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GLOBAL ECONOMICS

FLASH REPORT

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ECB: Five Weeks Later, Another 25bps Cut

- **The ECB met widely shared expectations for a 25bps cut, taking its deposit facility rate to 3.25% with its third rate cut of the cycle following moves in June and September. We expect the ECB will cut at each of its next four or five meetings towards a 2% terminal rate.**
- **Lagarde noted that it was a unanimous decision and that there are more downside ('a bit') than upside risks to inflation. Overall, she was clear in that inflation is heading in a direction that they like and did not in any noticeable way attempt to push back against market expectations. The EUR is 0.5% weaker and markets are assigning about a 20% chance to a half-point cut in December (unlikely).**
- **There were but small changes to the ECB's statement, with the highlight being a suggestion that they see the 2% target being reached sooner than previously thought, and that "the disinflationary process is well on track." Still, the ECB is "not pre-committing to a particular rate path" and will keep rates sufficiently restrictive, as needed.**

The ECB met widely shared expectations for a 25bps cut today to its three key policy rates, taking its deposit facility rate to 3.25% with its third rate cut of the cycle following moves in June and September. We project that the ECB will cut rates consecutively over the next four meetings before possibly skipping its June decision but ultimately reach our projected terminal rate of 2% no later than the July decision—with the odds of reaching 2% in June and/or a lower terminal rate higher than those of 2% in September and/or a higher terminal rate.

There was no outsized reaction in EUR markets to the release of the policy decision but Lagarde's presser (as is often the case) triggered more significant moves in the currency and yields. During her presser, Lagarde noted that it was a unanimous decision and that there are more downside ('a bit') than upside risks to inflation. Overall, she was clear in that inflation is heading in a direction that they like and did not in any noticeable way attempt to push back against market expectations. US retail sales and jobless claims data overshooting and undershooting, respectively, was a modest and brief, influence on local rates and the currency, as well.

At writing (9.30ET), the EUR is about 0.5% lower against the USD nearing 1.08, German 2s have fallen 5bps on the day (6bps since statement), and year-end cuts pricing is about 3/4bps higher to show ~30bps expected by December as traders bet on a large rate cut (20% odds).

Five weeks ago, at the time of the September decision, it seemed that the ECB would skip today's meeting to leave rates unchanged given the limited amount of data on tap between the September and October gatherings and a preference for taking stock of the policy stance once a quarter alongside updated projections. The data from September to December would go a long way to refine growth and inflation expectations for ECB policymakers, and on the basis of these data (if in line) the next rate cut would come in December.

But things in the Eurozone have certainly changed much faster than thought a few weeks ago. September CPI data released in late-September from France, Spain, and Germany showed lower-than-expected inflation (especially in the first two) to leave Eurozone inflation at just 1.7% y/y in September. A small rebound is expected in the next few prints, but truly as far as headline inflation is concerned (and its implications for wage setting and inflation expectations) it's looking like mission accomplished; it's now time to pull services inflation lower (3.9%).

And that also seems likelier now as the bloc's economies sit in, or will enter, a rougher growth patch that should result in lessened job growth and overall consumption as PMIs released just a few days prior to the CPI readings (and after the ECB's September meeting) reflected a much darker economic outlook in the bloc (especially in Germany and France) that aligns with negative media reports regarding the Eurozone's manufacturing sector while local political risks also dampen sentiment.

The ECB had to justify its rate cut today and, in line with the above, the only notable change to its statement (aside from those related to the September projection round) is the inclusion of "[the] incoming information on inflation shows that the disinflationary process is well on track. The inflation outlook is also affected by recent downside surprises in indicators of economic activity." The ECB is also teeing up a downward revision to its inflation forecasts, as it now sees inflation "declining to target in the course of [2025]", compared to "towards our target over the second half of [2025]"; 'to' vs 'towards', and 'in the course' vs H2-25.

Those were the only dovish adjustments to the ECB's monetary policy decision statement, while the unchanged final paragraph noting a data-dependent and meeting-by-meeting approach and that it will keep policy rates sufficiently restrictive for as long as necessary reflects the ECB's caution in "not pre-committing to a particular rate path." We didn't expect that the ECB would modify this as it would not want to add to rate cut bets that see consecutive cuts at roughly the next five meetings (minimum of 19bps priced in across these decisions), but there's also nothing in today's statement that would suggest they will not cut in December. For that we'd need to see as fast of a turnaround in the economic outlook as we saw it worsen in the last few weeks, as well as some unforeseen stickiness or rise in services inflation and Q3 compensation data.