



## Fixed Income Special

NORD/LB Floor Research

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Marketing communication (see disclaimer on the last pages)

## Table of content

<b>ECB decision: Between interest rate-Scylla and inflation-Charybdis</b>	<b>3</b>
<b>Publication overview</b>	<b>7</b>
<b>Contacts at NORD/LB</b>	<b>8</b>

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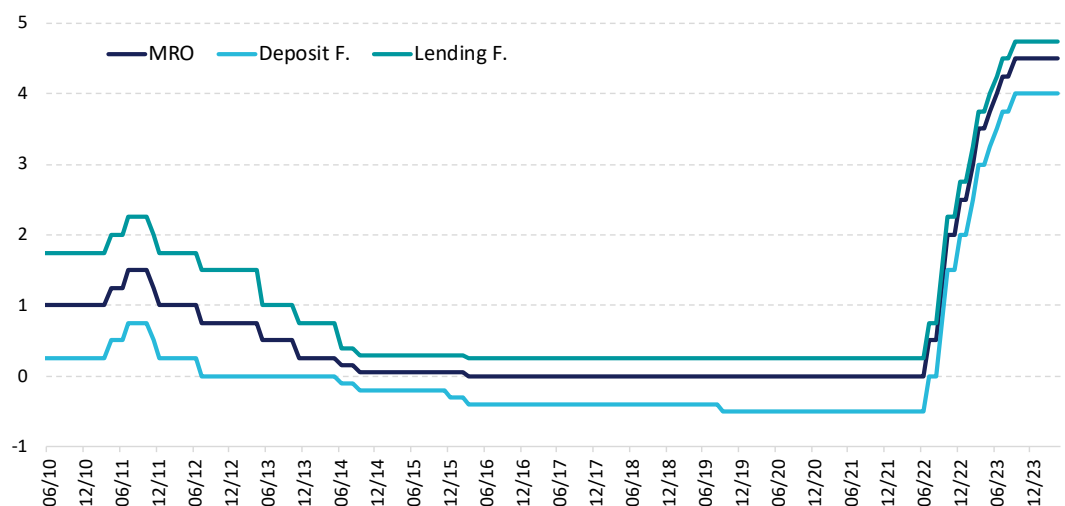
## ECB decision: Between interest rate-Scylla and inflation-Charybdis

Authors: Dr Norman Rudschuck, CIAA // Christian Ilchmann // Lukas-Finn Frese

### ECB key interest rate decision: Countdown for June is on

As expected, the decision-makers at the European Central Bank once again made no adjustments to the three key interest rates today. Accordingly, the interest rate for the main refinancing operations was left unchanged at 4.50%, the interest rates for the marginal lending facility (4.75%) and the deposit facility (4.00%) also remained untouched. The relevant [press release](#) now points out that, in the Council's opinion, key interest rates are at a level that makes a significant contribution to the ongoing decline in inflation. In the statement, the ECB does not reveal whether it will actually act in June. To stay in the image of Greek mythology: the strait of the first three interest rate sessions of 2024 has been navigated. Now it remains to be seen who will have the upper hand in June. We find ourselves between interest rate-Scylla and inflation-Charybdis. This is also how the journalists' critically interested questions were understood. After all, it would be a novelty if the ECB initiated the interest rate cutting cycle before the Fed. In our [ECB preview](#) last week we called it: "The early bird catches the worm?" This describes the fact that (premature) interest rate cuts by the ECB would make the US interest rate market appear even more attractive. This in turn would redirect capital flows to the USA and (negatively) influence the exchange rate.

### ECB key interest rates (in %; incl. current interest rate decision)



Source: ECB, Bloomberg, NORD/LB Floor Research

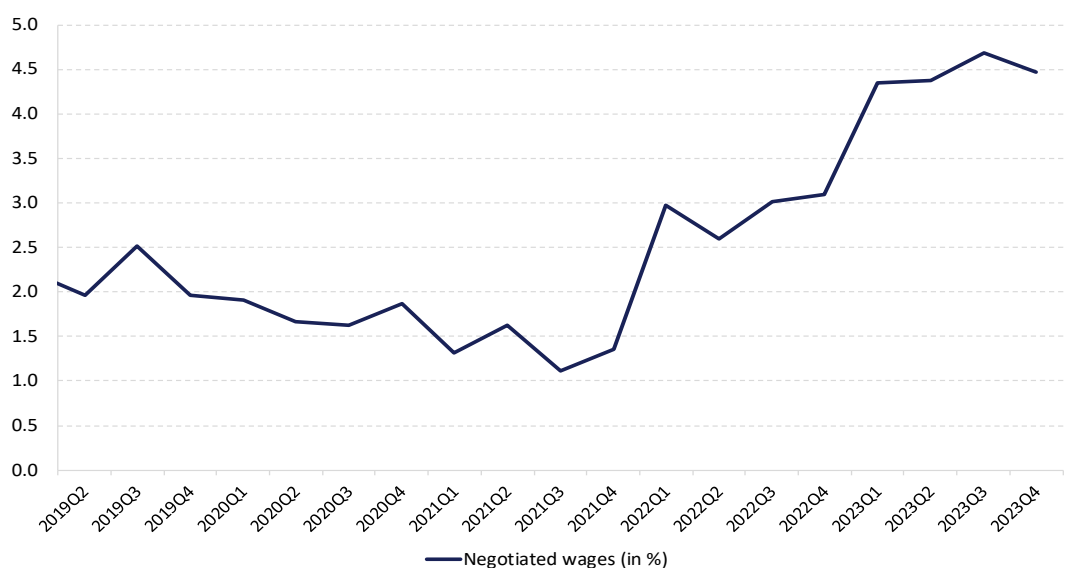
### Changed ECB statement: A dream of buzz words for economists

