Minutes of the ECB's March meeting strengthen case for June cut

The just-released minutes of the European Central Bank's last meeting in March strike a fine balance between sounding hawkishly concerned and at the same time, preparing for a first rate cut. This won't happen next week, in our view, but at the June meeting

Yesterday's drop in eurozone headline inflation has fuelled the discussion on whether the risk of inflation eventually undershooting instead of overshooting the ECB's target should be the main concern for the central bank. While we think that the ECB will not easily give the all-clear on inflation, the just-released minutes of the March meeting show that the option of a rate cut has entered the central bank's radar screen.

Here are the highlights from the minutes of the ECB's March meeting:

- **Risks to the growth outlook are still tilted to the downside.** The macro assessment of some bottoming out of economic activity, softer inflation readings but with signs of inflation sluggishness was not new. Interestingly, the ECB discussed that weaker-than-expected economic activity would not necessarily lead to more disinflationary pressure but could lead to higher inflation, at least in a scenario where productivity does not rebound.

- **Concerns about services inflation.** Despite the slowing in headline inflation, the ECB remains concerned about services inflation, which has been too sluggish and "lent further support to the picture of "last mile" persistence in that component of inflation". Also, the recent increase in all HICP components, except food, was considered a warning that the fight against inflation was not over, yet.
- **Hawkish bias.** The difficulty of the last mile was an important argument for "perseverance in keeping monetary policy sufficiently restrictive".
- **On rate cuts.** The most interesting aspect of the minutes. According to the minutes, "there was consensus that it would be premature to discuss rate cuts at the present meeting". However, at the same time, the Governing Council concluded that "the case for considering rate cuts was strengthening". A clear hint regarding the timing of the first rate cut came from the following phrase: "the Governing Council would have significantly more data and information by the June meeting, especially on wage dynamics. By contrast, the new information available in time for the April meeting would be much more limited, making it harder to be sufficiently confident about the sustainability of the disinflation process by then".

What to expect from next week's ECB meeting

As explained in our preview of next week's ECB meeting, we think that 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 ask why the rate-cutting process shouldn't start 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' rather than 'if' rates will be cut.

A rate cut next week is highly unlikely. Not only is actual inflation still above target and services inflation still too high, the ECB will not easily give the all-clear on inflation. The risk of reflation remains too high. This is why we expect the ECB to wait until the June meeting 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.

Still, even without actual rate action, next week's meeting is likely to pave the way for a June cut. We think that the ECB has three potential options for its communication:

- The easiest and least committed one would be to pick up ECB President Christine Lagarde's comments at the last meeting when she said that the Bank 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 market expectations. Anything along the lines of "almost sufficiently confident" would clearly hint at a June rate cut.
- An even stronger signal would be to mimic the communication the ECB used ahead of the first rate hike. In June 2022, the ECB used a communication sledgehammer, simply pre-announcing a hike at the next meeting 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 and will opt for "the ECB intends to cut interest rates at the June meeting" in next week's official communication.

- A softer version of the sledgehammer approach would be to make the intentions a bit more conditional by, for example, stating that the ECB intends to hike rates at the June meeting if the incoming data confirms a further easing of inflationary pressures.

All in all, the minutes of the ECB's March meeting confirmed our view that next week's meeting looks like the prelude to yet another turning point for monetary policy in the eurozone: the final stop before a cut.

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