# FOREX FOCUS: Just Stick To The Talk, Mr. Trichet

14 Jan 2011, 12:15

By Nicholas Hastings
A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--Yes, Mr. Trichet, talk the anti-inflation talk.

But no, Mr. Trichet, don't walk the anti-inflation walk.

First, there isn't any evidence that the rally in global commodity prices, the main driver of inflation pressure at the moment, will persist.

Second, higher interest rates might be good for Germany and even for France but they are hardly what the rest of the euro zone needs.

And third, that five cent rise in the euro this week might already be doing a bit of the monetary-tightening trick.

The European Central Bank president's admission Thursday that inflation risks had shifted was hardly a surprise given December data showing that the year-on-year rise in consumer prices had edged up over the bank's 'just below 2%' medium-term target to 2.2%.

The ECB's primary policy is to achieve price stability. Since monetary union, the central bank has done this, with inflation averaging 1.97% over the last 10 or so years, according to data from ING Financial Markets.

The last thing Trichet would like to do now is to miss the ECB's target and go down in history books as the ECB president who failed.

However, there is some considerable doubt about whether those inflation pressures that Trichet cited will remain. Commodity prices may have rallied strongly in recent months on the back of global recovery expectations but there are already signs that demand could be subsiding.

Also, the inflationary impact on the euro zone itself could well prove limited, especially if the single currency remains strong against the dollar, the currency in which most commodities are denominated.

See how the euro has climbed against the dollar:
http://www.dowjoneswebservices.com/chart/view/5272

Even one of the ECB's most hawkish members, Juergen Stark, appears unconvinced about the recent rise in inflation, suggesting that price rises should abate. Also, as Thursday's unanimous vote within the ECB to keep rates unchanged indicates, Trichet's hawkishness may not find much support from other members of the bank's policy-making committee.

But even if inflation were to raise its ugly head, Trichet and the ECB could find that their hands are tied by the continued deterioration in the sovereign-debt crisis.

Optimism around the euro over the last few days has been driven largely by the success of debt auctions in Portugal, Spain and Italy, as well as by hopes that the European Financial Stability Facility will be increased.

Nonetheless, those nations still had to pay more for their money than they did before and, with Germany and France still dragging their feet, expansion of the EFSF is hardly a foregone conclusion.

In other words, that optimism could yet prove to be premature. Chances are that Portugal could still seek a bailout and the risk of Spain following suit remains high.

So the last thing these debtors need is higher rates at this stage. This would increase the threat of contagion and prove counter-productive for the euro itself.

Of course, the euro's performance against the dollar has as much to do with events in the U.S. as those in the euro zone, with a widening of the yield differential between the two areas contributing to the euro's strength this week.

But, given the ECB's recent support for euro-zone debt markets and now Trichet's arguably over-zealous hawkishness, investors may well focus more on the price of euro-zone credit default swaps to gauge whether the euro's post-Trichet rally really is justified.

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| Bloomberg | TNI FRX POV |
| Reuters | USD/DJ |
| Thomson | P/1066 or P/1074 |

January 14, 2011 06:15 ET (11:15 GMT)