Mizuho Market Comment

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ECB on hold, focus on summer. EUR/USD bias is to drift higher near term

- **ECB to leave rates unchanged, lower 2024 CPI forecast. Longer-term forecasts little changed**
- **FX volatility is near multi-year lows, our policy forecasts suggest it will remain so for much of Q2**
- **The path of least resistance for EUR/USD seems to be higher, as the risk backdrop remains +ve…**
- **…but gains are likely to be limited as the US macro backdrop remains solid.**

June remains the most likely date for the start of the ECB easing cycle

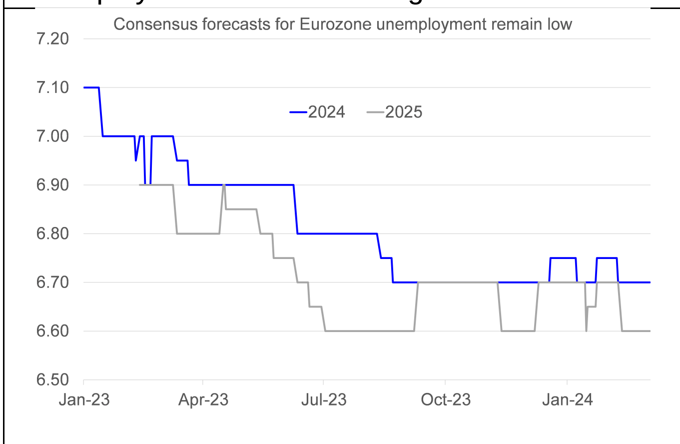
A number of ECB members have been quite open in marking June as the meeting most likely to see the start of the easing cycle. Most of the doves seem on board with waiting until summer, although one or two are muttering about data dependence, which they think would mean an April cut. Many ECB members have noted that they see the outcome of annual wage bargaining in Q1 as the key development for the policy outlook. Such data will not be available at the time of the 11 April ECB meeting, pushing the first move to the June meeting. In the January press conference recall that President Lagarde tied the unit wage outlook to the unit profit outlook saying that she expected to see wages rise as profits normalised. Comments from Greece's Stournaras ("*The latest deceleration in wages gives hope that we are on track…But we won't have enough information to decide on rate cuts before the end of the second quarter — so June*") are typical. As such a change in policy rates is highly unlikely at this week's ECB meeting.

New ECB forecasts the focus

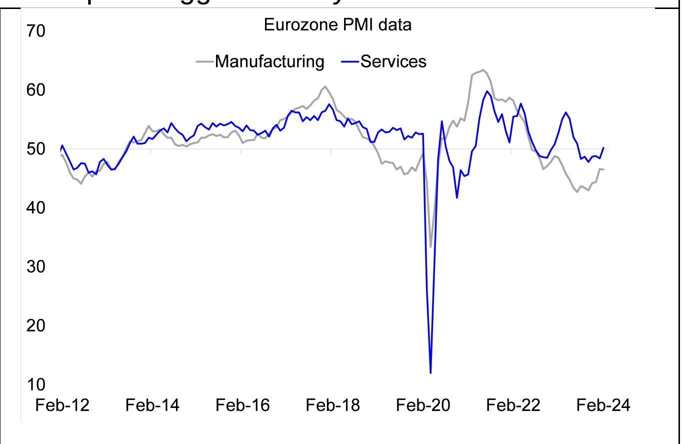
The March meeting will come with new ECB forecasts. It is likely that these will detail lower inflation and lower growth for 2024. The longer-term forecasts are likely to change less, if at all. The ECB's view that the labour market will remain solid through the forecast period is on track for now, with unemployment remaining at the cycle low, despite sluggish growth in H2 2023. We note that the EC Commission's labour hoarding index still shows some degree of hoarding, even if its has eased sharply from the peak.

The consensus GDP forecast for 2024 is down 0.1pp to 0.5% since the Dec-23 ECB meeting. The activity data remain disappointing, with Q4 GDP coming in a little lower than the ECB expected. This suggests a downward revision to the ECB's 2024 GDP forecast, which currently sits at 0.8%, towards the 0.5~0.6% region. There has been a 0.2pp drop in the consensus 2024 CPI forecast since the Dec-23 ECB meeting and it was already below the ECB's forecast. The ECB's 2.7% forecast for 2024 is likely to see a large downside revision, especially as gas prices have continued to push sharply lower. The consensus 2024 CPI forecast is 2.3% and we expect the ECB's forecast to be close to that. The 2025 forecasts are likely to be little changed, although the risks are to the downside.

