Account of the monetary policy meeting

of the Governing Council of the European Central Bank, held in Frankfurt am Main on Wednesday and Thursday, 25-26 April

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 monetary policy meeting on 7-8 March 2018.

With regard to recent bond market developments, a gradual decline in the ten-year German government bond yield, which started in mid-February, had pushed yields back to levels not far from those observed for most of 2017. In the week leading up to the current meeting there had been a partial reversal of this downward trend. However, yields still remained well below the levels that had been observed earlier in 2018. By contrast, the ten-year US Treasury bond yield had resisted broad downward pressure and was approaching levels around 3% for the first time in more than four years. As a result, the yield spread between ten-year German Bunds and US Treasuries was at its widest since the late 1980s.

Changes in both components of long-term yields, the term premium and average expected short-term rates, contributed to these developments. A model-based breakdown suggested that the decline in long-term rates up until the week before the current meeting could be attributed to a drop in the term premium on both sides of the Atlantic. However, while the expectations component of German yields had remained fairly stable, there had been a continued rise in the expected path of future short-term rates in the United States. This helped to offset the initial drop in the term premium in the United States and suggested that investors maintained a favourable view about the prospects for the US economy.

As regards the causes for the decline in the term premium both in the United States and in the euro area, which had only recently come to a halt, two broad factors could be distinguished. The first related to incoming data that had been weaker than expected, in particular in the euro area. The second likely reflected global concerns about the current geopolitical environment.

The increase in global uncertainty, as well as the recent weaker than expected economic data, had also contributed to expectations of a later first rate hike in the euro area. According to the EONIA forward curve, a 10-basis point increase was currently priced in for around June 2019. This was consistent with the evidence from market surveys on euro area monetary policy expectations, which suggested a growing conviction among market participants that a rate rise would take place in the second quarter of 2019.

Turning to developments in stock markets, equities had, on the whole, benefited from the shifts in monetary policy expectations and the fall in long-term yields. The EURO STOXX 50 index had gone up by around 3% since the Governing Council's March monetary policy meeting. The picture differed somewhat in the United States, where the Standard & Poor’s 500 index had lost around 2% over the same period, and in emerging markets, where stock markets had also declined.

In foreign exchange markets, volatility remained close to record low levels. Some market participants saw technical factors as having contributed to the broad stabilisation of the US dollar, in particular the cost of hedging. Mr Cœuré noted that the stability of exchange rates also suggested that investors did not appear to have materially changed their views on the euro area or US economic outlook.

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.

Regarding the external environment, global economic activity remained sustained, although recent indicators had pointed to some softening in momentum in the last couple of months. In March, the global composite output Purchasing Managers’ Index had decreased, but it remained close to its long-term average. By contrast, consumer and business confidence indicators had held up well in February. Global financial conditions had remained supportive, sustained by accommodative monetary policies. Global trade indicators had been mixed, overall signalling some deceleration in the first quarter of this year.

Inflation dynamics had continued to be modest and underlying price pressures remained subdued. Annual consumer price inflation in the OECD countries had remained stable in February, while inflation excluding food and energy had edged up marginally. Since the Governing Council’s March monetary policy meeting, Brent oil prices had risen sharply and stood at USD 73.5 on 24 April 2018, their highest level since the end of November 2014. Over the same period, the euro had remained broadly stable against the US dollar and also in nominal effective terms.

Turning to the euro area economy, euro area GDP growth had remained robust in the fourth quarter of 2017. Eurostat’s third estimate for the quarter put quarterly growth at 0.7%, implying that the euro area had grown for almost five consecutive years. However, recent incoming information had generally surprised to the downside and pointed to some moderation, following several quarters of higher than expected growth. Surveys had shown a broad-based decline in sentiment in the first quarter of 2018 across most sectors and countries. At the same time, sentiment indicators were still at high levels and well above their historical averages.

