

THE ECONOMIC SITUATION IN THE EURO AREA

LOWER GROWTH AND LOWER INFLATION

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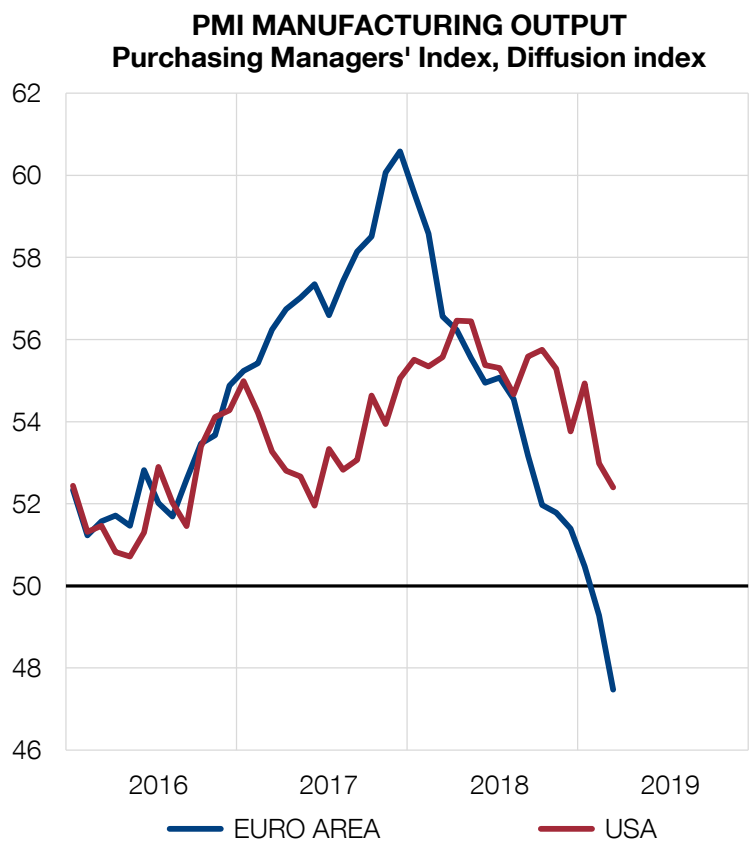
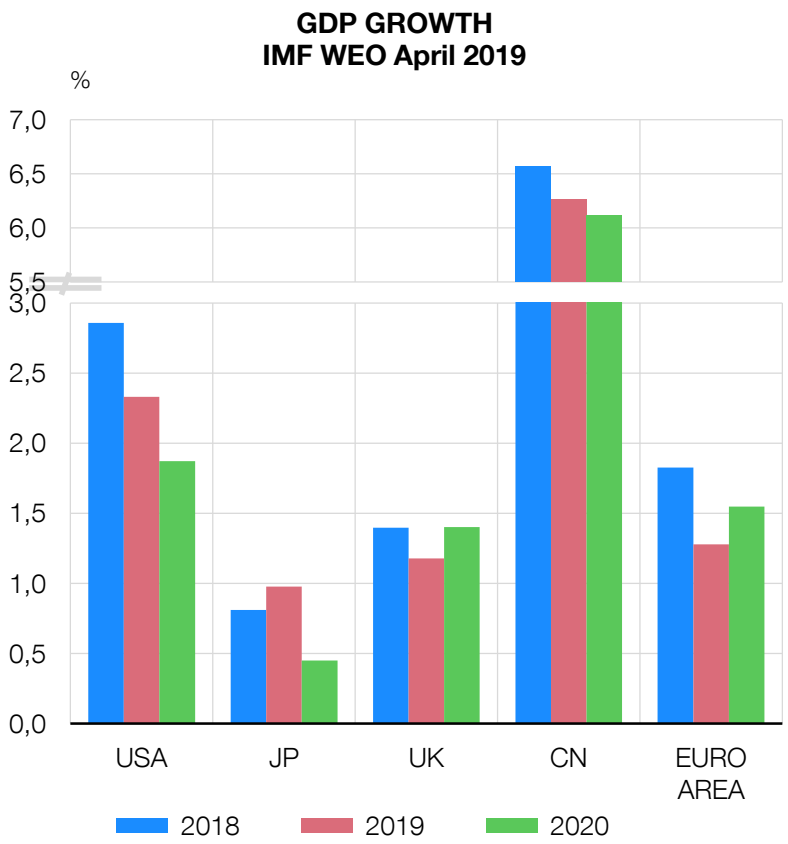
CVII REUNIÓN DE GOBERNADORES DE BANCOS CENTRALES DEL CEMLA

Cartagena de Indias, 29 y 30 de abril de 2019

GLOBAL GROWTH IS WEAKENING, PARTICULARLY IN THE EURO AREA



- Against a background of increasing policy uncertainty and weakening trade growth, the global economy is experiencing a slowdown. The weakening has been particularly intense in the euro area where the manufacturing sector is experiencing a contraction.



