

ECB Watch: Rapid ascent, slow descent

It has happened! After increasing key interest rates by 450 basis points over the past two years, the ECB has decided to revert course and decrease key interest rates by 25 basis points at today's meeting. While being cautious in giving too much forward guidance, it is likely that the way down will be much slower than the way up. The ECB's new set of economic forecasts show a similar outlook compared to March with somewhat higher growth and inflation.

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ECB Economic Forecasts (% yoy)

Year	GDP growth		Inflation		Core Inflation*	
	Jun. 2024	Mar. 2024	Jun. 2024	Mar. 2024	Jun. 2024	Mar. 2024
2024	0.9	0.6	2.5	2.3	2.8	2.6
2025	1.4	1.5	2.2	2.0	2.2	2.1
2026	1.6	1.6	1.9	1.9	2.0	2.0

* Inflation rate ex energy and food
Source: ECB, RBI/Raiffeisen Research

As expected, the **ECB Governing Council decided today to cut the three key ECB interest rates** by 25 basis points each. The deposit rate now stands at 3.75%, the main refinancing rate at 4.25% and the marginal lending rate at 4.50%. This was widely expected, as ECB Governing Council members were very keen to signal their intention in advance. The decision to reduce the PEPP portfolio by EUR 7.5bn per month in the second half of the year is also no surprise and follows earlier decisions.

In general, it can be said that the monetary policy statement **does not come with big surprises**. On the one hand, it emphasises the progress made in reducing inflation and the improved inflation outlook since September last year. This was also the time of the last interest rate hike. On the other hand, however, the continued strong domestic inflationary pressure is mentioned, which should be seen in the context of increased wage growth. The latest inflation release for May has further fuelled this concern.

The ECB has not issued any **forward guidance**. In its last monetary policy decision (April), the ECB stated that it would be appropriate to reduce the degree of monetary policy restriction should confidence in the return of inflation to the inflation target grows. In theory, data-dependent forward guidance of this kind would not contradict the ECB's data-driven approach. Nevertheless, the ECB does not want to fuel speculation about a continuation of the rate cutting cycle at the next interest rate meeting in July. **Data-driven** and from **meeting to meeting**, the ECB is currently not offering any more forward guidance.

The ECB's **new economic forecasts** developed as we expected. Both GDP growth and the inflation forecast were raised. 0.9% GDP growth in 2024 instead of 0.6% reflects the

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better start to the year, but also assumes that the positive momentum will continue. In terms of inflation, both the forecast for the overall rate and the core rate for 2024 have been raised by 0.2 percentage points. Better economic momentum but also slightly higher energy price assumptions are probably behind this upward revision. However, the ECB's medium-term outlook has not changed significantly as a result.

At the **press conference**, President Lagarde emphasised that inflation will remain above the inflation target until well into next year. A development close to the current level is expected over the next few months. However, the inflation path is volatile and will be characterised by expected and unexpected bumps. The interest rate path will prove to be data-driven, according to Lagarde. In order to make decisions on further interest rate cuts, sufficient data must be available to review the ECB's three parameters (inflation outlook, underlying inflation, strength of monetary policy transmission). Naturally, the probability of a decision is greater after a longer period of time, such as a quarter, especially if updated forecasts are available. We consider our assessment of further interest rate cuts in quarterly fashion to find support

On **financial markets**, the interest rate cut was reflected by rising Bund yields and an appreciation of the euro. However, in light of the recent volatility, the effects can be seen as marginal. One to two additional key interest rate cuts until the end of the year are still being priced. Given the ECB's data-driven approach, financial markets will continue to react volatile to data releases.

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