



## ECB declares victory over inflation?

Last week's ECB policy meeting marked a firm shift in the focus of the Governing Council away from inflation towards growth concerns in the Eurozone. For the third time this year, it reduced rates by 25 basis points (bps), with the Deposit rate lowered to 3.25%, while the Re-fi rate was decreased to 3.40%.

The policy easing represented the first consecutive rate cuts from the ECB in 13 years and the decision was unanimous. The statement noted that the decision was based on the ECB's updated assessment of (1) the inflation outlook, (2) dynamics of underlying inflation and (3) the strength of monetary policy transmission. This change in tone and language in both the statement and the press conference by President Lagarde, reflected the weakness of the incoming data since the last ECB meeting in September. Last month's PMI surveys were particularly concerning, with broad-based softness across sectors and countries. These data were referenced throughout President Lagarde's press conference, alongside commentary that headline and core inflation are "all heading in the same direction: downwards".

On inflation, while the headline rate is now below target at 1.7% in September, this reflects prior weakness in energy prices in the month, which has unwound somewhat in recent weeks. For the remaining hawks on the Governing Council, the still elevated and sticky core rate of 2.7% in September, should be enough to advocate for a cautious easing cycle from here, which likely rules out a bumper 50bps cut at the next meeting. Indeed, the risks to the inflation outlook are likely still tilted to the upside in the Eurozone, given the exposure to geopolitical risks via supply chain and commodity market disruption from ongoing conflicts in Ukraine and the Middle East. Nevertheless, market pricing has softened in the aftermath of the meeting, with at least a 25bps rate cut expected in December.

Unless incoming data surprise significantly to the upside of expectations, which seems unlikely, the ECB's data dependent approach will likely see it cut rates again in December by 25bps. This would see the Deposit rate end the year at 3%, with further cuts likely in the new year also. Attention will soon turn to where the likely terminal rate is, with the President of the ECB unwilling to be drawn on this



question, as yet. Futures pricing currently indicates that the Deposit rate could bottom out at around 2%, which suggests the market is of the view that the current easing cycle in the Eurozone still has a way to run yet.

Turning to the week ahead, the main focus will be on the flash PMIs for October in the UK, US and Eurozone, with expectations for an uptick in growth following a weak September print across most surveys.

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