5 September 2024

ECB preview

Dialling back, but pace uncertain

- On Thursday 12 September, the ECB is widely expected by both analysts and markets to deliver a 25bp rate cut. The moderation in the labour market and economic activity since the June meeting should fuel confidence in the disinflationary process being on track, in particularly given the slowdown in wage growth.
- We expect Lagarde to confirm that that it is entering the dialling back phase, but we do not expect a commitment to a specific timing of further rate cuts; thus, we do not anticipate that it will deviate from the meeting-by-meeting and data-dependent approach to the policy rate changes, thereby keeping its guidance's optionality and flexibility.
- The updated September staff projection is expected to be largely unchanged, which is expected to lead to a cautious approach by the ECB. We will pay attention to the staff's projections on wages and productivity, on top of the inflation projection, in order to assess 'Lane's formula'.

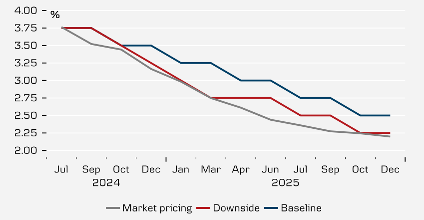
September cut seems given, but pace uncertain

Data over the past weeks have overall supported the case for further rate cuts from the ECB. Excluding the one-off boost from the Olympics, soft indicators have weakened over the summer, while the labour market is showing signs of moderation as seen in the stagnation of the PMI employment measure and decline in negotiated wage growth. So, while the domestic inflation indicator is still at elevated levels around 4.3%, the totality of data still speaks in favour of a rate cut next week. The question then becomes at what pace and to where.

A risk of an October cut

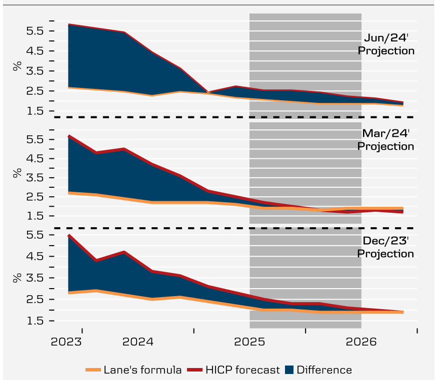
Historically, once central banks start cutting rates, the easing path has been relatively quick, at least to the top end of the neutral rate. According to *Reuters* this discussion has flared up in the ECB and not least to what level the neutral rate is. Previously, the 3% mark has been mentioned as the top end of neutral estimates. Importantly, we need to recall that episodes of policy easing have historically coincided with economic downturns. This is not the base case today. However, with global central banks shifting focus to the risk of excessive monetary policy restrictiveness, markets have started to speculate on the possibility of an October cut from the ECB. While an October rate cut could happen in a downside scenario, not least influenced by the totality of data and an aggressive Fed cutting cycle, we think it is unlikely that the incoming information between the September and the October meeting will be sufficiently weak to bring an October rate cut in play, unless Lagarde already next week clearly communicates this to be the baseline. Domestic inflation (services) remained elevated in August, and this will most likely keep ECB hawks on the defence in terms of changing the gradual approach. Our expectation for the staff projections does not allow for an October cut being the new baseline either. According to 'Lane's formula' it is expected to show a positive gap and the risk of headline inflation may only reach 2% in late 2025/ early 2026.

ECB rate path scenarios



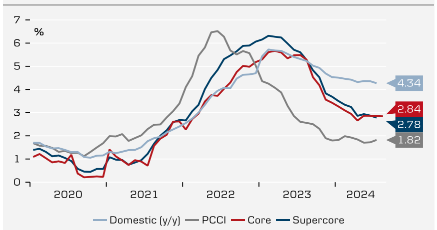
Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank

Lane's formula (2% inflation = 3% wages-1% prod growth)



Source: ECB, Macrobond Financial, Danske Bank

Underlying inflation pressure in the euro area



Source: Macrobond Financial, Danske Bank

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Important disclosures and certifications are contained from page 6 of this report.

