

THE EURO AREA ECONOMY AFTER A PROLONGED PERIOD OF MONETARY STIMULUS

CIII REUNIÓN DE GOBERNADORES DE BANCOS CENTRALES DEL CEMLA

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Governor
Banco de España

19th May 2017

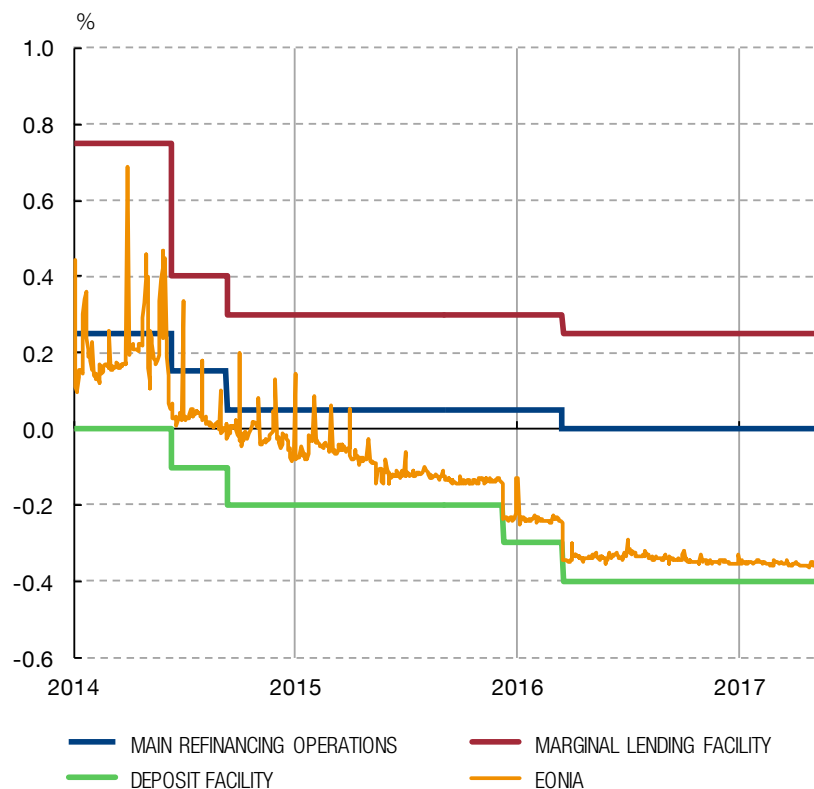
San Carlos de Bariloche, Argentina

A PROLONGED PERIOD OF MONETARY STIMULUS



- 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

EONIA AND ECB INTEREST RATES



➤ OFICIAL INTEREST RATES

- Marginal lending facility 0.25%
- Main refinancing operations 0%
- Deposit facility -0.40%

➤ FORWARD GUIDANCE

➤ BALANCE SHEET EXPANSION

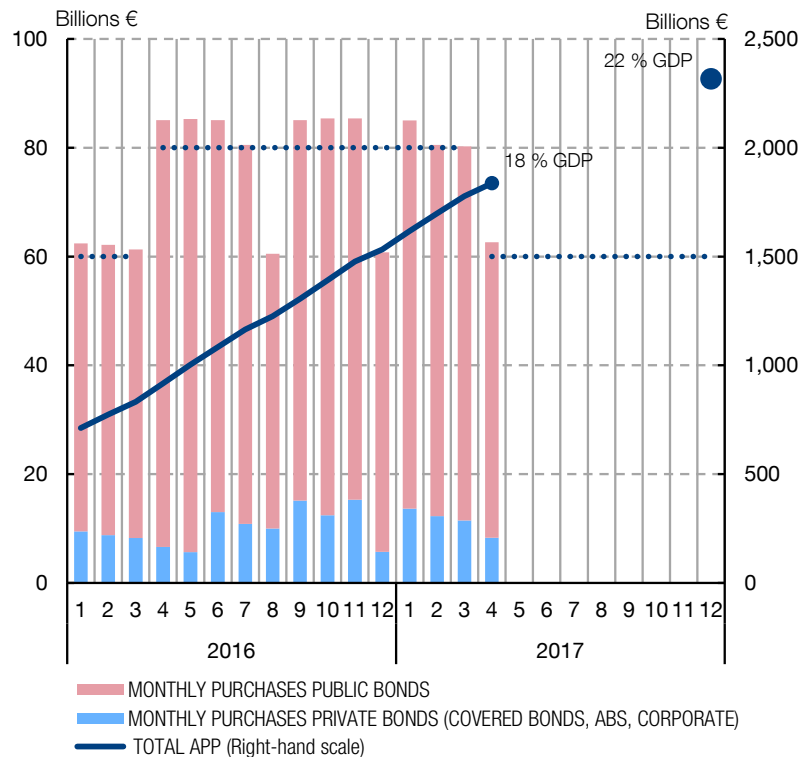
- TLTRO-II: Targeted Long Term Refinancing Operations (4-year maturity)
- Expanded Asset Purchase Programme (public and private securities)

