more broadly. Once again, he emphasised that these purchases (linked to TLTROs) will have a sizeable impact on the ECB´s balance sheet. On the economic outlook, as highlighted in the September statement, the GC continues to closely monitor risks on inflation over the medium term, while risks to the economic outlook continue to the downside.

At the press conference, the attention was focused on the details of the ABSPP and CBPP announced on 4 September, as the GC did not give any details at that meeting. Regarding the maturity of the programmes, both will last for at least two years, and they will commence in the fourth quarter of 2014, starting with covered bonds (euro-denominated) in the second half of October and ABS later in the quarter. Concerning the eligibility of assets to be purchased, the Eurosystem´s collateral framework will be the guide for deciding the eligibility in both programmes. However, ABSs and covered bonds from Greece and Cyprus that are currently not eligible as collateral for monetary policy operations will be subject to specific rules. The purchases will be conducted in both the primary and secondary markets. Moreover, the ECB will apply an issuer share limit of 70% per ISIN. The ECB will also consider buying fully retained ABSs subject to participation by other market investors, while fully retained covered bonds are eligible for CBPP. (See)

Despite the information released today, important details were not yet published. In response to questioning about the size of the purchases, Mr. Draghi refrained from given any figure but he highlighted there is a "potential universe of purchasable assets" stating that this universe of bonds could reach EUR1trn. With the information provided until now, it seems difficult to get close to that number as conditions seem to be quite restrictive, although the programmes are not target-sized and they are clearly open to extension. Moreover, the eligibility criteria for guaranteed mezzanine tranches within the ABSPP were not yet revealed. This shows the difficulties in achieving an overwhelming consensus within the members of the CG and the needed support from some European authorities to give guarantees to mezzanine tranches. Including these tranches could have a significant effect in terms of reducing the risk to banks' balance sheets, and not only in reinforcing their liquidity.

In our view, unless there is a deterioration of inflation expectations, the ECB will stay on hold over the coming months, monitoring the impact of the measures taken until now. Reiterating the commitment on the pledge that the GC is unanimous in using additional instruments within its mandate to tackle a prolonged period of low inflation, the ECB insists that the door remains open to a full-scale QE.

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,
~~Frankfurt am Main, 4 September~~Naples, 2 October 2014

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 Katainen~~I would like to thank Governor Visco 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, ~~the Governing Council~~ and in line with our forward guidance, we decided ~~today to lower the **interest rate** on the main refinancing operations of the Eurosystem by 10 basis points to 0.05% and the rate on the marginal lending facility by 10 basis points to 0.30%. The rate on the deposit facility was lowered by 10 basis points to -0.20%. In addition, the Governing Council decided~~ to keep the key ECB interest rates unchanged. Following up on the decisions of 4 September 2014, we also decided on the key operational details of both the asset-backed securities purchase programme and the new covered bond purchase programme.

This will allow us to start purchasing ~~non-financial private sector assets. The Eurosystem will purchase a broad portfolio of simple and transparent~~ covered bonds and asset-backed securities (ABSs) ~~with underlying assets consisting of claims against the euro area non-financial private sector under an **ABS purchase programme** (ABSPP). This reflects the role of the ABS market in facilitating new credit flows to the economy and follows the intensification of preparatory work on this matter, as decided by the Governing Council~~ in ~~June. In parallel, the Eurosystem will also purchase a broad portfolio of euro-denominated covered bonds issued by MFIs domiciled in the euro area under a new **covered bond purchase programme** (CBPP3). Interventions under these programmes will start in October 2014. The detailed modalities of these programmes will be announced after~~the fourth quarter of 2014, starting with covered bonds in the second half of October. The programmes will last for at least two years. Together with the ~~Governing Council meeting~~series of ~~2 October 2014. The newly decided measures, together with the~~ targeted longer-term refinancing operations ~~which will~~to be conducted ~~in two weeks,~~until June 2016, these purchases will have a sizeable impact on our balance sheet.

