

ECB's estimates of neutral interest rates leave plenty of room for further rate cuts

The European Central Bank today released a new research piece on where the neutral interest rate in the eurozone could be. Whether or not the ECB uses this concept and the estimates, there is still plenty of room for further rate cuts



ECB President Christine Lagarde

It doesn't happen very often that market participants are impatiently awaiting the release of an ECB working paper. Today was one of those rare occasions as the ECB released new analysis on the neutral interest rate, which ECB President Christine Lagarde had preannounced at last week's press conference. As anticipated, the analysis did not meet high expectations

The concept of neutral interest rates and the ECB's latest research

The concept of the neutral interest rate uses the theoretical level of interest rates that neither stimulates nor restrains economic activity. It represents a balance between economic growth and inflation, ensuring the economy operates at full employment without overheating or contracting. In theory. The neutral rate is influenced by several factors, including productivity growth, demographic trends, and global savings and investment patterns.

For those hoping for real clarity about what's next for the ECB, the long-awaited working paper will have been a disappointment. In short, [the paper](#) concludes that the neutral interest rate ranges between 1.75% and 3% when using the most recent data between 1.75% and 2.25%.

ECB will continue cutting rates

Are we now any more knowledgeable about how far the ECB will cut interest rates? No. Despite Lagarde raising expectations, other ECB officials have dismissed the concept of neutral interest rates as a useful proxy for the central bank in recent days. Rightly so, as the problem with this concept is that it can change over time, over the cycle and over different economic models. Plus, as so often in economics, it is much easier to identify something ex-post than determine it ex-ante.

With or without today's latest estimates on where a purely theoretical and conceptual neutral interest rate for the eurozone might be, we continue to see the ECB cutting rates to at least 2% by the summer. Let's not forget that if growth continues to disappoint and inflation remains under control, the ECB's next major research focus will need to be on what an accommodative, rather than neutral, monetary policy stance would look like.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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