

Eurozone: A sense of stabilisation

Sentiment indicators, which had been falling since the start of 2018 are finally stabilising, but with growth expectations scaled back and inflation still not going anywhere, the ECB has had to finally adjust to the Eurozone's new reality of elevated uncertainty. So overall, expect a low-interest rate environment to remain in place for some time to come



Source: Shutterstock

The stock market rally over the first months of the year has brought some welcome relief. Sentiment indicators, which had been falling since the start of 2018, are finally stabilising, though we shouldn't overdo the potential for a strong recovery over coming months.

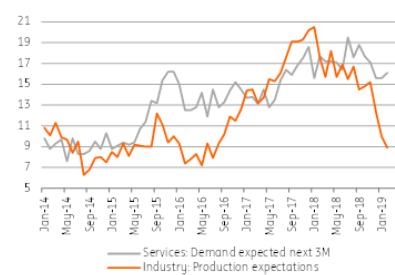
The European Commission's sentiment indicator fell again in February, but the drop was very small, with several sectors actually improving. The weakness seems to be mainly concentrated in the manufacturing sector on the back of a weaker global economy and increased volatility.

The uncertainty surrounding Brexit and the [danger of higher tariffs on European cars](#) in the US are still important and might lead to some hesitation as far as business investment is concerned. [Research](#) from the ECB shows that heightened uncertainty is indeed likely to weigh on investment decisions. Loan growth to non-financial corporates dropped from 3.9% to just 3.3% year-on-year

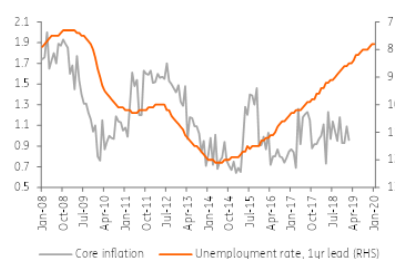
on an adjusted basis in January. Still positive, but clearly decelerating. The European Commission's sentiment indicator fell again in February, but the drop was very small, with several sectors actually improving. The weakness seems to be mainly concentrated in the manufacturing sector on the back of a weaker global economy and increased volatility.

[Read here for an assessment of the likely impact of US tariffs on European cars](#)

Eurozone manufacturing remains the weak link and there is slow transmission from low unemployment to inflation



Source: Thomson Reuters Datastream



Source: Thomson Reuters Datastream

Consumption-related indicators, on the other hand, look rather upbeat. Sentiment indicators improved both in the services and retail sectors, while consumer confidence also climbed in February. With the petering out of the yellow vest movement in France, the winter of discontent seems to be all but over. In Germany, a strong wage agreement in the public sector is yet another indication that consumption is likely to be supported this year by increasing purchasing power. No wonder eurozone retail sales started the year on a strong footing.

Where are things headed next?

With the economic situation now stabilising, the question is where things will head next. The Eurocoin indicator, an estimate of the underlying growth pace, fell further to 0.24% in February. But the eurozone should be able to benefit from improving confidence, assuming the threat of a no-deal Brexit is dispelled, and the European Union isn't dragged into a trade war with the US.

We maintain a GDP growth forecast of 1.2% for both 2019 and 2020, with the quarterly growth pace somewhat slower next year compared to 2019

We still expect a minor acceleration in the second quarter, but given the stage of the business cycle, we believe that such an upturn is just a temporary improvement in an overall slowing trend. We maintain a GDP growth forecast of 1.2% for both 2019 and 2020, with the quarterly growth pace somewhat slower next year compared to 2019 (the fact that the average growth rate is the same has to do with base effects).

We still expect a minor acceleration in the second quarter, but given the stage of the business cycle, we believe that such an upturn is just a temporary improvement in an overall slowing trend

Inflation is still going nowhere. We know that headline inflation can show some volatility on the back of gyrating oil prices, but underlying inflation has remained remarkably stable and low. As a matter of fact, core inflation even fell back below 1.0% in February (though rounded to 1.0%).

So we're still quite far away from a one-for-one transmission from higher wages to higher inflation, as we argued last month. Selling price expectations actually moderated in all sectors in February, according to the European Commission's monthly survey. So expect only very mild upward pressure on core inflation over coming quarters.

A low-interest rate environment to remain in place for some time

With growth expectations scaled back and the last inflation figures not really pointing to increasing price pressures, the ECB has to tread carefully. At its March meeting, the Governing Council decided to extend its forward guidance, signalling that it will not hike interest rates before the end of 2019. On top of that, a new series of TLTROs will be introduced from September 2019 onwards, to prevent an unwarranted tightening of credit conditions.

With the US (and probably also the eurozone) slowing further into 2020, we don't expect the ECB to hike the main refinancing rate over the forecasting horizon, meaning that money market rates are likely to remain negative throughout 2020.

In this case, the upward potential for sovereign bond yields remains limited. With US bond yields likely to decline in 2020 in anticipation of a more pronounced slowdown, we believe European bond yields will not end 2020 any higher than in 2019. So overall a low-interest rate environment will remain in place for some time to come.

Author

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information

purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.