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

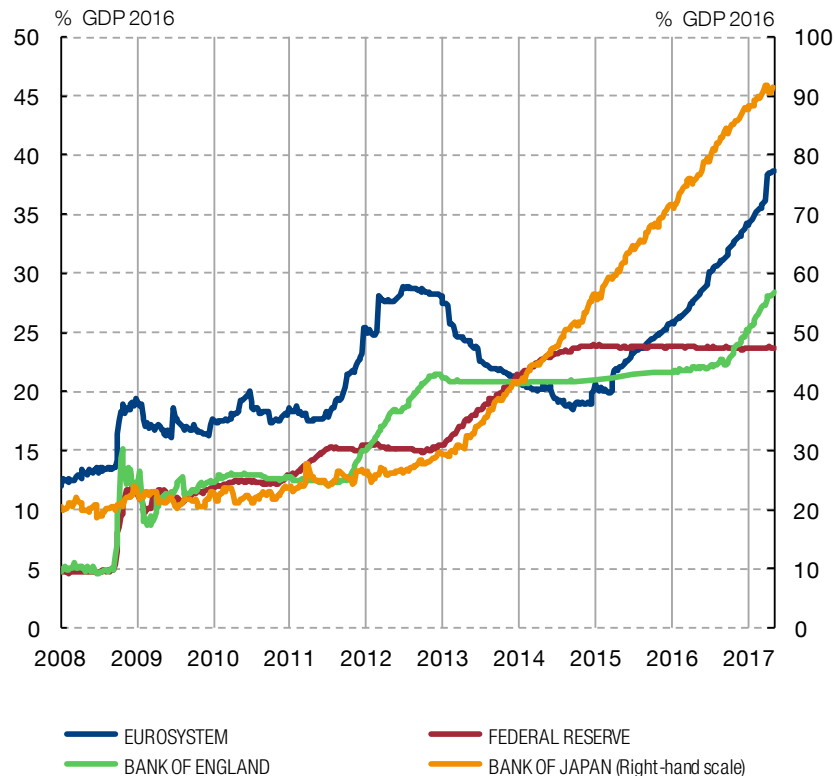


THE EXPANSION OF CB BALANCE SHEETS

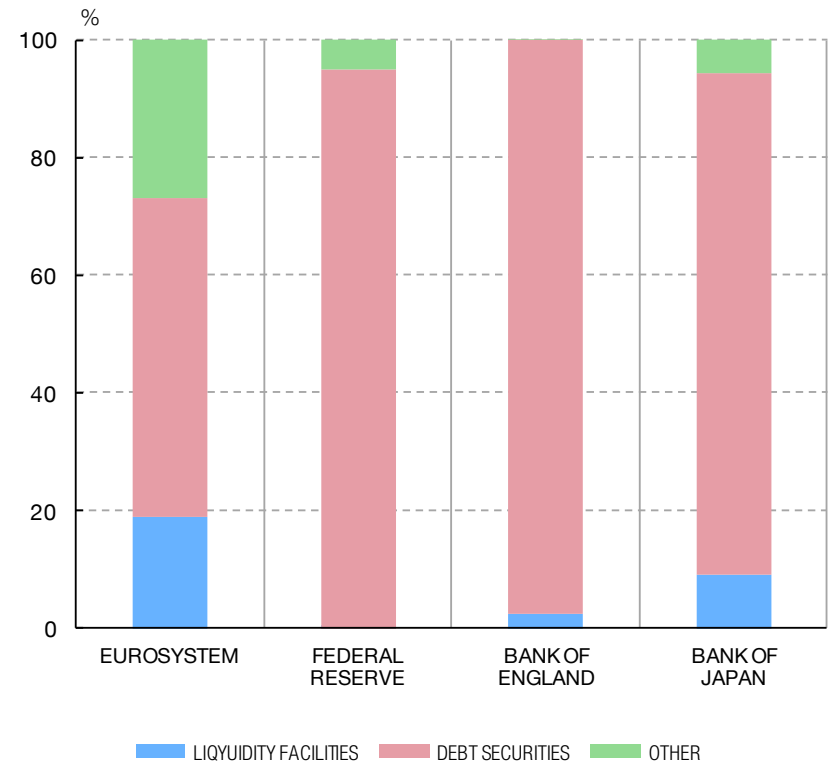


- Unprecedented measures have resulted in a huge expansion of central bank's balance sheet in main advanced economies, with important changes in their composition

CENTRAL BANKS' BALANCE SHEET



**BREAKDOWN OF CENTRAL BANKS' BALANCE SHEET
MAY, 2017**



ECB MONETARY POLICY TRANSMISSION

FINANCIAL CONDITIONS



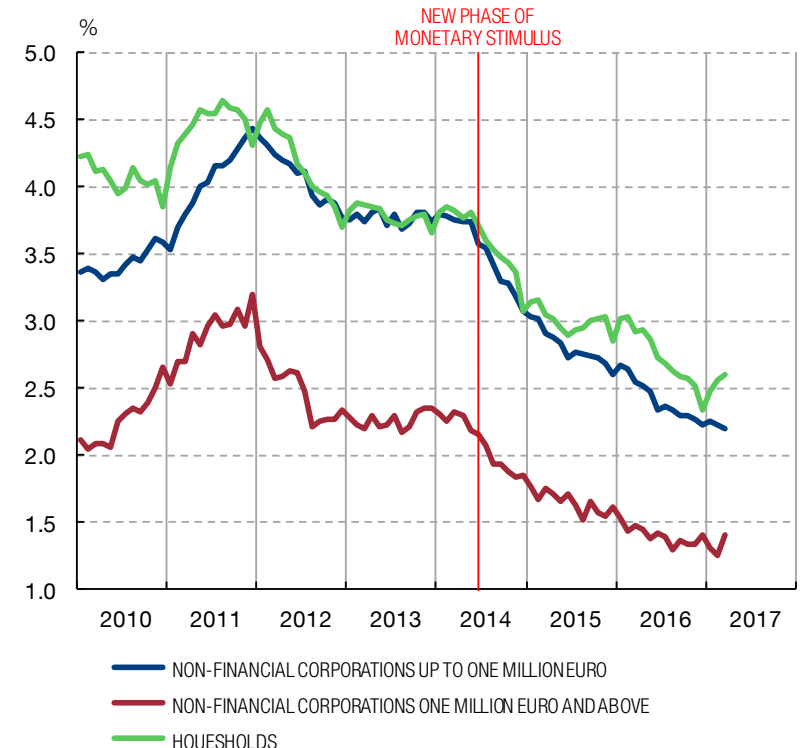
- Monetary policy expansion has improved financial conditions considerably, encouraging new borrowing and expenditure for investment and consumption.
- Yields on a broad range of assets have been lowered and thus the stimulus has been transmitted more widely to the economy.

