mni

All Signal, No Noise

MARKET ANALYSIS

ECB Preview: May 2023

Details:

Monetary policy decision: 13:15UK/14:15CET, Thursday 4th May 2023
Press conference: 13:45UK/14:45CET, Thursday 4th May 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:

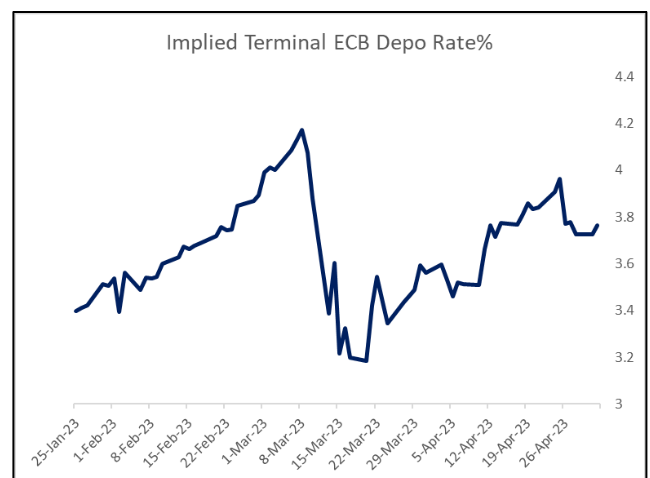
https://www.ecb.europa.eu/press/tvservices/webcast/html/webcast_pc_youtube.en.html

Bloomberg: MEDI <Go>

MNI Point of View:

Stepping Down, But Not Done Yet

- *The ECB is set to hike its key policy rates by 25bp on May 4, with latest inflation and banking sector data diminishing the case for 50bp.*
- *Given the uncertain outlook, the ECB is unlikely to provide explicit forward guidance at this juncture, though will likely nod to further tightening being likely in the baseline scenario.*
- *There is potential for a TLTRO "bridge" operation to be announced Thursday; more surprising - but possible - would be a decision on APP runoff beyond June.*



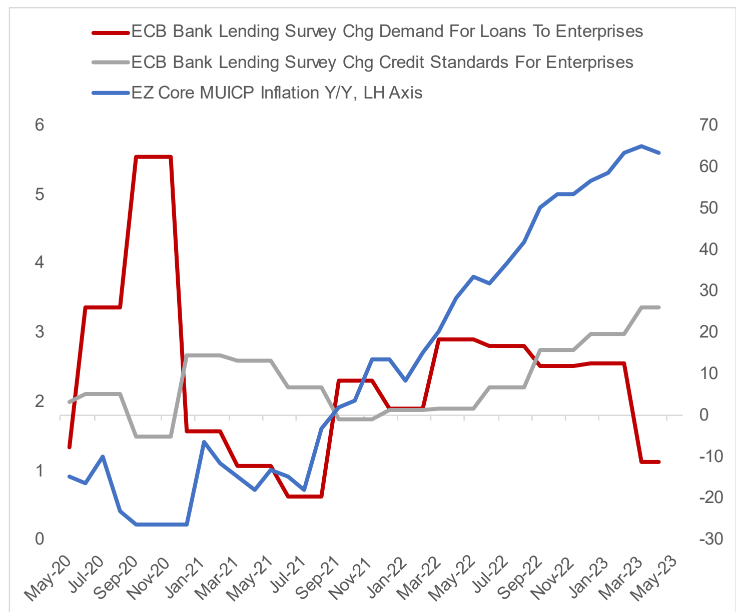
The ECB is set to raise its key policy rates by 25bp on May 4, with the deposit rate moving to 3.25%. A stepdown from March's half-point raise to a quarter-point raise at this meeting hasn't been a foregone conclusion. Banking turmoil didn't dissuade the ECB from hiking 50bp in March, and the combination of relative financial sector calmness since then plus still-sticky core inflation pressures has maintained potential for another half-point in May. At one point in mid-April, market-implied probability of a 50bp May hike was as high as 35%.

However as Pres Lagarde said in March, the ECB was looking at three key factors in its future decisions: "the inflation outlook in light of the incoming economic and financial data,

the dynamics of underlying inflation, and the strength of monetary policy transmission”. And the totality of developments since then have guided to a step-down to 25bp this week.

Indeed, key data on the latter two fronts released on May 2 have likely sealed the deal on 25bp. The much-anticipated Bank Lending Survey showed more onerous conditions than had been expected. Details pointed to Eurozone credit standards seeing “further substantial net tightening,” driven by rising interest rates, lower fixed investment, weakening housing markets, TLTRO repayments and end of full APP reinvestments. It also showed a sharp drop in loan demand.

Meanwhile the Eurozone April flash inflation readings didn’t substantially move the needle on tightening expectations. Core Y/Y softened for the first time in 10 months (to 5.6% from 5.7%), with core goods falling to 6.2% from 6.6% but core services accelerating to a fresh record of 5.2% from 5.1%. M/M core was in line with expectations at 1%, which while still It was a “sticky” enough set of numbers to caution against calling the peak of inflation pressures, but sufficiently in line with expectations to allay fears of an unexpected re-acceleration for the time being.



