Account of the monetary policy meeting

of the Governing Council of the European Central Bank, held in Frankfurt am Main on Wednesday and Thursday, 8-9 March 2017

6 April 2017

1. Review of financial, economic and monetary developments and policy options

Financial market developments

Mr Cœuré reviewed the latest financial market developments.

Since the Governing Council's previous monetary policy meeting on 18-19 January 2017, two key developments had taken place. First, financial markets had significantly repriced monetary policy expectations in the United States. Second, events in the euro area had impacted both the short and the long end of the yield curve.

In the United States, financial markets had significantly repriced expectations of an interest rate hike by the Federal Open Market Committee (FOMC) in March 2017. The probability of a March hike, as implied by the Fed funds futures market on 8 March, stood at 96%, compared with 15% at the time of the Governing Council's January monetary policy meeting. As a consequence, market expectations of the future path of US rates had moved closer towards the forecasts of the median of FOMC members for 2017, which predicted three hikes in 2017, while longer-term rate expectations were largely unchanged. Separately, on the fiscal side, market participants had scaled down their expectations regarding stimulus from the new US Administration's fiscal measures and appeared rather to be in a wait-and-see mode.

Turning to the euro area, since the Governing Council's previous monetary policy meeting, the aggregate synthetic euro area yield curve for central government bonds and the yield curve for AAA-rated central government bonds had evolved differently. The former had steepened due to an increase in yields at the long end of the curve, whereas the short end of the curve was broadly unchanged. The latter had steepened due to a decrease at the short end, whereas the increase at the long end had been more muted.

Mr Cœuré highlighted some of the factors driving these developments.

One factor was related to safe-haven flows. Faced with a series of political surprises last year, including the outcomes of the UK referendum on EU membership and the US presidential elections, market participants appeared to have become more sensitive to political tail risk events. This uncertainty had led to increased safe-haven flows, in particular into German short-term government bonds, which had pushed yields down at the short end of the German curve while widening long-term spreads in some other jurisdictions.

Another factor related to the availability of bonds. Flight to quality and, generally, demand for safe assets, had exacerbated the scarcity of short-term safe bonds available to private investors. Bearing in mind that short-term yields of some highly rated euro area jurisdictions had been gradually decoupling from equivalent overnight index swap (OIS) rates for some time, this implied a sustained demand, particularly for German short-term bonds, linked to a generally higher need for safe collateral, in an environment in which issuance had been shifting from short-term to long-term bonds. Beyond regulatory reasons that could explain this development, as shown by acute end-month and end-quarter tensions, other elements might come into play, in particular the demand for safe assets by investors with no access to the ECB's deposit facility, namely non-bank investors, such as asset managers and central counterparties, which had to invest their liquidity. In addition, non-euro area investors, with no access to the deposit facility either, had to buy bonds to keep liquidity in euro. These elements might have added to the downward pressure on German bond yields. Moreover, since investors now expected higher yields in the United States, there may have been a general reluctance by private investors to take duration risk, which further added to the demand for short-term bonds. Money therefore remained parked at the short end of the curve and was not moving to the longer end, which itself contributed to a further steepening of the curve.

Although more tentative, a third factor related to lower bond market liquidity, which may have amplified the widening of sovereign spreads in some jurisdictions, against the background of a reduced capacity of bond dealers to cushion volatility shocks.

A fourth factor was the Eurosystem's ongoing asset purchases, now also including securities with yields below the deposit facility rate, which, in conjunction with market participants' expectations of the future availability of bonds, might have contributed to the decline in rates at the front end of the curve in some jurisdictions in the weeks before the meeting.

Mr Cœuré then highlighted that the repo market had remained fairly stable over recent weeks. For instance, the decline in the two-year German bond yield on the cash bond market had not been matched by a similar development in the repo market. Also, money market rates and general collateral repo rates had been relatively stable and continued to be mostly driven by structural factors – such as supply and demand imbalances in the collateral market – and, to a lesser extent, by short-term volatility and political uncertainty. The Eurosystem cash collateral facility had been instrumental in mitigating pressures in the repo market.

The high level of excess liquidity, together with regulation, had also played a positive role in preventing a larger spillover of the tensions on the bond market to short-term funding markets. As euro area banks' liquidity buffers were generally ample, their short-term borrowing needs remained limited, preventing an abrupt increase in the cost of unsecured borrowing.

