

Research

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

Silence of the doves

- **The ECB delivered a cautious 25bps hike today as expected: there was no teeing up of a second hike.** But there was a hawkish caveat. The doves lost this one. During the press conference with President Lagarde and the new Vice President Boris Vujcic, nary a word was spoken about the weak economy. When a journalist quizzed Lagarde about kicking the economy when it’s down, she responded with a tirade about inflation. That was no incident at all. During the presser, inflation was – and is – front and center.
- **Lagarde was crystal clear that today’s hike was absolutely not an “insurance hike”: taken out on the possible risk of inflation broadening.** No, the hike was justified by inflation already broadening and increased risk of the formation of what the ECB dubs “second round effects”: price increases begetting further price increases.
- **Predictably, ECB staff have increased their inflation forecasts while decreasing growth forecasts.** Risks for inflation are to the upside, predictably, while for growth, they’re still to the downside. In the baseline scenario, staff see core inflation at 2.5 percent this year and the next before dropping to 2.2 percent in 2028 (for what it’s worth). Headline inflation is expected to print at 3.0 percent this year, then 2.3 percent next year and 2.0 percent in 2028. Across the board, (core) inflation forecasts are increased by several tenths of a percent. GDP forecasts were lowered for each for the three years by a tenth of a percent each – hence the doves’ weak hand.
- **So, the takeaway is that today’s decision – which was unanimous, by the way – is likely to be followed by another 25bps hike, even if Lagarde gave no such clues (and refused to entertain a hawkish 2022 rate hike cycle).** The undertones were hawkish, and the ECB is now only paying lip service to the scenario entailing a quick reopening of the Strait of Hormuz. Yes, a mild scenario is still possible. But the baseline scenario from the June forecast is much closer to the adverse scenario from March, especially with regards to core inflation.
- **I expect the next hike in September, not July.** July will be a stock taking meeting unless inflation prints shift above the ECB’s baseline, or if we see bad developments in household and business survey data on price expectations, or an unanchoring of market-based measures of inflation. It is worth mentioning in this regard that price expectations in the latest EU Commission survey decreased a bit in May compared to April, but are still, of course, elevated compared to the pre-war baseline.

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