Even if core inflation is in the process of peaking, though, the hawkish elements of the GC will be wary of both the strong services prices amid a resilient labor market, and the potential for inflation to remain well above the 2% medium term target (Schnabel said in April that she “would not over emphasise the peak as such…we need to see a sustained decline in core inflation that gives us confidence that our measures are starting to work”).

For May at least, the combined data – which had been seen as a potential last-minute wild card auguring for a 50bp rather than 25bp tightening – saw pricing fall back by a couple of basis points at ~28bp of tightening priced, suggesting only a slight chance (~12%) of a 50bp raise.

3.75% Terminal The Central Case, With Two-Way Risks

The question is where to go beyond May. Market pricing and sell-side analyst outlooks centre on a 3.75% terminal depo rate reached by October, representing another 50bp of hikes beyond May. That seems to be a reasonable central expectation for now, with stubborn inflation providing upside risks, and tightening financial conditions potentially signalling a lower terminal rate.

The default assumption is that another 25bp is coming in June. Communications from several senior ECB policymakers suggest that a 25bp raise with data dependent further raises is the central scenario. Several Governing Council members see policy rates already in restrictive territory.

Given the uncertain outlook, it’s unlikely we get anything more in the way of explicit forward guidance at the May meeting. We do note that some analysts (at least, prior to the May 2 data) envisaging a 50bp hike accompanied with no specific forward guidance, while others see a different sort of compromise, with a 25bp hike combined with a reactivation of data-dependent forward guidance.

As we note in our communications section below, while some GC members have steered clear of providing explicit guidance on future policy rate moves, in line with the data-dependent approach, others have continued to indicate their preferences. Broadly speaking since the bank turmoil in March in particular, there appears to have been some

moderation in tone among the more hawkish members, who had previously been more assertive in calling for larger policy rate hikes.

Higher For Longer?

In particular there appears to be a tolerance of slowing the pace of hikes, with relatively more focus on the peak rate. While many GC members acknowledge that the majority of tightening is in the past, the hawks' case is for a terminal rate closer to 4%. The MNI Policy Team's reporting per sources close to the Governing Council's discussions point to a 25bp hike in May, followed by at least one further 25bp raise this summer - then rates holding steady at their peak into 2024.

Other Decisions To Make On TLTROs And Asset Runoff

Another area to watch at this meeting is TLTROs. The ECB could introduce a "bridge" TLTRO with an eye on the large repayments (~E500bln) of existing term operations due by June. Eurosystem sources told MNI that this discussion could occur either at this month's meeting or in June.

Also expected by June's meeting is an announcement on APP portfolio runoff pace for Q3 (i.e. effective July). Some analysts see potential for a decision to be made on raising the APP redemption cap from the current E15bln monthly as soon as the May meeting. However, this may be too soon, given lingering uncertainties regarding the banking sector.

mni Central Bank Watch - ECB

27 April 2023

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	6.9	9.2	↓	10.0	↓					0.18
Core Inflation	% y/y	5.7	5.2	↑	4.8	↑					1.31
Oil Prices	$	79.8	85.9	↓	88.0	↓					-1.34
5y/5y Inflation Swap	%	2.43	2.37	↑	2.02	↑					0.09
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	54.4	50.3	↑	47.3	↑					0.27
Industrial Production	% y/y	2.0	3.6	↓	4.8	↓					-0.12
Business Climate Indicator	Index	0.70	0.57	↑	0.82	↓					-0.06
Consumer Confidence	Index	-17.5	-20.7	↑	-27.4	↑					1.18
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	-2.7	2.4	↓	6.8	↓					-2.43
Broad Money (M3)	% y/y	2.9	4.8	↓	6.1	↓					-1.55
Loans to Non-Fin Corps	% y/y	4.9	7.2	↓	7.8	↓					-1.37
Loans to Households	% y/y	3.2	4.0	↓	4.4	↓					-1.61
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	-3.0	-2.4	↓	-1.2	↓					-1.00
Unemployment Rate	%	6.6	6.7	↓	6.7	↓					-1.62
Labour Costs (Quarterly)	% y/y	5.7	3.8	↑	-0.3	↑					1.41
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	4348	3794	↑	3318	↑					1.35
Bund Yield	%	2.40	2.57	↓	2.11	↑					0.29
10y BTP Spreads	%	187.5	214.4	↓	241.1	↓					1.09
EUR TWI	Index	124.18	121.76	↑	117.35	↑					1.10

Source: MNI, Bloomberg

Summary of Analyst Views:

- The majority of analysts expect the ECB to hike by 25bp at the May meeting.
- All of the following previews were published prior to the May 2 data releases – particularly the flash estimate of April inflation and the Bank Lending Survey – which per market reaction appeared to mitigate upside risks of a 50bp hike.

