



All eyes on the US Federal Reserve as the ECB holds for now

The ECB's Governing Council meeting for September saw the central bank leave interest rates on hold for a second consecutive meeting. The deposit and refi rates were maintained at 2.00% and 2.15%, respectively. However, the September meeting statement was short and offered little in the way of new guidance, other than to note that inflation "is currently at around the 2%" target and that the "assessment of the inflation outlook is broadly unchanged". Instead, the meeting statement focused on the updated set of macro staff projections that were published and helped to inform the Governing Council's policy deliberations/decision.

Overall, the updated batch of ECB forecasts paint a broadly similar outlook to those published in June. The September edition of its GDP and inflation projections contained minor revisions, with the ECB more optimistic on the near-term growth prospects. Encouragingly, the ECB no longer views the risks to its economic outlook as being tilted to the downside. Instead, it is now of the view that growth risks have "become more balanced". It is not surprising then, that President Lagarde's comments during the press conference suggest that while the ECB retains a willingness to ease policy again, if required, it appears the ECB rate-cutting cycle is over for now. She stated the ECB's policy setting continued to be "in a good place" and that "inflation is where we want it to be".

In contrast, amid further soft labour market data from the US, markets are fully pricing in a rate cut by the Fed this week, with attention now turning to the frequency and magnitude of cuts by the central bank in the coming months. Overall, markets are pricing in up to three rate cuts by year end, and a total of circa 150bps of policy easing by the end of 2026. Against this backdrop, near term US real interest rate expectations have rapidly converged with euro rates recently, with 2-year interest rate falling from c.1.5% in January to just 0.35% presently. These interest rate dynamics should be supportive for EUR/USD, with euro rate futures firming slightly in the aftermath of the ECB meeting by c.5bps; however, the currency pair is holding around the \$1.17 level for now.

The subtle hawkish shift in tone by the ECB alongside a recent dovish tilt by the Fed adds to the sense that the US economy could be moving back towards the European pack in terms of the near-term growth outlook. Elsewhere on the monetary policy front, both the Bank of England and the Bank of Japan will hold policy meetings this week, with neither expected to tweak policy at this juncture.

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aibgb.co.uk/fxcentre

Economic Research Unit

AIBeconomics.unit@aib.ie

Tel: 353-1-6600311

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