

MARKET COMMENTARY

ECB to cut in June if disinflation remains on track

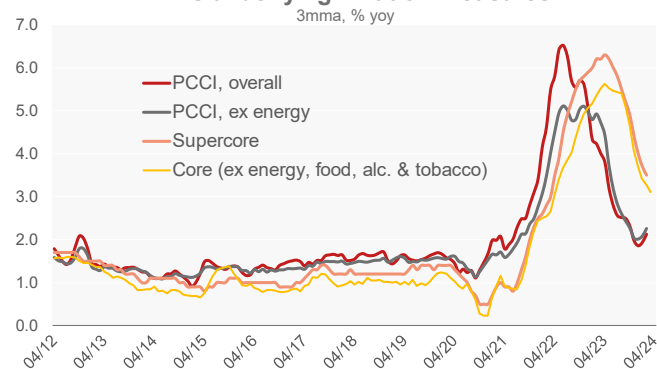
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April 11, 2024

- At today's meeting the ECB's Governing Council (GC) left its key rates unchanged, in line with expectations.
- Most importantly, it adopted a much softer language about inflation. The GC noted that wage growth was "*gradually moderating*" while domestic price pressure was characterized as "*strong*" but no longer as "*high*".
- The GC and President Lagarde in the press conference made clear that if disinflation were to continue in line with the ECB's projections "*it would be appropriate to reduce the current level of monetary policy restriction.*"
- While "*a few GC members*" already wanted to act today the majority preferred to wait until the June meeting at which updated projections will be available. In the Q&A President Lagarde pointed out that inflation data will be bumpy over the coming months but that the GC is aware of that. The hurdle to derail the pivot seems to be high.
- We stick to our call of a first 25 bps rate cut by June 6 and continue to see cumulative cuts of 100 bps in 2024. Markets barely reacted to today's ECB meeting leaving the expected path of key rate cuts almost unchanged.

GC unsurprisingly decided not to act today: At today's meeting the GC unsurprisingly decided to again leave key rates unchanged, the deposit rate at 4.00% and the repo rate at 4.50%. It continues with APP non-reinvestments and sticks to the previous announcement that it "*intends to reduce the PEPP portfolio by €7.5 billion per month on average*" over the second half of 2024 and to fully stop reinvestments at the end of 2024.

ECB's underlying inflation measures



Source: Datastream, ECB, GenAM

Euro area wage growth slows



Source: Datastream, indeed, GenAM

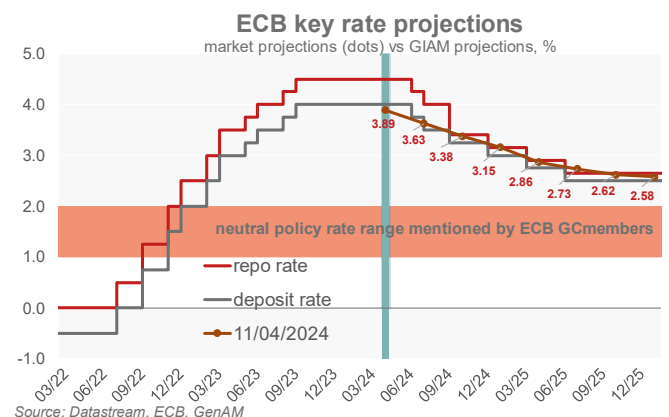
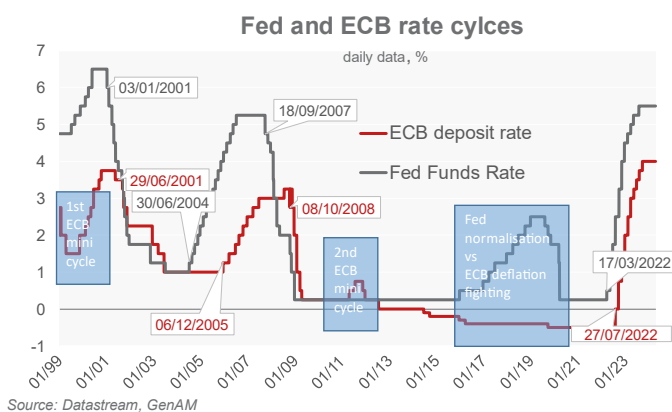
Disinflation on track: Over the past months disinflation has been continuing and the ECB’s proprietary measures for underlying inflation (e.g., supercore, PCCE) suggest that the fall to 2.9% yoy in March is backed by fundamentals. With March headline inflation at 2.4% yoy, the Q1 inflation data are in line with the ECB’s latest projection. Accordingly, the GC saw the latest data as a confirmation of its medium-term inflation outlook. Domestic price pressure remains a concern, but its qualification has been scaled down from “high” to “strong”.

Wage risk reduced ...: Already in the past meetings the GC had become more confident on disinflation, but President Lagarde had also stated that the GC was not yet “sufficiently confident” to act. The elephant in the room is high domestic price pressure “in part owing to strong growth in wages”. However, the latest data from the Indeed wage tracker (see right-hand chart above) implies lower wage growth as well as services inflation. While at the last meeting, she was “extremely vigilant” regarding the evolution of profits and wages, the ECB now became more relaxed on this risk. The GC finds that “firms are absorbing part of the rise in labour costs in their profits”, a key assumption underlying the March (dis)inflation projection and something the GC is “particularly attentive” to. Moreover, it noted that wage growth was “gradually moderating”.

... and GC is aware of a bumpy road ahead: That said, the ECB made very clear that it is not looking for immaculate disinflation. Especially base effects from last year’s drop in energy prices will make inflation data volatile over the coming months. And concerning geopolitical risks, the ECB is very attentive to the evolution and outlook of oil prices. Asked about stubbornly high services inflation President Lagarde answered that the ECB will not wait until everything goes to 2% but take an overall assessment. All in all, we got the impression that the hurdle for seeing inflation no longer on the disinflation path seems to be high.

The Fed wouldn’t stop the ECB: While the ECB is on track to cut soon, the latest US inflation data led markets to postpone the timing of the first Fed cut beyond June. As usual, President Lagarde pushed back expectations that the ECB would then also need to adjust its policy path. She emphasized data dependence and pointed out that the nature of inflation was diverging between the US and the euro area. It became very clear that the Fed wouldn’t stop the ECB. In a recent [paper](#), we laid down why there had been ‘autonomous’ ECB policy cycles also in the past (see also left-hand graph below).

Easing cycle to start in June: We continue to look for a first 25 bps key rate cut by June and deem cumulative cuts of 100 bps in 2024 still likely. Markets currently price in only 75 bps. Overall, financial markets barely reacted to today’s ECB meeting.



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