

Rates Spark: Markets now contemplating a 50bp December ECB cut

The ECB cut the deposit rate by 25bp as expected, but the communication was more dovish than anticipated, with unanimous support for the decision. Markets now price in a 25% chance of a 50bp cut in December, which seems overly ambitious but we wouldn't push back until the US elections. Global dynamics still drive the back-end of the EUR curve



ECB cut by 25bp and leaving dovish aftertaste

The European Central Bank cut the deposit rate by 25bp to 3.25% as expected, but what we did not expect was the overly dovish angle in the communication surrounding the decision. During the Q&A, ECB President Christine Lagarde highlighted that the decision was unanimous, which means that the earlier pushback by hawks did not materialise in an opposing vote. On the other hand, growth concerns seemed to be downplayed yet this did not persuade markets into a more hawkish perception. Risks stemming from a Trump victory were also referenced, giving market doves another hook for reinforcing expectations for a December cut.

In fact, and to our surprise, markets now price in about a 25% chance of a 50bp cut in December.

Markets have got ahead of themselves before, and based on the current economic data, we think the positioning is overly ambitious. Having said that, the catalysts to persuade rates markets away from a 50bp cut are hard to see as economic data is likely to continue softening for the time being. Add further downside inflation surprises, and markets may well see an ECB tempted to accelerate the trajectory back to neutral.

Now that traders are seriously contemplating 50bp cuts, the EUR curve could see further steepening from the front-end. Until we have clarity about Harris vs Trump, more easing on the back of growth concerns will be the prevailing theme. The endpoint for the ECB seems to be relatively anchored for now and thus we're talking about an acceleration of cuts rather than the number of cuts. The back-end of the curve remains more driven by global dynamics, reflected in the strong spillovers from the bear steepening of the UST curve on better-than-expected economic data.

Today's events and market view

The ECB will release the survey of professional forecasters, but not much other data of relevance features on the calendar. We will watch out for the usual post-meeting flurry of commentary from ECB members, especially since the hawks appear to have fallen in line with Thursday's decision. No speakers are officially scheduled, though.

The US will release housing start numbers and a few Fed speakers including Raphael Bostic, Christopher Waller and Neel Kashkari fill the calendar for the day.

More attention will be paid to sovereign ratings over coming weeks. This Friday evening the focus is on Italy with both S&P and Fitch reviewing their BBB ratings, both currently with stable outlooks. Sentiment appears to be geared towards the upside, underscoring an ongoing reordering within the semi-core and periphery eurozone sovereign bond space.

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