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Data Insights: ECB and Euro Area Economy Monitor

Thursday, October 26, 2023

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

~~14 September~~26 October 2023

~~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 its 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. The Governing Council's past interest rate increases continue to be transmitted forcefully into financing conditions. This is increasingly dampening demand and thereby helps push down inflation.

The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. ~~In order to reinforce progress towards its target, the Governing Council today decided to raise the three key ECB interest rates by 25 basis points.~~

~~The rate increase today reflects the Governing Council's 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% in 2023, 3.2% in 2024 and 2.1% 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% in 2023, 2.9% in 2024 and 2.2% in 2025. The Governing Council's 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 this 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% in 2023, 1.0% in 2024 and 1.5% in 2025.~~

Based on its current assessment, the Governing Council considers that the key ECB interest rates ~~have reached~~are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to ~~the timely return of inflation to the target.~~this goal. The Governing Council's future decisions will ensure that ~~the key ECB interest~~its policy rates will be set at sufficiently restrictive 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 interest rate decisions will 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.

Key ECB interest rates
~~The Governing Council decided to raise the three key ECB interest rates by 25 basis points. Accordingly, the~~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~~remain unchanged at 4.50%, 4.75% and 4.00% respectively~~, with effect from 20 September 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 no longer reinvests the principal payments from maturing securities.

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.

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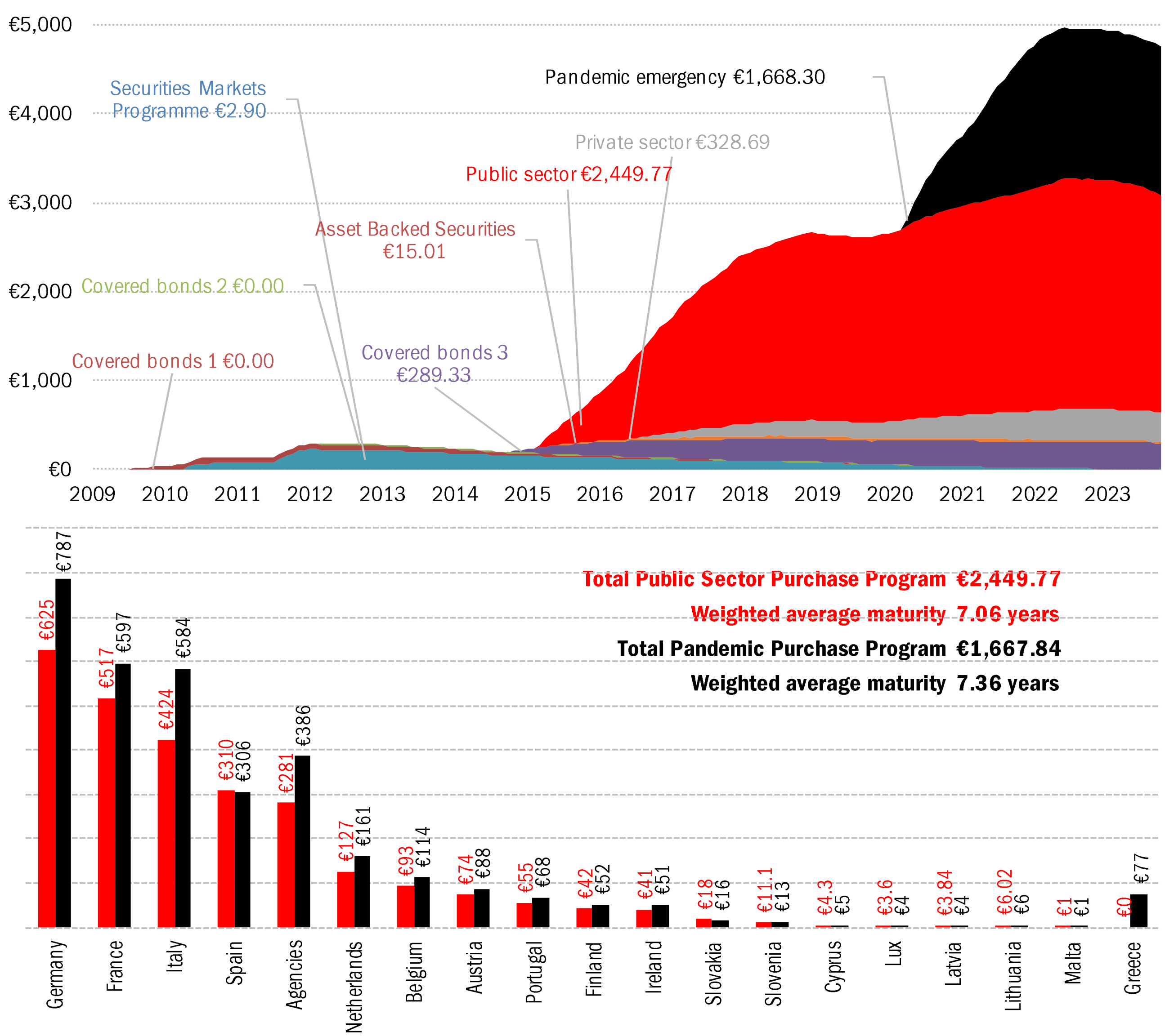
The Governing Council stands ready to adjust all of its instruments within its mandate to ensure that inflation returns to its 2% target over the medium term and to preserve the smooth functioning of monetary policy transmission. Moreover, the Transmission Protection Instrument is available to counter 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

