Playing it by ear

ECB post-meeting comment

Contents
Policy rates: two more 50bp hikes? 1
50 wasn’t just a concession to the hawks 1
Two more 50bp hikes to follow? 2

Anti-fragmentation: TPI bound to be tested? 3
Eligibility and activation: a significant grey area 3

Summary

• The ECB delivered a semi-surprising 50bp hike, ending an era of negative policy rates.
• This wasn’t only a trade-off between the hawks and doves in return for an anti-fragmentation instrument; the ECB again sounded more hawkish regarding the inflation outlook.
• Further hikes will be appropriate, but the Council dropped all guidance regarding the size of these hikes. Instead they will shift to a meeting-by-meeting approach.
• We maintain our call for 50bp in September, with upside risks of 75.
• We are however pencilling in another 50 in October, assuming the outlook doesn’t deteriorate significantly, and assuming that the TPI will effectively limit spread widening – though it may very well be put to the test first.

Policy decisions

• The ECB announced a 50bp rate hike. The Council dropped its forward guidance, leaving future moves fully up to economic developments.
• The Transmission Protection Instrument was approved. Purchases “will not be restricted ex ante” and will focus on the 1 to 10 year segment of the curve.
• Lagarde mentioned quite a shopping list of eligibility criteria relating to fiscal soundness, but their assessment offers quite a bit of grey area.
• The ECB will evaluate options for remunerating excess liquidity holdings, in an attempt to counteract the undesired TLTRO arbitrage. No measures were announced, though.

Whereas we had expected the anti-fragmentation tool to be the highlight of today’s meeting, the changes in interest rate policy are at least as noteworthy. The ECB delivered a 50bp hike, which was partly due to inflation concerns, and partly a trade-off in return for a relatively unrestricted Transmission Protection Instrument (TPI). After this surprise hike, the Council has finally given up trying to predict its own next steps, dropping most of its rates guidance. Seeing the ECB’s continued inflation concerns, we have pencilled in two follow-up hikes of 50bp.

Policy rates: two more 50bp hikes?

Lagarde mentioned two reasons for the 50bp hike: the availability of an anti-fragmentation instrument and the updated assessment of inflation risks. Particularly the latter suggests that further hikes are forthcoming. We maintain our call for a 50bp hike in September, but seeing the growing concerns about the inflation outlook, we have pencilled in another 50bp for October.

50 wasn’t just a concession to the hawks

While we were admittedly still in the 25bp camp, the decision to hike by 50bp didn’t come as a complete surprise. However, the reasons for the larger move were somewhat unexpected. As we
noted in our preview, the risk of a 50bp hike were non-negligible due to the horse-trading regarding the anti-fragmentation tool. It is very likely that the hawks demanded a faster hiking cycle in return for a less restricted Transmission Protection Instrument (see below). Moreover, as we concluded, an effective TPI was a prerequisite for a faster, yet still orderly, hiking cycle. Lagarde also admitted this herself, stating that the tool allowed the ECB to “go big”.

However, it did strike us as somewhat surprising that Lagarde stressed the Council’s updated assessment of inflation as a second reason, considering that there had not been much talk of a potentially larger move ahead of the meeting. Nonetheless, President Lagarde –again– sounded more hawkish regarding the latest inflation developments, noting that “inflation risks remain to the upside and have intensified, particularly in the short-term”. Moreover, the ECB is clearly still concerned about the elevated inflation expectations.

The recent depreciation of the exchange rate was one of the main risks that had materialised since the June meeting, according to Lagarde. However, as we feared ahead of the meeting, so far the ECB’s 50bp hike has failed to provide EUR much support – though this may also be related to the reception of the TPI.

Two more 50bp hikes to follow?

After yet another last-minute change of plans, the ECB now appears to have given up on predicting its own next steps. The ECB has dropped most of its forward guidance, including June’s message that a larger step would likely be appropriate in September. Instead, Lagarde argued that the larger increase today allows the ECB to shift to a meeting-by-meeting approach, with each subsequent decision being fully data dependent.

Even though Lagarde was quoted as saying that the September guidance was “no longer appropriate”, we don’t see this as an indication that the ECB is looking to slow down. Indeed, considering that the Council again stressed their unease with the current inflation outlook, we maintain our call for another 50bp move in September. Risks to this call are skewed to the upside, but we believe that the ECB is more likely to deliver a subsequent hike than embarking on a 75bp move in September. We have therefore added another 50bp hike in October to our forecast.

