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ECB ends the era of negative interest rates in one hawkish swoop

- ECB raises its 3 key interest rates by 50 basis points
- 'Anti-fragmentation' tool called TPI approved

Today, the European Central Bank (ECB) ended the era of negative interest rates in the Eurozone in one hawkish swoop, raising key rates by half a percentage point — its first increase since 2011 and twice the magnitude expected by markets.

- The deposit rate will rise from -0.5% to zero

- The main refinancing operations rate will rise from zero to 0.5%
- The marginal lending facility will increase from 0.25% to 0.75%

The governing council said that it "judged that it is appropriate to take a larger first step on its policy rate normalisation path than signalled at its previous meeting" because of an "updated assessment of inflation risks" and the approval of a new anti-fragmentation tool designed to ensure the effective transmission of monetary policy across the bloc. Eurozone inflation rose to a record-high of 8.6% in June on the back of soaring energy and food prices.

The ECB probably felt it had to act quickly while the window of opportunity was still open.

The new policy tool, the Transmission Protection Instrument, is designed to "counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area," the bank said. All Eurozone countries are eligible but must meet four criteria, including compliance with the EU fiscal framework.

Looking ahead, the ECB indicated that rates would rise again at future meetings, adding: "The frontloading 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."

With regard to its balance sheet, the ECB said it would continue reinvesting, in full, the principal payments from maturing securities purchased under the Asset Purchase Program (APP) for as long as necessary to maintain ample liquidity conditions. With regard to the Pandemic Emergency Purchase Program (PEPP), the ECB intends to reinvest the principal payments from maturing securities until at least the end of 2024.

Government bond yields shot higher, as investors adjusted to the bigger-than-expected rate hike. Italian bond yields are also pressured upwards by the resignation of Prime Minister Mario Draghi. A glint of good news is that Russia has, for now, resumed the flow of natural gas to Germany after maintenance on the Nord Stream I pipeline.

The currency failed to appreciate despite the bold move in hiking rates.

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