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# Fixed Income Special

NORD/LB Floor Research

12 September 2024

Marketing communication (see disclaimer on the last pages)

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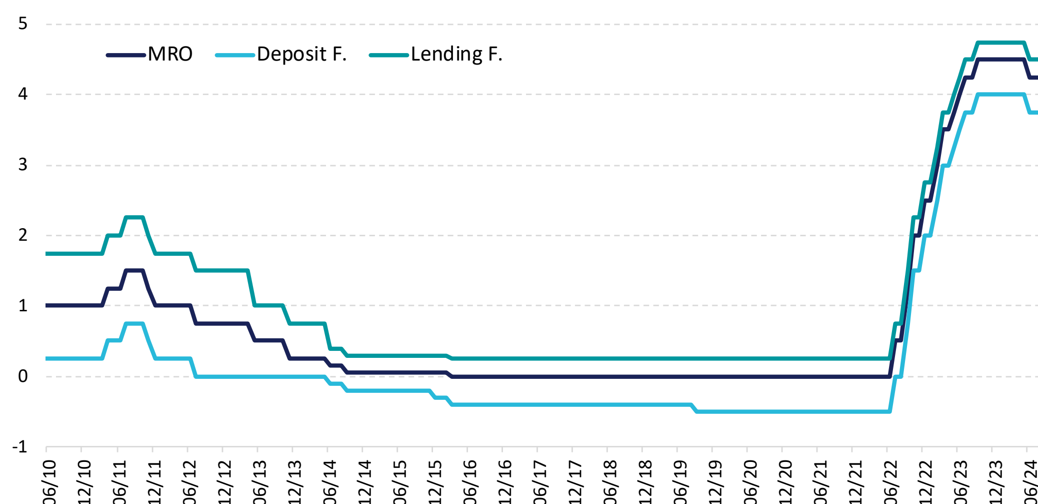
# ECB decision: Cut, sleep, repeat

Authors: Dr Norman Rudschuck // Christian Ilchmann // Lukas-Finn Frese

**Interest rate decision at a glance**

We already explained it in our ECB preview last week: today's key interest rate decision was largely influenced by the changes to the monetary policy framework decided by the ECB Council in March 2024. Expected by (almost) all market participants and accompanied by new *staff projections*, the ECB Council has reduced the interest rate for the deposit facility rate (DFR) by 25bp to 3.5%. Furthermore, the rate for the main refinancing operations (MROs) will fall from the current 4.25% to 3.65%, and that for the marginal lending facility (MLF) will be reduced from 4.5% to 3.9%. In our view, however, the technical reduction of the last two interest rates by 60bp each should not be seen as a monetary policy signal from overweight doves.

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




Source: ECB, Bloomberg, NORD/LB Floor Research

**Adjustments to the monetary policy framework**

Instead of obese dovish heavyweights, it was the already indicated changed monetary policy framework that had a significant influence on today's ECB decision, at least with regard to the adjustment of the interest rate corridors. Due to the decision in March, which has received little media attention to date, the interest rate for the main refinancing operations (MROs) had to be adjusted so that the gap between the interest rate for the MROs and the DFR was reduced from the current 50bp to 15bp. In cloaked ECB rhetoric, the reasoning sounds like this: The smaller gap should provide a (stronger) incentive to submit bids in the weekly tenders, which should bring the short-term money market rates close to the deposit rate. In addition, the smaller gap is expected to limit the extent of potential fluctuations in short-term money market rates. At the same time, it would leave scope for money market activities and offer banks incentives for market-based refinancing solutions. The interest rate on the MLF will also be adjusted so that the spread between the interest rate on the MLF and the rate on the MROs remains unchanged at 25bp.

**ECB statement and projections**

You already knew it: “The Governing Council stands ready to adjust all its instruments within its mandate to ensure that inflation returns to its 2% target in the medium term” and “will keep key interest rates sufficient for as long as necessary and keep it restrictive in order to achieve this goal.” This primarily concerns the dynamics of the underlying inflation and the strength of monetary policy transmission. Much more interesting than the well-known ECB statement were the adjusted *staff projections*: while the forecasts for the real GDP growth rate were revised downwards the expectations regarding the future inflation are kept on the June level. For the current year, the central bank’s experts still expect an average inflation rate of 2.5%. 2.2% is still predicted for 2025. 2026 is still sufficiently far away in the future and the outlook for this year stands once more at 1.9%. On the contrary, the projections for the core inflation had to be revised upwards. The ECB sees inflation excluding energy and food at 2.9% in 2024 (previously: 2.8%), before rising to 2.3% in 2025 (previously: 2.2%) and to 2.0% in 2026 (previously: 2.0%). Explicitly disinflationary tendencies, as we were used to from past *staff projections*, are therefore – as of today – still off the table. Regarding economic activity in the Eurozone, we continue to assume the basic “soft landing” scenario, albeit in a somewhat weaker form. The ECB experts adjusted their growth projection for 2024 slightly downwards to 0.8% (previously: 0.9%). For the following years 2025 and 2026, the ECB communicated a growth rate in real economic output in the Eurozone of 1.3% and 1.5% respectively (2025 so far: 1.4%; 2026 so far: 1.6%). Although the ECB has now adjusted its forecast for short-term economic performance slightly downwards for the current as well as the coming years, we continue to see the “soft landing” scenario as more realistic than an impending recession.