Overall, although incoming survey data suggested slower growth in the short term, the data remained consistent with a solid and broad-based expansion across sectors and countries. The moderation in part reflected a pull-back from the high pace of growth observed at the end of 2017, while temporary factors and supply constraints in certain sectors in some countries might also have played a role. Concerns about trade protectionism could also have dampened business sentiment and expectations. The underlying strength in growth continued to be supported by favourable financing conditions, a robust labour market and steady income and profit growth.

Forecasts by public and private institutions for euro area real GDP growth since the early March monetary policy meeting were broadly in line with the March 2018 ECB staff macroeconomic projections.

Euro area annual HICP inflation had stood at 1.3% in March 2018, up from 1.1% in February. This increase reflected mainly higher food inflation, which had continued to be driven by base effects. HICP inflation excluding food and energy had stood at 1.0% in March, unchanged from February and January but slightly up from the 0.9% recorded in December 2017. Measures of underlying inflation remained subdued and had yet to show convincing signs of a sustained upward trend. Meanwhile, price pressures along the pricing chain had continued to be subdued, with no clear evidence as yet of the euro's appreciation having had an impact on later stages of the chain. Recent developments in wage growth were signalling a moderate upward trend.

The results of the ECB Survey of Professional Forecasters (SPF) for the second quarter of 2018 had shown slight downward revisions for HICP inflation expectations in 2019 and 2020. At the same time, average longer-term inflation expectations had remained broadly unchanged, at 1.9%. Expectations for inflation excluding food and energy were unchanged over the whole horizon. Similarly, market-based inflation expectations stood broadly unchanged.

Compared with forecasts by other public and private institutions, which had become available since the Governing Council's early March meeting, the inflation projection in the March ECB staff projections was on the low side for both 2018 and 2019, but well within the range for 2020.

Financial conditions continued to be accommodative despite geopolitical uncertainties. Since the Governing Council's March monetary policy meeting, the EONIA forward curve had flattened. Long-term rates were somewhat lower than in March, notwithstanding a very recent increase, while inflation expectations were broadly unchanged. Equities were still supported by solid earnings expectations. The overall cost of financing for euro area firms had declined marginally since the March monetary policy meeting.

The annual growth rate of the broad monetary aggregate M3 had moderated in February 2018, to 4.2%, but remained close to the narrow range of 4.5-5.5% observed since mid-2015. The annual growth rate of loans to the private sector had overall remained on a path of moderate expansion. Credit developments continued to be supported by low bank lending rates for non-financial corporations (NFCs) and households and a favourable economic outlook. According to the euro area bank lending survey for the first quarter of 2018, credit standards had eased considerably for loans to enterprises and loans for house purchase. At the same time, loan demand had continued to increase across all categories.

Monetary policy considerations and policy options

Summing up, Mr Praet recalled that financial conditions had remained broadly stable at accommodative levels amid increased uncertainties about the prospects for international trade relations, and that borrowing conditions remained very favourable.

Incoming information since the Governing Council's March monetary policy meeting had pointed to some moderation in the pace of economic growth, which, in part, reflected a pull-back from the high growth rates observed at the end of 2017. Temporary factors might also have been at work. It was thus important to monitor to what extent these developments also reflected a more prolonged softening in demand.

Overall, growth could still be considered to remain solid and broad-based. Risks to growth continued to be broadly balanced, but those related to global factors, including the threat of increased protectionism, had become more prominent.

Measures of underlying inflation had moved sideways since the March meeting and had yet to show convincing signs of a sustained upward trend. At the same time, wages continued to edge higher and were expected to lend support to price pressures.

All in all, the underlying strength of the euro area economy continued to support confidence that inflation would converge to the Governing Council's inflation aim over the medium term. However, inflation convergence would likely proceed only gradually, remaining contingent on a highly accommodative monetary policy stance.

On the basis of this assessment, Mr Praet proposed, at this stage, to keep monetary policy unchanged and to reconfirm all elements of the ECB's forward guidance, including the sequencing.