Mr Cœuré recalled that market-implied inflation expectations had remained broadly unchanged since the Governing Council's January monetary policy meeting and maintained their close correlation with spot energy prices in the euro area.

The global environment and economic and monetary developments in the euro area

Mr Praet reviewed the global environment and recent economic and monetary developments in the euro area.

With regard to the global economy, survey indicators continued to suggest a rebound in activity, with some signs of a resynchronisation of the business cycle across major regions. The global composite output Purchasing Managers' Index (PMI) stood at 53.5 in February, close to its long-term average. Global trade was gaining strength while remaining at modest levels. Global inflation had continued to pick up gradually in January, to 2.3% overall and to 1.9% excluding food and energy. Brent crude oil prices had declined marginally since the 18-19 January meeting of the Governing Council, while non-oil commodity prices had increased somewhat. In addition, the euro had depreciated by 1.1% in nominal effective terms vis-à-vis the currencies of 38 of the euro area's major trading partners.

Turning to the euro area, incoming information, notably sentiment indicators, continued to point to a firming and broadening of the recovery. Real GDP had increased by 0.4% quarter on quarter in the fourth quarter of 2016, after 0.4% in the third quarter and 0.3% in the second, mainly driven by domestic demand on the back of sustained employment gains and higher labour income. The unemployment rate had decreased further from the fourth quarter of 2016, to 9.6% in January 2017. Private consumption had continued to increase in the fourth quarter and the cyclical recovery in business investment proceeded, benefiting from the prevailing very favourable financing conditions. Euro area export dynamics in December 2016 had been broadly in line with developments in global trade.

In their March 2017 macroeconomic projections, ECB staff saw annual real GDP as growing by 1.8% in 2017, 1.7% in 2018 and 1.6% in 2019. Compared with the December 2016 Eurosystem staff projections, the growth outlook had been revised upwards slightly for 2017 and 2018. The March staff projections for growth were slightly above those of other institutions.

Turning to euro area prices, annual HICP inflation had increased further in February, to 2.0%, up from 1.8% in January and 1.1% in December 2016, reflecting mainly a strong increase in annual energy and unprocessed food price inflation. Excluding food and energy, inflation had stood at 0.9% in February, unchanged since December 2016. Annual industrial producer price inflation, excluding energy and construction, had also increased, to 1.5% in January. While indicators of pipeline pressures were showing tentative signs of emerging upward pressures at the earlier stages of the production chain, domestic producer prices for non-food consumer goods had yet to show an upward trend. Wage growth in the euro area had remained subdued.

In the March 2017 ECB staff projections, annual HICP inflation was seen at 1.7% in 2017, 1.6% in 2018 and 1.7% in 2019. Compared with the December 2016 Eurosystem staff projections, the inflation outlook had been revised upwards significantly for 2017 and slightly for 2018, while it was unchanged for 2019. The March staff projections for inflation were slightly above those of other institutions.

Market-based measures of inflation expectations, derived from inflation-linked swap rates, had been slightly lower compared with levels observed at the 18-19 January meeting of the Governing Council.

As regards financial and financing conditions, the EONIA forward curve had increased marginally since the previous monetary policy meeting, while the overall nominal cost of external financing for non-financial corporations had remained broadly stable. The nominal cost of bank borrowing for both non-financial corporations and households remained at low levels.

Turning to money and credit, the annual growth rate of the broad monetary aggregate M3 had remained broadly stable in January 2017, at 4.9%, after 5.0% in December 2016, with robust M1 growth as the main driver. The gradual recovery in loan growth had continued and was becoming more widespread across euro area countries, although differences persisted. Bank lending dynamics were broadly in line with historical patterns at the euro area level. Credit standards for loans had remained broadly stable, while net demand for loans had continued to increase.

Finally, the fiscal stance in the euro area, as measured by the change in the cyclically adjusted primary balance, was estimated to have been slightly less expansionary in 2016, compared with the assessment at the January monetary policy meeting. The fiscal stance continued to be seen as broadly neutral over the remainder of the projection horizon.

Monetary policy considerations and policy options

Summing up, Mr Praet concluded that the Governing Council's monetary policy measures had continued to preserve very favourable financing conditions. Their ongoing pass-through supported the economic upturn, which was steadily firming and broadening across sectors. Strong sentiment among consumers and businesses furthermore suggested that the cyclical recovery might be gaining momentum.

