Central Banks

ECB hastens the easing cycle

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October 17 2024

- **The ECB lowered its policy rates by 25bps, as anticipated, and sounded dovish**
- **President Lagarde acknowledged downward surprises on inflation and economic activity, but ruled out an imminent euro zone recession; disinflation process is well on track**
- **The ECB continues to follow a "data-dependent" approach. We anticipate another rate cut in December**

The ECB lowered its key policy rates by 25bps, as expected, following strong signals from President Lagarde during her late September speech at the European Parliament, **as well as from other ECB officials. These signals came in response to a downward surprise in September's inflation and weaker activity data since the last ECB meeting**. Specifically, the interest rates on the deposit facility, the main refinancing operations, and the marginal lending facility will be reduced to 3.25%, 3.40%, and 3.65%, respectively.

This marks the third interest rate cut this year, and the decision was unanimous. The central bank reiterated its commitment to a data-dependent approach, with decisions being made on a meeting-by-meeting basis. Lagarde highlighted this month's decision as a clear example of such an approach, as they are reacting to incoming data. Regarding the possibility of a rate cut in December, Lagarde noted that **the ECB will not pre-commit to any specific course of action.**

There were no new projections released at this meeting, but many of the questions were about how the macroeconomic data released since the last meeting in September might alter the next outlook in December. Lagarde highlighted that **all activity indicators published since then pointed downwards**, and were "somewhat weaker than expected". In addition to the already prolonged weak data for manufacturing and exports, the ECB mentions a recent moderation in the services sector. However, and after being asked several times, **Lagarde ruled out for the time being the likelihood of a euro zone recession** and did not comment on the current weak situation of the German economy. With this easing cycle, the main driver of growth for the ECB continues to be the recovery in household consumption and investment, even though the recent hard data on household consumption was weaker than they expected, with the saving rates well above pre-pandemic levels.

On inflation, **Lagarde recognized that the ECB was somewhat surprised by the acceleration of the disinflationary process**, **which reinforces their confidence that the target is "well on track"**. Lower energy prices explain much of this surprise, but they also noted a significant progress in service inflation from August to September on a three-month basis. In addition, Lagarde said that the risks to inflation are "probably more to the downside than to the upside" and that the inflation target will be reached in the course of next year, rather than in the fourth quarter as previously projected. **The assessment definitely was mostly dovish**. However, **they acknowledged that during this quarter the slowdown of inflation will not be linear**, as expected, due to the energy base effects and still high wage growth. Nor do they ignore the potential effects on energy and food prices that the current geopolitical conflicts may have.

Overall, the ECB struck a dovish tone on both economic activity and inflation, effectively laying the groundwork to justify a rate cut they had almost pre-announced in the weeks leading up to the meeting. **While they continue to emphasize a data-dependent approach, all signs point toward another 25bp 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, 12 SeptemberLjubljana, 17 October 2024

Good afternoon, the Vice-President and I welcome you to our press conference. I would like to thank Governor Vasle for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council.

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. In particular, the decision to lower the deposit facility rate – the rate through which we steer the monetary policy stance – by 25 basis points. Basedis based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to take another step in moderating the degree of monetary policy restriction. The incoming information on inflation shows that the disinflationary process is well on track. The inflation outlook is also affected by recent downside surprises in indicators of economic activity. Meanwhile, financing conditions remain restrictive.

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 in the coming months, before declining to target overin the second halfcourse of next year. For core inflation, the projections for 2024 and 2025 have been revised up 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. HoweverAt the same time, labour cost pressures are moderating, and set to continue easing gradually, with profits are partially buffering thetheir impact of higher wages on inflation. Financing conditions remain restrictive, 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 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. 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~~press release available on our website.
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 suggests that economic activity has been somewhat weaker than expected. While industrial production has been particularly volatile over the summer months, surveys indicate that manufacturing has continued to contract. For services, surveys show an uptick in August, likely supported by a strong summer tourism season, but the latest data point to more sluggish growth. Businesses are expanding their investment only slowly, while housing investment continues to fall. Exports have weakened, especially for goods.

Although incomes rose in the second quarter, households consumed less, contrary to expectations. The saving rate stood at 15.7 per cent in the second quarter, well above the pre-pandemic average of 12.9 per cent. At the same time, recent survey evidence points to a gradual recovery in household spending.

The labour market remains resilient. ~~The economy grew by 0.2 per cent in the second quarter, after 0.3 per cent in the first quarter, falling short of the 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 survey indicators, the recovery is continuing to face some headwinds.~~

The unemployment rate stayed at its historical low of 6.4 per cent in August. However, surveys point to slowing employment growth and a further moderation in the demand for labour.

