

ECB meeting: first rate cut set for spring, but the size of the rate cut cycle remains in doubt



If Christine Lagarde’s objective was to dampen market expectations of rate cuts she did not fully succeed. The President of the European Central Bank (ECB) managed to push back expectations for the first cut from March to April. However, markets are still discounting steep cuts by year end. We think the ECB will be more cautious for two reasons: inflation may prove more stubborn from now on and the ECB needs to keep a close eye on the euro.

Lagarde lists arguments for a spring cut. At the post-meeting conference on 25 January, Christine Lagarde repeated that any discussion of rate cuts was still premature and that ECB decisions would remain data-dependent. As a result, she strongly hinted that there would be no cut at the next meeting in March. But she then went on to lay out the case for easing monetary policy over the coming months. First, inflation has come down fast. Secondly, the economy remains sluggish. Despite a small rebound in January, PMI business sentiment surveys remain downbeat, suggesting economic stagnation short term. Credit growth remains feeble, even if the last ECB survey showed a modest improvement in both credit standards and demand. Lastly, she mentioned early signs of a stabilisation in wage growth. Her focus on these factors stoked money markets’ expectations of an April rate cut, now priced in as 75% likely.

Modest cuts to follow. In our view, while an April rate cut seems credible, the size of rate cuts now being priced in by the market for 2024 - at least 125 basis points - may well be excessive. We see at least two reasons for trimming back such expectations.

- **Inflation is likely to fall more slowly from now on.** First, the rate of disinflation is likely to benefit less from base effects, especially those related to energy prices. Second, the persistence of a tight labour market with low productivity gains will slow down the convergence of inflation to the 2% target. This is because the combination of low productivity gains, low employment and still resilient wage growth translates into higher unit production costs and hence higher selling prices.
- **A close eye on the euro exchange rate:** concerns for the EUR/USD exchange rate was surely one of the reasons behind the ECB rate hike cycle in 2022-23. Had the ECB stood by while the Fed ramped up its key rates the EUR/USD would have plunged, adding to imported price pressure. This reasoning still holds. Euro area’s inflation is similar to that of the US while GDP growth is much weaker. This should in theory allow the ECB to cut rates faster and in larger size than the Fed. But to do so would risk another run on the euro and a resulting boost to imported inflation. We therefore expect the three main central banks to cut rates in a quasi-synchronised timing and by similar amounts.

Chart 1: ECB: Implied probability of a 25bp rate cut

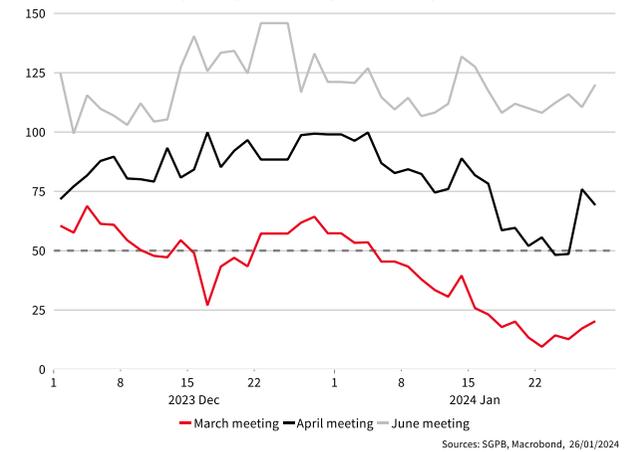
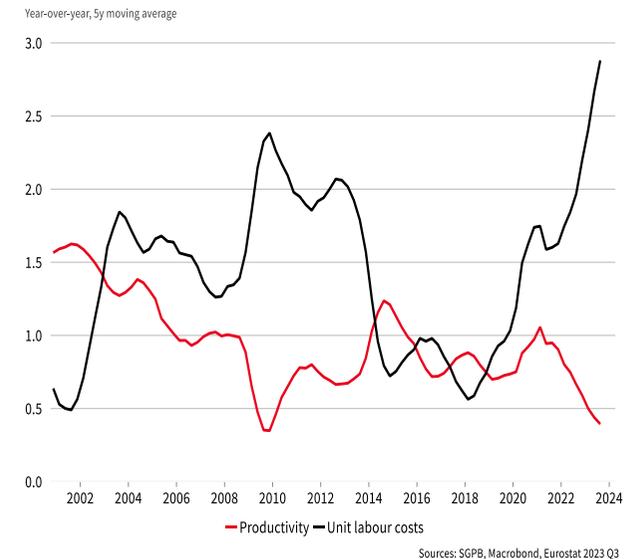


Chart 2: Euro area unit labour costs and productivity gains



Past performance should not be seen as a guarantee of future returns.