The latest ECB staff projections saw euro area real GDP as growing at a slightly stronger pace in 2017 and 2018 than had been expected in December. At the same time, the risks to the economic outlook, while becoming less pronounced, remained tilted to the downside.

As expected, headline inflation had continued to increase. This had mainly reflected a sharp rise in energy and, more recently, food price inflation. The staff projections for HICP inflation had been revised upwards significantly for 2017. Underlying inflation dynamics continued to be subdued.

As regards the medium-term outlook, the March ECB staff projections – which included the effects of the latest non-standard measures – broadly confirmed the December 2016 Eurosystem staff projections, with inflation moving towards levels below, but close to, 2%. However, as yet, one could not be sufficiently confident that inflation would converge towards levels consistent with the Governing Council's aim in a durable and self-sustaining manner. Inflation dynamics continued to be conditional upon the present, very substantial degree of monetary accommodation.

Against this background, it was important to confirm the Governing Council's monetary policy stance, including its forward guidance, which had contributed to the present, very substantial degree of accommodation. This was still needed to secure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term. Moreover, it was a safeguard in the face of the downside risks still being confronted.

In terms of communication, Mr Praet considered it important to acknowledge the steady firming of the economic recovery, while stressing that the risks, although becoming less pronounced, remained tilted to the downside and that the staff projections were conditional on the full implementation of the Governing Council’s monetary policy measures.

It was likewise important to clarify that, in view of the upward revision to inflation for 2017, the Governing Council would look through changes in HICP inflation, to the extent they were judged to be transient and to have no implication for the medium-term outlook for price stability.

Finally, it was important to confirm both the intended pace and horizon of the asset purchases and to reassert the forward guidance on policy rates and on the asset purchase programme (APP), as previously communicated. It was furthermore appropriate to de-emphasise the sense of urgency towards taking further actions that had been communicated in the past.

2. Governing Council’s discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members broadly shared the assessment of the outlook and risks for economic activity in the euro area, provided by Mr Praet in his introduction. Recent data and survey results pointed to the economic recovery in the euro area steadily firming and broadening, supported by the pass-through of the ECB’s monetary policy measures, while sentiment indicators, in particular, suggested that the cyclical recovery might be gaining momentum. Looking ahead, the expansion of the euro area economy was expected to continue to be driven by private consumption, supported by rising employment and wages, and by a cyclical recovery in business investment. At the same time, growth prospects were dampened by the sluggish pace of implementation of structural reforms and remaining balance sheet adjustments in a number of sectors. This assessment was broadly reflected in the outlook for growth in the March 2017 ECB staff macroeconomic projections. Compared with the December 2016 Eurosystem staff projections, the outlook for growth had been revised up slightly for 2017 and 2018 and was unchanged for 2019.

As regards the external environment, it was noted that the latest staff projections pointed to a strengthening in global growth momentum and a cyclical recovery in global trade. However, the external outlook was perceived to remain very uncertain, with reference made to a number of factors that were seen as contributing to this uncertainty, including the nature and timing of future policy choices by the new US Administration, the economic impact of the United Kingdom’s withdrawal from the European Union, the transition towards lower growth and the rebalancing of demand in China, and developments in other emerging market economies. The balance of risks to the outlook for global growth was generally viewed as remaining on the downside.

Turning to the euro area, there was broad agreement with the growth outlook embodied in the March 2017 ECB staff projections, which provided confirmation that the recovery in the euro area economy was continuing, with small upward revisions to the outlook for 2017 and 2018. The latest projections, while broadly confirming the December projections, were seen as providing further evidence of the robust nature of the ongoing economic upturn, although significant risks and uncertainties remained.

Members observed that the large contribution from domestic demand – with net trade providing only a small contribution to growth – rendered the economy more resilient to adverse shocks. It was underlined that the forecast for real GDP growth in 2017 had gradually been revised upwards over time, from 1.6% in the September 2016 projections to 1.7% in the December 2016 projections, and then to 1.8% in the March 2017 projections. Including the first quarter of 2017, there were now eleven consecutive quarters of quarter-on-quarter growth above the potential growth rate. The European Commission's latest Economic Sentiment Indicator and euro area PMIs were very positive, with the composite output PMI for the euro area at its highest level for almost six years. Incoming data had surprised on the upside for some time. The labour market had continued to improve, with unemployment declining steadily and a recovery now taking place in the housing and construction sectors.

