24 May 2024

ECB preview

A political rate cut in June, and no cut in September

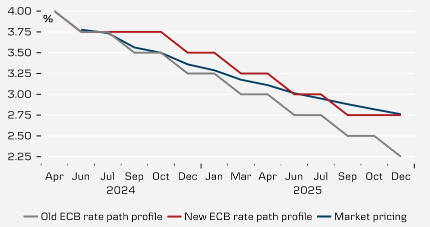
- On Thursday 6 June, the ECB is widely expected to deliver a 25bp rate cut, largely because the governing council members have stated as much. The updated June staff projection is expected to suggest that the prevailing economic and monetary policy narrative stays broadly unchanged and we expect the rate cut to be formulated as a roll-back of the 'insurance hike' from September last year. We expect the ECB to repeat the meeting-by-meeting and data-dependent approach to the policy rate path beyond June.
- We have revised our ECB rate path for the first time in more than 12 months and now expect the ECB to deliver two rate cuts this year (June and December), and three cuts next year. This will bring the deposit rate at 2.75% by the end of 2025.
- Markets have already repriced the ECB expectations for this year and points to 61bp cut this year.

New ECB call reflects a stronger start to 2024 and sticky inflation

The incoming inflation since the start of the year has been stronger than anticipated, mainly due to the service sector. In addition, most recent indicators suggest that the worst is over in the manufacturing sector, where for example the order-inventory balance in May increased to a two-year high. Overall, we find the resilience of the European economy noticeable, which is reflected in the labour market strength being historically tight with the number of people employed growing by 0.3% q/q in Q1 24.

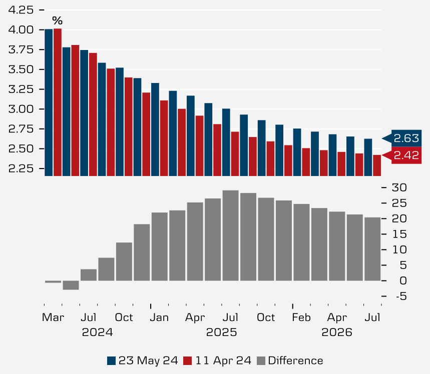
The new round of staff projections is expected to largely show cosmetic changes, and thus not warranting a change to the narrative. With economic data for Q1 better than expected, we expect a minor lift to the growth profile this year. Inflation is expected to show mechanical changes, reflecting the technical assumptions. However, we will closely monitor the wage growth assumptions that feed into this projection round, where we note clear upside risk. A recent ECB *blog* indicated that 4.1% negotiated wage growth for 2024 was assumed at previous meetings, compared with the Q1 24 data release of 4.7%. In terms of the technical assumptions change since the 24 March cut-off date, we see most indicators as broadly unchanged, except the ECB front-end pricing. End-2024 ECB pricing: +47bp, effective exchange rate: +1.2%, Brent (in EUR): -0.7%, 10y nominal GDP weighted yield: +15bp, 10y real GDP weighted yield: +10bp.

New ECB rate profile



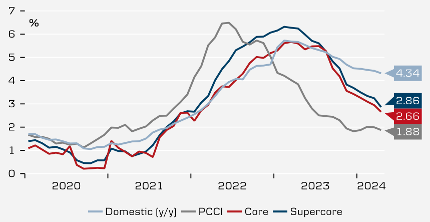
Source: Macrobond, Bloomberg and Danske Bank

ECB market pricing since April ECB meeting



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond, Bloomberg and Danske Bank

Underlying inflation pressure in the euro area



Source: Macrobond Financial and Danske Bank

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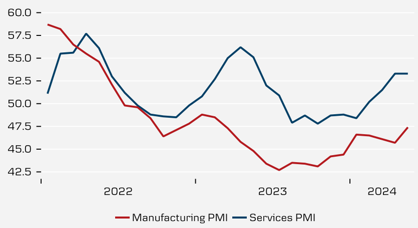
Domestic inflation is marginally weakening yet still too high

The inflation picture in the euro area is a story of two tales with the service driven inflation rising at around 3.7% y/y (and expected to only moderate slightly this year), while non-energy industrial goods inflation is still low at 0.9% (and set to further decline close to zero this year). Diving into the ECB's focus on domestic driven inflation since last summer, which has only gained prominence in the ECB communication since December last year, shows that the domestic inflation is still too high at 4.3%, and declining at a modest pace. Domestic inflation is down by 0.2pp since December last year. Looking at the risk picture on the inflation, we see this on the upside, as we highlight that the momentum in goods inflation, as well as the sticky service inflation, is set to dominate the risk of slower growth-induced downside risk to inflation.

