

## ECB cuts again, with another cut on the cards for March

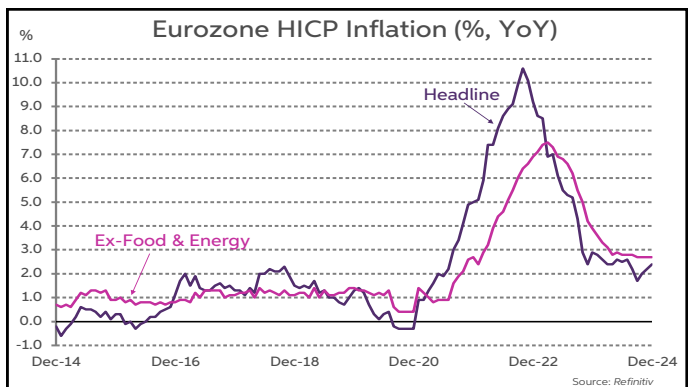
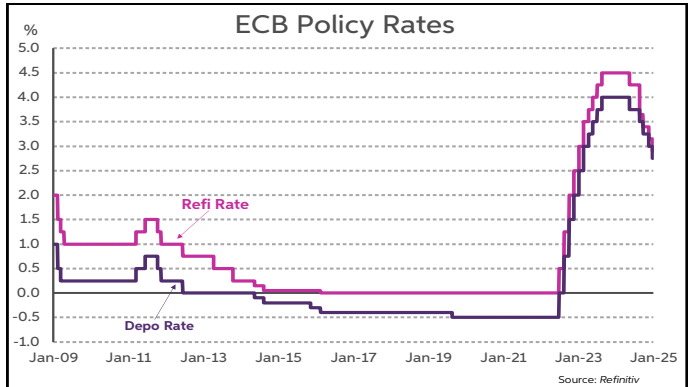
The first ECB Governing Council policy setting meeting of 2025 saw the central bank cut interest rates. It reduced them by 25bps, with the Deposit rate lowered to 2.75%, while the Re-fi rate was decreased to 2.90%. This marked the fifth 25bps rate cut since the ECB commenced its easing cycle in June of last year. Today's decision by the ECB to cut rates was unanimous.

The meeting statement outlined the ECB's rationale for its decision to cut interest rates again. It noted that "the disinflation process is well on track" and that incoming inflation data is broadly in line with staff projections and consistent with inflation returning to its 2% target over the medium term. It referenced the fact that "most measures of underlying inflation" indicate that inflation "will settle at around" its target "on a sustained basis". The meeting statement also mentioned that while "domestic inflation remains high", wage growth, which had been a key source of upward pressure "is moderating".

The most recent set of macro forecasts from the ECB were released at its December meeting. They saw a downgrade to its growth expectations. The ECB is forecasting GDP growth of 1.1% (from 1.3%) for this year. Meanwhile, it sees GDP averaging 1.4% in 2026 (was 1.5%) and is pencilling in growth of 1.3% for 2027. This is a very subdued growth outlook. President Lagarde, noted once again today that the Governing Council views the risk to economic growth as remaining "tilted to the downside". In terms of the outlook for headline inflation, the December forecasts also saw modest downward revisions from the September projections. The ECB expects inflation to average 2.1% this year (from 2.2%) and 1.9% in 2026 (no change). For 2027, it sees inflation averaging 2.1%. It continues to expect the core rate to average 2.3% this year. The projection for 2026 was revised marginally lower to 1.9% (was 2.0%) while further out, it is anticipating core inflation to remain at 1.9% during 2027.

Today's 25bps rate cut was fully priced in by markets. As a result, the key focus for investors was what guidance, if any, would be forthcoming from the Governing Council in relation to the outlook for official interest rates in the Eurozone. In this regard, the meeting statement continued to emphasise that the central bank will follow a "data-dependent" and "meeting-by-meeting approach" and is not "pre-committing". However, in the press conference, President Lagarde highlighted that the ECB retains a clear easing bias. She noted that monetary policy is "still in restrictive territory" and the Governing Council has not had a discussion on when to stop easing policy. **President Lagarde stated that the ECB "knows the direction of travel" for interest rates (i.e. downwards), but that the pace and magnitude of further rate cuts will be informed by incoming data and ECB staff analysis on the data. The ECB President also highlighted that the Governing Council is "comfortable" that it will reach its 2% target and it will "do everything required to reach that goal". Interestingly, she referenced the fact that the ECB's next policy setting meeting on 6th March will have updated staff macro projections and two additional readings of inflation to inform the central bank's policy deliberations. In other words, another rate cut is on the cards in March.**

In terms of market expectations, futures contracts suggest traders are envisaging around a further 75bps of policy easing from the ECB over the remainder of this year. This would see the Depo rate end the year at 2%, with the next 25bps rate cut expected in March. Given the anaemic growth outlook and continued downtrend in inflation, the Deposit rate settling in and around the 2% level by end year seems a reasonable expectation.



