The ECB confirms its hawkish stance; prepare for yet more rate hikes

The ECB President, Christine Lagarde has confirmed the Bank's hawkish stance and has prepared markets for more hikes to come. We still think the European Central Bank is too optimistic about growth but have changed our call; we now expect it to hike rates by another 75bp before the end of the year

ECB President, Christine Lagarde, at Thursday's news conference

The ECB news conference just confirmed the message that was already clear from the policy decisions: the European Central Bank is fully determined to hike interest rates aggressively. Earlier, it announced a 75 basis point rate rise, the largest hike since the start of monetary union. It's given up on inflation targeting and its main aim now seems to be restoring its inflation-fighting credibility. It is still hard to see how the ECB can bring down inflation that is mainly driven by supply side factors, other than 'hoping' for a recession that suppresses demand.

During the press conference, President Christine Lagarde said the ECB still intends to hike interest rates several times in the coming months but didn't say where it sees the level of the neutral interest rate.

We still think the ECB is too optimistic about the economic outlook

We still think it's being too optimistic about the economic outlook. The ECB's baseline scenario is +0.9% GDP growth in 2023 which is much more optimistic than our own forecast. Only in its downside risk scenario do we see GDP growth coming in at -0.9% but this scenario assumes a full end to Russia's rationing of oil and gas in the eurozone. Interestingly, in its baseline scenario, the ECB expects inflation to still come down to 2.3% in 2024 and actually to reach 2.2% from the second quarter of 2024. Admittedly, there is currently very little belief among ECB members in the reliability of these long-term projections. However, the very hawkish tone today doesn't really match these inflation projections.

Taking today's decision and Lagarde's comments at the news conference at face value, we have to change our ECB call. For the time being, there are no more doves. The Bank is clearly determined to bring interest rates to their neutral level, and this level is clearly at the upper end of the common range of between 1% and 2%. If it were up to the hawks, they would probably like to hike by another 100bp before next spring. However, we think that at some point in the coming months, the ECB will have to acknowledge that its growth expectations are too positive. In our view, the ECB will only be able to hike rates by a total of 75bp by the end of the year. This could be another 75bp at the October meeting or 50bp in October and a last-minute 25bp hike at the December meeting.

For now, the doves have clearly left the ECB nest. However, we don't think that they have left that nest for good and they will be back, somewhat earlier than the migrating birds which return to Europe after the winter.

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