A lot more data by June

During both the March and the April ECB meeting, ECB president Lagarde highlighted that they will know 'a lot more' by June, and the key indicators since then has been a surprising pickup in activity in April that extended into May, as well as a smaller than expected decline in inflation. Next week's May inflation print is set to rise from April, not least due to base effects stemming from the German transportation, but we find it unlikely to be strong enough to change signals. We thus conclude that while inflation is still expected to hit the target during the monetary policy relevant horizon, albeit with a slight delay relative to our previous assessment, we expect ECB policy rates to stay more restrictive than otherwise.

Pickup in services activity and rebounding manufacturing sector



Source: Macrobond and Danske Bank

Turning to the wage indications and the key determinant for the ECB policy outlook, yesterday's Q1 24 negotiated wage growth figure pointed to a rise of 4.7%, from 4.5% in Q4 23. This specific release has been highlighted by the ECB governing council members as particular important. However, the rise is largely due to base effects, particularly from the German side, and we do not want to put too much weight on this as there is a partly lagged effect. More timely indicators point to wage moderation as the ECB has acknowledged on several occasions.

Roll-back of 'insurance hike' – not the beginning of an easing cycle in June

Recent macro data has placed the ECB in a good position that buys extra time to wait for more data on economic activity, inflation, and wage growth before embarking on a series of rate cuts. With the pickup in growth momentum and inflation still declining, the ECB is in a favourable position to wait for the data in the coming months before making firm commitments on the policy rate path. As a result, we expect the June rate cut of 25bp to be communicated as a roll-back of the 'insurance hike' from September last year without a commitment to a specific rate path beyond June. We expect the data-dependent and meeting-by-meeting approach to continue.

The ECB has guided for three key criteria for its reaction function for more than a year. The three criteria are 1) the inflation outlook, 2) the underlying inflation dynamics, and 3) the strength of monetary policy transmission. As regards 2 and 3, this is where we become more uneasy relative to the past couple of months, and thus warrants a change to our expectation of the ECB policy rate path. With the pickup in activity and sticky inflation, we expect the ECB to have a more restrictive monetary policy stance than before. Markets are also pricing a restrictive monetary policy stance from the ECB in years to come.

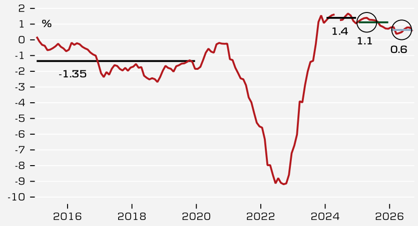
Limited immediate market reaction due to open-worded guidance

The market reaction to the meeting may turn out to be underwhelming, in-line with recent ECB GC meetings, and there is a risk that the 25bp rate cut is a non-event from a market perspective, for the following reasons; 1) markets are pricing 22.5bp and next to all ECB GC members have expressed an expectation of a rate cut in June, 2) the changes to the staff projections are likely 'cosmetic' and thus not set to change the narrative, 3) data-dependent and meeting-by-meeting guidance may not de facto rule out a cut in a specific meeting, but given the lack of data and no further guidance, a July cut seems unlikely, 4) consequently, the September meeting is the next big event, with its new staff projections, yet no clear guidance on this, 5) the ECB does not seem to dislike the market pricing, 6) the ECB (and central banks in general) are natural 'sellers' of volatility, and with a clear reaction function, they do not wish to rock the boat.

