CENTRAL BANKS

Further easing measures favor unconventional measures over rate cuts

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- **The ECB cut rates to record lows, increased the size -and widened the scope - of its APP (making investment-grade non-financial euro corporate bonds eligible) and introduced a new round of (attractive) TLTROs.**
- **The Staff revised its inflation projections significantly downwards, as expected. It also reduced its growth forecasts for 2016 and 2017 (while announcing a 1.8% expected growth for 2018)**
- **The ECB remains vigilant and ready to act if necessary, favoring further “unconventional measures” over (not-excluded) additional rate cuts.**

At today’s monetary policy meeting the ECB Governing Council (GC) cut rates and announced further non-standard measures in order to counteract heightened risks to the ECB´s price stability objective. In particular, the GC announced: i) to cut the main policy rate by 5bp to 0.0%, a historic low, the deposit facility rate by 10bp to -0.40% and the marginal lending rate by 5bp to 0.25%, ii) to expand monthly purchases under the asset purchase program (APP) to EUR80 bn from EUR60 bn, iii) to broaden the scope of asset purchased under the APP (to now include investment-grade euro-denominated bonds issued by non-bank corporations) and iv) to introduce a new round of four-year TLTROs. Mr. Draghi said that today's decision was not unanimous but counted with an “overwhelming majority”.

Looking forward, the GC retained its easing bias and its willingness to act further if needed, highlighting that the central bank is not short of ammunition. After today´s action, the central bank has left the door open for further rate cuts, as it stated that “rates are to remain at present or lower levels for an extended period of time and well past the horizon of our net asset purchases." That said, at the press conference Draghi expressed that the ECB would favor further unconventional measures over any additional rate cuts.

On the economic outlook, the Staff revised its forecasts down on the back of weak data that has been piling up on top of the 0.3% QoQ growth of the previous quarter (we expected 0.4%): it lowered 2016´s expected growth by 0.3pp (to 1.4%) and 2017´s expected growth by 0.2% (to 1.7%). It also established a 1.8% expected growth for 2018 while adding a negative bias to the overall outlook (bias driven by as still uncertain global economy). The Staff´s forecasts are slightly more pessimistic than the ones we elaborated right before the financial turbulences at the start of the year (we then established 1.8% and 1.9% for 2016 and 2017, respectively). The drivers of the current outlook have not changed from those described in the latest statement: supportive economic policies and low energy prices favouring growth, compensated by a negative outlook for foreign activity and financial markets, high debt and slow structural reforms. Risks continue to be biased downwards.

Regarding inflation, the ECB pointed out that it will continue to be in negative territory over the coming months and should pick up by the end of the year. The downward revisions of inflation projections are in line with what we expected given the oil price outlook and recent negative surprises: from 1% to 0.1% in 2016, and from 1.6% to 1.3% in 2017, while for 2018 they expect 1.6% (in this case we expected a slightly higher figure). Core inflation is revised down by 2 and 3 decimal points in 2016 and 2017, respectively, to 1.1% and 1.3%, and project a 1.6% in 2018. The statement does not refer to inflation risks in any one direction, but points out that they will be vigilant on eventual second round effects (something Mr.Draghi had previously mentioned in various occasions).

At the press conference, the focus was put on the many announced measures, with Draghi emphasising that the ECB still counts with significant ammunition: including additional rate cuts, yet favoring further "unconventional measures" if needed.

- **Additional rate cuts**. The GC cut the main policy rate by another 5bp to 0.0%, a historic low, the deposit facility by 10bp to -0.40% and the marginal lending rate by 5bp to 0.25%, thus leaving an asymmetric corridor for interest rates. Yet when asked why the ECB had not introduced a tiered deposit rate (one of the possible measures that markets expected as a way to soften the impact of negative rates on the banking sector), Mr. Draghi responded that the GC did not want to signal that rates cuts would continue to be the tool of choice (he also pointed out technical complexity).
- **Extension and additional increase in monthly purchases under APP.** The GC decided to increase the current monthly pace of purchases from EUR60 billion to EUR80 billion. The central bank will maintain the program until the end of March 2017, conditional on inflation effectively adjusting to rates below, but close to, 2% over the medium term.
- **Broadening the scope of eligible assets for the APP.** The central bank decided to include "investment grade euro-denominated bonds issued by non-bank corporations established in the euro area" in the list of eligible assets for regular purchases. The inclusion of corporate bonds was not anticipated by markets and opens the door to the purchase of a whole new set of euro-denominated assets.
- **Raising the issuer and issue share limits within the APP.** The limit applied to the purchase of securities issued by eligible international organisations and multilateral development banks was raised from 33% to 50%.
- **A new round of TLTROs.** A new series of four targeted longer-term refinancing operations (TLTRO II), each with a maturity of four years, will be launched, starting in June 2016. The news are welcomed by EZ banks under the pressure of negative deposit rates, as these four TLTRO II have no mandatory prepayments, are not conditional on banks increasing their lending to the economy, and have a maximum of 0% interest rate (if the rate for MROs does not increase until March 2017) and a minimum of -0.4% (or whatever the rate on the loan deposit facility is at each settlement date). The amount of loans that can be borrowed is sizeable: 30% of outstanding eligible loans as of 31 January 2016, i.e. ~€1.7tr minus the €200bn borrowed in the 2014 TLTROs. Thus the cost of these funds is very favourable (potentially negative), and the possibility to rollover the current TLTROs to the new TLTRO II - together with the four-year maturity - eliminates any concern about funding for European banks.

