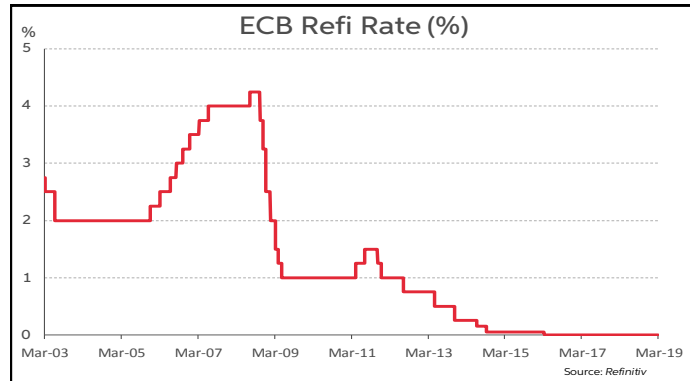


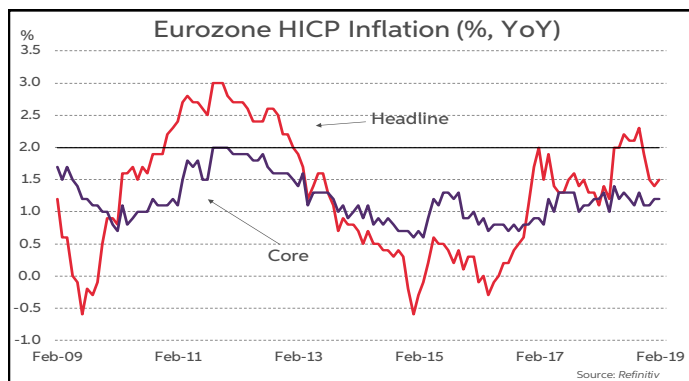
ECB pushes out start time for any rate hikes to 2020

As expected, the March meeting of the ECB Governing Council concluded with no changes to interest rates from their present levels of 0% for the refi rate and -0.4% for the deposit rate.

However, the ECB did make some significant announcements from a monetary policy perspective. In particular, it pushed out the timing of its guidance on when interest rates may start to rise. It is now guiding that rates are on hold “at least through the end of 2019” from its previous reference to “through the summer of 2019”. Indeed, in the press conference, President Draghi noted that “several members” of the Governing Council wanted to change this guidance to March 2020.



The other key decision from the ECB was the launch of another targeted longer-term refinancing operation—TLTRO III. Starting in September 2019 and ending in March 2021, the repos have a maturity of two years, at a “rate indexed to the interest rate on the main refinancing operations”. Its aim is to help “preserve favourable bank lending conditions” in an environment of bank funding “congestion” owing to maturing of existing TLTROs and bank debt, as well as greater regulatory compliances that require increasing bond funding by banks.



The rationale for the ECB’s dovish announcements is the weaker and more challenging economic backdrop for the Eurozone economy. Not surprising, this was evident in the updated set of ECB macro forecasts. The ECB revised down its GDP growth forecasts. It is now projecting GDP growth of 1.1% in 2019 (from 1.7%) and 1.6% in 2020 (from 1.7%). Meanwhile, the 2021 GDP forecast was left unchanged at 1.5%. It also stated that the risks to this outlook remain “tilted to the downside”.

The March update of its inflation forecasts also show downward revisions. HICP inflation is forecast at 1.2% in 2019 (from 1.6%), 1.5% in 2020 (from 1.7%) and 1.6% in 2021 (from 1.8%). Crucially, today’s updated projections show that the ECB now expects inflation to be further below its 2% target over the next 3 years, with President Draghi stating that the “weaker economic momentum is slowing the adjustment of inflation towards our aim”.

ECB Macroeconomic Forecasts for the Euro Area				
(%)	2018	2019	2020	2021
HICP	1.7	1.2	1.5	1.6
Real GDP	1.9	1.1	1.6	1.5

Forecasts are mid-point of a range and based on assumption that Brent crude oil prices will average \$61.7 in 2019, \$61.3 in 2020, and \$60.6 in 2021
 Source: ECB March 2019

