

ECB Preview: March 2023

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Details:

Monetary policy decision: 13:15BST/14:15CET, Thursday 16 March 2023

Press conference: 13:45BST/14:45CET, Thursday 16 March 2023

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):

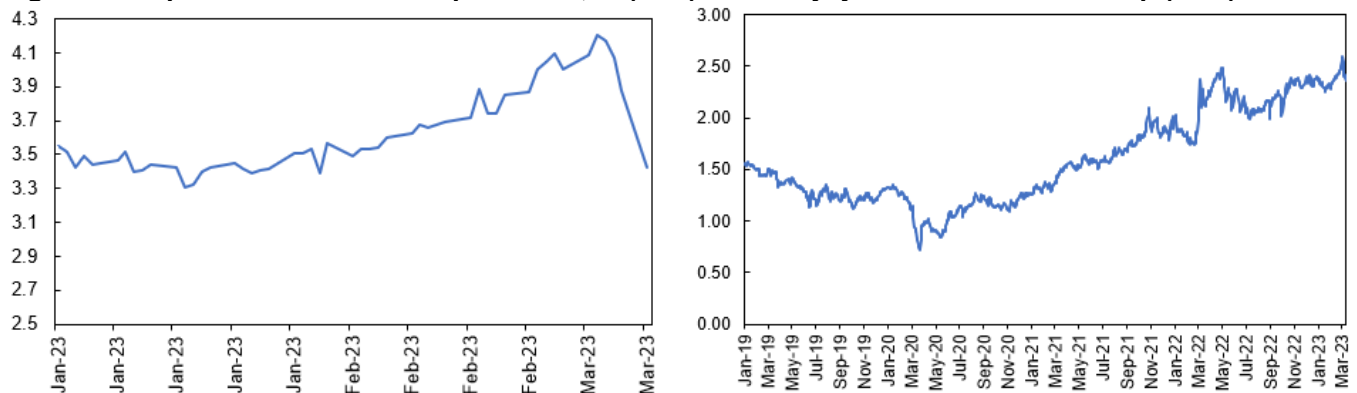
50bp March Hike Still On The Cards, Explicit Guidance For May Unlikely

- President Lagarde has strongly guided the market to a 50bp hike in March and stressed that this would happen unless an extreme scenario materialises. Clearly the failure of Silicon Valley Bank (SVB) is an extreme event.
- With the fallout of SVB ongoing at the time of writing, and the situation fluid, the ECB's prior pre-commitment for March is clearly in doubt.
- Absent any further communication from the ECB, we still expect the ECB to hike by 50bp in March given the persistence of underlying inflation and resilience of the euro area economy, but our conviction is much weaker at this point. Even if the ECB goes ahead as planned, the heightened uncertainty would preclude further explicit rate guidance beyond March.

Having pre-committed at the February ECB meeting to delivering a further 50bp hike in March, President Lagarde has repeatedly guided the market towards this outcome, with many on the Governing Council similarly echoing this guidance. In reference to another 50bp hike in March, Lagarde had also stressed "I can't think of scenarios, unless they were quite extreme, where that would not happen." The ongoing fallout from SVB could certainly qualify as an 'extreme scenario', with bank stocks selling off and EGBs rallying sharply on Monday 3th March – at one point, the

2-year Schatz yield was 60bp lower on the day. Concomitantly, market expectations of a 50bp ECB hike in March have started to pull back at the time of writing, while terminal rate pricing has retrenched from a little over 4% to around 3.1%.

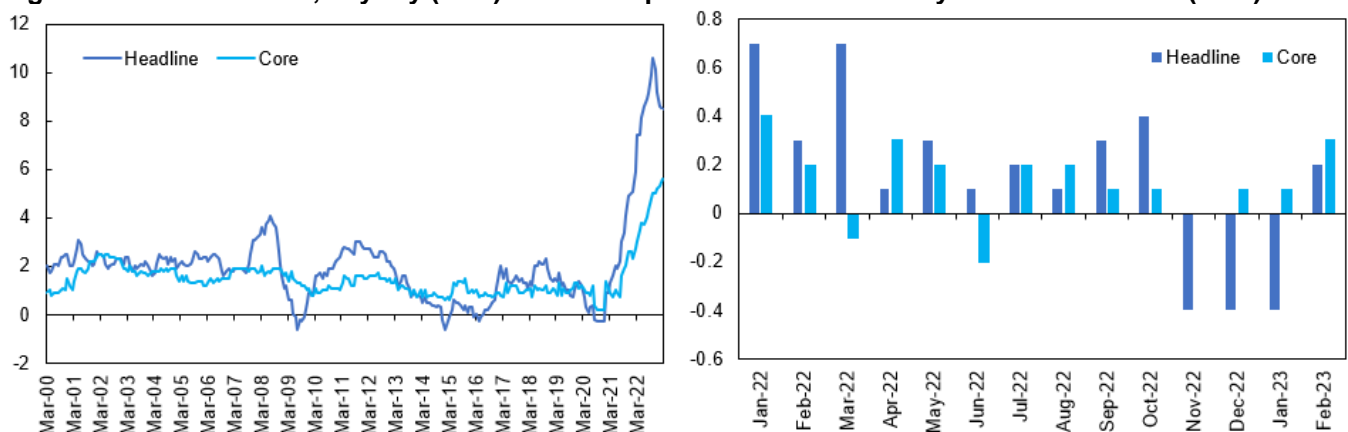
Fig 1. OIS-Implied ECB Terminal Deposit Rate, % (LHS) & EUR 5y5y Forward Inflation Swap (RHS)



Source: MNI, Bloomberg.

In light of the ongoing fallout of SVB, the ECB's prior pre-commitment for March is now looking shaky. Although our conviction is weaker at this point, we would still come down on the side of a 50bp hike at this week's meeting. While pausing the tightening cycle and awaiting more evidence on the impact of SVB on financial conditions may be the more comfortable position, the persistence of underlying inflation does not afford the ECB such luxury. Headline inflation appears to have passed an inflexion point, but core inflation continues to grind higher with no negative surprises recorded since June 2022. Although the energy price shock has subsided, the previous surge is feeding into output prices, while the euro area economy has avoided the worst case risk scenarios previously envisaged and the labour market remains historically tight – the regional unemployment rate sits at a record low of 6.6%.

Fig 2. Eurozone Inflation, % y-o-y (LHS) & Data Surprises From Preliminary Inflation Estimate (RHS)



Source: MNI, Bloomberg

The lack of evidence on inflation expectations becoming de-anchored or a wage-price spiral breaking out have previously mitigated the need for even more aggressive policy tightening. However, this will remain a risk even as headline inflation recedes given the compounding effect on the general price level. Indeed, while 2022 can be considered the year of the initial large price shock, 2023 is the year in which the shock decays but the squeeze on real incomes continues. Since the beginning of 2021 the general price level (as measured by euro area HICP) has increased by 15%, with even a small increase in prices this year providing significant fuel for wage negotiations. Moreover, while employees may have accepted the argument last year that economic uncertainty (owing in large part to the war in Ukraine and China's lockdown policies) should be factored into wage demands, the resilience of the economy and sustained squeeze on incomes may tip the balance in favour of higher wage settlements.

With these factors in mind, and given that the next (scheduled) opportunity to raise rates will be in May, it would be a big call for the ECB to not follow-through on its commitment to hike by 50bp in March. The fallout from SVB, however, will further strengthen the argument among some on the GC that the ECB should steer clear of further explicit rate guidance and instead opt for a 'data dependent' and 'meeting-by-meeting' approach.