Today´s measures come almost exactly a year after the ECB announced the purchase of EZ government bonds (9 March 2015). With today´s significant announcements, the ECB stressed that there is ample room for further measures, dismissing the view that everything is done in terms of easing policy while emphasizing that in case of need, the GC would opt for further unconventional measures over additional rate cut. That said, despite today´s welcomed announcements, one fact remains: the ECB has less and less margin for maneuver while, as reiterated by Draghi, the effectiveness of additional monetary measures diminishes as long as they are not accompanied by coordinated fiscal stimuli

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, ~~21 January~~10 March 2016

Ladies and gentlemen, ~~first of all let me wish you a Happy New Year. The~~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, ~~and after~~ we have conducted a thorough review of the ~~recalibration of~~ monetary policy stance, in which we also took into account the new macroeconomic projections by our ~~monetary policy measures last month, we~~staff extending into the year 2018. As a result, the Governing Council has decided on a set of measures in the pursuit of its price stability objective. This comprehensive package will exploit the synergies between the different instruments and has been calibrated to ~~keep~~further ease financing conditions, stimulate new credit provision and thereby reinforce the momentum of the euro area's economic recovery and accelerate the return of inflation to levels below, but close to, 2%.

First, as regards the key ECB interest rates ~~unchanged and we expect them~~, we decided to lower the interest rate on the main refinancing operations of the Eurosystem by 5 basis points to 0.00% and the rate on the marginal lending facility by 5 basis points to 0.25%. The rate on the deposit facility was lowered by 10 basis points to -0.40%.

Second, we decided to expand the monthly purchases under our asset purchase programme from €60 billion at present to €80 billion. They are 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. To ensure the continued smooth implementation of our asset purchases, we also decided to increase the issuer and issue share limits for the purchases of securities issued by eligible international organisations and multilateral development banks from 33% to 50%.

Third, we decided to include investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area in the list of assets that are eligible for regular purchases under a new corporate sector purchase programme. This will further strengthen the pass-through of our asset purchases to the financing conditions of the real economy. Purchases under the new programme will start towards the end of the second quarter of this year.

Fourth, we decided to launch a new series of four targeted longer-term refinancing operations (TLTRO II), starting in June 2016, each with a maturity of four years. These new operations will reinforce the ECB's accommodative monetary policy stance and will strengthen the transmission of monetary policy by further incentivising bank lending to the real economy. Counterparties will be entitled to borrow up to 30% of the stock of eligible loans as at 31 January 2016. The interest rate under TLTRO II will be fixed over the life of each operation, at the rate on the Eurosystem's main refinancing operations prevailing at the time of take-up. For banks whose net lending exceeds a benchmark, the rate applied to the TLTRO II will be lower, and can be as low as the interest rate on the deposit facility prevailing at the time of take-up. There will be no requirement for mandatory early repayments under TLTRO II, and switches from TLTRO I will be allowed.

Finally, looking ahead, taking into account the current outlook for price stability, the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time~~. Regarding our non-standard monetary policy~~, and well past the horizon of our net asset purchases.

Separate press releases with further details of the measures~~, the asset purchases are proceeding smoothly and continue to have a favourable impact on the cost and availability of credit for firms and households~~ taken by the Governing Council will be published this afternoon at 15:30 CET.

