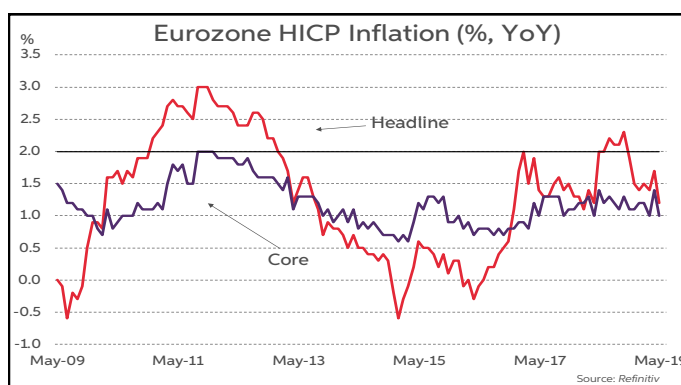
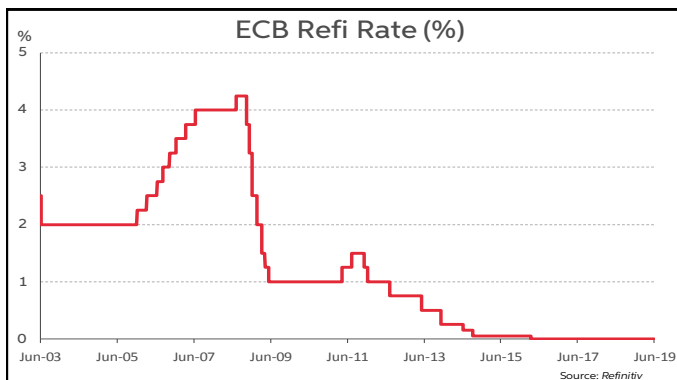


ECB pushes out forward guidance to mid-2020

In line with expectations, the June meeting of the ECB Governing Council concluded with no changes to interest rates from their present levels of 0% for the refi rate and -0.4% for the deposit rate. The main focus on today's meeting outcome was centred on the central bank's forward guidance regarding interest rates.

In this regard, the ECB announced that it was pushing out further its timing of when it may start to raise interest rates. It is now guiding that rates will remain on hold at their current levels "at least through the first half of 2020", compared to end 2019 previously. In the post meeting press conference, President Draghi stated the rationale for this extension was a prolonging of uncertainty in relation to issues such as global trade and Brexit. The decision to push out the timing for unchanged rates to at least mid-2020 was unanimous.

Interestingly, the market has moved recently to price in a small rate cut before year end. President Draghi did state that the Governing Council discussed policy easing initiatives. This included members raising the possibility of rate cuts, restarting net asset purchases and/or pushing out even further the forward guidance on rates. However, there was no discussion on what circumstances would warrant the use of these policy tools.



Today also saw the release of the ECB's updated staff macroeconomic projections. It is now projecting GDP growth of 1.2% in 2019 (from 1.1%) and 1.4% in 2020 (from 1.6%). Meanwhile, the 2021 GDP forecast was revised to 1.4% (from 1.5%). It also stated that the risks to this outlook remain "tilted to the downside". The June update of its inflation forecasts also showed small revisions. HICP inflation is forecast at 1.3% in 2019 (from 1.2%), 1.4% in 2020 (from 1.5%) and 1.6% in 2021 (no change). Crucially, today's updated projections continue to show that the ECB expects inflation to remain below its 2% target over the next 3 years.

Given the current uncertain global economic backdrop, if there is any change from the ECB in the near term, the market expects it to be a rate cut. Market reaction to today's ECB meeting saw the euro initially make some gains suggesting that the market may have been a bit disappointed that the signal was to keep rates unchanged for the next year. At the same time, the terms of the TLTRO III (targeted longer term refinancing operation) were not as generous as the previous round. The market expectation now is that rates will not start to be raised until H1 2022 at the earliest. Futures contracts suggest the market is factoring in around 25bps of tightening by end 2022. Over the medium term horizon, futures contracts reflect an expectation of rates remaining low for an extended period. Three month rates are only expected to get back into positive territory around spring 2023. These rates are envisaged to rise by just 50bps in the next four years, with three month money rates not getting to 0.5% until 2025.

