Luis de Guindos: Most recent ECB monetary policy decisions

Welcome remarks by Mr Luis de Guindos, Vice-President of the European Central Bank, at the meeting of the ECB's Bond Market Contact Group, Frankfurt am Main, 26 June 2018.

* * *

Ladies and Gentlemen,

I am very pleased to be here today to give the introductory remarks to the Bond Market Contact Group meeting. I will focus on two issues. First, I will take this opportunity to briefly explain the important decisions taken by the Governing Council earlier this month. And second, I would like to provide some food for thought on the topics that you will be discussing today.

Let me start by explaining the backdrop to the decisions taken by the Governing Council on 14 June 2018.

While euro area economic activity moderated in the first quarter of 2018, following high levels of growth in 2017, the fundamentals remain in place for continued solid and broad-based economic growth.

In fact, economic growth continues to be supported by the domestic strength of the economy. Private consumption growth is expected to remain robust thanks to continued improvements in the labour market. The unemployment rate is at its lowest level in almost ten years, while the number of people employed in the euro area has increased by some eight and a half million since mid-2013. The outlook for business investment continues to strengthen and is supported by the favourable financing conditions, an improvement in profitability and solid demand. The euro area fiscal stance is projected to be expansionary in 2018 and to become broadly neutral over 2019–20. Also the external environment remains supportive. The expected continuation of the broad-based expansion in global demand should support euro area exports. In particular, growth in the United States is expected to accelerate on the back of solid investment and consumption data and significant fiscal stimulus.

Our assessment that broad-based economic growth will continue is largely echoed in the June 2018 Eurosystem staff macroeconomic projections for the euro area. Real GDP is projected to increase by 2.1% in 2018, 1.9% in 2019 and 1.7% in 2020.

While we still find that the risks to the growth outlook are balanced, those related to global factors have become more prominent. In fact, downside risks to the outlook stem from the threat of increased protectionism, rising oil prices and its impact on inflation and global growth, as well as very elevated levels of global debt. Moreover, the risk of persistent heightened financial market volatility warrants monitoring.

Inflation measured by the Harmonised Index of Consumer Prices increased to 1.9% in May 2018 and, on the basis of current futures prices for oil, headline inflation is likely to hover around its current level for the remainder of the year. While measures of underlying inflation remain generally muted, they are higher than earlier low levels. Domestic cost pressures are strengthening amid high levels of capacity utilisation and tightening labour markets.

So against this background, the Governing Council carefully reviewed the progress towards a sustained adjustment in the path of inflation to levels below, but close to, 2% in the medium term. Our assessment on the progress made was guided by the three criteria of convergence, confidence and resilience.

First, on convergence, headline inflation should be well on track towards reaching levels below, but close to, 2% over the medium term, which is also supported by our staff projections.

Second, on confidence, uncertainty around the inflation outlook has further diminished. In addition, high levels of capacity utilisation and a progressive tightening in labour markets provide increasing confidence that price and wage pressures will emerge more strongly and show through in inflation developments.

Finally, on resilience, the projected sustained adjustment in the path of inflation is expected to be maintained even without additional net asset purchases.

In summary, we concluded at our meeting on 14 June that progress towards a sustained adjustment in inflation has been substantial. The underlying strength in the euro area economy, together with well-anchored, longer-term inflation expectations, provide grounds to be confident that the sustained convergence of inflation towards our inflation aim will continue in the period ahead, even after a gradual winding down of net asset purchases.

Let me reiterate the Governing Council's policy decisions on our policy instruments.

- First, we anticipate reducing the current monthly pace of net asset purchases of €30 billion to €15 billion at the end of September 2018 and ending net purchases at the end of December 2018.
- Second, we intend to maintain our policy of reinvesting the principal payments from maturing securities purchased under the asset purchase programme for an extended time after the end of net purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.
- Third, we expect the key ECB interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path.

Looking ahead, monetary policy will be firmly guided by the outlook for price stability and our stance will evolve in a data-dependent and time-consistent manner. Our monetary policy will remain patient, persistent and prudent. The benign market reaction following the announcement of our decision supports the appropriateness of our current assessment.

Let me turn to today's Bond Market Contact Group meeting. The topics on your agenda are as relevant to the ECB as ever, in particular given the updated guidance from the ECB Governing Council. I would like to present a few considerations that you may want to touch upon in your discussions.

Under your first agenda item, the *bond market outlook*, you will be holding an in-depth discussion on bond market developments and the outlook for the months ahead. Euro area bond market developments in the past weeks were notably volatile. I hope your discussion will shed some additional light on the underlying drivers of this market turbulence. Yes, political factors played an important role. However, were there other perspectives? Has the market structure changed so much that it exacerbated the market reaction to the political events? Could something be done from a structural perspective to prevent such a gapping in the market? How do you see the bond market outlook for the second half of 2018? What are the key factors that will drive markets during the rest of the year?

The second item on your agenda, the *global quantitative easing unwind and the implications for financial markets*, is of particular importance. From my perspective, the reduction at the start of this year of the average net purchase volume under the expanded asset purchase programme from €60 billion to €30 billion had been well anticipated. Similarly, the announcement that we will reduce the monthly pace of the net asset purchases to €15 billion until the end of December 2018 and then end net purchases, was also followed by a benign market reaction. Nevertheless, I would be interested in your views on the implications for fixed income markets given that net asset purchases are likely to be coming to an end on a global scale – perhaps with the exception of Japan. Looking at central bank communication, what is of particular importance to market participants as central banks wind down their net asset purchases? What were the main lessons from the US Federal Reserve's experience? Are there certain structural developments that could hinder a smooth end to net purchases? How do you foresee the reaction in fixed income segments that have benefited from inflows through the portfolio rebalancing channel?

Last but not least, your third item, the discussion on the *hidden risks to bond markets*, is probably the most challenging topic. It is widely known that market participants often tend to focus on the same risks at the same time. But today's discussion should be an exercise in thinking outside of the box to try to identify potential pressure points and gauge the likelihood of these risks materialising over the short to medium term. Do you see a concentration of risk in certain asset classes? Does the continued popularity of exchange-traded funds harbour risks for financial market functioning, in particular in times of stress? To what extent is algorithmic and high frequency trading in the fixed income space a cause for concern? Are you observing certain financial market practices that seem unsound or unsustainable to you?

Let me conclude by saying that we greatly value the structured interactions we have with you to inform our understanding of ongoing financial market developments. The topics discussed at today's Bond Market Contact Group meeting could not come at a better time, given the recent bond market developments and the recent Governing Council decisions.

Since the inception of our market contact groups, you have informed us about financial market dynamics, some of which were less well known though nonetheless important. You have raised concerns that helped us diagnose potential pressure points in the financial system. And your market insights have been helpful in our efforts to increase the efficiency and effectiveness of the implementation of our monetary policy. Thank you again for your participation today.