Central Banks

Second ECB rate cut this year, eyes on December

Carlos Castellano / Maria Martinez

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- **The ECB cut the deposit facility rate by 25b, as expected, but gave no clues about the path of further rate reductions**
- **The ECB`s staff maintained that the inflation target will be reached next year but revised core inflation upwards due to persistent service prices. They also slightly revised down activity due to weak private consumption. This assessment is in line with our view**
- **The ECB remains in a "data dependent" mode. We expect one further cut in December as there were no clear dovish signals for a move in October**

As expected, the ECB lowered the deposit rate by 25 basis points. Moreover, it reduced the rates on its other two facilities (the main refinancing rate and the marginal lending facility rate) **by 60 basis points each, implementing the adjustments to the operational framework announced in March.** Specifically, at that time, the ECB announced that the spread between the interest rate on the main refinancing operations and the deposit facility rate would be set at 15 basis points. The spread between the rate on the marginal lending facility and the rate on the main refinancing operations will remain unchanged at 25 basis points. Accordingly, the deposit facility rate will be decreased to 3.50%. The interest rates on the main refinancing operations and the marginal lending facility will be decreased to 3.65% and 3.90% respectively. **The agreement reached by policymakers on the rate decision was unanimous.**

There was little information on the next steps, both in the official statement and during President Lagarde's press conference. Emphasizing its stance of not being predetermined and avoiding precommitment, the ECB will rely on data and adopt a meeting-by-meeting approach. Lagarde stressed that being data-dependent does not imply focusing on a single data point, stating that they are not going to be fixated on one specific number and are considering a broad range of indicators. On the neutral rate, she refrained from providing a specific number, reiterating that as they get closer to it, they will know.

On prices, the forecast of **underlying inflation was slightly revised up by 0.1pp in both 2024 and 2025, to 2.9% and 2.3% respectively on the stickiness of the service prices**. The **headline forecast remained unchanged** (2.5% in 2024 and 2.2% in 2025) thanks to lower energy and food prices, maintaining that the 2% target would be reached by the end of next year. There was a relatively **unchanged view** on inflation despite the latest data on wages, corporate profits and, to a lesser extent, labor productivity, that were in line with the ECB's June outlook. These better-than-expected incoming data were not used to adopt a more dovish tone as Largarde underlined that the **main worry is still on service inflation**, which remains at high rates and is driven mainly by wage catch-up. The wage growth outlook was almost unchanged, with an expected pick-up in the last quarter of this year due to ongoing collective bargaining negotiations, but a notable deceleration in 2025.

It is also worth noting her emphasis on **not overreacting on a single data point**; this is particularly relevant as September's inflation is expected to be below target due to base effects and **the next ECB meeting is just over a month away**. As well, Lagarde´s emphasis on the December forecast to confirm domestic demand weakness suggests that an October rate cut is unlikely.

Lagarde also did not put much emphasis on the weaker data activity to strike a more dovish tone, even though **ECB´s staff revised activity growth slightly downwards over the forecast horizon** (down 0.1pp in 2024, 2025 and 2026, to 0.8%, 1.3% and 1.5%, respectively). This revision was driven by the incoming data that points to **private consumption and investment weaker than foreseen** in the ECB´s June projections. Still, the **activity outlook looking forward is based on a consumption-driven recovery** together with an improvement also on investment and trade. Questions concerning the economic weakness of Germany were shifted to the heterogeneity of performance within the bloc. Overall, the growth and inflation projections and assessment are in line with our view.

Mario **Draghi´s EU competitiveness report recently published captured many of the questions** during the Q&A. Lagarde **welcomed the diagnosis of structural problems** in Europe and hoped that European authorities will implement many of its concrete proposals, as higher productivity growth will facilitate the task of the ECB. However, she stressed that the report does not significantly affect the role of the ECB, which is to provide price stability to the region.

All in all, **today's ECB meeting did not offer much new information, as widely expected**, apart from making the second rate cut this year. The main interest lay in discerning the tone of the ECB's statements regarding the timing of the next rate cut. With virtually **no hints today, this meeting supports our expectation of a very gradual cycle of rate cuts, with one more rate cut in December**.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

1.1. Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB

Frankfurt am Main, ~~18 July~~12 September 2024

Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to ~~keep~~lower the ~~three key ECB interest rates unchanged. The incoming information broadly supports~~deposit facility rate – the rate through which we steer the monetary policy stance – by 25 basis points. Based on our ~~previous~~updated assessment of the ~~medium-term~~ inflation outlook~~. While some measures~~, the dynamics of underlying inflation ~~ticked~~and the strength of monetary policy transmission, it is now appropriate to take another step in moderating the degree of monetary policy restriction.

