

ECB meeting preview: A final hike

It's a very close call but we continue to expect a final rate hike at next week's ECB meeting



To hike or not to hike?
That is the question....
(pictured: ECB President
Christine Lagarde)

At the July European Central Bank meeting, President Christine Lagarde officially [switched off the autopilot](#), saying that both another hike and a pause were possible at the September meeting.

Even though we have always thought that every central bank meeting in the world is data-dependent, Lagarde emphasised the ECB's dependence on incoming data between July and September. Almost two months later, released macro data since the July meeting have pointed to a kind of stagflation scenario in the eurozone with confidence indicators plunging and inflation remaining high. A very complicated mixed bag, making the ECB decision next week anything but easy.

We expect a very heated debate with a close outcome. While there are good arguments to justify both a pause and another rate hike, we are sticking to our view that the ECB will hike rates one final time next week. Here are some pros and cons.

Rate hikes so far and plunging confidence indicators argue in favour of a pause

Plunging sentiment indicators since the July meeting suggest that the eurozone economy is losing

steam quickly. Falling demand for new loans, both by households and corporates, doesn't bode well for future activity. The recession risk is back.

Additionally, after a total of 425bp rate hikes in slightly more than a year, a pause in the ECB's hiking cycle at the September meeting would make sense. However, the [minutes of the July meeting](#) illustrated that the ECB has taken a more benign stance on growth. The fact that the eurozone economy still grew in the second quarter despite weakening soft indicators seems to have strengthened the case for waiting for actual data rather than reacting to confidence indicators.

Concerns about high inflation still outweigh disinflation in the months ahead

Headline inflation in the eurozone has only marginally come down over the summer. However, this stubbornness of headline inflation can to a large extent be credited to base effects in Germany as a result of last year's three-month fiscal stimulus measures, i.e. cheap public transportation and lower taxes on gasoline. At the same time, wage growth remained high at around 5% year-on-year in the second quarter and the ECB's latest consumer expectations showed a minor edging up of inflation expectations.

In a recent interview, ECB chief economist Philip Lane sounded remarkably confident with the ECB's current inflation projections. A similar statement was made in the minutes of the July meeting. It looks as if the ECB's staff projections will not bring downward revisions to inflation. Instead, the recent increase in oil prices could actually lead to a minor upward revision.

Looking beyond recent developments, disinflationary trends are likely to gain momentum. Not only have food prices started to actually decrease, but selling price expectations in both industry and services have come down, despite some recent rebound, reflecting weaker pricing power. As the German base effects will disappear after the summer, we expect inflation in the eurozone to drop further. The recent rebound in inflation expectations should support the more cautious ECB members, strengthening the call for a hike.

How the ECB will weigh weaker growth and high inflation

Macro data released since the July meeting give room for both a pause and a rate hike decision next week. More forward-looking central banks would clearly opt for a pause after more than a year of 425bp rate hikes, increasing growth concerns and disinflation probably gaining momentum over the coming months. Buying some time to assess how the rate hikes so far will play out would be the main theme.

However, the experience of the last year has shown that the ECB has been sticking to its stance of putting more emphasis on actual data rather than on expected data, and still sees a higher risk of stopping tightening too early rather than going too far. The minutes of the July meeting as well as recent comments suggest that the ECB currently still seems to have a higher tolerance for negative growth surprises than for unexpected inflation developments.

For the hawks, the risk might be too high that a pause could actually transform into an actual full stop later this year.

Using other tools than just interest rates

The minutes of the July meeting showed that the ECB is also increasingly discussing other tools than just policy rates. The decision to stop the remuneration of banks' minimum reserve was presented as such a measure even if at least for us it looked like a measure to reduce central banks' losses. In the same vein, the discussion to actually increase the minimum reserve from 1% to 2% could still resurface next week, even if we think that it will not be supported by enough ECB members.

Another discussion alongside the debate about rates could be the outright sales of the ECB's asset purchases or an earlier end to the pandemic emergency purchase programme (PEPP) reinvestments (which currently run until the end of 2024). While outright asset purchases could lead to unwarranted market turmoil, an earlier end to PEPP reinvestments could eventually be the bargaining chip the doves would have to accept for the hawks to agree to a pause.

A final hike

All in all, next week's ECB meeting will see heated and complicated debates. In any case, we don't expect the ECB to communicate any end to its hiking cycle before the turn of the year. We admit that it is a very close call, but still too high inflation, a focus on actual rather than on predicted developments, and the fear of stopping prematurely will tilt the balance towards a final 25bp rate hike next week.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.