

5 June 2008

Economic News

MONETARY POLICY IN THE EURO ZONE

ECB in “heightened alertness”

“We considered that (...) we could decide to move our rates (...) in our next meeting.” Such was ECB President Trichet’s surprisingly hawkish message today, which sent bond markets into a tailspin and gave economic forecasters pause for thought. We do not consider a rate hike a foregone conclusion and estimate the probability of a hike in July to be 40%. However, surprisingly good data flow – for instance, an increase in the Ifo index – could tip the scales in favour of the hawks by July 3.

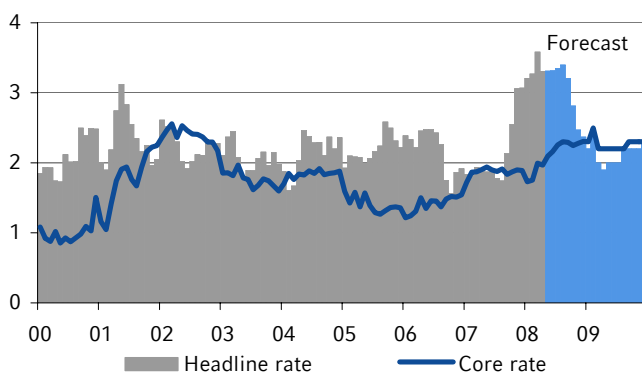
- According to the ECB, medium-term inflation risks have increased again, as evidenced in the higher inflation rate projections (refer to table on p. 2) for this year and the next. The ECB’s projections are now roughly in line with our forecasts.
- Trichet repeatedly signalled that the ECB Governing Council was in a state of “heightened alertness”, which was strongly reminiscent of the “strong vigilance” wording the ECB had used until the middle of last year to prepare the markets for rate hikes. Several members of the ECB Council would have backed an immediate tightening of monetary policy, while others would have favoured tightening at a later date. ECB President Trichet stated that a rate hike in July was possible but not certain.
- July surely would have a certain charm for the ECB, as the expected poor growth figures for Q2 will not be published until August. Over the rest of the second quarter, predominantly weak economic data may well make it difficult for the ECB to justify tightening monetary policy. So, insofar as a rate hike is on the cards, it should be done either swiftly or – as we anticipate – after the growth dip has been overcome next year.
- Conclusion: The ECB rate decision in July is very much touch and go. We expect that further weak economic data will mean that the hawks in the ECB Council will not be able to gain the upper hand.

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Eurozone consumer prices

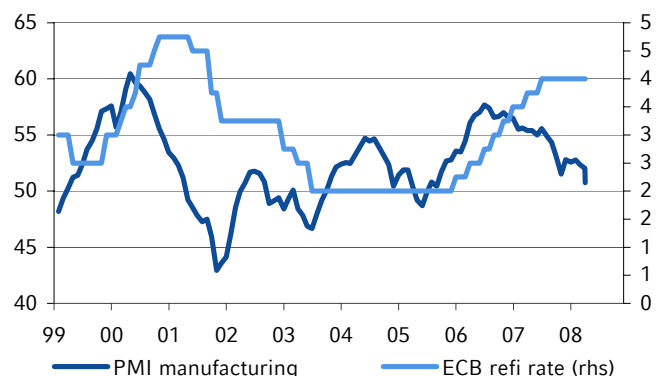
in % y/y



Source EcoWin, WestLB Research

ECB policy rate and Purchasing Managers Indices

in % and index points



Source EcoWin, WestLB Research

ECB information

Schedule of ECB's interest rate decisions

	Date*
2008	10 January
	7 February
	6 March
	10 April
	8 May
	5 June
	3 July
	7 August
	4 September
	2 October
	6 November
	4 December

* Source: ECB

Forecasts (% y/y)

	GDP		Consumer prices	
	2008	2009	2008	2009
ECB				
June 2007	2.3	-	2.0	-
September 2007	2.3	-	2.0	-
December 2007	2.0	2.1	2.5	1.8
March 2008	1.7	1.8	2.9	2.1
June 2008	1.8	1.5	3.4	2.4
WestLB	1.6	1.5	3.3	2.3

Source ECB, middle of the projected range.

Euro zone

	2007	2008	2009	2007		2008			
				Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (% y/y)	2.6	1.6	1.5	2.7	2.2	2.2	1.8	1.4	1.3
Real GDP (% q/q)				0.7	0.4	0.7	-0.1	0.3	0.3
Consumer prices (% y/y)	2.1	3.3	2.3	1.9	2.9	3.4	3.5	3.6	2.8
Budget balance (% of GDP)	-0.6	-1.1	-1.0						
Unemployment rate (%)	7.4	7.1	7.0						
Current account balance (% of GDP)	0.1	0.1	0.2						

Source EcoWin, WestLB Research; 2008-09: WestLB forecast.

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