EURO AREA FINANCIAL CONDITIONS

TEN-YEAR INTEREST RATES



INTEREST RATES ON BANK LOANS



ECB MONETARY POLICY TRANSMISSION

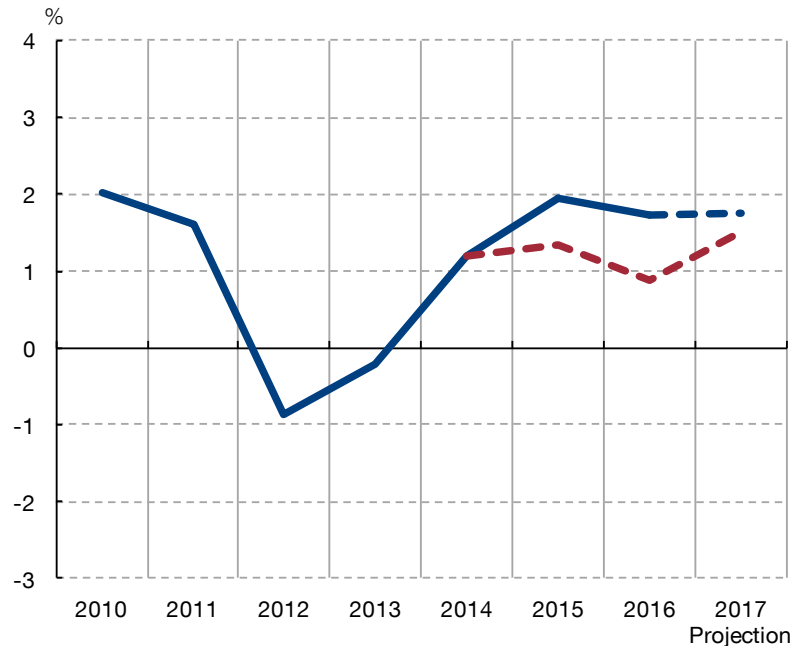
GROWTH AND INFLATION



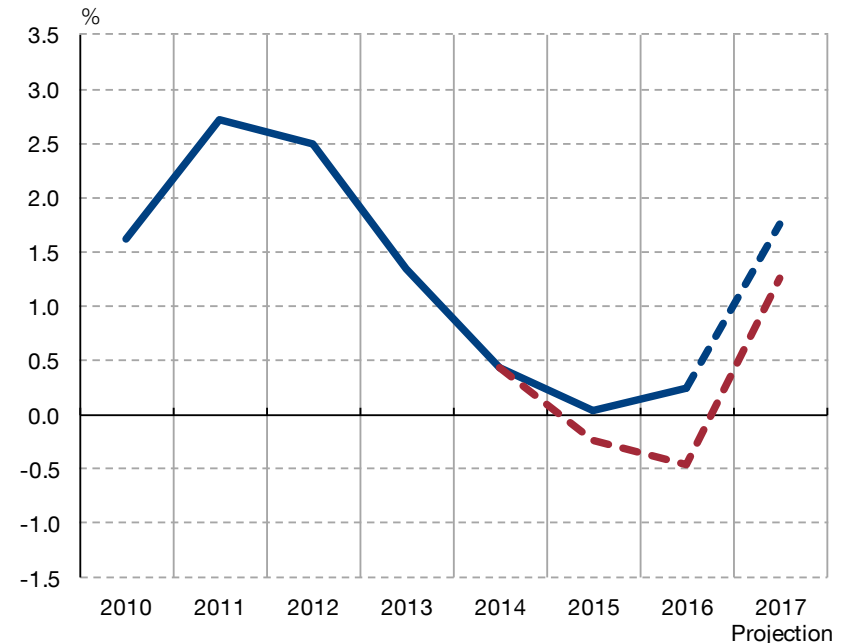
- Analysis in Banco de España 2015 Annual Report estimates the effects of ECB monetary policy since mid 2014 for euro area - accumulated effect in 2015-17: 1.7 pp for GDP growth, 1.5 pp for inflation (about 50% of nominal growth)-

