

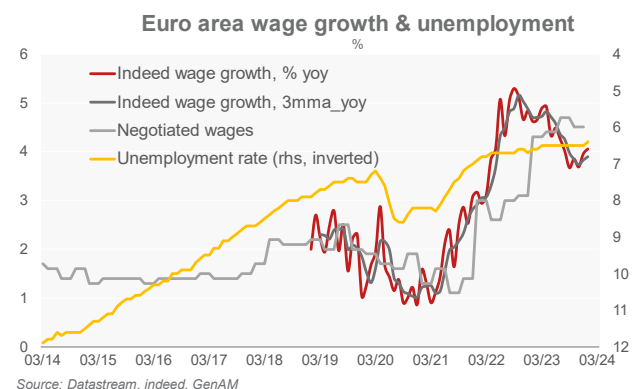
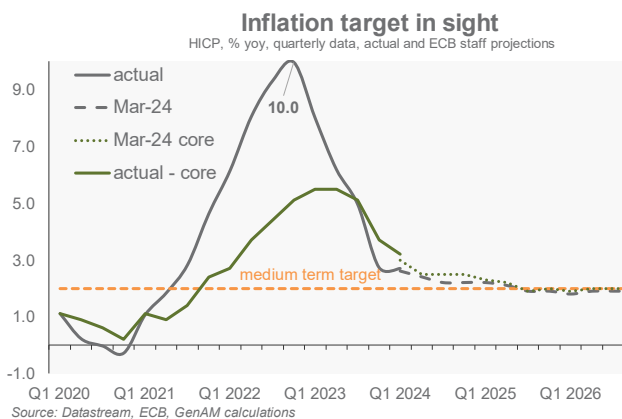
MARKET COMMENTARY

ECB not yet sufficiently confident to cut, all eyes on wage data

Martin Wolburg

March 7, 2024

- At today's meeting, the ECB's Governing Council (GC) left its key rates unchanged, in line with expectations.
- Most importantly, the GC noted that *"inflation has declined further"*. In the updated macro projections the expected inflation path has shifted down and annual headline as well as core inflation are now expected to be in line with target by 2026 while high domestic price pressure *"in part owing to strong growth in wages"* persists.
- Altogether, the GC's confidence in the decline of inflation increased but it is not yet sufficiently high to act. Rate cuts were not discussed today while awaiting pivotal wage data over the second quarter.
- We stick to our call of a first 25 bps rate cut by June and continue to see cumulative cuts of 100 bps in 2024. Markets left the expected path of key rate cuts almost unchanged and assessed today's ECB meeting as mildly dovish.



GC unsurprisingly decided not to act today: At today's meeting the GC unsurprisingly decided again to leave key rates unchanged, the deposit rate at 4.00% and the repo rate at 4.50%. It continues with APP non-reinvestments and sticks to the previous announcements that it *"intends to reduce the PEPP portfolio by €7.5 billion per month on average"* over the second half of 2024 and to fully stop reinvestments at the end of 2024.

A more favourable inflation outlook ... : Over the past months disinflation has been continuing and the ECB's proprietary measures for underlying inflation (e.g. supercore, PCCE) suggest that the fall from 3.4% yoy in Dec. to 3.1% yoy in Feb. is backed by fundamentals. The updated inflation projections acknowledge this and the expected annual inflation is now set to