~~These decisions will add to the range of monetary policy measures taken over recent months. In particular, they will support~~ The new measures will support specific market segments that play a key role in the financing of the economy. They will thereby further enhance the functioning of the monetary policy transmission mechanism, facilitate credit provision to the broad economy and generate positive spillovers to other markets. Taking into account the overall subdued outlook for inflation, the weakening in the euro area's growth momentum over the recent past and the continued subdued monetary and credit dynamics, our asset purchases should ease the monetary policy stance more broadly. They should also strengthen our forward guidance on the key ECB interest rates and ~~reflect~~reinforce the fact that there are significant and increasing differences in the monetary policy cycle between major advanced economies. ~~They will further enhance the functioning of the~~

Together with the monetary ~~policy transmission mechanism and support the provision of credit to the broad economy. In our analysis, we took into account the overall subdued outlook for inflation, the weakening in the euro area's growth momentum over the recent past and the continued subdued monetary and credit dynamics. Today's decisions, together with the other measures~~ accommodation already in place, ~~have been taken with a view to underpinning~~the determined implementation of the new measures will underpin the firm anchoring of medium to long-term inflation expectations, in line with our aim of maintaining inflation rates below, but close to, 2%. As all our measures work their way through to the economy they will contribute to a return of inflation rates to levels closer to ~~2%.~~our aim. Should it become necessary to further address risks of too prolonged a period of low inflation, the Governing Council is unanimous in its commitment to using additional unconventional instruments within its mandate.

A separate press release will provide further information on the modalities of our new purchase programmes for ABSs and covered bonds. It will be released at 3.30 p.m.

Let me now explain our assessment in greater detail, starting with ~~the~~ the **economic analysis**. Following four quarters of moderate expansion, euro area real GDP remained unchanged ~~in~~between the first and second quarter of this year ~~compared with the previous quarter. While it partly reflected one-off factors, this outcome was weaker than expected. With regard to the third quarter, survey~~. Survey data available up to ~~August indicate a loss in cyclical~~ September confirm the weakening in the euro area's growth momentum, while remaining consistent with a modest economic expansion~~.~~

in the second half of the year. Looking ahead to 2015, the outlook for a moderate recovery in the euro area remains in place, but the main factors and assumptions shaping this assessment need to be monitored closely. Domestic demand should be supported by ~~the range of~~ our monetary policy measures, the ongoing improvements in financial conditions, the progress made in fiscal consolidation and structural reforms, and lower energy prices supporting real disposable income. Furthermore, demand for exports should benefit from the global recovery. At the same time, the recovery is likely to continue to be dampened by high unemployment, sizeable unutilised capacity, continued negative ~~MFI~~bank loan growth to the private sector, and the necessary balance sheet adjustments in the public and private sectors. ~~Looking ahead, the key factors and assumptions shaping the outlook for growth need to be monitored closely.~~

~~These elements are reflected in the September 2014 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 0.9% in 2014, 1.6% in 2015 and 1.9% in 2016. Compared with the June 2014 Eurosystem staff macroeconomic projections, the projections for real GDP growth for 2014 and 2015 have been revised downwards and the projection for 2016 has been revised upwards.~~

~~The Governing Council sees the risks surrounding the economic outlook for the euro area on the downside. In particular, the loss in economic momentum may dampen private investment, and heightened geopolitical risks could have a further negative impact on business and consumer confidence. Another downside risk relates to insufficient structural reforms in euro area countries.~~

~~According to Eurostat's flash estimate, euro area annual HICP inflation was 0.3% in August 2014, after 0.4% in July. This decline reflects primarily lower energy price inflation, while the other main components remained broadly unchanged in aggregate. Inflation rates have now remained low for a considerable period of time. As said, today's decisions, together with the other measures in place, have been taken to underpin the firm anchoring of medium to long-term inflation expectations, in line with our aim of maintaining inflation rates below, but close to, 2%.~~The risks surrounding the economic outlook for the euro area remain on the downside. In particular, the recent weakening in the euro area's growth momentum, alongside heightened geopolitical risks, could dampen confidence and, in particular, private investment. In addition, insufficient progress in structural reforms in euro area countries constitutes a key downward risk to the economic outlook.

