European Central Bank Raises Key Interest Rate

Contributed by Marc Courtenay
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The ECB raised its benchmark interest rate Thursday by a quarter percentage point to 4.25 percent in an effort to rein in escalating inflation in the 15-nation euro zone.

The move comes despite worries in some quarters that it could dampen growth, but ECB President Jean-Claude Trichet said at a news conference that the fundamentals of Europe's economy "are sound" and focused on inflation, which he said could remain high "for a more protracted period than previously thought."

He did not clearly indicate more rate increases were coming, as he did at last month's meeting.

"The monetary policy stance after today's decision will contribute to achieving our objective of price stability," he said. "I have no bias and we are never precommitted...and we do what is necessary to deliver price stability in the medium term."

Howard Archer, the chief UK and European economist for Global Insight in London, took that to mean that the bank had clearly moved itself back into neutral.

"The ECB's statement and Mr. Trichet's comments do little to support the view that this could be the first of a series of interest rate hikes," he said in an e-mail. "There was no reference to the ECB being in a 'state of heightened alertness' or 'strong vigilance,' thereby suggesting that no further interest rate hikes are currently planned in the near term at the very least."

Trichet has stressed that his main objective is to keep prices stable, and all but promised an increase this month at last month's meeting. But he had also suggested that repeated interest rate hikes are probably not likely.

Inflation has been troubling central banks around the world as commodity prices including oil and food have spiked in a surge of new global demand. While higher interest rates slow inflation, they can also slow economic growth as money becomes more expensive to borrow; Trichet appears to have targeted inflation as the bigger threat.

The precious metals market yawned at the ECB rate rise even though it theoretically puts downward pressure on the dollar. Hours after the ECB announcement gold was down $10 an ounce at $935 and silver's price was down 12 cents at $18.25.

Of gold, Kitco’s Jon Nadler wrote that, “Another stab at the $947 to $950 zone could be in the cards, barring a selling bout in oil, or the opposite in the dollar.”

Nadler added that, “Bullion remains fairly well-supported near the $920 and $930 marks at the moment, as participants factor in a small ECB rate hike ... and little in the way of a Fed response to inflationary pressures in the near term.”

Peru, the world's largest producer of silver, seems to be adding to the rumor that labor strikes at gold and silver mines are impacting pricing. Rumors of the growing number of mines going out on strike also lent support.

Reports that workers at two more mines in Peru threatened to go out on strike are contrtibuting to the growing sense of uncertainty about silver and gold supply disruptions. While the latest struck mines primarily produce copper, zinc and gold, the strike action in general appears to be spreading across all types of mines, which implies silver could be affected as well.

So with the dollar in the decline, the euro continuing to rise, worldwide concerns about the economic threats driving investors to safe hedges against inflation, it looks like the next 6 months should be mostly positive for the price of gold and silver. If oil prices also continue to rise or even stay at current levels over $140 a barrel, ...well, the sky might be the limit and the high side of gold and silver price projections might prevail.