

Flash Comment

ECB meeting: A double dip is not on the cards

- Full allotment at all auctions was extended until year-end and interest rates were kept unchanged as expected.
- Trichet was softer in tone than at the last meeting, but did not seem too concerned about the risk of a double dip: “A double dip is not on the cards in our own analysis”.
- The staff growth forecasts were revised upward – in particular for this year – while the inflation forecast was revised a little up for both 2010 and 2011.

Taking a pause on the exit path

As expected the ECB kept all its key interest rates unchanged. The ECB also decided that it will conduct its main refinancing operations (MROs) and its special-term refinancing operations with a maturity of one maintenance period as fixed-rate tender procedures with full allotment until at least the end of the twelfth maintenance period on 18 January 2011.

In addition the ECB will provide three new three-month long-term refinancing operations (LTRO) with full allotment at a fixed rate corresponding to the average rate of the MROs over the life of the respective LTRO. These operations will be carried out in October, November and December. It was fully in line with our expectation and not that big a surprise given Weber's comments on 20 August.

In addition to these measures, the ECB is expected to smooth out potential liquidity tensions by undertaking three fine-tuning operations on 30 September, 11 November and 23 December when 6M and 12M LTROs mature. A fine-tuning operation was also put in place when the one-year LTRO matured on 1 July.

No double-dip

In the Q&A Trichet said that he is not anticipating a double dip: “A double dip is not on the cards in our own analysis”, he said. Asked about US growth he said that he was not too disappointed: “What we see is more or less what we had in mind”. Trichet noted that he did not expect very dynamic growth. This is in line with our expectations of an early mid-cycle slowdown with growth not far from trend for the rest of the year.

New staff projections slightly more upbeat

The quarterly update of staff projections included upward revision of 2010 GDP expectations by 0.6 percentage points, while 2011 GDP projections were increased 0.2pp to 1.4%. The large upward revision for 2010 is caused by the very strong Q2. The new forecast is compatible with growth around 0.3% q/q in Q3 and Q4. We expect that growth will be slightly higher. The upward revision of 2011 partly reflects an improved outlook, but is primarily a result of the positive Q2 10. Trichet noted that confidence can counter the negative impact of fiscal tightening”. Trichet also talked enthusiastically about such expansionary fiscal contraction at Jackson Hole on 27 August.

Policy rates (September)

Actual	DB	Con	Last
Refinancing rate	1.0%	1.0%	1.0%
Deposit rate	0.25%	0.25%	0.25%

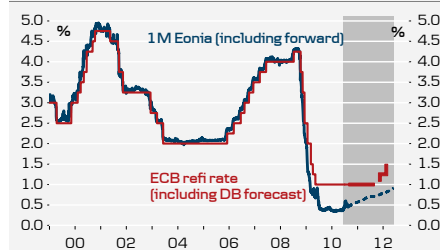
Source: Ecowin

ECB and Danske Bank projections

%	2010	2011
GDP growth		
ECB Sept. (June)	1.6 (1.0)	1.4 (1.2)
Danske Bank (June)	1.3	2.1
Inflation		
ECB Sept. (June)	1.6 (1.5)	1.7 (1.6)
Danske Bank (June)	1.4	1.6

Source: ECB and Danske Markets

No hikes any time soon



Source: Reuters Ecowin and Danske Markets

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The inflation outlook has changed slightly due to price pressure from commodity prices. The inflation forecast was revised up by 0.1 percentage points for both 2010 and 2011 to 1.6% and 1.7% respectively. Trichet said that “risks to prices are slightly on the upside”. In the Q&A he said that “the anchoring of price stability is exceptionally good” and that slightly tilting to the upside it was relative to the staff scenario and partly reflected administrative prices, but is fully in line with the definitions of price stability. Trichet noted that all data on inflation are going in the right direction and deflation risks did not materialise. Trichet also noted that wage moderation is very important for job creation.

Not much new on the bond purchase programme

There was little new on the bond purchase programme. Trichet said that the ECB continues to adjust what it does to ensure the functioning of market. Indeed the ECB is still in the market, but with very small amounts, and it thus seems that the ECB is willing to accept rather high sovereign spreads in the secondary market as long as there is some kind of a market with both sellers and buyers.

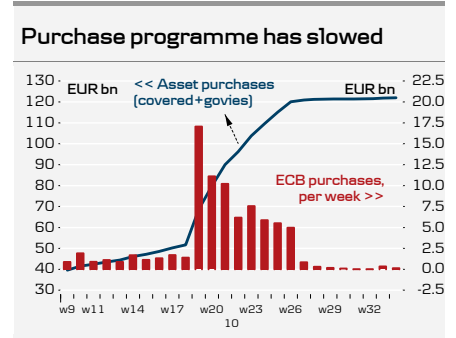
Outlook

We continue to expect a first ECB hike in Q4 11, which is in line with other ECB observers in a recent Reuters’ opinion poll. The current market pricing suggest no hikes from the ECB within the next couple of years.

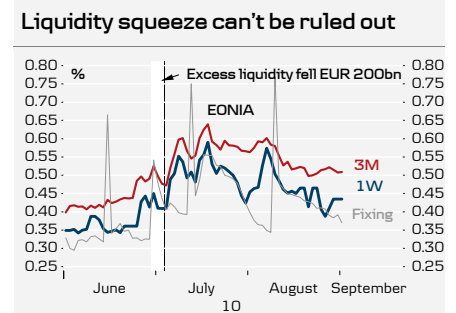
We expect that the ECB to continue with full allotment at the main refinancing operations in Q1 11, but could shift to fixed allotment at the LTROs if the euro area economy continues to recover and the debt crisis does not reignite.

Market comment

There was no major market movement after the ECB press conference, as the ECB delivered full allotment at least until 2011, as expected. There was a little relief in short-dated EONIA rates (1W-3M), which fell a few basis points as the ECB announced that additional fine-tuning operations will be put in place to smooth out transition in liquidity when large amounts of LTRO matures. In our view the risk is still for some squeeze around end-September when EUR225bn worth of LTRO matures, even with fine-tuning operations in place. This was seen around 1 July, when excess liquidity fell EUR200bn and led to a steepening of the EONIA curve.



Source: Reuters Ecowin and Danske Markets



Source: Reuters Ecowin and Danske Markets

Disclosure

This research report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority. The authors of this report are Frank Øland Hansen, Senior Economist and Lars Tranberg Rasmussen, Senior Analyst.

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