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ECB keeps rates and communication unchanged, discussion of rate cuts premature

European Central Bank President Christine Lagarde stressed during the press conference that any discussion on rate cuts was still premature

ECB President Christine Lagarde

At today's meeting, the European Central Bank kept everything unchanged: both policy rates and communication. The press release with the policy announcements is almost a verbatim copy of the December statement. The ECB only dropped two phrases that could be interpreted as opening the door to rate cuts very softly: the December comments on domestic price pressure being elevated, and the temporary pick-up in inflation. The fact that these two phrases were dropped, however, could also simply be linked to the fact that there are no new forecasts. And during the press conference, ECB President Lagarde mentioned that observers shouldn't pay too much attention to subtle changes in the text. Admittedly, we don't know what to do with this comment, bearing in mind that central bankers are normally known for weighing every single word and comma in their communication.

Also during the press conference, Lagarde stressed that the Governing Council had concluded that any discussion on rate cuts was currently premature. She repeated the importance of wage developments in the coming months for the next ECB steps, pointing to some indicators that already show some slowing in wage growth. While this could be seen as a very tentative shift towards more dovishness, Lagarde also emphasised the need for inflation to be on a sustainable downward trend.

Asked whether she would repeat her statement from last week in Davos that rate cuts by the summer were likely, Lagarde replied that she always stood by what she had said. Even though we today learned that we shouldn't pay too much attention to every single word, we do remember that Lagarde said in November last year that the ECB wouldn't cut rates in the next couple of quarters. Combining these two comments would imply that a first rate cut could not come in June but only in July at the earliest. However, past experience has shown that the ECB president is not necessarily the best ECB forecaster.

We stick to our call of a June cut

Looking ahead, today's meeting once again stressed that the ECB is in no position to start cutting rates soon. In any case, even if actual growth continues to turn out weaker than the ECB had expected every single quarter, as long as the eurozone remains in de facto stagnation mode and doesn't slide into a more severe recession, and as long as the ECB continues to predict a return to potential growth rates one or two quarters later, there is no reason for the ECB to react to more sluggish growth with imminent rate cuts. Also, the job of bringing inflation back to target is not done yet. In the coming months, inflation developments will be determined by two opposing trends: more disinflation and potentially even deflation as a result of weaker demand, but also new inflationary pressures due to less favourable base effects, new inflationary pressure as a result of the tensions in the Suez Canal as well as government interventions in some countries, above all Germany. As long as actual inflation remains closer to 3% than 2%, the ECB will not look into possible rate cuts. It would require a severe recession or a sharp drop in longer-term inflation forecasts to clearly below 2% to see a rate cut in the coming months. We continue to believe that a first rate cut will not come before June.

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