
Data Insights: ECB and Euro Area Economy Monitor

Thursday, January 25, 2024

Today's monetary policy decision: how the language changed from prior meeting

~~14 December 2023~~

25 January 2024

The Governing Council today decided to keep the three key ECB interest rates unchanged. ~~While inflation~~ ~~The incoming information~~ ~~has dropped in recent months, it is likely to pick up again temporarily in~~ ~~broadly confirmed its previous assessment of the near-medium-term.~~ ~~According to the latest Eurosystem staff projections for the euro area, inflation is expected to decline gradually over the course of next year, before approaching the Governing Council's 2% target in 2025.~~ ~~Overall, staff expect inflation outlook.~~ ~~Aside from an energy-related upward base effect on headline inflation to average 5.4% in 2023, 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026.~~ ~~Compared with the September staff projections, this amounts to a downward revision for 2023 and especially for 2024.~~

~~Underlying, the declining trend in underlying inflation has eased further.~~ ~~But domestic price pressures remain elevated, primarily owing to strong growth in unit labour costs.~~ ~~Eurosystem staff expect inflation excluding energy and food to average 5.0% in 2023, 2.7% in 2024, 2.3% in 2025 and 2.1% in 2026.~~

~~The continued, and the~~ ~~past interest rate increases~~ ~~continue to be kept being~~ ~~transmitted forcefully to the economy.~~ ~~Tighter into financing conditions.~~ ~~Tight~~ ~~financing conditions are dampening demand, and this is helping to push down inflation.~~ ~~Eurosystem staff expect economic growth to remain subdued in the near term.~~ ~~Beyond that, the economy is expected to recover because of rising real incomes—as people benefit from falling inflation and growing wages—and improving foreign demand.~~ ~~Eurosystem staff therefore see growth picking up from an average of 0.6% for 2023 to 0.8% for 2024, and to 1.5% for both 2025 and 2026.~~

The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. Based on its current assessment, the Governing Council considers that the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to this goal. The Governing Council's future decisions will ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary.

The Governing Council will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, ~~it's~~ the Governing Council's interest rate decisions will be based on its assessment of the inflation outlook in light of the incoming economic

and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission.

~~The key ECB interest rates are the primary tool for setting the monetary policy stance. The Governing Council also decided today to advance the normalisation of the Eurosystem's balance sheet. It intends to continue to reinvest, in full, the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) during the first half of 2024. Over the second half of the year, it intends to reduce the PEPP portfolio by €7.5 billion per month on average. The Governing Council intends to discontinue reinvestments under the PEPP at the end of 2024.~~

Key ECB interest rates

The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 4.50%, 4.75% and 4.00% respectively.

Asset purchase programme (APP) and pandemic emergency purchase programme (PEPP)
The APP portfolio is declining at a measured and predictable pace, as the Eurosystem no longer reinvests the principal payments from maturing securities.

The Governing Council intends to continue to reinvest, in full, the principal payments from maturing securities purchased under the PEPP during the first half of 2024. Over the second half of the year, it intends to reduce the PEPP portfolio by €7.5 billion per month on average. The Governing Council intends to discontinue reinvestments under the PEPP at the end of 2024.

The Governing Council will continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Refinancing operations

