MARKET COMMENTARY

ECB sees inflation on track so far but keeps September move wide open

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- **At today's meeting the ECB's Governing Council (GC) unanimously decided to leave its key rates unchanged, in line with expectations.**
- **The GC sees the latest inflation developments as in line with its projections. While the rhetoric on wage growth sounded less concerned than in June the future inflation assessment will also depend on corporate margins and productivity.**
- **In the Q&A President Lagarde pushed against indicating future action. She emphasized that the GC was truly data dependent and that "*what we do in September is wide open*".**
- **We continue to look for further 25 bps rate cuts in Sep. and Dec., largely in line with market expectations. Markets were not surprised by today's decision which had already been telegraphed by GC over the past weeks.**

ECB stayed on hold today: At today's meeting the GC unsurprisingly decided to keep its key interest rates unchanged, the deposit rate at 3.75% and the repo rate at 4.25%. It continues with APP non-reinvestments and– as previously announced – does no longer invest maturing securities purchased under the PEPP, reducing corresponding holdings by €7.5 billion per month on average. It intends to fully stop reinvestments at the end of 2024.

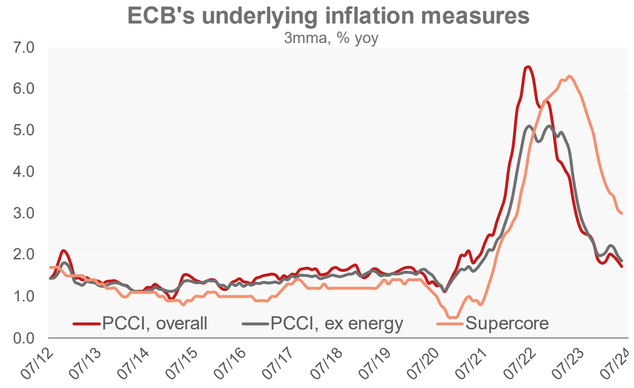
Less concern about wage growth …: The latest inflation data are assessed as in line with the macro projections from June. Measures of underlying inflation are seen on a downtrend. The wording on wage growth that had characterised as "*elevated*" in June was scaled down to "*high*". In the Q&A President Lagarde sounded confident that wage growth would moderate next year. She referred to many surveys run by the ECB as well as the ECB's proprietary wage tracker. Also, national central banks reportedly see wage growth moderating to levels consistent with the inflation target by 2025.

… but productivity still has to increase: However, she also emphasized that the end the interaction of wage growth with profits and productivity were decisive for the inflation outlook. While the GC finds that "*the inflationary impact of higher wage growth has been buffered by profits*." Mrs Lagarde pointed out that there was so far no strong pick up in productivity.

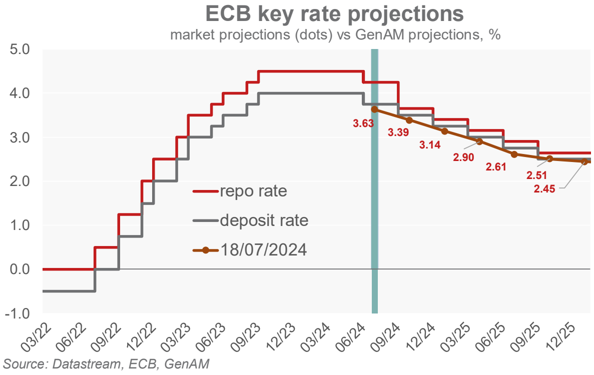
A lot of information until September: During the Q&A Mrs Lagarde carefully avoided to give any concrete data needed to trigger the next rate cut. She quite generically mentioned the inflation outlook, underlying inflation and the transmission of monetary policy were factors to watch, and that data-dependency does not mean data-point dependency. She conveyed that the GC was looking at lots of data and that "*between now and September we will receive a lot of information*". She even suggested that in case of detrimental developments monetary policy could be tightened again.

GC unanimously endorsed data-dependency: Today's decision was taken unanimously according to Mrs Lagarde. This and Mrs Lagarde's attempt to avoid any statement that could be interpreted as pre-commitment suggests to us that the GC wants to keep leeway for the September meeting.

Quarterly rate cuts still most likely: All in all, we continue to look for further rate cuts. We expect the next 25 bps cuts by September and December bringing the deposit rate down to 3.25% by year-end, broadly in line with markets. However, the reluctance of Mrs Lagarde to nurture any expectations about a September rate cut suggests that the risk of no action has increased somewhat now. Markets were not surprised by today's decision which had already been telegraphed by GC members over the past weeks.



Source: Datastream, ECB



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