EUROPEAN CENTRAL BANK
EUROSYSTEM

Meeting of 10-11 April 2024

Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 10-11 April 2024

10 May 2024

1. Review of financial, economic and monetary developments and policy options

Financial market developments

Ms Schnabel noted that since the Governing Council's previous monetary policy meeting on 6-7 March 2024 financial markets had started to price in some divergence between the monetary policy paths expected in the euro area and in the United States. This was reflected in a widening interest rate differential. In the United States, a series of solid economic data releases had signalled the US economy's resilience to the current levels of interest rates. This had led financial markets to expect the timing of a first interest rate cut to be later and the overall extent of monetary policy easing to be less than previously anticipated.

In the euro area, by contrast, expectations regarding the path of the ECB's monetary policy had changed to a lesser extent. Owing to the Governing Council's communication and incoming euro area economic data, spillovers of US rate expectations to the short end of the euro area yield curve had remained contained. Investors saw almost no chance of a rate cut at the present meeting, but had fully priced in a rate cut for June, followed by another two rate cuts later in the year. This was in line with evidence from the April round of the Survey of Monetary Analysts (SMA).

The increasing divergence between expected developments in euro area and US short-term interest rates had been mirrored in a visible divergence between longer-term interest rates in the two economies. Euro area longer-term overnight index swap (OIS) rates had increased only modestly since the Governing Council's previous monetary policy meeting on 6-7 March 2024, while OIS rates in the United States had increased notably over the same period. The increase in the United States reflected a rise in both the real interest rate and inflation compensation. This had not spilled over to the euro area, which pointed to a degree of decoupling of the longer end of the yield curve. An unprecedented combination of macroeconomic and monetary policy shocks common to both economies had driven the co-movement of US and euro area interest rates in 2022 and 2023 to the closest level seen since the global financial crisis. Since the start of 2024 the extent of the co-movement had diminished, as both macroeconomic developments and the outlook for monetary policy had become less synchronised across the two economies. The resulting widening of the yield differential since the Governing Council's monetary policy meeting in March had been accompanied by a slight depreciation of the euro exchange rate vis-à-vis the US dollar.

While recent ECB communication had cemented expectations of the timing of the initial cut in policy interest rates, the uncertainty around the subsequent policy path remained elevated. Volatility in euro area interest rate markets remained markedly elevated compared with the period before the ECB began to hike rates. By contrast, the benign macroeconomic developments in the global economy – especially in the United States – and reduced downside tail risks to economic growth had gone hand in hand with very low volatility in risk asset markets. Measures of implied volatility in euro area and US equity markets had returned to pre-pandemic levels.

One source of still elevated uncertainty about the path of the ECB's monetary policy was that, based on options pricing, investors continued to assess risks to the euro area inflation outlook to be tilted to the upside despite the ongoing disinflation process. Among the drivers of these perceived upside risks to the inflation outlook, food prices had increased sharply over recent weeks, in part owing to extreme weather events related to climate change and the El Niño phenomenon. Brent crude oil prices had risen above USD 90 per barrel on fears of rising tensions in the Middle East.

Risk asset markets remained resilient to monetary policy uncertainty. The benchmark EURO STOXX index had increased further since the March monetary policy meeting, but the latest equity valuations continued to stand close to the historical median in the euro area. The rally in euro area equity markets since the start of the year had mainly been driven by large, internationally active euro area firms. Small and medium-sized companies, which were likely to be more dependent on domestic markets, had benefited less from the global risk-on environment. Given stretched market valuations in some segments, especially in the United States, the risk of a market correction had increased.

The combination of buoyant global risk asset markets with resilient growth and low market volatility had also continued to support euro area sovereign spreads vis-à-vis OIS rates. Despite a recent small uptick, spreads had remained at compressed levels, notwithstanding higher debt servicing costs and a recent deterioration in the fiscal outlook in several euro area economies.

As regards bank funding, markets were functioning well and liquidity was being redistributed smoothly in the banking system as excess liquidity declined. The recent repayments in March 2024 of funds borrowed in the seventh operation of the third series of targeted longer-term refinancing operations (TLTROs) had led to a further drop in euro area excess liquidity, which had declined by 31% – falling by €1.5 trillion from its peak of €4.7 trillion in November 2022. The increase in the take-up of funds in standard refinancing operations relative to the size of repayments in March had been very limited and was comparable to levels seen at the time of earlier TLTRO repayments. Banks had adapted to lower central bank funding by increasing their funding from other sources, including repo borrowing, amid significantly increased activity in secured money markets. Another important funding source had been new bank bond issuance. In particular, covered bond issuance had picked up markedly in 2022 and 2023, reversing developments seen over the previous two years.

Overall, it was encouraging that bond and money markets were functioning smoothly with signs of reduced fragmentation risks. Developments in bank funding markets would continue to be closely monitored, in line with the Governing Council's decisions in the context of the operational framework review.