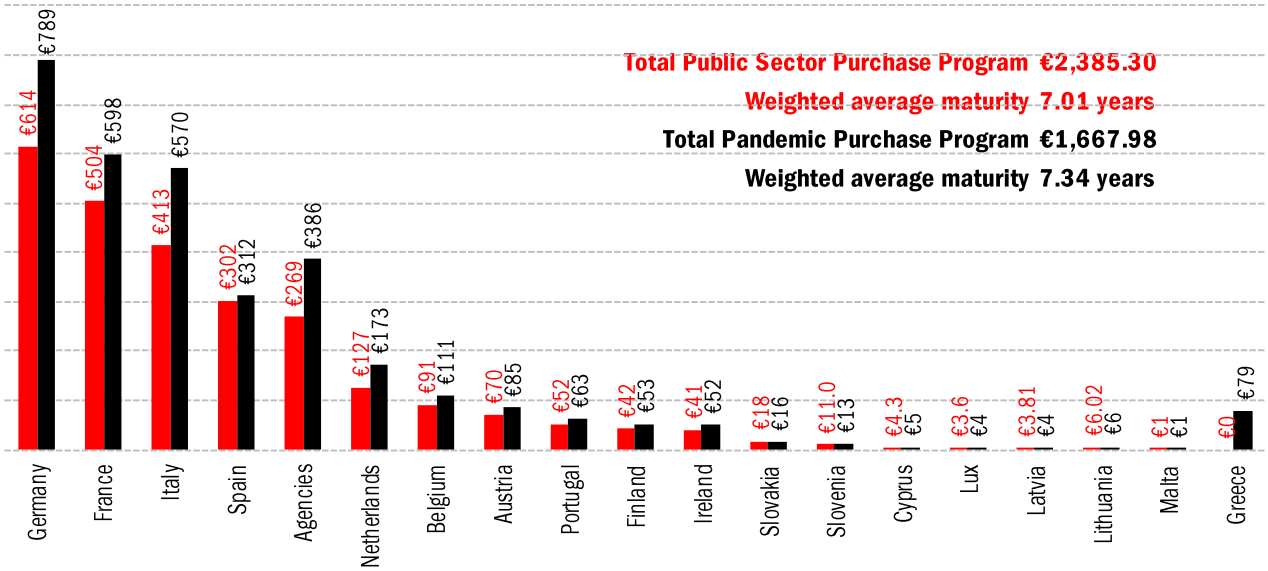
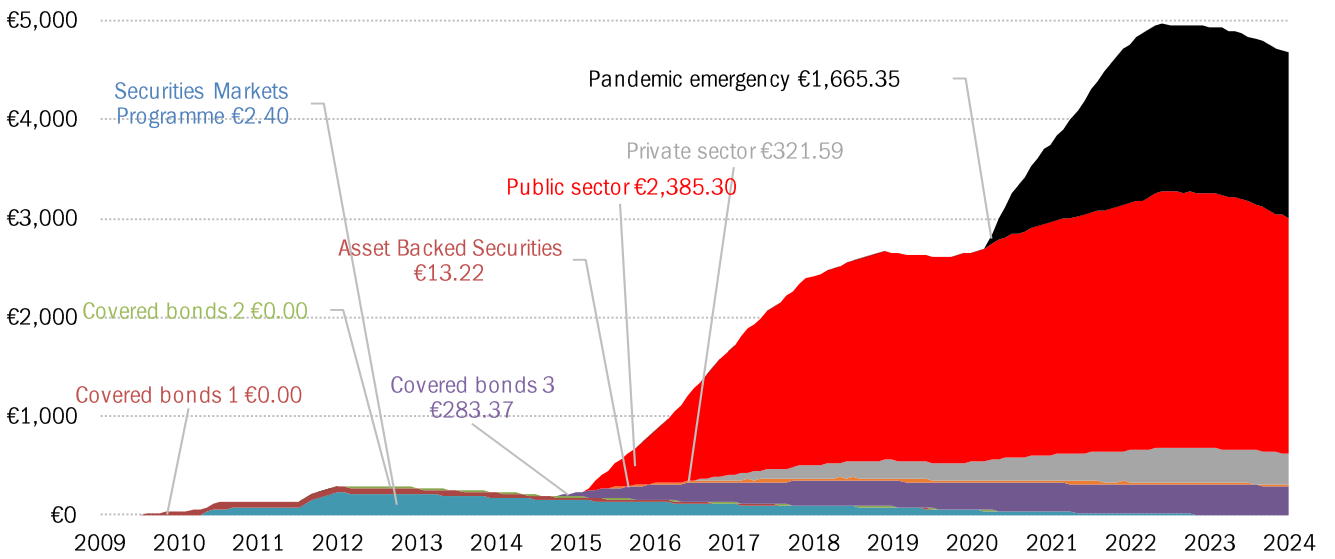
As banks are repaying the amounts borrowed under the targeted longer-term refinancing operations, the Governing Council will regularly assess how targeted lending operations and their ongoing repayment are contributing to its monetary policy stance.

