

The NewsLine

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EUROZONE

Mini-inflation should leave ECB cold

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Inflationary pressures in the eurozone increased slightly in January, but the annual inflation rate remains mired close to zero. The dramatic slide in the oil price is the main factor weighing on inflation. However, the stubbornly low inflation should not prompt the ECB to loosen monetary policy further as deflationary trends are nowhere in sight and the increasingly self-sustaining upswing in the eurozone does not require any further monetary policy stimulus. With its frequent policy tweaks, the ECB is at risk of exacerbating market uncertainty.

As Eurostat announced today, consumer prices in the eurozone rose in January by 0.4% on a year earlier. The main reason behind weak inflation was the nosedive in oil prices. In January the price of Brent slipped intermittently below USD 30 a barrel. Stripping out the energy component, the annual inflation rate would stand at 1.1%. In 2016 we are expecting consumer prices to rise by an average 0.4%.

Despite the slight acceleration in the annual inflation rate compared with the previous month (December 2015: 0.2%), further monetary policy loosening in the eurozone remains on the cards. At the last press conference ECB president Draghi left little doubt that further loosening measures would follow in March (possibly encompassing a further reduction in the deposit rate to -0.4% and/or an expansion of monthly bond purchases to EUR 75-80bn). The only thing which might prevent a further relaxation of the monetary reins would be a continuation of the current rebound in the oil price.

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With its announcement that it will reconsider its monetary policy stance in March, the ECB wishes to signal to the markets that it takes its inflation goal seriously. However, as in December, it runs the risk of disappointing the high market expectations. What is more, its frequent policy tweaks are contributing to the uncertainty: The main factors cited by President Draghi for the possible need for further action on the heels of the measures passed in December were increased downside risks in the face of nagging uncertainty about the emerging market growth outlook, the volatility on the financial and commodity markets and the geopolitical risks. The risk of adverse side effects from the ultra-loose monetary policy is also rising steadily.

The ECB would be better advised to stay cool in the face of the largely oil-price driven trend in inflation. We believe a degree of optimism is in order that the eurozone economy will gain momentum, breadth and stability in 2016 and that the upswing will become increasingly self-sustaining, buoyed inter alia by a pickup in investment and an ongoing improvement on the labor market.

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