

ECB demonstrates hawkishness

At the press conference today, the European Central Bank tried to demonstrate a gradually accelerating hawkishness, keeping the door open to a series of rate hikes. With a chance that the ECB's own growth forecasts are too optimistic, today's hawkishness might soon turn out to have been premature



Christine Lagarde,
president of the
European Central Bank

The facts are clear: the ECB today finally put an official end to its long era of unconventional monetary policy measures. Net asset purchases will be ended by 1 July and negative interest rates will be history before the end of the summer. However, whether the ECB is now fully determined to bring inflation back to 2% as soon as possible or whether it will be a gradual process of policy normalisation remains unclear.

What did the ECB decide?

- Net asset purchases will end as of 1 July.
- Reinvestments of the Pandemic Emergency Purchase Programme will continue at least until the end of 2024 and will remain the main instrument against a widening of yield spreads.
- The policy rate remains unchanged, but the ECB announced it 'intends' to hike rates by 25bp in July and 'expects to raise' rates probably by 25bp in September.
- The door to a rate hike of 50bp in September is wide open as the statement says, "If the

medium-term inflation outlook persists or deteriorates, a larger increment will be appropriate at the September meeting.”

- The door to a tightening cycle was left open as the ECB also said that “a gradual but sustained path of further increases in interest rates will be appropriate” beyond September.

The macro-economic backdrop of today's decision has stagflation written all over it. The latest projections of the Eurosystem estimate inflation will come in at 6.8% in 2022, 3.5% in 2023, and 2.1% in 2024. GDP growth is expected to come in at 2.8% in 2022, 2.1% in 2023, and 2.1% in 2024. Interestingly, the staff projections show that inflation will return to 2.0% in the second half of 2024. It is also noteworthy that the technical assumptions have the 3m Euribor interest rate at 1.3% in 2023 and 1.6% in 2024. In combination with inflation returning to 2%, this gives a very good proxy of where the neutral interest rate could be, without talking about such a concept.

Finally, given that oil prices have increased again since the cut-off date of these forecasts, we expect further upward revisions to these inflation forecasts and downward revisions to the growth forecasts.

More hawkishness during the press conference

During the press conference, ECB President Christine Lagarde said that today's decision was taken unanimously and that the discussion at today's meeting mainly focused on the challenge of high inflation and how to tackle it. She emphasised that the ECB was on a journey of normalisation which would not stop in September and that the ECB was also determined to bring down inflation as quickly as possible. A clear hawkish message. At the same time, however, Lagarde stressed the graduality of this normalisation process and the full awareness for potential fragmentation and widening bond yields.

With inflation running red hot but at the same time the eurozone economy slowing down and facing stagnation or even recession, the ECB's window to normalise monetary policy has been narrowing almost by the day. Today's decision shows it's managed to find a compromise between the doves and the hawks. A 50bp rate hike in July seemed to be fended off by opening the door to a 50bp move in September. The era of net asset purchases will come to an end in three weeks, and the era of negative interest rates will come to an end before the autumn. Simply put, the ECB just announced the end of a long era of unconventional monetary policy and this is not where the ECB wants it to stop. Given Lagarde's tone at the press conference, the ECB seems to be determined to engage in further rate hikes beyond September. How far this tightening cycle could go, however, is still far from certain.

But is this really the time for a hiking cycle?

Inflation is still mainly driven by higher energy and commodity prices. The pass-through of higher producer prices will continue but there is a high likelihood that inflation will come down significantly in the course of 2023. Also, there is very little that ECB normalisation can currently do to bring down supply-driven inflation.

Today's decision illustrates that the ECB is willing to engage in a series of rate hikes. Given that the ECB's own growth forecasts currently look very optimistic, there is, however, a high risk that there will be far fewer rate hikes beyond September than today's ECB meeting suggested. The ECB clearly wants to go beyond 'just' ending unconventional measures but whether it will really get there is far from certain. The journey Lagarde talked about today could be much shorter than the

ECB thinks.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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