

## ECB preview: The best moment to pause

If anything, developments since the September meeting have made it even easier for the European Central Bank to pause at its next meeting



ECB President Christine Lagarde

Communication following the ECB's September meeting had already given clear indications that the October meeting would be an intermediate one, waiting for new information from the Bank Lending Survey, GDP growth in the third quarter and a new round of staff projections – all of which will only be available at the December meeting and not yet next week.

Even if they are off recent peaks again, surging bond yields have strengthened the transmission of the ECB's monetary policy tightening so far and recent events in Israel have increased geopolitical tensions and uncertainties. We expect the ECB to keep rates on hold next week and to basically stick to a hawkish bias, keeping the door open to yet another rate hike in December.

### Recent developments have put the ECB in an even more difficult position

As much as the ECB has tried to keep the door to further rate hikes open since the September decision, recent developments have clearly complicated this position. While the conflict in Israel and the Middle East – as well as the rise in bond yields – will further dampen eurozone growth prospects, the surge in oil prices will put new upward pressure on inflation and could make

reaching the 2% target at the end of 2025 more unlikely.

The ECB's September staff projections were based on the technical assumption of an average oil price of \$82/bbl in 2024. If oil prices were to average \$95/bbl next year, this would probably push up the ECB's inflation forecasts to 3.3% for 2024 (from 3.2%) and more importantly to 2.4% in 2025 (from 2.1%). As a result, the return to 2% would be delayed to 2026.

Prior to the pandemic, most central banks would probably have looked past surging oil prices. Some even considered rising oil prices to eventually be deflationary, undermining purchasing power and industrial competitiveness. However, as we are no longer in the pre-pandemic era but now in the era of stickier-than-expected inflation, the ECB could still be tempted to choose its own credibility over a potential recession in the eurozone and opt for yet another rate hike in December if the inflation outlook worsens further.

## Other monetary policy tools

At next week's meeting, the ECB won't be in any rush to take further action. Instead, it will use a welcome pause to wait for more data points on the delayed impact of the rate hikes so far and developments in the oil price. We expect the ECB to have a discussion on non-interest rate monetary policy instruments, i.e., minimum reserves, reversed tiering and a possible earlier unwinding of the reinvestment of bond purchases under the Pandemic Emergency Purchase Programme (PEPP).

Currently, these reinvestments are set to last at least until the end of 2024. The surge in bond yields, combined with new debt sustainability concerns in the eurozone, will make it harder for the ECB to eventually agree on an apparently envisaged earlier end. More broadly speaking, none of the discussions will be conclusive, but they will set the scene for the December meeting. The other big discussion on the review of the ECB's operational framework seems to take a bit longer and could be postponed until spring next year.

## Good moment to pause

We still expect a further worsening of the economic outlook until the ECB's December meeting, strong enough not to continue hiking rates. However, with the latest surge in oil prices and consequently an upward revision of the inflation trajectory in the eurozone for 2024, we cannot entirely exclude that the ECB would still opt for yet another rate hike in December – not that it would help anything other than the ECB's own reputation. But this is a discussion for December, and not for next week. With all the new uncertainties, there hasn't been a better moment in the last 16 months for the ECB to take a pause than now.

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