**Bailing on ECB Rate Cut**

**Executive Summary**
As a result of stabilizing activity and inflation data and more constructive comments from a range of policymakers, **we no longer expect any further ECB rate cuts** for the foreseeable future, and expect policymakers to strike a fairly upbeat tone at this week’s policy announcement. While the balance of risks is still tilted toward ECB easing in our view, we recognize that further easing is unlikely unless the outlook turns materially for the worse.

**When the Facts Change...**
We have for several months been expecting an additional interest rate cut from the European Central Bank (ECB), first calling for one at the December meeting and then punting to the March meeting after the growth and inflation data in the Eurozone showed signs of stabilizing. Since then, economic data have generally been resilient, and ECB policymakers have sounded more upbeat about the outlook as a result.

This has generally been true for both growth/activity data as well as inflation figures. Perhaps most notable has been the resilience of the services sector, with retail sales growth firming on trend in recent months and the services PMI edging higher to 52.8 as of January. Meanwhile, inflation has picked up recently, as core CPI inflation quickened to 1.3% year-over-year in both November and December, and market-based inflation expectations have also stabilized and climbed in recent weeks. Comments from policymakers have become a bit more upbeat amid the stabilization in the economy, with ECB policymakers Villeroy and Mersch noting that recent data are consistent with steady interest rates. Against this backdrop of stable economic data and more constructive commentary from central bank officials, **we no longer expect an ECB rate cut in March**, and expect the central bank to strike a fairly upbeat tone at this week’s policy announcement.

**Figure 1**
Eurozone Retail Sales
Year-over-Year Percent Change, 3-MMA

**Figure 2**
Eurozone Core CPI
Year-over-Year Percent Change, 3-MMA

Source: Datastream and Wells Fargo Securities
As a caveat, we would still describe the balance of risks around our forecast as tilted toward further ECB easing, even if it is no longer our base case. Indeed, the manufacturing sector in the Eurozone remains sluggish at best, and despite being resilient, services sector figures are far from inspiring. Moreover, while Eurozone core inflation has ticked higher recently, it remains well below the ECB’s target, and is unlikely to move meaningfully higher in the near-term given still-weak growth. Against that backdrop, we still think ECB easing is possible, but the key difference now is that the ECB will likely hold rates steady unless the data worsen materially, whereas previously the central bank appeared to be leaning toward easing unless the data showed signs of improvement. Thus, we will be calibrating our ECB view carefully in the coming weeks and months, and could revert back to an ECB rate cut if the data worsen.