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ECB’s Lagarde: We’re ditching forward guidance

The press conference following the ECB’s announcement to keep its policy interest rates unchanged confirms that, at least for now, the ECB has given up on forward guidance. And rightly so...

ECB President, Christine Lagarde, at Thursday's news conference

A meeting-by-meeting approach

It comes as no surprise that the European Central Bank kept its policy interest rates unchanged. There simply hasn't been a lot of important data releases since the ECB’s June meeting. If anything, the latest data has pointed to weaker growth and lower headline inflation but still sluggish core and services inflation. In more detail, dropping confidence indicators in June and weak hard data for May underline that the eurozone’s economic recovery has lost steam. At the same time, inflation has been broadly in line with ECB forecasts, even if sticky services inflation and continued wage pressure have increased upward risks to these forecasts. But for now, there simply hasn't been enough new data for the ECB to change course. In this regard, it is noteworthy that the ECB’s official risk assessment for growth slightly changed today. According to ECB president Christine Lagarde, risks to the growth outlook were now tilted to the downside. In June, this label only applied to the longer-term growth outlook.

Talking about Lagarde and the comments during the press conference, there was very little news. For once, the ECB really seems to be sticking to the plan not to give any forward guidance. And rightly so. Lagarde’s emphasis on data-dependency and a meeting-by-meeting approach confirm that there is no preset plan for the September meeting. Lagarde introduced a new concept – WPP (Wage Profit Productivity) – which apparently is gaining more importance in the ECB's discussion.

September rate cut not a done deal

Looking ahead, it is important to remember that this is not yet a typical rate-cutting cycle in the eurozone. In the past, easing cycles had always been triggered by recessions or crises. Fortunately, neither of these is currently the case. Therefore, any further rate cuts will not be on autopilot. In fact, it is clear that the ECB will have to find a balance between potential reputational damage and rising concerns about an overly optimistic inflation forecast. The ECB won't have any interest in making the June cut look like a policy mistake over the coming weeks, which would be a strong non-economic argument in favour of another rate cut at the September meeting. At the same time, however, weakening economic momentum, stubbornly high domestic inflation and a risk of elevated wage growth are not a combination to cheer for, and this will make it harder for the hawks to agree on a September cut.

In June, the decision to cut rates was driven by an improving growth and inflation outlook. Now, with a worsening growth outlook and the risk of inflation taking longer to return to target, a September rate cut is anything but certain. As we think that inflation will remain sticky and it actually needs a further weakening of demand to structurally bring inflation back to target, there is not a lot of room for manouvre for the ECB in the coming months. Picking up the ECB's theme of data dependency, we see a 50% chance for a rate cut in September and a 100% chance for a cut in December.

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