ISSN: 1791-35 35

Eurobank Research
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GLOBAL ECONOMIC & MARKET OUTLOOK
January 22, 2016
FOCUS NOTES

January ECB meeting: Signalling further easing in March

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- As widely expected, the ECB Governing Council decided to keep its monetary policy unchanged at its regular monetary policy meeting on Thursday 21 January, after adopting a new round of easing measures just a month earlier.

- At a press conference that followed the conclusion of the meeting, President Mario Draghi highlighted that the monetary policy measures adopted by the ECB since mid-2014 have efficiently worked and supported the euro area economic recovery, sheltering the economy from financial market turbulence and a worsening global growth environment. Nevertheless, downside risks on the euro area growth outlook have increased materially since the December meeting amid heightened uncertainty about emerging market economies' growth prospects, geopolitical risks and volatility in financial and commodity markets.

- In addition, Mr. Draghi emphasized that euro area inflation dynamics have deteriorated significantly following the renewed fall in oil prices and the EUR's appreciation on a trade-weighted basis. He noted that annual HICP inflation will probably remain at very low or negative levels in the following months, before picking up later in 2016. Note that the ECB's December macroeconomic projections were based on crude oil prices averaging $52.2/barrel in 2016.

- Adopting a more dovish than expected tone, the ECB President also made clear that the Central Bank has "power, willingness and determination" to do whatever is needed to pursue its price stability mandate, and revealed that all members of the Executive Board unanimously agreed that the monetary policy stance would be reviewed and possibly reconsider at the March meeting, when the new staff macroeconomic projections including the year 2018 will be published.

- In our view, the ECB will likely cut the deposit facility rate by another 10bp to -0.40% in its March monetary policy meeting, given that the minutes from the December meeting suggested that further rate cuts might be the preferred tool by the ECB Governing Council should the Central Bank decide to ease again. In the adverse scenario that global outlook deteriorates more significantly than currently expected (sharper deceleration in China and other EM economies and/or downtrend in commodity and oil prices), inflation expectations move lower or/and the EUR firms against its major currency peers, the ECB could potentially consider a larger than 10bps rate cut and/or an expansion/extension of the €60bn monthly QE purchases.

- Reacting to the ECB President's more dovish than expected tone, German government bonds extended recent gains with the 2-yr bond yield hovering on Friday close to yesterday's fresh record closing low of 0.447%. European equity markets were firmer with the Euro Stoxx 600 index rising by 3.1%, while in FX markets the EUR came under pressure. The EUR/USD was trading close to 1.0817/18 in early New York trade on Friday, not far from yesterday's multi-session closing low of 1.0777 after testing levels near 1.1000 earlier this week. Despite the latest downward move, the EUR/USD remained trapped within the 1.0550- 1.1050 trading range we have witnessed over the last few weeks amid lingering concerns about the pace of the Fed's rate tightening ahead. With the ECB policy meeting out of the way, market focus now turns on the outcome of the upcoming FOMC policy meeting scheduled for January 26-27 for potential clues about the pair's short-term direction.

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