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

Raiffeisen RESEARCH

September 7, 2022 16:02 CEST

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".

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. Howerver, 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.

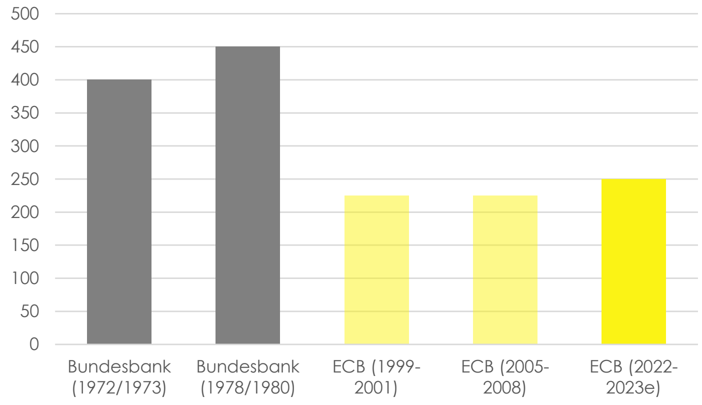
ECB Director Schnabel (partly in line with other central bankers and the IMF) drew firm monetary policy conclusions for the ECB in a noteworthy speech (see here) based on outlined changes in the global environment. First of all, according to Schnabel, ECB is confronted with a completely new environment 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

Gunter DEUBER
Analyst Editor
+43 1 71707-5707
gunter.deuber@rbinternational.com

Gottfried STEINDL
Analyst Editor
+43 1 71707-1523
gottfried.steindl@rbinternational.com

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

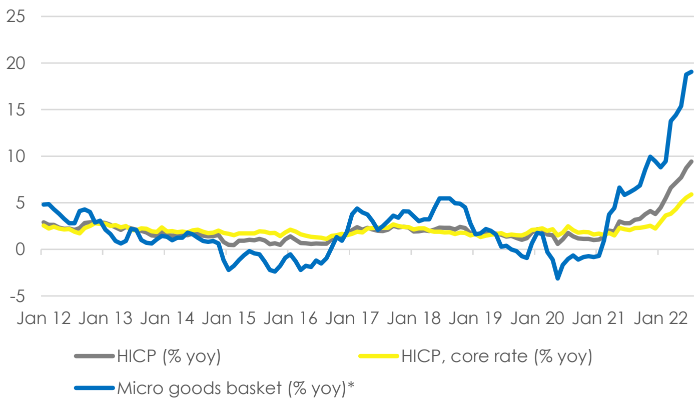
"Robust control approach" to inflation - risk factor consumer inflation expectations

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

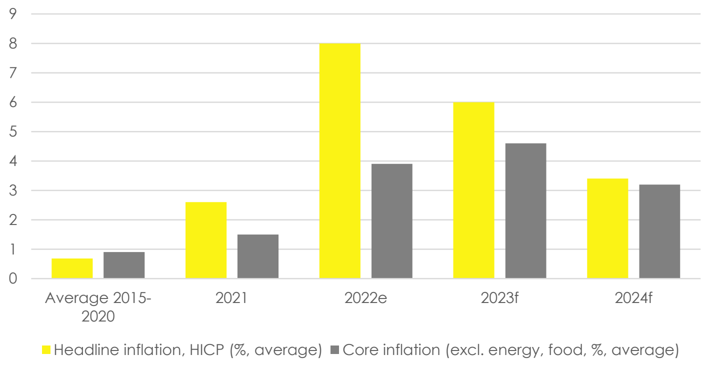
ECB's target and could **scratch** the **5% mark** for a **long time** in **2023**. And that is not all. Since governments are likely to limit the rise in energy prices in 2023 as well, this creates further scope for higher inflation in 2024. We therefore do not expect headline inflation to fall below 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