Unemployment seen remaining near record low…



…despite sluggish activity



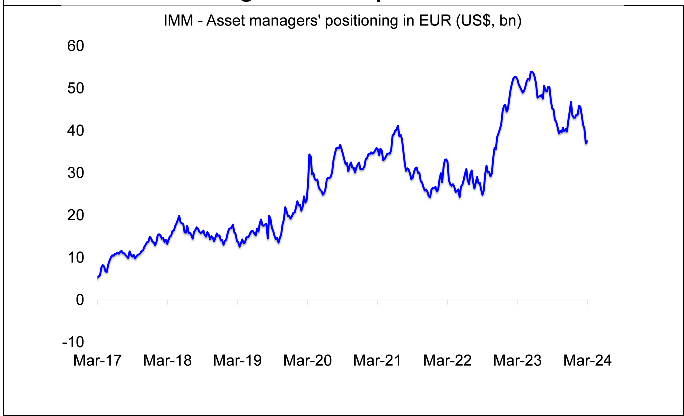
Source: Bloomberg

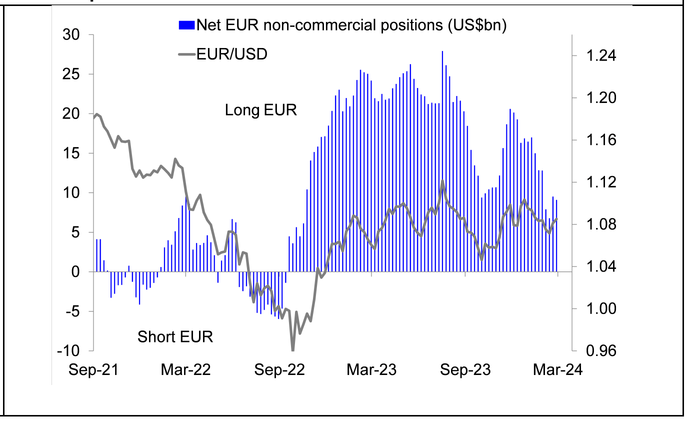
Positioning and valuation both mixed for EUR

Both asset managers and speculative investors have been trimming long-EUR positioning in recent months but positioning in general remains a hurdle rather than a help for EUR, albeit a modest one. We sense the path of least resistance for EUR/USD is higher but with the US economy and credit/equity markets continually seeing upgrades, investors look to be losing patience and cutting positions. Note that positioning remains positive. On balance most investors still expect that EUR will appreciate against USD, although expectations are now more muted that they were through most of 2023.

In nominal NEER terms EUR looks anything but cheap but on a REER basis its much cheaper, having failed to appreciate much despite low inflation. It is also somewhat cheap on a number of PPP measures. That said, valuation metrics do not argue for any significant moves.

Both asset managers and speculative investors are less upbeat

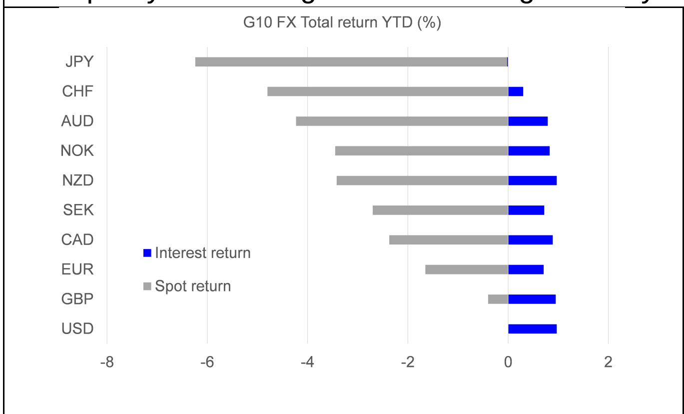


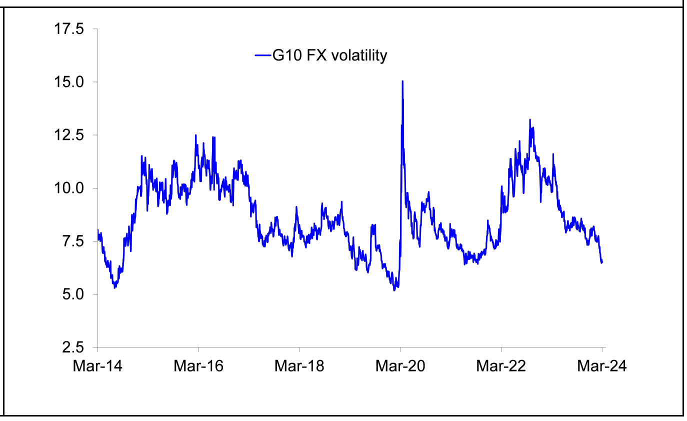


Source: Bloomberg

At 4.0% the ECB's deposit rate, the de facto policy rate, is relatively elevated for a currency that in the past has been seen as a funding currency alongside JPY and CHF. G10 FX volatility is low and equity and credit markets are buoyant. Such a backdrop suits carry trades. EUR total return is lagging only USD and GBP in G10 FX in the year to date, which when the soft macro backdrop of recent months is considered looks to be a decent performance.

ECB policy rate too high to be a funding currency for now





Source: Bloomberg

Our forecasts suggest limited change in G10 central bank policy rates over the next few months. Market pricing of near-term policy changes now seems much more reasonable to us than it did at the start of the year and thus volatility seems likely to remain low. Against this low volatility, positive risk asset backdrop, we would expect EUR/USD to drift mildly higher in coming months but see large gains as unlikely.