MARKET COMMENTARY

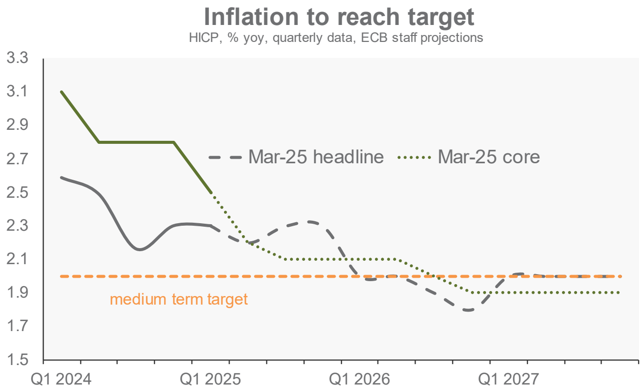
Approaching neutral

Martin Wolburg

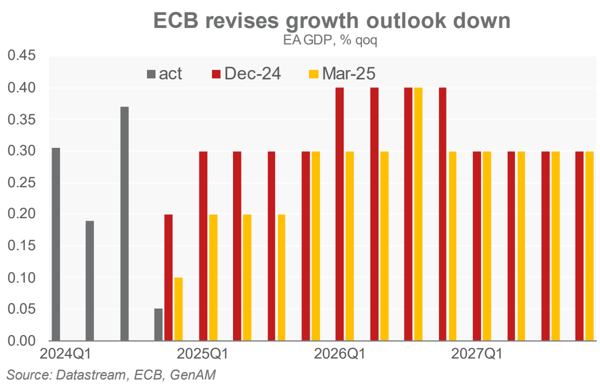
March 6, 2025

- **At today's meeting the ECB's Governing Council (GC) decided to cut again its key rate by 25 bps to 2.50%, in line with latest market expectations.**
- **The updated macro projections show the expected downward revision of growth (esp. 2025 to 0.9%, from 1.1%) with trade policy uncertainty a key driver while the inflation outlook was revised up (esp. 2025 to 2.3%, from 2.1%) reflecting higher energy prices. Overall, the disinflation process is again seen "*well on track*".**
- **The latest news about EU military spending and the German fiscal plans are not included yet. In the Q&A President Lagarde emphasized that the impact on growth and inflation is not clear yet but that she was confident it would increase growth.**
- **At current levels, rates are considered "*meaningfully less restrictive*" but the GC still sees headwinds from past tightening at work. The decision to cut was met by consensus and according to Mrs Lagarde there was a lively and quite intense discussion.**
- **All in all, we think that further rate cuts are still in the offing, but that ECB will likely stop at 2.0%. As Mrs Lagarde strongly emphasized uncertainty, we see the risks tilted to even a higher landing rate and a pause at the April meeting.**

ECB cut by 25 bps today: At today's meeting the GC again decided to cut the deposit rate, to 2.50%. It continues with fully non-reinvestments of its APP and PEPP purchases.



Source: Datastream, ECB, GenAM calculations



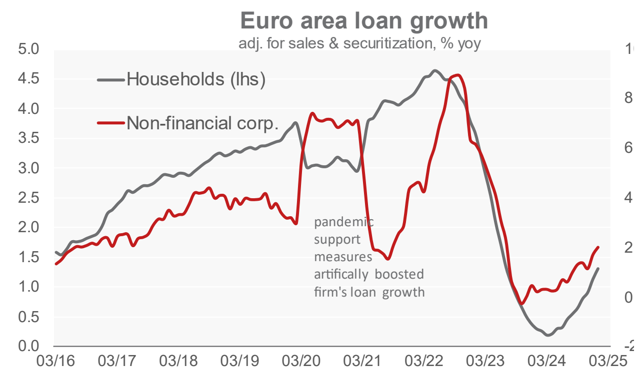
Source: Datastream, ECB, GenAM

Growth outlook does not include German fiscal boost yet: The updated staff projections show the widely expected downward revisions of annual growth which is now set to be at 0.9% (from 1.1%) in 2025, 1.2% (from 1.4%) in 2026 and 1.3% (unchanged) in 2027. A key rationale for the downward revisions in 2025/26 is lower exports and ongoing weakness in investment, in part originating from high trade and broader policy uncertainty. The latest news about a forthcoming fiscal boost in Germany were not yet included in this projection but President Lagarde, in the Q&A sounded positive on their growth impact The June staff projections will probably include this fiscal boost.

Disinflation still well on track: The outlook for headline inflation was mildly revised upwards to 2.3% (from 2.1%) in 2025, 1.9% (unchanged) in 2026 and 2.0% (from 2.1%) in 2027. However, the view on core inflation was not changed much (2025: 2.2%, from 2.3%, 2026: 2.0%, from 1.9%, 2027: 1.9%, from 1.9%). President Lagarde emphasized very much that the upward revision for 2025 was that mainly due to expected hight energy prices and that the 2% will be reached by early 2026, before it was late 2025. She pointed out that the fundamentals driving inflation further down were still in place, especially moderating wage growth. Services inflation is heading in the anticipated direction.

Monetary policy now meaningfully less restrictive but uncertainty even higher: At current rates monetary policy is now assessed as "*meaningfully less restrictive,*" after having been characterized still as restrictive before. Still headwinds from past policy tightening are seen at work. Looking ahead, however, huge uncertainties are surrounding the future policy path. Mrs Lagarde mentioned for instance that tariffs could be inflationary (via EUR depreciation) and that the effect of the announced fiscal spending measures would, if implemented, increase demand to a yet uncertain degree. Uncertainty was even higher than before and therefore she reiterated the ECB's data-dependency and meeting-by-meeting approach. Asked about whether the direction of travel was still clear, she stated that a pause now also was a realistic option. In the end it will depend on the interaction of the trade war risk and likely fiscal boost. The more inflationary this blend becomes the less willing will the ECB be to cut rates further.

Air for rate cuts getting thinner in the GC: According to Mrs Lagarde, today's cut was a consensus decision following an intense and lively discussion with nobody opposing but one Governor abstaining. This shows to us that, especially given looming inflationary risks from fiscal policy and tariffs, the air for rate cuts is getting thinner. Still, we think that ongoing disinflation leaves room for further cuts. But we have revised up our landing rate target from 1.75% up to 2.0%. Depending on the materialization of the above-mentioned risks we could in a risk scenario now also imagine that further rate cuts only at quarterly meetings along with updated macro projections or that the ECB even stops at 2.25%, the upper range the neutral corridor mentioned in a recent publication.



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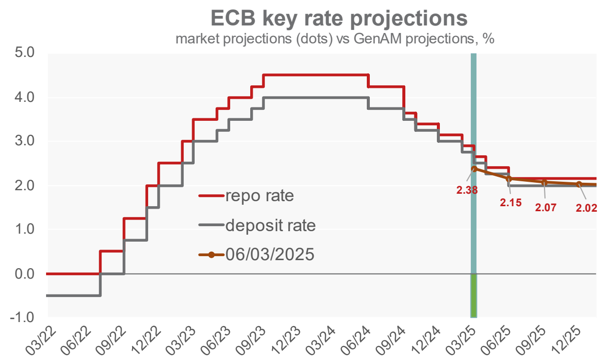

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