Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

Data Insights: ECB and Euro Area Economy Monitor

Thursday, June 16, 2023

Today's monetary policy decision: how the language changed from prior meeting

~~4 May~~15 June 2023

~~The inflation outlook continues~~Inflation has been coming down but is projected to ~~be~~remain too high for too long. ~~In light of the ongoing high inflation pressures, the~~ The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. It therefore today decided to raise the three key ECB interest rates by 25 basis points. ~~Overall~~

The rate increase today reflects the Governing Council's updated assessment of the inflation outlook, the ~~incoming information broadly supports the assessment of the medium-term~~ dynamics of underlying inflation ~~outlook that the Governing Council formed at its previous meeting. Headline~~, and the strength of monetary policy transmission. According to the June macroeconomic projections, Eurosystem staff expect headline inflation ~~has declined over recent months, but~~ to average 5.4% in 2023, 3.0% in 2024 and 2.2% in 2025. Indicators of underlying price pressures remain strong~~.~~, although some show tentative signs of softening. Staff have revised up their projections for inflation excluding energy and food, especially for this year and next year, owing to past upward surprises and the implications of the robust labour market for the speed of disinflation. They now see it reaching 5.1% in 2023, before it declines to 3.0% in 2024 and 2.3% in 2025. Staff have slightly lowered their economic growth projections for this year and next year. They now expect the economy to grow by 0.9% in 2023, 1.5% in 2024 and 1.6% in 2025.

At the same time, the Governing Council's past rate increases are being transmitted forcefully to ~~euro area~~ financing ~~and monetary~~ conditions~~, while the lags and strength of transmission to the real economy remain uncertain~~ and are gradually having an impact across the economy. Borrowing costs have increased steeply and growth in loans is slowing. Tighter financing conditions are a key reason why inflation is projected to decline further towards target, as they are expected to increasingly dampen demand.

The Governing Council's future decisions will ensure that the ~~policy~~key ECB interest rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target and will be kept at those levels for as long as necessary. The Governing Council will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, ~~the Governing Council's policy~~its interest rate decisions will continue to be based on its 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 ~~key ECB interest rates remain the Governing Council’s primary tool for setting the monetary policy stance. In parallel, the~~ Governing Council confirms that it will ~~keep reducing the Eurosystem’s asset purchase programme (APP) portfolio at a measured and predictable pace. In line with these principles, the Governing Council expects to~~ discontinue the reinvestments under the ~~APP~~ asset purchase programme as of July 2023.

Key ECB interest rates
The Governing Council decided to raise the three key ECB interest rates by 25 basis points. Accordingly, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will be increased to ~~3.75%,~~ 4.00%, 4.25% and 3.~~25~~50% respectively, with effect from ~~10 May~~21 June 2023.

Asset purchase programme (APP) and pandemic emergency purchase programme (PEPP)
The APP portfolio is declining at a measured and predictable pace, as the Eurosystem does not reinvest all of the principal payments from maturing securities. The decline will amount to €15 billion per month on average until the end of June 2023. The Governing Council ~~expects to~~will discontinue the reinvestments under the APP as of July 2023.

As concerns the PEPP, the Governing Council intends to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

The Governing Council will continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

