ECB keeps rates on hold

After 10 consecutive interest rate hikes, the European Central Bank just announced a first pause in the cycle, shifting the emphasis to 'higher for longer'

ECB President Christine Lagarde

The no-brainer pause. After 10 consecutive hikes, the ECB's decision to leave policy rates unchanged should have been an easy one. The 'higher for longer' principle was stressed a bit more than at the September meeting, with the central bank saying it would "continue to follow a data-dependent approach to determining the appropriate level and duration of restriction".

The economic situation in the eurozone is deteriorating stronger and faster than the ECB had anticipated. The rise in bond yields since the September meeting has strengthened the impact of the ECB's tightening efforts so far. At the same time, however, the events in Israel and Gaza as well as the roller coaster ride of oil prices reminded everyone about the uncertainty and imprecision of inflation forecasts. If in doubt, cut it out is not only a golden rule for editors but also an often-practised principle of central bankers. If in doubt, just pause.

At the press conference, starting at 2.45pm CET, the focus will not only be on the ECB's latest take on growth and inflation but also on the discussion regarding the Eurosystem's bond portfolio and reserve requirements for banks. As much as there seems to have been a growing consensus to stop the reinvestments under the Pandemic Emergency Purchase Programme (PEPP) earlier than the official "at least until the end of 2024", the latest fiscal policy and market developments show how difficult such a decision could still be. The discussion on banks' minimum reserves has gained some traction recently but we expect it to be addressed in full only when the ECB presents the outcome of its review of the operational framework, probably in the spring of next year.

All in all, we will pay close attention to ECB President Christine Lagarde's comments, assessing whether today's pause is a dovish or a hawkish one. In our base case scenario, the ECB is done with hiking rates as the eurozone economy is simply weaker than the central bank has always thought. Still, higher oil prices run the risk of stirring a second inflation wave for the eurozone in 2024. The stagflation risk is real. While in a stagflation scenario, the pre-pandemic ECB would have always opted to support growth, the current ECB is likely to tackle inflation, rather than stagnation.

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