Market Bulletin

8 March 2018

European Central Bank meeting: Subdued inflation to keep policy accommodative

The European Central Bank (ECB) met today and kept policy unchanged. The key interest rates—the refinancing rate and the deposit rate—were held at 0% and -0.4% respectively. The ECB is still purchasing assets under its quantitative easing (QE) programme at a rate of Euro 30billion per month. It will continue at this pace until September at least.

President of the Council Mario Draghi stressed that despite robust growth there is still little sign that inflation is moving back towards the target of close to but below 2%. Indeed, the new forecasts revised growth up slightly this year but revised down inflation (see **Exhibit 1**). In three years' time inflation still sits well below the target. Mr Draghi argued that "patience and persistence" was required with current policy.

EXHIBIT 1 : European Central Bank staff macroeconomic projections for the euro area

	Real GDP (y/y)			HICP inflation (y/y)		
Meeting	2018	2019	2020	2018	2019	2020
Dec-17	2.3%	1.9%	1.7%	1.4%	1.5%	1.7%
Mar-18	2.4%	1.9%	1.7%	1.4%	1.4%	1.7%
Change	+0.1%	-	-	-	-0.1%	-

Source: European Central Bank. Data as of 8 March 2018

The meeting took place against a backdrop of escalating tensions between the US and other large economies over trade and tariffs. When questioned over this issue Mr Draghi responded by saying that "If you're going to put tariffs up against your allies one has to wonder who your enemies are?". He argued that an escalation of tensions would reduce the outlook for global activity and have implications for policy.

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The meeting and press conference was perceived as slightly dovish by the markets. The Euro to U.S. dollar exchange rate fell slightly during the press conference and the major European bourses were up between 0.5% and 1%.

The market did not expect a major shift of tone at this meeting but it has been considering whether the European economic recovery could lead to the ECB ending its QE programme and taking steps towards tighter policy over the course of the year. In our view, there are cyclical and structural forces that will continue to bear down on inflation in the eurozone, including a sizeable amount of slack in the labour market. As a result we believe the ECB will not be shifting away from very accommodative policies until the second half of 2019. Low interest rates, coupled with an ongoing improvement in the health of the European banking system, will continue to provide a tailwind for the economy and in turn European corporate earnings.

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