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Commission more downbeat on core inflation than ECB

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Euro macro: Commission more downbeat on core inflation than ECB – The European Commission published its Spring Economic Forecast today. It has become a bit more optimistic about the outlook for the eurozone economy, lifting its forecast for GDP growth in 2017 from 1.6% to 1.7%, a fraction below our own forecast of 1.8%. Meanwhile, according to the Commission, 'the risks to the forecasts are more balanced but still to the downside'. This is broadly in line with the ECB's view that 'downside risks to the economy have further diminished', as was expressed in the statement after the April meeting and has been repeated by several ECB officials since then. In regard to inflation, the Commission forecasts that 'headline inflation should continue to be largely driven by energy prices and base effects, rather than by a durable and self-sustained momentum'. This is in line with the ECB's assessment that 'underlying inflation pressures continue to remain subdued and have yet to show a convincing upward trend'. The Commission expects inflation to increase to 1.6% this year from 0.2% in 2016, but to subsequently fall back to 1.3% in 2018. Core inflation is expected to increase 'only very slightly' according to the EC, from 0.8% in 2017Q1 to 1.4% by the end of 2018 'as wage growth finally picks up'. This implies that the EC's forecast for average core inflation during 2018 (1.3%) is below the ECB's forecast of 1.5%, but more in line with our own view of 1.2%. (Aline Schuiling)

Global FX: Sterling's recovery stalled for now. In 2016, sterling lost 15% of its value against a basket of currencies. So far this year, sterling has rallied by 4% versus the US dollar and 1% versus the euro. For many this has been a surprise because they thought that Brexit would send sterling much lower in 2017 as well. Therefore, net-short speculative positions have been very large. At some point in time, every investor who wanted to be positioned for sterling weakness was positioned. Under those circumstances prices will not decline anymore. This is exactly what has happened so far this year. Some investors have closed short-sterling positions on the back of better-than-expected UK data and expectations that the Bank of England might be forced to tighten monetary policy because of higher inflation. This has resulted in GBP/USD rising towards 1.30. Investors had expected that today's quarterly inflation report and the vote at the MPC would be more hawkish. The outcome (a 7-1 vote) and the upward adjustment in the 2017 inflation forecasts were not as hawkish as expected. As a result, sterling came under pressure across the board. We think this sell-off is healthy after the recovery sterling has experienced so far this year. We expect GBP/USD to move towards 1.25 in the coming weeks, also because of a recovery of the US dollar. However, we don't expect sterling to weaken beyond that. Investors will likely use any weakness in sterling as an opportunity to close some of their excessive sterling shorts. As a result, GBP/USD may not even reach 1.25. (Georgette Boele).

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