

## ECB Preview: Don't look back in anger

A 25bp rate hike looks like a done deal for next week's European Central Bank meeting. However, with growth disappointing, the economic outlook getting gloomier and inflation dropping, arguments for several more rate hikes are becoming weaker. That said, the ECB is likely to ignore this



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Macro developments since the May meeting have clearly had more to offer the doves than the hawks at the ECB. Headline inflation has continued to come down but remains far off 2%, survey-based inflation expectations have also started to slow, growth has disappointed and confidence indicators seem to have peaked. In previous times, such a backdrop would have been enough for the ECB to consider pausing rate hikes and wait for the effects of the rate hikes so far to fully unfold. However, the ECB is fully determined right now to err on the side of higher rates.

### Minutes of May meeting point to ongoing tightening bias

This tightening bias was also reflected in the minutes of the ECB's May meeting. The surprisingly weak Bank Lending Survey ahead of the last meeting clearly scared some ECB members enough to slow the pace of rate hikes but not enough to start thinking about an end to, or at least a pause in, the hiking cycle. In fact, a large number of ECB members assessed the risks to price stability as

being clearly tilted to the upside over the policy-relevant horizon. High underlying inflation and stubbornly high core inflation were the main reasons behind the ECB's view that the conditions were not in place to "declare victory" or to be complacent about the inflation outlook.

## Staff projections won't bring substantial change

Next week's meeting will also bring a new round of ECB staff projections. While gas prices have dropped further since the last projections in May, oil prices are broadly back at where they were in March. Market interest rates have also hardly changed and only the slightly weaker euro could technically add some inflationary pressure. At the same time, however, it will be interesting to see how the ECB is dealing with the disappointing soft and hard macro data of late. Remember that back in March, the ECB expected eurozone GDP growth to return to its potential quarterly growth rate of 0.4% quarter-on-quarter from the third quarter of 2022 onwards. This was a surprising forecast given the delayed adverse impact from monetary policy tightening and ongoing structural transitions. It was also remarkable as at the same time, inflation was forecast to return to 2% by the end of 2025. An economy growing at full speed which also gradually allows inflation to disappear is a very unlikely phenomenon.

For next week, we expect slight downward revisions to the ECB's GDP growth forecasts for this year and next but hardly any revisions to the inflation forecasts. This would mean that the ECB sticks to the 2025 forecast of 2.1% for headline and 2.2% for core inflation.

## Hiking will continue, and not only next week

Despite the recent decreases, actual headline and core inflation and expectations for inflation only to return to target in two years from now are clear arguments for the ECB to not only continue hiking by 25bp next week but to also keep the door open for rate hikes beyond then.

However, the eurozone economy has turned out to be less resilient than anticipated a few weeks ago and confidence indicators, with all the caveats currently attached to them, point to a weakening of growth momentum again. As headline inflation is gradually retreating, the risk increases that any additional rate hike could quickly turn out to be a policy mistake; at least in a few months from now. Still, the ECB simply cannot afford to get it wrong again. This is why they are putting more than usual emphasis on actual inflation developments. Even if this completely contradicts forward-looking monetary policy, the ECB is in no position to take a chance and is not giving any impression that it might look back in anger.

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