Inflation continued to decline, mainly due to weaker food and goods price increases. There is an easing in most metrics, wage growth is gradually weakening and companies are absorbing some of the rising labor costs through their profits. However, due to strong domestic price pressure, inflation for services remains high. Should its updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission further strengthen the Governing Council's confidence that inflation is moving towards its target value of 2% in the medium term on a sustained basis, an easing of the current monetary policy tightening would be appropriate.

### Wage growth is gradually weakening

The development of wages in the Eurozone is traditionally a critical indicator in the ECB's decision-making process. In the past, interest rate cut scenarios have always pointed out that they are highly dependent on wage growth. As current data from the ECB on the development of negotiated wages shows, growth fell slightly in Q4/2023 to a value of 4.5% (Q3/2023: 4.7%). At the end of March, the Italian newcomer Piero Cipollone, who was appointed a member of the six-member ECB Governing Council with effect from 01 November 2023 and is therefore a voting member of the Council, expressed optimism about the medium-term wage development in the Eurozone: "Wage growth appears on track to gradually moderate in the medium term towards levels that are consistent with our inflation target and productivity growth, in line with the projections." At the same time, however, he warned against an overly rigid focus on wage developments in the short term. The [minutes of the March meeting](#) published on 04 April also indicate this and underline that the wage data available in June for the first quarter of 2024 will continue to play a decisive role for the ECB Council. In addition, it was expressly noted that data on wage developments available at the April meeting were too "limited" to provide sufficient confidence about the sustainability of the disinflationary process. The fact that the ECB will also have new staff projections, data on GDP growth and the results of the Bank Lending Survey available for evaluation at the June meeting already hinted at the monetary authorities' wait-and-see attitude in advance, which was confirmed at today's meeting. According to ECB chief economist Philip R. Lane, it is "desirable and inevitable" that the currency area is characterized by wage increases above "normal levels". However, the data in this regard is currently not (yet) compatible with the inflation target of 2%. Upcoming collective tariff agreements also harbor the potential for uncertainty. The focus continues to be on the June meeting.

### Development of negotiated wages in the Eurozone (in %)



Source: ECB, NORD/LB Floor Research

### Maybe this is all presumptuous?!

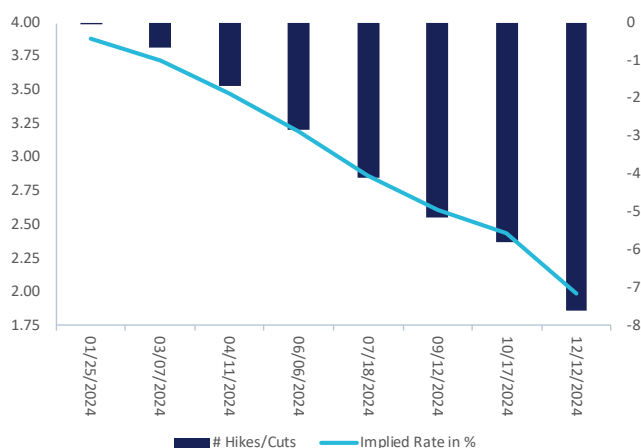
The development of inflation will obviously be of decisive importance as to whether we see two interest rate cuts in the summer or not. As so often in the past, Christine Lagarde once again tried to distinguish between “HICP inflation” and “core inflation”, i.e. excluding prices for energy and food. Now that energy prices have somewhat normalized, trouble threatens from another direction: The ECB should and will pay attention to the change in service prices, which means that they make up around 45% of the HICP's basket of goods. While HICP growth has declined steadily from its peak (11.5% Y/Y) in October 2022 and was just shy of the magic ECB inflation target of 2% in February. The price index for services continued to rise until August 2023 (6.4% Y/Y). Since then, the growth rate of the latter has consistently exceeded that of the consumer price index. The inflation screw continues to turn. Care is also required on the real estate market: When the ECB reached its peak in interest rates last year, it caused a significant deterioration in financing conditions for real estate. With the key interest rate, loan interest rates for real estate financing also rose from 1% to a peak of up to 4.2%. The average value has now fallen back to 3.6%, but is still more than three times as high as two years ago. Such an increase in interest rates obviously means additional costs, which increase the costs of financing a home by an average of around 40%. This resulted in a decline in demand on the real estate market, which in turn led to falling prices. According to relevant studies, these fell by an average of around 10% nationwide in Germany last year alone. In the meantime, a trend reversal is becoming apparent: in the first quarter of this year, house prices rose in 14 of the 15 largest German cities. The reason for the price increase is once again the ECB's interest rate policy. If rising interest rates were responsible for falling prices, now it is the prospect of falling interest rates. These are also passed on to the loan market for real estate financing. When financing becomes cheaper again, demand increases and so do prices.

