European Central Bank President Mario Draghi will turn his attention to nursing the euro region back to economic health this week as the urgency to deploy crisis measures recedes after three years.

Draghi’s Governing Council, which sits for its first session this year on Jan. 10, will seek to extend the calm it’s instilled on markets with last year’s pledge to do anything in its power to end the crisis, economists said. While policy makers will likely keep interest rates unchanged for now, the threat of unlimited bond purchases has bought time to focus more on ending the region’s looming recession.

“Draghi’s threat is working,” Tobias Blattner, an economist at Daiwa Capital markets in London, said in an interview. “Foreign investors are gradually coming back and Spain can live with the current yield levels,” he said, referring to a 10-month low in Spanish borrowing costs.

Draghi and European policy makers are returning to work with the turmoil that has ravaged the region’s bond markets at bay. Even so, they face potential pitfalls arising from widening debt in Spain, next month’s election in Italy and continuing austerity in Greece.

European finance ministers are also assembling a rescue package for Cyprus, the crisis’s fifth bailout.

**Spanish Yields**

The yield on Spain’s 10-year bond fell to almost 5 percent last week after closing 2012 at 5.27 percent, around the price at the beginning of last year and down from a July 24 high of 7.62 percent. The euro fell 1.1 percent against the U.S. dollar last week, trading at $1.3069.

Even as politicians and economists brace for recession, only three out of 45 economists in a Bloomberg News survey expect a rate cut when the 23 governing council members convene in Frankfurt. The central bank will keep the key rate unchanged at a record low of 0.75 percent until at least the first quarter of 2014, a separate survey showed.

Still, a majority of ECB policy makers were open to cutting the benchmark rate at the bank's meeting in December after revising down economic and inflation projections that forecast a 0.3 percent contraction this year. Rates were kept on hold because of the negative signals a cut may send, three officials with knowledge of deliberations said Dec. 7.

**Unconventional Measures**

“There are so many reasons against a rate cut,” Christian Schulz, a former ECB economist now working for Berenberg Bank in London, said. “First of all, it wouldn’t really achieve anything; secondly, policy makers are still unsure about the impact on the deposit rate; thirdly, it looks like we are reaching the bottom in terms of the economy and the Bundesbank would never agree to it.”

ECB Executive Board member Yves Mersch told Germany's Frankfurter Allgemeine Zeitung in a Dec. 17 interview that unconventional measures are for now the ECB’s main policy tools “because they are more effective given the distorted transmission channel of conventional monetary policy.”

For now, the task of the currency union will be to wrest the 17 member states out of an economic slump. European services and factory output contracted more than initially estimated in December, adding to signs the recession will extend into this year.

At the same time, there are some indications of stabilization in the global economy and in Germany, Europe’s largest economy. U.S. manufacturing picked up in December after dropping to a three-year low and China’s services industry grew at
the fastest pace in four months.

**Export Demand**

Data last week showed German unemployment rising less than economists had forecast in December and business confidence rising for a second month after demand from outside Europe boosted factory orders and exports.

“I remain confident that 2012 will go down in history as the year when it all turned,” Erik Nielsen, London-based chief global economist at UniCredit SpA (UCG), wrote in a note to clients. “I wouldn’t be surprised if the 2013 recovery turns out somewhat stronger than expected.”

Finance ministers will seek not to rattle markets as they struggle with the possibility of writing off debt for Cyprus. While euro ministers have pledged not to repeat a Greek debt write-off, the International Monetary Fund is pushing for more sustainable financing.

**Cyprus Talks**

Cyprus has been negotiating with the European authorities and the IMF over rescue financing since June. Chancellor Angela Merkel plans to join some European leaders for a meeting of the European People’s Party at the end of the week in the Cypriot port city of Limassol.

Cypriot banks lost more than 4 billion euros ($5.2 billion) in Greece’s debt restructuring.

Luxembourg Premier Jean-Claude Juncker, head of the group of euro finance ministers, signaled last month that leaders would stand by their pledge, even as ECB Executive Board member Joerg Asmussen said that post-bailout debt levels for Cyprus might not be sustainable. Ministers will “almost conclusively” deal with Cyprus at this month’s meeting, Juncker said.

“It will be tough to explain to the northern European taxpayer that we have to act on Cyprus, still, it needs to happen,” Juncker said on Dec. 21.

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