PREVIEW: ECB Policy Announcement due Thursday 15th June 2023

- **ECB policy announcement due Thursday 15th June; rate decision at 13:15BST/08:15EDT, press conference from 13:45BST/08:45EDT**
- **Consensus and market pricing look for a 25bps hike, taking the deposit rate to 3.5%**
- **Focus will fall on clues over the ECB's tightening ambitions beyond June**

OVERVIEW: All surveyed analysts expect the ECB to come to market with another 25bps hike, taking the deposit rate to 3.5%. Market pricing concurs, with 26bps of hikes factored in for the announcement. Since the prior meeting, headline Eurozone CPI has cooled to 6.1% from 7.0%, whilst the “super-core” measure fell to 5.3% from 5.6%. Furthermore, the ECB’s Consumer Expectations survey for April saw the 1yr ahead inflation expectation decline to 4.1% from 5.0% and 3yr view fall to 2.5% from 2.9%. That said, despite the disinflationary impulses, President Lagarde has reiterated that inflation “is too high and is set to remain so for too long”, adding that the ECB will “keep moving forward”. In terms of what happens beyond June, as it stands, markets assign a roughly 75% chance of a further 25bps move in July. However, for now, the ECB will likely continue to stress its “data-dependent approach”.

PRIOR MEETING: As expected, the ECB stepped down to a 25bps cadence of rate hikes from the 50bps unveiled in March. The decision to implement further tightening was based on the Governing Council’s judgement that the "inflation outlook continues to be too high for too long". The main surprise from the announcement came via the balance sheet, where the GC now expects to discontinue reinvestments under the APP as of July 2023. Some observed that the decision on the balance sheet could have been part of a compromise between the doves and the hawks, with the latter favouring a 50bps hike or a potentially more aggressive rate path going forward, something which President Lagarde later denied. However, source reports later suggested that there was a deal involved, but the hawks apparently gave up on a 50bps hike without much of a fight. At her follow-up press conference, Lagarde stated that the policy decisions were not to be read as a "pause", and the ECB still had "more ground to cover". However, no members argued for an unchanged outturn. Looking beyond May, Lagarde said she did not have an exact number for what "restrictive" will mean for the ECB with regards to the terminal rate, however, she judges the Bank will know when it gets there. Sources later revealed that some policymakers see two-to-three hikes ahead.

RECENT ECONOMIC DEVELOPMENTS: Eurozone headline CPI has cooled to 6.1% from 7.0%, whilst the "super-core” measure fell to 5.3% from 5.6%. Furthermore, the ECB’s Consumer Expectations survey for April saw the 1yr ahead inflation expectation decline to 4.1% from 5.0%, whilst the 3yr ahead view fell to 2.5% from 2.9%. From a growth perspective, Q1 EZ GDP was revised lower to -0.1%, which means that the bloc entered into a technical recession at the start of the year after negative growth in Q4. More timely PMI data saw the the manufacturing sector slip further into contractionary territory in May, whilst the services print fell from the prior level, but remained comfortably in positive territory, leaving the composite reading at 52.8. The accompanying report noted "the euro area economy continued to expand midway through the second quarter. However, the rate of growth slowed for the first time in 2023 so far...". In the labour market, the Eurozone unemployment rate fell to a record low of 6.5%.

RECENT COMMUNICATIONS: Since the prior meeting, President Lagarde (1st June) stated that the May inflation data "was" too high and is set to remain so for too long. As such, the ECB will "keep moving forward" in a "determined" and "undeterred" way until its inflation mandate is fulfilled. Lagarde (5th June) also remarked that rate hikes are being transmitted forcefully to financing conditions for firms and households. Chief Economist Lane (26th May) has noted that there is no certainty over the terminal rate with uncertainty in the model "high". He added that the wage correction will be a gradual process with most of the intense correction to take place this year. Germany's Schnabel (7th June) stated "a peak in underlying inflation would not be sufficient to declare victory; we need to see convincing evidence that inflation returns to our 2% target in a sustained and timely manner. We are not at that point yet." At the more hawkish end of the spectrum, Netherland's Knot (7th June) has said that, following the increases in June and July, policy will become more data dependent. Germany's Nagel (5th June) is of the view that several more rate hikes are needed and it is not certain that rates will peak this summer. At the more dovish end of the spectrum, Italy's Panetta (2nd June) has conceded that inflation is "too high", but cautioned against being too hasty in raising rates, whilst his Italian colleague Visco (31st May) notes that longer-term inflation expectations remain in line with the definition of price stability and the risk of inflation remaining above target for too long has gone down considerably from the peak of mid-2022.

RATES/BALANCE SHEET: All 62 economists surveyed by Reuters expect the ECB to come to market with another 25bps hike, taking the deposit rate to 3.5%. Market pricing concurs, with 26bps of hikes baked in for the announcement. As such, the immediate policy announcement by the Bank should pass with little in the way of fanfare. Potentially of greater interest for the markets will be what happens beyond June. From a guidance perspective, the ECB will likely continue to reiterate its "data-dependent" approach whilst taking decisions on a meeting-by-meeting basis. Therefore, until the data is released, guidance from officials will be limited. That said, nobody from the ECB so far has got in the way of market pricing which pencils in another 25bps hike in July, whilst nothing is priced in yet for September. Survey data by Reuters shows that 38/59 expect the deposit rate to be held at 3.75% (following hikes in June and July) until the end of the year; 17 had it at 3.5% or lower, 4 had it higher at 4%. Source reporting ahead of the meeting has suggested that some on the Governing Council believe a rate hike in September will be required, however, given the volume of data between now and then, it is hard to solidify calls for such a move at this stage.

ECONOMIC PROJECTIONS: For the accompanying macro projections, Nordea does not expect any significant changes to the growth profile given that Q1 GDP of -0.1% was largely as expected. On the inflation front, Rabobank notes that market pricing (which is a key input for the forecasts) has moved in a hawkish direction since the prior forecasting round (terminal currently expected at 3.75% vs. prev. 3.5%). As such, the ECB could present a slightly lower inflation profile this time around, one which could be indicative of the ECB meeting its mandate by 2025 which would also suggest that the Bank is comfortable with current market pricing. Rabobank notes that this could "complicate a more hawkish message regarding the pause, if the Council does indeed intend to send one. Instead, it would possibly be construed as dovish by the markets".

Current forecasts:

HICP INFLATION:

2023: 5.3% 2024: 2.9% 2025: 2.1%

HICP CORE INFLATION (EX-ENERGY & FOOD):

2023: 4.6% 2024: 2.5% 2025: 2.2%

GDP:

2023: 1.0% 2024: 1.6% 2025: 1.6%