



Market Expectations Central Bank Policy

Main indicators and recent developments

Money Market Contact Group
European Central Bank

3 December 2018

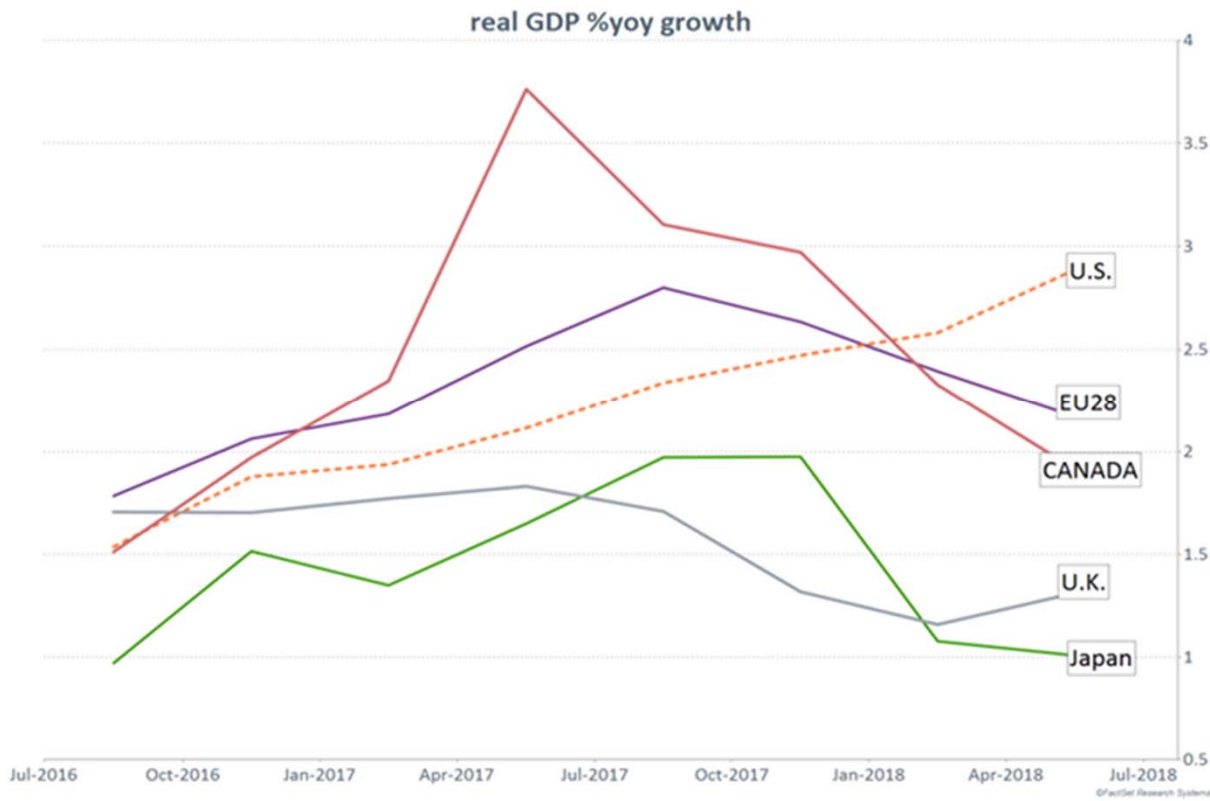


Agenda

- GDP Growth in the Eurozone
- Headline and Core Inflation
- Market expectations for the first rate hike
- TLTRO talk
- APP reinvestments
- Forward Guidance: some recent quotes
- Bond and FX (swap) markets



Real GDP Growth: a growth dip after the 2017 recovery



- Contrary to continued growth in the US, **growth in the Eurozone decelerated to 2.1% in Q2 2018.**
- In France and Germany, economic growth has weakened from 2.8% at the end of 2017 to respectively **1.7% and 1.9%.**
- Events like US tariffs, Brexit and the Italian budget discussions are not helping the matter.
- ECB growth forecasts (Q4)