Cutting rates but still restrictive

That the ECB is about to cut rates next week should in our view not be seen as a sign of an easy monitor policy stance. We have long argued that when inflation expectations fall in line with the target one needs to cut nominal interest rates in order for the central bank to not run an increasingly restrictive monetary policy. Looking at broad indicators, financial conditions in the euro area remain as restrictive as they were prior to the June cut.

Weaker growth momentum compared to July

Following decent economic activity in the first half of the year, recent growth indicators have cast doubts on the sustainability of euro area growth momentum since the June and July ECB meetings. Particularly the manufacturing sector continues to struggle, not least in Germany, but the global industrial activity has also slowed down, and foreign demand looks frailer. As a result, we expect GDP growth in the third quarter to fall short of the June staff projections of 0.4% q/q like it did in the second quarter, thus a downward revision of the growth projection should be warranted. While we expect the ECB to take notice of the weakening in the near-term growth projects and lower the growth forecast this year, we expect it to sound relatively calm due to the prospects of continued growth in the new staff projections driven by private consumption and service providers, reaching the potential growth rate in H2 25. The labour market has moderated lately but overall remains solid with record-low unemployment, which together with rising real incomes should bolster consumer spending. See more in *Research Euro Area: Progressing despite near-term hurdles*, 5 September.

Disinflationary process on track but services remain sticky

The disinflationary process in the euro area is still on track, albeit some slowdown has been observed since the July meeting owing to persistent high services inflation. The most recent momentum in services inflation remains strong with services prices rising 0.42% m/m s.a. (4.15% y/y) in August on the back of elevated wage growth. However, the overall trend for inflation is pointing lower as sellers have scaled back price increase expectations, and wage growth has come down more than expected with the decline in negotiated wages to 3.55% y/y in Q2 from 4.72% in Q1. Tomorrow (Friday), ECB will publish its favourite wage measure, namely compensation per employee, which is also expected to moderate. Headline inflation declined to a three-year low of 2.2% y/y in August, owing primarily to base effects on energy prices. Due to the stickiness in core inflation coupled with headline close to the target, we expect the ECB to have a gradual and cautious rate cutting as inflation is moving in the right direction, but sticky core means upside risks are still present, although recent labour market data has limited the upside risks.

Staff projections to show higher core inflation and unchanged headline

In terms of the staff projections, headline inflation has come in as expected by the ECB, while core inflation has been stronger than expected at 2.85% y/y in both July and August compared to the expectation of 2.7% for Q3 (we expect core to remain at a similar level in September). Hence, we expect a small upward revision to the staff projections on core inflation. On the other hand, energy futures have moved lower since the cut-off date for the technical assumption of the June staff projections, which suggests the energy inflation forecast will be lowered, according to our expectations, which should leave the projection of headline inflation largely unchanged.

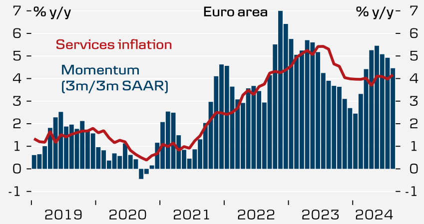
New projections to show lower growth and higher core inflation

ECB projections September 2024	2024		2025		2026	
GDP growth	0.8% (0.9%)	↘	1,2% (1.4%)	↘	1.6% (1.6%)	→
HICP inflation	2.5% (2.5%)	→	2.2% (2.2%)	→	1.9% (1.9%)	→
Core inflation	2.9% (2.8%)	↗	2.3% (2.2%)	↗	2.0% (2.0%)	→

Parenthesis are the old ECB projections (from June 2024)

