

## 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



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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.

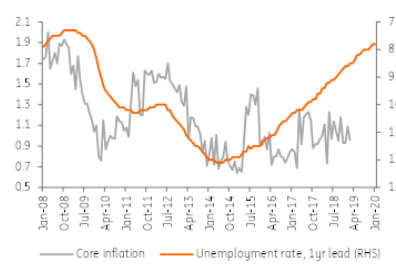
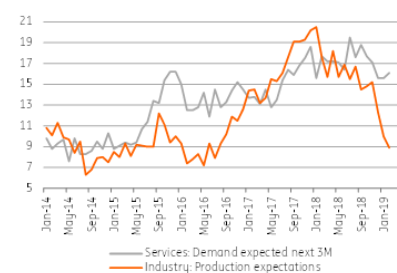
The European Commission's sentiment indicator fell again in February, but the drop was very small, with several sectors actually improving. The weakness seems to be mainly concentrated in the manufacturing sector on the back of a weaker global economy and increased volatility.

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



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.

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*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*

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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).

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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.

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