**Latest ECB projections for euro area growth and inflation (in %)***

| | *September 2024 projections* | | |
|---|---|---|---|
| | **2024** | **2025** | **2026** |
| **Real GDP** | 0.8 | 1.3 | 1.5 |
| **HICP inflation** | 2.5 | 2.2 | 1.9 |

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

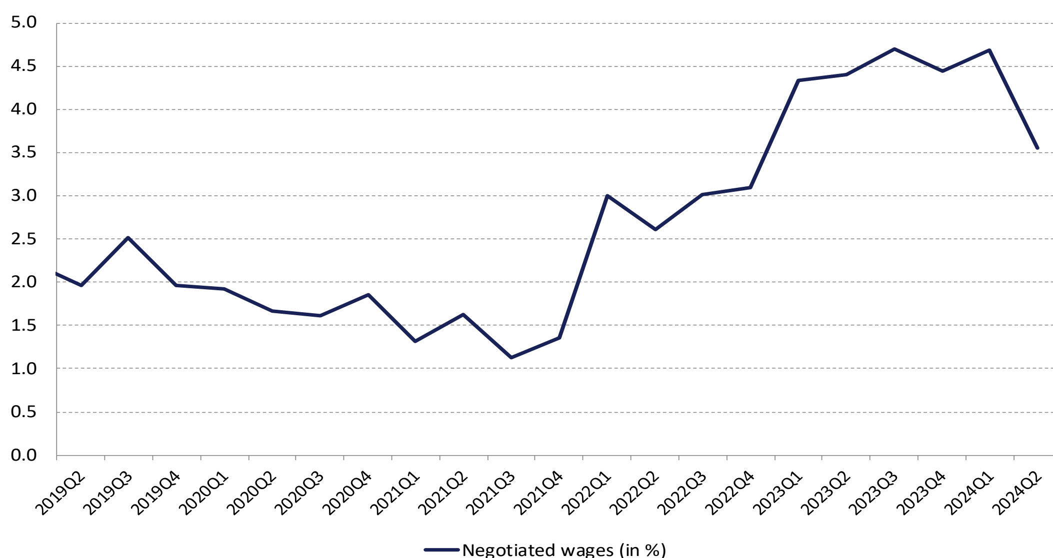
**ECB press conference and the long shadow of Mario Draghi**

Just on Monday, former ECB President Mario Draghi presented his report on EU competitiveness and described Europe as being in a partly devastating state. In order to solve the “existential challenges”, massive investments of at least EUR 750-800bn annually are necessary across Europe. In this context, the collapse of the Carola Bridge in Dresden yesterday, seemed like a highly tragic highlight of the investment backlog in ailing infrastructure. In Draghi’s opinion, the EU should take on community debt for this purpose in the future. It was to be expected that Christine Lagarde would be asked to comment through questions from the journalists present. In her opinion, the points raised in the report should primarily be addressed with structural or regulatory reforms, as these lie outside the ECB’s mandate. Nonetheless, the ECB’s work could be facilitated in future by appropriate and successful measures.

**Negotiated wages: development paves the way for interest rate cuts**

An important indicator of the growth of wages and salaries in the common currency area slowed down significantly in Q2/2024. As can be seen from the data published by the ECB on 22 August on the development of collective bargaining wages in the euro zone, they rose by +3.5% in Q2/2024 compared to the same period in the previous year. In the previous quarter, growth was +4.7% compared to Q1/2023. There were already indications of slowing wage growth from the German Bundesbank, which stated in its Monthly Report – August 2024 that wages in Europe's largest economy rose by only +3.1% between April and June compared to the previous year. This means a more than significant reduction in growth compared to Q1/2024 with +6.2%. According to the Bundesbank, this was primarily due to the effects of high tax-free inflation compensation premiums from 2023, which increased the rate in Q1/2024 and the elimination of which would have now severely dampened growth in the second quarter. Nevertheless, high wage increases can still be expected in the future, as the negotiating unions will focus more on permanent, long-term salary increases due to the expiry of the tax exemption for inflation compensation bonuses at the end of 2024. A high level of willingness to strike until recently and a widespread labour shortage would also suggest comparatively high wage increases in the future. In her speech on 30 August in Tallinn, Estonia, ECB Director Isabel Schnabel also recently warned of accelerated wage growth in the third quarter. In 2025 and beyond, growth would then be more moderate again. Nevertheless, the latest European data formed the basis for the ECB's renewed interest rate cut, as announced at today's meeting. However, collective wage growth remains at a high level and could increase more strongly again in the future. We still assume that the upcoming data for Q3 and Q4/2024 will continue to allow interest rate cuts in December. However, the ECB will not commit to a decision in advance.

