

# Wide Angle Shot: ECB "Zeitenwende" - in the footsteps of the Bundesbank?

Central banks hammered out stakes in Jackson Hole, also for 2023. The Fed coins "Powell Pain" rather than a "Greenspan Put" as the name of the game, while ECB delivered an intellectual turnaround. The "robust control" approach to fighting inflation could push ECB into the shoes of the Deutsche Bundesbank of the 1970s. In the euro area, we expect inflation to average 6% from 2022-24 — close to or above "elevated inflation" seen in Germany in the 1970s/80s. A Bundesbank-style interest rate step of 75-100bp would be possibly a good start to the "robust control approach".



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## Most focus on combating inflation needed since 40 years

The Jackson Hole international central bank conference at the end of August brought some interesting aspects of monetary policy reflection, adjustment and reorientation from a short- and longer-term perspective. Less dramatic adjustments compared to the ECB were evident on the part of the US Fed. Above all, the Fed once again underlined that the **traditional "Fed Put"** is something that market participants should rather not speculate on and, above all, not speculate on prematurely. Rather, a **"Powell Pain"** is to be expected, according to the statements of the US Fed President. In this light, it should also be interpreted that the Fed has (for the time being) **rejected any speculation** about **interest rate cuts** and underlined its focus on inflation fighting. The Fed has thus prepared the markets for a longer phase of restrictive monetary policy. Interest rate cuts by the Fed as early as 2023 do not seem to be in the Fed's calculus at present. However, we continue to regard the Fed as a very pragmatic central bank and the latest monetary policy statements should certainly not be seen as hard "forward guidance". The Fed is clearly in a more comfortable position than the European Central Bank (ECB). In the US, inflation may have already peaked. Moreover, energy prices are probably not as much of a burden in the medium term in the USA as they are in Europe. In this respect, it is not surprising that **ECB** dared to deliver a **significant reorientation** in Jackson Hole in our opinion.

ECB Director Schnabel (partly in line with other central bankers and the IMF) drew firm monetary policy conclusions for the ECB in a noteworthy speech (see [here](#)) based on outlined changes in the global environment. First of all, according to Schnabel, ECB is confronted with a completely new environment of **increased macroeconomic volatility**. In light of the previous low-inflation phase, inflation volatility is even above the level of the much-cited 1970s. In addition, the ECB again clearly refers to **changing global factors** of **price developments** with **upside risks**. In this respect, the ECB emphasises that for the first time in **40 years, central banks** must once again clearly and **uncompromisingly defend** their **inflation (fighting) mandate**. In other words, monetary policy must protect price stability in an environment of increased volatility and structural change. The geopolitical turning point (or much-cited "Zeitenwende") thus

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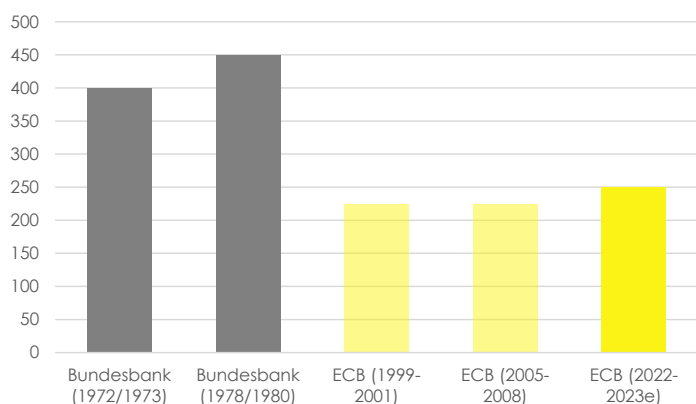
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implies that, macroeconomically, the period of "great moderation" should be followed by a period of "great volatility". Moreover, it appears that shocks are potentially larger, more persistent and more frequent, be it climate change, war conflicts, pandemics, protectionism (trade blockades) or frictions in the fields of energy supply.

### Interest rate cycles: ECB & Deutsche Bundesbank Change key rate (basis points)



Refinitiv, BIS, RBI/Raiffeisen Research

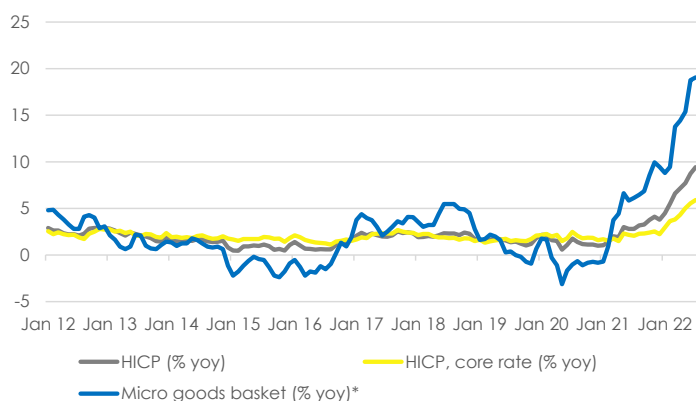
### "Robust control approach" to inflation - risk factor consumer inflation expectations

