Central Banks

Setting the stage for rate cuts

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- **The ECB kept interest rates on hold for the 5th meeting in a row, as expected**
- **For the first time, they mention they consider appropriate to reduce the current level of monetary policy restriction if inflation continues to move toward its target**
- **The institution asserted its data-driven mode, independent from the Fed's rate decisions**
- **The latest inflation data aligns with the ECB's forecasts. Yet, they will closely monitor wages and their impact on services prices**

Today's ECB meeting proceeded without major announcements, keeping all monetary policy rates unchanged for the fifth consecutive session. The focus of the press conference was expected to center on signals of a commitment to an initial rate cut in June, along with insights into the trajectory of the upcoming easing cycle. In this regard, Mrs. Lagarde said again (she did it at the last meeting) that there will be much **more relevant information available in June**, **keeping the door open for a rate cut by then**. However, she mentioned that there has already been debate on this front among the Governing Council, as **a few members felt sufficiently confident to cut rates already (although a very large majority preferred to wait for more data).**

On the possibility of rate cuts, there has been a change in the statement. In particular, **the ECB explicitly mentioned the possibility of rate cuts** if three criteria are met—namely, 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. However, **the ECB emphasized that it will stick to its data-dependent, meeting by meeting approach, and it made clear that it is not pre-committed to a particular rate path.**

After the upward inflationary surprise in the US yesterday, which dialed back expectations of Fed rate cuts, and the subsequent market reaction and Euro depreciation against the US dollar, the focus was on whether the ECB decisions were dependent on the Federal Reserve rates path. Addressing these queries, Lagarde aimed to recognize the distinct differences between both economies and the decision-making **autonomy of the ECB from the Fed**. She emphasized that **the ECB's approach is not contingent upon the Fed's actions**, stressing that they do not speculate on the actions of other central banks. However, they focus on price stability and inflation impacts, whether domestic or imported, so she assured that **the impact from what happens in the US will naturally be integrated into the ECB's projections** set to be published in June. Definitely, the financial influence of the US, together with other big economies such as China or Japan, is another factor that the ECB policy-makers will be analyzing carefully.

On the latest inflation data, the ECB is comfortable with it as it is in line with its forecasts published by the institution last March. **Inflationary pressures are clearly easing** thanks to lower food and goods prices, although **they are aware that services prices remain strong**. Therefore, until the next meeting in June, **the ECB will closely monitor the publication of first quarter wage growth** (expected in May) and whether firms are absorbing part of it. The weaker-than-expected growth in wages and unit profits in the fourth quarter of 2023, together with more recent data, seem to reaffirm the expected moderation. There were many questions about the recent rise in oil prices, though Lagarde did not show much concern and referred to the volatility of the energy component to indicate that

they expect the inflation path to fluctuate above current levels in the coming months, but to decline to the 2% target by mid-2025. This sounded as a dovish remark precluding any upward surprise in inflation, as well as a warning that they will not wait until all components reach the 2% target to start the cutting cycle.

The dovish tone was also underscored by **concerns about economic activity, especially weak demand from the manufacturing sector** and its energy-intensive firms. The institution is relying on the **resilience of the services sector as a catalyst for this year's economic recovery** in the face of a recovery in domestic demand aided by stronger household purchasing power and improved terms of trade. The ECB also expects the manufacturing sector to recover in the face of stronger external demand growth.

Finally, during the Q&A there was a **question regarding whether excessive deficit procedures will impact a country's qualification for TPI** (Transmission Protection Instrument, the emergency mechanism to buy sovereign bonds of specific countries in case of tensions). Mrs. Lagarde stated that it is only one of the criteria to be evaluated, suggesting that **countries could potentially activate TPI if other criteria are met**.

All in all, while waiting for wage data that underpin the expected slowdown in service prices, **the ECB heads to the June meeting leaving the stage set to begin the cycle of cuts**, regardless of the Fed's monetary policy steps.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

