EUROPEAN CENTRAL BANK

EUROSYSTEM

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Account of the monetary policy meeting

of the Governing Council

of the European Central Bank

held in Nicosia

on Wednesday and Thursday, 4-5 March 2015

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Mario Draghi

President of the European Central Bank

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

Financial market developments

Mr Cœuré reviewed recent financial market developments.

Since the Governing Council's previous monetary policy meeting on 21-22 January 2015, the announcement of the ECB's expanded asset purchase programme (APP) had had a significant impact on euro area financial markets, contributing to lower government bond yields and money market rates, particularly at longer maturities, while the euro had depreciated further against the US dollar especially in the days leading up to the meeting.

With the decision to expand the APP, augmenting the existing private sector asset purchase programmes with a public sector purchase programme (PSPP), euro area government bond yields had continued to trend lower, declining to all-time lows in most jurisdictions, with more bond yields turning negative since the 21-22 January meeting. At the same time, sovereign yield curves had flattened further. Intra-euro area sovereign yield spreads had narrowed after the initial widening recorded in the weeks following the January monetary policy meeting of the Governing Council. Market-based inflation expectations, for example as measured by the five-year forward inflation-linked swap rate five years ahead, had initially risen following the announcement of the expanded APP but had subsequently declined, reversing most of the increase, to stand marginally above 1.60% at the beginning of March.

Euro area equity markets had continued to perform strongly after the expanded APP announcement.

As regards the implementation of the programme, market participants had highlighted the potential scarcity of bonds to be purchased under the PSPP, citing two main factors. First, net issuance from euro area jurisdictions over the life of the programme was expected to be modest, as already reflected in the pricing of term repos at significantly negative levels in some markets, pointing to expected scarcity of certain types of collateral. Second, in the view of market participants, the euro area government bond investor base could be reluctant to sell its holdings due to regulatory constraints, a lack of attractive investment alternatives and institutional investors managing "buy-and-hold" portfolios.

Greek markets had experienced some episodes of high volatility in response to unfolding events, but contagion to other euro area government bond markets had remained limited.

Purchases under the third covered bond purchase programme (CBPP3) and the ABS purchase programme (ABSPP) had amounted to €51.2 billion and €3.5 billion respectively, as at Friday, 27 February 2015. In line with seasonal patterns, public issuance of covered bonds had rebounded in January and had remained sustained. The issuance had been more broad-based in terms of issuers and jurisdictions and also of a longer average maturity than previously observed. Secondary market spreads had continued to narrow for covered bonds across most euro area jurisdictions, particularly for Spain and Italy. Purchases under the ABSPP had remained low which, according to market participants, could be attributed to several factors. Supply had remained subdued, as many banks reportedly had more attractive funding alternatives than ABSs and saw

limited scope for capital relief via ABS issuance given the absence of progress in the regulatory framework. A pick-up in new issuance was foreseen, while activity in the secondary ABS market was structurally thin and the market characterised by buy-and-hold behaviour.

As regards Eurosystem credit operations, the maturity of the two three-year longer-term refinancing operations (LTROs) on 29 January and 26 February 2015 had not had much of an impact on the level of excess liquidity, as the maturing operations had been, to a large extent, rolled over into shorter Eurosystem liquidity-providing operations. Furthermore, developments in autonomous factors had also affected the level of excess liquidity favourably. Combined with the monetary policy decisions taken at the 21-22 January meeting, the level of excess liquidity had put further downward pressure on money market rates. Since then, the three-month EURIBOR and the one-year EURIBOR had continued to decline and had reached new lows of 3.8 basis points and 2.3 basis points respectively, in part reflecting expectations of ample excess liquidity going forward. The EONIA had stood at levels between -4 and -6 basis points for most of the period, not far from the historical low of -8.5 basis points. In the repo markets, short-term rates for general collateral had stood between -10 basis points and -15 basis points.

Regarding market measures of monetary policy expectations, the EONIA swap curve had declined by 6 basis points for maturities of longer than two years on expectations that the expanded APP would maintain significant excess liquidity over a longer horizon.

As regards currency market developments, the euro's exchange rate against the US dollar had been relatively stable for most of the period since the previous monetary policy meeting, before depreciating in the days immediately before the Governing Council meeting in Nicosia. Looking forward, market participants expected a further depreciation of the euro due to the divergence of the monetary policy stances in the United States and in the euro area, after recent improvements in the US labour market had brought forward market expectations about the first increase in the federal funds rate. In addition, according to market participants, the widening of the USD/EUR cross-currency basis spread, in particular for maturities of over two years, had been mostly driven by the expected increase in excess liquidity in the euro area following the implementation of the expanded APP and the notable increase in euro-denominated issuance by non-European institutions benefiting from favourable issuing conditions, even after swapping the proceeds into US dollars.