Considering the components of demand, it was noted that, while improving corporate profitability and very favourable financing conditions should also continue to support a recovery in investment, private consumption remained a key element in the growth outlook. Rising employment, which was also benefiting from past structural reforms, was having a positive impact on households' real disposable income, thereby providing support for private consumption.

Looking ahead, it was highlighted that the robustness of real income growth in the staff projections crucially depended on further growth in employment and on nominal wage growth over the projection horizon to more than offset the adverse impact of higher energy prices. It was remarked that at present inflation was driven mainly by higher energy prices, which represented worsening terms of trade and a negative supply shock for households and firms. Hence the baseline outlook for activity embodied in the projections might turn out to be overly optimistic. Moreover, the ECB staff projections saw employment growth as slowing, while a projected strong pick-up in wages was expected to soften the impact of higher energy prices on real income growth. Together with an assumed decline in the saving ratio, this underpinned private consumption growth in the staff projections. The argument was made that the projected strength in consumption was open to question, given its reliance on a future pick-up in wages and the assumed intertemporal consumption smoothing behaviour by households. In this context, it was also noted that the ECB staff projections for euro area growth were slightly above the forecasts published by other institutions.

There was broad agreement among members that risks to euro area activity were becoming more balanced but remained on the downside. Views were exchanged on the extent to which downside risks to the growth outlook had diminished and on the characterisation of the balance of risks.

On the one hand, it was argued that the projections' reliance on stronger wages and a declining saving ratio to offset the adverse impact of higher energy prices on real income growth pointed to some downside risk to domestic demand looking ahead. Furthermore, political and economic uncertainty remained high, and it was possible that the negative effects on the euro area economy from external risks – notably from the United States and Brexit – might be underestimated. While there was no clear evidence of a negative impact of uncertainty so far, it was too early to draw the conclusion that there would be no adverse effects on the economy, with the impact of Brexit, for example, likely to become more apparent in the medium term. It could also be argued that uncertainty had not had much of an effect so far because there had been an offsetting impact from monetary policy measures, which had contributed to maintaining favourable financing conditions.

On the other hand, the latest data were indicative of the euro area economy gaining cyclical momentum, with the possibility that growth might turn out to be stronger, at least in the short run, than anticipated in the March 2017 ECB staff projections. In addition, it was noted that, although political uncertainty was very high at the moment, some reassurance could be taken from analysis suggesting the effect of elevated political uncertainty on economic activity was not significant. It was noted that other measures of uncertainty which appeared to be more relevant with respect to economic developments remained low. It was also remarked that the relevant benchmark for the risk analysis was the degree to which specific risks were already priced into financial markets. This suggested that, if any of the downside risks under consideration failed to materialise, an upward impact should be anticipated, relative to market expectations, which also needed to be part of the picture.

Against this background, there was broad agreement that risks to euro area activity had become more balanced, while remaining tilted to the downside and related predominantly to global factors. In view of the evolution of recent data and indicators, a number of members considered that risks could be characterised as broadly balanced. At the same time, other members made the point that there were still substantial downside risks to real GDP in view of the fragility of some of the assumptions underpinning the baseline projection and the prevalence of fundamental risks and uncertainties, both globally and in the euro area.

It was recalled that the recent trends and the outlook of a firming and broadening recovery were largely benefiting from the exceptionally favourable financing conditions and were reliant on continued support from the ECB's monetary policy measures. In order to reap the full benefits from the ECB's measures, however, other policy areas needed to contribute much more decisively to supporting economic activity. The implementation of structural reforms needed to be stepped up substantially in order to increase the resilience of the euro area economy, as well as to reduce the level of structural unemployment and to raise potential growth.

As regards fiscal policies, it was essential that all countries intensified their efforts towards achieving a more growth-friendly composition of public finances, while remaining in compliance with the EU fiscal rules. The full and consistent implementation of the Stability and Growth Pact over time and across countries remained crucial to ensure confidence in the EU's governance framework.