The global environment and economic and monetary developments in the euro area

Starting with the global economy, Mr Lane reviewed the incoming information, which pointed to a modest pick-up in global activity in the first quarter. Global trade was expected to recover gradually during the year as the economic recovery proceeded, expenditure patterns gradually rebalanced from services back to goods, and the inventory cycle normalised. However, the tensions in the Red Sea area remained a downside risk to trade.

The euro exchange rate had remained broadly stable since the March monetary policy meeting, both against the US dollar and in nominal effective terms. There had been a clear jump in oil prices since the March meeting, with Brent crude oil increasing by 4.7%, to USD 92.8 per barrel. The price futures curve implied a partial retracement of the latest increases over the coming months. European natural gas prices had increased by 6.9% since the March meeting, but still stood a lot lower than at the time of the December 2023 meeting. Metal prices had increased somewhat. Food commodity prices had increased substantially since the March meeting, driven mainly by rising cocoa prices.

Turning to the euro area, Mr Lane highlighted that headline inflation, as measured by the Harmonised Index of Consumer Prices (HICP), had been improving gradually over the past few months and had declined to 2.4% in March, from 2.6% in February. Energy inflation had risen to -1.8% in March, from -3.7% in the previous month, mainly owing to an upward base effect and the reversal of some fiscal support measures. Food inflation had weakened further to 2.7% in March, from 3.9% in February, with processed food inflation continuing to decline and unprocessed food inflation turning negative. Core inflation (i.e. the HICP excluding energy and food) had decreased to 2.9% in March, from 3.1% in February. The non-energy industrial goods inflation rate had again decelerated, to 1.1% in March, from 1.6% in the previous month. Services inflation had remained unchanged at 4.0% in March, owing in part to the early timing of Easter. Many observers had noticed that the momentum of inflation had picked up again, which was visible across the different components – but it was important to note that this was taken into account in the March 2024 ECB staff macroeconomic projections.

Focusing on services, inflation had come down from 5.6% at the peak last summer to 4% in March. A large part of that reduction had been due to the pandemic reopening effects fading away, particularly in "contact-intensive" services such as tourism, accommodation and restaurants. There was a tight correlation between wages and the inflation rate in wage-sensitive sectors, which explained why a material drop in services inflation would not be seen until 2025, in line with the projected deceleration in wages in 2025 compared with 2024.

Most measures of underlying inflation had declined further in February, confirming the picture of gradually diminishing price pressures. The impact of past adverse supply shocks was continuing to fade and tight monetary policy still weighed on demand. At the lower end of the range of measures, the indicators based on the Persistent and Common Component of Inflation (PCCI) had edged higher but remained close to 2%. The annual rate of domestic inflation was unchanged at 4.5%.

Wage pressures were gradually moderating but remained elevated compared with a steady-state benchmark. Annual growth in compensation per employee had decelerated to 4.6% in the fourth quarter of 2023, from 5.1% in the third quarter. This outcome was 0.2 percentage points below the March ECB staff projections. Growth in compensation per hour had also slowed, falling in annual terms to 4.4% in the fourth quarter of 2023 from 5.0% in the third quarter. The wages and salaries component of the labour cost indicator had decreased to 3.3% in the fourth quarter, from 5.1% in the third quarter. Annual unit labour cost growth had fallen to 5.8% in the fourth quarter, from 6.5% in the previous quarter, but remained high, in part reflecting weak productivity growth. Negotiated wage growth, including one-off payments, had declined from 4.7% in the third quarter of 2023 to 4.5% in the fourth quarter. The ECB's forward-looking wage trackers had also continued to show signs of easing. The Indeed tracker, based on job adverts, and the feedback from firms participating in the Corporate Telephone Survey (CTS) and the Survey on the Access to Finance of Enterprises (SAFE) pointed to lower wage growth in the course of the year.

The ongoing and projected deceleration in wage growth remained the fundamental underpinning of the expected convergence of inflation to the ECB's 2% target in 2025. But it was important to emphasise that wage growth was not going to be stable for the rest of this year and that the reduction in wage pressures was not going to follow a linear trend. Negotiated wage growth would bounce around – mainly as a result of one-off payments. It was therefore important to keep in mind the overall dynamics, as embedded in the projections, rather than just the latest reading.

Profits continued to buffer the pass-through of higher labour costs to inflation. Annual growth in unit profits had decelerated further in the fourth quarter of 2023, falling to 2.8% from 4.7% in the third quarter. The significant decline was the main driver of the reduction in the annual growth rate of the GDP deflator, which had fallen by 0.6 percentage points to stand at 5.3% in the fourth quarter.

Turning to inflation expectations, in the Survey of Professional Forecasters (SPF), the centre of the distribution of long-term inflation expectations had remained around 2% since inflation had peaked in the fourth quarter of 2022. But the right tail of the distribution, which reflected a risk measure, implied that far fewer respondents now expected inflation to be noticeably above target in the longer term. This was reassuring in terms of people having a solid understanding of the inflation target. From the perspective of firms, as reflected in the SAFE, median expectations and the interquartile range for inflation one year ahead were lower than in the previous survey round. Selling price expectations of firms were also lower, as reported in the SAFE, as well as in the corresponding European Commission survey that captured near-term selling price expectations.

