
Data Insights: ECB and Euro Area Economy Monitor

Thursday, June 6, 2024

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

~~11 April~~ 6 June 2024

~~The Governing Council today decided to keep the three key ECB interest rates unchanged. The incoming information has broadly confirmed the Governing Council's previous assessment of the medium-term inflation outlook. Inflation has continued to fall, led by lower food and goods price inflation. Most measures of underlying inflation are easing, wage growth is gradually moderating, and firms are absorbing part of the rise in labour costs in their profits. Financing conditions remain restrictive and the past interest rate increases continue to weigh on demand, which is helping to push down inflation. But domestic price pressures are strong and are keeping services price inflation high.~~
The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. Based on an

~~The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. It considers that the key ECB interest rates are at levels that are making a substantial contribution to the ongoing disinflation process. The Governing Council's future decisions will ensure that its policy rates will stay sufficiently restrictive for as long as necessary. If the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to moderate the degree of monetary policy restriction after nine months of holding rates steady. Since the Governing Council meeting in September 2023, inflation has fallen by more than 2.5 percentage points and the inflation outlook has improved markedly. Underlying inflation has also eased, reinforcing the signs that price pressures have weakened, and inflation expectations have declined at all horizons. Monetary policy has kept financing conditions restrictive. By dampening demand and keeping inflation expectations well anchored, this has made a major contribution to bringing inflation back down.~~

~~At the same time, despite the progress over recent quarters, domestic price pressures remain strong as wage growth is elevated, and inflation is likely to stay above target well into next year. The latest Eurosystem staff projections for both headline and core inflation have been revised up for 2024 and 2025 compared with the March projections. Staff now see headline inflation averaging 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026. For inflation excluding energy and food, staff project an average of 2.8% in 2024, 2.2% in 2025 and 2.0% in 2026. Economic growth is expected to pick up to 0.9% in 2024, 1.4% in 2025 and 1.6% in 2026.~~

The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. ~~were to further increase its confidence that inflation is converging to the target in a~~

~~sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. In any event, it will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. The~~ Governing Council will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, ~~and it. In particular, its 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 Governing Council~~ is not pre-committing to a particular rate path.

~~The Governing Council today also confirmed that it will reduce the Eurosystem's holdings of securities under the pandemic emergency purchase programme (PEPP) by €7.5 billion per month on average over the second half of the year. The modalities for reducing the PEPP holdings will be broadly in line with those followed under the asset purchase programme (APP).~~

Key ECB interest rates

~~The~~ Governing Council decided to lower the three key ECB interest rates by 25 basis points. Accordingly, 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~~ be decreased to 4.50%, 4.50% and 3.75% ~~and 4.00%~~ respectively, with effect from 12 June 2024.

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~~ will continue to reinvest, in full, the principal payments from maturing securities purchased under the PEPP ~~during until~~ the first half end of June 2024. Over the second half of the year, it ~~intends to~~ will 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