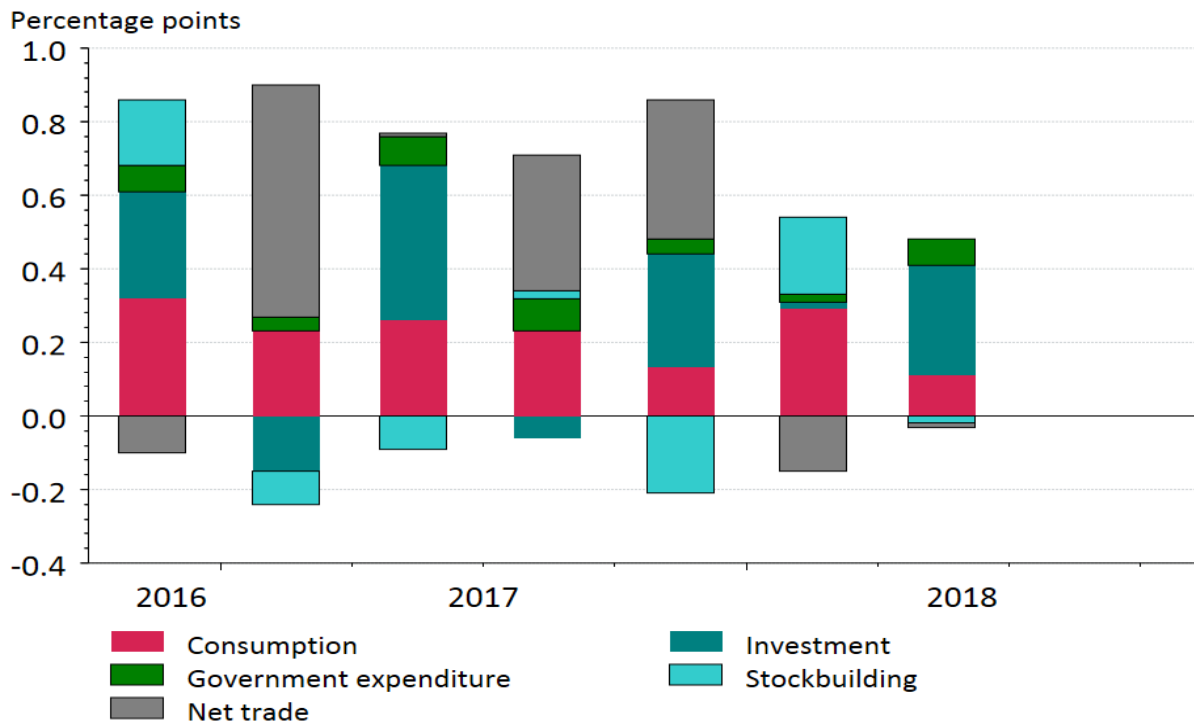
	2018	2019	2020	LT
Real GDP	2.0	1.8	1.6	1.6

Source: Belfius research



GDP Growth: trade no longer contributed in H1 2018

Euro area contributions to quarterly GDP



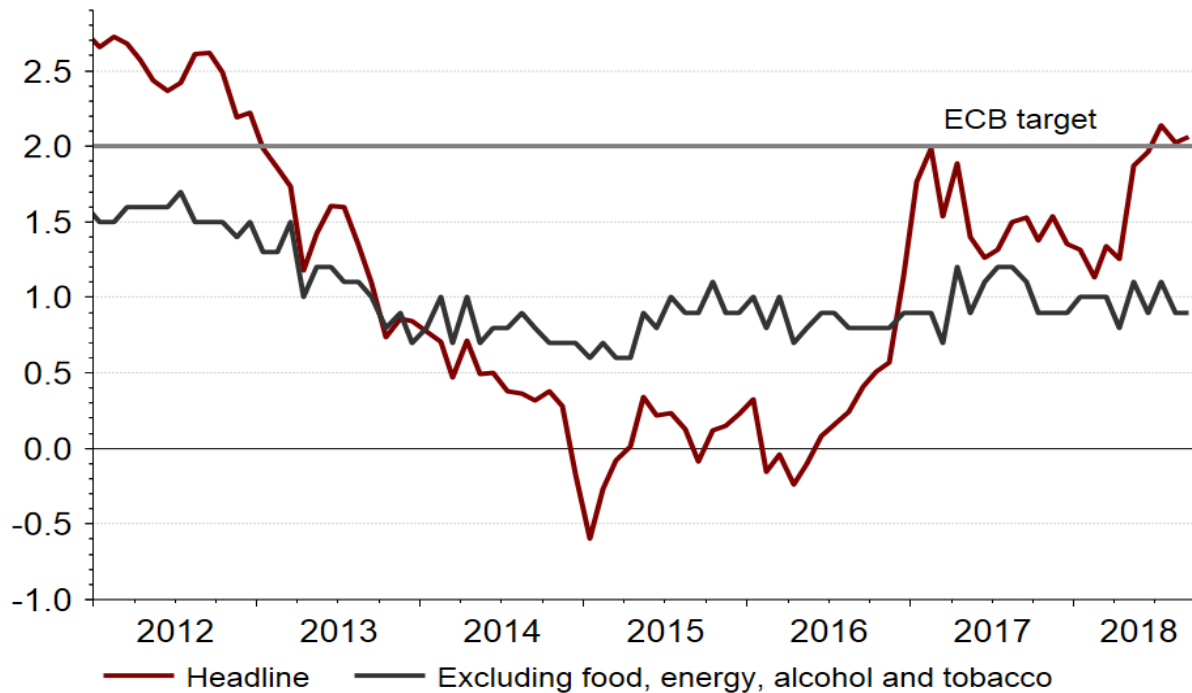
- In 2017 the recovery was based on an increase of net trade.
- In 2018 this growth pillar has disappeared and was temporarily replaced by an inventory increase and investments but this is not sustainable in the longer end.
- We see a bigger contribution from internal consumption in H2 2018 and 2019, in line with the trend of 2016/17.



