Markit Economic Research

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Eurozone

ECB cuts rate to all-time low amid deflation worries

- **ECB cuts main policy rate to 0.25%**
- **Cut comes amid signs of weakening recovery and steep drop in inflation**

The European Central Bank cut its main policy rate by 0.25% at its Governing Council's November meeting to an all-time low, reflecting worries about deflation taking hold amid on-going economic weakness.

Lower borrowing rates

The ECB cut its main refinancing rate from 0.50% to 0.25%. The rate at which banks can borrow was also cut from 1.0% to 0.75%. ECB head Mario Draghi also highlighted in the press conference following the decision that the central bank was open to the idea of its deposit rate (the rate paid on reserves held at the ECB) falling into negative territory, though the rate was held at 0.0% at the meeting.

The ECB also extended the provision of unlimited liquidity to the region's banks until at least 2015.

Draghi also reiterated that the central bank would hold rates at current or lower levels for an extended period.

However, Draghi reported that there had been no meaningful discussion of a further LTRO.

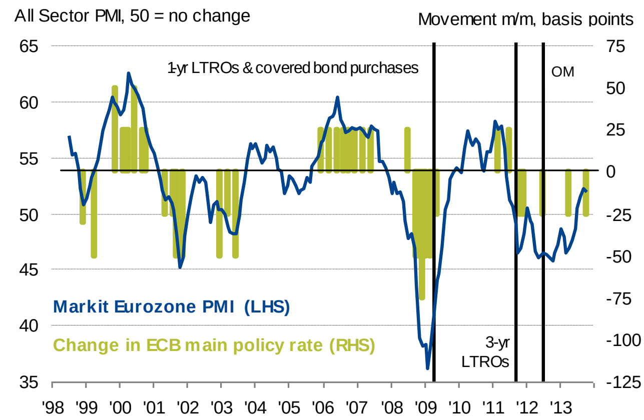
Deflationary forces

Expectations had been confirmed that the ECB was poised for further action after a raft of weaker than expected economic data.

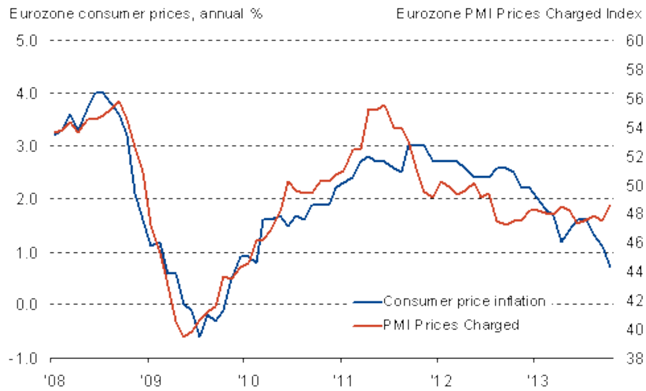
Perhaps most importantly, consumer price inflation had fallen sharply in October, down from 1.1% to 0.7%, its lowest since November 2009.

The Markit Eurozone PMI™ had also lost ground in October. Although still well up on earlier in the year, the index fell slightly and remains at a level consistent with only weak GDP growth of approximately 0.2% per quarter. The Prices Charged Index from the PMI survey has also signalled falling prices levied by companies for their goods and services, highlighting a lack of pricing power amid weak demand.

ECB policy decisions and the PMI

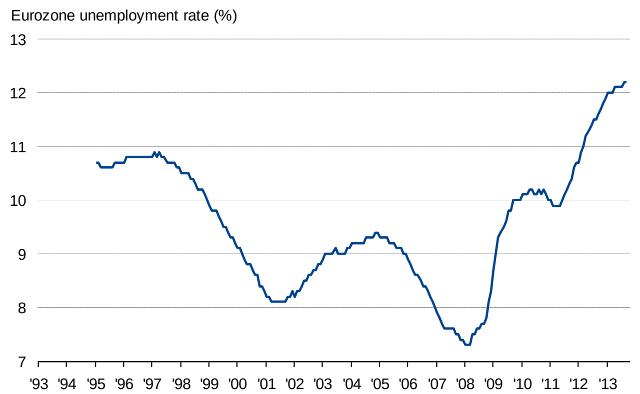


Prices



Sources: Markit, Eurostat via Ecowin.

Unemployment



Source: Eurostat via Ecowin.

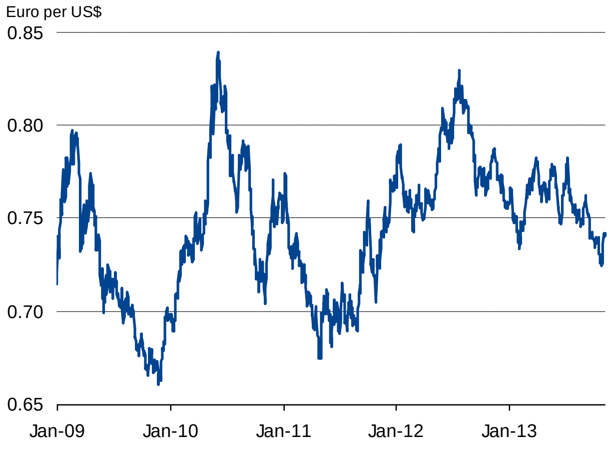
Unemployment in the region meanwhile remains at an all-time high of 12.2%.

The ECB is mandated to ensure price stability, and the combination of inflation running well beneath its target of “below but close to 2.0%” and an economy that is failing to grow at a rate that is likely to generate inflationary pressures was widely seen as having justified the rate cut.

Exchange rate

The rate cut hit the euro, which had risen in recent month against the US dollar in particular – though mainly reflecting a weaker dollar due to signs that the Fed is in no rush to taper its asset purchase programme. The rise in the euro had started to cause concerns that the stronger currency could harm the region’s recovery.

Exchange rate



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