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GLOBAL ECONOMIC & MARKET OUTLOOK

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FOCUS NOTES

March ECB meeting: Moving closer towards the exit

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- At its monetary policy meeting yesterday, the ECB decided unanimously to omit from the accompanying policy statement the explicit pledge that had been in place since 2016 suggesting that the Central Bank stands ready to increase the volume of monthly asset purchases and/or extend the duration of the programme, should the euro area outlook or financial conditions become less favorable. In the Q&A session, President Mario Draghi attempted to downplay the aforementioned change in the forward guidance, stressing that it does not signify a signal for future monetary policy. He cited that it is substantially "a backward-looking decision", pointing out the improving euro area growth momentum and reduced uncertainty over the path of inflation converging to the inflation target. However, there were no modifications to the more fundamental parts of the forward guidance, with the ECB reiterating that net asset purchases at a monthly pace of €30bn "are intended to run until end-September 2018, or beyond, if necessary" and interest rates are expected "to remain at their present levels for an extended period of time, and well past the horizon of net asset purchases".

- The new macroeconomic ECB projections were little changed from the December 2017 forecasts. The GDP growth forecast for 2018 was revised slightly higher to 2.4% from 2.3% on the back of stronger growth momentum but broadly unchanged for 2019 and 2020 at 1.9% and 1.7%, respectively. On the inflation front, the ECB revised down the 2019 projection to 1.4% from 1.5%, reflecting temporary factors, while keeping the 2018 and 2020 forecast unchanged at 1.4% and 1.7%, respectively. The path for core inflation remained in line with that of December, i.e. at the subdued pace of 1.1% for 2018 and 1.5% for 2019 before accelerating to 1.8% in 2020 on the back of an expected pick-up in wage growth, albeit still below the ECB's medium-term inflation target of "below but close to 2.0%". Wage growth was revised up slightly for both 2018 and 2019 by 0.1pp to 2.2% and 2.0%, respectively, but unchanged at 2.7% for 2020. Regarding the euro area's fiscal position, it is expected to remain on average broadly neutral over the projection horizon, while both the government deficit and debt ratios are expected to be on a downward path mainly supported by more favorable macroeconomic developments. The ECB revised down its fiscal deficit forecast for the period 2018-2020, expecting the debt to fall below 80% as a percent of GDP in 2020 for the first time since 2009, shrugging off somewhat higher government bond yields.

- The overall dovish tone of the ECB President and the downward revision of the 2019 HICP forecast favored EU government bonds, with the 10-yr Bund yield hovering slightly below 0.65% in late European trade on Friday, c. 5.5bps lower from a three week intra-session high hit on Thursday soon after the release of the ECB statement which revealed the drop of the easing bias on QE. In spite of its downward move, it remained above levels close to 0.63% marked earlier today, taking cue from US Treasuries ahead of the key US non-farm payrolls report for February later today. In FX markets, the EUR/USD was hovering around 1.2300 at the time of writing, 1.2% lower from Thursday's peak marked ahead of the ECB press conference, but still within the 1.2150-1.2450 range that prevails since mid-January.

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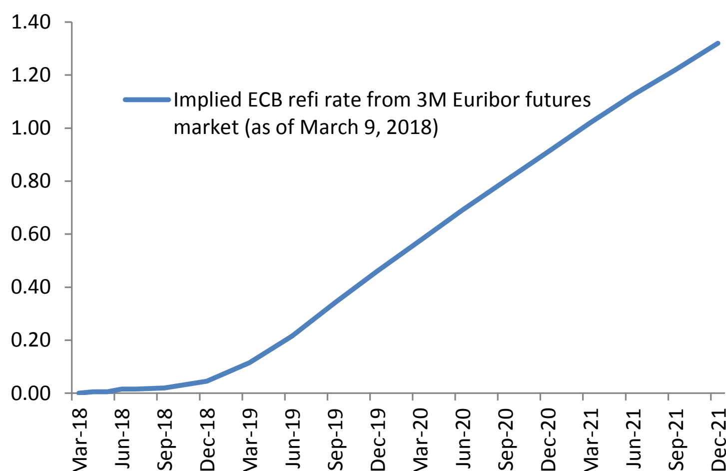
- Although the ECB President tried to downplay the change in the forward guidance, it does however mark another small step towards the phasing-out of net asset purchases by the end of 2018. Taking into account that ECB President Mario Draghi opposes a sudden stop of the programme and a number of ECB Governing Council members would prefer not to keep QE open-ended, a quick tapering in Q4 seems the most likely scenario. Hence, we expect that the ECB will likely provide, no earlier than June/July, a plan to taper its asset purchases to zero in the last three months of 2018, trying to prevent a further EUR appreciation and an unwarranted tightening of financial conditions. The key driver for the first interest rate hike will be the future path of core inflation and wage growth, so we do not envisage a hike before Q1 2019, at the earliest, as inflationary pressures are expected to remain subdued by year-end. Adding to our view, Bundesbank President Jens Weidmann, one of the most hawkish members of the ECB's Governing Council, has recently stated that current analyst expectations for a first rate hike no earlier than min-2019 are largely in line with the ECB's forward guidance.

Table 1
ECB Staff macroeconomic forecasts on inflation and growth, March 2018

	2018	2019	2020
GDP growth (%YoY)	**2.4**	**1.9**	**1.7**
December projection	2.3	1.9	1.7
HICP (%YoY)	**1.4**	**1.4**	**1.7**
December projection	1.4	1.5	1.7
Core HICP (%YoY)	**1.1**	**1.5**	**1.8**
December projection	1.1	1.5	1.8
Wages (%YoY)	**2.2**	**2.0**	**2.7**
December projection	2.1	1.9	2.7

Figure 1
ECB refi rate increase no earlier than Q1 2019, with cumulative rate hikes of ca. 130 by end 2021



Source: ECB, Bloomberg, Eurobank Economic Research

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