Headline versus core inflation

Euro area inflation

Twelve-month percentage changes



Source: Thomson Reuters Datastream / Fathom Consulting

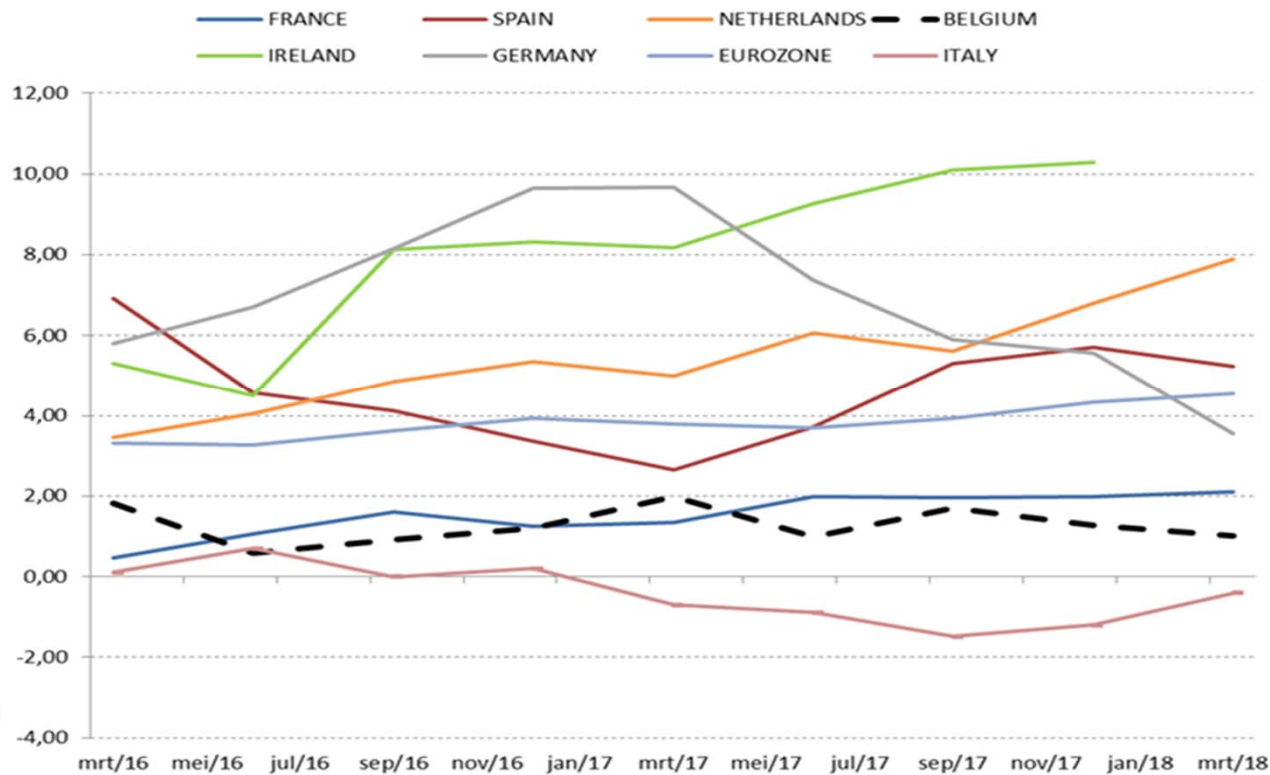
- Headline inflation in the Eurozone has increased towards 2% but Core inflation remains rather stable at or around 1%.
- There is **no urgency** for the ECB to increase interest rates but the headline inflation increase could weigh on consumers' purchasing power.
- ECB Inflation forecasts (Q4)

	2018	2019	2020	LT
HICP	1.7	1.7	1.7	1.9
HICP Core	1.1	1.4	1.7	1.8



Low consumer inflation but strong asset price inflation

Real yearly growth in house prices (%)



➤ In some countries, low interest rates have translated in an exaggerated year-on-year increase in **real estate** prices.



