European Monetary and Financial Outlook

26th Annual Hyman P. Minsky Conference on the State of the US and World Economies

19 April 2017
6-10 years ahead euro area growth expectations

Real GDP growth
(percentage per annum)

Source: Consensus Economics.
Latest observation: October 2016.
Declining expectations of long-term growth

Potential euro area output reduction due to crisis
*(index 1999 = 100)*

*Sources: European Commission.*
*Note: The counterfactual potential GDP path assumes that potential GDP continued to grow at its 2007 growth rate.*
*Latest observation: 2016.*
Conditions for a balance sheet recession

Real GDP and pre-crisis expected path
(index 2007 = 100)

Bank loans to private sector
(annual percentage change)

Source: ECB, Consensus Economics, ECB calculations
Note: Dotted lines represent evolution of GDP based on private sector expectations in October 2007.
Recent developments and short-term outlook

Euro area real GDP growth, composite PMI and ESI
(q-o-q % change, index and percentage balance)

Source: Markit, DG-ECFIN, Eurostat, ECB and MPE.
Note: ESI is rescaled using the PMI standard deviation.
Dispersion of euro area sovereign bond yields

(percentage per annum)

Sources: Thomson Reuters and ECB calculations.

Note: The data used is based on euro area country composition as in 2011. The yields for Greece, Cyprus, Estonia, Luxembourg, Malta and Slovenia are excluded owing to infrequent or a lack of observations.

Public finances

Euro area government debt and deficit
(% of GDP)

Source: European Commission’s winter 2017 economic forecast.
Sources: Bloomberg.
## The ECB response

### LTROs
- Post-Lehmann phase: Elastic provision of long-term liquidity to banks under full allotment
  - Placed ceiling on money market rates, safeguarded access to funding for banks in liquidity deficits
  - Large endogenous expansion of balance sheet contained fragmentation, restored confidence.
  
  _But: expansion of Eurosystem balance sheet was only temporary and non-discretionary…_

  … _so that measures lost traction as banks started actively contracting their exposures and reimbursing ECB loans, leading to a contraction of money_

### SMP and OMT
- Debt crisis: Targeted interventions in securities markets (SMP) and conditional commitment to stamp out break-up risk compensation from bonds of stressed jurisdictions (OMT)
  - OMT acted as potent circuit breaker and restored financial stability
  
  _But: confidence crisis had undermined banks’ willingness and capacity to keep credit flowing in vast portion of the euro area_

  … _and tightening borrowing conditions amplified renewed slump, jeopardizing macroeconomic and price stability_

### Transmission and deflation risks:
- TLTROs give banks incentives to increase loan supply and reduce borrowing costs for the real economy
- Asset purchases compress term spreads on securities encouraging portfolio rebalancing towards assets with a higher risk-adjusted return
- Negative DFR discourages liquidity hoarding and speeds up asset reallocation
Impact of VLTROs and OMT in Spain

Banks’ vs. sovereign CDS premia
(basis points)

Source: Thomson Reuters, ECB calculations.
Notes: Charts show daily observations during a given quarter. Last observation: 30 December 2016.
Impact of VLTROs and OMT in Italy

Banks’ vs. sovereign CDS premia
*(basis points)*

**Deterioration in banking sector**

**Summer 2012 intensification of crisis**

*Source: Thomson Reuters, ECB calculations.*
*Notes: Charts show daily observations during a given quarter. Last observation: 30 December 2016.*
Euro area and US forward rates

1y OIS forward rates
(percentage per annum)

Forward interest rates: 1-year 1 year ahead
(percentage per annum)

Source: ECB calculations.

Source: ECB.
Notes: The forward rates correspond to the OIS rate of the euro area and the US respectively.
Central bank balance sheets

(Monetary policy instruments as percent of GDP)

Source: ECB, Federal Reserve.
HICP and HICP excluding food and energy
(annual percentage changes)

Source: Eurostat.
Last observation: March 2017.
# Financial sector agenda: Restoring resilience

## Regulatory initiatives towards a European banking union

<table>
<thead>
<tr>
<th>SSM Regulation</th>
<th>BRRD</th>
<th>SRM Regulation</th>
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<tbody>
<tr>
<td>• Establishes SSM</td>
<td>• Framework for resolution of credit institutions and investment firms</td>
<td>• Establishes single system for efficient and harmonised resolution of banks within the SSM</td>
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<td>• Supervision of all banks in participating Member States by ECB and NCAs</td>
<td>• Harmonised tools and powers relating to prevention, early intervention and resolution for all EU Member States</td>
<td>• Single Resolution Board (SRB) and Single Resolution Fund (SRF)</td>
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<td>• In force since 3 Nov 2013</td>
<td>• In force since 2 Jul 2014</td>
<td>• In force since 19 Aug 2014</td>
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<td>• SSM operational since 4 Nov 2014</td>
<td>• Applies to MS since 1 Jan 2015</td>
<td>• SRF applicable as of 1 Jan 2016</td>
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<td>• Bail-in provisions applicable as of 1 Jan 2016</td>
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