Central Banks

# Easing path on track

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- **The ECB reduced rates by 25 basis points and removed its pledge to keep rates restrictive for as long as necessary**
- **As expected, growth and inflation forecasts were revised down, with a loss of momentum in activity and with balanced risks in inflation**
- **Lagarde did not provide many clues on future rates, or where the neutral rate is, but we expect four more rate cuts down to 2% for the depo rate**

At today’s ECB monetary policy meeting, **the ECB cut key interest rates by 25 basis points** (marking the third consecutive reduction and the fourth since the easing cycle began), as broadly expected. The deposit rate was lowered to 3.00%, while the rates for the main refinancing operations and the marginal lending facility were reduced to 3.15% and 3.40%, respectively. **A larger cut of 50 basis points was also discussed, but there appeared to be a broad consensus on a 25 basis point reduction.** While some members advocated for a more substantial cut, the Council ultimately agreed on the more moderate adjustment.

**The ECB removed the reference in its policy statement to keeping rates “restrictive for as long as necessary,”** paving the way for lower interest rates in the future. President Lagarde justified this removal by emphasizing that monetary policy remains restrictive. She also noted the significant progress achieved, with four cuts implemented so far, totaling 100 basis points, which aligns with the disinflation process being “well on track.” This change reflects the acknowledgment that substantial progress has been made, and while the ECB will continue to be data-dependent and avoid pre-committing to a particular path, removing the reference to restrictiveness underscores how far the situation has evolved. The ECB is now much closer to its target and continues to adjust its policies accordingly.

During the Q&A session, journalists raised several questions about the **neutral rate**, seeking clarity on where rates might settle by the end of the current cycle. President Lagarde indicated that this topic **will likely be debated further as the ECB approaches that level** but noted that it is currently premature to discuss the issue in detail. She acknowledged that the prevailing view among Governing Council members suggests the neutral rate is slightly higher than it was before, citing a report published about a year ago by ECB staff. This report estimated the neutral rate to fall within a range of 1.75% to 2.5%, based on various tools and methodologies.

This December meeting brought new projections from the **ECB staff which, unsurprisingly, lowered their forecasts for both activity and inflation**, especially for 2025, bringing them closer to our official forecasts (see table below). Many questions were raised about the effects that the second Trump administration could have on the eurozone economy. In terms of growth, there has been no change in tariff assumptions and they have clearly given more weight to the factors of protectionism and fragmentation of trade in their balance of risks, while in terms of inflation they have been more ambiguous in the effects that it could have.

The **downward revisions in activity are mostly due to the loss of momentum**, especially due to the weakness in the manufacturing sector and the slowdown in the services sector. In fact, the main revision, that of 2025, is due to **expected lower exports in the face of ongoing competitiveness issues**. Private household consumption is also expected to be weaker than previously thought, given the growing geopolitical uncertainties that are underpinning high savings rates. However, it remains the main driver of growth thanks to a still robust labour market and rising real wages. Also, investment should improve moderately based on the expected lower interest rates.

**On inflation, the ECB has shown its confidence that the target will be met in the medium term**, even though the downward revision has been marginal and limited to the headline inflation (due to lower incoming data and lower oil price assumptions), highlighting that there are still upside risks based on high domestic inflation (4.2%) and high wage growth. However, the most relevant aspect of the ECB´s confidence in the disinflationary process has been **Lagarde's clarity that the risks on inflation are balanced**, and also the fact that the ECB staff has lowered its wage projections for next year.

In sum, **the ECB struck a relatively dovish tone today** while delivering the widely anticipated rate cut. This aligns with the ongoing progress in the disinflation process, the softer momentum in the Eurozone economy, and the slight downward revisions to inflation and growth projections. After the meeting, we continue to expect four more rate cuts during the first half of 2025, to land at 2% (for the deposit rate).

