

# ECB Preview

## Holiday season

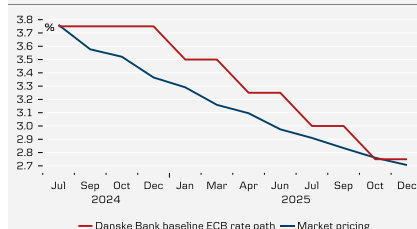
### Incoming data since June unlikely to shift the ECB's view

Since the last ECB meeting five weeks ago in June, only a limited amount of new economic data has become available, and this data is unlikely to have significantly changed the ECB's perspective on the economy and consequently its policy stance (see our data monitor at the end of the report for more details). The outlook moderated slightly due to the weaker-than-expected euro area PMIs and industrial production figures. However, the higher-than-expected core inflation rates likely counterbalance this in terms of the policy stance, and thus concerns on the pace of the inflationary progress to target are still present. With the resurgence of economic growth, we expect the ECB will use the flexibility to wait for additional data on inflation and, specifically, wage growth, productivity and profit data, as communicated by Lagarde and others, before altering its communication or policy stance. See our piece *ECB Research - The profit, wage and productivity triangulation*, 20 June 2024. Thus, the July meeting should be a stock taking meeting and consequently relatively uneventful for markets. Lagarde will most likely face questions on the recent spread widening of French bonds and the relation to its TPI, but we expect her to answer much in line with chief economist Lane who last week said that the recent French spread widening had been orderly.

### Growth data give downside risks to the ECB's June staff projections...

June PMIs declined unexpectedly with the composite indicator falling to 50.8 from 52.5 in May, below expectations of 52.5. We believe the drop was likely a correction to the stronger than expected data in April and May and focus more on the last quarter as an average. In Q2 24, the composite PMI was significantly higher compared to Q1, indicating that the economy also grew in Q2. Yet, the decline in June releases (industrial production and retail sales) raises questions about the strength of growth and we see downside risks to the ECB's June staff projections of 0.4% q/q GDP growth in Q2 and the following quarters this year. The Achilles heel of the growth outlooks is still the (German) manufacturing sector, which has now stabilised at low levels but is struggling to pick up growth. The weakness of the sector was highlighted by German industrial production, which fell 2.5% m/m in May due to a drop in machinery and car production.

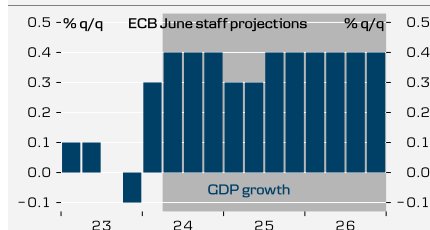
#### ECB rate path



Note: Past performance is not a reliable indicator of current or future results

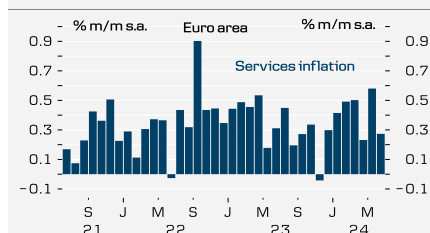
Source: Macrobond Financial, Bloomberg, Danske Bank

#### June staff projections expect strong 0.4% q/q GDP growth in Q2, Q3, and Q4 this year



Source: ECB, Macrobond Financial

#### Services inflation stays elevated, but turned south in June



Source: ECB, Macrobond Financial

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### ... but stronger core inflation counterbalances this in terms of the policy stance

Headline inflation aligns with the June ECB staff projections, which anticipated an average of 2.5% for the second quarter. However, core inflation exceeded slightly the ECB’s projected 2.7% for the quarter by 0.1pp. The sticky core inflation continues to be driven by strong momentum in services inflation and we expect the focus on domestic inflation to continue. For June we expect the print which will be released on Wednesday 17 July to decline only marginally to 4.3%.

We also take note of the labour market which is still robust, evidenced by a record low unemployment rate of 6.4% in May, and along with sustained high services inflation presents an upward risk to the inflation outlook, a concern both Lane and Lagarde reiterated in Sintra.

### No reason to send new policy signals

With the elements of the ECB’s reaction function well understood by the markets, and several GC members having said that they are ‘fine’ (Knot) and ‘reasonable’ (Wunsch and Kazaks), we do not find a compelling argument for the ECB to want to change that. Markets are pricing 40bp of rate cuts this year and 68bp next year. Thus, we expect the meeting next week to be a stock taking meeting on the incoming information and a discussion of the survey data (SPF, BLS, SMA etc) and not a reason to send policy signals while they wait for key information, as well as the new staff projection around in September. We expect the data-dependent and meeting-by-meeting approach to continue.