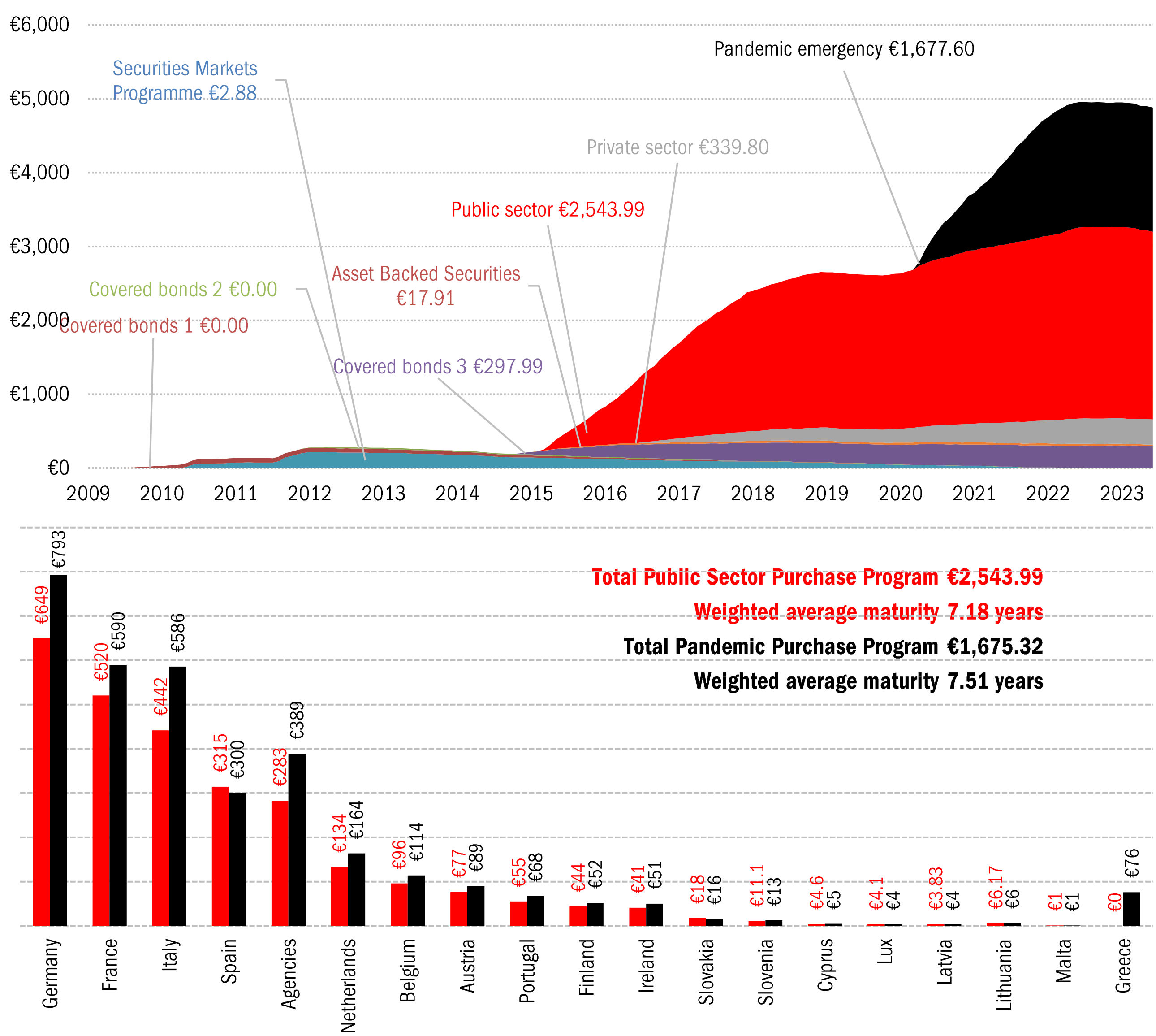
Refinancing operations
As banks are repaying the amounts borrowed under the targeted longer-term refinancing operations, the Governing Council will regularly assess how targeted lending operations and their ongoing repayment are contributing to its monetary policy stance.

***

The Governing Council stands ready to adjust all of its instruments within its mandate to ensure that inflation returns to its 2% target over the medium term and to preserve the smooth functioning of monetary policy transmission. ~~The ECB’s policy toolkit is fully equipped to provide liquidity support to the euro area financial system if needed.~~ Moreover, the Transmission Protection Instrument is available to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across all euro area countries, thus allowing the Governing Council to more effectively deliver on its price stability mandate.

