Economist's Weekly Market View

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ECB rates to stay low in 2018 despite strong economic growth

The economic prospects for Ireland's main export market, the Eurozone, look better now than at any time in the past decade or more. Following the economy's strong performance in 2017, the OECD is forecasting that Eurozone GDP will grow by 2.1% in 2018 and 1.9% in 2019. This is broadly in line with the view of the European Commission.

The latest ECB staff forecasts, which were published last month, show the Central Bank has become even more upbeat in its view of the economic outlook, with its GDP growth projections revised substantially higher. The ECB now expects GDP to grow by 2.3% this year, up from 1.8% previously. Its GDP forecast for 2019 was revised up to 1.9% from 1.7%. The first ECB GDP forecast for 2020 was also published, with growth of 1.7% being pencilled in for that year.

This positive outlook for the economy is based on a number of factors, including the fact that ECB policy looks set to remain very loose in the coming years, with interest rates staying at extremely low levels. Meantime, fiscal policy is generally becoming more expansionary, while the global economy is picking up momentum.

Inflation is also expected to remain low, which combined with ongoing solid employment gains should help to maintain growth in real consumer spending. The recovery in the Eurozone is also less advanced than elsewhere, implying that it has the capacity to continue growing strongly for quite some time.

The improving prospects for the economy have been reflected in significant gains for the euro over the past year, especially against the dollar and sterling. Nevertheless, apart from sterling, the single currency is still at quite low levels against most currencies following its marked weakening in the 2014-16 period. This augurs well for a continued strong export performance by the Eurozone.

Recent data have been particularly encouraging. The manufacturing PMI, a good leading indicator of industrial activity, hit is highest level in December since the series began over 20 years ago in 1997. The services PMI also finished the year on a very strong note, reaching its highest level in 7 years.

Meanwhile, the EC measure of Eurozone economic sentiment picked up to its highest level in 17 years in November. National level indicators, such as the German Ifo, French INSEE and Italian ISTAT indices have also been at, or close to, record highs recently. This shows that the economy is continuing to grow at a strong pace as it enters 2018.

Encouragingly, growth is quite broad-based across the Eurozone. Indeed, the European Commission expects only three of the Euro area economies to have a growth rate of less than 2% this year, with the lowest, Italy at 1.3%, quite possibly exceeding the growth rate of the UK.

The economic recovery is having a major impact on the labour market. Strong employment growth has been evident in recent years. Employment grew by a solid 0.4% in third quarter of 2017, with the year-on-year rate picking up to 1.7%, the strongest in ten years. This is translating into a steady fall in jobless numbers, with the unemployment rate dropping below 9% in the closing months of 2017 to its lowest level since early 2009.

Despite the buoyancy of the economy, the ECB appears content to maintain interest rates at their current very low levels through 2018 as inflation remains well below its 2% target level. Data on Friday showed inflation at 1.4% in December, with the core rate even lower at 1.1%. This will reinforce the ECB's inclination to keep interest rates at very low levels.

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