ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The Governing Council has decided that at 1.00%, the key rate remains appropriate and should not be changed.
- The latest information has confirmed that the euro zone economy continued to grow at the end of 2009, but some of the factors that fuelled GDP growth are temporary in nature. According to the Council, Euroland’s economy should expand at a moderate pace in 2010.
- Inflationary pressures are expected to remain low in the medium term as the latest statistics show that the M3 money supply and private sector loans are down.
- The Council calls upon the euro zone governments to quickly implement ambitious plans to cut their huge deficits.

COMMENTS

As expected, the ECB made no changes to its monetary policy this morning. Following an annualized growth of 1.7% in the third quarter, real GDP in the euro zone advanced again in the last quarter of 2009. In addition to significant macroeconomic stimulus, the return to growth was fuelled by a change in inventories and a recovery in exports.

However, various statistics, including weak retail sales and an increase in unemployment, show that the euro zone economy is still fragile. Like most analysts, the ECB expects moderate GDP growth for Euroland’s economy in 2010. In light of weak domestic demand and less credit availability, the ECB expects inflationary pressures to remain contained.

Beyond the economy and inflation, analysts were focused this morning on the budget impasse affecting many countries in the euro zone, especially Greece. President Trichet refused to comment on the possibility that Greece or other countries will leave the monetary union, saying such a suggestion was “absurd”. That said, he believes that the countries in difficulty must do what it takes to put their finances in order. The ECB will therefore be taking a close look at the plan submitted this morning by the Greek government to slash its deficit, which stood at 12.7% of GDP in 2009, to below 3% in 2012. According to Trichet, efforts to help countries in difficulty have to come from within: “The problem isn’t to get help but to help themselves.” Responding to a journalist, he stated that the Irish government’s efforts to dramatically cut expenses were impressive, bold and courageous.

Implications: The euro zone is starting the year off on a tense note. It’s too early to bet that some countries will leave the union, but the gargantuan efforts that will be required of a number of European governments may create tensions that could shake the confidence of economic agents. In this difficult context and in the absence of inflation, the key rate will likely remain unchanged throughout 2010.

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EXCERPT FROM THE EUROPEAN CENTRAL BANK PRESS RELEASE

« [...] Based on its regular economic and monetary analyses, the Governing Council decided to leave the key ECB interest rates unchanged. The current rates remain appropriate. Taking into account all the information and analyses that have become available since our meeting on 3 December 2009, price developments are expected to remain subdued over the policy-relevant horizon. The latest information has also confirmed that towards the end of 2009 euro area economic activity continued to expand. However, some of the factors supporting the growth in real GDP are of a temporary nature. Overall, the Governing Council expects the euro area economy to grow at a moderate pace in 2010, recognising that the recovery process is likely to be uneven and that the outlook remains subject to uncertainty. The outcome of the monetary analysis confirms the assessment of low inflationary pressure over the medium term, given the ongoing parallel decline in money and credit growth. All in all, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. Medium to longer-term inflation expectations remain firmly anchored in line with the Governing Council’s aim of keeping inflation rates below, but close to, 2% over the medium term [...] As regards fiscal policies, many euro area governments are faced with high and sharply rising fiscal imbalances. The very large government borrowing requirements carry the risk of triggering rapid changes in market sentiment, leading to less favourable medium and long-term market interest rates. This, in turn, would dampen private investment and thereby weaken the foundations for sustained growth [...] The Governing Council therefore calls upon governments to decide and implement in a timely fashion ambitious fiscal exit and consolidation strategies based on realistic growth assumptions, with a strong focus on expenditure reform [...] »