In April, the European Central Bank maintains its status quo

According to the ECB (European Central Bank):

- The ECB has decided to keep its key rate unchanged at 2.50% following the increase of 25 basis points in March.
- The risks to growth appear to be balanced over the shorter term, but high oil prices and global imbalances continue to constitute a potential hindrance to growth in the longer term.
- Inflation risks remain present due to high oil prices, possibly stronger pass-through effects than currently anticipated and other indirect tax increases.

Commentary:

As expected, the ECB today opted to keep its key rate unchanged at 2.50%. Following 25 basis point increases in December 2005 and last March, everything suggested the ECB would opt for the status quo at its April meeting. Business and household confidence surveys do show a substantial advance in the economic outlook for the euro zone, but improvements in real economic data are taking their time in emerging. Under these circumstances, the ECB naturally opted to remain cautious.

That said, the marked increase in Euroland economic sentiment in recent months, and the 15-year peak reached by Germany’s IFO index signal that economic activity is about to rebound strongly in the euro zone. This means that more rate hikes should be expected in the near future. Persistent high oil prices and the marked increase in loans to the private sector remain concerns for the ECB. Aside from energy, inflation is largely contained, but total inflation, the ECB’s benchmark index, has been evolving above the upper limit of 2.0% for over a year. With the economy expected to pick up in 2006, the inflation pressure underlying the domestic economy will be greater than it has been in recent years. The ECB will thus want to gradually decrease the level of monetary accommodation so as to maintain price stability in the euro zone.

A third rate increase as of the May 4 meeting is not out of the question, but we believe the ECB will opt to wait for the results for the national accounts for the first quarter of 2006, scheduled for publication on May 11, before moving ahead. At least two more 25 basis point increases will follow this year, bringing the Bank’s key rate to at least 3.25% in December. Moreover, during the question period following the decision, President Trichet seemed to be leaning in the same direction as we are leaning, noting that the strong odds associated with a rate hike at the next meeting did not correspond to committee members’ sentiments.
ECB Press Release:

[...] On the basis of our regular economic and monetary analyses, we have decided to keep the key ECB interest rates unchanged, following the increase of 25 basis points on 2 March 2006. [...] With interest rates across the whole maturity spectrum still at very low levels in both nominal and real terms, and monetary and credit growth remaining strong and liquidity ample, our monetary policy remains accommodative. We will continue to monitor very closely all developments to ensure that risks to price stability over the medium term do not materialise.

[...] recent information has confirmed our assessment of an improved outlook for economic growth in the euro area, following the more subdued developments in late 2005. On the basis of the latest data, survey releases and various indicator-based estimates, it appears that growth is strengthening and broadening in the first half of 2006. [...] The risks to economic growth appear to be broadly balanced over the shorter term. Further ahead, downside risks still relate to potential increases in oil prices and concerns about global imbalances.

Turning to price developments, [...] inflation rates are likely to remain above 2%, with the precise levels depending largely on developments in the more volatile components of the index. Beyond the short term, changes in administered prices and indirect taxes are expected to significantly affect inflation in 2006 and 2007, and an upward impact may also be expected from the indirect effects of past oil price increases. [...] Risks to the outlook for price developments remain on the upside and include further increases in oil prices, a possibly stronger pass-through of oil price rises into consumer prices than currently anticipated, additional increases in administered prices and indirect taxes, and – more fundamentally – stronger wage and price developments than expected due to second-round effects of past oil price increases. [...]