According to the European Central Bank:

- The ECB raised its key rate by 25 basis points, i.e. from 2.75% to 3.00%.
- This decision reflects increased inflationary risks in the medium term.
- Despite the increase announced today, key rates in the euro zone remain low in real and nominal terms. Growth in the money supply and credit remains strong.
- Therefore, the monetary policy remains accommodating and according to the ECB’s base case, other increases in the cost of money will be necessary in Europe.

Commentary:

As expected by analysts, the ECB today announced another key rate hike, the fourth since the end of 2005. There were some telltale signs that this was going to occur. First, the meeting was originally supposed to be held by teleconference but ECB president Jean-Claude Trichet later announced the meeting would be more traditional, followed by a press conference. It was therefore clear that the ECB authorities planned to make some kind of change to the monetary policy.

Second, the last ECB press release indicated that monetary authorities would be very vigilant regarding inflationary risks. Every time the ECB used the term “vigilant” in its press releases over the past few months, the key rates were hiked at the next meeting.

As for the economic indicators, the latest data show that economic growth is relatively solid in the euro zone. As such, after growing at an annualized rate of 2.5% in the first quarter, the economy should continue to grow in the second and third quarters. The harmonized annual inflation rate for the euro zone was 2.5% in June, above the ECB target of 2.0%. Moreover, European monetary authorities expect inflation to stay above the target throughout the second half of 2006 and 2007, on average, because of high energy prices.

According to the Bank, all signs point to rising inflation over the next few months. Given that Euroland key rates are still relatively low, the ECB will probably continue to increase its key rates in the next few quarters. In our view, two more 25-point hikes may be announced before the end of the year.
ECB Press Release:

[...] At today’s meeting, we decided to increase the key ECB interest rates by 25 basis points. This decision reflects the upside risks to price stability over the medium term that we have identified through both our economic and monetary analyses. It will contribute to ensuring that medium to longer-term inflation expectations in the euro area remain solidly anchored at levels consistent with price stability. [...] 

[...] Also after today’s increase, the key ECB interest rates remain low in both real and nominal terms, money and credit growth remain strong, and liquidity in the euro area is ample by all plausible measures. Our monetary policy therefore continues to be accommodative. If our assumptions and baseline scenario are confirmed, a progressive withdrawal of monetary accommodation will be warranted. Against this background, we will continue to monitor very closely all developments so as to ensure price stability over the medium and longer term. [...]