There are two key assumptions behind this new forecast. First of all, this assumes that the TPI will effectively limit fragmentation risks in the Eurozone. Secondly, this assumes that the economic outlook does not deteriorate too sharply in the next couple of months. While we still believe that the ECB’s next set of forecasts will probably require a downward revision of the growth forecasts, it also looks as though the Council’s tolerance towards growth risks has increased somewhat as long as inflation remains uncomfortably high.

These two potential downside risks are offset by the upside risk of more persistent inflationary pressures, and all-in-all, we therefore see risks to our view for the remainder of 2022 as roughly balanced. Despite the upgrade of our 2022 call, we remain of the view that the ECB’s hiking cycle will probably be relatively short-lived, assuming that a recession will eventually block the ECB from further normalisation of its interest rates. The Council itself doesn’t seem to have a clear idea how far they will take the hiking cycle: Lagarde said that at this point in time, she does not know what that neutral rate might be. “We will cross that bridge when we cross that bridge.”

Table 1: Updated ECB expectations

<table>
<thead>
<tr>
<th></th>
<th>Hike</th>
<th>Deposit facility rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>50bp</td>
<td>0.50%</td>
</tr>
<tr>
<td>October</td>
<td>50bp</td>
<td>1.00%</td>
</tr>
<tr>
<td>December</td>
<td>25bp</td>
<td>1.25%</td>
</tr>
</tbody>
</table>

Source: Rabobank
Anti-fragmentation: TPI bound to be tested?

On paper, the TPI appears to be a relatively powerful instrument. Its size is not limited from the outset, and despite a long list of eligibility conditions there appears to be sufficient grey area for the ECB to argue that any country is eligible. Nonetheless, the fact that a lot is left to the Council’s discretion does run the risk that the market will test the TPI before it fully believes its power.

In another surprise move, the (working) name of the ECB’s anti-fragmentation tool was changed from Transmission Protection Mechanism to Transmission Protection Instrument. If activated, the TPI purchases will focus on bonds issued by sovereigns, regional governments and agencies with a remaining maturity of 1 to 10 years. The size of these purchases is not limited, and does not appear to be bound by any rules like the issuer limits embedded in the APP. However, as the ECB notes, “the scale of TPI purchases would depend on the severity of the risks facing monetary policy transmission.” This is clearly an acknowledgement of the earlier court rulings on the OMT programme, and an attempt to avoid a new legal challenge without hamstringing the TPI from the outset.

Oddly enough, the ECB did indicate that any purchases will be sterilised in order to ensure that “they cause no persistent impact on the overall Eurosystem balance sheet and hence on the monetary policy stance.” However, the ECB has not released any details how it would do so. While we still believe that liquidity draining operations are the most likely sterilisation instrument – at least in the early days of the TPI – the desire to limit the impact on the balance sheet does suggest that the ECB may still be contemplating the sale of assets acquired under its other programmes. After all, although purchasing assets under TPI while conducting liquidity draining operations at the same time would neutralise the impact on excess liquidity and hence the policy stance, it would still see the ECB’s balance sheet increase in size as both assets and liabilities are added.

Eligibility and activation: a significant grey area

The unlimited capacity of the TPI was certainly welcomed by the market, but the relatively long list of eligibility criteria caused some concerns – even though President Lagarde stressed that all countries will be eligible. Specifically, the TPI requires four criteria:

1. Compliance with the EU fiscal framework;
2. Absence of severe macroeconomic imbalances;
3. A sustainable trajectory of public debt; and
4. Sound and sustainable macroeconomic policies, which means compliance with the plans submitted for the Recovery and Resilience Facility as well as the European Commissions’ country specific recommendations.

While this long shopping list of fiscal may have caused some consternation in markets, we currently see no reason why any country would be ineligible. Moreover, there appears to be some grey area that allows the Council sufficient discretion as regards the fulfilment of these conditions; especially seeing that the debt sustainability will not only be based on external sources, but also the ECB’s internal analysis.

As we suggested earlier, the ECB gave little guidance as to when the TPI might be used. The ECB will use “a comprehensive assessment of market and transmission indicators”, as well as “a judgement that the activation […] is proportionate to the ECB’s inflation objective”. By keeping these parameters very vague, the ECB avoids that the market will focus on particular yield or spread levels. However, the fact that a lot regarding the eligibility and activation is left to the Governing Council’s discretion may invite the market to test the ECB’s resolve; particularly after Lagarde noted that the Council “prefers not to use the TPI, but will not hesitate [to do so]”. 
### RaboResearch
Global Economics & Markets
mr.rabobank.com