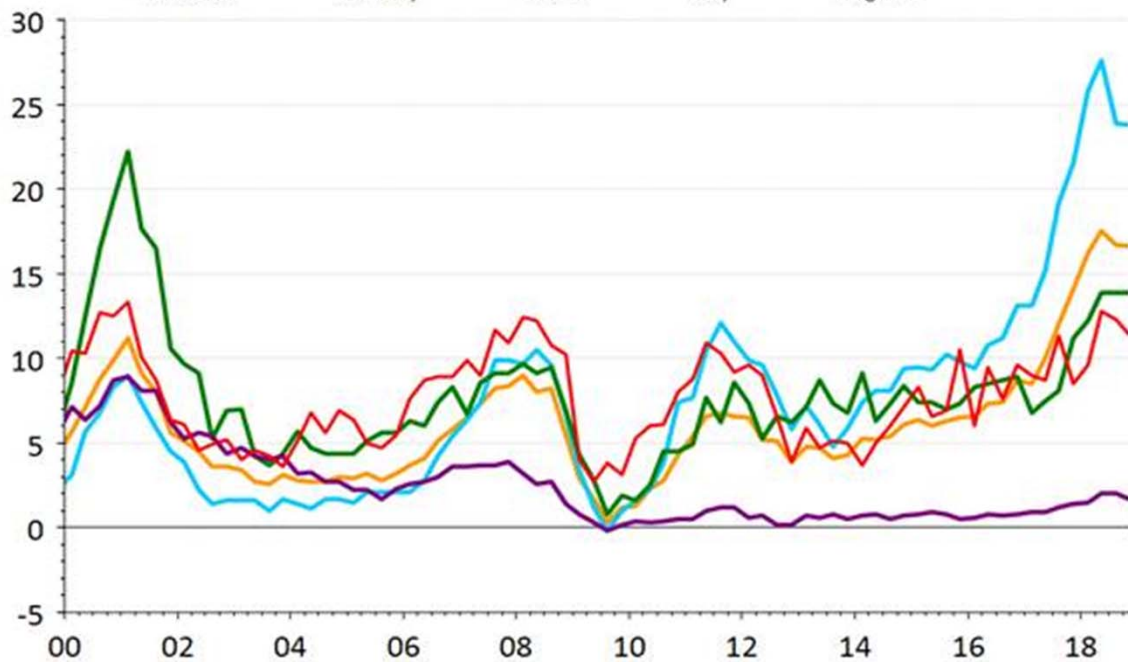
Source: Belfius research

Inflation: Improving labour markets a reason for optimism

Euro area factors limiting production: labour

Per cent of industrial firms reporting labour as a constraint on production

— Euro area — Germany — France — Italy — Belgium



Source: Thomson Reuters Datastream / Fathom Consulting

- A stronger labour market makes more jobs hard-to-fill and as such creating a bigger risk for wage inflation, like we have seen in the US.
- There is still a big divergence between labour markets on both sides of the Atlantic and certainly between countries in the Eurozone.
- ECB U-rate forecast (Q4)

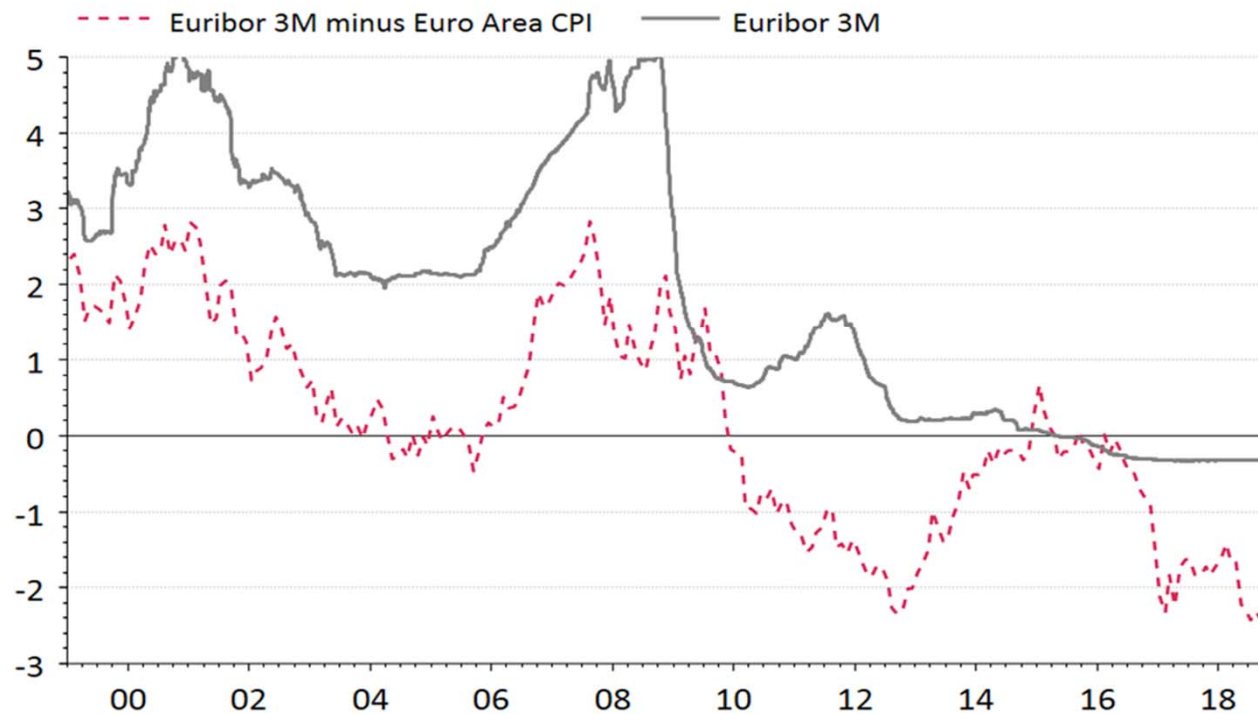
	2018	2019	2020	LT
U-Rate	8.2	7.8	7.5	7.5



