
# Liquidity letter

n° 106 I 30 M a y 2024

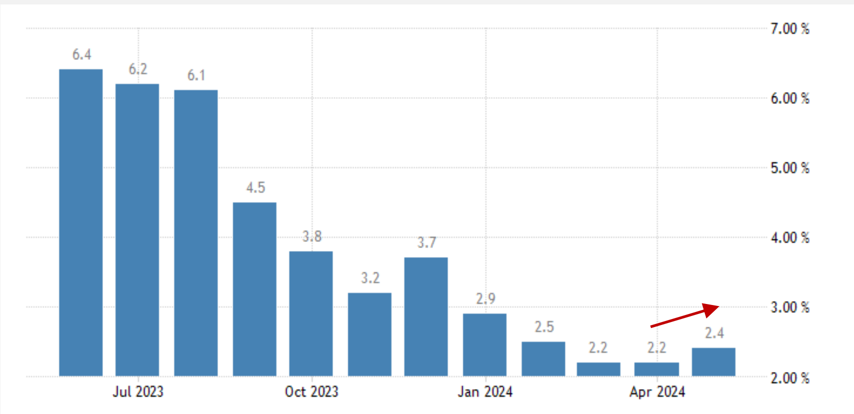
# The start of the descent

## ECB set to cut interest rates next week

### What happens next remains uncertain.

- Barring any unforeseen events, **the ECB** will decide next week to start cutting interest rates, after holding them at record levels for some 9 months. While this decision now seems certain, greater uncertainty remains as to the decisions that will follow, which will depend on the data available, not to mention the decisions that will be taken by the FED.
- **Inflation Inflation** data for the end of May - estimates will be published on Friday 31st - are expected to rise slightly (2.5% vs. 2.4%), in line with the data already published by Germany and Spain, among others, but should not cause the ECB to change its mind.
- **Schnabel** The German member of the ECB's Executive Board has said that the quantitative easing sought by the ECB may have mitigated the impact of interest rate rises, by keeping the cost of borrowing on the debt market under control.
- **FED On the** US side, there is still no desire to cut rates. According to some Fed members, we should even consider raising them if inflation does not continue to fall. According to the markets, the first rate cut is expected in the final quarter of the year.

## Inflation in Germany




Source: Destatis 29/05/24

Germany's annual inflation recorded its first rise of 2024 in May, in line with economists' estimates.
According to preliminary data published by the Federal Statistics Office (Destatis) on Wednesday, the consumer price index rose by **2.4%** in May 2024 compared with a year earlier, up from 2.2% in April and in line with the expected rise of 2.4%.

## Number of the week

**2,4%**

This is the level of inflation in Germany at the end of May, up on the 2.2% recorded in April.

## Philip Lane

« **Barring any major surprises, there is enough in what we are seeing to lift the highest level of restriction**
Managing the war and the energy problem has cost Europe dearly, but this first step [the start of the rate cut] is a sign that monetary policy has succeeded in bringing inflation down in time. In that sense, I think we have succeeded.

ECB members had to keep rates in restrictive territory this year to ensure that inflation continued to ease and didn't get stuck above target, which would be very problematic and probably quite painful to get rid of.

However, the pace at which the ECB lowers borrowing costs this year will be determined by assessing the data to decide whether it is proportionate, whether it is safe, within the restrictive zone, to go down".

## ECB: Schnabel: QE may have lessened the impact of the rate hike

The ECB's massive QE bond purchases in recent years may have mitigated the impact of subsequent interest rate rises by keeping borrowing costs under control on the debt market. This is what **Isabel Schnabel**, member of the ECB's Executive Board, said.

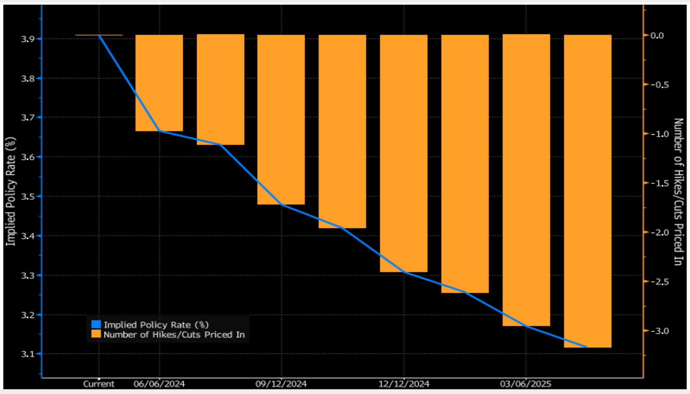
Between 2015 and 2022, the ECB bought over €5 trillion worth of bonds to stimulate inflation, which was too low at the time, before suspending further purchases when prices began to rise rapidly after Russia invaded Ukraine.
The ECB is now letting the bonds in its portfolio mature without reinvesting the principal, but according to Mr Schnabel, the huge amount of debt still on the Eurosystem's balance sheets could still interfere with its fight against inflation.