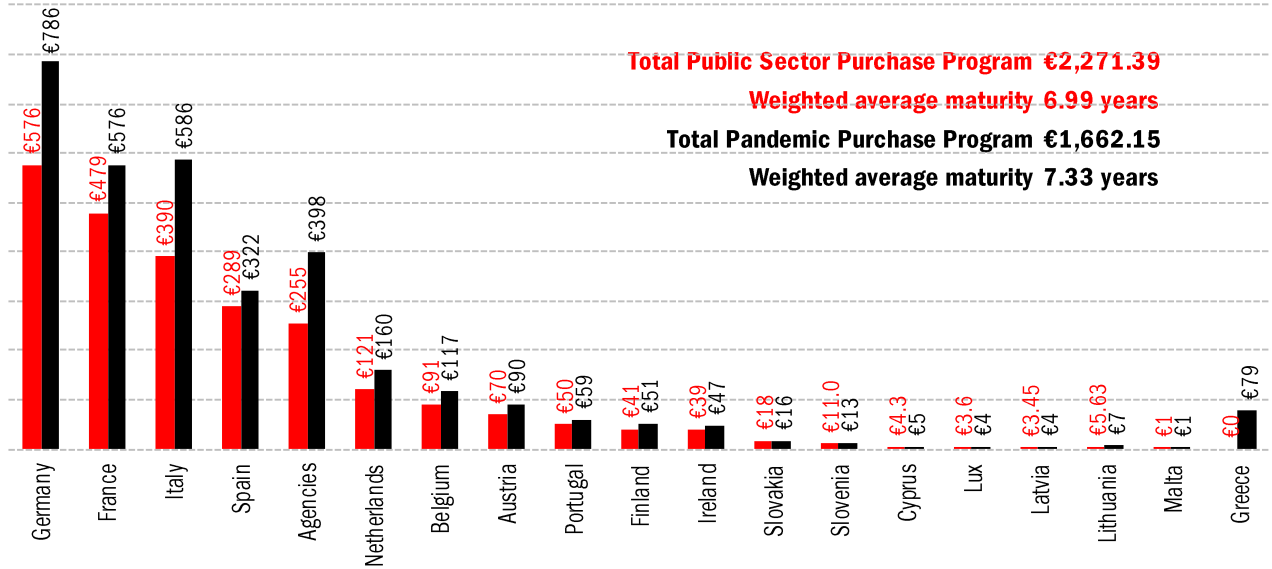
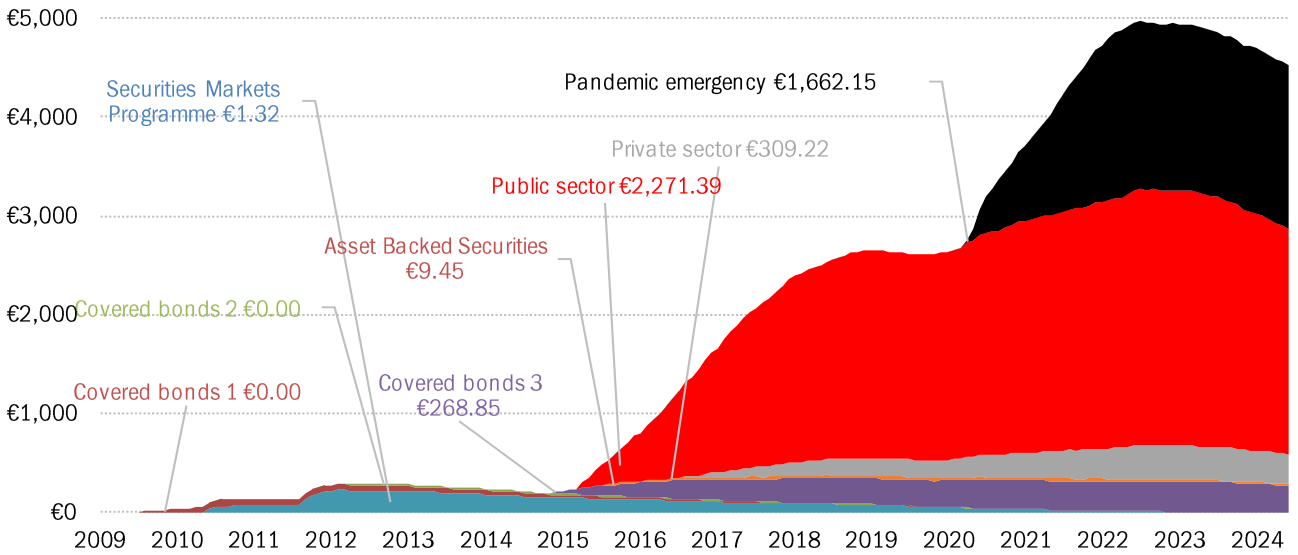
As banks are repaying the amounts borrowed under the targeted longer-term refinancing operations, the Governing Council will regularly assess how targeted lending operations and their ongoing repayment are contributing to its monetary policy stance.