Monetary policy still accommodative

Euro area real interest rate

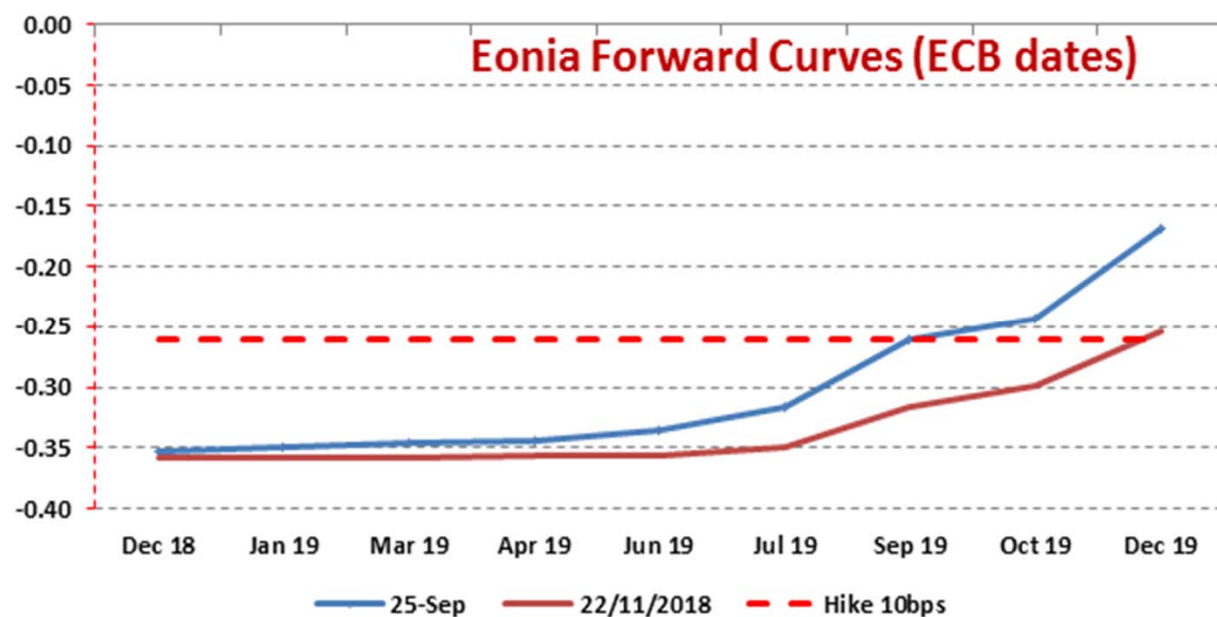
Per cent



- Negative real interest rates were necessary to ward off deflationary risks earlier in this decade.
- The surge in headline inflation made real short term interest rates reach a new bottom.
- **After the summer 2019, the ECB is widely expected to gradually normalize short term interest rates.**



Monetary policy expectations in the Eonia market

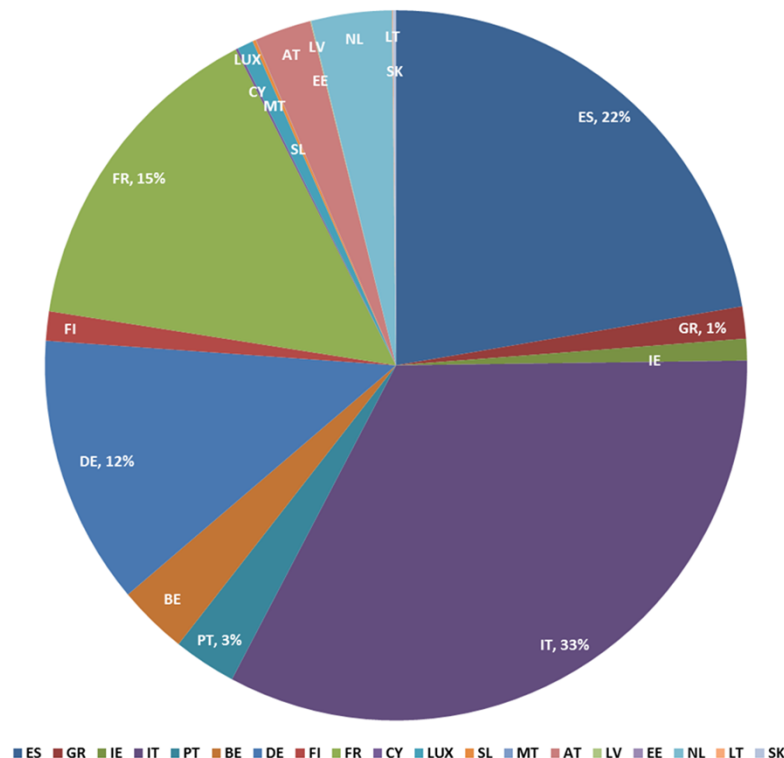


- Since last MMCG the first rate hike has been **postponed** from September 2019 to December 2019.