Analyst Views:

BNP Paribas

- Given that concerns with the banking sector have calmed, the ECB will refocus on inflation.
- The ECB is expected to reduce the pace of tightening at the May meeting to 25bp, especially given that many on the GC agree that policy rates are now in restrictive territory.
- Moreover, this would mark a hawkish downshift. The ECB will not want to provide any guidance on the June decision, but would likely stress that if the baseline scenario plays out then the general direction for rates is higher.
- The ECB could also indicate that policy rates will remain at restrictive levels for as long as is necessary to return inflation to target.
- Given the better than expected incoming activity data, BNP have raised their terminal deposit rate forecast by 25bp to 3.75%. This is still below the 4.00% level that was previously expected before the fallout from SVB.
- At the May meeting the GC is also expected to announce that it will fully cease to reinvest the APP portfolio from July. No changes are expected with respect to the guidance on PEPP reinvestments.

Danske

- The ECB is expected to hike in May, with the debate focused on whether this should be a 25bp or 50bp move. Danske believes it will be a 50bp compromise hike involving no forward guidance, and instead stressing data dependence at future meetings.
- Danske believes that a 25bp hike would otherwise trigger a dovish market reaction.
- A 50bp hike in May would likely be the last move of that magnitude.
- Danske does not expect the ECB to provide any forward guidance, including with respect to APP reinvestments. At the June meeting the ECB is expected to announce a full end to APP reinvestments starting on July 1 until the first rate cut from the ECB.

HSBC

- The ECB is expected to hike by a more ‘cautious’ 25bp at the May meeting as policymakers are aware of the lagged impact of previous hikes.
- However, in the event of the flash estimate of April inflation surprising to the upside or a more encouraging report on credit conditions, the hawks on the GC would likely argue for a 50bp hike.
- HSBC expects the ECB to announce at the May meeting that it will cease all APP reinvestments from H2 2023 – doubling the pace of QT.
- Moreover, HSBC also see scope for the ECB to introduce a new longer-term financing tool for weaker banks, which would replace the TLTROs that expire in June.

ING

- ING expects the ECB to hike by 25bp at the May meeting. This will be followed by a further and final 25bp hike in June.

- The ECB is expected to pursue a ‘higher for longer’ approach to tackle stubbornly high core inflation, with the first rate cut not coming before the second half of 2024.

J.P. Morgan

- Following various commentary from the likes of Philip Lane, Isabel Schnabel and Francois Villeroy, JPM believes that the overall mood music is supportive of a 25bp hike at the May meeting.
- Upcoming data releases are likely to be solid and so a 50bp hike is a real possibility.
- In any case, the JPM terminal rate forecast of 3.75% is not too dependent on the May decision.

Morgan Stanley

- At the May meeting the ECB faces a trade-off between sticky core inflation which points towards further rate hikes, and the recent banking sector shock that suggests gradualism is warranted. MS see a compromise decision in which the ECB hikes by 25bp and a reactivation of forward policy rate guidance linked to incoming data.
- MS continue to forecast a terminal rate of 3.75%, which will be reached via three 25bp hikes in May, June and July.
- No announcements are expected at the May meeting on the pace of APP tapering after June 2023.
- MS believes that the ECB is likely to introduce a bridge TLTRO operation given the upcoming TLTRO repayment in June and renewed focus on bank funding conditions.

Nordea

- Given that the majority of the GC remain concerned about upside inflation risks, the ECB will be pushed into further hikes. They note that the account of the March meeting indicated that were it not for the banking sector concerns, the central bank would have been determined to signal more tightening ahead.
- Nordea’s baseline scenario anticipates a 25bp hike at the May meeting. However, they stress that an important set of data releases on May 2 (flash estimate for April inflation, BLS update) which could tilt the balance in favour of a 50bp hike.

Rabobank

- The ECB is expected to hike by 25bp at the May meeting. However, should the latest Bank Lending Survey point to less credit tightening, the ECB could opt for a 50bp hike instead.
- Rabobank forecasts a terminal rate of 3.75% and believes that the risks around this projection are roughly balanced.
- Rabobank argues for an increase in the APP redemption cap to EUR25bn. While a decision could be taken on this at the May meeting, this is not a given.
- They also see scope for a LTRO backstop, which the ECB could pre-announce ahead of the June redemptions.

RBC

- The ECB is expected to hike by 25bp at the May meeting given that core inflation remains elevated and there is no sign of labour market tightness abating.
- The ECB will want to retain optionality and so will refrain from providing explicit forward guidance for subsequent meetings. However, there may be an indication that there is a bias towards further tightening.
- Beyond the May meeting, RBC expects the ECB to deliver a further two 25bp hikes, which would take the deposit rate to its terminal level of 3.75%.
- It is likely that the ECB will wait until the June meeting to announce the Q3 pace of APP runoff. Rabobank expects the ECB to raise the monthly redemption cap to EUR20-25bn from EUR15bn.

UBS

- The ECB is expected to hike the deposit rate by 25bp to 3.25%. This would be followed by another 25bp hike in June and would mark the terminal rate in the UBS baseline scenario.
- Nonetheless, UBS stress that the risks to both the May call and the terminal rate projection are skewed to the upside.
- If core inflation does not come down in April, or if the latest BLS does not show serious tightening in credit conditions as a result of the recent banking sector developments, then the GC could be swayed towards a 50bp hike.
- Similarly, if the inflation environment does not turnaround quickly enough, then UBS envisage a potential terminal rate of 3.75-4.00%.
- The ECB is not expected to decide on the post-June QT at the May meeting. This will instead be decided at the June meeting and will depend on the prevailing financial conditions at that time.