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

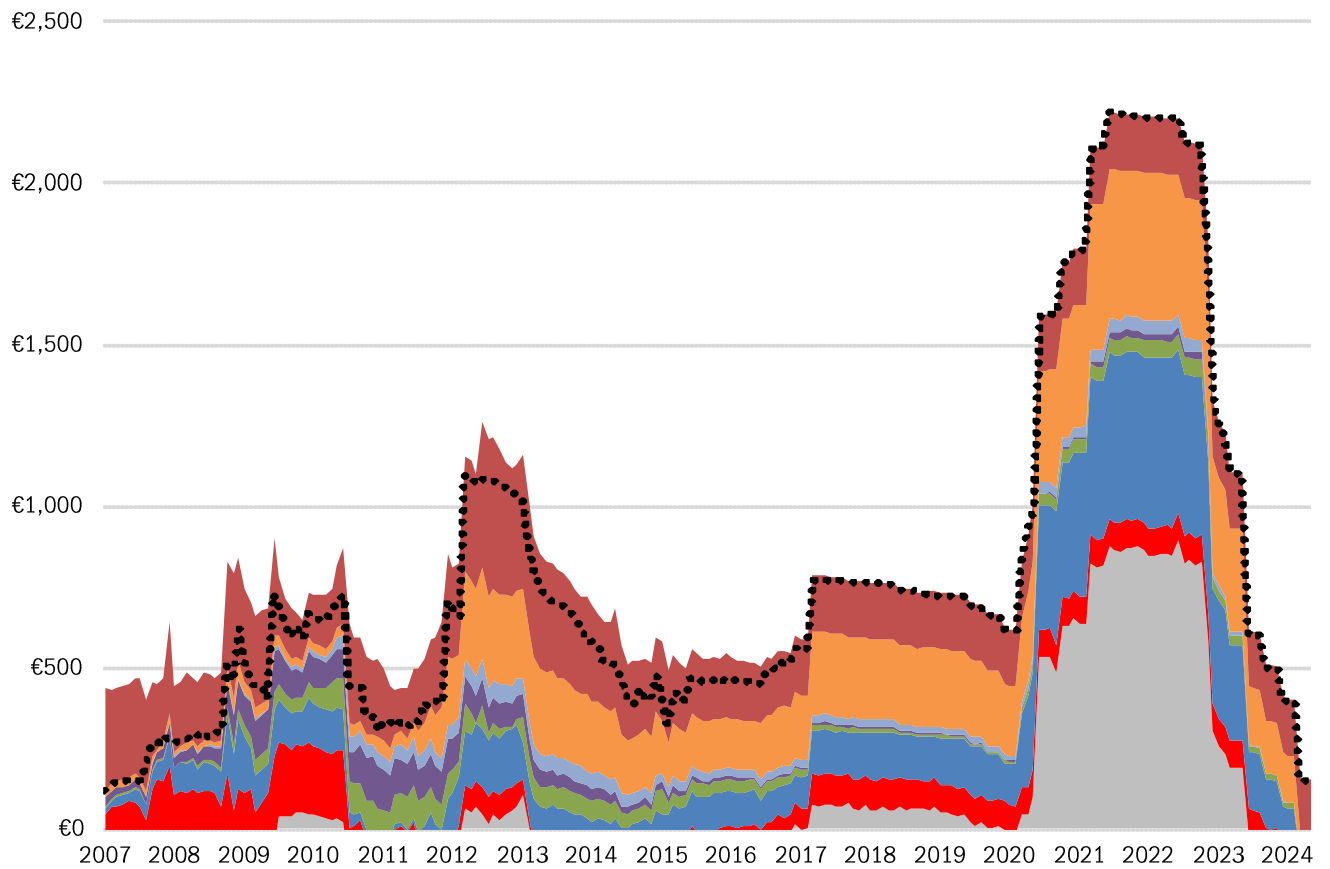
Euro-QE (€ billions)



Source: ECB, TrendMacro calculations

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

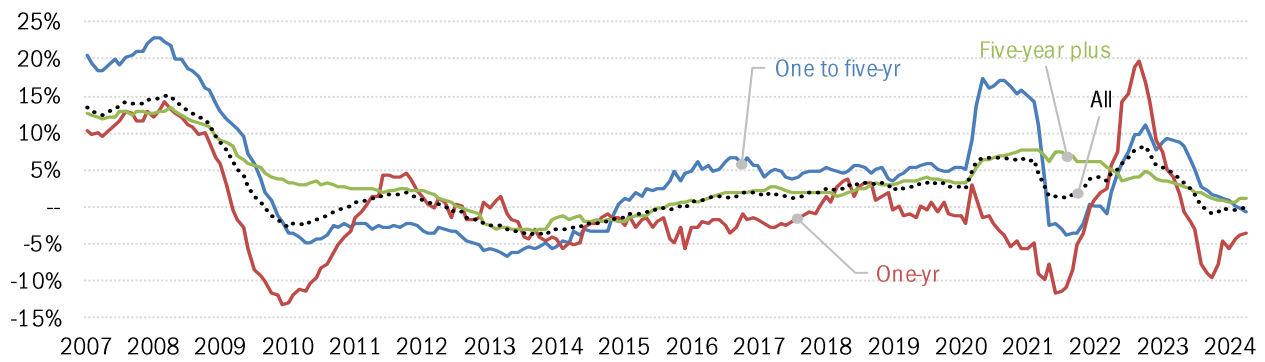
... Total LTRO ■ Spain ■ Italy ■ Portugal ■ Ireland ■ Greece ■ France ■ Germany ■ Other



