ECB Watch

AIB Treasury Economic Research Unit

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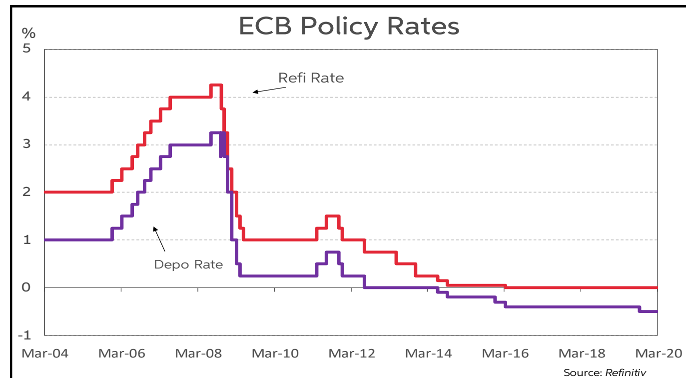
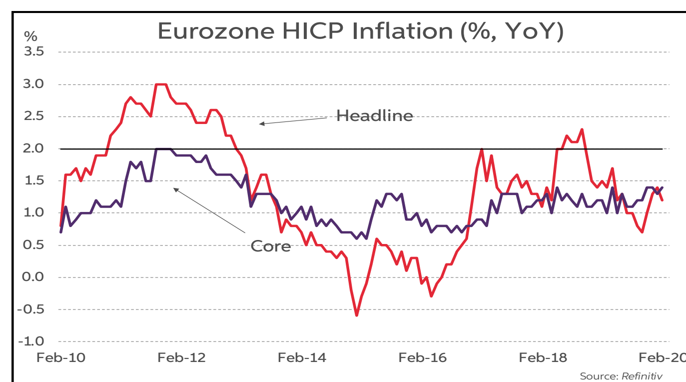
ECB disappoints markets with its easing package

The ECB today announced a number of easing measures to help support the Eurozone economy amid the risks poised by the Coronavirus pandemic. However, in contrast to the other major central banks, this did not include any cuts to its key interest rates, with the depo rate left unchanged at -0.5%. The market had been envisaging a 10bps cut in the depo rate to –0.60%.



The measures announced today included a "temporary" increase in its QE programme, with additional net asset purchases of €120bn until the end of the year. It also introduced an additional longer-term refinancing operations (LTROs) to provide immediate liquidity support to the Eurozone financial system until the next round of its TLTRO3 in June. On top of this, the ECB introduced more favourable terms to TLTRO3. It reduced the rate charged (to 25bps below the average rate applied in the main refinancing operations) to financial institutions availing of this facility in order to support bank lending into the real economy. President Lagarde stated that the decision on today's "comprehensive package" was "unanimous".



In its assessment of the economic outlook, the ECB stated that the spread of the Coronavirus has been a "major shock to the growth prospects" for the global economy and the Eurozone. It noted the "considerable worsening of the near-term growth outlook. The ECB revised lower its GDP growth forecasts in its latest macroeconomic projections. **However, it did state its forecasts (both growth and inflation) were completed before the recent escalation of the Coronavirus and the collapse in oil prices. The ECB commented that the risks to its growth outlook are "clearly on the downside". Therefore it is very likely that these growth forecasts will be revised lower.**

In terms of today's update, the ECB is now projecting GDP growth of 0.8% (from 1.1%) in 2020. It has also revised slightly lower its 2021 projection to 1.3% (from 1.4%), while its 2022 growth expectation remains at 1.4%. Meanwhile, its inflation forecasts were left broadly unchanged, with the on-going expectation that the HICP rate will remain well below its 2% target over the medium term**.**

ECB Macroeconomic Forecasts for the Euro Area

(%)	2019	2020	2021	2022
HICP	1.2	1.1	1.4	1.6
Real GDP	1.2	0.8	1.3	1.4

Forecasts are mid-point of a range and based on assumption that Brent crude oil prices will average $56.4 in 2020, $55.6 in 2021 and $55.4 in 2022

Source: ECB March 2020

The market is now pricing in 15bps of easing in total by year end rather than the 25bps that was envisaged before the meeting. This would see the deposit rate falling to –0.65%. President Lagarde did not rule out rate cuts, stating that they are certainly not at the lower bound. However, the lack of a rate cut today and the lower than expected increase in QE suggests that policy is close to limit. Certainly market reaction was negative with European stocks falling further and the euro coming under pressure. Meanwhile, President Lagarde's comments that the ECB was not there to "close spreads" coincided with considerable pressure coming on Eurozone bond yields, with southern periphery spreads versus bunds widening sharply and spreads even widening in some core markets also.