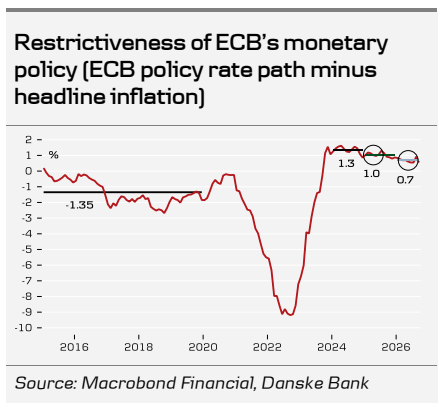
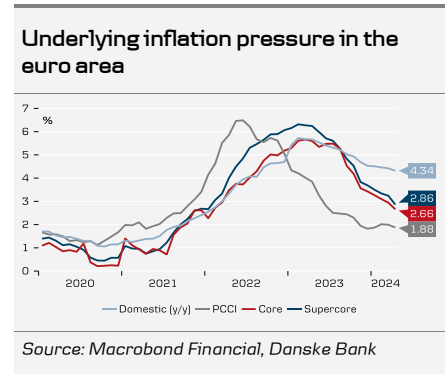
Our median baseline of no rate cut in September still holds, which is built on a combination of the strength of the labour market, sticky underlying inflation and the recovery of the euro area growth. We repeat that a key risk to our ECB September rate call is whether the Fed will cut in September and whether or not this may add ‘political’ pressure to cut rates as well, despite the sticky underlying inflation. We find the September rate cut case more compelling in the US (also in light of Powell’s comments this week) than in the euro area.

### Restrictive monetary policy is still needed

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 have become more uneasy relative to the past couple of months, which thus warrants a change to our expectation of the ECB policy rate path. With the pickup in activity expected in H2 this year and sticky inflation, we expect the ECB to have a more restrictive monetary policy stance than during the pre-COVID-19 pandemic episode. Markets are also pricing a restrictive monetary policy stance from the ECB in years to come.

This was also clear from the June ECB minutes as it showed that the ECB intends to keep a restrictive monetary policy in the months and quarters ahead, and thus the rate cut should not (necessarily) be seen as the start of a gradual easing cycle. Specifically, the ECB has intentionally not said that it has entered the ‘dialling back phase’ as Lagarde referred to it in her March ECB watchers’ conference. Had the ECB concluded this it would lead to an expectation of a series of rate cuts to come. Lagarde intentionally also left this out of her speech in Sintra last week, see also *COTW: The 10y point is yet to budge*, 5 July 2024.

The key question is, though, how tight it should be? Looking at the real rate market pricing, we see that markets are pricing a gradual easing of the monetary policy, yet still restrictive. We find this pricing to be broadly fair.



## EUR/USD: quiet ECB masks potential summer volatility

We do not agree with the EUR/USD options market's assessment that it will be a quiet summer in the currency market, but we do not believe it will be the ECB that will disturb the summer calm. It is currently a wait-and-see situation for the ECB, and consequently also a wait-and-see for EUR/USD in this regard. The FOMC meeting on 31 July, the next round of flash PMIs, and the question of whether President Biden will step down, on the other hand, have the potential to move EUR/USD. We expect EUR/USD to hover around 1.08-1.09 over the summer, but there is room for larger fluctuations than what the options market suggests. We have written more about this here: *FX Strategy – EUR/USD's summer mirage*, 9 July 2024.

# Euro area data overview

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

Aggregate	Last values	New values since last ECB meeting
Average augmented Z-score*	0.095	0.104

\*A positive augmented Z-score 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.

