ECB keeping its options open on rates outlook

In the past week we have seen the July/August round of the key central bank meetings get underway, with the European Central Bank (ECB) first up. As expected, its Governing Council kept interest rates unchanged. This means that the Deposit rate remains at 3.75% while the Refi rate stays at 4.25%.

The 'hold' on rates in July follows the 25bps cut implemented in June to the ECB's main interest rates. The rate cut in June represented the first change in six meetings, and followed on from the rate hiking cycle in 2022-23. The decision by the ECB to keep its policy rates unaltered this month was unanimous.

Given the lack of any rate policy changes from the ECB for July was very much in line with expectations, the focus on this month's meeting was on what guidance, if any, the central bank would give regarding the potential for further rate cuts over the coming months. The meeting statement provided no new insight in relation to this. It continued to note that the Governing Council will follow a "data-dependent and meeting-by-meeting approach" to determine the appropriate interest rate setting. It also re-emphasised that it is not "pre-committing to a particular rate path".

Meanwhile, during the press conference, President Lagarde reiterated this approach. However, in response to a number of questions on the possibility of a rate cut at its next meeting on September 12th, President Lagarde did state that September "is wide open" and any decision will be determined by incoming data over the coming weeks.

She also commented that "it is clear between now and September, we will be receiving a lot of information". In other words, the ECB is not ruling out a rate cut in September, while at the same time maintaining flexibility on the timing of any decision on rates.

Market rate expectations for the ECB have remained relatively stable over the last number of months. Broadly speaking, since the last ECB meeting in June, the market has been pricing in around 50bps of rate cuts between now and year end.

In the aftermath of the July Governing Council meeting, the market though is attaching a lower probability to the chance of a rate cut in September compared to before the meeting. It is now envisaging a 60% probability for a September rate cut versus 90% prior to last week's meeting. A 25bps rate cut is fully priced-in by markets by the time of its October 17th meeting.

We believe that a further 50bps of rate cuts from the ECB over the remainder of 2024 is a plausible scenario if underlying inflation, especially in relation to the services sector and wage growth, shows further signs of moderating. This magnitude of rate cuts would see the ECB Deposit rate end the year at 3.25%.

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