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FLASH REPORT
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ECB Delivers Expected Cut; Next One In September (Most Likely)

- **The ECB surprised no one today with its first rate cut after a five-meeting run of unchanged rates; the deposit facility rate will now sit at 3.75%, down from 4.00%.**
- **Although the ECB feels the time is right to cut and it acknowledges "progress over recent quarters", the bank's statement was taken somewhat hawkishly by markets given worries about wage growth and upward revision to inflation forecasts.**
- **We expect the ECB will have enough information by the September meeting to cut again by 25bps, but it will not know enough by July to cut then; we also continue to forecast a total of 100bps in cuts through 2024.**
- **Lagarde's press conference saw some choppiness in markets, but she held her cards close to her chest. The market reaction was sharp on the statement, with a jump in yields on the 'hawkish cut' but range-bound throughout the presser.**

The ECB surprised no one today with its first rate cut after a five-meeting run of unchanged rates since a final hike last September; the deposit facility rate will now sit at 3.75%, down from 4.00%. The ECB joins the BoC, SNB, and Riksbank in kicking off their respective easing cycles, all of them starting with a 25bps move and all them due to lead the Fed by several months. Inflation has behaved in a good enough manner and the economy remains sluggish, generally requiring a less restrictive stance of monetary policy as had been well teed-up by policymakers ahead of today's decision.

Although the ECB feels the time is right to cut and it acknowledges "progress over recent quarters", the bank's statement was taken somewhat hawkishly by markets as it noted discomfort with elevated wage growth and the pressures it creates on domestic price pressures. The April statement had a more positive twist on wages, saying that "wage growth is gradually moderating, and firms are absorbing part of the rise in labour costs in their profits." No such thing in today's statement, a position that the ECB likely took to counteract the natural dovishness of a cut and that also follows the Q1 uptick in negotiated wage growth.

The higher inflation forecasts (notably 2025 core inflation at 2.2% from 2.1%), despite being relatively small and expected by economists, also weighed on European rates, as did the statement highlighting that "inflation is likely to stay above target well into next year." Overall, there is little to indicate that the majority will support a rate cut at the next decision. The ECB probably wants more inflation data (as well as, e.g., wages leading indicators) than what may be on offer over the six weeks until the next policy announcement.

The June inflation print, June PMIs, and Q1 compensation/unit labour cost (out tomorrow) data—among other lower tier releases—are unlikely to give the ECB enough confidence to cut in July (it would require large undershoots). By the September meeting, we then expect the ECB will have enough information to cut again by 25bps; we also continue to forecast a total of 100bps in cuts through 2024.

Lagarde's press conference saw some choppiness in markets, but she held her cards close to her chest. As she often does, Lagarde reiterated their expectation that wage growth will moderate and that firms are absorbing part of the increase in wages via lower profit margins. Markets were briefly taken by surprise by Lagarde saying that she "wouldn't volunteer" whether the ECB is moving into a 'dialing-back' phase, which could be interpreted as her not thinking that they are clearly in a downtrend for rates (could there be a long pause?), but she followed this by saying "there is a strong likelihood" of having begun this chapter. That was about it in terms of market-relevant or noteworthy comments from Lagarde, a sign of a successful presser (**see Macklem yesterday** for the opposite). She noted that a single member dissented today—Austria's uber-hawk Holzmann according to reports.

The market reaction was sharp on the statement, but range-bound throughout the presser aside from the short-lived chop on the dialing-back phase comments. At the conclusion of Lagarde's presser (cutoff time for market levels here), German 2yr and 10yr yields are up about 3bps versus pre-decision (and a net ~5bps higher vs USTs after some ULC revisions). The EUR is fractionally higher against the USD in the high 1.08s and also barely firmer against the GBP. The market has taken out some in terms of expected cuts by year-end, roughly 4bps less to see a total of ~60bps (today's 25bps inclusive). We think this undershoots what the ECB will deliver, at least 75bps in total.