ECB Preview: March 2022

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Details:

Monetary policy decision: 12:45BST/13:45CET, Thursday 10 March 2022

Press conference: 13:30BST/14:30CET, Thursday 10 March 2022

Expected links:

Monetary Policy Decisions:
https://www.ecb.europa.eu/press/govcdec/mopo/html/index.en.html

Interest Rate Announcements:
https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html

ECB Press Conference Video:
https://www.ecb.europa.eu/press/tvservices/webcast/html/webcast_pc_youtube.en.html

Bloomberg: MEDI <Go>

MNI Point of View (POV):

Hawks Stand Down, For Now

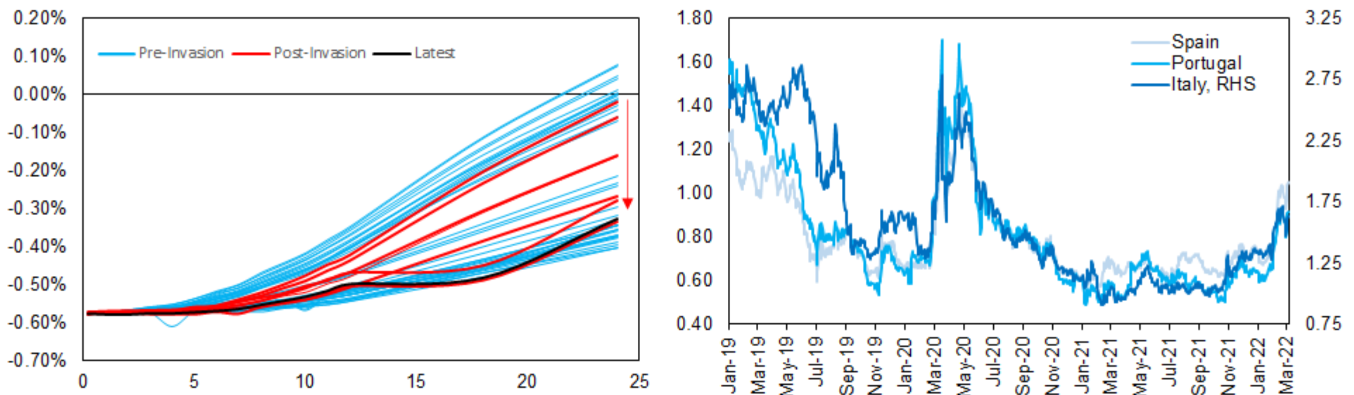
- Having appeared to be gearing up to normalise monetary policy, the ECB's calculus has now changed following the Russian invasion of Ukraine.
- For the time being, the direction of travel for monetary policy remains unchanged, but any momentum building behind a near-term tightening has subsided.
- The ECB will reconfirm the December policy calibration, but the narrative on the medium-term inflation outlook will now reflect the new two-way risks that have resulted from the Ukrainian crisis.

The assumptions underpinning the hawkish pivot at the February GC meeting have not been entirely upended by the Russian invasion of Ukraine (and the resulting shocks to the inflation and economic outlooks), but have evolved sufficiently to warrant further caution on policy normalisation. As a result, despite updated staff macroeconomic projections likely to show an upward revision to the inflation forecasts – particularly for 2022 and 2023 – the ECB is unlikely to provide any further policy signals at this stage and will instead reconfirm the December policy setting. President Lagarde will argue that the crisis has introduced new two-way risks to the medium-term inflation outlook and that the ECB will need time to gauge the economic impacts of the Ukrainian war.

The latest developments have further complicated the ECBs communication strategy. Until recently the ECB had resolutely defended its baseline assumption that the inflation shock would prove transitory, even as inflation

continued to surprise higher and the ECBs position was increasingly at odds with the consensus among peer central banks. Ahead of the February meeting, and in the immediate aftermath, even the more dovish ECB members started to concede that inflation would remain higher for longer and that monetary policy should start to normalise. Having pivoted in a hawkish direction in early February, the ECBs communication strategy is once again being stressed as the Ukrainian war has introduced new risks which were not present at the previous meeting. Current inflation will remain elevated and the persistent energy price shock will further amplify price pressures, but the medium-term outlook is now clouded by the opposing forces acting on inflation (the supply shock will intensify price pressures, but could also dent economic activity).

Fig 1. ESTR Curve, Monthly Maturity (LHS) & 10-Year Sovereign Spreads Over Bunds, % (RHS)

