

ECB Watch Summary– 12th January 2007

TOPIC OF THE DAY FROM AIB GLOBAL TREASURY SERVICES

The European Central Bank left interest rates unchanged at its monthly policy meeting yesterday, Thursday, 11th January 07.

Below are some highlights from our full ECB Watch publication which can be found on our website www.fxcentre.com or by clicking below: -
http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf

- Based on Mr Trichet's comments at the ECB press conference, it is clear that rates have not yet peaked in the eurozone. The ECB still regards monetary policy as accommodative and believes that the level of official rates remains low.
- However, the ECB appears to have changed the timing of interest rate decisions back to 3 month intervals from 2 months.
- The President did signal that the market was correct in anticipating another increase in March.
- A move to 4%, therefore, is on the cards by the middle of the year.
- The 4% level may not represent the peak of eurozone interest rates.

Indicators Point to Continuing Strong Activity

Real GDP probably grew by as much as 2.7% in 2006. Growth was particularly strong in the first half of last year with an average quarterly rise in real GDP of 0.9%. Growth slowed to 0.5% in the third quarter and may have increased by 0.5-0.6% in the final quarter. This trend still leaves the economy with plenty of momentum going into 2007. Indeed, the overall impression from recent eurozone economic indicators is that growth will remain relatively strong in 2007. [for the full text click http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf](http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf)

Inflation Falls to Under 2%

Although various measures of the eurozone's unused capacity still point to some slack in the economy, this is diminishing rapidly. The labour market continues to show a strong improvement with employment now growing by well over 1% year-on-year. The unemployment rate is now down to 7.6%. The European Commission recently reported that the non-accelerating wage rate of unemployment had fallen to 7.8% in 2006. It's no wonder, therefore, that the ECB has emphasised the risks of higher wage costs in the period ahead and the threat that these could bring to the outlook for the overall inflation rate in the eurozone. [for the full text click http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf](http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf)

ECB to Hike Rates to 4% by Mid Year

In deciding on future interest rate increases, the ECB will also have to take into account developments in the US economy. Though the US economy will weaken this year, the impact on the eurozone could be limited, as the US downturn is principally a US housing market correction. Furthermore, there are lags in the way in which US economic developments affect the euro economy. As a result, any negative impact on the eurozone could be delayed until into the second half of 2007, as well as proving modest enough. [for the full text click http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf](http://www.fxcentre.com/other/fxcentre_EconomicResearch.pdf)

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