The Governing Council stands ready to adjust all of its instruments within its mandate to ensure that inflation returns to its 2% target over the medium term and to preserve the smooth functioning of monetary policy transmission. Moreover, the Transmission Protection Instrument is available to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across all euro area countries, thus allowing the Governing Council to more effectively deliver on its price stability mandate.

The President of the ECB will comment on the considerations underlying these decisions at a press conference starting at 14:45 CET today.

Source: ECB, TrendMacro analysis

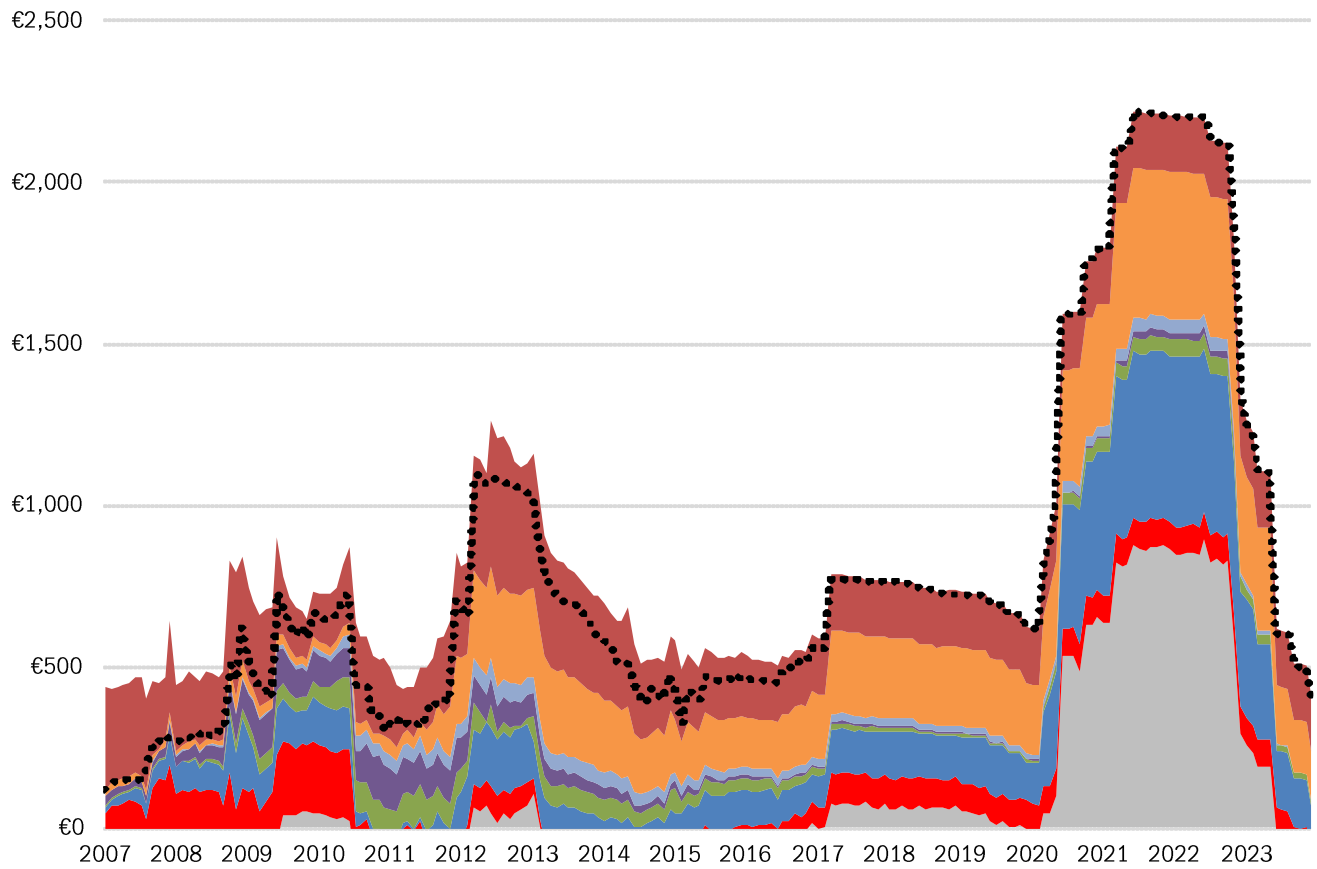
Euro-QE (€ billions)



