Draghi Drives ECB Toward Stimulus Even as Economy Grows

By Stefan Riecher - May 12, 2014

The euro-area’s fastest economic growth in three years probably won’t be enough to stop Mario Draghi from easing monetary policy.

Even with data this week predicted to show the expansion accelerated in the first quarter, the European Central Bank president looks set to push ahead with measures that could range from rate cuts to liquidity injections. Inflation stuck at less than half the ECB’s goal points to a revival that is still too slow, according to economists from UniCredit SpA to UBS AG.

“A slightly stronger economy isn’t going to change much,” said Marco Valli, chief euro-area economist at UniCredit in Milan, who expects the ECB to cut both the benchmark and the deposit rate in June. “The ECB is becoming increasingly intolerant of low inflation.”

Draghi is fighting to prevent a prolonged period of subdued price gains from derailing the recovery in the 18-nation currency bloc before it becomes entrenched. His declaration last week that officials are “comfortable” with taking action in June suggests a new policy response is imminent.

Three-quarters of respondents in the latest Bloomberg Markets Global Investor Poll, which surveys traders, bankers and money managers who subscribe to the Bloomberg Professional service, said deflation is a greater threat to the euro area than inflation.

Multiple Releases

Gross domestic product in the euro area probably climbed 0.4 percent in the three months through March, according to the median of 40 estimates in a Bloomberg News survey. That would be twice as fast as the prior quarter and the highest rate since the beginning of 2011. The region exited its longest-ever recession in the second quarter of last year.

The European Union’s statistics office in Luxembourg is due to release the GDP data at 11 a.m. on May 15. Germany, France, Italy, Austria and the Netherlands will release their national figures earlier in the day.

Growth in Germany, the region’s largest economy, will accelerate to 0.7 percent, and Italy and France will post their second straight quarterly expansions, according to separate Bloomberg surveys.

“The recovery is proceeding, but it’s proceeding at a slow pace and it still remains fairly modest,” Draghi said last week in Brussels after the ECB left its benchmark interest rate at a record low of 0.25
percent and its deposit rate at zero. “There is consensus about being dissatisfied with the projected path of inflation.”

**June Projections**

The EU’s statistics office will release its first estimate for May consumer-price gains on June 3. Inflation was 0.7 percent in April, according to the office’s initial estimate. While that’s up from 0.5 percent in March, it was below forecast and compares with the ECB’s goal of just under 2 percent. The rate has been less than 1 percent since October.

Draghi will present revised macroeconomic forecasts when policy makers meet in Frankfurt in June. The ECB predicted in March that gross domestic product will rise 1.2 percent this year, 1.5 percent in 2015 and 1.8 percent in 2016. Inflation is projected at 1 percent in 2014, accelerating to 1.5 percent in 2016.

Reinhard Cluse, an economist at UBS in London, changed his policy forecast after Draghi’s comments in Brussels and now predicts a reduction in interest rates.

“The bottom line” is that data are “unlikely to keep the ECB from cutting in June,” said Cluse. “In the case of GDP, even a massive upside surprise would not mean that there would be an immediate pass-through to inflation.”

**Biggest Fear**

Even with the economy recovering and surveys showing a pickup in countries such as Spain and Ireland, which both exited bailout programs in the past six months, unemployment in the euro area is only gradually declining from a record. That signals the expansion has yet to find its way through to the region’s job markets, damping aggregate demand.

Draghi said after April’s rate decision that his “biggest fear” is a protracted stagnation that leads to high unemployment becoming structural.

Joblessness in the currency bloc was 11.8 percent for a fourth month in March, near the all-time high of 12 percent last year. The uneven recovery is highlighted by unemployment rates that range from 4.9 percent in Austria to 25.3 percent in Spain.

**Strong Euro**

The recovery may also struggle to gain traction because of the strength of the euro, which Draghi said is a “cause for serious concern.” The single currency has climbed almost 8 percent against the dollar since July, curbing the price of imported goods and undermining the competitiveness of euro-area companies. It was little changed at $1.3769 at 12:17 p.m. Frankfurt time today.

The central bank is keeping an eye on the euro, ECB Vice President Vitor Constancio said in Vienna today. “It has a material impact,” he said, adding that it’s too early to speculate about ECB action in June. Governing Council member Ewald Nowotny said at the same event that should action be needed,
then a package of measures may be sensible.

“First-quarter GDP will only matter if it surprises upward significantly,” said Laurence Boone, chief European economist at Bank of America Merrill Lynch in London. “Unless the euro weakens, inflation surprises on the upside, or data appear a notch stronger, the scenario of action is more likely than not.”

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