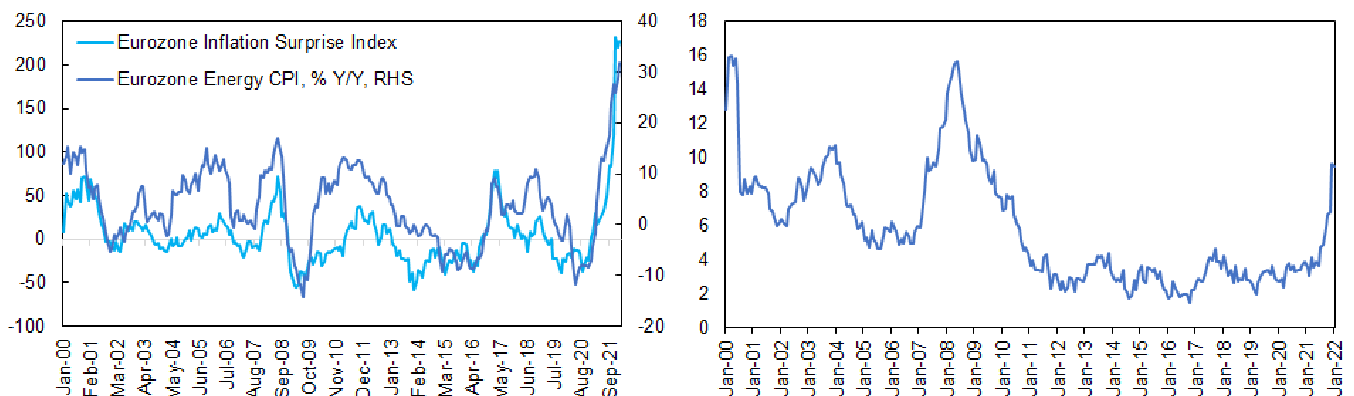


Source: MNI, Bloomberg

GC members had previously stressed that the ECB does not want to repeat historical mistakes when inflation forecasts were overly optimistic and policy was prematurely tightened. These scars have loomed large and have underpinned the ECBs resistance to tighten monetary policy in the face of rapidly accelerating inflation. While the fear of premature tightening gave way to the fear of falling behind the curve, the ECB will now be concerned about performing another volte-face and unwinding the hawkish shift at the February meeting. This will pose a particularly difficult challenge for the ECB at this week's meeting. The most likely, and least damaging, course of action would involve:

- Restating the existing policy setting.
- A cooling-off period to reassess the inflation outlook in light of the new geopolitical developments.
- A commitment to adjust all policy instruments as needed to satisfy the price stability objectivee.
- A willingness to provide additional liquidity for the banking sector if required.
- A pledge to prevent any potential financial fragmentation risks.

Fig 2. Eurozone Inflation (LHS) & Spread Between Highest and Lowest CPI Readings In The Eurozone, % (RHS)



Source: MNI, Bloomberg

Given that the euro area is close to the epicentre of the Ukrainian crisis (in terms of financial and trade exposure, dependence on Russian energy etc) compared to the US and UK, the spillovers to inflation and economic activity could be more severe. Even if the war quickly ground to a halt and the Russian military retreated, economic sanctions are likely to stay for the long-term which presents an unknown risk to regional inflation and economic activity. Some GC members have already warned of stagflation risks, which would further complicate the ECBs efforts to eventually normalise monetary policy.

Baseline: The ECB reconfirms the December policy setting and staff projections show an upward revision to the medium-term inflation forecasts. President Largarde avoids providing any new policy signals and instead indicates that there are two-way risks to the inflation outlook and that time is needed to assess the impacts of the Ukrainian crisis. Furthermore, Lagarde stresses that all policy instruments can be adjusted as needed to satisfy the financial stability objective and that the ECB stands ready to prevent any potential financial fragmentation risks.

Dovish Scenario: The existing policy setting is again confirmed, but President Lagarde downplays the possibility of accelerating the end of net asset purchases or a rate hike this year. While the ECB continues to assert that time is needed to gauge the economic impacts of the Ukrainian crisis, President Lagarde indicates that risks to the economic outlook have tilted to the downside. The possibility of net asset purchases being resumed/accelerated at a later date if needed is also stressed.

Hawkish Scenario: As before, the current policy setting is maintained, inflation risks remain tilted to the upside and President Lagarde stresses that the Ukrainian war will further fuel inflationary pressures. It is clear that the ECB is more concerned about the upside risks to inflation resulting from the geopolitical crisis rather than the potential impact on economic activity.

mni Central Bank Watch - ECB

08 March 2022

MNI ECB Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
HICP	% y/y	5.8	4.9	↑	3.0	↑					2.03
Core Inflation	% y/y	2.7	2.6	↑	1.6	↑					0.97
Oil Prices	$	101.0	70.6	↑	73.0	↑					1.91
5y/5y Inflation Swap	%	2.18	1.86	↑	1.69	↑					0.32
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Eurozone PMI (Comp)	Index	55.5	55.4	↑	59.0	↓					0.55
Industrial Production	% y/y	1.6	4.0	↓	10.8	↓					-0.64
Business Climate Indicator	Index	1.79	1.77	↑	1.69	↑					0.59
Consumer Confidence	Index	-8.8	-6.8	↓	-5.3	↓					-1.22
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Narrow Money (M1)	% y/y	9.0	10.7	↓	11.0	↓					-1.52
Broad Money (M3)	% y/y	6.4	7.7	↓	7.8	↓					-1.79
Loans to Non-Fin Corps	% y/y	3.7	1.9	↑	1.3	↑					1.45
Loans to Households	% y/y	4.4	4.3	↑	4.5	↓					0.00
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	7.8	1.7	↑	3.4	↑					0.68
Unemployment Rate	%	6.8	7.3	↓	7.6	↓					-1.52
Labour Costs (Quarterly)	% y/y	2.5	2.9	↓	3.6	↓					0.11
Employment (Quarterly)	% y/y	2.1	-1.7	↑	-2.8	↑					1.10
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3512	4063	↓	4196	↓					0.55
Bund Yield	%	-0.03	-0.35	↑	-0.38	↑					1.60
10y BTP Spreads	%	162.4	131.8	↑	109.2	↑					-1.83
EUR TWI	Index	117.80	120.89	↓	123.52	↓					-1.13

Source: MNI, Bloomberg

Summary of Analyst Views

- In what is likely to mirror the outcome of the March ECB meeting, analysts have for the time being adopted a cautious posture and have avoided significantly updated policy forecasts.
- The ECB is widely expected to confirm the existing policy setting and retain full optionality given the heightened uncertainty around the war in Ukraine and the fluid nature of geopolitical developments.