Turning to price developments, there was broad agreement with the assessment of the outlook presented by Mr Praet in his introduction. To a large extent, the recent increase in headline inflation reflected an increase in energy price inflation and, in February, was also related to an increase in unprocessed food price inflation. In the coming months headline inflation was expected to remain at levels close to 2%, mainly as a result of movements in the annual rate of change of energy prices. This assessment was reflected in the March 2017 ECB staff projections, where the outlook for HICP inflation had been revised up significantly for 2017 and slightly for 2018, while remaining unchanged for 2019.

Commenting on this outlook, it was pointed out that higher headline inflation reflected the fact that energy prices were 9.2% higher in February 2017 than one year ago, but that base effects were expected to turn negative over time. It was also recalled that the rise in unprocessed food prices observed in recent months was likely to be reversed, while the latest downward movement in oil prices suggested that a continued upward impact of higher energy prices on overall inflation could not be taken for granted in the period ahead. At the same time, it was underlined that the downward-sloping profile of oil prices derived from the futures markets played a crucial role in the HICP projections. In this context, it was remarked that alternative models and tools for gauging the outlook for the oil markets pointed to some upside risks to prices.

It was observed that measures of underlying inflation remained subdued and, according to the ECB staff projections, were expected to increase only gradually over the medium term, supported by the projected continuation of the economic recovery, the gradual absorption of economic slack and the ECB's accommodative monetary policy stance. Annual HICP inflation excluding food and energy had been fluctuating within a range of 0.7-0.9% since April 2016. At the same time, it was remarked that the impression should be avoided that the ECB's price stability objective was based on underlying inflation. It was recalled in this context that underlying inflation was not an unbiased predictor of headline inflation, having been significantly below headline inflation and averaging 1.4% since 1999, in the case of HICP inflation excluding food and energy. It was noted that this measure, according to the latest ECB staff projections, would reach 1.8% at the end of the projection horizon, which was well above this historical average and also slightly above headline inflation.

Members also discussed the outlook for wages and the possible impact of second-round effects. It was underlined that the projected increase in HICP inflation excluding food and energy, from the current level of 0.9% to 1.8% in 2019, was based on a strong pick-up in wage growth. It was argued that a turnaround in wage dynamics was thus the linchpin for the upward profile in underlying inflation to materialise. However, wage developments had so far remained moderate and there was no evidence yet of second-round effects on inflation. As a large number of wage negotiations had already been concluded for this year, it was suggested that the increase in headline inflation seen for 2017 was likely to have a stronger effect on the wage bargaining process only in 2018. At the same time, it was pointed out that the proportion of collective bargaining agreements that included some degree of indexation had decreased over time in parts of the euro area, which might suggest that second-round effects would be contained.

Members considered the influence of labour market slack on the wage outlook. Attention was drawn to the expectation that, in the context of the March 2017 projection exercise, labour market slack would prevail for longer than previously thought. Moreover, broader measures of labour underutilisation, which took into consideration groups that are marginally attached to the labour market, such as discouraged workers, and the underemployed, pointed to a much higher degree of labour market slack than was evident from the unemployment statistics. This argued in favour of caution with regard to the wage outlook, as the level of slack in the labour market was likely to be an important factor in determining wage growth.

At the same time, questions were raised about the likely impact of the economic recovery on the labour force participation rate, and doubts were expressed about the extent to which unemployed persons and discouraged workers would return to the labour market and thus continue to exert downward pressure on wages. It was argued that, if no such reintegration materialised, inflationary pressures could become stronger than anticipated.

Members also took note of recent developments in inflation expectations for the euro area. Survey-based measures of longer-term inflation expectations, such as the ECB’s Survey of Professional Forecasters, as well as market-based measures of inflation expectations, were broadly unchanged. For example, the five-year forward inflation-linked swap rate five years ahead had been broadly stable around 1.7% since the Governing Council’s January monetary policy meeting, following an earlier upward trend. Market expectations also indicated that the probability of a deflationary scenario was very low.

Overall, while the outlook for headline inflation had been revised upwards, notably for 2017, owing mainly to higher oil prices, measures of underlying inflation remained low and were expected to rise only gradually over the medium term, supported by the ECB’s monetary policy measures and the continued economic recovery. The Governing Council would continue to look through changes in HICP inflation if judged to be transient and to have no implication for the medium-term outlook for price stability. At the same time, there was broad agreement that the risk of deflation and of an unanchoring of inflation expectations had largely disappeared. Adverse downside scenarios were thus judged to have become less likely.

