

ECB update

A Smaller hike, but even more hawkish promises

- The Governing Council raised all key interest rates by another 50 basis points and expects to raise them significantly further
- Despite expected recession, the ECB revised inflation projection upwards

As widely expected, the Governing Council today decided to raise all three ECB interest rates by 50 basis points. Although this was a smaller increase than during the previous two meetings, it was accompanied by a very hawkish message – the expectation to raise rates significantly further, because inflation, in the Governing Council’s view, remains far too high and is projected to stay above the target for too long. The ECB now sees average inflation decreasing to 6.3% in 2023, then projected to average 3.4% in 2024. This is significantly higher than our forecast – we expect economic weakness and normalization of energy costs to bring annual inflation close to 2% by the end of next year. Admittedly, the uncertainty related to inflationary forces is very high, but the ECB seems to be choosing to rather err on expecting too high, rather than too low inflation. As long as the euro area economy is muddling through the energy crisis the safer choice is to frontload the interest rate hikes and minimize the risk of excessive inflation expectations.

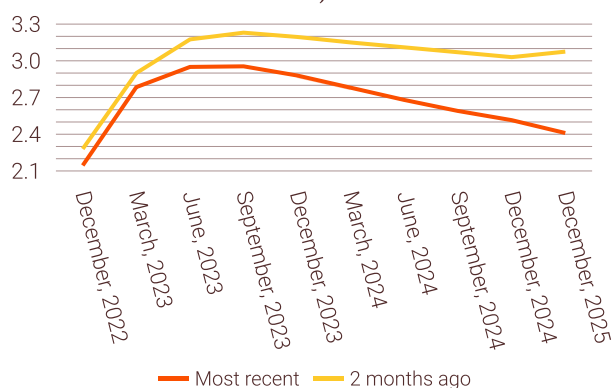
The ECB has also announced that from the beginning of March 2023 onwards, it will not reinvest all of the principal payments from maturing securities from its APP portfolio. This is slightly later than we had expected with a somewhat lower cap of EUR 15bn per month (roughly half of the projected redemptions).

We revise our forecast and now expect another 50-basis point hike in February and a final 25 basis point increase in March. This is still slightly less than the current market expectations, as we expect inflation to decline somewhat faster than currently projected by the ECB. A frontloaded hawkishness strengthens our view that interest rates will have to be cut as soon as at the end of 2023.

Analyst:

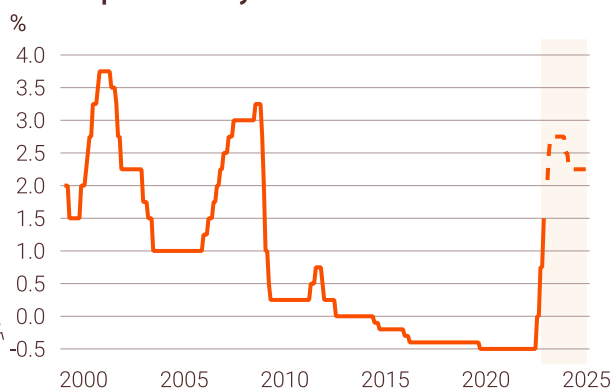
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3 month euribor futures, %



Sources: Swedbank Research & Macrobond

ECB Deposit facility rate and forecasts



Sources: Swedbank Research & Macrobond

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