Markets already repriced the rate path expectation higher

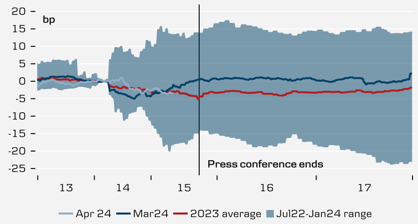
Markets have already repriced its expectations for the number of rate cuts by the ECB this year. While a part of the repricing has been spill-over from the US, in particular in the start of the year, the surprisingly strong euro area data has taken this repricing one leg higher this year. Markets are pricing 22.5bp for the June meeting, 16bp for the September meeting, and 61bp by year-end. This is around 25bp higher than at the timing of the April meeting.

Restrictiveness of ECB's monetary policy (ECB policy rate path minus headline inflation)



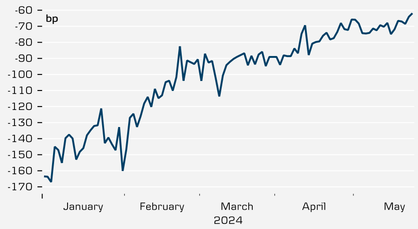
Source: Macrobond and Danske Bank

Change in 10Y Bund yield since ECB decision at 14:15 CET



Note: Past performance is not a reliable indicator of current or future results.
Source: Danske Bank, Macrobond, Bloomberg

December 24 ECB rate cut pricing



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Source: Danske Bank, Macrobond, Bloomberg

Euro area data overview

indicates less upbeat data print, red colour indicates more upbeat data print compared to other six months shown.
r indicates cut-off for incoming data since last ECB meeting.

Aggregate	Last values	New values since last ECB meeting
Average augmented Z-score*	0.114	0.123

*A positive augmented Z-zcore can be interpreted as the component showing a hawkish change in its last release, and vice versa for negative Z-scores. This augmentation is achieved by multiplying the Z-scores for unemployment, the labour force, the 10y Bund and GDP weighted rates, and the EUR/USD and effective exchange rates (real and nominal) by -1.

		Nov/23	Dec/23	Jan/24	Feb/24	Mar/24	Apr/24	May/24	Last 12 obs
Inflation (%)									
	Headline (YoY)	2.4	2.9	2.7	2.6	2.4	2.4		
	Core (YoY)	3.6	3.4	3.2	3.0	2.9	2.7		
	SuperCore (YoY)	3.9	3.7	3.5	3.3	3.1	2.8		
	Services (YoY)	4.0	4.0	4.0	4.0	4.0	3.7		
	LIMI (Domestic inflation, YoY)	4.7	4.5	4.5	4.5	4.4	4.3		
	Headline (MoM)	-0.2	0.0	0.4	0.4	0.2	0.1		
	Core (MoM)	0.0	0.2	0.3	0.4	0.3	0.1		
	SuperCore (MoM)	-0.2	0.3	0.3	0.3	0.2	0.2		
	Services (MoM)	0.0	0.3	0.4	0.5	0.5	0.3		
Economic Growth									
›P[1]	... QoQ (%)	-0.1	-0.1	0.3	0.3	0.3			
PMI	... Composite	47.6	47.6	47.9	49.2	50.3	51.7	52.3	
	... Manufacturing	44.2	44.4	46.6	46.5	46.1	45.7	47.4	
	... Services	48.7	48.8	48.4	50.2	51.5	53.3	53.3	
IFO	... Current	89.4	88.5	87.0	86.9	88.1	88.9		
	... Expectations	85.0	84.1	83.4	84.3	87.7	89.9		
ESI	Index	94.2	96.4	96.0	95.4	96.2	95.6		
Eurocoin	...%	-0.8	-0.2	-0.6	-0.3	0.2	0.3		
	Consumer Confidence	-16.9	-15.1	-16.1	-15.5	-14.9	-14.7		
Labour Market									
%	Unemployment	6.5	6.5	6.5	6.5	6.5			
QoQ (%)	Employment[1]	0.3	0.3	0.3	0.3	0.3			
	Labour Force[1]	0.2	0.2						
YoY (%)	Negotiated Wages[1]	4.5	4.5	4.7	4.7	4.7			
	Job Postings Wages	3.6	4.0	4.0	3.7	3.3	3.0		
	Comp per Employee[1]	4.7	4.7						
Labour Shortage	... Industrials[1]	20.0	20.0	19.6	19.6	19.6			
	... Services[1]	26.4	26.4	27.6	27.6	27.6			
	EC Employment Expectations Indicator	102.9	103.2	102.5	102.5	102.5	101.8		
Credit									
%	BLS credit standards[1]	4.4	4.4	3.3	3.3	3.3			
YoY (%) - loan growth	Non-Financial corporations	0.0	0.5	0.2	0.3	0.4			
	Households	0.5	0.4	0.3	0.3	0.2			
YoY (%)	Euro Area M1	-9.3	-8.2	-8.7	-7.9	-6.8			
	Euro Area M3	-0.8	0.4	0.1	0.3	0.9			
Financial indicators									
% (eom)	10y Bund	2.5	2.0	2.2	2.4	2.3	2.6		
	10y GDP weighted rate	3.1	2.6	2.7	2.9	2.8	3.1		
% (eom), HICP	10y GDP wght. real rate	33.6	33.2	35.3	36.7	36.2	37.6		
% (eom), €STR	10y GDP wght. real rate	78.9	48.6	61.2	76.2	59.4	77.1		
bp (eom)	BTP-Bund Spread	172.0	168.0	157.0	143.0	141.0	134.0		
YoY(%) (eom)	Stoxx600	4.9	12.7	7.2	7.3	12.0	8.2		
	Stoxx50	10.5	19.2	11.6	15.1	17.8	12.9		
Spot rates	EER (YoY %, eom)	5.4	4.0	3.1	3.9	3.0	1.9		
	REER (YoY %, eom)	3.6	2.2	2.2	1.6	2.0	0.3		
	EURUSD (YoY %, eom)	5.3	3.6	0.0	1.9	-0.6	-2.4		
Energy & commodities									
YoY(%) (eom)	Commodities index	-2.4	-4.3	0.1	5.0	11.1	13.3		
	Energy index	-3.4	-5.2	3.9	9.6	20.1	20.2		
EUR/MWh (eom)	TTF NatGas	41.0	30.5	30.1	24.8	27.1	29.0		
USD/bbl (eom)	Brent oil	82.8	77.0	81.7	83.6	87.5	87.9		

