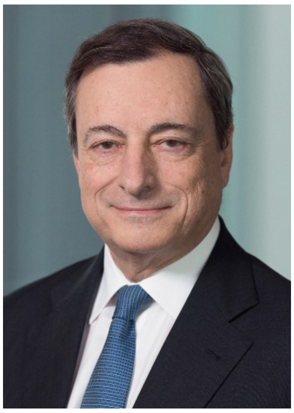
EUROPEAN CENTRAL BANK

EUROSYSTEM

# Annual Report

2017

# The year at a glance



In 2017, the economic recovery in the euro area developed into a solid and broad-based expansion. The **economy grew by 2.5%** and by the end of the year had recorded 18 straight quarters of growth. This represented the strongest expansion for a decade, and the broadest for two decades. The **dispersion of growth rates among euro area countries fell** to its lowest level since the start of Monetary Union.

Robust growth ensured that the recovery in the labour market continued apace. **Employment rose by 1.6%** to reach its highest level ever, buoyed by record participation rates for women and older people. Unemployment fell to its lowest level since January 2009. Overall, 7.5 million jobs have been created since mid-2013, offsetting the total number of jobs lost during the crisis.

As in previous years, the ECB’s monetary policy played a central role in this recovery and convergence story. In 2017, past asymmetries in the transmission of our monetary policy largely disappeared and financing conditions stabilised at record lows across the euro area. This contributed to the strongest increase in the growth of credit to the private sector since the crisis began in 2008.

The robust performance of the real economy, however, was not matched by developments in inflation. While **headline inflation** recovered from its past lows, **averaging 1.5%** over the year, domestic price pressures remained muted and underlying inflation lacked signs of a sustained upward trend.

The differing outlooks for growth and inflation shaped the ECB’s **monetary policy decisions** during the year, leading us to recalibrate our asset purchase programme.

In October, the Governing Council decided to further reduce the pace of asset purchases from €60 billion to €30 billion per month, but to extend the programme by at least nine months until September 2018. Additionally, in March 2018 the Governing Council removed from its official communication the explicit reference to its readiness to expand the asset purchase programme if the outlook became less favourable.

The Governing Council's decisions reflected its increased confidence in the outlook for the economy, in which context an unchanged policy stance would have become increasingly expansionary. But they also acknowledged that patience was needed for inflationary pressures to build up, and that persistence was necessary in our monetary policy for inflation dynamics to become durable and self-sustained.

Though monetary policy is having its intended effects, it can also produce side effects. The ECB therefore continued to closely monitor **financial stability risks** in 2017, which appeared to be contained.

Stronger nominal growth helped reduce risks by improving the debt sustainability of firms and households. Debt ratios in both sectors dropped to their early 2008 levels, indicating that the recovery has not come at the price of re-leveraging in the private sector. In fact, for virtually the first time since the start of Monetary Union, private spending has risen while private indebtedness has fallen.

For banks, too, the improving economy offered a window of opportunity to further strengthen their balance sheets. The stronger economy helped stabilise profitability through higher business volumes and lower impairment costs. Banks' shock-absorbing capacity continued to rise, with Common Equity Tier 1 ratios reaching 14.5% in the third quarter of 2017, and asset quality improved.

Euro area banks accelerated their reduction of **non-performing loans (NPLs)**, which decreased from 8% of total loans in 2014 to 5.2% in the third quarter of 2017. NPLs fell by €119 billion in the first three quarters of 2017 alone, with loan sales in secondary markets making up an increasing share of disposals. This was helped by ECB initiatives to improve transparency in NPL markets. However, further efforts to reduce high NPL stocks remain necessary.

The ECB also continued to monitor financial market conditions. Markets were relatively calm in 2017, but remained vulnerable to an abrupt repricing of risk and increases in financial market volatility. These risks materialised in global equity markets in early 2018, although to date without significant spillovers to euro area credit markets and hence broader financial conditions.

2017 saw important developments in the payments architecture of the euro area as well. The final wave of migration to **TARGET2-Securities** was completed, and the platform processed an average of 556,684 transactions per day thereafter. The new €50 banknote was launched, improving payment security for euro area citizens, for whom cash remains the primary means of payment at points of sale.

Finally, the ECB took a number of steps to improve its **transparency and accountability** towards EU citizens. We answered 138 questions from Members of the European Parliament in 2017. We opened our new Visitor Centre, which is expected to host 40,000 people a year. Our website had visitors from all over the world and was viewed over 17 million times.

Looking ahead, we expect the pace of economic expansion to remain strong in 2018. While we remain confident that inflation will converge towards our aim over the medium term, there are still uncertainties about the degree of slack in the economy.

A patient, persistent and prudent monetary policy therefore remains necessary to ensure that inflation will return to our objective.

Frankfurt am Main, April 2018

Mario Draghi
President