

International Commentary — July 21, 2022

European Central Bank Exits Negative Interest Rates

Summary

- The European Central Bank (ECB) joined the global rate hike cycle at today's announcement, delivering a larger-than-expected 50 bps Deposit Rate increase, to 0.00%. The ECB said a further normalization of interest rates would be appropriate at upcoming meetings.
- The ECB also approved the Transmission Protection Instrument (TPI), a tool aimed at supporting orderly conditions across Eurozone government bond markets, in particular the region's peripheral markets such as Italy and Spain. While full details are yet to be released, the ECB said purchases using the tool are not restricted *ex ante*, and that the scale of TPI purchases depends on the severity of the risks facing policy transmission.
- We believe inflation remains elevated enough, and inflation risks worrisome enough, to continue with a more forceful pace of rate hikes for the time being. Our view remains that today's hike will be followed up by another 50 bps Deposit Rate increase at the September meeting. In addition, while inflation remains elevated and until Eurozone economic growth slows in a much more meaningful manner, we also see a steady series of rate increases as more likely than not. In that context, we also forecast a 25 bps rate increase at the October and December meetings, which would bring the Deposit Rate to 1.00% by the end of 2022.

Economist(s)

Nick Bennenbroek

International Economist | Wells Fargo Economics
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

European Central Banks Joins Global Rate Hike Cycle

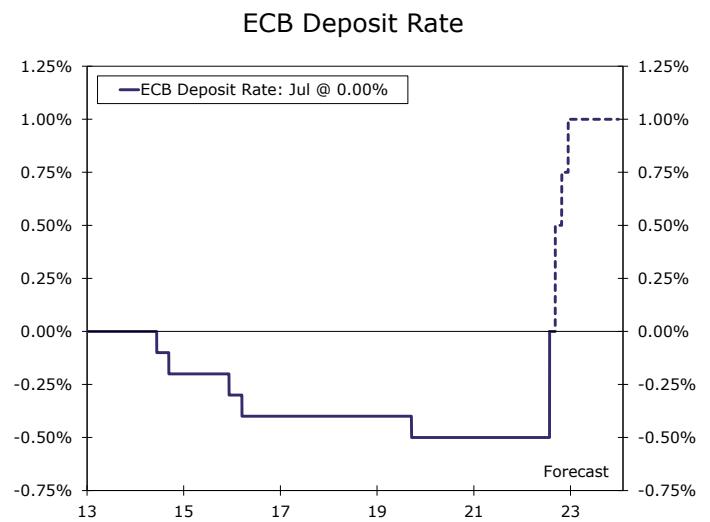
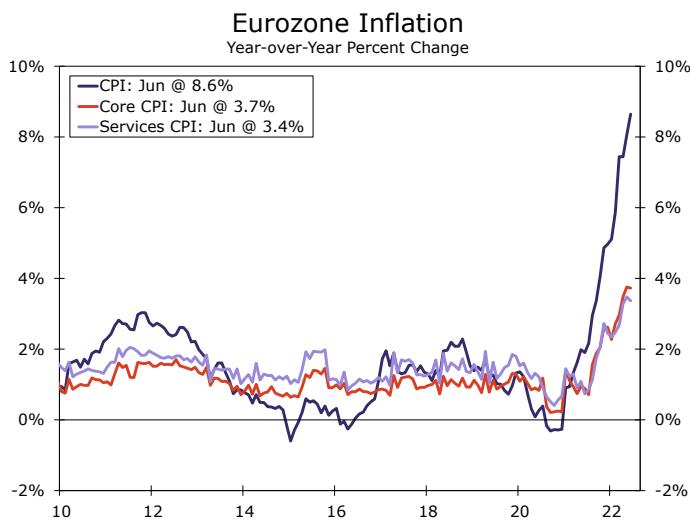
The European Central Bank (ECB), as widely expected, joined the global rate hike cycle at today's monetary policy announcement, but in doing so also managed to spring a couple of mild surprises. **The ECB delivered a larger than expected 50 bps Deposit Rate increase, thereby exiting its negative interest rate policy and taking the Deposit rate to 0.00%.** The other key policy interest rates were also lifted by 50 bps, taking the refinancing rate to 0.50% and the marginal lending rate to 0.75%.

In announcing the larger interest rate increase, the ECB said "further normalization of interest rates will be appropriate. The front-loading today of the exit from negative interest rates allows the Governing Council to make a transition to a meeting-by-meeting approach to interest rate decisions. The Governing Council's future policy rate path will continue to be data-dependent and will help to deliver on its 2% inflation target over the medium term."

Separately and importantly, **the ECB also approved the Transmission Protection Instrument (TPI), aimed at supporting orderly conditions across Eurozone government bond markets**, in particular the region's peripheral markets such as Italy and Spain. While full details are yet to be released, **the ECB said purchases using the tool are not restricted ex ante, and that the scale of TPI purchases depends on the severity of the risks facing policy transmission.** While the announcement of such a tool today was viewed as more likely than not, it was certainly not seen as a "done deal" and, indeed, some reports ahead of today's meeting hinted at a possible quid-pro-quo among ECB policymakers in that a larger 50 bps increase could shore up support for the anti-fragmentation tool. Whether such a quid-pro-quo was explicitly part of discussions, there certainly appears to be some trade-off between the larger rate increase and the approval of the Transmission Protection Instrument. The ECB said that in addition to an updated assessment of inflation risks, the larger first step towards policy normalization was also reinforced by the support provided by the TPI for the effective transmission of monetary policy.

Of course, after today's large rate increase the focus now turns to what happens next from the European Central Bank, particularly since they had previously hinted at a 50 bps hike in September. The comments in today's decision about "front-loading" the exit from negative interest rates and transitioning to a "meeting-by-meeting" approach to interest rate decisions offers hints of at least some potential to shift to smaller 25 bps increments going forward. Indeed, ECB President Lagarde also said prior guidance on the September interest rate move no longer applies. However, as the lead into the July meeting made clear, even forward guidance on interest rates does not guarantee a particular policy rate outcome. Moreover, we believe inflation remains elevated and inflation risks worrisome enough—Lagarde cited inflation risks were to the upside and have intensified in the short-term—to continue with a more forceful pace of rate hikes for the time being.

As a result, our view remains that today's hike will be followed up by another 50 bps Deposit Rate increase at the September meeting. In addition, while inflation remains elevated and until Eurozone economic growth slows in a much more meaningful manner, we also see a steady series of rate increases as more likely than not. In that context, we also forecast a 25 bps rate increase at the October and December meetings, which would bring the Deposit Rate to 1.00% by the end of 2022. We anticipate that will be the peak during the current cycle—as inflation begins to recede by 2023 and growth slows sharply, we see the ECB keeping interest rates steady through most, if not all, of next year. In essence, after today's announcement, we anticipate a shorter, sharper rate hike cycle from the European Central Bank than previously.



Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. ("WFBNA"). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation offer or solicitation with respect to the purchase or sale of any security or other financial product nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report. The views and opinions expressed in this report are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2022 Wells Fargo Bank, N.A.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority ("FCA"). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE