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# ECB February Meeting: The dove has left the nest

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On Thursday, the ECB confirmed its dovish stance – for the time being. Its policy statement was along the expected lines - essentially a carbon copy of its December statements: the deposit rate was left unchanged at -0.5%, with the ECB confirming the end of bond purchases under the pandemic emergency purchase program (PEPP) in March and reiterating that it will slow bond-buying across 2022 and end asset purchases entirely before raising borrowing costs.

The ECB's position also signals that policy makers in Frankfurt are for now sticking to their guns when it comes to their view that elevated inflation will abate once energy costs and supply chain snarls ease but have left a bigger margin for error, pointing out that the inflation outlook is uncertain and acknowledging that inflation is to remain elevated for longer. Lagarde said: "compared with our expectations in December, **risks to the inflation outlook are tilted to the upside, particularly in the near term**".

Last week, the Eurozone headline inflation reading for January set a new all-time record at 5.1%, with gains largely led by energy (up 28.6% in January), while the growth in prices for manufactured goods slowed: core inflation, which strips out more volatile energy and food prices, was 2.3%, down from 2.6% in December, providing very little evidence of more ingrained inflation in the bloc so far. However, with that said, elevated energy prices mean that concerns about future second-round effects remain valid. At the same time, Eurozone unemployment was recorded at a record low of 7.0% in December 2021 (from a downwardly revised 7.1% in the previous month), highlighting how the region's labour market has bounced back much faster than expected from the pandemic, largely thanks to furlough schemes and the quick return of demand.

While President Christine Lagarde previously insisted that a rate hike is unlikely this year, she is now concerned about making the right decisions at the right time. Money markets have already chosen their camp, predicting a 20 basis-point increase from the ECB by July and now see almost 50 basis points of tightening by year end. During and after the usual press conference where Lagarde refused to confirm that a rate hike is unlikely for this year, investors dumped their fixed income securities and the German 10Y moved up by 10bps, a jump not seen since November 2020.

*"DURING AND AFTER THE USUAL PRESS CONFERENCE WHERE LAGARDE REFUSED TO CONFIRM THAT A RATE HIKE IS UNLIKELY FOR THIS YEAR"*

This can be seen as a clearly hawkish turn by the ECB at the press conference and the next policy meeting on March 10th could potentially bring fireworks. An announcement of an accelerated taper of bond purchases to clear the way for a first rate hike later this year now seems like a plausible outcome. After all, Lagarde confirmed that a rate hike could happen "shortly" after ending purchases. The central bank will also update its inflation projections at this meeting.

Over the Channel and also on Thursday, the Bank of England raised its benchmark rate by 0.25% to 0.5% as expected by market participants but the devil was in the details. The decision for the 0.25% rise was far from unanimous with 4 out of 9 voters wanting a bigger hike going from 0.5% to even a 0.75% hike.

In terms of its holding of bonds, officials unanimously voted to begin the process of shrinking the balance sheet. The BOE will immediately stop reinvesting the proceeds of expired gilts, allowing more than 200 billion pounds to run off by 2025. It also announced plans to offload the entire 20 billion pound stock of corporate bonds by the end of 2023.

With evolutions in the health epidemic proving less severe than could have been over winter, and inflation proving quite relentless, it is clear that the global tightening cycle is shifting up a gear. After years of suppressed yields, the sands are shifting in the investment landscape and

investors have to quickly get acquainted with this new environment.

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