Baseline Scenario: The ECB hikes by 50bp and signals that policy rates will rise further, without providing explicit guidance for the May meeting. The SVB crisis is seen as a significant risk event for markets, and while the ECB will be monitoring the situation carefully, it is not expected to materially impact the trajectory for inflation.

Hawkish Scenario: The ECB hikes by 50bp and either directly states that there will be another 50bp move in May, or indirectly implies it by suggesting that the March hiking pace will be maintained or that another 'significant' hike is coming. While the ECB acknowledges the impact on financial conditions from the SVB fallout, the GC stresses its concern with the core inflation trend.

Dovish Scenario: The ECB climbs down from its previous commitment to hike by 50bp and delivers a 25bp hike instead. In the most dovish scenario, the ECB keeps rates unchanged as it assesses the impact of SVB.

mni Central Bank Watch - ECB

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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	8.5	10.0	↓	9.1	↓					0.77
Core Inflation	% y/y	5.6	5.0	↑	4.3	↑					1.33
Oil Prices	\$	83.9	85.4	↓	96.5	↓					-0.81
5y/5y Inflation Swap	%	2.38	2.35	↑	1.99	↑					1.28
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	52.0	47.8	↑	48.9	↑					-0.37
Industrial Production	% y/y	-1.7	5.1	↓	2.2	↓					-1.32
Business Climate Indicator	Index	0.72	0.56	↑	0.84	↓					-0.24
Consumer Confidence	Index	-19.0	-23.7	↑	-25.0	↑					1.50
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	-0.7	3.8	↓	6.8	↓					-2.29
Broad Money (M3)	% y/y	3.5	5.1	↓	5.7	↓					-1.69
Loans to Non-Fin Corps	% y/y	5.4	8.1	↓	6.6	↓					-1.27
Loans to Households	% y/y	3.4	4.1	↓	4.5	↓					-1.84
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	-2.3	-2.5	↑	-0.8	↓					-0.90
Unemployment Rate	%	6.6	6.6	→	6.7	↓					-1.62
Labour Costs (Quarterly)	% y/y	2.9	2.5	↑	0.7	↑					0.41
Employment (Quarterly)	% y/y	1.5	3.1	↓	2.3	↓					-0.24
Markets		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Equity Market	Index	4230	3965	↑	3517	↑					1.18
Bund Yield	%	2.44	1.93	↑	1.54	↑					1.08
10y BTP Spreads	%	183.9	194.6	↓	235.2	↓					1.33
EUR TWI	Index	122.40	119.69	↑	117.68	↑					0.89

Source: MNI, Bloomberg

NOTE: The analyst views section was compiled during 6-10th March and may not reflect latest thinking on ECB monetary policy given the evolving SVB situation.

Summary of Analyst Views

- Analysts are unanimous in expecting a 50bp hike for the March meeting and believing that focus will be on the signal for the May meeting.
- Views are more mixed on whether the ECB will opt for further explicit forward guidance for May, or revert to a commitment to 'raise rates further'.
- Forecasts for the terminal rate range from 3.25% to 4.25%, with 4.00% being the most widely targeted.
- No further QT announcements are expected at this week's meeting.

Table 1: Analyst ECB Deposit Rate Forecasts

	Mar-23	May-23	Jun-23	Jul-23
Barclays	+50bp	+50bp	+25bp	+25bp*
Commerzbank	+50bp	+50bp	+25bp	+25bp
Danske	+50bp	+50bp	+25bp	+25bp*
HSBC	+50bp	+50bp		
ING	+50bp	+25bp	+25bp	
J.P. Morgan	+50bp			
Morgan Stanley	+50bp	+50bp	+25bp	+25bp
NatWest	+50bp	25*		
Nomura	+50bp	+50bp	+50bp	+25bp*
Nordea	+50bp	+50bp		
RBC	+50bp	+25bp	+25bp	+25bp*
SEB	+50bp	+50bp	+25bp	+25bp
TD Securities	+50bp	+50bp	+25bp*	
UniCredit	+50bp	+50bp	+25bp	+25bp

*Note: We have only included meeting-by-meeting policy rate forecasts where they have been explicitly presented. As such, there may be forecasts for some future ECB meetings that are missing from the table below. * Indicates explicitly stated terminal rate.*

Analyst Views

Bank of America

- The ECB is expected to hike by 50bp in March with some guidance on 50bp in May.
- A necessary condition for slowing the pace of hikes is a clear slowdown in core inflation. While this would appear unlikely for May, it may become clear by June.
- As such, BofA expects 25bp hikes in June and July, taking the deposit rate to a terminal level of 4.00%.
- Cuts are not expected until June 2024.

Barclays

- The ECB will hike by 50bp at the March meeting given that recent inflation data have validated the previous pre-commitment to such a move. Moreover, not doing so would risk fuelling more concerns about the health of the financial system and contagion from the US to the Eurozone.
- Barclays now expects the GC to offer no forward guidance on the pace of hikes for May (having previously expected a signal of another 50bp), given the numerous and important data releases between the March and May policy meetings.
- The ECB will hike the deposit rate by 50bp in March and May. Thereafter the pace of hiking will slow to 25bp in June and July.
- Barclays expects the ECB to remain on hold at 4.00% until H224 and will then cut policy rates by a cumulative 100bp.
- Expected GDP forecast revisions: 2023: 1.0% (+0.5pp), 2024: 1.7% (-0.2pp), 2025: 1.5% (-0.3pp).
- Expected inflation forecast revisions: 2023: 5.6% (-0.7pp), 2024: 3.0% (-0.4pp), 2025: 2.1% (-0.2pp).

Commerzbank

- It should be a done deal for the ECB to hike by 50bp at the March meeting.
- Commerzbank expect a further 50bp hike in May given the persistence of underlying inflation.
- Beyond May, the ECB is expected to revert to 25bp hikes until the deposit rate reaches a terminal rate of 4.00% in July.

Danske Bank

- The ECB is expected to hike by 50bp in March.
- Danske believes that the ECB will need to give some indications to markets on the expected size of the May policy rate hike, but without making an irrevocable commitment.
- Given the persistence of underlying inflation, Danske expects the end of policy rate tightening to be pushed further out.
- Following the March hike, the ECB is expected to deliver another 50bp hike in May, followed by 25bp in June and July. This would take the deposit rate to 4.00%.
- Danske believes that the risks to their projected rate hike profile are broadly balanced.
- Once the medium-term inflation outlook is in line with the target, the ECB will need to cut policy rates, not to ease monetary policy, but to keep the monetary stance unchanged. Danske expects the deposit rate to remain at 4.00% until early summer 2024 before starting a gradual rate cutting cycle.
- The H2 roll off for the APP is likely to be announced at the June meeting and Danske see scope for a complete end to APP reinvestments to be announced.

HSBC

- Given that there have not been any 'extreme events' since President Lagarde stated that she could not think of any scenarios where a 50bp hike in March would not happen (other than "quite extreme" ones), and given supportive comments from other GC members, a 50bp hike at this week's meeting seems a done deal.
- Although HSBC expects further guidance on policy rates, they doubt that it will be as explicit as it was in February. It is likely that the ECB will mention the need for "significant" rate rises, which would point to a possible 50bp move in May.
- No further announcements are expected on the APP at the March meeting.