Source: ECB, TrendMacro calculations

Banking system dependency: borrowing from the ECB (€ billions)

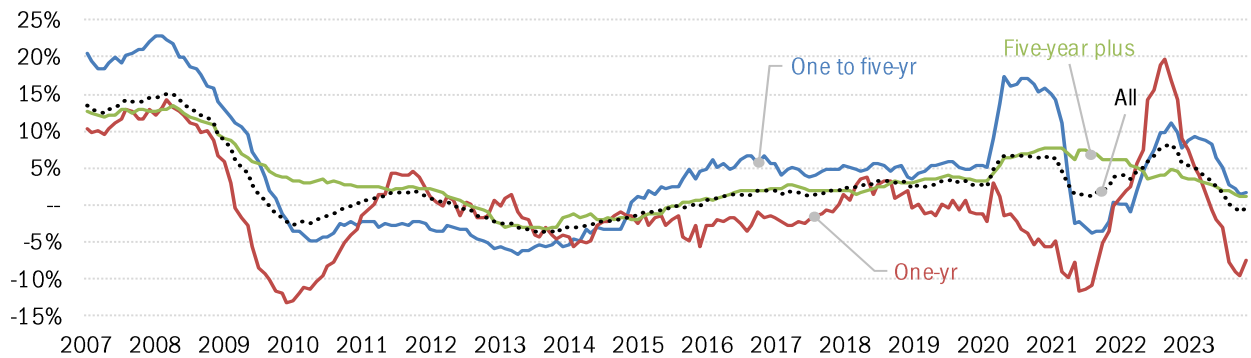
--- Total LTRO ■ Spain ■ Italy ■ Portugal ■ Ireland ■ Greece ■ France ■ Germany ■ Other



Source: ECB, National central banks, TrendMacro calculations

The credit drought: loans to non-financial businesses (YOY growth)