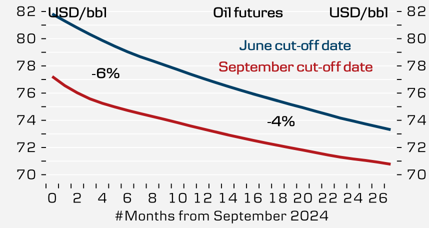
Source: ECB, Macrobond Financial

Services inflation far from target



Source: ECB, Macrobond Financial

Lower energy futures compared to June staff projections



Source: ECB, Macrobond Financial

'Too much' priced, but not fading it

Rates markets have already priced in a significant easing from the central bank, with 61bp this year and just above 100bp next year. We find that clearly on the aggressive side, but this difference of views boils down to the different inflation expectations we have. We have taken note of markets already pricing the inflation to average 1.8% through 2025, which contrasts with our expectation of ECB inflation above 2%. However, from a risk/reward perspective, we do not see it is attractive to fade the pricing at these levels.

We expect a limited FX reaction

Given that a 25bp rate cut is fully priced in, we do not anticipate a notable reaction in EUR/USD upon the announcement. The focus will be on the ECB's communication. Despite weaker growth momentum in the euro area and benign data on negotiated wages, underlying inflation, particularly in the services sector, remains elevated. Therefore, any hints, particularly regarding the October meeting and the broader future rate path, could cause some market jitters.

However, the FOMC meeting on 18 September will likely be more important for the near-term direction of EUR/USD. The August jobs report will likely be decisive in determining whether the Fed initiates its rate-cutting cycle with a 25bp or 50bp rate cut. We believe the jobs report will solidify a 25bp rate cut in markets, which could provide some support for US yields and the USD in the weeks to come. However, we do not expect a major USD rally in the near term, as the USD could be pressured by incoming Fed cuts and potentially positive risk appetite. On the longer horizon, we maintain our strategic case for a stronger USD due to the relative strength of the US economy. We forecast EUR/USD to move towards 1.07 in 12M.

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*	0.115	0.118

*A positive augmented Z-zcore 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.