ECB Communication: The Detail

Inflation Outlook

Despite the turnaround in headline inflation, still elevated core inflation has clouded the near-term outlook and creates uncertainty around the degree of inflation persistence. This is reflected in the broadly cautious interpretation of improving headline inflation data from GC members.

Getting straight to the predicament facing the ECB, President Lagarde stressed on March 22:

> “So far, we do not see clear evidence that underlying inflation is trending downwards.”

And warned about the risk of a

> “tit-for-tat dynamic”

Between workers and companies which raises profit margins and wages. Nonetheless, Lagarde continued to assert that:

> “Bringing inflation back to 2% over the medium term is non-negotiable.”

And further followed up on April 14:

> “Resilient labour markets and strong wage growth, especially in advanced economies, suggest that underlying inflationary pressures remain strong.”

Luis de Guindos reflected on the improvement in headline inflation and the need to evaluate underlying price pressures, stating on March 26:

> “I am positive about the decline of headline inflation, but we need to look very carefully at the evolution of core inflation.”

> “To reach our target, core inflation must also start to decelerate.”

> "It is very difficult to converge toward the 2% target in a sustainable way without a clear decline in core inflation."

On April 1 Guindos indicated that core inflation remains strong:

> "We believe that headline inflation is likely to decline considerably this year, while underlying inflation dynamics will remain strong."

Adding on April 12:

> "Underlying inflation is proving to be much stickier"

Edward Scicluna highlighted his concerns about core inflation on April 13:

> "We are worried about core inflation not yet peaking."

> "We are expecting it to peak and we have to show that we are serious about continuing fighting this sort of monster."

Gediminas Šimkus was particularly emphatic in describing the inflation threat on April 14:

> "Inflation is still there. It's broad based. It's stubbornly high. It's too high for too long."

Joachim Nagel argued on April 13 that underlying inflationary pressures remain elevated and that the ECB would need to do more:

> "We have to do more on the inflation front, this is also for sure"

> "Core inflation is still on this very elevated level and so I believe that will take time until core is coming down. But the headline inflation is maybe giving the right direction."

> "I see that core is coming down maybe before the summer but for the next months I believe it will stay on rather high levels and this is the reason why we have to stay really alert when it comes to the inflation story."

He provided a relatively constructive update on April 17 on the near-term inflation outlook:

> "Core inflation sadly has accelerated in recent months."

> "But I'm also counting on a retreat before the summer break."

Robert Holzmann stressed the importance of tracking core inflation on April 13:

> "The persistence of core inflation is quite definitely one of the elements which will have to be taken into account, because core inflation is a great predictor of future headline inflation."

Financial Turmoil

The fallout from SVB and Credit Suisse has complicated the near-term policy outlook as the ECB now has to balance the risks of tightening in the face of potential credit market stresses against the need to return inflation to target. GC members were quick to stress that European banks have strong liquidity positions and, so far, there has been no sign of systemic contagion.

Immediately following the decision to hike by 50bp at the last meeting, François Villeroy de Galhau argued on March 17 that the move was a signal of strength and resilience in European banks:

> "We have sent a signal of confidence that is strong and double: it's confidence in our anti-inflation strategy and confidence in the solidity of European and French banks."

Ignazio Visco downplayed the risks to European banks on March 20:

> "We have all the tools to deal with any liquidity problem but we do not see capitalization and liquidity problems in our banks."

This was a sentiment echoed by:

Nagel on March 27:

> "I'd like to emphasize that the European banking and financial system is resilient and solid."
>
> "It has strong capital and liquidity positions. At the same time, the Eurosystem has suitable instruments to provide support if necessary."

Schnabel on March 29:

> "It looks like our banks look rather resilient. Overall, I would say it looks like we have a somewhat smaller problem than we're seeing in the U.S."

And Kazaks on March 21, who stated that European banks are:

> "well capitalized and financial resources and liquidity are available."

Guindos indicated on March 26 that the ECB would need to closely monitor credit conditions:

> "The question now is how the events in the US banking system and Credit Suisse will impact the euro-area economy."
>
> "Over the next weeks and months, we need to assess whether they will give rise to an additional tightening of financing conditions."

President Lagarde also reiterated on March 20, her argument from the previous ECB meeting that there is no trade-off between price stability and financial stability.

> "Price stability goes with financial stability, and they are both present and come together — but there is no trade off."
>
> "Financial stability to the extent that it impacts the economic situation, to the extent that it impacts our projections, has an impact on how we see the situation from a macroeconomic point of view, but they are two different stabilities addressed by different tools."

Monetary Policy Setting

President Lagarde provided a succinct overview on March 22 of the ECB's near-term strategy, particularly with respect to data dependence, the reaction function and the recent financial turmoil – elements of which various GC members have subsequently further touched on (see below).