In Switzerland, since the Swiss National Bank's decision on 15 January 2015 to discontinue the minimum exchange rate of CHF 1.20 per euro, the Swiss franc had depreciated from CHF 1.00 to CHF 1.07 against the euro, thus pointing to a correction after the Swiss currency's initial, very sharp appreciation following the decision.

At the end of February, the exchange rate of the Danish krone against the euro had again moved closer to its central rate within ERM II, as inflows into the krone had slowed in response to the policy measures taken by the Danish authorities to defend the central rate.

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.

The recovery in the global economy was expected to continue but to remain uneven across regions. After weakening slightly in the fourth quarter of 2014, the momentum of global growth had shown signs of stabilising in early 2015, supported by previous declines in oil prices. Similarly, the global Purchasing Managers' Index (PMI) for new export orders pointed to sustained growth at the start of 2015, after some moderation in the fourth quarter of 2014. Annual OECD CPI inflation had fallen to 0.5% in January 2015, driven by a negative contribution from energy prices, although excluding food and energy it had decreased only slightly to 1.7%. Since the Governing Council's monetary policy meeting on 21-22 January 2015, Brent crude oil prices had risen by 26% to stand at around USD 61 per barrel on 3 March 2015, still roughly 50% below their mid-2014 peak. Non-energy commodity prices had declined by 3%, mainly owing to developments in metal prices. The euro had depreciated by 4% in bilateral terms against the US dollar and by 2.2% in nominal effective terms.

For the euro area, real GDP had risen by 0.3%, quarter on quarter, in the fourth quarter of 2014. While no breakdown was as yet available, short-term indicators and available country data suggested that both domestic demand and exports had continued to provide impetus to growth. The modest growth dynamics in the euro area over recent quarters had mainly been driven by low investment activity in the context of continued weak corporate profits, ample spare capacity and uncertainty about the growth outlook. Although output had been growing in recent quarters and the unemployment rate had been declining from its peak in 2013, there was still considerable slack in the economy.

Available indicators pointed to an ongoing economic recovery at the beginning of 2015. The composite output PMI and the European Commission's economic sentiment indicator had improved in both January and February and stood, on average, above their respective levels in the fourth quarter of 2014. Private consumption dynamics appeared to have held up, as both the volume of retail sales and new car registrations had risen sharply in January. In addition, consumer confidence had risen markedly in January and February, reaching pre-crisis levels.

As regards labour markets, employment had risen by 0.2%, quarter on quarter, in the third quarter of 2014 and labour productivity per person employed had increased by 0.2% on an annual basis. The unemployment rate had decreased further, by 0.1 percentage point to 11.2% in January 2015, following similar declines in the previous two months. Survey data pointed to continued moderate employment growth in the fourth quarter of 2014 and in the first quarter of 2015.

The March 2015 ECB staff macroeconomic projections for the euro area foresaw annual real GDP increasing by 1.5% in 2015, 1.9% in 2016 and 2.1% in 2017. Compared with the Eurosystem staff macroeconomic projections published in December 2014, the projections for real GDP growth in 2015 and 2016 had been revised upwards, reflecting the favourable impact of lower oil prices, the weaker effective exchange rate of the euro and the impact of the ECB's non-standard monetary policy measures taken since June 2014. To capture and assess the full impact of these measures on the macroeconomic outlook, a more comprehensive

approach had been adopted to include also those channels of transmission that are usually not fully captured by the standard modelling framework used in the projection exercise, such as a portfolio rebalancing channel, certain expectational channels and real-financial feedback loops.

Turning to prices, inflation in the euro area had remained very low and the short-term outlook was subdued. According to Eurostat, euro area annual HICP inflation had fallen to -0.2% in December 2014 and to -0.6% in January 2015. In February, according to Eurostat's flash estimate, it had rebounded to -0.3%, mainly reflecting a higher annual rate of change of the energy and food components. HICP inflation excluding energy and food had stood at 0.6% in February, unchanged from January and 0.1 percentage point lower than in December 2014.

PMI survey data on input and output prices in the manufacturing and services sectors had shown a slight rebound in February, after a substantial drop in January. The February data had been closer to the levels observed in December but continued to point to subdued price pressures in the months ahead. Similarly, European Commission survey data on selling prices across all the main sectors of the euro area economy had pointed to a pick-up, particularly in the retail sector.

