Snap | 5 June 2025

ECB cuts rates by 25bp as risk of inflation undershooting increases

The ECB has cut interest rates once again, bringing the deposit rate to 2%, from 2.25%. As the risk of inflation undershooting target has clearly increased, today's rate cut will not be the last

ECB President Christine Lagarde

The European Central Bank (ECB) has cut interest rates to the lowest level since December 2022, bringing the deposit rate to 2%, from 2.25%. Rapidly fading inflationary pressures have given the ECB ample room to bring interest rates into neutral territory. With the risk of inflation undershooting currently increasing, today's rate cut will not be the last.

Risk of inflation undershooting has increased – at least in the nearer term

Inflationary pressures in the eurozone are receding faster than expected. Not only did US President Donald Trump make the European economy great again – for one quarter, as frontloading of exports and industrial production boosted economic activity – he also made inflation almost disappear.

The strengthening of the euro exchange rate and the drop in oil prices due to erratic US economic policy have increased disinflationary pressures in the eurozone. And while there had been some countermovement in recent weeks, the nominal effective exchange rate of the euro is still some 3% higher and oil prices some 10% lower than at the ECB's March meeting and the last round of ECB forecasts. These two developments are also reflected in the ECB's latest staff projections which show headline inflation coming in at 2% in 2025, 1.6% in 2026 and 2% in 2027.

Even if the eurozone economy has shown some unexpected resilience and trade tensions could still fade, the risk of inflation undershooting target has become pressing enough for the ECB to cut rates once again.

Watch out for Lagarde's travel plans at the press conference

At the press conference, starting at 2.45pm CET, all eyes will be on ECB President Christine Lagarde and any signals about what might be next for the ECB. Unless trade tensions return with a vengeance, we suspect that the ECB will stick to a wait-and-see approach over the summer. It will take a bit longer to understand whether the current disinflationary risks are merely one-offs or whether they signal a broader trend.

At the same time, the more resilient the eurozone economy is, the more worried the ECB will be about the potentially inflationary impact of German fiscal stimulus in 2026 and beyond. We're therefore very curious to hear more about the famous direction of travel, but fear that Lagarde will not share her travel plans today.

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