3 March 2022

Article

ECB minutes confirm increasing hawkishness

The minutes of the European Central Bank's February meeting confirm increasing unease about ultra-loose monetary policy and a growing willingness to start normalising. However, this was before the war in Ukraine

European Central Bank, Frankfurt, Germany - 26 Oct 2021

Takeaways from the minutes

The just-released minutes from the ECB's February meeting have added more substance to explain why the Bank changed its communication and become more hawkish. The minutes show a growing willingness to start normalising monetary policy at the March meeting.

The most important messages from the minutes are:

- Risks to the inflation outlook were tilted to the upside. The return of this assessment came on the back of higher energy prices, a stronger-than-expected pass-through of higher producer prices to consumer prices, the continued overshooting of actual inflation developments compared with forecasts and the notion that "longer-term inflation expectations had continued to converge to the 2% target".
- Still strong economic rebound expected. As the minutes say: "looking beyond the near term, growth was likely to rebound strongly over the course of 2022, driven by robust domestic demand, the global recovery and the ongoing fiscal and monetary policy support.

- Criticism of macro models and staff projections was repeated. Some ECB members pointed out that "the average error in the staff projections for projected inflation two years ahead, which was around three-quarters of a percentage point…raised the question of whether the underlying models were performing sufficiently well and whether the historical relationships underpinning the models and projections still held."
- Close to fulfilling criteria of forward guidance. "Some members argued that the likelihood that inflation would settle at around 2% over the medium term had already increased significantly, with the outlook coming close to satisfying the conditions established in the forward guidance on interest rates."
- Distinction between normalisation and tightening. The ECB members who argued in favour of a "timely adjustment of the still highly accommodative monetary policy stance", favoured an end of net asset purchases and negative policy rates.

All of the above as well as speeches and comments by ECB officials after the February meeting suggest that the ECB had been on its way to announcing the first steps of a policy normalisation at the March meeting. However, with the war in Ukraine, the minutes of the ECB's February meeting have become a rather historical piece of evidence of a changing mood at the ECB rather than a valid signal of what the ECB will actually decide next week.

What to expect from next week's ECB meeting

Looking at next week's meeting, the latest inflation data and the overall economic picture since the start of the war in Ukraine have once again complicated the road to normalisation. Given that the cut-off for the ECB's staff projections was several weeks ago, any new inflation forecasts can be thrown into the waste paper bin as they are outdated. The new uncertainty, as well as the direct economic implications of the war, are still hard to model into numbers. As a consequence, we will probably have a situation at next week's ECB meeting in which the inflation projections for 2023 and 2024 could be at 2%, calling for ECB action. In fact, the risk of stagflation has clearly increased, complicating the ECB's dilemma: how to react to accelerating inflation that cannot be softened by monetary policy. No one can seriously expect the ECB to start normalising monetary policy at such a moment of high uncertainty.

Therefore, we expect the central bank to strike a cautious balance between staying on track for policy normalisation while at the same time keeping maximum flexibility. This strategy would mean the ECB sticks to the already announced rotation of its asset purchase programmes, i.e. ending the Pandemic Emergency Purchase Programme in March and increasing the Asset Purchase Programme from €20bn to €40bn, and instead of announcing targets for 3Q and 4Q, announcing a monthly reduction of the net asset purchases by €5-10bn per month, starting in May. Contrary to the December meeting, the ECB will want to avoid hinting at end dates for QE or start dates for rate hikes. At the current juncture, the ECB needs to repeat the promises of Mario Draghi and Jean-Claude Trichet to "never pre-commit". If everything goes well, net asset purchases can still end in the third quarter and interest rates can be hiked for the first time before the end of the year. But this is not for next week's meeting.

Carsten Brzeski
Global Head of Macro
+49 69 27 222 64455
carsten.brzeski@ing.de

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