Market Bulletin

13 December 2018

European Central Bank meeting: Quantitative easing is coming to an end but low rates likely to persist

Today the European Central Bank (ECB), at its final monetary policy meeting of the year, confirmed that it will cease net asset purchases at the end of this year, in line with its previous guidance. The ECB kept its key interest rates unchanged and also kept the forward guidance on its deposit rate the same. They also produced new macro-economic projections that include forecasts for 2021.

European Central Bank President Mario Draghi had previously stated that the central bank's key interest rates would stay at their present levels "at least through the summer of 2019". There was no change to this forward guidance on rates but he did acknowledge some of the risks to growth. These downside risks could postpone the move away from negative rates. While we are seeing the end of new net purchases, the ECB will reinvest its maturing bonds for an extended period of time beyond the date when it starts to raise interest rates.

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

	Real GDP (y/y)				HICP inflation (y/y)			
Meeting	2018	2019	2020	2021	2018	2019	2020	2021
Sep-18	2.0%	1.8%	1.7%	-	1.7%	1.7%	1.7%	-
Dec-18	1.9%	1.7%	1.7%	1.5%	1.8%	1.6%	1.7%	1.8%
Change	-0.1%	-0.1%	0.0%	-	0.1%	-0.1%	0.0%	-

Source: European Central Bank, J.P. Morgan Asset Management. Data as of 13 December 2018

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While Draghi highlighted some risks to the growth outlook he remained positive on the strength in domestic demand and was constructive on the inflation outlook. Eurozone wage growth of 2.5% year-over-year—the highest since 2008—caused the ECB to remain confident that core inflation will rise. Although, headline inflation is expected to be below target over the next few years, the strength in wage growth means they expect both headline and core inflation to converge towards target and reach 1.8% by 2021.

The latest forecasts produced show a small downgrade to real GDP growth for 2018 and 2019 by 0.1% and for growth to slow towards 1.5% by 2021. The ECB has continued to describe the European economic expansion as being supported by the strength of the domestic economy. However, the balance of risks is moving to the downside, primarily due to increased geopolitical uncertainty and weaker economic data.

If the weakness in economic momentum and external demand persists, the ECB may be forced to keep rates on hold beyond next summer. In which case, negative interest rates will continue to pose a challenge for the profitability of Europe's banks for some time yet.

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