

# More to Follow as ECB Raises Rates by 0.25%

TOPIC OF THE DAY FROM AIB GLOBAL TREASURY SERVICES

**A**s expected, the European Central Bank raised the official refinancing rate to 3.25% at today's Governing Council meeting. This represents the fifth increase of 0.25% in official interest rates since the ECB began its tightening campaign in December 2005.

And it would appear that the ECB is not yet finished. From the hawkish tone of Mr. Trichet's comments at the post meeting press conference, we continue to believe that rates are set to be raised in December and again in early 2007 by 0.25% on each occasion.

The ECB continues to be of the view that, despite the moves to date, further withdrawal of monetary accommodation is warranted, with rates still at low levels. Recent data have confirmed a significant acceleration in the pace of economic activity. Indeed, the recovery is more robust and broader based than had been anticipated. Despite the possibility of some moderation in activity going forward, growth should remain robust over the remainder of 2006 and into 2007.

The current pace of economic expansion, coupled with positive trends in the labour market, could result in higher than expected wage demands impacting adversely on price stability.

Another factor behind the ECB's decision to continue tightening interest rates is its concerns about the inflationary risks associated with the pace of growth in monetary aggregates. In general, the rate of monetary and credit expansion remains high with the annual growth in M3 rising to 8.2% in August. Meanwhile, growth in lending to the private sector continues at double digit levels.

According to the flash HICP, the annual rate of inflation fell to 1.8% in September from 2.3% previously. The decline in the inflation rate was most likely due to the recent sharp fall in oil prices. However, **the ECB still considers that the risks to the outlook for price stability remain clearly on the upside.**

There may be a considerable degree of volatility in the annual HICP over the short-term but inflation is expected to move back above the 2% level again before year end and remain at elevated levels in 2007. Thus, against this background, the ECB remains determined to keep these inflationary risks under control.

In other news today, the Bank of England announced that it was leaving interest rates on hold at 4.75%. However, given the tone of recent activity and survey data, the central bank is still expected to hike rates by 0.25% when it next meets on 8/9 November.

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