

## ECB preview

### The tail tries to wag the dog

- Economy is in a (mild) recession, inflation below the ECB expectations.
- The ECB will probably lower inflation forecasts but is likely to push back against market expectations of imminent and rapid rate cuts

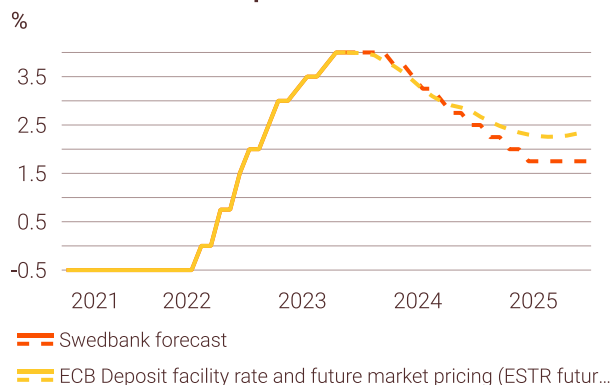
Economic activity remained subdued in November – both services and manufacturing PMIs have recovered somewhat but remained well below 50, indicating that the euro area economy is stagnating at best. Price pressures continued ebbing rapidly – in November headline inflation dropped to 2.4% while core inflation eased to 3.6%. This was below ECB's and market expectations but in line our long-standing view, that disinflation will be more rapid than expected. Our view is supported not only by substantial retreat of energy and most commodity prices, but also by continued weakness in demand. Given that profit margins in many sectors have increased in 2022, there is room for them to adjust downwards and create additional disinflationary pressure (even while the wage growth remains above trend). Thus, we expect that next week the ECB staff will revise its 2024 inflation and GDP projections downwards.

No monetary policy changes are expected during next week's Governing Council meeting, all eyes will be on changes in macroeconomic projections and verbal forward guidance. Market expectations have caught up with our forecast, but ECB is still likely be on a defensive and will probably send a somewhat hawkish message. Nevertheless, we see headline inflation falling to 2% over the next several months which will open the door to rate cuts. We maintain our forecast that the ECB will start cutting rates in April and will lower them 6 times in 2024, leaving deposit rate at 2.5% at the end of next year.

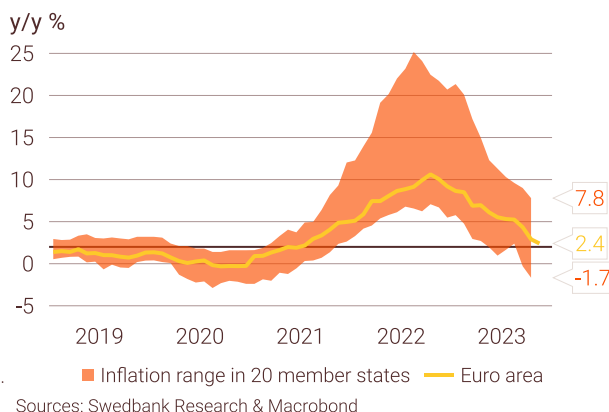
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#### ECB rate market expectations and forecasts



#### Headline inflation



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