ECB Macroeconomic Forecasts for the Euro Area

(%)	2018	2019	2020	2021
HICP	1.7	1.3	1.4	1.6
Real GDP	1.9	1.2	1.4	1.4

Forecasts are mid-point of a range and based on assumption that Brent crude oil prices will average \$68.1 in 2019, \$65.8 in 2020, and \$62.7 in 2021

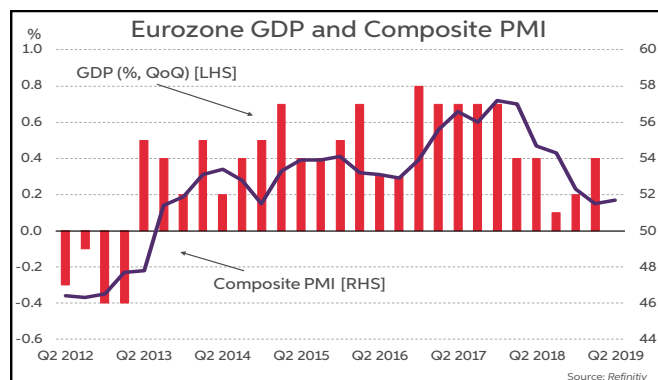
Source: ECB June 2019

Eurozone growth to remain subdued

Following two quarters of lacklustre growth, Eurozone GDP unexpectedly expanded by 0.4% in the opening quarter of 2019. This left the year-on-year growth rate at a still subdued 1.2%, reflecting the slowdown in H2 2018.

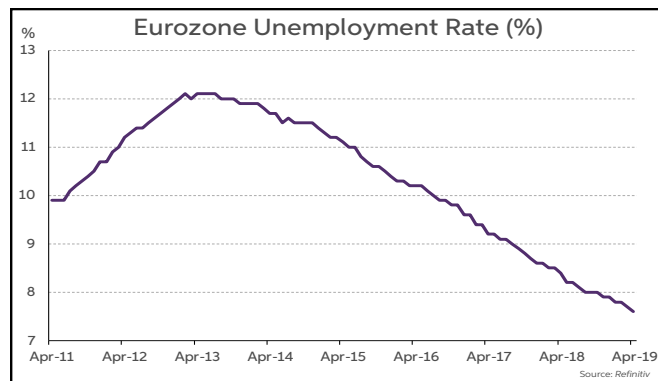
The breakdown shows that domestic demand drove growth in the quarter. Household expenditure was particularly strong, contributing 0.3 percentage points (p.p.) to the quarterly total, while investment added 0.2 p.p.. There was also a positive contribution from net external trade, while inventories acted as a drag on growth.

However, survey data, which understated GDP growth in the opening quarter of the year, suggest that it is unlikely to be sustained at this level in Q2. The Markit composite PMI averaged 51.7 in April/May. While this is in line with Q1's average of 51.5, such a level has historically been consistent with growth of around 0.2%.



The subdued composite reading is largely due to the weakness in the manufacturing sector. Indeed, the manufacturing PMI has now held below the 50.0 level that separates growth from contraction for 4 consecutive months. Furthermore, the new orders subcomponent, which remains firmly in recessionary territory, does not suggest that a recovery is imminent. In contrast, the services index has registered a slight improvement in April/May, edging up to 52.9, from 52.4 in the first quarter. Mirroring the PMIs, the EC sentiment indices have been disappointing in the quarter-to-date. The headline index did improve in May, the first increase in ten months, however it failed to fully reverse April's decline. On a national level, the continued gradual decline in the German Ifo suggests that growth has lost momentum again in the current quarter, although the French INSEE hit a 6-month high in May.

Meanwhile, labour market data have been generally solid. Employment increased by 0.3% in the opening quarter of 2019, matching Q4's expansion. This left the year-on-year growth rate at a strong 1.3%. Looking forward, the timelier composite PMI employment sub-component suggests that employment growth may have moderated in Q2. More positively, the unemployment rate edged down to 7.6% in April, an over 10-year low.



On the inflation front, price pressures in the region remain very subdued. Inflation spiked in April but that was largely due to the impact of the timing of Easter. Indeed, headline HICP fell back to just 1.2% in May, partly reflecting lower energy prices, while the core rate decelerated to 1%. This is well under the ECB's target of close to, but below, 2%.

Overall, in spite of the better Q1 data, the outlook for the Eurozone economy is for continuing subdued growth. While domestic demand has gained some momentum, the weak global environment may weigh on activity in the coming months. On that note, the recent flare-up in trade tensions between the US and China is a significant risk factor for the external sector. Growth in international trade has decelerated markedly over the past year and will likely slow further if the tensions are not resolved. Meanwhile, on the political front, conflict between the Italian government and the European Commission is a source of worry, as is the ongoing uncertainty surrounding the final outcome of Brexit.

There are some factors that should act to support growth. These include subdued inflation, the ECB's accommodative policy stance and a projected increase in fiscal expenditure across the currency bloc. However, the near-term assessment remains downbeat. Today's ECB GDP projections are for growth of 1.2% in 2019 and 1.4% in 2020, right in-line with the OECD's latest forecasts.

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