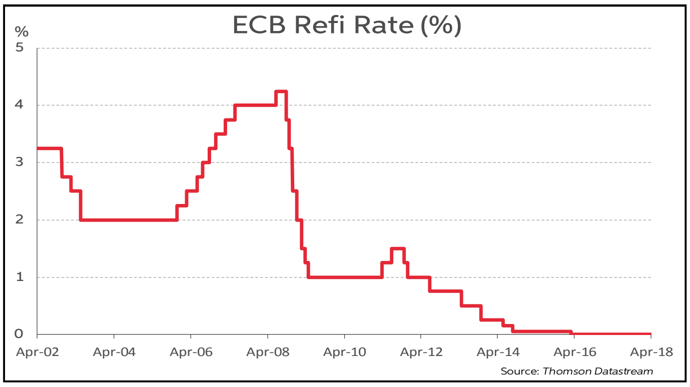
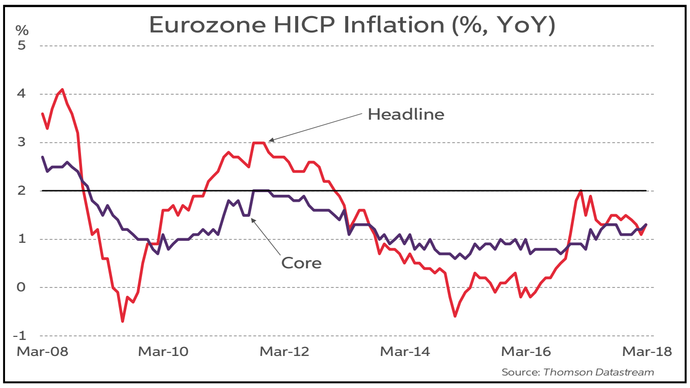
ECB provides no fresh insights on policy

Today's meeting of the ECB Governing Council concluded in line with market expectations, with no changes to monetary policy. The Bank's deposit rate was left at -0.4%, while the refi rate remained at 0.0%.



Meanwhile, the **ECB's forward guidance on its asset purchase programme was also left unchanged** in the post-meeting statement. The ECB repeated that asset purchases will continue "until the end of September 2018, or beyond, if necessary". At present, the ECB is purchasing €30bn of assets each month under its QE programme. The market expects that the ECB will end net asset purchases in either September or December.

ECB President Draghi's post-meeting press conference provided no new information on the timeframe for halting net purchases. He stated that the QE programme was not discussed at the meeting, nor was the outlook for monetary policy. Instead, the feeling of the meeting was that the ECB should maintain a "steady hand" while it awaits further data on the economy.



The ECB, though, noted that recent Eurozone data suggest that growth has slowed somewhat since earlier in the year. The Composite PMI came in at 55.2 in both March and April, compared to the 58 averaged in January and February. Other survey data have weakened recently as well, suggesting that growth in the Eurozone may have peaked. This is not that surprising, though, with the ECB noting that growth was very strong last year. Temporary factors may also be at play in explaining part of the recent slowdown in activity according to the ECB. Its most recent staff macroeconomic projections (March) showed that the ECB expects growth of 2.4% in 2018. GDP growth is then projected to slow to 1.9% and 1.7% in 2019 and 2020, respectively, which would still be a solid performance.

With regard to inflation, **Mr. Draghi noted that recent price developments show inflation remains subdued.** Eurozone HICP inflation held at just 1.3% in March, still well below the ECB's target of close to, but below, 2%. The ECB expects inflation to average 1.4% in both 2018 and 2019, before picking up somewhat to 1.7% in 2020.

The still soft price pressures mean that **the ECB is expected to remain cautious with regard to future tightening in monetary policy.** The ECB continues to guide that it expects to keep interest rates at their current very low levels well past the time when it ends net asset purchases. Thus, **markets expect interest rates to remain very low for some time to come.** This is reflected in futures contracts, with markets seeing unchanged rates in 2018 and anticipating that 3-month Eurozone rates will remain negative until near the end of 2019. They see rates staying low for an extended period beyond that, only reaching 1% by around the middle of 2022.

The reaction in markets to today's ECB meeting was muted enough, which is not surprising given that the Central Bank did not provide any fresh insights on policy. The euro has lost some ground recently, dropping to around the $1.2150 level against the dollar before the meeting. The euro rose marginally to $1.22 after the meeting, possibly reflecting the fact that there was no discussion by the Governing Council on extending QE, before slipping back again. Meanwhile, there was little change in fixed income markets either.