ING

- President Lagarde's de facto pre-announcement in February, coupled with supportive discussions since then from GC members, indicate that a 50bp hike in March is a done deal.
- The focus of the March meeting will be on the steps taken after this point and how to communicate them.
- In ING's base case scenario, the ECB will hike by 25bp in May and June, after which the hiking cycle will be paused.

- If, however, the hawkish GC members remain dominant, the growth outlook improves and inflation remains stubbornly high, then the ECB could continue with 50bp hikes beyond March.

J.P. Morgan

- The ECB is expected to follow through with its 'intention' signalled in February to hike by 50bp at the March meeting, with focus turning to the forward-looking signal.
- The press statement is likely to indicate that the GC expects to raise rates further, without specifying an explicit amount. President Lagarde could indicate during the press conference that a 50bp hike is more likely than a 25bp move in May.
- No further QT announcements are expected at the March meeting. JPM believes that the ECB can wait until May before needing to signal the QT pace from July onwards.

Morgan Stanley

- The upside surprise to core inflation in February tilted the balance in favour of a 50bp hike in March.
- Furthermore, the ECB is expected to signal another 50bp hike in May.
- MS now expect a terminal rate of 4.00% on the back of the 50bp hikes in March and May, followed by 25bp hikes in June and July. The ECB will then pause the hiking cycle in September.
- MS' expectation of a longer and more aggressive hiking cycle is predicated on a higher and later peak in core inflation.
- No further announcements on APP or TLTROs are expected at the March meeting.
- May is realistically the first possible date for the ECB to announce the tapering path beyond Q223, but June is the more likely candidate. MS expects the ECB to accelerate the pace of declining reinvestments after June 2023. A decline in reinvestments of 75% in the second half of the year would set the stage for a full end of reinvestments by the end of the year.
- Expected GDP forecast revisions: 2023: 0.7% (+0.2pp), 2024: 1.7% (-0.2pp), 2025: 1.8% (unchanged).
- Expected inflation forecast revisions: 2023: 5.8% (-0.5pp), 2024: 3.6% (+0.2pp), 2025: 2.2% (-0.1pp).

NatWest

- Another 50bp hike in March is certain and warranted. Beyond March, NatWest do not think that rates needs to rise significantly further.
- They have pencilled in a 25bp hike in May, while stressing that the risks are skewed to the upside.
- Expected inflation forecast revisions: 2023: 5.7% (-0.6pp), 2024: 2.6% (-0.8pp), 2025: 2.1% (-0.2pp).

Nomura

- The ECB is expected to hike the policy rate by 50bp in March.
- Nomura believes that the ECB will want to be 'hawkish enough' to maintain tight financial conditions and to support the view that rates will be maintained higher for longer.
- Nomura expects no further information or guidance on QT at the March meeting.
- The ECB will deliver additional 50bp hikes in May and June, followed by a final 25bp hike in July.
- Nomura had previously pencilled in a 50bp hike in March followed by 25bp in May and June.
- As a result, Nomura have raised their terminal deposit rate call by 75bp to 4.25%.
- Furthermore, they have pushed out their expectation for cuts starting in July 2024 to October 2024 with the cutting cycle extended until mid-2025. They project the deposit rate reaching a trough of 2.75% by the June 2025 meeting.
- Expected GDP forecast revisions: 2023: 1.1% (+0.6pp), 2024: 1.9% (unchanged), 2025: 1.8% (unchanged)
- Expected inflation forecast revisions: 2023: 5.9% (-0.4pp), 2024: 2.7% (-0.7pp), 2025: 2.1% (-0.2pp).

Nordea

- The ECB will hike by 50bp in March and signal that this pace will be maintained at the May meeting.
- Given the conflicting views within the GC on pre-committing to future specific policy rate hikes (notably Robert Holzmann) or being data dependent (notably Ignazio Visco), President Lagarde could strike a compromise by signalling another 50bp hike in May while providing more balanced comments on the pace beyond then.
- Given current market pricing, Nordea believes that the risks are tilted towards a dovish market reaction in response to the ECB's message at the March meeting.

RBC

- The ECB is expected to deliver a 50bp hike in March in line with the guidance from February.
- RBC expect further 25bp hikes in May, June and July, which would take the terminal rate to 3.75%.
- The ECB could push against market expectations for rate cuts in 2023/2024.

SEB

- Given higher than expected inflation indicators, SEB believes that a 50bp hike at the March meeting will be combined with clear signals that another 50bp is coming in May.
- Furthermore, given the persistence of inflation, the ECB is expected to hike by 25bp in June and July, taking the deposit rate to 4.00%. At this point the ECB will shift focus to balance sheet reduction.
- While there is broad consensus on the need for further hikes, some GC members have pushed back against pre-committing to specific policy rate hikes. Philip Lane recently stressed the lags of monetary policy tightening, but SEB believes that it is premature for the ECB to emphasise this just yet.
- For the March meeting, a hawkish stance would involve signalling a 50bp hike in May, while under a dovish scenario the ECB would signal further hikes but stress that the pace will be data dependent. SEB believes the hawkish scenario will materialise as the ECB will want to avoid softening its message.

TD Securities

- The ECB is expected to hike by 50bp in March, with focus turning to the press conference and what President Lagarde could say on the direction of policy from here.
- TD expects the ECB to drop explicit guidance on future rate moves and instead indicate that it will 'raise rates further'.
- The ECB is expected to hike by another 50bp in May, with a final 25bp in June. TD notes that the risks are skewed towards another 25bp hike in July.
- Once the terminal rate has been reached, it is expected to hold until June 2024 when rates will begin to be cut at a gradual pace.

UniCredit

- The ECB will almost certainly hike the deposit rate by 50bp at the March meeting.
- Although recent inflation data tilt the balance in favour of a further 50bp hike in May, the ECB is unlikely to communicate that explicitly.
- Nonetheless President Lagarde is likely to remain hawkish and the monetary policy statement will likely assert the need to continue raising rates "significantly"
- UniCredit have revised the terminal rate forecast to 4.00% from 3.50% given that core inflation is now expected to be more persistent in the short term. Specifically, UniCredit indicate 50bp hikes in March and May followed by 25bp hikes in June and July.

ECB Communication: The Detail

Economic Outlook

Despite warnings of a marked economic slowdown on the back of the energy price shock and heightened uncertainty stemming from the war in Ukraine, the worst-case scenario has failed to materialise. Resilient demand is supportive of underlying price pressures and further raises the ante on the ECB to respond with tighter monetary policy. President Lagarde argued on February 15 that near-term activity would remain weak:

“Euro area growth slowed in the fourth quarter of 2022. The outcome was better than we had initially expected, as the adverse economic effects from Russia’s unjustified war were partly buffered by improving supply conditions and fiscal support related to the energy crisis. While confidence is rising and energy prices have fallen, we expect activity to remain weak in the near term.”

While highlighting on March 5 the improvement in the economic outlook:

“...I expect somewhat better economic growth compared with the stagnation in the last quarter of 2022.”

“The projections by ECB staff do not include a recession in 2023”

“We anticipate positive growth and increased activity over the course of the year. But it’s true there is huge uncertainty.”

Inflation Outlook

Although the inflation shock has receded somewhat, the persistence of underlying price pressures remains a concern for many on the GC. With respect to the outlook for headline inflation, François Villeroy de Galhau stated on March 1:

“According to our forecasts, inflation should reach its peak in this first half and could have halved by the end of the year.”

