European Central Bank points to slowing economic growth

Nick Beams
27 April 2018

Signs of an economic slowdown in the euro zone for the first months of this year have put a question mark over moves by the European Central Bank (ECB) to further wind back its program of quantitative easing and its ultra-low interest rate regime.

The ECB had been expected to announce by June the future direction of monetary policy after September, when its program of asset purchases is due to end. The ECB currently purchases €30 billion of bonds per month, down from the highest levels of €80 billion per month.

But at the meeting of its governing council in Frankfurt yesterday, the ECB appears to have adopted something of a "wait and see" approach to the future direction of monetary policy in light of the slowdown, following the highest level of annual growth for a decade in 2017.

The first question addressed to ECB president Mario Draghi following the meeting was on the impact of weaker-than-expected data on the bank's monetary policy. "The interesting thing is that we didn't discuss monetary policy per se," he replied.

Draghi then sought to elaborate why that was the case, pointing to the extent of the slowdown. He noted that all countries had reported a loss of momentum and it was across most sectors of the economy.

"Sharp declines" were experienced in purchasing managers' indexes in almost all sectors, including retail, manufacturing, services and construction. "Then we had declines in industrial production, in capital goods production," as well as in export orders. There were also declines in "national business and confidence indicators."

Draghi admitted: "All of these declines were sharp and in some cases the extent of these declines was unexpected."

In assessing these developments, Draghi pointed to a variety of factors, including cold weather and the impact of workers' strikes. He said that after four quarters of growth at around 0.7 percent per quarter "some sort of normalisation was expected."

However, there were also other factors in the manufacturing and capital goods areas that "could suggest a more durable softening in demand."

Draghi returned to the issue of lower growth in response to another questioner who said he was "a little bit surprised" that the governing council did not discuss monetary policy or a roadmap. The questioner suggested it was "already high time" that such things were discussed, given they were not decisions to be made in a couple of weeks.

Draghi's answer indicated that the ECB policymakers have been somewhat wrong-footed by the downturn and unsure how to assess it.

"The reason why we didn't discuss monetary policy per se is that the reading of the current developments since the beginning of the year is actually very important in deciding the next steps," he said.

"The very first thing we have to do is understand exactly—and place what's happened in the proper context—whether it's temporary or permanent, whether it's supply or more demand. Whether it's something that is just the beginning of a more significant decline or it's simply normalisation after a prolonged period of very strong growth."

There had been considerable speculation that the ECB would indicate at its June meeting what the tapering of its easy monetary policy could look like, but Draghi brushed aside a question on that issue. He said the policy had not been discussed and it would be "premature" to make a comment.

Another major issue to arise during the question and answer session was the impact of trade war measures. In his prepared remarks, Draghi said the risks surrounding the euro area remained broadly balanced, however, "risks related to global factors, including the threat of increased protectionism, have become more prominent."

In response to a question, Draghi again adopted a “wait and see” approach. “We have to see what the exchange of, so far, rhetoric … about protectionism will produce.” There could be direct trade-related effects but so far they did not seem to be substantial.

“However we don’t know the extent of the retaliation yet,” Draghi said. “Obviously we can’t yet know what are going to be the direct effects of potential retaliation.

“What is certainly known is that these events have a profound and rapid effect on confidence, on business confidence, on exporters’ confidence, on confidence generally speaking. Confidence can in turn affect the growth question.”

The official rationale for the ECB’s monetary policy is that “accommodative” measures, that is, very low interest rates and asset purchases, must continue until the inflation rate reaches the ECB’s designated target of below, but close to, 2 percent.

However, there is little sign of an upward movement. The annual inflation rate increased to 1.3 percent in March, from 1.1 percent in February, and the headline rate is expected to hover around 1.5 percent for the remainder of the year. In his prepared remarks Draghi noted that “measures of underlying inflation remain subdued and have yet to show convincing signs of a sustained upward trend.”

There is some speculation in financial circles that after moving to pull back on its low-interest rate regime and asset purchasing program, the ECB may be considering delaying its first rise in interest rates until later in 2019 because of the weak economic data for the first quarter of this year. Some analysts also are predicting that the asset purchases may continue beyond September this year.

The concern in the ruling class is that if the low-interest rates and quantitative easing continue the ECB will have little monetary ammunition at its disposal if the current weakness in growth turns out to be then start of a more substantial downturn.