Regarding communication, it was deemed important to highlight that, despite some moderation in the pace of growth, economic indicators had remained consistent with a solid and broad-based expansion in the euro area. Moreover, it needed to be emphasised that the risks surrounding the euro area growth outlook remained broadly balanced, but those related to global factors, including the threat of increased protectionism, had become more prominent. Furthermore, the Governing Council could stress that the underlying strength of the euro area economy continued to support confidence that inflation would converge to its aim over the medium term, while reiterating the importance of prudence, patience and persistence in its monetary policy for inflation pressures to build up.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, members agreed with 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 some moderation in the pace of growth since the start of the year, but were so far considered to remain consistent with a solid and broad-based expansion, supported by very favourable financing conditions. It was underlined that this moderation in growth had come after a period of very strong growth and when incoming data had surprised on the upside. This moderation might therefore reflect in part an expected normalisation from last year's exceptionally high growth rates, while unexpected temporary factors were also seen to have played a role. Hence, the underlying growth momentum was on the whole assessed to remain intact. At the same time, it was widely felt that uncertainty surrounding the outlook had increased and caution was seen as warranted in interpreting recent developments, also because the moderation in growth appeared to be broad-based across countries and sectors. A more pronounced weakening of demand, notably related to external factors, could therefore not be ruled out. Overall, the risks surrounding the outlook for economic growth were assessed to have remained broadly balanced, with downside risks related to the threat of trade protectionism having become more prominent.

Regarding the outlook for the external environment, global economic activity was seen as remaining robust, although recent indicators suggested that momentum had weakened somewhat in the last few months. The picture of a sustained global economic expansion was supported by the latest IMF projections for world real GDP growth. In this context, it was remarked that the impact of the fiscal stimulus in the United States remained a major factor in the outlook for global activity. Overall, the balance of risks to the outlook for global activity, including a more prominent risk of increasing trade tensions and the uncertain implications of the United Kingdom's withdrawal from the European Union, was considered to remain tilted to the downside.

Members agreed on the importance of external risks to the economic outlook for the euro area. In particular, concern was expressed that trade conflicts might not only have an adverse impact on activity for the countries involved via reduced trade, but could exert broader effects as a consequence of increased uncertainty and diminished confidence. Some of this uncertainty was related to upcoming decisions on trade policies. It was also remarked that turbulent trade relations had the potential to give rise to disorderly movements in exchange rates and to heightened volatility in financial markets.

The impact of trade protectionism and of possible retaliatory measures on global and euro area economic growth was considered as ranging from limited to having more substantial effects, depending on the scale of the imposed tariffs and on the diversion of trade flows and relocation of production in response to such measures. Reference was also made to evidence suggesting quantitatively large effects from the uncertainty associated with protracted tensions in trade relations. Some euro area economies might have been seeing such effects in recent months, for example in weaker export orders.

Turning to euro area activity, members discussed in more detail the moderation in economic growth at the start of the year, which was suggested by the latest hard data and survey-based indicators. It was noted that euro area real GDP had previously increased at a strong pace – by 0.7% quarter on quarter in both the third and fourth quarters of 2017, well above current estimates of potential output growth.

Members concurred that the underlying growth momentum in the euro area and its largest economies remained broadly intact, and expressed confidence in the continuation of the expansion at a solid pace. The observation was made that, while there had been a decline in hard data and survey-based indicators since the Governing Council's March monetary policy meeting, which had been rather broad-based both across euro area countries and across economic sectors, the indicators remained at elevated levels and were still clearly above their long-run historical averages.

In exchanging views about the interpretation of incoming information, members shared information on recent developments in the respective national economies and sought to provide an assessment of the factors behind the signs of weaker activity. A number of reasons of a temporary nature could in part explain a stronger than anticipated moderation. For many economies, reference was made to the possible impact of weather conditions earlier in the year, which implied a loss in value added in some sectors of the economy, such as construction or retail, but could equally imply gains in other sectors, such as those related to energy. Other temporary factors related to strikes affecting certain sectors of the economy and the unusually severe wave of seasonal influenza in some countries.

