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TD Economics

International Commentary: ECB leaves monetary policy unchanged, announces one-time reduction to monthly asset purchases beginning in April 2017

- At the conclusion of today's meeting, the ECB's Governing Council agreed to leave interest rates unchanged and reiterated that they anticipate interest rates to remain "at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases". As a reminder, the interest rate on the ECB's main refinancing operations remains at 0%, while rates for the marginal lending facility and the deposit facility remain at 0.25% and -0.40%, respectively.

- The pace of asset purchases will remain at €80 billion per month through the end of March of 2017. However, asset purchases will fall to €60 billion per month starting in April 2017 through the end of December 2017 or beyond if deemed necessary by the Governing Council. Proceeds from maturing securities purchased as part of the asset purchase program will continue to be reinvested for the foreseeable future. The parameters around its corporate sector purchase program remain unchanged.

- The decision to extend asset purchases at the €60 billion monthly pace is state contingent, and an extension will rest upon the Governing Council's assessment at that time of whether inflation is on track to converge with its 2% target, given the outlook for the economy and financial conditions.

- In addition to the change in the size of the asset purchase program (APP), some smaller tweaks were announced. The maturity range of the public-sector purchase program (PSPP) will expand to include securities with minimum time to maturity of 1 year (from 2 years). Furthermore, securities with a yield to maturity below the interest on the ECB's deposit facility "will be permitted to the extent necessary." Lastly, the ECB announced that cash of up to €50 billion for the entire Eurosystem will be accepted as collateral by central banks as part of its PSPP lending program.

- Markets this morning reacted by selling off longer maturity euro area bonds, however the euro depreciated relative to the U.S. dollar following the news, and continued to do so even after the press conference was complete.

Key Implications

- After hinting about forthcoming reevaluation of its APP at its last meeting in October, the ECB's Governing Council delivered a modest one-time reduction to its monthly purchases this morning. While a plan to taper asset purchases was widely anticipated to be announced this morning, ECB President Mario Draghi made it clear this was a one-time adjustment and that a full "tapering" (or schedule of diminishing purchases) down to zero had yet to be discussed by the Governing Council. President Draghi also reinforced that today's decision was intended to maintain extraordinary monetary accommodation as well as signal that the ECB will have a sustained presence in financial markets, exerting price pressures on bonds for a long-time.

- The updated economic projections were broadly unchanged from those released this past September with the economy expecting to sustain growth momentum into the fourth quarter. Real GDP is anticipated to grow 1.7% in 2016 and 2017, before falling off slightly to 1.6% in 2018 and 2019. Headline inflation is expected to firm up to 1.7% through 2019 owing largely to rising energy prices. Nevertheless, Governing Council is unconvinced at this time that rising energy prices will contribute much to underlying inflation pressures. Moreover, the risks to inflation remain tilted to the downside, particularly due to elevated uncertainty stemming from events earlier this year (Brexit, U.S. election, Italian referendum), and European elections next year.

- President Draghi stressed the need for targeted fiscal policy and expedience on structural reforms to help maximize the traction that highly accommodative monetary policy can have on lifting economic activity and in helping the ECB achieve its price stability mandate. During the press conference he highlighted the need for all Euro Area nations to speed-up the implementation of necessary structural reforms, and, for those with fiscal space, to undertake productivity enhancing investments while still respecting established fiscal rules on government budget balances.

- Overall, in the aftermath of Brexit, the U.S. elections, and the Italian referendum, which saw the resignation of pro-EU Italian Prime Minister Matteo Renzi, the ECB has decided to leave monetary conditions at current highly accommodative stance through 2017 and likely beyond. This should help support the gradual economic recovery in the Euro Area, with the state-contingent optionality of the adjusted asset purchase program allowing for the possibility of more stimulus if economic conditions warrant it.

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