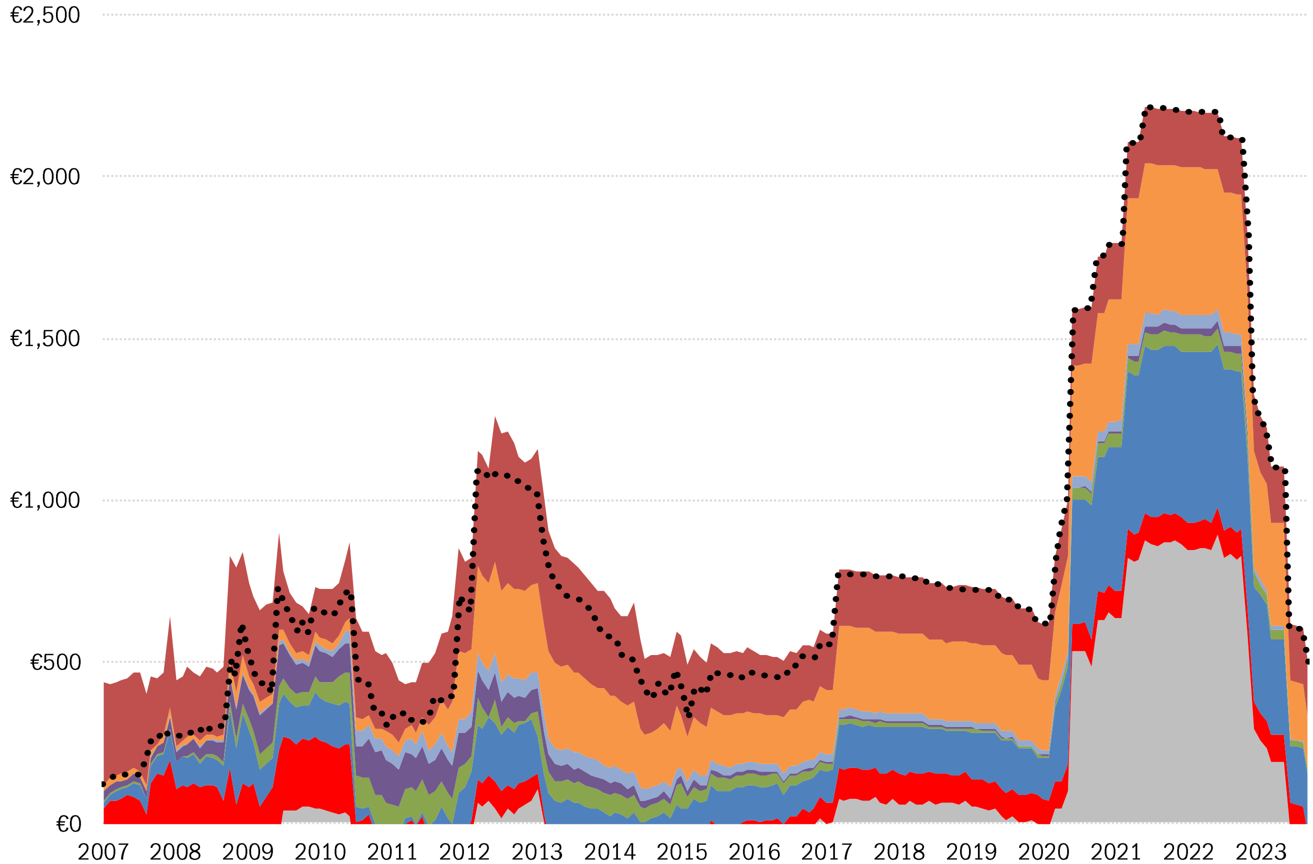
Euro-QE (€ billions)



