COMMENT

ECB to reassess inflation threat

BY Brian Blackstone

It is a "close call" whether the European Central Bank will pull back on its warning against inflation, a top official said in an interview, suggesting sharply weaker economic growth and falling oil prices are spurring the bank to rethink its view of the greatest risks to the economy.

The ECB has for many months warned that inflation risks are to the upside, a view that formed the basis of its April and July rate increases. If the ECB says the risks are balanced at its Sept. 8 meeting, it would dramatically lower the odds of another increase later this year.

The ECB was the first major developed-country central bank to raise rates from lows stemming from the global financial crisis of 2008, and its recent policy of tightening has put it at odds with other developed countries. The Federal Reserve pledged this week to keep interest rates near zero until at least 2013, and opened the door to more stimulus if needed to help spur growth.

In a Wall Street Journal interview, Central Bank of Luxembourg Governor Yves Mersch, long considered one of the ECB's most strident anti-inflation hawks, said he would wait for staff projections due at the next meeting on Sept. 8 to be sure of his own view.

Mr. Mersch remains against shifting direction further, he said from the central bank's office in Luxembourg. "It is doubtful sustainable economic growth could be achieved from a lower interest rate or more favorable financial conditions," he said.

He showed no enthusiasm for additional ECB stimulus either via rate cuts or additional financial-support measures, despite recent turbulence in global markets. Mr. Mersch said he sees no risk of a double-dip recession.

Mr. Mersch declined to comment on any differences between the Fed and ECB approaches, but said "the best contribution we can make is to restore confidence to deliver on your objective, which in our case is price stability."

He acknowledged that the euro-zone economy has weakened since the first quarter, when it grew 3.4% at an annualized rate.

The soft patch could extend to the third quarter, he said. However, Mr. Mersch said a renewed recession in Europe is an "extremely low probability."

His comments come just days after the ECB, in a bid to contain Europe's debt crisis, expanded its government-bond purchases to include Spain and Italy.

The central bank has been active in the market all week, helping to pull those countries' 10-year government bond yields down from over 6% last Friday to just under 5% on Thursday.

Mr. Mersch declined to say whether he supported the move, but stressed that it must be temporary.

He urged government leaders to quickly allow Europe's €440 billion ($623.8 billion) crisis fund to buy bonds and take that responsibility away from the ECB before incoming ECB President Mario Draghi, who currently heads Italy's central bank, takes the helm on Nov. 1.

"I think that the incoming ECB president ought not to be in the same mode as the present one," Mr. Mersch said.

Mr. Mersch at times expressed dismay over recent gyrations in financial markets, particularly the rising cost of default insurance for German bonds, as measured by credit-default swaps. Those costs exceeded comparable ones for the U.K. for the first time ever on Tuesday, even though the U.K budget gap is much larger than Germany's.

"I fail to see how the (credit-default spreads) of Germany should be worse than the CDS of a European country which is not part of the euro area but currently experiences riots and which has a deficit that is higher than any single country inside the euro area, including Greece," he said.

Despite renewed stress in markets—which has led to a marked rise in ECB loans to commercial banks—the ECB is pressing ahead with its work on finding ways to wean weak banks off their dependence on the central bank for funding.

"We have agreed on a tool kit of measures that ought to be taken" to monitor use of the ECB's facilities, he said, adding that more details will be forthcoming "in due course."

Other than ECB President Jean-Claude Trichet, Mr. Mersch, 61 years old, is the only ECB board member to have been with the central bank since its creation in 1998.

He said the ECB has seen itself pulled into unchartered waters as the debt crisis unfolded, evolving more and more into the first line of defense against crises "by default, rather than by mission creep." He said he hopes it doesn't stay that way.

"I hope in five years time we will operate in crisis-prevention mode rather than crisis-management mode," he said.

(Source: Dowjones)

MAJOR CURRENCIES

Currency	To U.S. Dollars	To IR. Rial	Currency	To U.S. Dollars	To IR. Rial
US dollar	1	10,566	100 Japanese yen	1.306	13,783
British pound	1.627	17,091	Canadian dollar	1.019	10,663
Swiss franc	1.297	14,534	Australian dollar	1.031	10,831
Swedish krona	0.154	1,615	Saudi riyal	0.266	2,818
UAE dirham	0.272	2,877	Chinese yuan	0.156	1,652
Kuwait dinar	3.663	38,730	Euro	1.423	15,031

Sources: cbi.ir & xe.com

MAJOR COMMODITIES

Light crude	$ 85.28 per bbl.	Silver	$ 38.65 per oz.
Gold	$ 1,750.30 per oz.	Platinum	$ 1,794.00 per oz.
Copper	$ 4.00 per pound	Wheat	698.25 ¢ / bushel

Source: cnnmoney.com

French economy stalls as spending declines

The slowdown may jeopardize President Nicolas Sarkozy's target of 2 percent growth for 2011, a key component in the government's plans to reduce its deficit.

