ECB Watch: A first tweak in the forward guidance

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- **The ECB remove the easing bias on rates**
- **Growth projections are more positive while the inflation outlook remains unchanged despite lower headline inflation projections**
- **In September, we expect the ECB to open the door to tapering next year**

As expected, at today's monetary policy meeting there were no changes in the ECB's monetary policy stance, as the central bank left key policy rates unchanged and confirmed that the monthly asset purchases of €60 billion are intended to run until the end of December 2017 (or beyond if necessary). However, the ECB adopted a neutral bias on interest rates; as they are now expected "to remain at present levels for an extended period", rather than "at present levels or lower". Still, the dovish stance remains in place as the ECB is ready to increase purchases in size and or in duration if needed.

A stronger-than-expected cyclical recovery is reflected in the upward revision of the ECB's Staff projection for GDP growth, by 0.1pp over the forecast horizon, to 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. In addition to solid domestic factors and growth supportive policies, the global recovery is increasingly supporting activity. The ECB considers that the risks to the growth outlook are now broadly balanced. In contrast, projections for headline inflation have been revised down by 0.2pp to 1.5% in 2017, 0.3pp to 1.3% in 2018 and by 0.1pp to 1.6% in 2019. The drivers underlying this revision are the lower futures prices for Brent (around 9% in the forecast horizon) and a more appreciated euro (around 2% in 2018-19). More importantly, projections for core inflation have barely changed (1.1% in 2017, 1.4% in 2018 and 1.7% in 2019), so broadly speaking the ECB's assessment on inflation has not changed. According to Mr Draghi, there are structural reasons (especially in the labour market) curbing the translation of the economic expansion into stronger inflation dynamics, but once the tail risk of deflation has disappeared, the ECB remains confident on the expected gradual recovery of core inflation over the forecast horizon.

The main novelty of the meeting was the removal of the easing bias on interest rates, which Mr Draghi attributed to the fact that the risk of deflation has disappeared. "Deflation risks have definitely gone away." On the question about the unanimity of this decision, Mr Draghi clarified "We didn't have a vote but I didn't hear any dissenting voice by any governing council member." Although, he emphasized that the ECB has to be persistent and help the economy achieve full recovery. In this regard, he clarified that the central bank can still cut interest rates if needed.

During the Q&A, part of the attention was focused on the process of monetary policy normalization. Mr Draghi stated that the GC did not discuss any exit strategy but he clarified that two members made observations on this issue. Moreover, he emphasized that the ECB will be in the market for a long time stressing that "the net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the asset purchase programme".

All in all, the message from the ECB has come in line with expectations, as it left the monetary policy unchanged but made slight changes in the forward guidance (removing the downward bias on rates), although maintaining a cautious tone. Regarding the normalization process, our baseline scenario remains unchanged: we expect in September they open the door to a slower pace of asset purchases to start by early 2018.

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

in grey, 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, 27 April~~Tallinn, 8 June 2017

INTRODUCTORY STATEMENT

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~~ I would like to thank Governor Hansson for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council~~, which was also attended by the Commission Vice-President, Mr Dombrovskis~~. We will now report on the outcome of our meeting.

Based on our regular economic and monetary analyses, we decided to keep the **key ECB interest rates** unchanged. We ~~continue to~~ expect them to remain at their present ~~or lower~~ levels for an extended period of time, and well past the horizon of our net asset purchases. Regarding **non-standard monetary policy measures**, we confirm that our net asset purchases, at the ~~new~~current monthly pace of €60 billion, are intended to run until the end of December 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 inflation aim. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the asset purchase programme.

Our monetary policy measures have continued to preserve the very favourable financing conditions that are necessary to secure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term. ~~Incoming data since our meeting in early March confirm that the cyclical recovery of the euro area economy is becoming increasingly solid and that downside risks have further diminished. At the same time, underlying inflation pressures continue to remain subdued and have yet to show a convincing upward trend. Moreover, the ongoing volatility in headline inflation underlines the need to look through transient developments in HICP inflation, which have no implication for the medium-term outlook for price stability~~The information that has become available since our last monetary policy meeting in late April confirms a stronger momentum in the euro area economy, which is projected to expand at a somewhat faster pace than previously expected. We consider that the risks to the growth outlook are now broadly balanced.