Madis Müller similarly highlighted on March 3 the improvement in headline inflation while also warning about the persistence of underlying inflation:

“Headline inflation started to come down toward the end of last year, mainly thanks to a decline in energy prices, and it fell to 8.5% in January. More worrying however is that core inflation has remained persistently high at more than 5%, as the underlying price pressures aren’t yet receding”

Luis de Guindos similarly highlighted the importance of underlying inflation on March 3:

“In March we’ll have some projections, we’ll have more data on the evolution of underlying inflation”

“Underlying inflation is very, very important.”

President Lagarde indicated on March 5:

“...I am confident that headline inflation will go down in 2023, while core inflation will be stickier in the near term”

Isabel Schnabel argued in more detail on the importance of core inflation on February 17:

“We are still far away from claiming victory on inflation. A broad disinflation process has not even started in the euro area. If we look at underlying inflation in particular, we are seeing that it is very high and more persistent than headline inflation. Underlying inflation developments play an important role in our thinking.”

"...the drop in energy prices is feeding into headline inflation, and eventually it will also feed into underlying inflation. The pass-through from lower energy prices to core inflation may be slower than on the way up, but eventually it is going to happen."

"...The attractor of headline inflation over the medium term is core inflation, which is why it matters so much for our monetary policy. We have defined our target in terms of headline inflation, but we know what drives headline inflation over the medium term is core inflation."

While underlying inflationary pressures are proving persistent, GC members broadly agree that there remains little evidence of inflation expectations becoming de-anchored. Mario Centeno stated on February 14:

"We are on a trajectory of reducing inflation in a sustainable way, and we don't see a de-anchoring of inflation expectations at the end of the line."

With Fabio Panetta similarly arguing on February 16:

"...so far there is no convincing evidence that inflation expectations are de-anchoring, which is a necessary condition for a wage-spiral to take hold. Survey evidence suggests that consumers expect inflation to moderate over the medium term. And longer-term inflation expectations remain firmly anchored."

Olli Rehn echoed these sentiment on February 20:

"I don't see a profound wage-price spiral so far"

"But we have to be mindful and monitor the wage development very closely. It is crucial that wages only rise so much that the competitiveness of the economy is maintained and that a wage-price spiral is avoided. Otherwise we might have to act more forcefully if necessary."

Finally, some GC members have warned that markets are potentially too sanguine on the outlook for inflation. Luis de Guindos stated on February 8:

"It might well be that financial markets are too optimistic with regard to inflation and our monetary-policy response"

"Inflation is still a reason for concern for us."

While Isabel Schnabel warned on February 17:

"Markets are priced for perfection. They assume inflation is going to come down very quickly toward 2%...That would be a very good outcome, but there is a risk that inflation proves to be more persistent than is currently priced by financial markets."

Risks To Outlook

With the energy price shock receding and the worst case scenario for the euro area economy not materialising, the risks to outlook have become more balanced, as suggested by President Lagarde on February 15:

"The risks to the growth outlook are now more balanced than they were in December. Russia's war against Ukraine and its people continues to be a significant downside risk, but a faster resolution of the energy shock would support growth. The risks to the inflation outlook have also become more balanced, especially in the near term."

Fabio Panetta also indicated on February 16:

"Key assumptions underpinning economic projections can change quickly. In fact, recent surveys and the latest European Commission forecast see headline inflation significantly below our December projections for 2024. And risks have become more balanced."

"In my view, even though we need to be cautious as energy prices are highly volatile, recent developments in energy markets have made the risks surrounding the inflation outlook more balanced."

Mario Centeno similarly concurred on February 13:

"Given what was in the outlook in December, risks now are at least much more balanced and I don't see upside risks to inflation"

"There's a big 'if' here, which is if no further shocks occur."

The Need For Further Policy Normalisation

While opinions differ on the amount of additional policy rate hikes required to return inflation to target, there is little doubt that further policy normalisation is still required. President Lagarde stated simply on March 5:

"I cannot tell you how high rates will go"

"I know that they will be higher than they are now and we still have more work to do because we cannot declare victory. We are making progress, but we still have work to do."

Peter Kažimír had previously stressed on February 3:

"The fight against inflation is far from won"

A sentiment shared by Boštjan Vasle on February 3:

"Additional interest rate hikes will be needed if we want to curb inflation this year"

Vasle added on February 6:

"For the time being, we are firmly determined to continue with the increases"

Even at the more dovish end of the GC, Ignazio Visco stated on March 1:

"There's no question that the tightening of the euro-area monetary stance must continue to ensure that a temporary increase in inflation caused by a supply shock doesn't become a more persistent phenomenon sustained by demand factors"

The more hawkish policymakers remain particularly concerned about the risk of not doing enough to tame inflation. Joachim Nagel stated on February 7:

"If we let up too soon, there's a great danger that inflation becomes sustained"

"From my perspective today, more significant rate increases will be needed."

Adding on February 9:

"A resolute response of monetary policy is needed to prevent the risk of an unanchoring of long-term inflation expectations,"

"We sent a clear signal for March"

"Beyond that, we should stick to our course. We'll get new projections that may offer a clearer picture. But there's one cardinal sin and that's letting up too soon. I'd like to avoid that for the euro zone."

Robert Holzmann similarly argued on February 6:

"The risk of over-tightening seems dwarfed by the risk of doing too little"

“Monetary policy must continue to show its teeth until we see a credible convergence to our inflation target.”

While Madis Müller indicated on March 3:

“It’s most likely this won’t be the last rate rise in this cycle”

“It’s quite possible that interest rates will need to stay high for quite some time so that we can be sure that inflation will come back to, and remain at, close to 2%.”

“If we hesitate, we may later have to raise interest rates much higher, and keep them high for much longer, in order to get inflation down to the target of 2% and to keep it there”

Pierre Wunsch argued on March 3:

“If we don’t get clear signals that core inflation is going down, we’ll have to do more”

“That means “looking at rates of 4% would not be excluded”

“But I want to insist, I won’t make any judgment on where rates would have to go without seeing developments in core inflation.”

With respect to the policy rate level, Gabriel Makhlouf indicated on February 14:

“I could see it being higher than 3.5%”

“I’m open to acting forcefully to get inflation down to our target”

The March Meeting

Expectations of a 50bp hike in March have been firmly embedded among the analyst community largely as a result of several GC members confirming President Lagarde’s prior commitment to such a move. Having announced the ECB’s intention to hike by 50bp in March at the February meeting, Lagarde confirmed on February 15:

“In view of the underlying inflation pressures we intend to raise interest rates by another 50 basis points at our next meeting in March, and we will then evaluate the subsequent path of our monetary policy.”

And further stressed on February 26:

“There’s every reason to believe that we’ll do another 50 basis points in March”

“After that, we’ll see. We’re data dependent.”

By March 5, there had been no change in Lagarde’s position:

“It is very likely that we will raise interest rates by 50 basis points”

High level support came from Isabel Schnabel on February 17:

“Given the current level of policy rates and the level and persistence of underlying inflation, a rate hike by 50 basis points is necessary under virtually all plausible scenarios in order to bring inflation back to 2%. There is no inconsistency between our principle of data-dependency and these intentions because it is very unlikely that the incoming data is going to put this intention into question.”

