



ECB watch

Meeting: March 6th 2008
Next meeting: April 10th 2008

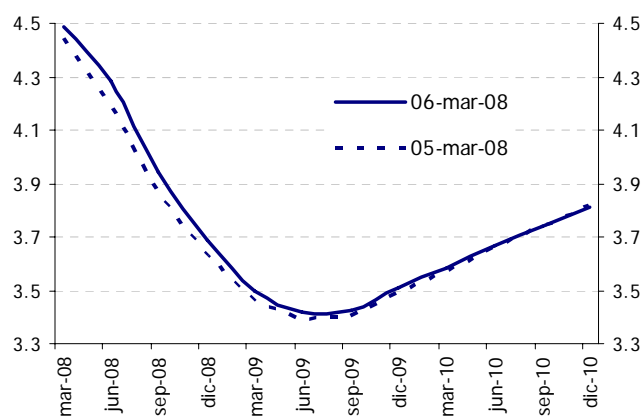
Back to a more hawkish tone

- As expected, the ECB left the key rates unchanged at 4%.
- The ECB Staff's growth projections have been revised downwards to 1.7% in 2008 and 1.8% in 2009, in line with other international organizations. Risks to growth remain on the downside, but seem less important in the statement
- Inflation projections for 2008 have been revised upwards for 2008 to 2.9%, well above consensus. Inflation for 2009 remains subdued though (2.1% on average, implying they remain within the ECB target by end-2009).
- We maintain our ECB interest rate outlook of a rate cut in June and a further one in September.

In the statement: the softening of language from past month has been partly reversed.

- In the introductory paragraph, the Governing Council maintains the anti-inflationary tone of recent months ("we emphasize that maintaining price stability in the medium term is our primary objective"; "strongly committed to prevent second-round effects"). It adds that "the latest information has confirmed the existence of strong short-term upward pressure on inflation", and provides a more positive view on ongoing growth: "Incoming macroeconomic data" [...] "point to moderating but ongoing real GDP growth" instead of "have confirmed that the risks surrounding the outlook for economic activity lie on the downside". The reference to "unusually high" uncertainty resulting from financial market turmoil has been downgraded to merely "high".
- Staff's projections for GDP growth have been revised from a mid-point of 2.0% to 1.7% in 2008, and from 2.1% to 1.8% in 2009, due to "weaker global demand, stronger pressure from commodity prices and less favourable financing conditions than were foreseen in December". Uncertainty about growth prospects remains "unusually high" on similar grounds that last month (financial markets, commodity price rises, protectionist pressures and disorderly unwinding of global imbalances).

UEM: 3 month Euribor contract future



Miguel Jiménez
mjimenezq@grupobbva.com

- Inflation projections have been revised from midpoints of 2.5% and 1.8% in 2008 and 2009, respectively, to 2.9% and 2.1%, under the assumption that underlying pressures from labour costs, profits and commodity prices will be subdued. The Governing Council expects “a more protracted period of relatively high rates of inflation than we did a few months ago”. Risks continue to be on the upside, coming from the same sources as last month (commodity and administered prices, wage pressures due to high capacity utilization, profit margins, indirect taxes). The Council also warns against the use of wage indexation schemes.
- The monetary analysis remains very similar to the previous month. The statement stresses the high growth rate of credit to non-financial corporations, which has accelerated in January.

The Q&A session: inflation is the only needle in ECB’s compass.

- The decision was unanimous.
- When asked if the current dollar/euro exchange rate was “brutal”, Mr Trichet only referred to standard remarks from G-7 meetings against excessive volatility.
- To stress the commitment to medium-term price stability, Mr Trichet said that “there is a tendency to consider we are in a two-needle universe. It is not the case. We have one needle in our compass which is price stability”.
- On credit growth. Mr Trichet signalled that growth of credit to non-financial corporations was “very, very dynamic”, but that there is “big necessity to work a lot to disentangle various influences”. This growth remains to be fully explained.
- When asked (twice) about the excessively recourse by banks to ECB financing with collateral, Mr Trichet stressed that collateral rules have not changed since the creation of the ECB. Other central banks have changed the rules.

Markets reaction: The curve of three-month interest rate futures’ contracts increased by about 10bp. The euro appreciated the meeting from 1.526 to 1.535.

Concluding remarks

Overall, the ECB seems to have reversed somewhat the slight softening tone from the previous meeting, which had been interpreted by markets and by some analysts as evidence of immediate cuts, but had been talked down by subsequent ECB speak during the month. Risks to growth remain on the downside, but the Governing Council seems less worried about them, and more about inflation risks. Inflation projections by the Staff are well above the analysts consensus and our own projections (2.6% for 2008), and are a good excuse for maintaining the hawkish tone. It is important that medium-term projections (end 2009) remain below 2%, even under the technical assumption of lower rates given by markets. This implies that rate cuts will be compatible with inflation stability once some growth risks materialize, as we think will happen.

