ECB Watch

16th July 2015

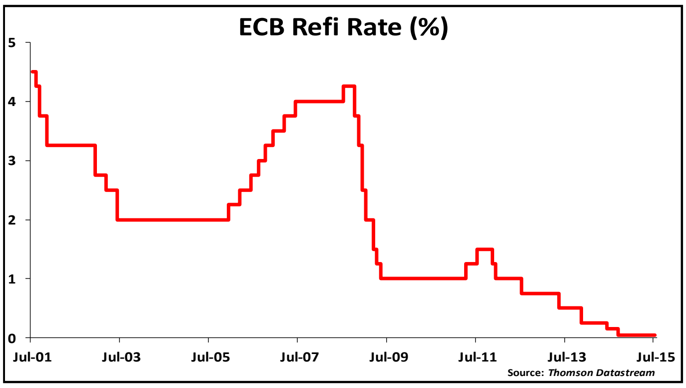
AIB Treasury Economic Research Unit

ECB Increases ELA to Greek Banks

Today's meeting of the ECB Governing Council was in line with market expectations for no changes to monetary policy. Thus, purchases under its QE programme will continue to run at a rate of €60 billion per month until at least September 2016.

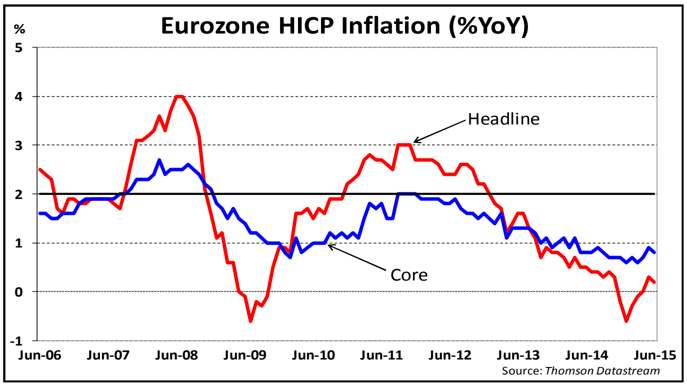
The Governing Council statement emphasised it willingness to act further if any "factors were to lead to an unwarranted tightening of monetary policy or if the outlook for price stability were to materially change". ECB President Mario Draghi stated that the Central Bank would "respond to such a situation by using all the instruments available within its mandate". **So, it is clear that the ECB retains an easing bias and is prepared to take additional action if required to meet its price stability objective.**

In terms of its assessment of the macro backdrop, the **ECB has taken encouragement from the fact that the downside risks for the Eurozone's economic outlook have "generally been contained" as a result of its monetary policy** decisions. It expects the economic recovery to "broaden further" and a "gradual increase" in inflation over the coming years.



Not surprisingly, 'Greece' dominated the question and answers section of the press conference, with all but a handful of questions being about the country. President Draghi announced that **the Governing Council had "completely and fully" accommodated a request from the Bank of Greece regarding Emergency Liquidity Assistance (ELA)** to Greek banks. ELA is to be increased by €900m, bringing the total to just under €90bn, while there was no change to collateral requirements.

The President justified the decision to increase ELA by noting that "several positive" things had happened, including last nights Greek parliamentary vote. However, he stated that it is **"hard to predict" when the situation with Greek banks would return to a more 'normal' situation**, emphasising that the decision regarding capital controls is the responsibility of the Greek government.



Meanwhile, in terms of next week's payment of €3.5bn due to the ECB from Greece, President Draghi expressed confidence that this obligation would be met. Indeed, he commentated that the evidence and information (incl. the approval of a bridge financing package) at his disposal indicates that the ECB payment will be honoured next Monday (20th July). Meantime, on the issue of 'debt sustainability', the President said that "its uncontroversial that debt relief is necessary". But, he made the point that the key factor is what type of debt relief is most suitable within the ECB's legal framework.

