



PREVIEW: ECB JUNE INTEREST RATE DECISION

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- **ECB rates approach bottom at 1%, what now?**
- **“Enhanced credit support”**
- **Downward revisions to staff forecasts**

ECB rates approach bottom at 1%, what now?

ECB is widely expected to keep interest rates unchanged at 1% following a cut of 325bps since October 2008. Therefore, the focus will be very much on the ECB plan to purchase EUR 60bln of covered bonds. Also, markets will be on the look for updated forecasts on inflation and GDP growth for 2009 and 2010, which are likely to be revised markedly following a disastrous Q1 GDP contraction.

At the ECB press conference succeeding last month’s meeting, Trichet signalled that there was little scope for further interest rate cuts. This was, however, a surprise after it emerged that the Eurozone economy will shrink more than the US and UK’s. This led some to question whether the ECB had done enough to steer the economy out of the downturn. As a result, the increased uncertainty surrounding the health of the EU economy caused some members of the ECB, such as Liikanen, to reiterate that 1% is not the lowest possible minimum.

Trichet said ECB’s credit easing approach was not the same as quantitative easing and ECB had not bowed down to international pressure to follow BoE and Fed asset purchase programs. However, some analysts have questioned the size of the proposed scheme, noting that the purchase of EUR 60bln might prove insignificant considering the Eurozone bond market is worth more than EUR 6,000bln.

If the ECB does intend to reduce longer term interest rates then this could open the door for quantitative easing, though this scenario would seem unlikely after Trichet said the size of its credit easing programme is appropriate.

Staff projections

The economic outlook has not deteriorated significantly since the last meeting and the recent strength in markets is pointing to tentative stabilisation in economy but more importantly in the financial sector. However, the recovery is still a long way off and Germany’s Weber believes “a quick bottoming-out should not be expected, even if the downward pressure eases in the coming months”. It is seen that the ECB is to revise down its GDP forecast but leave the inflation expectation roughly unchanged.

Below are the projected estimates for the ECB staff projections for both GDP and HICP:

ECB Staff Projections				
	June 2009 *		March 2009	
	2009	2010	2009	2010
GDP	-4%	0%	-2.70%	0
HICP	0.25%	0.75%	0.40%	1.00%
* Reuters consensus				

Sources: RTRS, BBG, 4Cast