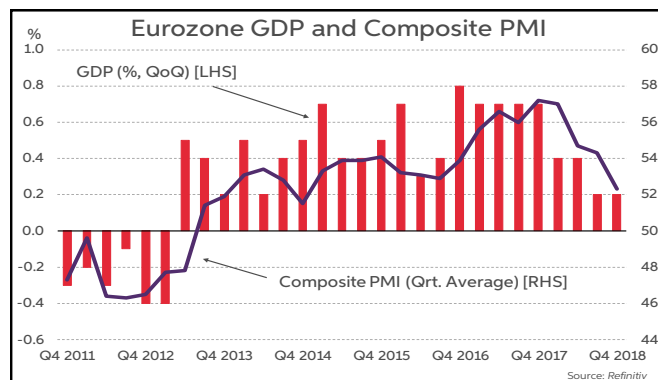
The market expectation now is that rates will not start to be raised until September 2020. Futures contracts suggest the market is factoring in around 15bps of tightening by end 2020. Over the medium term horizon, futures contracts reflect a market view of rates remaining low for an extended period. Three month rates are only expected to get back into positive territory around end 2021 and are envisaged to still be below 1% by end-2024. Today’s surprising dovish action from the ECB saw the euro come under some downward pressure, with EUR/USD falling from \$1.13 to around \$1.123, while the bond market made gains on the more dovish rate outlook.

Sluggish Eurozone growth

Quarterly growth in the Eurozone economy was unchanged at just 0.2% in Q4. The slowdown in H2 2018 has in large part been due to the easing of activity in Germany, where weaker global growth and temporary delays to car production have negatively impacted exports, and Italy, which entered into recession in the second half of 2018. Growth elsewhere, while not spectacular, has remained solid enough.

Underlying data released today show that net trade was the main source of growth in the quarter, accounting for 0.2 percentage points (p.p.). This was partly due to a fall in imports. Consumer spending, government expenditure and fixed investment each contributed 0.1 p.p. Meanwhile, inventories subtracted 0.3 p.p. from the quarterly total.

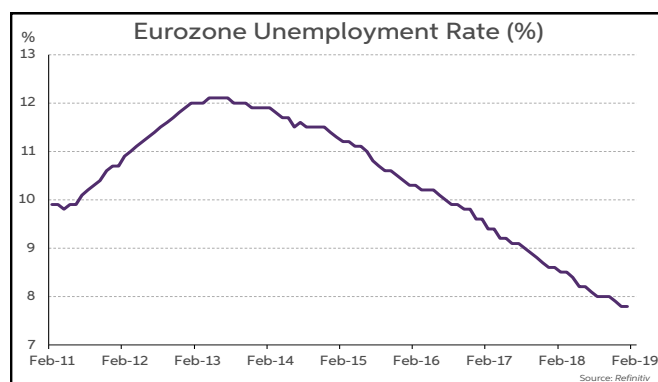
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Survey data suggest that the economy has failed to regain momentum in the first quarter of 2019. The Markit composite PMI averaged 51.5 in January/February versus 52.3 in Q4. The index is on track for its worst quarterly performance since Q4 2014. This is largely due to the slowdown in the manufacturing sector. Indeed, in February the manufacturing PMI fell below the 50.0 threshold separating expansion from contraction for the first time since June 2013. In contrast, the service sector index moved up in February to 52.8, from its 4-year low of 51.2 in December and January. Meanwhile, mirroring the PMIs, the EC Eurozone Economic Sentiment index has also dis-improved in Q1, averaging 106.3 in January/February against 108.9 in Q4. On a national level, both the French INSEE and German Ifo also suggest that economic activity has failed to pick up in the current quarter.

In terms of the 'hard' data available, we have only the retail sales report for January. Sales increased by a solid 0.7% in January on Q4 levels, when they rose by 0.6%. This indicates that household spending remains supportive of growth.

Turning to the labour market, Q4 data show that employment growth weakened in the second half of 2018, leaving the average 2018 growth rate at 1.4%, slightly down on 2017's 1.6% rate. The timelier composite PMI employment sub-component suggests that employment growth may have slowed further at the beginning of 2019. Meanwhile, the jobless rate held at 7.8% in January, an over 10 year low.



On the inflation front, price pressures in the region remain very subdued. Lower energy prices have seen the headline HICP inflation rate falling to around the 1.5% level, while the core measure remains close to 1%. This is well under the ECB's target rate of close to, but below 2%.

Overall, the Eurozone economy has returned to a period of much slower economic growth. External demand has softened as the outlook for the global economy deteriorates. On this note, weaker growth in China, the protectionist policies pursued by the Trump administration and the possibility of a no-deal hard Brexit are all a source of worry. Meanwhile, country specific factors such as the delays to car production in Germany as well as higher borrowing costs and increased uncertainty in Italy are also weighing on activity.

However, falling inflation, continuing very low interest rates and an easing of some current headwinds to growth should see activity pick up pace again as the year progresses. Nevertheless, growth forecasts for the Eurozone have been slashed. Yesterday saw the OECD cut its 2019 GDP forecast from 1.8% to 1.0%, while the 2020 forecast was reduced from 1.6% to 1.2%. Similarly, today the ECB revised down its GDP projections from 1.7% in both 2019 and 2020, to 1.1% and 1.6% respectively.

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