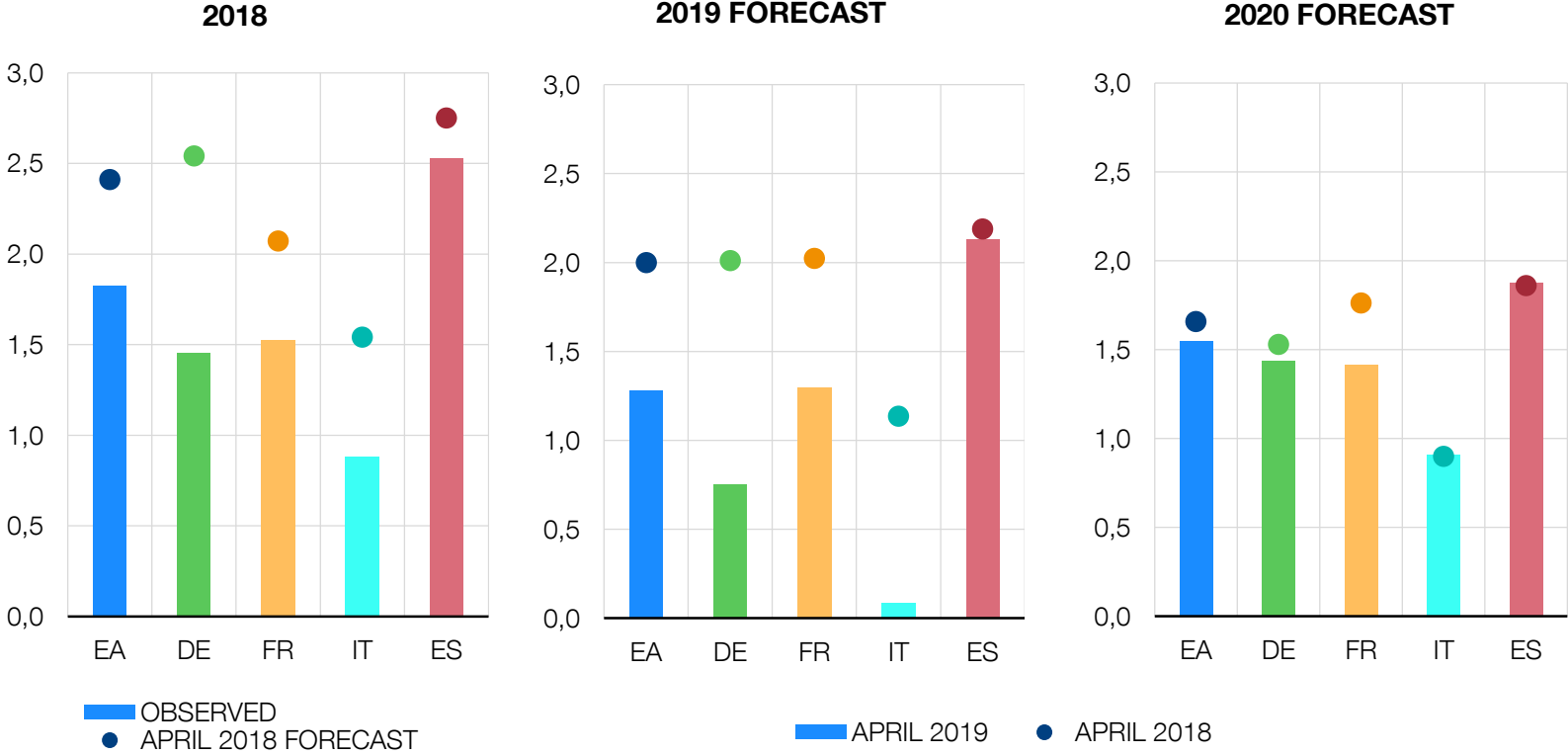
Sources: IMF and IHS Markit

THE SLOWDOWN AFFECTS LARGE COUNTRIES



- Economic growth in 2018 was well below of expectations in large countries (except Spain) and GDP growth forecasts for 2019 have been revised notably.
- In addition to external factors, a combination of specific factors exerted a more protracted effect than foreseen - new emission standards, social tensions in France and fiscal policy uncertainty in Italy-.

GDP GROWTH BY COUNTRIES (IMF FORECASTS)

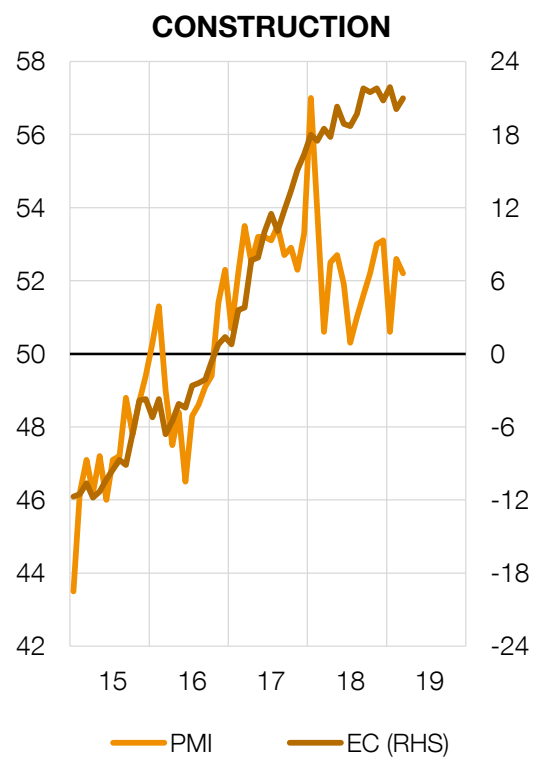
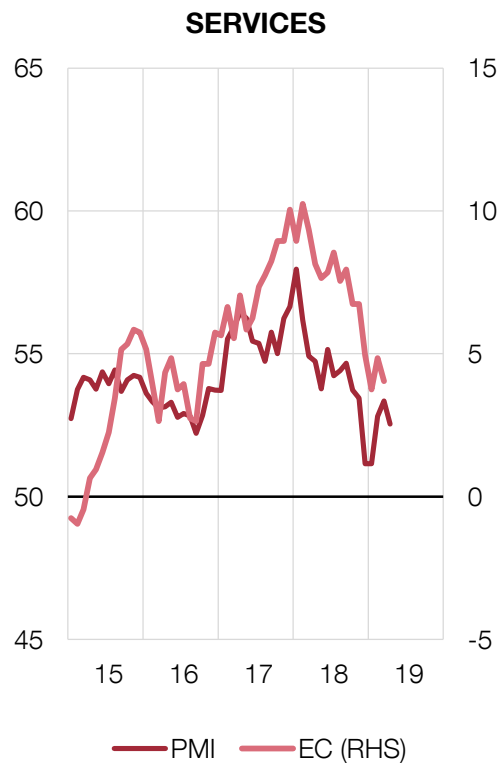
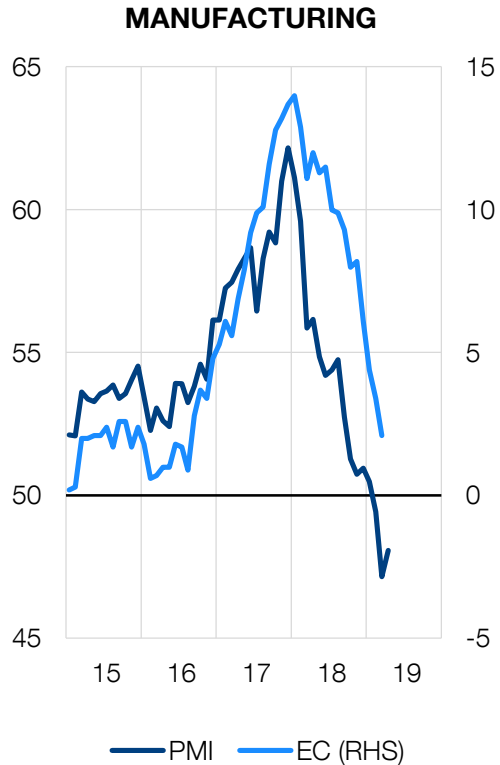


