Inflation is back on the European Central Bank’s radar, complicating efforts to bolster growth as the sovereign debt crisis pushes the economy toward recession.

The ECB will lift its 2012 inflation forecast above the 2 percent price-stability threshold today, limiting its ability to cut interest rates further even as it lowers the outlook for growth, economists said. Policy makers in Frankfurt will keep the benchmark rate at a record low of 1 percent, 55 of 58 economists in a Bloomberg News survey predict. The decision is due at 1:45 p.m. and ECB President Mario Draghi will unveil the bank’s new economic projections at a 2:30 p.m. press conference.

“Draghi’s message won’t be a particularly pleasant one,” said Klaus Baader, chief euro-area economist at Societe Generale SA in London. “The ECB will breach its inflation limit for another year and the economic outlook hasn’t brightened significantly. That’s tying their hands on rates for now.”

Having flooded the banking sector with more than 1 trillion euros ($1.31 trillion) to avert a credit crunch, the ECB is now confronted with an oil-price spike that’s propping up inflation at a time when at least six of the 17 euro nations are in recession. Greece is waiting for private creditors to agree to the biggest sovereign-debt restructuring in history, which should reduce its burden by about 100 billion euros. The deadline for acceptances is 10 p.m. in Athens today.

**Divergences**

With widening economic divergences already making it harder for the ECB to set a common monetary policy, its response may be to do nothing. It will keep rates on hold at least through the third quarter of 2013, the median forecast in another Bloomberg survey shows.

The Bank of England will today hold its key rate at 0.5 percent and maintain its commitment to buy an additional 50 billion pounds ($79 billion) of bonds by May after lifting its target for asset purchases to 325 billion pounds last month. That decision is due at noon in London. The U.S. Federal Reserve has committed to keep rates low through 2014.

Oil prices have climbed 6 percent this year to $105 a barrel amid concern European and U.S. sanctions against Iran will lead to military conflict in the Persian Gulf, home to more than half the world’s crude. That’s feeding through into higher consumer prices.

Euro-area inflation unexpectedly accelerated to 2.7 percent in February; the ECB aims to keep it just below 2 percent.

**German Wage Claims**

In Germany, where unemployment is at a two-decade low, unions are demanding a 6.5 percent wage increase for 2 million public-sector workers. That contrasts with employees in nations from Ireland to Greece whose pay is being cut as governments try to reduce debt.
German inflation quickened to 2.5 percent last month and business, consumer and investor confidence jumped as Europe's largest economy showed signs of weathering the debt crisis.

“The rebound in confidence in combination with short-term inflationary pressure from the higher oil price will make most ECB members wary of another rate cut,” said Christian Schulz, an economist at Berenberg Bank in London. “We do not expect another rate cut this year. Instead, once the euro-zone economy returns to healthier growth, the ECB is likely to be the first major central bank to raise rates again, in early 2013.”

The ECB, which cut rates in November and December, will probably increase its 2012 inflation projection to 2.3 percent from 2 percent, said Marco Valli, an economist at UniCredit in Milan.

‘Wait and See’

“The probability of a further reduction in the policy rate has decreased appreciably over the last couple of months,” Valli said, adding there's a good chance the ECB has entered a prolonged “wait-and-see posture, both on conventional and unconventional policy.”

The ECB’s unprecedented 1.02 trillion euros of three-year loans to banks has helped ease tensions on financial markets, fueling bond and equity-market rallies. That’s reduced pressure on the ECB to cut rates again, giving policy makers time to assess whether the flood of money is flowing through to households and businesses.

Still, economists including Schulz at Berenberg expect the ECB to predict a 0.3 percent economic contraction this year, revising its forecast from 0.3 percent growth.

Euro-area unemployment is at 10.7 percent, a 14-year high, and services and manufacturing output is contracting as companies postpone investments. Furthermore, the ECB is likely to project 2013 inflation of 1.6 percent, said Juergen Michels, chief euro-area economist at Citigroup in London.

Rate-Cut Door ‘Open’

“The ECB is probably not too concerned about the inflationary impact from higher oil prices,” he said. “More news about prolonged economic weakness and further increases in unemployment should keep the door open for lower interest rates in the course of 2012.”

The ECB raised rates in April and July last year to quell inflation, only to go into reverse as the debt crisis escalated. While the economy’s fragility may have tempered the bank’s enthusiasm for higher rates, its previous behavior suggests a readiness to combat oil-driven inflation, said Nick Kounis, head of macro research at ABN Amro in Amsterdam.

“If you look at the last two times that oil prices spiked, in March last year and in 2008, the ECB followed up with a rate hike,” he said. “We don’t see rate hikes now, but we assume the ECB will take this quite seriously.”

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