Mario Draghi is trying to prevent investors from overestimating the economy’s resilience.

Having predicted a recovery at every European Central Bank policy meeting since December 2011, the month after he took office, the ECB president has finally seen the 17-nation euro area exit recession. The central bank will today present new growth and inflation forecasts for the currency bloc, reflecting an expansion in the three months through June that beat forecasts and snapped six quarters of contraction.

Draghi’s dilemma is that the strength of the rebound has helped boost interest-rate expectations to levels he described last month as “unwarranted.” That’s a signal some investors are questioning his commitment made in July to keep rates low for an extended period. Higher borrowing costs risk undermining what has so far proved to be a jobless recovery.

“At a time when this recovery is in its early stages, it is important for the ECB president to limit any abrupt upward reaction in yields,” said Alan Clarke, an economist at Scotiabank in London. “Draghi will highlight growing optimism on the growth outlook, though he is likely to maintain a dovish bias on many aspects.”

**Rate Expectations**

The overnight rate that banks expect to charge each other by the ECB’s August 2014 rate meeting, as measured by Eonia forward contracts, was at 0.29 percent today. That’s near the level in late June that triggered Draghi’s July 4 pledge to keep rates low for an extended period. It fell as low as 0.09 percent on July 8.

Policy makers meeting in Frankfurt today will keep the ECB’s benchmark interest rate unchanged at a record low of 0.5 percent, according to all 56 economists in a Bloomberg News survey. The central bank will announce its interest-rate decision at 1:45 p.m. and Draghi will hold a press conference 45 minutes later.

The Bank of England will keep its quantitative-easing program at 375 billion pounds ($585 billion) and hold the benchmark rate at a record low of 0.5 percent, according to separate surveys of economists. That decision is due at noon in London.

The euro-area economy expanded 0.3 percent in the three months through June, led by faster-than-expected growth in its biggest economies, Germany and France. Recent economic indicators point to a further recovery in the second half as an index of services and factory output climbed to the highest level since June 2011 and economic confidence soared to a two-year high.

**Fed Unwinding**

The ECB’s July introduction of forward guidance followed signs that the U.S. Federal Reserve will start unwinding its $85 billion a month bond-buying program this year. That had sparked a global sell-off in bonds, driving yields higher in stressed economies including Spain (GSPG10YR) and Portugal (GSPT10YR).

The U.S. economy maintained a “modest to moderate” pace of expansion from early July through late August, the Fed said in its Beige Book report yesterday. The bank will start to slow its bond purchases at its Sept. 17-18 meeting according to 65 percent of economists in a Bloomberg News survey last month. The survey also indicated policy makers will end the program, known as quantitative easing, by June 2014.

Draghi has so far fought rising market rates with words. His pledge to keep rates low has been accompanied by his outlook for subdued inflation extending into the medium term and broad-based weakness in the euro-area economy. The region’s unemployment rate held at a record 12.1 percent in July.

“The risks surrounding the economic outlook for the euro area continue to be on the downside,” Draghi reiterated last month.
**Minor Revisions**

Economists from Nomura International Plc to Royal Bank of Scotland Group Plc predict that even with the euro area’s recession over, the ECB will make only minor changes to its forecasts today.

The bank predicted in June that the economy will shrink 0.6 percent this year before growing 1.1 percent in 2014. It forecast inflation at 1.4 percent in 2013 and 1.3 percent next year, well below its target of just under 2 percent.

“Despite incoming business-cycle data continuing to surprise to the upside, we do not expect the ECB to be building a case for strong endorsement of the recovery,” said Nick Matthews, senior European economist at Nomura in London. “Draghi will judge the short-term data as evolving in line with expectations and only revise the 2013 growth forecast up slightly.”

**Mixed Messages**

“We do not see any revision to the projection for inflation in 2014, which is the key number in terms of the rate discussion and the guidance, and we have left our estimate of the 2013 figure unchanged,” said Richard Barwell, an economist at RBS in London. The economic expansion “should be sufficient to deliver modest upwards revisions to the output for growth in 2013 and 2014,” he said.

The return to growth has led to investors getting mixed messages from some ECB Governing Council members on whether scope remains for further interest-rate cuts.

There aren’t “many arguments now for a rate cut,” the Austrian National Bank Governor Ewald Nowotny told Bloomberg News on Aug. 22, before saying a week later that a rate cut is still possible. The option to reduce borrowing costs “is still on the cards,” Bank of Cyprus Governor Panicos Demetriades told Bloomberg News on Aug. 24.

“The ECB is surely leaning toward waiting and observing,” said Stefan Schilbe, an economist at HSBC Trinkaus & Burkhardt AG (TUB) in Dusseldorf. “Draghi will be very careful not to be too optimistic. He won’t stress the topic of a rate cut as much as last month, but it’s too soon to scrap it altogether.”

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