Source: ECB, TrendMacro calculations

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

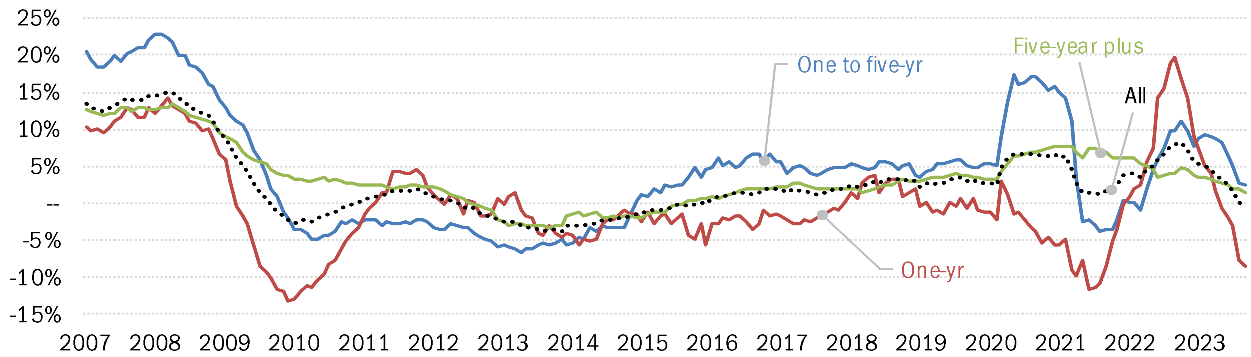
Total LTRO, Spain, Italy, Portugal, Ireland, Greece, France, Germany, Other



Source: ECB, National central banks, TrendMacro calculations

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

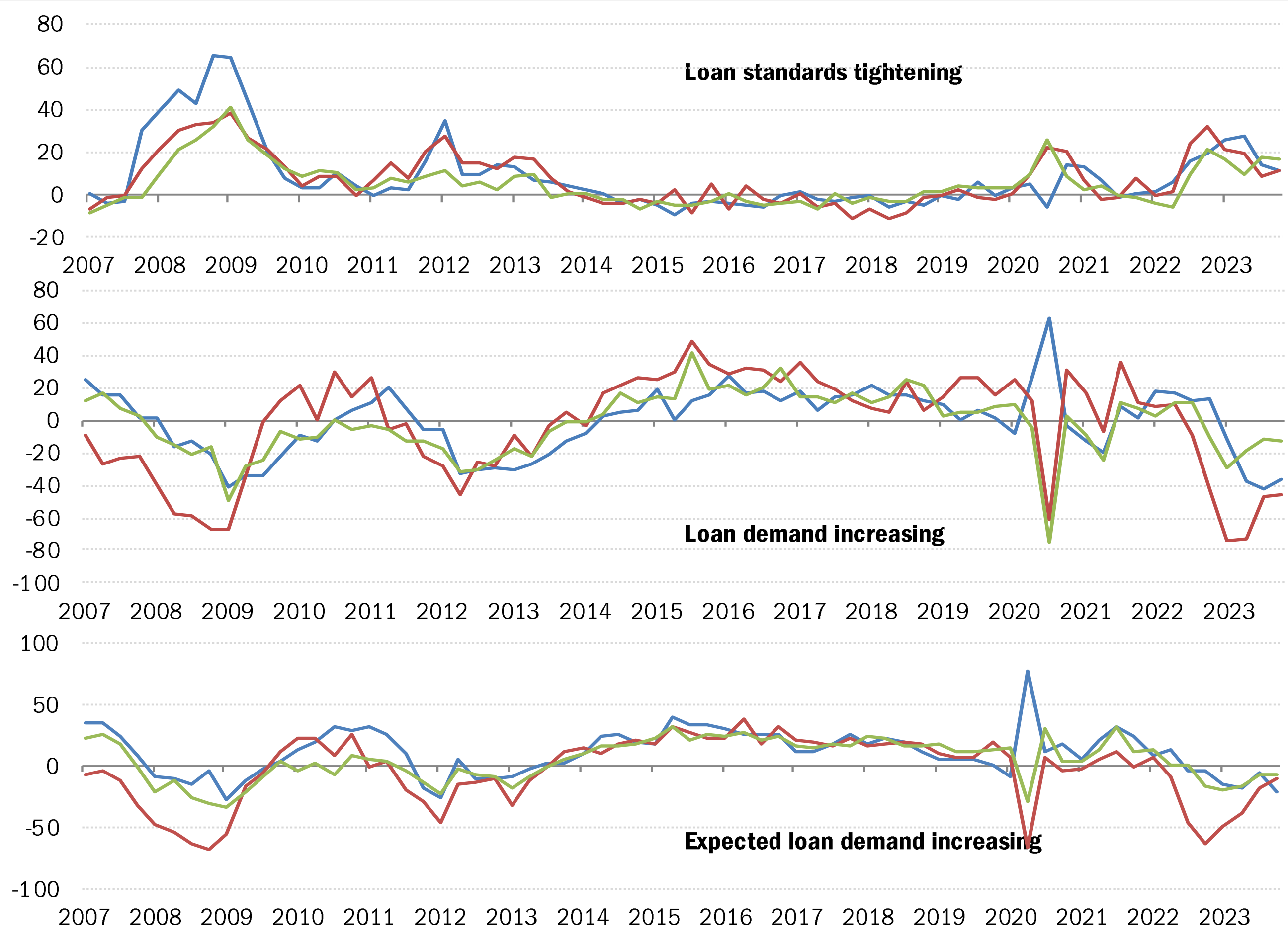
Loans to 1 year — Loans 1-5 years — Loans 5 years plus ··· Total



