

Research

Arne Petimezas
 Director Research
 +31 20 522 0244
 a.petimezas@afsgroup.nl

No smoking guns for rate hike enthusiasts...

- **If you were looking for a smoking gun today – the ECB flagging a potential hike soon, you are sure to be disappointed by today’s Governing Council meeting.** As I wrote in the preview, it’s too soon for the ECB to guide for a hike when there exists the distinct probability that President Trump might walk away from his misadventure – his Special Military Excursion in Iran. President Lagarde & Co inserted no forward guidance. They will simply stick to the meeting-by-meeting approach,
- **What the ECB did instead was flag the conditions of what could trigger hikes.** Namely a sustained energy shock – meaning an open-ended war in Iran. If an enduring shock results in what central bankers dub second-round effects, the ECB will likely believe it has no choice but to hike.
- **To gauge such second-round effects emerging, the ECB will watch how a spike in energy and broader commodity prices affect pricing behavior of firms and households.** They don’t want to be late like they were in 2022 – this trauma is now ingrained in the collective memory of our central bank overlords. At the same time, during the press conference Lagarde spelled out that this economy is different from the hot economy of 2022. The suggestion being that the ECB has the luxury of a bit of time when it comes to deciding on a hike. The takeaway is that the ECB still sees a path for holding rates, especially when it considers the downgrade of GDP growth forecasts and the recessionary risks posed by an energy price shock. So, quite dovish.
- **The takeaway from the staff forecasts is hawkish on the other hand.** ECB staff forecasts have core inflation at 2.3 percent this year, 2.2 percent next year, then 2.1 percent in 2028. Compared to the December forecasts, 2026 and 2028 were raised by a tenth of a percent, but there was a glaringly large increase of 0.3 percentage points for 2027. Now, herein lies the rub. These forecasts are conditional on market interest rate developments up until the March 11 cut-off date. So, the forecasts incorporate market pricing for a couple of hikes. And they incorporate relatively low oil prices, peaking at just \$90 a barrel. However, the natural gas price assumptions are more realistic with prices peaking at 50 EUR/MWh. Bottom line: to keep underlying inflation at the upper tolerance limit, the ECB must validate market pricing. Game over for ECB-watchers penicillin in no hikes, right?
- **If you believe – almost Deus Ex Machina – that President Trump will take the first opportunity to exit the war in the next weeks or months, the ECB will shoot itself in the foot by tightening when the shock will likely only result in a one-off increase in inflation, with underlying inflation rising only a bit.** The

ECB might talk about pouring over survey data and whatnot, but its mind is clearly elsewhere. No one mentioned his name during the press conference, but he looms large, Trump. Even the ECB gods are not immune.

AFS GROUP AMSTERDAM

All opinions and estimates expressed in this document are subject to change without notice. AFS does not accept any liability whatsoever for any direct or consequential loss arising from the use of this document. This document is for information purposes only and is not, and should not be construed as, an offer to buy or sell any securities or derivatives. The information contained in this document is published for the assistance of the recipient, but is not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient.