

## Why the ECB's Lagarde is looking out the window but could soon be rushing for the door

Today's ECB conference following its decision to cut rates by 25bp signalled a clear intent to lower rates further. They're still in restrictive territory, and reaching neutral seems like the next step – but not necessarily the final one. We think Lagarde's position on the lookout for economic developments could very well turn into a full blown sprint



President of the European Central Bank, Christine Lagarde, at today's press conference in Germany

Even without having it fully telegraphed in recent weeks, the European Central Bank's decision to cut policy interest rates by 25bp today is no surprise. Despite somewhat stickier headline inflation, the [sluggishness of the eurozone economy](#) as well as the ECB's strong conviction that inflation will return to target were strong arguments for today's rate cut.

During the press conference, ECB President Christine Lagarde indicated that the central bank's macro assessment had hardly changed from its December meeting. The ECB still sees the

disinflationary process on track and expects a pick-up in demand, though it acknowledges the near-term weakness of the eurozone economy.

Interestingly, Lagarde mentioned exports as a main driver of the region's expected recovery. While understandable given that recovery across the eurozone is often triggered by stronger exports, it's also risky given the current tariff threat stemming from the US. On inflation, Lagarde said that the ECB expected the headline rate to fluctuate around current levels in the near term before settling down at 2% later this year. This level of confidence is remarkable given the recent increase not only in actual headline inflation but also in survey-based inflation expectations in both services and manufacturing.

Lagarde reiterated the phrase from the official policy statement that despite today's rate cut, monetary policy in the eurozone remains restrictive – in our view, actually too restrictive for the eurozone economy's current weak state. Even if some argue that monetary policy can do very little to solve structural issues, political instability and uncertainty in many countries will force the ECB to continue doing the heavy lifting.

## Another cut in March almost a done deal

Looking ahead, the latest data once again confirmed that the ECB is currently looking at a mild version of stagflationary tendencies: continued sluggishness of the economy and accelerating inflation. Still, the ECB seems to be looking through this temporary acceleration of inflation, and sounds determined to continue cutting interest rates. The desire to stay ahead of the curve – also in light of potential incoming economic worries for the eurozone stemming from the US administration – remains a compelling reason to return interest rates to neutral.

According to the ECB's logic, the Bank will have to bring interest rates to where market expectations were in December in order to deliver the December forecasts' outcome. This means cutting rates by a total of another 75bp. Otherwise, inflation would undershoot and growth underperform. This means that another 25bp rate cut at the March meeting is almost a done deal.

Bringing interest rate at least to the upper end of estimates for the neutral interest rate, i.e., 2.5%, seems like a no-brainer. How far the ECB will go from there depends on several factors: estimates of where the neutral interest rate is (a staff paper with new estimates will be released next week), consistency, precision and direction of the staff projections (next round to be released in March) as well as whatever economic policies emerge from the White House.

As we see the neutral rate at around 2% and expect the eurozone economy to perform worse than the ECB had forecast in December (at least in the first half of this year), we continue to see the ECB cutting the deposit interest rate to at least 2% by the summer. A growing worry, however, that the ECB doesn't yet seem to share is the mentioned increase in survey-based inflation expectations.

For now, today's meeting suggests that the ECB's voyage to neutrality will continue. Or, to paraphrase Christine Lagarde: the direction of the ECB's travel is clear, and the next stop is neutral, but this might not be the final stop. In fact, as Lagarde also said that she wanted to look out of the window to monitor economic developments. We might see her sprinting to the door at some point once she notices the 'final stop' sign.

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