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Eurozone

Patience and cautious optimism

- **As in April, the ECB left its monetary policy unchanged, leaving the European economy time to absorb the easing measures voted in March, including one of the biggest (if not the biggest), the T-LTRO II, which has not even started yet.**
- **Except for an upward revision in 2016, macroeconomic forecasts were not changed. Inflation is expected to remain capped at 1.6% in 2018, the same level as in the March forecast.**
- **To justify the decision to maintain the current profile, Mario Draghi insisted that the easing effects of the measures announced in March have not been fully captured by the new projections.**
- **Although monetary policy is likely to focus on implementing previously approved measures, new measures cannot be ruled out in case of an unwanted tightening of monetary and financial conditions and/or the materialisation of second-round effects.**
- **Lastly, Mario Draghi also revealed the ECB's position on the Greek situation. Despite the agreement that was reached in late May, the Governing Council has yet to reintroduce the waiver that would allow Greek banks to refinance normally via the central bank.**

No major decisions were expected at the ECB's June monetary policy meeting. As in April, the central bank maintained the *status quo*, leaving the European economy time to absorb the easing measures approved in March, the biggest of which, the T-LTRO II, has not even started yet. The presentation of the same inflation forecasts for 2018 supported a persistently accommodating message though.

As at the end of each quarter, the ECB presented its updated macroeconomic projections for growth and inflation. In the previous two projections, in December and March, inflation estimates were revised downwards, which led to the announcement of new monetary easing measures. This time, it served more as a communication support: it helped show the effectiveness of the policy measures deployed so far, without sending an overly optimistic message that would risk fuelling premature expectations of monetary tightening.

The 2016 growth and inflation forecasts were revised slightly upwards (see table) after the year started off strongly in terms of growth (+0.5% q/q in Q1) and oil prices rebounded. At a more distant horizon, however, which is more pertinent for the central bank, the inflation forecast remains the same: inflation continues to be capped at 1.6% in 2018, the same level as in the March forecast when the ECB announced that it was lowering key rates, beefing up its quantitative easing programme, and launching a new round of long-term lending (T-LTRO II). Actually core inflation has even been revised downward, compensating for rebounding energy prices.

ECB staff projections

	June 2016				March 2016			
	2015	2016	2017	2018	2015	2016	2017	2018
Real GDP	1.6	1.6	1.7	1.7	1.5	1.4	1.7	1.8
Unemp. rate	10.9	10.2	9.9	9.5	10.9	10.4	10.2	9.9
Inflation	0,0	0.2	1.3	1.6	0,0	0.1	1.3	1.6
Core infation	0.8	1.0	1.2	1.5	0.8	1.1	1.3	1.6

Table Source : ECB

To justify maintaining the same profile, Mario Draghi insisted that the new projections had not yet taken into account the full impact of the measures announced in March. This is notably due to the gradual launching of the monetary easing measures: the corporate sector purchase programme (CSPP) and T-LTRO II will not start up until 8 and 22 June, respectively. Patience is needed.

In the end, it is in qualitative terms that the ECB best accounted for the effectiveness of its action, pointing out that although risks were still skewed to the downside, they are now more balanced thanks to the monetary easing measures previously decided.

Mario Draghi used the press conference to deliver an accommodating message, in line with stubbornly sluggish forecasts. Although in the future, monetary policy is bound to concentrate on implementing previously approved measures, we should not rule out further actions in case of an unwanted tightening of financial and monetary conditions and/or the emergence of second-round effects. In our view, the absence of wage pressures and low core inflation dynamics should push the ECB to extend the duration of its quantitative easing programme beyond March 2017.

Lastly, Mario Draghi also presented the ECB's position on the Greek situation. Despite the agreement reached in late May, the Governing Council still has not reintroduced the waiver that would allow Greek government bonds to be adopted as collateral in refinancing operations. For that, we must wait until the conclusion of the first review of the third European bailout plan which requires the implementation by Greek authorities of a list of prior actions.