### Global Head
- **Jan Lambregts**
  +44 20 7664 9669
  Jan.Lambregts@Rabobank.com

### Macro Strategy

#### Global
- **Michael Every**
  Senior Macro Strategist
  Michael.Every@Rabobank.com

#### Europe
- **Elwin de Groot**
  Head Macro Strategy
  Eurozone, ECB
  +31 30 712 1322
  Elwin.de.Groot@Rabobank.com

- **Stefan Koopman**
  Senior Macro Strategist
  UK, Eurozone
  +31 30 712 1328
  Stefan.Koopman@Rabobank.com

- **Teeuwe Mevissen**
  Senior Macro Strategist
  Eurozone
  +31 30 712 1509
  Teeuwe.Mevissen@Rabobank.com

- **Bas van Geffen**
  Senior Macro Strategist
  ECB, Eurozone
  +31 30 712 1046
  Bas.van.Geffen@Rabobank.com

- **Erik-Jan van Harn**
  Macro Strategist
  Germany, France
  +31 6 300 20 936
  Erik-Jan.van.Harn@Rabobank.nl

- **Maartje Wijffelaars**
  Senior Economist
  Italy, Spain, Portugal, Greece
  +31 88 721 8329
  Maartje.Wijffelaars@Rabobank.nl

#### Americas
- **Philip Marey**
  Senior Macro Strategist
  United States, Fed
  +31 30 712 1437
  Philip.Marey@Rabobank.com

- **Christian Lawrence**
  Senior Cross-Asset Strategist
  Canada, Mexico
  +1 212 808 6923
  Christian.Lawrence@Rabobank.com

- **Mauricio Une**
  Senior Macro Strategist
  Brazil
  +55 11 5503 7347
  Mauricio.Une@Rabobank.com

- **Gabriel Santos**
  Macro Strategist
  Brazil
  +55 11 5503 7288
  Gabriel.Santos@Rabobank.com

#### FX Strategy
- **Jane Foley**
  Head FX Strategy
  G10 FX
  +44 20 7809 4776
  Jane.Foley@Rabobank.com

- **Christian Lawrence**
  Senior Cross-Asset Strategist
  LatAm FX
  +1 212 808 6923
  Christian.Lawrence@Rabobank.com

Please note the disclaimer at the end of this document.
## Rates Strategy

**Richard McGuire**  
Head Rates Strategy  
+44 20 7664 9730  
Richard.McGuire@Rabobank.com

**Lyn Graham-Taylor**  
Senior Rates Strategist  
+44 20 7664 9732  
Lyn.Graham-Taylor@Rabobank.com

## Credit Strategy & Regulation

**Matt Cairns**  
Head Credit Strategy & Regulation  
Covered Bonds, SSAs  
+44 20 7664 9502  
Matt.Cairns@Rabobank.com

**Bas van Zanden**  
Senior Analyst  
Pension funds, Regulation  
+31 30 712 1869  
Bas.van.Zanden@Rabobank.com

**Paul van der Westhuizen**  
Senior Analyst  
Financials  
+31 88 721 7374  
Paul.van.der.Westhuizen@Rabobank.com

**Cas Bonsema**  
Senior Analyst  
ABS, Covered Bonds  
+31 6 127 66 642  
Cas.Bonsema@Rabobank.com

## Agri Commodity Markets

**Carlos Mera**  
Head of ACMR  
+44 20 7664 9512  
Carlos.Mera@Rabobank.com

**Michael Magdovitz**  
Senior Commodity Analyst  
+44 20 7664 9969  
Michael.Magdovitz@Rabobank.com
**Client coverage**

### Wholesale Corporate Clients

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Region</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Martijn Sorber</td>
<td>Global Head</td>
<td></td>
<td>+31 30 712 3578</td>
<td><a href="mailto:Martijn.Sorber@Rabobank.com">Martijn.Sorber@Rabobank.com</a></td>
</tr>
<tr>
<td>Hans Deusing</td>
<td>Europe</td>
<td></td>
<td>+31 30 216 9045</td>
<td><a href="mailto:Hans.Deusing@Rabobank.com">Hans.Deusing@Rabobank.com</a></td>
</tr>
<tr>
<td>Neil Williamson</td>
<td>North America</td>
<td></td>
<td>+1 212 808 6966</td>
<td><a href="mailto:Neil.Williamson@Rabobank.com">Neil.Williamson@Rabobank.com</a></td>
</tr>
<tr>
<td>Adam Vanderstelt</td>
<td>Australia, New Zealand</td>
<td></td>
<td>+61 2 8115 3102</td>
<td><a href="mailto:Adam.Vanderstelt@rabobank.com">Adam.Vanderstelt@rabobank.com</a></td>
</tr>
<tr>
<td>Ethan Sheng</td>
<td>Asia</td>
<td></td>
<td>+852 2103 2688</td>
<td><a href="mailto:Ethan.Sheng@Rabobank.com">Ethan.Sheng@Rabobank.com</a></td>
</tr>
<tr>
<td>Ricardo Rosa</td>
<td>Brazil</td>
<td></td>
<td>+55 11 5503 7150</td>
<td><a href="mailto:Ricardo.Rosa@Rabobank.com">Ricardo.Rosa@Rabobank.com</a></td>
</tr>
</tbody>
</table>

