Hawkish ECB rate-setter says wage 'slowdown' key to timing of policy shift

March interest rate cut 'highly unlikely', says Belgian central bank governor Pierre Wunsch

Financial Times – Martin Arnold

Investors are "too optimistic" that the European Central Bank will begin cutting interest rates in March, especially while eurozone wage growth keeps up pressure on prices, Belgium's central bank governor has said.

Pierre Wunsch, one of the more hawkish members of the ECB's governing council, told the Financial Times he was not yet ready to rule out raising borrowing costs further if wages in the bloc kept rising rapidly, although he said "the probability of a hike has gone down quite a lot".

"We are moving in the right direction on inflation and I am much more optimistic than a few months ago, but we still need to see good news on wages," said Wunsch in an interview, a day after the ECB left rates on hold and committed to keeping them "at sufficiently restrictive levels for as long as necessary".

Eurozone wage growth accelerated at its fastest pace for over a decade in the third quarter, when hourly labour costs rose 5.3 per cent from a year earlier, up from 4.6 per cent in the second quarter, according to figures published on Friday by Eurostat, the EU's statistics arm.

"It is going in the right direction for some indicators but wage increases are still too high and there are no clear signs that this is slowing down fast enough," said Wunsch. "We need to see a slowdown."

Annual growth of median wages in eurozone job adverts slowed from above 5 per cent last year to below 4 per cent in the third quarter of this year, according to a tracker by job search website Indeed and the Central Bank of Ireland. But negotiated wages in the region rose 4.7 per cent in the third quarter, the biggest annual rise in the eight years since the ECB started tracking the data.

There are signs of companies starting to absorb rising wage costs by compressing their profit margins rather than passing them on to customers via higher prices, he said. "We see that happening so it is not like we are dreaming this is going to happen."

Most ECB governing council members agreed this week on the need to wait until at least next summer to be confident inflation would keep falling rather than being kept elevated by spiralling labour costs as workers seek compensation for the surge in living costs over the past two years, according to several meeting participants.

"We know a lot of negotiations will take place in the first quarter and the data will not be ready to interpret until the second quarter," Wunsch said, adding that the chances of a rate cut in March seemed extremely slim.

"There is a combination of shocks where we could continue to have much weaker inflation and a sharp downturn early next year that brings March into play for a rate cut, but that is highly unlikely and not our assumption," he said.

The ECB on Thursday held its deposit rate at 4 per cent, the highest level in its history, for the second meeting in a row. But after eurozone inflation fell to 2.4 per cent in November, the lowest level since July 2021, investors ramped up bets on how quickly the ECB would start cutting rates.

Swaps markets were on Friday pricing in 1.55 percentage points of ECB rate cuts next year, with an 85 per cent chance of them starting in March.

This week's meetings of major central banks revealed a transatlantic divergence on the potential timing of rate cuts next year, with the US Federal Reserve revealing it had started discussing this possibility, while the ECB and the Bank of England pushed back on the idea more firmly.

If the Fed started cutting rates before the ECB, "it doesn't make it easier for us" even if it would not be "a binding constraint", Wunsch said. "It has an impact, such as on market expectations. But we have to decide on the basis of what is happening in the eurozone."

ECB president Christine Lagarde said on Thursday "we should absolutely not lower our guard" against inflation. She added that about half of the workers covered under its wage tracker will have their collective bargaining agreements renegotiated in the first half of next year. "So it will be data-rich, particularly on the employment front," she said.

Wunsch said ECB rate-setters did not want to "over-emphasise" the "good news" from November's bigger-than-expected drop in eurozone inflation.

The ECB's forecast for euro area inflation to drop from an average of 5.4 per cent this year to 1.9 per cent in 2026 was based on assumptions that borrowing costs would be higher than they are now, following the recent bond market rally. Looser financial conditions — bond yields fall as their prices rise — may also keep inflation higher by boosting economic activity and demand.

"A lot of governors believe financial conditions are now not likely to be restrictive enough," said Wunsch. "They are a lot looser than those we have in our projections. But that is partly offset by the fall in energy prices since the cut-off date for our projections and other elements."