Monetary policy expectations: (new) T-LTRO talk

T-LTRO Participation per Country

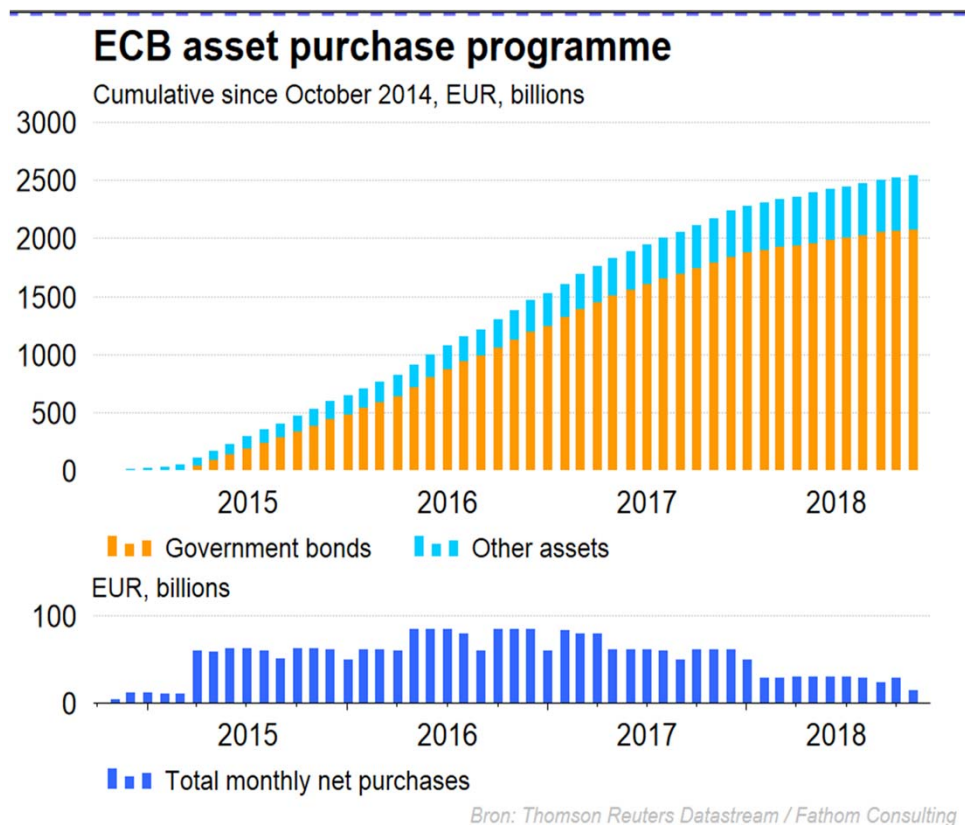
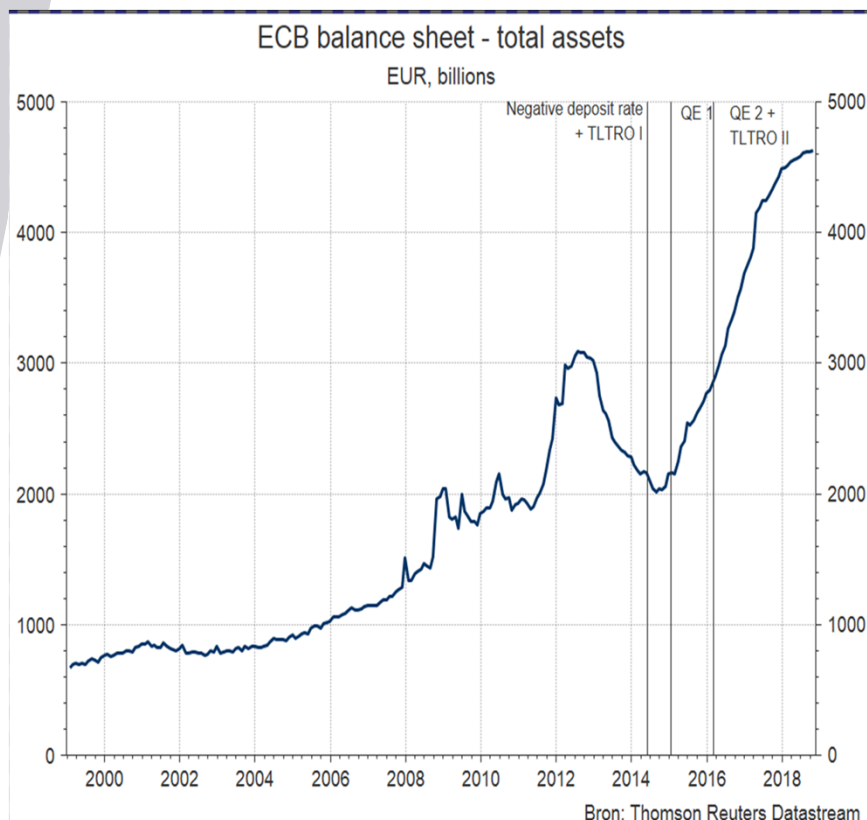