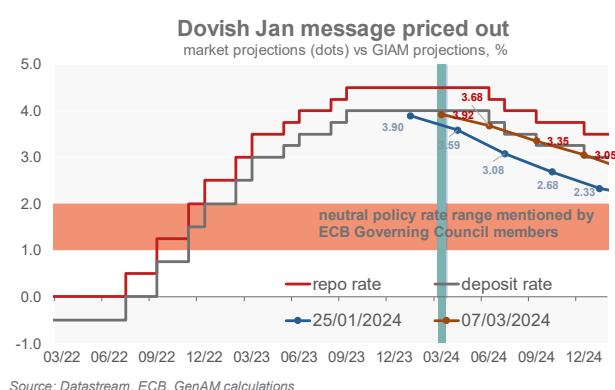
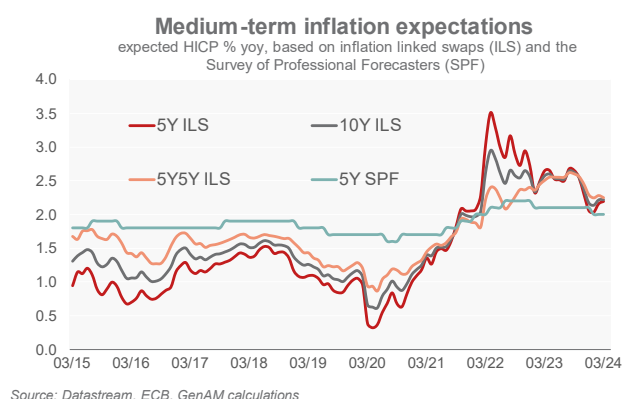
average 2.3% (from 2.7%) in 2024 (mainly due to lower energy prices), 2.0% (from 2.1%) in 2025 and 1.9% (unch.) in 2026. Core inflation is seen at 2.6% (from 2.7%), 2.1% (from 2.3%) and 2.0% (from 2.1%) in the respective years. As result, the GC expects inflation to be back to target by 2026. With near-term growth revised down (2024: 0.6%, from 0.9%) the cyclical price risks should be reduced. Accordingly, in the Q&A President Lagarde clearly saw the euro area economy on a disinflation path with “good progress towards inflation target”.

... but not yet enough progress: But while the GC became more confident on disinflation, President Lagarde was also very explicit in stating that the GC was not yet “sufficiently confident” to act. The elephant in the room is high domestic price pressure “in part owing to strong growth in wages”. In the Q&A, she once again referred to pivotal wage data that will be released over the second quarter. The concern about a wage-price spiral seems still be on the GC’s radar screen and it is “extremely vigilant” regarding the evolution of profits and wages. The ECB will want to see confirmation for its assumption that wage increases eat mainly into profits.

Lagarde confirms expectation of first rate cut in June: In the press conference, President Lagarde very openly stated that there will be only a few of such data in April but a lot more in June. Moreover, at today’s meeting rate cuts were not discussed. On the other hand, she also stated that the 2% inflation target will not need to be reached to take a decision. To us this suggests that the ECB’s default is to start the easing cycle by June.

Wage data key signposts to watch, don’t look at the Fed: Whether or not the ECB will cut by then crucially depends on the domestic inflation outlook and the incoming wage data especially. We think that wage growth has peaked (see also rh-graph above) and that services inflation will gradually come down further. Only if this expectation is defied the GC might further postpone the timing of the first cut. In contrast, the Fed’s behaviour will not have a significant impact. President Lagarde was very clear on that. And in a recent [paper](#) we laid down why it would be no surprise if the ECB moved earlier than the Fed, as there had been ‘autonomous’ ECB policy cycles also in the past.

Easing cycle to start in June: We continue to look for a first key rate cut by June and deem cumulative cuts of 100 bps in 2024 likely. Key rate expectations had converged to this view over the past weeks and were not much impacted by today’s meeting. However, markets took it as mildly dovish with yields slightly lower and equities gaining somewhat.



This document is based on information and opinions which Generali Asset Management S.p.A. Società di gestione del risparmio has obtained from sources within and outside of the Generali Group. While such information is believed to be reliable for the purposes used herein, no representation or warranty, expressed or implied, is made that such information or opinions are accurate or complete. The information, opinions estimates and forecasts expressed in this document are as of the date of this publication and represent only the judgment of Generali Asset Management S.p.A. Società di gestione del risparmio and may be subject to any change without notification. It shall not be considered as an explicit or implicit recommendation of investment strategy or as investment advice. Before subscribing an offer of investment services, each potential client shall be given every document provided by the regulations in force from time to time, documents to be carefully read by the client before making any investment choice. Generali Asset Management S.p.A. Società di gestione del risparmio may have taken or, and may in the future take, investment decisions for the portfolios it manages which are contrary to the views expressed herein. Generali Asset Management S.p. A. Società di gestione del risparmio relieves itself from any responsibility concerning mistakes or omissions and shall not be considered responsible in case of possible damages or losses related to the improper use of the information herein provided. It is recommended to look over the regulation, available on our website www.generali-am.com. Generali Asset Management S.p. A. Società di gestione del risparmio is part of the Generali Group which was established in 1831 in Trieste as Assicurazioni Generali Austro Italiane.