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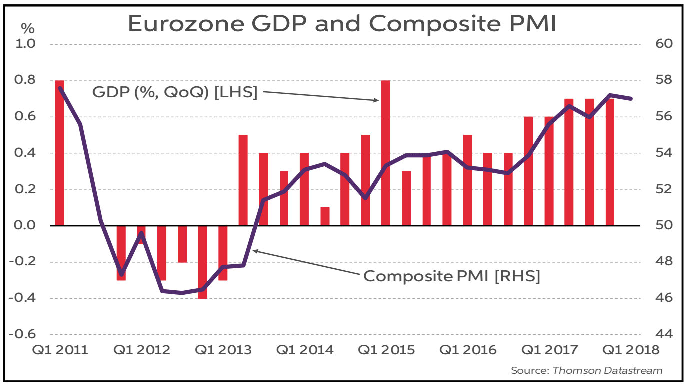
Eurozone continues to grow at a solid pace

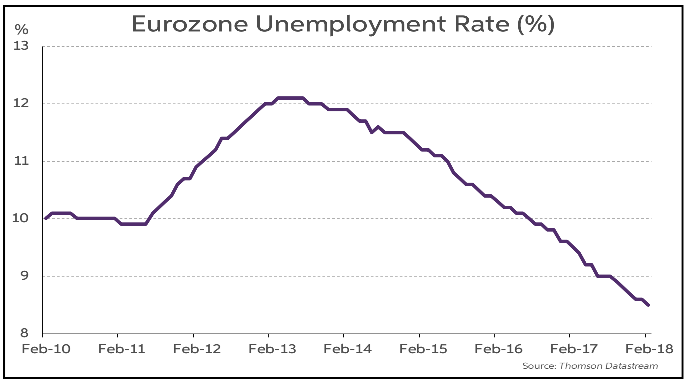
The Eurozone economy continued to perform very well in Q4 2017, recording a third consecutive 0.7% quarterly increase in GDP. This meant that the economy grew by 2.4% in 2017 as a whole, outpacing growth in the US and representing the currency bloc's best annual performance since 2007.



Leading indicators of activity for Q1 2018 suggest that the economy continued to grow at a quite robust pace. The key Eurozone Composite PMI averaged 57 in the quarter, broadly in line with Q4's 57.2 performance. This would point to another 0.7% increase in GDP in the first quarter. Likewise, the EC economic sentiment index averaged a strong 113.9 in Q1, after 114.3 in Q4.

However, **the hard data for Q1 have not been as upbeat.** For example, retail sales declined by 0.3% in January/February compared to Q4 2017. Weak sales may partly reflect changing consumption patterns in some countries, with 'Black Friday' sales in November resulting in some spending being brought forward. Unseasonably warm weather in the first two months of the year also depressed clothing sales. Warm weather weighing on energy output was also a factor in the 0.5% decline in industrial production in Jan/Feb.

While the available hard data point to a slower pace of growth in Q1, the labour market has continued to improve. The Eurozone jobless rate fell to 8.5% in February, compared to 9.5% in the same month in 2017. This represents its lowest rate since December 2008.



Eurozone employment figures for Q1 are not due for another few weeks. However, the Eurozone composite employment PMI suggests that the jobs market continued to expand at an encouraging pace. The index averaged a strong 55.2 in Q1, close to a 17-year high. This would point to another 0.3-0.4% increase in employment in the quarter.

More recent survey data suggest that the economy lost some momentum at the end of Q1/start of Q2. The Composite PMI came in at 55.2 in both March and April, compared to the 58 it averaged in Jan/Feb, when it hit a multi-year high. At a national level, the recalibrated German Ifo index (now includes all services) averaged 102.7 in March/April compared to 107.5 in Jan/Feb. The latest French INSEE and Italian ISTAT indices also point to a more modest pace of activity, suggesting that Eurozone growth may have peaked. Nonetheless, the data still suggest that the economy should continue to grow at a solid rate.

Overall, the economic prospects for the Eurozone continue to appear favourable. The IMF is forecasting GDP growth of 2.4% in 2018 (revised up from previous 2.2% projection) and 2% in 2019. This is based on a number of positive factors for the currency bloc, including the likelihood that ECB policy will remain loose for some time, generally more expansionary fiscal policy and stronger momentum in the global economy. Inflation is also likely to remain low, helping to maintain growth in real spending power. The European Commission has also noted that given the Eurozone recovery is less advanced than in many other major economies, the currency bloc has the capacity to continue to grow strongly for quite some time.

Nonetheless, the Eurozone economy still faces challenges, including marked regional disparities in unemployment including very high youth unemployment in some countries, a need to boost productivity, low wage growth and a continuing aversion to structural reforms in some member states. Overall though, while growth may have peaked in the Eurozone, the economy is still expected to continue expanding at a solid pace.

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