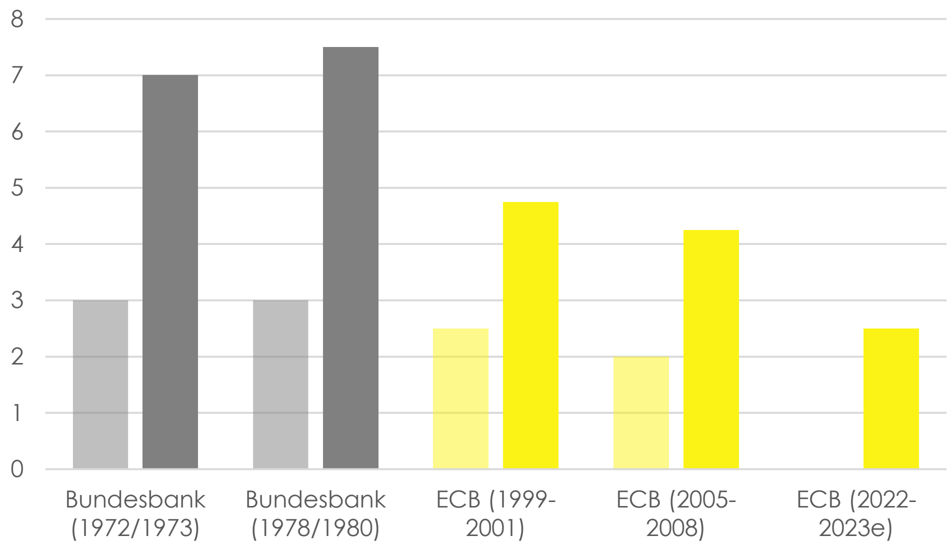
ECB "Zeitenwende": 75 basis points would be a straightforward call

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 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

Disclosure

Risk notifications and explanations

Warnings:

- Figures on performance refer to the past. Past performance is not a reliable indicator for future results and the development of a financial instrument, a financial index or a securities service. This is particularly true in cases when the financ...
  A description of the concepts and methods used in the preparation of financial analyses is available under: www.raiffeisenresearch.com/concept_and_methods.

  "

  Detailed information on sensitivity analyses (procedure for checking the stability of potential assumptions made in the context of financial analyses) is available under: www.raiffeise..."

  Disclosure of circumstances and interests which may jeopardise the objectivity of RBI: www.raiffeisenresearch.com/disclosuresobjectivity

  "

  Detailed information on recommendations concerning financial instruments or issuers disseminated during a period of 12 month prior to this publication (acc. to Art. 4 (1) i) Commission Delegated Regulation (EU) 2016/958 of 9.3.2016) is available under...

IMPORTANT LEGAL NOTICE

Copyright law

The contents offered on this website and subsites (hereinafter: the "RBI Research-Website") are protected by copyright law. The downloading or storage of applications or programmes contained on the RBI Research-Website and the (complete or partial...

Information content, timeliness of information

The contents of the RBI Research-Website you are seeking to access is for information only and does neither qualify as investment advice nor constitute or form part of any offer to buy or sell any securities or other financial instruments as defined i...

RBI has made every effort to ensure reliability in researching the information published on the RBI Research-Website or sent via RBI Research-Website as well as in selecting the source of information used. Nonetheless, RBI does not assume any liabilit...

The information contained on the RBI Research-Website as well as forecasts published on the RBI Research-Website are based on the information available and the market assessment at the point in time stated in the respective publications. Certain infor...

You agree and acknowledge that the information and statements contained in the materials you are accessing on the RBI Research-Website speak only as of the date of such document and such information and statements will become inaccurate, stale and/or ...

RBI assumes no responsibility to maintain documents posted on the RBI Research-Website or to update any documents. Therefore, users of the RBI Research-Website acknowledge that the content of documents available on the RBI Research-Website may not sho...

Restricted access due to local regulations

Users of the RBI Research-Website can access some documents and information without registration requirements and without further barriers (the respective area on the RBI Research-Website is hereinafter referred to as "Unrestricted Area"). By acce...

Raiffeisen RESEARCH

Other documents are only available to persons who have registered themselves in accordance with the required procedure. The part of the RBI Research-Website which can only be acceded by way of registration is hereinafter referred to as “Restricted A...

Due to the laws applicable in some jurisdictions or regulations imposed by capital market or securities authorities, some of the information published on the RBI Research-Website (e.g. stock analyses) is not addressed to private individuals. In order ...

