

Rates Spark: First balance sheet tweaks

The ECB is likely to hike by 75bp and attempt a first reduction of its balance sheet via the TLTROs. Given the markets current predisposition with a rebalancing of risks among global central banks, they may be more sensitive to the dovish bits in today's meeting – like continued vagueness on QT. But the desire to tighten remains, and we see more rates upside



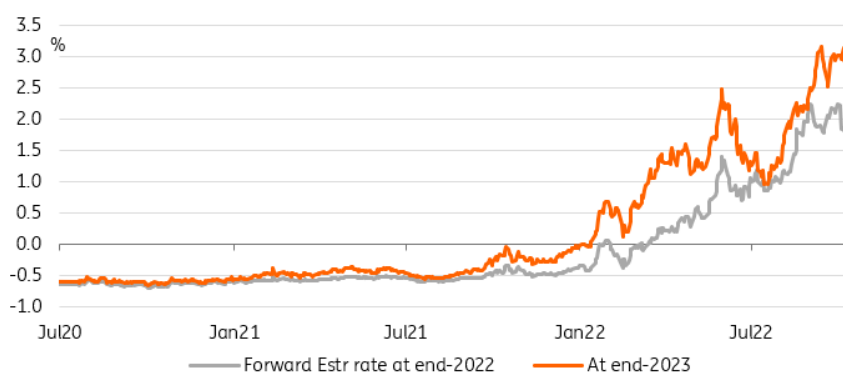
Beyond today's ECB hike: From the balance of risks to first balance sheet tweaks

The European Central Bank policy statement and press conference will be the driver of today's markets. As [our economists note in their preview](#), communication by the ECB has appeared unusually streamlined ahead of the meeting so that a clear consensus for a larger 75bp hike has distilled in market pricing. More important for the market reaction should thus be the ECB's communication on its economic outlook as well as any decisions regarding the ECB's balance sheet and excess liquidity. But all decisions today should still point to a desire to further normalise policy and unwind stimulus in light of unbudging inflation.

Today's decision should reflect a desire to further normalise policy and unwind stimulus in light of unbudging inflation

The ECB's action will be interpreted against the more broader backdrop of global central bank meetings where the Bank of Canada has just yesterday surprised markets with a smaller-than-expected hike as rising recession risks are being accounted for. While more tightening will still be needed, the Bank of Canada was trying to balance the risks of under- and over-tightening as Governor Macklem noted. In that regard all eyes are already turned to next week's Federal Open Market Committee meeting for any hint of policy pivot, but also President Lagarde's statements today will be scrutinized for any sign of the ECB shifting the balance of inflation versus growth risks within its new reaction function.

Fed pivot chatter has also knocked ECB hike expectations off their peak



Source: Refinitiv, ING

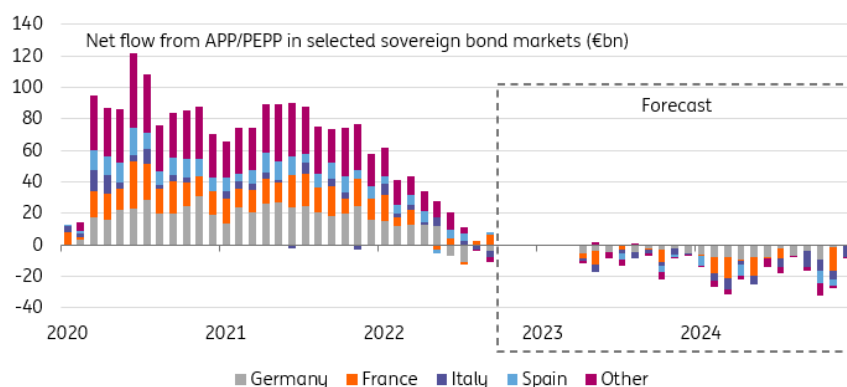
What we will be watching in today's ECB press release and press conference

- **A 75bp rate hike:** The ECB is likely to increase all policy rates by 75bp today, which would take the refinancing rate to 2% and the deposit facility rate – the market relevant rate – to 1.5%. Markets already attach a c.90% probability to this outcome. We do not see the ECB providing a clearer idea of the terminal rate, sticking to the meeting-by-meeting approach.
- **Macro outlook:** There are no updated staff forecasts for the public, but the ECB's assessment of current risks and economic conditions versus its base and downside scenarios will be relevant for market reaction. The ECB's growth projections already looked optimistic in September, and since then survey indicators have continued to decline. Hard data does not point to the economy dropping off a cliff and fiscal support measures are also taking shape. Inflation remains high, but we have seen a drop in energy prices, albeit they are prone to volatility. All in all there might be more discussion within the Council, but the outlook remains highly uncertain and the ECB may find it warranted to maintain a hawkish line here.
- **Steering excess liquidity lower:** Measures to incentivise the early repayment of targeted

longer-term refinancing operations are widely anticipated. Background stories suggest the ECB was leaning towards [unilaterally changing the terms of the TLTRO](#). However, this option has received more pushback yesterday by market- and banking associations in a last ditch lobbying effort. Among the other options reportedly on the table are reverse tiering or lowering the minimum reserve remuneration while increasing the requirement at the same time. [In the end all of the aforementioned options are means to steer excess liquidity lower](#) – which should have knock-on effects in widening money market spreads and to a degree also sovereign spreads.

- **Discussing quantitative tightening:** After the Cyprus meeting the ECB confirmed it has started to discuss quantitative tightening. Given the experiences of the UK and the fragile state of markets also in the eurozone [we suspect the ECB will leave it at that for now](#) – it was discussed – and not provide further concrete guidance. The hawkish outcome would be to tweak the APP reinvestment guidance contained in the press statement already today. This would set the ECB on a clearer path to decide on QT in December or February for a start in the second quarter of next year, in line with the ideas that the ECB’s hawks have outlined in public over the past month.

ECB officials have flagged a gradual start of Quantitative Tightening in 2023



Source: Refinitiv, ING

Today’s events and market views

Markets are clearly trading with an eye for any signs of policy pivot, especially after the smaller hike than anticipated from the Bank of Canada yesterday. As such they may pick up more on the dovish bits in today’s ECB meeting and post-meeting reporting, such as any hints of more discussion surrounding the appropriate size of the hike. The ECB not committing to anything on QT just yet, may also be a relief when compared to the already very concrete ideas that had been voiced by some of the ECB hawks over the past month.

Beyond any short-term reaction today, we think the market should come around to the notion that near-term the ECB will need to deliver more tightening. This will come in the form of more hikes and quantitative tightening is clearly waiting in the wings. Tweaks on the TLTROs are just the first step of scaling back the balance sheet. Before we can look for a more lasting turn towards lower yield we would want to see a confirmation – or compelling evidence as the Fed puts it – that the inflation problem has been tackled.

Away from the ECB the focus is on the US data today. The first print for third quarter GDP should point to a return to growth, but durable goods orders ex transport could come in softer. Also on the menu are initial jobless claims data and – in terms of supply – a US\$35bn 7Y US Treasury note auction.

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