Recent inflation data have come in broadly as expected, and the latest ECB staff projections confirm the previous inflation outlook. Staff see headline inflation averaging 2.5 per cent in 2024, 2.2 per cent in 2025 and 1.9 per cent in 2026, as in the June projections. Inflation is expected to rise again in the latter part of this year, partly because previous sharp falls in energy prices will drop out of the annual rates. Inflation should then decline towards our target over the second half of next year. For core inflation, the projections for 2024 and 2025 have been revised up ~~in May owing to one-off factors, most measures were either stable or edged down in June. In line with expectations, the inflationary~~slightly, as services inflation has been higher than expected. At the same time, staff continue to expect a rapid decline in core inflation, from 2.9 per cent this year to 2.3 per cent in 2025 and 2.0 per cent in 2026.

Domestic inflation remains high as wages are still rising at an elevated pace. However, labour cost pressures are moderating, and profits are partially buffering the impact of ~~high wage growth has been buffered by profits. Monetary policy is keeping financing~~higher wages on inflation. Financing conditions remain restrictive~~. At the same time,~~, and economic activity is still subdued, reflecting weak private consumption and investment. Staff project that the economy will grow by 0.8 per cent in 2024, rising to 1.3 per cent in 2025 and 1.5 per cent in 2026. This is a slight downward revision compared with the June projections, mainly owing to a weaker contribution from domestic ~~price pressures are still high, services inflation is elevated and headline inflation is likely to remain above our target well into next year.~~demand over the next few quarters.

We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. We will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. We will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

The decisions taken today are set out in a ~~press release available on our website~~press release available on our website. As announced on 13 March 2024, some changes to the operational framework for implementing monetary policy will take effect from 18 September. In particular, the spread between the interest rate on the main refinancing operations and the deposit facility rate will be set at 15 basis points. The spread between the rate on the marginal lending facility and the rate on the main refinancing operations will remain unchanged at 25 basis points.
I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

1.2. Economic activity

The ~~incoming information indicates that the euro area~~ economy grew by 0.2 per cent in the second quarter, ~~but likely at a slower pace than in~~ after 0.3 per cent in the first quarter, falling short of the ~~first quarter. Services continue~~ latest staff projections. Growth stemmed mainly from net exports and government spending. Private domestic demand weakened, as households consumed less, firms cut down business investment and housing investment dropped. While services supported growth, industry and construction contributed negatively. According to ~~lead~~survey indicators, the recovery~~, while industrial production and goods exports have been weak. Investment indicators point to muted growth in 2024, amid heightened uncertainty. Looking ahead, we~~ is continuing to face some headwinds.

We expect the recovery to ~~be supported by~~strengthen over time, as rising real incomes allow households to consume more. The gradually fading effects of restrictive monetary policy should support consumption~~, driven by~~ and investment. Exports should also continue contributing to the ~~strengthening of real incomes resulting from lower inflation and higher nominal wages. Moreover, exports should pick up alongside a rise in~~recovery as global demand~~. Finally, monetary policy should exert less of a drag on demand over time~~ rises.

The labour market remains resilient. The unemployment rate was broadly unchanged in July, at 6.4 per cent~~ in May, remaining at its lowest level since~~. At the ~~start of the euro. Employment, which grew by~~same time, employment growth slowed to 0.2 per cent in the second quarter, from 0.3 per cent in the first~~ quarter, was supported by~~. Recent survey indicators point to a further ~~increase~~moderation in ~~the~~demand for labour~~ force, which expanded at the same rate. More jobs are likely to have been created in the second quarter, mainly in the services sector. Firms are gradually reducing their~~, and the job ~~postings, but from high~~vacancy rate has fallen closer to pre-pandemic levels.

~~National fiscal~~Fiscal and structural policies should ~~aim~~be aimed at making the economy more productive and competitive, which would help to raise potential growth and reduce price pressures in the medium term. ~~An effective, speedy~~Mario Draghi's report on the future of European competitiveness and ~~full implementation of the Next Generation EU programme, progress towards capital markets union and the completion of banking union, and a strengthening of~~Enrico Letta’s report on empowering the Single Market ~~are key factors that would help foster innovation and increase investment in the green and digital transitions. We welcome the European Commission’s recent guidance calling~~stress the urgent need for ~~EU Member States~~reform and provide concrete proposals to ~~strengthen fiscal sustainability and the Eurogroup’s statement on the fiscal stance for the euro area in 2025.~~make this happen. Implementing the EU’s revised economic governance framework fully, transparently and without delay will help governments bring down budget deficits and debt ratios on a sustained basis. Governments should now make a strong start in this direction in their medium-term plans for fiscal and structural policies.

1.3. Inflation

~~Annual~~According to Eurostat's flash estimate, annual inflation ~~eased~~dropped to 2.~~5~~2 per cent in ~~June~~August, from 2.6 per cent in ~~May. Food~~July. Energy prices ~~went up by 2.4 per cent in June – which is 0.2 percentage points less than in May – while energy prices remained essentially flat. Both goods~~ fell at an annual rate of 3.0 per cent, after an increase of 1.2 per cent in the previous month. Food price inflation went up slightly, to 2.4 per cent in August. Goods inflation and services ~~price~~ inflation ~~were unchanged~~moved in ~~June, at~~opposite directions. Goods inflation declined to 0.4 per cent, from 0.7~~% and 4.1% respectively. While some~~ per cent in July, while services inflation rose, to 4.2 per cent from 4.0 per cent.

