

Combined monetary policy decisions and statement

6 June 2024

Monetary policy decisions

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. Based on an updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to moderate the degree of monetary policy restriction after nine months of holding rates steady. Since the Governing Council meeting in September 2023, inflation has fallen by more than 2.5 percentage points and the inflation outlook has improved markedly. Underlying inflation has also eased, reinforcing the signs that price pressures have weakened, and inflation expectations have declined at all horizons. Monetary policy has kept financing conditions restrictive. By dampening demand and keeping inflation expectations well anchored, this has made a major contribution to bringing inflation back down.

At the same time, despite the progress over recent quarters, domestic price pressures remain strong as wage growth is elevated, and inflation is likely to stay above target well into next year. The latest Eurosystem staff projections for both headline and core inflation have been revised up for 2024 and 2025 compared with the March projections. Staff now see headline inflation averaging 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026. For inflation excluding energy and food, staff project an average of 2.8% in 2024, 2.2% in 2025 and 2.0% in 2026. Economic growth is expected to pick up to 0.9% in 2024, 1.4% in 2025 and 1.6% in 2026.

The Governing Council is determined to ensure that inflation returns to its 2% medium-term target in a timely manner. It will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. The Governing Council will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. In particular, its interest rate decisions will be based on its assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. The Governing Council is not pre-committing to a particular rate path.

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The Governing Council today also confirmed that it will reduce the Eurosystem's holdings of securities under the pandemic emergency purchase programme (PEPP) by €7.5 billion per month on average over the second half of the year. The modalities for reducing the PEPP holdings will be broadly in line with those followed under the asset purchase programme (APP).

Key ECB interest rates

The Governing Council decided to lower the three key ECB interest rates by 25 basis points. Accordingly, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will be decreased to 4.25%, 4.50% and 3.75% respectively, with effect from 12 June 2024.

Asset purchase programme (APP) and pandemic emergency purchase programme (PEPP)

The APP portfolio is declining at a measured and predictable pace, as the Eurosystem no longer reinvests the principal payments from maturing securities.

The Governing Council will continue to reinvest, in full, the principal payments from maturing securities purchased under the PEPP until the end of June 2024. Over the second half of the year, it will reduce the PEPP portfolio by €7.5 billion per month on average. The Governing Council intends to discontinue reinvestments under the PEPP at the end of 2024.

The Governing Council will continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Refinancing operations

As banks are repaying the amounts borrowed under the targeted longer-term refinancing operations, the Governing Council will regularly assess how targeted lending operations and their ongoing repayment are contributing to its monetary policy stance.

The Governing Council stands ready to adjust all of its instruments within its mandate to ensure that inflation returns to its 2% target over the medium term and to preserve the smooth functioning of

monetary policy transmission. Moreover, the Transmission Protection Instrument is available to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across all euro area countries, thus allowing the Governing Council to more effectively deliver on its price stability mandate.

The President of the ECB will comment on the considerations underlying these decisions at a press conference starting at 14:45 CET today.

Monetary policy statement

Press conference

**Christine Lagarde, President of the ECB,
Luis de Guindos, Vice-President of the ECB**

Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. Based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to moderate the degree of monetary policy restriction after nine months of holding rates steady. Since our meeting in September 2023, inflation has fallen by more than 2.5 percentage points and the inflation outlook has improved markedly. Underlying inflation has also eased, reinforcing the signs that price pressures have weakened, and inflation expectations have declined at all horizons. Monetary policy has kept financing conditions restrictive. By dampening demand and keeping inflation expectations well anchored, this has made a major contribution to bringing inflation back down.

At the same time, despite the progress over recent quarters, domestic price pressures remain strong as wage growth is elevated, and inflation is likely to stay above target well into next year. The latest Eurosystem staff projections for both headline and core inflation have been revised up for 2024 and 2025 compared with the March projections. Staff now see headline inflation averaging 2.5 per cent in 2024, 2.2 per cent in 2025 and 1.9 per cent in 2026. For inflation excluding energy and food, staff project an average of 2.8 per cent in 2024, 2.2 per cent in 2025 and 2.0 per cent in 2026. Economic growth is expected to pick up to 0.9 per cent in 2024, 1.4 per cent in 2025 and 1.6 per cent in 2026.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. We will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. We will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

The Governing Council today also confirmed that it will reduce the Eurosystem's holdings of securities under the pandemic emergency purchase programme (PEPP) by €7.5 billion per month on average

over the second half of the year. The modalities for reducing the PEPP holdings will be broadly in line with those followed under the asset purchase programme (APP).

