

October 27, 2022

ECB Flash – October



- ECB lifts its deposit rate by 75bp, to 1.50%, in line with expectations
- The refinancing rate also was raised by 75bp, to 2.00%, also as expected
- The marginal lending facility rate was increased to 2.25%, from 1.50%
- Rate guidance was tweaked suggesting possibility of fewer hikes ahead
- The ECB plans to change terms of pandemic emergency loans

At today's monetary policy meeting, the ECB hiked its key policy rates in line with expectations as it continues to battle stickier-than-expected inflation: HICP hit 9.9% YoY in September and

Lagarde noted that price pressures “are evident in more and more sectors”.

Looking ahead, the central bank expects further rate increases, but Lagarde commented that the bank is “very much and deliberately” turning its back on forward guidance, adding that “the destination for us is clear, the exact pace will have to be determined meeting by meeting.”

Albeit, markets concluded that a slower pace of tightening is coming based on two points:

- The comment: “With this third major policy rate increase in a row, the Governing Council has made **substantial progress** in withdrawing monetary policy accommodation”
- While the ECB noted that while policy rates will “raise further”, it dropped the notion it would continue for several meetings.

In response, money markets scaled back tightening bets by more than 15 basis points, pricing the deposit rate to peak just above 2.75% next year.

Officials also toughened the terms on more than €2 trillion of pandemic-era loans to banks known as TLTROs. The conditions on the TLTRO III loans had allowed banks to borrow from the ECB at negative rates, the exact level depending on how much of that preferential funding they passed on to households and companies. As the ECB has raised rates, the incentive to 'park' those funds back at the ECB's deposit facility has increased, essentially subsidising Eurozone banks with billions of euros. As such, the ECB will change the terms of the TLTRO III so that “the interest rate on TLTRO III operations will be indexed to the average applicable key ECB interest rates over this period,” as of November 23.

Lagarde said that quantitative tightening was deliberately not discussed at this meeting and that the principles of portfolio reduction will be discussed in December.

During the press conference, Lagarde noted that while risks to inflation are tilted to the upside, risks to growth are skewed to the downside and that it was likely that Q3's significant slowdown will deepen through Q4 and Q1 2023. This is in keeping with flash PMI data released on Monday that showed both the manufacturing and services sectors fell further into contractionary territory at 46.6 and 48.2, respectively.

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