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ECB: Bland 25bps Cut as Scheduled; October Pause and December Cut Await

- **The ECB failed to surprise on policy decision day as it delivered a well-telegraphed 25bps rate cut, while Lagarde poured cold water on small October cut bets that slightly weighed on European debt but with limited impact on the EUR or local bourses.**
- **The "relatively short period" until the next meeting will not provide enough information to judge that a faster pace/size of cuts is needed, so see you at the December forecasts round for the next 25bps cut.**
- **ECB staff predictably made minimal changes to their macroeconomic projections, with small upside revisions to core inflation contrasting with marginally lower growth over the forecast horizon.**

Once again, the ECB failed to surprise on policy decision day as it delivered a well-telegraphed 25bps rate cut to its deposit facility rate to 3.50% as we, economists, and markets had fully expected. The rate cut size, according to Pres Lagarde, was also unanimously agreed upon. Technical adjustments to its main refinancing and marginal lending facility rates to narrow spreads between official rates were also executed in line with guidance, bringing these to 3.65% and 3.90%, from 4.25% and 4.50%, respectively.

The unsurprising monetary policy statement and roughly in line forecast revisions gave markets little to move on until Lagarde's presser (and US data in between) fed a small increase in yields and EUR strength. Lagarde pouring cold water on (already small) October cut expectations may have been the bigger driver of the small moves. At writing (9.15ET), when compared to pre-statement levels, markets have left German 2s 4bps higher (vs 2bps in US and UK 2s), implied October cuts trimmed by 2bps at 6bps, and the EUR up only 0.2% while Euro Stoxx broadly track US futures.

The ECB is clearly acting cautiously given worries about services inflation and wages growth, sticking to a data-dependent, meeting-by-meeting approach. After maybe boxing itself into cutting somewhat early at its June decision, it's clear they want to take their time to monitor data and slowly reduce the degree of policy tightening. The ECB's quarterly forecast revisions rounds, like today's and again in December, are the best opportunity to take stock and adjust real policy rates.

ECB staff predictably made minimal changes to their macroeconomic projections. Headline inflation forecasts were left unchanged at a 2.5/2.2/1.9% average for 2024/25/26, but core inflation projections were lifted by 0.1ppts this year and next, and held steady for 2026, leaving them at 2.9/2.3/2.0% respectively. In contrast to the marginally higher core inflation path, the GDP growth outlook was revised lower by 0.1ppts each year, to 0.8/1.3/1.5% average for 2024/25/26.

These forecast revisions are not large enough to suggest in any material way that the ECB would consider a faster or slower pace of easing—especially in the near-term. Inflation is still converging towards target in headline terms, though elevated services inflation and wages growth are delaying the achievement of the ECB's goals.

Pres Lagarde pointed to a series of wages growth data and trackers that support their optimism for easing services inflation. She also highlighted that strong negotiated wages growth over the next few quarters would owe to the result of large bargaining agreements—namely in German industry—while the underlying trend is more encouraging. On this note, recent news and data regarding the bloc's manufacturing sector reinforce the view that these big pay increases are mostly catch-up to past inflation (i.e., backward looking) rather than industrial strength, which faces demand and competitiveness challenges (e.g. China, and high energy and labour costs).

Barring a marked economic deterioration (or market collapse) in the five weeks until the next decision, the ECB will hold at its October meeting, after which we expect quarterly 25bps rate cuts in December, through 2025. Though Lagarde noted in her press conference that Eurozone growth risks are tilted to the downside, the data due for release between meetings would not be evidence enough to determine the bloc's GDP is sharply slowing or contracting. September Regional PMIs on the 23rd and a combination of August industrial production or retail sales data won't do it.

Lagarde didn't rule out an October cut due to a strict adherence to the meeting-by-meeting approach, but it was heavily implied. Lagarde remarked the "relatively short period" until the next meeting and also highlighted the "data dependency does not mean data-point dependency" and that they will not fixate on one single number like the September HICP release. On this, she also highlighted that base effects (mainly due to energy) will be behind a low reading for the month, and that they anticipate an acceleration in Q4; meaning, don't read too much into it.