

MARKET COMMENTARY

ECB to go into hibernation

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- At today's meeting the ECB's Governing Council (GC) unanimously and unsurprisingly decided to keep its key rate unchanged at 2.0%.
- The macro projections, extended to 2028 show a less pronounced inflation undershooting in 2026 (1.9% vs 1.7%), an unchanged 2027 number (1.9%) but convergence towards target by 2028 with core inflation being revised up by cumulatively 0.5 pp in 2026/27. A key reason was stronger wage dynamics.
- The growth projections were increased by cumulatively 0.5 pp for 2025-27 and set at 1.4% in 2028 with domestic activity being the main engine of growth.
- While the policy implications of the macro-outlook clearly became more hawkish, President Lagarde reconfirmed that the ECB was "*in a good place*" and that neither cuts nor hikes were discussed at the meeting. Yet all options should be on the table.
- We feel confirmed in our view that the ECB maintains a wait-and-see stance and goes into hibernation at 2.0%.

ECB kept key rate unchanged today: Quite unspectacularly, at today's meeting the GC left its key rate, the deposit rate, at 2.00% for the third consecutive time. The principal payments of APP and PEPP purchases are no longer reinvested.

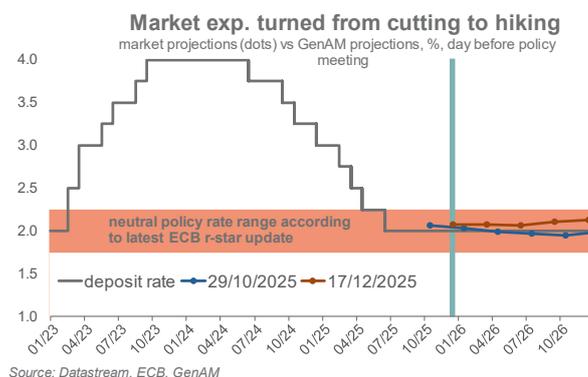
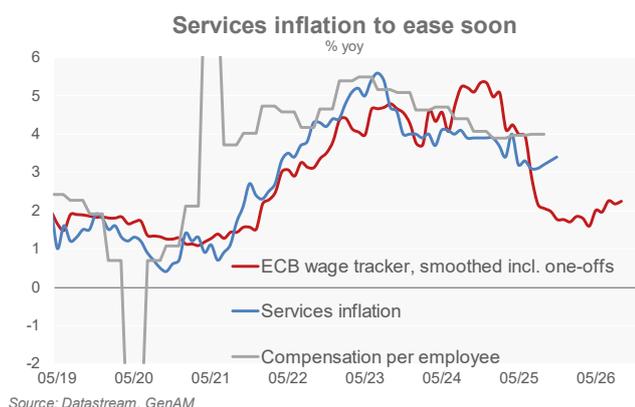
A better growth outlook....: Over the past months activity data surprised on the upside with GDP growth above September projections and sentiment indicators like the PMIs signalling a further strengthening. Inflation data came in above previous projection expectation too. The updated staff projections reflect this improved macro-outlook. Not only the 2025 growth number was revised up (to 1.4%, from 1.2%) but also the ones for 2026/27 (to 1.2%/1.4%, from 1.0%/1.3%) were lifted and for 2028 output is expected to expand by 1.4%. Growth is set to be largely driven by domestic activity with services and AI investment being the main drivers while the challenging international environment is expected to remain a drag on growth.

... and less disinflation: The latest inflation data (headline at 2.1% yoy, core at 2.4% yoy) are still above target. That said, there is strong disinflation in the pipeline as significantly moderating wage growth will drive core inflation down while energy-price related base effects will push down headline inflation strongly at the start of 2026. However, compared to the September projections the ECB "*now expects services inflation to decline more slowly*". In the Q&A President Lagarde explicitly mentioned surprisingly strong growth of compensation per employee, as a headwind to strong disinflation. While the 2025 expectation of 2.4% was confirmed, for the next two years core inflation forecasts were revised up by cumulatively 0.4 pp (2026: 2.2% vs 1.9%, 2027: 1.9% vs 1.8%) and by 2028 it is projected to be at the 2.0% level. Headline inflation is now expected to stay close to target over the projection horizon (2026: 1.9% vs 1.7%, 2027: 1.9% unchanged and 2028: 2.0%) and the GC pointed out that a rather technical factor, namely the postponement of the next phase of the EU emission trading system to 2028, will prevent energy prices to become

inflationary earlier. All in all, the GC now faces considerably less disinflation ahead than in September but the “*updated assessment reconfirms that inflation should stabilise at the 2% target in the medium term.*”

But Governing Council maintains a balanced view: The situation remains complicated by persisting uncertainties, especially the higher-than-usual one on inflation. Against this backdrop it did not come as a surprise that President Lagarde reconfirmed that the ECB was still in a ‘good place’, a view obviously shared by all GC members as neither hikes nor cuts have reportedly been discussed and the decision to leave rates unchanged was made unanimously.

What’s next? At the current level of 2.0% the policy rate is in the middle of the neutral range (of 1.75% to 2.25%) of the ECB staff estimates. At today’s meeting President Lagarde made very clear that the ECB adopts a truly neutral stance with all optionality on the table. Markets have swung from 2026 key rate cut expectations before the October meeting to hiking expectations just before today’s meeting. Barring the materialization of external risk, we continue to look for a hike as the next policy step. However, we also think that 2026 will be a year of strong disinflation and that Mrs Lagarde sounded too alarming on wage inflation. We do not expect the alarm bells ringing because of too high underlying inflation (see left graph below). We feel confirmed in our view that the ECB maintains a wait-and-see stance and goes into hibernation at 2.0% throughout 2026. Only in 2027 when disinflation will largely have run its course and the cyclical price pressure will increase we see leeway for higher rates again.



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