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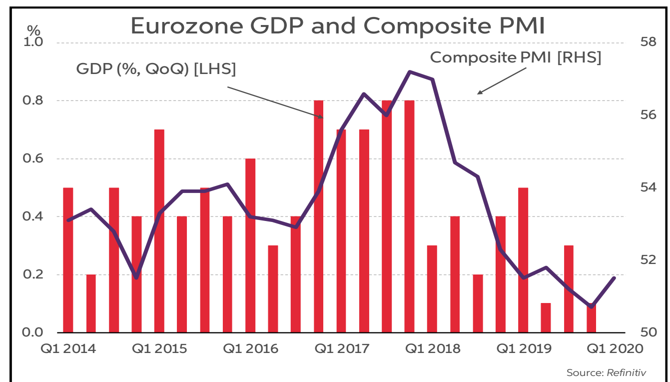
Coronavirus to push Eurozone into recession



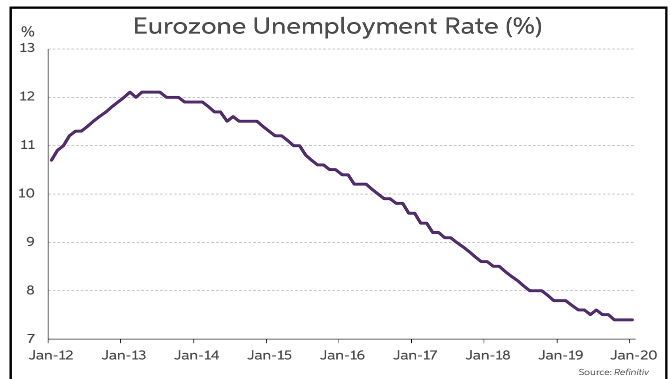
Eurozone GDP growth eased to just 0.1% in the final quarter of 2019, with the year-on-year rate slowing to 0.9%. In the year as a whole, the economy expanded by just 1.2%, down from 1.9% in 2018. The national data showed growth in the region was very uneven. The German and Italian economies virtually stagnated in 2019, but activity held up reasonably well in France and Spain.

With regard to the underlying breakdown, domestic demand was weak in the Eurozone in the final quarter of the year. Consumption expanded by just 0.1%, with consumer and government spending adding only a combined 0.1 percentage points (p.p.) to growth. Meanwhile, investment and net trade figures appear distorted, likely reflecting both the impact of the unwinding of Brexit related stockpiling, as well the on-shoring of intellectual property in Ireland. Overall, they largely offset each other, subtracting 0.1 p.p. from the quarterly total.

Leading indicators of activity suggest that the economy picked up some momentum in the first two months of the year. The composite PMI averaged 51.5 in January/February, up from 50.7 in Q4. However, February's figure was flattered by a sharp improvement in the manufacturing sub-index, which was driven by an increase in supplier delivery times due to the coronavirus. In March, we expect sharp falls in both the manufacturing and service sector indices as the impact of the coronavirus outbreak is felt. Similarly, the EC consumer confidence index, which jumped higher in February, will likely fall sharply.

The limited amount of 'hard data' available for January have been positive. Although, again they pre-date the emergence of the coronavirus. Retail sales rose by 0.6% in January, following a weak end to 2019. Industrial output increased by 2.3% in the same month, though the year-on-year rate is still deep in negative territory. Even if the coronavirus outbreak is short-lived, it is likely to push the Eurozone economy into recession, with GDP declining in both Q1 and Q2.

Despite moderating activity in 2019, the labour market remained solid. Indeed, employment growth picked up to 0.3% in Q4, leaving the 2019 average annual growth rate at 1.1%. This helped the jobless rate hold at its multi-decade low of 7.4% in H2 2019. Looking ahead, though, the coronavirus is likely to weigh on jobs growth and may push the unemployment rate higher.



A deceleration in earnings growth evident since mid-2019, combined with the recent collapse in oil prices, means inflation looks set to fall from already low levels. As of February, the headline HICP had eased to 1.2% from 1.4%, while the core measure held at 1.2%.

The near-term outlook for the Eurozone is very downbeat. The spread of the coronavirus represents both a demand and a supply shock. Efforts to contain its spread are likely to weigh heavily on consumption. Consumer spending will also be hit by the decline in household's incomes. Turmoil in financial markets, threatened supply chains and reduced demand for goods and services pose significant threats to firms and provide a particularly challenging backdrop for investment. The outbreak will also delay indefinitely the expected recovery in global trade volumes, another headwind for the export orientated economy.

We do not know how long the coronavirus outbreak will last. Today's action by the ECB will do little to offset the damage being done to the real economy. Targeted fiscal expenditure would be beneficial but to-date only Italy, the worst impacted country, has announced sizeable stimulus measures. There are significant downside risks to the ECB's and OECD's forecasts for growth of 0.8% this year. The Eurozone economy is heading for recession, with its duration and depth very much dependent on the course of the Coronavirus.

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