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A cut in June?

ECB post-meeting comment

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Summary

- A rate cut in June is now more likely than not. We adopt this as our base scenario.
- If the downward trend in wages and core inflation comes to a standstill, the start of easing may still be delayed to September.
- Either way, the easing cycle will be cautious and gradual. Nonetheless, several risks could force the ECB to interrupt the easing cycle or end it earlier than anticipated.

Policy decisions

- The ECB **kept rates on hold,** leaving the deposit facility rate at 4.00% and the refi rate at 4.50%.

The ECB left its policy on hold, as widely expected. The staff projections for both growth and inflation were revised down, with the ECB's economists now seeing core inflation at target in 2026, and close to this in 2025. This added a dovish element to today's meeting. Lagarde was slightly more reserved during her press conference. Nonetheless, the ECB seems to be hinting at a June rate cut, unless the inflation outlook deteriorates significantly in the coming months.

Policy rates: preparing for June

A June rate cut is now the most likely scenario. Only very disappointing inflation data seem able to derail this now. That doesn't mean the cuts will follow in rapid succession. In fact, it exposes the ECB to the risk of a policy error.

Heading into today's policy meeting, inflation has continued to move in the right direction. President Lagarde summarized that the Governing Council is *"more confident as a result, but not sufficiently confident."* Future wage negotiations and the evolution of profit margins are still the main concerns as the ECB tries to gauge whether underlying inflation will continue to trend lower. President Lagarde clearly pointed to a decision by the end of Q2, noting that "*we will know a little more in April, but a lot more come June.*"

It is clear that the Council's confidence is building. And not just in the directionality of inflation, but also in their own forecasts. "*Our projection errors have reduced significantly,*" Lagarde observed. "*This makes us more confident that we will reach our target.*" In other words, rather than relying mostly on incoming data, the Governing Council seems to be increasingly willing to also rely on their projections again.

The updated staff projections essentially see the ECB meet its policy target by end-2025 (see below). Even though we are a bit less optimistic than that, we also forecast that wages and core inflation will continue to trend lower in the coming months. We just expect it to happen a little more slowly than the ECB does. But a somewhat slower pace of decline no longer seems sufficient to prevent a rate cut in June; the fall in underlying inflation would have to come to a standstill.

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We have therefore brought forward the timing of a first rate cut. Our baseline now sees this happen in June, with risks that this only materialises in September. Moreover, we continue to expect a cautious cutting cycle from the ECB, with subsequent cuts pencilled in for September and December.

How low can they go?

Such an earlier start of policy easing does increase the risk that the ECB will be forced to pause or abort its easing cycle earlier than expected. Geopolitical risks could still drive up energy prices and freight rates, and disrupt global trade more broadly. Plus, our US strategist now assumes that President Trump will return to the White House in 2025. His stance on global trade may be felt in European inflation as well, particularly if this speeds up de-globalisation.

Even if the easing cycle is not interrupted by a new inflationary surge, we believe that the endpoint of the cycle may be higher than markets currently anticipate.

Today, policymakers repeated their assessment that *"past interest rate increases continue to weigh on demand."* However, they omitted their earlier observation that *"past interest rate increases keep being transmitted forcefully into financing conditions."* This suggests that policymakers expect that most of the impact of policy tightening is now behind us. And, considering that the staff projections see growth recover even with interest rates at current levels, that does beg the question how much easing will be required when the ECB starts to reverse some of its earlier hikes.

Economic outlook: Minority Report

Looking purely at the staff projections, the ECB is essentially within a hair's breadth of their price stability target. And while the central bank is slightly less optimistic about near-term growth, it continues to see a recovery from the second half of the year.

The downward adjustments in the inflation forecast mainly reflect a lower contribution from energy prices. More notably, the ECB's economists have also revised down their projections for core inflation. These are seen at 2.1% in 2025 and 2.0% in 2026, i.e., virtually in line with the ECB's target of 2%.

Table 1: Inflation forecasts compared

	2024	*2025*	*2026*
ECB, March 2024	**2.3**	**2.0**	**1.9**
ECB, December 2023	2.7	2.1	1.9
Rabobank	2.6	2.4	2.2

Source: ECB, RaboResearch

Table 2: Growth forecasts compared

	2024	*2025*	*2026*
ECB, March 2024	**0.6**	**1.5**	**1.6**
ECB, December 2023	0.8	1.5	1.5
Rabobank	0.5	1.4	1.4

Source: ECB, RaboResearch

President Lagarde noted that incoming data broadly confirm this view. The different measures of underlying inflation are converging, and are all heading lower, with one exception: Domestic inflation remains the outlier, in large part driven by persistence in services inflation (figure 1). Policymakers acknowledge this upside risk. Additionally, the ECB's baseline scenario does not take into account significant supply constraints from disruptions in the Red Sea. On the other hand, the Governing Council noted that inflation could also turn out lower if monetary policy dampens demand by more than expected, or if the global economy slows significantly.

Surprisingly, President Lagarde did not conclude whether the Governing Council mainly saw upside risks to the inflation outlook, or whether they now consider these risks to be more or less balanced. It does appear that there are now more scenarios in which inflation converges to target

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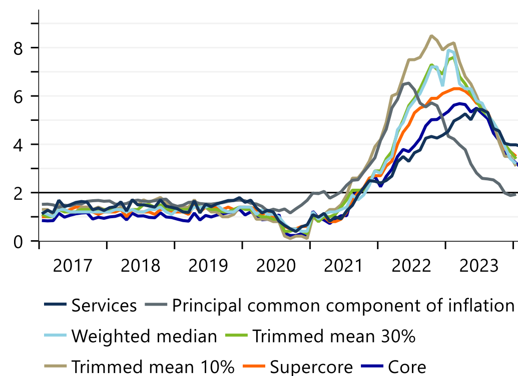
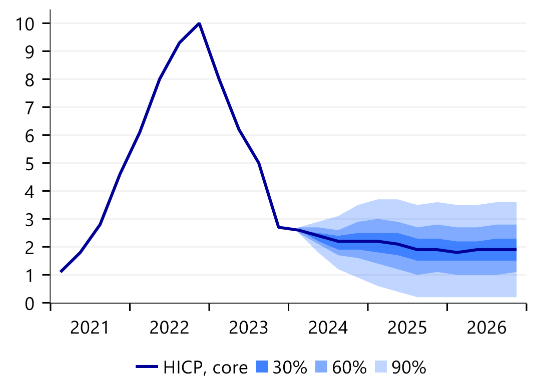
than in the previous round of staff projections. That said, the 90% upside scenario sees risks of a significant rebound. In fact, the 90th percentile of the inflation estimates is a tad *higher* than it was in December (figure 2). This underscores our concern that adverse developments in the global economy could lead to a renewed surge in inflation, and possibly a policy U-turn from the ECB.

Figure 1: Measures of underlying inflation



Source: Macrobond, Rabobank

Figure 2: Staff sees inflation heading towards the target in a majority of cases



Source: ECB

Table 3: Policy rate expectations by meeting

	Deposit facility rate	*Main refinancing operation rate*
7 March 2024	4.00%	4.50%
11 April 2024	4.00%	4.50%
6 June 2024	3.75%	4.25%
18 July 2024	3.75%	4.25%
12 September 2024	3.50%	4.00%
17 October 2024	3.50%	4.00%
12 December 2024	3.25%	3.75%

Source: Rabobank

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