The distribution or dissemination of information published on the RBI Research-Website as well as the purchase and offering of the respective products in certain jurisdictions may be subject to restrictions or additional requirements. Persons who retr...

Users of the Unrestricted Area should be aware that the documents available on this part of the RBI Research-Website are not made available on the basis that any customer relationship is created between RBI and such user solely on the basis of such us...

Links to websites or URLs of third-party providers

With the exception of the cases regulated under § 17 of the Austrian E-Commerce Act, RBI does not assume any liability for the content of websites or URLs of other providers to which links are provided. Neither does RBI assume any liability for the u...

Exclusion of liability

RBI makes no warranty and will accept no liability for any damages whatsoever (including consequential or indirect damages, or lost profits) relating to the access to the RBI Research-Website, the opening, use or querying of the contents on the RBI Re...

Furthermore, RBI shall not be liable for technical disruptions such as server breakdowns, operating disruptions or failures of the telecommunications links and other similar events, which could lead to the (temporary) unavailability of the RBI Researc...

Storage of registration data

The content in the Restricted Area of the RBI Research-Website is only available to registered users. By sending the completed online registration form, the user confirms the completeness and correctness of the data given and also confirms having trut...

Changes to the RBI Research-Website

RBI retains the right to change and to remove the RBI Research-Website at any time (if necessary also without prior notice), in particular as regards changing existing contents (in full or in part) and adding new contents.

General terms and conditions of business

For (authorised) users who use the services of RBI provided on the RBI Research-Website, the General Terms and Conditions of Business, as amended, of RBI shall apply in addition to the terms and conditions of this Disclaimer.

Please also take ...

IF YOU CANNOT SO CERTIFY, YOU MUST CLICK THE BUTTON LABELLED “I DECLINE” OR OTHERWISE EXIT THIS WEBSITE.

BY ACCESSING THE MATERIALS ON THIS WEBSITE, YOU SHALL BE DEEMED TO HAVE MADE THE ABOVE REPRESENTATIONS AND CONSENTED TO DELIVERY BY ELECTRONIC TRANSMISSION.