1.1. Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB

Frankfurt am Main, ~~7 March~~11 April 2024

Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to keep the three key ECB interest rates unchanged. ~~Since our last meeting in January, inflation has declined further. In the latest ECB staff projections, inflation has been revised down, in particular for 2024 which mainly reflects a lower contribution from energy prices. Staff now project inflation to average 2.3 per cent in 2024, 2.0 per cent in 2025 and 1.9 per cent in 2026. The projections for inflation excluding energy and food have also been revised down and average 2.6 per cent for 2024, 2.1 per cent for 2025 and 2.0 per cent for 2026. Although most~~The incoming information has broadly confirmed our previous assessment of the medium-term inflation outlook. Inflation has continued to fall, led by lower food and goods price inflation. Most measures of underlying inflation ~~have eased further, domestic price pressures remain high, in part owing to strong~~ are easing, wage growth ~~in wages.~~is gradually moderating, and firms are absorbing part of the rise in labour costs in their profits. Financing conditions ~~are~~remain restrictive and our past interest rate increases continue to weigh on demand, which is helping to push down inflation. ~~Staff have revised down their growth projection for 2024 to 0.6 per cent, with economic activity expected to remain subdued in the near term. Thereafter, staff expect the economy to pick up and to grow at 1.5 per cent in 2025 and 1.6 per cent in 2026, supported initially by consumption and later also by investment~~But domestic price pressures are strong and are keeping services price inflation high.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. ~~Based on our current assessment, we~~We consider that the key ECB interest rates are at levels that~~, maintained for a sufficiently long duration, will make~~ are making a substantial contribution to ~~this goal.~~the ongoing disinflation process. Our future decisions will ensure that our policy rates will ~~be set at~~stay sufficiently restrictive ~~levels~~ for as long as necessary.

~~We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our~~ If our updated assessment of the inflation outlook~~ in light of the incoming economic and financial data~~, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase our confidence that inflation is converging to our target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. In any event, we will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and we are not pre-committing to a particular rate path.

The decisions taken today are set out in a ~~press release~~press release available on our website.
I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

1.2. Economic activity

The economy ~~remains~~remained weak~~. Consumers continued to hold back on their~~ in the first quarter. While spending~~, investment moderated and companies exported less, reflecting a slowdown in external~~ on services is resilient, manufacturing firms are facing weak demand and ~~some losses~~production is still subdued, especially in ~~competitiveness. However, surveys~~energy-intensive sectors. Surveys point to a gradual recovery over the course of this year~~. As~~ , led by services. This recovery is expected to be supported by rising real incomes, resulting from lower inflation~~ falls and~~, increased wages ~~continue to grow, real incomes will rebound, supporting growth.~~and improved terms of trade. In addition, the ~~dampening impact of past interest rate increases will gradually fade and demand for~~ growth of euro area exports should pick up over the coming quarters, as the global economy recovers and spending shifts further towards tradables. Finally, monetary policy should exert less of a drag on demand over time.

The unemployment rate is at its lowest level since the start of the euro. ~~Employment grew by 0.3 per cent in the final quarter of 2023, again outpacing economic activity. As a result, output per person declined further. Meanwhile,~~ At the same time, the tightness in the labour market continues to gradually decline, with employers ~~are~~ posting fewer job vacancies~~, while fewer firms are reporting that their production is being limited by labour shortages~~.

Governments should continue to roll back energy-related support measures ~~to allow the~~so that disinflation ~~process to~~can proceed sustainably. ~~Fiscal~~Implementing the EU's revised economic governance framework fully and without delay will help governments bring down budget deficits and debt ratios on a sustained basis. National fiscal and structural policies should be ~~strengthened to make our~~aimed at making the economy more productive and competitive, ~~expand supply capacity and gradually bring down high public debt ratios. A speedier~~which would help to reduce price pressures in the medium term. At the European level, an effective and speedy implementation of the Next Generation EU programme and ~~more determined efforts to remove national barriers to deeper and more integrated banking and capital markets can help~~a strengthening of the Single Market would help foster innovation and increase investment in the green and digital transitions~~ and reduce price~~

~~pressures in the medium term. The EU's revised economic governance framework should be implemented without delay~~. More determined and concrete efforts to complete the banking union and the capital markets union would help mobilise the massive private investment necessary to achieve this, as the Governing Council stressed in its statement of 7 March 2024.

1.3. Inflation

~~1.3.~~1.1. ~~Inflation~~

Inflation ~~edged down~~has continued to decline, from an annual rate of 2.~~8~~6 per cent in ~~January and~~February to 2.4 per cent in March, according to Eurostat's flash estimate~~, declined further to 2.6 per cent in February.~~. Food price inflation ~~fell again, to 5.6 per cent in January and 4.0~~dropped to 2.7 per cent in March, from 3.9 per cent in February, while energy ~~prices in both months continued to decline compared with a year ago but at a lower rate than in December.~~price inflation stood at -1.8 per cent in March, after -3.7 per cent in the previous month. Goods price inflation ~~also~~ fell ~~further~~again in March, to ~~2.0~~1.1 per cent ~~in January and~~, from 1.6 per cent in February. ~~Services~~However, services price inflation~~, after remaining~~ remained high in March, at 4.0 per cent ~~for three months in a row, edged lower to 3.9 per cent in February~~.