- T-LTRO outstanding of € 725 Bn.
- First maturity of € 385 Bn in June 2020.
- From June 2019, this might cause some reason for concern because of **NSFR reasons**.
- + avoid cliff effect and panic in capital markets
- + compensate hawkish measures like end of APP
- + decrease market stress around Italy
- - contradiction with normalization process
- - stigma could come back, depending on conditions
- How: 2 years? Fixed/Floating? Rate? Repayments?
- Timing of announcement: important for funding plan and future LT issuance of banks.



Source: Belfius research

Monetary policy expectations: APP reinvestments



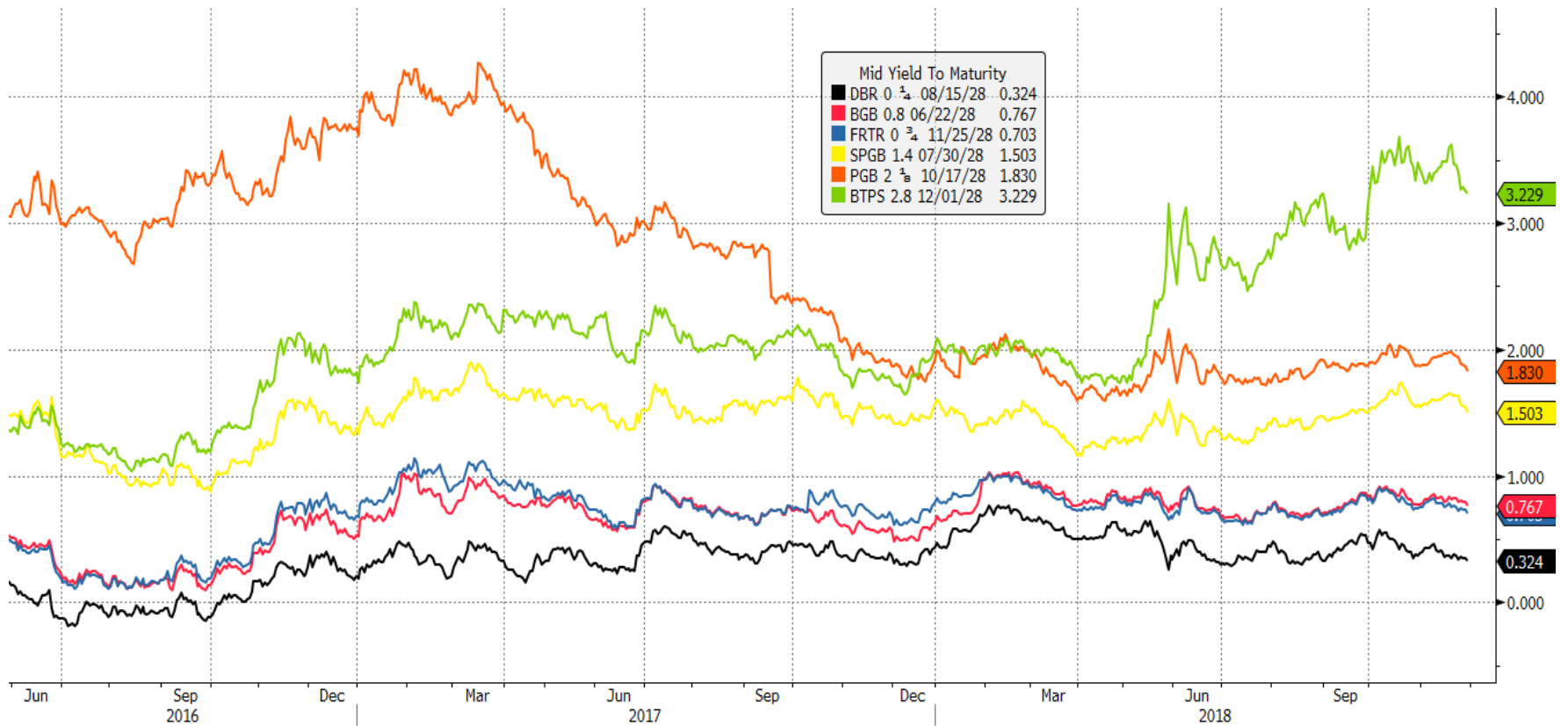
Monetary policy expectations: Forward Guidance

