Swedbank

ECB Update

A 50bp hike not ruled out, more likely in September

- Main rates unchanged, but very clear forward guidance of upcoming rate hikes
- We now forecast 25bp hike in all rates in July, followed by a 50bp hike in September

The Governing Council decided to end net asset purchases under its asset purchase programme (APP) as of 1 July 2022. The Governing Council and intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period. The principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) will be reinvested until at least the end of 2024. It was reiterated that PEPP reinvestments can be adjusted flexibly across time, asset classes and jurisdictions. In other words, the ECB sees widening sovereign spreads and does not want them to spiral out of control. The ECB has left all main interest rates unchanged but has clearly signalled that it will increase them by the 25bp in July, while the interest rates increase in September may be of "a larger increment" but will be data dependent. During the press conference, the yield spread between German and Italian 10-year government bond yields has increased to 220 basis points, the highest level in more than 2 years.

Interestingly, new the ECB macroeconomic projections show that core inflation is expected to average 2.8% in 2023 and 2.3% in 2024 – i.e., to remain slightly above its target. This elevated inflation is only likely if demand, economic activity and labour markets remain strong throughout the forecasting period. This kind of soft landing is desirable scenario, but a plethora of unfavourable factors point to a moderation in growth and, consequently, inflation. Thus, we maintain our view that the interest rate hikes will be frontloaded and after the initial aggressive tightening ECB will have to take a pause. We now forecast a 25bp hike in all rates in July, followed by the 50bp hike in deposit rate in September (rates on the main refinancing operations and on the marginal lending facility will continue increasing by 25bp). Additional two 25bp hikes in October and December should be plenty to curb the inflation expectations and demand.

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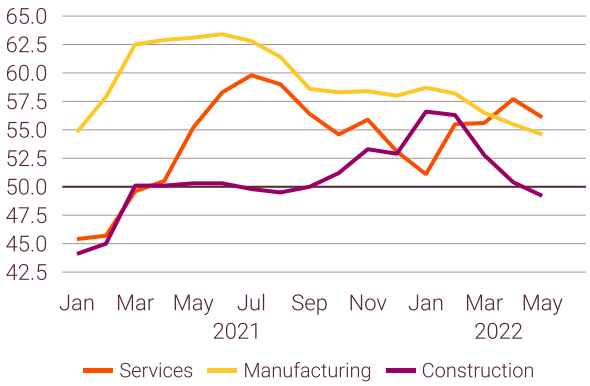
Euro area PMIs, sa



Sources: Swedbank Research & Macrobond

Spread between Italian and German 10-year government bond yields

Sources: Swedbank Research & Macrobond

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