Central Banks

ECB kept rates on hold following 10 consecutive hikes

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- **The ECB maintained key rates unchanged**
- **No new insights on PEPP reinvestments and bank reserve requirements.**
- **The ECB deemed it premature to discuss potential future rate cuts.**

Today's ECB policy adhered to broader expectations of **maintaining the status quo on policy rates and quantitative tightening.** After a remarkable streak of 10 consecutive rate hikes, the ECB's decision today to **leave the three key ECB interest rates unchanged** came as no surprise, in line with our expectations. The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 4.50%, 4.75% and 4.00% respectively. What's noteworthy is the **unanimous agreement reached by the policymakers,** underscoring the unity within the central bank.

On the **possibility of further rate hikes,** just as in the previous meeting, Mrs. Lagarde refrained from firmly closing the door on such a prospect. She stated that **they have not necessarily reached the peak.** The ECB will remain **dependent on data, and decisions will be made on a meeting-by-meeting basis.** During the Q&A also in the realm of interest rates, when the question arose about **when the ECB might consider lowering rates,** Mrs. Lagarde mentioned that this matter was not discussed today. She emphasized that such a debate would be **"absolutely premature"**, supporting the perspective that **the current interest rate levels will be maintained for as long as necessary.**

Regarding **quantitative tightening,** Mrs. Lagarde ensured that the ECB Governing Board **did not discuss anything** about this topic. Therefore, **they would keep its purpose of reinvesting** the maturing principal payments from securities purchased under **the pandemic emergency purchase programme (PEPP) until the end of 2024.** It was expected by some analysts that the ECB could stop the full reinvestment of the PEPP before its planned end date of December 2024, since there seemed to be some discrepancies among the members of the Governing Council about this possibility. The possible total or partial stop of PEPP reinvestment worried investors, especially in Italy amid government finances concerns, so **the Italian risk premium narrowed significantly,** following the Q&A.

Another topic that was expected to receive some hints from the ECB was about **the reserve remuneration ratio.** Mrs. Lagarde emphasized that **this issue was not discussed either**, amid some expectations that it could rise from 1% to 2%. In this regard, asked for a question **about central banks losses**, Mrs. Lagarde highlighted that the ECB's mission is price stability and **it is not their aim to generate profits or offset losses**, which would imply a deviation from pure monetary policy objectives.

On data developments, the ECB emphasizes **the weakness of the economy**, where the already fragile situation in the manufacturing sector is starting to spill over into the services sector, with an external sector that weighs down. However, although **in the short term** they foresee economic growth being weak as **the impact of higher interest rates was broad**, **in the medium term**, with lower inflation and a strong labor market, **household real incomes will recover and push the economy forward**.

They continue to see the energy crisis fading, at least the one caused by Russia's invasion of Ukraine, and therefore advocate the withdrawal of subsidies to avoid inflation surprises in the medium term. In this sense, **they do not change**

their stance that inflation continues to fall as they are reinforced by the recent good data and the expected base effects in the last quarter of this year. Nonetheless, **monitoring will continue** to reach the inflation target in the face of a **strong labor market**, which could further increase wages, and **new geopolitical tensions in the Middle East**, which make energy prices less predictable.

Therefore, **risks to growth are clearly on the downside**, with demand, already weakened by the effects of monetary policy, to be further affected if geopolitical tensions escalate. These tensions are also sources of **upside risk to inflation from higher energy prices**, framed as a short-term risk and balanced by lower global economic activity in the medium term. However, Mrs. Lagarde stressed that **these higher energy prices are less likely to translate into higher price pressures in the eurozone** as it is a different economic moment today.

Overall, **today's meeting yielded few surprises and the overall tone was dovish**, with a tempered attention to the current challenging geopolitical environment. Thus, despite Lagarde's assertion that the hiking cycle remains open, **we do not anticipate additional rate increases**

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in black, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

1.1. Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB

~~Frankfurt am Main, 14 September~~Athens, 26 October 2023

Good afternoon, the Vice-President and I welcome you to our press conference. I would like to thank Governor Stournaras for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council.

~~Inflation continues to decline but is still expected to remain too high for too long.~~ The Governing Council today decided to keep the three key ECB interest rates unchanged. The incoming information has broadly confirmed our previous assessment of the medium-term inflation outlook. Inflation is still expected to stay too high for too long, and domestic price pressures remain strong. At the same time, inflation dropped markedly in September, including due to strong base effects, and most measures of underlying inflation have continued to ease. Our past interest rate increases continue to be transmitted forcefully into financing conditions. This is increasingly dampening demand and thereby helps push down inflation.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. ~~In order to reinforce progress towards our target, the Governing Council today decided to raise the three key ECB interest rates by 25 basis points~~Based on our current assessment, we consider that the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to this goal. Our future decisions will ensure that our policy rates will be set at sufficiently restrictive levels for as long as necessary.

