Economic Research Department

BBVA

EMU

ECB Watch

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Next meeting: February 4th 2010

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Pause in monetary policy news, tough on Greece

- **As expected after the decision and information-charged meeting last month, there were no news this month on the monetary policy stance or the exit strategy.**
- **Interest during the press conference was focused on fiscal issues, especially on Greece. On this, Mr Trichet repeated the tough message recently heard from other Council members**

The meeting today was uninformative on monetary policy issues, as was broadly expected after last month the ECB published new projections, decided to retire one year and six month's tenders after the December and March ones, and maintained the full-allotment fixed-rate weekly tenders but only up to the end of March. The statement read today was very similar to the one last month, especially on monetary policy issues and on the economic and monetary assessment. Perhaps because of the lack of news on this front, the ECB was more outspoken on fiscal issues, which also dominated the press conference as many questions were posed about Greece, and to a lesser extent on other countries. There was also a reflection on regulatory issues.

On the economic outlook: The ECB still expects positive growth in Q4 and moderate growth on average for 2010. Mr Trichet repeated his line of a "bumpy road ahead" and prudence: "we have to remain very alert, very prudent". The statement says (and Mr trichet stressed afterwards) that growth is partly based on temporary factors, in particular macroeconomic stimulus. This coincides with out relatively pessimistic outlook for the European economy.

On inflation: no risks in sight over the relevant period. There is no change here. Inflation is to hover around 1% in the near term. When asked, Mr Trichet corroborated recent declarations by hardliner Mr Stark saying that there is no inflation risks until end-2011.

On the monetary analysis: Credit to households has turned slightly positive, though credit to non-financial corporations is falling. "We are not surprised […] There are lagged effects for credit outstanding growth". No news here either, it is the same "no credit restrictions" defence line as in previous months.

On rates: Rates are appropriate. The decision on interest rates was unanimous. Mr Trichet did not want to comment on market speculation that Eonia rates will go back to repo rates in the second half of the year: "I am not surprised that Eonia is quite close to the deposit rate because of the level of liquidity of the market […] When we will change handling of liquidity, then there will be a different position of the Eonia rate”. This argument has been used several times before, although it does not mention the obvious –that the present level of Eonia is something wanted by the ECB (not only the unintended result of liquidity management).

On the exchange rate: usual statement of agreement with the US position on a strong dollar (adding this time “I speak with gravity” on this).

On Greece: The no bailout warning mentioned by Mr Stark and Mr Weber recently was implicitly repeated by Mr Trichet today: “No state can expect a special treatment”. “Some governments, one in particular, have very difficult decisions to take”. He also made comments on the credibility of Greece figures: they are “absolutely essential […] the government is getting the message very very clearly”, to which Mr Papademos added that the main point on the new Greek plan to improve statistics is now its implementation and the independence of the statistical office. Mr Trichet also indicated that they will not be influenced by the Greek situation when deciding if reversing the collateral rules in 2011, after their easing in 2008: “We will not change our collateral framework for the sake of any particular country. That’s crystal clear”. All this is a hard stance, as would be expected, but perhaps the harshness of the message comes also from the length that the Greek issue took from the press conference. But when asked to comment on worries on an euro break-up or the abandonment of the Eurozone by one member, he started replying that he does not like to comment “on absurd hypotheses” although he recognized there is work to do. He also wanted to put the Greek problem into perspective, saying that the Greek economy is only 2.5% to 3% of the Eurozone’s.

On other countries’ fiscal situation: On Ireland, he said the country had taken measures which are “quite impressive”. “What we see till now seems to go in the right direction”. On Spain less positive, saying he did not want to give good or bad marks to different countries, adding that “like others of the 16, Spain has homework to do”.

On supervision: Commenting on the German government’s decision to provide the Bundesbank with bank supervision powers, Mr Trichet reminded us that the public view of the ECB was in favour of a “rapprochement” of central banking and bank supervision, while recognising that there are many different models of division of responsibilities between central banking and supervision in the World or even within the Eurozone.

Summing up

The lack of news on monetary policy was predictable. The tone on the outlook is still relatively (and justifiably in our view) soft, given the temporary nature of some factors behind the timid recovery. The relatively hard position last month on the exit strategy is still, in our view, at odds with this outlook and with the lack of adjustment in parts of the Eurozone banking system. We still expect official interest rates at 1% for at least the rest of 2010. All references to the fiscal situation of Greece are hard, but do not constitute a surprise in our view either, as we are in a period where all European institutions are putting pressure on Greece to be credible on its consolidation efforts. We consider that the Greek problem has probably a weight on the ECB when taking its decisions (even if Greece is small in terms of GDP, its public debt is large and systemically important), but we would not expect them to recognise it in public.

Box: ECB Statements

	October 8th	November 5th	December 4rd	January 14th	Concluding remarks*
Monetary policy stance	**Rates remain appropriate**. The GC will make sure that **measures taken are unwound in a timely fashion and the liquidity provided absorbed**.	**Rates remain appropriate**. **Not all our liquidity measures will be needed to the same extent as in the past**. The GC will make sure that the **extraordinary liquidity measures taken are phased out in a timely and gradual fashion and the liquidity provided absorbed**.	**Rates remain appropriate**. **Not all our liquidity measures will be needed to the same extent as in the past**. 6 and 12 month auctions phased out; full allotment maintained as long as needed and at least until March.	**Rates remain appropriate**. The GC will also **continue to implement the gradual phasing-out** of the extraordinary liquidity measures that are no needed t same extent than in the past.	**Rates remain appropriate. GC will continue to implement the gradual phasing-out of liquidity**
Growth	**Economy is stabilizing and is expected to recover at a gradual pace.**	Latest information continues to signal an **improvement in economic activity in H209**. They expect the euro area economy **in 2010 to recovery at a gradual pace**.	Available survey data suggest that the recovery is continuing during Q4. **Euro area economy is expected to grow only at a moderate pace** (0.8%) **in 2010**, and the recovery process is likely to be uneven.	Latest information confirms that towards the end of last year economic activity continued to expand. **Euro area economy is expected to grow only at a moderate pace** (0.8%) **in 2010** and the recovery process could be uneven.	**Activity continued to expand in Q4, but gradual recovery and “bumpy road” ahead. Risks are balanced**
Inflation	Current negative inflation rates are expected. Owing to base effects, **annual inflation rates are projected to turn positive again in the coming months**, but staying subdued reflecting ongoing sluggish demand.	Current negative inflation rates are in line with previous expectations. Owing to base effects, **annual inflation rates are projected to turn positive again in the coming months**, but staying subdued reflecting ongoing sluggish demand.	Inflation is **expected to rise further in coming months** (upward base effects in energy and food components), but **remaining moderate over the policy-relevant horizon** as a consequence of the slow recovery in demand.	Inflation is **expected to remain around 1% in the near term** and **moderate over the policy-relevant horizon** as a consequence of the slow recovery in demand.	**Inflation rates will remain well below 2% in 2010. Inflation expectations remain firmly anchored**
Risks	Risks to these projections are **broadly balanced**. Cautious interpretation of available information.	Risks to these projections are **broadly balanced**.	Risks to these projections are **broadly balanced**.	Risks to these projections are **broadly balanced**.	**Broadly balanced**
Monetary analysis	Developments in broad money and credit growth remain subdued, being in line with the lag that normally prevails between trends in economic activity and developments in loans to enterprises.	In the next few months, the annual growth rates of monetary aggregates will **most likely be affected downwards** by base effect associated with the intensification of the turmoil one year ago. The growth of loans to enterprises typically only picks up with some lag compared with the cycle in economic activity.	The monetary analysis confirms low inflation pressures as money and credit continue to slow down. Loans to households level off at low rates. The growth of loans to enterprises typically only picks up with some lag compared with the cycle in economic activity.	The monetary analysis supports the assessment of a decelerating underlying pace of monetary expansion and low inflationary pressures over the medium term. Turning points in the growth of loans to enterprises typically lagging those in economic activity.	**Money and credit continue to slow down. Low inflationary pressures**
Movement	0.00	0.00	0.00	0.00	
“Refi” rate	1.00	1.00	1.00	1.00	

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

Relevant events before the next ECB meeting (February 4th)

January, 15	Euro Area inflation, December
January, 15	Euro Area trade balance, November
January, 19	Euro Area construction output, November
January, 22	Euro Area industrial new orders, November
January, 28	Euro Area quarterly sector accounts, Q3/2009
January, 28	Euro Area business and consumer survey, January
January, 28	Euro Area PMI, January
January, 29	Euro Area monetary aggregates, December
January, 29	Euro Area flash inflation estimate, January
January, 29	Euro Area unemployment, December
February, 2	Euro Area industrial producer prices, December
February, 3	Euro Area retail trade, December