Article | 17 April 2025

ECB shows increased sense of urgency to cut rates further

At the press conference following the 25bp rate cut decision, European Central Bank President Christine Lagarde showed an increased sense of urgency in light of ongoing trade tensions and increased disinflationary pressures

What started last year in June as the ECB's very measured attempt to gradually reduce the level of monetary policy restrictiveness has turned into efforts to avoid too much disinflation. With the latest developments, escalating trade tensions, unprecedented policy uncertainty and the strengthening of the euro exchange rate, today's ECB's decision to cut interest rates by 25bp – bringing the deposit rate to 2.25% – came as little surprise.

Back in March, the ECB had labelled its monetary policy stance as "becoming meaningfully less restrictive". Today, this phrase was dropped and not replaced by anything else. At the press conference, ECB President Christine Lagarde explained that it was currently meaningless to assess any level of restrictiveness. In our view, she rightly dismissed the reliance on the concept of neutral interest rates - a framework that may have been effective in a shock-free world but falls short in the current environment - by emphasising that the monetary policy stance is always evaluated in relation to this benchmark. After today's meeting, we stick to our call that the ECB will cut the deposit rate to 1.75% by September.

Unanimous rate cut decision as disinflationary forces increase

US tariffs and the never-ending back-and-forth have brought back growth concerns for the eurozone, clearly offsetting previous optimism stemming from the German fiscal policy U-turn, at least in the near term. The strengthening of the euro and the drop in energy prices have added to the disinflationary impact that the current trade tensions will have on the eurozone.

It is not only the bilateral euro-dollar exchange rate that has increased disinflationary pressures, but also the trade-weighted exchange rate, which has reached a record high. As a result, the ECB, which looked hesitant to decide between a pause and a cut only a few weeks ago, cut rates today for the seventh time since June last year.

During the press conference, Lagarde stressed that downside risks to the eurozone growth outlook had increased and that there was now more uncertainty about the eurozone inflation outlook.

Even though the prospects of a trade war and the German fiscal u-turn were already visible at the March meeting, it looks as if at least some ECB members have still been taken by surprise by the tariff tensions of the last two weeks.

The 50bp vs 25bp debate

Lagarde said during the press conference that the option of a 50bp cut had been debated today but that the decision to cut by 25bp was unanimously taken. Given the current high level of uncertainty, coupled with the fact that just weeks ago some Governing Council members were clearly in favour of pausing at today's meeting, a 50bp rate cut was evidently a step too far. Such a bold move might have been characteristic of the ECB under Mario Draghi, who often tried to stay ahead of the curve. The ECB's decision to opt for a more modest 25bp cut reflects not only the uncertainty but also the possibility of a still-unexpected positive shift in circumstances—for instance, the easing of trade tensions or the swift enactment of fiscal stimulus measures in Germany.

More rate cuts to come

Looking ahead, the main problem for the ECB will remain the exceptionally high level of uncertainty. This issue is further complicated by the ECB's standard practice of only factoring economic or fiscal policy measures into its official reaction function once they have been formally enacted into legislation. Something that in some jurisdictions outside of the eurozone is far from clear. Or to put it differently, there is not only a high level of uncertainty, there is also a large gap or divergence between policy announcements and policy implementation.

Assuming that the trade tensions will not fade away any time soon and that the coming weeks will show the first fallout for the eurozone economy, the risk for the ECB of undershooting its inflation target will increase. Lagarde may not have been as straightforward and explicit as her predecessor Mario Draghi but stressing the ECB's 'readiness' and 'agility' was a clear hint that the ECB will not shy away from cutting rates further. Let's be honest, any 'whatever it takes' moment would not be sufficient right now. And Lagarde knows this. This is probably why, at the very end of the press conference, she made a strong plea to eurozone governments to finally get started with overdue longer-term projects like increasing competitiveness or the capital markets union.

We are convinced that there are more rate cuts to come. The ECB's sense of urgency has clearly increased. However, everyone should know by now that rate cuts alone will not shield the eurozone economy against the current historic changes and challenges.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Disclaimer