

March ECB cheat sheet: The “restrictive” dilemma

The European Central Bank will almost certainly cut rates by 25bp on Thursday 6 March, an outcome that is fully priced in. With the deposit rate being lowered to 2.5%, the question is whether ECB President Christine Lagarde will still characterise policy as “restrictive”. We think she will, but failing to do so could trigger further hawkish repricing

Scenario analysis: How to position for Lagarde's alternatives

	Inflation outlook	Growth outlook	Interest rates		
Current stance	Inflation to fluctuate in the near term, settle around 2% in medium term	Conditions for a recovery remain in place. Risks to the downside	Depo at 2.75%. Data-dependent, meeting-by-meeting approach	EUR/USD (1.047)	10Y Bund (2.53%)
Dovish	Risks of inflation undershooting target in 2025 and beyond	Growth outlook even more tilted to the downside due to US tariffs	25bp cut. QT increasing restrictiveness, clear hints at more cuts	1.038	2.40%
Moderately dovish ING base-case	Overlooking short-term fluctuations. Expecting inflation at 2% this year	Unchanged. Balance of risks for growth remains tilted to downside	25bp cut. Monetary policy remains restrictive. Guidance unchanged	1.043	2.50%
Neutral	Greater near-term upside risks for infl. but medium-term view unchanged	Improvement in activity indicators, but US tariff risk tangible	25bp cut. Dropping reference to restrictive policy, retaining flexibility	1.053	2.60%
Hawkish	Increasing risk that inflation will be above target in the medium term	Downplaying US protectionism risk, growth outlook now more balanced	25bp cut. Explicitly outlining the case for a pause in easing	1.060	2.65%

Source: ING

Eyes on the details

An ECB deposit facility rate cut by 25bp this week is fully priced in, but the outlook for next month is already becoming a lot less certain: a cut in April is seen with only a 60% probability. The market is homing in on a quarterly cutting schedule after this week. It is also still eyeing the possibility of the ECB cutting rates below 2% eventually, with the forward OIS for the year end below 1.9%. US tariffs could yet become more concrete and weigh on the macro outlook. But the perceived chances of the ECB cutting faster and further have slimmed noticeably again after the [latest flash inflation readings](#) declined less than markets had hoped.

Given the ECB's recent tendency to give little away in terms of forward guidance, we think the determinant for market reaction will be whether President Lagarde continues to characterise monetary policy as “restrictive”. This is particularly relevant as a 25bp cut would take the deposit rate to 2.5%, which is the upper-bound of the neutral rate range. As shown in our scenario analysis

above, we think the “restrictive” reference will remain in place for now, which could be received by the market as a moderately dovish signal.

Lingering questions on EU defence spending impact

The ECB Council remains constrained by sticky core inflation readings. While it's forecasting the data to eventually fall in line with targets, this uncertainty around inflation limits the Council's ability to sound more dovish as policy rates close in on the neutral rate. It will only add to any ECB caution that larger stimulus is now being discussed by eurozone countries and importantly in Germany, and not just for defence spending. The numbers involved look huge with €900bn across two special funds, one for defence and one for infrastructure investments. But so far, there is very little known about the crucial details, such as the time frame or whether these numbers reflect the final outcome.

We would not be surprised if the ECB were questioned about its stance on the implications of defence spending for longer term bond markets, and potentially the impact on those countries with already constrained finances. We suspect that as long as eurozone government bond spreads remain relatively stable, the ECB will be content with a standard pointer to the Transmission Protection Mechanism (TPI). One question to ask would be whether the EU plans to trigger national escape clauses from the deficit rules, which would also impact the conditionality of the backstop.

FX: ECB not the primary driver

At the time of writing, markets are anxiously waiting to see whether the US will go ahead with 25% tariffs on Mexico and Canada on 4 March as planned. The implications for FX spreads go beyond MXN and CAD, as markets are still gauging the materiality of Trump's protectionism threat. Our scenario analysis above is based on the current EUR/USD spot, but we may well see large swings before Thursday's ECB meeting.

Recent EUR/USD strength has not hugely relied on the ECB story, but more on soft US data and hopes for a Ukraine-Russia ceasefire. Looking a few months ahead, we think US tariffs on the EU will drive most of the EUR/USD moves, and we retain a bearish stance on the pair. Such a stance also relies on the ECB cutting rates at least another 50bp to 2.0%.

We don't think any ECB impact on EUR/USD will exceed 1% this week, although the question about the “restrictive” reference makes this meeting a bit more binary than previous instances. At the margin, we expect the ECB to trigger a moderately bearish reaction in the euro.

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