Overall then, today's ECB meeting provided few surprises. **The ECB is satisfied that its recent monetary policy decisions are contributing to its medium term objective of returning inflation "towards levels below, but close to, 2%".**

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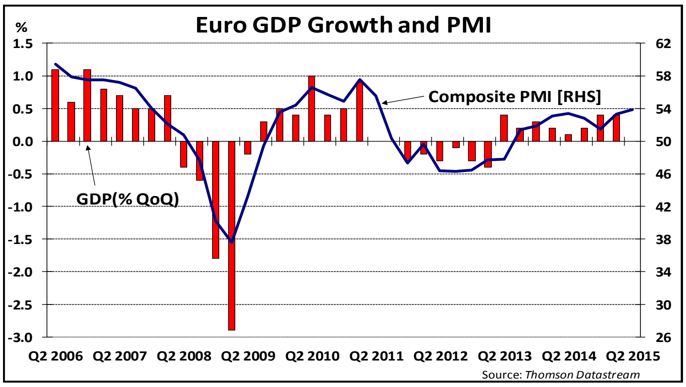
Economy maintained its pace of growth in Q2

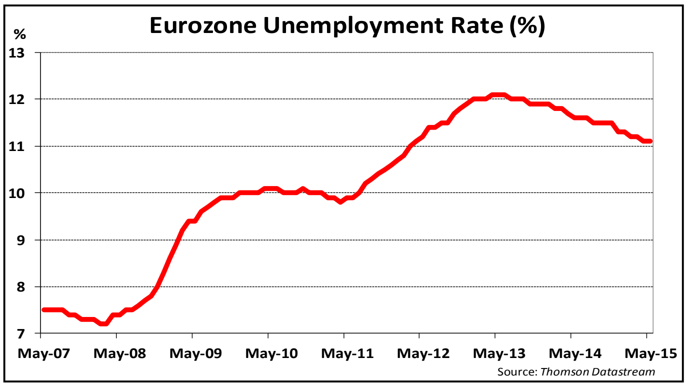
Eurozone GDP maintained its improved pace of growth in Q1, growing by 0.4% for a second consecutive quarter. On a year-on-year basis, growth edged up to 1% from 0.9%. The expenditure breakdown of GDP showed broad based improvement, though net trade did act as a slight drag. Also of some encouragement was the fact that growth in Q1 was less reliant on the performance of Germany, the currency bloc's largest economy (roughly 30% of GDP). While German growth slowed (0.3% from 0.7%), this was offset by improved growth in France (0.6% from 0%), Italy (0.3% from 0%) and Spain (0.9% from 0.7%), amongst others.

In terms of the performance of the Eurozone economy in Q2, leading indicators of activity suggest that it managed to maintain its momentum. The key composite PMI averaged 53.9 in the quarter, above the Q1 average of 53.3. The upbeat picture is also backed up by the EC economic sentiment index, which averaged 103.7 in Q2 compared to 102.6 in Q1. At a national level, important indicators such as the German Ifo, French INSEE and Italian ISTAT indices have also improved in Q2 compared to Q1.



The positive tone from the survey data is also being reflected in the 'hard' data for Q2. For example, retail sales data for April/May show that growth remained solid, picking up by 0.6% compared to Q1, in which sales grew by 0.7%. The underlying sales data show relatively broad based growth. Meantime, while industrial production declined by 0.2% in April/May versus Q1, this was largely due to sharp falls in energy output. Manufacturing, which excludes the energy sector, picked up, growing by 0.4% in April/May versus Q1.

The modest improvements in Eurozone activity in recent quarters have also benefited the labour market. The Eurozone unemployment rate has edged lower, standing at 11.1% in May, an over three year low. Although, this still represents a high level. Furthermore, there is quite a dichotomy in terms of individual member states labour market performance. The unemployment rate in Germany is at just 4.7%, compared to 10.3% in France and 22.5% in Spain.



Meanwhile, **the employment component of the Eurozone composite PMI strengthened again in Q2,** averaging 52.1 versus 51.5 in Q1, suggesting a firmer pace of job growth**.** The German PMI employment component slowed slightly in Q2, while it increased in France, Italy and Spain. Overall, we may see unemployment continue to edge lower over the coming months.

Meantime, **monetary aggregates have also been on a generally improving trend.** While annual growth in M3 money supply slowed slightly in May, at 5% it remains very encouraging. Growth has average 4.6% in 2015 so far, after averaging just 1.9% in 2014. Meantime, underlying growth in loans to the private sector continued to improve in May, picking up to 1% year-on-year, its best level since the start of 2012.

Overall, the Eurozone recovery still faces some significant headwinds. These include the continuation of tight fiscal policy, high levels of unemployment in many countries and a lack of structural reforms in some economies, which continue to act as restraints on the pace of activity. **However, there are also some tailwinds for the economy** including the favourable impact from lower oil prices, a weaker euro and the impact of recent monetary policy easing measures, with interest rates likely to remain at very low levels for the next few years. These factors are reflected in the fact that the ECB is expecting GDP growth of some 2% in 2016 and 2017.

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