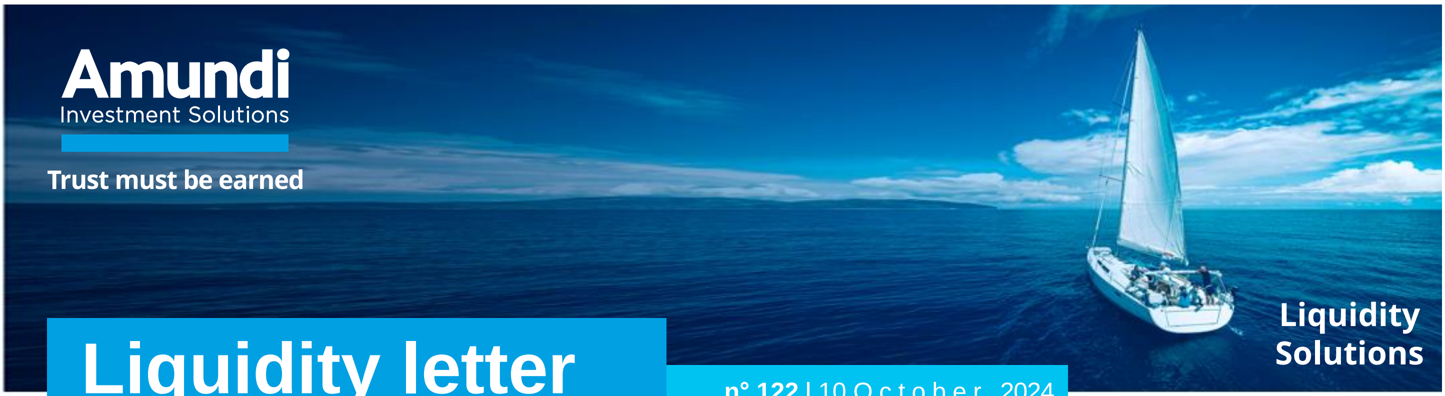


Liquidity letter

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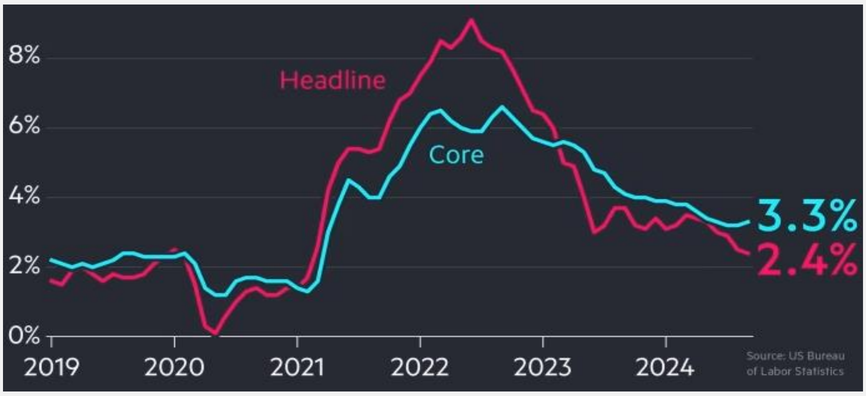
# ECB ready to step up the pace

## The markets seem convinced by a further fall in interest rates

### Eurozone inflation data reassures ECB

- **ECB** With a week to go before the ECB's next monetary policy meeting, the markets now seem convinced that interest rates will be cut by a further 25 basis points. This would be the second rate cut in the space of a month.
- **Interest rates** Several ECB members spoke this week about forthcoming monetary policy decisions. Among them, the Governor of the Banque de France, François Villeroy de Galhau, is convinced that rates will be cut in October, while his Greek colleague is forecasting two rate cuts by the end of the year, in line with market expectations.
- **United States** The publication of the minutes of the Fed's last meeting highlighted differences of opinion over the 50 bp cut decided by the FOMC last month. Although all were in favour of the decision, some would have preferred a 25 bp cut.
- **US inflation** During the week, the publication of the inflation figure for the end of September (2.4% compared with 2.5% the previous month) marked the sixth consecutive fall in consumer prices.

### Inflation in the US




Inflation in the US fell to 2.4% in September. This is lower than the 2.5% annual increase recorded in August, but higher than economists' expectations of 2.3%. This report, the last before the presidential election on 5 November, marks the 6ème consecutive month of decline in the annual rate. However, excluding volatile items such as food and energy, core inflation rose faster than expected (3.3% vs. 3.2% in August). Although the inflation figures were slightly higher than expected, investors were betting that they were not high enough to dissuade the Fed from cutting interest rates next month.

## Number of the week

**2,4%**

This is the annualised rate of inflation in the United States at the end of September, down on the previous month (2.5%).

## Yannis Stournaras

The governor of the Greek central bank, **Yannis Stournaras, is** backing two interest rate cuts this year and expects them to continue in 2025 as inflation continues to fall.

"Even if we cut rates by 25 bp now and another in December, we will be back to just 3%, still in very restrictive territory".

Mr Stournaras said that inflation could be on track to reach the ECB's 2% target in the first half of 2025, prompting policymakers to cut "very restrictive" interest rates sooner than expected.

He added that inflation was falling faster than we (the ECB) had forecast in September.
"If inflation continues to approach the 2% target, why not make cuts at every meeting?

## F. Villeroy de Galhau (ECB): the ECB will most likely cut rates in October

It is "very likely" that the European Central Bank will decide on a further interest rate cut this month, **François Villeroy de Galhau** told the Italian newspaper La Repubblica. He also reiterated that the institution was keeping "all options" on the table.

