

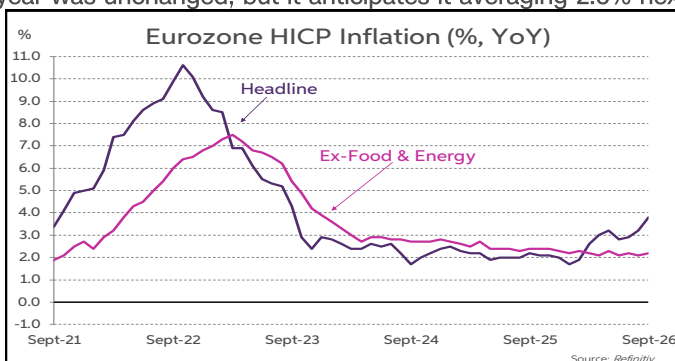
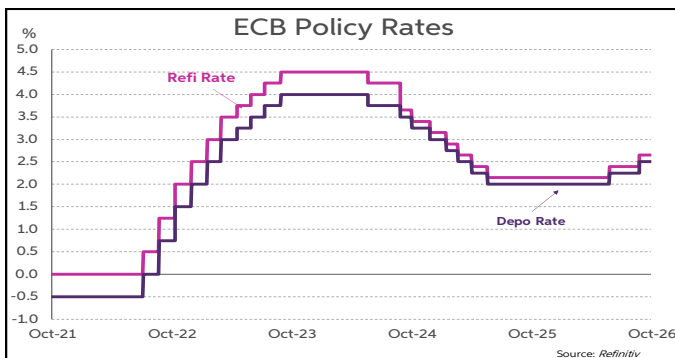
ECB keeps rates on hold

The October meeting of the ECB's Governing Council saw the central bank leaves its key interest rates unchanged. The deposit and refi rates were maintained at 2.50% and 2.65%, respectively. This was very much in line with expectations. The most recent policy change from the ECB was at its previous meeting in September, when it hiked rates by 25bps for a second time this year (previous hike occurred in June).

The most up-to-date detailed assessment of the ECB's view on the economic outlook was published at its previous meeting in September. The ECB revised modestly higher its baseline GDP projections, stating that this was to reflect the "greater than expected resilience" of the economy, particularly in relation to private consumption and public expenditure. It is forecasting that GDP will average 0.9% (was 0.8%) this year, 1.4% in 2027 (was 1.2%) and 1.5% (unchanged) for 2028. It re-affirmed its view today that the risks to the growth outlook remain to the downside. Meanwhile, its September macro update also incorporated upward revisions to its inflation projections. Its expectation for inflation to average 3.0% this year was unchanged, but it anticipates it averaging 2.5% next year (was 2.3%), and 2.1% in 2028 (was 2.0%). Meanwhile, it continues to forecast that core inflation will run above the 2% target over the forecast period, averaging 2.5% this year (no change) and 2.6% in 2027 (from 2.5%), before easing slightly to 2.3% (was 2.2%) in 2028. **Today's meeting statement, once again, stated that the ECB view the "risks to the inflation outlook are to the upside".**

At today's post-meeting press conference, there was no surprise that there were many questions in relation to the announcement that President Lagarde would be stepping down early from her position (next February rather than October). Her decision is in very stark contrast to her previous comments dismissing speculation of an early departure when she stated "When there are big clouds on the horizon, the captain does not leave the ship. And this captain is not going to leave the ship." However, before the captain does indeed leave the ship, President Lagarde did give strong indications that December was a 'live' meeting in the context of potential rate hikes. She commented that while the decision to leave rates on hold today was unanimous, the Governing Council "debated whether a hike was appropriate". In the end, the Council decided that it was "well positioned enough at this stage to hold". However, she noted that the "inter-meeting period will be information-rich" and "six weeks of additional time will give us a lot more information" while also repeating the ECB's mantra of "not pre-committing" and following a "data-dependent and meeting-by-meeting approach" to any policy decisions. Meanwhile, on questions in relation to France and its current elevated yields, President Lagarde noted that while the ECB has instruments available, the main solution lies with French domestic fiscal policy.

Overall, the ECB retained a hawkish tone today and positioned its next Governing Council gathering in December as a 'live' meeting without pre-committing to hiking. The market is attaching around a 70% probability to a 25bps rate hike in December, which seems a sensible assessment. The market envisages rates rising by around another 50bps in 2027. However, we believe that the Depo rate may peak at 2.75%. The recent tightening in financial conditions as well as limited second round inflationary effects so far may limit the extent of additional rate increases the ECB needs to implement.



