The ECB Cuts as all Indicators Point Down

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The ECB's Governing Council remained true to its mantra of "data dependence" at its latest policy meeting, choosing to cut the main policy rate by 25 bps to 3.25%. Only a few short weeks ago, there was widespread conviction that the ECB would keep rates on hold at this meeting. However, the combination of broad-based slowing in euro area economic activity and weaker inflation data shifted those perceptions to a cut.

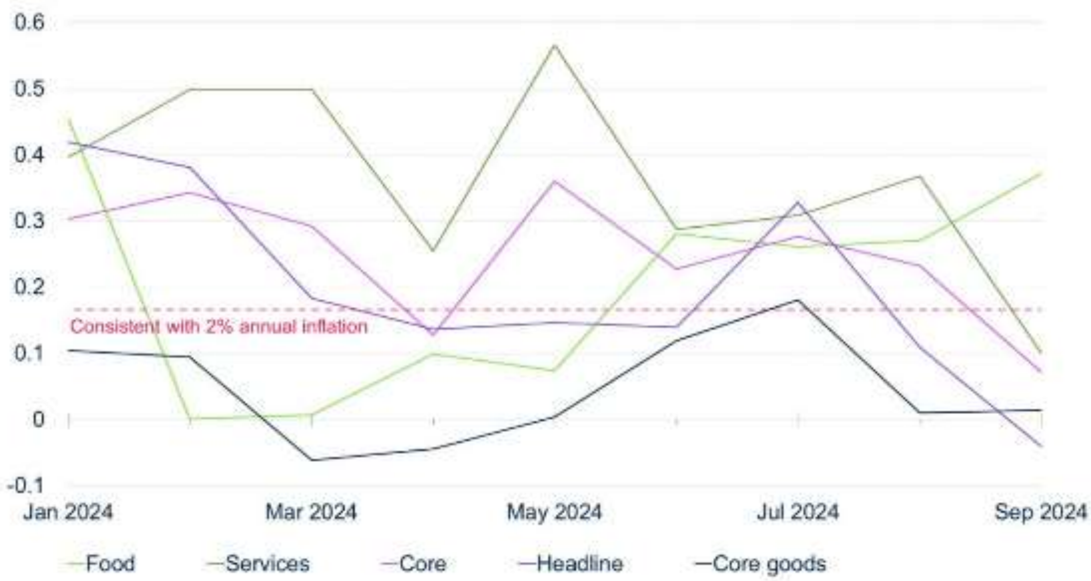
And the ECB delivered. We take today's move as a positive signal that the ECB is likely to be more proactive and aggressive in the coming months should the widespread economic easing gather pace.

Our Take on the Meeting

The Governing Council cut the deposit facility rate at its October policy meeting, citing growing confidence in the disinflationary process on the back of the recent data flow. We see this unanimous decision as reflecting an important shift towards a more dovish and proactive policy stance.

Critically, this is not the pre-pandemic ECB - a central bank seemingly loath to ease policy against a backdrop of weak growth and inflation stuck well below 2%. Recall that in both the early days of the pandemic and again in the recent inflation spike, the Lagarde-led ECB started slowly, but then adjusted policy in earnest. For example, the ECB was one of the last major central banks to hike rates in mid-2022, but when it did, it did so aggressively in a sequence of 50-75 bp increments.

FIGURE 1: Euro Area Monthly Inflation Rates (%) and Euro Area PMIs



Source: Macrobond as of October 17, 2024.

The ECB may not know where neutral is, but ECB President Lagarde reiterated at the press conference that the Governing Council is certain that policy is currently restrictive. That view opens the door to going aggressive at first, before fading the pace of cuts as rates converge closer towards the estimated neutral rate - e.g., of around 2%. We see this pivot as plausibly happening at the December meeting, when the ECB updates its forecast and we have greater clarity on the global spillovers from the U.S. election. Explore our analysis of tariffs on the EA economy and our assessment of U.S. political policies.

Market Insights

The 10-year bund was relatively unchanged following the announcement as the bulk of performance in rates during the press conference was centred around the December 2024 ECB meeting, with rate cut expectations falling 5 bps to 30 bps of cuts priced in reaction to the dovish undertones of the meeting outcome. As the upside risk to growth and inflation data has diminished, the market pricing has zeroed in on sequential 25 bp cuts for the ECB at every policy meeting until summer of next year. If data continue to come in weak, markets will quickly price in more aggressive ECB cuts starting in December when the market turns its attention to the ECB's refreshed economic projections.

Source(s) of data (unless otherwise noted): PGIM Fixed Income, PGIM Fixed Income, as of October 2024.
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