Source: IMF

WITH DIVERGENCES BETWEEN SECTORS



EURO AREA QUALITATIVE INDICATORS

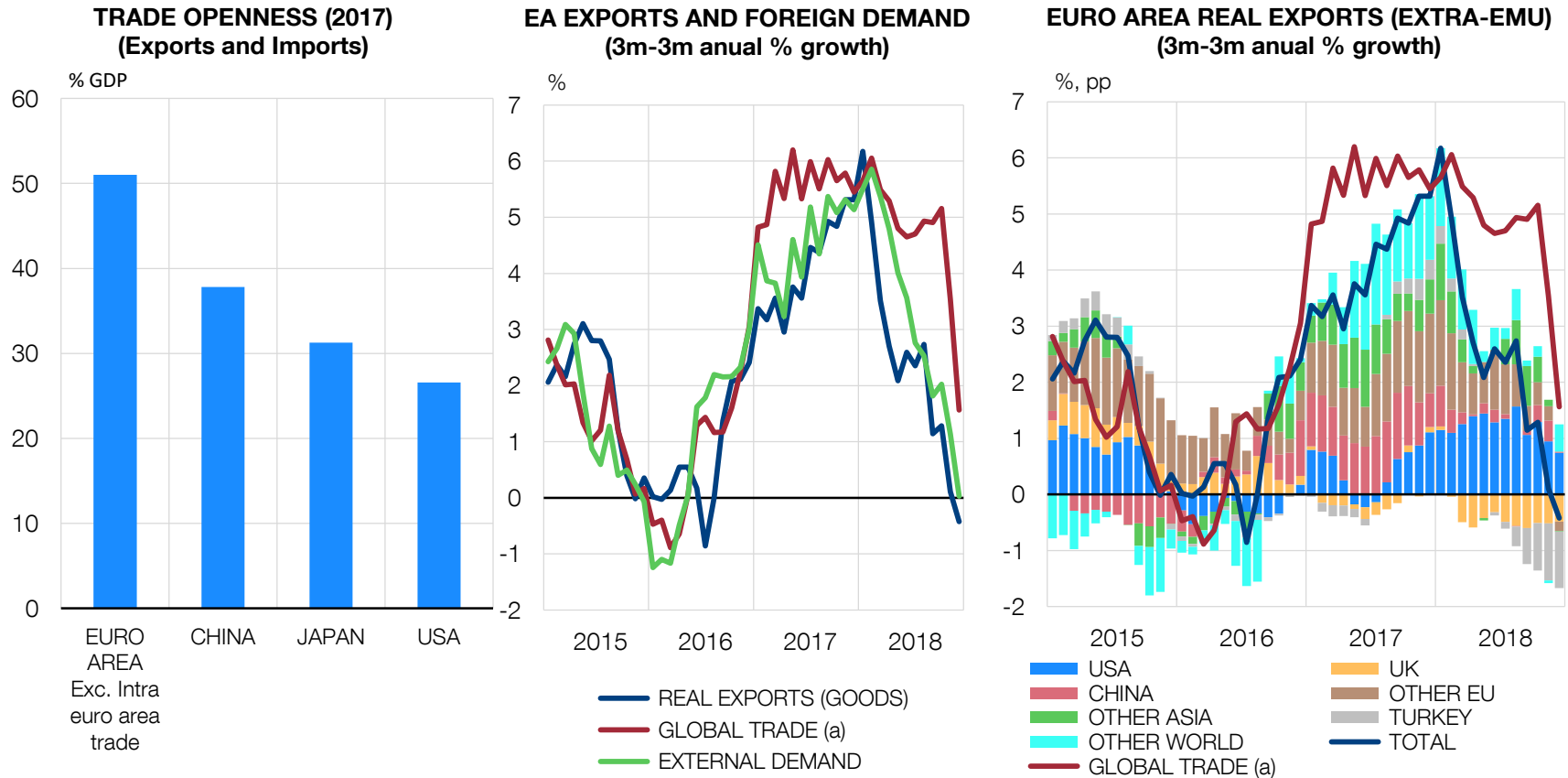


Sources: European Commission (EC) and IHS Markit (PMI)

THE EURO AREA IS PARTICULARLY EXPOSED TO GLOBAL TRADE MODERATION (I)



- Exports have slowed significantly, contributing to weaker than expected growth in the euro area.



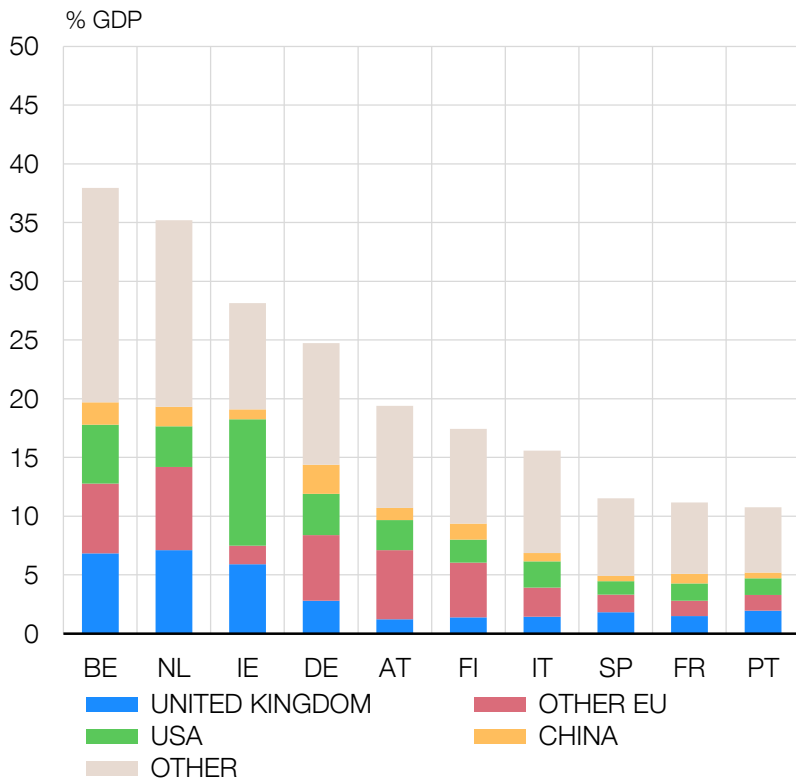
Sources: WTO, CPB and Eurostat
(a) Global imports excluding euro area

THE EURO AREA IS PARTICULARLY EXPOSED TO GLOBAL TRADE MODERATION (II)

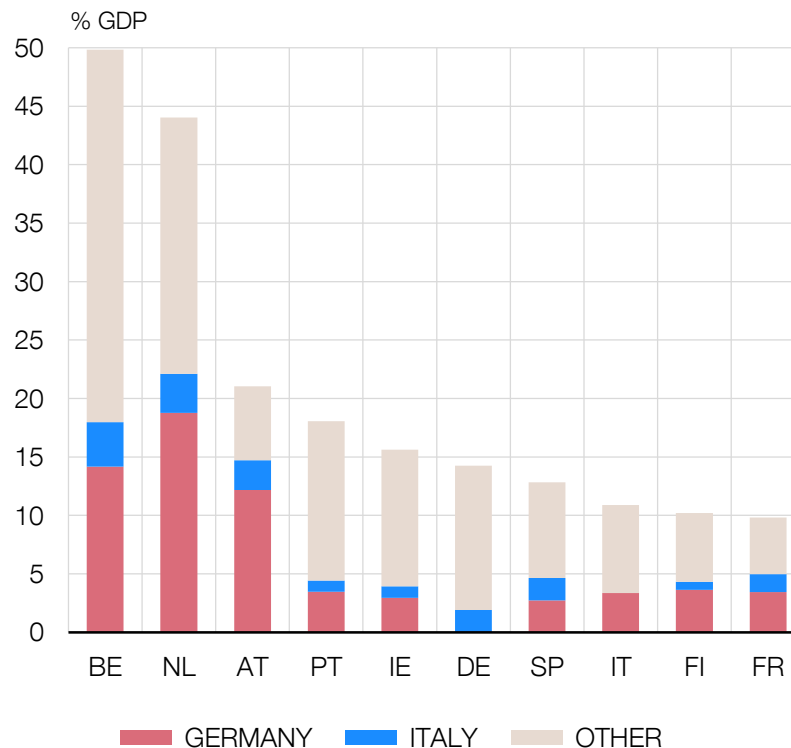


- Across countries, Germany and Italy are the two major economies which exhibit the biggest vulnerability to non-euro area markets (particularly to other EU members).