Most measures of underlying inflation ~~declined~~fell further in ~~January as~~February, confirming the ~~impact~~picture of ~~past supply shocks continued to fade and tight monetary policy weighed on demand. However, domestic~~ gradually diminishing price pressures ~~are still elevated, in part owing to robust wage growth and falling labour productivity. At the same time, there are signs that growth in~~. While domestic inflation remains high, wages ~~is starting to moderate. In addition,~~and unit profits ~~are absorbing part~~grew less strongly than anticipated in the last quarter of ~~the rising~~2023, but unit labour costs~~, which reduces the inflationary effects~~ remained high, in part reflecting weak productivity growth. More recent indicators point to further moderation in wage growth.

Inflation is expected to ~~continue this downward trend~~fluctuate around current levels in the coming months~~. Further ahead, it is expected~~ and to then decline to our target ~~as~~next year, owing to weaker growth in labour costs~~ moderate and~~, the unfolding effects of ~~past energy shocks, supply bottlenecks~~our restrictive monetary policy, and the ~~reopening~~fading impact of the ~~economy after~~energy crisis and the pandemic~~ fade~~. Measures of longer-term inflation expectations remain broadly stable, with most standing around 2 per cent.

1.4. Risk assessment

The risks to economic growth remain tilted to the downside. Growth could be lower if the effects of monetary policy turn out stronger than expected. A weaker world economy or a further slowdown in global trade would also weigh on euro area growth. Russia’s unjustified war against Ukraine and the tragic conflict in the Middle East are major sources of geopolitical risk. This may result in firms and households becoming less confident about the future and global trade being disrupted. Growth could be higher if inflation comes down more quickly than expected and rising real incomes mean that spending increases by more than anticipated, or if the world economy grows more strongly than expected.

Upside risks to inflation include the heightened geopolitical tensions, especially in the Middle East, which could push energy prices and freight costs higher in the near term and disrupt global trade. Inflation could also turn out higher than anticipated if wages increase by more than expected or profit margins prove more resilient. By contrast, inflation may surprise on the downside if monetary policy dampens demand more than expected, or if the economic environment in the rest of the world worsens unexpectedly.

1.5. Financial and monetary conditions

Market interest rates have ~~risen~~been broadly stable since our ~~January~~March meeting and ~~our monetary policy has kept broader~~wider financing conditions remain restrictive. ~~Lending rates~~ The average interest rate on business loans ~~have broadly stabilised, while mortgage~~edged down to 5.1 per cent in February, from 5.2 per cent in January. Mortgage rates were 3.8 per cent in February, down from 3.9 per cent in January.

Still elevated borrowing rates ~~declined in December~~ and ~~January. Nevertheless,~~associated cutbacks in investment plans led firms to further reduce their demand for loans in the first quarter of 2024, as reported in our latest bank lending ~~rates remain elevated, at 5.2 per cent for business loans~~ survey. Credit standards for loans remained tight, with a further slight tightening for lending to firms and ~~3.9 per cent~~ a moderate easing for mortgages.

Against this background, credit dynamics remain weak. Bank lending to firms ~~had turned positive~~grew marginally faster in ~~December, growing~~February, at an annual rate of 0.~~5~~4 per cent~~. But, in January, it edged lower, to~~, up from 0.2 per cent~~, owing to a negative flow in the month. The growth~~ in January. Growth in loans to households ~~continued to weaken, falling to~~ remained unchanged in February, at 0.3 per cent on an annual basis ~~in January~~. Broad money – as measured by M3 – grew at a subdued rate of 0.~~1~~4 per cent in February.

1.6. Conclusion

The Governing Council today decided to keep the three key ECB interest rates unchanged. We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. ~~Based on our current assessment, we~~We consider that the key ECB interest rates are at levels that~~, maintained for a sufficiently~~

~~long duration, will make~~ are making a substantial contribution to ~~this goal.~~the ongoing disinflation process. Our future decisions will ensure that our policy rates will ~~be set at~~stay sufficiently restrictive ~~levels~~ for as long as necessary. ~~We~~ If our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase our confidence that inflation is converging to our target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. In any event, we will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and we are not pre-committing to a particular rate path.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

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