All data taken from Bloomberg and Macrobond on the 26/01/2024, publication achievement date. In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.



Our macro comments

Events of the week



United States GDP growth in the last quarter of 2023 reached an above expectations annualised rate of 3.3%, after 4.9% in the previous quarter. This result testifies to the robustness of the economy, especially as all the components made a positive contribution this quarter: mainly household consumption, followed by net exports, which had made no contribution since Q1, public spending and investment. In addition, the core private consumption deflator (the Fed's preferred inflation indicator) reached an annualised rate of 2.0%, the central bank's target. This initial estimate tends to confirm that the US economy is on track for a soft landing with limited inflation pressures.



China's central bank (PBoC) announced a 0.5 percentage point reduction in the reserve requirement ratio, which will inject around 1 trillion RMB (\$140 billion) of liquidity into the financial system. PBoC Governor Pan Gongsheng has pledged to support growth this year with "countercyclical" adjustments. In response, Chinese markets are up this week - the first weekly rise of the year.

Figures of the week

| Country | Data | Actual | Last | Forecast |
|---------------|------------------------------|--------|--------------------|----------|
| Germany | HCOB Composite PMI JAN | 47.1 | 47.4 | 47.8 |
| Germany | Ifo Business Climate JAN | 85.2 | 86.3 [®] | 86.7 |
| Spain | Unemployment Rate Q4 | 11.76% | 11.84% | 11.9% |
| United States | Durable Goods Orders MoM DEC | 0% | 5.5% [®] | 1.1% |
| United States | GDP Growth Rate QoQ Q4 | 3.3% | 4.9% | 2% |
| United States | Initial Jobless Claims JAN | 214K | 189K [®] | 200K |
| United States | Core PCE Price Index MoM DEC | 0.2% | 0.1% | 0.2% |
| United States | Personal Income MoM DEC | 0.3% | 0.4% | 0.3% |
| United States | PCE Price Index MoM DEC | 0.2% | -0.1% | 0.2% |
| United States | PCE Price Index YoY DEC | 2.6% | 2.6% | 2.6% |
| France | HCOB Composite PMI JAN | 44.2 | 44.8 | 45.2 |
| France | Business Confidence JAN | 99 | 99 [®] | 100 |
| France | Consumer Confidence JAN | 91 | 89 | 90 |
| Japan | BoJ Interest Rate Decision | -0.1% | -0.1% | -0.1% |
| Euro Zone | Consumer Confidence JAN | -16.1 | -15.1 [®] | -14.3 |
| Euro Zone | HCOB Composite PMI JAN | 47.9 | 47.6 | 48 |
| Euro Zone | Deposit Facility Rate | 4% | 4% | 4% |
| Euro Zone | ECB Interest Rate Decision | 4.5% | 4.5% | 4.5% |

Source: Macrobond, January the 26th, 2024

The colors in the 'Actual' column correspond to the difference from the forecast

The Week Ahead

| Tuesday | |
|----------------|-------------------------------|
| Japan | Unemployment Rate DEC |
| France | GDP Growth Rate Q4 |
| Spain | GDP Growth Rate Q4 |
| Spain | Inflation Rate JAN |
| Germany | GDP Growth Rate Q4 |
| Italy | GDP Growth Rate Q4 |
| United Kingdom | BoE Consumer Credit DEC |
| Euro Zone | GDP Growth Rate Q4 |
| Euro Zone | Economic Sentiment JAN |
| IMF | IMF/World Economic Outlook |
| Wednesday | |
| Japan | BoJ Summary of Opinions |
| Japan | Industrial Production DEC |
| Germany | Retail Sales DEC |
| France | Inflation Rate JAN |
| Germany | Unemployment Rate JAN |
| Italy | Unemployment Rate DEC |
| Germany | Inflation Rate JAN |
| United States | Fed Interest Rate Decision |
| United States | Fed Press Conference |
| Thursday | |
| China | Caixin Manufacturing PMI JAN |
| Euro Zone | Inflation Rate JAN |
| Euro Zone | Core Inflation Rate JAN |
| Euro Zone | Unemployment Rate DEC |
| Italy | Inflation Rate JAN |
| United Kingdom | BoE Interest Rate Decision |
| United States | ISM Manufacturing PMI JAN |
| Friday | |
| France | Industrial Production MoM DEC |
| United States | Unemployment Rate JAN |