For the euro area as a whole, it was underlined that the signs of a moderation in economic growth at the start of the year did not change the picture regarding the underlying pace of expansion. In some parts of the euro area and in some sectors, the moderation in growth could be attributed to capacity constraints becoming increasingly binding. This was seen as consistent with the survey evidence on increasing labour supply shortages, suppliers' delivery times and order backlogs provided by Mr Praet in his introduction. It was argued that, in the absence of supply constraints, there would be an elastic response of output to changes in demand but, as capacity constraints were reached, growth in activity could be expected to slow down, with price pressures picking up instead. However, it was also argued that there were signs of softening demand, which warranted monitoring.

In this context, it was recalled that, while the direction of change in the measures of slack was clear, the measurement of the level of the output gap was surrounded by considerable uncertainty, as had been discussed by the Governing Council at its March monetary policy meeting.

Looking ahead, members agreed that the underlying strength of the economic expansion remained broadly intact. At the same time, uncertainty surrounding the outlook had clearly increased and data releases ahead of the June monetary policy meeting would need to be carefully scrutinised to better understand the sources of the recent moderation in growth. In this regard, it was also deemed important to gain a deeper understanding of the reasons behind the high degree of synchronicity in the downturn in indicators, which might point to a broader weakening of demand. The need to closely monitor and assess the incoming data was emphasised. More generally, it was necessary to distinguish between temporary and potentially more lasting influences and to determine the extent to which they reflected a softening in demand as opposed to the emergence of supply constraints. This latter distinction was seen as especially relevant, as supply constraints had opposite implications for price pressures.

Overall, the risks to the euro area growth outlook were assessed to have remained broadly balanced. At the same time, the downside risks related to global factors had become more prominent. It was also emphasised that there was a risk of a more expansionary and pro-cyclical fiscal policy.

With regard to price developments, there was broad agreement with the assessment presented by Mr Praet in his introduction. Euro area annual HICP inflation had increased to 1.3% in March 2018, from 1.1% in January. This increase mainly reflected higher food price inflation. On the basis of current futures prices for oil, annual rates of headline inflation were likely to hover around 1.5% for the remainder of the year. It was noted that higher energy prices were currently supporting the outlook for headline inflation, while the latest data for non-energy industrial goods price inflation had surprised on the downside, which was argued to possibly also reflect a delayed pass-through from past appreciation of the euro. On balance, the picture for headline inflation had not changed materially. At the same time, measures of underlying inflation in the euro area remained subdued and had moved mostly sideways since the March monetary policy meeting.

Members observed signs in a number of euro area countries that wage dynamics continued to pick up gradually and thus would, over time, contribute to the expected rise in underlying inflation. It was noted that, in some cases, this might not only reflect a reduction in labour market slack and higher productivity, but also a stronger role of the inflation expectations component in wage settlements. At the same time, evidence for some euro area economies suggested that there was stronger dynamism in the labour costs of the self-employed, as reflected in the prices that they charged for their services. Reference was also made to emerging signs of labour shortages and capacity constraints in a number of euro area countries and sectors of the economy, which could be expected to lead to increased wage and price dynamism over time. At the same time, it was cautioned that the degree of pass-through of wage pressures to prices remained uncertain and the ability of firms to absorb higher costs via lower mark-ups, as well as the behaviour of margins more generally, deserved further analysis.

As regards recent developments in longer-term inflation expectations, members noted that both market-based and survey-based measures had remained broadly stable. Expectations of inflation five years ahead in the SPF for the second quarter of 2018 were unchanged at 1.9%. Market-based inflation expectations, as measured by the five-year forward inflation-linked swap rate five years ahead, stood at 1.70%, the same level as that observed at the time of the March monetary policy meeting.

With regard to the monetary analysis, members concurred with the assessment provided by Mr Praet in his introduction. Broad money (M3) had continued to expand at a robust pace, although it had fallen slightly below the range observed since mid-2015. The slight moderation in the growth rate of M3 was seen to reflect mainly a decline in the contribution of credit to general government amid the reduction in monthly purchase volumes by the Eurosystem under the asset purchase programme (APP).