Source: ECB, TrendMacro calculations

Supply and demand for lending: ECB Bank Survey

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

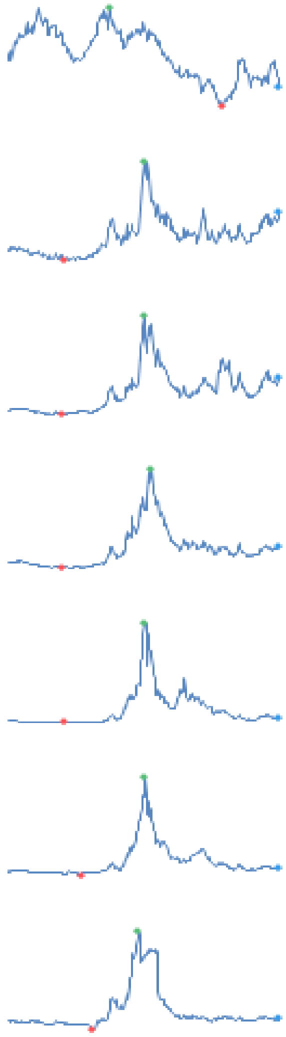


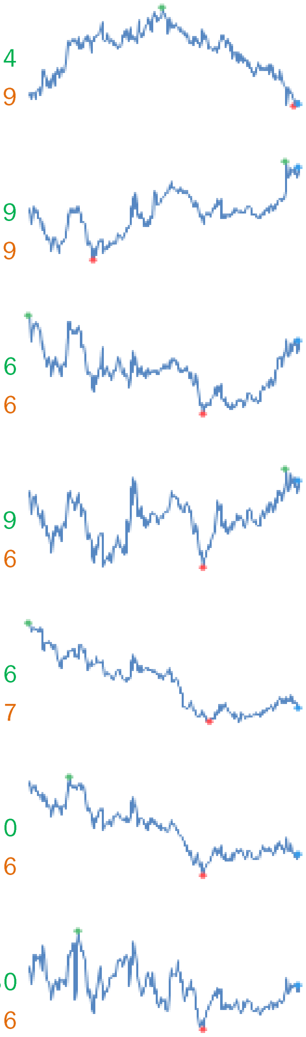
Source: ECB, TrendMacro calculations

Sovereign stress monitor: 10-year bond spreads

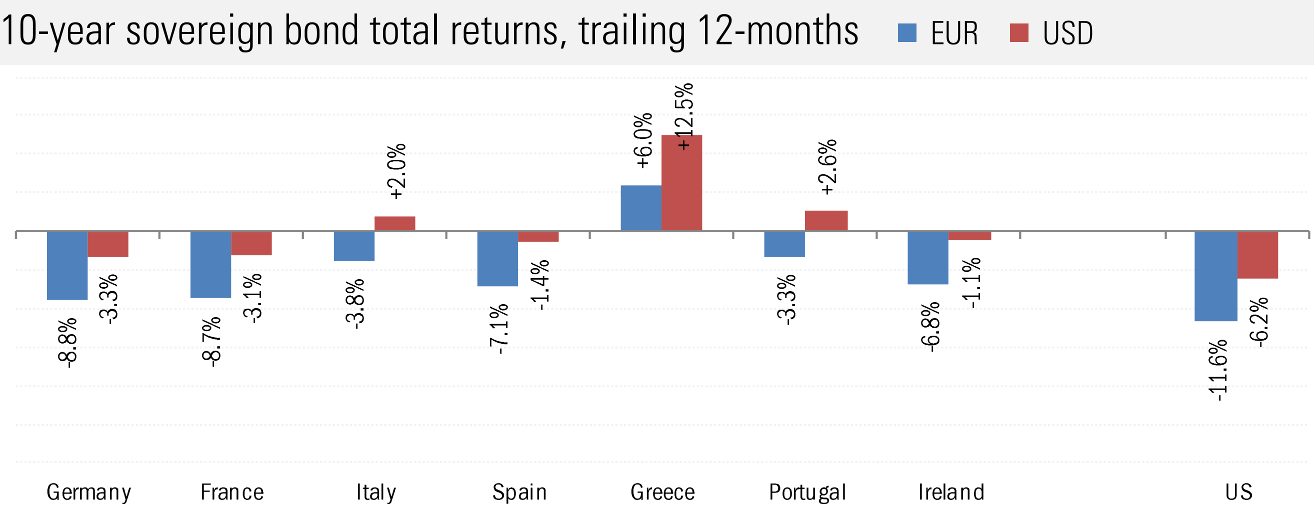
· High · Low · Last

	2000 to present			Trailing 12m	
Germany					
Spread to US	High 0.74%	Dec '08		High -0.98%	Apr 24
Last -2.02%	Low -2.76%	Oct '18		Low -2.06%	Oct 19
France					
Spread to Germany	High 1.32%	Dec '11		High 0.65%	Oct 9
Last 0.63%	Low -0.01%	Jan '05		Low 0.42%	Jan 19
Italy					
Spread to Germany	High 5.28%	Dec '11		High 2.22%	Oct 26
Last 2.04%	Low 0.09%	Nov '04		Low 1.56%	Jun 16
Spain					
Spread to Germany	High 5.52%	Aug '12		High 1.15%	Oct 9
Last 1.12%	Low -0.05%	Nov '04		Low 0.91%	Jun 16
Greece					
Spread to Germany	High 33.13%	Dec '11		High 2.53%	Oct 26
Last 1.40%	Low 0.09%	Jan '05		Low 1.22%	Jun 27
Portugal					
Spread to Germany	High 14.61%	Jan '12		High 1.04%	Dec 20
Last 0.72%	Low -0.54%	Jun '06		Low 0.64%	Jun 16
Ireland					
Spread to Germany	High 8.67%	Jun '11		High 0.56%	Dec 30
Last 0.44%	Low -0.67%	Jun '07		Low 0.35%	Jun 16





