Paris, 14 December 2023

EcoBrief

Eurozone: for the ECB, time for relaxation has not come yet

While the latest meeting of the US Federal Reserve reinforced the idea, from the markets' point of view, of a monetary pivot across the Atlantic in 2024, the tone adopted during the ECB's meeting on Thursday 14 December was cautious. The decision to keep policy rates at their current levels – at 4.0% for the deposit facility rate – was widely expected. The key development is the ECB's decision to accelerate the decline of its balance sheet by starting, in the second half of 2024, to reduce its PEPP portfolio by EUR 7.5 billion per month on average, before discontinuing reinvestments under this programme at the end of 2024. No changes were previously expected until "*at least the end of 2024*".

The ECB's latest macroeconomic projections show fairly marginal downward revisions to inflation (headline and core) and economic growth for both 2023 and 2024, compared to the September forecast. With real GDP growth now foreseen at 0.6% on average this year and 0.8% next year, the ECB's projections are slightly higher than ours, currently at 0.5% and 0.6% respectively.

What stands out most from these forecasts is the very gradual return to the 2% inflation target, not to occur before the second half of 2025, which is a much slower phase of disinflation than we anticipate. In any case, wage developments will remain a key factor in the decline in inflation over the medium term, assuming that commodity and food prices stabilise. More specifically, it is the evolution of unit labour costs in the euro area that will be scrutinised. The increase amplified in the third quarter – from 6.3% y/y to 6.5% – driven by both a rise in hourly compensations (+5.2% y/y) and the decline in hourly productivity (-1.2% y/y). The ECB only expects unit labour costs to slow to 2.0% in 2026. With a view to a sustained return of inflation to the 2% target, wage developments will obviously be an important factor, but the restoration of more significant productivity gains will also be a crucial issue.

Guillaume Derrien
Senior Economist, Eurozone – UK
guillaume.a.derrien@bnpparibas.com