



# ECB Watch

Next Meeting: July 2<sup>nd</sup> 2009  
June 29<sup>th</sup> 2009

## Few news expected

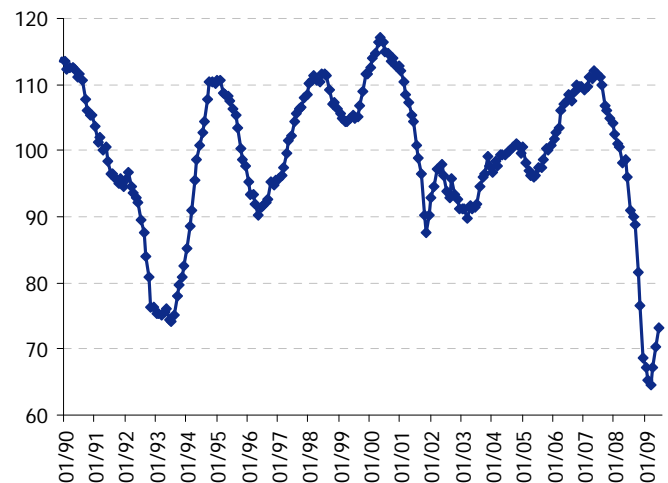
- We expect the ECB to maintain its policy interest rates unchanged, with the key refi rate at 1%, at its next meeting on July 2<sup>nd</sup>.
- Regarding economic activity, confidence data continued to improve in June, suggesting that the economic decline is slowing. Today the European Commission has published the economic sentiment indicator which increased in June for the third consecutive month, although the level is still below the lows reached at the end of 1992. However, on the real side, incoming information still fails to reflect the improvement seen in soft data.
- Inflation decelerated from 0.6% y/y to 0% in May, while core inflation fell to 1.5% y/y from 1.7% y/y in April. Looking forward, we have revised slightly upwards our forecasts for headline inflation in 2009 and 2010 due to revisions in oil prices. We expect negative records in the next months and a return to positive values by the end of 2009. This will lead to an average inflation rate of 0.35% in 2009 and 1.3% in 2010.
- The most important news this month came from the first ECB's 12-month "full allotment" auction at 1%, reducing the short end of the curve, and approaching the interbank interest rates to the *refi rate*. The amount lent (€ 442bn) is higher than expected, responding high incentives: i) no penalty, ii) interest rate at 1% compared to the possible inclusion of a differential for the next auction to be held in late September and mid-December (since the ECB has signalled that they may raise the rate applied to these auctions without moving other key policy rates) and iii) obtaining secured financing to 1 year at a low rate in a context of liquidity tensions.
- In recent weeks, the internal debate about quantitative easing measures and further rate cuts have been more muted than in the previous month. The recent comments have been more focused on the exit strategy and the need to drain the liquidity excess when the economy begins to recover. This, coupled with the large injection of liquidity last week in the first full allotment auction, has toned down the pressure for further measures. We still see further cuts after the summer, as the recovery in the euro zone will be very slow, although the upward risks of this scenario are clear.

Agustín García Serrador  
[agustin.garcia@grupobbva.com](mailto:agustin.garcia@grupobbva.com)

Miguel Jiménez  
[mjimenezg@grupobbva.com](mailto:mjimenezg@grupobbva.com)

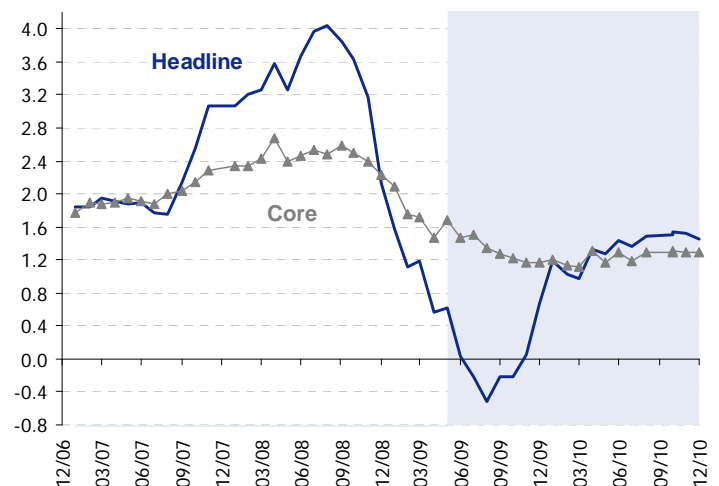
Elvira Prades  
[elvira.prades@grupobbva.com](mailto:elvira.prades@grupobbva.com)