And Philip Lane on February 28:

“Our assessment of December remains solid, that we needed a sequence of 50 basis point hikes to bring us inside a zone where we would need to think harder about whether rates are sufficiently restrictive to deliver

the return of inflation to 2%. The data flow since then suggests that the assessment is solid, that we need another 50 basis points in March."

Joachim Nagel spoke in terms of 'robust' rate increases on February 24:

"I expect a robust rate increase in March"

"I don't exclude that further significant rate hikes may be needed beyond March"

Mārtiņš Kazāks, meanwhile, appeared to support the baseline assumption while also opening the door to other possible rate moves in the even of a material change in the data, stating on February 6:

"If the incoming data meets the ECB Council's current expectations then the rates will be raised by 50 basis points in March."

"If however the incoming data will significantly differ from what is currently expected by the March meeting, the decision may also be changed."

Beyond March

Most of the commentary that we have seen from policymakers indicate a belief that further tightening is required beyond March, but that more data is needed before determining the size of subsequent hikes. The pool of hawks publicly pushing for specific rate hikes at subsequent meetings has noticeable shrunk.

Philip Lane indicated on March 6:

"The current information on underlying inflation pressures suggests that it will be appropriate to raise rates further beyond our March meeting, while the exact calibration beyond March should reflect the information contained in the upcoming macroeconomic projections, together with the incoming data on inflation and the operation of the monetary transmission mechanism."

Olli Rehn similarly suggested on February 20 that further hikes were needed, but stopped short of making any explicit calls:

"With inflation so high, further rate hikes beyond March seem likely, logical and appropriate."

Gabriel Makhlouf similarly stated on February 14:

"We announced our intention that there will be a further increase in the March meeting."

"I expect us to increase interest rates after the March meeting."

Peter Kažimír indicated on February 3:

"I think the March increase will not be the last. We will decide how many more will be needed afterward"

Mārtiņš Kazāks added on February 8:

"It's natural to expect rate increases will slow to smaller increments, but we're not there yet"

"I'm very aligned with the 50 basis-point increase in March and after March I don't see a reason to take a pause or stop rate increases."

Klaas Knot appeared open to the possibility of maintaining the March hiking pace, **stating on February 8 during a webcast organised by MNI:**

"I consider it highly unlikely that the March hike will be our endpoint."

“And if underlying inflation pressures do not materially abate, maintaining the current pace of hikes into May could well remain warranted.”

A sentiment seemingly shared by Joachim Nagel on March 1:

“One thing is clear: the interest-rate step announced for March will not be the last. Further significant interest-rate steps might even be necessary afterwards, too.”

Robert Holzmann has maintained a notably hawkish position and spelled out his explicit view on the trajectory for policy rates on March 6:

“I assume that core inflation will not weaken significantly in the first half of the year and will remain around the current level.”

“In that case, I expect we’ll hike rates by half a percentage point four more times this year.”

“Even if we now raise interest rates three times by 0.5 percentage points, we are only at a deposit rate of 4%”.

“Only there would we roughly get into the restrictive area.”

At the opposite end of the spectrum, Fabio Panetta indicated on March 8 a preference for smaller policy rate adjustments beyond March:

“With rates now moving into restrictive territory, it is the extent and duration of monetary policy restriction that matters.”

“By smoothing our policy rate hikes — that is, moving in small steps – we can ensure that we calibrate both elements more precisely in the light of the incoming information and our reaction function.”

Restrictive Territory & The Terminal Rate

There is broad support for moving policy rates into restrictive territory, with some slight divergence of views as to when this will occur.

Reflecting on the need to raise policy rates to restrictive levels, Philip Lane argued on March 6:

“The current information on underlying inflation pressures suggests that it will be appropriate to raise rates further beyond our March meeting, while the exact calibration beyond March should reflect the information contained in the upcoming macroeconomic projections, together with the incoming data on inflation and the operation of the monetary transmission mechanism. By bringing the key policy rates to a sufficiently restrictive level and fostering a period of below-trend growth through the dampening of demand, we will counter-act above-target medium-term inflation pressures and also ensure that the prolonged phase of above-target inflation does not become embedded through a de-anchoring of inflation expectations. In particular, the dampening of demand through the tightening of monetary policy means that price setters and wage setters are on notice that excessive price and wage increases will not be sustainable.”

Isabel Schnabel indicated on February 10:

“Rates must reach a sufficiently restrictive level. We need to see that our policies are being transmitted to the economy”.

“We’ll keep rates high until we see robust evidence that underlying inflation returns to our target in a timely and durable manner.”

President Lagarde stated on February 15 that restrictive levels for policy rates would be needed to prevent inflation expectations from becoming de-anchored:

“Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations. Our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.”

A view supported by Constantinos Herodotou on March 7:

“Keeping interest rates at restrictive levels will over time reduce inflation and will guard against the risk of inflation expectations becoming de-anchored.”

Boštjan Vasle stated on February 6:

“With core inflation persisting at such high levels, it’s clear rates will have to be moved into a restrictive zone”

Mārtiņš Kazāks stressed on February 8 that restrictive levels would persist:

“We’ll raise rates significantly into restrictive territory and we’ll keep them there for quite some time”

When restrictive levels will be reached is unclear. Mario Centeno suggested on February 13 that this could occur soon:

“For sure we’re much closer to that terminal rate than before”

“We are approaching it and I think March will be a great moment for us to be very clear about it.”

Adding on February 14:

“...it’s quite important to convey a message that while tightening will be with us for quite some time, at some point interest rates will converge to the neutral rate. That’s the anchor.”

Olli Rehn indicated on February 20:

“I assume that we will reach the terminal rate in the course of the summer.”

While François Villeroy de Galhau similarly suggested on March 1:

“It seems to me desirable to reach this terminal rate by the summer, that is to say by September at the latest”

Klaas Knot stated on February 8 that once restrictive territory is reached:

“the more important it becomes to fine-tune our actions.”

“Once we see a clear and decisive turn in underlying inflation dynamics, I therefore expect us to move to smaller steps,”

“But absent such a turn, the ECB will continue to stay the course on its steady pace upwards, in pursuit of price stability.”

Data Dependency Vs Pre-Committing

While further policy hiking and moving rates into restrictive territory is a view broadly shared across the GC, there is some disagreement on whether the ECB should be strictly data-dependent and adopt a meeting-by-meeting approach, or provide explicit forward guidance to the market on planned rate moves.

Fabio Panetta argued on February 16:

"..the ECB should not unconditionally pre-commit to future policy moves. Instead, we need to calibrate our monetary policy in a way that is data-dependent, forward-looking and adaptable to changing developments.

And following Robert Holzmann explicit call on March 6 for four additional 50bp hikes this year, Ignazio Visco stated on March 8:

"Uncertainty is so high that the Governing Council of the ECB has agreed to decide 'meeting by meeting', without 'forward guidance.'"

"I therefore don't appreciate statements by my colleagues about future and prolonged interest rate hikes."

Quantitative Tightening

Mirroring the dovish-hawkish split on the pace of policy rate tightening after March, views on the speed of quantitative tightening similarly differ. At the more hawkish end, Joachim Nagel indicated on March 1 he was:

"...in favour of taking a steeper path of reduction starting in July in light of experience gained up to that point"

Robert Holzmann argued on March 6 that in order to reduce the balance sheet to:

"...a reasonable level, we'll probably have to be somewhat more aggressive"

Fabio Panetta, however, has been in favour of a more gradual approach, stating on February 16:

"We also need to ensure consistency across our tools. It is natural to normalise the size of the balance sheet in a tightening phase, thereby making it "push" in the same direction as our interest rate policy. But we are in unprecedented territory, and the pace of normalisation should be gradual and prudent, with rates remaining the key instrument to steer our monetary stance. There is little reliable experience of balance sheet tightening. It is hard to assess how a contraction of our balance sheet will affect bond markets and financial stability – especially if it happens in conjunction with an abrupt increase in interest rates."

