Central Banks

The end of QE and caution for the future

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- **The ECB confirmed that it will end the net asset purchases at the end of the month, after almost four years**
- **Minor changes in the outlook, but more cautious due to growing downward risks**

As expected, the ECB has taken today an important step in the normalization process of its monetary policy by confirming the end of **net asset purchases**, while it **enhancing its forward guidance on the reinvestment policy**, as reinvestment will continue well beyond the start of interest rate hikes. On standard measures, **the forward guidance on policy rates was left unchanged** "at least through the summer of 2019". The tone remained relatively dovish; the easing bias was retained as the central bank reiterated that it “stands ready to adjust all of its instruments as appropriate to ensure that inflation continues to move towards the GC’s inflation aim in a sustained manner.”

There are **no major changes in the ECB’s assessment of the economic outlook** - beyond mentioning a slower momentum ahead due to softer incoming data, **but with still balanced risks, which are moving to the downside** reflecting the persistence of uncertainties related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility. GDP growth forecasts have been revised slightly down -by 0.1pp to 1.9% in 2018 and 1.7% in 2019- driven by slowing external demand despite the strength of domestic factors. Over the forecast horizon, growth will gradually converge to potential, from the unchanged 1.7% in 2020 to 1.5% in 2021. Despite the persistence of very low core inflation, the ECB **remains confident that inflation is converging to target,** as broad-based increasing wages and other production costs are expected to pass-through consumer prices, although not uniformly across regions. The updated forecasts for both core (1.4% in 2019 and 1.6% in 2020) and headline inflation (1.6% in 2019 and 1.7% in 2020) were revised slightly down, but trending up afterwards, to 1.8% by 2021.

Today, **the ECB has put an end to its APP net purchases after almost four years of buying sovereign bonds of Eurozone countries**. During this period, the ECB has bought almost 2.6 trillion of assets, and more than 2 trillion of those are holdings of public sector securities. On reinvestments, Mr Draghi made clear that the wanted to keep flexibility and the **ECB did not discuss any specific timing. Regarding how the reinvestment policy will be instrumented**, the central bank unveiled that “redemptions will be reinvested in the jurisdiction in which principal repayments are made, but portfolio allocation across jurisdictions will continue to be adjusted to bring share of the PSPP portfolio in **closer alignment with ECB capital key.**” At first glance, in the short run this reinvestment framework is more favorable for core countries than peripheral ones for two main reasons: peripheral bond redemption in the ECB balance sheet will be lower than that of core bonds in the first three years, according to the average maturity of the ECB bond portfolio, and the share of core countries in the new ECB capital key has increased to the detriment of peripheral countries. .

On the question if the Governing Council discussed other tools of monetary policy **-i.e. the possibility of another TLTRO-** Mr Draghi remarked that they have not talked about other specific tools, but their intention is to keep liquidity as available as it needs to be, revealing that **“committees will start work on liquidity issues.”** Against this background of monetary policy instruments discussion, Mr Draghi took the opportunity to make clear that the APP is not disappearing, emphasizing that QE will remain as a permanent instrument of monetary policy, and it can be considered to be useable by the Governing Council in the future.

All in all, the ECB has announced the end of the QE, as expected, taking an important step in the exit strategy. While moving forward, the focus will turn in coming months on the pace at which interest rates will rise. So far, the ECB seems comfortable with survey expectations.

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

in grey, 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)

PRESS CONFERENCE

Mario Draghi, President of the ECB,

Luis de Guindos, Vice-President of the ECB,

Frankfurt am Main, ~~25 October~~13 December 2018

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 today's meeting of the Governing Council, which was also attended by the ~~Commission Vice-~~President of the Eurogroup, Mr ~~Dombrovskis~~Centeno.

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 levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.

Regarding **non-standard monetary policy measures**, ~~we will continue to make~~our net purchases under the asset purchase programme (APP) ~~at the new monthly pace of €15 billion until the~~ will end ~~of~~in December 2018. ~~We anticipate that, subject to incoming data confirming our medium-term inflation outlook~~At the same time, we are enhancing our forward guidance on reinvestment. Accordingly, we ~~will then end net purchases. We~~ intend to ~~reinvest~~continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time ~~after the end of our net asset purchases~~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.

~~Incoming~~While incoming information~~, while somewhat~~ has been weaker than expected, ~~remains overall consistent with an ongoing broad-based expansion of~~reflecting softer external demand but also some country and sector-specific factors, the underlying strength of domestic demand continues to underpin the euro area ~~economy~~expansion and gradually rising inflation pressures. ~~The underlying strength of the economy continues to support~~This supports our confidence that the sustained convergence of inflation to our aim will proceed and will be maintained even after ~~a gradual winding-down~~the end of our net asset purchases. At the same time, uncertainties ~~relating~~related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility remain prominent. Significant monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term. ~~This support will continue to be provided~~Our forward guidance on the key ECB interest rates, reinforced by the ~~net asset purchases until the end~~reinvestments of the ~~year, by the~~ sizeable stock of acquired assets ~~and~~, continues to provide the necessary degree of monetary accommodation for the ~~associated reinvestments, and by~~ sustained convergence of inflation to our ~~enhanced forward guidance on the key ECB interest rates.~~ aim. In any event, the Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