Producer price developments had remained very subdued. The annual rate of change in industrial producer prices excluding energy and construction had declined further to -0.7% in January, after -0.4% in December and -0.1% in November. Producer price inflation for non-food consumer goods, which tended to lead non-energy industrial goods price inflation, had declined in January compared with December and November. At the same time, the annual rate of change in import prices for intermediate goods had been positive for the third consecutive month and the annual rate of change in import prices for non-food consumer goods had increased following the depreciation of the euro. The annual rate of change in producer prices for consumer food had continued to decline since mid-2014.

Looking ahead, the latest available information suggested that annual HICP inflation rates were likely to remain very low or negative for some time. This reflected mainly previous declines in US dollar-denominated oil prices, which were only partly offset by the recent depreciation of the euro. Looking further ahead, the upward slope of the oil price futures curve implied that the downward impact of the decline in oil prices would fade later this year. This, together with the expected recovery in demand, the impact of the non-standard monetary policy measures taken since June 2014 and the depreciation of the euro, would continue to support a gradual increase in inflation rates.

The March 2015 ECB staff macroeconomic projections for the euro area foresaw annual HICP inflation at 0.0% in 2015, 1.5% in 2016 and 1.8% in 2017. In comparison with the Eurosystem staff macroeconomic projections published in December 2014, the inflation projection for 2015 had been revised downwards, mainly reflecting the past fall in oil prices. In contrast, the inflation projection for 2016 had been revised slightly upwards, also reflecting the expected impact of recent monetary policy measures.

As regards measures of longer-term inflation expectations, the ECB Survey of Professional Forecasters for the first quarter of 2015 indicated that the expected five-year-ahead inflation rate was 1.77%. Medium and long-term market-based measures, such as forward inflation-linked swap rates, had broadly stabilised since the previous monetary policy meeting.

Regarding monetary and financial conditions, the EONIA forward curve had remained at values close to zero for the past few months at very short maturities, while it had declined further at longer maturities. Long-term sovereign bond yields in the euro area had also declined further following the announcement of the expanded APP. Euro area stock prices had increased strongly over the period. Bank lending rates had declined sharply since summer 2014, with the nominal cost of bank borrowing for non-financial corporations (NFCs) declining for two consecutive quarters and continuing to fall in January 2015.

Money and loan growth had recovered further, albeit at low levels. The annual growth rate of M3 had increased to 4.1% in January 2015 from 3.8% in December. This was mainly driven by M1, in particular overnight deposits, while other short-term deposits continued to exert a drag on monetary dynamics. These substitution effects could be partly explained by the very low interest rates. The annual growth rate of M1 reached a robust 9.0% in January, which was consistent with a recovery in the euro area in the coming quarters.

The recovery in loan dynamics had also continued. The annual rate of change in loans to NFCs originated by monetary financial institutions (MFIs), adjusted for loan sales and securitisation, had continued to improve in January 2015, rising to -0.9% from -1.1% in December 2014, after -1.4% in November and -1.6% in October. The annual growth rate of loans to households originated by MFIs, adjusted for loan sales and securitisation, had increased slightly in January to 0.9%, from 0.8% in December. On an annual basis, MFIs had continued to increase their securities portfolios. The 12-month cumulated net purchases of securities by euro area MFIs had remained positive in January on account of larger holdings of domestic sovereign bonds and reduced net redemptions of private securities.

Turning to other M3 counterparts, the annual flows of MFIs' net external assets had moderated further in January 2015 from their historical peak in mid-2014. The ongoing reduction in longer-term MFI liabilities (excluding capital and reserves), which stood at an annual rate of change of -5.7% in January, after -5.5% in December, had contributed significantly to the increase in annual M3 growth.

Regarding fiscal policies, the average euro area fiscal stance was expected to remain broadly neutral.

Monetary policy considerations and policy options

Summing up, Mr Praet noted that economic activity had gained momentum recently and that the latest staff projections pointed to an improved outlook for euro area economic growth, although surrounded by downward risks. In addition, euro area HICP inflation was expected to return gradually towards levels below, but close to, 2% over the policy-relevant horizon, supported by the pronounced easing of the monetary policy stance resulting from the non-standard monetary policy measures adopted by the Governing Council since last June. Cross-checking the results of the economic analysis with the evidence from the monetary analysis, money and credit dynamics had strengthened further and were also consistent with the outlook of a slowly improving environment for euro area growth and inflation. All in all, the Governing Council's decisions of 22 January 2015 had made a strong contribution in confronting the risks of too prolonged a period of low inflation and had given grounds for confidence. At the same time, the Governing Council had to remain cautious given the very early

stages of the economic recovery and the high degree of uncertainty, particularly regarding the outer years of the projection horizon, which now extended up to 2017.