The decisions taken today are set out in a press release available on our website.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

After five quarters of stagnation, the euro area economy grew by 0.3 per cent over the first quarter of 2024. The services sector is expanding, and manufacturing is showing signs of stabilisation at low levels. We expect the economy to continue to recover as higher wages and improved terms of trade push up real incomes. Stronger exports should also support growth over the coming quarters, as global demand for goods and services rises. Finally, monetary policy should exert less of a drag on demand over time.

Employment rose by 0.3 per cent in the first quarter of this year, with around 500,000 new jobs created, and surveys point to continued job growth in the near term. The unemployment rate edged down to 6.4 per cent in April, its lowest level since the start of the euro. Companies are still posting many job vacancies, though slightly fewer than before.

National fiscal and structural policies should aim at making the economy more productive and competitive, which would help to raise potential growth and reduce price pressures in the medium term. An effective, speedy and full implementation of the Next Generation EU programme, progress towards capital markets union and the completion of banking union, and a strengthening of the Single Market would help foster innovation and increase investment in the green and digital transitions. Implementing the EU's revised economic governance framework fully and without delay will help governments bring down budget deficits and debt ratios on a sustained basis.

Inflation

Annual inflation rose to 2.6 per cent in May, from 2.4 per cent in April, according to Eurostat's flash estimate. Food price inflation declined to 2.6 per cent. Energy price inflation increased to 0.3 per cent, after recording negative annual rates for a year. Goods price inflation continued to decrease in May, to 0.8 per cent. By contrast, services price inflation rose markedly, to 4.1 per cent from 3.7 per cent in April.

Most measures of underlying inflation declined further in April, the last month for which data are available, confirming the picture of gradually diminishing price pressures. However, domestic inflation remains high. Wages are still rising at an elevated pace, making up for the past inflation surge. Owing to the staggered nature of the wage adjustment process and the important role of one-off payments, labour costs will likely fluctuate over the near term, as seen in the pick-up in negotiated wages in the first quarter. At the same time, forward-looking indicators signal that wage growth will moderate over the course of the year. Profits are absorbing part of the pronounced rise in unit labour costs, which reduces its inflationary effects.

Inflation is expected to fluctuate around current levels for the rest of the year, including due to energy-related base effects. It is then expected to decline towards our target over the second half of next year, owing to weaker growth in labour costs, the unfolding effects of our restrictive monetary policy, and the fading impact of the energy crisis and the pandemic. Measures of longer-term inflation expectations have remained broadly stable, with most standing at around 2 per cent.

Risk assessment

The risks to economic growth are balanced in the near term but remain tilted to the downside over the medium term. A weaker world economy or an escalation in trade tensions between major economies would weigh on euro area growth. Russia's unjustified war against Ukraine and the tragic conflict in the Middle East are major sources of geopolitical risk. This may result in firms and households becoming less confident about the future and global trade being disrupted. Growth could also be lower if the effects of monetary policy turn out stronger than expected. Growth could be higher if inflation comes down more quickly than expected and rising confidence and real incomes mean that spending increases by more than anticipated, or if the world economy grows more strongly than expected.

Inflation could turn out higher than anticipated if wages or profits increase by more than expected. Upside risks to inflation also stem from the heightened geopolitical tensions, which could push energy prices and freight costs higher in the near term and disrupt global trade. Moreover, extreme weather events, and the unfolding climate crisis more broadly, could drive up food prices. By contrast, inflation may surprise on the downside if monetary policy dampens demand more than expected, or if the economic environment in the rest of the world worsens unexpectedly.

Financial and monetary conditions

Market interest rates have risen since our April meeting. Financing costs have plateaued at restrictive levels as our past policy rate increases have worked their way through the financial system. The

average interest rates on new loans to firms and on new mortgages were unchanged in April, at 5.2 per cent and 3.8 per cent respectively.

Credit dynamics remain weak. Bank lending to firms grew at an annual rate of 0.3 per cent in April, down slightly from the previous month. Loans to households continued to grow at 0.2 per cent on an annual basis. The annual growth in broad money – as measured by M3 – rose to 1.3 per cent in April, from 0.9 per cent in March.

In line with our monetary policy strategy, the Governing Council thoroughly assessed the links between monetary policy and financial stability. Euro area banks remain resilient. The improving economic outlook has fostered financial stability, but heightened geopolitical risks cloud the horizon. An unexpected tightening of global financing conditions could prompt a repricing of financial and non-financial assets, with negative effects on the wider economy. Macroprudential policy remains the first line of defence against the build-up of financial vulnerabilities. The measures that are currently in place or will soon take effect are helping to keep the financial system resilient.

Conclusion

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. We will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. We will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

We are now ready to take your questions.