EXPOSURE TO EXTRA-EURO AREA MARKET



EXPOSURE TO INTRA-EURO AREA MARKET



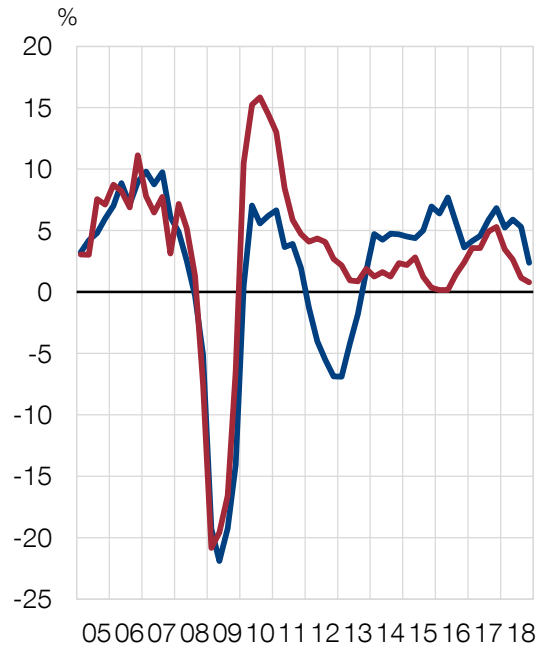
Source: Eurostat

PRIVATE INVESTMENT AND CONSUMPTION ARE ALSO SUFFERING



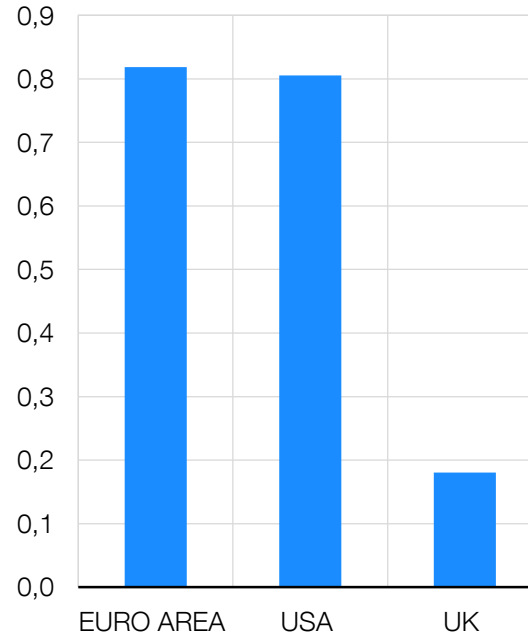
- Weakening exports combine with other domestic factors (production difficulties in industry, social unrest in France and policy uncertainty in Italy) to hinder economic growth in the euro area.

EURO AREA: INVESTMENT AND EXPORTS
(year-on-year- growth)

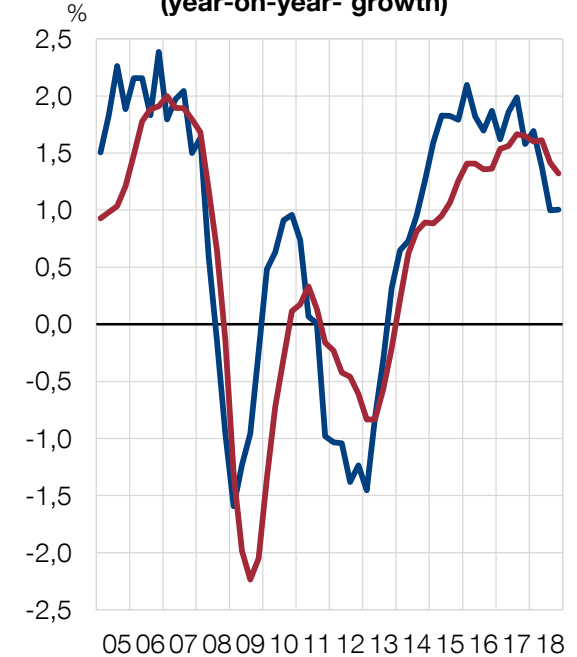


— GFCF (MACHINERY AND EQUIPMENT)
— EXPORTS OF GOODS (EXTRA EURO AREA)

EURO AREA: INVESTMENT AND EXPORTS CORRELATION
(year-on-year- growth)



EURO AREA: PRIVATE CONSUMPTION AND EMPLOYMENT
(year-on-year- growth)



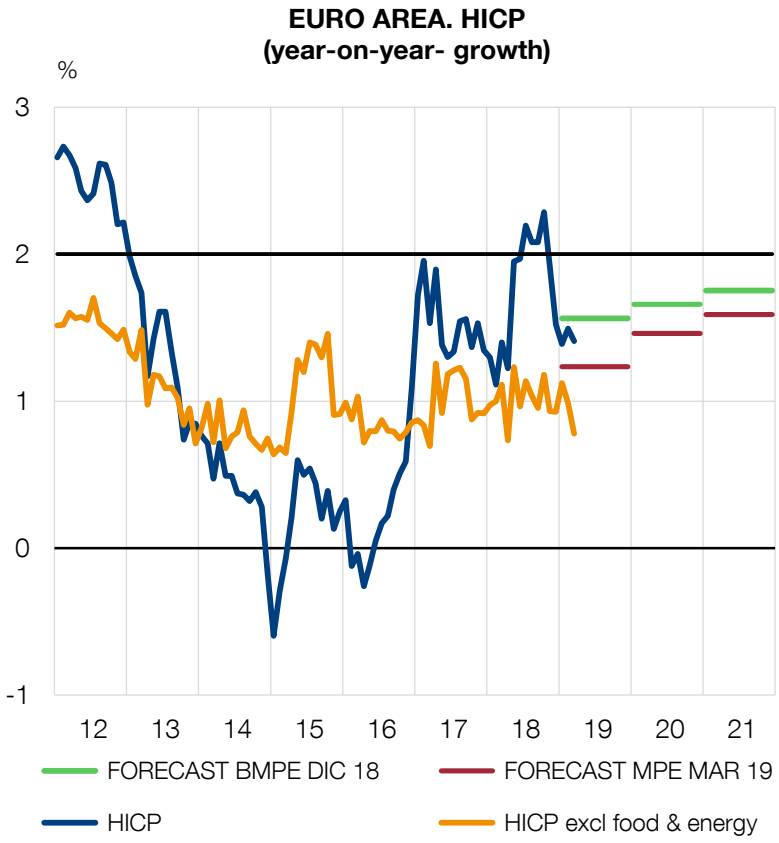
— CONSUMPTION — EMPLOYMENT

Sources: Eurostat and Datastream

INFLATION REMAINS SUBDUED...



- Inflation continues to surprise on the downside
- Long-term inflation expectations have fallen to fairly low levels, which is an important cause of concern.

