ECB: Waiting for Data to Confidently Cut in June

Scotiabank

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FLASH REPORT
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- **The ECB left all monetary policy settings unchanged, as was widely expected. We maintain our forecast for a 25bps cut by the ECB at its June 6th decision with the ECB watching data over the next eight weeks (inflation and wages) before beginning its easing cycle.**
- **Lagarde said the ECB does not want to 'pre-commit' to a rate path (even after the first rate cut), but the lack of pushback to the possibility of a June rate cut means it's a high bar for the ECB to stand pat then.**
- **The small US PPI miss and comments by Fed officials were the main driver of European market swings, with a slight hint of a negative impact from the ECB decision on European yields and the EUR. Markets are penciling in 20bps in cuts by June, and 75bps by year-end.**

No surprises here, so we'll keep it brief. The ECB left all monetary policy settings unchanged, as was widely expected. Today's rate announcement comes just five weeks after the March 7th meeting where the ECB unveiled a new set of forecasts (namely, **lower inflation**) and at which Lagarde had already indicated they would not have enough information at hand by this week's meeting to adjust policy. We continue to expect a 25bps cut by the ECB at its June 6th decision that will be followed by an additional 75bps in easing through the remainder of the year.

Maybe some thought that the ECB would more clearly tee up a June rate cut today, while others maybe expected the bank to show a bit more apprehension to signaling openness to near-term cuts. The latter result seemed relatively more likely to us than the former, particularly as it relates to the 15–20% year-to-date increase in crude oil prices and, to a lesser degree, a delay to the start of Fed cuts. The statement and presser fell somewhere in between.

The ECB "will know a little more in April but a lot more in June" is what Lagarde said at the March decision, and that remains the case. The ECB can afford to watch data, prices, and market developments over eight weeks and then choose whether to cut. This simple reaction function had already pitched today's decision as a placeholder in between rounds of data-watching. Unfortunately, we have a long wait until the next Euro Area CPI prints in late-April to significantly shift cut timing and size bets.

Lagarde said the ECB does not want to 'pre-commit' to a rate path (even after the first rate cut), but the lack of pushback to the possibility of a June rate cut means it's a high bar for the ECB to stand pat then. It wasn't a widely-shared view, but Lagarde noted that a few participants felt sufficiently confident on the path for inflation to cut today.

There was little in terms of noteworthy statement changes, but the conditions for a rate cut were explicitly laid out in today's monetary policy decision statement—conditions that Lagarde and co have already mentioned in past speeches or pressers. The statement now reads "If the GC'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." 'Updated assessment' is obvious code for the June forecast round, where they will have key Q1 wages data and a couple more months of inflation data to revise projections.

The new text highlights again the continued decline in inflation (led by food and goods prices) and that most measures of underlying inflation are easing, but it now notes the gradual moderation of wages growth and that firms are absorbing higher labour costs.

This is a shift from the more worrying language in the March statement that noted “domestic price pressures remain high, in part owing to strong growth in wages.” The ECB will also now ensure that its “policy rates will *stay* sufficiently restrictive” versus “policy rates will *be set* at…”; it’s a marginal change that seems intended to eliminate the possibility of a hike (that no one expects).

The release of a marginal miss in US PPI—on the heels of yesterday’s CPI beat—released between the ECB’s statement and Lagarde’s presser was the main catalyst of a rally in EGBs and the EUR, with only a small share of the bid in European debt possibly explained by the set of ECB communications. At writing, two hours after the statement release, German yields are roughly back to pre-statement levels with the long-end underperforming alike the move in USTs. Markets have ~20bps in implied ECB cuts by June (as pre-statement) and a total of 75bps by year-end (ditto); this compares to unchanged Fed June pricing and December incorporating a marginal 2/3bps in additional easing totaling 41bps. As global yields rebounded, the mood turned a bit more sour to now have the EUR down a small 0.1% vs the USD and practically flat versus the GBP, both compared to pre-decision levels.