Source: ECB, National central banks, TrendMacro calculations

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

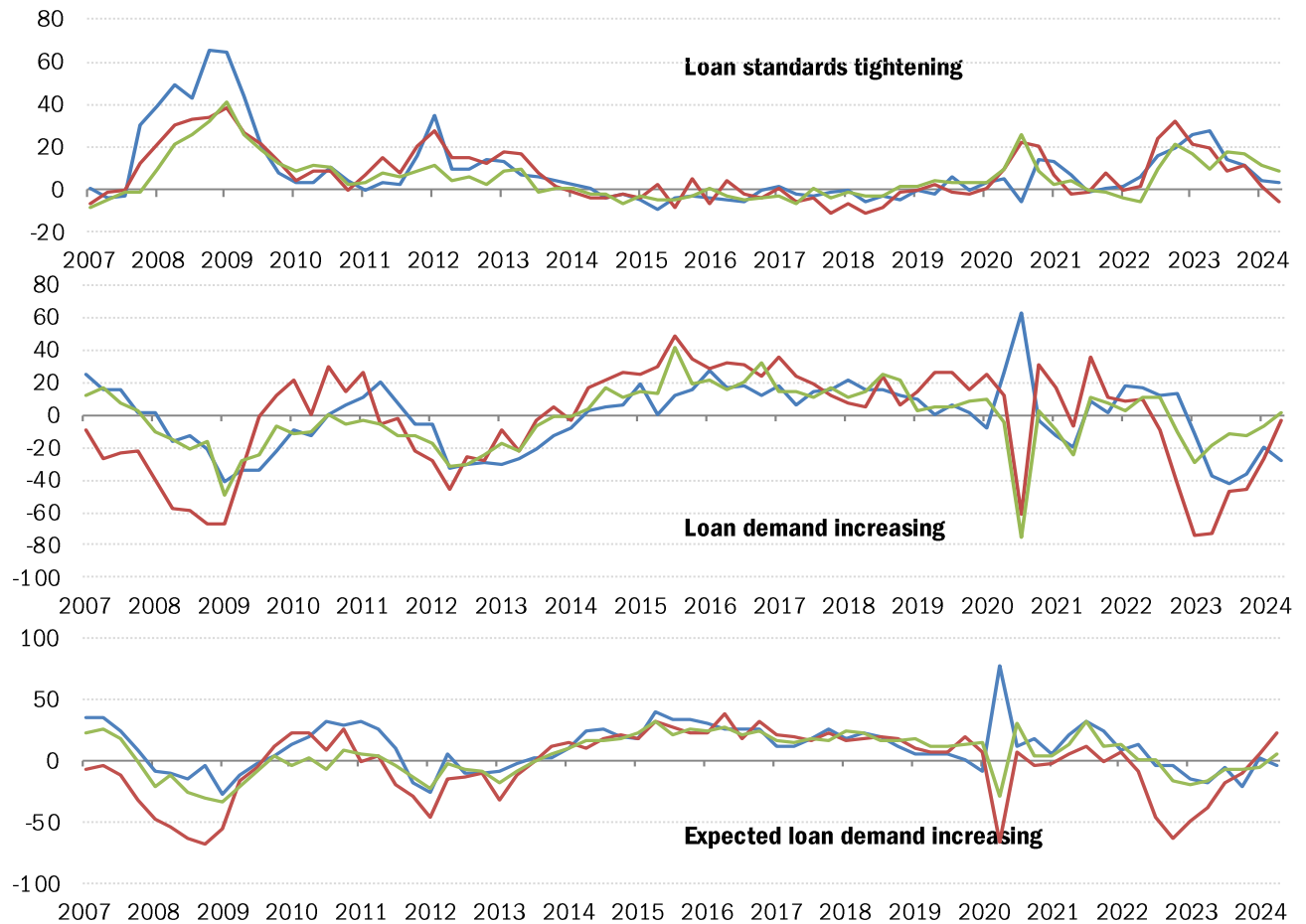
— Loans to 1 year — Loans 1-5 years — Loans 5 years plus ... Total



