Article | 14 December 2023

# ECB stays on hold and makes first tentative dovish shift

The European Central Bank keeps interest rates on hold and, at least in its official statement, has made a very small shift towards dovishness

With the drop in inflation, a further weakening of the economy and the latest comments by senior ECB officials, no one had seriously considered a rate hike at today's meeting. Instead, the only question had been how dovish the ECB's communication shift will be. Before today's meeting, financial markets had already priced in ECB rate cuts by a total of 150bp for next year.

The just-released policy statement signals that at least the end of rate hikes is here. The fact that the phrase "*inflation is expected to remain too high for too long*" is gone. At the same time, however, the phrase that "*rates will be set at sufficiently restrictive levels for as long as necessary"* is still in the official communication. The ECB also announced a very gradual phasing out of the reinvestments under the Pandemic Emergency Purchase Programme (PEPP) in the second half of 2024.

Despite their dismal track record, the ECB's staff projections will play an increasingly important role again over the coming months. Today's forecasts show headline inflation at 5.4% in 2023, 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026. GDP growth is expected to come in at 0.6% in 2023, 0.8% for 2024, and 1.5% in both 2025 and 2026. These forecasts would not justify aggressive rate cuts next year.

For now, we still think that the ECB's shift to full dovishness will be more gradual than markets are pricing in. Today's policy announcements and the staff projections nicely confirm this. And, in fact, it is hard to see how the ECB could decide on a full U-turn on policy rates only on the back of a few weaker-than-expected inflation prints without headline inflation falling below 2% and the longer-term inflation forecasts still being at around 2%.

Also, the ECB's forecasting mistakes of the past are probably an almost automatically built-in brake on premature and large-sized rate cuts. In fact, we think that it would require a sharper economic downturn and/or inflation sustainably falling below 2% to see the ECB cutting rates by as much as the currently priced in 150bp. Our base case scenario remains a more gradual shift towards full dovishness and more gradual rate cuts in 2024. Let's see whether ECB Christine Lagarde will say anything to confirm or change this view at the press conference starting at 2.45pm CET.

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