Barclays

- The ECB is not expected to announce any changes to the path of QE that was decided in December 2021 and will keep policy rates unchanged.
- The ECB will pledge to preserve price and financial stability and accommodate unwarranted tightening of financial conditions by postponing the exit from QE for as long as possible.
- An increase in policy rates is not expected until the Ukrainian conflict is over and when there is clarity on the impact on the medium-term inflation outlook. In any case, this is not expected before March 2023.
- Optionality will be retained to use old and new instruments in order to maintain price stability.
- The ECB is not expected to review its forecast guidance or the link between asset purchases and policy rates in the near term, but could reconsider this under special circumstances.
- Expected ECB forecast revisions for GDP: 2022 (-1.4pp to 2.8%), 2023 (-0.6pp to 2.3%), 2024 (+0.2pp at 1.8%).
- Expected ECB forecast revisions for inflation: 2022 (+2.1pp to 5.3%), 2023 (+0.9pp to 2.7%), 2024 (+0.1pp to 1.9%).
- Expected ECB forecast revisions for core inflation: 2022 (Unchanged), 2023 (+0.3pp to 2.0%), 2024 (+0.2pp to 2.0%).

Danske

- Following the hawkish pivot at the February meeting, the ECB will now need to balance a stronger inflation outlook with the uncertain impact of the Russia-Ukraine war.
- The ECB is expected to continue towards entering a 'neutral' monetary policy calibration and setting an end date for the APP programme (in September) but will steer clear of indicating an upcoming rate hike.
- The ECB will remove the 'or lower' wording from the forward guidance on interest rates, as well as giving no indication between the end of APP and the first rate hike.
- Danske expects staff projections to show core inflation of 2% in 2023 and 2024, which will set the stage for policy normalisation.

Goldman Sachs

- GS remains confident that the ECB will cease asset purchases in line with the current guidance. However, the ECB is no longer expected to provide a calendar commitment for the end of QE at the March meeting.
- Instead, the ECB will state that it now 'expects to' (rather than 'will') continue APP until September and will likely emphasise data dependence over calendar commitments in the coming months.
- GS believes that QE will end in June, paving the way for a policy rate hike in September.
- Thereafter the ECB is expected to use policy rate hikes rather than balance sheet run off to tighten the monetary policy stance.
- Expected ECB forecast revisions for GDP: 2022 (-0.4pp to 3.8%)
- Expected ECB forecast revisions for inflation: 2022 (+1.8pp to 5.0%), 2023 (+0.4pp to2.2%), 2024 (Unchanged at 1.8%).
- Expected ECB forecast revisions for core inflation: 2022 (+0.5pp to 2.4%), 2023 (+0.1pp to 1.8%), 2024 (+0.2pp to 2.0%).

J.P. Morgan

- The war in Ukraine is pulling the ECB in opposing directions given the hawkish pull from higher inflation and the dovish pull from lower growth. At this stage it is difficult to gauge their net effects.
- JPM expects the ECB to stick with the existing path for the APP.
- December remains the expected lift off date for rates.
- The ECB will stress that optionality is two-way given that high inflation is itself a drag on growth.
- Only if second round effects emerge via wages and inflation expectations would the ECB consider responding more quickly.
- The ECB will indicate that it stands ready to provide liquidity support to banks and consider new asset purchases if needed.
- Fragmentation risks could be addressed through flexible PEPP reinvestments and APP purchases if required.

Natixis

- Given the heightened uncertainty following the Russian invasion of Ukraine, Natixis believes that broad agreement will be found at the March meeting as to whether the envisaged policy tightening should be put on hold or pursued further.
- As such, the ECB is expected to provide a “neutral” statement and will not announce any new policy measures.
- The APP is expected to continue at the current EUR20bn pace for the time being.
- Expected ECB forecast revisions for GDP: 2022 (-0.4pp to 3.8%), 2023 (+0.2pp to 3.1%), 2023 (Unchanged at 1.6%)
- Expected ECB forecast revisions for inflation: 2022 (+1.8pp to 5.0%), 2023 (+0.2pp to 2.0%), 2024 (+0.2pp to 2.0%).
- Expected ECB forecast revisions for core inflation: 2022 (+0.9pp to 2.8%), 2023 (+0.3pp to 2.0%), 2024 (+0.2pp to 2.0%).

NatWest

- Given the current geopolitical events, a rapid normalisation of monetary policy should not be expected.
- The ECB will maintain its decision to end PEPP in March and is expected to suggest that QE could end in Q3 or Q4 while also leaving open the possibility of restarting or accelerating net purchases if needed.
- Net purchases under the APP are expected to be maintained at EUR40bn in Q2, but future amounts will be announced meeting by meeting and be data dependent.
- The ECB will de-link the end of net asset purchases from rate hikes in the forward guidance.
- The ECB could also opt to announce a reinforcement of financial stability/anti-fragmentation tools.

Nomura

- With the Ukrainian war likely to weaken economic growth in the euro area and fuel inflation, the ECB’s plans for policy normalisation are likely to be put on hold.
- The GC could decide to delay the point at which is provides more concrete guidance on the fate of the APP and the point at which interest rates are expected to rise.
- Nomura continues to forecast 25bp policy rate hikes per quarter from December with the ECB pausing at the end of 2023 when the deposit rate is projected to reach +0.5%.

Nordea

- While the ECB will want to keep its options open, Nordea expects the GC to opt for a faster taper of its asset purchases.
- Specifically, Nordea expects net asset purchases to end in Q3 compared to the current policy of open-ended EUR20bn/month from Q4. This in turn would provide scope for the ECB to raise policy rates this year if needed.

- The ECB is also expected to cut the link between the end of net purchases and the first rate hike to signal that rate hikes could be delayed.
- Nordea argues that while a central bank may ordinarily look through a surge in energy prices stemming from a supply shock, the ECB has underestimated inflation for more than a year and that prior to the Russian invasion of Ukraine second-round risks were rising.
- Recent ECB speeches show that even though policy tightening could be delayed, the direction of travel is still in favour of policy normalisation.
- High uncertainty, higher energy and raw materials prices, coupled with a reduction in exports to Russia, could underpin a reduction in the ECB's growth forecasts to 3.5% in 2022 from 4.2% and to 2.5% from 2.9% in 2023.
- Nordea expects headline inflation to rise to around 5% from 3.2% in 2022 with core inflation rising to around 3% from 1.9%.

