Economic Research Department

BBVA

EMU

ECB Watch

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Next meeting: June 10th 2010

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No easing measures, no easing hints

- **The ECB does not take further easing measures nor provides a sign to do so**
- **Language on inflation and activity becomes somewhat stronger, but still cautious**
- **The ECB wants rates of 3-months auctions close to the *refi* rate**
- **Default in Greece is out of question; no comments on contagion to other periphery countries**

Apart of the explanations of why the ECB relaxed collateral rules for Greece, the interest in today's meeting was focused in eventual signs by the ECB that they are ready to take further loosening action, given the situation of sovereign markets in Europe. Although comments over the last two days on the likeliness of new measures (buying bonds, returning to full allotment in LTR or extending the relaxation of collateral rules to other countries) looked premature, there might have been signs that the ECB is ready to take such actions in the future. But there were not such signs. Instead, the statement changes somewhat its tone towards more optimism on the activity front and the recognition of upward surprises in inflation over the last two months, though without being really hawkish. As a result, market reaction has been negative.

On activity: The ECB sees signs of improvement, especially in the second quarter of the year ("some strengthen appears to be taking place during the spring"), while recognising that the first one will be weak ("not flattering at all"), in part due to weather conditions. In contrast, the environment is of "high uncertainty", instead to mere "uncertainty" both in the introductory and concluding paragraphs.

On inflation: A new remark in the introduction says that global inflationary pressures driven by foreign prices are still being counteracted by low domestic price pressures. There is also a new sentence saying that "the firm anchoring of inflation expectations remains of the essence" and that "monetary policy will do all what is necessary to maintain price stability…". This sounds harder hat in previous statements, although "inflationary pressures over the medium term remain contain". The reference to "do all what is necessary" may respond to concerns that the recent relaxation of collateral rules for Greece implies a relaxation in the fight against inflation, as manifested by one of the questions posed to Trichet during the press conference.

On monetary aggregates: despite the fall of loans to the private sector in March, "the data over the last few months point to a possible discontinuation of the earlier downward trend in annual loan growth". We will see.

On collateral rules: Trichet made a careful defence of the new collateral rules applied to Greece: because they had asked Greece to approve such programme, they had been asked by the Commission to validate such a programme, and they had been asked by governments to judged if it was the case to approve the bailout to Greece, and in the three cases the positive response of the Council had been given by unanimity, it was considered consistent with that to accept all Greek paper. Although the causality is not very clear to us, the decision is correct in our view. The decision, however, was taken only with an “overwhelming majority” (no unanimity). He also made clear that these measures are for Greece and only for Greece, closing the door for the moment for an extension to other countries, which would be difficult to justify given the detailed justification of the measure in the case of Greece.

Bond purchases: Trichet did not want to comment on bond purchases. It was not discussed in the meeting (in the March meeting he remarked that not decision had been taken on the issue). Together with yesterday’s declarations by Mr Weber against such purchases, this is clearly a hawkish sign.

Liquidity measures: asked if they are thinking of returning to full allotment, Trichet remarked that it is still applicable for weekly operations. He also made the interesting comment that they do not intend that the interest rate of 3-months operations goes much higher than the official 1%, which may suggest they could be ready to intervene somehow if it is not the case.

Default is out of question: Trichet was asked several times about the possibility of an orderly restructuring of the Greek debt, responding always that it was out of question.

Senior loans to Greece: Trichet said the question if the bailout loans to Greece are senior to previous debt depends on national authorities.

Contagion to other countries and fiscal policies: many journalists, some of them Portuguese, asked Trichet about his opinion on the situation of Portugal, Spain and on contagion in general. At each occasion he avoided expressing a view, apart from saying that Spain and Portugal are not Greece, repeating the line that complying with the Stability and Growth Pact was key to avoid problems. He was again very defensive on the SGP, recalling that in 2004 many European authorities were attacking the pact and the ECB was one of the few voices defending it. In the statement, there is a remark saying that “the correction of the large fiscal imbalances will, in general, require a stepping-up of current efforts”. Although expressed softy, this is also a hawkish novelty in the statement.

Rating agencies: the question about an eventual public agency was also recurrent, and Trichet said it was an open question subject to a global and coordinated solution.

Competitiveness: On structural measures, there is in the statement a new reference to those measures that may help countries dealing with competitiveness problems, with a reference to wage bargaining systems. This is significant given that much of the bad press of peripheral countries in Europe is now related to lack of competitiveness and foreign imbalances (although our view is that in some of these countries external imbalances are more related to demand excesses in recent years than to competitiveness problems, given that lack of export market shares losses over the past decade).

Markets' reaction

The press conference has definitely not helped to ease tensions in global markets. During Q&A yields on European government bonds rose, while stock markets turned down just after recovering from the initial trades early in the morning. The euro also fell sharply, reaching at the end of the press conference the $1.26.

Summing up, European bond markets today registered very large losses with Greece leading the scoreboard after the yield on 2yr notes jumped 145bps to 16.2%. Nonetheless, other sovereigns followed the rush and at the end of the session the Irish yield on 2yr bonds raised 78bps to 4.32% while Portugal was up 22bps to 5.6%.

