AIB Group Treasury
Economic Services Unit

ECB Signals "No Change" Yet

It would be difficult to find anyone who would argue against the need for further easing of monetary policy in the eurozone. The timing of such reductions however, is as always, the subject of much debate and speculation will be intense in the run up to this week's meeting. There was some hope that, following the release of the latest inflation data, the ECB would cut rates on 25th. However, despite a much weaker than forecast German Ifo sentiment survey for September hopes of a near term cut in rates were dashed by other data released last week. Inflation fell in September, but not by as much as expected. Industrial production for August came in well ahead of expectations. Also, the executive summary of the ECB's latest bulletin reiterated the gloomier but still cautious tone of Wim Duisenberg's last press conference.

Inflation in the eurozone slowed to 2.5% in September, the lowest rate since January of this year. Much of the reduction came from lower oil prices. This was the fourth month in a row that inflation has fallen and the headline HICP rate is now well down on May's peak of 3.4%. Expectations, however had been for a drop to 2.4%. Moreover, core inflation, which excludes food , energy and tobacco rose to 2.2%, its highest level since June 1996. Given the downward trend in oil prices and the unwinding of pressures in the food sector we believe that headline inflation remains on track to come in below the ECB's 2.0% target in 2002. This is also the view of the ECB and the European Commission. The increase in the underlying rate however, may see that ECB holding fire on monetary policy until more flattering numbers are released next month.

The industrial production data are less worrying and are likely to be a "blip" rather than signaling any imminent recovery in the eurozone. The outlook for industry post 11 September attacks is not good with new orders falling and inventories still high. Given the inventory overhang in the eurozone, the trend in industrial production numbers over the coming months is unlikely to be favourable. Industrial production in the UK also surged in August but here too the rebound is expected to prove temporary. The output expectations component of the monthly CBI industrial trends survey moved deeply into negative territory in August and September while the PMI index for manufacturing declined further in Q3.

According to the ECB's latest monthly bulletin, it believes the current level of interest rates to be consistent with price stability over the medium term but given the high level of uncertainty will monitor developments very closely. While the attacks on 11 September did have an effect, it was too soon to formulate a thorough analysis. As well as the note of caution in the bulletin, ECB council members have stressed the need for caution frequently enough in recent days to suggest that rates will not be changed. According to governing council member and Bank of France Governor, Jean-Claude Trichet, there is not "immense room" for action on interest rates. Following calls from EU politicians for "further decisive action", board member Domingo Salons was quoted as saying that the "ECB will take the decision it thinks fit at the time. It will act independently. The easy thing is to be indulgent, but we are not paid to do that." Political interference in the run up the meeting virtually guarantees no change.

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19 October 2001