RBC

- The ECB will not announce any decision to end the APP and instead simply retain the current guidance.
- It is possible that the ECB announces further liquidity providing operations in light of the ongoing Ukrainian crisis and the end of the special interest rate window of the LTROs at the end of June.
- Given elevated oil prices, the ECB is likely to present high inflation rates as external and transitory and focus on the downside risks to the economy.
- The ECB will also take into considering widening bond spreads and the drop in equity prices, which represent a tightening of financial conditions.
- New staff forecasts are likely to show an upward revision to inflation over the medium term.

SEB

- The highly uncertain impacts of the Ukrainian crisis will encourage the ECB to maintain its policy stance at the March meeting.
- No changes are expected to forward guidance on rates and the sequencing of policy normalisation.
- The ECB will state that it will safeguard liquidity conditions and will counter fragmentation risks if necessary.
- The ECB will also stress its data dependence and readiness to proceed towards policy tightening once the current uncertainty subsides.
- Expected ECB forecast revisions for GDP: 2022 (-0.5pp or even more)
- Expected ECB forecast revisions for Inflation: 2022 (raised by at least 2pp to above 5%)

Swedbank

- Swedbank argues that the ECB should not try fighting inflation with tighter monetary policy given the nature of the external supply shock which is fuelling prices.
- Even if the ECB decides to exit negative rates, asset purchases should and are likely to continue.
- Swedbank expects the APP and reinvestments to continue as previously announced. The ECB could also reiterate that purchases can be ramped up if needed.

TD Securities

- The ECB will confirm the end of PEPP at the end of March and that the APP will continue beyond then as required at a pace of EUR20bn/month.
- Updated staff macroeconomic projections are likely to show a downward revision for GDP and upward revisions for inflation in 2022 and 2023.

UBS

- Having initially expected the ECB to announce at the March meeting that it will end APP later this year, UBS now believes that this decision will be deferred until the April meeting.
- However, UBS expected the ECB to remove the language from the forward guidance indicating the possibility of policy rates being cut further (the passage referring to “or lower”).
- The ECB will also remove the hint that the APP will end “shortly” before the first rate hike. This would allow the ECB to lengthen the time between the end of the APP and the first rate hike.
- UBS’ call that the ECB will end the APP in August and hike the deposit rate by 25bp in September and December is now under review.
- Expected ECB forecast revisions for GDP: 2022 (-0.3pp to 3.9%), 2023 (-0.3pp to 2.6%).
- Expected ECB forecast revisions for inflation: 2022 (+1.8pp to 5.0%), 2023 (+0.1pp to 1.9%), 2024 (+0.1pp to 1.9%).

UniCredit

- Given the heightened uncertainty, the ECB will want to play it safe by confirming QE at EUR40bn/month in Q2 and retaining full optionality for the coming quarters.
- Normalisation of monetary policy is likely to be delayed but not derailed.
- Expected ECB forecast revisions for GDP: 2022 (-0.7pp to 3.5%)
- Expected ECB forecast revisions for Inflation: 2022 (raised to at least 5%), 2023 (raised slightly above 2%), 2024 (lowered to slightly below 2%).

Wells Fargo

- Having adopted a more hawkish tone at the February meeting, the ECB is expected to tighten monetary policy this year even as the Ukraine crisis poses downside risks to growth and upside risks to inflation.
- At the March GC meeting the ECB will keep its deposit rate unchanged at -0.50% but also indicate an accelerated tapering of bond purchases.
- Asset purchases will be conducted at a pace of EUR40bn/month in Q2 before slowing to EUR20bn/month in Q3.
- The ECB will also signal that it intends to end asset purchases in September 2022 and maintain the existing sequencing.
- An initial 25bp deposit rate increase is expected in December.

ECB Communication: The Detail

The February GC meeting proved relatively unique given the disparity between the initial policy outcome (no change) and the narrative during the subsequent press conference (notably hawkish). As we highlighted in our review of that meeting:

> The Governing Council was said to be unanimously concerned about the recent upside inflation surprises, while inflation risks have now tilted to the upside. When questioned, Lagarde failed to restate her position at the December meeting that rate hikes were unlikely in 2022 and also did not push back against hawkish market pricing. Finally, the optionality and flexibility embedded in monetary policy was stressed, with Lagarde also stating that the GC will make another assessment on inflation at the March meeting when new staff projections are available.

Subsequent communication from GC members in the aftermath of the February meeting did not stray too far from President Lagarde's message. While the ECB appeared to be gearing up for a tightening of monetary policy, the subsequent Russian invasion of Ukraine has now distorted the roadmap to normalisation as reflected in the change in tone of communication pre- and post-invasion. For now, there is no sign that the direction of travel for monetary policy has changed, but any momentum building behind a near-term tightening of policy has dissipated with policymakers now urging a period of reflection to gauge the impact of the war on economic activity and inflation.

Starting with the outlook for economic activity, President Lagarde stated on February 7:

> "The current pandemic wave and associated restrictions are likely to continue to have a negative impact on growth at the start of this year. Two other factors which we discussed at the previous hearing − namely supply bottlenecks and high energy costs − are also expected to dampen economic activity in the near term."

> "However, the economic impact of the current pandemic wave appears to be less damaging to activity than previous ones. Moreover, the aforementioned bottlenecks will still persist for some time, but there are signs that they may be starting to ease. This will allow the economy to pick up strongly again later this year."

Prior to the Russian invasion, policymakers were starting to agree on the risk of higher inflation, with even the previously staunch defenders of the 'transitory' thesis admitting that inflation would stay higher for longer.