ECB Inter-Meeting Communication

Date	Speaker	Event
02/02/2023	Christine Lagarde	Speech at the Franco-German Business Awards 2023 in Paris
03/02/2023	Ignazio Visco	Speech
04/02/2023	Ignazio Visco	Speech
06/02/2023	Robert Holzmann	Lámfalussy Lecture for the event "New Dimensions of Central Banking in the Post-Covid Era" https://www.mnb.hu/en/lamfalussy/programme
07/02/2023	Peter Kažimír	Speech at the Climate and Sustainability Risks and opportunities conference at the National Bank of Slovakia. https://nbs.sk/o-narodnej-banke/konferencie-a-podujatia/climate-and-sustainability-risks-and-opportunities/
07/02/2023	Klaas Knot	Speech at the Climate and Sustainability Risks and opportunities conference at the National Bank of Slovakia.

<https://nbs.sk/o-narodnej-banke/konferencie-a-podujatia/climate-and-sustainability-risks-and-opportunities/>

07/02/2023	François Villeroy de Galhau	Speech
07/02/2023	Isabel Schnabel	Speech "Monetary policy in times of pandemic and war" at Webinar Finanzwende https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230207~e3ac4b6b62.en.pdf?e162a4bfd461d465b381e90bc71386d2
08/02/2023	Luis de Guindos	Interview with Süddeutsche Zeitung conducted by Markus Zydra and Meike Schreiber https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230208~028be3e58d.en.html
08/02/2023	Frank Elderson	ECB Banking Supervision press conference covering the 2022 SREP results https://www.youtube.com/watch?v=PYZF0w47dJs
08/02/2023	Klaas Knot	Participation in MNI Webcast covering the eurozone economic and inflation outlook https://www.youtube.com/watch?v=4jXhvdNJ_Ao
09/02/2023	François Villeroy de Galhau	Keynote address: "Big Techs in Finance: A Bildungsroman That Is Far From Over" for the Big Techs in Finance Conference organised by the BIS https://www.bis.org/events/confresearchnetwork2302/overview.htm
09/02/2023	Joachim Nagel	Speech on energy prices and inflation at the University of Hohenheim. https://www.bundesbank.de/de/presse/presstetermine/digitaler-uro-fuer-eine-digitale-wirtschaft-deutsche-bundesbank-hauptverwaltung-in-sachsen-und-thueringen-903060
09/02/2023	Pablo Hernández de Cos	Speech 'Dialogues with the Governor of the Bank of Spain on the Future of Globalisation' at the London School of Economics and Political Science https://www.bde.es/bde/en/secciones/prensa/Agenda/pablo-hernandez-de-cos--%E2%80%9Cdialgues-with-the-governor-of-the-bank-of-spain-on-the-future-of-globalisation%E2%80%9D.html
09/02/2023	Luis de Guindos	Speech at the Foro Economía y Humanismo organized by Instituto Karol Wojtyła in Madrid
10/02/2023	Isabel Schnabel	Q&A on Twitter conducted and published on 10 February 2023 https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230210~349b6691b9.en.html
10/02/2023	Pablo Hernández de Cos	Speech at Warwick Economic Summit. https://www.warwickeconomicssummit.com/
11/02/2023	Ignazio Visco	Speech at Warwick Economic Summit. https://www.warwickeconomicssummit.com/
13/02/2023	Klaas Knot	Speech at the Dutch Parliament
13/02/2023	Mario Centeno	Speech "Surging Inflation and War - Challenges and new Approaches to European Monetary Policy" for the 22nd German Symposium organised by the London School of Economics and Political Science https://www.germansymposium.co.uk/agenda
14/02/2023	Gabriel Makhlouf	Participation in the discussion 'Has Europe Moved Beyond Financial Fragility?' in Berlin

15/02/2023	Isabel Schnabel	Interview with Bloomberg conducted by Jana Randow and Alexander Weber on 15 February 2023 https://www.ecb.europa.eu/press/inter/date/2023/html/in230217~936be841f2.en.html
15/02/2023	Christine Lagarde	Speech "European Parliament plenary debate on the ECB Annual Report" at the plenary session of the European Parliament https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230215~a512d68d9f.en.html
16/02/2023	Fabio Panetta	Speech "Fabio Panetta: Monetary policy after the energy shock" at an event organised by the Centre for European Reform, the Delegation of the European Union to the United Kingdom and the ECB Representative Office in London https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230216~a297a41feb.en.html
16/02/2023	Joachim Nagel	Speech 'Use Europe's Opportunities: Reforms For More Prosperity and Stability' in Berlin.
16/02/2023	Philip Lane	Dow Lecture "Philip R. Lane: The euro area hiking cycle: an interim assessment" at the National Institute of Economic and Social Research https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230216_1~f8cf2cd689.en.html
16/02/2023	Gabriel Makhoul	Speech at London School of Economics & Political Science
16/02/2023	Yannis Stournaras	Speech at a Greek-Deutsche Chamber of Commerce event in Athens.
17/02/2023	François Villeroy de Galhau	Speech on monetary policy and inflation in Paris
21/02/2023	Christine Lagarde	
23/02/2023	Pablo Hernández de Cos	Speech for the Economic Affairs Commission at the Spanish parliament.
24/02/2023	Joachim Nagel	Speech during a G-20 meeting in India. https://www.bundesbank.de/de/presse/pressetermine/treffen-der-g20-finanzenminister-und-notenbankgouverneure-863316
25/02/2023	Christine Lagarde	Interview with Helsingin Sanomat conducted by Petri Sajari https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230225~043f187a63.en.html
27/02/2023	Christine Lagarde	Interview with The Economic Times (India) conducted by M.C. Govardhana Rangan on 24 February 2023 https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230227~7c09d930f7.en.html
27/02/2023	Pablo Hernández de Cos	Speech for the event "Adapting to a Changing World", organised by the EIB. https://events.eib.org/event/4d89be85-4a2c-476c-8d4e-820910f51498/websitePage:9d6d23f5-8634-48e3-8c4b-76df9051f068
27/02/2023	Philip Lane	Presentation "Macro-Financial Stability in the EU: Some Lessons on the occasion of Fifty Years of Irish Membership of the EU" at the Lecture organised by the Consulate General of Ireland and Goethe Universität in Frankfurt https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230227~7c5d976edb.en.pdf?b02716011db4515f9128ea180c2a3003