France's economy unexpectedly stalled in the second quarter as consumer spending plunged just as investors spooked by Europe's debt crisis turn their attention to the region's second-largest economy.

Gross domestic product was unchanged from the first quarter, when it rose 0.9 percent, the most in four years, Paris-based statistics office Insee said on Friday. Economists forecast a 0.3 percent gain, the median of 15 estimates in a Bloomberg News survey showed.

The slowdown may jeopardize President Nicolas Sarkozy's target of 2 percent growth for 2011, a key component in the government's plans to reduce its deficit. Concerns about debt and slow growth have caused credit default swaps on French government bonds to double in the past six weeks. Swaps approached a record high on Friday.

"We will not have tremendous growth especially with these austerity programs," Philippe d'Arvisenet, a global economist at BNP Paribas in Paris, said in an interview with Bloomberg Television. Even so, austerity measures are "inescapable," he said. Otherwise, "you have more turmoil in the markets."

'Determination'

France moved center-stage in the debt crisis this week, as the yield on government debt compared to German bonds rose to a euro-era record. France's CAC 40 Index plunged 5.5 percent on Aug. 10, dragged down by banks including Societe Generale SA, which is heading for a 19 percent retreat this week. Sarkozy and German Chancellor Angela Merkel will meet in Paris on Aug. 16 to discuss the crisis.

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The French government will hold firm to its deficit-reduction targets and its growth forecasts, Finance Minister Francois Baroin said after Friday's report.

"No one should doubt our determination to respect the deficit targets that the president of the republic has fixed," Baroin said in an interview on RTL Radio. He said tax levels would not rise, and the deficit reduction would come from spending cuts.

France has pledged to reduce the deficit to 5.7 percent of output this year and 4.6 percent in 2012. It then aims to reduce it to 3 percent and 2 percent in the two following years. The International Monetary Fund said last month that on current plans, France will fail to achieve its targets in 2012 and 2013.

Consumer spending, previously the motor for the French economy, fell 0.7 percent in the report, while exports were flat. Investment was the only significant contributor to growth, gaining 0.9 percent.

'Still investing'

"The good news is that companies are still investing," Michel Martinez, an economist at Societe Generale in Paris, said before the data came out. "The concerns are about competitiveness and slowing world trade."

Sarkozy this week moved up the process of approving the 2012 budget by a month, announcing a meeting of his inner Cabinet on Aug. 24.

France "is set to miss" its deficit target "unless it takes further action," Christian Schulz, an economist at Berenberg Bank in London, said in a note to clients.

"While the miss may not be large, the evidence and expectation of slower growth and more fiscal drag is likely to fuel the nervousness of markets."

Efforts to reduce the deficit could further hit growth, said d'Arvisenet at BNP.

'Never happy'

"Markets are never happy," he said. "We want growth but also we want consolidation. You give consolidation, they are not happy because there is no growth. There is growth but no consolidation, they are not happy."

The spread between the yield on French 10-year government debt and benchmark German bunds rose as high as 89 basis points this week from 40 at the start of July. It was at 71 basis points on Friday.

Credit default swaps on France have doubled in the past six weeks to 169.8 basis points, more than triple the U.S., which last week lost its top rating at Standard & Poor's. Swaps on France rose 4 basis points to 173, within 1.5 basis points of a closing-price record high, according to CMA at 9 a.m. in London.

A basis point equals $1,000 annually on a swap protecting $10 million of debt.

The French government expects the economy to grow 2 percent this year and 2.25 percent in 2012. The IMF predicts growth of 2.1 percent and 1.9 percent. Schulz said France's long-term growth prospects remain "intact" because of the lack of any real-estate or credit bubble.

Growth forecasts

D'Arvisenet at BNP said the government may have to cut its 2011 forecast to 1.7 or 1.8 percent growth. Jennifer McKeown, senior European economist at Capital Economics in London, said she's now expecting expansion of 1.5 percent this year.

"Next week's release might show that Germany performed a bit better, but with Italy and Spain barely growing, the euro- zone as a whole will have managed only a very modest expansion in the second quarter," McKeown said in a note to clients.

"As for France itself, the 0.7 percent drop in consumer spending was the sharpest in nearly 15 years, suggesting that the household sector can no longer be relied upon to support the economy."

