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ECB hikes by 25bp and signals end to hiking cycle

Another rate hike of 25bp from the European Central Bank, but a clear signal that the current hiking cycle has come to an end. These are the main takeaways from today's meeting

European Central Bank President Christine Lagarde at today's press conference in Germany

The fear of not getting inflation fully under control and the risk of stopping too early must have outweighed concerns around the rising recession risk in the eurozone, motivating the European Central Bank to hike interest rates for the tenth consecutive time since July 2022. After a total of 450bp rate hikes, the ECB's deposit rate is now at a record high.

ECB's staff projections point to too high inflation and lower growth

The ECB remains highly concerned about inflation, not only actual inflation but also future inflation. The newest ECB staff projections show headline inflation coming in at 3.2% in 2024 and 2.1% in 2025. However, the upward revision for 2024 is mainly the result of higher energy prices. The inflation forecast for 2025 was revised downwards. The ECB's core inflation forecasts were slightly revised downwards to 2.9% in 2024 and 2.2% in 2025. Still, in the eyes of the ECB, both headline and core inflation above 2% in 2025 is not compatible with its own definition of price stability. It was not so much the direction of the revisions but rather the absolute levels and the long period of deviating from the target which motivated the ECB's decision today.

The ECB's staff projections for eurozone GDP growth were also revised downward to 0.7% in 2023, 1.0% in 2024 and 1.5% in 2025. However, the downward revision for 2024 is purely the result of carry-over effects and the quarterly profile for 2024 remained unchanged, showing a return to potential growth from the second quarter of 2024 onwards. The ECB is still sticking to the view of a temporary slowdown and not of more structural growth weakness.

Dovish rate hike as a compromise

The staff projections have probably increased the ECB's dilemma: inflation, while coming down, remains too high but the growth outlook continues to deteriorate. With this macro backdrop, both a rate hike and a pause would have been plausible. This time, the ECB decided to compromise: a dovish hike, mainly aimed at strengthening credibility and probably bridging growing divergences between ECB hawks and doves.

In this regard, one remark in the official communication is key: "Based on its current assessment, the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target". Given the imprecision of the ECB's own models over the last few years, it is questionable how the ECB has now come to the conclusion that the current level is enough. Why not 25bp less? Why not 25bp more?

During the press conference, ECB President Christine Lagarde hinted at different views within the Governing Council. According to Lagarde, today's decision was taken with a "solid" majority. A dovish hike as compromise to balance between credibility, inflation, growth and team spirit.

The final hike

Looking ahead, the ECB would be crazy to completely rule out further rate hikes. Inflation has simply taken too many unexpected turns and the ECB has been wrong too often in the past. This is why today's meeting still leaves the possibility of picking up hiking at a future stage. However, such a scenario is highly unlikely. A further weakening of the economy and more traction in a disinflationary trend will make it very hard to find arguments for additional rate hikes any time soon.

For now, the ECB is determined to keep rates where they currently are, waiting for the 450bp of total rate hikes to filter through to the economy. The next discussion will be on how long the new "high for longer" can be sustained.

Even if the door to future rate hikes remains open, today's rate hike will soon be remembered as the final hike of the ECB's most aggressive rate hike cycle in history.

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