Swedbank

ECB update

Not done yet, but start seeing tighter financial conditions

- A smaller but not the final interest rate hike
- We reiterate our forecast of two more 25 basis points hikes in June and July

As widely expected, the ECB governing council decided to raise all three key interest rates by 25 basis points. Although the ECB reiterated that the "inflation outlook continues to be too high for too long", it started admitting that the past rate increases are starting to bite, as they "are being transmitted forcefully to euro area financing and monetary conditions". Indeed, past interest rate increases are only starting to feed into the real economy, thus the ECB has extremely difficult task - tightening monetary policy enough, but not too much. On the asset purchase front the ECB governing council was a bit more hawkish and now expects to discontinue all the reinvestments under the APP as of July 2023. This means that starting July the pace of balance sheet reduction would roughly double from the current EUR 15bn per month.

During the press conference Christine Lagarde admitted increasing downside risks associated with tighter financial conditions, but at the same time reiterated that there are still inflationary risks, not least because of the recent negotiated wage agreements. Final April PMI figures show further strong divergence between stuttering manufacturing and accelerating services sectors. Although this divergence is unlikely to last – weakness in manufacturing is likely to spill-over into services later this year – so far economic resilience gives the ECB enough arguments to continue hiking its interest rates. We maintain our forecast, that the ECB will raise interest rates by 25 basis points in June and July, bringing deposit rate to 3.75%. However, tightening financial conditions increase the probability, that the ECB will end hikes sooner. We do not expect any interest rate cuts this year but forecast that retreating inflation and a likely economic weakness will lead to numerous rate cuts in 2024.

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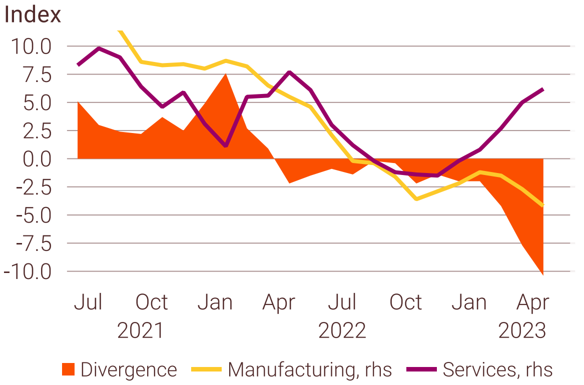
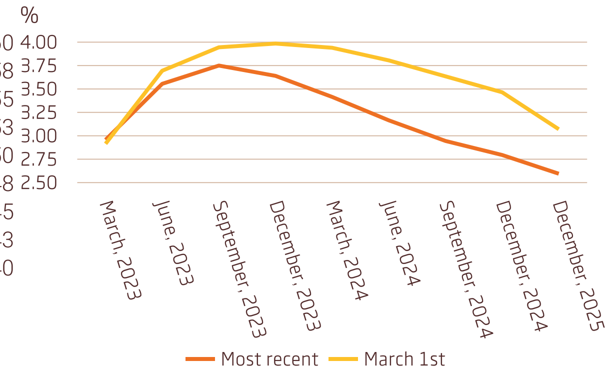
Euro Area PMIs: A Tale of Two Cities



Sources: Swedbank Research & Macrobond

3 month euribor futures: steeper inversion



Sources: Swedbank Research & Macrobond

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