~~The rate increase today reflects our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission. The September ECB staff macroeconomic projections for the euro area see average inflation at 5.6 per cent in 2023, 3.2 per cent in 2024 and 2.1 per cent in 2025. This is an upward revision for 2023 and 2024 and a downward revision for 2025. The upward revision for 2023 and 2024 mainly reflects a higher path for energy prices. Underlying price pressures remain high, even though most indicators have started to ease. ECB staff have slightly revised down the projected path for inflation excluding energy and food, to an average of 5.1 per cent in 2023, 2.9 per cent in 2024 and 2.2 per cent in 2025. Our past interest rate increases continue to be transmitted forcefully. Financing conditions have tightened further and are increasingly dampening demand, which is an important factor in bringing inflation back to target. With the increasing impact of our tightening on domestic demand and the weakening international trade environment, ECB staff have lowered their economic growth projections significantly. They now expect the euro area economy to expand by 0.7 per cent in 2023, 1.0 per cent in 2024 and 1.5 per cent in 2025.~~

~~Based on our current assessment, we consider that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to our target. Our future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary.~~ We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation~~,~~ and the strength of monetary policy transmission.

The decisions taken today are set out in a ~~press release~~press release available on our website.
I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

1.2. Economic activity

~~The economy is likely to remain subdued in the coming months. It broadly stagnated over the first half of the year, and recent indicators suggest it has also been weak in the third quarter. Lower demand for the euro area's exports and the impact of tight financing conditions are dampening growth, including through lower residential and business investment. The services sector, which had so far been resilient, is now also weakening. Over time, economic momentum should pick up, as real incomes are expected to rise, supported by falling inflation, rising wages and a strong labour market, and this will underpin consumer spending.~~

~~The labour market~~ The euro area economy remains weak. Recent information suggests that manufacturing output has continued to fall. Subdued foreign demand and tighter financing conditions are increasingly weighing on investment and consumer spending. The services sector is also weakening further. This is mainly because weaker industrial activity is spilling over to other sectors, the impetus from reopening effects is fading and the impact of higher interest rates is broadening. The economy is likely to remain weak for the remainder of this year. But as inflation falls further, household real incomes recover and the demand for euro area exports picks up, the economy should strengthen over the coming years.

Economic activity has so far ~~remained resilient despite~~ been supported by the ~~slowing economy.~~strength of the labour market. The unemployment rate ~~stayed~~stood at ~~its~~a historical low of 6.4 per cent in ~~July. While~~August. At the same time, there are signs that the labour market is weakening. Fewer new jobs are being created, including in services, consistent with the cooling economy gradually feeding through to employment ~~grew by 0.2 per cent in the second quarter, momentum is slowing. The services sector, which has been a major driver of employment growth since mid-2022, is now also creating fewer jobs~~.

As the energy crisis fades, governments should continue to roll back the related support measures. This is essential to avoid driving up medium-term inflationary pressures, which would otherwise call for ~~an~~ even ~~stronger~~tighter monetary policy ~~response~~. Fiscal policies should be designed to make our economy more productive and to gradually bring down high public debt. ~~Policies~~Structural reforms and investments to enhance the euro area's supply capacity – which would be supported by the full implementation of the Next Generation EU programme – can help reduce price pressures in the medium term, while supporting the green ~~transition. The~~and digital transitions. To that end, the reform of the EU's economic governance framework should be concluded before the end of this year and progress towards Capital Markets Union and the completion of Banking Union should be accelerated.

1.3. Inflation

Inflation ~~declined~~dropped to ~~5~~4.3 per cent in ~~July but remained at that level in August, according to Eurostat's flash estimate. Its decline was interrupted because energy prices rose compared with July. Food price inflation has come down from its peak in March but was still~~ September, almost ~~10 per cent in~~a full percentage point lower than its August level. In the ~~coming months,~~ near term, it is likely to come down further, as the sharp price increases in energy and food recorded in ~~the~~ autumn ~~of~~ 2022 will drop out of the yearly rates~~, thus pulling inflation down~~. September's decline was broad-based. Food price inflation slowed again, although it remains high by historical standards. In annual terms, energy prices fell by 4.6 per cent but, most recently, have risen again and become less predictable in view of the new geopolitical tensions.