28/02/2023	Philip Lane	Interview with Reuters conducted on Friday, 24 February 2023 by Balázs Korányi and Frank Siebelt https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230228~c78d1f2ca5.en.html
28/02/2023	Boris Vujčić	Speech for the event "Adapting to a Changing World", organised by the EIB. https://events.eib.org/event/4d89be85-4a2c-476c-8d4e-820910f51498/websitePage:9d6d23f5-8634-48e3-8c4b-76df9051f068
01/03/2023	Philip Lane	Interview with IMF Finance and Development magazine conducted by Nicholas Owen https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230301~0bb220670c.en.html
01/03/2023	François Villeroy de Galhau	Speech at the Finance Committee of the French National Assembly
01/03/2023	Joachim Nagel	Presentation of the Bundesbank Annual Report
01/03/2023	Ignazio Visco	Speech on 'Monetary Policy and the Return of Inflation' at the Frankfurt School of Finance & Management
02/03/2023		Account of the February ECB Policy Meeting
02/03/2023	Isabel Schnabel	Speech "Quantitative tightening: rationale and market impact" at Money Market Contact Group (MMCG) https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230302~41273ad467.en.html
03/03/2023	Robert Holzmann	Speech at the workshop event "The Measurement of Augmented Wealth: Concepts, Methods and Results" organised by the Austrian National Bank
03/03/2023	Luis de Guindos	Speech and Q&A at Colegio Universitario de Estudios Financieros (CUNEF) in Madrid. https://www.youtube.com/watch?v=jy-ZHFL_KG0
03/03/2023	Boštjan Vasle & Madis Müller	Speech "Why is Inflation So High and So Different in Different Euro Area Countries?" in Ljubljana. https://www.bsi.si/en/media/1997/zakaj-je-inflacija-visoka-in-tako-razlicna-med-drzavami-evrskega-obmocja
05/03/2023	Christine Lagarde	Interview with Grupo Vocento conducted by Adolfo Lorente, from El Correo https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230305~77055ddd44.en.html
06/03/2023	Philip Lane	Lecture "Underlying inflation" at Trinity College Dublin https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230306~57f17143da.en.html
07/03/2023	Pablo Hernández de Cos	Participation in the III Observatorio de las Finanzas de El Español in Madrid
08/03/2023	Ignazio Visco	
08/03/2023	Christine Lagarde	Speech "Empowering women in a changing global economy" at the International Women's Day event organised by World Trade Organization (WTO) in Geneva https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230308_1~daa5630397.en.html

08/03/2023	Fabio Panetta	Introductory remarks "The Quick and the Dead: building up cyber resilience in the financial sector" at the meeting of the Euro Cyber Resilience Board for pan-European Financial Infrastructures https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230308~92211cd1f5.en.html
09/03/2023	Boris Vujčić	Participation in the lecture "Introducing the €uro in Times of High Inflation: The Case of Croatia" organised by the ICMB https://www.cimb.ch/public-lectures.html
09/03/2023	Boris Vujčić	Participation in the event "Introducing the €uro In Times of Inflation: The Case of Croatia" organised by the Geneva Graduate Institute. https://www.graduateinstitute.ch/communications/events/introducing-euro-times-inflation-case-croatia
10/03/2023	Fabio Panetta	Presentation "Digital euro – a work in progress" at the European Banking Federation Executive Committee Meeting https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230310~f9a6d3e362.en.pdf?90d60e3a243c4feadaf1ff23e3de6a9e

MNI Policy Team

MNI SOURCES: ECB Clings To 50Bp Hike Plan Amid Market Turmoil

13th March 2023

(MNI) London - The European Central Bank hopes to push ahead with its plans to hike by 50 basis points in line with its guidance on Thursday despite the collapse of U.S. bank SVB and sliding market rate expectations, eurosystem sources told MNI, though they acknowledged that a more cautious outlook will be required for the future rate path.

"There is still time until Thursday. In general it's always better to stick with what you said if you can," one official at a national central bank said.

Only one official told MNI he thought it was possible the ECB would step down to a 25-bp hike on Thursday, though all acknowledged that SVB's collapse raised questions about the rates path for future meetings.

OIS futures implied a rise in the deposit rate from its current 2.5% to 2.731% as of Monday afternoon, down from 2.89% a week earlier. Peak rate expectations slid from almost 4% in October last week to around 3.2%.

"Regarding Thursday, it doesn't change a lot but we could see a significant difference in the guidance," one source said. Another said there did not appear to be any reason to back down from the 50-bp guidance yet, adding though that "I'm sure a fuller docket will be presented to us when we gather."

There were currently no plans for additional meetings ahead of Thursday's Governing Council, the second official said.

CREDIBILITY ON LINE

Another official agreed.

"If ever something is changed it is not the 50 basis points, for now," the official said, though the same might not be true for other policy meetings going forward. "Depending on what the analysis will show, if there is a clear link between rates increases and issues in banks' balance sheets that could happen also in Europe, then perhaps they will say, 'Be more careful.' But that doesn't mean that they will say, 'Oh, let's stop,' If inflation is still too high."

One official, though, thought the ECB could slow down, though he acknowledged that only going ahead with a 25-basis-point increase would be negative for its credibility.

"I guess they will pick up the 25, and say ...will wait and see," the official said.

But other Eurosystem officials were in the 50-camp.

"It's a specialised bank. It's not that big," said one. "A Central Bank isn't here to protect bets by banks," one said.

A former senior official pointed out that hiking by less than the 50 basis points guided could point to concerns about the eurozone financial system

"I guess they will go for 50 and be very careful about communication on future rate guidance," the former official said.

An ECB spokesperson had no comment on whether the ECB would depart from its guidance.

MNI SOURCES: 100bp Gap Between Hawk-Dove ECB Peak Rates**10th February 2023**

(MNI) London - Hawkish European Central Bank officials want to push rates higher than 4% this year, but doves see the cycle peak as much as 1 percentage point lower, and are preparing to argue for a slowdown in hikes in May after what is likely to be another 50-basis-point increase in March, Eurosystem sources told MNI.

While Dutch central bank chief Klaas Knot argued in [an MNI Webcast](#) this week for considering a further 50 basis points in May if necessary, and could find hawkish support, others will point to the need to balance the risks of inflation with those to growth as energy prices slide, and highlight the four significant inflation data releases between now and the June meeting. This data, together with the ECB's March projections, will be key in deciding a potential downshift to a 25-basis-point increment in May, said one highly-placed source at a national central bank.

While some national central banks want to see more than 150 basis points in additional hikes, the centre of gravity in the Council would probably favour a peak rate somewhere between 3% and 3.5%, said the source. Another, with links to one of the more hawkish banks agreed that resistance to taking the deposit rate above 3.5% would be significant.

HIGH FOR LONGER

Several sources emphasised that once the peak is reached that rates could stay there for longer than markets anticipate.

While markets focus on the peak rate, the amount of time that this rate is kept unchanged after being reached is even more important for the economy, another senior official said.

In its February decision, the Governing Council indicated it would raise interest rates significantly at a steady pace and then keep them at levels that are sufficiently restrictive to ensure a timely return to its inflation target.

Forward rates pricing currently indicates that the deposit rate will top at around 3.5% by September, before drifting 10 basis points lower by the end of the year.

"I don't think we go above 3.25% and I certainly can't see anything that, as a collective, pushes us above 3.5%," one source said. "If neutral is 2%, that's 150 basis points of restriction," he said, noting that this would be the tightest setting for ECB monetary policy for decades on that measure. It was even possible the ECB could decide to pause hikes in May, another source from the same bank added.

Sources were agreed that only a significant surprise would blow the ECB off course from 50 basis points in March, and most agreed that a subsequent stepdown to 25 basis-point-increments was likely, but few foresaw much likelihood of a pause. A pause in May could only occur if there was a far greater decline in inflation than expected, one source said.

A more hawkish source saw continuing rapid hikes.

