ECB hikes by 75bp and takes gloves off to fight inflation

The European Central Bank has decided on the largest rate hike since the start of the monetary union and has given the impression that it is fully determined to do more

The ECB did it. In a historic move and the single largest rate hike since the start of the monetary union, the ECB just announced it will hike all three policy interest rates by 75bp. At the same time, the ECB decided to suspend the two-tier system by setting the multiplier to zero.

With today's decision, it is clear that the ECB has given up on inflation targeting and forecasting and has joined the group of central banks focusing on bringing down actual inflation. It's not so much a new strategy based on conviction but rather a strategy based on missing alternatives. We still can't see how monetary policy can bring down inflation that is mainly driven by (external) supply-side factors. Even the impact of policy rate hikes on inflation expectations is anything but certain. At the same time, the size of today's rate hike will not determine whether or not the eurozone economy slides into recession and will also not make the recession more or less severe. Any recession in the eurozone in the winter will be driven by energy prices and not by interest rates.

Today's decision shows that the doves and hawks are on the same page. We will have to wait for ECB President Christine Lagarde's comments at the press conference but at face value, today's decision shows that the ECB is willing to hike interest rates towards the upper rather than lower end of the range of neutral interest rates. In our view, this range for the refi rate is between 1% and 2%. It indeed looks as if the doves have left the ECB nest.

While Christine Lagarde had not made any public remarks on monetary policy since the end of the summer, ECB Chief Economist Philip Lane went on record calling for a more gradual and measured approach to normalising rates. Today's decision shows that Lane's influence in ECB decisions has been significantly diminished.

For us, today's decision also means that we will have to strongly adjust our ECB call. Dovishness is no more, even if the ECB is still far more optimistic about growth (+0.9%) in 2023 than we are (-0.6%). The question remains whether the ECB would really be willing to continue hiking as aggressively as they are suggesting if the recession becomes reality. Hiking into a recession is one thing, hiking throughout a recession another.

Let's stay tuned to see whether the ECB press conference, starting at 2.45pm CET will bring any additional insights.

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