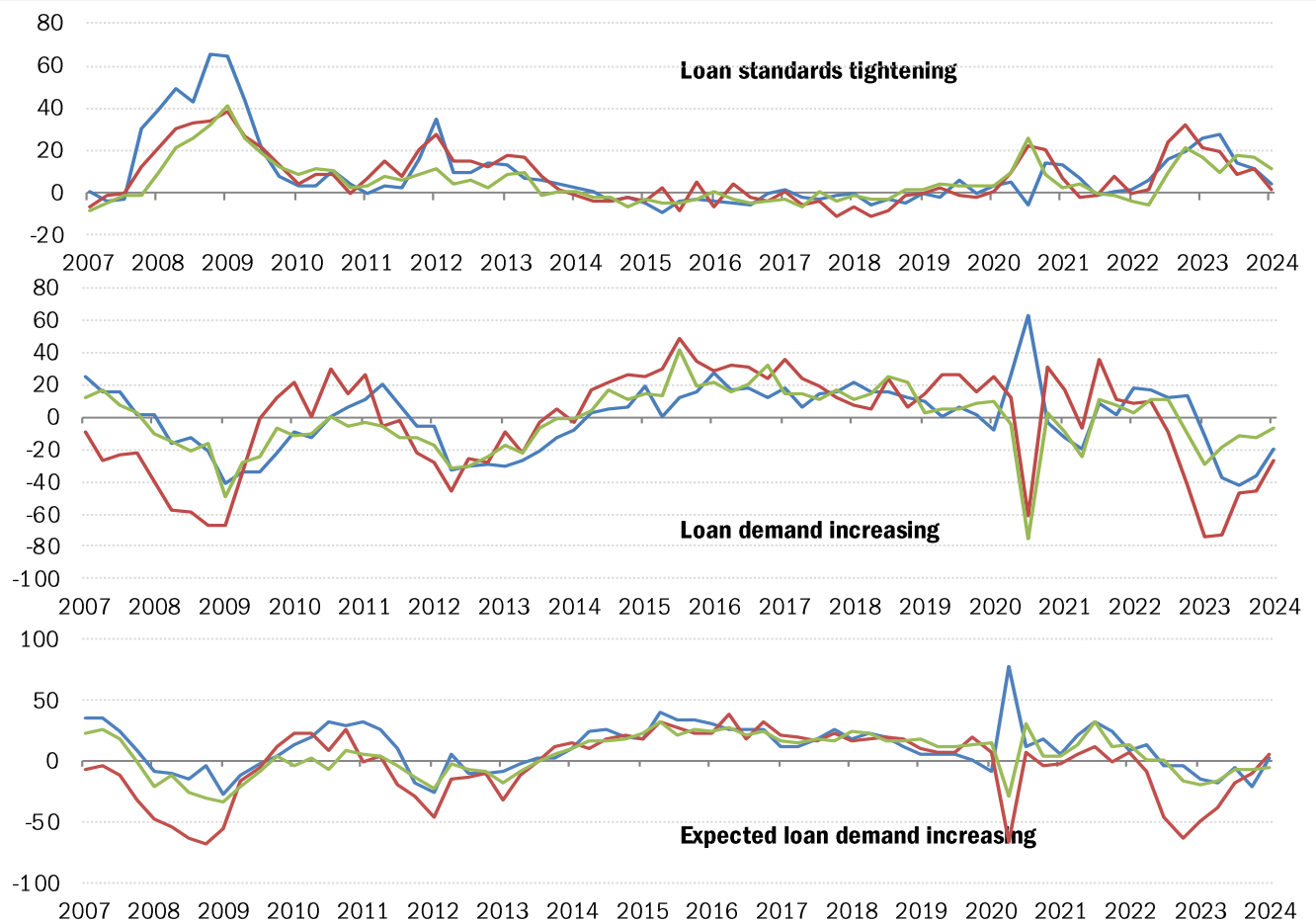
— Loans to 1 year — Loans 1-5 years — Loans 5 years plus ... Total



Source: ECB, TrendMacro calculations

Supply and demand for lending: ECB Bank Survey

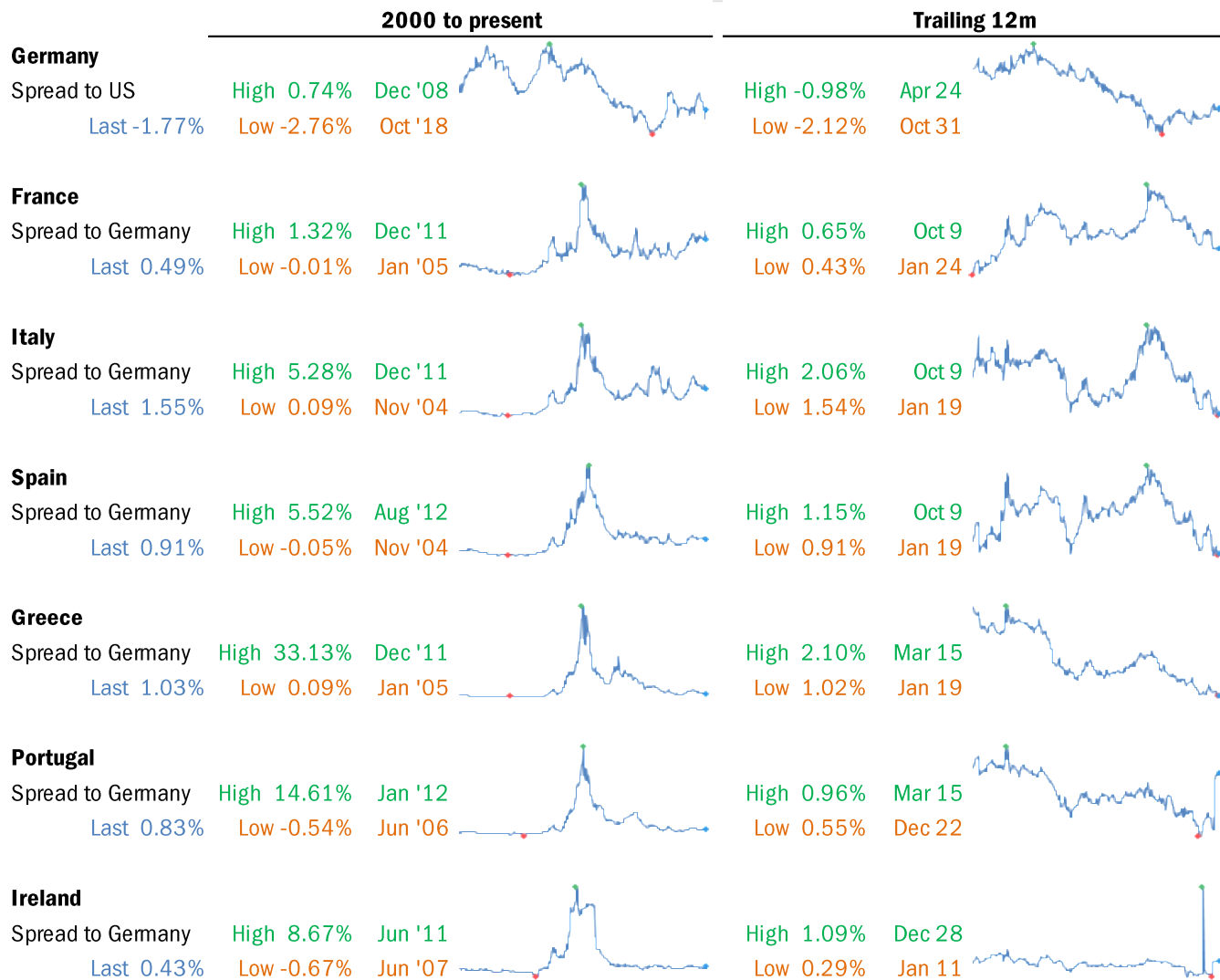
Net number of banks reporting for: — Enterprises — Home mortgage — Consumer



Source: ECB, TrendMacro calculations

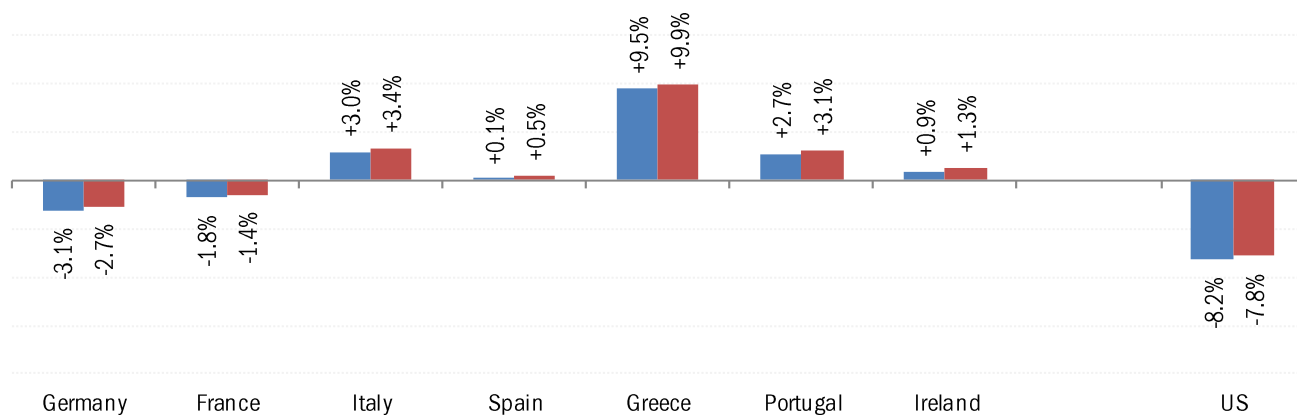
Sovereign stress monitor: 10-year bond spreads

