Rates Spark: October ECB cut more likely than ever

With eurozone disinflation broadening, markets now price in six consecutive 25bp cuts from the European Central Bank, including one in October. Frontloading cuts should help the EUR curve steepen from the back-end

Markets are now pricing six consecutive 25bp rate cuts by the European Central Bank

ECB dedicated to staying ahead of the curve

With disinflation broadening across the eurozone and Lagarde underlining this will be taken into account in next decision, an October ECB cut suddenly seems more likely than before. After falling inflation numbers from France and Spain last week, now also Germany and Italy are added to that list. And Lagarde's acknowledgements that the latest survey indicators (e.g. PMIs) are showing headwinds, adds to the probability that we'll already see the next cut in October.

The ECB earlier appeared to resist the idea of an October cut, on the premise that no new projections would be available, but Lagarde's speech appears to set markets up for another perfectly orchestrated cut. With 23bp priced for October, the strategy seems to work. Both cuts earlier this year were also fully priced in weeks ahead, avoiding any surprises on the day of the decision. In fact, market pricing is now almost at exactly one 25bp cut for each meeting until June 2025.

With the front-end anchored the back-end will start seeing more action

With markets dedicated to consecutive cuts for the six meetings, the next question to answer will be about the total number of cuts. In other words, the end point of the ECB. We likely won't know the answer before approaching mid-2025 and therefore the coming months could see a shift of volatility from the front-end of the curve towards the back-end of the curve.

Considering the ECB's dedication to staying ahead of the curve, and a front-end well-anchored to consecutive cuts, we think the next move will come from higher back-end yields. Frontloaded rate cuts should support the economic recovery quicker, boost financial conditions, and help risk sentiment in the near term. In addition, the currently implied terminal rate is now below 2.0%, which is too low in our view (and the ECB's view) and should be closer towards 2.25%.

Tuesday's events and market views

From the eurozone the CPI estimates for September will draw most attention. The core figure, however, is expected to remain hot at 2.7%, which would only be a 0.1% decline from last month. We also have Dutch inflation numbers, whereby the consensus for the headline CPI number is 3.2%. From Spain and Italy we'll see manufacturing PMIs, which are likely to weaken looking at the broader eurozone trend. From the US the key data will be the JOLTS job openings report and the ISM manufacturing numbers. The ISM is actually expected to pick up slightly, but remains weak at 47.6.

In terms of notable issuance we have Germany auction €6bn of 5Y Bobls and the UK £2.25bn of 19Y Gilts.

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