Source: ECB, TrendMacro calculations

Supply and demand for lending: ECB Bank Survey

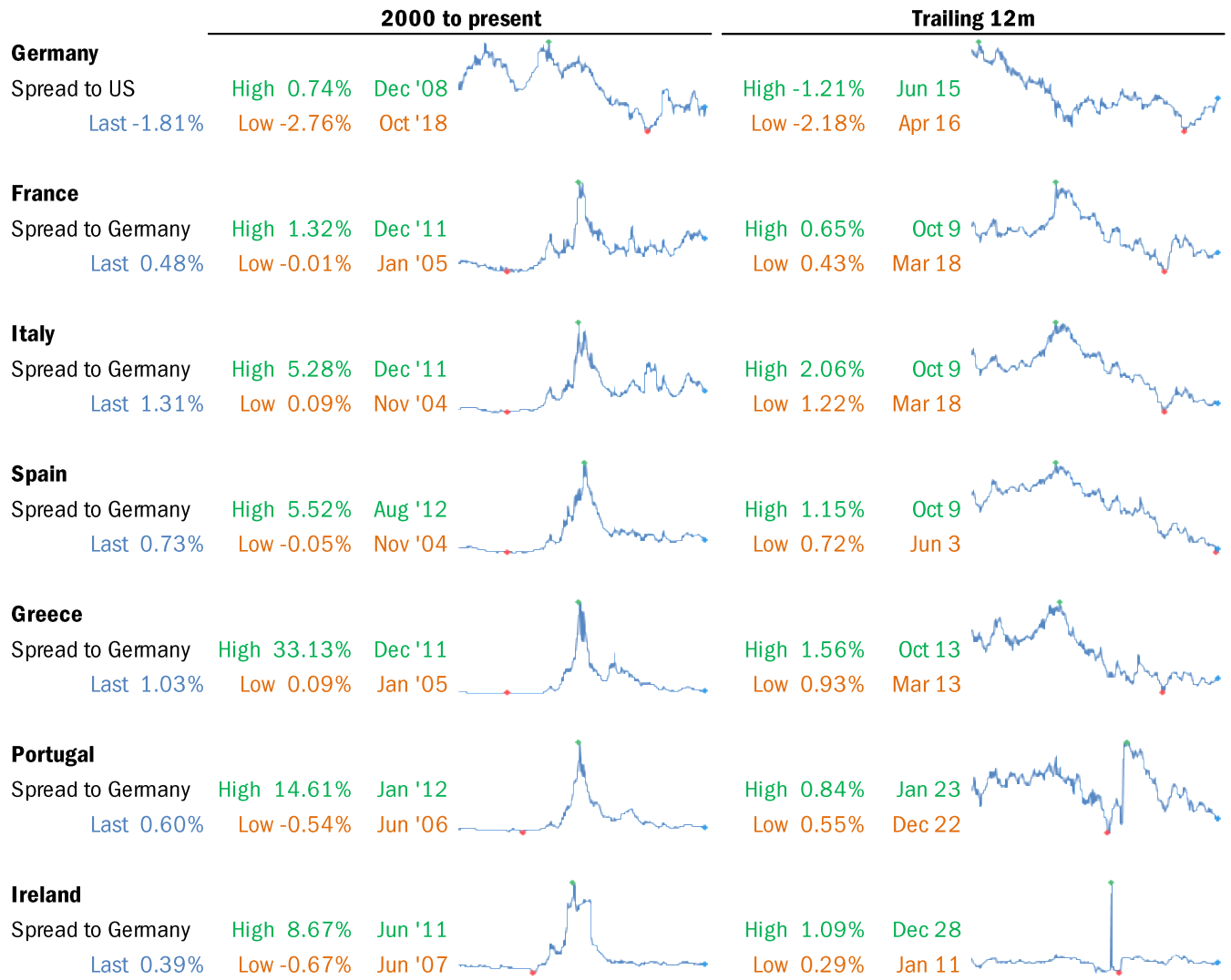
Net number of banks reporting for: — Enterprises — Home mortgage — Consumer