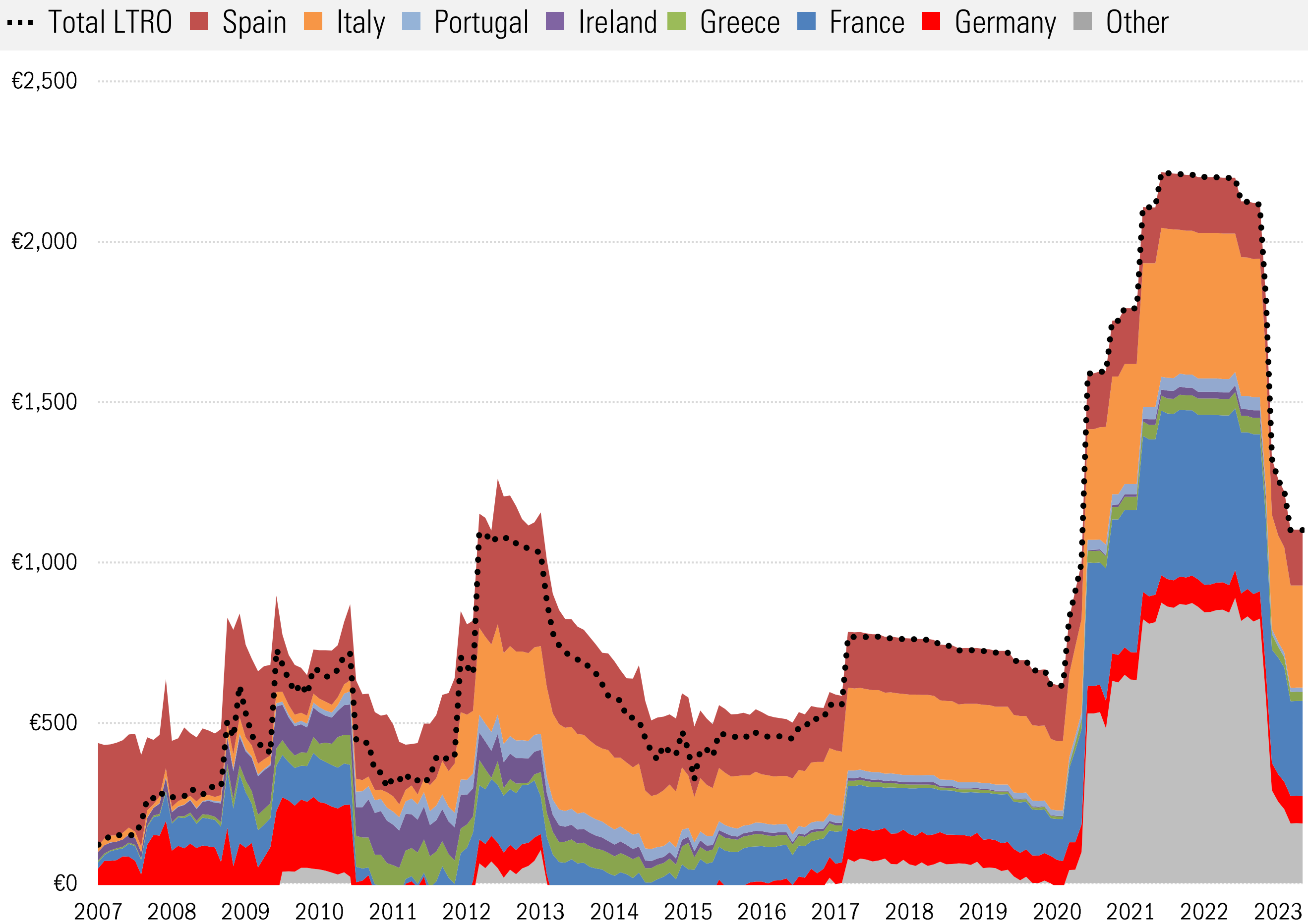
Source: FOMC, TrendMacro analysis

Euro-QE (€ billions)