The gradual recovery in the growth of MFI loans to the private sector, underway since the start of 2014, was proceeding. Growth in loans to NFCs, in particular, continued to be supported by the targeted longer-term refinancing operations, with the reference period for the second series having ended in January. Reference was also made to the bank lending survey for the first quarter of 2018, which indicated increasing loan demand across all loan categories and a further easing of credit standards for loans to enterprises and loans for house purchase. Against this background, it was remarked that the risk-taking channel had so far supported the effectiveness of monetary policy by encouraging bank lending to the economy and it was reiterated that, from a prudential perspective, the impact of very easy credit conditions and low bank lending rates needed to be monitored closely. It was noted that potential financial stability risks should be addressed by macroprudential measures, as had already been proposed or implemented in some jurisdictions.

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. The recent incoming information pointed to some moderation in activity but so far remained consistent with a solid and broad-based expansion of the euro area economy. The underlying strength of the euro area economy continued to support the Governing Council's confidence that inflation would gradually converge to its inflation aim of below, but close to, 2% over the medium term. At the same time, measures of underlying inflation remained subdued and had yet to show convincing signs of a sustained upward trend. For underlying inflation pressures to continue to build up and support the path of headline inflation over the medium term, patience, persistence and prudence with regard to monetary policy remained warranted.

Members broadly agreed that financial conditions continued to be very accommodative overall, in spite of increased uncertainty and volatility in some markets. A remark was made that survey and analysts' expectations regarding APP net purchases were unchanged, with market participants continuing to anticipate net purchases concluding towards the end of 2018. Overall, the pass-through of the ECB's monetary policy measures was continuing to provide significant support to borrowing conditions for firms and households.

With regard to the progress towards a sustained adjustment in the path of inflation, the incoming information had on the whole changed little compared with the assessment made at the previous meeting. Headline inflation was up slightly from its recent trough but remained some distance from the Governing Council's inflation aim. Price pressures were still weak and measures of underlying inflation had moved sideways.

Despite the observed moderation in activity, confidence in the underlying strength of the euro area economy and the eventual convergence of inflation to the Governing Council's inflation aim remained unchanged. While measures of underlying inflation continued to be subdued, some comfort was drawn from encouraging signs of a strengthening in nominal wage growth and the continued anchoring of long-term inflation expectations at levels consistent with the Governing Council's aim. In this context, a remark was made that the Phillips curve relationship may be non-linear, and this could support a swifter rebound in inflation when capacity constraints became binding. At the same time, it was widely cautioned that the uncertainty around the outlook had increased since the March monetary policy meeting. In particular, risks related to global factors, including the threat of increased protectionism, had become more prominent and warranted monitoring with regard to their implications for the medium-term outlook for growth and prices. The June 2018 Eurosystem staff projections would provide the next occasion for a more comprehensive assessment of progress with inflation.

Members broadly agreed that an ample degree of monetary policy accommodation remained necessary to accompany the economic expansion and secure the gradual convergence of inflation to levels below, but close to, 2%. The remaining uncertainties and the still muted underlying inflation pressures continued to justify caution and underlined the need to maintain patience, persistence and prudence with regard to monetary policy.

Overall, while a view was expressed that the Governing Council's criteria for a sustained adjustment in the path of inflation could be considered as close to being satisfied over a medium-term horizon, there was broad agreement that the evidence remained insufficient at the current stage.

Against this background, members widely agreed that a steady hand with regard to monetary policy was warranted at the current stage, in line with the elements proposed by Mr Praet in his introduction. This called for maintaining the current monetary policy stance in relation to the full set of policy instruments, which involved reconfirming the October 2017 monetary policy decisions on net asset purchases and reinvestments, the ECB key interest rates and the Governing Council's forward guidance on those measures, including the sequencing of policy instruments.