As with the discussion on the risks surrounding the outlook for growth, views were exchanged about the extent to which the risks to medium-term price stability had become more balanced. It was underlined that the inflation profile in the March 2017 ECB staff macroeconomic projections was above forecasts by other institutions and that underlying price pressures remained weak. At the same time, it was noted that the risk assessment might be unduly backward-looking and coloured by persistent past forecast errors, and that such errors would typically change signs around cyclical turning points. All in all, there was broad agreement that both downside and upside risks to the inflation outlook continued to warrant close monitoring.

With regard to the monetary analysis, members concurred with the assessment presented by Mr Praet in his introduction. Broad money (M3) had continued to expand at a robust pace, mainly supported by its most liquid components. Loan growth had proceeded on the path of gradual recovery observed since the beginning of 2014.

The observation was made that credit growth had reached an eight-year high and that the monetary policy measures put in place since June 2014, reinforced by the December 2016 decisions, had continued to pass through effectively to the borrowing conditions for firms and households and to credit flows across the euro area. This was supported by continued favourable bank funding costs, even though the scope for lowering bank deposit rates was becoming increasingly limited, with possible implications for lending rates, margins and ultimately bank profitability in the period ahead. In this context, the constellation and slope of yield curves – in conjunction with differences across jurisdictions in terms of the prevalence of fixed or floating rate debt instruments – were seen to merit attention with regard to the consequences for the bank-based transmission of monetary policy across the euro area. At the same time, it was noted that vulnerabilities in some parts of the banking sector persisted.

Monetary policy stance and policy considerations

With regard to the monetary policy stance, members widely shared the assessment provided by Mr Praet in his introduction that, while inflation had continued to increase, largely on account of rising energy and food price inflation, underlying inflation pressures had remained subdued and signs of a convincing upward trend were still lacking. There was therefore broad agreement that a very substantial degree of monetary accommodation continued to be needed for underlying inflation pressures to build up and to secure a sustained return of inflation rates towards levels below, but close to, 2% over the medium term.

Members expressed satisfaction that the ECB's monetary policy measures, notably supported by the decisions taken in December 2016, had continued to preserve the very favourable financing conditions that were necessary to secure such a sustained convergence of inflation towards the objective. Financial conditions, overall, had remained broadly stable at very accommodative levels since the first half of 2016, with some further easing seen recently, reflecting mainly an increase in share prices and a weaker euro. This had been offset to some extent by a slight increase in bond yields, largely owing to a widening of sovereign bond spreads in some jurisdictions, which was judged to mainly reflect country-specific factors.

The argument was made that, as the economy continued to recover and as inflation rose, some indicators were starting to point to an increasingly expansionary monetary policy stance, for example when considering recent declines in real interest rates, in particular, those based on actual inflation. It was, however, also remarked that, while short-term real interest rates had declined with the rise in headline inflation, medium to longer-term rates had declined only marginally since the January meeting. Moreover, it was highlighted that the decline in short-term real interest rates was mainly driven by an increase in energy and food prices. This suggested that any positive impact of a lower real rate was likely to be counterbalanced by a corresponding negative impact of rising food and energy prices on real disposable incomes.

The ongoing pass-through of the ECB's stimulus to the borrowing conditions for firms and households was seen to benefit credit creation and to support the steadily firming recovery of the euro area economy and its resilience to external influences. While more time was still needed for the effects of the policy measures on growth and inflation outcomes to unfold fully, they were regarded as an important factor behind the positive trend in the overall macroeconomic climate and its resilience to adverse shocks and prevailing uncertainties. At the same time, it was remarked that the sluggish reaction of underlying inflation in the wake of the financial crisis was not confined to the euro area but appeared to be a global phenomenon.

