ECB: Final stop before the cut

With yet another quarter of eurozone inflation coming in slightly lower than the European Central Bank had expected, the case for rate cuts is getting stronger and we will be looking at the ECB's degree of confidence at next week's meeting

Source: Shutterstock

Incoming data since the ECB's March meeting has had something for both the doves and hawks. Signals of a bottoming out of the eurozone economy, with some improvement in lending growth and confidence indicators, should encourage the hawkish team not to rush into rate cuts. At the same time, the slightly faster-than-expected fading away of inflationary pressures could motivate some Governing Council members to even ask the question as to why not start to cut rates already next week. Let's not forget that the ECB's staff projections in January had inflation returning to target in the second half of 2025, while growth would be slightly above potential in both 2025 and 2026. Given how their models work, the ECB would have to cut rates by some 100bp to get to these – what the ECB would call – favourable macro outcomes. This is why the only questions left are: when and by how much but not if rates will be cut.

Sticking to our June rate cut call

Since the March meeting, ECB members managed not to deviate too much from ECB President Christine Lagarde's comments at the press conference. The current narrative is clearly pointing to a first rate cut in June as this will be the meeting with a full batch of important data available: a fresh round of ECB staff forecasts, GDP growth and wage growth data for the first quarter of 2024 and results of the Bank Lending Survey, just to mention the most relevant ones. We expect the ECB to stay on hold next week and to further prepare markets for a first rate cut in June.

What to watch at next week's meeting

Even without actual rate action, next week's meeting could provide some interesting insights in what will be next for the ECB. We will be mainly looking for two things: changes to the communication and some hints at the size of the first and following rate cuts.

At the March meeting, Lagarde said that the ECB was "confident" but "not sufficiently confident" that inflation is falling back towards 2%. The degree of confidence will be a good tool to further steer markets' expectations. Anything along the lines of "almost sufficiently confident" would almost pre-announce a June rate cut. However, while discussing any subtle changes to the ECB's communication, we should also remember that in the past the ECB has used the communications sledgehammer. In June 2022, the rate hike cycle was simply and unexpectedly pre-announced by stating that the ECB "intends to hike rates by 25bp" at the next meeting. Maybe some ECB members will also remember this communication style next week.

As regards to the size of the first and further rate cuts, once the ECB starts cutting rates, we believe it will not be a one-off rate cut. Instead, the ECB will have to have at least an idea how far it eventually would like to lower rates before actually engaging in a rate cut cycle. This is a discussion that will already start next week. We think that as long as the eurozone economy is not in recession and risks to inflation and the inflation outlook remain to the upside (be it due to cyclical but also structural drivers), the ECB will opt for a "slow hand" policy of 25bp rate cuts every quarter. Any more aggressive rate cut scenario would smell like panic and require a more adverse growth outlook for the eurozone.

All in all, next week's ECB looks like the prelude to yet another turning point for monetary policy in the eurozone: final stop before the cut.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de