> "Now a sizeable policy adjustment is already behind us: since July last year we have raised interest rates by 350 basis points. However, inflation is still high, and uncertainty around its path ahead has increased. This makes a robust strategy going forward essential.

Such a strategy has three elements.

First, with high uncertainty, it is even more important that the rate path is data-dependent.

This means, ex ante, that we are neither committed to raise further nor are we finished with hiking rates. Indeed, as I explained last week, if the baseline scenario in our most recent projections is confirmed, we will still have ground to cover to make sure that inflation pressures are stamped out.

Second, while the European banking sector is resilient, with strong capital and liquidity positions, in view of recent financial market volatility, we are ready to act and provide liquidity support to the financial system if needed and to preserve the smooth transmission of monetary policy.

But it should be clear that there is no trade-off between price stability and financial stability. As we have proven many times, we are able to set the appropriate policy stance to control inflation and at the same time use other instruments to address risks to monetary policy transmission.

We did this when we decided to use reinvestments under the pandemic emergency purchase programme more flexibly, and when we agreed on the transmission protection instrument. These programmes ensured that rate normalisation proceeded smoothly.

The third element of a robust strategy is a clear reaction function. At our last meeting, we clarified our reaction function and the sources of information that will be important to us. The future calibration of the rate path will be determined by – and will require continuous monitoring of – three key inputs, and this is what I will explain now."

Data Dependence

The banking sector shock has added to pre-existing uncertainties over the inflation outlook, which further bolsters the ECB's argument that upcoming policy rate decisions should be data-dependent.

President Lagarde stated the case simply on March 22:

"With high uncertainty, it is even more important that the rate path is data dependent."

"We are neither committed to raise further nor are we finished with hiking rates."

With respect to returning to a data-dependent approach, Villeroy stated on March 17:

"We have strengthened our future adaptability."

"We've moved away from a kind of autopilot to flying by instruments."

Adding on March 20:

"We will take decisions meeting-by-meeting depending on economic data, but we remain determined to beat inflation."

Yannis Stournaras appeared adamant on March 23 that forward guidance should be abandoned:

"We should make no pre-commitment, I'm glad that we decided in our last meeting that we'll give no forward guidance."

Fabio Panetta similarly emphasised the importance of data dependence on March 22:

> "Monetary policy must remain fully adaptable to changing developments, given the prevailing uncertainty, the lags with which it operates and the risk of sudden financial tensions. This requires a data-dependent approach that does not prejudge future policy decisions and that reflects the risks on both sides."

> "This prudent approach holds truer still as our policy rates move more firmly into restrictive territory, inflationary forces ease and the risks to the inflation outlook become balanced. At times like this, abrupt policy moves are not necessary."

Pablo Hernández de Cos similarly stressed that a flexible approach to monetary policy was now needed, stating on March 27:

> "In light of the current elevated uncertainty, the most sensible thing to do is to emphasize that our future monetary-policy decisions will depend more than ever on how the different sources of risk materialize, including experiences in recent days in financial markets."

Olli Rehn argued on April 14:

> "In my view, it is important that we carry on, and act consistently, but we have to calibrate our decision on the basis of an approach based on data dependency."

Nagel stated on March 27:

> "It's becoming ever more important to decide on further monetary-policy steps from meeting to meeting considering economic and financial developments."

Finally, on March 20 Mārtiņš Kazāks stressed that while forward guidance is not appropriate in the current environment, it could be revived when necessary in the future:

> "Providing very clear guidance over multiple meetings currently is not only inappropriate, but also counterproductive."

> "But of course, forward guidance is as good an instrument as any, and if we will see it necessary and the environment is going to be appropriate, we may use it again."

The Need for Further Tightening

While most GC members appear to support the argument that further policy tightening is still required, the rhetoric has evolved and become more nuanced. The dovish members are stressing that the majority of policy rate tightening has already occurred, but are yet to call time on further tightening. The hawks, meanwhile, have tended to focus more on the threat of inflation persistence even as the headline data improves.

Yannis Stournaras struck a particularly dovish note on March 20:

> "Rate hikes are mostly now a story of the past."

Adding on April 2:

> "Especially after the latest events I feel now that we are close to the end. I can't say we're at the end, that it's over, but we're definitely close to the end."

Šimkus argued that policy still needs to tighten to tackle inflation, indicating on March 17:

> "Inflation trends haven't disappeared."

"While we must remain cautious regarding future assessment, I still believe this wasn't the last interest rate increase."

Adding on April 3 that the bulk of the policy rate adjustment has already been delivered:

"Core inflation is sticky,"

"I believe we've covered the larger part of the path of the interest-rate increases, but we're not there yet."

Villeroy indicated on March 31 that the new policy setting would need to be sustained for some time to return inflation to target:

"Although we have completed most of our rate-hiking journey, we may possibly still have a little way to go."

"After that, we need to stay the course for as long as necessary."

On April 15 Villeroy highlighted the impact of previous policy rate hikes:

"We've completed most of the journey and we need to look at the delayed transmission: the effect of past decisions is even more important then the effect of future hikes that will perhaps happen in the coming meetings."