Looking ahead, there was consensus that the net asset purchases would continue to be guided by the Governing Council's assessment of the progress made towards a sustained adjustment in the path of inflation according to the three criteria of convergence, confidence and resilience.

With regard to communication, steadiness was seen as important and members widely agreed with the elements for communication put forward by Mr Praet in his introduction. This entailed highlighting the need for prudence, patience and persistence in monetary policy for inflation pressures to build up and to deliver on the Governing Council's commitment to secure a sustained return of inflation rates towards levels below, but close to, 2%. Despite some moderation in the pace of growth, economic indicators so far remained consistent with a solid and broad-based expansion in the euro area. The underlying strength of the euro area economy continued to support the Governing Council's confidence that inflation would converge to its aim over the medium term. At the same time, while risks surrounding the euro area growth outlook remained broadly balanced, it was acknowledged that risks related to global factors, including the threat of increased protectionism, had become more prominent and warranted monitoring with regard to their implications for the medium-term outlook for growth and prices.

It was reiterated that, beyond the horizon of the net asset purchases, the monetary policy support still necessary for inflation to converge to the inflation aim would be provided by the stock of acquired assets, by reinvestments continuing for an extended period of time, and by policy rates remaining at their present levels well past the end of the net asset purchases. Finally, as on previous occasions, the continuing case for substantial reform efforts by euro area governments was made with a view to reinforcing the longer-term growth potential of the euro area economy, increasing its resilience and reducing vulnerabilities. It was argued that structural reforms in euro area countries needed to be substantially stepped up, including with regard to reforms of education and training with a view to reducing skill mismatches in labour markets and enhancing productivity. There was broad agreement among members that it was warranted to reinforce calls for existing fiscal rules to be respected and for fiscal buffers to be rebuilt, in particular with regard to those Member States with high government debt. In addition, calls for a swift and substantive completion of the banking union and of the capital markets union were reiterated.

Monetary policy decisions and communication

Taking into account the foregoing discussion among the members, on a proposal from the President, the Governing Council decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council expected the key ECB interest rates to remain at their present 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 the net asset purchases, at the current monthly pace of €30 billion, were intended to run until the end of September 2018, 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 Eurosystem would reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary. This would contribute both to favourable liquidity conditions and to an appropriate monetary policy stance.

The members of the Governing Council subsequently finalised the draft 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/2018/html/ecb.is180426.en.html English

Press release

http://www.ecb.europa.eu/press/pr/date/2018/html/ecb.mp180426.en.html

Meeting of the ECB's Governing Council, 25-26 April 2018

Members

Mr Draghi, President

Mr Constâncio, Vice-President

Mr Cœuré

Mr Costa

Mr Knot

Mr Lane

Ms Lautenschläger

Mr Liikanen*

Mr Linde

Mr Makúch*

Mr Mersch

Mr Nowotny

Mr Praet

Mr Reinesch

Mr Smets*

Mr Stournaras

Mr Vasiliauskas

Mr Vella

Mr Villeroy de Galhau

Mr Visco

Mr Weidmann*

* Members not holding a voting right in April 2018 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 Alves

Mr Bradeško

Ms Buch

Mr Demarco

Mr Dolenc, Alternate to Mr Jazbec

Ms Donnery

Mr Gaiotti

Ms Goulard

Mr Hernández de Cos

Mr Kaasik, Alternate to Mr Hansson

Mr Kuodis

Mr Ódor

Mr Pattipeilohy

Mr Randveer

Ms Razmusa

Ms Ritzberger-Grünwald

Mr Rutkaste

Mr Schoder

Mr Stavrou, Alternate to Ms Georghadji

Mr Tavlas

Mr Välimäki

Mr Wunsch

Other ECB staff

Ms Graeff, Director General Communications

Mr Straub, Counsellor to the President

Mr Bindseil, Director General Market Operations

Mr Sousa, Deputy Director General Economic Developments, DG Economics

Mr Rostagno, Director General Monetary Policy, DG Economics

Release of the next monetary policy account foreseen on Thursday, 12 July 2018.

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