Looking ahead, headline inflation was expected to fluctuate around current levels in the near term, on account of base effects in the energy component and the reversal of the upward effect of the early timing of Easter on services inflation in March. Nevertheless, inflation was expected to decline to the ECB’s target in 2025 as labour cost pressures eased; the effects of past energy shocks, supply bottlenecks and the post-pandemic reopening of the economy continued to dissipate; and the disinflationary impact of monetary policy further unfolded.

Upside risks to inflation included the heightened geopolitical tensions, especially in the Middle East, which could push energy prices and freight costs higher in the near term and disrupt global trade. Inflation could also turn out higher than anticipated if wages increased by more than expected or profit margins proved more resilient. By contrast, inflation might surprise on the downside if monetary policy dampened demand more than expected, or if the economic environment in the rest of the world worsened unexpectedly.

The euro area economy had remained weak in the first quarter of 2024. The data available continued to point to a divergence between weak manufacturing sectors and improving services sectors, partly reflecting the persistent adverse impact of past energy price shocks on manufacturing output. Economic activity was expected to pick up modestly in the second quarter and to gain some momentum over the course of the year. The recovery should be supported by rising real incomes, resulting from lower inflation, increased wages and improved terms of trade. In addition, growth in euro area exports should pick up over the coming quarters as the global economy recovered and spending shifted further towards tradables. Finally, monetary policy should exert less of a drag on demand over time.

Consumer confidence had picked up to some extent, but it was still subdued compared with the levels prevailing before the war in Ukraine. The latest Consumer Expectations Survey (CES) showed signs of an upward trend in consumers' plans for major purchases and holidays.

Concerning housing investment, survey indicators remained very weak. The most recent property price data for the fourth quarter of 2023 showed that, after dropping, residential property prices were stabilising. For business investment, indications from surveys also remained weak – but with substantial variation across countries.

With regard to the labour market, weak GDP growth together with strong employment growth in 2023 had resulted in weak labour productivity. The unemployment rate had remained unchanged at a historical low of 6.5% in February. At the same time, the tightness in the labour market continued to decline gradually, with employers posting fewer job vacancies.

Looking at the fiscal stance, the euro area cyclically adjusted primary deficit in 2023 was likely to have been somewhat larger than indicated in the March ECB staff projections,

The risks to economic growth remained tilted to the downside. Growth could be lower if the effects of monetary policy turned out stronger than expected. A weaker world economy or a further slowdown in global trade would also weigh on euro area growth. Russia's unjustified war against Ukraine and the tragic conflict in the Middle East were major sources of geopolitical risk. This might result in firms and households becoming less confident about the future and global trade being disrupted. Growth could be higher if inflation came down more quickly than expected and rising real incomes meant that spending increased by more than anticipated, or if the world economy grew more strongly than expected.

Turning to the analysis of monetary and financial developments, risk-free interest rates had been broadly stable since the Governing Council's previous monetary policy meeting and the transmission of the restrictive monetary policy stance to broader financing conditions remained strong. Lending rates on business loans and mortgages had edged lower in February but remained elevated at 5.1% and 3.8% respectively. The information available continued to signal stagnant loan dynamics against the backdrop of weak aggregate demand, tight credit standards and restrictive monetary policy. The annual growth rate of bank loans to firms had increased slightly to 0.4% in February, but for loans to households it was unchanged at 0.3% in February. Weak credit creation had weighed on M3 growth, which had remained subdued at 0.4% in February, up from 0.1% in January. Bank funding costs remained at historically high levels.

The information from the latest bank lending survey (BLS) and the SAFE was consistent with persistently weak credit demand and a stabilisation at tight levels in credit supply conditions for firms. The BLS indicated a further modest net tightening of bank credit standards for loans to firms, mainly on account of banks' risk perceptions. In parallel, banks cited higher interest rates and cutbacks to investment plans as the main factors behind the further marked decline in net loan demand among firms in the first quarter of 2024. Confirming this profile, in the SAFE, companies had reported a decrease in the availability of bank loans. The SAFE had also registered a marked drop in the share of firms applying for bank loans. For households, the results of the BLS had indicated a moderate decline in net demand for loans for house purchase and broadly stable net demand for consumer credit. Credit standards for household mortgages had eased in the first quarter for the first time in over two years, but standards for consumer credit had tightened further.

Monetary policy considerations and policy options

Based on the assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, Mr Lane proposed keeping the three key ECB interest rates unchanged. The incoming data were in line with the medium-term inflation trajectory embedded in the March ECB staff macroeconomic projections, which foresaw headline inflation returning to target by mid-2025. Headline inflation had declined further in March and, looking beyond some near-term volatility associated with base effects and the reversal of various fiscal measures, it was expected to resume its downward path later in the year. Taken together, the range of underlying inflation measures also indicated further disinflation could be expected. At the same time, year-on-year domestic inflation and services inflation were edging down only slowly. Accordingly, the Governing Council needed further confirmation that wage growth was decelerating as anticipated and that profit margins continued to buffer the pass-through of higher labour costs to inflation.