At the more dovish end, François Villeroy de Galhau acknowledged concerns about high inflation on February 8:

> "The hump is higher and longer than expected, and is raising many questions from our citizens,"

But maintained on February 10 that inflation was close to peaking:

> "..the current level of inflation at 5.1% in the euro area and 3.3% in France is probably near the top of the hump."

Luis de Guindos argued on February 10 that while inflation would remain high in the near term, it would nonetheless subside:

> "Inflation is likely to remain elevated for longer than previously expected, but to decline in the course of this year."

However, Guindos was clear about the risks:

> "That is the central case, but there are upside risks to that outlook. Inflation could turn out to be higher if price pressures feed through into higher-than-anticipated wage rises, or if the economy returns to full capacity more quickly than foreseen."

President Lagarde offered a nuanced assessment of inflation on February 11:

> "We currently see inflation figures increasing and we are taking that into account in our projections. Inflation may turn out to be higher than we projected in December. We will analyse that in March and then take it from there."

> "Only if the wage settlements were to significantly and persistently exceed these measures could this accelerate inflation. But we are not seeing that at the moment at all. In most euro area countries, including Germany, wage demands are very moderate."

While Mārtiņš Kazāks, speaking on February 16, was less equivocal:

> "We see inflation significantly above what we saw in the past and that shifts the gravity"

Having been a leading voice behind the 'transitory' thesis, Isabel Schnabel conceded on February 9:

> "Inflation will remain high for longer than anticipated"

While also acknowledging the risks and uncertainty around the inflation outlook:

> "There is a risk that inflation continues to rise in the near term but it is likely to gradually decline toward the end of this year. There remains high uncertainty around the inflation outlook"

Speaking on February 24, it is clear that Schnabel's assessment of the inflation outlook had further evolved:

> "Today, inflation is not only higher than expected, but price pressures are also visibly broadening.

> "Measures of underlying inflation are following an unprecedented upward trend"

> "What is becoming increasingly clear is that inflation is unlikely to fall back below our 2% target this year. It may increase even further over the near term before declining gradually over the course of 2022 as energy price inflation should slow. But the decline is not going to be nearly as fast as we previously anticipated.

> "In addition, it is now becoming increasingly likely that, in the medium term, inflation will approach our 2% target from above, rather than from below."

As mentioned earlier, the Russian invasion has clouded the inflation outlook and has instilled a greater sense of caution. Mário Centeno warned on February 28:

> "..a scenario close to stagflation is not out of the possibilities that we can face. So we need to adjust our policies to that."

> "We should adjust policy carefully and recalibrate it as we see the effects of our decisions, so as to avoid suffocating the recovery"

Referencing the events in Ukraine, he added:

> "This terrible event has made the need for prudence even greater. The world has become darker, and our steps should be smaller still."

And in a potential nod to the risk of financial fragmentation:

> "The most important thing right now is for us to be ready and available to preserve financial stability"

Kazāks echoed Centeno's stagflation concerns on March 1:

> "Inflation will most likely remain higher than initially thought and of course these restrictions and higher prices will decrease economic growth"

As did Guindos on March 2:

> "It's to be expected that conflict through the macroeconomic channel and confidence and market sentiment ends up having an impact both from the point of view of higher inflation and lower economic growth in the coming weeks"

Fabio Panetta argued on February 28 that the Ukrainian crisis now demanded a period of reflection to gauge the economic impacts on the euro area:

> "The dramatic conflict in Ukraine is now weighing negatively on both supply and demand conditions, making uncertainty more acute and exacerbating risks to the medium-term inflation outlook on both sides. In this environment, it would be unwise to pre-commit on future policy steps until the fallout from the current crisis becomes clearer"

In a similar vein to the shift in sentiment with respect to inflation risks, the Russian invasion appears to have put the brakes on policy normalisation for now.

Reflecting her evolving position on inflation risks, Isabel Schnabel suggested on February 15, prior to the Russian invasion, that the ECB should consider tightening policy:

> "All of this implies that it has become increasingly likely that inflation is going to stabilize around our 2% target over the medium term"

> "This means that we should start thinking about a gradual normalization of our policy"

> "The risk of acting too late has increased and therefore we need a careful reassessment of the inflation outlook"

Olli Rehn urged a conservative approach to an eventual tightening of monetary policy, stating on February 10 that it is:

> "better to be safe than sorry, meaning monetary policy normalization needs to take place gradually and step by step"

Adding on February 12:

> "If we reacted strongly to inflation in the short term, we would probably cause economic growth to stop"

> "It's better to look beyond short-term inflation and look at what inflation is in 2023, 2024"

This view – policy normalisation, but a gradual pace – was echoed by others, including De Cos on February 8:

> "In this context of uncertainty and with medium-term inflation expectations not showing de-anchoring risks, any normalization of monetary policy must be very gradual"

De Cos stressed on February 17: that despite the clear direction of monetary policy, there was no need to overreact:

> "The direction in which we need to head is clear, but we should not draw premature conclusions as to the time frame"

> "The process will be both gradual and data-dependent"

> "The probability of inflation stabilizing at around 2% in the medium term has clearly increased"

> "I see no reason to overreact"

Meanwhile, Villeroy indicated on February 15 a potential end date for net asset purchases:

> "For me, increased optionality means that probably we should decide about an end date of the net asset purchases … And I think it could be the around Q3, but the precise point needs to be discussed"

Referring to the APP Peter Kazimir stated on February 18:

> "The risks this instrument was designed to address have subsided, while on the other hand the negative side effects are becoming more significant"

> "Trading activity weakens in August so that would be a good natural timing for ending the program."

> "Our road-map toward monetary tightening still has some blank points that represent risks, and we'll need more data that will decide whether or not a rate increase will be needed already this year"

> "I have no doubts that we're headed toward monetary tightening, but I'd advocate for a path of gradual steps."