## TABLE 1: ECB AND BBVA MACROECONOMIC PROJECTIONS

| | | 2024 | | | 2025 | | | 2026 | | | 2027 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2023 | BBVA November | ECB December | ECB September | BBVA November | ECB December | ECB September | BBVA November | ECB December | ECB September | BBVA November | ECB December |
| **Real GDP** | 0.5 | **0.8** | 0.7 | 0.8 | **1.0** | 1.1 | 1.3 | **1.1** | 1.4 | 1.5 | **1.1** | 1.3 |
| **HICP** | 5.4 | **2.4** | 2.4 | 2.5 | **2.0** | 2.1 | 2.2 | **1.8** | 1.9 | 1.9 | **1.9** | 2.1 |
| **HICP excluding energy and food** | 4.9 | **2.9** | 2.9 | 2.9 | **2.1** | 2.3 | 2.3 | **1.9** | 1.9 | 2.0 | **2.0** | 1.9 |
| **Unit labour costs** | 6.4 | | 4.7 | 4.5 | | 2.6 | 2.6 | | 2.0 | 2.1 | | 2.0 |
| **Compensation per employee** | 5.4 | | 4.6 | 4.5 | | 3.3 | 3.6 | | 2.9 | 3.2 | | 2.8 |
| **Labour productivity** | -0.9 | | -0.1 | 0.0 | | 0.8 | 0.9 | | 0.9 | 1.1 | | 0.8 |
| **3-month EURIBOR** | 3.4 | | 3.6 | 3.6 | | 2.1 | 2.5 | | 2.0 | 2.2 | | 2.2 |
| **10-year government bond yields** | 3.1 | | 2.9 | 2.9 | | 2.9 | 2.8 | | 3.1 | 3.0 | | 3.2 |
| **Oil price** (in USD/barrel) | 83.7 | | 81.8 | 83.2 | | 71.8 | 76.1 | | 70.1 | 73.2 | | 69.2 |
| **Natural gas prices** (EUR/MWh) | 40.6 | | 34.3 | 34.2 | | 42.9 | 41.1 | | 34.9 | 35.4 | | 29.3 |
| **USD/EUR exchange rate** | 1.08 | | 1.08 | 1.09 | | 1.06 | 1.10 | | 1.06 | 1.10 | | 1.06 |
| **World real GDP** (excl. EZ) | 3.6 | | 3.4 | 3.4 | | 3.5 | 3.4 | | 3.3 | 3.3 | | 3.2 |
| **Global trade** (excl. EZ) | 0.9 | | 4.0 | 3.1 | | 3.6 | 3.4 | | 3.3 | 3.3 | | 3.2 |
| **Euro area foreign demand** | 0.5 | | 3.1 | 2.5 | | 3.5 | 3.4 | | 3.3 | 3.3 | | 3.2 |
| **World CPI** (excl. EZ) | 5.0 | | 4.2 | 4.2 | | 3.2 | 3.3 | | 2.8 | 2.8 | | 2.6 |

Source: ECB and BBVA Research. Annual. var. (%), unless otherwise indicated.

## 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

*~~Ljubljana, 17 October~~Frankfurt am Main, 12 December 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 – is based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission.~~ 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.~~

~~Inflation~~The disinflation process is ~~expected to rise~~ well on track. Staff see headline inflation averaging 2.4 per cent in ~~the coming months, before declining to target~~2024, 2.1 per cent in ~~the course~~2025, 1.9 per cent in 2026 and 2.1 per cent in 2027 when the expanded EU Emissions Trading System becomes operational. For inflation excluding energy and food, staff project an average of ~~next year.~~2.9 per cent in 2024, 2.3 per cent in 2025 and 1.9 per cent in both 2026 and 2027.

Most measures of underlying inflation suggest that inflation will settle at around our two per cent medium-term target on a sustained basis. Domestic inflation has edged down but remains high, ~~as wages are still~~ mostly because wages and prices in certain sectors are still adjusting to the past inflation surge with a substantial delay.

Financing conditions are easing, as our recent interest rate cuts gradually make new borrowing less expensive for firms and households. But they continue to be tight because our monetary policy remains restrictive and past interest rate hikes are still transmitting to the outstanding stock of credit.