Further progress towards the target in the course of 2025 would be underpinned by the next phase of deceleration in wage growth, the ongoing fading-out of the energy shock and supply bottlenecks, and a smaller contribution from the reversal of fiscal measures. These disinflationary pressures would also be reinforced by the cumulative demand-dampening impact of the restrictive monetary stance, including by limiting the capacity of firms to pass on cost increases. The incoming data confirmed that the transmission of monetary tightening remained strong. There were some signs of stabilisation in credit supply at a tight level and some easing in the pricing of new loans, primarily owing to an anticipation of future policy rate cuts.

Based on the three elements of its reaction function, the Governing Council could conclude that the key ECB interest rates were at levels that were making a substantial contribution to the ongoing disinflation process. The Governing Council's future decisions would ensure that its policy rates would stay sufficiently restrictive for as long as necessary. If the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation was converging to target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. In any event, the Governing Council would continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and it was not pre-committing to a particular rate path.

2. Governing Council’s discussion and monetary policy decisions

Economic, monetary and financial analyses

As regards the external environment, global GDP growth had remained subdued but there were early signs of improvement. Global growth momentum was building up, with a strong increase in the Purchasing Managers' Index (PMI) for manufacturing. Moreover, despite only modest GDP growth, global trade had seen a rebound driven by emerging market economies. Strong economic data in the United States and a rebound of the UK economy were seen as supporting the global recovery. Members noted that industrial activity in China had been better than expected, but also stressed the uncertainties and risks for global growth related to the country’s recovery.

Members took note of the release of consumer price index (CPI) data for March in the United States, which had been higher than expected. The data were seen as confirmation that global inflation currently reflected mainly “sticky” services price developments. But it was also pointed out that recent US inflation outcomes reflected idiosyncratic factors. In any case, the depreciation of the euro following the release of the US inflation data pointed to a need for close monitoring of the impact of the exchange rate on euro area inflation. Spillovers from the United States through a sustained exchange rate effect would likely slow the disinflationary process in the euro area. More generally, it was argued that the exchange rate effects would depend on the underlying shocks driving economic activity and inflation. In this respect, inflation developments in the United States and the euro area were seen to be different in nature, with those in the United States being driven more strongly by demand factors and those in the euro area more by supply factors.

With regard to the euro area economy, members widely agreed that latest information broadly vindicated the growth and inflation outlooks entailed in the March 2024 staff projections. This indicated that the forecasting ability of the quarterly projection exercises had been restored.

On economic activity, members concurred with Mr Lane that the economy had remained weak in the first quarter of 2024. While spending on services was resilient, manufacturing firms were facing weak demand and production was still subdued, especially in energy-intensive sectors. Surveys pointed to a gradual recovery over the course of the year, led by services. The PMI for future activity 12 months ahead had reached its long-term average in March, and some incoming hard data were confirming this picture. This recovery was expected to be supported by rising real incomes, resulting from lower inflation, increased wages and improved terms of trade. In addition, growth in euro area exports was expected to pick up over the coming quarters, as the global economy recovered and spending shifted further towards tradables. Finally, monetary policy should exert less of a drag on demand over time.

Members acknowledged the mixed signals in the latest data. While some soft indicators had become more favourable, some hard indicators persistently pointed to weak growth momentum. Mechanical nowcasting tools indicated quarter-on-quarter real GDP growth in the first and second quarters that was broadly in line with the March staff projections, with a slight downward risk for the first quarter. Even though growth in the first quarter was still estimated to have been weak, comfort was drawn from the observation that the latest data were consistent with the March staff projections showing a recovery in activity as of the second quarter. At the same time, it was recalled that achieving the profile of the baseline projection remained quite a challenge. Observed upward movements in incoming data should therefore not be equated with a materialisation of upside risks to the baseline projections. Against this background, it was remarked that there were as yet no signs of a recovery in private consumption, which was expected to be the growth engine in 2024. Similarly, the latest weak indicators of business sentiment did not bode well for investment prospects. Even the relatively sluggish recovery foreseen in the staff projections had yet to unfold. Meanwhile, it was reassuring that a recession had been avoided despite the monetary policy stance contributing to bringing inflation down from double digits to moderate levels. It was also observed that the euro area growth landscape was heterogeneous, both across countries and across sectors. Less energy-intensive sectors were growing faster than energy-intensive ones, which could be seen as pointing to structural rather than cyclical weakness.

With respect to fiscal and structural policies, members reiterated that governments should continue to roll back energy-related support measures so that disinflation would stay on track. Implementing the EU’s revised economic governance framework fully and without delay would help governments bring down budget deficits and debt ratios on a sustained basis. National fiscal and structural policies should be aimed at making the economy more productive and competitive, which would help to reduce price pressures in the medium term. At the European level, an effective and speedy implementation of the Next Generation EU programme and a strengthening of the Single Market would help foster innovation and increase investment in the green and digital transitions. More determined and concrete efforts to complete the banking union and the capital markets union would help mobilise the massive private investment necessary to achieve this, as the Governing Council had stressed in its statement of 7 March 2024.