Source: ECB, TrendMacro calculations

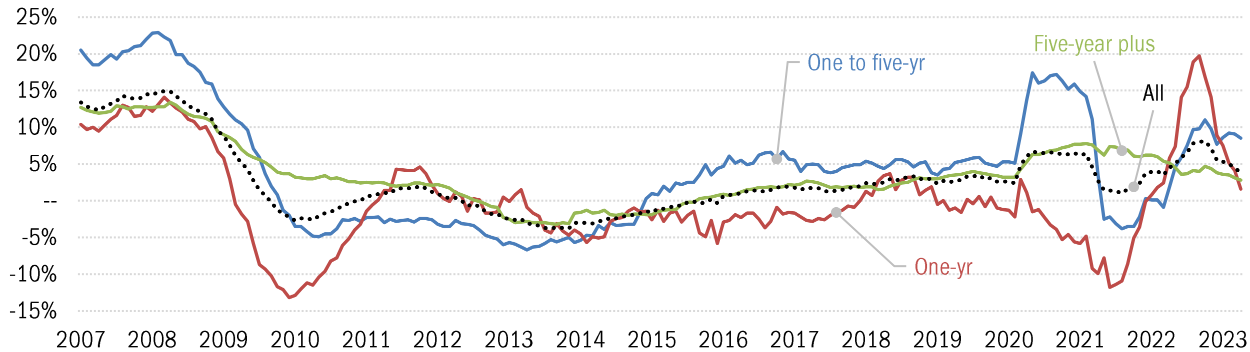
Banking system dependency: borrowing from the ECB (€ billions)



Source: ECB, National central banks, TrendMacro calculations

The credit drought: loans to non-financial businesses (YOY growth)

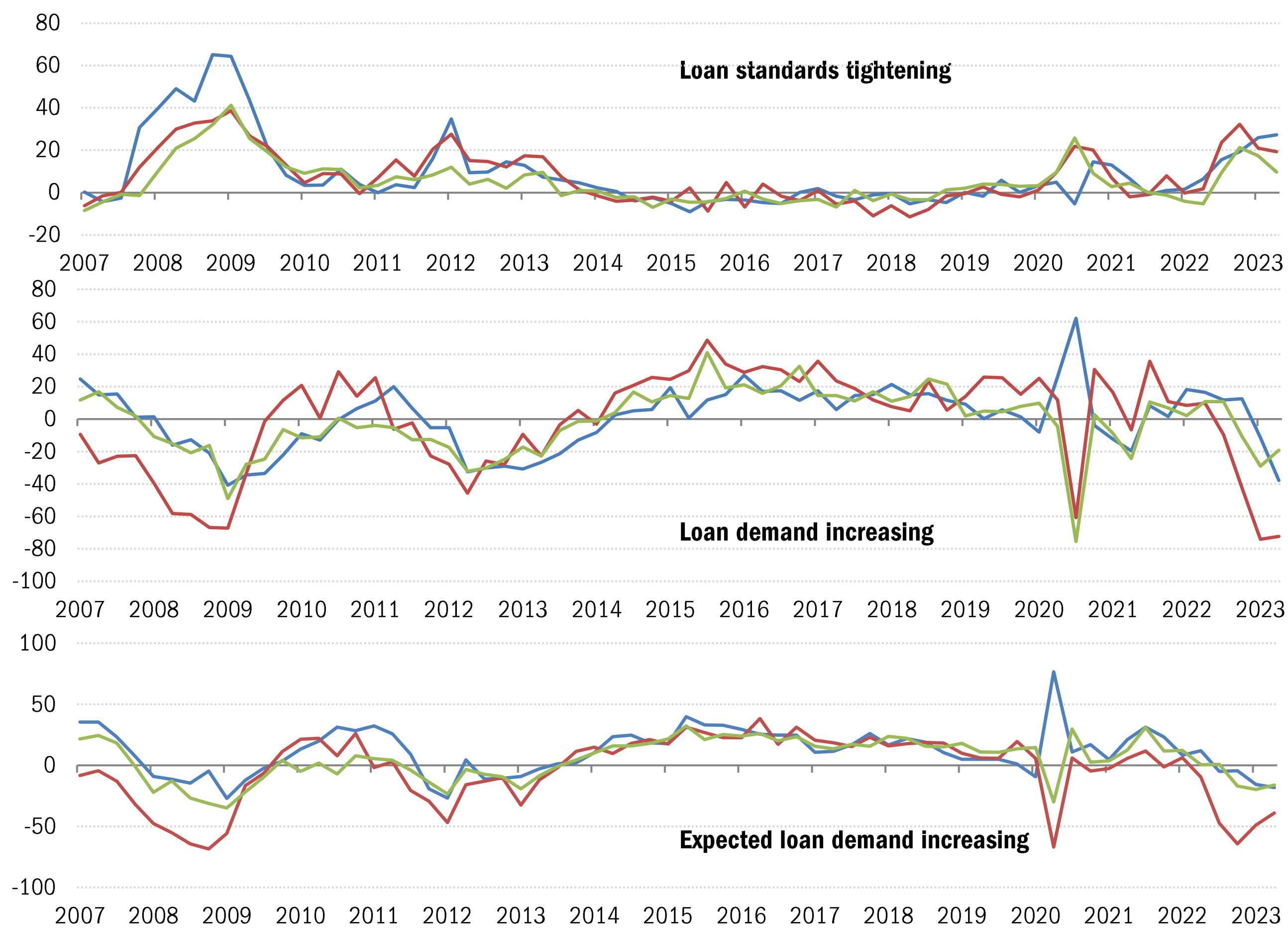
Loans to 1 year — Loans 1-5 years — Loans 5 years plus ··· Total



