



ECB watch

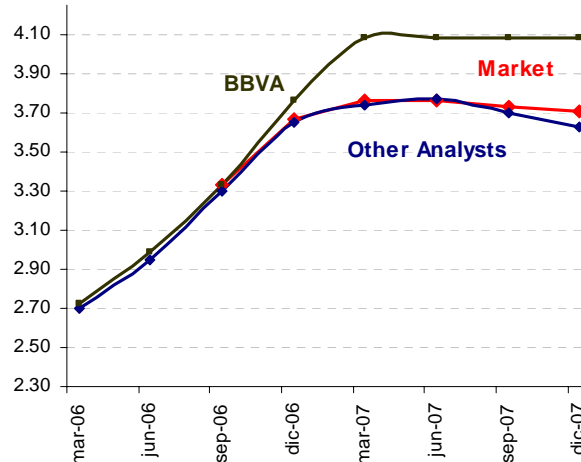
Meeting: 5 October 2006
29 September 2006

ECB: Increasing hawkish rhetoric?

- The ECB is expected to increase by 25 bp the official interest rates at its next meeting. Another hike is expected in December.
- The focus will concentrate on whether the statement and press conference validate current expectations or suggest a speed up in the pace of tightening.
- Interest rates remain at low levels, credit and monetary aggregates continue to show strong dynamism, and although sentiment indicators suggest that the peak in growth has been reached, it is likely that the euro zone economy will grow around its potential in coming quarters. Furthermore, inflation, after a transitory drop in September and October, will rise again above 2%.
- The balance of risks in the global scenario, the main reason for recommending a cautious approach, has improved somewhat in the last month. Certainly, concern about a housing-driven deceleration in the US has increased. But the likelihood of an oil price shock, with a much more potential damaging effect on the global economy, has diminished.
- In this context, it can be expected that the ECB will go ahead with the normalization process, but at a gradual pace, given the uncertainties still surrounding the international environment and the absence of any evidence of second round effects.






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EMU, 3 month interest rates
(Euribor future contracts, Consensus forecasts and BBVA forecasts)



Box 1: Economic indicators

A transitory drop in inflation in September due to a base effect is expected. Sentiment indices remain resilient. Strong monetary and credit growth.

		One year before	Jun-06	Jul-06	Ago-06	Sep-06	Impact on rates*
GER – IFO Economic Climate	Obs.	100.4	106.8	105.6	105.00	104.9	
	Cons.		105.0	106.0	105.0	104.4	
Euro–EC Industrial confid.	Obs.	-4.0	3	4	2	4	
	Cons.		1	2	3	1	
Euro –EC Consumer confid.	Obs.	-12.0	-9	-8	-8	-8	
	Cons.		-9	-8	-8	-8	
Euro – Industrial prod. (m/m)	Obs.	0.4	0.0	-0.4			
	Cons.		-0.1	0.2			
FRA – Household consump. (y/y)	Obs.	3.4	5.1	3.7	6.4		
	Cons.		3.6		4.0		
GER – Retail sales (y/y)	Obs.	0.9	-0.2	-0.3	1.0		
	Cons.		1.0	1.8	-0.3		
Euro – HICP (y/y)	Obs.	2.4	2.5	2.4	2.3	1.8	
	Cons.		2.5	2.5	2.3	1.9	
Euro – M3 (y/y)	Obs.	8.1	8.5	7.8	8.2		
	Cons.		8.7	8.2	7.5		
Euro – Loans to Priv. Sect. (y/y)	Obs.	9.7	11.0	11.1	11.3		
	Cons.						

* According to BBVA, the direction in which this data may affect the ECB monetary policy stance.

Obs: current data; Cons: consensus forecasts

Box 2: Speeches and comments by members of the ECB Governing Council

Hawkish rhetoric from ECB members, anticipating the October rate hike. Some of them point to higher increases than those pricing in the markets.

	Weber (6 sep.)	Mersch (7 sep.)	Garganas (27 sep.)	Weber (27 sep.)	Valoración
Activity			I am upbeat on euro zone growth in 2007		
Inflation	"An obvious darkening of the price outlook would mean we need to act differently in our tightening process than the current course of gradual tightening"			It is premature to assume a sustained easing of the risks to inflation	Concern remain
Credit and monetary aggregates					
Monetary policy	"No decision has been taken to end the process of normalization at the end of the year"	The ECB won't stop its determination at the end of the year	Date will determine future rate moves		More hikes in 2007?
Other		The ECB will exercise the strongest vigilance not only in the immediate future.			

Box 3: Market view

Markets are almost pricing a 25 bp hike in October. Official rates are expected to be 3.50 at the end of the year

	3m euribor Future Cont.	1m Eonia Future Cont.	Implied Forward overnight	Probability according to deposit curve			
				3.25	3.50	3.75	4.00
oct-06	3.49	3.24	3.23	91%			
nov-07	3.57	3.33	3.31		23%		
dic-07	3.67	3.46	3.51		100%		
ene-07	3.70	3.58	3.57			29%	
feb-07	3.73	3.60	3.59			35%	
mar-07	3.76	3.66	3.74			95%	
abr-07		3.68	3.68				0%

ECB-Barometer for the 5th of October Governing Council meeting

