

ECB cuts rates by 25bp and more to come

The European Central Bank cut interest rates by 25bp and we see more cuts coming



The ECB just announced another rate cut. The deposit interest rate, which is the new policy rate, will be lowered by 25bp. Don't forget that the spread between the deposit rate and the refi rate will be lowered to 15bp next week as a result of the ECB's review of its operational framework. This means that as of next week, the deposit rate will be at 3.5% and the refi rate at 3.65%.

Weaker growth should be the driver of more aggressive rate cuts next year

The reasons for today's rate cut seem obvious: headline inflation has continued to come down and the ECB's own growth and inflation forecasts have confirmed the ECB's macro picture of the last months. In the latest staff projections, GDP growth in the eurozone is expected to come in at 0.8% in 2024, 1.3% in 2025 and 1.5% in 2026, slightly lower than in the June projections. Headline inflation is expected to come in at 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026, unchanged from the June projections.

Looking ahead, we expect the ECB to eventually step up the pace of further rate cuts. Not this year, but next year. Why not this year? Because currently, German wage negotiations and

increasing selling price expectations still point to some stickiness of inflation. And given that the ECB's track record of predicting inflation on its way up is rather weak, the ECB will want to be entirely sure before engaging in more aggressive rate cuts.

A weakening eurozone growth outlook should be the trigger to eventually go for more aggressive rate cuts. Back in July, the ECB had already shifted the risk assessment to its growth outlook to "tilted to the downside". Given that the ECB's forecasts have been structurally overestimating the timing and the strength of the eurozone economy, it only seems to be a matter of time before a bleaker growth outlook will translate into more aggressive rate cuts. The soft landing in the US and the impact on the eurozone could be that trigger.

What to expect from the press conference

In today's press conference, we don't expect ECB President Christine Lagarde to provide any forward guidance but to stick to the data-dependency approach. In the eyes of the ECB, this communication at the July meeting worked perfectly well. Whether this was indeed due to the communication or simply because markets were rather interested in the Federal Reserve and not the ECB over the summer remains to be seen. Given the still high uncertainties, the ECB will probably also want to bank on something when taking the next rate decision. And as controversial as they sometimes are, the staff projections are the best thing to hold on to. Therefore, the next rate cut looks likely in December, not October.

But let's wait for the press conference, starting at 2.45pm CET, and see whether Christine Lagarde will simply repeat her April wording when she said that there would be more data in May but much more data in June.

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