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

GDP Y-O-Y GROWTH



INFLATION



— ACTUAL AND MARCH 2017 ECB PROJECTION - - - ESTIMATED PATH IN ABSENCE OF APP

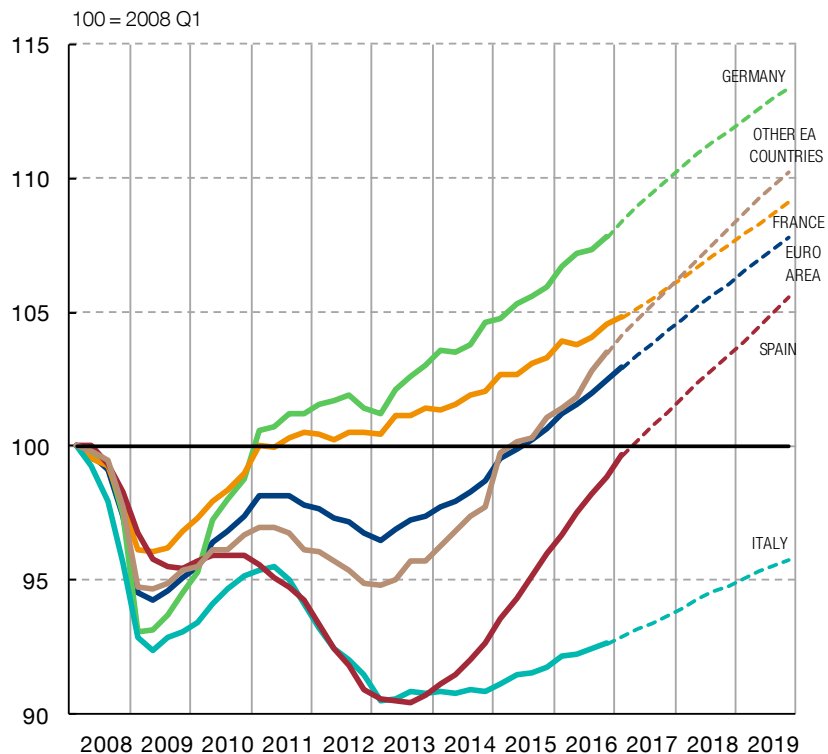
a Estimation based on Burriel and Galesi (2016), "Uncovering the heterogeneous effects of the ECB unconventional monetary policy across euro area countries" Working paper 1631. Banco de España.

EURO AREA ECONOMIC RECOVERY

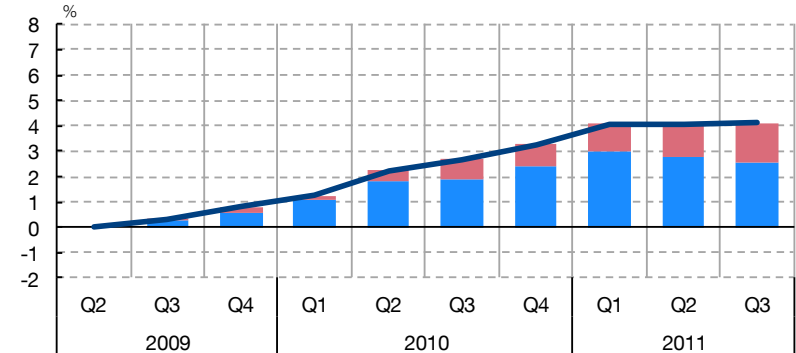


- Though moderate, the economic expansion is firming and broadening across countries - *real GDP rose by 1.7% in 2016, and it is expected to grow 1.8% this year-*
- In contrast to 2009, current economic recovery is driven by domestic demand

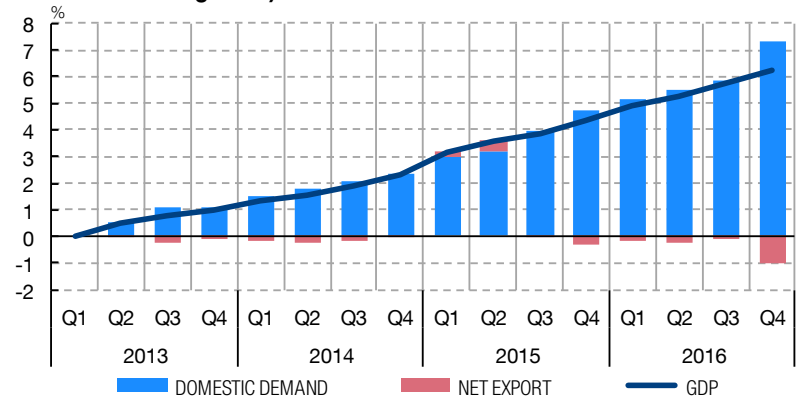
EURO AREA GDP SINCE 2008



2009-2011 ECONOMIC RECOVERY AFTER FINANCIAL CRISIS (GDP accumulated growth)



ECONOMIC RECOVERY 2013-NOW, AFTER SOVEREIGN DEBT CRISIS (GDP accumulated growth)