Assessing policy options for the present meeting, Mr Praet noted that the current state of the economy and expected developments, as well as the baseline outlook for price stability, appeared to be consistent with calibrations underlying the latest monetary policy decisions. Accordingly, he saw no need at the meeting for the Governing Council to reconsider any of the parameters underlying the expanded APP. Nor was it warranted to consider any new policy initiative. Rather, the focus should now be on the decisive implementation of the measures decided previously. At the same time, it was important to recognise that a cyclical economic recovery in the euro area along the lines of the March 2015 ECB staff projections was no grounds for complacency, as important structural challenges remained to be addressed, relating in particular to low potential growth and high structural unemployment.

2. Governing Council's discussion and monetary policy decisions

Economic and monetary analyses

With regard to the economic analysis, the members of the Governing Council generally shared the assessment of the outlook and risks for economic activity in the euro area provided by Mr Praet in his introduction. The latest economic data and, particularly, survey evidence available up to February 2015 were seen as pointing to a further improvement in economic activity at the beginning of the year. The various monetary policy measures taken by the Governing Council – including previous measures and the recently expanded APP – seemed to have contributed to this general improvement, notably supporting confidence as an important channel in the transmission of monetary policy. There also seemed to be clearer evidence that the past decline in oil prices had had a positive impact on aggregate demand in the short term, while the stimulative growth effect of the euro's depreciation was likely to unfold with some delay. Overall, the evidence was seen as suggesting a gradual broadening and strengthening of the euro area economy going forward.

This assessment was also broadly reflected in the March 2015 ECB staff macroeconomic projections for the euro area, as reported by Mr Praet. Predicated, as they were, on the full implementation of all the measures that had been decided since June 2014, the projections were seen to underpin the Governing Council's commitment and confidence in the effectiveness of the measures, which had since been corroborated by a broad range of financial market variables.

Members took note of the inclusion in the current projection baseline, unlike in previous projection exercises, of the full impact of the non-standard monetary policy measures, which also took into account financial transmission channels not normally captured by the standard projection framework, in addition to effects through the technical assumptions about interest rates, exchange rates and stock prices. The impact of the announcement of the expanded APP on the projections via the technical assumptions had accounted for a significant part of the upward revisions. In this respect, the importance of the methodological step capturing

additional financial transmission channels should not be overstated, given the rather limited quantitative impact.

In complementing their considerations of the baseline projections, members exchanged a number of views on the growth outlook. In line with Mr Praet's presentation, the cyclical nature of the projected acceleration in growth was emphasised, with potential growth remaining rather modest, underscoring the need for structural reforms to bring about an improvement in potential growth. In addition, it was remarked that the growth outlook for 2017 depended on a number of factors that might become less growth-supportive towards the end of the projection horizon. Specifically, it was not clear to what extent monetary policy would still be as supportive in 2017, taking into account that the monthly purchases of euro area securities under the expanded APP were intended to last until the end of September 2016 and, in any case, until the Governing Council saw a sustained adjustment in the path of inflation consistent with the aim of achieving inflation rates below, but close to, 2%. Moreover, the pick-up in growth over the projection horizon depended on the assumptions of continued low oil prices and a further strengthening in foreign trade. In this regard, the argument was put forward that oil price developments might turn out to be stronger than currently assumed if global demand were to improve considerably. In addition, growth might also be constrained by structural bottlenecks in some countries.

As to the various demand components, a number of factors were cited that might suggest a relatively strong effect of the oil price-induced strengthening of real disposable income on consumption, as embedded in the staff projections. Reference was made to favourable short-term consumption indicators, such as retail trade and car registrations in some euro area countries. A relatively strong consumption effect might also be rationalised by recent monetary policy measures, which might have increased the propensity to consume the oil price-related income gain, by reducing uncertainty, including about possible second-round effects from the oil price decline.