Let me now explain our assessment in greater detail, starting with the **economic analysis**. Euro area real GDP increased by 0.~~4~~2%, quarter on quarter, in ~~both~~ the ~~first and the second~~third quarter of 2018~~. Incoming information, while somewhat~~, following growth of 0.4% in the previous two quarters. The latest data and survey results have been weaker than expected, ~~remains overall consistent with~~ reflecting a diminishing contribution from external demand and some country and sector-specific factors. While some of these factors are likely to unwind, this may suggest some slower growth momentum ahead. At the same time, domestic demand, also backed by our ~~baseline scenario of an ongoing broad-based~~ accommodative monetary policy stance, continues to underpin the economic expansion~~, supported by domestic demand and continued improvements in the~~ in the euro area. The strength of the labour market~~. Some recent sector-specific developments are having an impact on the near-term growth profile. Our monetary policy measures continue to underpin domestic demand. Private consumption is fostered by~~, as reflected in ongoing employment ~~growth~~gains and rising wages~~. At the same time,~~, still supports private consumption. Moreover, business investment is ~~supported by solid~~benefiting from domestic demand, favourable financing conditions and ~~corporate profitability. Housing~~improving balance sheets. Residential investment remains robust. In addition, the expansion in global activity is still expected to continue, supporting euro area exports, ~~though~~although at a slower pace.

This assessment is broadly reflected in the December 2018 Eurosystem staff macroeconomic projections for the euro area. These projections foresee annual real GDP increasing by 1.9% in 2018, 1.7% in 2019, 1.7% in 2020 and 1.5% in 2021. Compared with the September 2018 ECB staff macroeconomic projections, the outlook for real GDP growth has been revised slightly down in 2018 and 2019.

The risks surrounding the euro area growth outlook can still be assessed as broadly balanced. ~~At~~However, the ~~same time,~~balance of risks ~~relating to~~is moving to the downside owing to the persistence of uncertainties related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility~~ remain prominent~~.

~~Euro~~According to Eurostat's flash estimate, euro area annual HICP inflation ~~increased~~declined to 2.~~1~~0% in ~~September~~November 2018, from 2.~~0~~2% in ~~August~~October, reflecting mainly ~~higher~~a decline in energy ~~and food price~~ inflation. On the basis of current futures prices for oil, ~~annual rates of~~ headline inflation ~~are~~is likely to ~~hover around the current level~~decrease over the coming months. ~~While measures~~Measures of underlying inflation remain generally muted, ~~they have been increasing from earlier lows. Domestic~~but domestic cost pressures are ~~strengthening~~continuing to strengthen and ~~broadening~~broaden amid high levels of capacity utilisation and tightening labour markets~~.~~, which is pushing up wage growth. Looking ahead, underlying inflation is expected to ~~pick up towards the end of the year and to~~ increase ~~further~~ over the medium term, supported by our monetary policy measures, the ongoing economic expansion and rising wage growth.

This assessment is also broadly reflected in the December 2018 Eurosystem staff macroeconomic projections for the euro area, which foresee annual HICP inflation at 1.8% in 2018, 1.6% in 2019, 1.7% in 2020 and 1.8% in 2021. Compared with the September 2018 ECB staff macroeconomic projections, the outlook for HICP inflation has been revised slightly up for 2018 and down for 2019.

Turning to the **monetary analysis**, broad money (M3) growth stood at 3.~~5~~9% in ~~September~~October 2018, after 3.~~4~~6% in ~~August~~September. Apart from some volatility in monthly flows, M3 growth ~~is increasingly~~continues to be supported by bank credit creation. The narrow monetary aggregate M1 remained the main contributor to broad money growth.

~~The growth of loans to the private sector strengthened further, continuing~~In line with the upward trend observed since the beginning of 2014~~.~~, the growth of loans to the private sector continues to support the economic expansion. The annual growth rate of loans to non-financial corporations ~~rose to~~stood at 3.9% in October 2018, after 4.3% in September~~ 2018, from 4.1% in August~~, while the annual growth rate of loans to households ~~stood at 3.1%,~~remained unchanged ~~from the previous month. The euro area bank lending survey for the third quarter of 2018 indicates that loan growth continues to be supported by increasing demand across all loan categories and favorable bank lending conditions for loans to enterprises and loans for house purchase.~~

at 3.2%. The pass-through of the monetary policy measures put in place since June 2014 continues to significantly support borrowing conditions for firms and households, access to financing – in particular for small and medium-sized enterprises – and 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 that an ample degree of monetary accommodation is still necessary for the continued sustained 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 and reducing vulnerabilities. The implementation of **structural reforms** in euro area countries needs to be substantially stepped up to increase resilience, reduce structural unemployment and boost euro area productivity and growth potential. Regarding **fiscal policies**, the ~~broad-based expansion calls~~Governing Council reiterates the need for rebuilding fiscal buffers. This is particularly important in countries where government debt is high and for which full adherence to the Stability and Growth Pact is critical for safeguarding sound fiscal positions. Likewise, the transparent and consistent implementation of the EU'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.

Further information on the technical parameters of the reinvestments will be released at 15:30 CET on the ECB's website.

We are now at your disposal for questions.

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