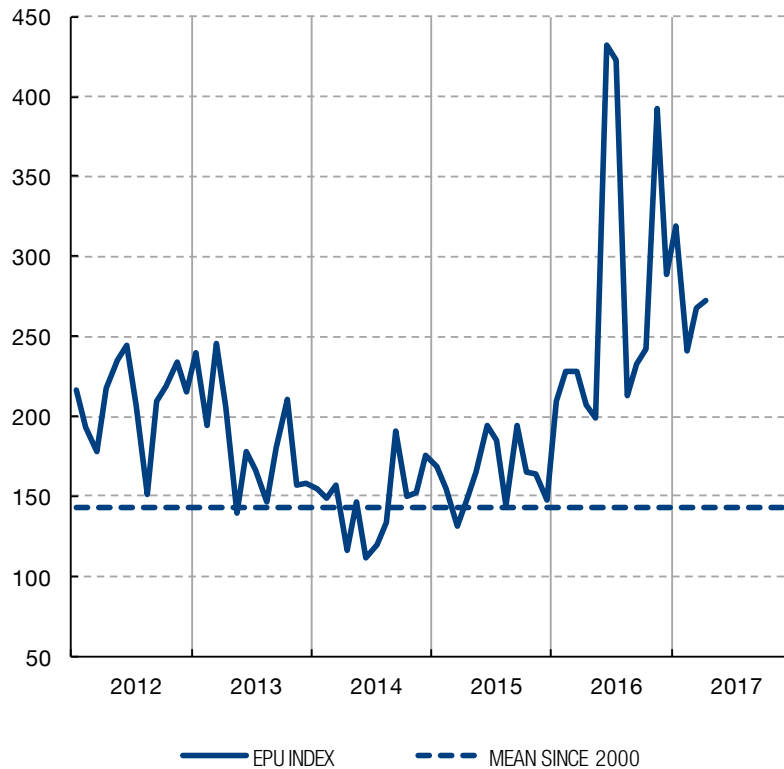


ECONOMIC POLICY UNCERTAINTY



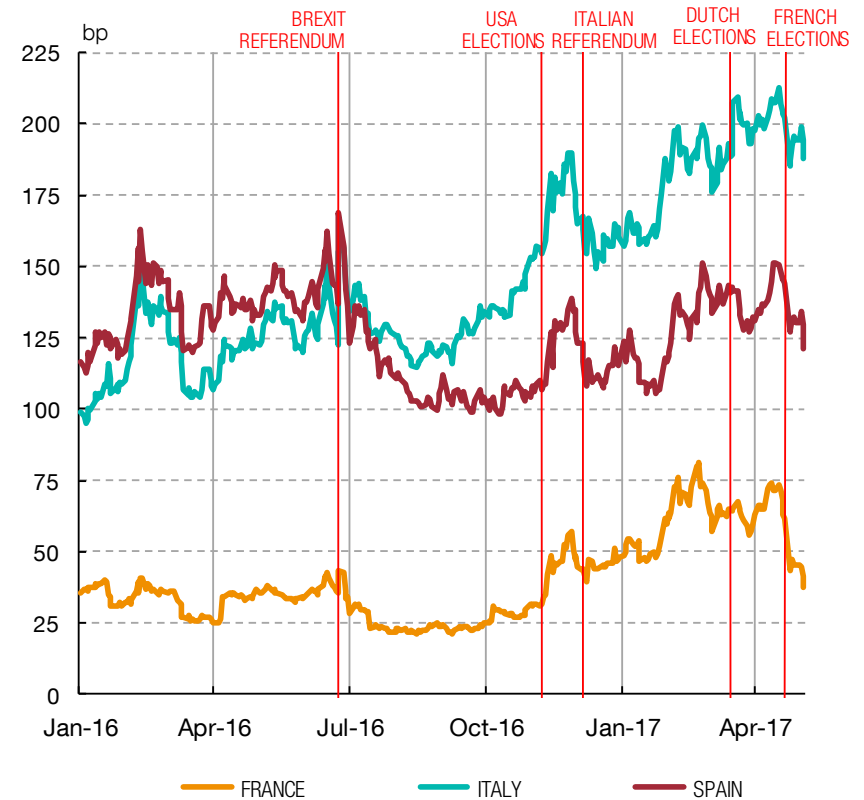
- The euro area recovery has been resilient to increasing political uncertainty
- Political risks – which led to increases in sovereign spreads – have receded after the French Presidential elections

EUROPEAN ECONOMIC POLICY UNCERTAINTY (EPU INDEX) (a)



(a) Includes United Kingdom, Germany, France, Spain and Italy. Source Baker, Bloom and Davis (2016)