"It could be possible that they will end in summer alongside the Fed, depending on developments in core inflation. That's not a totally unrealistic scenario - a rate of about 4%, remaining for a period of time until core inflation goes down," the source said.

The ECB will be concerned to monitor any signs of accelerating wage growth, and will also be wary of inflationary effects of China's reopening after Covid restrictions, said a former senior banker, predicting that once the peak was attained rates would stay unchanged at least for the rest of 2023.

INFLATION TO SLIDE

For now base effects and much cheaper gas are set to feed through into inflation data.

"Inflation will really start to drop significantly after March and maybe the whole narrative will begin to shift. It will start to be clear between March and June," said another source, who argued that the ECB has already reached the stage at which the risks of doing too much balance those of doing too little.

A clearer outlook will also reduce market uncertainty over the messaging from the ECB, which has both indicated it intends to hike by 50 basis points in March and that decisions are taken on a meeting-by-meeting basis. (See [MNI INTERVIEW: ECB Could End APP Reinvestments In Q3 - Kazaks](#))

"I think the divisions are bigger than before but we are clearly in the same boat," the source said. "The manner of referring to both a meeting-by-meeting approach and providing guidance tries to balance this. I think we are in a very delicate moment but as long as the picture clears up in the next months uncertainty will decrease and we won't seem contradictory."

An ECB spokesperson declined to comment.

MNI EXCLUSIVE: ECB Change Risk Collateral Squeeze – DMOs**17 February 2023***By Luke Heighton*

(MNI) LONDON - Further cuts to remuneration on government deposits at the European Central Bank risk a return of last year's collateral shortages, two Eurosystem debt management offices told MNI, although concerns over a near-term "cliff edge" were offset by a belief that further changes will likely proceed gradually, giving markets time to adjust.

Last week the ECB [set a ceiling](#) for remuneration at the euro short-term rate (€STR) minus 20 basis points from May, saying it would allow for an orderly reduction of such deposits - with policymakers adjusting the regime "as necessary."

Any further remuneration rate reductions will affect liquidity of short-dated securities, an official at one eurozone national Treasury said. This could prompt a scarcity of collateral similar to that seen before ECB's September announcement that it would pay government deposits at €STR, the official said, adding that there could also be implications for issuance.

Concerns over collateral were echoed by the Dutch State Treasury Agency, which said in a response to written questions that it had measures in place to ensure the liquidity of Dutch State Loans (DSLs) and Dutch Treasury Certificates (DTCs) if required.

"We provide liquidity to primary dealers by lending DSLs and DTCs against cash on an overnight basis if these primary dealers are not able to get these securities in the market," a spokesperson said. "The DSTA serves as a lender of last resort in these circumstances."

ISSUANCE PLANS

A spokesperson for the ECB told MNI "the Governing Council will continue to monitor money market developments and the evolution of these deposit holdings, and it stands ready to make further adjustments to the remuneration regime if necessary."

The first Treasury official was also concerned that any further decrease in remuneration could force his country to consider adjusting issuance of bonds and bills, introducing an element of unpredictability into funding plans. Other officials, though, saw no impact on issuance and stressed that the effect on collateral would be mitigated by the gradual nature of the ECB's moves.

"In the short term, it should help avoid any tensions on collateral," Spain's Director General of the Treasury and Financial Policy Alvaro Lopez Barcelo told MNI, though he expressed less certainty when asked the potential effect on collateral availability of further cuts to the remuneration rate on collateral.

"In the medium term, it's difficult to predict what effects a gradual fall in the remuneration rate will have on collateral," Lopez Barcelo said, "because there are many other factors at play."

Spanish issuance plans are unlikely to be affected, he said.

"As the year progresses and we have more clarity on the final funding needs, we can adjust our issuance, but we try to avoid drastic cuts to our funding needs, to maintain predictability and continue providing liquidity to the Spanish government debt market," said Lopez Barcelo. "If some of the risks we have planned for don't materialise, we end up with higher cash reserves."

Spain will continue its move of recent years to reduce its bill issuance in 2023, with negative issues of EUR5 billion of Letras del Tesoro, he said.

"We don't think that it's desirable to use the net issuance of Bills as a means to manage our cash reserves during the year for two reasons," Lopez Barcelo said. "On the one hand, we have already made substantial reductions to our outstanding Bills portfolio, and if we make large cuts to our issuance of Bills, it could damage the liquidity of our short-term securities. On the other hand ... we want to be predictable and stable in our issuance pattern and provide liquidity to our Bills program throughout the year."

The managing director of Austria's OeBFA, Markus Stix, said it had been preparing for such a move from the ECB since September 2022,

"The announcement of the new rate at this stage increases the predictability and therefore is helpful for the market," Stix said, "Overall, a gradual approach will reduce the likelihood of market distortions."

The Dutch Treasury spokesperson also reported no change to issuance of cash management plans.

MNI INTERVIEW: ECB Peak Rate Likely 3.5-3.75% - Gerlach

9th March 2023

By Luke Heighton

(MNI) LONDON - The European Central Bank is likely to raise its deposit rate to no more than 4% in a trade-off between hawks wanting to hike further and more dovish officials preferring a lower peak but to maintain it for much longer, former Central Bank of Ireland deputy governor Stefan Gerlach told MNI.

Despite recent hawkish remarks from some national central bank governors, a terminal rate of only 3.5% remains possible, Gerlach said, with the deposit rate increased by 50bps to 3% in March followed by two 25bp hikes in May and June. While hiking above 4% is on the table, this could prove prohibitively risky for a majority of Governing Council members, with a peak of 3.75-4% the most likely hawkish outcome, he said in an interview, in which he also pointed to a 50bp hike by the Swiss National Bank later this month. (see [MNI INTERVIEW: ECB Likely To Be Forced To Support Bond Markets](#)).

"There is a trade-off. If the ECB raised interest rates significantly above 4%, they wouldn't have to keep them there for a long time for the economy to slow. If they kept them at the current level they would have to wait quite some time. So there is a choice. Do you want to have a brief shock treatment, or a more gradual lowering of inflation?" said Gerlach, now chief economist at Zurich-based EFG Bank.

ACCUMULATED TIGHTENING

While evidence has so far been patchy of the effect of accumulated tightening on growth, unemployment, and property markets, despite the ECB having raised rates "sharply and quickly" and talked tough on inflation, Gerlach said this may be about to change.

"There is a fair chance that as time passes the impact of higher interest rates on the housing cycle will become more apparent, and the Governing Council desire to see higher rates will evaporate," he said. "Once those numbers start to change, I could well imagine the Governing Council could change direction rapidly."

Strong wage increases - a factor the ECB has identified as a main driver of underlying inflation - are unlikely to prevent policymakers from slowing the pace of rate hikes, Gerlach said.

"I don't see wages as necessarily being an autonomous driver of inflation as they were in the 1970s. The structure of the economy has changed too much since then."

Elsewhere in Europe, the SNB is likely to follow the ECB's lead at its meeting on March 23, after inflation surprised to the upside at 3.4% in February - well above the bank's target range of 0-2%, Gerlach said.

"The SNB will raise rates, most likely by 50bps, since the ECB has signalled that it will do so and since the SNB will not have another policy meeting until June."

China's reopening and sliding energy prices will help to prop up European economic activity, Gerlach said. But the positive contribution of growth to upward price pressures will fade, "whereas the effect of higher interest rates on domestic demand data is going to rise. So I think the balance would gradually shift over."