As regards the medium-term outlook, inflation was seen to gradually move towards levels below, but close to, 2%, as also reflected in the March 2017 ECB staff projections, which broadly confirmed the December 2016 projections. However, it was generally felt that, as yet, one could not be sufficiently confident that inflation would converge towards levels consistent with the Governing Council's aim in a durable and self-sustaining manner. Notably, the dynamics of underlying inflation were seen still to give scant indication of a convincing rebound, particularly as wage growth also remained subdued. Considering that increases in headline inflation were mainly due to rising energy and food price inflation and that these inflation developments might only be temporary, it was generally still seen as premature to draw firm conclusions regarding implications for the medium-term inflation outlook. Accordingly, the Governing Council was well advised to continue to look through changes in HICP inflation if judged to be transient and to have no implication for the medium-term outlook for price stability. Moreover, while deflationary risks had largely disappeared and medium-term inflation expectations had recovered some ground, market-based indicators of inflation expectations had remained at relatively low levels for an extended period of time. The assessment was complicated, however, by the presence of risk premia in the market-derived measures.

Finally, the prospect of an upward trend in inflation still depended on the prevailing very favourable financing conditions, which were judged to be, to a large extent, conditional on the current accommodative monetary policy stance.

All in all, there was broad agreement among members that the current monetary policy stance remained appropriate. Against the background of a largely unaltered outlook for medium-term price stability, the view was widely shared that patience and maintaining a steady hand remained warranted at the current meeting, coupled with a more confident tone on the underlying economic conditions in the euro area and a reduced sense of urgency for further policy action. A very substantial degree of monetary accommodation was seen to be still needed for underlying inflation pressures to build up and durably support the convergence of headline inflation towards levels below, but close to, 2% over the medium term. This entailed keeping the ECB's policy rates unchanged, as well as confirming both the intended pace and horizon of APP purchases and the Governing Council's forward guidance on policy rates and the APP.

Accordingly, it was seen as paramount for the Governing Council to fully implement its asset purchases as decided in December 2016, while remaining prepared to adjust the APP in terms of size and/or duration should the outlook become less favourable, or should financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation. At the same time, the point was made that it could be acknowledged that recourse to these options for providing further accommodation was becoming less likely, in line with the Governing Council's evolving assessment.

In this context, it was recalled that the Governing Council's December decision to continue APP purchases but to reduce the monthly pace to €60 billion as of April 2017, as well as the forthcoming expiry of the targeted longer-term refinancing operations, the last of which would be conducted at the end of March 2017, already reflected disappearing deflationary risks and the Governing Council's growing confidence in the outlook for the euro area economy.

Members continued to view the implementation of the APP as proceeding smoothly. In this context, it was noted that developments at the short end of the yield curve had continued to show divergent dynamics across maturities and jurisdictions. In particular, the short end of the German government bond curve had continued to decline on account of safe-haven flows, high demand for high-quality liquid assets and the start of the APP purchases below the deposit facility rate, as had been explained by Mr Cœuré in his introduction. While these developments had to some degree been mitigated by the enhancements made to the Eurosystem's securities lending facility, notably to accept cash collateral, they required further close monitoring.

As regards communication, members generally agreed with the proposals made by Mr Praet in his introduction to keep the communication with respect to the Governing Council's monetary policy stance and its forward guidance unchanged, while acknowledging that the economic expansion in the euro area had become more robust as the recovery was firming and broadening further, and that the risks to the economic outlook had become less pronounced, though they still remained tilted to the downside. An overall more positive tone in the Governing Council's communication with respect to the economic prospects of the euro area was seen to be conducive to supporting confidence among businesses and consumers. At the same time, remaining uncertainties and fragilities, notably related to the external environment but also to political developments in the euro area, continued to call for caution.

In this context, views were also exchanged on whether conditions had already improved to an extent that would allow for an attenuation of the "easing bias" embodied in the Governing Council's forward guidance. In this regard, it was recalled that the Governing Council's forward guidance represented a clarification of its policy reaction function that conveyed the Governing Council's expectation about its policy intentions, which was dependent on its assessment of economic conditions and the risks to the price outlook.

Against this background, the view was put forward that removing the downward bias regarding interest rates would be in line with a gradual and cautious adjustment of the Governing Council's forward guidance, in step with changes in the Governing Council's assessment. Keeping the Governing Council's forward guidance well aligned with its evolving assessment was seen to underpin the consistency and credibility of the Governing Council's communication, as both deflationary risks and associated market expectations of further rate cuts had largely vanished.

At the same time, it was recalled that the easing bias was an integral part of the Governing Council's forward guidance and of the monetary policy stance, which contained an important forward-looking signalling component. Changes in the formulation at the current juncture could lead to an undue upward shift in market interest rates and tighten financial conditions to an extent that was not warranted by the prevailing outlook for price stability.

