# Rates Spark: Dealing with eurozone disinflation

We don't think markets should dismiss another European Central Bank rate cut as eurozone inflation starts to drift below target. At the same time, the prospect of recovering growth – boosted by the German fiscal situation – should keep the back end anchored higher. We therefore see steeper curves in the near term

We expect inflation to keep coming down in the eurozone with steeper curves

## Dealing with disinflation through steeper curves

Recent growth indicators still point to a path of higher rates from here, but disinflation is a risk pushing in the opposite direction. The eurozone's August core CPI number is expected to come in at 2.2%, just a notch below the 2.3% from July. But the outlook is for lower values and the ECB's own projections even show the headline CPI number falling to just 1.6% in 2026. We think the ECB will have a bias towards more easing, not just because of the inflation outlook, but also because the hard data is still showing close to zero growth. Having said that, the direction of inflation from here is still a live debate at the Governing Council, as also highlighted by the more hawkish comments from Isabel Schnabel this morning.

As inflation numbers come in softer, we think the front end of the euro swap curve could find itself nudging lower again. A key question is how longer rates will react. On the one hand, the German fiscal impulse is expected to gain traction next year, which would then have an inflationary impact. In this case, the back end of the curve would hold high, resulting in a steeper curve. On the other hand, markets may be too quick to extrapolate lower inflation numbers as a return to a secular stagnation world. This would also drag down the back end of the curve, limiting the steepening. But with soft growth numbers still doing well, as Monday's PMIs confirmed, we think the balance of risks is to a further steepening in the near term.

## Tuesday's events and market views

The week starts with a focus on the eurozone as the flash CPI for August is released. Consensus looks for a slightly higher headline rate of 2.1% year-on-year, while the core rate is expected to edge down to 2.3%.

The US kicks off a busy data week with the release of the ISM manufacturing. The expected increase to 49 would leave the index still in contractionary territory, same with the employment component expected to rise to 45. The price component is seen coming in at a higher 65.

In primary markets, Italy will launch new 7y and 30y benchmarks via syndication. Germany auctions €4.5bn in the 2y Schatz. The UK sells a new 10y gilt via syndication.

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