ECB minutes confirm hawkishness amid growing concerns about growth

The just-released minutes of the European Central Bank's July meeting illustrate the slightly changed tone; from pure hawkishness to more doubtful

ECB President Christine Lagarde

At the European Central Bank's July meeting, the central bank hiked interest rates by 25 basis points before stopping the autopilot, with President Christine Lagarde stressing that both a pause and a rate hike were possible at the September meeting. The just-released minutes of this July meeting give some background to these decisions. The minutes show an ECB that was still more concerned about inflation not returning to target than an economy falling into recession.

Here are some key phrases from the minutes:

- “Headline inflation on an annualised three-month over three-month basis was about 2% in June, reflecting the strong negative momentum in energy inflation.”
- “It was also noted that the three measures identified by staff as performing best as indicators of medium-term inflation were currently pointing in different directions, with the PCCI declining swiftly, while HICP inflation excluding energy, food, travel-related items, clothing and footwear and the measure of domestic price pressures still pointed to the

upside."
- "However, in view of the still elevated inflation outlook, together with the weaker growth outlook, the concern was also raised that the economy might be entering a phase of stagflation, in contrast to a more benign scenario of a soft landing."
- "In view of the prevailing uncertainties and the large costs of bringing inflation down once it had become entrenched, it was argued that it was preferable to tighten monetary policy further than to not tighten it enough. Before deciding to stop the tightening cycle, the Governing Council needed clearer signs of whether inflation would converge to target once the effects of recent shocks had faded."
- "Taken together, the September projections, the evolution of underlying inflation and incoming information on monetary transmission would help the Governing Council update its assessment of the appropriate monetary policy stance."

The minutes also suggested that as long as the eurozone economy doesn't slide into a full recession, the ECB could have a higher-than-expected tolerance for growth disappointing and coming in weaker than its own forecast. A remark was made that the ECB's inflation forecasts had been more reliable recently than the growth forecasts.

The fact that underlying inflation remained high and growth was not weak enough pointed to a subtle hawkishness, even though at least one ECB member seemed to have opposed the 25bp rate hike decision initially.

Previewing the ECB's September meeting

The countdown is on until the next ECB meeting. Every day new macro information and/or comments by ECB officials fuel questions about whether or not there'll be another hike at the September meeting. To tell you the truth, as much as we would like to provide certainty of what will happen, the ECB itself will probably only know on the day of the next meeting what to do.

Macro developments over the summer have caused further complications for the ECB. While the rapid worsening of the economy should come as a surprise, at least judging from overly optimistic ECB growth forecasts so far, the speed with which headline inflation is coming down should still leave the central bank uncomfortable. Despite today's drop, core inflation remains too high and wage growth up until now signals that even without excessive wage settlements core inflation could stay higher for longer.

We still expect headline inflation to come down significantly after the summer, mainly on the back of German headline inflation falling. We also expect the ECB's September macro projections to bring downward revisions to both the short-term growth and longer-term inflation outlook. 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 perfect sense. However, times at the ECB have changed.

Today's minutes stress that the central bank is sticking to its stance of putting more emphasis on actual data rather than on expected data, that it still sees a higher risk of stopping tightening too early rather than going too far, and that it seems to have a higher tolerance for negative growth surprises than for unexpected inflation developments.

Also, for the hawks, the risk might be too high that a pause could actually transform into an actual full stop. This is why we think the hawks will have their final say and push the ECB for a final dovish hike at the September meeting. A last one for the road, even if it remains a very close call.

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