Staff now expect a slower economic recovery than in the September projections. Although growth picked up in the third quarter of this year, survey indicators suggest it has slowed in the current quarter. Staff see the economy growing by 0.7 per cent in 2024, 1.1 per cent in 2025, 1.4 per cent in 2026 and 1.3 per cent in 2027. The projected recovery rests mainly on rising ~~at an elevated pace. At the same~~real incomes – which should allow households to consume more – and firms increasing investment. Over time, ~~labour cost pressures are set to continue easing gradually, with profits partially buffering their impact on inflation~~the gradually fading effects of restrictive monetary policy should support a pick-up in domestic demand.

We are determined to ensure that inflation ~~returns to~~stabilises sustainably at 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~~monetary policy stance. 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~~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~~ economy grew by 0.4 per cent in the third quarter, exceeding expectations. Growth was driven mainly by an increase in consumption, partly reflecting one-off factors that boosted tourism over the summer, and by firms building up inventories. But the latest information suggests ~~that economic activity has been somewhat weaker than expected. While industrial production has been particularly volatile over the summer months, surveys~~it is losing momentum. Surveys indicate that manufacturing ~~has continued to contract. For~~ is still contracting and growth in 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~~ is slowing. Firms are ~~expanding~~holding back their investment ~~only slowly, while housing investment continues to fall.~~spending in the face of weak demand and a highly uncertain outlook. 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~~are also weak, with some European industries finding it challenging to remain competitive.

The labour market remains resilient. Employment grew by 0.2 per cent in the third quarter, again by more than expected. The unemployment rate ~~stayed~~remained at its historical low of 6.~~4 per cent in August. However, surveys point to slowing employment growth and a further moderation in the~~ 3 per cent in October. Meanwhile, demand for labour continues to weaken. The job vacancy rate declined to 2.5% in the third quarter, 0.8 percentage points below its peak, and surveys also point to fewer jobs being created in the current quarter.

~~We expect the~~The economy ~~to~~should strengthen over time, ~~as rising~~although more slowly than previously expected. The rise in real ~~incomes allow households to consume more. The gradually fading effects of restrictive monetary policy~~wages should strengthen household spending. More affordable credit should boost consumption and investment. Provided trade tensions do not escalate, exports should support ~~consumption and investment. Exports should contribute to~~ the recovery as global demand rises.

Fiscal and structural policies should ~~be aimed at making~~make the economy more productive, competitive and resilient. ~~That would help to raise potential growth and reduce price pressures in the medium term. To this end, it~~It is crucial to swiftly follow up, with concrete and ambitious structural policies, on Mario ~~Draghi's~~Draghi’s proposals for enhancing European competitiveness and Enrico Letta’s proposals for empowering the Single Market. ~~Implementing~~We welcome the European Commission’s assessment of governments’ medium-term plans for fiscal and structural policies, as part of the EU’s revised economic governance framework. Governments should now focus on implementing their commitments under this framework fully~~, transparently~~ and without delay. This 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~~, while prioritising growth-enhancing reforms and investment.

### 1.3. Inflation

Annual inflation ~~fell further~~increased to ~~1.7~~2.3 per cent in ~~September, its lowest level since April 2021. Energy prices dropped sharply, at an annual rate of -6.1~~November according to Eurostat's flash estimate, from 2.0 per cent~~.~~ in October. The increase was expected and primarily reflected an energy-related upward base effect. Food price inflation ~~went up slightly,~~edged down to 2.~~4~~8 per cent~~. Goods inflation remained subdued, at 0.4 per cent, while~~ and services inflation ~~edged down to 3.9~~to 3.9 per cent. Goods inflation went up to 0.7 per cent.

~~Most measures of underlying inflation either declined or were unchanged. Domestic inflation is still elevated, as wage pressures in the euro area remain strong. Negotiated wage growth will remain high and volatile for the rest of the year, given the significant role of one-off payments and the staggered nature of wage adjustments.~~

~~Inflation is expected to rise in the coming months, partly because~~Domestic inflation, which closely tracks services inflation, again eased somewhat in October. But at 4.2%, it remains high. This reflects strong wage pressures and the fact that some services prices are still adjusting with a delay to the past inflation surge. That said, underlying inflation is overall developing in line with a sustained return of inflation to target.

