THE EURO AREA ECONOMY AFTER A PROLONGED PERIOD OF MONETARY STIMULUS

CIII REUNIÓN DE GOBERNADORES DE BANCOS CENTRALES DEL CEMLA

Luis M. Linde
Governor
Banco de España

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Since mid-2014 the ECB has provided an extraordinary monetary stimulus through a combination of different instruments, including negative policy rates and ongoing quantitative easing.

**OFFICIAL INTEREST RATES**
- Marginal lending facility: 0.25%
- Main refinancing operations: 0%
- Deposit facility: -0.40%

**FORWARD GUIDANCE**

**BALANCE SHEET EXPANSION**
- TLTRO-II: Targeted Long Term Refinancing Operations (4-year maturity)
- Expanded Asset Purchase Programme (public and private securities)
ECB BALANCE SHEET MEASURES

- Quantitative easing started in March 2015 and it is intended to run at least until December 2017, with monthly net asset purchases of €60 billion.
- The APP portfolio will achieve around 22% of GDP, while TLTRO provided more than 7% of GDP of additional liquidity.

**ASSET PURCHASE PROGRAMME (APP)**
Monthly net purchases and cumulative purchases

**QUANTITATIVE AND CREDIT EASING**

TLTRO
March 2017
€ 762 bn

APP
Dec 2017
≈€ 2.317 bn

EURO AREA
December 2017
Unprecedented measures have resulted in a huge expansion of central bank’s balance sheet in main advanced economies, with important changes in their composition.
ECB MONETARY POLICY TRANSMISION
FINANCIAL CONDITIONS

- Monetary policy expansion has improved financial conditions considerably, encouraging new borrowing and expenditure for investment and consumption.
- Yields on a broad range of assets have been lowered and thus the stimulus has been transmitted more widely to the economy.

EURO AREA FINANCIAL CONDITIONS

TEN-YEAR INTEREST RATES

INTEREST RATES ON BANK LOANS

- NEW PHASE OF MONETARY STIMULUS

EURO AREA
USA

NON-FINANCIAL CORPORATIONS UP TO ONE MILLION EURO
NON-FINANCIAL CORPORATIONS ONE MILLION EURO AND ABOVE
HOUESHOLDS
ECB MONETARY POLICY TRANSMISSION GROWHT AND INFLATION

- Analysis in Banco de España 2015 Annual Report estimates the effects of ECB monetary policy since mid 2014 for euro area - accumulated effect in 2015-17: 1.7 pp for GDP growth, 1.5 pp for inflation (about 50% of nominal growth)-

IMPACT OF THE ASSET PURCHASE PROGRAMME (APP) ON EURO AREA GDP AND INFLATION (a)

GDP Y-O-Y GROWTH

INFLATION

Though moderate, the economic expansion is firming and broadening across countries - real GDP rose by 1.7% in 2016, and it is expected to grow 1.8% this year.

In contrast to 2009, current economic recovery is driven by domestic demand.
ECONOMIC POLICY UNCERTAINTY

- The euro area recovery has been resilient to increasing political uncertainty
- Political risks – which led to increases in sovereign spreads – have receded after the French Presidential elections

EUROPEAN ECONOMIC POLICY UNCERTAINTY (EPU INDEX) (a)

SOVEREIGN SPREADS TEN YEAR BONDS TO GERMAN BUND

(a) Includes United Kingdom, Germany, France, Spain and Italy. Source Baker, Bloom and Davis (2016)
UNCERTAINTY ABOUT US ECONOMIC POLICIES

- Trump’s US presidency has changed perspectives on US policies.
- Financial markets have reacted positively but there are risks of disappointment.
- Fiscal impulse could have a limited and short-lived impact on world GDP; on the contrary, measures related to international trade could have a substantial impact.

Source: Banco de España, using the NIGEM macroeconomic model and Rubini (2011)
The configuration of the future EU-UK relationship will be key for both economic areas given their close integration at present.

The UK economy has performed better than expected since the referendum and initial downward revisions to short-term forecasts for UK growth have been almost reverted; but a longer term impact continues to be expected.
Going forward, the euro area scenario remains one of moderate growth and subdued underlying inflationary pressures, still very dependent on monetary policy support.
EURO AREA INFLATION DEVELOPMENTS

- Headline inflation has recently increased driven by oil price and calendar effects
- Core inflation remains low, against the background of subdued wage behaviour
- Market-based indicators of long-term inflation expectations anticipate a slow convergence toward the 2% reference
Monetary policy will remain very accommodative for an extended period of time, in line with ECB forward guidance.

Monetary policies across the Atlantic will diverge for some time.
FINAL REMARKS

• After a prolonged period of exceptional monetary policy accommodation, economic recovery in the euro area is firming and broadening across countries;

• Supported by the monetary policy and some other tail winds, the economic recovery has been resilient to the rise in political uncertainty;

• Yet, the case for maintaining the current monetary stimulus is compelling:
  
  ➢ Underlying inflation remains subdued, and convergence of headline inflation towards the 2% reference is projected to be slow;
  ➢ The macroeconomic outlook of modest growth going forward is largely dependent on the current monetary stimulus …

• While monetary policy can buy time, there is a need for other economic policies to address the root causes of economic weakness and financial fragility
THANK YOU FOR YOUR ATTENTION