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Fixed Income Special

NORD/LB Floor Research

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Marketing communication (see disclaimer on the last pages)

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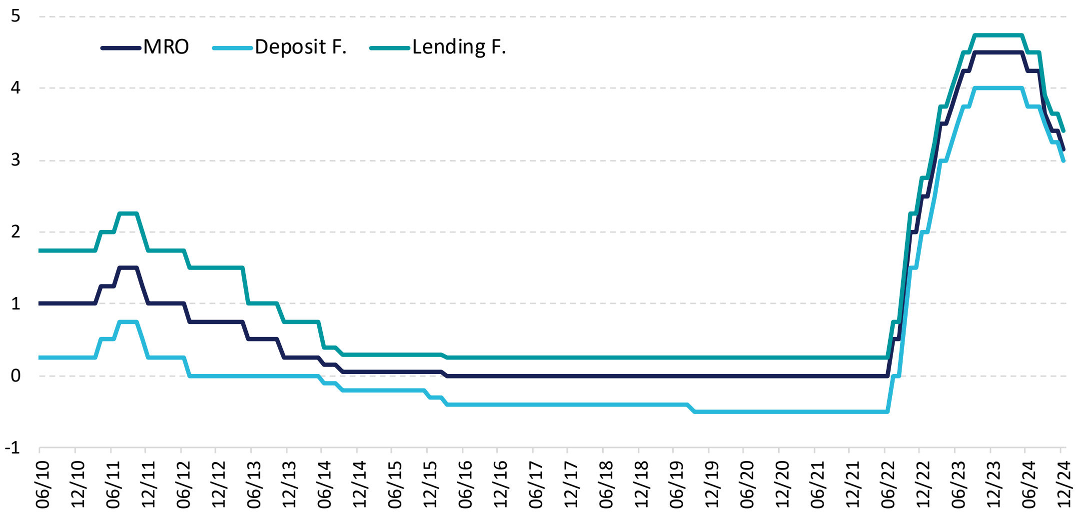
Silent night, lower rates: ECB prepares for the new year

Authors: Lukas-Finn Frese // Lukas Kühne

ECB continues interest rate cuts in December

The expectations of observers and market participants regarding the last interest rate decision in 2024 were clear: the ECB would continue its downward slide and once again fine-tune key interest rates. In our view, "delivered as ordered" adequately describes the final decision of the monetary authorities from the Main. In line with market expectations, the ECB lowered its three key interest rates by 25 basis points each, meaning that the interest rate for the main refinancing operations is now at 3.15%, while the interest rates for the marginal lending facility and the deposit facility stand at 3.4% and 3.00% respectively. After the minutes of the October meeting initially revealed quite different views in the ECB Governing Council with regard to the interest rate cut, the argument of a lack of data should not have held water this time against the background of the new *staff projections*. Nevertheless, the differing views on inflation expectations in particular are likely to remain at the center of attention and will continue to lead to disputes between doves and hawks in the ECB Governing Council. However, the *staff projections* presented today can be seen here as a kind of guideline on the basis of which the opinions of the monetary authorities can develop. For the first time, the new forecast also takes an initial look at inflation expectations and the projected economic development in the Eurozone in 2027. Against this backdrop, today's interest rate decision allows the ECB, in our opinion, to return to its old guiding principle of data dependency, after it seemed to have moved away from this a little with the decision in October. For the meetings in 2025, however, the monetary authorities did not reveal any details at today's press conference, but emphasized their usual meeting-by-meeting approach and the data dependency of their decisions. In other words, "the same procedure as every meeting" will also apply to the central bank meetings next year, in reference to a New Year's Eve classic.