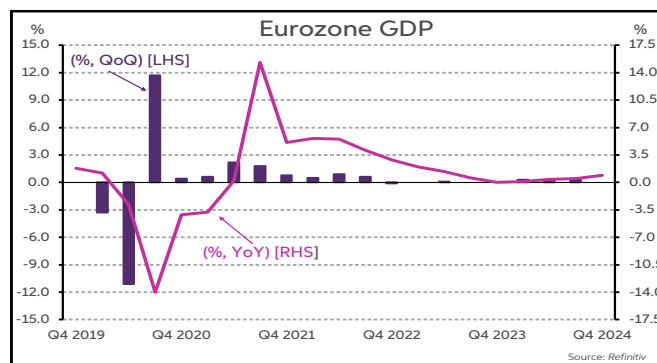
### ECB Macroeconomic Forecasts for the Euro Area

(%)	2024	2025	2026	2027
HICP	2.4	2.1	1.9	2.1
Real GDP	0.7	1.1	1.4	1.3

Forecasts are mid-point of a range and based on assumption that Brent crude oil prices will average \$81.8 in 2024, \$71.8 in 2025, \$70.1 in 2026 and \$69.2 in 2027  
Source: ECB, December 2024

# Eurozone economy stagnated in Q4

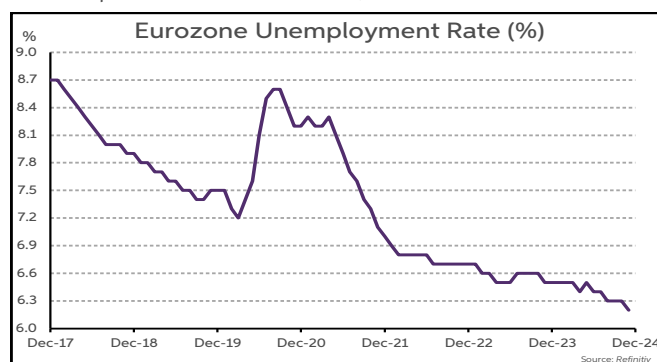
Having essentially flat-lined between the end of 2022 and 2023, the Eurozone economy returned to growth in 2024. However, it should be noted that the economy expanded only modestly, with GDP rising by 0.2-0.4% q/q in the first three quarters of the year, before stagnating in Q4. Overall, the economy expanded by 0.7% in 2024. Among the largest national economies in the Eurozone, growth remained uneven. Germany remained in the doldrums, with GDP contracting for a second consecutive year, by 0.2% in 2024, amid a continued slump in the manufacturing sector and weak consumer spending. In contrast, the Spanish economy registered robust growth of 3.1% last year, while the French and Italian economies recorded more modest expansions of 1.1% and 0.5%, respectively.



Meantime, the very limited available data for January suggest the economy remained on a weak footing. The services PMI was little changed in the month at 51.4, consistent with an expansion in activity in the sector. However, the manufacturing PMI stayed firmly in contraction mode, where it has been since July 2022. It printed at 46.1 in January, a marginal improvement on the 45.1 reading in December, indicating a slightly slower pace of decline. However, the main EC economic sentiment indicator rebounded somewhat in January, having deteriorated throughout Q4, while consumer confidence edged higher for the first time since October.

Regarding the labour market, conditions remain tight. The unemployment rate registered a new all-time low of 6.2% in November before rising slightly to 6.3% in December. Overall, the unemployment rate averaged 6.4% last year, down from 6.6% in 2023. Meanwhile, employment expanded for a fourteenth successive quarter in Q3, up by 0.2% in the quarter and by 0.9% y/y. It means that the number of people at work has risen by 7m or 4.7% since the end of Q4 2019. Tight conditions are contributing to elevated wage growth. The ECB negotiated wages metric increased by 5.4% y/y in Q3, the fastest pace of increase since Q1 1993. However, the Indeed wage tracker - a more frequent measure of wage pressures - indicates that wages have been rising more slowly in recent months. It indicates that wages rose by 3.3% y/y per month between September and December, the slowest rate of increase since January 2022.

On the inflation front, little progress has been made in recent months. The headline rate fell to 1.7% in September, its lowest level since April 2021, and below 2% for the first time since June 2021. However, the decline in September was widely expected, and it was largely driven by a sharp fall in energy prices. Furthermore, since then it has re-accelerated to 2.4% in December. Meantime core inflation is proving to be quite sticky. The ex-food and energy rate has been stuck between 2.6-2.8% since April, and it printed at 2.7% throughout Q4. The core rate that excludes food, energy, alcohol and tobacco has also running at 2.7% in the past four months. Services inflation, in particular remains elevated. It inched marginally higher to 4.0% in December. For the full year, headline inflation averaged 2.4% (vs. 5.5% in 2023), core inflation averaged 2.9% (vs. 6.2%) and services inflation averaged 4.0% (vs. 4.9%).



Overall, the Eurozone economy gathered some momentum in 2024, but economic growth remains quite fragile. On a positive note, the labour market is strong, with employment rising and unemployment at an all-time low. Secondly, the trade balance returned to surplus in 2023, and has continued to widen this year. Meanwhile, there has been a marked fall in inflation since its peak. Further rate cuts and disinflation should support real incomes and in-turn consumer spending. However, the outlook for the Eurozone is challenging and the risks are plentiful. Furthermore, political turbulence in France and Germany, as well as fiscal issues in the former and poor growth prospects in the latter, pose significant potential headwinds for the Eurozone overall. A more protectionist and isolationist US may also weigh on Eurozone growth prospects. Against this backdrop, the most recent growth forecasts for the Eurozone have been revised lower. The IMF sees GDP expanding by 1.0% this year and 1.4% in 2026, while the ECB is anticipating growth of just 1.1% and 1.4% over the same period.

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