1 March 2024

ECB Preview

Policy normalisation in sight

- Next week, on Thursday 7 March, the ECB is set to take another step in its policy normalisation process, from a restrictive monetary policy stance towards a neutral stance. The new staff projections on growth outlook are expected to be revised lower this year and broadly unchanged in 2025/2026. Inflation is set to be revised to 2% for 2025. While neither the revisions to staff projections nor Lagarde will close the door to a rate cut at a specific meeting, we continue to expect that the key meeting for the first rate cut will be the meeting in June. We do not believe that the incoming data since the January meeting has been sufficiently weak to make April the baseline meeting (see appendix on European data at the end of this report).
- Markets significantly repriced policy easing expectations in February from around 150bp worth of rate cuts to 87bp. We continue to expect the first rate cut in June of 25bp and 75bp worth in total for this year.

Macro data places the ECB in a good position

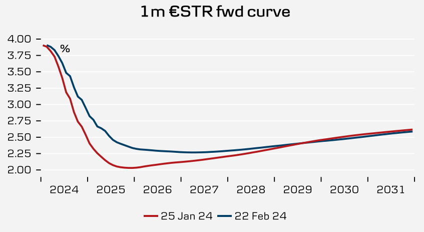
Recent macro data has placed the ECB in a good position that buys extra time to wait for more data on inflation and wage growth before embarking on the first rate cut. The economy is stagnating but not collapsing, inflation expectations are anchored, and employment increased 0.3% in Q4 23. The PMIs released since the last meeting were decent with the service sector at 50 for the first time since July while the manufacturing sector is closing in on 50 (disregarding the German manufacturing slump). Together with record-low unemployment, this sets the scene for a gradual rebound in growth during this year. See also the appendix with incoming data since the latest GC meeting.

Staff projections imply rate cuts this summer, but not in April

The new staff projections have been long-awaited for setting the scene in the monetary policy outlook for this year and next year. For the first time in this hiking cycle, we expect the staff projections to show that inflation will hit the 2% target in both 2025 and 2026 and this increases the chance of April being a live meeting, all things equal.

We expect that lowering of the inflation March projections relative to the December round will occur on the back of recent lower than expected inflation data, anchored inflation expectations, and lower energy futures. This will revise Q1 24 down by around 0.3pp to 2.6%. Looking further ahead, energy futures suggest significant downward revisions of the technical assumption for the inflation projections. Gas and electricity futures for 2024 now trade at almost 50% of what was embedded in the December projections, while the oil futures are USD5/bbl cheaper. We expect that these factors, combined with the low monthly momentum in inflation, will mean headline HICP projections will be lowered to 2.4% in 2024 (-0.3pp), 2.0% in 2025 (-0.1pp), and 1.9% in 2026 (unchanged).

ECB pricing: 1m €STR fwd curve



Source: Macrobond, Bloomberg, Danske Bank

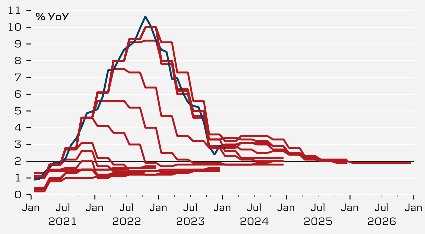
Expected changes to ECB staff projections

ECB projections March 2024	2024		2025		2026	
GDP growth	0.6% (0.8%)	↘	1.5% (1.5%)	→	1.5% (1..5%)	→
HICP inflation	2.4% (2.7%)	↘	2.0% (2.1%)	↘	1.9% (1.9%)	→
Core inflation	2.5% (2.7%)	↘	2.1% (2.3%)	↘	2,0% (2,1%)	↘

Parenthesis are the old ECB projections (from December 2023)

Source: ECB, Danske Bank

Realised HICP vs. ECB staff projections



Source: ECB, Danske Bank

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Staff projections used as onset of discussions, but wage discussion will likely dominate

The poor performance of the staff inflation projections in 2022 and into 2023 has led to governing council members questioning the reliability of the projections, in particular for the years ahead. We expect similar concerns to be voiced during the meeting and therefore the ECB is yet to argue that it has sufficient confidence in the projections pointing to 2% inflation for policy rate cuts in the near future. In particular, we expect Lagarde to highlight the upside risks to the inflation projection due to the uncertainty surrounding the wage growth outlook and corporate pricing power. With the resilient labour market, we think the ECB will opt for the cautious approach and wait for the June staff projections, as well as the wage growth data released at the end of April, before it starts to lower the policy rates. Lagarde has repeatedly said that the ECB must be sufficiently confident on inflation hitting 2% over the medium-term before starting to lower the policy rate.

The role of wages

The role of wages and their outlook have dominated recent ECB communication, and in particular the confirmation of Q1 wage data that will be released after the April meeting has been deemed necessary before the ECB delivers the first rate cut. The ECB is currently factoring that the high profit margins enjoyed by European companies – and not consumer prices – will bear the bulk of the rising wage costs. However, given accelerating real wage growth, solid levels of savings and increasing employment among households, it is certainly not unthinkable that corporate pricing power may be stronger than the ECB's inflation forecast currently assumes, and hence we find the ECB preferring to wait for the Q1 wage data. The latest negotiated wage data for Q4, which has been released since the January meeting, showed 4.46% y/y growth, down slightly from 4.7% in Q3. The ECB's favourite wage gauge, compensation per employee, is set to be published the day after the ECB meeting next week, i.e. 8 March with the Q4 data.

