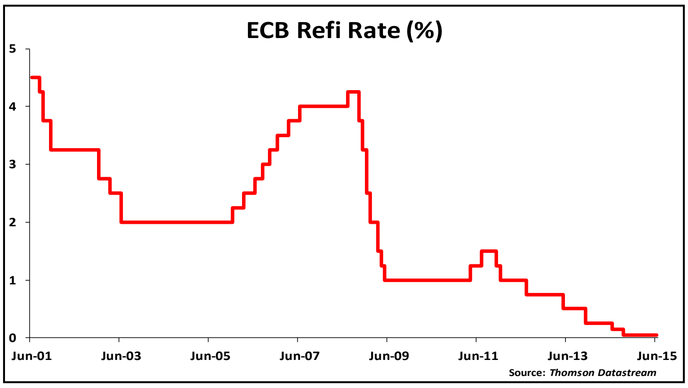
ECB Watch

3rd June 2015

AIB Treasury Economic Research Unit

ECB remains committed to QE programme

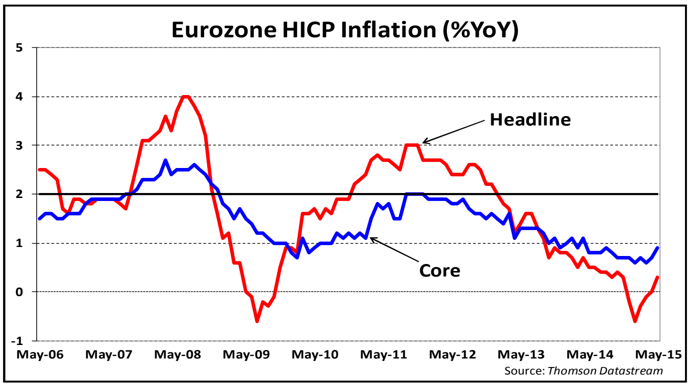
As expected, there were no changes to monetary policy following today's ECB meeting, with the Governing Council's QE programme locked in. Thus, purchases will continue to run at a rate of €60 billion per month until at least September 2016.



ECB President Draghi reiterated today that **the QE programme will be conducted until there is "a sustained adjustment in the path of inflation that is consistent with our aim of achieving inflation rates below, but close to, 2%".** HICP inflation currently stands at just 0.3% and is anticipated to remain very subdued in the coming months.

In his post-meeting press conference, President Draghi stated that the ECB's monetary policy measures are contributing to "a recovery in inflation expectations". **The latest ECB staff economic forecasts, released today, showed a slight upward revision to the forecast for inflation for this year from 0% to 0.3%.** Although, the forecasts for 2016 and 2017 remained unchanged at 1.5% and 1.8%, respectively.

While it is still early days in the lifetime of QE, indications are that it is generally having the desired effect. Interest rates remain low across the Eurozone, with Greece being the notable exception. QE has also put downward pressure on the euro, giving a boost to the competitiveness of Eurozone exports. While we have seen a steepening of Eurozone yields curves recently, as concerns over deflation ease and activity picks up, **the QE programme should help to limit the upward pressure on long-term yields.**



The ECB continues to see the risks to its economic outlook as being to the "downside". Although in the meeting statement, **the Governing Council noted that these risks were now "more balanced" than before.** However in his press conference, President Draghi noted the slight loss of momentum in the traded sector of the economy due to slower growth outside of the Eurozone, particularly in emerging markets.

ECB Macroeconomic Forecasts for the Euro Area

(%)	2014	2015	2016	2017
HICP	0.4	0.3	1.5	1.8
Real GDP	0.9	1.5	1.9	2.0

Forecasts are mid-point of a range and based on assumption that Brent crude oil prices will average $63.8 in 2015, $71.0 in 2016 and $73.1 in 2017. Source: ECB June 2015

As a result, today's ECB staff forecasts for GDP were "virtually unchanged". **The ECB continues to expect relatively modest growth of 1.5% this year and 1.9% in 2016.** The forecast for 2017 was revised down slightly from 2.1% to 2%.

Overall, **today's updates suggest that the ECB is content with the early impact of its QE programme, as well as being cautiously optimistic on the economic outlook.** The reaction on markets has seen the euro trading back up around $1.12 and 73p against the dollar and sterling, respectively.