Regarding the euro area's export profile, the view was expressed that a somewhat stronger impact of the euro's depreciation on export growth than currently foreseen could not be excluded, especially for some open economies, where the current exchange rate implied a very notable improvement in price competitiveness. Business investment was expected to contribute to the recovery by gaining momentum over the projection horizon. In the discussion, several considerations were offered to highlight a number of challenges to a swift recovery in business investment. The point was made that the projected trajectory of profits and margins could be seen as optimistic, given firms' continued lack of pricing power. Moreover, even if profits were to develop as foreseen in the projections, it was not clear that retained earnings would necessarily be used to fund investment in the euro area rather than in the rest of the world. Moreover, there was, as yet, little evidence from hard data to support the projected recovery in investment, which seemed to rely on the assumed impact from the low interest rate environment and a recovery in profits, as well as possibly being driven by high equity valuations, implying a low replacement cost of capital according to Tobin's q. The remark was also made that some favourable factors were less relevant for investment spending by small and medium-sized enterprises (SMEs) that had no access to capital markets and might also be more affected by bank lending constraints.

Members exchanged various views on the interaction between structural reforms and the output gap. On the one hand, the point was made that structural reforms, in particular those pertaining to labour markets, might be

expected to widen the output gap initially, as they would raise potential output without a corresponding pick-up in real GDP. On the other hand, it was argued that some structural reform measures in labour and product markets had the potential to generate positive short-run effects on actual growth, notably in the case of the liberalisation of certain markets. Similarly, reforms that made investment more attractive would initially have a strong demand effect before capital formation over time led to an actual increase in potential output. As a result, structural reforms might be seen as increasing inflationary pressures through their positive impact on the output gap in the short run, rather than reducing them. It was, however, acknowledged that it might not be straightforward to identify reform measures that would indeed bring about this effect. In some cases, positive effects on potential output might be very slow to materialise, as in the case of education reform. This would argue in favour of heightened urgency in their implementation. In any case, it was difficult to disentangle potential and cyclical output developments in real time. Reference was made to experience in the United States, which had shown that what had appeared to be structural unemployment had eventually turned out to be cyclical, as soon as aggregate demand started to strengthen. A diagnosis that unemployment was mainly structural in nature should thus not necessarily lead to the policy conclusion that demand-side policies were not needed.

Additionally, in view of the fact that the projection horizon had been extended to 2017, it was stressed that the degree of forecast uncertainty tended to increase with the length of the projection horizon. Uncertainty related not only to the underlying technical assumptions, such as those about oil prices and the exchange rate, and to potential growth and monetary policy in other jurisdictions, but also to the effectiveness of the adopted monetary policy measures. The point was also made that the technical complexities associated with fully incorporating the expanded APP into the projections in all likelihood implied that uncertainties were larger than in previous projection exercises, especially for the outer years of the projection horizon.

Overall, members saw the risks surrounding the euro area economic outlook as remaining on the downside, although they had diminished following recent monetary policy decisions and the fall in oil prices. The downside risks to growth were seen as stemming from geopolitical and political risks inside and outside the euro area. The possibility of weaker than expected investment growth was also considered to be a downside risk. In addition, it was remarked that the materialisation of the baseline scenario depended on a number of assumptions – including the closure of the output gap, a recovery in investment growth, the strengthening of corporate pricing power and a significant pass-through of the fall in oil prices to spending – each of which might be seen as being associated with some downside risks. The question was posed as to whether the strong rebound in the economy, in part also as a result of monetary policy measures, was fully consistent with the underlying financial market assumptions, since expectations of a pronounced recovery in growth appeared not to square easily with interest rates and monetary conditions remaining very accommodative far into the future. At the same time, it could also be argued that, while a constant level of the exchange rate was embedded in the technical assumptions, a further weakening would affect other variables such as export growth and investment activity.

The risk of insufficient progress on structural reforms was also highlighted as a major downside risk. In that context, the argument was advanced that the projected pick-up in growth could weaken incentives for governments to pursue the necessary structural reforms and thereby adversely affect potential growth. The

remark was made that a cyclical recovery along the lines of the March 2015 ECB staff macroeconomic projections was no cause for complacency, given the low level of potential growth and high structural unemployment, as had been highlighted by Mr Praet in his introduction. The point was also made that the importance of structural reforms for growth in the short term should not be overestimated. It was argued that the sharp contraction in output in 2008-09 had mainly been due to a large negative demand shock, which had been exacerbated by the ensuing weakness in demand owing to deleveraging. Nevertheless, structural reforms were absolutely essential, even if politically difficult to implement, for medium-term growth prospects, not least in view of adverse demographic developments, which called for compensatory efforts to increase total factor productivity.