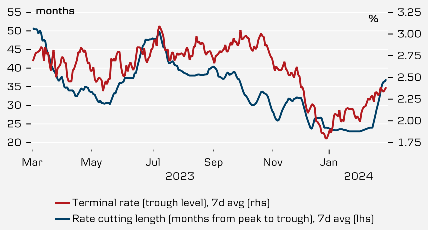
Disinflation underway – inflation declines but core proves sticky

The January inflation print declined to 2.8% y/y and core drifted lower to 3.3% y/y. The details of the final January HICP figures revealed that especially one-offs from tax changes and higher insurance premiums were behind the quite strong month-to-month service print. In February, we expect the HICP print will come in close to expectations of 2.5% y/y. However, the country data released before the deadline of this publication shows that core inflation was sticky in February and the monthly momentum is too high, especially in services. A sticky core print in February is another argument for the ECB to wait for the June meeting to start easing policy.

Repricing of central bank expectations

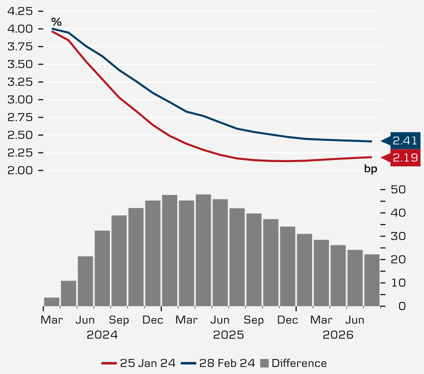
Following the 25 Jan ECB meeting, a few dovish GC speakers pushed the ECB pricing lower to a point where markets took that as pointing to almost 150bp worth of rate cuts this year. However, through the month of February, there has been significant repricing higher – much of it in the past two weeks – to a point where markets are now pricing just 87bp of rate cuts for this year, with the majority 82bp from June until Dec. At the same time, through February the trough level of €STR forwards were 25bp higher as well as flattening out to last almost 2y. We find that the reason for this repricing is a combination of spillover from the US and to some degree that markets realise that incoming data has not been sufficiently weak to justify significant rate cuts this year. Markets now have expectations closer to our and the ECB's outlook on inflation and growth.

Repricing of the 'anchor'



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

ECB pricing since Jan ECB meeting



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

Another meeting with limited market impact

Overall, we find that the ECB and Lagarde are comfortable with the current market pricing – and that includes for example the intra-euro area spreads, credit market risk gauges, and front-end pricing. We do not find compelling arguments why Lagarde should try to send other signals during the meeting that should warrant a repricing of financial conditions.

Given market expectations and the fact that data releases have more or less aligned with staff projections since the last meeting, we expect a muted market reaction.

We still expect EUR/USD to trend lower over the course of the year. Despite the recent positive risk appetite, driven by the global rally in equity markets, which strengthened EUR/USD for most of February, we ultimately view the equity rally as a net positive for the USD, as the catalyst for the rally is centred in the US market, attracting flows to the USD. Furthermore, there are signs that underlying inflation appears more persistent in the US compared with the euro area, which, all else equal, should support the USD. A strong USD, coupled with tighter financial conditions, is a necessary condition for the Fed to sustainably achieve its inflation target of 2%. Overall, we believe the US economy is in a stronger position relative to the euro area based on factors such as relative terms of trade, real rates, and relative unit labour costs. We forecast EUR/USD to reach 1.05/1.04 within a 6/12M horizon.

Appendix

Blue colour indicates 'dovish' data print, red colour indicates 'hawkish' data print
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*	0.27	0.28

*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 all individual Z-scores by -1except for the unemployment, labour force, and effective exchange rate (real and nominal) ones.

Inflation (%)		Jul/23	Aug/23	Sep/23	Oct/23	Nov/23	Dec/23	Jan/24	Last 12 obs
Headline (YoY)		5.2	5.1	4.3	2.9	2.4	2.9	2.8	
Core (YoY)		5.3	5.1	4.5	4.2	3.6	3.4	3.2	
SuperCore (YoY)		5.6	5.2	4.8	4.5	3.9	3.7	3.5	
Services (YoY)		5.4	5.3	4.7	4.5	4.0	4.0	4.0	
LIMI (Domestic inflation, YoY)		5.3	5.2	5.0	4.9	4.7	4.5	4.5	
Headline (MoM)		0.3	0.5	0.3	0.1	-0.2	0.0	0.4	
Core (MoM)		0.3	0.3	0.1	0.2	-0.1	0.2	0.3	
SuperCore (MoM)		0.5	0.2	0.2	0.2	-0.2	0.3	0.3	
Services (MoM)		0.4	0.2	0.3	0.3	-0.1	0.3	0.4	