Inflation (%)		Dec/23	Jan/24	Feb/24	Mar/24	Apr/24	May/24	Jun/24	Last 12 obs
Headline (YoY)		2.9	2.7	2.6	2.4	2.4	2.6	2.5**	
Core (YoY)		3.4	3.2	3.0	2.9	2.7	2.9	2.8**	
SuperCore (YoY)		3.7	3.5	3.3	3.1	2.9	2.9		
Services (YoY)		4.0	4.0	4.0	4.0	3.7	4.1	4.0**	
LIMI (Domestic inflation, YoY)		4.5	4.5	4.5	4.4	4.3	4.4		
Headline (MoM)		0.0	0.4	0.4	0.2	0.1	0.1	0.1**	
Core (MoM)		0.2	0.3	0.4	0.3	0.1	0.4	0.2**	
SuperCore (MoM)		0.3	0.3	0.3	0.2	0.2	0.3		
Services (MoM)		0.3	0.4	0.5	0.5	0.2	0.6	0.3**	
<b>Economic Growth</b>									
GDP <sup>1</sup>	... QoQ (%)	-0.1	0.3	0.3	0.3				
PMI	... Composite	47.6	47.9	49.2	50.3	51.7	52.2	50.9	
	... Manufacturing	44.4	46.6	46.5	46.1	45.7	47.3	45.8	
	... Services	48.8	48.4	50.2	51.5	53.3	53.2	52.8	
IFO	... Current	88.5	87.0	87.0	88.1	88.9	88.3	88.3	
	... Expectations	84.3	83.4	84.3	87.7	89.8	90.3	89.0	
ESI	Index	96.4	96.1	95.5	96.3	95.6	96.1	95.9	
Eurocoin	...%	-0.2	-0.6	-0.3	0.2	0.3	0.2	0.2	
Consumer Confidence		-15.1	-16.1	-15.5	-14.9	-14.7	-14.3	-14.0	
<b>Labour Market</b>									
%	Unemployment	6.5	6.5	6.5	6.5	6.4	6.4		
QoQ (%)	Employment <sup>1</sup>	0.3	0.3	0.3	0.3				
	Labour Force <sup>1</sup>	0.2	0.0	0.0	0.0				
YoY (%)	Negotiated Wages <sup>1</sup>	4.5	4.7	4.7	4.7				
	Job Postings Wages	3.8	3.6	3.5	3.5	3.4	3.4		
	Comp per Employee <sup>1</sup>	4.9	5.0	5.0	5.0				
Labour Shortage	... Industrials <sup>1</sup>	20.0	19.6	19.6	19.6				
	... Services <sup>1</sup>	26.4	27.6	27.6	27.6				
EC Employment Expectations Indicator		103.2	102.5	102.5	102.5	101.6	101.3	99.7	
<b>Credit</b>									
%	BLS credit standards <sup>1</sup>	4.4	3.3	3.3	3.3				
YoY (%) - loan growth	Non-Financial corporations	0.5	0.2	0.3	0.3	0.2	0.3		
	Households	0.4	0.3	0.3	0.2	0.2	0.3		
YoY (%)	Euro Area M1	-8.2	-8.7	-7.9	-6.7	-6.0	-5.0		
	Euro Area M3	0.4	0.1	0.3	0.9	1.4	1.6		
<b>Financial indicators</b>									
% (eom)	10y Bund	2.0	2.2	2.4	2.3	2.6	2.6	2.5	
	10y GDP weighted rate	2.6	2.7	2.9	2.8	3.1	3.1	3.1	
% (eom), HICP	10y GDP wght. real rate	33.3	35.4	38.0	36.3	37.7	37.6	43.3	
	10y GDP wght. real rate	48.8	61.3	71.8	59.5	77.3	86.7	91.1	
bp (eom)	BTP-Bund Spread	168.0	157.0	143.0	141.0	134.0	131.0	157.0	
YoY (%) (eom)	Stoxx600	12.7	7.2	7.3	12.0	8.2	14.7	10.7	
	Stoxx50	19.2	11.6	15.1	17.8	12.9	18.2	11.3	
Spot rates	EER (YoY %, eom)	4.0	3.1	3.9	3.0	1.9	3.5	0.7	
	REER (YoY %, eom)	2.2	2.3	1.6	2.0	0.3	1.1	0.2	
	EURUSD (YoY %, eom)	3.6	0.0	1.9	-0.6	-2.4	1.6	-1.5	
<b>Energy &amp; commodities</b>									
YoY (%) (eom)	Commodities index	-4.3	0.1	5.0	11.1	13.3	18.4	15.0	
	Energy index	-5.2	3.9	9.6	20.1	20.2	25.1	24.9	
EUR/MWh (eom)	TTF NatGas	30.5	30.1	24.8	27.1	29.0	34.1	34.1	
USD/bbl (eom)	Brent oil	77.0	81.7	83.6	87.5	87.9	81.6	86.4	

\*\*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		Jul/24	Aug/24	Sep/24	Oct/24	Nov/24	Dec/24	Jan/25
YoY(%)	Inflation market pricing	2.5	2.2	2.0	2.0	2.5	2.5	2.3

SMA* and market pricing		Jul/24	Aug/24	Sep/24	Oct/24	Nov/24	Dec/24	Jan/25
%	Market priced deposit rate (€STR+10bp)	3.76		3.58	3.52		3.36	3.29
bp	- change	-0.06		-18.3	-5.5		-15.5	-7.3
	SMA DFR	3.75		3.50	3.50		3.00	0.00
	SMA TLTRO	170	113	113	113	33	33	33
EURbn	SMA PEPP	1691	1691	1691	1669	1669	1669	1624
	SMA APP	2969	2969	2969	2888	2888	2888	2804

SPF*		2024	2025	2026	Long Term	Released since last ECB meeting
	SPF HICP	2.4	2.0	2.0	2.0	No
YoY%	SPF HICP, Core	2.6	2.1	2.0	2.0	No
	SPF Real GDP	0.6	1.3	1.4	1.3	No

Latest ECB Staff Projections		Q3/2024	Q4/2024	Q1/2025	Q2/2025	Q3/2025	Q4/2025	Q5/2026
	HICP	2.2	2.2	2.2	2.1	1.9	1.9	1.8
YoY%	HICP CORE	2.5	2.5	2.3	2.2	1.9	2.0	1.9
	GDP	0.3	0.4	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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