**Indicates release is flash, and not final.
Superscript with the number "1" indicates data is released in quarterly intervals, hence the border marking new releases reflects this.
Sources: ECB, Eurostat, Macrobond and Danske Bank.

Forward looking indicators

Inflation		Jun/24	Jul/24	Aug/24	Sep/24	Oct/24	Nov/24	Dec/24
YoY(%)	Inflation market pricing	2.5	2.4	2.1	2.0	2.0	2.3	2.4
SMA* and market pricing		Jun/24	Jul/24	Aug/24	Sep/24	Oct/24	Nov/24	Dec/24
%	Market priced deposit rate (€STR+10bp)	3.78	3.74		3.56	3.50		3.36
bp	- change	-23.08	-3.8		-17.3	-6.3		-6.3
	SMA DFR	3.75	3.75		3.50	3.50		3.00
EURbn	SMA TLTRO	170	113	113	113	33	33	33
EURbn	SMA PEPP	1714	1691	1691	1691	1669	1669	1669
EURbn	SMA APP	3039	2969	2969	2969	2888	2888	2888
SPF*		2024	2025	2026	Long Term		Released since last ECB meeting	
YoY%	SPF HICP	2.4	2.0	2.0	2.0		Yes	
YoY%	SPF HICP, Core	2.6	2.1	2.0	2.0		Yes	
YoY%	SPF Real GDP	0.6	1.3	1.4	1.3		Yes	
Latest ECB Staff Projections		Q2/2024	Q3/2024	Q4/2024	Q1/2025	Q2/2025	Q3/2025	Q4/2025
YoY%	HICP	2.4	2.2	2.2	2.2	2.1	1.9	1.9
YoY%	HICP CORE	2.5	2.5	2.5	2.3	2.2	1.9	2.0
YoY%	GDP	0.2	0.3	0.4	0.4	0.4	0.4	0.4

*SMA is latest release, coinciding with latest ECB meeting. SPF is latest release.
Blank cells under SMA and market pricing indicate no ECB GC meeting that month.
Sources: ECB, Eurostat, Macrobond and Danske Bank.

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Expected updates

None

Date of first publication

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