It was highlighted that the assumptions for fiscal policies embedded in the March staff projections constituted an element of uncertainty and risk. Concerns were expressed about the sizeable upward revisions to the deficit and debt figures for 2023 in a number of euro area countries. The need for fiscal prudence and consolidation across the euro area had to be clearly spelled out. This was especially important in view of the special situation in 2024, with the transition to a new EU framework for assessing excessive deficits and fiscal trajectories. At the same time, it was widely considered good news from a monetary policy perspective that there would soon be a new framework in place, providing guiding principles and enhancing prospects for more credible implementation.

Turning to the labour market, it was recalled that the unemployment rate was at its lowest level since the introduction of the euro. At the same time, the tightness in the labour market continued to diminish gradually, with employers posting fewer job vacancies. Labour market developments could be seen from different perspectives. On the one hand, it was suggested that the state of the labour market had remained broadly unchanged and its tightness remained a concern for the medium-term inflation outlook. The unemployment rate was at a historical low, employment was growing robustly, and indicators of tightness continued to stand well above pre-pandemic levels. On the other hand, it was acknowledged that the direction of developments in the indicators implied some cooling of labour demand. This was particularly visible in decreasing job vacancies. Concerns were expressed that the labour market support to the economy had reached its limit. Labour supply had already increased substantially and firms had limited buffers left for hoarding labour. A turn of the cycle in the labour market could thus imply greater labour shedding and reduced hirings. A deterioration in the employment outlook could prompt lower consumption.

On that basis, members assessed the risks to economic growth as remaining tilted to the downside. Growth could be lower if the effects of monetary policy turned out to be stronger than expected. A weaker world economy or a further slowdown in global trade would also weigh on euro area growth. Russia’s unjustified war against Ukraine and the tragic conflict in the Middle East were major sources of geopolitical risk. This might result in firms and households becoming less confident about the future and global trade being disrupted. Growth could be higher if inflation came down more quickly than expected and rising real incomes lifted spending more than anticipated, or if the world economy grew faster than expected.

The downside risks to economic growth were seen as particularly relevant for the short term and were confirmed by the mechanical nowcasting tools. However, the view was also expressed that near-term risks were now balanced, with reference made to recent rebounds in survey-based indicators and some hard data. Looking ahead, it was stressed that factors that had previously cushioned the economy against potential adverse shocks – including high levels of liquidity, ample household savings, fiscal space, rising labour supply and sizeable business profit margins – had partly diminished. It was also suggested that the geopolitical risk stemming from the conflict in the Middle East had increased in tandem with the escalation of the conflict during past weeks.

With regard to price developments, members concurred with the assessment by Mr Lane that the incoming information had broadly confirmed the previous assessment of the medium-term inflation outlook. Inflation had continued to edge down from an annual rate of 2.6% in February to 2.4% in March, led by lower food and goods price inflation. However, services price inflation had remained high in March, at 4.0%. Most measures of underlying inflation had fallen further in February, confirming the picture of gradually diminishing price pressures. While domestic inflation remained high, wages and unit profits had grown less strongly in the last quarter of 2023 than anticipated, and more recent indicators pointed to further moderation in wage growth. Unit labour cost growth had remained high, in part reflecting weak productivity growth, but firms were using profits to absorb part of the rise in labour costs. Inflation was expected to fluctuate around current levels in the coming months and to then decline to the inflation target next year, owing to weaker growth in labour costs, the unfolding effects of restrictive monetary policy, and the fading of the impact of the energy crisis and the post-pandemic reopening.

Members saw the latest inflation developments as evidence that the impact of the past extraordinary shocks was waning and economic relationships were normalising. This bolstered confidence in the projections and the expected path towards reaching the ECB's inflation target in 2025. Outcomes for the first quarter of 2024 were very similar to what had been anticipated in the March staff projections. Members took note of the bumpy profile of headline inflation for 2024 as indicated by the projections and that there would be no downward linear trend for the remainder of the year. Many of the expected "bumps" were related to base effects in energy inflation and were already taken into account in the baseline projections. While headline inflation was naturally a key variable to monitor, it was not the only one that would be particularly volatile. Services inflation, which had recently seen an increase in momentum, as measured by the annualised three-month-on-three-month rate, and developments in wage growth were also affected. In this respect, it was important to identify the underlying direction of developments and to look at the big picture.

