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PREVIEW: ECB Policy Announcement due Thursday 14th April 2022

- **ECB policy announcement due Thursday 14th April; rate decision at 12:45BST/07:45EDT, press conference from 13:30BST/08:30EDT**
- **The press conference will offer Lagarde an opportunity to provide a stock-take on how the EZ is responding to the Ukraine crisis**
- **Traders will be mindful of any hints of an early-end to APP and a potential 2022 rate hike**

OVERVIEW: After pivoting its APP at the March meeting in a more hawkish direction, the upcoming announcement is expected to be more of a stock-take on how the Eurozone economy is responding to the fallout from the Ukraine/Russia crisis and subsequent impact on inflation. As it stands, the Eurozone is facing a deteriorating growth outlook given the economic reverberations from the Russia and Ukraine conflict whilst trying to tame rampant inflation which saw Y/Y HICP jump to 7.5% in March from 5.9% in February. The possibility of stagflation in the Eurozone will naturally lead to a split in views between the doves and the hawks on the Governing Council with the former represented by the likes of Panetta who suggests that asking the ECB to bring down high inflation in the near-term would be extremely costly. At the more hawkish end of the spectrum, Belgium's Wunsch expects the deposit rate (currently -0.5%) to reach 0% by year-end. The ECB will ultimately most likely not be forced into making a policy decision at the upcoming meeting with uncertainty surrounding Ukraine providing some cover. However, various desks expect that by June, the Bank will need to offer greater guidance on how it intends to navigate the current economic climate. ING suggests that one compromise that might be sought on the Governing Council would be a more explicit distinction between policy normalisation and monetary policy tightening whereby the former would include an end to net asset purchases and bringing the deposit rate back to zero whereas tightening would be the start of a longer rate hike cycle. In terms of the latest polling, Reuters reported that of the 41/53 respondents who forecast the deposit rate to rise from a record low of -0.50% this year, 31 expect it to do so in Q4, 10 say it will happen as soon as July-Sep.

PRIOR MEETING: Amid a backdrop of rampant inflation in the Eurozone and the potential for further upside in the coming months, the ECB opted to revise its schedule for APP in a more hawkish direction. Previously, it was announced that monthly purchases under APP would be beefed up to EUR 40bln from EUR 20bln and then subsequently lowered to EUR 30bln in Q3 and back down to EUR 20bln in Q4, with no-end date provided. The new schedule now sees APP increased to EUR 40bln from EUR 20bln in April before being lowered to EUR 30bln in May and EUR 20bln in June. Furthermore, purchases under APP will be concluded in Q3, albeit the schedule could be re-revised if the economic outlook warrants an adjustment. Policymakers also opted to break the linkage between APP and rate hikes with any adjustments to the key ECB interest rates set to take place "some time" after the end of the Governing Council's net purchases under the APP compared to prior guidance of "shortly" after. At the follow-up press conference, introductory remarks by President Lagarde emphasised the uncertainty presented by the conflict in Ukraine, suggesting that the war will have a material impact on activity and inflation, the extent of which will depend on the evolution of the conflict (note, the ECB outlined several scenarios for the Eurozone outlook). Accordingly, the ECB characterised risks to the economic outlook as "tilted to the downside" vs. its previous assessment of "broadly balanced". The accompanying staff economic projections saw a downgrade to 2022 growth from 5.2% to 3.7% with 2023 revised trivially lower. On the inflation front, 2022 HICP is now seen at 5.1% vs. prev. 3.2%, 2023 is forecast at 2.1% vs. prev. 1.8% before returning below target to 1.9% in 2024; Reuters sources later added that policymakers agreed that the 1.9% inflation forecast for 2024 is compatible with target. In terms of the policy decision, Lagarde noted that some members wished to "do nothing" amid the uncertainty, whilst other more hawkish members did not want to apply conditionality to the decisions. Note, the sources also noted a handful of policymakers made the case for keeping APP open-ended. With regards to a 2022 rate hike, Lagarde gave little away on that front, suggesting that "some time" after could mean "weeks or months".

RECENT DATA: The most noteworthy data release since the prior meeting has been the eye-watering inflation print for March which saw the Y/Y HICP metric jump to 7.5% from 5.9% (Exp. 6.6%), whilst the core metric rose to 3.2% from 2.9%. ING noted that the increase in the headline figure was predominantly driven by upside in energy and food prices on account of the Ukraine crisis, however, broad-based pressure in goods and services were also observed for the core metric. Q1 GDP metrics are not due for release until 29th April, however survey data via S&P Global saw the EZ-wide composite PMI for March fall to 54.9 from 55.5 with economist Chris Williamson noting that "the resilience of the economy will be tested in the coming months by headwinds which include a further spike in energy costs and other commodity prices due to Russia's invasion of Ukraine, as well as worsening supply chain issues arising from the war and a marked deterioration in business optimism regarding prospects for the year ahead". Elsewhere, the Sentix release

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for April saw a decline to -18 from -7. On the employment front, the unemployment rate in February declined to 6.8% from 6.9%.

