Minutes of ECB's February meeting show determination to hike rates beyond March

The just-released minutes of the European Central Bank's February meeting reflect a very hawkish debate and a clear intention to continue hiking rates

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It is always useful to understand where the ECB is coming from when looking ahead to the next policy meeting. The minutes of the February meeting stress the ECB's clear intention to continue hiking interest rates, beyond the March meeting.

Here are the most important comments made in the minutes:

- The ECB was surprised by the resilience of the eurozone economy and believes more strongly in a soft landing.
- While the ECB assessed that the risks to the inflation outlook had become more balanced, it was "much too early to declare victory".
- The main reason for the ECB's hawkishness seems to be the risk of higher wage growth and stickier-than-expected core and underlying inflation, as well as "only limited evidence of a stabilisation so far". However, not all ECB members seemed to agree as there was a longer discussion on whether there wasn't too much focus on core inflation.

- The discussion on where the terminal rate could be remained rather vague. The minutes state that “any assessment of what level of rates could be seen as excessively restrictive was complex and uncertain, although it was generally felt that concerns of 'overtightening' were premature at the present high levels of inflation and in view of the likely persistence of underlying price pressures. It was emphasised that policy rates were, at present, barely consistent with the range of estimates for the neutral rate”.
- Interestingly, the ECB tried to downplay the current pace of monetary policy tightening, calling it “a reversal of previous loosening and was a necessary normalisation to address high inflation, it was not viewed as a severe squeeze by the banks or their customers”.

What to expect next from the ECB?

Exactly two weeks from today, the ECB will get together again. The macroeconomic background will hardly have changed by then compared with the February meeting. Energy prices were already low in February, confidence indicators had already started to improve and headline inflation had just come off record highs. If anything, the downward revisions of German GDP growth in the fourth quarter have shown that the eurozone might not have avoided recession after all. And even though confidence indicators have improved, still weak current assessments and the high inventory build-up simply preclude too much optimism. Still, a fresh round of ECB staff forecasts will have to take into account the sharp drop in energy prices and the increase in bond yields compared with the December forecasts. However, no matter what the new staff projections show, another 50bp rate hike looks like a done deal.

It's not so much today’s February headline inflation that is the biggest concern for the ECB but rather the more general risk that what started as supply-driven inflation could morph into demand-driven inflation.

Beyond the March meeting, the ECB seems to be entering a new game in which further rate hikes will not necessarily get the same support within the governing council, as hiking deep into restrictive territory increases the risk of adverse effects on the economy. We expect the ECB to stop its back-and-forth on forward guidance at the March meeting and to shift towards a real meeting-by-meeting approach.

The main question beyond the March meeting will be whether the ECB will wait to see the impact of its tightening on the economy or whether it will continue hiking until core inflation starts to substantially come down. In this regard, don’t forget that between March and the next meeting in May, important data releases like an update of the Bank Lending Survey and tentative first-quarter GDP growth data will be available. These are two important pieces of evidence that could tilt the balance in either direction; continue hiking rates until actual inflation comes down or prepare to pause to better assess the impact of the rate hikes so far. We currently expect a compromise: two additional rate hikes by 25bp each in May and June, before pausing the hiking cycle and entering a longer wait-and-see period. This would still bring ECB rates close to historic highs.

All in all, the minutes of the ECB's February meeting underline the ECB's determination to continue hiking interest rates beyond the March meeting.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

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