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ECB: Watching the Euro Slide

by Andrew Wroblewski*

It has been speculated that once the ECB actually started its well-advertised bond buying program (as it did on March 9), bond yields and certainly the euro may have started to reverse their recent moves as markets took profits and envisaged that those swings in financial market prices would boost growth and inflation prospects. Instead, the euro has continued to fall, very clearly against the dollar, where speculation about Fed policy has been a factor.

However, the euro has been falling on a broad base, ie sliding to a seven-year low against sterling! Partly this is a result of continued political worries dogging the euro, not least with the Greek question still festering in the background. But what is interesting is the extent to which the solid real activity data and less soft price signals have failed to support the euro – NB upside surprises in regard to Eurozone economic data have been the order of the day of late!

ECB Rhetoric Important.

It is notable that many were surprised at the economic optimism stressed by the ECB at is Council meeting statement and forecast made earlier this month. This surprise looks misplaced as the more pertinent question is why the ECB was so pessimistic prior to this month, as output, spending and monetary data have been on the mend for some time, particularly that related to the consumer where increasing strength in recent months has served to quash any worry that households were developing any deflation psyche. NB: February **Car Registration** data (Tue) may once again highlight the strength in discretionary Eurozone consumer spending.

Instead, the ECB used the March press conference to infer that the improved economic prospects it envisaged were very much a result of its policy moves both actual and expected. In other words, the ECB tried to stress to markets that unless it went ahead with its bond buying program, the Eurozone economic recovery could well falter, if not reverse. This begs the further question as to when markets may start to question the necessity of continued further easing the ECB envisaged out to September next year: would the prospects of a Q1 GDP result of around 2% saar (as DE envisages and which would be over twice the potential growth rate) start to make markets reassess and/or some of more the skeptical member of the ECB Council more vocal?

Upside Inflation Risks?

Alongside this risk is the fact that the fall in the euro is adding to upside inflation risks. Already there are signs that pipeline price pressures have started to stabilize and the weaker euro may accentuate this. It is noteworthy that the (trade-weighted) euro is already some 3% below the average level the ECB expected for this year, an undershoot that would add 0.2-0.3 percentage point to the inflation rate in the course of the next year.

DE View: If so, this would only reinforce the DE view that headline Eurozone HICP inflation may move back toward the 2% target by year end rather than taking until 2017 as the ECB envisaged!

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