The increase in compensation per employee moderated to 4.4 per cent in the third quarter from 4.7 per cent in the second. Amid stable productivity, this contributed to slower growth in unit labour costs. Staff expect labour costs to increase more slowly over the projection horizon as a result of lower wage growth and higher productivity growth. Moreover, profits should continue to partially offset the effects of higher labour costs on prices, especially in the near term.

We expect inflation to fluctuate around its current level in the near term, as previous sharp falls in energy prices ~~will~~continue to drop out of the annual rates. ~~Inflation~~It should then ~~decline to target in the course of next year. The disinflation process should be supported by easing~~settle sustainably at around the two per cent medium-term target. Easing labour cost pressures and the continuing impact of our past monetary policy tightening ~~gradually feeding through to~~ on consumer prices~~.~~ should help this process. Most measures of longer-term inflation expectations stand at around 2 per cent, and market-based indicators of medium to longer-term inflation compensation have decreased measurably since the Governing Council's October meeting.

### 1.4. Risk assessment

The risks to economic growth remain tilted to the downside. The risk of greater friction in global trade could weigh on euro area growth by dampening exports and weakening the global economy. Lower confidence could prevent consumption and investment from recovering as fast as expected. This could be amplified by ~~sources of~~ geopolitical ~~risk~~risks, 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 due, for instance, to a weaker world economy or an escalation in trade tensions between major economies would further weigh on euro area growth.~~ Growth could also be lower if the lagged effects of monetary policy tightening ~~turn out~~

~~stronger~~last longer than expected. ~~Growth~~It could be higher if ~~the world economy grows more strongly than expected or if~~ easier financing conditions and ~~declining~~falling inflation ~~lead to a faster rebound in~~allow domestic consumption and investment to rebound faster.

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 more than expected. 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, if monetary policy dampens demand more than expected, or if the economic environment in the rest of the world worsens unexpectedly. Greater friction in global trade would make the euro area inflation outlook more uncertain.

### 1.5. Financial and monetary conditions

~~Shorter-term market~~Market interest rates in the euro area have declined further since our ~~September~~October meeting, ~~owing mainly to weaker news on the euro area economy and~~reflecting the ~~further fall in inflation. While~~perceived worsening of the economic outlook. Although financing conditions remain restrictive, ~~the~~our interest rate cuts are gradually making it less expensive for firms and households to borrow.

The average interest ~~rates~~rate on new loans to firms ~~and~~ was 4.7 per cent in October, more than half a percentage point below its peak a year earlier. The cost of issuing market-based debt has fallen by more than a percentage point since its peak. The average rate on new mortgages~~ were down slightly in August, to 5.0 per cent and~~ , at 3.~~7 per cent respectively~~6 per cent in October, is about half a percentage point lower than at its highest point in 2023, even though the average rate on the outstanding stock of mortgages is still set to rise.

~~Credit 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 for loans by firms rose for the first time in two years. Overall lending to firms 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.~~

Bank lending to firms has gradually picked up from low levels, and increased by 1.2 per cent in October compared with a year earlier. Debt securities issued by firms were up 3.1% in annual terms, which was similar to the increase in the previous few months. Mortgage lending continued to rise gradually in October, with an annual growth rate of 0.8 per cent.

In line with our monetary policy strategy, the Governing Council thoroughly assessed the links between monetary policy and financial stability. Euro area banks remain resilient and there are few signs of financial market stress. Financial stability risks nonetheless remain elevated. Macroprudential policy remains the first line of defence against the build-up of financial vulnerabilities, enhancing resilience and preserving macroprudential space.

### 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 – 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~~stabilises sustainably at 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~~monetary policy stance. 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~~stabilises sustainably at our medium-term target and to preserve the smooth functioning of monetary policy transmission.

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