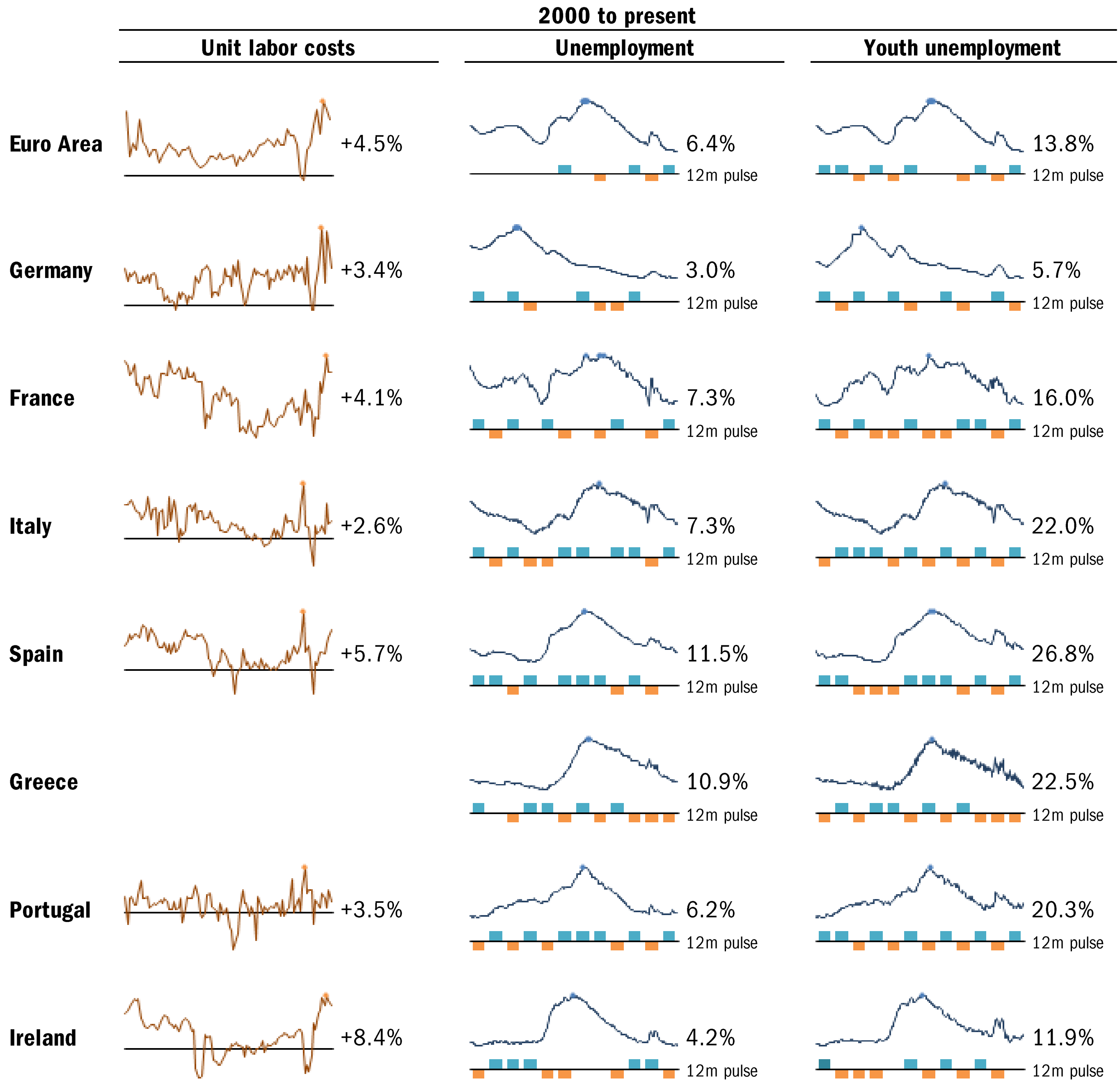
10-year sovereign bond total returns, trailing 12-months



Source: Bloomberg, TrendMacro calculations

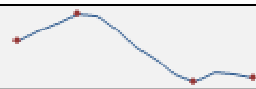
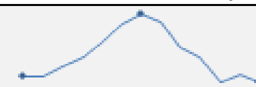
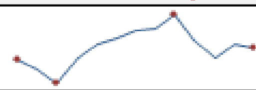
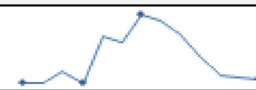
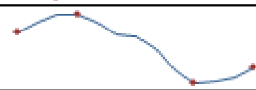
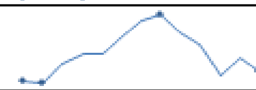
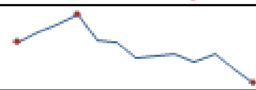
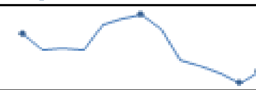
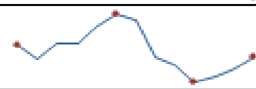
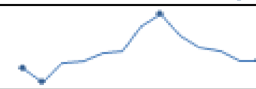
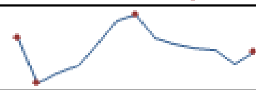
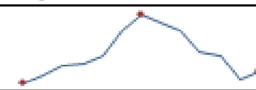
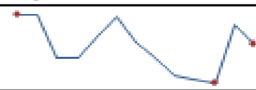
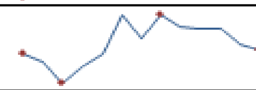
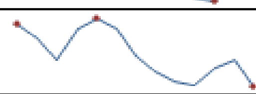
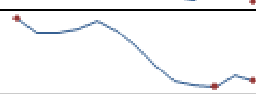
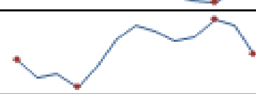
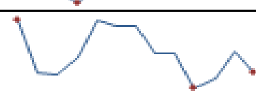
Labor market in intensive care