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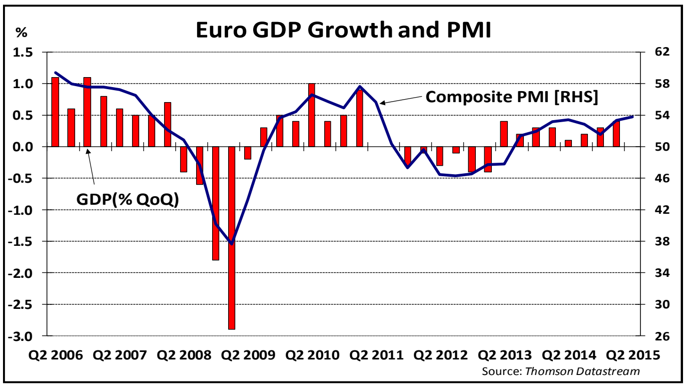
Economy maintaining improved performance

The Eurozone economy improved further in Q1, growing by 0.4% in the quarter after increasing by 0.3% in Q4 last year. On a year-on-year basis, growth edged up to 1% from 0.9%.

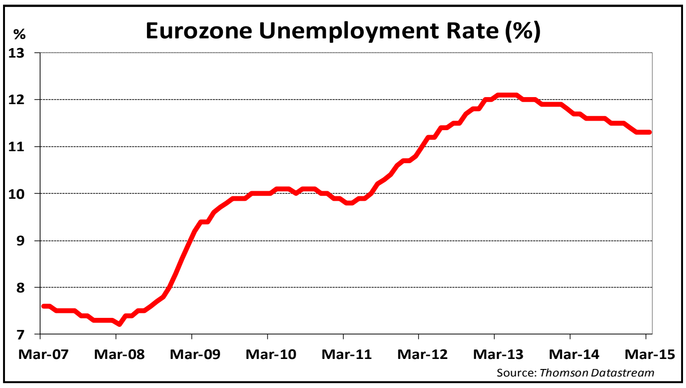
Encouragingly, the improvement in Q1 was 'broader', with a slowdown in the Eurozone's largest economy, Germany (0.3% from 0.7%), being more than offset by firmer growth in France (0.6% from 0%), Italy (0.3% from 0%) and Spain (0.9% from 0.7%). Peripheral economies also generally improved in the first quarter.



Leading indicators of activity for Q2 have generally suggested that the Eurozone economy has maintained its improved momentum so far. For example, the key composite PMI averaged 53.8 in April/May, above the Q1 average of 53.3. The more encouraging picture is also backed up by the EC economic sentiment index, which averaged 103.8 in April/May compared to 102.6 in Q1. National level leading indicators have also improved in Q2 versus Q1, including the German Ifo, French INSEE and Italian ISTAT indices.

Meanwhile, **'hard' data measures of performance, such as retail sales, have also shown some improvement in Q2.** A pick-up in consumer spending has been an important feature of the improvement in the Eurozone economy in recent quarters. Retail sales rose by 0.7% in April, following off the back of another strong quarterly increase (0.7%) in Q1. Meantime, the EC measure of Eurozone consumer sentiment has been stronger overall in Q2 than Q1, suggesting that the improved growth in sales could continue.

The improved performance of the Eurozone economy is also having a positive impact on the labour market. The unemployment rate fell to 11.1% in April, its lowest level in over three years. Although, this does still represent a high level both by historical standards and when compared to other advanced economies. In terms of the outlook for the labour market, the employment component of the Eurozone composite PMI has moved further above the job growth indicating 50 level in Q2. It averaged 52.1 in April/May compared to 51.5 in Q1. Thus, we should see the Eurozone unemployment rate continue to edge lower over the coming months.



Monetary aggregates have also been more encouraging of late. Growth in M3 money supply picked up to 5.3% year-on-year in April, its fastest pace in six years. Meantime, **underlying growth in loans to the private sector remained at its strongest pace for three years (+0.8%) in March.**

The Eurozone recovery, though, still faces some significant headwinds. These include still tight fiscal policy, high unemployment and a lack of structural reforms in some economies, which continue to act as restraints on the pace of activity. However, **there are also some tailwinds for the economy including the favourable impact of lower oil prices, a weaker euro and the impact of recent monetary policy easing measures, with interest rates likely to remain at very low levels.** These factors are reflected in the fact that the ECB is looking for GDP to grow by some 2% in 2016 and 2017.

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