

THE GOVERNOR'S MESSAGE¹

1 Finalised mid-June 2016.



In 2015, the economic recovery in the euro area has continued. Although this recovery has firmed up, downside risks remain. Inflation has remained very low and is expected to increase only gradually.

Against the background of very low inflation, the Governing Council of the European Central Bank (ECB) has taken additional measures. On 22 January 2015, it announced the introduction of an expanded asset purchase programme targeting both private and public securities. When inception, this programme included the asset backed securities and covered bonds purchase programmes introduced in 2014 as well as a new programme targeting public sector securities. While the initial monthly purchases under the asset purchase programme amounted to €60 billion, they were increased to €80 billion in March 2016.

The expanded programme introduced in January 2015 was subsequently widened twice. On 3 December 2015, the Governing Council decided to broaden the list of assets eligible under the public sector purchase programme. In its 10 March 2016 meeting, it decided to widen the programme again by including securities of the corporate sector from June 2016. These purchases pertain to investment grade securities issued by non-bank corporations established in the euro area.

The purchases made under the expanded asset purchase programme are intended to run until the end of March 2017, or beyond if necessary. The objective of the programme is a sustained adjustment in the path of inflation that is consistent with the definition of price stability, defined as inflation rates below, but close to 2% over the medium term. The Governing Council expects that the Eurosystem's policy rates will remain at their current level, or lower, over a prolonged period of time and well beyond the horizon of the asset purchase programme.

Following the introduction of the first series of targeted longer-term refinancing operations in 2014, the Governing Council decided in March 2016 to introduce some changes and to launch a second series of such operations from June 2016 to incentivise the banks to grant loans to the real economy.

The Governing Council also decided to lower the interest rate on the deposit facility to -0.3% in December 2015 and to -0.4% in March 2016. The Governing Council also decided to leave the interest rate on the main refinancing operations unchanged at 0.05% in 2015 and to lower it to 0%, an historic low, in March 2016. Hence, both conventional and unconventional monetary policy measures have continued to underscore the accommodating stance of the Eurosystem's monetary policy. Through these new measures, the Governing Council has reiterated its commitment to prevent any risk of disinflationary trend.

The year 2015 also witnessed changes in the ECB's governance.

First, with Lithuania joining the euro area on 1 January 2015, a rotation scheme of voting rights among the governors of the national central banks, which had been designed some time ago, came into force. In this system, central bank governors currently fall into two groups. The governors of the first group, emanating from the larger countries, vote with a frequency that is slightly higher than the governors that are part of the second group. The members of the Executive Board have a permanent voting right. It is important to note that the governors who do not have a voting right at a certain moment in time can still participate in the discussions and that the decision-making process in the Governing Council remains based on consensus.

Second, the Governing Council decided to publish regular accounts of its monetary policy meetings. These accounts, which aim to provide more information about the underlying reasoning leading to monetary policy decisions, are published four weeks after every monetary policy meeting. Since 1 January 2015, such meetings take place every six instead of every four weeks.

The Single Supervisory Mechanism, the first pillar of the Banking Union, has functioned well since its inception in November 2014. The *Banque centrale du Luxembourg (BCL)* participates in the decision-making process of the Single Supervisory Mechanism at the level of the Governing Council, the Supervisory Board and various committees and working groups. The BCL also assists the ECB directly in Joint Supervisory Teams (JSTs), especially for the supervision of liquidity. In 2015, the number of banks directly supervised by the ECB increased from 123 to 129. In Luxembourg, this number increased from five to six. One of the challenges at the European level is to continue harmonising supervision practices in

the countries participating in the Mechanism. A first Regulation aimed at harmonizing the exercise of national options and discretions that are provided for by Union law has been adopted by the ECB.

On 1 January 2016, the Single Resolution Mechanism, the second pillar of the Banking Union, has become operational. It applies to the countries that participate in the Single Supervisory Mechanism and is composed of a Single Resolution Board and a Single Resolution Fund. While the former is the resolution authority of the Banking Union and has as a mission to prepare and implement the resolution of banks that are likely to fail or have failed, the latter aims to guarantee the availability of funds that are necessary to finance the restructuring or the resolution of banks. Initially, these financial resources will be provided by credits institutions at the national level. An intergovernmental agreement, which entered into force on 1 January 2016, foresees the gradual pooling of these national funds among countries that are signatories to the agreement in order to achieve the full capacity of the Single Resolution Fund on 1 January 2024.