		Feb/24	Mar/24	Apr/24	May/24	Jun/24	Jul/24	Aug/24	Last 12 obs
Inflation (%)									
Headline (YoY)		2.5	2.4	2.4	2.6	2.5	2.5	2.2**	
Core (YoY)		3.0	2.9	2.7	2.9	2.8	2.8	2.8**	
SuperCore (YoY)		3.3	3.1	2.9	2.9	2.9	2.8		
Services (YoY)		4.0	4.0	3.7	4.1	4.1	4.0	4.1**	
LIMI (Domestic inflation, YoY)		4.5	4.4	4.3	4.4	4.3	4.3		
Headline (MoM)		0.4	0.2	0.2	0.2	0.1	0.3	0.2**	
Core (MoM)		0.4	0.3	0.2	0.4	0.2	0.2	0.3**	
SuperCore (MoM)		0.3	0.2	0.2	0.3	0.3	0.3		
Services (MoM)		0.5	0.5	0.3	0.6	0.3	0.3	0.4**	
Economic Growth									
GDP[1]	... QoQ (%)	0.3	0.3	0.3	0.3	0.3			
PMI	... Composite	49.2	50.3	51.7	52.2	50.9	50.2	51.0	
	... Manufacturing	46.5	46.1	45.7	47.3	45.8	45.8	45.8	
	... Services	50.2	51.5	53.3	53.2	52.8	51.9	52.9	
IFO	... Current	86.9	88.1	88.9	88.3	88.3	87.1	86.5	
	... Expectations	84.5	87.7	89.8	90.3	88.8	87.0	86.8	
ESI	Index	95.5	96.3	95.6	96.2	96.0	96.0	96.6	
Eurocoin	...%	-0.3	0.2	0.3	0.2	0.2	0.2	0.3	
Consumer Confidence		-15.5	-14.8	-14.7	-14.3	-14.0	-13.0	-13.5	
Labour Market									
%	Employment	0.3	0.3	0.2	0.2	0.2			
QoQ (%)	Unemployment[1]	6.5	6.5	6.5	6.5	6.5	6.4		
	Labour Force[1]	0.0	0.0						
YoY (%)	Negotiated Wages[1]	4.7	4.7	3.6	3.6	3.6			
	Job Postings Wages	3.5	3.5	3.5	3.4	3.9	3.8		
	Comp per Employee[1]	4.8	4.8						
Labour Shortage	... Industrials[1]	19.7	19.7	19.3	19.3	19.3			
	... Services[1]	27.6	27.6	26.4	26.4	26.4			
EC Employment Expectations Indicator		102.4	102.4	101.5	101.2	99.7	97.9	99.2	
Credit									
%	BLS credit standards[1]	3.3	3.3	2.5	2.5	2.5			
YoY (%) - loan growth	Non-Financial corporations	0.3	0.3	0.2	0.3	0.7	0.6		
	Households	0.3	0.2	0.2	0.3	0.3	0.5		
YoY (%)	Euro Area M1	-7.9	-6.7	-5.9	-5.2	-3.5	-3.1		
	Euro Area M3	0.3	0.9	1.4	1.6	2.4	2.5		
Financial indicators									
% (eom)	10y Bund	2.4	2.3	2.6	2.6	2.5	2.3	2.3	
	10y GDP weighted rate	2.9	2.8	3.1	3.1	3.1	2.9	2.9	
% (eom), HICP	10y GDP wght. real rate	38.0	36.3	37.7	37.6	43.6	44.3	44.7	
% (eom), €STR	10y GDP wght. real rate	71.8	59.5	77.3	86.7	91.4	76.8	84.1	
bp (eom)	BTP-Bund Spread	143.0	141.0	134.0	131.0	157.0	134.0	139.0	
YoY(%) (eom)	Stoxx600	7.3	12.0	8.2	14.7	10.7	9.9	14.6	
	Stoxx50	15.1	17.8	12.9	18.2	11.3	9.0	15.4	
Spot rates	EER (YoY %, eom)	3.9	3.0	1.9	3.5	0.7	0.9	1.2	
	REER (YoY %, eom)	1.6	2.0	0.3	1.2	0.3	-0.6	-0.4	
	EURUSD (YoY %, eom)	1.9	-0.6	-2.4	1.6	-1.5	-1.8	2.0	
Energy & commodities									
YoY(%) (eom)	Commodities index	5.0	11.1	13.3	18.4	15.0	0.2	-2.1	
	Energy index	9.6	20.1	20.2	25.1	24.9	3.4	-3.7	
EUR/MWh (eom)	TTF NatGas	24.8	27.1	29.0	34.1	34.1	35.1	38.8	
USD/bbl (eom)	Brent oil	83.6	87.5	87.9	81.6	86.4	80.7	78.8	

**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		Sep/24	Oct/24	Nov/24	Dec/24	Jan/25	Feb/25	Mar/25
YoY(%)	Inflation market pricing	1.8	1.8	2.0	2.2	2.0	1.8	1.7
SMA* and market pricing		Sep/24	Oct/24	Nov/24	Dec/24	Jan/25	Feb/25	Mar/25
%	Market priced deposit rate (€STR+10bp)	3.52	3.43		3.15	2.95		2.70
bp	- change	-24.30	-8.6		-28.2	-20.1		-24.8
	SMA DFR	3.50	3.50		3.00	0.00		0.00
EURbn	SMA TLTRO	170	113	113	113	33	33	33
	SMA PEPP	1691	1669	1669	1669	1624	1624	1624
	SMA APP	2969	2888	2888	2888	2804	2804	2804
SPF*		2024	2025	2026	Long Term		Released since last ECB meeting	
YoY%	SPF HICP	2.4	2.0	2.0	2.0		Yes	
	SPF HICP, Core	2.6	2.1	2.0	2.0		Yes	
	SPF Real GDP	0.6	1.3	1.4	1.3		Yes	
Latest ECB Staff Projections		Q3/2024	Q4/2024	Q1/2025	Q2/2025	Q3/2026	Q4/2026	Q5/2026
YoY%	HICP	2.2	2.2	2.2	2.1	1.9	1.9	1.8
	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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None

Date of first publication

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