

# ECB Watch Summary– 9<sup>th</sup> February 2007

TOPIC OF THE DAY FROM AIB GLOBAL TREASURY SERVICES

The European Central Bank, as expected, left official interest rates unchanged at its monthly policy meeting yesterday, Thursday, 8<sup>th</sup> February '07.

Below are some highlights from our **ECB Watch** publication.

The full document can be found on our website [www.fxcentre.com](http://www.fxcentre.com)

or by clicking below: -

<http://www.aibeconomics.com/PDFS/ECB%20Watch%20FEB%202007.pdf>

## ECB to Hike in March, More to Follow

- Although leaving official interest rates unchanged, the ECB sent a strong signal that rates would be increased in March.
- ECB seems to have changed the timing of interest rate decisions back to 3 month intervals from 2 months.
- Monetary policy still regarded as accommodative by ECB.
- Significant base effects may lead to lower inflation rates by mid-year. However, these effects will be temporary and inflation is expected to rise again later in the year.
- Crucially, the ECB believes that over the medium term, the risks to inflation are on the upside.
- High wage settlements are now the biggest threat to inflation. Mr. Trichet said that the ECB would monitor the upcoming wage negotiations in the euro area very carefully.

## ECB Rates of 4% by Mid-Year . . . May Not be Peak

- Even after a further rate increase in March, it is likely that the ECB will still view policy as accommodative. If, as expected, the economy continues to perform well, the ECB will no doubt at some stage see a need to move to a more neutral policy stance.
- The case for further normalisation is strong and a level of 4% for the ECB's refi rate could well be an initial target level.
- It is too early to suggest that 4% would represent the peak for official rates in the eurozone.
- We see further upward pressure on market interest rates and bond yields. Two year swap rates could well reach 4.5% before end 2007, with the curve possible inverting.

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