~~A~~At the same time, the economic expansion has yet to translate into stronger inflation dynamics. So far, measures of underlying inflation continue to remain subdued. Therefore, a very substantial degree of monetary accommodation is still needed for underlying inflation pressures to build up and support headline inflation in the medium term. If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, we stand ready to increase our asset purchase programme in terms of size and/or duration.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~5~~6%, quarter on quarter, in the ~~fourth~~first quarter of 2017, after 0.5% in the last quarter of 2016~~, following a growth rate of 0.4% in the third quarter.~~. Incoming data, notably survey results, ~~bolster our confidence that the ongoing economic expansion will~~ continue to ~~firm and broaden.~~point to solid, broad-based growth in the period ahead. The pass-through of our monetary policy measures ~~is supporting domestic demand and facilitates~~has facilitated the ~~ongoing~~ deleveraging process~~. The~~ and should continue to support domestic demand. In particular, the recovery in investment continues to benefit from very favourable financing conditions and improvements in corporate profitability. Employment gains, which are also benefiting from past labour market reforms, are supporting real disposable income and private consumption. Moreover, the ~~signs of a stronger~~ global recovery ~~and increasing global trade suggest that foreign demand should~~is increasingly ~~add to the overall resilience of the economic expansion in the~~ supporting trade and euro area exports. However, economic growth ~~continues~~prospects continue to be dampened by a sluggish pace of implementation of structural reforms, in particular in product markets, and by remaining balance sheet adjustment needs in a number of sectors~~. The risks surrounding the euro area growth outlook, while moving towards a more balanced configuration, are still tilted to the downside and relate predominantly to global factors~~, notwithstanding ongoing improvements.

~~Headline inflation~~This assessment is broadly reflected in the June 2017 Eurosystem staff macroeconomic projections for the euro area, finalised in late May, which are conditional on the full implementation of all our monetary policy measures. These projections foresee annual real GDP increasing by 1.9% in 2017, by 1.8% in 2018 and by 1.7% in 2019. Compared with the March 2017 ECB staff macroeconomic projections, the outlook for real GDP growth has been ~~recovering from the very low levels seen in 2016, largely owing~~revised upwards over the projection horizon.

The risks surrounding the euro area growth outlook are considered to ~~higher energy price~~ be broadly balanced. On the one hand, the current positive cyclical momentum increases~~. After reaching 2.0% in February 2017~~ the chances of a stronger than expected economic upswing. On the other hand, downside risks relating to predominantly global factors continue to exist.

According to Eurostat's flash estimate, euro area annual HICP inflation ~~stood at~~was 1.4% in May, following 1.9% in April and 1.5% in March. ~~This reflected~~ As expected, the recent volatility in inflation rates was mainly ~~lower~~due to energy prices and ~~unprocessed food price inflation, but also a decline~~temporary increases in services ~~price inflation.~~prices over the Easter period. Looking ahead, on the basis of current futures prices for oil, headline inflation is likely to ~~increase in April and thereafter to hover~~remain around current levels ~~until the end of this year. However~~in the coming months. At the same time, measures of underlying inflation remain low and have yet to show convincing signs of a pick-up, as unutilised resources are still weighing on domestic price and wage ~~and price~~ formation~~, measures of underlying~~. Underlying inflation ~~remain low and are~~is expected to rise only gradually over the medium term, supported by our monetary policy measures, the ~~expected~~ continuing economic ~~recovery~~expansion and the corresponding gradual absorption of economic slack.

This assessment is also broadly reflected in the June 2017 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.5% in 2017, 1.3% in 2018 and 1.6% in 2019. By comparison with the March 2017 ECB staff macroeconomic projections, the outlook for headline HICP inflation has been revised downwards, mainly reflecting lower oil prices.

Turning to the **monetary analysis**, broad money (M3) continues to expand at a robust pace, with an annual rate of growth of 4.~~7~~9% in ~~February~~April 2017, after ~~4.8~~5.3% in ~~January~~March. As in previous months, annual growth in M3 was mainly supported by its most liquid components, with the narrow monetary aggregate M1 expanding at an annual rate of ~~8.4~~9.2% in ~~February~~April 2017, ~~unchanged from the previous month.~~after 9.1% in March.

The recovery in loan growth to the private sector observed since the beginning of 2014 is proceeding. The annual growth rate of loans to non-financial corporations ~~declined~~increased to 2.~~0~~4% in ~~February~~April 2017, from 2.3% in the previous month, while the annual growth rate of loans to households remained ~~broadly stable at 2.3% in February. At the same time, the euro area bank lending survey for the first quarter of 2017 indicates that net loan demand has increased and bank lending conditions have further eased across all loan categories.~~stable at 2.4% in April. The pass-through of the monetary policy measures put in place since June 2014 continues to significantly support borrowing conditions for firms and households ~~and~~, access to financing, notably for small and medium-sized enterprises, and, hence, 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 a continued very substantial degree of monetary accommodation to secure a sustained return of inflation rates towards levels that are below, but close to, 2~~% without undue delay.~~%.

In order to reap the full benefits from our monetary policy measures, other policy areas must contribute much more decisively to strengthening economic growth. The implementation of **structural reforms** needs to be substantially stepped up to increase resilience, reduce structural unemployment and boost productivity and potential output growth.

Regarding~~-~~ **fiscal policies**, all countries ~~should intensify~~would benefit from intensifying efforts towards achieving a more growth-friendly composition of public finances. A full, transparent and consistent implementation of the Stability and Growth Pact and of the macroeconomic imbalances procedure over time and across countries remains ~~crucial~~essential to ~~enhance~~bolster the resilience of the euro area economy.

We are now at your disposal for questions.

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