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



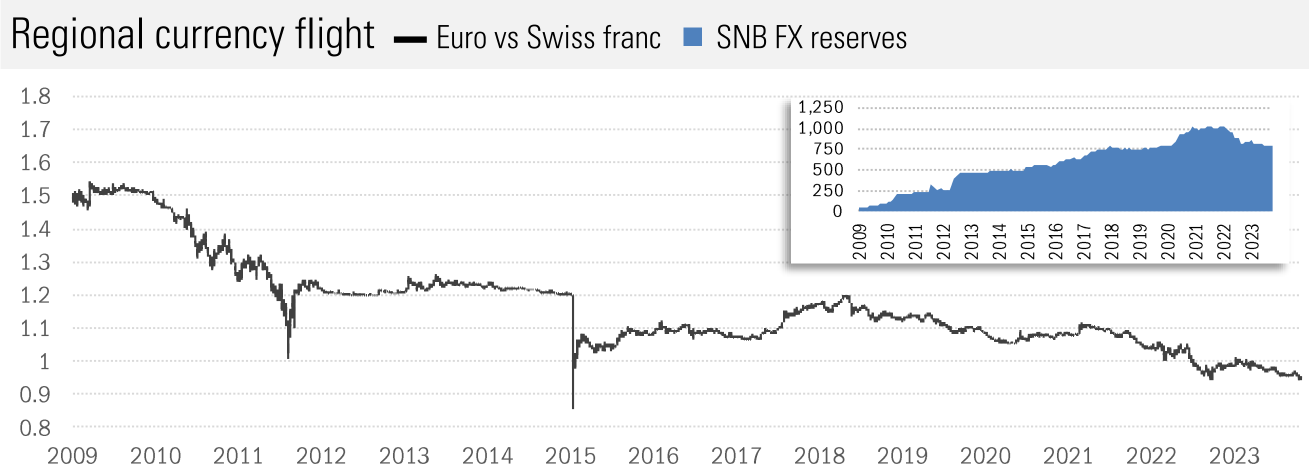
Source: Eurostat, TrendMacro calculations

Purchasing Manager Indices

Manufacturing	Last	Prev	13-month history	***Services***	Last	Prev	13-month history
Eurozone Oct	43.0	43.4		Eurozone Oct	47.8	48.7	
UK Oct	45.2	44.3		UK Oct	49.2	49.3	
Germany Oct	40.7	39.6		Germany Oct	48.0	50.3	
France Oct	42.6	44.2		France Oct	46.1	44.4	
Italy Sep	46.8	45.4		Italy Sep	46.4	49.5	
Spain Sep	47.7	46.5		Spain Sep	50.5	49.3	
Ireland Sep	49.6	50.8		Ireland Sep	54.5	55.0	
Netherlands Sep	43.6	45.9					
Austria Sep	39.6	40.6					
Greece Sep	50.3	52.9					
Czech Rep Sep	41.7	42.9					

