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ECB View: Officials try to rein in hike expectations following pivot-related overshoot - Over recent days, Governing Council members have been trying to pour cold water on the aggressive rate hike expectations fuelled by the February meeting pivot.

ECB President Christine Lagarde played down the ECB's ability to impact supply-driven inflation in an interview with the Redaktionsnetzwerk Deutschland. Referring to the surge she asked 'what can the ECB do about that? Can we resolve supply bottlenecks? Can we transport containers, lower oil prices or pacify geostrategic conflicts? No, we can't do any of that'. The ECB President went on to assert that 'if we acted too hastily now, the recovery of our economies could be considerably weaker and jobs would be jeopardised. That wouldn't help anybody'.

Meanwhile, Olli Rehn, Governor of the central bank of Finland struck a similar note, saying that 'If we reacted strongly to inflation in the short term, we would probably cause economic growth to stop'. Chief Economist Philip Lane underlined this message, saying that 'since monetary policy steers domestic demand, a tightening of monetary policy in reaction to an external supply shock would mean that the economy would be simultaneously confronted with two adverse shocks'.

However, the logic that monetary policy did not need to tighten into supply shocks, did not mean that any kind of normalisation was off the table. Italy's central bank chief Ignazio Visco emphasised that 'gradual normalization will continue at a pace consistent with the economic recovery and changes in the outlook for prices'. The Governor of the central bank of Ireland Gabriel Makhlouf explained that 'If current trends in overall inflation persist, the case for monetary policy action becomes stronger. But we need to be conscious of the effects of tightening policy'.

Our take away from these comments is that the ECB is still minded to reduce monetary policy accommodation in the coming months, but judged that the aggressive exit that had started to be priced in by financial markets following the pivot was unrealistic. We have therefore seen a co-ordinated campaign to push back on the speed and extent, rather than the general direction.

We expect the Governing Council to announce a tapering of the APP in March, with net purchases ending altogether in September. We expect APP to average EUR 30bn in Q2 and EUR 15bn in Q3. We have also pencilled in a 10bp deposit rate hike in December of this year and an additional one in March of next year. After that we expect rate hikes to be aborted, or at least put on ice, with the deposit rate at -0.3% by the end of 2023.So essentially, we are predicting somewhat of a false start for policy normalisation. Indeed, we think it is a close call whether by the end of this year the window of 'opportunity' for rate hikes may close. Our overall sense is that the significant and sustained rate hike cycle priced in by financial markets is unlikely.

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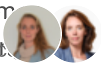

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