



ECB Watch

Next Meeting: October 8th 2009

2nd October 2009

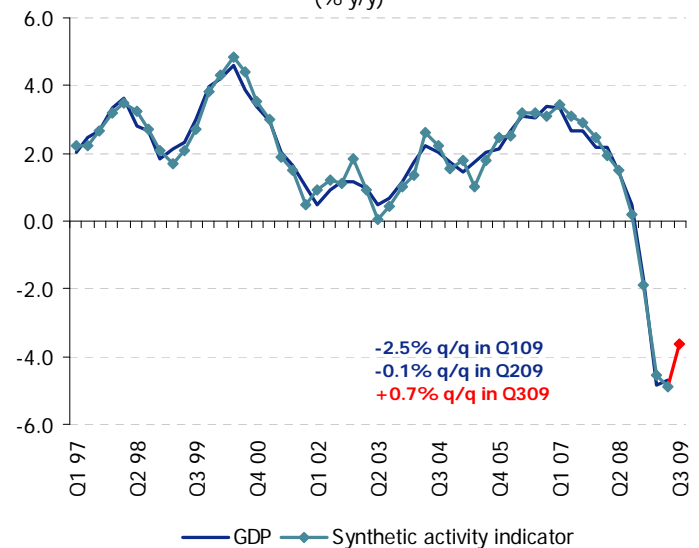
See and wait mode

- The ECB is expected to keep rate on hold at 1% at its next meeting on October 8th. There is no much news since the last meeting for the ECB: inflation is subdued but there is no risk of deflation, caution on the economic outlook is evident and rates are considered appropriate. There is much talk on the timing, sequence (rates vs. non-standard measures) and coordination of the exit strategy, but there is unanimity that it is too soon to exit.
- Regarding **economic activity**, confidence data continued to improve in September and although the increase was somewhat lower than in previous months, it cumulated a significant quarterly increase of 9.6 points in Q3 (after rising by 4.5 points in August). However, hard data available for Q3 (for July until now in most cases) shows mixed signals, with industrial production falling slightly, while industrial orders rose rapidly. The later suggest an increase in activity should continue in coming months, and indeed we forecast positive growth in Q3 (+0.7% q/q) and Q4 (lower and more uncertain), but we also foresee negative growth in 2010 H1 as the effects on the fiscal stimulus wane.
- According to euro area flash estimate, annual **inflation** in the euro area fell by 0.1pp to -0.3% y/y in September, mainly driven by the fall of fuel prices, slowing its recovery and therefore the reversal of the base effect of energy prices. However, we expect core inflation to remain stable at 1.2% y/y. For the 2009 average, we maintain our forecast for both headline and core inflation at 0.3% and 1.3%, respectively. All in all, the outlook of mild inflation has not changed.
- ECM members' comments have insisted on the caution note predicated during the meeting a month ago, underlying the need to talk about exit strategies although it is soon to withdraw stimulus. This week Mr Trichet made remarks **about the "extraordinary importance" that the dollar remains strong**. It will be interesting to hear what the ECB Council has to say about this point during next week's meeting, since a strong euro would make early rate rises in Europe (earlier than in the US, anyway) even more difficult.
- We continue to see a cut to 0.50% in the official rate in early 2010 as growth returns to negative, and unchanged rates after that until well into 2011.

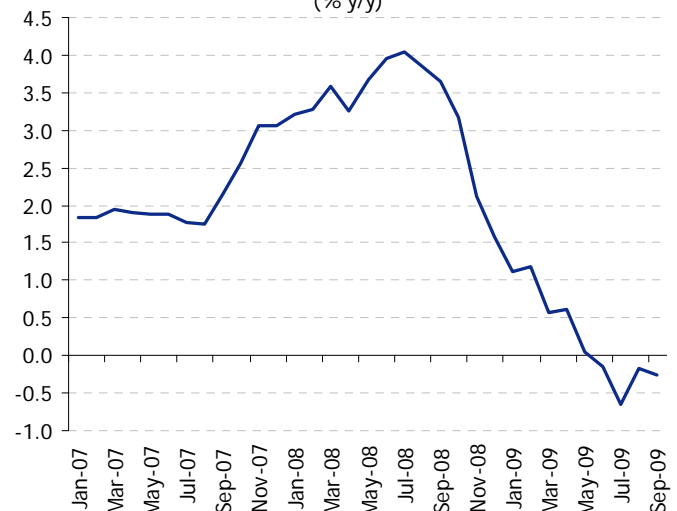
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Euro Area: GDP growth
 (% y/y)