There was broad agreement that services inflation and the role of wages remained key issues for the inflation outlook. This was also signalled by services inflation having stayed at the high level of 4% over the past five months. Moreover, the indicator of domestic inflation, which reflected inflation in those HICP items with relatively low import intensity, was standing at around 4.5%. Meanwhile, the GDP deflator, a measure of domestic inflation in the national accounts, had remained above 5% in the fourth quarter of 2023. In view of these figures, conclusive evidence of progress on disinflation in the more persistent domestic components had yet to become apparent. At the same time, the greater "stickiness" of services inflation was seen as natural, as it was less affected by the fading of supply-side shocks. In addition, the transmission of monetary policy to the services sector was likely weaker because services were less capital-intensive, while the pass-through from wages was higher owing to the characteristic cost structures in that sector. The capacity for services firms to absorb higher wage costs through profit margin compression remained uncertain, as they had neither experienced the same level of profit margin increases in the wake of the pandemic as other sectors, nor benefited as much from the declines in other input costs. For these reasons, developments in services inflation warranted close monitoring and further confirmation was required of weakening pressures on both wages and profits. However, disaggregated data available up to February suggested that price pressures in services had not come from the more wage-sensitive items. Instead, these pressures had come from items typically affected by repricing at the beginning of the year to include adjustments for past cost increases, for instance insurance policies or goods and services with administered prices.

Turning to domestic price pressures more broadly, as measured by the GDP deflator in the national accounts, members saw the wages-profits-productivity triangle as key to assessing the speed and extent of further disinflation. There was still considerable uncertainty about whether assumptions and expectations regarding these variables would play out as projected in March. Having a new data point and new projections for these variables was therefore important but euro area national account data for the first quarter of 2024 would only be released shortly after the Governing Council's June monetary policy meeting. It was underlined that the inflation outlook remained very sensitive to the behaviour of profit margins. Concern was expressed that margins might not absorb higher costs to the extent assumed in the projections. It was argued that still elevated margins combined with a relatively weak economic environment could be an indication of persistently strong pricing power and relatively weak competition. At least, this could be the case for businesses serving domestic demand – and notably the services sector. This could then lead to further increases in wages and, in turn, might put additional competitive pressure on exporters.

It was pointed out that there had been no additional upward pressure on wages from recently signed wage agreements and that wage growth was so far broadly in line with the projections. If anything, wage pressures had even diminished somewhat compared with earlier expectations. It was suggested that, with wage growth having begun to moderate as expected, the focus should shift to productivity developments. These were crucial from the perspective of ultimate labour cost pressures, which would be higher if productivity growth did not recover as quickly and as strongly as foreseen in the baseline of the March staff projections. It was argued that this might be the case if current low and negative productivity growth rates turned out to be not merely cyclical, but also partly structural in nature. The point was made that with the bleak investment outlook embedded in the projections it was difficult to see a more structural improvement in labour productivity.

As regards longer-term inflation expectations, market-based measures of inflation compensation and survey-based indicators had remained broadly stable, with most standing around 2%. The fact that inflation expectations had remained well anchored was seen as reassuring, since it indicated that the monetary policy stance was having the desired effect.

Upside risks to inflation included the heightened geopolitical tensions, especially in the Middle East, which could push energy prices and freight costs higher in the near term and disrupt global trade. Inflation could also turn out higher than anticipated if wages increased by more than expected or profit margins proved more resilient. By contrast, inflation could surprise on the downside if monetary policy dampened demand more than expected, or if the economic environment in the rest of the world worsened unexpectedly.

Further upside risks could result from higher growth in unit labour costs, especially if productivity growth did not recover as expected. Upside risks were also seen as prevailing in food and oil prices. The risk of second-round effects was, however, considered to be relatively small in an environment of general disinflation, unlike in 2022-23. Nevertheless, it was noted that oil prices had increased substantially in the year to date and were significantly higher than in the assumptions for the March projections. This pointed to some upside risk for inflation. Moreover, the slowdown in inflation had recently been supported by lower gas and electricity prices, following a relatively warm winter and low demand due to a recession in manufacturing sectors. This implied upside risks as and when typically inelastic energy demand met with a recovery in economic activity or a colder period. The upside risks to food prices were partly related to extreme weather events, including the El Niño and La Niña phenomena, and climate shocks.

Turning to the monetary and financial analysis, members largely concurred with the assessment provided by Mr Lane and Ms Schnabel in their introductions. Market interest rates had been broadly stable since the Governing Council's previous meeting and wider financing conditions had remained restrictive. Financial markets had been calm and steady since the meeting in March, amid a further compression of risk premia. Markets were pricing in a first cut in ECB interest rates in June, with further cuts priced in by the end of the year.

It appeared that peak restrictiveness in euro area financing conditions might have passed. Interest rates on new loans to households and firms had started to come down, primarily in anticipation of future policy rate cuts, while average rates on existing loans were still edging up overall. The most recent information had continued to signal weak bank loan dynamics on the back of weak aggregate demand, tight credit standards and restrictive monetary policy.

