



ECB Watch

Next Meeting: February 4th 2010

3rd February 2010

Waiting for the March meeting

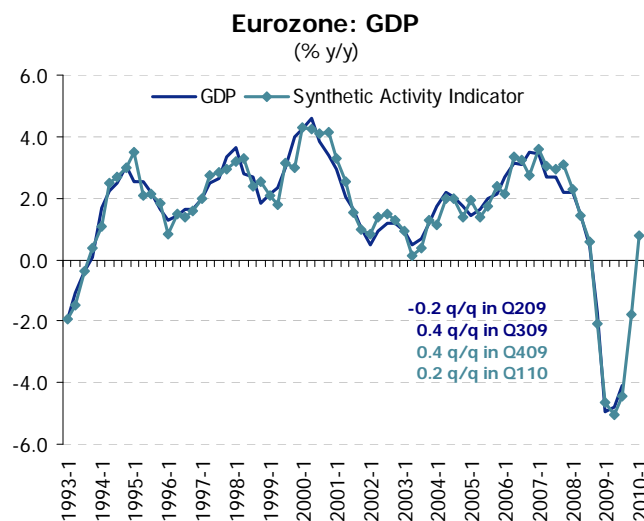
- Not much is expected for the next ECB council meeting on February 4th. The Council will keep its refi rate on hold at 1% and will not say much on future rate rises nor the exit strategy, being a transition meeting to March's one, when the ECB will have to say for how long it prolongs the auctions of unlimited amounts at fixed rates, and will also update its projections.
- The update of what has happened in the Eurozone in terms of economic data since the last meeting (a very recent one: Jan 14th) shows only nuances. **Regarding activity**, the significant increase of both industrial new orders and industrial production in the euro zone in November continued to be consistent with a positive quarterly growth in Q4 09, similar to that observed in the previous quarter (+0.4% q/q, before we were expecting 0.5%). However, some downside risks came from both trade (exports were negative in November for the second consecutive month) and national GDP figures (German GDP growth could be flat in Q4 09) which suggest that the recovery could be flatening. Confidence data improved further in January but at a slower pace, consistent with our view that the economic recovery should lose momentum over Q1 10 but growth will still be positive. The deterioration in the labour market deterioration (unemployment rate increased to 10% in December after 9.9% in November) pushes down consumer confidence, and thus private consumption should remain very weak and saving rates stand at high levels (15.8% in Q3 09).
- Regarding **credit data**, the divergence between loans to households and to non-financial corporations continued in December. Loans to households increased further, driven by mortgage lending, but those to non-financial corporations fell again on monthly terms and are at -2% in annual terms (see graph). The delayed recovery of loans to firms (similar to past cycles) hoped for by the ECB has not arrived yet. In addition, the euro area **bank lending survey** for Q4, released last Friday, points to a further net tightening of credit standards in Q4 09, but a slower pace than in previous quarter. Looking forward, banks expect some more tightening of credit standards on loans to enterprises, but a reduction of those on housing loans. As for responses on loan demand, that for loans to enterprises remained for the third quarter in a row.

Miguel Jiménez

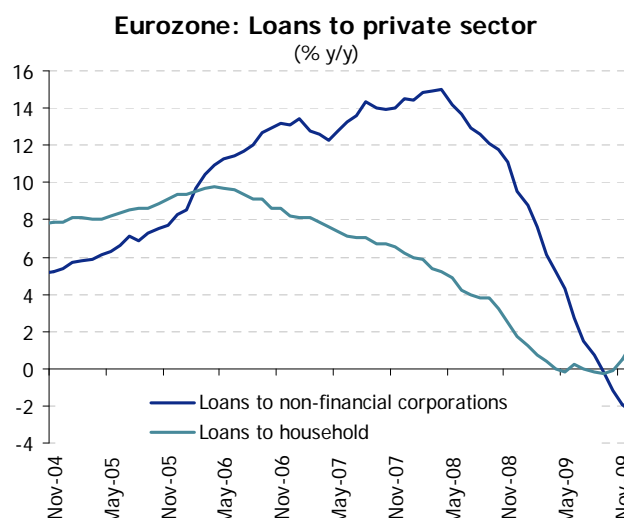
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Source: Eurostat and BBVA ERD