Even with a record trade deficit of more than 7 billion euros in both April and May, international trade added 0.3 percent to growth in the second quarter because of a 0.9 percent decline in imports, Insee said.

Baroin said the slowdown in consumer spending resulted from the expiry of a government-funded rebate system for buyers of new cars.

(Source: Bloomberg)

NEWS IN BRIEF

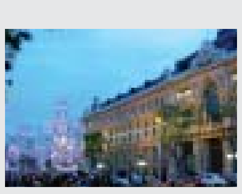
Serbian central bank may lower benchmark rate as inflation pressures ease

Serbia's central bank will lower its benchmark interest rate, the second-highest in Europe, for a third consecutive meeting as inflationary pressures subside, a survey of economists shows. The Narodna Banka Srbije will cut the two-week repurchase rate by a quarter-point to 11.5 percent on Friday, according to 12 of 22 economists in a Bloomberg survey. Four expect a half-point decrease and six see no change. The rate, which is 10 times higher than the European Central Bank's benchmark, is topped in Europe only by former Soviet republic Belarus.

Mantega says Brazil can use bank reserves to fight crisis

Brazil could employ the 400 billion reais ($246 billion) that banks hold in reserves at the central bank in the event of a crisis caused by turbulence in world markets, Finance Minister Guido Mantega said. "The central bank has a bigger volume of reserves on Friday, of more than 400 billion reais, which could be employed if necessary," Mantega said in a video shown at an event in Sao Paulo last night. "We have successful experience from the crisis of 2008, and all the instruments created are at the disposal of the government." Brazil eased banks' reserve requirements in the fourth quarter of 2008 as the economy suffered its deepest contraction on record in the wake of the collapse of Lehman Brothers Holdings Inc.

Spain national inflation ticks lower in July



Spanish consumer inflation fell to its lowest since December in July, hit by weak domestic demand and the fading of impact from a value-added tax hike a year earlier. High energy prices still drove national consumer prices 3.1 percent up year-on-year, in line with flash reading and analysts' forecasts, but that was down from 3.2 percent a month earlier, National Statistics Institute data showed. Consumer prices rose 3.0 percent year-on-year in July on an EU-harmonised basis, equal to that recorded in June.

Russian ruble unlikely to become reserve currency soon

MOSCOW (RIA Novosti) — Russia's economy is too small and its financial markets are too illiquid for its national currency, the ruble, to become the reserve currency the government wants it to be, analysts say.

The Russian authorities have nurtured the idea of turning the ruble into a reserve currency since the height of the global financial crisis of 2008, when President Dmitry Medvedev challenged the status of the U.S. dollar as a reserve currency and called for a fairer international financial architecture built on more than one reserve currency.

Prime Minister Vladimir Putin, who in August described the United States as a parasite on the global economy, said in April he hoped to strengthen the ruble to make it the reserve currency of the post-Soviet area.

"This is an interesting fantasy and speculation for the future," said Sergei Moiseyev, deputy head of the financial stability department at the central bank.

Russia's two percent share in the world's gross domestic product is too small for its national unit to enjoy the status of a reserve currency, said Yakov Mirkin, chairman of financial markets committee at the Russian Chamber of Commerce and Industry.

"A share of five to six percent of the world's GDP is likely to give the status of a regional currency," he said.

Russia would also need to have a per capita GDP of $25,000-30,000 rather than the current $15,800 to aim for reserve currency status, he said. According to the International Monetary Fund Russia ranked only 52nd by GDP per capita in 2010.

Moiseyev said that the country should also boast a large and highly liquid money market, which is impossible with an unconvertible currency like the ruble.

"I do not see any prospects for the ruble to become a reserve currency in the foreseeable future," Dmitry Miroshnichenko from the High School of Economics said.

Paying a price for prestige

The status of a reserve currency is enviable not only from the point of view of prestige, it also means that the country can cover its balance of payments deficit with the money it prints and can help its companies strengthen positions on international markets.

The status of reserve currency also considerable disadvantages and responsibilities, Moiseyev said.

A reserve currency country should have a large financial market which offers institutional investors, such as central banks, pension funds and insurance companies, low-risk investment instruments which inevitably means boosting sovereign debt to 100 percent of GDP from the current 10 percent, he said.

It should also have a trade deficit which would open a channel for the domestic currency to go abroad instead of Russia's hefty trade surplus earned thanks to oil exports.

"Russia has to work on the criteria for many years if it wants to achieve the status of a reserve currency for the ruble," Moiseyev said. "And it is not clear that it will enjoy that status, and not regret it."