



Fixed Income Special

NORD/LB Markets Strategy & Floor Research

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Marketing communication (see disclaimer on the last pages)

Table of content

ECB: This rate terminates here – 99.9% sure	3
Publication overview	6
Contacts at NORD/LB	7

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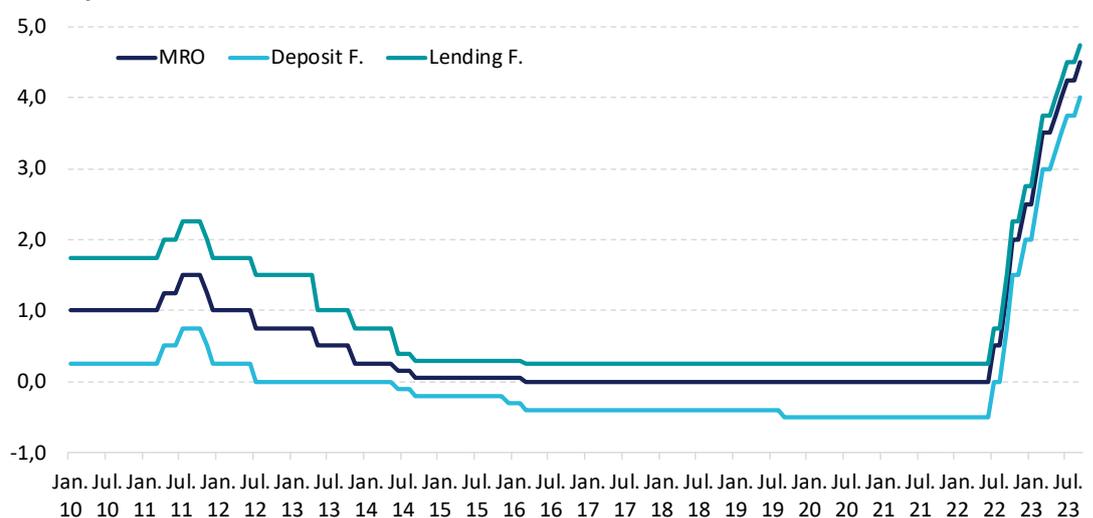
ECB: This rate terminates here – 99.9% sure

Authors: Dr Norman Rudschuck, CIAA // Christian Ilchmann

ECB key rate decision: A final “+25”

One of our favorite jokes on business trips is, "Nice here, but have you ever been to Lüneburg?" The ECB must feel like that or something similar today. It has finally arrived at its destination. As a reminder, every journey begins with a first step. In July 2022, the journey on the way to the "terminal rate" began. It has now taken ten Council meetings to reach this destination. The steps have sometimes been large (+50bp), sometimes larger (+75bp) and in the end smaller (+25bp). Rarely has it been as close as today: in the course of today's key interest rate meeting, the Governing Council again announced that all three reference rates would be raised by 25bp. Accordingly, the interest rate for the main refinancing operations will be 4.50% effective September 20, while the marginal lending operations will be at 4.75% and the deposit facility at 4.00%. Already in our ECB preview ("[Knives out... It's edging-time](#)") on September 8, various questions came to mind that may have crossed the minds of many market observers and us: Will a (dovish) pause or a final (hawkish) rate hike follow? Much of the uncertainty stemmed from the fact that outsiders could not guess what the new *staff projections* might look like. Now, average headline inflation in 2023 is expected to be 5.6% (previously: 5.4%), while experts now expect 3.2% (3.0%) for 2024 and 2.1% (2.2%) for 2025. The 2% inflation target for 2025 has thus moved somewhat closer into reach. However, this was diminished by the adjustments for 2023 and 2024, as they were again made for the inflation rate excluding energy and food – the usefulness of this indicator remains questionable: For 2023, the ECB continues to assume 5.1%. For 2024 2.9% (3.0%) and 2025 2.2% (2.3%), the projections have been adjusted slightly downward. At this point, we would also like to point out, in textbook Friedmanian fashion, that a restrictive monetary policy only takes full effect on average after twelve months (with a considerable range of fluctuation) and that its real economic consequences cannot be fully observed to date.