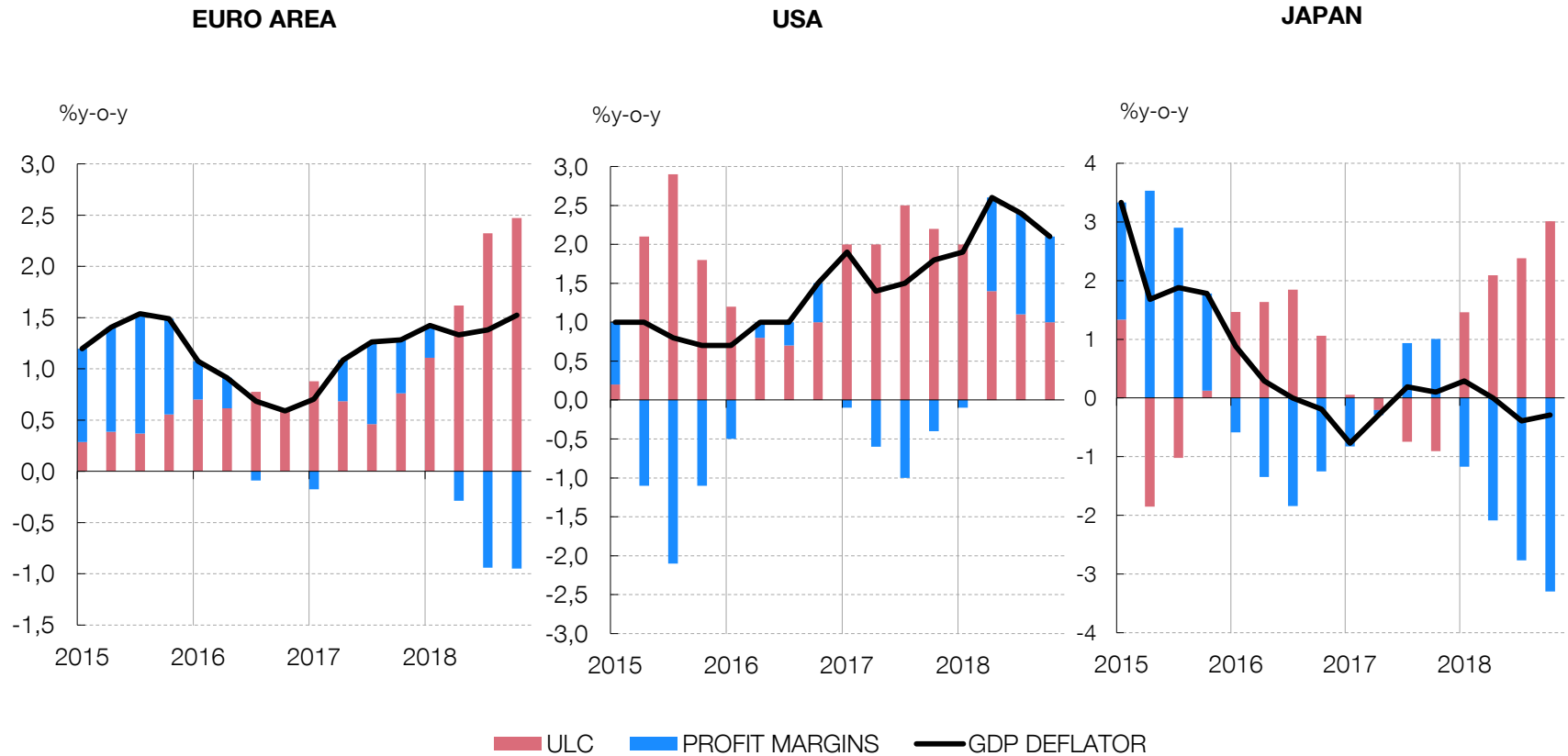


Sources: Eurostat, Datastream and ECB

...AS INCREASING LABOR COSTS DO NOT PASS THROUGH INTO HIGHER INFLATION AMID FALLING PROFIT MARGINS



- Labor costs increases did not result into higher inflation, as firms reduced their profit margins.



Source: Datastream

THE EXPANSIONARY PHASE IS EXPECTED TO CONTINUE AT A MORE MODERATE PACE, WHILE INFLATION WILL REMAIN SUBDUED



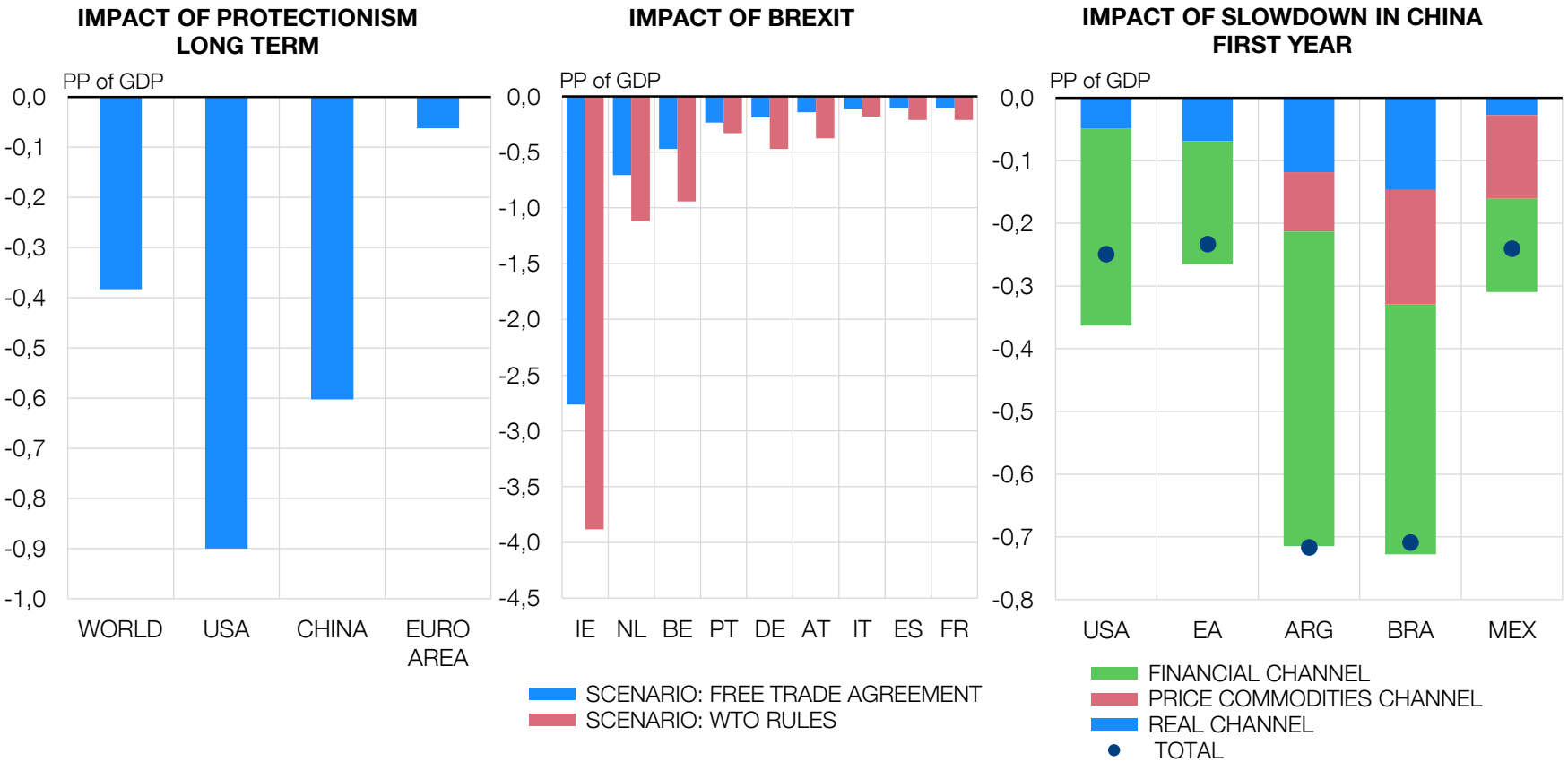
- After some temporary factors fade out, the expansionary phase in the euro area is expected to continue, supported by favorable financial conditions, increases in employment and wages and a more expansionary fiscal policy in some countries.
- On the external side, monetary policy accommodation in major central banks and fiscal stimulus in China could contribute to a recovery of global growth in the second half of 2019.
- Inflation will remain subdued in the medium term.

