

MARKET COMMENTARY

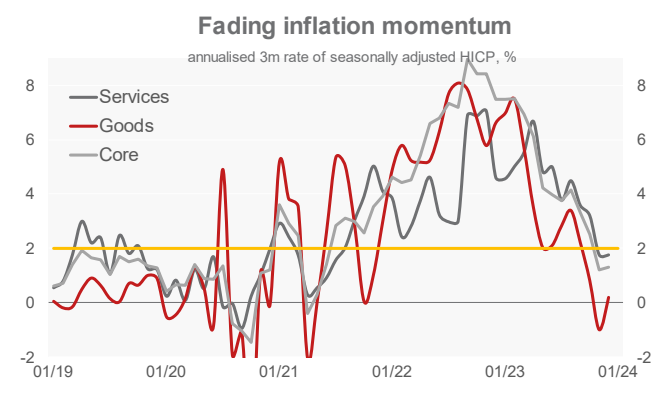
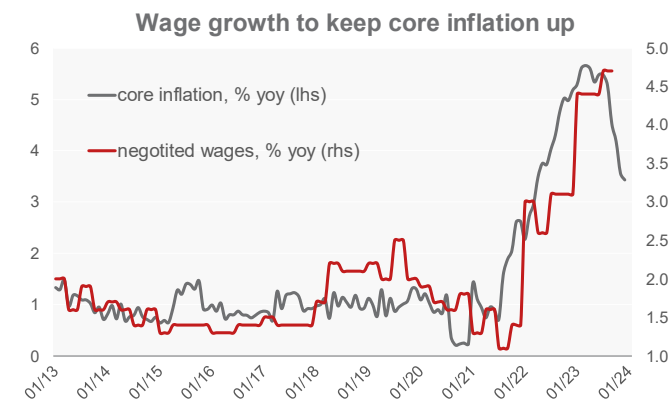
ECB more confident about disinflation but not yet considering rate cuts

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- At today's meeting the ECB's Governing Council (GC) left its key rates unchanged, in line with expectations.
- Most importantly, the Governing Council (GC) became more confident on the medium-term inflation outlook and now even speaks of a *"declining trend in underlying inflation"*. And in the press conference President Lagarde expressed increased confidence that higher wages eat primarily into profits and not boost inflation.
- That said, she also played down the importance of the GC's wording and stated that more reassuring inflation data would be needed emphasizing again data-dependence of future decisions.
- Rate cuts were not discussed today. We think the update of the growth and inflation projections by March will fuel this discussion. We stick to our call of a first rate cut by June but given the cautiously dovish tone of today's meeting the risk of a cut before June has increased somewhat.
- Markets perceived today's ECB meeting as dovish and increased the probability of an April cut from 67% to 87%. Bund yields and the EUR receded while equities reversed their morning losses.

GC unsurprisingly decided not to act today: At today's meeting the GC unsurprisingly decided to again leave key rates unchanged, the deposit rate at 4.00% and the repo rate at 4.50%. It continues with APP non-reinvestments and sticks to the December announcement that it *"intends to reduce the PEPP portfolio by €7.5 billion per month on average"* over the second half of 2024 and to fully stop reinvestments at the end of 2024.



More confidence in the decline of inflation ...: The set of benign inflation data since the December policy meeting left its mark in the inflation assessment of the GC. It sees its medium-term inflation outlook “*broadly confirmed*”. While at the last meeting a temporary pick up in inflation had been projected it now mentions only an “*energy-related upward base effect*” on headline inflation. Even more important the GC no longer mentioned that “*domestic price pressures remain elevated*” in the accompanying communique. In the press conference President Lagarde furthermore showed less concerns about wage growth than previously. She was confident that higher wages eat primarily into profits and not boost inflation. Also, she hinted at inflation expectations stabilizing at around 2%.

... but not enough to embark on outright action: That said, in Q&A Lagarde stated that more reassuring inflation data would be needed. Moreover, she played down the importance of the more dovish wording in the GC’s assessment. Having been asked why no longer mentioning domestic price pressures she simply said that she “*would not give it too much weight as such*”. We rather interpret this as an attempt to calm down expectations of swift policy easing. One reason probably is still remaining uncertainty regarding the wage growth momentum. While the ECB’s proprietary wage tracker sees some stabilization, she also mentioned that 40% of the workforce’s wages are yet to be determined. Also, upside risks from an escalation of the situation in the Red Sea keep the GC “*attentive*”.

Discussion about rate cuts likely to start at next meeting: At today’s meeting the GC did not discuss rate cuts. According to Lagarde the consensus was that it was “*premature*” to do so. Instead data-dependence remained the common denominator. But with the update of the growth and inflation projections at the March 7 meeting we expect a further increase in confidence about the return of inflation towards target in the medium term. The discussion about key rate cuts will likely start by then also in the GC meetings.

First rate cut in June 2024 still our base case but risks towards earlier cuts: We continue to look for a first key rate cut by June and deem cumulative cuts of 100bps in 2024 still most likely. However, given today’s surprisingly dovish view about inflation and wage growth we see the risks tilted to earlier cuts. Markets perceived today’s ECB meeting as dovish and increased the probability of an April cut from 67% to 87%. In a knee-jerk reaction 10-year Bund yield receded by about 8 bps, the EUR weakened against the greenback and equities more than reversed their morning losses.

Medium-term inflation expectations

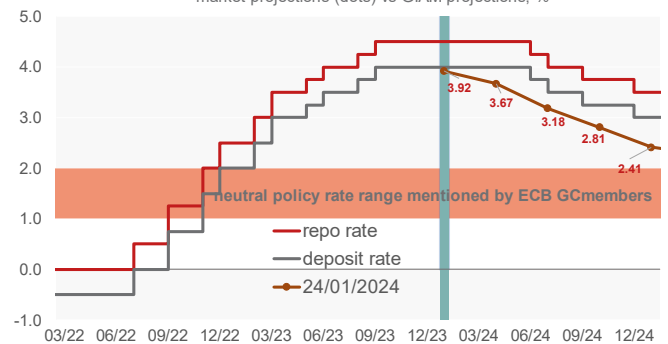
expected HICP % yoy, based on inflation linked swaps (ILS) and the Survey of Professional Forecasters (SPF)



Source: Datastream, ECB, GenAM calculations

ECB key rate projections

market projections (dots) vs GIAM projections, %



Source: Datastream, ECB, GIAM calculations

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