



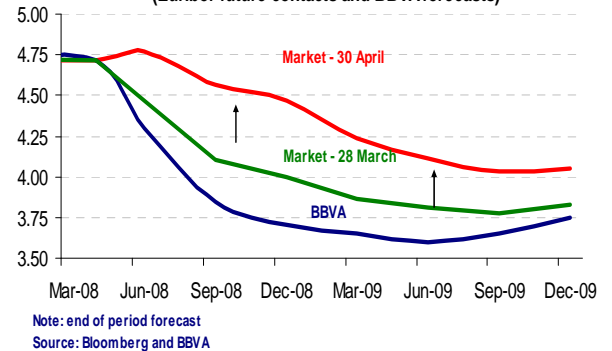
Meeting: May 8th 2008
April 30th 2008

ECB watch

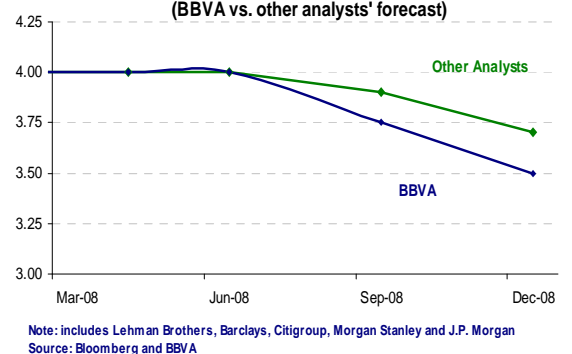
A shift in market expectations

- We expect the ECB to keep the *refi* rate on hold at 4.0% at its meeting next week.
- Incoming data have confirmed that the euro area economy remains resilient, though moderating gradually. In February, both industrial production and orders have turned out to be better than expected. However, most confidence indicators have deteriorated significantly in April.
- Monetary aggregates have moderated in March, but continue growing at double-digits. As in previous months, the rate of growth of loans to non-financial firms has accelerated but we believe this series is contaminated by re-intermediation and by the recourse to open credit lines by firms.
- After several months of bad inflation surprises that pushed up our inflation forecast for 2008 to 3.0% on average, the flash for April has put annual inflation at 3.3% (below expectations). Looking forward, we still think that inflation will fall below 2% in the second half of 2009 as base effects disappear, commodity prices moderate and lower demand combined with a high exchange rate put a break on activity.
- ECB talk has remained predominantly hawkish, especially after the strong surprise in March inflation, lowering market expectations on rate cuts. At the moment, future markets discount stable rates in 2008, while many analysts have again postponed or cancelled their projections of rate cuts (Box 4).
- In this context, we expect that the ECB will lower policy rates in September and December (25bp each) as the economic outlook deteriorates.






EMU, 3 month interest rates
(Euribor future contracts and BBVA forecasts)



Official rates
(BBVA vs. other analysts' forecast)



Box 1: Economic indicators

		Average 2006	Jan-08	Feb-08	Mar-08	Apr-08	Impact on rates*
GER – IFO Economic Climate	Obs.	105.5	103.4	104.1	104.8	102.4	
	Cons.		102.3	102.9	103.5	104.3	
Euro–EC Industrial confid.	Obs.	2.3	1	0	0	-2	
	Cons.		2	1	1	-1	
Euro –EC Consumer confid.	Obs.	-9.0	-12	-12	-12	-12	
	Cons.		-10	-12	-12	-13	
Euro – Industrial prod. (m/m)	Obs.	0.4	0.6	0.3			
	Cons.		0.4	0.2			
Euro – HICP (y/y)	Obs.	2.2	3.2	3.3	3.6	3.3**	
	Cons.		3.1	3.2	3.3	3.4	
Euro – M3 (y/y)	Obs.	8.5	11.5	11.3	10.3		
	Cons.		11.3	11.5	10.6		
Euro – Loans to Priv. Sect. (y/y)	Obs.	11.0	11.1	11.0	10.8		

* 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

The ECB talk remains hawkish. Uncertainty remains high about the fallout from the financial turbulence.

	Liebscher	Garganas	Papademos	Weber	
Activity		“GDP growth continues at a slower pace ... For the moment, the economic slowdown in the U.S. has had a limited negative impact.”	“Moderating but ongoing economic growth... outlook surrounded by unusually high uncertainty and downside risks, stemming in particular from continuing financial market tensions.”	“Uncertainty about the economic outlook and the downside risks associated with the tensions in global financial markets.”	High uncertainty due mainly to a broader impact from the financial turbulences
Inflation	“My best guess is that we will see a decrease in inflation but probably not as much as forecast perhaps a few months ago.”	“It will remain at high levels in the coming months and will gradually recede later, but not at a fast pace ... Medium-term risks to price stability have increased in the euro area.”	“There is a risk that the current temporarily high annual inflation rates, which may persist for a rather protracted period of time, could have second-round effects on wage and price-setting.”	“ECB will have to raise its forecast for 2008 and 2009 inflation considerably... increased the risk of a prolonged period of intolerably high inflation.”	Concerned about wage spirals. Risks have increased
Monetary policy	“Very concerned... There's no reason for any kind of complacency, in no way... We have to do everything necessary to prevent any materialization of second-round effects.”	“Anchoring medium-term and long-term inflation expectations is its highest priority and that there's no room for complacency.”	“Firm anchoring of medium to longer-term inflation expectations is of the highest priority ... solid commitment to do what is necessary to preserve price stability over the medium term.”	“Do what is needed to ensure that inflation expectations will continue to remain firmly anchored at low levels ... fight the risk of broad-based second-round effects decisively and proactively.”	Still hawkish
Financial turbulences		“Uncertainty in financial markets remains high.”	“Continuing financial market tensions, which may last longer than initially expected.”	“We don't see turbulence leaving deep economic scars... Confidence remains considerably distorted.”	Uncertainty high, ongoing process.

Box 3: Market view

No signs of rate cuts in the short term.

	3m euribor Future Cont.	1m Eonia Future Cont.
May. 08	4.820	4.030
Jun. 08	4.765	4.025
Sep. 08	4.565	4.020
Dec. 08	4.465	3.980

ECB-Barometer for the May 8th Governing Council meeting

