Article | 7 March 2024

Lagarde opens the door slightly to June rate cuts

ECB President Christine Lagarde slightly opened the door to rate cuts at the June meeting. However, with inflation gradually coming down but not undershooting the target and growth returning to potential later this year, the central bank's macro outlook doesn't offer a lot of room for a longer series of rate cuts

ECB President Christine Lagarde

Today, we saw no policy action and all focus on communication from the European Central Bank. This had already been the focus of today's meeting for a while. The just-published policy announcement shows that now is not the time for rate cuts and that – at least in its official communication – the ECB is resisting the temptation to send any new signals regarding upcoming rate reductions.

All policy rates were kept unchanged and the overall tone of the policy statement didn't shift towards more dovishness. In fact, the central bank maintained the stance that rates at current levels being maintained "for a sufficiently long duration will make a substantial contribution to this [bringing inflation back to 2%] goal."

Staff projections bring downward revisions

A lot of attention went to the ECB's staff projections. While its general economic assessment did not change, the latest round of staff projections brought a stronger-than-expected downward revision to growth, and particularly to inflation forecasts. For this year, ECB staff now expect inflation to come in at 2.3% in 2024, 2.0% in 2025 and 1.9% in 2026, with underlying inflation at 2.1% in 2025 and 2.0% in 2026. While this downward revision and downward trend in inflation should give the central bank some comfort, ECB President Christine Lagarde still warned against high domestic inflationary pressure.

Regarding growth, ECB staff expects eurozone GDP growth to come in at 0.6% in 2024, 1.5% in 2025 and 1.6% in 2026 – slightly lower than in the December projections but still a more optimistic view than ours. Risks to the growth outlook were tilted to the downside, while there was still no official net balance of risk to the inflation outlook. Looking at the quarterly profile of the forecasts, the fact that inflation will only drop below 2% in the third quarter of 2025 and that growth will return to potential growth in the third quarter of this year still illustrates a relatively benign macro scenario, giving little reason for longer rate cut sequence.

Lagarde keeps rate cut cards close to her chest

The worsening of the eurozone's economic outlook and further fading away of (headline) inflationary pressures would argue for rather imminent smaller rate cuts to bring some relief. But stubborn underlying inflation – particularly services inflation – as well as uncertainty regarding wage developments and the never-ending confidence in an economic rebound in the eurozone still prevent the ECB from cutting rates – at least for now. As long as the ECB is not willing to accept that inflation is only roughly returning to target, rate cuts should only be on the agenda at the June meeting at the earliest. June will be the point where enough data points will be available, either confirming that the inflation beast has really been tamed or pointing to renewed upward pressure on prices. Here, Lagarde commented that the central bank was not "sufficiently confident" yet that inflation will return to target and that it needed more evidence. According to Lagarde, the ECB will know more at the April meeting and a "lot more" at the June meeting.

It took a while, but towards the end of the press conference a journalist finally asked whether the ECB today had discussed rate cuts. Lagarde's response was a clear and meaningful statement that the ECB had not discussed rate cuts today but had "just" started a discussion on how to dial back its restrictive stance. On a different matter, however, Lagarde announced that the results of the review of the operational framework will be released next week on 13 March.

We still believe in our June rate cut call

We continue to believe that three main criteria need to be fulfilled before the ECB will start cutting rates: i) long-term inflation forecasts (which currently have inflation back at 2.0% from the third quarter of 2025 onwards) need to remain unchanged; ii) nominal wage growth needs to come down to around 4%; and iii) actual inflation should be at least around 2.5% for a few months, as the central bank would fear harming its credibility when cutting rates with an actual inflation rate of around 3%. Of course, any unexpected severe financial market stress or a severe recession in the eurozone economy could trigger an earlier rate cut. Any such clarification would signal more agreement within the Governing Council.

Looking beyond the timing of a first rate cut, the next question is how far and how fast the ECB would go. Here, the fact that the eurozone economy is not in recession and that risks to inflation and the inflation outlook remain to the upside (be it due to cyclical but also structural drivers) plays an important role. Financial market participants still seem to be betting on a simple and swift reversal of the rate hikes of the last two years. However, this kind of turnaround traditionally only takes place if the economy falls into a severe recession. It therefore makes more sense to expect a very gradual rate cut cycle once it starts. With inflation at target in late 2025 and growth returning to potential in 2025, there is not much room for the ECB to actually cut rates. As much as the central bank hastily and sharply hiked rates on the way up, we think it will be cautious and gradual on the way back down.

Gradual reversal of rate hikes to start in June

All in all, today's meeting was a clear and well-structured meeting with an unambiguous message that for now, it's too early to discuss rate cuts, but the time for that will come. We think it will be in June. Let's hope that today's meeting will also end the cacophony of national central bankers commenting on the timing of future rate cuts, which has resembled something of a noisy atonal choir in recent weeks. This would give markets and the ECB some time to prepare the gradual end of its current restrictive stance.

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