**Indicates release is flash, and not final

Economic Growth		Jul/23	Aug/23	Sep/23	Oct/23	Nov/23	Dec/23	Jan/24
GDP	... QoQ (%)	0.0	0.0	0.0				
PMI	... Composite	48.6	46.7	47.2	46.5	47.6	47.6	47.9
	... Manufacturing	42.7	43.5	43.4	43.1	44.2	44.4	46.6
	... Services	50.9	47.9	48.7	47.8	48.7	48.8	48.4
IFO	... Current	91.4	89.0	88.7	89.1	89.4	88.5	86.9
	... Expectations	83.8	83.0	83.2	84.7	85.0	84.1	83.5
ESI	Index	94.8	94.0	93.9	93.9	94.2	96.4	96.1
Eurocoin	...%	-0.6	-0.3	-0.2	-0.7	-0.8	-0.2	-0.6
Consumer Confidence		-15.2	-16.0	-17.7	-17.9	-17.0	-15.1	-16.1

Labour Market		Jul/23	Aug/23	Sep/23	Oct/23	Nov/23	Dec/23	Jan/24
%	Unemployment	6.5	6.5	6.5	6.5	6.4	6.4	
QoQ (%)	Employment	0.2	0.2	0.2	0.3	0.3	0.3	
	Labour Force	0.4	0.4	0.4				
YoY (%)	Negotiated Wages	4.7	4.7	4.7	4.5	4.5	4.5	
	Job Postings Wages	4.3	4.0	3.7	3.8	3.7	3.9	4.1
	Comp per Employee	5.3	5.3	5.3				
Labour Shortage	... Industrials	21.8	21.8	21.8	19.9	19.9	19.9	
	... Services	31.4	31.4	31.4	26.5	26.5	26.5	
EC Employment Expectations Indicator		103.1	102.7	102.9	102.9	103.2	103.3	102.3

Financial indicators		Jul/23	Aug/23	Sep/23	Oct/23	Nov/23	Dec/23	Jan/24
%	BLS credit standards	11.7	11.7	11.7	4.4	4.4	4.4	
YoY (%) - loan growth	Non-Financial corporations	2.2	0.7	0.2	-0.3	0.0	0.5	0.2
	Households	1.3	1.0	0.8	0.6	0.5	0.4	0.3
Index	Stoxx600	460.9	456.8	454.7	441.6	451.4	474.2	476.6
	Stoxx50	4,364.5	4,296.8	4,227.2	4,104.0	4,275.0	4,509.8	4,506.5
Spot rates	EER (avg)	121.1	121.2	120.5	120.0	120.7	120.3	
	REER (avg)	113.3	112.6	112.0	111.5	111.9	110.8	
	EURUSD (eom)	1.106	1.091	1.068	1.056	1.081	1.091	1.091

Energy & commodities		Jul/23	Aug/23	Sep/23	Oct/23	Nov/23	Dec/23	Jan/24
YoY(%)	Commodities index	-6.8	-3.2	7.0	1.4	-2.7	-1.4	-0.9
YoY(%)	Energy index	-15.2	-6.6	9.5	1.4	-4.5	-1.2	1.5
EUR/MWh	TTF NatGas	29.0	33.7	35.7	43.4	44.5	34.9	29.7
USD/bbl	Brent oil	80.2	85.1	92.5	88.7	82.0	77.4	79.1

Forward looking indicators								
		Feb/24	Mar/24	Apr/24	May/24	Jun/24	Jul/24	Aug/24
YoY(%)	Inflation market pricing	2.5	2.7	2.4	2.6	2.4	2.5	2.2
%	Market priced deposit rate (€STR+10bp)	0.1	4.0	3.9	3.9	3.6	3.4	3.4
bp	- and its change	0.0	-2.0	-10.6	-10.6	-23.4	-20.8	-20.8
SMA* and market pricing		Mar/24	Apr/24	May/24	Jun/24	Jul/24	Aug/24	Sep/24
	Market pricing DFR	4.006%	3.996%	3.951%	3.951%	3.779%	3.633%	3.633%
	SMA DFR	4.00	4.00	4.00	4.00	3.75	3.75	3.75
EURbn	SMA TLTRO	170	113	113	113	33	33	33
EURbn	SMA PEPP	1714	1714	1714	1714	1714	1691	1691
EURbn	SMA APP	3133	3133	3039	3039	3039	2969	2969
SPF*		2024	2025	2026	Long Term		Released after last ECB meeting	
YoY%	SPF HICP	2.4	2.0	2.0	2.0		Yes	
YoY%	SPF HICP, Core	2.6	2.1	2.0	2.0		Yes	
YoY%	SPF Real GDP	0.6	1.3	1.4	1.3		Yes	
Latest ECB Staff Projections		Feb/24	Mar/24	Apr/24	May/24	Jun/24	Jul/24	Aug/24
YoY%	HICP	2.9	2.9	2.7	2.7	2.7	2.5	2.5
YoY%	HICP CORE	3.1	3.1	2.6	2.6	2.6	2.6	2.6
YoY%	GDP	0.2	0.2	0.3	0.3	0.3	0.4	0.4

*SMA is latest release, coinciding with latest ECB meeting. SPF is latest release.

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