· High · Low · Last



10-year sovereign bond total returns, trailing 12-months

■ EUR ■ USD



Source: Bloomberg, TrendMacro calculations

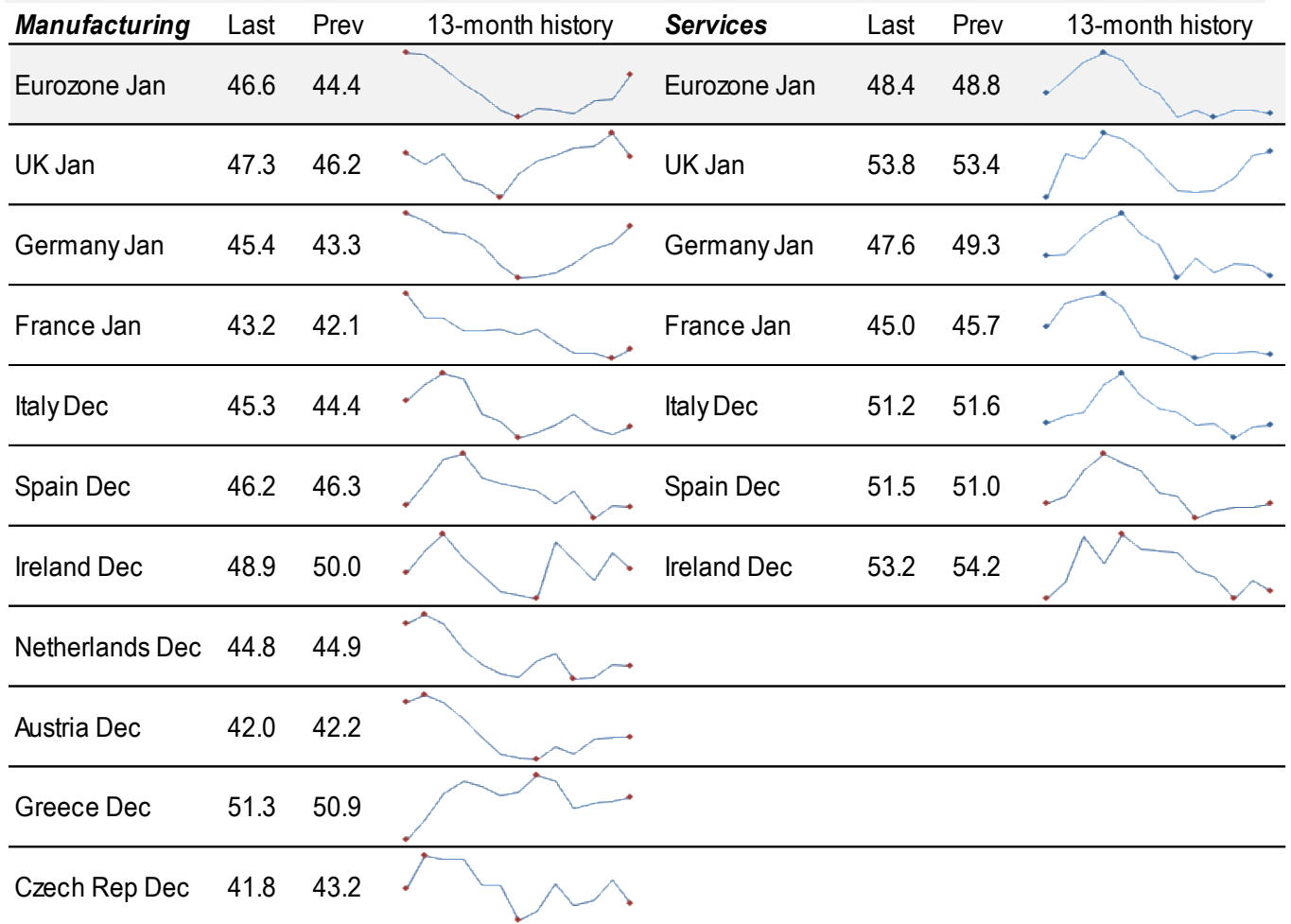
Labor market in intensive care

ULC: Nominal, quarterly YOY UE: High 12m pulse: monthly ■ improvement or ■ worsening in rate of change



