



ECB Watch

Next Meeting: September 3rd 2009

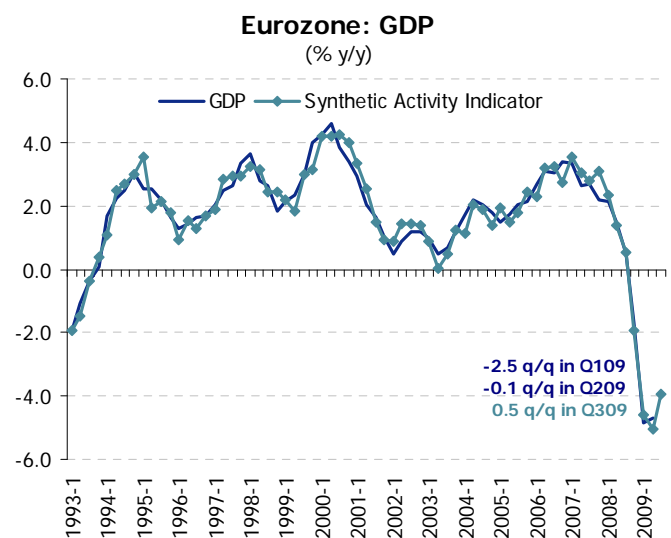
28th August 2009

Caution expected

- **The ECB will keep its policy interest rates unchanged (refi rate at 1%) at its next meeting on September 3rd.** After the good GDP data published in August, the main point of interest will be by how much they revise their quarterly projections of GDP growth and inflation. Also of interest will be the possible signals they provide on eventual exit strategies from their current accommodative policies.
- Regarding **economic activity**, GDP growth was much better than projected in the second quarter in the euro area (-0.1% q/q vs -0.8% we were expecting), mostly because of positive surprises in Germany and France. New indicators on confidence continue to turn out better than expected, pointing to positive GDP growth for the third quarter. **Our synthetic activity indicator updated with these data now suggests that quarterly growth should be around +0.5% in the current quarter.** This positive trend was corroborated by a large jump in industrial orders in June, suggesting an increase in activity in coming months.
- **Consumer prices** declined by -0.7% m/m in July, leaving the annual inflation rate at -0.7% y/y, after -0.1% y/y in June. Core inflation fell further from 1.3% to 1.2% y/y, cumulating a 1.4 points fall since the peak reached in March 2008 (2.7% y/y). Given the recent evolution of fuel prices, we have revised slightly upwards our inflation forecast for August, from -0.2% to -0.1% y/y. **Looking forward, we maintain our forecasts of low rates for both headline and core inflation in 2009 (0.2% and 1.2%, respectively), a trend that should continue in 2010 given the very large unused capacity in the euro area.**
- Given this outlook, it is a given that the ECB will rise its GDP projections for 2009, but **the key issue will be how high they see growth for 2010 (their June projection was -0.3%). A significant upwards revision will imply they see a low risk of a retrenchment in growth once the fiscal stimulus wanes and unemployment goes up further.** Our own view is that the likelihood that the current positive growth is temporary is high. In relation with this, **we also expect, as suggested by recent declarations (see Box 2) the ECB to provide some signs that the reversal of non-standard liquidity stimulus is not for now and will not be implemented until a firmer recovery is underway.**

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Source: Eurostat and ERD BBVA

August 2009	Eurozone HICP						
	y/y				m/m		
	Flash	Forecast	Current	Previous	Forecast	Current	Previous
		%	%	%	%	%	%
Headline		-0.1	-0.7	-0.1	0.4	-0.7	0.2
Energy		-10.4	-14.4	-11.7	1.5	-1.8	2.5
Fresh Food		-0.9	-1.1	0.0	-0.8	-1.2	-0.5
Core excluding Fresh Food and Core		1.2	1.2	1.3	0.3	-0.5	0.0
Services		1.9	1.9	2.0	0.3	0.8	0.1
Non-Energy Industrial Goods		0.5	0.5	0.6	0.4	-2.5	-0.3
Processed Food		0.6	0.8	1.1	0.1	0.1	0.2

Source: European Commission & BBVA ERD

Box 1: Economic indicators

		2008	may-09	jun-09	jul-09	ago-09	Impact on Interest Rates *
Euro- Manufacturing PMI	Obs.	46.5	40.7	42.4	46.0	47.9	
	Cons.		40.5	42.4	43.5	47.5	
Euro- Services PMI	Obs.	48.5	44.8	44.7	45.6	49.5	
	Cons.		44.7	44.5	45.1	46.3	
Euro- Economic Sentiment Indicator	Obs.	91.1	70.2	73.2	76	80.6	
	Cons.					78.0	
Euro- Industrial Production m/m	Obs.	-1.1	0.5	-0.6			
	Cons.		1.5	0.3			
Germany - Retail Sales y/y	Obs.	-0.5	-2.9	-2.0			
	Cons.		-1.6	3.0			
Germany - IFO Business Climate y/y	Obs.	96.8	84.3	85.9	87.3	90.5	
	Cons.		85.0	85.0	86.5	88.7	
Euro - HICP y/y	Obs.	3.3	0.0	-0.1	-0.7		
	Cons.		0.0	-0.1	-0.5		
Euro - M3 y/y	Obs.	9.5	3.7	3.5	3.0		
	Cons.		4.6	4.0	2.9		
Euro - Loans to Private Sector y/y	Obs.	9.3	1.8	1.5	0.6		

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

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

There are few statements from ECB members due to the summer recess, showing a cautious interpretation of positive recent economic data. Regarding non-standard measures, they think that it is too early to withdraw them, due to they are still necessary to support economic activity.

Activity	Speech/Comment	Member	Member	Member	Impact/Conclusion
Activity	"The free fall is over, but we must remember the level of economic activity is still below what it was a year ago". (Liikanen)	"I have a cautious attitude in interpreting these data (Q2 GDP flash)". (Nowotny)	"I am not yet convinced that the recovery is sustained and that the economy can support itself". (Weber)	"There are increasingly signs that the global recession is bottoming out". (Trichet)	Caution when interpreting positive recent data
Inflation	He sees no risk of deflation in the euro area as negative inflation rate is due to "temporary effects on commodity price developments". (Stark)	"Next year, inflation will be very moderate". (Smaghi)	"Over the medium term, we expect price stability". (Weber)	"There was never in our case a materialization of a risk of deflation". (Trichet)	Risks of both deflation and high inflation are low
Interest rates	Interest rates are at an "appropriate" level. (González-Paramo)	"Rates are currently appropriate". (Trichet)			The current level is appropriate
Non-standard monetary policy	"It is too early to withdraw support measures" because "financial markets are still dependent on the central banks support". (Weber)	"I'm not sure whether at this stage the liquidity policy that we can do as central banks has all the potential of solving all our other problems". (Weber)	"We choose instruments that are easy to exit". (Trichet)	"ECB's covered-bond plan "hasn't had as much impact in the secondary market as we would have liked". (Papademos)	They are discussing the exit strategy to withdraw the excess of liquidity, but it is soon to implement it

Box 3: Market view

	3m euribor Future cont.	1m Eonia Future cont.
ago-09		0.375
sep-09	0.790	0.360
dec-09	0.885	0.450
mar-10	1.105	0.680
jun-10	1.450	0.975

ECB-Barometer for the September 3rd Governing Council meeting

