European interest rates are expected to rise again this year after the European Central Bank became the first to introduce a change upwards since the credit crisis.

The rise to 1.25% had been widely expected and comes at a time when the ECB has to balance the challenges of growing economies like Germany and failing ones like Portugal.

European Union finance ministers meet today (Friday April 08) in Hungary to discuss the Portuguese financial crisis. ECB chief Jean-Claude Trichet has emphasized the need to deliver stability in the medium term.

‘Trichet clearly emphasised that he saw the success in delivering price stability as being in the interest of all residents in the Eurozone. This justifies the increase in interest rates even given the ongoing financial strains in the periphery of the Eurozone,’ said Peter Hensman, global strategist at Newton Investment Management.

‘Although the ECB President indicated that the Council did not decide that this was the start of a series of rate increases, the indication that the ECB sees upside risks to inflation remain, indicates that further increases are likely,’ he added.

According to Stewart Robertson of Aviva Investors financial markets now expect European interest rates to rise a further 75bp by the end of the year to 2%, then almost another 100bp throughout 2012.

‘This would benefit particularly the German economy, which is growing at a reasonable rate. However, policy tightening looks unnecessary for peripheral countries, particularly those that have had to ask the EU for a bail out or are in the process of doing so. With large scale fiscal consolidation underway, or about to begin in these economies, higher interest rates are probably the last thing they need,’ he explained.

'The ECB will have to balance these competing demands when setting rates over the course of the next eighteen months. In our view, this means the market has got a little ahead of itself. The interest rate is likely to be closer to 2%, not 3%, by the end of 2012. Our forecast is for 2.25%,' he added.

The decision reflected the different philosophies of the central banks with the ECB placing greater emphasis than its British counterpart in taking pre-emptive action in curbing inflation, according to Ted Scott of F&C Investment.

'The decision to raise rates is just as brave as the Bank of England's was to maintain rates for different reasons. The ECB will be accused of callously endangering economic recovery and making the sovereign debt crisis even more difficult to manage just as a third country seeks a bailout,' he said.

'There is little evidence of wage pressures within the Euro zone, even in Germany that is growing robustly, and money supply growth has also been modest. The ECB has a reference rate of annual broad money supply growth of 4.5% and currently the rate is just 2%. Furthermore, narrow money supply is contracting on a 6 month annualised basis,' he explained.

'For the periphery economies, many of the domestic banks are still dependent on the ECB for emergency funding almost on a daily basis. For them, this is unequivocally bad news as the cost of borrowing will rise at a time when they desperately need to rebuild their capital strength and inter-bank confidence is so low. Spain remains the key for a satisfactory solution to the debt crisis where confidence in the banks and the economy has happily improved this year. However, they remain significantly exposed to a weakening housing market that the rise in rates could exacerbate,' he added.