

## ECB comments suggest there's a new rush towards neutral rates

The European Central Bank (ECB) has made a remarkable U-turn recently. Last week's rate cut was just the beginning, and this week's comments indicate that the ECB is now eager to quickly bring rates down to neutral and stay ahead of the curve in monetary policy



Christine Lagarde, president of the European Central Bank, at an IMF meeting this week

International gatherings following an ECB meeting invariably lead to a flood of comments from ECB officials, and the current IMF meetings are no exception. Numerous officials are commenting on the future path of interest rates and it is clear that the rift between doves and hawks is widening again. Time for a brief assessment.

### The ECB has opened the 50bp rate cut discussion

At last week's press conference, ECB president Christine Lagarde explained that the decision to cut interest rates was mainly driven by the "disinflation is on track" motive. Lagarde tried to convey the message that the ECB was in no state of panic but in full control of the disinflationary process and cut rates not because it had to but because it could.

It's worth noting that between the September and October meetings, very little macro data had

been released. In fact, a single data point of weaker sentiment indicators and an expected drop in headline inflation seemed like a weak justification for stepping up the pace of rate cuts from quarterly to meeting-by-meeting.

The fact that at least some ECB officials are now openly discussing a 50bp rate cut at the December meeting indicates a further acceleration in the pace of monetary policy easing. Just one week after the last ECB meeting, it now appears that the ECB not only can cut rates but must cut them.

## But why?

The interesting question no one has been asking is what exactly triggered this sudden excitement as Lagarde last week dismissed the possibility of a eurozone recession, and the ECB's macro projections in September showed a return to potential growth by early 2025.

The official data alone is not enough to justify a significant change in the ECB's macro assessment. In fact, the official data seems to confirm the growth and inflation profile from the September projections. Therefore, this new dovishness must be due to a worsening gut feeling about the state of the eurozone economy and the growing awareness that the economy is stuck again in structural weakness.

And there seems to be more: the risk of inflation undershooting. For a long time, the ECB warned against sticky domestic inflation, but there are now more ECB members talking about the risk of inflation undershooting. Indeed, actual headline inflation dropped below 2% but mainly as a result of favourable energy base effects. Services inflation and core inflation remain too high.

Also, interestingly, there is currently very little talk at the ECB about factors structurally pushing up inflation. What happened to 'greenflation' or the arguments made in the past that demographics and changes to globalisation would also potentially push up price pressures? What happened to the old central bankers' narrative that monetary policy cannot solve structural problems in an economy? All of a sudden, the ECB seems to be back in the 2010s.

## Where do we go from here?

Over the last few weeks, the ECB has made a remarkable U-turn, one which we expected to come in early 2025. It's a U-turn away from inflation concerns towards rising growth concerns. The U-turn is even more remarkable as it is not fully driven by hard data but by gut feeling.

Having been slow to address rising inflation and arguably late in stopping rate hikes last year, the ECB now appears determined to get ahead of the curve and return interest rates to neutral as quickly as possible. For the doves this is a no-brainer, and for the hawks, the argument might be that getting rates back to neutral quickly could be enough to avoid another episode of unconventional monetary policy with quantitative easing and negative interest rates further down the line.

This new determination also means that a 50bp rate cut in December can no longer be excluded. To see a 50bp rate cut in December, however, we need to see another batch of low actual inflation data plus a significant downward revision to the inflation and growth forecasts. Without these revisions, a negative gut feeling alone won't suffice.

All in all, this week's ECB comments clearly show that what looked like a well-balanced decision to

gradually reduce the level of monetary policy restrictiveness is currently turning into a panic to rush to neutral as soon as possible.

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