We expect the ~~recovery~~economy to strengthen over time, as rising real incomes allow households to consume more. The gradually fading effects of restrictive monetary policy should support consumption and investment. Exports should ~~also continue contributing~~contribute to the recovery as global demand rises.

~~The labour market remains resilient. The unemployment rate was broadly unchanged in July, at 6.4 per cent. At the same time, employment growth slowed to 0.2 per cent in the second quarter, from 0.3 per cent in the first. Recent survey indicators point to a further moderation in demand for labour, and the job vacancy rate has fallen closer to pre-pandemic levels.~~

Fiscal and structural policies should be aimed at making the economy more productive~~ and~~, competitive~~, which~~ and resilient. That would help to raise potential growth and reduce price pressures in the medium term. To this end, it is crucial to swiftly follow up, with concrete and ambitious structural policies, on Mario Draghi's ~~report on the future of~~proposals for enhancing European competitiveness and Enrico Letta's ~~report on~~ proposals for empowering the Single Market~~ stress the urgent need for reform and provide concrete proposals to 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

~~According to Eurostat's flash estimate, annual~~Annual inflation ~~dropped~~fell further to ~~2.2~~1.7 per cent in ~~August, from 2.6 per cent in July~~September, its lowest level since April 2021. Energy prices ~~fell~~dropped sharply, at an annual rate of ~~3.0~~-6.1 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 inflation moved in opposite directions. Goods inflation declined to~~ remained subdued, at 0.4 per cent, ~~from 0.7 per cent in July,~~ while services inflation ~~rose,~~edged down to ~~4.2 per cent from 4.0~~3.9 per cent.

Most measures of underlying inflation either declined or were ~~broadly~~ unchanged~~ in July~~. Domestic inflation ~~edged down only slightly, to 4.4 per cent from 4.5 per cent in June, with strong price~~ is still elevated, as wage pressures ~~coming especially from wages.~~in the euro area remain strong. Negotiated wage growth will remain high and volatile ~~over~~for the ~~remainder~~rest of the year, given the significant role of one-off payments ~~in some countries~~ and the staggered nature of wage adjustments.~~ At the same time,~~

Inflation is expected to rise in the coming months, partly because previous sharp falls in energy prices will drop out of the ~~overall growth in labour costs is moderating. The growth in compensation per employee fell further to 4.3 per cent~~annual rates. Inflation should then decline to target in the ~~second quarter, the fourth consecutive decline, and ECB staff project it to slow markedly again~~ course of 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 labour costs.~~

The disinflation process should be supported by ~~receding~~easing 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 remain tilted to the downside. Lower confidence could prevent consumption and investment from recovering as fast as expected. This could be amplified by sources of geopolitical risk, such as Russia's unjustified war against Ukraine and the tragic conflict in the Middle East, which could also disrupt energy supplies and global trade. Lower demand for euro area exports~~, owing~~ due, for instance, to a weaker world economy or an escalation in trade tensions between major economies~~,~~ would further 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 or if easier financing conditions and declining inflation lead to a faster rebound in consumption and investment.

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 low confidence and concerns about geopolitical events prevent consumption and investment from recovering as fast as expected, 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

~~Market~~ Shorter-term market interest rates have declined ~~markedly~~ since our ~~July~~September meeting, ~~mostly~~ owing mainly to ~~a~~ weaker ~~outlook for global growth~~news on the euro area economy and ~~reduced concerns about~~ the further fall in inflation~~ pressures. Tensions in global markets over the summer led to a temporary tightening of financial~~ . While financing conditions ~~in the riskier market segments.~~

~~Overall, financing costs~~ remain restrictive ~~as our past policy rate increases continue to work their way through the transmission chain. The~~, the average interest rates on new loans to firms and on new mortgages ~~stayed high~~were down slightly in ~~July, at~~August, to 5.~~1~~0 per cent and 3.~~8~~7 per cent respectively.

Credit ~~growth remains sluggish amid weak~~standards for business loans were unchanged in the third quarter, as reported in our latest bank lending survey, after more than two years of progressive tightening. Moreover, demand~~. Bank~~ for loans by firms rose for the first time in two years. Overall lending to firms ~~grew~~continues to be subdued, growing at an annual rate of 0.8 per cent in August.

Credit standards for mortgages eased for the third quarter in a row, owing especially to greater competition among banks. Lower interest rates and better housing market prospects led to a strong increase in the demand for mortgages. In line with this, mortgage lending picked up slightly, growing at an annual rate of 0.6 per cent ~~in July, down slightly from June, and growth in loans to households edged up to 0.5 per cent. Broad money – as measured by M3 – grew by 2.3 per cent in July, the same rate as in June~~.

1.6. Conclusion

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. In particular, the decision to lower the deposit facility rate ~~by 25 basis points.~~ – the rate through which we steer the monetary policy stance – is based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. 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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