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PREVIEW: ECB Policy Announcement due Thursday 27th July 2023

- **ECB policy announcement due Thursday 27th July; 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 3.75%**
- **Focus will fall on clues over the ECB's tightening ambitions beyond July**

OVERVIEW: The ECB is anticipated to raise its deposit rate by 25 basis points to 3.75%, according to market pricing and analysts' consensus. The decision will be driven by the Governing Council's concern that inflation is set to remain high for an extended period. Despite a slight cooling in headline inflation from 6.1% to 5.5%, the super-core metric has increased to 5.5% from 5.3%. With the rate hike widely expected, attention will turn to any future tightening measures from September onwards. Bloomberg reporting suggested a challenge for policymakers will be keeping options open for the September meeting, avoiding explicit signals for either another rate hike or a pause. Market pricing currently gives a 50% probability of another 25 basis points hike in September. ECB President Lagarde is expected to emphasize the Bank's reliance on data, given that July and August inflation reports and latest macro projections will be available by September.

PRIOR MEETING: The ECB delivered another 25bps hike to the Deposit Rate, taking it to 3.5%. The decision to raise rates was once again premised on the judgement that inflation “is projected to remain too high for too long”. Going forward, policy decisions will continue to follow a data-dependent approach and be taken on a meeting-by-meeting basis. Perhaps the main takeaway from the initial announcement came via the accompanying macro projections which saw upgrades to headline and core inflation for 2023 through 2025 with the core 2025 print expected above-target at 2.3%. Elsewhere, the GC confirmed that it will discontinue reinvestments under the asset purchase programme as of July 2023. At the follow-up press conference, when questioned on whether the GC expects to keep raising rates, Lagarde replied that there was still “more ground to cover” and that the ECB is not done on hikes.

RECENT ECONOMIC DEVELOPMENTS: Headline Y/Y HICP in the Eurozone fell to 5.5% from 6.1% in June, whilst the super-core metric rose from 5.3% to 5.5%. Oxford Economics notes that the uptick in core was driven by base effects from last June's temporary introduction of a public transport subsidy in Germany. The consultancy estimates that the core would have been lower if it hadn't been for the distortion from Germany. The latest ECB consumer inflation expectations survey for May saw the 12-month ahead metric fall to 3.9% from 4.1%, whilst the 3-year ahead print held steady at 2.5%. On the growth front, flash data for Q2 GDP is not released until July 31st. However, more timely survey data via July PMI metrics saw the manufacturing component slip further into contractionary territory, at 42.7 vs. prev. 43.4, services fall to 51.1 from 52.0, leaving the composite at 48.9 vs. prev. 49.9. The accompanying release noted "the eurozone economy will likely move further into contraction territory in the months ahead, as the services sector keeps losing steam". In the labour market, the unemployment rate remained at the historic low of 6.5% in May.

RECENT COMMUNICATIONS: President Lagarde followed up her remarks at the June policy meeting with an appearance at the Sintra Forum (28th Jun) whereby she reiterated her view that there was still further ground to cover for the ECB and if the Bank's baseline still stood, the ECB would likely hike again in July. On the September meeting, she noted that the decision would be data dependent. Chief Economist Lane (28th June) remarked that policy needs to continue to tighten and expects a sustained period of restrictive rates. He also (12th July) noted the considerable monetary tightening over the last year will only play out over the next couple of years. The influential Schnabel (19th Jun) of Germany suggested the "the fact that we underestimated inflation persistence last year raises the probability that we are underestimating inflation now" adding that the Bank should "err on the side of doing too much rather than too little". Known-hawk Knot (18th July) of the Netherlands drew attention when he remarked that a hike in July was a "necessity", adding that hikes beyond July are possible but "not a certainty". At the more dovish end of the spectrum, Greece's Stournaras (19th July) stated that more tightening could harm the economy, adding that another 25bps hike would be enough.

RATES/BALANCE SHEET: As judged by market pricing and surveyed analysts, the ECB is once again expected to deliver a 25bps hike which would take the deposit rate to 3.75%. The decision to move on rates again will be based on the GC’s view that inflation “is projected to remain too high for too long”, which prompted President Lagarde to declare at the June meeting that there was still “more ground to cover” and the ECB is “not done” on rate hikes. With a July hike a done deal, focus for the release will be on any accompanying guidance or hints about what tightening (if any) will be delivered from September onwards. On which, reporting from Bloomberg has suggested that the toughest challenge policymakers are set to face will be how to keep the September meeting an open one by avoiding “strong signals of either another hike or a pause”. As a guide, the policy statement currently includes the line “interest rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target and will be kept at those levels for as long as necessary”. Market pricing for September puts the chance of another 25bps move at around 50/50 in the wake of comments from hawkish GC member Knot (and partly as a result of global rate pricing on the back of soft UK inflation data) who refrained from putting a September hike on the table by suggesting that rate increases beyond July are “possible” but “not a certainty”. President Lagarde’s best course of action will likely be to stress the Bank’s data-dependence given that come September it will have seen the release of July and August inflation reports and will be armed with the latest macro projections. On the balance sheet, after confirming in June that it will discontinue reinvestments under the asset purchase programme as of July 2023, no more decisions are expected on this front. Going forward Croatia's Vujcic has noted that it is "not unimaginable to discuss bringing forward the end of PEPP reinvestment"; however, this is not expected to be a feature of the upcoming meeting.

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