Snap | 6 March 2025

ECB cuts rates by 25bp but direction of travel no longer that clear

The ECB just announced another rate cut, bringing the deposit rate to 2.5%, from 2.75%. The phrase 'monetary policy is becoming meaningfully less restrictive' indicates that the ECB's direction of travel is no longer that clear

ECB President Christine Lagarde

Few doubted the ECB's resolve to continue cutting rates at today's meeting. As expected, the ECB proceeded with what President Christine Lagarde described in January as the journey towards neutral interest rates. The 25bp rate cut was anticipated.

At 2.75%, the deposit rate was still too restrictive for a eurozone economy showing signs of bottoming out but not yet recovery. And with looming US tariffs on European goods and high geopolitical uncertainty, as well as falling headline inflation, the decision to cut interest rates again was a no-brainer.

At the same time, the new phrase 'monetary policy is becoming meaningfully less restrictive' indicates that ECB policy rates are approaching neutral territory.

Direction of travel no longer that clear

However, an important basis for today's policy decision was already outdated when the ECB's Governing Council discussed it: the latest staff projections. Due to their cut-off date two weeks ago, these staff projections have not taken into account the events of the last few days. Neither the discussion to increase defence spending nor the announcement in Germany of a €500bn infrastructure fund, in addition to planned changes to the debt brake, will have been covered in the projections. But for the sake of completeness, ECB staff expect GDP growth to come in at 0.9% for 2025, 1.2% for 2026 and 1.3% for 2027, with downward revisions for 2025 and 2026. At the same time, it sees inflation coming in at 2.3% in 2025, 1.9% in 2026 and 2.0%

The most important question ahead of today’s meeting was not so much whether the ECB would cut interest rates again but rather what comes next after today’s meeting. Here, developments of the last few days will have triggered an even more heated debate between doves and hawks on whether or not more rate cuts are needed. If eurozone governments do indeed take over the baton and big fiscal stimulus is coming, the ECB will no longer need to do the heavy work to support eurozone growth. Instead, a more optimistic growth outlook on the back of German infrastructure and European defence spending would allow the ECB to stop the current rate cut cycle earlier than we had previously anticipated. At the same time, however, let’s not forget that rising bond yields are also more restrictive, increasing costs for private sector investments - a typical example of crowding out.

With the increased uncertainty and the prospects of large fiscal stimulus, the ECB’s direction of travel after today’s rate cut is no longer as clear as it was a few weeks ago. A pause at the next meeting to come to terms with the new macro reality now looks like a possibility. However, even if the need for further rate cuts is gradually fading away, the ECB won’t be off the hook. Rising bond yields on the back of higher government debt could bring another theme to the eurozone soon: yield curve control.

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