	MPE MARCH 2019				DIFERENCIA FROM BMPE DECEMBER 2018			
	2018	2019	2020	2021	2018	2019	2020	2021
REAL GDP	1.9	1.1	1.6	1.5	0.0	-0.6	-0.1	0.0
HICP	1.7	1.2	1.5	1.6	-0.1	-0.4	-0.2	-0.2
<i>Excluding energy and food</i>	1.0	1.2	1.4	1.6	0.0	-0.2	-0.2	-0.2

SUBSTANTIAL INTERCONNECTED RISKS EXISTS (I)



- i. Global weakness of manufacturing and trade tensions (cars, agricultural products, aerospace industries)
- ii. Uncertainty surrounding the Brexit outcome
- iii. Vulnerabilities in emerging markets and a more intense slowdown in China;

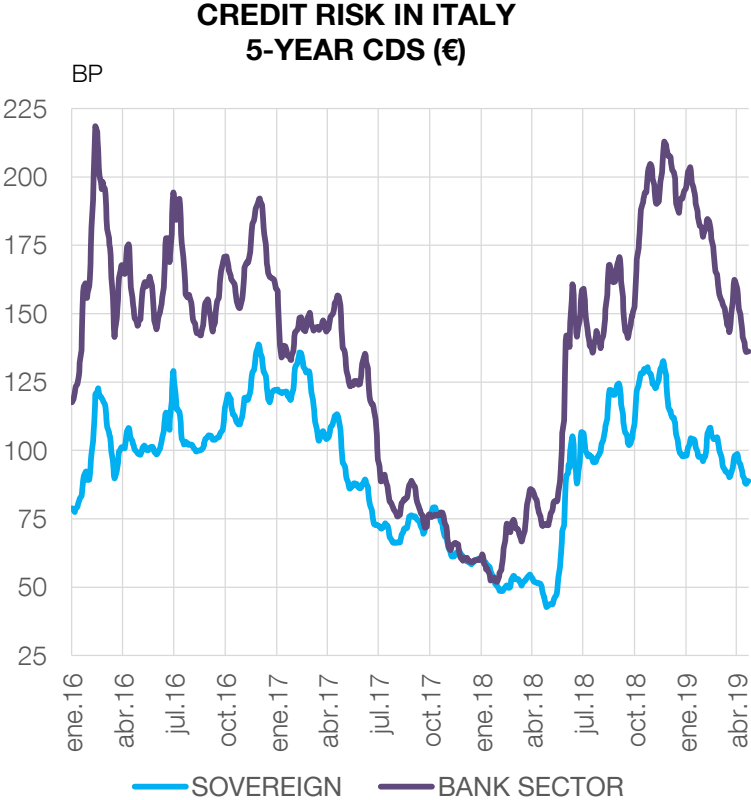


Sources: Banco de España, Bank of England, IMF, NIESR and UK Treasury

SUBSTANTIAL INTERCONNECTED RISKS EXISTS (II)



iv. Political uncertainty particularly in Italy, could derail growth. Sovereign yield spreads in Italy remain high. The economic recession and uncertainty over the Italian fiscal outlook could activate the sovereign-bank feedback loop and trigger adverse confidence effects on other countries.

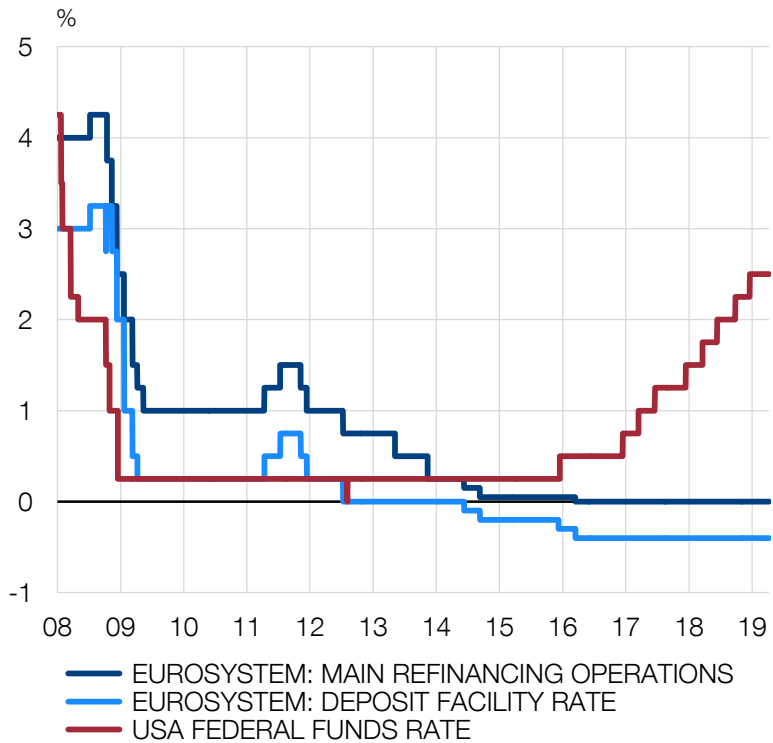


Source: Datastream

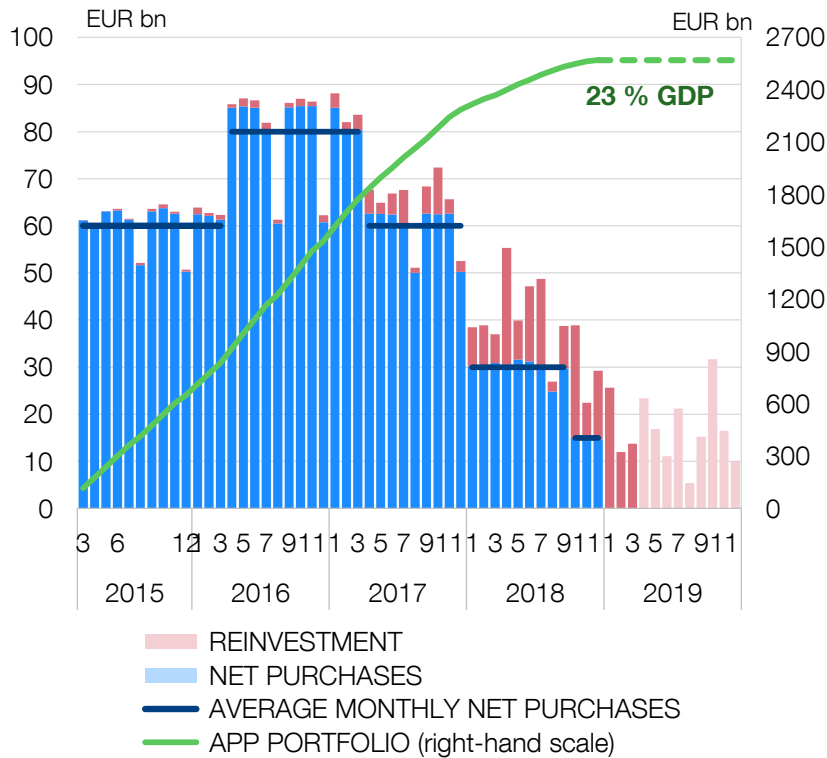
THE ECB MONETARY POLICY

- In December 2018, the ECB ended net asset purchases under the APP.
- Monetary policy remains very accommodative: reinvestments of APP portfolio, enhanced forward guidance and new TLTRO.