Inflation excluding energy and food ~~fell~~dropped to 4.5 per cent in September, from 5.3 per cent in August~~, from 5.5 per cent in July. Goods inflation declined to 4.8 per cent in August, from 5.0 per cent in July and 5.5 per cent in June, owing to better~~. This fall was supported by improving supply conditions, the pass-through of previous ~~drops~~declines in energy prices, ~~easing price pressures in the earlier stages of~~ and the ~~production chain and weaker~~ impact of tighter monetary policy on demand~~. Services inflation edged down to 5.5 per cent but was still kept up by strong spending on holidays and travel~~ and ~~by the high growth of wages. The annual growth rate of compensation per employee remained constant at 5.5 per cent in the second quarter of the year. The contribution of labour costs to annual domestic inflation increased in the second quarter, in part owing to weaker productivity, while the contribution of profits~~corporate pricing power. Goods and services inflation rates fell ~~for the first time since early 2022~~substantially, to 4.1 per cent and 4.7 per cent respectively, with services inflation also being pulled down by pronounced base effects. Price pressures in tourism and travel appear to be moderating.

Most measures of underlying inflation ~~are starting to fall as demand and supply have become more aligned and the contribution of past energy price increases is fading out.~~continue to decline. At the same time, domestic price pressures ~~remain strong.~~

~~Most measures~~are still strong, reflecting also the growing importance of rising wages. Measures of longer-term inflation expectations ~~currently~~mostly stand ~~at~~ around 2 per cent. ~~But~~Nonetheless, some indicators ~~have increased~~remain elevated and need to be monitored closely.

1.4. Risk assessment

The risks to economic growth ~~are~~remain tilted to the downside. Growth could be ~~slower~~lower if the effects of monetary policy ~~are more forceful~~turn out stronger than expected~~, or if the~~. A weaker world economy ~~weakens, for instance owing to a~~would also weigh on growth. Russia's unjustified war against Ukraine and the tragic conflict triggered by the terrorist attacks in Israel are key sources of geopolitical risk. This may result in firms and households becoming less confident and more uncertain about the future, and dampen growth further~~ slowdown in China.~~. Conversely, growth could be higher than ~~projected~~expected if the ~~strong~~still resilient labour market~~,~~ and rising real incomes ~~and receding uncertainty~~ mean that people and businesses become more confident and spend more, or the world economy grows more strongly than expected.

Upside risks to inflation ~~include potential renewed upward pressures on the costs of~~ could come from higher energy and food~~. Adverse~~ costs. The heightened geopolitical tensions could drive up energy prices in the near term, while making the medium-term outlook more uncertain. Extreme weather~~ conditions~~, and the unfolding climate crisis more broadly, could push food prices up by more than expected. A lasting rise in inflation expectations above our target, or higher than anticipated increases in wages or profit margins, could also drive inflation higher, including over the medium term. By contrast, weaker demand – for example ~~due~~owing to a stronger transmission of monetary policy or a worsening of the economic environment ~~outside~~in the ~~euro area~~rest of the world amid greater geopolitical risks – would ~~lead to lower~~ease price pressures, especially over the medium term.

1.5. Financial and monetary conditions

Longer-term interest rates have risen markedly since our last meeting, reflecting strong increases in other major economies. Our monetary policy ~~tightening~~ continues to ~~be transmitted~~transmit strongly ~~to~~into broader financing conditions. Funding has ~~again~~ become more expensive for banks, ~~as savers are replacing overnight deposits with time deposits that pay more interest~~ and ~~the ECB's targeted longer-term refinancing operations are being phased out. Average lending~~ interest rates for business loans and mortgages ~~continued~~rose again in August, to ~~increase in July, to 4.~~5.0 per cent and 3.9 per cent ~~and 3.8 per cent~~ respectively.

~~Credit~~Higher borrowing rates, with the associated cuts in investment plans and house purchases, led to a further sharp drop in credit demand in the third quarter, as reported in our latest bank lending survey. Moreover, credit standards for loans to firms and households tightened further. Banks are becoming more concerned about the risks faced by their customers and are less willing to take on risks themselves.

Against this background, credit dynamics have weakened further. ~~Loans to firms grew at an~~The annual growth rate of loans to firms has dropped sharply, from 2.2 per cent in July~~, down from 3.0 per cent in June. Loans to households also grew less strongly, by 1.3 per cent, after 1.~~ to 0.7 per cent in ~~June. In annualised terms based on the last three months of data, household loans declined by~~August and 0.2 per cent in September. Loans to households remained subdued, with the growth rate slowing to 1.0 per cent in August and 0.8 per cent~~, which is the strongest contraction since the start of the euro~~ in September. Amid weak lending and the reduction in the Eurosystem balance sheet, the annual growth rate of M3 fell ~~from 0.6~~to -1.3 per cent in ~~June to an all-time low~~August – the lowest level recorded since the start of ~~-0.4~~the euro – and still stood at -1.2 per cent in ~~July. In annualised terms over the past three months, M3 contracted by 1.5 per cent~~September.

1.6. Conclusion

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In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

We are now ready to take your questions.

Creating Opportunities

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