Euro Area: HICP
 (% y/y)



Source: Eurostat

Box 1: Economic indicators

		2008	jun-09	jul-09	ago-09	sep-09	Repercusión sobre los tipos *
Euro- Manufacturing PMI	Obs.	46.5	42.4	46	48.2	49	
	Cons.		42.4	43.5	47.5	49.8	
Euro- Services PMI	Obs.	48.5	44.7	45.6	49.9	50.6	
	Cons.		44.5	45.1	46.3	50.2	
Euro- Economic Sentiment Indicator	Obs.	91.1	73.2	76	80.6	82.8	
	Cons.				78	82.5	
Euro- Industrial Production m/m	Obs.	-1.1	-0.6	-0.3			
	Cons.		0.3	-0.2			
Germany - Retail Sales y/y	Obs.	-0.5	-1.0	-2.6			
	Cons.		3.0	-1.8			
Germany - IFO Business Climate y/y	Obs.	96.8	85.9	87.3	90.5	91.3	
	Cons.		85.0	86.5	88.7	92.0	
Euro - HICP y/y	Obs.	3.3	-0.1	-0.7	-0.2	-0.3	
	Cons.		-0.1	-0.5	-0.2	-0.2	
Euro - M3 y/y	Obs.	9.5	3.5	3.0	2.5		
	Cons.		4.0	2.9	2.7		
Euro - Loans to Private Sector y/y	Obs.	9.3	1.5	0.7	0.1		

* According to BBVA, the direction that this data can affect the monetary Policy by the ECB

Obs: actual data; Cons: forecasts by consensus

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

ECB members continue to be cautious with positive recent economic data. Regarding monetary policy, recent declaration suggest that the most hawkish side of the ECB Governing Council is push for rapid interest rises once the exit strategy starts to be implemented.

Activity	Speech/Comment	Speech/Comment	Speech/Comment	Speech/Comment	Implication
Activity	"We can expect a moderate recovery with positive growth rates in 2010". (Mersch)	"We'll experience an L-shaped recovery". (Nowotny)	"The economic recovery is likely to be very gradual". (Stark)	"The economic recovery will be fairly slow as the global financial situation remains very fragile". (Wellink)	Caution when interpreting positive recent data. Gradual recovery
Inflation	"There are no immediate risks of inflation". (Smaghi)	"Annual inflation rates are expected to turn positive again within the next few months, but to remain relatively subdued". (Stark)	"Money and credit growth could increase, and therefore over the longer run, inflation pressure could re-emerge." (Weber)	"Once the economy recovers slowly and price pressures increase, a tightening of monetary policy will be on the agenda". (Weber)	Inflation will remain positive but subdued over the policy relevant horizon
Interest rates	"It isn't time to exit." (Weber)	"No reason to change the monetary policy stance at the moment". (Liikanen)	"The tightening phase cannot wait until inflation materializes but will have to precede it". (Smaghi)	"It is conceivable to raise rates after withdrawing liquidity measures...but the alternative is also conceivable". (González-Paramo)	The current level is appropriate
Non-standard monetary policy	"The exit can only happen when the functioning on the interbank market has been secured". (Mersch)	"The recovery isn't self-sustainable yet. It's too early to withdraw measures". (Weber)	Stimulus should be withdrawn once the recovery is under way, "in our view at the latest in 2011". (Trichet)	"Most non-standard measures will phase out naturally". (Trichet)	An exit strategy is under discussion, but it is too soon to implement it

Box 3: Market view

	3m euribor Future cont.	1m Eonia Future cont.
Oct-09		0.405
Nov-09	0.740	0.405
Dec-09	0.740	0.455
Mar-10	0.915	0.580
Jun-10	1.190	0.800

ECB-Barometer for the October 8th Governing Council meeting