Source: ECB, TrendMacro calculations

Supply and demand for lending: ECB Bank Survey

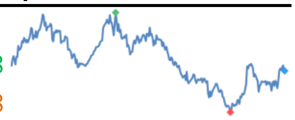
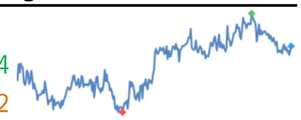
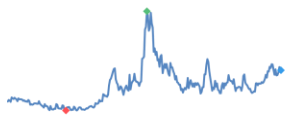
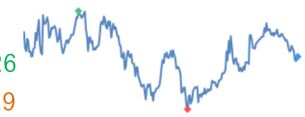
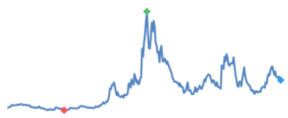
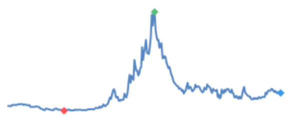
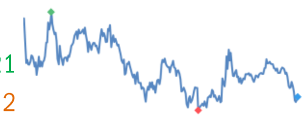
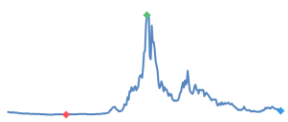
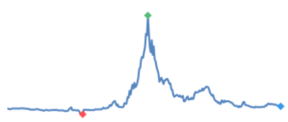
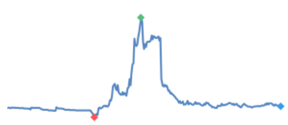
Net number of banks reporting for: Enterprises — Home mortgage — Consumer



Source: ECB, TrendMacro calculations

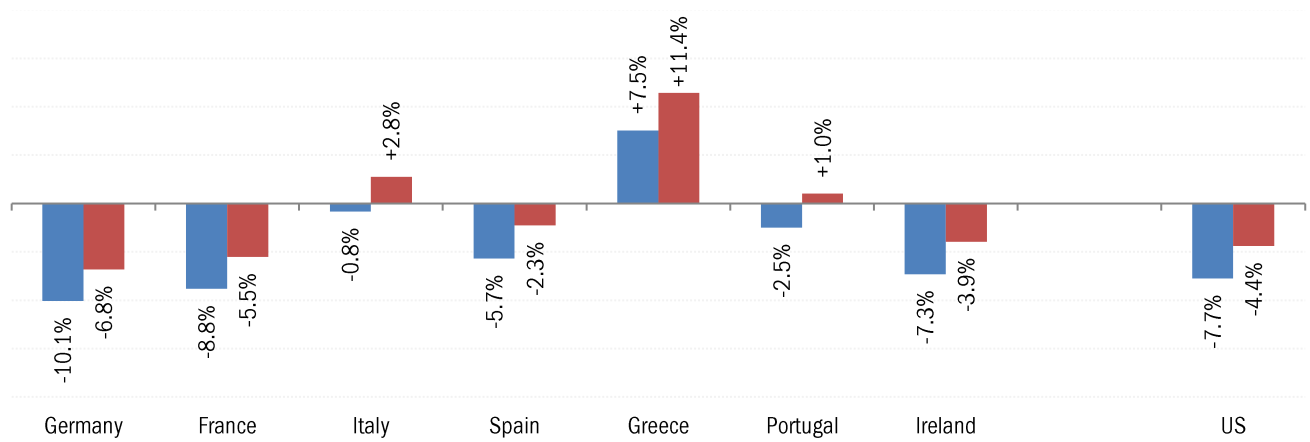
Sovereign stress monitor: 10-year bond spreads

