European Central Bank President Mario Draghi left open the option of further stimulus if the economy continues to deteriorate as investors await the outcome of elections in Greece and France.

While policy makers didn’t discuss lowering interest rates at a meeting in Barcelona yesterday, Draghi pointed to new growth and inflation forecasts next month that may change the ECB’s policy stance. Uncertainty about the commitments of future leaders in Greece and France to fiscal reforms, paired with worsening economic data and renewed tensions in financial markets, may force the ECB’s hand.

“There are significant downside risks to the ECB’s growth outlook,” said Joerg Kraemer, chief economist at Commerzbank AG in Frankfurt. “Draghi indirectly hinted at next month’s ECB meeting when the bank will publish its new projections. Since the ECB may lower its growth forecasts, the rate-cut discussion will stay with us.”

Austerity measures aimed at stemming the debt crisis have pushed euro-area economies from the Netherlands to Spain back into recession and may embolden Greek politicians who are challenging the country’s commitment to spending cuts. ECB officials, who have flooded financial markets with more than 1 trillion euros ($1.3 trillion) to avert a credit crunch, have signaled they’re reluctant to do more for now as they press governments to enact reforms.

Rate-Cut Bets

The euro rose after Draghi said policy makers didn’t discuss lowering the benchmark rate from 1 percent, already a record low. It climbed as high as $1.3180 from $1.3117 before his press conference started. Investors had increased bets on rate cuts after Draghi last week indicated the ECB was reassessing the growth and inflation outlook.

“We’ve discussed quite extensively the monetary policy stance” which “we found accommodative in view of an economic outlook that becomes more uncertain,” Draghi said yesterday.

That suggests that the ECB will wait to see how its lending to banks will feed into the real economy, said Jens Sondergaard, senior European economist at Nomura Plc in London.

While there is “a compelling case for further policy loosening,” the ECB will probably “err on the side of hawkishness and delay any rate cuts for as long as possible,” he said. “Economic conditions need to deteriorate significantly in the weeks ahead before the ECB will consider loosening monetary policy further at the June meeting.”

Latest Data

A gauge of euro-area manufacturing plunged in April to the lowest in almost three years, according to London-based Markit Economics. The index, based on a poll of purchasing managers, shows that...
manufacturing activity has contracted for nine straight months.

Euro-area unemployment rose to a 15-year high of 10.9 percent in March, and an economic confidence indicator published by the European Commission fell last month to the lowest level since December.

“We saw stabilizing economic activity at low levels in the first three months” of the year, Draghi said. “The most recent survey indicators show uncertainty prevailing. We will be clearer in our assessment next month.”

In March, the ECB revised down its 2012 outlook for the 17-nation euro economy to a contraction of 0.1 percent from an expansion of 0.3 percent.

Draghi’s assessment “seems to be a rather positive gloss on the latest news,” said Howard Archer, chief European economist at IHS Global Insight in London. It will take a sustained further weakening in economic data to trigger policy action, and “unfortunately that could very well happen,” he said.

**Greek Elections**

Elections in Greece on May 6 could empower smaller, anti-bailout parties that promise an end to austerity measures and threaten membership of the euro, even as a majority of Greeks say they don’t want a return to the drachma. The two main parties, New Democracy and Pasok, are polling around 45 percent of the vote. Anti-bailout parties have about the same level of support.

With the decisive second round in France’s presidential election two days away, challenger Francois Hollande leads incumbent Nicolas Sarkozy in opinion polls. Hollande has criticized Europe’s German-led austerity push and argued for the renegotiation of Europe’s fiscal compact.

Angela Merkel, who said yesterday that opponents of austerity display “old thinking,” faces two regional elections in the next nine days, one in Germany’s most-populous state. Merkel’s debt-cutting message is helping her Christian Democrats close the gap on incumbent social democrats, according to polls.

**‘Utmost Importance’**

“It is of utmost importance to ensure fiscal sustainability and sustainable growth in the euro area,” Draghi said. “Most euro-area countries made good progress in terms of fiscal consolidation.”

He said the ECB has “full confidence” that Spain will undertake actions to shore up its banking system and reduce its deficit. “The track record is good,” he said. “We have no doubt whatsoever that the action will be taken and will be as speedy and transparent as in other countries.”

In Italy, Draghi said “remarkable progress has been achieved,” and the government “should be encouraged in its efforts.”

“The pain threshold of the ECB for more policy action is high and has not been reached,” said Christian Schulz, an economist at Berenberg Bank in London. “However, Draghi maintained that the ECB never pre-commits. Deteriorating survey data may be revisited at the next meeting, leaving the door for policy action at the June meeting open very slightly.”

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