Most measures of underlying inflation ~~ticked up in May owing to one-off factors, most measures were either stable or edged down in June.~~

were broadly unchanged in July. Domestic inflation ~~remains high. Wages are still rising at an elevated rate, making up for the past period of high inflation. Higher nominal~~edged down only slightly, to 4.4 per cent from 4.5 per cent in June, with strong price pressures coming especially from wages~~, alongside weak productivity, have added to unit labour cost~~. Negotiated wage growth~~, although it decelerated somewhat in~~ will remain high and volatile over the ~~first quarter~~remainder of ~~this~~the year~~. Owing to~~, given the significant role of one-off payments in some countries and the staggered nature of wage adjustments~~ and the large contribution of one-off payments,~~. At the same time, the overall growth in labour costs ~~will likely remain elevated over the near term. At the same time, recent data on~~ is moderating. The growth in compensation per employee ~~have been in line with expectations and the latest survey indicators signal that wage growth will moderate over the course of next year. Moreover, profits contracted in the first quarter, helping to~~fell further to 4.3 per cent in the second quarter, the fourth consecutive decline, and ECB staff project it to slow markedly again next year. Despite weak productivity, unit labour costs grew less strongly in the second quarter, by 4.6 per cent, after 5.2 per cent in the first quarter. Staff expect unit labour cost growth to continue declining over the projection horizon owing to lower wage growth and a recovery in productivity. Finally, profits are continuing to partially offset the inflationary effects of higher ~~unit labour costs, and survey evidence suggests that profits should continue to be dampened in the near term.~~

~~Inflation is expected to fluctuate around current levels for the rest of the year, partly owing to energy-related base effects. It is then expected to decline towards our target over the second half of next year, owing to weaker growth in~~ labour costs~~, the effects of our restrictive monetary policy and the fading impact of the past inflation surge. Measures of longer-term inflation expectations have remained broadly stable, with most standing at around 2 per cent~~.

The disinflation process should be supported by receding labour cost pressures and the past monetary policy tightening gradually feeding through to consumer prices. Most measures of longer-term inflation expectations stand at around 2 per cent, and the market-based measures have fallen closer to that level since our July meeting.

1.4. Risk assessment

The risks to economic growth ~~are~~remain tilted to the downside. ~~A~~Lower demand for euro area exports, owing for instance to a weaker world economy or an escalation in trade tensions between major economies, would weigh on euro area growth. Russia's unjustified war against Ukraine and the tragic conflict in the Middle East are major sources of geopolitical risk. This may result in firms and households becoming less confident about the future and global trade being disrupted. Growth could also be lower if the lagged effects of monetary policy tightening turn out stronger than expected. Growth could be higher if inflation comes down more quickly than expected and rising confidence and real incomes mean that spending increases by more than anticipated, or if the world economy grows more strongly than expected.

Inflation could turn out higher than anticipated if wages or profits increase by more than expected. Upside risks to inflation also stem from the heightened geopolitical tensions, which could push energy prices and freight costs higher in the near term and disrupt global trade. Moreover, extreme weather events, and the unfolding climate crisis more broadly, could drive up food prices. By contrast, inflation may surprise on the downside if monetary policy dampens demand more than expected, or if the economic environment in the rest of the world worsens unexpectedly.

1.5. Financial and monetary conditions

~~The policy rate cut in June has been transmitted smoothly to money market~~ Market interest rates~~, while broader~~ have declined markedly since our July meeting, mostly owing to a weaker outlook for global growth and reduced concerns about inflation pressures. Tensions in global markets over the summer led to a temporary tightening of financial conditions ~~have been somewhat volatile. Financing~~in the riskier market segments.

Overall, financing costs remain restrictive as our ~~previous~~past policy rate increases continue to work their way through the transmission chain. The average interest ~~rate~~rates on new loans to firms ~~edged down to 5.1 per cent~~and on new mortgages stayed high in ~~May, while mortgage rates remained unchanged~~July, at 5.1 and 3.8 per cent respectively.

Credit ~~standards for loans remain tight. According to our latest bank lending survey, standards for lending to firms tightened slightly in the second quarter, while standards for mortgages eased moderately. Firms'~~growth remains sluggish amid weak demand ~~for loans fell slightly, while households' demand for mortgages rose for the first time since early 2022.~~

~~Overall, credit dynamics remain weak.~~. Bank lending to firms ~~and households~~ grew at an annual rate of 0.~~3~~6 per cent in ~~May, only marginally~~July, down slightly from June, and growth in loans to households edged up ~~from the previous month. The annual growth in broad~~to 0.5 per cent. Broad money – as measured by M3 – ~~rose to 1.6 per cent in May, from 1~~grew by 2.3 per cent in ~~April~~July, the same rate as in June.

1.6. Conclusion

The Governing Council today decided to ~~keep~~lower the ~~three key ECB interest rates unchanged~~deposit facility rate by 25 basis points. We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. We will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim. We will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

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ENQUIRIES TO:
BBVA Research: Azul Street, 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25
www.bbvaresearch.com