Source: Markit, TrendMacro calculations

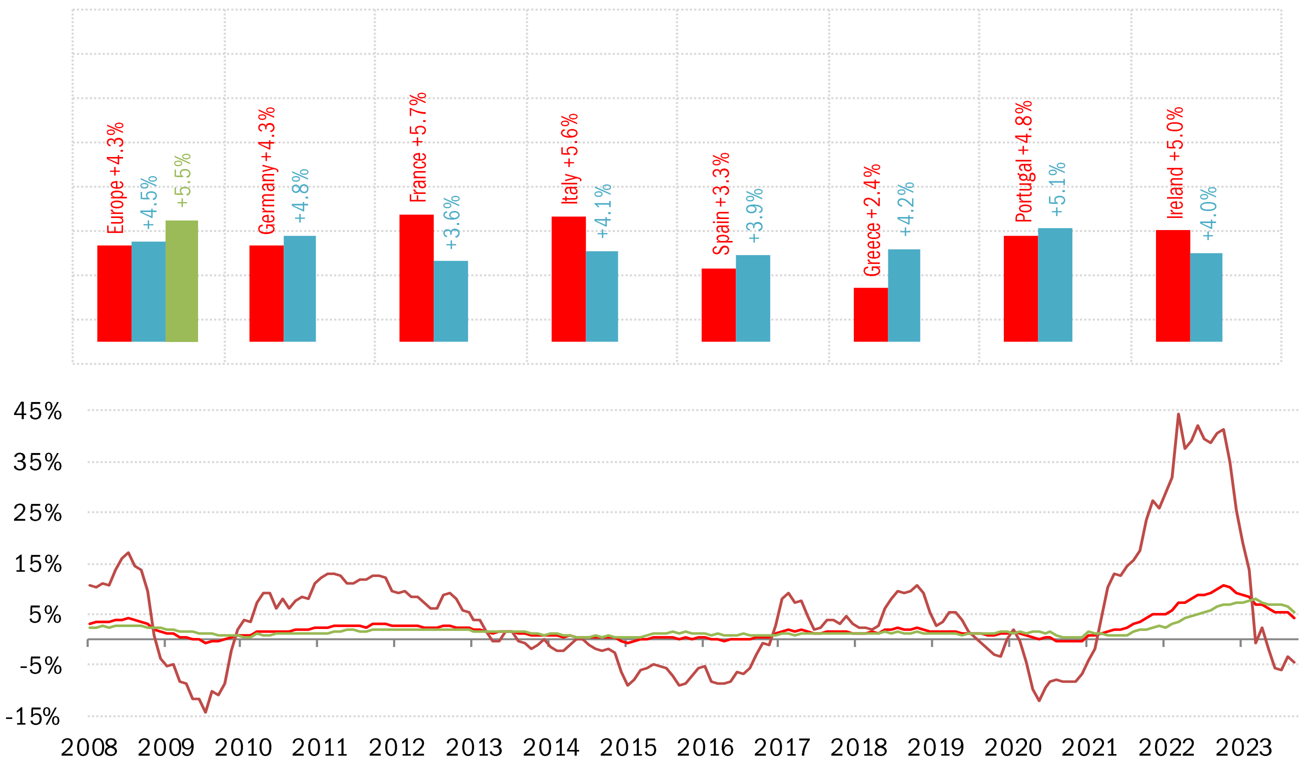
Regional currency flight



Source: Bloomberg, TrendMacro calculations

Euro area consumer inflation, year on year

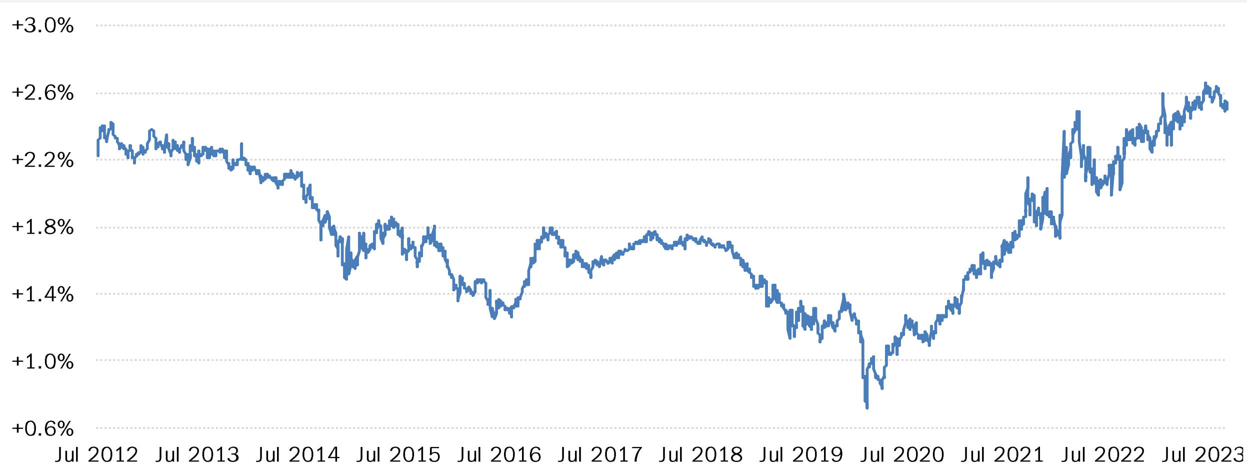
Country: Headline Ex-food and energy Ex-energy Euro area: Headline Energy Ex-energy



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