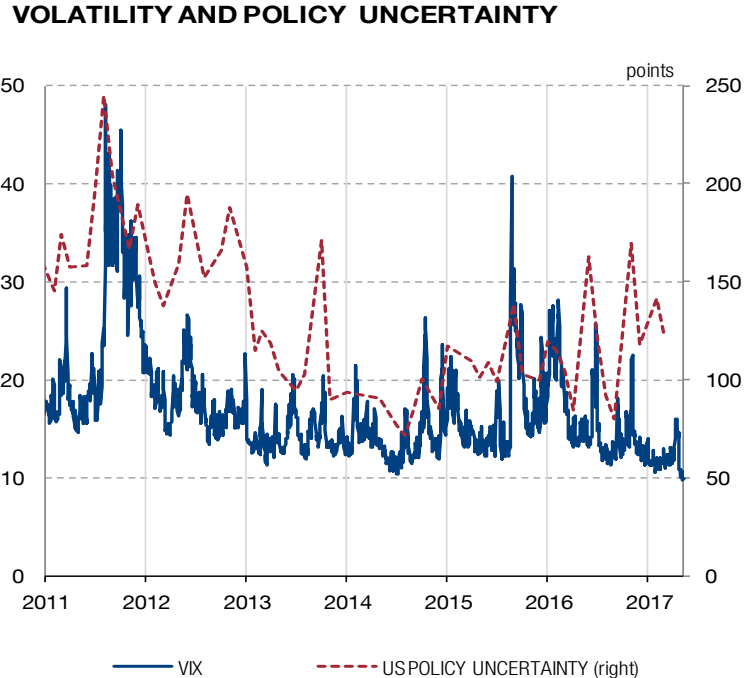
SOVEREIGN SPREADS TEN YEAR BONDS TO GERMAN BUND



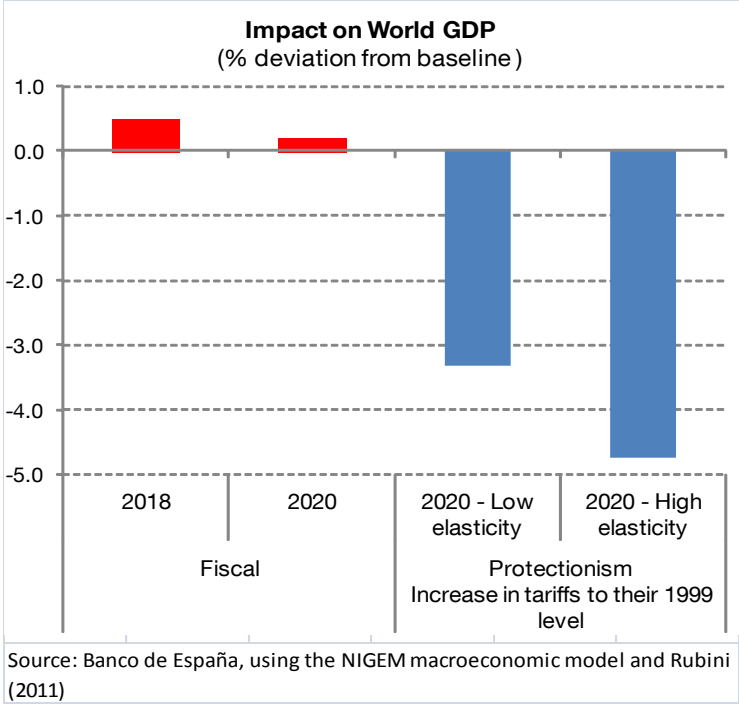
UNCERTAINTY ABOUT US ECONOMIC POLICIES



- 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



FUENTE: ECONOMIC POLICY UNCERTAINTY, DATASTREAM

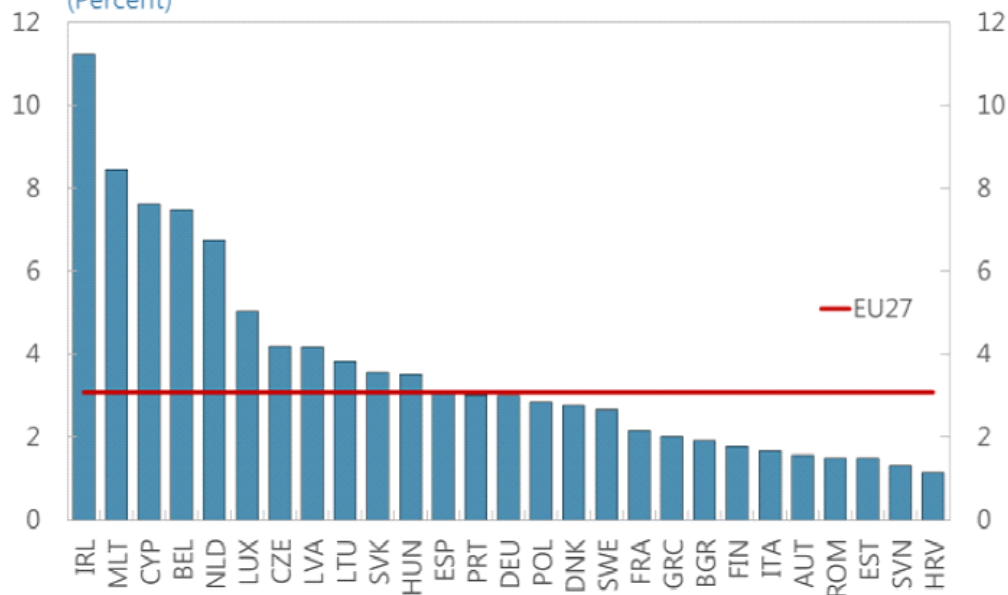


UNCERTAINTY ON THE BREXIT PROCESS



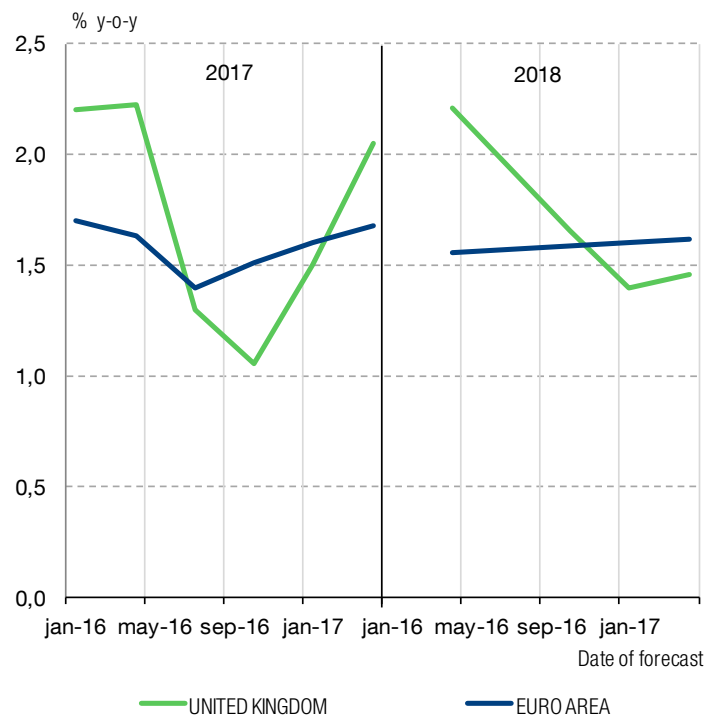
- The configuration of the future EU-UK relationship will be key for both economic areas given their close integration at present.
- The UK economy has performed better than expected since the referendum and initial downward revisions to short-term forecasts for UK growth have been almost reverted; but a longer term impact continues to be expected

UK Imports in Terms of Source Country GDP
(Percent)



Sources: Office for National Statistics; Eurostat; and IMF staff calculations.

