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ECB: Third (Expected) 25bps Cut in a Row, and Streak to Continue

- **The ECB rolled an unsurprising third consecutive 25bps cut to its deposit facility rate to 3.00% at its final meeting of the year with the Governing Council widely agreeing on a move of this magnitude against a few that seemingly floated a 50bps move. All signs point to another 25bps move at each of the bank's January, March, April, and June decisions to a 2.00% level followed by possibly another 25bps cut at either of the July or September gatherings.**
- **One HICP release and a couple of PMI prints until the late-January meeting seem, as things stand, unlikely to prompt a pause nor a half-point cut (external risks notwithstanding).**
- **Statement changes were minimal outside of dropping a pledge to “keep policy rates sufficiently restrictive for as long as necessary” as the ECB eyes a more growth-supportive stance with inflation well on track towards the 2% target. In its new forecasts, the ECB slightly trimmed HICP and GDP growth projections for 2024–2026, as was widely expected, with new forecasts for 2027 still showing inflation around target and muted growth.**

To no one's surprise, the ECB rolled a third consecutive 25bps cut to its deposit facility rate at its final meeting of the year, bringing it to 3.00% from the 4.00% peak that lasted until mid-2024. Economic conditions and the outlook for growth have remained worrying since the bank's October decision amid political chaos and uncertainty in France and Germany combining with already weak manufacturing prospects weakening further on Trump protectionism risks. In turn, inflation is due to slow slightly more quickly than expected a few months ago, despite possible tariff tailwinds.

Accompanying today's monetary policy decision, the ECB's updated staff projections showed slightly weaker growth and lower inflation across the whole of the 2024–2026 forecast horizon and also include new forecasts for 2027. Changes are fairly small with headline HICP inflation seeing 0.1ppts lower versus the previous round in each of 2024 and 2025 at 2.4% and 2.1%, respectively, then unchanged at 1.9% before flipping back just slightly above 2% in 2027 (2.1%). Core HICP forecasts were virtually untouched except for a 0.1ppts lower projection for 2026 at 1.9% which is also the pace expected for 2027. In terms of magnitude, the biggest yet still small revision was in the 2025 GDP growth projection at 1.1% from 1.3%; 2024 and 2026 were both trimmed by 0.1ppts (0.7% and 1.4%, respectively) and the new 2027 growth forecast still leaves growth relatively weak at 1.3%.

With forecasts like these, it should be no surprise that markets are pricing in a cumulative ~110bps in cuts over the four meetings that follow today's for a terminal deposit rate target of 2.00% with possibly another cut priced in by July/September to 1.75%—as is our latest forecast. Markets are eyeing about a 30% chance of an ECB rate cut at the January meeting six weeks from now (practically as it was prior to the announcement), with another round of HICP and two PMIs releases standing as the main on-calendar items that may shape pricing in either direction (while geopolitical developments also play a part). Today's set of ECB communications largely reinforces our view, but we think it is more likely that policymakers reach our terminal rate forecast sooner or perhaps reduce rates to a lower level were the Eurozone to post no or negative growth in the current or coming quarters.

The ECB's refreshed statement had a slightly more dovish tone than expected as it dropped its pledge to “keep policy rates sufficiently restrictive for as long as necessary” (though this was predicted by some). The statement does make a point,

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however, to note in a previous paragraph that monetary policy remains restrictive which seems like a minor concession to hawks while the direction of travel is towards providing accommodative monetary conditions for firms and households.

As for Lagarde's presser, it was mostly a rather uneventful one, for once, as she stuck to script, noted that the decision on a 25bps cut was unanimous (despite some floating a 50bps move), and also highlighted that there was quite a bit of confidence that inflation was truly on track towards the 2% target. The main market mover of the presser was when Lagarde noted that they see two-sided risks to inflation (and pointed to tariffs probably being inflationary), standing in contrast to the October press conference when she said that risks to inflation were mostly to the downside.

German 2s yields jumped about 4/5bps around Lagarde's comments regarding inflation risks (though it's possible this simply coincided with some large profit-taking), to mostly correct a rally in global rates led by a higher-than-expected US jobless claims print (and a mixed PPI release). The long-end of rates markets also didn't take too kindly to Lagarde noting that they did not discuss the Transmission Protection Instrument (TPI)—at a time when political risks are causing sharp moves in sovereign spreads. On net, through all the noise to writing at 9:30ET, short- and long-term European yields are practically sitting at pre-statement levels, the EUR is marginally weaker amid broad USD strength on the day continuing (unfazed by a brief move lower in US yields), and Euro Stoxx are flat on the day.

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