ECB Quotes

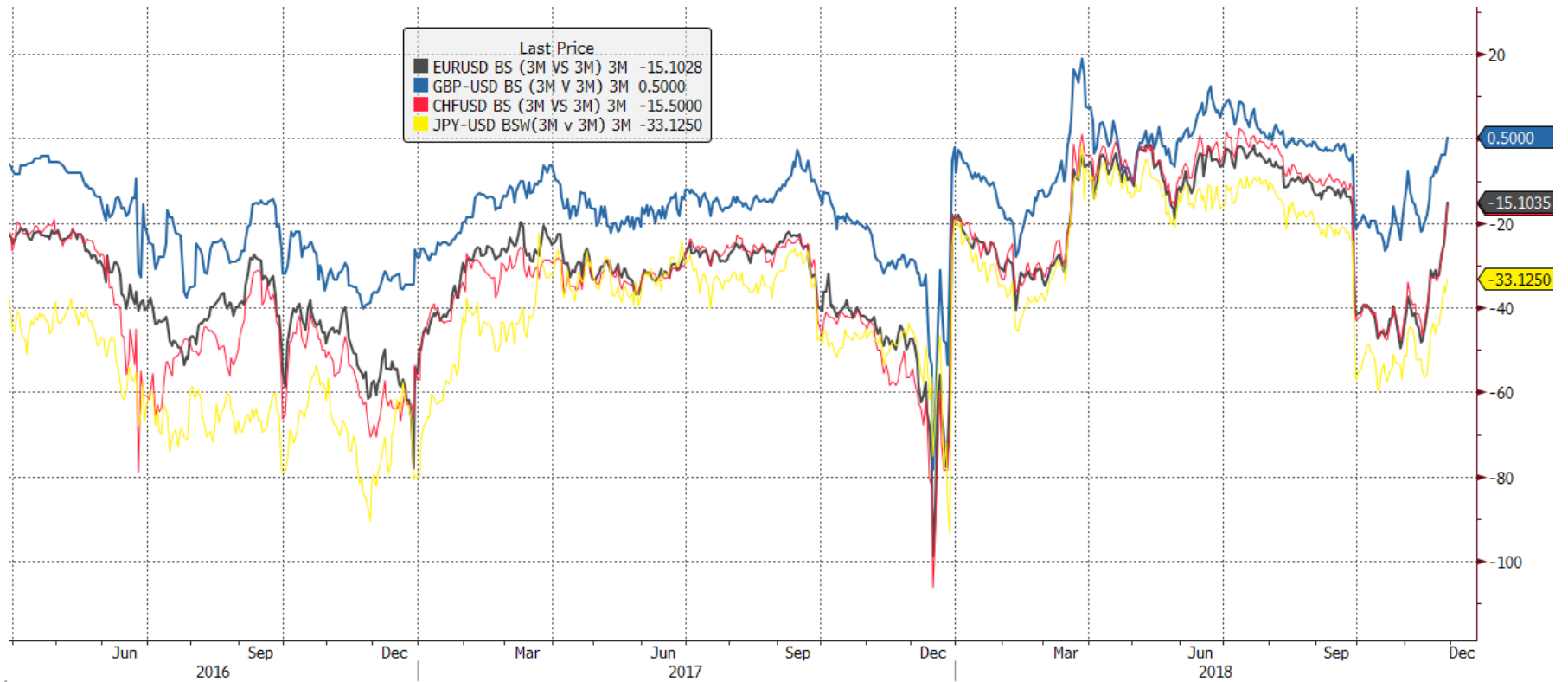
- 28/11 Lane says rate increase dependent on what data will be like in H2 2019
- 28/11 Lane says important not to be overly-dramatic about slowdown in Euro zone growth
- 26/11 Draghi says GC continues to anticipate that net Asset Purchases will come to an end in December.
- 26/11 Draghi says a gradual slowdown is normal as expansions mature and growth converges towards its long-run potential.
- 26/11 Draghi says expects headline inflation to decline in line with oil price fall.
- 26/11 Praet says will have to clarify what ECB means by reinvesting for an extended period of time.
- 26/11 Praet says downside risks have increased noticeably; significant monetary policy stimulus still needed.
- 22/11 Praet says premature to decide on a new TLTRO now.
- 20/11 Weidmann says policy normalization will take several years, ending QE only first step.
- 20/11 Nowotny says sees no reason to deviate from ECB growth forecast.
- 19/11 Villeroy says end of net asset purchases will not mean the end of our monetary stimulus, far from it.
- 16/11 Draghi says labor market is already showing signs of tightness, pass-through to prices relatively muted.
- 16/11 Draghi says we expect the expansion to continue in the coming years.
- 16/11 Draghi says forward guidance has been effective in anchoring expectations about the future path of interest rates and preventing an undue tightening.
- 15/11 Knot says at this point impact of slowdown not enough to change outlook.
- ₁₂ 15/11 Weidmann says inflation in Euro zone now broadly in line with price stability
- 15/11 Weidmann says monetary policy room for manoeuvre likely to be limited in a future economic downturn.



Bond Markets: all eyes on Italy



FX swap markets preparing for Year End volatility



Currency Markets: a stronger Dollar





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