As for the third pillar of the Banking Union, the European Deposit Insurance Scheme, the European Commission has introduced a draft regulation aiming to pool the national schemes by the year 2024.

The preparation of the Capital Markets Union, which, together with the Banking Union, aims to create a European Financial Union, has been ongoing, notably with the draft regulations on securitisation presented by the European Commission.

On 25 November 2015, the Eurosystem issued the new €20 banknote of the “Europa” series. After the €5 and €10 banknotes, this is the third banknote issued under the new series launched in 2013. On 4 May 2016, the Governing Council decided to discontinue the production of the €500 banknote. Hence, the “Europa” series will not include the €500 banknote. The issuance of the €500 denomination will end toward the end of 2018 but the banknote will remain legal tender and it will continue to be exchangeable during an unlimited period of time at the central banks of the Eurosystem. This decision does not impact other denominations and the Eurosystem will take the necessary measures to ensure the availability of other denominations is sufficient.

In Luxembourg, the financial institutional framework has been modified to implement the decisions taken at the European level.

The “Systemic Risk Committee” was established by a law of 1 April 2015. It is composed of the Minister whose area of responsibility includes the financial centre, who chairs the Committee, the Director general of the *Commission de surveillance du secteur financier (CSSF)*, the Director of the *Commissariat aux assurances* and the Governor of the BCL. The Secretariat, which is notably in charge of drafting and publishing the recommendations, opinions and warnings issued by the Committee, is provided by the BCL, under the direct authority of its Governor. In 2015, the Committee issued three recommendations and one opinion. The Committee’s work is described in its annual report.

The law of 18 December 2015 on the measures pertaining to the resolution, restructuring and liquidation of credit institutions and certain investment companies as well as to the deposit guarantee and investor compensation schemes has introduced new decision-making bodies.

For the resolution of banks, the law has created a “Resolution Council” within the CSSF as well as a new public institution, the “Resolution Fund Luxembourg”. Concerning the guarantee of deposits, the law has replaced the “Deposit Guarantee Association, Luxembourg”, a private system that was not prefunded, with a prefunded public system. The new system comprises, within the CSSF, the “Council of Protection of Depositors and Investors” and the “Deposit Guarantee Fund Luxembourg”. Through the law, the Governor of the BCL has received four new mandates. Henceforth, he sits on the four newly-created bodies, without prejudice to his independence.

The widening and the deepening of the BCL’s missions have continued to be a challenge in terms of organisation, staffing and financial resources. The BCL’s very low capital is incompatible with the necessity to cover its commitments adequately. These notably include the provisions for the coverage of asset-related risks, the provisions required to entirely finance the legal pensions (1st pillar) of all staff and the increasing staffing needs.

In relation to its total balance sheet, the BCL’s capital is insufficient, both in absolute and in relative terms compared to the other central banks of the Eurosystem. Against this background, the Prime Minister announced in March 2015 that a gradual and sustainable solution would be sought to endow the BCL with adequate capital. Since then, a dialogue has taken place among the parties involved and the efforts to find a solution that is acceptable to all parties have been

sustained. Such a solution will have to be consistent with the BCL's independence, including its financial independence, and take into account the economic context and the situation of the public finances.

In 2015, the BCL signed a cooperation agreement with the Toulouse School of Economics. Through the financing of a Chair labelled "Aggregate Stability and Central Banks", the agreement aims to promote research in the areas of macroprudential analysis and virtual currencies. This approach is consistent with the BCL's endeavour to achieve a level of excellence in the areas of research that are of particular interest to its missions.

Finally, the BCL has sustained its efforts to better communicate on its activities. Against this backdrop, its new website, which is more comprehensive and more user friendly, went live in December 2015. In the same vein, the BCL launched a visitors' programme aimed at presenting the Bank's national and European missions and the history of money in Luxembourg. In 2015, the BCL also participated in the launch of the initiative "The week of money" (*D'Woch vun de Suen*) by offering an independent programme aimed first and foremost at allowing groups of schoolchildren to get acquainted with euro banknotes and coins. In light of the success of its first participation, the BCL organized an extended programme for the 2016 edition.

To conclude, I would like, together with the two other members of the Executive Board, thank the staff for their commitment and the quality of their work, in an institution that is both European and national and the missions of which are permanently deepening and widening.

A handwritten signature in dark ink, consisting of a vertical line on the left, a horizontal line extending to the right, and a small dot above the horizontal line.

Gaston Reinesch