According to Eurostat's flash estimate, euro area annual HICP inflation was 0.3% in September 2014, after 0.4% in August. Compared with the previous month, this reflects a stronger decline in energy prices and somewhat lower price increases in most other components of the HICP. On the basis of current information, annual HICP inflation is expected to remain at low levels over the coming months, before increasing gradually during 2015 and 2016.

~~The September 2014 ECB staff macroeconomic projections for the euro area foresee annual HICP inflation at 0.6% in 2014, 1.1% in 2015 and 1.4% in 2016. In comparison with the June 2014 Eurosystem staff macroeconomic projections, the projection for inflation for 2014 has been revised downwards. The projections for 2015 and 2016 have remained unchanged.~~

The Governing Council~~, taking into account the measures decided today,~~ will continue to closely monitor the risks to the outlook for price developments over the medium term. In this context, we will focus in particular on the possible repercussions of dampened growth dynamics, geopolitical developments, exchange rate developments and the pass-through of our monetary policy measures.

Turning to ~~the~~ the **monetary analysis**, data for ~~July~~August 2014 continue to point to subdued underlying growth in broad money (M3), with the annual growth ~~standing at~~ rate increasing moderately to 2.0% in August, after 1.8% in July~~, compared with 1.6%~~. Annual growth in ~~June. The growth of~~ M3 continues to be supported by its most liquid components, with the narrow monetary aggregate M1 ~~stood~~growing at an annual rate of 5.~~6~~8% in ~~July, up from 5.4% in June. The increase in the MFI net external asset position, reflecting in part the continued interest of international investors in euro area assets, remained an important factor supporting annual M3 growth~~August.

The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) remained negative at -2.0% in August, after -2.2% in ~~July, unchanged compared with~~ the previous month. ~~However, net redemptions were again sizeable in July.~~On average over recent months, net redemptions have moderated from the historically high levels recorded a year ago. Lending to non-financial corporations continues to reflect the lagged relationship with the business cycle, credit risk, credit supply factors 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) was 0.5% in ~~July~~August, broadly unchanged since the beginning of 2013.

Against the background of weak credit growth, the ECB is now close to finalising the comprehensive assessment of banks' balance sheets, which is of key importance to overcome credit supply constraints.

To sum up, ~~a~~ a **cross-~~check~~** check of the outcome of the economic analysis with the signals coming from the monetary analysis ~~led~~confirms the recent decisions taken by the Governing Council to ~~decide on measures to~~ provide further monetary policy accommodation and to support lending to the real economy.

~~With regard to **structural reforms**, important steps have been taken in several Member States, while in others such measures still need to be legislated for and implemented. These efforts now clearly need to gain momentum to achieve higher sustainable growth and employment in the euro area. Determined structural reforms in~~ Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance contributes to supporting economic activity. However, in order to strengthen investment activity, job creation and potential growth, other policy areas need to contribute decisively. In particular, the legislation and implementation of structural reforms clearly need to gain momentum in several countries. This applies to product and labour markets as well as ~~action~~to actions to improve the business environment ~~are warranted.~~for firms. As ~~regards~~ regards **fiscal policies**, ~~comprehensive fiscal consolidation in recent years has contributed to reducing budgetary imbalances. Euro~~euro area countries should not unravel the progress already made ~~with fiscal consolidation~~ and should proceed in line with the rules of the Stability and Growth Pact. ~~The Pact acts as an anchor for confidence, and the existing flexibility within the rules allows the budgetary costs of major structural reforms to be addressed and demand to be supported. There is also leeway to achieve a more growth-friendly composition of fiscal policies.~~ This should be reflected in the draft budgetary plans for 2015 that governments will now deliver, in which they will address the relevant country-specific recommendations. The Pact should remain the anchor for confidence in sustainable public finances, and the existing flexibility within the rules should allow governments to address the budgetary costs of major structural reforms, to support demand and to achieve a more growth-friendly composition of fiscal policies. A full and consistent implementation of the euro area's existing fiscal and macroeconomic surveillance framework is key to bringing down high public debt ratios, to raising potential growth and to increasing the euro area's resilience to shocks.