OFFICIAL INTEREST RATES



**ASSET PURCHASE PROGRAMME (APP)
Net asset purchases and reinvestments**



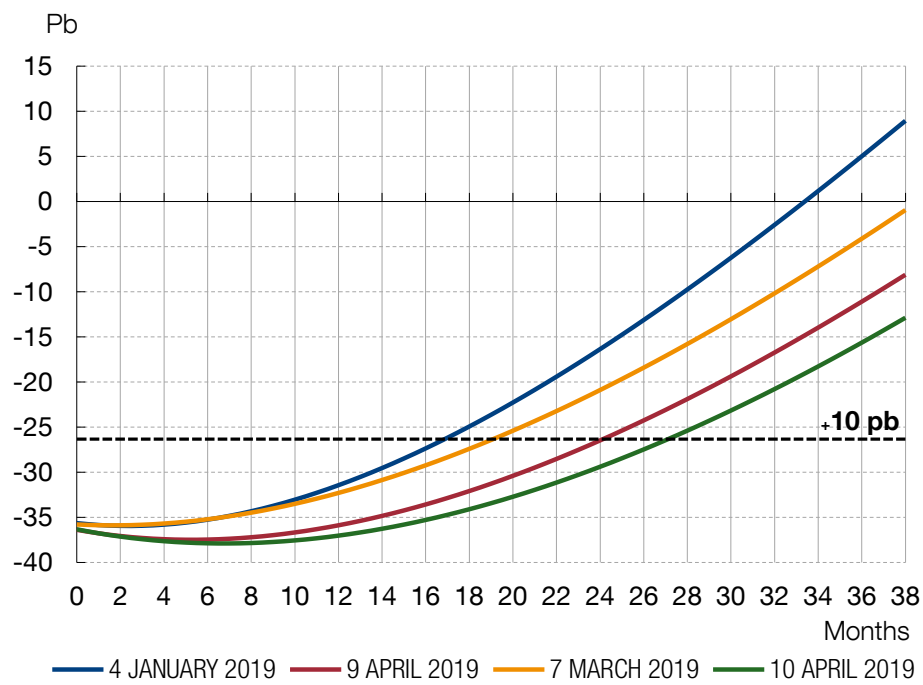
Source: ECB



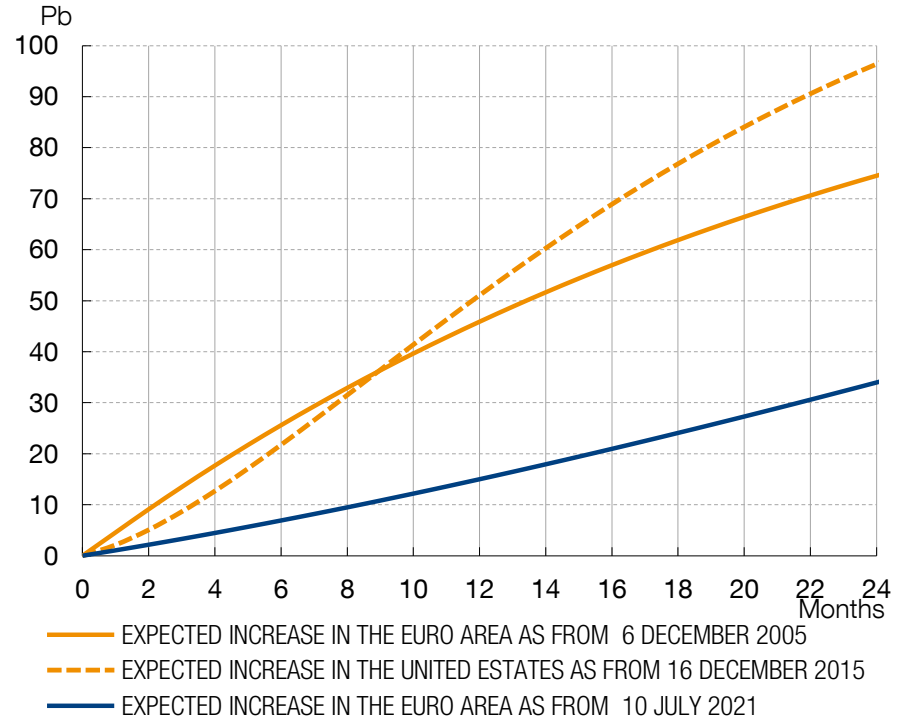
MARCH ECB GC: EXPECT OFFICIAL INTEREST RATES TO REMAIN AT THEIR PRESENT LEVELS AT LEAST THROUGH THE END OF 2019...

- Also relevant is the recent deterioration of the macro and inflation outlook, which have led markets to revise downwards their expectations of the future interest rates. The first increase (+10bp) is expected in July 2021 (27 months ahead) .
- The pace of the expected increase of the interest rates is slower than the one anticipated by the markets in the beginnings of previous cycles of interest rate increase in the Eurozone and USA.

LEVEL OF EXPECTED RATES IN THE EURO AREA WITHIN N MONTHS



EXPECTED INCREASE IN RATES IN N MONTHS AS FROM THE FIRST RISE

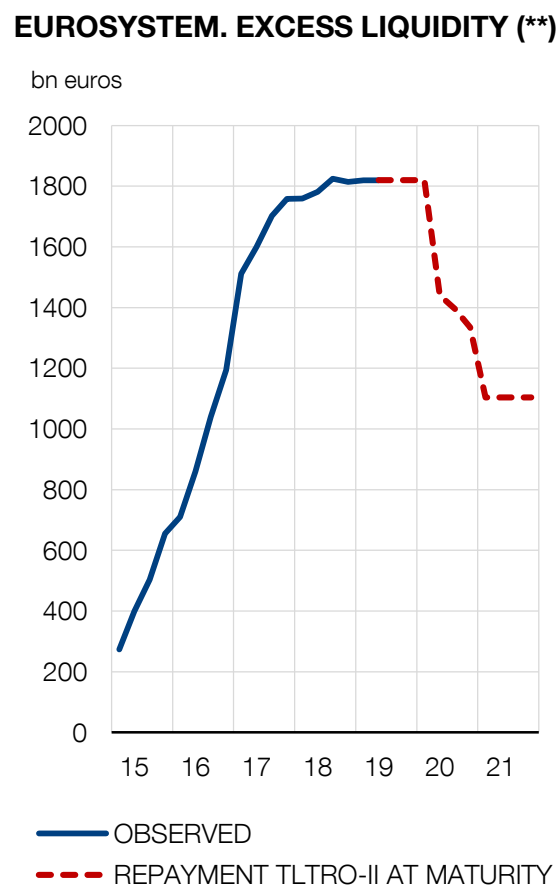
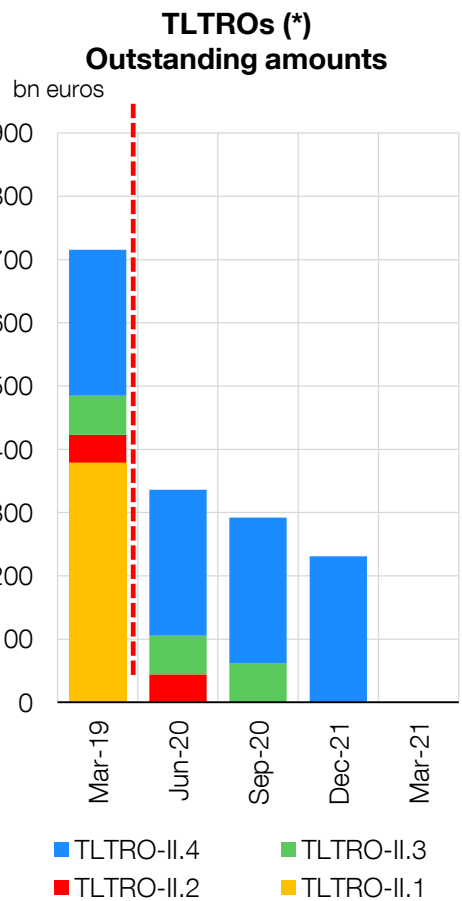
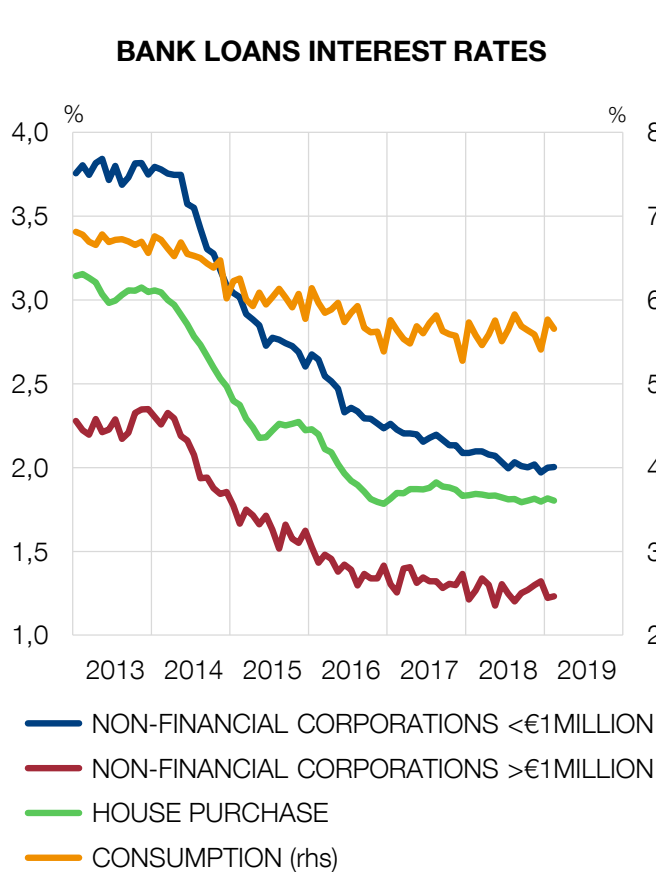


