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The door's still open to a bigger than expected ECB rate hike, according to minutes

The just-released minutes of the European Central Bank's June meeting suggest that the door to a rate hike bigger than 25 basis points at the upcoming meeting on 21 July is still open

The door's still open for a bigger than expected ECB rate hike by President Christine Lagarde later this month

Looking for hints

Analysing ECB minutes often resembles dissecting football matches from three weeks ago and trying to extract any information this match could provide for upcoming games. The nature of this kind of analysis is that it is outdated by definition as new developments can always change a football team's shape (and a central bank's views). Still, we keep on looking for pieces of evidence of whether the ECB's discussion in Amsterdam in June can be of any guidance on what to expect from the 21 July meeting. To be more precise, we are looking for any hint on whether the ECB could hike rates by more than 25bp and what an anti-fragmentation tool could look like. To be short: the door to more than 25bp on 21 July is still open but for more news on the anti-fragmentation tool we can better follow news wires rather than ECB minutes.

Door to larger rate hike on 21 July remains open

As to the anti-fragmentation tool (or: transmission protection mechanism as it will be called according to the latest news reports), the minutes of the ECB June meeting don't provide any new insights. It rather looks as if the ECB had a very muted discussion on this issue and must have been surprised by market movements after the press conference, which explains the hastily organised emergency meeting less than a week after the regular session.

As to the size of the first rate hike, the discussion in June has been more controversial. There seems to have been a group of ECB members favouring a rate hike by more than 25bp at the July meeting. There was broad agreement that risks to inflation remain to the upside, even though the ECB didn't spot any second-round effects or wage-price spirals. Comments like "i*n view of the baseline inflation projection exceeding the ECB's target at the relevant horizon, together with the large and persistent upside risks, it was suggested that the ECB needed to respond more strongly than implied by the market expectations*" or "*a number of members expressed an initial preference for keeping the door open for a larger hike at the July meeting*" illustrate different views on the size of the first rate hike.

However, the majority view in Amsterdam still seemed to be that the first rate hike in eleven years had "*to be prepared and explained carefully"*. Judging from more recent comments, the ECB also seems to take some comfort from the Fed, which also hiked interest rates by 'only' 25bp at the start of the current hiking cycle. The June announcement that there could be larger rate hikes in September was apparently the compromise solution.

All of this means that our base case of the ECB hiking interest rates by 25bp in July and another 50bp in September remains in place. However, with the risk of a looming recession in the eurozone and a cooling US economy, some hawks might regret waiting for too long. Instead, they could still push for a rate hike of 50bp in July, trying to frontload the normalisation and also preempting any unwanted discussions in September on whether or not (larger) rate hikes are still justified.

The euro approaching parity vis-à-vis the US dollar could be another reason for the hawks to push for a surprise. In any case, remember that it only needed one article in the Wall Street Journal a few days ahead of the last Fed meeting to quickly change market expectations from a 50bp rate hike to a 75bp one. We shouldn't rule out that Christine Lagarde could still ask Jerome Powell for some communication advice.

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