ECB key interest rates (in %; incl. current interest rate decision)

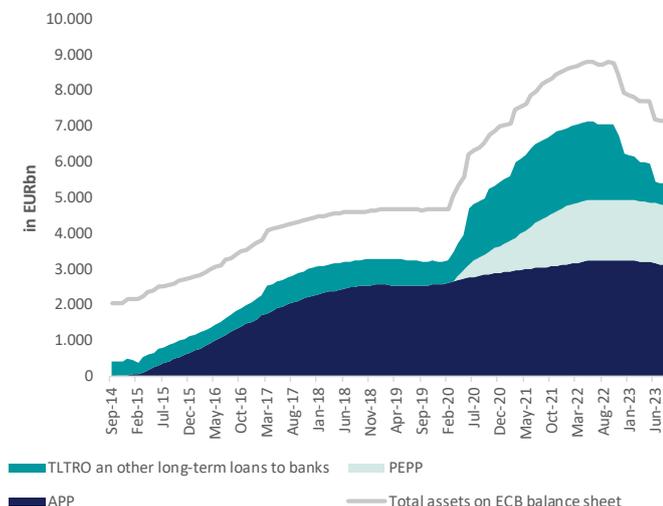


Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Statement and press conference: Small backdoor open for further hike(s)

The clouds in the economic sky are increasingly darkening due to the braking effects of the previous interest rate decisions. Slight downward adjustments have been made to the economic output forecast, with GDP growth of 0.7% (previously: 0.9%) expected for 2023. For 2024, the experts forecast a figure of 1.0% (1.5%), with the estimate for 2025 being adjusted slightly downward to 1.5% (1.6%). So it seems that the ECB still does not assign a high probability to the "hard landing" scenario either. Iain Macleod might have called this mixed situation *stagflation* at the end of the 1960s. It has already been observed in the past that the ECB experts have also had to adjust their expectations for further economic activity in the single currency area on a quarterly basis. Nevertheless, we were of the opinion in advance that the ECB would have to raise key rates if the *staff projections* for inflation in 2023 and/or 2024 were revised upward. So it came then today actually also. What is exciting now is that one should either leave when it is most beautiful or, of course, be allowed to linger extensively. Whether this was really the last step, Lagarde did not want to announce. However, we assume it is. The ECB seems to have decided to stay at the interest rate level it has now reached until the second half of 2024. Not everyone will see it that way, but as we know, the ECB is only committed to its inflation target and not responsible for the tender shoots of the economy or even the management of exchange rates, for example EUR/USD.

ECB balance sheet



Inflation development



Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

What's next?

We hope that the ECB will be able to take a deep breath on October 26 and December 14 and shape its future monetary policy course from a position of strength. We alone lack faith in this wish. We expect the first questions to be asked at the press conference at the end of October as to when the ECB intends to lower interest rates again. However, this question is likely to come up at the latest when the *staff projections* are adjusted again in December and forecasts for 2026 are published for the first time. Indeed, this is always the most exciting economic moment for us on the part of the ECB looking ahead. We (personally) would ask the question in Q2/2024 at the earliest and would not assume an interest rate cut before the second half of next year.

Conclusion and comment

An exciting journey comes to an end... Today, it was really 50:50 in the run-up to the ECB Governing Council meeting. Therefore, no unanimity was to be expected. However, with a "solid majority", as Madame Lagarde admitted. The updated and adjusted *staff projections* with a view to the inflation rate for 2023 and 2024 left the Governing Council no choice but to add another 25bp to the previous interest rate steps. We had expected this. Ten meetings in a row, the ECB has now raised its three key interest rates in parallel flight. As of today, we assume a very long dwell time, so that the first rate cut could be on the horizon on July 18, 2024 at the earliest. Sure, there's still a lot of water running down the Main River between now and then, and a lot can happen. But the inflation data justify our opinion as well as the ECB's anticipated action – as of now. To put it another way: Doves and hawks have reached their cruising altitude with a very high probability and will remain in soaring flight exactly at this altitude and speed for many months. In our view, the descent – i.e. interest rate cuts – should not be called for or even initiated too early.

Appendix

Publication overview

Covered Bonds:

[Issuer Guide Covered Bonds 2023](#)

[Covered Bond Laws](#)

[Covered Bond Directive: Impact on risk weights and LCR levels](#)

[Risk weights and LCR levels of covered bonds](#) (updated semi-annually)

[Transparency requirements §28 PfandBG Q2/2023](#) (quarterly update)

[Covered bonds as eligible collateral for central banks](#)

SSA/Public Issuers:

[Issuer Guide – German Laender 2023](#)

[Issuer Guide – European Supranationals 2023](#)

[Issuer Guide – French Agencies 2023](#)

[Issuer Guide – German Agencies 2022](#)

[Issuer Guide – Dutch Agencies 2022](#)

[Beyond Bundeslaender: Belgium](#)

[Beyond Bundeslaender: Greater Paris \(IDF/VDP\)](#)

[Beyond Bundeslaender: Spanish regions](#)

Fixed Income Specials:

[ESG-Update 2023](#)

[ECB preview: Knives out... It's edging-time](#)

[ECB: From the bottom to the top time to stop? Nobody knows it](#)

[ECB preview: About scrambling and hiking to the terminal rate](#)

Appendix

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