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ECB cuts rates again with more to come, even if Lagarde won't commit

Christine Lagarde's comments at today's European Central Bank press conference suggest the Bank is trying to get interest rates down to neutral levels as soon as possible



ECB President, Christine Lagarde

No, nothing to see here. At least no growth panic. Rates were cut again because the ECB thought it could do so, not because it necessarily had to. This somehow is the main message the European Central Bank tried to convey at today's meeting in Ljubljana.

The decision to cut rates by 25bp only five weeks after the last cut and with only very few pieces of economic data since then suggests that the ECB must have become much more concerned about the eurozone's growth outlook and the risk of inflation undershooting the target. That said, ECB president Christine Lagarde tried to play down growth concerns and rather emphasised fading inflationary pressure.

Decoding the ECB's language

During the press conference, Ms Lagarde argued that today's rate-cut decisions were in no way a deviation from the data-dependency strategy. Still, some doubts remain. In fact, as the drop in headline inflation had been expected, it was only the weaker-than-expected PMIs

which seem to have driven the ECB's decision to cut rates today. No words about potential changes to the still very benign growth profile in the September forecasts. To us, this looks like a change from data-dependency to data-point dependency and a growing divergence between how, on the one hand, the Governing Council and, on the other, ECB staff (models) look at the economy.

Just as a reminder, back in September, the ECB expected a short-lived softening of the economy in the second half of this year and a subsequent return to potential growth from early 2025 onwards. At the same time, inflation was expected to come down to 2.0% by the end of 2025.

To some extent, we are currently witnessing an interesting back-and-forth of the ECB's main focus, from actual data to forecasts and back. While the run-up to the first two rate cuts in June and September was basically dominated by the ECB's growing confidence in its own (stable) longer-term inflation forecasts, today's rate cut is driven by actual data developments. And a shift from inflation concerns to growth concerns.

Following this logic, as long as there are no signs of a significant rebound of the eurozone economy or reflation, the ECB will continue cutting rates. However, Lagarde's comments during the press conference also suggest that the ECB is not yet entirely convinced about its next steps. She reiterated that after today's cut, monetary policy is still restrictive and that inflation is not yet beaten.

More rate cuts to come

Looking ahead, given the very shaky explanation for today's rate cut decision, it looks as if the ECB has in no way made up its mind yet on what's next. With the current negative momentum in the eurozone economy, however, we see a weaker trajectory for the economy than the Bank has pencilled in. If we are right, this means that the ECB will continue cutting rates.

We now understand that having just a bit more data is no longer a barrier to cutting rates. Even if Christine Lagarde and her team avoid providing forward guidance, it appears the Bank has shifted from rate cuts tied to new macro projections every quarter to considering them at every meeting. It looks like they're aiming to bring interest rates to neutral levels as quickly as possible.

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