The issue was raised that the possibility of short-term demand effects emanating from a more contractionary fiscal stance had to be seen in perspective, in the light of the recent decisions by the European Commission in the context of the Stability and Growth Pact. In that respect, it was also remarked that, while the direct impact on growth over the short term of a flexible interpretation of the Stability and Growth Pact was likely to be limited, the negative effect over the medium and long term on the overall credibility of the institutional framework of EMU could potentially be significant. It was remarked that weakening the credibility of the fiscal framework also entailed a risk of a negative impact on the effectiveness of the expanded APP through heightened uncertainty adversely affecting expectations and risk premia. At the same time, the point was made that, from a macroeconomic point of view, one should be cautious in calling for too restrictive a fiscal policy stance at the current juncture.

With regard to price developments, there was broad agreement with the assessment presented by Mr Praet in his introduction. Reference was made to the fact that the inflation outturn for February was above the projected levels for the first time following a long series of lower than expected outcomes, but at the same time there was also a lack of clear improvement on the nominal side. On the basis of the current information and prevailing futures prices for oil, annual HICP inflation could be expected to remain very low or negative in the months ahead. Later in 2015 inflation rates could be expected to start increasing again, supported inter alia by the favourable impact of recent monetary policy measures on aggregate demand. This assessment was also broadly reflected in the March 2015 ECB staff projections as presented by Mr Praet earlier in the meeting.

In their discussion of the inflation outlook, the members put forward a number of considerations and challenges. Regarding the relatively pronounced rebound in inflation rates over the projection horizon, it was pointed out that this was largely a reflection of base effects related to the past sharp decline in oil prices, which was assumed not to continue. The crucial role of external factors, notably oil prices and the exchange rate, in driving inflation developments over the projection horizon was highlighted, and their effect was expected to be temporary. The expected contribution of lagged exchange rate effects in bringing inflation rates close to 2% in 2017 was singled out in particular. Some caution was expressed concerning the degree to which the pick-up in inflation rates could be expected to be maintained in 2017 and beyond the projection horizon.

It was remarked that recent wage agreements in a large euro area country confirmed that second-round effects stemming from the past decline in oil prices were likely to be contained in that Member State and any overall effect on prices was therefore likely to be limited. Accordingly, the past sharp fall in oil prices had thus

far had no visible impact on wage negotiations in a country where nominal rigidities did not limit the scope for downward adjustment in wage settlements. In several other countries, such downward adjustments might be limited by nominal rigidities, implying that wage developments would not fully reflect the past decline in oil prices. Some comments were also made about the key role in the March 2015 projections of developments in profit margins in bringing inflation back into line with the Governing Council's aim of achieving inflation rates below, but close to, 2%.

The members exchanged views regarding the risks surrounding the inflation projections. It was observed that, while the projected reversal in the inflation trend might indeed be the most likely scenario, a number of factors warranted close monitoring. These included the trend in global inflation and the possibility that the past decline in oil prices might be more persistent than currently envisaged. In any case, the Governing Council would continue to monitor closely all relevant factors, including the pass-through of its monetary policy measures, geopolitical developments, exchange rate developments and energy price developments.

All in all, the members agreed that, even though the March 2015 ECB staff macroeconomic projections suggested that inflation rates would move closer to 2% over the projection horizon, there was no room for complacency. It was underlined that for the baseline scenario to materialise the expanded APP had to be fully implemented and supported by appropriate communication. Moreover, it was essential that structural reforms were ambitiously implemented, in part with a view to supporting private sector decisions conducive to innovation.

With regard to the monetary analysis, the members concurred with the assessment presented by Mr Praet in his introduction that recent data had confirmed a gradual increase in underlying growth in broad money and the continued gradual recovery of loans to NFCs. Despite a gradual improvement, the dynamics of loans to NFCs remained subdued. Annual growth in loans to households increased to 0.9% in January 2015. Recent monetary policy measures were expected to support a further improvement in credit flows.

The view was advanced that the evolution of the monetary data had consistently provided moderately positive news for a number of months. This suggested that the impact of the credit easing package that had been adopted during the course of 2014 was starting to be felt and that comfort could be drawn with respect to the effectiveness of those measures. The question was also raised as to whether the renewed expansion of assets on the MFI balance sheet without a concomitant increase in bank lending, notably associated with an increase in the MFI net external asset position, could be interpreted as a symptom of speculative positions in the banking system, possibly in part as a side effect of the monetary policy programmes in place. It was, however, also noted that a more benign explanation of such developments could be offered, with higher MFI net external assets reflecting capital inflows and external demand for euro area assets.

