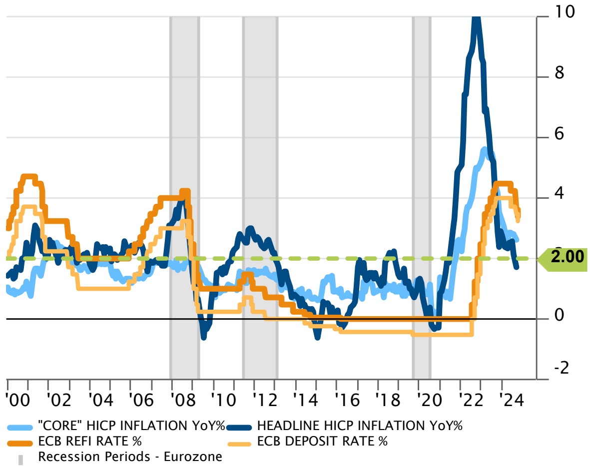
As growth stalls in Europe, the ECB accelerates its easing cycle

Image source: Fabrice Coffrini/AFP

PRIVATE BANKING

The European Central Bank lowered today its key rates by 25bp. After this third rate cut in four months, the deposit facility rate is now set at 3.25%, its lowest level in more than a year. The decision was widely expected by financial markets after the recent economic data releases and comments from ECB officials.

As headline inflation fell to 1.7% in September, the ECB cut rate for the third time this year



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Indeed, inflation has been slowing down in the past two months and is within the target of the European Central Bank in September, at 1.7%. The recent slowdown has been mostly driven by lower energy prices as oil fell to its lowest level since 2021, but underlying drivers of inflation have also trended lower.

Weak economic activity data, and in particular signs that the labour market is slowing down across Europe, will likely contribute to tame inflationary pressures in the coming months. Wage growth is still too elevated for the ECB, but slowing growth and employment will ease labour cost pressures going forward. Based on these developments, the ECB stated that "the disinflationary process is well on track", suggesting strong confidence around the outlook for prices.

The slowdown in economic activity and in employment dynamics will ease wage growth and underlying inflationary pressures in the coming months

While a pickup in inflation rate is expected in the coming months due to unfavourable base effects, inflation will thereafter decline to target "in the course of next year" according to the ECB. The central bank appears to expect a faster slowdown as it was previously seeing inflation reach target "over the second half of next year". The weaker economic growth momentum during the late months of the summer certainly dampens inflation prospects for next year.

Even after this third rate cut of the year, monetary policy remains restrictive in Europe, with the real short-term rate still at a level not seen in the past 15 years. Given the ongoing dynamics in economic activity and inflation, this implies that the ECB will have to continue lowering rates in the coming months, in order to bring its monetary policy to a neutral stance at minimum.

The ECB's monetary policy is still clearly restrictive as the EUR real short-term rate (nominal rate – inflation) remains very positive, even after today's rate cut

Additional rate cuts at the coming meetings are therefore to be expected, in December and in the course of 2025. Given the worrying trend in economic activity data, an acceleration in the pace of easing, with a possible 50bp cut at the December meeting, cannot be ruled out. If growth in the Eurozone stalls or even turns negative, a faster pace of action to remove the restrictiveness of the monetary policy, or even to move it into supportive territory, might be warranted.

For further information

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