



ECB Watch

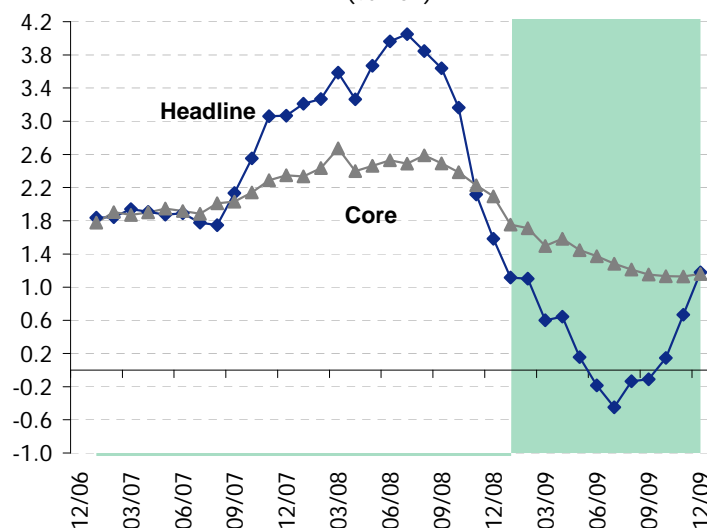
Meeting: March 5th 2009
February 27th 2009

Another cut of 50bp is widely expected

- We expect the ECB to cut the refi rate by 50bp to 1.5% at its next meeting on March 5th, coinciding with most analysts. Recent declarations of ECB members tacitly acknowledge that there will be a rate cut, after the pause in February. The ECB will also release next week its quarterly macroeconomic projections which, as suggesting by some members' speeches, will present substantial revisions with respect to those published in December and should be in line with those of other international organizations. This probably implies a central forecast of GDP growth of about -2% for 2009 by the ECB (our projections are of a larger contraction) and a pace of inflation around zero by mid 2009 but still far from zero for core inflation.
- The main line of interest of this meeting will be what the statement and Mr. Trichet say about further cuts down the road and about the possibility to expand the balance sheet of the ECB in coming months. On this later point, and based on recent declarations by Council members, we do not expect any announcement for this meeting.
- Regarding economic activity, soft indicators declined in February, after having shown some signs of stabilization in January. Our synthetic activity indicator has been updated and points now to a further quarterly contraction in the first quarter (-1% q/q), but by less than in previous one (-1.5%).
- Inflation declined to 1.1% in January, in line with our projections. Core inflation decelerated from 2.1% to 1.8%, one decimal point below our expectations, mostly due to downward surprises in non-energy goods prices. This was compensated by higher than expected energy inflation. We expect core inflation to drop further during the year, recording an average annual growth rate of 1.4% in 2009, still far from deflation.
- We have revised our projection of rate cuts, and now we see the bottom at 0.5% by mid-year (instead of 1%). This is due to continuously deteriorating economic conditions, which look gloom for at least the first half of this year.

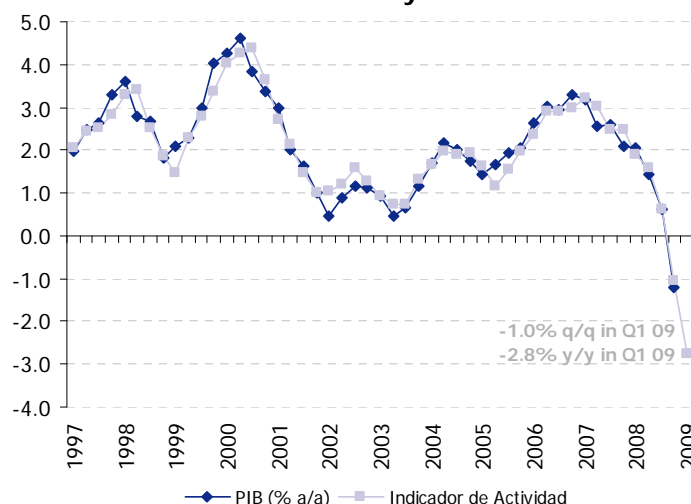
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Euro Area: HIPC
(% YoY)