A cross-check of the outcome of the economic analysis with the signals coming from the monetary analysis broadly confirmed the appropriateness of the further monetary policy accommodation provided with the decisions taken on 22 January 2015. All the monetary policy measures adopted, taken together, should support further improvements in credit flows, provide support to the euro area recovery and bring inflation rates closer to levels below, but close to, 2% over time.

Monetary policy stance and policy considerations

With regard to the monetary policy stance, the members generally shared the assessment that significant positive effects from the monetary policy decisions taken on 22 January 2015, in conjunction with the package of measures decided in June-September 2014, could already be seen, namely an easing in financial market conditions and in the cost of external finance for the private economy. Moreover, recent data on economic activity had been somewhat positive and there were signs of a turnaround in inflation dynamics, including a stabilisation in market-based measures of inflation expectations. This provided grounds for "prudent optimism" regarding the scenario of a gradual recovery and a return of inflation rates to levels closer to 2%. It was recalled that the March 2015 ECB staff macroeconomic projections were predicated on the full implementation of all monetary policy measures taken by the Governing Council, including the expanded APP comprising monthly purchases of €60 billion, which were intended to be carried out until the end of September 2016 and, in any case, until the Governing Council saw a sustained adjustment in the path of inflation consistent with the aim of achieving inflation rates below, but close to, 2%. The March 2015 projections should therefore not be interpreted as suggesting that the latest monetary policy measures were less necessary. On the contrary, they confirmed that full implementation of these measures was required to deliver on the Governing Council's mandate. At the same time, the Governing Council would continuously assess the effectiveness of the measures and would regularly review progress towards the attainment of the objectives as evidence accumulated over time.

The favourable financial market impact of the latest measures was highlighted again, particularly with respect to the yield curve and, to a lesser degree thus far, with respect to inflation expectations. This confirmed that the measures were working as intended in anticipation of the start of purchases under the expanded APP, laying the groundwork for a positive scenario. It also underlined the need to fully implement the measures, as otherwise part of the favourable market impact might be reversed. Hence, it was essential for the Governing Council to remain firm, implementing the measures adopted without hesitation until the objectives were reached, in line with its commitment to keep this policy in place for as long as needed.

At the same time, there were various reasons for caution with respect to the materialisation of the March ECB staff projection baseline and to the expected time frame for the non-standard measures, particularly towards the end of the horizon. The high degree of uncertainty surrounding the transmission of non-standard policies and the lack of historical precedent were emphasised, also in view of limited and mixed evidence, thus far, on the impact of earlier non-standard measures. Moreover, other policy areas needed to play their part in supporting a sustained recovery. The view was widely shared that, on the basis of current information, the package of monetary policy measures taken since June 2014, including the expanded APP, was warranted and fully adequate to gradually reach the intended objectives over time. There was therefore no need to consider any new policy initiatives at this stage or to reconsider any of the parameters of the PSPP decided on 22 January 2015. The focus was now on the determined implementation of all the monetary policy measures that had been adopted over recent months.

A number of reflections were offered on the scope and effectiveness of the purchase programmes as a basis for monitoring their implementation going forward.

Caution was expressed in view of some market perceptions that the deposit rate could fall below -20 basis points, which, it was affirmed, should be regarded by the Governing Council as the effective lower bound.

With respect to the parameters of the PSPP, the possibility of adjusting the issue limit – initially set at 25% – on some future occasion was recalled, in view of possible scope for differentiation according to applicable law on blocking minority clauses in collective action clauses in different jurisdictions.

Regarding the envisaged maturity profile of purchases, it was underlined that conducting purchases in the same proportions across the yield curve appeared appropriate to safeguard market neutrality. However, the behaviour of bond holders in different segments of the yield curve could differ significantly and needed to be taken into account. This called for close monitoring of the impact of purchases on interest rates and on different investor “habitats” along the yield curve.

With regard to purchases from non-resident holders, the remark was made that in this case the transmission channel of the additional liquidity provided would not operate in the same way as typically assumed for domestic holding sectors, but would depend on the use made of the extra liquidity injected, while in any case a stimulus was to be expected, either via a rebalancing of portfolios into other euro area assets or via an impact through the exchange rate channel.

More broadly, attention was drawn to the need to carefully monitor changes in the operation of financial markets over the coming years in the context of evolving financial structures in reaction to non-standard policies, unusual constellations of yields and changes in risk appetite, in conjunction with regulatory reforms. Understanding such changes would be important from the perspective of financial stability, but it was also seen as essential for assessing the transmission mechanisms for monetary policy geared to price stability.

