Snap | 27 July 2023

The ECB switches off autopilot

While the policy announcement earlier today left the door wide open for another rate hike in September, ECB President Christine Lagarde stressed during her press conference that anything was possible, including a pause

ECB President Christine Lagarde

The ECB has hiked its main policy interest rate by 25bp. The deposit interest rate is now at 3.75%. What is more interesting, though, is that the accompanying policy statement kept the door for further rate hikes open and did not strike a more cautious tone.

The ECB also announced that the remuneration of minimum reserves will be reduced to zero.

During the subsequent press conference, however, ECB President Christine Lagarde was adamant not to pre-announce anything for September, leaving the door not only open for a rate hike but also for a pause.

Hike, pause or stop? It's all possible in September

After the June pre-announcement, it was hard for the ECB not to hike interest rates today. The central bank has been too explicit that the risk of stopping rate hikes prematurely is much higher than going too far. However, the recent batch of negative data from the eurozone, ie. weak PMIs and a weak Ifo index, another drop in demand for new bank loans, tighter lending standards and weak loan growth must have had a terrifying impact on sentiment in the EuroTower, even if this was not reflected in the policy statement.

In fact, the ECB is again running the risk of being behind the curve. This time not by being too benign on inflation but rather by being too optimistic and too benign on the economic impact of its own policy measures.

During the press conference, Lagarde emphasised the weaker economic outlook for the eurozone economy in the near term but remained optimistic that growth would rebound in the medium term. Inflation, according to Lagarde, was set to come down further but would remain above target for an extended period of time. Whether it was this macro-economic assessment or something else remains unclear, but Lagarde stated over and over again that all options were on the table for September.

She refused to repeat previous terms like “more ground to cover” and “we are not done, yet”, and the statement heard in the lead-up to today’s meeting was that stopping rate hikes too early was riskier than hiking too far. Lagarde said, “The September meeting will be deliberately data-dependent”. A somehow unfortunate term. Every single central bank meeting of any central bank should always be data-dependent. Let’s hope the ECB will drop this description and instead say that “all options are on the table”, even if for the time being Lagarde has explicitly excluded a rate cut.

One more hike but not necessarily in September

It took Lagarde many words to put forward a simple message: the ECB has officially switched off the autopilot. Whether this means that rates will no longer be hiked is unclear. The mention of inflation coming down but staying above target “for an extended period” does not sound as if the ECB is yet willing to stop hiking rates. On the other hand, the worsening macro outlook seems to have scared off some ECB members, making a pause in September a possibility.

We think that the ECB is not yet done with hiking rates but a pause has become fashionable amongst central banks, which had been ahead of the ECB in their hiking cycles. In fact, the ECB’s own growth and inflation projection in September will have to see a significant downward revision in order to stop the central bank from hiking rates at least once more after today.

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