

February 7, 2008



EUROPEAN CENTRAL BANK

The ECB stays prudent on inflation ... But takes a less hawkish tone

ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- Risks to price stability are tilted to the upside. The Governing Council is ready to keep second-wave effects from materializing.
- The latest information on economic activity around the turn of the year points to a more moderate pace of growth in the euro area than that observed in the third quarter of 2007.
- The economic slowdown being experienced by some of the euro zone's main trading partners is likely to have an impact on real growth in the euro area in 2008.
- Uncertainty about the prospects for economic growth is unusually high, and the risks surrounding the outlook for economic activity have been confirmed to lie on the downside.

COMMENTS

As expected, the ECB chose to stay on course, keeping its key rate at 4.0% this morning. With annual inflation at 3.2% in January (according to the flash estimate), the ECB is clearly concerned about inflation risks. However, the ECB is being increasingly open about the risks to the economic outlook. Under the circumstances, while the Governing Council says it is ready to combat potential second-wave effects associated with elevated inflation, it now seems clear that the monetary bias is more neutral. Here, ECB President Jean-Claude Trichet remarked that, in reaching this morning's unanimous decision, there was no question of either an increase or a decrease in rates.

The status quo was widely expected. Note that Axel Weber, one council member, had said that rate cuts were «wishful thinking», but it would have been surprising for the ECB not to adjust its stance to take the latest developments into consideration. The European exchanges are down by about 15% from the beginning of the year, and the U.S. economic outlook has darkened further. The ECB is now showing its

Decoupling? What decoupling?



Sources: Reuters, Datastream and Desjardins, Economic Studies



concern about the potential impacts of a slowdown by the euro area's major trading partners. Clearly, this shows that the idea of decoupling has fewer and fewer fans among the governors.

Implications: Elevated inflation is not the be all and end all (the ECB lowered its key rate in May of 2001, although inflation was at 2.7% and rising), but it will take more concrete signs of an economic slowdown in the euro area before the ECB begins a monetary easing cycle. Yet, the use of the expression «unusually high» to describe the uncertainty surrounding economic growth shows that the situation at the ECB could change very quickly. We remain confident that the ECB will be more open at the March meeting, but rate cuts could only begin to be ordered in the spring.

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NOTE TO READERS: The letters **K**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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**EXCERPT FROM THE EUROPEAN CENTRAL BANK PRESS RELEASE
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[...] This decision reflects our assessment that risks to price stability over the medium term are on the upside [...] the Governing Council remains committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term. As the reappraisal of risk in financial markets continues, there remains unusually high uncertainty about its overall impact on the real economy. While the economic fundamentals of the euro area are sound, incoming data have confirmed that the risks surrounding the outlook for economic activity lie on the downside. [...]

[...] The latest information on economic activity around the turn of the year points to a more moderate pace of growth in the euro area than the quarter-on-quarter rate of 0.8% observed in the third quarter of 2007. [...]

[...] while the slowdown in the economies of some of the euro area's major trading partners is likely to have an impact on euro area real GDP growth in 2008, both domestic and foreign demand are expected to support ongoing growth. [...]

[...] That said, uncertainty about the prospects for economic growth is unusually high and the risks surrounding the outlook for economic activity have been confirmed to lie on the downside. [...]

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
November 2007			
6	Reserve Bank of Australia	+25 b.p.	6.75
8	European Central Bank	s.q.	4.00
8	Bank of England	s.q.	5.75
8	Bank of Japan	s.q.	0.50
23	Bank of Mexico	s.q.	7.50
December 2007			
4	Reserve Bank of Australia	s.q.	6.75
4	Bank of Canada	-25 b.p.	4.25
5	Reserve Bank of New Zealand	s.q.	8.25
5	Bank of Brazil	s.q.	11.25
6	European Central Bank	s.q.	4.00
6	Bank of England	-25 b.p.	5.50
7	Bank of Mexico	s.q.	7.50
11	U.S. Federal Reserve	-25 b.p.	4.25
January 2008			
10	European Central Bank	s.q.	4.00
10	Bank of England	s.q.	5.50
18	Bank of Mexico	s.q.	7.50
21	Bank of Japan	s.q.	0.50
22	Bank of Canada	-25 b.p.	4.00
22	U.S. Federal Reserve	-75 b.p.	3.50
17	Bank of Norway	s.q.	5.25
24	Reserve Bank of New Zealand	s.q.	8.25
30	Bank of Brazil	s.q.	11.25
30	U.S. Federal Reserve	-50 b.p.	3.00
February 2007			
7	Reserve Bank of Australia	+25 b.p.	7.00
4	European Central Bank	s.q.	4.00
7	Bank of England	-25 b.p.	5.25

s.q.: status quo; b.p. : basis points
Source: Desjardins, Economic Studies

**Table 2
Coming soon**

Date	Central Bank
February 2008	
13	Bank of Sweden
14	Bank of Japan
15	Bank of Mexico
March 2008	
3	Reserve Bank of Australia
4	Bank of Canada
5	Reserve Bank of New Zealand
5	Bank of Brazil
6	European Central Bank
6	Bank of England
6	Bank of Japan
13	Bank of Norway
13	Swiss National Bank
14	Bank of Mexico
18	U.S. Federal Reserve
April 2008	
1	Reserve Bank of Australia
8	Bank of Japan
10	European Central Bank
10	Bank of England
16	Bank of Brazil
18	Bank of Mexico
22	Bank of Canada
23	Bank of Norway
23	Reserve Bank of New Zealand
23	Bank of Sweden
29	Bank of Japan
30	U.S. Federal Reserve
May 2008	
6	Reserve Bank of Australia

Source: Desjardins, Economic Studies