"Risk premiums could remain compressed in many market segments, making financial conditions more accommodative than they otherwise would be. This may have weakened the transmission of monetary policy during the last tightening cycle".

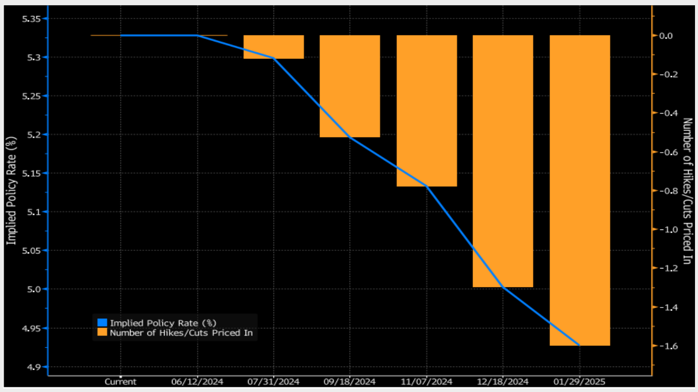
*There are enough elements in what we see to lift the highest level of restriction*

*Philip Lane, Chief Economist ECB*

**ECB**




**FED**




Source: Bloomberg 30/05/24

We are a week away from the next **ECB** meeting, where President Christine Lagarde will almost certainly announce the central bank's first rate cut 9 months after the last increase.

Data on inflation in the eurozone at the end of May point to a slight rise (2.5% compared with 2.4% in April), but this is unlikely to be enough to change the Frankfurt-based institution's mind.

The markets are anticipating three rate cuts by the ECB between now and June 2025, although uncertainty remains over what the Fed will decide to do.

On the US side, according to expert forecasts, **Fed** rate cuts will be delayed. To be sure of a first rate cut, we will have to wait until the December meeting.

A first cut in September is cited as a possibility by 50% of respondents, and in November by 80%. In total, the markets expect only one cut between now and January 2025.

These expectations reflect the positions of some central bankers who, while showing no hurry to cut rates, are not closing the door on a further rise.

Neel Kashkari, FED Minneapolis

### N. Kashkari: progress on US inflation needed before rate cuts

The US Federal Reserve should wait to see "significant progress" on inflation before cutting interest rates.
This is what **Neel Kashkari**, President of the Minneapolis Fed, told CNBC. According to Mr Kashkari, the Fed could even raise rates if inflation does not continue to fall.
"I don't think we should rule anything out at this stage« , he said.
However, the Minneapolis Fed President expressed confidence in the Fed's ability to reach the 2% target, "but I don't see the need to rush into cutting rates. We need to take our time and get it right.

## Spanish inflation accelerates further

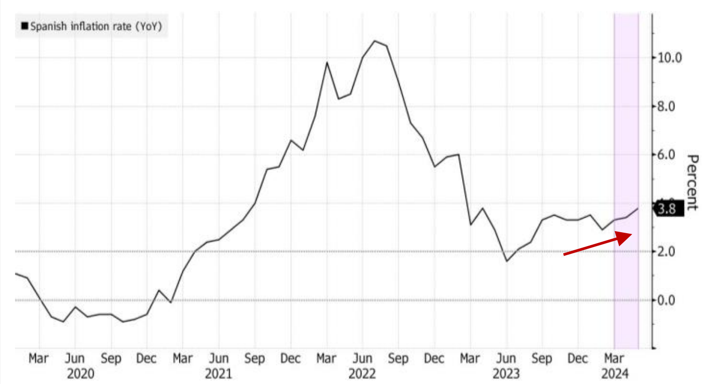
**The consumer price index rose by 3.6%** in May.

The provisional data published this Thursday by the National Statistics Institute (INE) show a further rise in inflation in **Spain**, the **third in a row**, which is 0.3% higher than in April, once again affected by the base effect of the comparison. Core inflation also rose by a tenth of a point to 3%, but remains below the general index.

The increase in May leaves the level of inflation at its highest level since April 2023 and is mainly due to the fact that electricity prices, now without the VAT rebate, have increased compared to the fall recorded in the same month in 2023, and to the smaller fall in fuel prices.

In terms of **core inflation** (which does not take into account unprocessed food or energy products due to their volatility), the rise was influenced by the increase in prices of tourism-related services.

### Inflation in Spain




Source: INE /Bloomberg 30/05/24

*According to the Minister for the Economy, Carlos Cuerpo,"inflation has remained stable in recent months, which has improved the purchasing power of families, who have already returned to their pre-pandemic level, while maintaining the competitiveness of Spanish companies. This situation is occurring against a backdrop of growth in the Spanish economy, which is above the eurozone average".*

## News

**Japan |** Core inflation falls to 1.8% on a reported basis per annum. It was 2.2% the previous month

**US |** Publication of the FED's Beige Book

## Agenda

**5 June** I Bank of Canada decision on interest rates

**6 June** I Central Bank decision European interest rates