ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The ECB opts for the status quo at 4.00%.
- The risks associated with price stability are tilted to the upside.
- However, given the recent volatility noted on the financial markets and resurgence of risk, the outlook is surrounded by “heightened uncertainty.”

COMMENTS

To no one’s surprise, the ECB kept its repo rate at 4.00% this morning. It is still concerned about the inflation pressures underlying the job market’s solid performance, rapid growth by Euroland’s money supply, and by the increase in prices for oil and agricultural products, and says it is ready to counter the risks to price stability. However, the tone of the statement that accompanied this morning’s decision is more dovish than usual, and opens the door to an extension of the current monetary policy status quo.

The ECB is no longer saying that the monetary policy is “on the accommodative side,” which suggests that key rates are now at appropriate levels. Moreover, it is concerned about the potential risks to the real economy posed by the financial crisis. Here, more than ever, ECB monetary policy developments seem dependent on future economic data. The ECB clearly states that it is “necessary to gather additional information and examine new data” before deciding on the next steps for monetary policy. With some indications that the bulk of the economic recovery is now behind us, it is likely that the ECB’s key interest rates will crest at 4.0% in the euro zone.

ACCORDING TO THE BANK OF ENGLAND (BoE)

- The BoE keeps its key rate at 5.75%.
- No statement was issued following the decision.
- The Inflation Report is scheduled for November 14, 2007.

COMMENTS

As expected, the BoE left its key rate at 5.75% at its September meeting, keeping it at its highest level in over six years. The troubles facing Northern Rock, a major British mortgage lender, made it clear that the country is not safe from the problems associated with demand for asset-backed commercial paper (ABCP). However, at this time, it is hard to assess the impacts on the real economy, which is why the BoE once again opted for prudence. Under these conditions, the BoE will probably maintain the status quo for the months to come. However, it is increasingly clear that the BoE will be the first to fall into step with the U.S. Federal Reserve if the economic situation deteriorates by the end of the year, or early next year. For now, production capacity is a little tight but some indicators show that consumer spending is poised to slow and wage increases are tepid. With annual inflation (at 1.8% in August) already well down from the 3.1% peak posted in March, the BoE has the leeway it needs to stave off any sign of economic slowdown by dropping its key rate. We will know more when the Inflation Report is released in November.

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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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[...] On the basis of our regular economic and monetary analyses, we decided at today’s meeting to leave the key ECB interest rates unchanged. The information that has become available since our previous meeting has confirmed that the outlook for price stability over the medium term is subject to upside risks. Against this background, and with money and credit growth vigorous in the euro area, our monetary policy stands ready to counter upside risks to price stability, as required by our primary objective. The fundamentals of the euro area economy support a favourable medium-term outlook for economic activity. In particular, corporate earnings and profitability have been sustained, employment growth has been robust and unemployment has fallen. However, given the financial market volatility and the reappraisal of risk seen in recent weeks, this assessment is surrounded by heightened uncertainty. In view of the only limited range of new economic data that have become available since our meeting in early September, particular caution needs to be exercised when assessing any potential impact of the financial market developments on the real economy. Hence, it remains necessary to gather additional information and examine new data before drawing further conclusions for monetary policy in the context of our medium-term-oriented monetary policy strategy focused on maintaining price stability. Accordingly, the Governing Council will monitor very closely all developments. On the basis of our assessment, and by acting in a firm and timely manner, we will ensure that risks to price stability over the medium term do not materialise and that medium and long-term inflation expectations remain firmly anchored in line with price stability, thereby favouring an environment conducive to sustained economic growth, well-functioning markets and job creation. Providing such an anchor for medium and long-term inflation expectations is all the more important at times of financial market volatility and increased uncertainty. As regards the financial markets, we will continue to pay great attention to developments over the period to come. [...]