Madis Müller stated on March 23 that most of the policy rate tightening has now occurred:

"Looking at how quickly and sharply the interest-rate increases have taken place in less than a year, I dare say the bigger part of this is behind us and now it is a time for adapting and coping"

While indicating on March 28 that there was still further scope to raise rates:

"I'm careful about commenting on terminal rate and how much room we have to go."

"But I think we probably still have room to increase interest rates and that's necessary for price rises to slow as fast as the forecast envisions."

Philip Lane provided a balanced assessment on March 29:

"If the financial stress we see is non-zero, but turns out to be still fairly limited, interest rates will still need to go up"

"However, if the financial stress we talked about becomes stronger, then we'll have to see what's appropriate."

On hiking policy rates amid the banking sector shock, Wunsch stated on March 22:

"If there is stabilization in the market, I think, again, on the basis of the last projection, it's still clear that we might have more to do."

Similarly responding to the recent bout of financial turmoil, Klaas Knot argued on March 23 that before the shock inflation trends warranted further action:

"Without this episode, the risks to the inflation outlook were so strongly tilted to the upside that I would have been very convinced that we need to make another step in May."

"…I am not yet ready to say the ECB will no longer be able to raise interest rates. I still believe that without this tension we still had so much to do."

Adding on April 7:

> "We are certainly not done with interest-rate hikes"

> "Core inflation in the euro zone is now almost 6%, and you can't fight that with an interest rate of 3%."

De Cos stated on April 10:

> "If the baseline scenario in the March projections are confirmed we still have ground to cover to make sure that inflation pressures are stamped out"

Ignazio Visco highlighted the current low level of real rates on March 22:

> "In real terms, interest rates are still relatively low."

Boštjan Vasle provided clear advocacy for addition rates hikes on April 13:

> "We have to continue raising interest rates"

Scicluna stated on April 13 that policy hikes have:

> "still some way to go"

Reflecting on the last ECB meeting, Kazimir indicated on March 17:

> "The 50 basis-point increase was inevitable and necessary"

And that the March hike would not be the last:

> "The situation is delicate, but we are not yet at the finish line."

While avoiding a specific rate call, he indicated that further hikes were still needed:

> "The future development of inflation over the entire horizon of our forecast period speaks clearly in favour of the need to continue."

> "Whether, how vigorously, in how many steps and to where — time and data will show."

At the more hawkish end, Kazāks argued on March 20:

> "Inflation is still very high — rates, in my view, needed to go up."

> "And if the baseline scenario holds and market volatility calms down and does not derail the scenario, then with the current macro outlook and the outlook for inflation, more interest-rate increases will be necessary."

While downplaying the risks of over-tightening.

> "the consequences of raising by 25 basis points too much are easier to repair than consequences of raising by 25 basis points too little."

> "You can always cut rates if necessary, but if you want to cover for the earlier shortfall, it is very likely that you would need to raise by much more than 25."

Adding on March 21

> "It's not possible to say that we've stopped raising rates at this point,"

"at the moment the fog is too thick to say what the next decision will be"

Referencing stubbornly high inflation, he stressed on March 22:

"I believe that raising interest rates is necessary at the moment,"

"Because inflation is simply still too high. It's the most painful for lower incomes."

And continued with this theme on March 31:

"Inflation still remains high and continued rate increases will be necessary in order to bring inflation down"

While acknowledging that the pace of tightening would eventually need to slow, Kazāks argued on April 13 that such a time was not now:

"At some point one has to start slowing down because we want to find what is the appropriate terminal point during this cycle and of course it may involve both smaller steps or taking a pause at some point, but at least in my books I don't see any reason to slow down any time soon in terms of interest-rate increases, because inflation does remain very high"

Finally adding on April 17:

"The economy is still resilient, there will probably not be a recession in the euro zone this year, the labor market remains strong, the pressure on wages is still very high and in some cases even increasing. Therefore, in my opinion, a further increase in rates is necessary."

Joachim Nagel argued in favour of bold action on March 22:

"We have to tame inflation, and to do so, we have to be bold and decisive."

"In my view, our job is not done yet. If inflation develops as projected, further interest-rate hikes have to follow in upcoming meetings."

And noted that the inflation forecasts:

"still contains significant uncertainty, and in particular upside risks."

On March 24 Nagel indicated that policy rates should continue to go higher as long as the baseline scenario holds:

"If inflation develops as projected, this should in my view not mark the end of the hike sequence"

Adding on April 14:

"We are not pre-committed to future rate hikes, but we are committed to delivering price stability,"

"Thus, it's certainly far too early to stop raising rates or even think about lowering them."

And further on April 17:

"The task isn't done yet, we still have a way to go, we haven't yet slayed the inflation beast," he said. "My colleagues in the ECB council and I will keep at it."

The most hawkish member of the GC, Robert Holzmann, argued on April 12 that under-tightening remained the bigger risk:

"The danger of currently doing too little and to fan inflation is bigger than the risk of doing too much"

The May Meeting

While some GC members have steered clear of providing explicit guidance on future policy rate moves, in line with the data-dependent approach, others have continued to indicate their preferences. Broadly speaking there appears to be some moderation in tone among the more hawkish members, who had previously been more assertive in calling with larger policy rate hikes.

