# ECB Watch

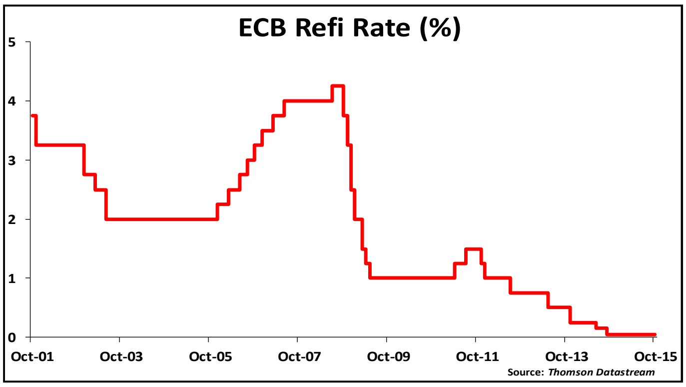
*22nd October 2015*

AIB Treasury Economic Research Unit

# ECB working on additional monetary easing

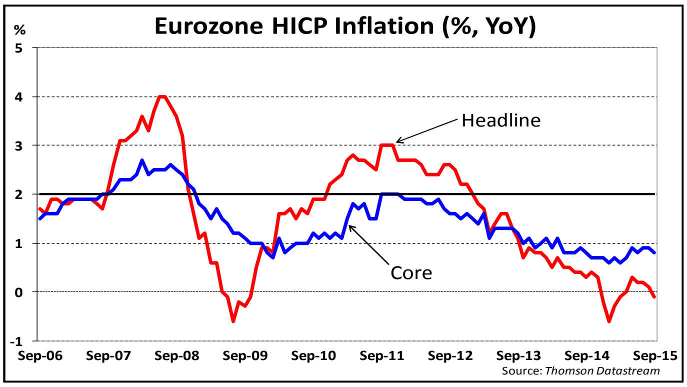
As expected, there were no changes to monetary policy at today's meeting of the ECB Governing Council. **However, the tone of the meeting statement and subsequent press conference from President Mario Draghi were very much on the dovish side.** The statement referenced that "concerns over growth prospects in emerging markets and possible repercussions for the economy from developments in financial and commodity markets" highlighted the downside risks to the outlook for growth and inflation in the Eurozone economy.

More specifically, these risks could "further slow down the gradual increase in inflation" towards the ECB's target of close to, but below, 2%. Inflation in the Eurozone remains very subdued and in Draghi's words the "inflation picture is less sanguine". **HICP inflation fell back into negative territory in September at −0.1%** and is expected to remain at very muted levels over the coming months.




**The Governing Council also gave a strong signal today that additional monetary stimulus may be announced at its next policy meeting** by stating that "the degree of monetary policy accommodation will need to be re-examined at our December" meeting. In this context, the ECB will "monitor closely all relevant incoming information as concerns their impact on the medium-term outlook for price stability".

Both the statement and comments from President Draghi suggest that these additional monetary policy measures could be in the form of **adjusting the "size, composition and duration" of its QE** programme, which is due to run till at least September 2016. The current rate is €60bn of asset purchases per month.




**President Draghi emphasised that the ECB was ready to act and open to a whole menu of monetary policy instruments.** He mentioned that the deliberations on possible easing tools were not just confined to its QE programme and said that a discussion took place on the deposit rate and a possible reduction in this, which is currently at −0.2%.

**Indeed, in another clear signal that further easing is coming sooner rather than later, he mentioned on a few occasions in the press conference that the ECB "attitude is not wait-and-see mode but work-and-assess".** Overall, based on the strongly dovish tones and signals from today's meeting, the ECB appears to be readying itself to provide additional monetary stimulus to the Eurozone economy, and this announcement could come at its next meeting on December 3rd.

**Not surprisingly, market reaction to today's ECB meeting has seen the euro weaken on the exchanges.** The euro has lost over 1% against a basket of other currencies. EUR/USD has dropped below the $1.12 mark after having started the day above $1.13. Likewise, EUR/GBP has fallen back, changing hands below 73p. Bond yields also fell sharply, right along the curve, while equities rose strongly.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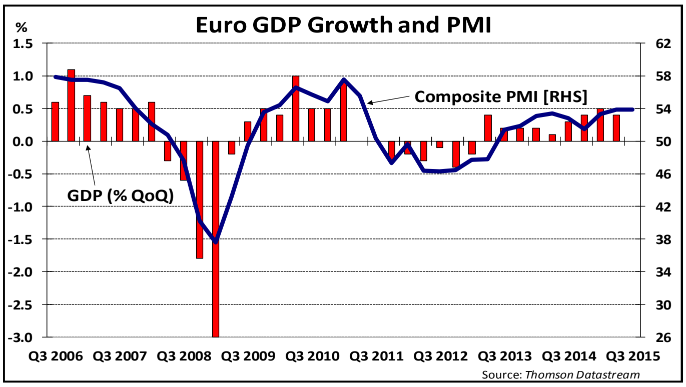
# Data Point to Continued Modest Growth