European Stocks posted also big losses with the Eurrostoxx 50 falling around 2.5% and the Ibex-35 dropping close to 3%. Nonetheless, the Euro was finally the main looser of a turbulent session as it broke the $1.27 floor and now was trading at $1.266 in New York.

Summing up

Overall, there were no news today on further easing measures. It would have been a surprise to us if the ECB had reacted so early, but we would have liked to hear softer words from Mr Trichet. Instead, we read some incipient language on activity and inflation that might lead to measures in the opposite direction. The market reaction and the probable continuation of tensions over the coming weeks may force the ECB to change course. What is not clear today is if the ECB does not want to say yet that they are ready to act, or if there is strong opposition within the Council to further loosening.

Box: ECB Statements

	February 4th	March 4th	April 8th	May 6th	Concluding remarks*
Monetary policy stance	**Rates remain appropriate**. The **GC will, in early March, take decisions on the continued implementation of the gradual phasing-out** of the extraordinary liquidity measures that are no needed to the same extent than in the past.	**Rates remain appropriate**. The GC decided to **continue conducting both the MROs and one-month refinancing operations** as **fixed rate tender procedure with full allotment for as long as necessary**. Three-month LTRO will return to variable rate tender procedures in April.	**Rates remain appropriate**. The GC decided to **keep the minimum credit threshold for assets in the collateral framework** at investment grade level **beyond the end of 2010**.	**Rates remain appropriate.** The ECB decided to suspend the application on the minimum credit rating threshold in the collateral eligibility requirements to Greece.	**Rates remain appropriate. Collateral changes only affect Greece.**
Growth	Latest information confirmed that euro area economic activity continued to expand around the turn of the year. **Euro area economy is expected to grow at a moderate pace in 2010**, while the recovery process is likely to be uneven and subject to uncertainty.	Available indicators suggest that the economic recovery in the euro area is on track, although it is likely to remain uneven. **Real GDP growth should remain moderate in 2010**, due to the ongoing process of balance sheet adjustment, expectations that the low capacity utilization is likely to dampen investment and that consumption is being dampened by weak labour market prospects.	Available indicators has also **confirmed that the economic recovery in the euro area continued in the early months of 2010**, expecting the **economy to expand at a moderate pace in 2010**, due to the ongoing process of balance sheet adjustment and the expectation that low capacity utilization is likely to dampen investment and that consumption is being hampered by weak labour market prospects.	Recent economic data support the view that **the economic recovery is continuing in 2010,** expecting the **economy to expand at a moderate pace in 2010**. GDP growth is likely to be flat in Q1, strengthening in Q2. The ongoing recovery at the global level, and its impact on the demand for euro area exports, should provide support to the euro area economy. At the same time, the financial crisis is expected to have a dampening effect on economic growth.	**Recovery continued, but uneven. Risks are balanced**
Inflation	Inflation is **expected to remain around 1% in the near term** and to remain **moderate over the policy-relevant horizon**, in line with a slow recovery in demand.	Inflation is **expected to remain around 1% in the near term** and to remain **moderate over the policy-relevant horizon**, in line with a slow recovery in demand.	Inflation **is expected to remain moderate over the policy-relevant horizon**.	**Global inflationary pressures** – driven mainly by commodity prices and in fast-growing economic regions of the world- are still being **counteracted by low domestic prices pressures**. **Inflation rates are expected to be moderate over the policy-relevant horizon**.	**Inflation rates will remain well below 2% in 2010. Inflation expectations remain firmly anchored**
Risks	Risks to this outlook remain **broadly balanced**.	Risks to this outlook remain **broadly balanced**.	Risks to this outlook remain **broadly balanced**.	Risks to this outlook remain **broadly balanced.**	**Broadly balanced**
Monetary analysis	Monetary analysis continued to support our assessment of a moderate underlying pace of monetary expansion and low inflationary pressures over the medium term. **M3 and credit growth is likely to remain weak for some time to come**.	Monetary analysis confirmed the assessment of continued weak monetary growth and thus the inflationary pressures are low. **M3 and credit growth is likely to remain weak for some time to come**.	Monetary analysis confirmed that the **underlying pace of monetary expansion is moderate** and thus the inflationary pressures in the medium term are low. The **flow of loans to firms in February was positive** for the first time since August 2009, **but they remain weak** for some time after economic activity has picked up.	Monetary analysis support that the **underlying pace of monetary expansion is moderate** and thus the inflationary pressures over the medium term are contained. While the lagged response of **loans to firms** to economic activity is a normal feature of the business cycle, the **data over the past few months point to a possible discontinuation of the earlier downward trend**.	**Weak monetary and credit growth. 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 (June 10th)

May, 12	Euro Area industrial production, March
May, 12	Euro Area GDP flash estimate, Q1/2010
May, 18	Euro Area trade balance, March
May, 18	Euro Area inflation, April
May, 19	Euro Area construction output, March
May, 21	Euro Area flash PMI, May
May, 25	Euro Area industrial new orders, March
May, 31	Euro Area monetary aggregates, April
May, 31	Euro Area business and consumer confidence, May
May, 31	Euro Area flash inflation estimate, May
June, 1	Euro Area unemployment, April
June, 2	Euro Area industrial producer prices, April
June, 3	Euro Area retail trade, April
June, 4	Euro Area national accounts, Q1/2010 1st release