

DISSECTION - THE EUROPEAN CENTRAL BANK PRESS CONFERENCE

	April 2, 2009	March 5, 2009	February 5, 2009
THE TD TAKE	The Governing Council disappointed market and our expectations by announcing only a 25bps cut. Given reducing the main refi rate more than the deposit rate may have driven a build up of deposits with the ECB, they seem to have decided to err on the side of caution and said rather clearly that while the refi rate is not at a bottom, the deposit rate almost certainly is. However, for once, the ECB has precommitted, this time to announce their plans for further non-standard measures when they meet next month. In our opinion, this will very likely include the extension of the duration of ECB loans and may include asset purchases. In the prepared remarks on credit, President Trichet specifically mentioned issues with short-term loans and some broader supply constraints. As such, we do see a need and ability of the ECB to begin buying bank debt. It is also possible but not certain that they could come to a consensus on an equitable way of purchasing the debt of member governments, but there is less appetite for this at present.	Talk about a turnaround. After failing to reach even a consensus last month on the balance of risks to inflation, this month, inflation is acknowledged to remain "well below 2% over 2009 and 2010" with inflation risks broadly receding. So much so that the GC this month provided risks around the GDP forecasts, and said the downward revision to inflation reflected issues in the economy, but detailed no risks around the inflation forecast. It is worth highlighting this was a consensual, not unanimous decision, though, and Trichet still highlighted in Q&A that they still see a number of drawbacks of a zero level of rates. However, he also said they have not decided ex ante that 1.50% is the bottom, and that they are at least discussing modalities of possible "nonstandard measures," so our bias would be for a further 50bps easing by the ECB in April.	With much of Trichet's prepared statement left unchanged from the previous month, this month's meeting would fall somewhere between a rerun and a flashback episode in TV parlance. Two changes do stand out. First, a significant weakening in corporate credit conditions replaces the need for further data and analysis at the time of the January meeting. Second, an odd decision to provide two upside and two downside risks to price stability, but removing any mention of these risks being broadly balanced, as in January. When questioned, Trichet would only reference the exceptional uncertainty, so it seems there may be a sharp divide among GC members as to the balance of inflation risks. While the bias at this time should be for a cut in March given how much Trichet went out of his way in the Q&A to say 2.00% is not a bottom and even suggested 50bps is a possibility, there is a significant risk around that outcome.
REAL ACTIVITY			
Consumer	The substantial fall in commodity prices since the summer of 2008 is supporting real disposable income and thus consumption.	...the fall in commodity prices is expected to support real disposable income and consumption in the period ahead.	We continue to see persistent weakness in economic activity in the euro area over the coming quarters...there have been tentative signs of stabilisation in some survey data, albeit at historically low levels...
Investment	...domestic demand should increasingly benefit from the effects of the significant macroeconomic stimulus...		
ECB Assessment	...economic activity in the euro area...is expected to gradually recover in 2010...risks to this outlook for economic activity as being broadly balanced.	ECB staff macroeconomic projections for ...annual real GDP growth in a range of -3.2% to -2.2% in 2009, and...-0.7% and +0.7% in 2010...the risks to the economic outlook now appear to be more balanced.	Overall, risks to economic growth remain clearly on the downside.
INFLATION			
Non-labour prices	...base effects stemming from past energy price effects will play a significant role in the shorter-term dynamics of the HICP...temporarily reaching negative levels around mid-year	...inflation rates have decreased significantly and are now expected to remain well below 2% over 2009 and 2010...	Owing mainly to base effects...headline annual inflation rates are projected to decline further in the coming months...[but then] are expected to increase again in the second half of the year.... Such short-term volatility is, however, not relevant.
Wages		...diminishing domestic price and cost pressures, reflecting the severe downturn in economic activity...	
Credit	...the pace of monetary expansion in the euro area has continued to decelerate markedly and supports the assessment of diminishing risks to price stability in the medium term....The flow of MFI loans to non-financial corporations and households has remained very subdued....The decline in short-term lending may be indicative of a reduction in loan demand related to the weakening of economic activity. However, supply effects have probably also affected loan developments.	...confirms the decline in the growth of bank credit to households and non-financial corporations observed in 2008. At the same time, it appears that the substantial past reduction in the key ECB interest rates is increasingly being passed through to bank lending rates...the transmission mechanism of monetary policy is not significantly hampered in the euro area...	...further deceleration in monetary and credit growth in the euro area...the underlying pace of broad money expansion continues to decelerate gradually...outstanding MFI loans to non-financial corporations contracted for the first time since the onset of the financial turmoil, confirming the significant weakening of corporate credit at the end of the year after a long period...some indications that the pace of tightening of bank credit standards is stabilising, albeit at high levels...
Expectations	Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim...	...inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation at rates of below, but close to, 2% over the medium term...	...[ECB expectation of price stability] supported by available indicators of inflation expectations for the medium term.
ECB Assessment	...over the policy-relevant horizon, annual HICP inflation is expected to remain below 2% in 2010, reflecting mainly ongoing sluggish demand in the euro area and elsewhere....The risks surrounding this outlook are broadly balanced.	ECB staff inflation projections...foresee annual HICP inflation at between 0.1% and 0.7% in 2009...[and] between 0.6% and 1.4% [in 2010]...Risks to these projections are broadly balanced...	...both external and domestic inflationary pressures are diminishing. We continue to expect inflation rates in the euro area to be in line with price stability over the policy-relevant medium-term horizon...
GC REASONING			
Balance of Risks	...there may be stronger than anticipated positive effects due to the decrease in commodity prices and to policy measures taken...On the other hand, there are concerns that the turmoil in financial markets could have a stronger impact on the real economy...	...signs of a more broad-based reduction in inflationary risks are also increasingly emerging...	Regarding risks to price stability over the medium term, unexpected further declines in commodity prices or a stronger than expected slowdown in the economy could put downward pressure on inflation, while upside risks to price stability could materialise, particularly if the recent fall in commodity prices were to reverse or if domestic price pressures turn out to be stronger than assumed.
ECB Assessment	After today's decision we expect price stability to be maintained over the medium term...	After today's decision we expect price stability to be maintained over the medium term...	...we continue to expect inflation rates in the euro area to be in line with price stability over the policy-relevant medium-term horizon...
Decision	25bps cut to 1.25%	50bps cut to 1.50%	Unchanged at 2.00%
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