Other GC members had been more emphatic in advocating a faster normalisation of policy, with Boštjan Vasle stating on February 18 that the ECB should be

> "…somewhat quicker at adjusting monetary measures"

While Madis Müller also suggested February 4 that the ECB:

> "may review how quickly we complete bond purchases"

> "All indications are that it's time to move in a clear direction to reduce the European Central Bank's support for the economic recovery"

Reflecting the change in tone following the Russian invasion, Robert Holzmann suggested on February 24 that the war would not alter direction of monetary policy, but could delay normalisation:

> "It's clear that we're moving toward normalizing monetary policy"

> "It's possible however that the speed may now be somewhat delayed."

Speaking on the same day, Yannis Stournaras struck a notably more dovish note:

> "Judging the situation from today's point of view, I would rather favour a continuation of the APP at least until the end of the year, beyond September, rather than bringing the end closer"

> "I wouldn't be in favour of announcing the end of APP in March

And reflecting on the war, he argued:

> "…in the medium to long term I think that the consequences will be deflationary through adverse trade effects and of course through the rise in energy prices"

While conceding on February 28 that inflation could still prove more persistent than expected, Stournaras nonetheless argued for caution:

> "If we see prospects of inflation exceeding our target in the medium term, we will act accordingly in March or later. But we will review the evidence carefully, since we do not want to repeat past mistakes of tightening too early, especially in the face of such an important supply shock like the one caused by the Ukrainian crisis"

Following the Russian invasion, Olli Rehn reiterated the need for caution on March 1 when considering normalising policy:

> “The economic recovery is relatively strong and employment is increasing. However, given the new situation, we need to take a moment of reflection as regards the speed and way of a gradual normalization of monetary policy.”
>
> “In this kind of a situation, it’s usually better to wait with your decisions until your sight clears so that you avoid doing damage”
>
> “We would risk a slowdown or even a recession in Europe if we acted in a premature manner.”

Against the backdrop of heightened uncertainty, Philip Lane again stressed on March 2 the risk posed by premature tightening:

> “Premature monetary tightening runs the risk of an economic slowdown and a reversal in the medium-term inflation dynamic, de-railing the prospects of ultimate convergence to the inflation target”

Moving beyon the inflation and policy outlooks, the issue of sequencing has also come to the fore as the ECB considers the exit from emergency pandemic measures. The official line remains that rate hikes will follow the end of net asset purchases, but this order has started to come into question. Sticking with the baseline assumption, President Lagarde stressed on February 7:

> “There is a defined sequencing between the end of our net asset purchases and the lift-off date. A rate hike will not occur before our net asset purchases finish.”

Pablo Hernández de Cos was similarly unambiguous on February 23:

> “We will not raise interest rates until the end of the net asset purchases under the PPP,”

In a speech titled “Finding the Right Sequence” on February 24, Isabel Schnabel argued:

> “While both the calibration and the time of adjustment of our policy instruments are data-dependent, the sequence with which we intend to adjust our policy stance is not.”
>
> “During such a process of gradual normalisation, the focus should be first on unwinding step-by-step the exceptional measures we took to fight low inflation, starting with net asset purchases”

And reflecting on why sequencing matters:

> “…the clear sequence with which we intend to remove monetary stimulus, if and when necessary, reduces the uncertainty about how our actions will affect financing conditions and the broader economy.”

Robert Holzmann suggested on February 24:

> "When it comes to the interest rate outlook, the ECB has always signalled that an interest rate hike should not take place until shortly after the bond purchases have ended"
>
> "But it would also be possible to take a first interest rate step in the summer before the end of the purchases and a second at the end of the year. I would favour that"

And even offered his take on what would be appropriate level for policy rates:

> "I think that a key interest rate of very roughly 1.5% in 2024 could be realistic, although that may well shift forward or backward somewhat"

> "I would like two rate hikes by the end of this year or early next year"

Finally, the issue of spread widening and fragmentation risks has cropped up. Referring to this issue on February 15, Isabel Schnabel stressed:

> "Spreads have increased, but from very low levels and they remain well below the levels that we saw in the years before the pandemic. Governments will continue to benefit from the low interest rates that we've now had over a long period of time and also from the marked increase in the maturity of public debt. Therefore, even if current bond yields adjust upwards, average interest rates on the countries' debt will stay low for an extended period of time."

While Fabio Panetta stated on February 28 that the ECB:

> "…stands ready to act to avoid any dislocation in financial markets"

ECB Inter-Meeting Communication

Date	Time	Speaker	Event
04/02/2022	16:00	François Villeroy de Galhau	Speech at an online event organised by the University of Warwick
06/02/2022	11:11	Klaas Knot	
07/02/2022	15:45	Christine Lagarde	Introductory statement at the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament (by videoconference) https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220207~7208d9e3a2.en.html
08/02/2022	08:00	Pablo Hernández de Cos	Speech on monetary policy at an event organised by Deusto Business school.
08/02/2022	17:00	François Villeroy de Galhau	Speech at the Finance Committee of the French National Assembly
09/02/2022	15:00	Isabel Schnabel	Interview on Twitter conducted and published on 9 February 2022
10/02/2022		Luis de Guindos	https://www.ecb.europa.eu/press/inter/date/2022/html/ecb.in220209~5cb6c09d90.en.html Speech: "Managing Europe's economic recovery after the pandemic" at the London School of Economics German Symposium
			https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220210~2923b1c6d4.en.html
10/02/2022	12:30	François Villeroy de Galhau	Speech at a Politico conference
10/02/2022	13:15	Philip R. Lane	Contribution to panel discussion on supply-chain disruptions