Among those who have adhered to the data dependent approach, Villeroy stated on April 12:

> "We may possibly still have a little way to go on rate hikes at our next meetings."
>
> "Though I think it premature to decide now what we'll do in May."

Klaas Knot has also steered clear of providing any explicit insight on rates, stating on March 23:

> "I still think that we need to make another step in May, but I don't know the size of that."

Adding on April 7:

> "The only question is whether you still need to take a further step up by half a percentage point, like the last few times we raised rates, or can you already scale back to smaller increments of a quarter of a percentage point."
>
> "We will have to determine that in the ECB meeting in May — I haven't made up my mind yet."

Müller stressed on March 17:

> "I wouldn't want make predictions in a situation where it's not known what the economic indicators are for the coming months and what else could happen in the meantime".
>
> "The financial markets expect interest rates to continue to rise, so in order to reduce inflation to the numbers that are in this forecast, there's a presumption that interest rates still need to rise"
>
> "It's still too early for the central bank to conclude that the backbone of rapid inflation has been broken and interest-rate hikes can be stopped."

At the dovish end, Mario Centeno indicated on April 15 a preference for either slowing the pace of hikes, or pausing:

> "For the May decision, either zero or 25 are numbers that are feasible."
>
> "I don't see any reason whatsoever to do more."

Vasle, meanwhile, stated on April 13 that the choice was between maintaining the current pace, or slowing the pace of hikes:

> "The options for May are between 25 and 50 basis points. It's not necessary to decide now already as the size of the next step will depend on the data — including on bank lending, growth and inflation."

Wunsch suggested a similar choice on April 13:

> "We still have one inflation reading before we take this decision in May. But it's going, I guess, to be between 25 or 50 basis points."
>
> "A lot will depend on the reading of core: if it keeps going up that, of course, would be very bad news," he said, referring to underlying inflation that strips out volatile elements like energy and food."

> “One month’s reading is not going to be a big change,” Wunsch said. “But we’ve had three months of core readings that were moving in the wrong direction — a fourth reading of moving in the wrong direction I think would shift the vote, but we can have a surprise in the other direction.”

Adding further on April 14:

> "I think May will be about 25 or 50 basis points."
>
> "If there's another upside surprise in core inflation and the lending survey doesn't look too bad, we might have to do 50."
>
> "If there is a positive surprise in core, then perhaps 25 is more appropriate."

Kažimír was open to the possibility of slowing the pace of hikes, stating on March 29:

> “Personally I think we shouldn’t ease up if the base scenario doesn’t change significantly.”
>
> “We should continue hiking, maybe at slower pace.”

While avoiding an explicit policy rate call, Kazāks nonetheless indicated on April 13 that 50bp was still on the table:

> “At the current moment, I would certainly not exclude also 50 basis points”

Robert Holzmann, however, has been far more explicit and stated on April 3 following the OPEC+ decision to cut production:

> “If things in May haven’t really become more terrible, I think we can afford another 50 basis points, and in particular, if no social agreement emerges to temper inflation we’ll have to do more to produce it.”

<u>Beyond May</u>

Given the near-term uncertainties and belief among many GC members that the majority of policy rate tightening has now occurred, the has been limited discussion on the direction for policy rates later in the year.

Robert Holzmann indicated on March 18 that he still expects several rate hikes:

> “Some hope that the peak rate will be below 4%, but I fear it will go above 4%”
>
> “I am expecting a few more hikes.”
>
> “The peak rate depends on how stubborn inflation is”

He further emphasised that core inflation is

> “very, very high”

And that:

> “This means we have to be more persistent than we all would like.”

Furthermore, on March 21 in response to the likelihood of three more half-point rate hikes following the March decision, Holzmann stated:

> “I wouldn’t rule them out, but I also wouldn’t say that they’ll necessarily come either.”

Finally, asked whether a rate cut toward the end of the year was thinkable for the euro area, Klaas Knot described such a scenario on April 7 as:

> "almost impossible."
>
> "Even if we have reached an interest rate level here that we are convinced will bring inflation back to 2% in the medium term, we may well have to keep interest rates at that peak level for a long time."

Restrictive Territory and Persistence:

Several GC members have indicated that policy rates are homing in on restrictive territory, if not already there, and that the policy setting would need to be maintained in order to return inflation to target.

Olli Rehn stated on April 14:

> "We have been reaching restrictive territory and it's important that we don't relax prematurely"

Nagel argued on March 22:

> "There's still some way to go, but we are approaching restrictive territory,"
>
> "There's certainly no mistaking that price pressures are strong and broad-based across the economy"
>
> "If we are to tame this stubborn inflation, we will have to be even more stubborn."

Adding on March 24:

> "It will be necessary to raise policy rates to sufficiently restrictive levels in order to bring inflation back down to 2% in a timely manner. We should likewise keep policy rates sufficiently high for as long as necessary to ensure lasting price stability."
>
> "We have not yet won the fight against inflation."