Bank lending to firms, in particular, was seen as persistently weak. In part, this was due to lower demand for loans from firms. The decline had also been reported by banks and firms in the latest BLS and the SAFE, and reflected still elevated borrowing rates and cutbacks in investment plans. As for lending to households, credit standards for mortgages had eased for the first time in over two years but standards for consumer credit had tightened further. The point was made that weaker demand for consumer credit and an increase in rejected bank loan applications could suggest fragile household balance sheets or greater risk aversion by banks. If so, this in turn would signal risks of a more persistent weakness in consumption. Overall, the latest credit developments remained subdued and could point to a pick-up in credit growth later on, with loan creation being held back by higher rates and tighter credit standards. It was highlighted that the ratio of credit to GDP had been falling rapidly, with continued weak credit dynamics seen as posing a risk to the recovery or raising the prospect of a "credit-less recovery" as liquidity buffers diminished. However, signs of stabilisation were visible in loan flows to both households and firms, despite some volatility around the turn of the year.

Monetary policy stance and policy considerations

Turning to the monetary policy stance, members assessed the data that had become available since the last monetary policy meeting in accordance with the three main elements that the Governing Council had communicated in 2023 as shaping its reaction function. These comprised (i) the implications of the incoming economic and financial data for the inflation outlook, (ii) the dynamics of underlying inflation, and (iii) the strength of monetary policy transmission. Overall, each of the three elements suggested that the key ECB interest rates were at levels that were making a substantial contribution to the ongoing disinflation process.

Starting with the inflation outlook, members widely agreed that the data were broadly in line with the medium-term inflation trajectory embedded in the March staff projections, which foresaw headline inflation returning to target by mid-2025. While inflation had come in slightly higher than expected in February, the increase had been offset by a weaker than expected outturn in March. Overall, the figures suggested limited news, thus broadly validating the projections. Economic growth was assessed as having been slightly weaker than expected in the first quarter of 2024, but the narrative of an improving growth outlook remained intact. While significant risks remained around the baseline projections for both growth and inflation, members expressed increasing confidence in the projections, since the extraordinary shocks of the recent past were waning and economic relationships were normalising. Moreover, inflation expectations had remained well anchored. At the same time, the view was widely shared that further evidence was required to gain sufficient confidence that inflation was solidly on track to return to the ECB's target in a timely and sustained manner.

Members also generally concurred that further progress had been made regarding underlying inflation. Most measures had continued to decline and were expected to continue on a downward path in the period ahead. Indications from wages and profit margins were broadly in line with the March staff projections or suggested slightly more muted developments than anticipated. At the same time, domestic inflation was still elevated and there had been little progress in services inflation, which was steady at 4%. It was stressed that a return of inflation to target remained conditional on a rebound in productivity growth and a significant compression of unit profits through the absorption of higher costs.

The most recent data confirmed that the transmission of monetary tightening continued to be strong. While there had been some signs of stabilisation in credit conditions at a restrictive level, further weak credit data were suggesting that the credit channel of monetary policy transmission was more powerful than previously expected. The decline in the demand for loans, as reported in the BLS, was seen as a downside risk for the growth outlook because it pointed to weak investment. At the same time, it was argued that the tightening impulse from monetary policy had already reached its peak, with the likelihood of a gradual easing of conditions in the near future. Forward-looking indicators were recovering, with firms indicating in their responses to the SAFE that they were expecting an increase in both investment and turnover. Moreover, the transmission of monetary policy was seen as weaker for the services sector than for other parts of the economy because services were less capital-intensive and therefore less interest rate-sensitive.

With inflation declining and a delayed pick-up in economic growth, it was regarded as important to assess how restrictive the monetary policy stance was, as a basis for future monetary policy decisions. It was underlined that there was considerable uncertainty about the degree of restrictiveness of the ECB's monetary policy stance, both measured against unobservable concepts like the neutral rate of interest and judged by the transmission lags to the capital, labour and goods markets in the real economy and ultimately to inflation.

One way of assessing the restrictiveness of monetary policy was to evaluate the level of policy rates relative to available model-based estimates of the natural or neutral rate of interest. In this context, it was argued that ongoing structural changes might have led to an increase in such benchmark rates. These changes included the anticipation of the significant global investment needs to address climate change and the green transition, geopolitical shifts and trade fragmentation leading to deglobalisation, and advances in artificial intelligence and digitalisation. In addition, rising public debt burdens worldwide might exert further upward pressure on the natural rate of interest. At the same time, it was recalled that staff estimates for the euro area, published recently in the ECB's Economic Bulletin, did not suggest a significant increase. In view of the sizeable model and parameter uncertainty attached to such model-based constructs, the natural rate – while providing useful indications – was seen as being of limited use for day-to-day policymaking. For the time being, to assess the restrictiveness of monetary policy, it was preferable to look at incoming data.

Monetary policy decisions and communication

Against this background, a very large majority of members agreed with Mr Lane's proposal to maintain the three key ECB interest rates at their current levels. Members concurred that the most recent information had broadly confirmed the March staff projections, thus increasing their confidence that the disinflationary process was continuing. At the same time, important new data – including new staff projections – would be released ahead of the June meeting, allowing the Governing Council to make a more comprehensive assessment. While progress had been seen, monitoring the triangle between wages, productivity growth and profits continued to be key. It was seen as plausible that the Governing Council would be in a position to start easing monetary policy restriction at the June meeting if additional evidence received by then confirmed the medium-term inflation outlook embedded in the March projections.