11/02/2022	08:05	Frank Elderson	Contribution to panel discussion on sustainable finance at the Finance Summit 2022
11/02/2022	11:00	Mārtiņš Kazāks	Speech on monetary policy in Riga
11/02/2022		Christine Lagarde	Interview with Redaktionsnetzwerk Deutschland conducted by Andreas Niesmann and Tim Szent-Ivany https://www.ecb.europa.eu/press/inter/date/2022/html/ecb.in220211~237298e6fa.en.html
12/02/2022	08:05	Olli Rehn	Interview for Finland's TV1
12/02/2022	10:00	Ignazio Visco	
14/02/2022	14:15	Christine Lagarde	Speech: "20th anniversary of the entry into circulation of euro banknotes and coins" at the plenary session of the European Parliament https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220214~2c44645ea0.en.html
14/02/2022		Christine Lagarde	Introductory statement at the plenary session of the European Parliament https://www.ecb.europa.eu/press/key/date/html/index.en.html
15/02/2022	17:30	François Villeroy de Galhau	Speech on monetary policy at the London School of Economics
15/02/2022		Isabel Schnabel	Interview with Financial Times conducted by Martin Arnold on 14 February and published on 15 February https://www.ecb.europa.eu/press/inter/date/2022/html/ecb.in220216~5ffb80137b.en.html
17/02/2022	08:45	Pablo Hernández de Cos	Governing Council member Pablo Hernández de Cos speaks on the ECB's new monetary strategy at Bruegel event https://www.bruegel.org/events/a-debate-on-fiscal-rules-and-the-new-monetary-s trategy/
17/02/2022	08:45	Pablo Hernández de Cos	Speech on the ECB's new monetary policy strategy at an event organised by Bruegel.
17/02/2022	14:00	Philip R. Lane	Opening remarks: Inflation in the near-term and the medium-term at MNI Market News Webcast https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220217_1~592ac6ec12.en.html
17/02/2022		Isabel Schnabel	Presentation: "Euro area inflation: causes and outlook" at a meeting organised by the Arbeitsgruppe Finanzen of the SPD-Bundestagsfraktion https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220217~d5ecda1129.en.pdf?0affca526d51c8ce7f89a861a6129e2b
18/02/2022	09:00	Boštjan Vasle	Q&A at an open day for the Bank of Slovenia
18/02/2022	18:30	Fabio Panetta	Contribution to a panel discussion on central bank digital currencies at the US Monetary Policy Forum https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220218_1~938e881b13.en.html
18/02/2022		Frank Elderson	Keynote speech: "Towards an immersive supervisory approach to the management of climate-related and environmental risks in the banking sector"

			https://www.ecb.europa.eu/press/key/date/html/index.en.html
21/02/2022	08:30	Pablo Hernández de Cos	Speech at an event organised by El Espanol newspaper
23/02/2022	07:30	François Villeroy de Galhau	Conference speech
23/02/2022	11:30	Luis de Guindos	Q&A at the event "Observatorio de las Finanzas" organised by El Español and Invertia
23/02/2022	16:00	Pablo Hernández de Cos	Speech
23/02/2022		Philip R. Lane	Interview with Frankfurter Allgemeine Zeitung conducted by Gerald Braunberger and Christian Siedenbiedel on 21 February https://www.ecb.europa.eu/press/inter/date/2022/html/ecb.in220223~6fb3349f80.en.html
23/02/2022		Frank Elderson	Contribution on the panel "Sustainable finance: what is expected from transition scenarios?" at the Eurofi High Level Seminar 2022 https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220223~7505dcf777.en.html
23/02/2022		Frank Elderson	Welcome address during a seminar presenting the ECB Opinions on the proposed regulation establishing the AML/CFT Authority, AML Regulation, the sixth AML Directive and the Funds and Crypto-assets Transfers Regulation https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220223_1~d58aaf0546.en.html
24/02/2022	16:00	Isabel Schnabel	Speech: "Finding the right sequence" at a virtual policy panel on "Unwinding QE" at the first annual Bank of England Agenda for Research (BEAR) conference https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220224~232cb567cd.en.html
25/02/2022	14:00	Christine Lagarde	Speech following Eurogroup meeting in Paris
28/02/2022	11:30	Fabio Panetta	Speech : "Small steps in a dark room: guiding policy on the path out of the pandemic" at an online seminar organised by the Robert Schuman Centre for Advanced Studies and Florence School of Banking and Finance at the European University Institute https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220228~2ce9f09429.en.html
02/03/2022	11:00	Luis de Guindos	Speech and Q&A at the National Congress of Economics Students organised by the Universidad Carlos III Student's Council
02/03/2022	16:00	Philip R. Lane	Speech: "The monetary policy strategy of the ECB: the playbook for monetary policy decisions" at the Hertie School, Berlin https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220302~8031458eab.en.html
03/03/2022	08:05	Pablo Hernández de Cos	Speech at a Swiss Finance Council virtual annual conference

MNI Policy Team

MNI SOURCES: Ukraine War To Shelve Calls For ECB Rate Hikes **1st March 2022**

MNI (London) - Russia's invasion of Ukraine is set to put an end to any talk of increasing eurozone interest rates this year even from previously hawkish officials, Eurosystem officials told MNI, as European Central Bank policymakers emphasise two-way flexibility to deal with the competing risks of an additional spike in inflation and a potential blow to output.

This month's Governing Council meeting will send a message of reassurance, one official said, while pushing ahead with plans to increase the asset purchase programme to EUR40 billion a month in the second quarter.

"They will retain and stress the flexibility in March -- probably leave the APP at 40 billion for Q2 and say events determine we stick with our course for now, but we are very aware of building two-way risks and that we retain our flexibility and can use and adjust our full range of tools as and when needed," the source said.