Source: Eurostat, TrendMacro calculations

Purchasing Manager Indices



Source: Markit, TrendMacro calculations

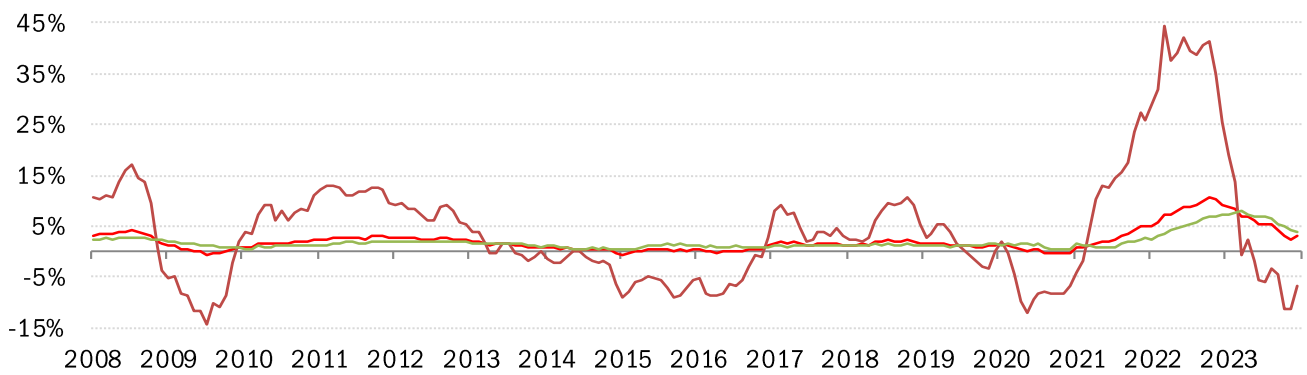
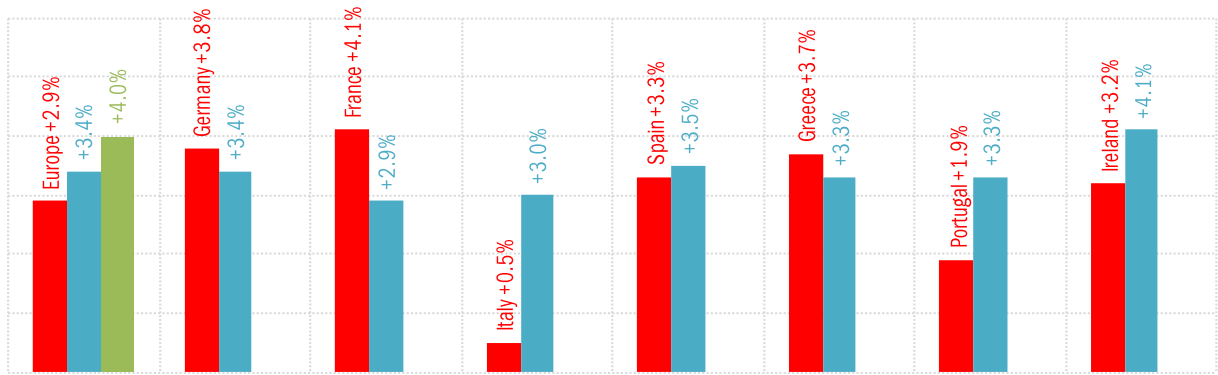
Regional currency flight — Euro vs Swiss franc ■ SNB FX reserves



Source: Bloomberg, TrendMacro calculations

Euro area consumer inflation, year on year

Country: ■ Headline ■ Ex-food and energy ■ Ex-energy Euro area: — Headline — Energy — Ex-energy



Source: Eurostat, TrendMacro calculations

Draghi's old dashboard:

Swap-implied inflation expectations since "Whatever it takes"

— 5-year inflation-swap rate, 5 years forward



Source: Bloomberg, TrendMacro calculations