~~Taking stock of the evidence available at the beginning of 2016, it is clear that the monetary policy measures that we 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 maturing securities for as long as necessary, were fully appropriate. They will result in a significant addition of liquidity 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 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.~~

Adding to the measures taken since June 2014, with today's comprehensive package of monetary policy decisions we are providing substantial monetary stimulus to counteract heightened risks to the ECB's price stability objective. While very low or even negative inflation rates are unavoidable over the next few months, as a result of movements in oil prices, it is crucial to avoid second-round effects by securing the return of inflation to levels below, but close to, 2% without undue delay. The Governing Council will continue to monitor very closely the evolution of the outlook for price stability over the period ahead.

Let me now explain our assessment in greater detail, starting with the economic analysis. Euro area real GDP growth was confirmed at 0.3%, quarter on quarter, in the ~~third~~fourth quarter of 2015, supported ~~mainly~~ by ~~private consumption~~domestic demand, while being dampened by a negative contribution from net exports. The most recent survey ~~indicators, available up to December,~~data point to ~~ongoing real GDP~~weaker than expected growth momentum ~~in~~at the ~~fourth quarter~~beginning of ~~last~~this year. Looking ahead, we expect the economic recovery to proceed at a moderate pace. 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~~continued employment gains benefiting from past structural reforms. Moreover, the ~~renewed fall in~~low price of oil~~ prices~~ should provide additional support for households' real disposable income and private consumption, as well as corporate profitability and~~, therefore, for private consumption and~~ investment. In addition, the fiscal stance in the euro area is ~~becoming~~ slightly expansionary, partly 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, 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 March 2016 ECB staff macroeconomic projections for the euro area, which foresee annual real GDP increasing by 1.4% in 2016, 1.7% in 2017 and 1.8% in 2018. Compared with the December 2015 Eurosystem staff macroeconomic projections, the outlook for real GDP growth has been revised slightly down, mainly reflecting the weakened growth prospects for the global economy.

The risks to the euro area growth outlook remain ~~on~~tilted to the downside~~ and~~. They 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.~~

~~Euro~~According to Eurostat's flash estimate, euro area annual HICP inflation was -0.2% in ~~December 2015~~February 2016, compared with 0.~~1% in November. The December outcome was lower than expected, mainly reflecting the renewed sharp~~3% in January. All main HICP components contributed to this decline~~ in oil prices, as well as lower food price and~~

~~services price inflation. On the~~. Looking ahead, on the basis of 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~~ for energy, 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. Thereafter, supported by our monetary policy measures and the expected economic recovery, inflation rates should ~~continue to recover, but risks of~~ recover further. The Governing Council will closely monitor price-setting behaviour and wage developments in the euro area, paying particular attention to ensure that the current low inflation environment does not become entrenched in second-round effects ~~should be monitored closely. A more comprehensive picture of the impact of oil prices~~on wage and ~~other external and domestic factors on the outlook for HICP inflation will become available~~price-setting.

This broad pattern is also reflected in the March 2016 ECB staff macroeconomic projections~~, which will also cover the year~~ for the euro area, which foresee annual HICP inflation at 0.1% in 2016, 1.3% in 2017 and 1.6% in 2018. In comparison with the December 2015 Eurosystem staff macroeconomic projections, the outlook for HICP inflation has been revised down, mainly reflecting the fall in oil prices over recent months.

Turning to the monetary analysis, recent data confirm solid growth in broad money (M3), with the annual rate of growth of M3 standing at 5.~~1~~0% in ~~November 2015~~January 2016, after ~~5.3~~4.7% in ~~October~~December 2015. 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~~10.5% in ~~November~~January, after ~~11~~10.8% in ~~October~~December.

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~~6% in ~~November 2015~~January 2016, up from 0.~~6~~1% in ~~October~~December 2015. 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~~remained stable at 1.4% in ~~November, compared with 1.2% in 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~~January 2016. Overall, the monetary policy measures in place since June 2014 have clearly improved borrowing conditions for ~~both~~ firms and households, 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 ~~effectiveness of the~~need for further monetary ~~policy measures in place and the need to review and possibly reconsider our monetary policy stance at our next meeting in early March~~stimulus in order to secure a return of inflation rates towards levels that are below, but close to, 2~~%.~~% without undue delay.

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 raise productivity and improve the business environment, including the provision of an adequate public infrastructure, are vital to increase ~~productive~~ investment~~,~~ and 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~~make the euro area more resilient to global shocks. As indicated by the European Commission, the implementation of country-specific recommendations continued to be fairly limited in 2015; reform efforts thus need to be stepped up in the majority of euro area countries. 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 to maintain confidence in the fiscal framework. At the same time, all countries should strive for a more growth-friendly composition of fiscal policies.

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