MARKET COMMENTARY

Inflation sustainably around target backs further ECB cuts

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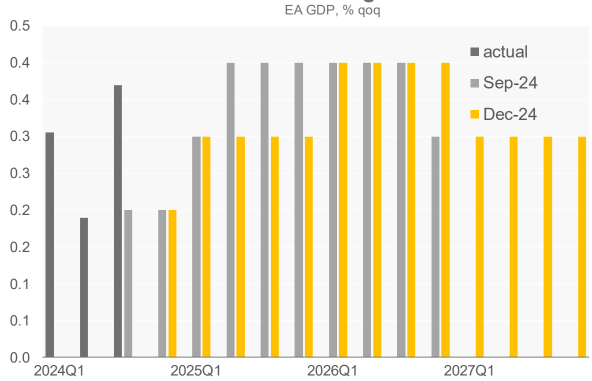
- **At today's meeting the ECB's Governing Council (GC) decided again to cut its key rate by 25 bps to 3.0%, in line with latest market expectations. The decision was backed by updated macro projections, now expecting inflation to "*settle at around the Governing Council's 2% medium-term target on a sustained basis*" amid lower expected growth.**
- **At current levels rates are still seen as restrictive but in the current environment the need to "*keep policy sufficiently restrictive*" was no longer mentioned. The drop of the tightening bias also reflects that inflation risks became more two-sided while growth risks stay tilted to the downside.**
- **While data-dependency and the meeting-by meeting approach were maintained President Lagarde also made clear that further rate cuts are in the pipeline and that there was still leeway until the neutral rate is reached. We expect the series of 25 bps cuts at each meeting to continue until July at a terminal rate of 1.75%.**
- **In the aftermath of the decision yields increased suggesting that market might have expected an even more dovish message.**

Inflation to stay around target
HICP, % yoy, quarterly data, ECB staff projections

Source: Datastream, ECB, GenAM calculations

A more realistic ECB growth outlook
EA GDP, % qoq



Source: Datastream, ECB

ECB cut by 25 bps today: At today's meeting the GC again decided to cut its key rate, the deposit rate, to 3.0%. It continues with APP non-reinvestments and announced to fully stop these reinvestments at the end of 2024.

Inflation to stay around target over most of the projection horizon…: At today's meeting the ECB staff presented the updated macro projections, now extended until 2027. Most notable, headline as well as core inflation are set to stay around the 2% target from 2025 onwards with annual inflation rates of 2.1%, 1.9%, 2.1% in case of headline inflation and 2.3%, 1.9%, 1.9% for the core inflation over the years 2025 to 2027 respectively. The wording about inflation has hence been scaled down. The GC speaks no longer of a disinflationary process only but an outright disinflation process that is seen "*well on track*". The statement that "*inflation will settle at around the Governing Council's 2% medium-term target on a sustained basis*" reflect further increased confidence in disinflation. At the same time President Lagarde pointed out that services inflation is still high (at around 4% for about one year) and that the ECB would like to see a change in the composition of inflation to be fully certain that inflation is back to normal again.

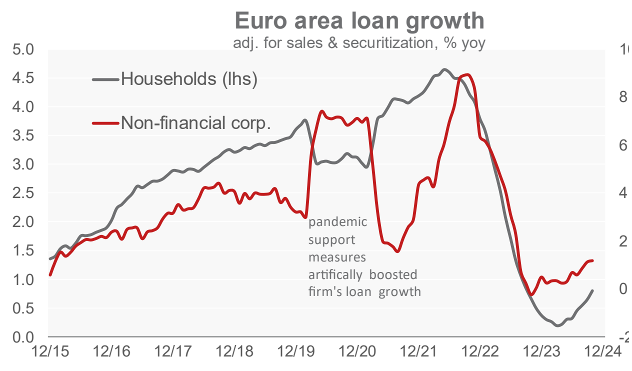
… while growth expectations were cut: While Q3 GDP (0.4% qoq) came in stronger than expected, key sentiment indicators were weak, political woes in Germany and France came on the table and looming US tariffs made the outlook shakier compared to the September projection. GDP is now expected to expand by 1.1% in 2025, 1.4% in 2026 and 1.3% in 2027 thereby cutting cumulative growth by 0.3pp over the next two years. The risks to growth remain tilted to the downside.

Still restrictive monetary policy stance: At current rates monetary policy is still assessed as "*restrictive*". Asked about the neutral rate, President Lagarde made clear that the GC will start debating this more intensively in due course. By mentioning a range of 1.75% to 2.5% derived from staff analysis she made in our view clear that she does not agree with more hawkish GC members like Mrs Schnabel that the neutral rate corridor is now already reached or close to be reached.

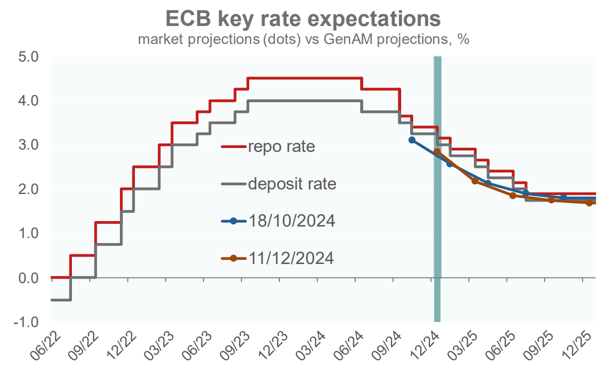
Meeting-by-meeting approach maintained: Not surprisingly, President Lagarde again praised the ECB's data-dependence and meeting-by-meeting approach. However, she also mentioned that the direction of travel was very clear but that the inflation risks became more two-sided. The elephant in the room are clearly US tariffs which are not incorporated in the updated staff projections.

Frontloading of policy easing likely: Today's decision was not met unanimously as there was reportedly initially some discussion about a bolder cut before the GC finally converged to the 25 bps easing. This underpins our expectation that further rate cuts are ahead. In the press conference, however, President Lagarde said that she does not find a 50 bps cut at the forthcoming January meeting likely. This is in line with our view. Although we do not look for a full implementation of the campaigned Trump tariff measures we are more pessimistic on activity in 2025 and see annual growth only at 0.8%. This will keep the ECB in easing mode. We look for protracted 25 bps cuts until July bringing the key rate down to 1.75%.

Markets: In the aftermath of the decision yields increased suggesting that market might have expected an even more dovish message.



Source: Datastream, GenAM



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