

ECB minutes show tentatively growing recession concerns

At first glance, the minutes of the European Central Bank's October meeting do not point to a pivot any time soon. However, reading between the lines, there seem to be growing recession concerns, at least with some members, which could lead to a pause in the hiking cycle in the coming months



The just-released minutes of the ECB's October meeting underline the ECB's determination to continue hiking interest rates, while at the same time coping with high uncertainty and growing concerns about the severity of the looming recession.

Here are the main takeaways from the minutes:

- **Shallow recession not enough to bring down inflation.** There was a discussion on the potential severity of a looming recession, with a common view that a shallow recession would not be enough to bring down inflation. The ECB discussed possible channels through which a shallow recession could become a deeper and longer recession. Interestingly, and

despite earlier credit crunches, the ECB did not see the banking sector as a potential channel but rather the housing market and eventually the labour market. “It was argued that, in the event of a shallow recession, the Governing Council should continue normalising and tightening monetary policy, whereas it might want to pause if there was a prolonged and deep recession, which would be likely to curb inflation to a larger extent.”

- **Fiscal policy.** The ECB’s view on fiscal stimulus and its impact on the economy was a bit ambiguous, seeing “a risk that fiscal compensation packages would turn out to be bigger than warranted”.
- **Longer-term inflation.** Remarkably, there was a common view that most measures of longer-term inflation expectations stood at around 2%. Remarkable as this would take away the necessity to move monetary policy into restrictive territory.
- **Debate on neutral level of policy rate.** It remains unclear what the ECB has in mind as a neutral level for interest rates. In some paragraphs, it is said that a “neutral level” should be reached swiftly, while in other paragraphs, the entire concept of a neutral or terminal interest rate is debunked.
- **On the size of the rate hike.** Some ECB members argued in favour of a 50bp rate hike but the large majority favoured the 75bp option.
- **Tail wagging the dog?** One argument to go for a 75bp rate hike was the fact that financial market participants had also priced in such a hike. “It was argued that falling short of these market expectations would imply an unwelcome loosening impulse, potentially undermining confidence in the Governing Council’s commitment to price stability.”
- **Nothing on pivot.** At least according to the minutes, there hadn’t been a discussion on potentially slowing down the pace of rate hikes or starting quantitative easing.

All in all, there were only some signs between the lines that the ECB could slow down the pace of rate hikes at the December meeting.

What's next for the ECB?

While the October decision was very uncontroversial and supported by a large majority, recent comments by ECB officials suggest that the discussion at the December meeting will be much more heated and controversial. In fact, the voices of the doves have again become louder, while the hawks seem to be prepared to slow down the pace of rate hikes. Data releases and the forecasts presented at the December meeting will have something for both: a further increase in headline inflation and no further weakening of the economy but also very likely inflation coming down significantly in 2024 and 2025.

As a consequence, we currently expect the ECB to hike rates by 50bp in December and by another 25bp in February. The big question and probably also the big bargain between doves and hawks will be around quantitative tightening (QT) or in other words, the shrinking of the ECB’s balance sheet. Earlier and more significant QT could be the bargaining chip for an end to rate hikes. We expect the ECB to announce a gradual reduction of the reinvestments of its bond holdings under the Asset Purchase Programme (APP) at the December meeting, with the aim to stop the reinvestments by end-2023.

The minutes of the ECB’s October meeting have some tentative signs that concerns of a more severe recession are growing, at least with some ECB members. This note of caution combined with long-term inflation expectations that are still close to 2% could allow the ECB to at least move towards a pause in its rate hike cycle soon.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.