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Conflicting rate calls

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There's growing expectation among European economists that the European Central Bank (ECB) will be forced to follow the Federal Reserve and the Bank of England and start lowering interest rates.

Ironically, iterations from executive board member Juergen Stark suggest the ECB stands poised to raise interest rates to counter inflation which has accelerated to 3.1 per cent – well above the ECB's target of just below 2 per cent.

Calls to lower rates follow signs that the European economy could be in for a more pronounced slowdown as collateral damage from the US sub-prime mortgage slump surfaces.

There's also mounting fear that the European Commission may cut its original 2008 growth projection from 2.2 per cent to 1.8 per cent.

Based on these numbers Michael Schubert, economist at Commerzbank AG in Frankfurt is now predicting two (rate) cuts by October after initially projecting one in the fourth quarter.

Attributable largely to weaker foreign demand and a record-high euro negatively effecting exports, Europe's manufacturing and services industries expanded at the slowest pace since June 2005.

Industrial output fell sufficiently in November for economists at the Royal Bank of Scotland to signal that manufacturing has slipped into its first recession in over six years.

Unsurprisingly, recent surveys show German business confidence at its lowest in two years, while investor confidence fell to its lowest ebb since 1992.

Meantime, Europe's Dow Jones Stoxx 600 Index experienced its largest fall since the September 11 2001.

With the days of easy credit all but over, Martin van Vliet, economist at ING Bank in Amsterdam expects European banks to make it harder for companies and consumers to get loans over the next quarter.

Given that good access to credit markets underscored Europe's economy last year, potential tightening also threatens to dampen corporate investment. Based on these concerns Munich-based Ifo institute now expects investment spending in Germany to grow by around 4 per cent this year – half that of 2007.

The Royal Bank of Scotland's manufacturing and services report and the Ifo institute's business confidence figures, due for release January 23rd and 24th respectively should make for interesting reading.

Mark Story