Market Performances

| Interbank rates | Last. | -1W | -3M | YTD | -12M |
|------------------------|--------------|------------|------------|------------|-------------|
| €STER O/N | 3.91 | 3.90 | 3.90 | 1.91 | 1.90 |
| USD SOFR O/N | 5.31 | 5.32 | 5.30 | 4.30 | 4.31 |
| JPY TONAR O/N | -0.01 | -0.01 | -0.02 | -0.02 | -0.01 |
| GBP SONIA O/N | 5.19 | 5.19 | 5.19 | 3.43 | 3.43 |
| CHFO/N | 1.65 | 1.65 | 1.70 | 0.80 | 0.80 |

| Long term sov. rates | Last. | -1W | -3M | YTD | -12M |
|-----------------------------|--------------|------------|------------|------------|-------------|
| 10Y OAT | 2.83 | 2.82 | 3.45 | 2.98 | 2.60 |
| 10Y Bund | 2.30 | 2.28 | 2.88 | 2.44 | 2.11 |
| 10Y BTP | 3.89 | 3.92 | 4.90 | 4.55 | 3.96 |
| 10Y JGB | 0.63 | 0.59 | 0.84 | 0.41 | 0.41 |
| 10Y Bonos | 3.25 | 3.25 | 3.99 | 3.51 | 3.11 |
| 10Y Swiss | 0.91 | 0.83 | 1.07 | 1.57 | 1.13 |
| 10Y Gilt | 4.08 | 4.04 | 4.62 | 3.66 | 3.25 |
| 10Y USTnote | 4.18 | 4.10 | 4.95 | 3.88 | 3.46 |

| Credit & EM | Last. | -1W | -3M | YTD | -12M |
|------------------------|--------------|------------|------------|------------|-------------|
| EUR Corporate Aaa | 3.00 | 3.06 | 3.73 | 3.12 | 2.90 |
| EUR Corporate Baa | 3.98 | 4.03 | 4.86 | 4.65 | 4.12 |
| GBP Corporate Baa | 4.77 | 4.76 | 5.42 | 4.59 | 4.16 |
| USD Corporate Aaa | 4.70 | 4.62 | 5.53 | 4.62 | 4.25 |
| USD Corporate Baa | 5.50 | 5.45 | 6.64 | 5.70 | 5.22 |
| USD EM aggregate | 7.30 | 7.27 | 8.39 | 7.52 | 7.00 |

| Commodities | Last. | -1W | -3M | YTD | -12M |
|------------------------|--------------|------------|------------|------------|-------------|
| Brent, USD/BL | 79.92 | 2.4% | -10.2% | -7.0% | -7.3% |
| Or, USD/oz | 2,014 | 0.4% | 1.7% | 10.3% | 3.5% |
| Copper, USD/metric ton | 8,551 | 2.7% | 6.6% | 1.8% | -7.9% |
| Platinum, USD/oz | 911 | 2.1% | 3.1% | -14.5% | -13.2% |
| Palladium, USD/oz | 965 | 3.9% | -13.5% | -46.0% | -44.2% |
| Silver, USD/oz | 22.77 | -0.2% | -0.2% | -4.9% | -2.8% |

| FX rates | Last. | -1W | -3M | YTD | -12M |
|-----------------|--------------|------------|------------|------------|-------------|
| EUR/USD | 1.09 | 0.3% | 3.1% | 2.1% | 0.2% |
| EUR/CHF | 0.94 | 0.0% | -0.7% | -4.6% | -6.2% |
| USD/GBP | 0.78 | -0.7% | -4.8% | -5.5% | -3.1% |
| USD/JPY | 147.11 | -0.8% | -1.9% | 12.5% | 13.5% |
| USD/BRL | 4.92 | -0.2% | -1.6% | -7.8% | -3.0% |
| USD/CNY | 7.08 | -0.7% | -3.2% | 2.7% | 4.4% |
| USD/RUB | 88.70 | 0.8% | -5.1% | 21.5% | 27.8% |

| Equity indices | -1W | -3M | YTD | -12M |
|-----------------------|------------|------------|------------|-------------|
| Developped markets | 1.7% | 10.9% | 7.7% | 3.7% |
| Euro area | 3.7% | 12.0% | 18.4% | 10.0% |
| Germany | 2.8% | 13.4% | 20.0% | 12.0% |
| France | 1.9% | 7.8% | 13.1% | 5.8% |
| United Kingdom | 1.1% | 1.5% | 1.0% | -2.8% |
| Switzerland | 0.4% | 7.7% | 4.4% | -1.8% |
| United States | 2.7% | 16.3% | 26.8% | 21.2% |
| Japan | 1.3% | 12.2% | 33.7% | 27.7% |
| Brazil | -0.6% | 13.3% | 20.2% | 11.9% |
| Hong Kong | 4.1% | -6.9% | -19.6% | -27.9% |
| India | -0.6% | 10.9% | 16.2% | 18.0% |
| China | 1.5% | -6.5% | -15.4% | -21.6% |

Source: Bloomberg, on 26th January 2024

-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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