A few members felt sufficiently confident that the three elements of the Governing Council's reaction function gave grounds for a reduction in the policy rates already at the present meeting. It was recalled that, since the last policy rate increase in September 2023, the decline in expected inflation had implied a further tightening in the policy stance, with real rates currently close to the peak of the cycle. Moreover, policy rates were seen as likely to remain in restrictive territory for some time, while the effects of the present restrictive policy stance would continue to be felt even after the start of the easing phase. It was also remarked that the reduction of the Eurosystem balance sheet was having a contractionary impact on the economy. Moreover, while there were currently no significant risks of inflation expectations becoming unanchored to the downside, such risks could emerge if the current weakness in growth persisted.

These members also referred to risk management considerations, seeing the balance of risks as having shifted recently. The risk of undershooting the inflation target and eventually having to pay too high a price in terms of declining activity was now seen as being at least as high as the risk of acting too early and overshooting the target over the medium term.

All in all, a broad consensus emerged whereby members agreed it was prudent to wait until the next monetary policy meeting to see further evidence of, and gain sufficient confidence in, a timely and sustained return of inflation to target. Compared with the outlook in March, no major surprise had been observed that would justify action at the present meeting. Conversely, as long as the available data continued to confirm the projections, looking ahead the policy path underlying the projections was seen as broadly consistent with a return of inflation to target in the medium term. Members stressed the value of waiting until June for further evidence confirming, or indicating a change to, the outlook, but also the value of taking into account any existing or new risks materialising by June, including renewed risks to inflation posed by a possible escalation of geopolitical tensions. The next projections in June would allow a more comprehensive analysis of the main risks and their implications for price stability.

Members stressed that maintaining a data-dependent approach with full optionality at every meeting was warranted, thus allowing all incoming data to be taken into account while excluding a pre-commitment to any particular rate path. Data dependence meant not overly focusing on one data point, as the path many indicators took was likely to be bumpy. Headline inflation, in particular, was expected to fluctuate around current levels in the near term and to decline again later on, suggesting that some bumpiness in the inflation profile was foreseen and consistent with a return of inflation to target by mid-2025.

On the whole, members felt that markets had understood the ECB's communication and reaction function and were prepared for the possibility of a rate cut at the June meeting, should the data confirm the current outlook.

Members also agreed with the Executive Board proposal to continue applying flexibility in reinvesting redemptions falling due in the pandemic emergency purchase programme portfolio.

Taking into account the foregoing discussion among the members, upon a proposal by the President, the Governing Council took the monetary policy decisions as set out in the monetary policy press release. The members of the Governing Council subsequently finalised the monetary policy statement, which the President and the Vice-President would, as usual, deliver at the press conference following the Governing Council meeting.

Monetary policy statement

Monetary policy statement for the press conference of 11 April 2024

Press release

Monetary policy decisions

Meeting of the ECB's Governing Council, 10-11 April 2024

Members

- Ms Lagarde, President
- Mr de Guindos, Vice-President
- Mr Centeno
- Mr Cipollone
- Mr Elderson
- Mr Hernández de Cos
- Mr Herodotou

- Mr Holzmann
- Mr Kazāks
- Mr Kažimír
- Mr Knot
- Mr Lane
- Mr Makhlouf*
- Mr Müller*
- Mr Nagel
- Mr Panetta
- Mr Patsalides
- Mr Rehn*
- Mr Reinesch
- Ms Schnabel
- Mr Scicluna
- Mr Šimkus
- Mr Stournaras
- Mr Vasle
- Mr Villeroy de Galhau*
- Mr Vujčić
- Mr Wunsch*

* Members not holding a voting right in March 2024 under Article 10.2 of the ESCB Statute.

Other attendees

- Mr Dombrovskis, Commission Executive Vice-President**
- Ms Senkovic, Secretary, Director General Secretariat
- Mr Rostagno, Secretary for monetary policy, Director General Monetary Policy
- Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

** In accordance with Article 284 of the Treaty on the Functioning of the European Union.

Accompanying persons

- Ms Bénassy-Quéré
- Mr Dabušinskas
- Mr Demarco
- Mr De Backer
- Mr Gavilán
- Mr Gilbert
- Mr Haber
- Mr Kaasik
- Mr Kelly
- Mr Koukoularides
- Mr Lünnemann
- Mr Martin
- Ms Mauderer
- Mr Nicoletti Altimari
- Mr Novo
- Mr Rutkaste
- Mr Šošić
- Mr Tavlas
- Mr Välimäki
- Ms Žumer Šujica

Other ECB staff

- Mr Proissl, Director General Communications
- Mr Straub, Counsellor to the President
- Ms Rahmouni-Rousseau, Director General Market Operations
- Mr Arce, Director General Economics
- Mr Sousa, Deputy Director General Economics

Release of the next monetary policy account foreseen on 4 July 2024.