Minutes of the June ECB meeting underline its hawkishness

With two weeks to go until the next European Central Bank meeting, the just-released minutes of the Bank's June meeting reiterated policymakers' determination to continue the current hiking cycle beyond the next meeting

The ECB's June meeting delivered not only another rate hike but also a de facto pre-announcement of a July hike by ECB President Christine Lagarde. The upward revision of the ECB's inflation forecasts for 2024 and a still-optimistic growth outlook were the main reasons for continued hawkishness. The pre-announcement at the press conference was reflected in the minutes, as the ECB concluded that in order to reach the inflation target the bank had "as a minimum, to deliver two successive interest rate increases in June and July".

Besides the next rate hike pre-announcement, the minutes provided some additional insights into the ECB's current thinking:

- Core inflation as a leading indicator. Here, a majority at the ECB seems to have some doubts, not only questioning the role of core inflation as a leading indicator but characterising it as a lagging indicator.
- Some doubts regarding the latest upward revision to inflation. Some members questioned the upward revision "in light of the latest, more encouraging data and with respect to changes in the assumptions underpinning the June projections".

- Getting inflation lower is easier than getting it to 2%. “It was also argued that bringing inflation down from very high numbers to more moderate levels was easier than achieving a full return to the 2% medium-term target. In this context, it was remarked that an envisaged return of inflation to 2% towards the end of 2025 could be considered too late.”

25bp rate hike in two weeks is done deal

Looking ahead, another 25bp rate hike at the ECB’s next meeting in two weeks looks like a done deal. Even if signs of a cooling economy and fading inflationary pressure are emerging, they are still too weak for the ECB to change course. However, looking beyond the July meeting, the discussion on how far the ECB should go with its current hiking cycle will intensify and become more controversial.

In fact, with still lower-than-expected energy prices, dropping food prices and fading pipeline price pressures in both services and manufacturing, inflation could come down faster than the ECB expects, at least after the summer. In fact, there is the risk that another chapter will be added to the misconceptions of inflation dynamics; after ‘inflation is dead’ and ‘inflation is transitory’, we could now have ‘inflation will never come down’.

Don’t get us wrong, we still believe that, structurally, inflation will be higher over the coming years than it was pre-pandemic. Demographics, derisking and decarbonisation all argue in favour of upward pressure on price levels. However, be cautious when hearing comments that inflation will never come down. These comments might come from the same sources that only a few years ago argued that inflation would never surge again. This does not mean that the loss in purchasing power as a result of the last inflationary years will be reversed any time soon. It only means that headline inflation can come down faster than currently anticipated. Finally, historic evidence suggests that core inflation normally lags headline inflation while services inflation lags that of goods.

If we are right and the economy remains weak, the disinflationary process gains momentum and core inflation starts to drop after the summer, the ECB’s hiking cycle should end with the September meeting, though the Bank might wait until the December meeting to officially declare it over.

Author

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