

FX Viewpoint

Currencies
Global

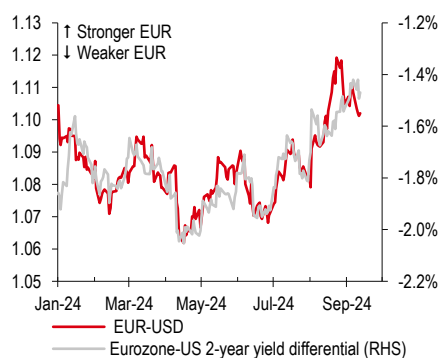
EUR: The ECB delivers its second rate cut

- ◆ As widely expected, the ECB cut rates again in September...
- ◆ ...but without providing any indication about a future rate path
- ◆ The Eurozone's challenging growth-inflation outlook may pose downside risks to the EUR over the medium term

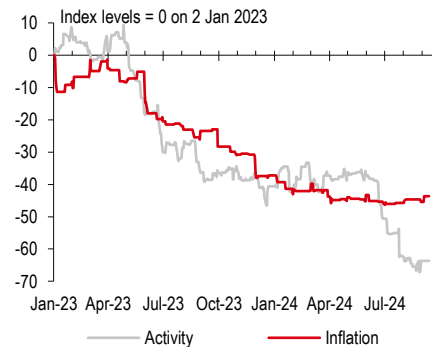
On 12 September, the **European Central Bank (ECB)** cut its key deposit rate by **25bp to 3.50%**. The two other rates, the main refinancing rate (at which banks can borrow money for a week or three months) and the marginal lending rate (an emergency overnight facility rate), were lowered by a much less conventional 60bp to 3.65% and 3.90%, respectively, amid a planned technical adjustment (after the framework review in March 2024). This was the second rate cut of the cycle and came in line with market expectations.

The ECB's forward guidance on interest rates remained unchanged. The ECB President, Christine Lagarde, seemed to re-enforce a meeting-by-meeting approach, with **no pre-determined future rate path and data dependency**. Ms Lagarde also stressed data dependency does not mean data-point dependency and **the ECB was aware that inflation was set to decline sharply in September, due to base effects**. That would be the last (and only) print before the 17 October meeting.

1. EUR-USD and its yield differential



2. Eurozone data surprise indices



As **EUR-USD has been tracking closely its yield differential** (Chart 1), this widely expected ECB decision had limited impact on the currency pair. While we are not convinced that the Federal Reserve (Fed) can match the pace of easing (of about 110bp by end-2024) priced in by markets, we are similarly sceptical that the ECB could be as dovish as the market pricing of around 40bp of additional easing by end-2024 (*Bloomberg*, 12 September 2024). **Our economists think that the ECB will stay on hold in October, before cutting again in December.**

It is worth noting that **the Eurozone has been facing an increasingly unhealthy combination of weak growth and sticky inflation** (Chart 2). Indeed, the ECB now expects slightly higher core inflation (precisely 0.1ppt higher than June's projections) for this year (to 2.9%) and next (2.3%), together with slightly weaker growth (by 0.1ppt lower) over the next three years (i.e., 0.8% in 2024, 1.3% in 2025, and 1.5% in 2026). This may pose downside risks to the EUR over the medium term, in our view. The return of the Growth and Stability Pact (which seeks to keep government finances in line) may mean a tighter fiscal policy in the coming quarters which may also weigh on the EUR via both economic and political channels.

As widely expected, the ECB delivered its second rate cut in September

The ECB is not data-point dependent

EUR-USD was little changed after the ECB announcement

The Eurozone's challenging economic outlook could pose downside risks to the EUR over the medium term

Disclosure appendix

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