### Financial Institutions

#### Short-term Interest Rates

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marcel de Bever</td>
<td>Global Head</td>
<td>+31 30 216 9740</td>
<td><a href="mailto:Marcel.de.Bever@Rabobank.com">Marcel.de.Bever@Rabobank.com</a></td>
</tr>
</tbody>
</table>

#### Bonds & Interest Rate Derivatives

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Henk Rozendaal</td>
<td>Global Head Fixed Income</td>
<td>+31 30 216 9423</td>
<td><a href="mailto:Henk.Rozendaal@Rabobank.com">Henk.Rozendaal@Rabobank.com</a></td>
</tr>
</tbody>
</table>

### Solutions

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sjoerd van Peer</td>
<td>Global Head</td>
<td>+31 30 216 9072</td>
<td><a href="mailto:Sjoerd.van.Peer@Rabobank.com">Sjoerd.van.Peer@Rabobank.com</a></td>
</tr>
</tbody>
</table>

### Relationship Management

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rogier Everwijn</td>
<td>Global Head</td>
<td>+31 30 712 2440</td>
<td><a href="mailto:Rogier.Everwijn@Rabobank.com">Rogier.Everwijn@Rabobank.com</a></td>
</tr>
<tr>
<td>Rob Eilering</td>
<td>Banks</td>
<td>+31 30 712 2162</td>
<td><a href="mailto:Rob.Eilering@Rabobank.com">Rob.Eilering@Rabobank.com</a></td>
</tr>
<tr>
<td>Petra Schuchard</td>
<td>Insurers</td>
<td>+31 30 712 2389</td>
<td><a href="mailto:Petra.Schuchard@Rabobank.com">Petra.Schuchard@Rabobank.com</a></td>
</tr>
<tr>
<td>Duurt Jan van Dijk</td>
<td>Asset Managers</td>
<td>+31 30 712 1015</td>
<td><a href="mailto:DuurtJan.van.Dijk@Rabobank.com">DuurtJan.van.Dijk@Rabobank.com</a></td>
</tr>
<tr>
<td>Javier Alvarez de Eerens</td>
<td>MDB</td>
<td>+31 30 712 2389</td>
<td><a href="mailto:Javier.Alvarez@Rabobank.com">Javier.Alvarez@Rabobank.com</a></td>
</tr>
<tr>
<td>Christel Kleinhaarhuis</td>
<td>Fintech</td>
<td></td>
<td><a href="mailto:Christel.Klein.Haarhuis@Rabobank.com">Christel.Klein.Haarhuis@Rabobank.com</a></td>
</tr>
</tbody>
</table>