**Development of negotiated wages in the Eurozone (in %)**




Source: ECB, NORD/LB Floor Research

**The most likely timetable for 2024/25**

Predicting the (further) timetable of the European monetary authorities for the final two meetings in 2024 and beyond remains the familiar look into the crystal ball. We had already confidently communicated at the end of last year that the music would play primarily in the second half of the year and the (for some: belated) interest rate cuts that have been implemented have confirmed this assessment. In recent weeks and months, the ECB has regained some of the credibility it lost in June and increased trust in its data-based meeting-by-meeting approach. Nevertheless, the current market environment offers a lot of uncertainty, making it difficult to look into the crystal ball even after the most recent meeting. However, we still stand by our forecast: At the last meeting on 12 December, the central bank will announce the final third interest rate cut this year, when the ECB Council has the latest *staff projections*, then for the first time for 2027. A look at the implicit interest rate probabilities supports our forecast: Markets continue to fully price in a rate cut in December. If you would ask us today, we would see most market participants currently too ambitious for October. The next meeting will take place five weeks from today. By then, of course, there will hardly be any new data available. We are therefore currently expecting another break in interest rate cuts, true to the motto: cut, sleep, repeat.

**Conclusion and outlook**

For a second, Madame Lagarde suddenly and completely unexpectedly became the young Doris Day: "Que sera, sera – whatever will be, will be. The future's not ours to see. Que sera, sera – What will be, will be." Unfortunately, we will not be able to get rid of the catchy tune until the end of the day and we are happy to share it with you. As part of our ECB preview last week, we outlined three possible interest rate scenarios for today's Council decision. Against the background of new *staff projections* and the changed monetary policy framework, what we believe to be the most likely scenario occurred today: the ECB lowers the DFR by 25bp to 3.5%. Furthermore, the rate for the MROs will fall from the current 4.25% to 3.65%, and that for the MLF will be reduced from 4.5% to 3.9%. Due to the changed interest rate corridors, we see today's interest rate cut as a dovish step with a good portion of technical adjustments rather than as a serious result of obese doves. After (not only) our criticism of the ECB in the past, the mantra-like, data-based meeting-by-meeting approach seems to be gaining credibility again. However, there was no announcement of any predetermination on future steps today. Although inflation rates continue to normalize gradually, in our view the danger has not yet been permanently averted. It is therefore likely that the monetary policy doves in the ECB will initially be put on a diet for the October meeting before they get a tailwind again in December. We think the market is currently being too ambitious about the meeting in exactly five weeks and therefore we do not see a cut as early as October.

# Appendix
# Publication overview

**Covered Bonds:**

Issuer Guide – Covered Bonds 2023

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 Q2/2024 (quarterly update)

Transparency requirements §28 PfandBG Q2/2024 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 2023

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: Caution – rate cut at the gates

| **NORD/LB:** | **NORD/LB:** | **NORD/LB:** | **Bloomberg:** |
|---|---|---|---|
| Floor Research | Covered Bond Research | SSA/Public Issuers Research | RESP NRDR <GO> |

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|---|---|
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| Sales Sparkassen & Regionalbanken | +49 511 9818-9400 |
| Institutional Sales MM/FX | +49 511 9818-9460 |
| Fixed Income Relationship Management Europe | +352 452211-515 |

## Trading

| | |
|---|---|
| Covereds/SSA | +49 511 9818-8040 |
| Financials | +49 511 9818-9490 |
| Governments | +49 511 9818-9660 |
| Länder/Regionen | +49 511 9818-9660 |
| Frequent Issuers | +49 511 9818-9640 |

## Origination & Syndicate

| | |
|---|---|
| Origination FI | +49 511 9818-6600 |
| Origination Corporates | +49 511 361-2911 |

## Sales Wholesale Customers

| | |
|---|---|
| Firmenkunden | +49 511 361-4003 |
| Asset Finance | +49 511 361-8150 |

## Treasury

| | |
|---|---|
| Liquidity Management/Repos | +49 511 9818-9620<br>+49 511 9818-9650 |

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