
Weekly Market Flash

ECB, Alone

June 7, 2024

We don't often think of Europe as leading the way when it comes to the doings of the global economy, but this week the European Central Bank made the first decisive move in the transition away from monetary tightening. The ECB lowered its benchmark deposit rate by 0.25 percent to 3.75 percent, its first rate cut in five years. With neither the Fed nor the Bank of England likely to be moving off their peak rates in the near future, the ECB is for now alone among the major central banks. There are questions, though, as to whether this is the beginning of a trend or a one-off.

A Hawkish Cut

The rate cut was not a surprise; ECB head Christine Lagarde and her colleagues have been telegraphing it for most of the time since the bank's previous meeting earlier this spring. As for what comes next, Lagarde et al were fairly circumspect and tight-lipped. German Bundesbank head Joachim Nagel cautioned that the ECB is "not driving on autopilot" when it comes to future rate cuts. Nagel and other typically conservative national bank chiefs, including those from Latvia and Estonia, warned that the fight against inflation, though largely on the right track, is not over. Recent strength in the Eurozone economy, including a higher than expected growth rate in hourly wages published today, suggests the lack of a pressing need to start cutting rates aggressively. The ECB's own forecast for inflation in 2024 ticked up to 2.8 percent from 2.7 percent. Prior to Thursday's meeting, futures markets had put a 70 percent probability on a second rate cut happening before September; that likelihood now stands at 56 percent.

Growth On The Margins

Is the European economy all that strong, though? Among the data points trickling out this morning is a weaker than expected figure for industrial production in Germany, the EU's largest national economy, which came in at minus 0.1 percent. Recently the Eurozone has been teetering on the edge between growth and recession, picking up slightly in the first quarter of this year after being negative for the fourth quarter of 2023. Nothing much has changed in the core economic model of the region, which remains heavily dependent on manufacturing and exports. High-value goods exporters like Germany have been hurt by ongoing weakness in China, one of its main export destinations. In key global growth sectors like artificial intelligence and cloud computing, Europe remains well behind the US as well as Asian economies including China, Taiwan and South Korea. One of the key reasons for the chronic underperformance of European equities – a theme we have covered extensively in our commentaries – is the relative absence of business leaders in these high-growth sectors.

Over To You, Jay

Next up is the Fed. The Federal Open Market Committee meets next week and we will have the full buffet of post-meeting statement, press conference and the always popular "dot plots" next Wednesday. There is not likely to be much drama here, as the chances of a rate cut from the Fed are vanishingly close to zero. While there are ample signs of a consumer spending slowdown, as we have noted in some of our recent commentaries, there are countervailing data points as well. The BLS jobs report that came out this morning showed 272,000 payroll gains, a much higher than expected job growth figure (the unemployment rate notched up ever so slightly to 4.0 percent, but that arguably has more to do with a

greater number of people actively seeking jobs than with a meaningful reversal of strength in the labor market). There is a growing chorus of economists arguing for action on rate cuts sooner rather than later, so as to ensure that a soft landing doesn't turn into negative growth. For now, though, the Fed is unlikely to signal a divergence from the recent mantra of "higher for longer." Thursday's ECB rate cut may well turn out to be the only one of its kind until summer winds down.

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