GDP GROWTH FORECASTS



SOURCE: IMF (WORLD ECONOMIC OUTLOOK)

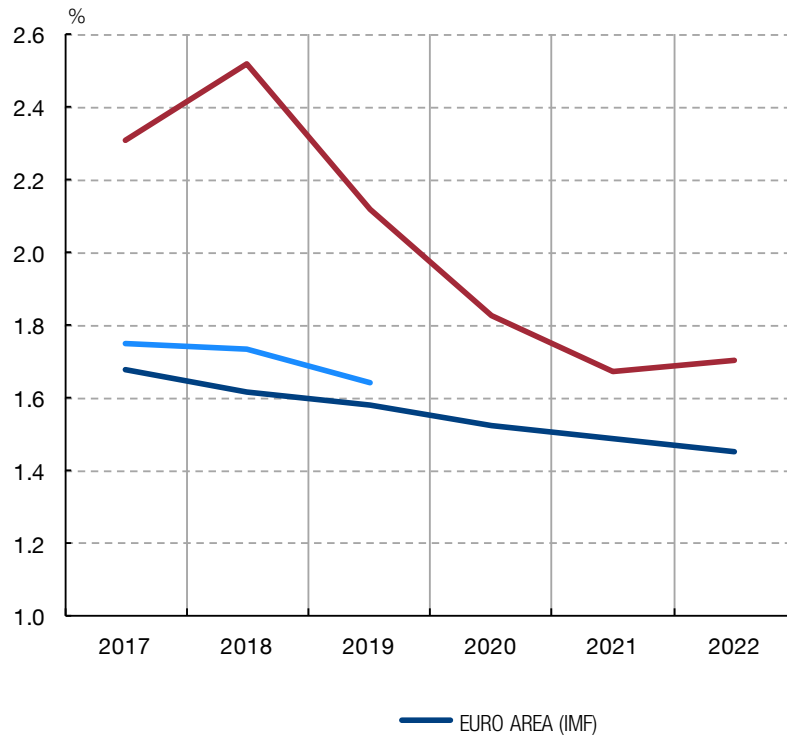
EURO AREA ECONOMIC PROSPECTS



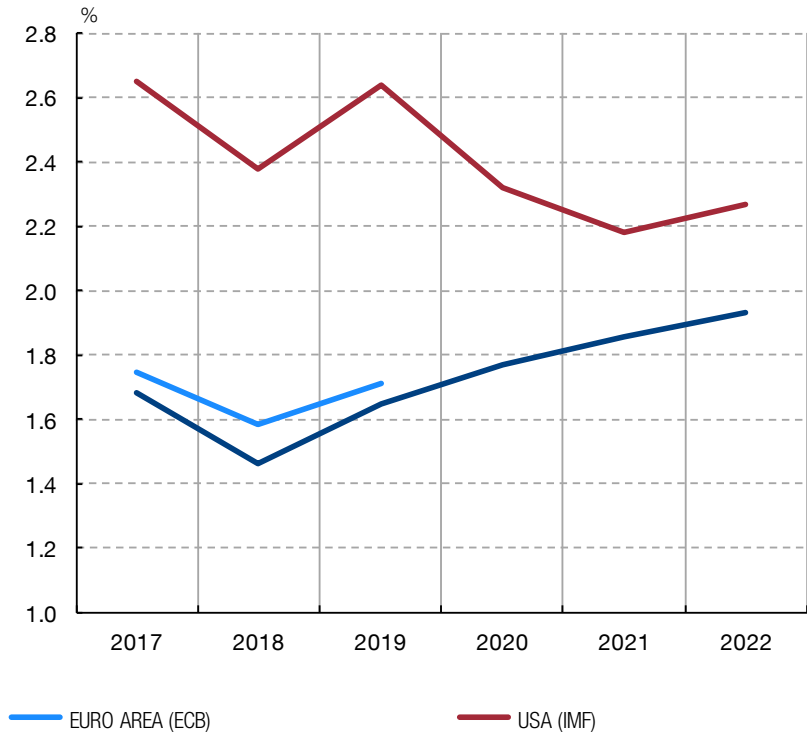
- Going forward, the euro area scenario remains one of moderate growth and subdued underlying inflationary pressures, still very dependent on monetary policy support

IMF FORECAST (APRIL, 2017) AND ECB FORECAST (MARCH, 2017)