ECB key interest rates (in %; incl. current interest rate decision)



Source: ECB, Bloomberg, NORD/LB Floor Research

ECB statement and projections

The published ECB statement offered some changes in the central bankers' rhetoric. For example, it was no longer emphasised that the Governing Council was determined to ensure a timely return of inflation to the medium-term target of 2%. Instead, the Council is now determined to ensure a sustained stabilisation of inflation around the target level. This could indicate that the monetary authorities from the Main consider the current level of interest rates to be restrictive enough. The adjusted *ECB staff projections*, in which expectations for 2027 have now been specified for the first time, paint a clear picture: both the forecasts for the real GDP growth rate and the expectations for future inflation have been revised downwards. For the current year, the central bank's experts therefore expect an average inflation rate of 2.4% (previously: 2.5%). However, 2.1% (previously: 2.2%) is the forecast for 2025, while 1.9% (previously: 1.9%) is still on the cards for 2026. The year 2027, in which the expanded EU Emissions Trading System will become operational, is sufficiently far in the future and the outlook is given as 2.1% for the first time. The ECB sees the inflation rate excluding energy and food for 2024 and 2025 unchanged compared to September at 2.9% and 2.3% respectively, before falling to 1.9% in 2026 (previously: 2.0%). In 2027, it should then also amount to 1.9%. Overall, we therefore recognise clear disinflationary tendencies here, which were decisive for today's decision by the ECB Governing Council. Regarding economic activity in the single currency area, expectations are still looking grim: the ECB experts have adjusted their growth projection for 2024 slightly downwards to 0.7% (previously: 0.8%). For the subsequent years 2025 and 2026, the ECB communicated a growth rate in real economic output in the Eurozone of 1.1% and 1.4% respectively (2025 previously: 1.3%; 2026 previously: 1.5%). For 2027, the forecast then envisages growth of 1.3%. Important to note here: the ECB can only take policy measures into account in its new projections once they have been formally approved. This also applies to any trade restrictions made by the new US administration under Donald Trump.

Latest ECB projections for euro area growth and inflation*

	December 2024 projections			
	2024	**2025**	**2026**	**2027**
Real GDP	0.7	1.1	1.4	1.3
HICP inflation	2.4	2.1	1.9	2.1

* Change versus previous year in %
Source: ECB, NORD/LB Floor Research

ECB press conference: Only a few new insights

The press conference following the announcement of the monetary policy decisions focused primarily on topics that were not included in the central bankers' statement or were only implicitly mentioned. With regard to the future path of interest rate cuts, President Lagarde stuck to her mantra of the meeting-by-meeting approach and the data dependency of the decision, as expected, but was particularly cautious with regard to the continued high service inflation in the eurozone. However, there were reportedly no discussions about the level of a "neutral" interest rate in the ECB Governing Council. With regard to possible tariff increases in the USA and their implications for growth and inflation, Lagarde referred to the high forecasting inaccuracy of such events. Overall, the President's answers provided little new information.

Negotiated wage growth accelerated again – Bundesbank sees plateau reached

An important indicator for the growth of wages and salaries in the common currency area rose again in Q3/2024, as had already been expected. According to data published by the ECB on 20 November on the development of negotiated wages in the Eurozone, they grew by +5.4% in Q3/2024 compared to the same period of the previous year. In the previous quarter however, growth was at +3.5% compared to Q2/2023. Especially in Germany the summer quarter marked the strongest rise in the figure since more than 20 years. As the German Bundesbank stated in its Monthly Report – November 2024, collectively agreed wages – including ancillary agreements – in Europe's largest economy rose by a substantial +8.8% in Q3/2024 compared to the same quarter of the previous year. This is the highest year-on-year growth rate since summer 1993 and can be primarily attributed to wage increases in retail, wholesale and foreign trade. Looking ahead, however, the Bundesbank believes it is likely that the peak of the wage growth phase was finally reached in Q3/2024. Due to the ongoing economic weakness and significantly lower inflation rates, the central bankers believe that the upcoming wage negotiations are likely to result in noticeably lower agreements than in the past two years. In this regard, the development of negotiated wages should cool down again in the coming quarters. As the ECB Governing Council had already anticipated a further increase for Q3/2024 in advance and had therefore also taken it into account in the decision-making process for the previous interest rate decisions, the recently published data did not seem to support a further cut today. However, this isolated data point alone did not seem to convince the Council to stop skiing down the metaphorical interest rate slope. In view of the current and emerging economic weakness in Germany and the Eurozone, we consider this to be a justifiable decision. At the same time, the current data situation is likely to have taken the wind out of the sails of any possible wishes from the dovish camp regarding an even bigger interest rate cut.