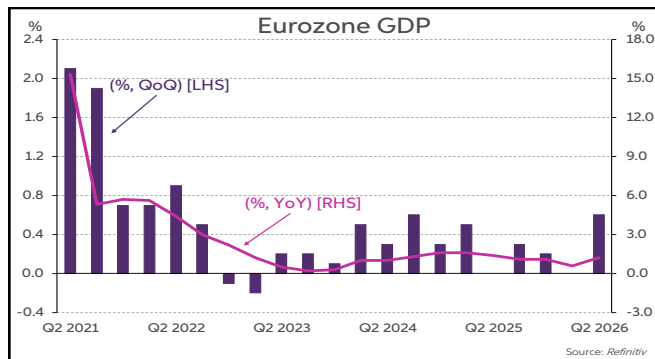
ECB Macroeconomic Forecasts for the Euro Area - Sept 2026

(%)	2025	2026	2027	2028
HICP	2.1	3.0	2.5	2.1
Real GDP	1.3	0.9	1.4	1.5

Base forecasts based on Brent oil prices avg. \$89.5 in 2026, \$78.0 2027, and \$73.6 in 2028.

Eurozone economy resilient in H1

The Eurozone economy expanded by a solid 1.4% last year, up from 0.8% and 0.5% in the two years prior. So far in 2026, growth has been volatile, but overall the economy has maintained this recent momentum. GDP flatlined in Q1 before expanding by 0.6% q/q in Q2. However, the volatility was largely caused by distortions in the Irish GDP data. GDP excluding Ireland expanded by 0.3% in both quarters. Looking at the latest quarterly data in more detail, personal consumption, and exports were the main drivers of growth. Consumption expanded by 0.4% in Q2 contributing 0.2 percentage points (p.p.) to GDP. Meanwhile, exports jumped by 3.4%, adding a hefty 1.6 p.p. to the total, albeit this was offset by a rise in imports, which knocked 0.7 p.p. off growth. Although, government spending rose by 0.2% q/q, its impact on GDP was negligible, as was the marginal contraction in investment. However, a sharp rundown in inventories reduced output by around 0.5 p.p. in the quarter.



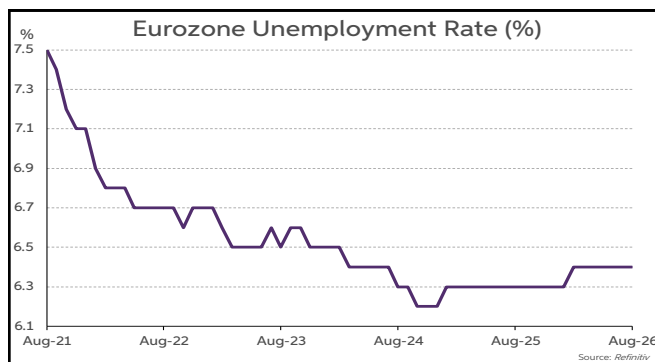
Meanwhile, survey data for Q3 indicate that economic conditions may have improved slightly in the quarter. Having moved into contraction territory in Q2, the services PMI returned to expansion mode in Q3. It averaged 52.1 in the quarter, up from 48.2 in Q2. Similarly, the manufacturing PMI averaged 52.5 in Q3, up marginally from an average of 51.7 in the previous quarter. At the same time, economic sentiment improved somewhat, albeit consumer, industrial, services and investor sentiment all remain at subdued levels. **The limited available hard data for Q3 though have deteriorated somewhat.** Retail sales contracted by 0.6% in July, before rising by just 0.1% in August. Meantime, industrial production has contracted in each of the last three months, including by 0.3% and 0.5% in July and August.

In terms of the labour market, conditions remain solid. Employment expanded for a twenty first successive quarter in Q2 (+0.1% q/q and by 0.5% y/y). It means that the number of people at work has risen by 5.9% (9.8 million) since the end of Q4 2019. Meanwhile, the unemployment rate has printed in a 6.3%-6.4% range in the first eight months of 2026. Ongoing tight conditions continue to support wage growth. The Indeed wage tracker indicates that earnings rose by 3.0% y/y on average in the three months to July, compared to just 2.4% y/y during the same period in 2025.

On the inflation front, price pressures were relatively stable in the Eurozone ahead of the recent surge in energy prices. Following a gradual downtrend in the first half of 2025, inflation remained in and around the ECB's 2% target rate. Indeed, the headline rate averaged just 2.1% in 2025. Meantime, underlying inflation proved to be somewhat sticky, with the core rate averaging 2.5% last year. However, amid the war in the Middle East, headline inflation has increased sharply in the past seven months. It rose from 1.9% to a peak of 3.8% in September. There has been limited evidence to date that energy price rises have let to broader inflationary pressures. Core inflation has printed in a narrow 2.1-2.3% range since the war started.

In summary, the Eurozone economy has shown resilience so far this year, but the energy price shock remains a key downside risk. Looking ahead, increased fiscal spending in Germany should continue to support growth in the Eurozone's largest economy.

However, the EZ continues to face challenges. Most notably, amid the energy price shock, if underlying inflation were to accelerate in a meaningful way, the ECB may have to raise rates further, bringing monetary policy into restrictive territory. At the same time, fiscal stability concerns in France and the recent widening in yield spreads are an added challenge facing the currency bloc at present. More broadly, geopolitical tensions, particularly in relation to the US-Iran and the Russia-Ukraine Wars, pose major downside risks to the EU. Against this backdrop, the IMF sees GDP rising by 1.1% this year and by 1.2% next year.



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