Source: European Commission & ERD BBVA

EURO AREA: GDP and Synthetic indicator of activity



Source: Eurostat and ERD BBVA

Box 1: Economic indicators

		Average 2008	Nov-08	Dec-08	Jan-09	Feb-09	Impact on rates*
GER – IFO Business Climate	Obs. Cons.	96.8	85.9 89.0	82.7 84.0	83.0 81.0	82.6 83.0	
Euro – Manufacturing PMI	Obs. Cons.	46.5	35.6 40.5	33.9 34.5	34.4 33.5	33.6 35.0	
Euro – Services PMI	Obs. Cons.	48.5	42.5 45.2	42.1 41.5	42.2 41.7	38.9 42.6	
Euro – Economic Sentiment Indicator	Obs. Cons.	91.1	76.8	68.9	67.2	65.4	
GER – Retail Sales (y/y)	Obs. Cons.	-2.6	-2.8 -0.3	0.3 0.3			
Euro – Industrial prod. (m/m)	Obs. Cons.	3.5	-2.2 -2.1	-2.6 -2.2			
Euro – HICP (y/y)	Obs. Cons.	3.3	2.1 2.4	1.6 1.8	1.1** 1.4		
Euro – M3 (y/y)	Obs. Cons.	9.4	7.7 7.9	7.5 7.6	5.9 6.9		
Euro – Loans to private sector (y/y)	Obs.	9.3	7.1	5.8	5.0		

* 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: Market view

Markets are discounting a rate cut in March and, after that, some stabilization. However, the information they provide is blurred by the increase in liquidity in recent weeks.

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Mar. 09	1.680	0.970
Jun. 09	1.580	0.770
Sep. 09	1.630	0.840
Dec. 09	1.800	0.945

Box 3: Speeches and comments by members of the ECB Governing Council

Despite the fact that the economic outlook is getting gloomier and inflation is slowing rapidly, ECB Government Council members are reluctant to lower interest rate to 0%, although they are actively discussing alternative non-conventional measures of monetary policy.

Activity	"The financial system remains under severe strain, which is hampering an economic recovery." (Trichet)	"It's to be expected that during 2009 the vast set of measures approved in last few months produce effects and are able to sustain the rhythm of the recession." (Constancio)	An economic recovery is expected to commence in Europe "in the last quarter of 2009" and "positive, if low" growth in the following year. (Nowotny)		GDP will contract in 2009 more than expected
Interest rate	"Basically I'm not an advocate for zero nominal interest rates, which would mean negative real interest rates." (Nowotny)	A cut of more than 50bp in March "cannot be excluded a priori, but it is unlikely. It is clear that we are now approaching the lower limit." (Provopoulos)	"There's still some room to maneuver that we can use until we get to 1 percent." (Weber)	"I'm among those who think that perhaps we shouldn't go to zero as there could be stability problems for some financial entities. If we can avoid reaching zero then I think that would be reasonable." (Fernández Ordóñez)	Reluctant to lower interest rate to 0%
Non-standard monetary policy	"The ECB was obliged to study the possible use of unconventional policy tools and that review of such methods is progressing." (Fernández Ordóñez)	"I think it is highly unlikely in March that we will be able to reach an agreement (on non-standard measures), given that the study of alternative options will take some time." (Provopoulos)	"It's correct that the ECB council is looking at the question of possible non-standard measures. There are no concret results." (Nowotny)	"I'm convinced that we have no exhausted our creativity to take initiatives." (Liikanen)	Discussing actively about non-standard monetary policy measures
Financial Markets	"Banks must take all necessary steps to increase transparency about the value of their assets, including transferring toxic loans to separate entities, to stimulate confidence and lending in credit markets." (Draghi)	"The current crisis is a loud and clear call for extending regulation and oversight to all systematically important institutions. The ECB and Eurosystem have the technical capacities to assume a stronger role in macro-prudential supervision." (Trichet)			Necessary regulation of the financial system
Government measures	"I expect the economic packages to show their impact toward the end of this year, stopping the downward trend and resulting in a stabilization. It is important that members with very high deficits launch programs that bring them back to the path of consolidation." (Stark)	Government measures should be consistent with our liquidity management operations and they should not impair the implementation of the single monetary policy." (Trichet)	If Government measures are not conceived of as temporary and an exit strategy is not established, there is a risk that those countries enter into an unsustainable fiscal situation. (González Paramo)		Stability-oriented policies

ECB-Barometer for the March 5th Governing Council meeting

