EUROPEAN BUSINESS NEWS

ECB Is Likely to Hold Interest Rates Steady

Strength of Euro, Fragility Of Recovery Are Expected To Be the Focus of Meeting

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FRANKFURT -- With a strong euro and a still-fragile economic recovery, the European Central Bank appears likely to hold the euro zone's interest rates steady at a meeting Thursday.

"Currently, the strong euro allows us to keep interest rates at a low level in an environment where demand is picking up and excess liquidity persists," Ernst Welteke, a member of the ECB's governing council, said in a speech prepared for delivery here Tuesday evening.

The euro -- up more than 50% against the dollar from its low in 2000 -- is acting as a drag on the economy of the 12 nations that use the common currency, primarily by making the region's exports more expensive and less competitive. Exports make up about 20% of the euro zone's overall economic output.

During the first 10 months of last year, exports to the U.S. fell 10% from the same period a year earlier. Some studies by ECB economists show that a 5% increase in the value of the euro against the currencies of major trading partners can knock half a percentage point off economic growth after a year.

Early Tuesday evening in Europe, the euro traded at $1.2562, up from $1.2427 late Monday in New York and less than four cents below its high of nearly $1.29 last month.

The delicate state of the euro-zone economy as it recovers from a three-year slump is also encouraging ECB officials to keep rates low. Officials believe a recovery is under way but describe their optimism as cautious.
Mr. Welteke, who is also president of the ECB's German branches, said the outlook for the euro zone and Germany was "rather good," though "some serious risks remain." The German banker cited the U.S.'s large current-account and budget deficits, a topic that Europeans are likely to bring up with the U.S. at this weekend's meeting of central bankers and finance ministers from the Group of Seven industrialized nations.

The ECB last cut its key rate in June, to 2%. Recently, the course of interest rates has become less certain. Just a few months ago, the ECB was hinting that its next move was likely to be a rate increase as the economy picked up steam. But then the euro appreciated, cooling the region's export sector, limiting inflation and raising speculation of a rate cut.

Though no move is expected on Thursday, ECB watchers will focus on whether the bank still deems the current interest-rate level as "appropriate," a word used for months to signal that rates are on hold for the foreseeable future. Some ECB officials in recent speeches have opted not to use the word.

In addition, a number of G-7 central banks have recently shifted tone. The central banks of Japan and Canada eased policy, in part to compensate a weak dollar. The U.S. Federal Reserve freed its hands for a future increase in rates by dropping a promise to keep rates low for "a considerable period."

Euro-zone officials, concerned about the euro's strength, have recently spoken out to restrain the currency's rise -- with some success. They have backed away from their long-held policy of promoting a "strong and stable" euro, and now stress stability, avoiding "strong."

Europeans this weekend are expected to press the U.S. for a more-aggressive verbal campaign to stabilize the sliding dollar. The European message has been muddied however with some officials, including Mr. Welteke, not sticking to the common line. "A strong currency is an asset," said Mr. Welteke, who will attend the G-7 meeting. "The strong Deutschmark served Germany well."

Meanwhile, economic data on Tuesday painted a picture of slowing inflation and continued stagnation in the economy. Industrial producer prices in the euro zone slipped 0.1% in December from the month before, a report from the European Union's statistics office showed. Another report from the same agency showed that the region's unemployment rate in December remained at 8.8% for a 10th month running.

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