· High · Low · Last

		2000 to present			Trailing 12m		
Germany Spread to US Last -1.30%	High 0.74% Low -2.76%	Dec '08 Oct '18		High -0.98% Low -1.96%	Apr 24 Nov 2	
France Spread to Germany Last 0.53%	High 1.32% Low -0.01%	Dec '11 Jan '05		High 0.63% Low 0.42%	Aug 26 Jan 19	
Italy Spread to Germany Last 1.68%	High 5.28% Low 0.09%	Dec '11 Nov '04		High 2.53% Low 1.63%	Sep 27 Jun 13	
Spain Spread to Germany Last 0.96%	High 5.52% Low -0.05%	Aug '12 Nov '04		High 1.27% Low 0.92%	Jul 21 Feb 2	
Greece Spread to Germany Last 1.38%	High 33.13% Low 0.09%	Dec '11 Jan '05		High 2.84% Low 1.28%	Oct 3 Jun 13	
Portugal Spread to Germany Last 0.68%	High 14.61% Low -0.54%	Jan '12 Jun '06		High 1.21% Low 0.67%	Jun 15 Jun 13	
Ireland Spread to Germany Last 0.38%	High 8.67% Low -0.67%	Jun '11 Jun '07		High 0.68% Low 0.36%	Jun 16 Jun 12	

10-year sovereign bond total returns, trailing 12-months

EUR USD



Source: Bloomberg, TrendMacro calculations

Labor market in intensive care

ULC: Nominal, quarterly YOY   UE: · High   12m pulse: monthly ■ improvement or ■ worsening in rate of change

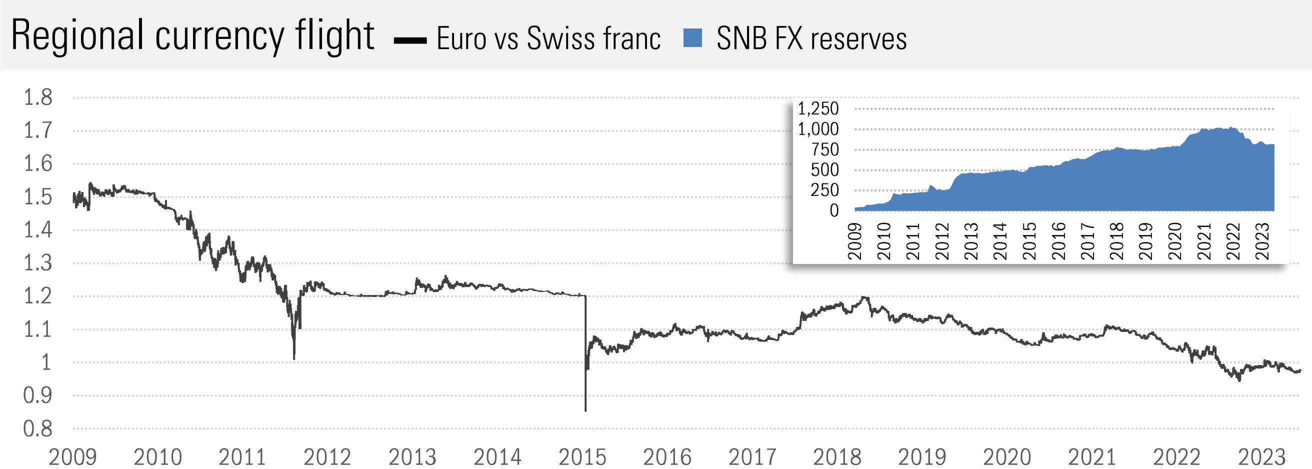
Source: Eurostat, TrendMacro calculations

Purchasing Manager Indices

Manufacturing	Last	Prev	13-month history	***Services***	Last	Prev	13-month history
Eurozone May	44.8	45.8		Eurozone May	55.1	56.2	
UK May	47.1	47.8		UK May	55.2	55.9	
Germany May	43.2	44.5		Germany May	57.2	56.0	
France May	45.7	45.6		France May	52.5	54.6	
Italy May	45.9	46.8		Italy May	51.6	48.4	
Spain May	48.4	49.0		Spain May	56.7	57.9	
Ireland May	47.5	48.6		Ireland May	57.0	58.4	
Netherlands May	44.2	44.9					
Austria May	39.7	42.0					
Greece May	51.5	52.4					
Czech Rep May	42.8	42.8					

