

# Eurozone economy

## ECB holds rates steady amid improved news flow

- **ECB hold rates unchanged at 1.0%**
- **President Draghi notes signs of stabilisation of business surveys alongside improvements in bank lending and bond markets**

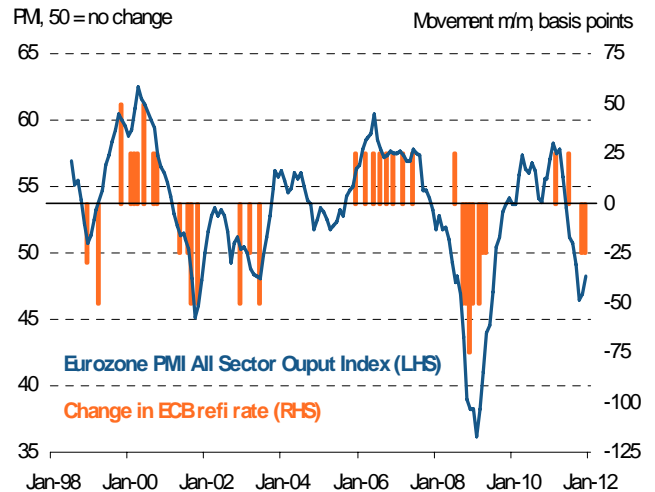
The European Central Bank held its main policy rate unchanged at 1.0% in January, as widely expected. The euro rallied as ECB President Mario Draghi noted that the recent initiatives to boost liquidity in the banking system appear to have helped prevent a credit squeeze and that business surveys had shown signs of stabilising, albeit at a low level.

The ECB announced in December that it was offering ultra-cheap three-year loans to banks to ensure that lending would not be constrained and thereby avert another credit crunch. This 'LTRO' offering was perceived by the ECB to have had a 'substantial' positive effect on easing credit conditions and boosting confidence in the financial system.

Meanwhile, Draghi saw tentative evidence that the economic situation had shown some signs of stabilisation. Markit's Eurozone PMI rose for the second month running in December, providing encouraging signs that the widely-watched indicator may have bottomed out.

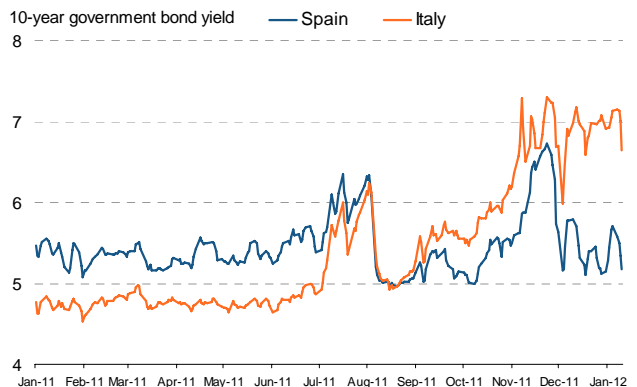
Further goods news came from well received auctions of Spanish and Italian debt. Ten-year bond yields fell sharply, down to 5.17% in Spain and 6.64% in Italy, taking borrowing costs down below the 7% level that is widely considered to be unsustainably expensive in the long-run for economies such as these with low growth potential.

### Draghi sees signs of stabilisation



Sources: Markit, ECB.

### Government borrowing costs fall



The euro rallied 0.6% against the US dollar on the news. However, the region's crisis is by no means resolved. Notably, at 48.3 the composite PMI measure of manufacturing and services activity remains deep in contraction territory, suggesting that the Eurozone economy is likely to have contracted by 0.6% in the fourth quarter. The three-month rate of contraction eased slightly over the course of the quarter, boding well for a smaller contraction in the first quarter of 2012, but the seeming inevitability of renewed recession means it is still possible that the ECB may cut rates by a further 0.25% if the survey data remain weak in coming months.

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