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ECB holds rates at 2 per cent as euro strengthens

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Published: January 13 2005 12:46 | Last updated: January 13 2005 12:46

The European Central Bank held its main refinancing rate at 2 per cent for the 19th straight month on Thursday. The move was widely expected with weak economic growth and the strength of the euro likely to deter the ECB from raising rates from their historic lows any time soon.

Of 30 economists polled by AFX News and Agence France-Presse, not one foresaw the ECB tightening monetary policy in the first quarter of 2005. Five respondents predicted an initial rate hike in the second quarter of the year, seven in the third quarter and six in the fourth quarter.

Ten economists forecast rates would be on hold for the whole of 2005, while two forecast an ECB rate cut.

The central bank did discuss the possibility of raising rates at its December meeting, and since then inflation in the 12-nation eurozone has edged up to 2.3 per cent, above its target of “close to, but below” 2 per cent.

Eurozone manufacturing data also improved in December, while business confidence has firmed amid falling oil prices and forward-looking economic indicators are seen as consistent with continuing growth.

However doves argue that the spike in consumer inflation was largely due to engineered price rises, such as higher German tobacco taxes, rather than a sign of intrinsic inflationary pressures. Furthermore headline inflation is likely to come under pressure from a recent softening in energy prices.

Core inflation, at 1.9 per cent in November, is still in line with the ECB's target, suggesting that second-round effects from last year's sharp spike in oil prices have so far been minimal.

The strength of the euro, which, at \$1.324 to the dollar, is still close to its lifetime high, is also likely to deter the bank from raising rates in the near future.

ECB president Jean-Claude Trichet, who warned late last year that foreign exchange movements had been both “brutal” and “unwelcome”, would be acutely aware that a surprise rate rise could push the euro higher still.

Tighter monetary policy in the eurozone would also risk exacerbating the global imbalances that have pushed the US dollar to multi-year lows.


US policymakers have repeatedly called for the eurozone to take measures to boost domestic growth, an eventuality that would increase demand for US exports and help reduce the latter's ballooning trade deficit.

Commenting on the US imbalances earlier in the week, Mr Trichet said: “Every part of the world has

homework to do”.

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