Quantitative Tightening

Communication on quantitative tightening has been relatively limited. This may indicate that the decision on post June reinvestments may not be taken at the May meeting, or perhaps that GC members believe that QT is operating as planned – steady, predictable and running in the background.

On the outlook for QT, Joachim Nagel stated on March 27:

> "In my view, it can be accelerated from the summer"
>
> "Markets will be able to handle it well, and in terms of monetary policy, it's necessary to reduce the balance sheet of the Eurosystem more quickly."

Wunsch added on April 14:

> "We need to do more on quantitative tightening"
>
> "We could do a full stop of reinvestments this year and even with that, it will take years to run down the portfolio."

With Robert Holzmann similarly indicating the need for a step-change on April 12:

> "On quantitative tightening: "If the current pace of €15 billion ($16.5 billion) a month doesn't trigger any problems on the markets for private or public securities, in my opinion there's a lot that would support increasing the tempo from July"

MNI Policy Team:

MNI SOURCES: ECB To Hold Rates At Peak Into 2024 *Apr 19, 2023*

(MNI) London - The European Central Bank looks set to hike by 25 basis points in May, with at least one further 25-point increase expected over the summer, after which policymakers see rates holding steady at their peak into 2024, sources close to the Governing Council's discussions told MNI.

With fallout from global banking turbulence in March and April seemingly limited for the eurozone, May's debate will focus on the size of the hike needed to contain inflation, rather than on whether to hike or not. An upside surprise in flash April inflation data could still tilt the argument towards 50bp, but for the moment most Governing Council members feel that downgrading to 25bp hikes will better enable them to gauge whether they need to push the deposit rate to 3.5% or to 3.75%, though some might still argue for a maximum of 4% if prices remains hot. (See MNI INTERVIEW:Core Inflation Jump Needed For 50Bp-ECB's Simkus)

After reaching the peak, the ECB is likely to stay on hold for some time. One eurosystem official, who foresees a possibly lower top than would have been anticipated earlier in the year but persisting for longer, said a cut in benchmark rates would be unlikely "well into 2024," although he wouldn't be drawn on whether that meant the second quarter or into the second half. Another looked for rates at stay at their peak until at least this Christmas.

Overnight index swaps currently imply the deposit rate will top at around 3.7% by September, before edging down close to 3.6% by January.

25 POINTS SEEN IN MAY

For the May meeting, consensus is now gathering around a 25bp hike, as more Governing Council members acknowledge the risk of doing too much tightening, as opposed to too little, and as the potential for further financial instability adds to the case for caution.

Only an April core inflation print significantly in excess of the 5.7% recorded in March would be likely to give calls for 50bp any impetus, sources said. April's flash inflation data is published on May 2, just two days ahead of the next

Governing Council meeting. The ECB’s bank lending survey, also released on May 2, will be another key consideration.

“All dependent on no upside surprise from the inflation data, at least 25 is guaranteed,” one national central bank official said, referring to the May meeting.

“There will be some who argue for unchanged, a few more for 50. I think the real discussion is between 25 and 50 and the proposition will be 25,” the source added.

"PRUDENCE"

Another source concurred, noting that though the “usual voices” had called for 50bp, “this time it is not the majority position of the council, where prudence is increasingly mentioned.”

The other source thought it would be easier for the ECB to scale back the size of rate hikes to 25bps in May following the shift in guidance at the last meeting, and that this meeting could bring another change of tone, to signal smaller adjustments in policy ahead.

“In March credibility was at stake, but at this meeting our hands are freer,” the source said.

In March, the ECB raised the deposit rate by 50bps to 3.0% despite market turbulence as Swiss authorities engineered a rescue of beleaguered Credit Suisse.

An ECB spokesperson declined to comment.

MNI SOURCES: ECB Set For TLTRO Discussions Ahead June Maturity *Apr 28, 2023*

(MNI) London - The European Central Bank is likely to discuss bridging finance for the upcoming maturity of EUR500 billion in cheap TLTRO loans to banks, either at its upcoming meeting next week or in June, Eurosystem sources told MNI.

“Given conditions, it’s not unrealistic to suggest another TLTRO bridge and I'm sure it will be discussed,” one source said.

While May would be a more beneficial time for the discussion, allowing banks to position themselves ahead of time, the source accepted that even if the ECB executed such a plan, “we may not need to have it in place until June”.

Following an EUR72 billion early TLTRO III repayment in March, June will see around EUR490 billion set for maturity. If completed, this would help get excess liquidity in the eurosystem down from current levels around EUR4 trillion to nearer EUR3.5 trillion, reducing the overall balance sheet to nearer EUR7.3 trillion from EUR7.7 trillion currently.

“Given the size of the June maturity, it makes perfect sense any impacts it could have will be discussed at some point over the next two meetings,” another source said, although he was unsure how deep current discussions had gone.

“Whether or not there is bridge financing of some shape may well depend how the bank turmoil plays out in the next month or so,” he added.

An ECB spokesperson declined to comment.

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