### Growth rates of HICP versus Services Price Index

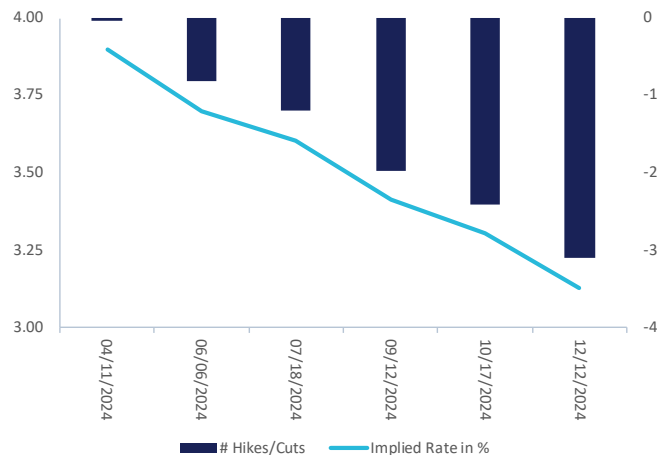


Source: Eurostat, NORD/LB Floor Research

Implied Overnight Rate 12/27/2023



Implied Overnight Rate 04/11/2024



Source: Bloomberg, NORD/LB Floor Research

### Conclusion and outlook

The ECB Governing Council must feel these days like a brave sailor from ancient times who wanted to pass through the Strait of Messina: On the one hand, Scylla with six heads and a triple row of fangs, symbolizing the ongoing danger that the “monster” inflation is woken up again by sharply rising service and real estate prices. On the other hand, Charybdis, whose pull could cause real wages to continue to rise in the future, even though, according to Lagarde, the tension in the labor market continues to decrease (in the form of fewer vacancies, but not in high unemployment). This should help reduce concerns about excessive wage pressure. However, collective tariff agreements for at least 12 million employees in Germany will expire in 2024. If we look at the delicate growth of the economy, we see structural limitations on the supply side – e.g. the lack of qualified or even unskilled workers, capacity bottlenecks due to underinvestment or dependencies on energy and raw materials. These pose the risk that a recovery in economic activity will in turn lead to disproportionately higher inflation. In summary, Christine Lagarde tried to appease: The ECB would have “a lot more data” in June as well as a new round of economic forecasts. As expected, no forward guidance again, in difficult times again: “We will look at all this information” she said. As a forecast, we stick to our opinion that there is a certain probability of an interest rate cut in June. However, the majority of activity will shift to the second half of the year and we expect small and slow steps. In concrete terms, this means that we expect steps of 25 basis points and that these will not take place at every upcoming meeting in the second half of the year. The first interest rate cut could well take place on 06 June. The chances of “only” three interest rate cuts in total by the end of the year have increased again in the last few days.

## Appendix

### Publication overview

#### Covered Bonds:

[Issuer Guide – Covered Bonds 2023](#)

[Covered Bond Laws](#)

[Covered Bond Directive: Impact on risk weights and LCR levels](#)

[Risk weights and LCR levels of covered bonds](#) (updated semi-annually)

[Transparency requirements §28 PfandBG Q4/2023](#) (quarterly update)

[Transparency requirements §28 PfandBG Q4/2023 Sparkassen](#) (quarterly update)

#### SSA/Public Issuers:

[Issuer Guide – German Laender 2023](#)

[Issuer Guide – German Agencies 2023](#)

[Issuer Guide – Canadian Provinces & Territories 2024](#)

[Issuer Guide – European Supranationals 2023](#)

[Issuer Guide – French Agencies 2023](#)

[Issuer Guide – Dutch Agencies 2023](#)

[Issuer Guide – Non-European Supranationals \(MDBs\) 2024](#)

[Beyond Bundeslaender: Belgium](#)

[Beyond Bundeslaender: Greater Paris \(IDF/VDP\)](#)

[Beyond Bundeslaender: Spanish regions](#)

#### Fixed Income Specials:

[ESG-Update 2023](#)

[ECB preview: The early bird catches the worm?](#)

## Appendix

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