Economic Monthly [Europe]

The ECB delays start of policy rate normalisation

REIKO SHINOHARA
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

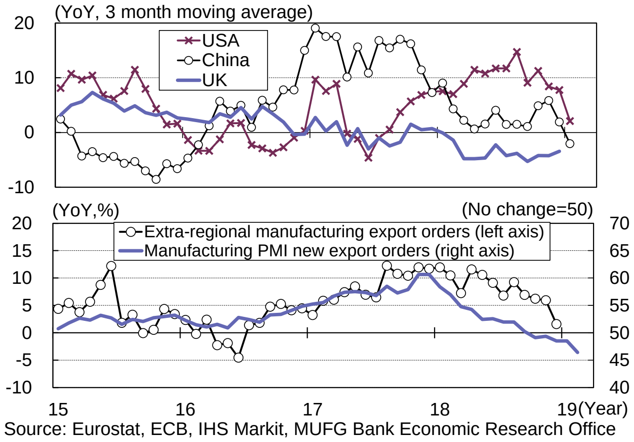
4 APRIL 2019
(ORIGINAL JAPANESE VERSION RELEASED ON 22 MARCH 2019)

At its 7 March meeting, the Governing Council of the European Central Bank (ECB) revised down its economic projections for this year citing both internal factors (decline in German automotive production, Italian economic downturn), and external factors (slower growth in global trade volumes, worsening corporate sentiment due to US-China trade frictions). In addition, the Governing Council changed its forward guidance on keeping policy rates unchanged 'through summer 2019' to 'through the end of 2019'. It also decided to launch a third series of targeted longer-term refinancing operations (TLTRO-III), starting in September 2019 and ending in March 2021. TLTRO-III could help banks in the Eurozone who are yet to repay mature loans from TLTRO-II to refinance on favourable terms. The wording of the risk assessment remains cautious, with Eurozone risks deemed to 'have moved to the downside'. The context cited (uncertainties related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility) remains the same as the January meeting.

Given the change in forward guidance at the most recent Governing Council meeting, we expect the deposit facility rate (currently -0.40%) to be raised next year, later than in our previous forecast of autumn this year. For the time being, we remain cautious over the external environment (which has dragged on growth) and future uncertainty over political and policy issues. Having said this, the approximate trajectory of these two issues is likely to become clear in the first half of this year, after which uncertainty will dispel to some extent. However, the export environment remains tough for the Eurozone: exports to China have slumped, manufacturing new export orders and PMIs have deteriorated (Chart 1), and employment expectations have fallen (Chart 2). We must keep a close eye on future developments, because if these factors end up restricting employment, this would affect the ECB's policy judgements.

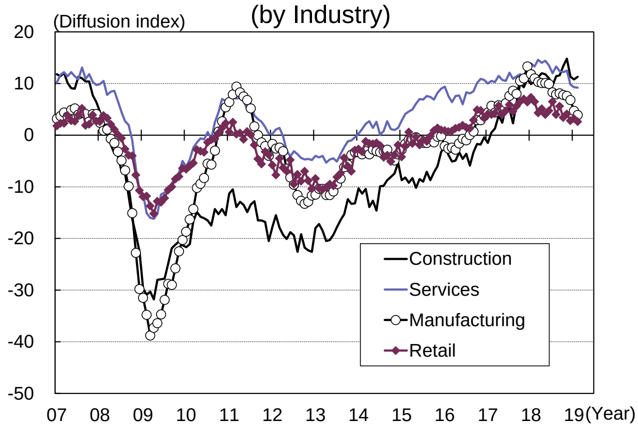
The Presidency of the ECB is another key area to monitor when forecasting monetary policy management. ECB President Mario Draghi will retire this October, and his successor is due to be selected after the European Parliament Elections on May 23-26. The new president's policy stance will influence the timing of monetary policy normalisation, meaning that we must keep a close eye on the candidates and their countries of origin.

Chart 1: Eurozone Export Volumes by Counterpart Country and Manufacturing PMI Export Orders



Source: Eurostat, ECB, IHS Markit, MUFG Bank Economic Research Office

Chart 2：Eurozone Corporate Employment Expectations (by Industry)



Note: Employment expectations over the next 3 months
Source: European Commission, MUFG Bank Economic Research Office

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Reiko Shinohara <reiko_shinohara@mufg.jp>