Overall, the sentiment was widely shared that with the January 2015 monetary policy decisions the Governing Council had added a sizeable further stimulus and had now deployed almost the full range of the instruments at the disposal of monetary policy in support of the economic recovery to deliver on its price stability mandate. To complement the measures taken by the ECB, determined policy action was needed in other policy areas. A strong message to governments was warranted to seize the opportunity for a renewed impetus for structural reforms to boost potential growth. In this context, it was also felt that greater efforts were needed at the European level to explain clearly that structural supply-side measures were aimed at increasing productivity, competitiveness and employment, and hence welfare in the longer term, even if possible adverse short-term impacts on demand could not be ruled out.

With regard to fiscal policies, members underlined that full and consistent implementation of the Stability and Growth Pact was key for confidence in Europe’s fiscal framework. While it was judged that the Governing Council should not interfere with the application of the fiscal rules on a case-by-case basis, which was the prerogative of the European Commission, concerns were expressed about a tendency in recent decisions to exercise greater discretion in the implementation of the legal provisions and to use flexibility to the maximum extent. Doubts about the enforcement of the Stability and Growth Pact were seen to increase uncertainty and

to risk weakening further the credibility of the fiscal framework over time. It was widely felt that lasting damage to confidence from a weakening of the rules-based approach would far outweigh any rather limited short-term gains that could conceivably arise by supporting activity via a loosening of the aggregate fiscal stance, as opposed to a full and consistent implementation of the rules at present and in future. However, a view was also put forward that, from a macroeconomic perspective, the recent decisions by the European Commission were defendable and appeared to be in line with the broadly neutral fiscal stance as entailed in the projections. Overall, there was broad agreement that the Governing Council should send a firm message on the need for full and consistent implementation of the fiscal rules.

Monetary policy decisions and communication

Taking into account the foregoing, 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 0.05%, 0.30% and -0.20% respectively.

With regard to the PSPP, the Governing Council adopted the ECB Decision on a secondary markets public sector asset purchase programme, establishing the PSPP and its eligibility criteria (ECB/2015/10).

Regarding implementation issues related to the PSPP, the Governing Council also decided on the initial list of eligible agencies located in the euro area, which would apply from 5 March 2015. This initial list of eligible entities may be amended following the Governing Council meeting on 15 April 2015, based on monetary policy considerations and duly reflecting risk management aspects. The Governing Council furthermore decided on the list of eligible international organisations and multilateral development banks located in the euro area. Both lists would be included in the communication provided by the ECB on its website on "Implementation aspects of the public sector purchase programme".

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/2015/html/is150305.en.html

Related press and web releases

http://www.ecb.europa.eu/press/pr/date/2015/html/pr150305.en.html

http://www.ecb.europa.eu/mopo/liq/html/pspp.en.html

Meeting of the ECB's Governing Council, 4-5 March 2015

Members

Mr Draghi	President
Mr Constâncio	Vice-President
Mr Bonnici	
Mr Coene	
Mr Cœuré	
Mr Costa	
Ms Georghadji *	
Mr Hansson	
Mr Honohan	
Mr Jazbec	
Mr Knot	
Ms Lautenschläger	
Mr Liikanen	
Mr Makúch	
Mr Mersch	
Mr Nowotny	
Mr Noyer	
Mr Praet	
Mr Rimšēvičs	
Mr Stournaras *	
Mr Vasiliauskas *	
Mr Visco *	
Mr Weidmann	

* Members not holding a voting right in March 2015 under Article 10.2 of the ESCB Statute.

Other attendees

Mr Van der Haegen	Secretary, Director General Secretariat
Mr Winkler	Deputy Secretary for monetary policy, Senior Adviser, DG Economics

Accompanying persons

Mr Ayuso	
Mr Bitāns	
Ms Buch	
Mr Gaiotti	
Mr Gauci	
Mr Gerlach	
Mr Hakkarainen	
Mr Kaasik	
Mr Kuodis	
Ms Le Lorier	
Mr Malo de Molina	Alternate to Mr Linde
Mr Mooslechner	
Mr Ramalho	
Mr Schoder	Alternate to Mr Reinesch
Mr Smets	
Mr Stavrou	
Mr Swank	
Mr Tavlas	
Mr Tóth	
Mr Tratnik	

Other ECB staff

Ms Graeff	Director General Communications
Mr Smets	Counsellor to the President
Mr Klöckers	Deputy Director General, DG Economics
Mr Rostagno	Director Monetary Policy, DG Economics

Release of the next monetary policy account foreseen on Thursday, 21 May 2015.