On balance, removing the downward bias on interest rates in the present formulation of the Governing Council's forward guidance at the current meeting was seen as premature, as there was still considerable uncertainty surrounding the economic outlook and the robustness of inflation convergence.

Accordingly, there was broad agreement to keep the communication with respect to the Governing Council's monetary policy stance and its forward guidance unchanged. This implied reiterating that asset purchases under the APP would continue at the current monthly pace of €80 billion until the end of the month, and from April 2017 at a monthly pace of €60 billion until the end of the year and, in any case, until the Governing Council saw a sustained adjustment in the path of inflation consistent with its inflation aim. This also included preserving the forward guidance on the ECB's key policy rates and the APP as previously communicated.

At the same time, economic conditions and the balance of risks had clearly improved, and, notably, deflationary risks had largely disappeared. As had been suggested by Mr Praet in his introduction, nuances in the communication could convey a more positive tone on the state of the euro area economy, while signalling less urgency for further monetary policy action. In particular, it was felt that there was no longer a need to emphasise the Governing Council's readiness to act by using all the instruments available within its mandate, reflecting that negative scenarios, which could trigger further monetary policy action, were assessed to have become less likely, even if they could not be fully excluded.

Looking ahead, it was recalled that, if the euro area economy were to recover further and as inflation proceeded further on its path towards the Governing Council's inflation aim in a sustained manner, a discussion on policy normalisation would become warranted in the future.

Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, on a proposal from the President, the Governing Council decided to keep the interest rates on the Eurosystem's main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council continued to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

Regarding non-standard monetary policy measures, the Governing Council confirmed that it would continue to make purchases under the APP at the current monthly pace of €80 billion until the end of March and that, from April 2017, the net asset purchases were intended to continue at a monthly pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council saw a sustained adjustment in the path of inflation consistent with its inflation aim. The net purchases would be made alongside reinvestments of the principal payments from maturing securities purchased under the APP. If the outlook became less favourable, or if financial conditions became inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council stood ready to increase its asset purchase programme in terms of size and/or duration.

The members of the Governing Council subsequently finalised the introductory statement, which the President and the Vice-President would, as usual, deliver at the press conference following the end of the current Governing Council meeting.

Introductory statement

http://www.ecb.europa.eu/press/pressconf/2017/html/is170309.en.html

Press release

http://www.ecb.europa.eu/press/pr/date/2017/html/pr170309.en.html

Meeting of the ECB's Governing Council, 8-9 March 2017

Members

- Mr Draghi, President
- Mr Constâncio, Vice-President
- Mr Cœuré
- Mr Costa
- Ms Georghadji
- Mr Hansson *
- Mr Jazbec
- Mr Knot
- Mr Lane
- Ms Lautenschläger
- Mr Liikanen *
- Mr Linde
- Mr Makúch
- Mr Mersch
- Mr Nowotny
- Mr Praet
- Mr Reinesch
- Mr Rimšēvičs
- Mr Smets *

- Mr Stournaras
- Mr Vasiliauskas
- Mr Vella
- Mr Villeroy de Galhau *
- Mr Visco
- Mr Weidmann

(*) Members not holding a voting right in March 2017 under Article 10.2 of the ESCB Statute.

Other attendees

- Mr Teixeira, Secretary, Director General Secretariat
- Mr Smets, Secretary for monetary policy, Director General Economics
- Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

Accompanying persons

- Mr Bradeško
- Ms Buch
- Ms Donnery
- Mr Gaiotti
- Mr Hernández de Cos
- Mr Kaasik
- Mr Kuodis
- Ms Le Lorier
- Ms Luz
- Mr Mifsud

- Mr Mooslechner
- Mr Pattipeilohy
- Mr Rutkaste
- Mr Schoder
- Mr Stavrou
- Mr Tavlas
- Mr Tóth
- Mr Välimäki
- Mr Wunsch

Other ECB staff

- Ms Graeff, Director General Communications
- Mr Straub, Counsellor to the President
- Mr Klöckers, Director General Economic Developments, DG Economics
- Mr Rostagno, Director General Monetary Policy, DG Economics

Release of the next monetary policy account foreseen on Thursday, 18 May 2017.

CONTACT

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