GDP



INFLATION

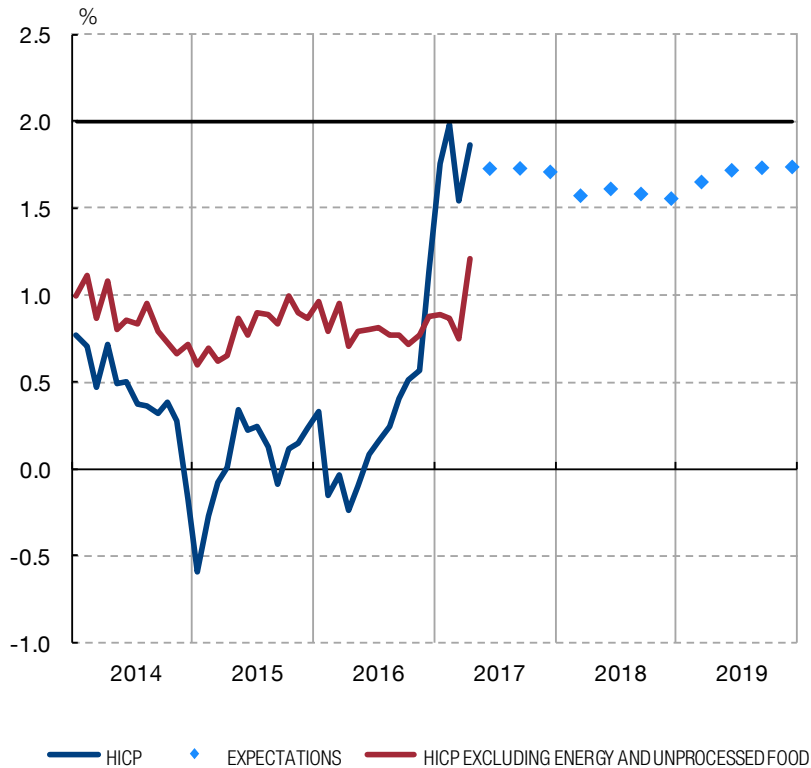


EURO AREA INFLATION DEVELOPMENTS

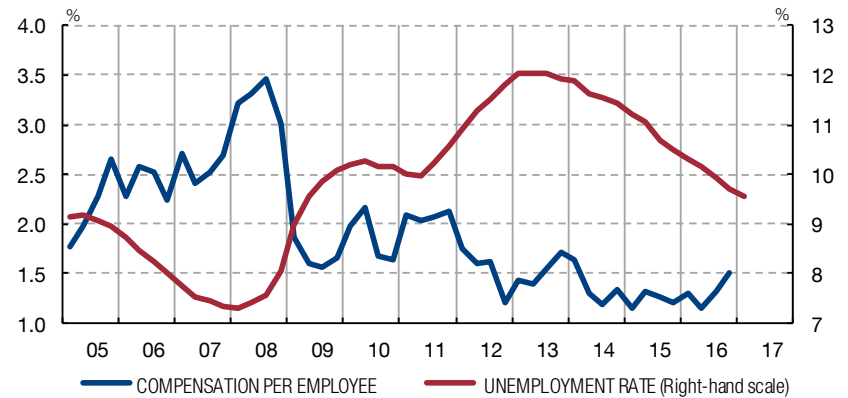


- Headline inflation has recently increased driven by oil price and calendar effects
- Core inflation remains low, against the background of subdued wage behaviour
- Market-based indicators of long-term inflation expectations anticipate a slow convergence toward the 2% reference

EURO AREA INFLATION



WAGE AND UNEMPLOYMENT RATE



**INFLATION SWAPS
IMPLIED INFLATION 5 YEARS AHEAD 5 YEARS**

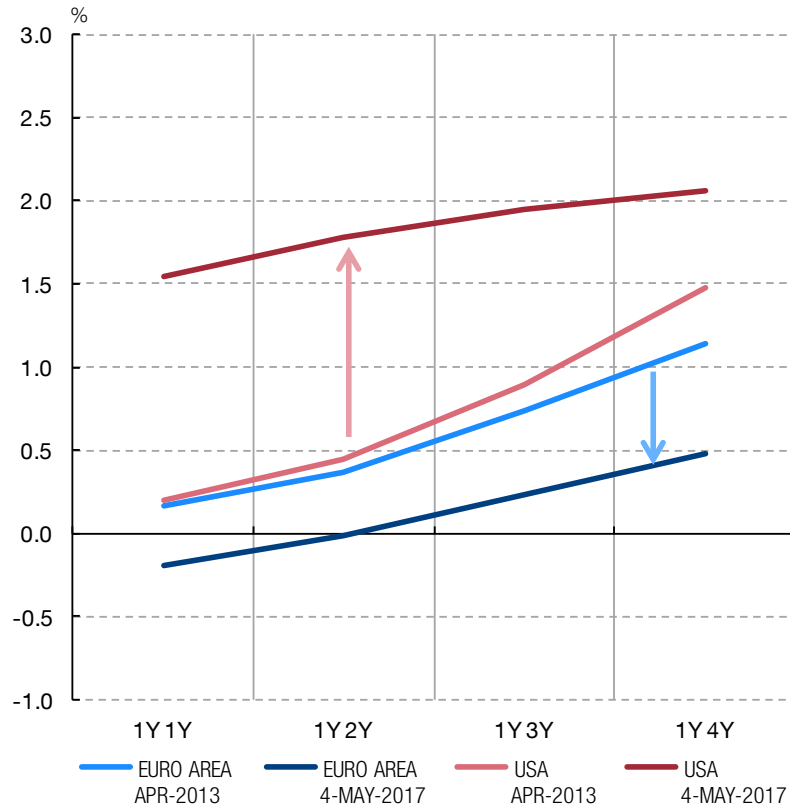


MONETARY POLICY PERSPECTIVES



- 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

1 YEAR OIS FORWARD RATES



FORWARD INTERES RATES
1-YEAR 1 YEAR AHEAD



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

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