PETER BREZINSCHEK
Austria ,
peter.brezinschek@rbinternational.com

GUNTER DEUBER
Austria ,
gunter.deuber@rbinternational.com

CASPER ENGELEN
Austria ,
casper.engelen@rbinternational.com

MATTHIAS REITH
Austria ,
matthias.reith@rbinternational.com

GOTTFRIED STEINDL
Austria ,
gottfried.steindl@rbinternational.com

ANNE VALDER
Austria German,
anne.valder@rbinternational.com

FRANZ ZOBL
Austria ,
franz.zobl@rbinternational.com

BRISIDA BUZI
Albania ,
Brisida.BUZI@raiffeisen.al

VALBONA GJEKA
Albania ,
valbona.gjeka@raiffeisen.al

FJORENT RRUSHI
Albania ,
Fjorent.Rrushi@raiffeisen.al

ARISTEA VLLAHU
Albania ,
Aristea.Vllahu@raiffeisen.al

OLGA ZHEGULO
Belarus ,
olga.zhegulo@priorbank.by

ASJA GRDJO
Bosnia Herzegovina ,
asja.grdjo@raiffeisengroup.ba

IVONA ZAMETICA
Bosnia Herzegovina ,
ivona.zametica@raiffeisengroup.ba

MIRZA ZORNIC
Bosnia Herzegovina ,
mirza.zornic@raiffeisengroup.ba

ANA LESAR
Croatia ,
ana.lesar@rba.hr

ELIZABETA SABOLEK-RESANOVIC
Croatia ,
elizabeta.sabolek-resanovic@rba.hr

ZRINKA ZIVKOVIC-MATIJEVIC
Croatia ,
zrinka.zivkovic-matijevic@rba.hr

HELENA HORSKA
Czech Republic ,
Helena.Horska@rb.cz

DAVID VAGENKNECHT
Czech Republic ,
david.vagenknecht@rb.cz

LEVENTE BLAHÓ
Hungary ,
levente.blaho@raiffeisen.hu

GERGELY PÁLFFY
Hungary ,
gergely.palffy@raiffeisen.hu

ZOLTÁN TÖRÖK
Hungary ,
torok.zoltan@raiffeisen.hu

DOROTA STRAUCH
Poland ,
dorota.strauch@raiffeisen.pl

NICOLAE COVRIG
Romania ,
Nicolae.Covrig@raiffeisen.ro

ANDREEA-ELENA DRAGHIA
Romania ,
Andreea-Elena.DRAGHIA@raiffeisen.ro

IONUT DUMITRU
Romania ,
Ionut.Dumitru@raiffeisen.ro

ANASTASIA BAYKOVA
Russia ,
ABAIKOVA@raiffeisen.ru

GREGORY CHEPKOV
Russia ,
grigory.chepkov@raiffeisen.ru

STANISLAV MURASHOV
Russia ,
stanislav.murashov@raiffeisen.ru

LJILJANA GRUBIC
Serbia ,
ljiljana.grubic@raiffeisenbank.rs

TIBOR LORINCZ
Slovakia ,
tibor_lorincz@tatrabanka.sk

SERHII KOLODII
Ukraine ,
serhii.kolodii@raiffeisen.ua

OLEKSANDR PECHERYTSYN
Ukraine ,
oleksandr.pecherytsyn@raiffeisen.ua

Imprint

Creation time of this publication: 07/09/2022 16:02 P.M. (CEST) ;
First Dissemination of this publication: 07/09/2022 16:02 P.M. (CEST)

Imprint

Information requirements pursuant to the Austrian E-Commerce Act

Raiffeisen Bank International AG Registered Office: Am Stadtpark 9, 1030 ViennaPostal address: 1010 Vienna, Postfach 50Phone: +43-1-71707-1846Fax: + 43-1-71707-1848Company Register Number: FN 122119m at the Commercial Court of ViennaVAT Identification Number: UID ATU 57531200Austrian Data Processing Register: Data processing register number (DVR): 4002771S.W.I.F.T.-Code: RZBA AT WWSupervisory Authorities: As a credit institution (acc. to § 1 Austrian Banking Act; Bankwesengesetz) Raiffeisen Bank International AG is subject to the supervision by the Austrian Financial Market Authority (FMA, Finanzmarktaufsicht) and the National Bank of Austria (OeNB, Oesterreichische Nationalbank). Additionally, RBI is subject to the supervision by the European Central Bank (ECB), which undertakes such supervision within the Single Supervisory Mechanism (SSM), which consists of the ECB and the national responsible authorities (Council Regulation (EU) No 1024/2013 - SSM Regulation). Unless set out herein explicitly otherwise, references to legal norms refer to norms enacted by the Republic of Austria.Membership: Austrian Federal Economic Chamber, Federal Bank and Insurance Sector, Raiffeisen Association.

Statement pursuant to the Austrian Media Act

Publisher and editorial office of this publication Raiffeisen Bank International AGAm Stadtpark 9, A-1030 Vienna**Media Owner of this publication**Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und FinanzmarktanalysenAm Stadtpark 9, A-1030 Vienna**Executive Committee of Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und Finanzmarktanalysen:**Mag. Peter Brezinschek (Chairman), Mag. Helge Rechberger (Vice-Chairman)Raiffeisen RESEARCH – Verein zur Verbreitung von volkswirtschaftlichen Analysen und Finanzmarktanalysen is constituted as state-registered society. Purpose and activity are (inter alia), the distribution of analysis, data, forecasts and reports and similar publications related to the Austrian and international economy as well as financial markets.**Basic tendency of the content of this publication**

- Presentation of activities of Raiffeisen Bank International AG and its subsidiaries in the area of conducting analysis related to the Austrian and international economy as well as the financial markets.
- Publishing of analysis according to various methods of analyses covering economics, interest rates and currencies, government and corporate bonds, equities as well as commodities with a regional focus on the euro area and Central and Eastern Europe under consideration of the global markets.

Producer of this publication Raiffeisen Bank International AGAm Stadtpark 9, A-1030 Vienna