

Snap | 4 May 2023

## Lagarde keeps door open for further rate hikes

At the press conference following the 25bp rate hike, European Central Bank President Christine Lagarde tried to send a rather hawkish message, keeping the door open for further hikes



ECB President Christine Lagarde

The ECB has entered the final stage of its rate hike cycle. As expected, the central bank increased its main policy interest rates by 25bp, bringing the deposit rate to 3.25%. Since July last year, the ECB has hiked interest rates at every single policy meeting, by a total of 375bp. This is by far, the most aggressive monetary policy tightening cycle since the start of the monetary union.

While today's hike is the seventh increase in a row, it is the smallest in the current cycle, suggesting that the ECB has entered the final stage of this tightening cycle. Although recent data has confirmed that underlying inflationary pressure is stickier than expected, weak credit growth and the latest results of the Bank Lending Survey have indicated that the rate hikes so far are leaving clear marks on the financing of the economy. Or as the ECB put it and unsurprisingly for all Star Wars fans on May the 4th: "the past rate increases are being transmitted forcefully to euro area financing and monetary conditions, while the lags and strength of transmission to the real economy remain uncertain".

At the same time, however, today's decision was not only a dovish twist but a good European compromise. The fact that the ECB de facto announced that the reinvestments of its Asset Purchase Programme (APP) will be stopped in July looks like a bargaining chip for hawks in order to agree to a 25bp increase instead of a 50bp hike. According to ECB President Lagarde, stopping the APP reinvestments would be equal to a €25bn reduction of the portfolio on average every month.

## Where will the ECB go from here?

The press conference made clear that the ECB's job is not done, yet. The key sentence was probably that "the inflation outlook continues to be too high for too long". Lagarde had some trouble signalling whether today's decision was dovish or hawkish as she reiterated that more ground had to be covered and that today's decision was not a pause. The longer the press conference lasted the more Lagarde seemed to emphasise the need for further rate hikes and increasingly sounded hawkish. In all honesty, what started off as a clear message of a meeting-by-meeting approach and data dependency ended with more questions than answers. Maybe it was just a sign of the fact that the ECB is increasingly divided about what to do next.

Leaving aside the press conference, it will be hard for the ECB to return to 50bp rate hikes in the current macro environment with the lagged impact from previous hikes, banking turmoil, and subdued growth but still sticky inflation. In this base case scenario, it will be equally difficult to hike rates more than one or at most two times. In fact, the risk is high that every single additional rate hike from here could turn out to be a policy mistake further down the road. Instead, keeping interest rates high for longer after another rate hike in June will probably be the next compromise between the doves and hawks. It would buy the ECB time to see its tightening up to now fully unfolding. The decision to stop APP reinvestments as of July also points in this direction.

All in all, with today's decision, the ECB has clearly entered the final stage of its tightening cycle and the peak of interest rates might be nearer than ECB President Lagarde tried to make markets believe at the press conference.

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