### Capital Markets

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Herald Top</td>
<td>Global Head</td>
<td>+31 30 216 9501</td>
<td><a href="mailto:Herald.Top@Rabobank.com">Herald.Top@Rabobank.com</a></td>
</tr>
<tr>
<td>Christopher Hartofilis</td>
<td>Capital Markets USA</td>
<td>+1 212 808 6890</td>
<td><a href="mailto:Christopher.Hartofilis@Rabobank.com">Christopher.Hartofilis@Rabobank.com</a></td>
</tr>
<tr>
<td>Ian Baggott</td>
<td>Capital Markets Asia</td>
<td>+852 2103 2629</td>
<td><a href="mailto:Ian.Baggott@Rabobank.com">Ian.Baggott@Rabobank.com</a></td>
</tr>
<tr>
<td>Willem Kröner</td>
<td>Global Head ECM</td>
<td>+31 30 712 4783</td>
<td><a href="mailto:Willem.Kroner@Rabobank.com">Willem.Kroner@Rabobank.com</a></td>
</tr>
<tr>
<td>Harman Dhami</td>
<td>DCM Syndicate</td>
<td>+44 20 7664 9738</td>
<td><a href="mailto:Harman.Dhami@Rabobank.com">Harman.Dhami@Rabobank.com</a></td>
</tr>
<tr>
<td>Crispijn Kooijmans</td>
<td>DCM Fls &amp; SSAs</td>
<td>+31 30 216 9028</td>
<td><a href="mailto:Crispijn.Kooijmans@Rabobank.com">Crispijn.Kooijmans@Rabobank.com</a></td>
</tr>
<tr>
<td>Bjorn Alink</td>
<td>DCM Securitisation &amp; Covered Bonds</td>
<td>+31 30 216 9393</td>
<td><a href="mailto:Bjorn.Alink@Rabobank.com">Bjorn.Alink@Rabobank.com</a></td>
</tr>
<tr>
<td>Othmar ter Waarbeek</td>
<td>DCM Corporate Bonds</td>
<td>+31 30 216 9022</td>
<td><a href="mailto:Othmar.ter.Waarbeek@Rabobank.com">Othmar.ter.Waarbeek@Rabobank.com</a></td>
</tr>
<tr>
<td>Joris Reijnders</td>
<td>DCM Corporate Loans</td>
<td>+31 30 216 9510</td>
<td><a href="mailto:Joris.Reijnders@Rabobank.com">Joris.Reijnders@Rabobank.com</a></td>
</tr>
<tr>
<td>Brian Percival</td>
<td>DCM Leveraged Finance</td>
<td>+44 20 7809 3156</td>
<td><a href="mailto:Brian.Percival@Rabobank.com">Brian.Percival@Rabobank.com</a></td>
</tr>
</tbody>
</table>
Disclaimer

Non Independent Research

This document is issued by Coöperatieve Rabobank U.A. incorporated in the Netherlands, trading as “Rabobank” ("Rabobank") a cooperative with excluded liability. The liability of its members is limited. Authorised by De Nederlandsche Bank in the Netherlands and regulated by the Autoriteit Financiële Markten. Rabobank London Branch (RL) is authorised by De Nederlandsche Bank, the Netherlands and the Prudential Regulation Authority, and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Further details are available on request. RL is registered in England and Wales under Company no. FC 11780 and under Branch No. BR002630. This document is directed exclusively to Eligible Counterparties and Professional Clients. It is not directed at Retail Clients.

This document does not purport to be impartial research and has not been prepared in accordance with legal requirements designed to promote the independence of Investment Research and is not subject to any prohibition on dealing ahead of the dissemination of Investment Research. This document does NOT purport to be an impartial assessment of the value or prospects of its subject matter and it must not be relied upon by any recipient as an impartial assessment of the value or prospects of its subject matter. No reliance may be placed by a recipient on any representations or statements made outside this document (oral or written) by any person which state or imply (or may be reasonably viewed as stating or implying) any such impartiality.

This document is for information purposes only and is not, and should not be construed as, an offer or a commitment by RL or any of its affiliates to enter into a transaction. This document does not constitute investment advice and nor is any information provided intended to offer sufficient information such that is should be relied upon for the purposes of making a decision in relation to whether to acquire any financial products. The information and opinions contained in this document have been compiled or arrived at from sources believed to be reliable, but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness.

The information contained in this document is not to be relied upon by the recipient as authoritative or taken in substitution for the exercise of judgement by any recipient. Any opinions, forecasts or estimates herein constitute a judgement of RL as at the date of this document, and there can be no assurance that future results or events will be consistent with any such opinions, forecasts or estimates. All opinions expressed in this document are subject to change without notice.

To the extent permitted by law, neither RL, nor other legal entities in the group to which it belongs accept any liability whatsoever for any direct or consequential loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

Insofar as permitted by applicable laws and regulations, RL or other legal entities in the group to which it belongs, their directors, officers and/or employees may have had or have a long or short position or act as a market maker and may have traded or acted as principal in the securities described within this document (or related investments) or may otherwise have conflicting interests. This may include hedging transactions carried out by RL or other legal entities in the group, and such hedging transactions may affect the value and/or liquidity of the securities described in this document. Further it may have or have had a relationship with or may provide or have provided corporate finance or other services to companies whose securities (or related investments) are described in this document. Further, internal and external publications may have been issued prior to this publication where strategies may conflict according to market conditions at the time of each publication.

This document may not be reproduced, distributed or published, in whole or in part, for any purpose, except with the prior written consent of RL. By accepting this document you agree to be bound by the foregoing restrictions. The distribution of this document in other jurisdictions may be restricted by law and recipients of this document should inform themselves about, and observe any such restrictions.

A summary of the methodology can be found on our website.

© Rabobank London, Thames Court, One Queenhithe, London EC4V 3RL +44(0) 207 809 3000