PREVIEW: ECB Policy Announcement due Thursday 14th December 2023

- **ECB policy announcement due Thursday 14th December; rate decision at 13:15GMT/08:15EST, press conference from 13:45GMT/08:45EST**
- **Consensus and market pricing look for no changes to the ECB's three key rates**
- **Focus will be on accompanying projections and how they align with the markets aggressive bets for 2024 rate cuts**

OVERVIEW: Expectations are for the ECB to stand pat on rates for a second consecutive meeting after halting its hiking campaign in October. In terms of recent economic developments, November’s flash CPI fell to 2.4% Y/Y from 2.9%, whilst the super-core metric declined to 3.6% Y/Y from 4.2%. Survey data saw a pick-up in the Eurozone composite PMI for November from 46.5 to 47.6, but ultimately is still suggestive of negative growth in Q4. In terms of communications from ECB officials, great attention has been placed on remarks from Germany’s Schnabel, who noted that further hikes were “rather unlikely” after November inflation data cooled, and declined to endorse guidance for steady rates for several quarters. These remarks have subsequently accelerated pricing for 2024 rate cuts with a March reduction priced with around 60% probability. Signalling for 2024 action may come via the accompanying macro projections, which ING suggests should see downward revisions for growth and inflation in 2024 and 2025. Finally, speculation continues to mount over the Bank’s balance sheet and a potential early conclusion to PEPP reinvestments after Lagarde stated on November 27th that PEPP will be discussed in the “not-so-distant future”. However, many desks are of the view that the December meeting would be too soon for such an adjustment.

PRIOR MEETING: As expected, the ECB opted to call a "pause" in its hike campaign. The Governing Council judged that rates are sufficiently restrictive to return inflation to target and noted that past interest rate increases continue to be transmitted forcefully into financing conditions. On the balance sheet, despite some outside expectations for a potential bringing forward, the ECB reaffirmed that reinvestments under PEPP will run until "at least the end of 2024". At the follow-up press conference, Lagarde revealed that actions were unanimously approved, adding that there was no discussion of an early end to PEPP reinvestments or adjustments to minimum reserves. However, sources via Reuters later noted that policymakers agreed to debate PEPP reinvestment end date in early 2024 and to debate minimum reserves as part of the framework review in the Spring. The sources added that the expectation was that reinvestments would not end abruptly and the ECB would follow the sort of gradual approach it did with the APP. In terms of what lies ahead for the Bank, the President noted that just because policymakers opted for a pause, it does not mean they won't necessarily hike in the future, but did note that the transmission of previous hikes will be felt into Q1 2024 and possibly beyond.

RECENT ECONOMIC DEVELOPMENTS: November’s flash CPI fell to 2.4% from 2.9%, whilst the super-core metric declined to 3.6% from 4.2%; ING highlights that goods and services inflation both fell significantly, to 2.9% and 4% year-on-year, respectively, whilst on a M/M basis core inflation was actually negative. In terms of market gauges of inflation the 5y5y forward has fallen from circa 2.5% at the time of the prior meeting to around 2.3%. On the growth front, Q/Q EZ GDP for Q3 was confirmed at -0.1%, whilst more timely survey data saw a pick-up in the Eurozone composite PMI for November from 46.5 to 47.6 but ultimately is still suggestive of negative growth in Q4. In the labour market, the unemployment rate remains just above its historic low and policymakers continue to eye firm wage growth.

RECENT COMMUNICATIONS: Since the prior meeting, President Lagarde has noted that the Bank has already done a lot on rates and can now observe, albeit it is not the time to declare victory. On the balance sheet, she stated that PEPP will be discussed in the not so distant future and will re-examine the proposal to continue reinvesting until end-2024. Great attention has been placed on remarks from Germany’s Schnabel, who noted that further hikes are "rather unlikely" after November inflation data and declined to endorse guidance for steady rates for several quarters; a view which was also backed by France's Villeroy in the aftermath of the data. These remarks subsequently accelerated pricing for 2024 rate cuts, however, Latvia’s Kazaks has dismissed a March rate cut as “science fiction”. Furthermore, the typically dovish-leaning de Guindos of Spain has cautioned that an increase in wages can still have an important inflationary impact.

RATES/BALANCE SHEET: Expectations are for the ECB to stand pat on rates for a second consecutive meeting after halting its hiking campaign in October. Markets concur with such an outcome priced at circa 94%. Looking beyond the upcoming meeting, remarks from Germany's Schnabel (see above) accelerated pricing for 2024 rate cuts with a March reduction priced at around 60% with circa 140bps of loosening priced in for next year; albeit Latvia’s Kazaks has dismissed a March rate cut as “science fiction”. It is expected that President Lagarde will likely push back on the notion that the ECB is currently thinking about rate cuts. In terms of surveyed expectations for next year, 51/90 economists surveyed by Reuters forecast at least one rate reduction at some point before the July meeting. Note, guidance for the 2024 policy path may come via the accompanying macro projections (see below). Speculation continues to mount over the Bank’s balance sheet and a potential early conclusion to PEPP reinvestments after Lagarde stated on November 27th that PEPP will be discussed in the “not-so-distant future”. Whilst adjustments to PEPP might be discussed at the upcoming meeting, many desks are of the view that December would be too soon for an actual decision by the Bank.

ECONOMIC PROJECTIONS: ING notes that with "the latest developments and the full impact of monetary policy tightening still having to unfold, we expect a downward revision to both the GDP growth and inflation forecasts." The desk also makes the point that softer 2024 and 2025 forecasts are, the higher the market will judge the likelihood of rate cuts next year.

Current forecasts:

HICP INFLATION:

2023: 5.6% 2024: 3.2% 2025: 2.1%

HICP CORE INFLATION (EX-ENERGY & FOOD):

2023: 5.1% 2024: 2.9% 2025: 2.2%

GDP:

2023: 0.7% 2024: 1.0% 2025: 1.5%