ECB minutes show what a difference a few weeks can make

The minutes of the European Central Bank's September meeting show a central bank that is increasingly concerned about disappointing growth but still very reluctant to give the all-clear on inflation

The ECB building in Frankfurt

Getting the minutes of the last ECB meeting only a week ahead of the next one is very unusual. The late release is the result of some calendar changes over the summer months. But regardless, it means that these minutes tell us even less about the next ECB steps than normal. In fact, this time around, the minutes show what a difference just a few weeks can make in the ECB's thinking.

Main takeaways from the minutes

The just-released minutes confirm that at the September meeting, the ECB seemed determined and comfortable to continue its very gradual pace of reducing monetary policy restrictiveness, ie a gradual and measured pace for rate cuts. The October meeting would come too early for the ECB to see any fundamental change of its own growth and inflation assessment. The December meeting was clearly the preferred option for the next rate cut as it will be a meeting with updated macro projections.

Here are the most important passages from the minutes:

- **Growing growth concerns:** "While broad agreement was expressed with the latest macroeconomic projections, it was emphasised that incoming data implied a downward revision to the growth outlook relative to the previous projection round."
- **Still hope for a consumption recovery:** "It rather reflected ongoing monetary policy transmission, which could, however, be expected to gradually weaken over time, with deposit and loan rates starting to fall."
- **A lot of caution regarding inflation.** "...it was emphasised that core inflation was very persistent. In particular, services inflation had continued to come in stronger than projected and had moved sideways since November of last year."
- **Full agreement on a very gradual approach to cutting rates:** "It was underlined that the speed at which the degree of restrictiveness should be reduced depended on the evolution of incoming data."
- **Data dependence is not the same as data point dependence:** "However, such data-dependence did not amount to data point-dependence, and no mechanical weights could be attached to near-term developments in headline inflation or core inflation or any other single statistic."

All in all, the minutes reflect an ECB which has become increasingly concerned about the growth outlook and is still very reluctant to give the all-clear on inflation.

To cut or not to cut?

It's well known by now that the weeks after the September meeting have shaken up the ECB. One batch of weak sentiment indicators and dropping headline inflation has brought back the rate cut option for next week's meeting. In fact, judging from official ECB comments over the last two weeks, there seems to be a large group of ECB members favouring a rate cut next week. However, given the voiced opposition by others, a cut is not a done deal, yet.

In fact, there are also good arguments against a cut. There hasn't been any hard macro data released since the ECB's September meeting. The fear of a further weakening of economic momentum is purely driven by sentiment indicators - the same sentiment indicators that not too long ago the ECB described as being not entirely reliable. Also, the loss of some economic momentum has already been incorporated into the ECB's staff projections. Markets took comfort from the fact that ECB member Isabel Schnabel in a speech recently said, "We cannot ignore the headwinds to growth". In the same speech, however, Schnabel also underlined the fact that monetary policy could do very little to solve structural weaknesses.

As regards inflation, ECB President Christine Lagarde had already telegraphed the drop in headline inflation at the September meeting. And, indeed, with headline inflation at 1.8% year-on-year in September, it was exactly in line with the ECB's own projections. Looking ahead, headline inflation is still highly dependent on oil price developments. While the drop in oil prices in September was an important driver of falling headline inflation, the ongoing tensions in the Middle East have pushed up prices again over the last two weeks. Finally, available country data suggest that services inflation remains high. This is another argument for the ECB not to cut rates next week.

A cut with clear risks of a surprise hold

We are far less certain than financial markets that the ECB will actually cut rates next week. The main question for the ECB will be how it interprets the distinction between data dependence and data point dependence. If all of the recent data is regarded as one big data point, there is no reason to cut at the October meeting. If it is regarded as one big series of disinflationary data, it is. In any case, if the ECB decides to cut rates next week, this would mark an important change in its own reaction function. It would be a rate cut to bolster growth. The advantage of such a rate cut would be that the ECB would then suddenly be on a meeting-by-meeting rate cut cycle, hoping to be ahead of the curve and lowering the level of monetary restrictiveness just in time to avoid an economic accident.

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