Source: ECB

- On **inflation**, the annual rate rose by 0.1pp to 1% y/y in January, less than expected, probably driven by more aggressive sales and the usual updates of weights of components implemented every year in January. This figure suggests that core inflation should have declined slightly in January (we expected it to remain stable at 1.1%). Overall, we continue to see subdued inflation in the months ahead as the recovery of activity will remain sluggish and the output gap large.
- **Public declarations of members of the ECB** council since the meeting of January 14th have not provided any clues on the road ahead for monetary policy, but they have given a feeling of what are their perceptions on the outlook for inflation and activity, even if with the usual distance between hawks and doves. Inflation is clearly not a concern for quite some time: “there are no signs that the abundant liquidity will pose risks to price stability” (hawk Mr Stark). The mood on the recovery continues to be very cautious, with references to a slow first half of 2010, high levels of unemployment, and general uncertainty on what the shape of the recovery will be. On the withdrawal of liquidity there is perhaps less unanimity: “We are in a process of progressively normalizing our refinancing operation framework in the course of the year” (Mr Weber); the bank will scale back its emergency measures “very carefully” to ensure the exit will not create new distortions in financial markets (Mr Nowotny).
- Most of the news over the last month regard the **evolution of the Greek fiscal crisis** and its possible extension to other euro area countries. In this respect, we continue to think that despite the tough talk by the ECB on the need of adjustment for Greece, it is very likely that the perceived fragility of the fiscal situation will have an effect on the speed of the tightening of monetary policy, although we do not expect softer words from Mr Trichet. If anything, given the recent news on the backing by the EC of the Greek consolidation plan and the eventual bailout by the EU, the language could become even harder in terms of the necessary adjustments to avoid a relaxation on the Greek side. In addition, the recent softness of the euro (linked to the Greek crisis) should have a direct impact on the inflation and activity outlook and therefore on the pace of monetary exit.
- **In sum, tomorrow’s meeting will not be charged with news. We expect a continuation of the cautious tone, no direct answers to monetary policy questions and further persuasion efforts for the Greek government to materialise its fiscal plans in effective measures.**

Box 1: Economic indicators

		2008	Oct-09	Nov-09	Dec-09	Jan-10	Impact on rates *
Euro- Manufacturing PMI	Obs.	46.5	50.7	51.2	51.6	52.4	
	Cons.		50.1	51.3	51.4	51.8	
Euro- Services PMI	Obs.	48.5	52.6	53.0	53.6	52.3	
	Cons.		51.3	52.6	53.2	54.1	
Euro- Economic Sentiment Indicator	Obs.	93.5	89.6	91.9	94.1	95.7	
	Cons.						
Euro- Industrial Production m/m	Obs.	-1.7	-0.3	1.1			
	Cons.		-0.7	1.0			
Germany - Retail Sales y/y	Obs.	-0.1	-0.8	-2.5			
	Cons.		-1.9	-1.7			
Germany - IFO Business Climate y/y	Obs.	96.8	92.0	93.8	94.6	95.8	
	Cons.		92.0	92.5	94.5	95.1	
Euro - HICP y/y	Obs.	3.3	-0.1	0.5	0.9	1.0**	
	Cons.		-0.1	0.5	0.9	1.2	
Euro - M3 y/y	Obs.	9.5	0.3	-0.3	-0.2		
	Cons.		0.7	0.4	-0.6		
Euro - Loans to Private Sector y/y	Obs.	9.3	-0.8	-0.7	0.0		
	Cons.						

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

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 about the economic recovery in the euro area. Tough talk on fiscal issues continued, following similar lines as in the past Council's press conference.

Activity					
Activity	"It is likely that H1 10 will be somewhat muted than H2 09. But that isn't necessarily a sign of another downswing, or double-dip." (Stark)	"I see a bumpy road ahead for the euro-zone recovery, but the underlying dynamic is intact." (Weber)	"In 2010, we expect only moderate growth in the euro region and a probably bumpy recovery." (Stark)		The tone is still relatively soft, given the temporary nature of some factors behind the timid recovery
Inflation	"The ECB sees neither an inflation or deflation perspective." (Nowotny)	"There are no visible signs of risks for price stability." (Stark)	"Inflation averages about 1.5% this year, with a positive acceleration at the end of the year to 1.8% to 1.9% due to base effects." (Weber)	"Inflation is expected to remain around 1% in the near term. Looking further ahead, inflation is expected to remain moderate over the policy-relevant horizon with overall cost and wage demand staying subdued." (Trichet)	Inflation will remain positive but subdued over the policy relevant horizon
Fiscal Policy	"Budget deficits in euro area countries must be reduced in a timely fashion to maintain confidence in public finance." (Trichet)	"Financial markets are starting to show certain worry over the fiscal situation and this adds urgency to the need for governments to get their public finances in order." (González-Paramo)	Called on Greece to start a "fundamental turnaround of its economic policies and an exhaustive consolidation program." (Stark)		Tough talk on fiscal issues. Emphasis on the need for fiscal consolidation
Non-standard monetary policy	"In general, the ECB should aim to return to normality as soon as the prevalent conditions allow it." (Stark)	After the end of the first quarter, "we will talk about returning to the auction process in the refinancing operations with longer-term maturities." (Weber)	"At the ECB we have made it clear that, in the past, any decision – even one concerning the exit – will be linked to the underlying economic conditions and in particular to the re-emergence of inflationary pressures." (Smaghi)	"The GC will also continue to implement the gradual phasing out of the extraordinary liquidity measures which are not needed to the same extent as in the past." (Trichet)	The ECB started the withdrawal of liquidity by announcing that the next 12 and 6 months auctions will be phased out

Box 3: Market view

	3m euribor Future cont.	1m Eonia Future cont.
Feb-10		0.355
Mar-10	0.685	0.370
Jun-10	0.950	0.475
Sep-10	1.235	0.870
Dec-10	1.505	1.075