Box: ECB Statements

	December 6 th	January 10 th	February 7 th	March 7 th	Concluding remarks*
Monetary policy stance	Strong short-term upward pressures on inflation. Governing Council stands ready to counter upside risks . We will therefore monitor very closely all developments.	Strong short-term upward pressures on inflation . Governing Council remains prepared to act preemptively ... risks surrounding the outlook for economic activity are on the downside ... will monitor very closely all developments.	Governing Council remains committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term... We will continue to monitor very closely all developments.	Governing Council remains committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term... We will continue to monitor very closely all developments.	Still a hawkish tone
Growth	Fundamentals ... remain sound. The range projected for growth in 2008 ... slightly downwards. Risks lie on the downside... broader impact from... financial markets on financing conditions, confidence and world and euro area growth	Fundamentals are sound. Risks lie on the downside... relate to a broader impact of the reappraisal of risk on financing conditions and economic sentiment... oil and other commodity price rises... disorderly developments due to global imbalances.	Fundamentals are sound, uncertainty about the prospects for growth is unusually high... risks for activity have been confirmed to lie on the downside ... relate ... impact of financial market developments on financing conditions and economic sentiment	The economic fundamentals of the euro area are sound . Incoming macroeconomic data point to moderating but ongoing real GDP growth . Yet the level of uncertainty resulting from the turmoil in financial markets remains high	Risks are on the downside but less present
Inflation	Inflation expected to remain significantly above 2% in the coming months and is likely to moderate only gradually in the course of 2008 . Staff projections have shifted upwards . For the recent increase in inflation to remain temporary, ... no second-round effects materialize	Expected to remain significantly above 2% in the coming months ... likely to moderate only gradually in the course of 2008... more protected than previously expected... Moderation assumes ... reversal of recent oil and food price dynamics and no broadly-based second-round effects.	Most likely remain significantly above 2% in the coming months and moderate only gradually in the further course of 2008... assumption ... recent rises in commodity prices will be partly reversed... their impact on inflation do not have broadly-based second-round effects.	HICP inflation rate ... to moderate only gradually in the further course of 2008... the projections assume that recent oil and food price dynamics... do not have broadly-based second-round effects on wage and price-setting behaviour.	Likely to moderate only gradually under the assumption of no second-round effects
Risks	Fully confirmed our assessment that there are upside ... the possibility of further rises in oil and agricultural prices... , administered prices and indirect taxes... capacity constraints... stronger wage growth may emerge.. pricing power	Fully confirmed to lie on the upside... include stronger than currently expected wage growth... pricing power of firms could be stronger than expected.	Confirmed to lie on the upside... stronger than currently expected wage growth... pricing power of firms stronger than expected... further rises in oil and agricultural prices ... increases in administered prices and indirect taxes.	Risks... confirmed to lie on the upside... include... stronger than currently expected wage growth... pricing power of firms... further rises in oil and agricultural prices... administered prices and indirect taxes	Upside risks
Monetary analysis	Confirms the prevailing upside risks to price stability. Money and credit ... vigorously. little evidence that the financial turbulence ... has strongly influenced the dynamics of ... money and credit ... may suggest ... that the supply of credit has not been impaired	Confirms the prevailing upside risks to price stability... Money and credit have grown vigorously in recent months... underlying rate remains strong... little evidence that the financial market turbulence has strongly influenced the dynamics.	Confirms the prevailing upside risks to price stability at medium to longer-term horizons... there is little evidence that the financial market turbulence ... has strongly influenced the dynamics of broad money and credit aggregates	Confirms the prevailing upside risks to price stability at medium to longer-term horizons... there is little evidence that the financial market turbulence ... has strongly influenced the dynamics of broad money and credit aggregates	Same as previous month: Aggregates growing vigorously; no sign of impact from financial markets
Movement	0.0	0.0	0.0	0.0	0.0
"Refi" rate	4.00	4.00	4.00	4.00	4.00

* BBVA interpretation of the ECB opinion according the statement and the press conference

Relevant events before the next ECB meeting (April 10th)

March 12	January Industrial Production
March 14	Labour cost index Q4/2007
March 14	February Euro area Inflation
March 17	Employment Q4/2007
March 19	January Construction Output
March 26	January Industrial New Orders
March 31	March Flash Estimate Euro area Inflation
March 31	March Business and Consumer Survey
April 1	February Unemployment
April 1	February Money Supply
April 2	February Industrial Producer Prices
April 3	February Retail Trade
April 9	Q4/2007 – 2nd release Euro area GDP