Until the Russian attack on Ukraine, Governing Council members had become more hawkish on inflation, with even some officials from normally dovish national central banks admitting that monetary policy might have to be tightened sooner. But the situation has now changed, sources from banks on different parts of the hawk-dove spectrum told MNI.

HIT TO GROWTH

The Ukrainian conflict could take 1% off growth, another eurosystem source said, adding that fiscal policy would be likely to stay more expansive than expected through this year and next. Bond-buying programmes, such as the pandemic emergency purchase programme, and the asset purchase programme, might still be wound down, but other measures remain in place, the source said.

"If the short-term cost is proved to be very high, monetary policy will be less tight (for example end of PEPP and APP programmes, but not touching interest rates)," he said.

The ECB is unlikely to react to any inflation surge prompted by the conflict in the Ukraine, and would provide liquidity if necessary, as MNI has previously reported. (see MNI: ECB Likely To Look Through Any Ukraine Inflation Spike) The ECB should avoid pre-committing on policy steps until the effects of the war become clear, Executive Board member Fabio Panetta said in a speech on Monday, though he added that it might be logical for the ECB to adjust its asset purchases once the crisis has abated.

"It seems that early rate hikes are no longer on the table," a third official said, adding that any discussion around changing the sequence of normalisation steps to allow rates to rise before QE ends would also be pushed back.

TWO-WAY RISKS

Conflict in the Ukraine injects great uncertainty into the eurozone economy, with some knock-on effects, including a likely increase in defence spending, adding to output, noted another official. But talk of rate rises is now clearly out of place, the official added.

"It's really senseless to discuss whether it's rate hikes in October, December or January. We don't know where we're going to be at by that point."

A spokesperson declined to comment on the matter to MNI.

MNI: ECB May Delay Hikes, Face German Wage-Price Spiral-Grimm **2nd March 2022**

By Luke Heighton

MNI (Frankfurt) - Germany faces both a wage-price spiral and a squeeze on growth, a leading government policy adviser told MNI, adding that soaring raw material costs linked to the Russian invasion of Ukraine might delay European Central Bank rate rises and force a rethink of German plans to transition to a green economy.

Inflation is likely to remain at around 5% in 2022 despite rising natural gas prices being passed on to consumers only gradually, Veronika Grimm, a member of the German Council of Economic Experts, said in emailed responses to questions. At the same time, supply shortages caused by the conflict could affect production, with car and chemical output particularly hard hit.

“Gas prices are currently at a very high level, and the situation is not expected to ease in the short term,” Grimm said. “However, wholesale price increases will only gradually be passed on to consumers. After all, many have longer-term contracts.”

Spillovers from rising prices for raw materials such as fertilisers will feed through into the cost of food, she said.

“Inflation is likely to remain high this year,” said Grimm, whose research focuses on energy markets. “We should see at least a 4 before the decimal point for 2022, more likely even a 5.”

CHALLENGE FOR ECB

Grimm’s comments echoed those of Bundesbank President Joachim Nagel, who on Wednesday indicated that annual average inflation could reach 5% in Germany and remain high in the rest of Europe. Headline average euro area inflation jumped to 5.8% in February, with Nagel calling on policymakers to “keep an eye on the normalisation of our monetary policy.”

The range of possible scenarios in Ukraine makes it difficult to estimate the negative impact on industrial production, Grimm said.

However, while growth in Germany is set to deteriorate further this year, leading to a possible delay in interest rate rises, a wage-price spiral is also “likely,” putting the ECB in a difficult position, she said. Separately, officials have told MNI that the Ukraine war would end early talk of any ECB rate hikes. (See MNI SOURCES: Ukraine War To Shelve Calls For ECB Rate Hikes)

“The situation is particularly challenging since growth will probably also be dampened. So we may end up in a phase of weak growth combined with high inflation. This will possibly lead to a delay in interest rate increases by the ECB,” Grimm said.

While one way to reduce energy dependencies would be to transition to climate neutrality faster than previously envisaged, Grimm noted that higher gas prices makes it a less attractive option in the transformation of such areas as steel production.

“If energy import prices remain at higher levels in the medium term - which is likely if we diversify energy dependencies - then a lot of things will have to be rethought,” she said.

MNI SOURCES: Brussels To Delay Decision On Fiscal Rules Return **1st March 2022**

By Les Commons

- EC May Keep Fiscal Recommendation For 2023 Budgets At Moderately Supportive

(MNI) Brussels - The EU Commission is set to delay confirming that the escape clause from the rules of the Stability and Growth Pact will end next year, even as it gives initial fiscal guidance to states on their 2023 draft budget plans Wednesday, Commission sources tell MNI.

Officials have made clear that the increased economic uncertainty arising from conflict in the Ukraine makes the outlook for growth more uncertain, although none expect recent events to lead to a full-scale recession in the euro zone.

EU Economic Affairs Commissioner Paolo Gentiloni said recently that 2023 fiscal guidance would “need to take into account the increased uncertainty”.

QUALIFICATION

As a result, one source said he expected any statement on the ending of the Escape Clause in 2023 to be qualified, with a final confirmation of deactivation maybe only coming at the time of the Commission’s Spring Forecasts due in May, when estimates of the impact of the Ukraine crisis on EU growth should be clearer.

Recent discussions among EU finance ministers before the outbreak of war in Ukraine had focused on whether the overall stance of fiscal policy should shift gear from a moderately supportive one in 2022 to a broadly neutral or moderately restrictive stance in 2023.

The increase in economic uncertainty as a result of the Ukraine crisis may lead to the EC’s 2023 fiscal guidance remaining unchanged from 2022 at moderately supportive, sources believe.

Senior Commission officials have cautioned that, while the impact of the war will certainly weigh on EU growth, the strength of the bloc’s recovery from Covid-19 and underlying fundamentals will help prevent a new recession.