EUROPE ECONOMY

ECB Worries Over Economy Mount, But Officials Stand Pat on Rates

Eurozone economy lost momentum in 2018 as overseas demand for its exports weakened

A Renault employee works on a car production assembly line in France in November. **PHOTO:** ETIENNE LAURENT/EPA-EFE/REX/SHUTTERSTOCK

By Tom Fairless in Frankfurt and Brian Blackstone in Zurich

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The European Central Bank opened the door on Thursday to new stimulus measures to prop up the region's stumbling economy, underscoring a new mood of caution among major central banks as they navigate fractious U.S.-China trade negotiations and disruptive political events such as Brexit.

At a news conference in Frankfurt, ECB President Mario Draghi acknowledged that the outlook for the 19-nation eurozone economy had deteriorated since December, when the ECB moved to phase out its landmark bond-buying program.

Mr. Draghi blamed the changes on "the persistence of uncertainties related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility."

The euro fell to $1.1297 in afternoon trading Thursday -around its weakest this year- after Mr. Draghi acknowledged downside risks to eurozone growth. Yields on 10-year German government bonds also moved lower, signaling a rise in prices.

While the ECB refrained from taking new policy steps to address the slowdown, leaving its key interest rates and policy guidance unchanged, investors are betting that the slowdown will ultimately delay a move by the ECB to raise short-term interest rates, currently set at minus 0.4%. Many investors don't expect an increase before mid-2020.

"The ECB is burying the last hope of an interest rate hike in 2019," said Klaus Bauknecht, chief economist at Deutsche Industriebank AG in Cologne, Germany.

Indeed, Mr. Draghi's comments suggest the ECB is leaning the opposite way: toward more easy-money policies.

"We have lots of instruments and we stand ready to adjust them or use them according to the contingency that is produced," Mr. Draghi said, listing options such as forward guidance on interest rates, bond purchases and long-term loans to commercial banks.

Mr. Draghi said Thursday's meeting had been "devoted to an assessment" of the economy, and that while there are implications for the bank's policy, those weren't discussed. He said that ECB officials considered the likelihood of recession to be low, highlighting solid employment trends, rising wage growth, lower energy prices and favorable financing conditions.

Still, the ECB's more cautious tone suggests it may be preparing to shift its policy, perhaps at its next meeting in March, when officials will have new forecasts for growth and inflation. One easy option would be to provide a new batch of cheap, long-term loans to banks, which would help support lenders in Spain and Italy.

Financial markets have grown fractious in recent weeks as investors worried about a possible turning point for the global economy, which is being buffeted by headwinds ranging from a slowdown in China to a possible messy Brexit.

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In response, Federal Reserve officials have signaled a willingness to pause on raising interest rates following last month's increase. Japan's central bank on Wednesday kept its key policy rate at minus 0.1%, as it revised its inflation forecasts lower. Earlier this month, China's central bank took steps to stimulate lending by reducing the amount of reserves Chinese banks are required to hold.

Bucking this trend was Norway's central bank, which on Thursday kept its key interest rate unchanged but confirmed plans to raise it in March.

ECB officials had hoped that the current slowdown would prove temporary. They had only recently started to phase out stimulus policies adopted since the global financial crisis aimed at supporting growth, including a €2.5 trillion ($2.8 trillion) bond-buying program known as quantitative easing or QE.

But there are few signs yet of any recovery in Europe. A closely watched business survey, published on Thursday, suggested that growth in the 19-nation eurozone may have ground to a standstill in January.

The results of that survey are “more associated with the ECB loosening rather than tightening policy,” said Chris Williamson, an economist in London with IHS Markit , which compiles the survey. They suggest a quarterly growth rate of just 0.1%, he said.

The eurozone economy enjoyed its fastest growth in a decade during 2017, at 2.4%, but economists estimate that it grew by just 1.9% in 2018 and have been lowering their projections for 2019. The 29 forecasters tracked by Consensus Economics now expect the eurozone economy to grow by 1.5% this year, a weaker rate of expansion than the 1.7% projected by the ECB.

The eurozone faces a number of headwinds. In France, President Emmanuel Macron is wrestling with rolling mass protests aimed at derailing his economic reform plans. Those protests contributed to a decline in economic activity during January, the sharpest in over four years, according to Thursday’s survey.

Meanwhile, holdups at Germany’s key automobile factories pushed Europe’s largest economy to the brink of recession in the final six months of last year.

Write to Tom Fairless at tom.fairless@wsj.com and Brian Blackstone at brian.blackstone@wsj.com