Eurozone Guidance

- ECB is ready to respond to "a new inflation outlook"
- Such a risk may be materializing
- Growth and price expectations are under pressure

Early last month, the ECB lowered its growth and inflation forecasts. The Bank predicted GDP growth of 1.1% this year (down from its 1.7% December projection) and inflation of 1.2% (down from 1.6%).

What was unusual about these projections was that despite their being accompanied by fresh stimulus measures - fresh TLTROs and more leisurely plans for a hike - Mr Draghi insisted that risks were still “tilted to the downside”.

Three weeks later and Mr Draghi was keen to assure on the ECB’s readiness to respond to any “new inflation outlook”.

Whether or not we are to infer limited confidence in the Bank’s projections, the evidence certainly appears to suggest that “a new inflation outlook” is a growing risk.

The continued run of weak manufacturing data sweeps away notions of a temporary blip caused by emissions-related issues in the auto sector in Q4. And the recent deterioration in German data has certainly captured the headlines.

Finalized PMI figures showed that activity is contracting at

Newswatch

1. Saudi Arabia threatening oil currency switch in event of US legislation exposing OPEC members to US antitrust lawsuits - Reuters >

2. Premier Xi in message of "substantial
a rate not seen in six years, and the slide in foreign
demand apparent from this report was also prominent in
yesterday's collapse in fresh industrial orders.

What is bad for an export-dependent economy geared to
China is doubly so for Italy

But what is bad for an export-dependent economy geared
to China is doubly so for Italy. Italian economy minister
Giovanni Tria reasons that 0.7-0.8% growth in Germany
this year would see Italian growth at zero, given a 1% point
differential these past 10 years.

This may be figuring in reports that the Ministry is to
downgrade Italy's 2019 forecasts – to 0.1% down from
1.0%; but Mr Tria may also await word from the Institute for
Economic Research – the body having preempted the
swathe of downgrades this month with its own 0.6%
projection in March.

As the guardian of price stability in the eurozone, the ECB
will be particularly troubled by the shift in price expectations
that is accompanying this slowdown.

The five-year/five-year forward break-even rate bounced in
late March but is heading lower once more, and is
nonetheless to be found around its lowest level since Q3
2016 (having fallen to 1.36% from 1.66% this time last
year).

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unacquainted with 2% since
2013 but for seven months
last year

Wages offer some hope given an annual rate of 2.3% in
the fourth quarter; but this may be a case of too little too
late if it is to be assumed that sub-trend growth projections
will serve to temper employment and limit the pass through
to prices from wages.

That the ECB "aims to maintain inflation rates below, but
close to, 2% over the medium term” affords it some flexibility – in term of the rate (“close”) and timescale (“medium term”). However, the fact remains that inflation would have been unacquainted with 2% from 2013 onwards but for six months of growth-sapping energy-induced price increases last year.

The core rate, meanwhile, speaks volumes about the challenge facing the ECB: it has steadfastly refused to breach 1.2% since mid-2017 – and has done so only fleetingly since 2013: it has now fallen to just 0.8%, its lowest rate in 12 months.

Uncertainty surrounding Brexit and global trade relations only compounds the risks facing a eurozone economy ill-placed to mitigate a developing slowdown. The prospects of a fresh ECB response – and a fresh boon to euro bears - are surely growing.

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