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# ECB's press conference signals its first cut will be hawkish

ECB President Christine Lagarde's comments at today's press conference suggest that the timing of the first rate cut is not a done deal yet – and that it's going to be a hawkish move as concerns about inflation reaccelerating remain

ECB President Christine Lagarde

The European Central Bank has kept all policy interest rates unchanged. Inflationary pressures have further decreased, enabling the ECB to be very explicit about next steps: "if the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction." This is the first time the ECB has talked about rate cuts in its official policy announcement since the tightening cycle has started.

## ECB concerned about domestic inflation

The ECB's assessment of the eurozone economy has not changed since the March meeting. In fact, the central bank acknowledged the easing of inflationary pressures as well as moderating wage growth, while at the same time stressing still strong domestic price pressures. It is exactly these domestic price pressures that seem to have become the ECB's biggest inflation concern.

## Door open to June cut

During the press conference, ECB President Christine Lagarde repeatedly stressed the hint at upcoming rate cuts mentioned above – but she also added that the ECB was not pre-committing to any path for policy rates. At the same time, Lagarde also mentioned that few ECB members had already been in favour of a rate cut today.

Today's meeting marked another step in the very gradual transition of the ECB's communication since December from hawkish to dovish, even if it was probably the mildest shift. The ECB clearly opted against giving more explicit guidance for a June cut. This reluctance to be more outspoken – combined with the fact that some ECB members were already in favour of a rate cut today – implies a higher degree of disagreement within the central bank. It seems as if at least some ECB members fear that still high services inflation and the recent surge in oil prices, as well as wage developments in Germany, suggest that there still is a considerable risk of inflation reaccelerating.

In fact, we disagree with what Christine Lagarde said regarding US inflation and the full decoupling of eurozone inflation developments from those in the US. Headline inflation developments in the US have nicely led eurozone developments with a lag of around half a year; not necessarily the exact monthly inflation numbers, but defintely the broader direction of inflation. Therefore, more generally speaking structural constraints to the supply side of the eurozone economy – e.g., the lack of skilled workers, capacity constraints due to underinvestment or energy and commodity dependencies – bear the risk that any recovery of economic activity leads to disproportionally higher inflation. Consequently, the room for manouver for the ECB to cut rates more significantly is limited.

## First cut will be a hawkish cut

Even if the policy announcement does not explicitly mention June as the moment for a first rate cut, we think that today's meeting should mark the final stop before the cut. The faster-than-expected drop in headline inflation, as well as anaemic growth, have opened the door for some rate cuts. However, the reluctance demonstrated at today's press conference illustrates that the ECB has no intention at all to fully reverse the rate hikes since July 2022, but will rather do some finetuning with a mild loosening of a still restrictive stance. As long as the eurozone economy remains on track for a gradual recovery – as weak as it might be – and as long as the risk of inflation reaccelerating remains high, we cannot see the ECB cutting rates by more than a total of 75bp this year.

All in all, the door to a June rate cut is open, even if the June cut is not a done deal yet. In any case, today's meeting made clear that the first cut will be a very hawkish one.

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