INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Governing Council meeting, ECB. 27/10/2022

All lending rates increased by a further 0.75%

The ECB's Governing Council met on 27th October and voted to raise the cost of borrowing by 0.75%. This decision comes only seven weeks after the previous meeting which also hiked rates by 0.75%. Since June, the cost of borrowing has risen by 2% in total. In the press conference which followed the meeting, Christine Lagarde, the ECB's President indicated that further rate rises could be expected before the end of 2022. Klaas Knot, the head of the Dutch Central Bank, was more specific, suggesting that rates would rise by a further 0.5% or 0.75% when the Governing Council next meets on 15th December. This tightening of monetary policy is a reflection of the ECB's desire to bring inflation down to its 2% target. Prices rose by no less than 10.7% across the 19-nation bloc in the year to October, with some individual member states seeing much higher inflation. The figure for Lithuania, for example, is 24.7%. The ECB intends to consider whether or not to start running down its balance sheet at the next meeting. With bond yields rising worldwide, the ECB is very keen to avoid widening the spread between different member states, hence the establishment of the Transmission Protection Instrument (TPI). This is a facility to re-invest money from maturing assets purchased under either the 2019 Asset Purchase Programme (APP) or the larger 2020 Pandemic Emergency Purchase Programme (PEPP). The money is to be spent on further bond purchases from the governments of the more heavily indebted Eurozone countries, notably Italy and Spain. Thus far, the spread has not been that great as the yield on 10-year German Bunds has risen to its highest level in over a decade while the yield on 10-year Italian and Greek debt has declined in recent weeks.

Consumers are being impacted by high inflation. Retail sales have been declining on an annual basis since June. The strong growth in new mortgage lending does not so far seem to have been affected by higher borrowing costs and growth in new credit to businesses stands at 8%, the highest reading in some years. Indeed, September's money figures have just been released by the ECB and they indicate that M3 grew at an annual rate of 8.4% in the third quarter of the year. This is too high to be consistent with 2% inflation and has largely been driven by the deposits created by new credit. Higher borrowing costs may perhaps deter some businesses or households from taking on additional debt in the coming months, but any resultant slowdown in M3 growth will take a while, most likely at least 18 months, for this to affect the rate of increase in consumer prices.

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