In light of the increased macroeconomic volatility and uncertainty, ECB (Schnabel) deduces that a **"robust control approach"** is currently called for in monetary policy. In this way, **monetary policy reacts** more **vigorously** to the current **surge in inflation** — even at the risk of lower growth and higher unemployment. The risk of doing too little is greater than the risk of doing too much. ECB should therefore pursue a **tight monetary policy**, even at the **risk downside risks** to the **economy**. Accordingly, decisive interest rate steps are indicated even in the weak economic winter half-year of 2022/23. For above all, inflation risks and **inflation expectations** must be **resolutely contained**. Interestingly, ECB placed a clear focus here on the **inflation expectations** of the **population** and **consumers** in Jackson Hole, and less on the priced inflation expectations on financial markets. The latter are currently still within ECB's target range, but the ECB currently sees **dramatic developments** in the **inflation expectations** of the **population**. According to the latest ECB surveys, these are currently at 3-5%. Moreover, according to the ECB, long-term inflation expectations are becoming more firmly entrenched, especially among (financially) educated parts of the population. The ECB even speaks of so-called "second-round effects" here. It is not surprising that inflation expectations of the population are soaring. At present, for example, the **price increase** for **weekly purchases** according to the specific measurement of the Statistical Office in Austria is at an **unprecedented 18-19%**, the gap to the general HICP increase is as high as never before. Similar trends shall be observable in other euro area countries. And with regard to the longer-term price development, it is clear that energy price increases can only be cushioned and delayed.

Applied to the ECB's expected monetary policy stance, the aforementioned implies that we see our scenario of a focused monetary policy normalisation course into the slightly restrictive range — despite cyclical risks — very well-supported. We expect at least **250 basis points** of **rate hikes** in the current monetary policy cycle. This week ECB should **symbolically deliver** the **largest rate hike in its history**, i.e. at least 75 basis points. This would fit well to the communicated inflation focus. At the upcoming monetary policy meeting ECB should also present its new euro area **inflation forecasts**. We have adapted ours and as of today we expect average **annual inflation rates** of **8% this year**, **6% next year** and around **3%** in **2024** for the euro area. This clearly shows the medium-term inflation problem in Europe in full force. Especially since **core inflation** in the period outlined should, according to our expectations, also remain permanently well above the

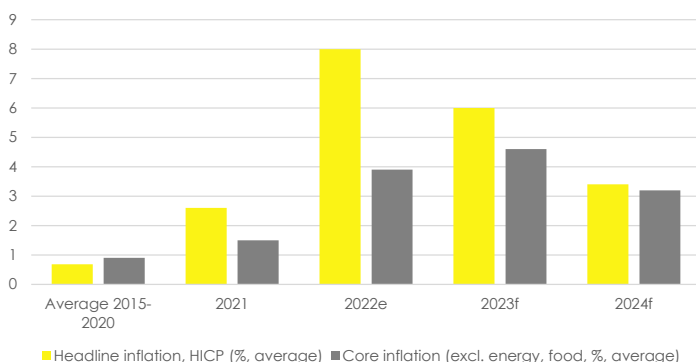
ECB's target and could **scratch** the **5% mark** for a **long time** in **2023**. And that is not all. Since governments are likely to limit the rise in energy prices in 2023 as well, this creates further scope for higher inflation in 2024. We therefore do not expect headline inflation to fall below the 3% mark by the end of 2024 and higher inflation to persist for much longer than we have expected up to now. So far, ECB has been rather cautious in its own inflation forecasts and is of course marked by a **history of missed inflation forecasts**. First, the inflation dynamic was overestimated for years, and most recently underestimated. According to the IMF statements in Jackson Hole (see [here](#)), this was not only a European problem, but ECB is particularly exposed here.

