

**LBBW**

Bereit für Neues

**To the point!**

Cross-Asset- and Strategy-Research

# ECB's mission accomplished – for now

After the rate cut, the ECB is now on a summer break

Yesterday, the ECB cut its key interest rates for the first time since 2019. The deposit stands now at 3.75%. This was universally anticipated, including by LBBW Research. But what seems like one small step for the ECB – it only reversed one-eighteenth of the cumulative rate hikes since 2022 – is in fact a giant leap for the capital market, as it marks a beginning. From this point, key interest rates are expected to head only in one direction for the foreseeable future: downwards.

## The stubborn beast has not been vanquished yet

Recently, the hope for a swift descent from the interest rate peak was once again unsettled: Many market participants were startled as inflation rose more sharply than expected in May for the first time in 2024 (see figure). It had been foreseeable that the journey on the last mile could become somewhat rugged. Not least because the benign so-called "base effects" have ended.

While price increases for energy and food have largely dissipated, the persistent high price pressure in services (4.1%) is likely causing concern for Christine Lagarde & Co. This can be partly explained by the recently observed acceleration in wage cost increases. Services often require a lot of manpower. Hence, higher labor costs have a significant impact.

## Overreaction in the bond market

The yield on the ten-year federal bond spiked after the inflation news, briefly approaching the 2.7% mark. This is the highest yield seen this year! Such a reaction seems exaggerated. Because over a decade, it hardly makes a difference whether the ECB cuts rates three times this year or maybe just twice. Don't forget: Since the inflation peak of 10.6% in October 2022, more

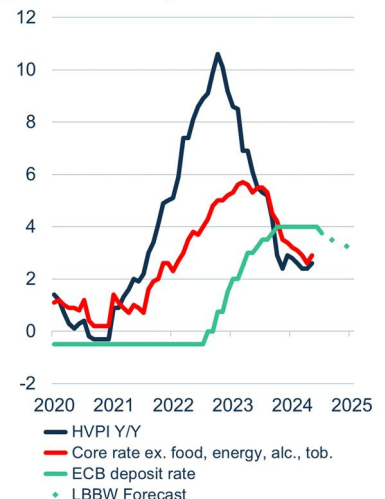
**Moritz Kraemer** -- Chief Economist

LBBWResearch@LBBW.de

June 7, 2024

## Descent from interest rate peak has begun

Euro area: Inflation rates and ECB deposit rate (2020-2024)



Source: Eurostat, ECB, LBBW Research

than 90% of the inflation exceeding the 2% target has already been trimmed. Yes, the last mile is the hardest, but as the long-distance runners among you know: Even with tired legs on the last kilometer, the finish line is within reach. This is encouraging.

Christine is no clairvoyant

The rate cut was the right move. Even with a deposit rate of 3.75%, monetary policy remains tight. At the press conference, Lagarde resisted the temptation to commit to future rate moves. She simply couldn't. To do so, she would need to be able to see the future and already know the inflation trends of the coming months.

The ECB has slightly raised its own inflation forecasts for 2025. However, staff continues to expect that wage growth will slow and that companies will partially absorb the wage cost increases within their margins, rather than passing them on to consumers. This is a plausible scenario. But is just one of several possibilities. Therefore, the ECB is wise to proceed with caution and not rush anything. Further rate cuts in July have been effectively ruled out by numerous members of the central bank council in interviews and speeches. And rightly so.

LBBW Research expects two more rate cuts by the end of the year, in September and then again at the end of the year. This makes us slightly more optimistic than the consensus. But we draw encouragement from the fact that since the rate pivot in the summer of 2022, we have correctly anticipated every single ECB rate move.

Please keep your fingers crossed that this streak continues!

Disclaimer:

This publication is addressed exclusively at recipients in the EU, Switzerland, Liechtenstein and the United Kingdom. This report is not being distributed by LBBW to any person in the United States and LBBW does not intend to solicit any person in the United States.

LBBW is under the supervision of the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany).

This publication is based on generally available sources which we are not able to verify but which we believe to be reliable. Nevertheless, we assume no liability for the accuracy and completeness of this publication. It conveys our non-binding opinion of the market and the products at the time of the editorial deadline, irrespective of any own holdings in these products. This publication does not replace individual advice. It serves only for informational purposes and should not be seen as an offer or request for a purchase or sale. For additional, more timely in-formation on concrete investment options and for individual investment advice, please contact your investment advisor.

**We retain the right to change the opinions expressed herein at any time and without prior notice. Moreover, we retain the right not to update this information or to stop such updates entirely without prior notice.**

Past performance, simulations and forecasts shown or described in this publication do not constitute a reliable indicator of future performance.

The acceptance of provided research services by a securities services company can qualify as a benefit in supervisory law terms. In these cases LBBW assumes that the benefit is intended to improve the quality of the relevant service for the customer of the benefit recipient.

Additional Disclaimer for recipients in the United Kingdom: Authorised and regulated by the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

The 2% target:  
So close  
and yet so far!

Two more rate  
cuts by the  
end of the year