Development of negotiated wages in the Eurozone (in %)

Source: ECB, NORD/LB Floor Research

Further interest rate cuts expected in 2025, only the number remains controversial

In our ECB preview last week, we described our expectations of the ECB for today's central bank meeting and the implications for monetary policy in 2025 with our favourite mantra "cut, sleep, repeat". The "cut" at today's Governing Council meeting should be followed by a pause at the first meeting of the new year (January 2025) in order to obtain more meaningful data points to be able to cut again at the following meeting (March 2025). Ideally, new *staff projections* will then also be available. Following our mantra and this cycle, we would see a maximum of four further rate cuts in the new year, with the two cuts in H1/2025 possibly appearing clearer in view than in the second half of the year despite all the political uncertainty with France and Germany. We do not currently expect interest rate cuts of 50 basis points in 2025. Today's interest rate decision and subsequent press conference also brought hardly any new insights into the ECB's future path of interest rate cuts. However, the market is certain that we will see further interest rate cuts from the ECB in the new year and is currently pricing in around five rate cuts by June 2025. We are somewhat more conservative in our expectations at this point and are only forecasting two key interest rate cuts of 25 basis points in this period.

Conclusion

Ultimately, there was no big surprise today. At its last meeting of the year, the ECB Governing Council decided to cut all three key interest rates by 25 basis points. In doing so, the monetary authorities did not follow the example of their Swiss counterparts, who had already announced a rate cut of 50 basis points in the Swiss Confederation earlier today. Nevertheless, an interest rate cut of similar size was also discussed among the members of the ECB Governing Council at today's central bank meeting but was ultimately rejected. While the signs in the Eurozone were also clearly pointing to a downward interest rate cut, we would have considered such a major move to be too excessive. The interest rate slide thus continued, but without a shot. In view of further economic uncertainties due to a possible tightening of US tariff policy towards Europe, it is conceivable that the monetary authorities on the Main will continue to monitor the situation for the time being and want to keep enough dry powder. Our view of the immediate future is true to our favourite motto "cut, sleep, repeat". In this context, we are forecasting the next interest rate cut in the single currency area for the second meeting of the Council in 2025 on 06 March, when the latest *staff projections* will also be available again. We therefore expect a total of four interest rate cuts in the coming year, all of which will be in the region of 25 basis points. Regarding the future monetary policy course, the ECB, in its usual manner, did not reveal its cards today. However, based on the adjusted statement, it can be understood that the Governing Council considers the current interest rate level to be restrictive enough.

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Appendix
Publication overview

Covered Bonds:

- Issuer Guide – Covered Bonds 2024
- Covered Bond Laws
- Covered Bond Directive: Impact on risk weights and LCR levels
- Risk weights and LCR levels of covered bonds (updated semi-annually)
- Transparency requirements §28 PfandBG Q3/2024 (quarterly update)
- Transparency requirements §28 PfandBG Q3/2024 Sparkassen (quarterly update)

SSA/Public Issuers:

- Issuer Guide – German Laender 2024
- Issuer Guide – German Agencies 2024
- Issuer Guide – Canadian Provinces & Territories 2024
- Issuer Guide – European Supranationals 2024
- Issuer Guide – French Agencies 2023
- Issuer Guide – Nordic Agencies 2024
- Issuer Guide – Dutch Agencies 2024
- Issuer Guide – Non-European Supranationals (MDBs) 2024
- Beyond Bundeslaender: Belgium
- Beyond Bundeslaender: Greater Paris (IDF/VDP)
- Beyond Bundeslaender: Spanish regions

Fixed Income Specials:

- ESG-Update 2024
- ECB preview 2025: Downhill with Lagarde, but no speeding, please

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