### Austria: Inflation & its special components



Source: Statistik Austria, RBI/Raiffeisen Research

### Euro area: Raiffeisen Research Inflation Forecasts % yoy



Source: Eurostat, RBI/Raiffeisen Research

### ECB "Zeitenwende": 75 basis points would be a straightforward call

**Key interest rate increases** by ECB of **250 basis points** sound like a lot (on the surface). This is especially true after the long phase of low interest rates. However, it should not be forgotten that in the 1970s/80s, for example, the **German Bundesbank** had to react with key interest rate increases of **400 to 450 basis points** in the context of similar inflation challenges as at present. Certainly, ECB is not the Bundesbank and it has changed into a more pragmatic institution of "Anglo-Saxon" character. Whereas such an "Anglo-Saxon" monetary policy orientation of "inflation targeting" also justifies decisive interest rate hikes in the current environment. In this respect, it cannot be ruled out that the **ECB's "robust control approach"** will lead to more interest rate hikes than in past cycles. To a certain extent, the "robust control approach" may even be **reminiscent** of the **decisive monetary tightening** of the past or of the **German Bundesbank**. After all, in the 1970s/80s the Bundesbank also decidedly raised the key interest rate in "only" 10 to 15 months. At that time, the Bundesbank was the only central bank in the G-7 countries that was able to prevent a double-digit inflation rate. In this respect, too hesitant monetary policy action could currently lead to a repetition of some of the monetary policy mistakes

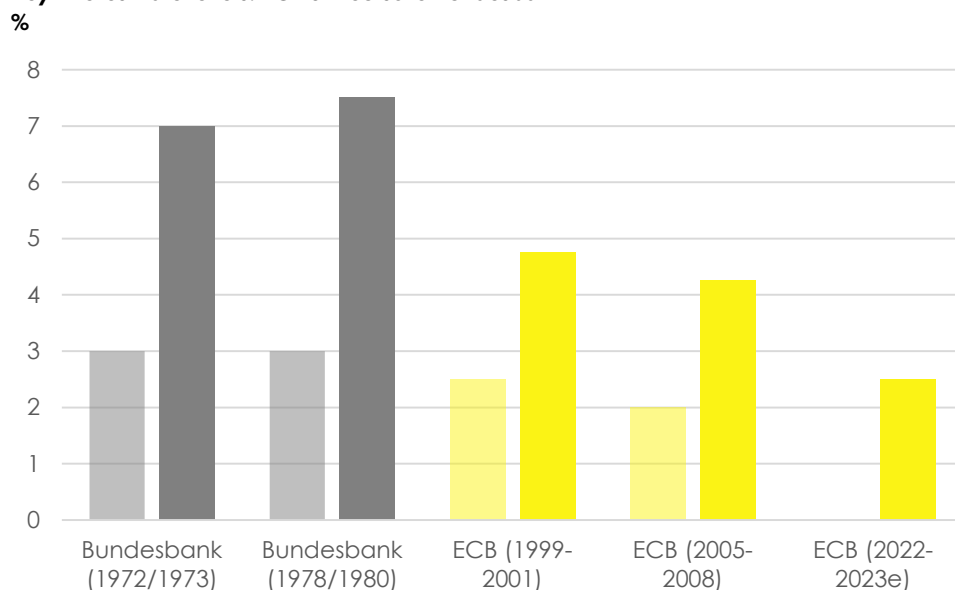
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of the 1970s. Of course, in today's times of comprehensive market control by central banks and especially in the light of the ECB's comprehensive market control of the last few years, a decisive monetary policy reaction also requires cushioning. In this respect, it will be exciting to see when the ECB will (have to) abandon its restraint in using the new bond purchase programme (TPI).

We see the **appearance** of **ECB Director Schnabel** in Jackson Hole as an important **milestone** in the ongoing **ECB's (re-)orientation**. However, it is also interesting that the outlined possible fundamental reorientation was neither presented by the ECB president nor the ECB chief economist. In this respect, it remains to be seen **to what extent** the **"robust control approach"** is already **widely or consensually shared** within the **ECB**. At least there are still some moderating statements by other ECB representatives. They tend to refer to the possible end point of monetary policy tightening or question the necessity of extremely bold rate hikes. The necessity of first taking decisive interest rate steps up to a neutral or no longer monetary policy-supportive interest rate level seems undisputed.

In Jackson Hole and with a likely interest rate step of (at least) 75 basis points this week (which has never happened before in the history of the ECB, but has happened in the history of the Deutsche Bundesbank), we have not only experienced a short-term turnaround in monetary policy at the ECB in September. The **ECB** is also facing a **longer phase of fundamental reorientation**. In the last decade, the ECB has fought against inflation that is too low and, above all, against inflation expectations that are too low. Such considerations also determined the somewhat hastily announced monetary policy strategy revision in summer 2020. It is all the more important that the ECB wants to review its monetary policy strategy again as early as 2025. In all likelihood, it will be able to gather a lot of "new" experience in terms of inflation targeting and inflation expectations by then.

#### Key interest rate levels: ECB & Deutsche Bundesbank



Source: Refinitiv, BIS, RBI/Raiffeisen Research

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