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More news from the ECB press conference after first rate hike since 2011

In an attempt to finally catch up with reality and putting its reputation as an inflation fighter over being predictable, the European Central Bank hiked interest rates by 50bp and softened its forward guidance. The new Transmission Protection Instrument is an attempt to stabilise spreads and could work

Christine Lagarde, president of the European Central Bank

What did the ECB just announce?

- All three key ECB interest rates were increased by 50bp.
- Forward guidance was changed to a "meeting-by-meeting" approach, which is a more dovish tweak compared with the aggressive forward guidance from the June meeting. Still, the ECB said that "at the...upcoming meetings, further normalisation of interest rates will be appropriate".
- A Transmission Protection Instrument (TPI) was introduced but without any details.

The decision to hike by 50bp took some by surprise. In fact, since the June meeting the ECB had repeatedly confirmed its 'intention' to hike rates by 25bp in July, before accelerating the hiking pace from September onwards. Today's change of mind shows that the hawks must have gotten cold feet, fearing that the promised higher-than-25bp rate hike in September would be washed away by the looming recession. The agreement on a TPI had to be paid for by the doves with a stronger rate hike today. And to be honest, this decision makes a lot of sense. Even if the ECB still keeps the idea of a series of rate hikes alive, the window for such a series is closing quickly as high energy and commodity prices, supply chain frictions and the war in Ukraine are all very likely to push the eurozone economy into recession towards the end of the year.

The end of forward guidance

Today's meeting also marks the definite end of forward guidance. Remember that at the end of last year, ECB president Christine Lagarde already gave her own personal forward guidance that she was not expecting rate hikes in 2022. The forward guidance decided at the June meeting was as much unnecessary as wrong. Let's simply conclude that in times of high uncertainty, forward guidance is no longer a tool any central bank should be using. With this in mind, let's be very cautious when making any predictions of what the ECB will do beyond September, based on today's communication.

The TPI

As regards the TPI, the press conference was rather confusing and we had to wait until the ECB released an official document after the press conference had ended. Lagarde explained during the press conference that there was no limitation ex-ante in terms of size and that the instrument would be used in case of "unwarranted disorderly market dynamics". The ECB doesn't clarify what kind of market developments would trigger purchases. What is clear is that there will be a lot of conditionality of which only part has been disclosed. The ECB explicitly mentions four indicators, which all relate to regular European fiscal and economic policy monitoring as compliance with the fiscal rules, no excessive macro-economic imbalances, sustainable government debt and compliance with the European national reform programmes to get funds from the European Recovery Fund. A country doesn't have to apply for ECB support, this is up to the ECB's discretion. All in all, it could work as conditions are lighter than with previous programmes and the size is unlimited. It might not be a whatever-it-takes but rather a whatever-we-want tool.

Not done, yet

We all know that today's rate hike will not bring down inflation in the short run – not even on the demand side of the economy, which will react much more to the looming recession than to any ECB action. The hike, as well as potential further hikes, are all aimed at bringing down inflation expectations and to restore the ECB's damaged reputation and credibility as an inflation fighter. Today's decision shows that the ECB is more concerned about this credibility than about being predictable. This matters more than forward guidance.

Today's decision conforms with our previous view that the window for the ECB to continue with what Lagarde back in June had still called a long journey is closing fast. We expect the ECB to deliver another rate increase by a total of 50bp before winter starts. Thereafter, we currently don't expect further rate hikes. Instead of a long rate hike journey, the ECB's policy normalisation currently rather looks like a short trip.

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