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ECB hikes rates by 50bp

The European Central Bank (ECB) continues to fight inflation and has announced a rate hike of 50bp. Price stability concerns clearly trump any financial stability worries – at least for the time being

European Central Bank President Christine Lagarde at today's press conference

With the latest financial market developments, there were doubts about whether the ECB would continue its hiking cycle today. But it has. With the latest inflation projections forecasting both core and headline inflation close to 2% in 2025, the ECB could easily present some dovishness during the Q&A session, hinting at a slowdown in the pace and size of further rate hikes.

Since the financial crisis in 2007 and 2008, financial markets have gotten used to the idea that central banks will always play the lender of last resort. In a European context, be it a financial crisis, a euro crisis or a pandemic, the ECB has always been there to help. “Whatever it takes”, if needed. However, the big difference between the last 15 years and now is that there is a severe inflation problem. The ECB cannot simply return to its role of firefighter as it has to fight inflation. The fact that balancing between financial stability and price stability can be quite a conflict of interest for the ECB has already been clear since European bank supervision, in the wake of the euro crisis, was moved to the ECB.

What markets and central bankers are currently experiencing is actually what undergraduate students learn at college in their first year of studying economics: monetary policy has an impact on the economy. It shouldn’t be a surprise to anyone that the most aggressive monetary policy tightening since the start of the eurozone in 1999 has and will have adverse effects. The last few days have been a good reminder to the ECB that the next steps in fighting inflation will be much harder than the steps taken so far. The first phase of exiting the so-called unconventional measures (negative interest rates and bond purchases) went relatively smoothly, but now that interest rates are in restrictive territory, every additional rate hike increases the risk of breaking something. As a result, we expect the ECB to turn more dovish today and in the coming weeks, probably hinting at a slowdown in the pace and size of any further rate hikes.

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