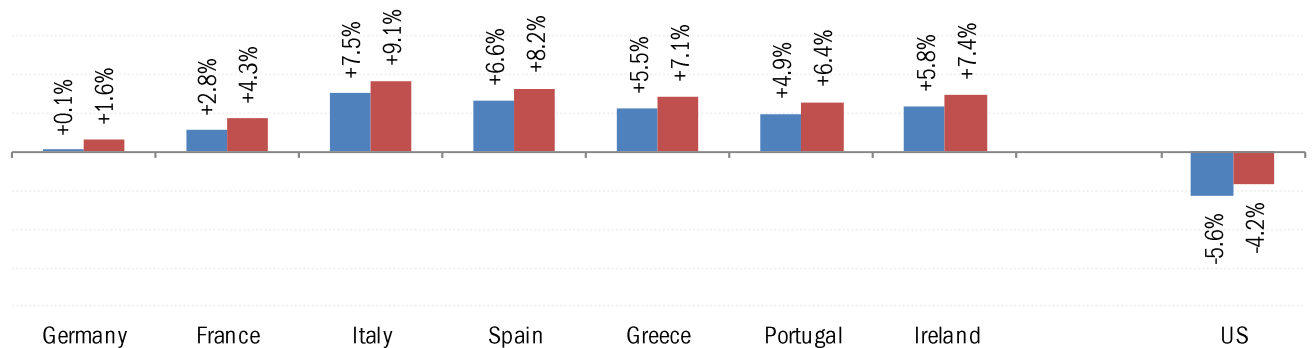
Source: ECB, TrendMacro calculations

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

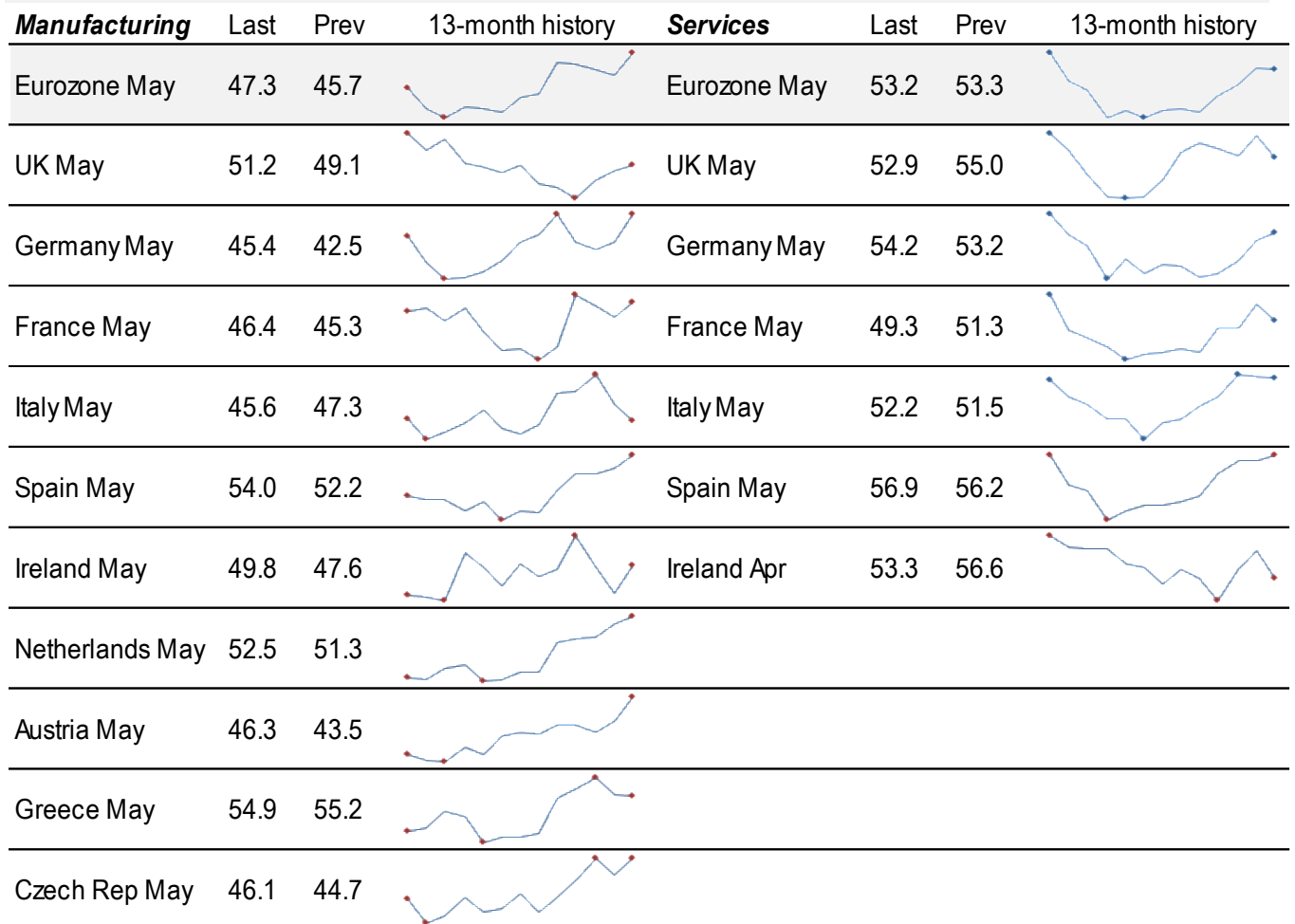
Labor market in intensive care

