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ECB's clear bias to ease, starting in June

- **Rates left unchanged at 4% for the fifth successive meeting** – The European Central Bank (ECB) left all key interest rates unchanged. There were no changes to the current stance on asset purchase programmes and refinancing operations.
- **Clear bias to ease on growing confidence of inflation returning to target in mid-2025** – The monetary policy statement introduced a new sentence to signal an easing bias as follows: *“If our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase our confidence that inflation is converging to our target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction”*.
- **But no pre-commitment to a particular path for monetary policy normalisation** – In the final sentence, the GC adds that *“In any event, we will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and we are not pre-committing to a particular rate path”*.
- **Few members have already seen sufficient progress** – President Lagarde explained however that they agreed to join the very large majority which wanted to wait until June before passing judgment on the matter.
- **The ECB will not be looking anxiously at the Fed** – With the balance of risk to economic activity tilted to the downside, and inflation expected to continue to fall, the overall message was that the ECB would not be waiting for the US Federal Reserve to adjust interest rates.
- **Growing confidence in inflation convergence to 2% target** – The absence of linear convergence to 2% does not matter as much as the stability in the inflation projections consistent with the ECB's target and the risk of some undershooting of the target in 2026.
- **The long-road to neutral** – We suspect that the first leg of an easing cycle will be geared to return monetary policy to a more neutral stance in the next 18 months, which would likely require the key policy rate to fall from 4% to around 2%.
- **What happens next?** – A first 25 basis point (bp) rate cut in June ought to be followed by similarly sized moves at each of the quarterly meetings when macroeconomic projections are updated (Sep-24 and Dec-24). Alternatively, given the distance to interest rate neutrality, 100bp of rate cuts could be delivered relatively quickly, followed by cuts at each of the forecast update meetings, implying a 2% policy rate by September 2025.
- **Negligible (but slightly positive) market reaction** – It was not surprising that markets did not react to a very predictable message during the press conference. Instead, it was the lower-than-expected US producer price report, which imparted a bullish tone to the short-end of the US fixed income market, while the Euro Stoxx index and the EUR/USD were largely unchanged, losing 0.2% and 0.1% to 512 and 1.0735, respectively.

ECB: clear bias to ease, likely starting in June

Rates left unchanged at 4% for the fifth successive meeting – The European Central Bank (ECB) left all key interest rates unchanged at its 11 April monetary policy meeting and reiterated its determination to ensure that inflation returns to its 2% medium term target in a timely manner. The press release of the monetary policy decisions did not contain any changes to the current stance on asset purchase programmes and refinancing operations.

Clear bias to ease based on growing confidence of inflation returning to its target in mid-2025 – The monetary policy statement, summarising the thinking of the Governing Council (GC) of the ECB, introduced a new sentence to signal an easing bias as follows: *“If our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase our confidence that inflation is converging to our target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction”*.

But no pre-commitment to a particular path for monetary policy normalisation – In the final sentence, the GC adds that *“In any event, we will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and we are not pre-committing to a particular rate path”*.

A few members have already seen sufficient progress – President Lagarde explained during the questions and answers session that ‘a few members’ of the GC, considering the new information that had become available since the March meeting, were sufficiently convinced that inflation is already on a sustained trajectory to its 2% target. However, they agreed to join the very large majority which wanted to wait until June before passing judgment on the matter.

The ECB will not be looking anxiously at the Fed – President Lagarde acknowledged that there were multiple variables, some of them related to the international environment (including broad financial conditions, the level of the euro effective exchange rate) but most of them domestically-focused that would be used in the assessment of the monetary policy stance at the June meeting when a decision to cut rates would likely be formalised. With the balance of risk to economic activity still tilted to the downside, and inflation expected to continue to fall over the forecast horizon, the overall message was that the ECB would not be waiting for the US Federal Reserve to adjust interest rates.

Growing confidence in inflation convergence to 2% target – The ECB will not wait for inflation to fall to 2% YY before reducing the degree of monetary policy restriction, taking comfort from the fact that disinflation is progressing, albeit slowly, and that the transmission of its monetary policy stance to the economy has been effective. President Lagarde pointed to the March projections already showing some fluctuations in the path of inflation in the next few months and quarters, and that ‘there will be ‘bumps on the road’ to reaching the 2% inflation target around the middle of 2025. The absence of linear convergence to 2% does not matter as much as the stability in the inflation projections consistent with the ECB’s target and the risk of some undershooting of the target in 2026.

The long-road to neutral – With economic activity in Europe not meaningfully different from stagnation in the last six months, not much appetite for loans by firms and households, and a clear disinflationary backdrop, the onus remains firmly on the ECB to reduce the degree of its monetary policy restrictiveness. While there is no appetite for any pre-commitment, we suspect that the first leg of an easing cycle will be geared to return monetary policy to a more neutral stance in the next 18 months, which would likely require the key policy rate to fall from 4% to around 2%.

What happens next? – We estimate that a first 25 basis point (bp) rate cut in June ought to be followed by similarly sized moves at each of the quarterly meetings when macroeconomic projections are updated (Sep-24 and Dec-24), meaning at least 75bp of cuts in 2025. Alternatively, given the distance to interest rate neutrality, 100bp of rate cuts could be delivered relatively quickly (with four consecutive moves of 25bp in June, July, September and October), followed by cuts at each of the forecast update meetings, implying a 2% policy rate by September 2025.

Negligible (but slightly positive) market reaction – ECB rhetoric going into the April meeting had cemented the likelihood of a formal easing bias, building on the March meeting (when the GC had agreed to continue monitoring information) and the ECB Watcher’s conference when President Lagarde’s keynote address had laid out the path towards monetary policy normalisation. Hence, it was not surprising that markets did not react to a very predictable message during the press conference. Instead, it was the lower-than-expected US producer price report, which imparted a bullish tone to the short-end of the US fixed income market, while the Euro Stoxx index and the EUR/USD were largely unchanged, losing 0.2% and 0.1% to 512 and 1.0735, respectively.

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Credit risk			
Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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