Source: ECB, Federal Reserve and Datastream. The left panel displays the OIS forward curve for the euro, which contains both an expectation term and a term premium

... AND ANNOUNCED A NEW TLTRO (III) PROGRAM WITH A MATURITY OF TWO YEARS



- These new credit operations should help to preserve favorable bank lending conditions and the smooth transmission of monetary policy.
- In the absence of the program, the balance sheet of the Eurosystem would shrink by more than 700 bn.



Source: ECB

* TLTRO holds for Targeted Longer-term Refinancing Operations

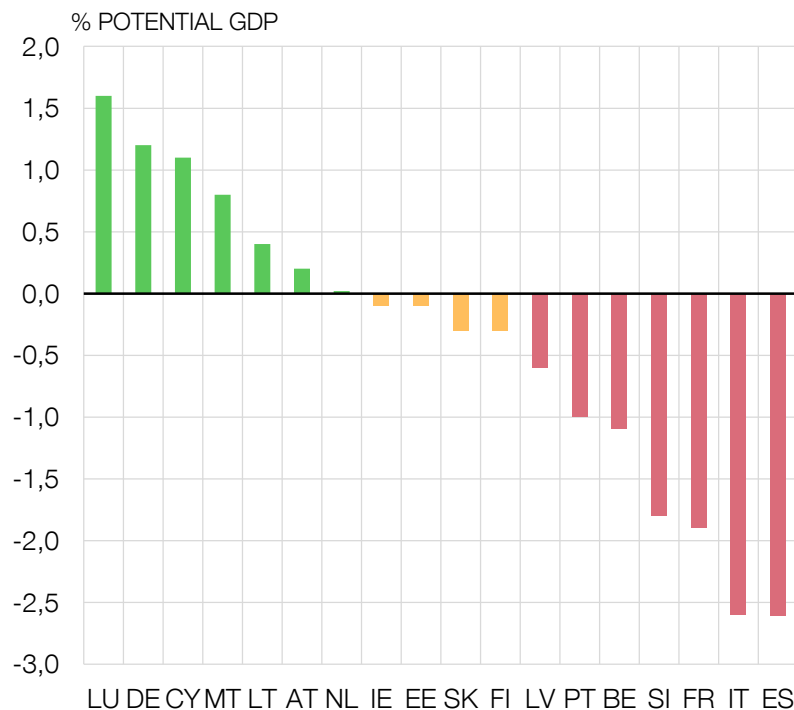
** Holdings of central bank reserves (current accounts and deposit facility) in excess of reserve requirements.

THE ROLE OF FISCAL POLICY IN THE SLOWDOWN

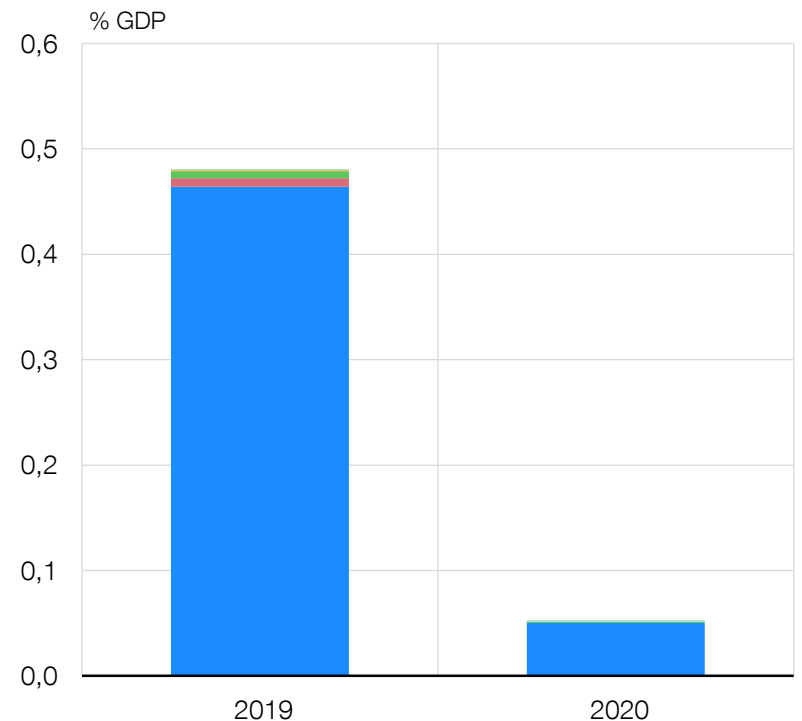


- Fiscal policy, particularly public investment would be able to provide some support for demand in those countries with fiscal space whose economic situation is significantly worsening (Germany).
- However, the euro area's current institutional architecture is not conducive to a coordinated budgetary action by its member countries.

FISCAL SPACE



IMPACT ON GDP. PUBLIC INVESTMENT GROWTH EQUAL TO FISCAL SPACE IN 2019



Source: European Commission and Eurosystem

THE EURO AREA FACES IMPORTANT CHALLENGES



- Domestic uncertainty is high and could weaken growth, particularly in Italy.
- In the high-debt countries, public debt loads are leaving insufficient fiscal space to respond to possible shocks, while productivity gaps remain wide, retarding per capita income convergence. Potential growth is low and structural reforms are needed to improve resilience.
- Although some steps towards a genuine Economic Monetary Union have already been taken in recent years, the architecture is still incomplete and vulnerabilities remain. Further progress to complete the Banking Union is a priority:
 - Further progress on risk reduction
 - Creation of a common European Deposit and Insurance Scheme (EDIS)
 - Deliver on the Capital Markets Union initiatives



APPENDIX

MONETARY POLICY DECISIONS OF THE GC OF ECB FROM MARCH 7, 2019

1. **Interest rates:** The Governing Council now expects the key ECB interest rates to remain at their present levels **at least through the end of 2019**
2. **Reinvestment: without changes, with the exception of updates in forward guidance**
 - *“The Governing Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates”*
3. **TLTRO-III:** a new series of quarterly targeted longer-term refinancing operations
 - will be launched, **starting in September 2019 and ending in March 2021**, each with a maturity of **two years**
 - counterparties will be entitled to borrow **up to 30% of the stock of eligible loans as at 28 February 2019 at a rate indexed to the interest rate on the main refinancing operations** over the life of each operation
 - TLTRO-III will offer **incentives for credit conditions to remain favorable**
 - **Further details on the precise terms of TLTRO-III** will be communicated in due course
4. **Full allotment:** The Eurosystem lending operations will continue to be conducted **as fixed rate tender procedures with full allotment** for as long as necessary, **and at least until** the end of the reserve maintenance period starting in March 2021