RECENT COMMUNICATIONS: President Lagarde (17th March) suggested that inflation will likely stabilise at the 2% target over the medium term whilst noting that there is scope to adjust policy in a timely manner should the ECB see risks of excess inflation extending into the medium term. Thereafter (30th March) she suggested that in the short-term the Eurozone will face higher inflation and slower growth and the crisis is beginning to drain confidence. That said, she is of the view that incoming data supports the inflation outlook and will conclude APP in Q3. Chief Economist Lane (1st April) labelled the March HICP print as "very high" whilst noting that signs of wage responses were very mild earlier this year, but inflation has since risen further. In follow-up remarks (April 6th), he stated it is important not to overreact to the surge in inflation as the orientation is towards the medium-term. Germany's Schnabel out-lined three factors which could make inflation sticky even as the recovery slows; wage catch-up, structural changes and pipeline pressures. Schnabel added that continuing the path of policy normalisation is the appropriate course of action. The speed of normalisation, in turn, will depend on the economic fallout from the war, the severity of the inflation shock and its persistence. The more hawkish soundings out of the Governing Council have seen the likes of Belgium's Wunsch, Austria's Holzmann and Slovenia's Vasle call for an end to negative rates by the end of the year. At the more dovish end of the spectrum, Italy's Panetta (April 6th) said that asking the ECB to bring down high inflation in the near-term would be extremely costly and the GC is not seeing any de-anchoring of inflation expectations. Elsewhere, Estonia's Muller (March 30th) has suggested that it is 'likely' that there will be a rate hike this year, but it is too early to say that the ECB will definitely lift rates in 2022, whilst Finland's Rehn noted that the ECB decided to proceed with gradual monpol normalisation in March, but recent inflation rates may give rise to the need for measures to curb inflation more quickly.

RATES/TIERING/TLTRO: From a rates perspective, consensus looks for the Bank to stand pat on the deposit, main refi and marginal lending rates of -0.5%, 0.0% and 0.25% respectively. Current forward guidance notes "any adjustments to the key ECB interest rates will take place some time after the end of the Governing Council's net purchases under the APP and will be gradual". As it stands, market pricing prices in the first 25bps hike to the deposit rate in September with another 25bps hike to follow in December. In terms of the latest polling, Reuters reported that of the 41/53 respondents who forecast the deposit rate to rise from a record low of -0.50% this year, 31 expect it to do so in Q4, while 10 say it will happen as soon as July-Sep. Since the February meeting, President Lagarde has refused to push back on the prospect of a 2022 rate hike, however, focus for the upcoming meeting will be on how forcefully, if at all, Lagarde pushes back on current market pricing. It is likely that Lagarde will emphasise the flexibility of the ECB's decision making with more explicit guidance not expected until June (which will be accompanied by new macro projections). Lagarde will need to tread carefully given the increasing divide between hawks and doves on the Governing Council as shown by recent commentary from Italy's Panetta and Belgium's Wunsch. On which, ING touts an eventual compromise which could help appease doves and hawks whereby emphasis is placed on the difference between normalisation and tightening. The former would involve an end to net asset purchases and bringing the deposit rate back to zero whereas the latter would involve the start of a longer rate hike cycle, bringing rates close to, or even above, neutral levels. ING adds that "As long as wage growth remains below 3%, an outright ECB tightening cycle is unlikely". In terms of other measures, Rabobank expects the ECB will confirm that the TLTRO-III discount will not be extended after June. Rabobank also expects the tiering multiplier to increase to c. 10 times minimum reserves (currently six).

BALANCE SHEET: At the prior meeting, the ECB opted to revise its schedule for APP in a more hawkish direction. Previously, it was announced that monthly purchases under APP would be beefed up to EUR 40bln from EUR 20bln and then subsequently lowered to EUR 30bln in Q3 and back down to EUR 20bln in Q4, with no-end date provided. The new schedule now sees APP increased to EUR 40bln from EUR 20bln in April before being lowered to EUR 30bln in May and EUR 20bln in June. Furthermore, purchases under APP will be concluded in Q3, albeit the schedule could be re-revised if the economic outlook warrants an adjustment. Desks expect that no tweaks will be made to this schedule at the upcoming meeting. However, UBS will be looking for any signs on how committed the Bank is to adhering to its current schedule for phasing out bond purchases and whether there is any further clarity on when exactly bond purchases will be concluded in Q3. UBS suggests that this, along with risks surrounding its GDP forecast will help provide a framework on when to expect rate hikes by the Bank. Oxford Economics expects that purchases under APP could cease as soon as June in order to allow a rate tightening cycle to commence in H2.

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