Source: Markit, TrendMacro calculations

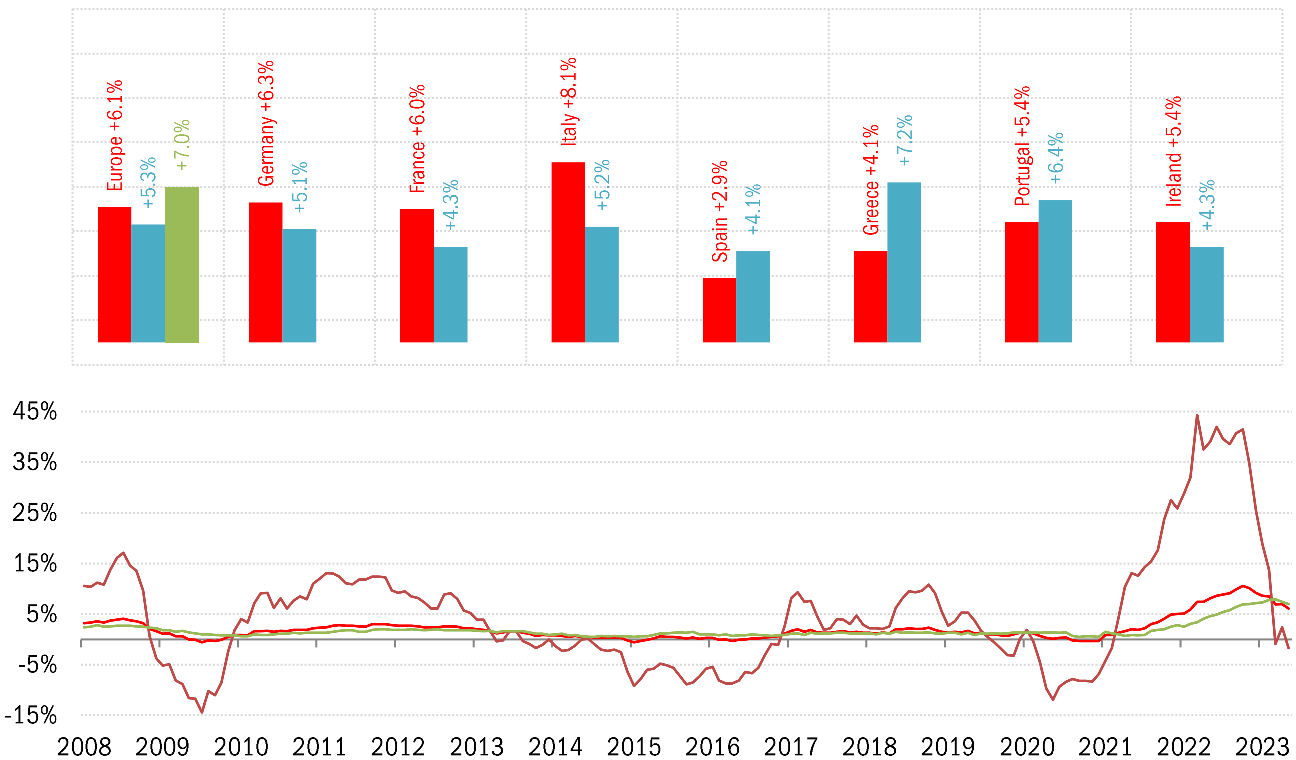
Regional currency flight



Source: Bloomberg, TrendMacro calculations

Euro area consumer inflation, year on year

Country: Headline · Ex-food and energy · Ex-energy   Euro area: Headline · Energy · Ex-energy



Source: Eurostat, TrendMacro calculations

Draghi's old dashboard:
Swap-implied inflation expectations since "Whatever it takes"

5-year inflation-swap rate, 5 years forward

Source: Bloomberg, TrendMacro calculations