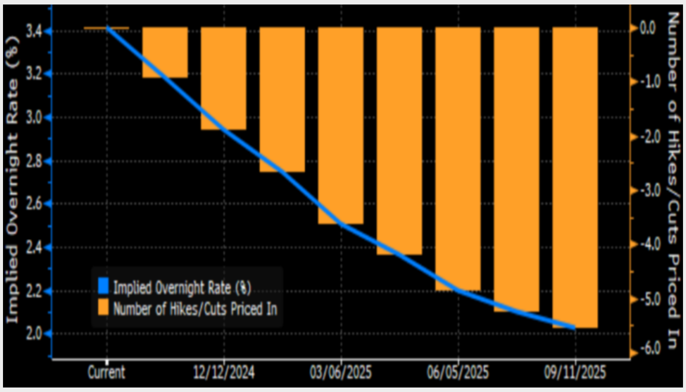
Asked whether a further reduction in borrowing costs should be expected at the next ECB meeting on 17 October, François Villeroy de Galhau pointed out that the President of the ECB, Christine Lagarde, had opened the way to this possibility when she addressed the European Parliament on Monday.

The Governor of the Banque de France pointed out that the ECB's main indicator was inflation, and noted that inflationary pressures had eased much more than expected in September.

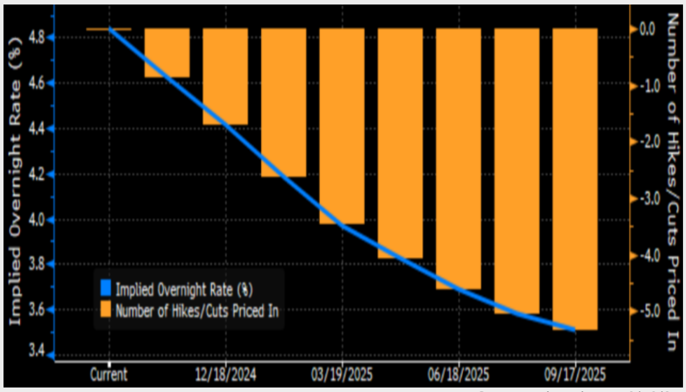
"The balance of risks has shifted. Over the past two years, our main risk was exceeding our 2% inflation target", he says in the interview. "Now we also have to pay attention to the opposite risk (...) due to weak growth and a tight monetary policy for too long".

> *Victory over inflation is in sight*
>
> *François Villeroy de Galhau, Governor of the Banque de France*

**ECB**




**FED**




Source: Bloomberg 10/10/24

With a week to go before the next **ECB** meeting, the markets are virtually convinced that the central bank will decide to cut rates by 25 bp for the third time, just one month after the last cut.

The recently published data on inflation in the eurozone, estimated at 1.8% at the end of September, i.e. below the 2% target, appears to have accelerated the Frankfurt-based institution's plans to ease monetary policy.

Experts expect another rate cut by the end of the year, and at least five by September 2025.

On the **Fed** front, inflation data published on Thursday showed a further fall to 2.4% at the end of September. The markets are now almost certain to see a rate cut of 25 basis points at the next FOMC meeting in November (the month of the US presidential election).

The chances of a further cut between now and the end of the year are also high (83%). A total of 5 rate cuts are expected between now and September 2025: in this scenario, the Fed Funds rate could fall to 3.52%.

### Minutes of the FED meeting: disagreement over the extent of the cut

A "substantial majority" were in favour of a 50 bp rate cut, and all were in favour of a rate cut. This is what emerges from the minutes of the last meeting of the FOMC, the Federal Reserve body responsible for US monetary policy. At this meeting, the FOMC decided to cut interest rates by half a point to 4.75% - 5%, the first cut in 4 years.

For most bankers, the risks of rising inflation are "diminishing" and the risks to the labour market are "increasing". Interest rates were lowered to 0-0.25% in March 2020 to combat the negative effects of the COVID pandemic on the US economy, and then gradually raised.

Since March 2022, there have been 11 rate hikes in 16 months, reaching the highest level since 2001. Rates were then held at 5.25-5.50% for 14 months.

## Rising borrowing costs in the UK

The UK's long-term borrowing costs have risen sharply. They are fuelled by investor concerns about the Labour government's budget, widening the yield differential with Germany, which is at its widest for over a year.

With three weeks to go until Rachel Reeves' first Budget, bondholders say the British Chancellor will have to walk a "tightrope" if she is to press ahead with her borrowing and investment plans without triggering a massive sell-off in gilts (UK government securities).

The spread between UK and German 10-year benchmark bond yields reached 1.94%, its highest level since August 2023.

As a result of the Chancellor's forecasts of a possible easing of borrowing rules in the Budget on 30 October, the yield on 10-year gilts rose from 3.75% in mid-September to 4.2% on Tuesday.


Andrew Bailey Governor BoE

*According to Andrew Bailey, UK rate-setters could be "a little more aggressive" in lowering borrowing costs if inflation continued to fall. While these comments have supported short-term government debt, longer-term gilts - which are generally more sensitive to government borrowing plans - have continued to weaken.*

### News

**New Zealand** | Central Bank cuts interest rates by 50 bp to 4.75%

**Germany** | orders to industry in down 5.8% over the month to end August (-1.9%) expected by experts (vs +3.9% in July)

### Agenda

**17 October** l Publication of inflation rate in the Eurozone at the end of September

**17 October** l Decision by the ECB on the interest rate



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