Servicio de Estudios Económicos

BBVA

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ECB watch

Meeting: December 6th 2007

November 30th 2007

A more pessimistic tone

- We expect the ECB to keep the refi rate on hold at 4.0% at its next meeting in December.

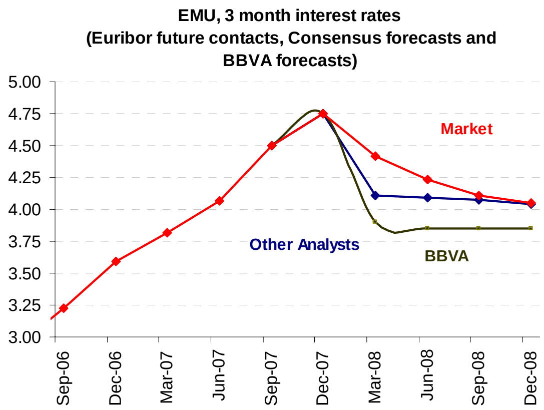
- Latest data suggest that GDP growth will be significantly weaker at the end of the year and very likely at the beginning of 2008. Meanwhile, inflation continues to surprise on the upside.

- In the current context, with the combination of euro appreciation, a tightening financial conditions and the recent bad news regarding the international scenario coming from the US and the UK, we have revised downwards our GDP growth projection for 2008 (1.8%).

- In addition, we expect the ECB staff to revise downwards its growth projection (2%) while upwards its inflation projection (higher than 2 percent) for 2008. Most relevant for monetary policy are the Eurosystem Staff projections for 2009. They are very likely to consider growth below potential and some moderation in inflation.

- Regarding financial turbulences, additional tensions have recently risen. The situation of the financial markets remains quite volatile and fragile. Looking forward, they are likely to stay that way over the near future.

- In our view, the time to “wait and see” is waning. We maintain our projection on policy rates of a 25 bps rate cut next Spring.



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Box 1: Economic indicators

Growth will be significantly weaker in Q4. Industrial confidence had improved slightly but service, consumer and construction confidence deteriorated further. Private consumption is weakening and inflation surprised on the upside.

		Average 2006	Aug-07	Sep-07	Oct-07	Nov-07	Impact on rates*
GER – IFO Economic Climate	Obs. Cons.	105.5	105.8 105.4	104.2 105.0	103.9 103.7	104.2 103.3	
Euro–EC Industrial confid.	Obs. Cons.	2.3	5 4	3 4	2 2	3 1	
Euro –EC Consumer confid.	Obs. Cons.	-9.0	-3 -2	-6 -4	-6 -5	-8 -7	
Euro – Industrial prod. (m/m)	Obs. Cons.	0.4	1.2 0.3	-0.7 -0.4			
GER – Retail sales (m/m)	Obs. Cons.	1.8	-1.4 0.3	1.2 0.8	-3.3 -0.4		
Euro – HICP (y/y)	Obs. Cons.	2.2	1.7 1.8	2.1 2.1	2.6 2.3	3.0** 2.8	
Euro – M3 (y/y)	Obs. Cons.	8.5	11.6 11.7	11.3 11.4	12.3 11.5		
Euro – Loans to Priv. Sect. (y/y)	Obs. Cons.	11.0	11.2	11.0	11.2		

* According to BBVA, the direction in which this data may affect the ECB monetary policy stance; **Flash estimate; Obs: current data; Cons: consensus forecasts.

Box 2: Speeches and comments by members of the ECB Governing Council

Still upwards bias on inflation. Growing concerns on euro appreciation and on external factors.

	Trichet	Papademos	Liebscher	Weber	
Activity	We have growth that is quite a flattering one; around potential for Europe. risks are on the downside, it is not disputed."	"Current conjuncture ... uncomfortable, though temporary… combination of higher inflation and somewhat slower economic growth".			More uncertainty regarding external factors
Inflation	Solid anchoring of inflation expectations is all the more important in a period of turbulences associated with this market correction	"Price stability is subject to a number of upside risks, including a jump in energy and food prices".	"Price stability over the medium term is subject to upside risks as increased oil, commodity and food prices as well as the favourable labour market".		On the upside
Monetary policy		"Prepared to act in an effective and timely manner to ensure risks don't materialize… the bank is in no rush to raise interest rates".	"Prepared to act pre-emptively to prevent risks from materializing if they continue to rise".	"Do what is necessary to keep inflation expectations in line with its definition of price stability … there are still inflation risks that may signal the need to raise rates further as tensions progressively ease".	Still an upward bias
Euro/ financial turbulences	"Sharp and abrupt moves in exchange rates are not welcome …and I do not welcome what I call brutal moves." should allow the yuan to appreciate faster against other currencies emerging	"Euro's appreciation is helping to curb inflation"	"Euro's appreciation was sharp and substantial… Strong euro has cushioned our economies from recent crude oil shocks.	"Markets are still tense and fragile… A significant improvement can't be expected before the end of the year."	More concern/Still fragile for a time

Box 3: Market view

Additional tensions.

	3m euribor Future Cont.	1m Eonia Future Cont.
Dec. 07	4.75	4.01
Mar. 08	4.42	4.02
Jun. 08	4.23	4.00
Sep. 08	4.11	3.95
Dec. 08	4.06	

ECB-Barometer for the December 6th Governing Council meeting