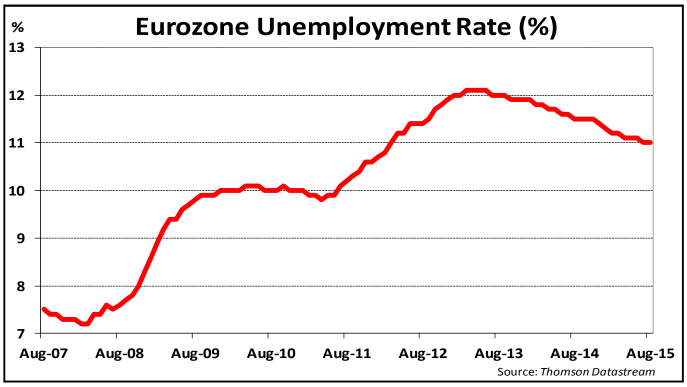
**The pace of GDP growth in the Eurozone moderated slightly in Q2 to 0.4%,** after rising by 0.5% in Q1. Year-on-year growth did pick up, though, from 1.2% to 1.5%. The breakdown of Q2 GDP data show that growth in the currency bloc continued to be driven by exports, which contributed 0.7 percentage points (p.p.), while the drag from imports diminished (0.4 p.p.). The other expenditure components remained subdued, with consumption continuing to show lacklustre growth (+0.2 p.p.).




At a national level, **growth in Germany, France and Italy, which account for c.65% of Eurozone GDP, was modest to flat.** Peripheral economies on the other hand, continued to show more solid growth, with Spain (+1% in the quarter) and Greece (+0.9%) performing particularly strongly. Meantime, the Irish economy grew 1.9% in Q2.

In terms of the more recent performance of the Eurozone economy, **leading indicators of activity for Q3 indicated that growth continued at a modest pace.** The key Eurozone composite PMI averaged 53.9 in the quarter, matching its performance from Q2. The EC economic sentiment index largely echoed the performance of the PMI, averaging 104.6 in Q3, slightly above Q2's 103.7 average.

**In terms of 'hard' data for Q3, retail sales continued to show encouraging improvement in July/ August, growing by 0.6% compared to Q2.** Sales were aided in part by the renewed fall in fuel prices. Meanwhile, industrial production continued to struggle for upward momentum, although it did grow by 0.3% in July/August after declining slightly in Q2. Slower growth in emerging markets is likely to be unhelpful for production, so too are lower energy prices, broadly reflecting the problems faced by other advanced nations.




**The steady pace of improvement in the Eurozone economy has had a marginal impact on the labour market.** While the Eurozone unemployment rate remained high at 11% in August, this still represents its lowest level since the start of 2012. The headline figure does hide a worrying dichotomy, though, with the unemployment rate in Germany currently at just 4.5%, compared to 10.8% in France and 22.2% in Spain. Growth in employment has been just below 1% year-on-year since the middle of 2014. Meanwhile, in terms of survey indicators, the Eurozone composite employment PMI averaged 51.8 in Q3 after an already subdued 52.1 in Q2. This suggests that employment growth will remain sluggish.

However, **monetary aggregates have been much improved year to date.** While annual growth in M3 money supply slowed in August from 5.3% to 4.8%, it still represents a significant improvement on the 2.1% rate seen in the same month in 2014. Meantime, underlying growth in loans to the private sector continued to pick up in August, rising by 1% year-on-year, its best rate since the end of 2011.

**Overall, growth in the Eurozone is expected to remain moderate as it still faces some significant headwinds.** These include the continuation of tight fiscal policy, high levels of unemployment in many countries, a lack of structural reforms in some economies, as well as the risks posed by a slowdown in growth in emerging markets (especially China). However, there are some positives for the economy too, including the favourable impact from lower commodity prices, a weaker euro and the impact of monetary policy easing measures, with interest rates likely to remain at very low levels for the next few years. The ECB is forecasting modest GDP growth of 1.7% in 2016 and 1.8% in 2017, up from 1.4% this year.

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