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

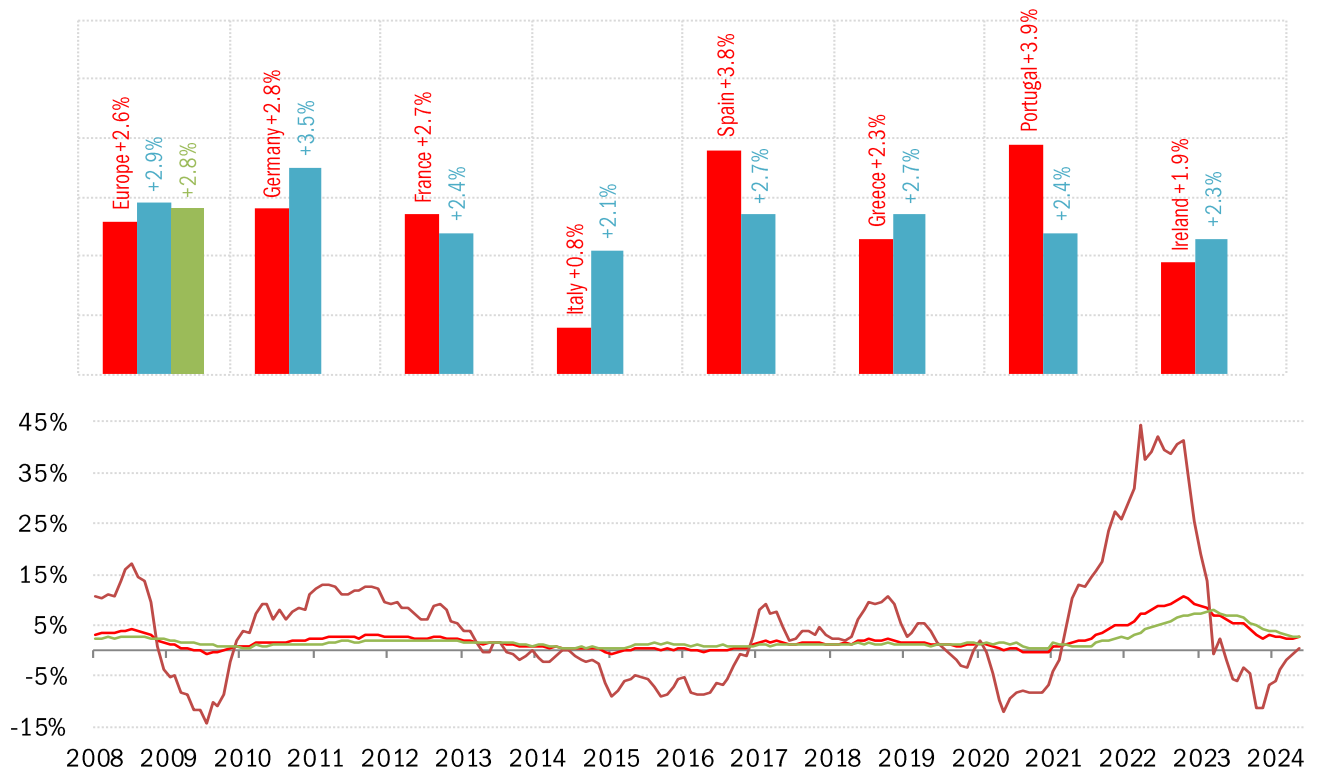
Regional currency flight — Euro vs Swiss franc ■ SNB FX reserves



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