

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

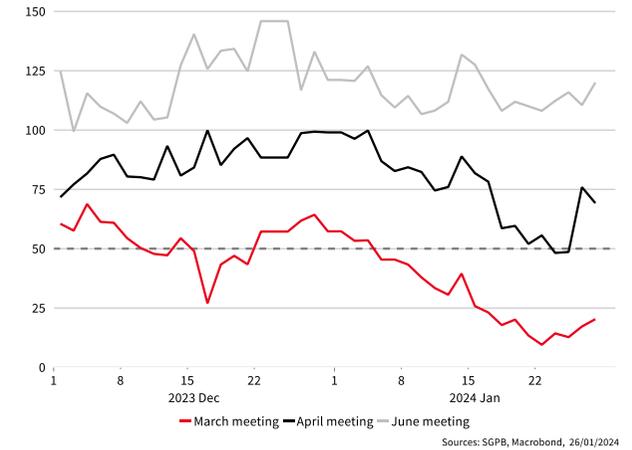
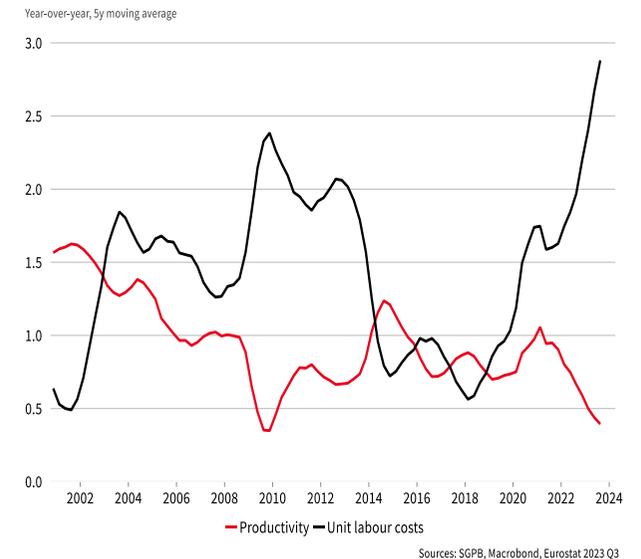


Chart 2: Euro area unit labour costs and productivity gains



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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