According to the European Central Bank (ECB)

- The key rate is unchanged at 1.00%, a level that the ECB judges to be appropriate given all of the available information and the enhanced credit support measures announced in May.
- Recent survey information indicates that, after two quarters of very negative growth, the euro zone’s economy should contract much less steeply over the remainder of the year. After a stabilization phase, the economy is expected to return to growth by mid-2010.
- Price growth will be impeded over the medium range by the marked weakening of economic activity in the euro area and globally. Indicators of inflation expectations show that they are firmly anchored in line with the aim of keeping inflation below but close to 2%. The ECB judges that the risks to its inflation scenario are broadly balanced.

Comments

As the vast majority of analysts had forecast, the ECB opted to leave its key rate unchanged this morning. Although President Trichet reiterated that 1.00% did not represent an absolute floor, it seems increasingly clear that it will take more substantial deterioration in economic and financial conditions to lower the key rate further still.

The ECB’s decision is based on a relatively pessimistic economic scenario. The new projections by Eurosystem staff call for the zone’s real GDP variation to be between -5.1% and -4.1% in 2009, followed by growth between -1.0% and 0.4% in 2010. Although some economic statistics have improved recently, growth is not expected to return until mid-2010. The inflation rate, which fell to 0% in May according to the flash estimate, should cross into negative territory in the next few months because of base effects. On average, the ECB’s new scenario calls for annual inflation to be between 0.1% and 0.5% in 2009, and between 0.6% and 1.4% in 2010.

President Trichet also provided a few additional details on the purchase of covered bonds. He confirmed that the amount would be €60B and that the purchases would be made in the primary and secondary markets. Designed to support credit, the program should run from July 2009 to June 2010. However, this does not constitute a quantitative measure. Answering questions regarding Chancellor Merkel’s recent criticism of actions taken by the central banks, the President reported that he had spoken with the Chancellor and reaffirmed the ECB’s independence.

Implications: Although the very weak outlooks for growth and inflation could justify a lower key rate and quantitative easing, the recent signs that the economy is stabilizing bolster the ECB’s decision not to do anything more. Also, there was nothing new from the Bank of England this morning. In both cases, key rates should remain unchanged for several quarters.

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 [...] On the basis of its regular economic and monetary analyses, the Governing Council decided to leave the key ECB interest rates unchanged. The current rates are appropriate taking into account our decisions of early May, including the enhanced credit support measures, and all the information and analyses which have become available since then. We confirmed our expectation that price developments over the policy-relevant horizon will remain dampened by the marked weakening of economic activity in the euro area and globally. Recent survey information indicates that, following two quarters of very negative growth, economic activity over the remainder of this year is expected to decline at much less negative rates. After a stabilisation phase, positive quarterly growth rates are expected by mid-2010. This assessment incorporates adverse lagged effects, such as a further deterioration in labour markets, which are likely to materialise over the coming months. At the same time, available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council’s aim of keeping inflation rates below, but close to, 2% over the medium term. The outcome of the monetary analysis supports the assessment of moderate inflationary pressure, as money and credit growth have further declined on an annual basis. Against this background, we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. [...]