**Eurozone: economic sentiment indicator**  
(EC Survey)






Source: European Commission Survey

**Eurozone: HIPC**  
(% y/y)



Source: European Commission and ERD BBVA

## Box 1: Economic indicators

		2008	Mar-09	Apr-09	May-09	Jun-09	Impact on Interest Rates *
Euro- Manufacturing PMI	Obs.	46.5	33.9	36.8	40.7	42.4	
	Cons.		34.0	36.7	40.5	42.4	
Euro- Services PMI	Obs.	48.5	40.9	43.8	44.8	44.5	
	Cons.		40.1	43.1	44.7	45.8	
Euro- Economic Sentiment Indicator	Obs.	91.1	64.6	67.3	70.2	73.3	
	Cons.					71.0	
Euro- Industrial Production m/m	Obs.	-1.1	-1.3	-1.3	--	--	
	Cons.		-1.0	-0.4	--	--	
Germany - Retail Sales y/y	Obs.	-0.5	-0.8	-0.8	--	--	
	Cons.		-0.3	-0.3	-1.5	--	
Germany - IFO Business Climate y/y	Obs.	96.8	82.2	83.7	84.3	85.9	
	Cons.		82.2	82.3	85.0	85.0	
Euro - HICP y/y	Obs.	3.3	0.6	0.6	0.0	--	
	Cons.		0.6	0.6	0.0	--	
Euro - M3 y/y	Obs.	9.5	5.0	4.9	--	--	
	Cons.		5.7	4.5	4.6	--	
Euro - Loans to Private Sector y/y	Obs.	9.3	3.2	2.4	--	--	

\* 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

The internal debate about quantitative easing measures and further rate cuts have been more muted than in the previous month. Additionally, coupled with the large injection of liquidity in the first full allotment auction with 12 months maturity, it has toned down the pressure for further measures.

<b>Activity</b>	"Recent business confidence indicators, both within the euro area and at the global level, suggest that the pace of the decline in economic activity has slowed somewhat." <b>(Stark)</b>	"The economic forecasts for this year are pretty negative, and also the forecasts for 2010 don't indicate a very strong recovery. But there are clear signs that in the real economy, there is some bottoming out." <b>(Nowotny)</b>	"We will have a gradual recovery and that we will start having positive growth rates again sometime in the middle of next year." <b>(Mersch)</b>	"There are some signs that the recovery will come in Asia and America next, before beginning in Europe." <b>(Weber)</b>	Some signs that the economic decline is slowing, but GDP will contract sharply in 2009 and a more protracted recovery is expected
<b>Inflation</b>	"The severity of the recession points to inflation remaining low in the next two years or so, but this is not expected to lead to the emergence of outright deflation." <b>(Smaghi)</b>	"We have zero or even negative inflation rates for some months, but for the year in total I don't see deflation." <b>(Nowotny)</b>	"In some countries there could be negative growth of prices in the summer. The risk of deflation is low so far." <b>(Sramko)</b>	"Deflation is almost excluded in Europe." <b>(Quaden)</b>	Negative inflation rates for some months. They recognize that deflation risks have increased.
<b>Interest rate</b>	"I don't see a likelihood for rate changes" at least the rest of the year. <b>(Nowotny)</b>	"There is no commitment to any position." <b>(Bonello)</b>	"Further measures are not necessary at this point." <b>(Weber)</b>		No commitment to any position.
<b>Non-standard monetary policy</b>	"This massive expansion of monetary liquidity made in order to weather the crisis will have to be rapidly." <b>(Smaghi)</b>	"we will make sure that the measures adopted are unwound swiftly and the liquidity provided is absorbed, so as to maintain price stability over the medium term." <b>(Stark)</b>	<b>Nowotny</b> said there's no need for the ECB to increase its program at the moment.	The exit "should be gradual and fitting with conditions on financial markets." <b>(González-Paramo)</b>	They are discussing the exit strategy to withdraw the excess of liquidity

### Box 3: Market view

	3m euribor Future cont.	1m Eonia Future cont.
Jul-09	1.050	0.570
Sep-09	1.030	0.680
dec-09	1.135	0.750
Mar-10	1.250	0.920

### ECB-Barometer for the July 2<sup>nd</sup> Governing Council meeting

