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EcoBrief

Eurozone: The ECB's gradualist approach

The ECB is still keeping control of things. This was the general message from Christine Lagarde at her press conference on Thursday 12 December. As expected, the ECB cut its key rates by 25 basis points for the fourth time since monetary easing began in June, taking the refinancing rate down to 3.5% and the deposit facility rate down to 3.0%. Inflation forecasts have been lowered slightly[1], with the forecast brought down to 2.1% for headline inflation and 2.3% for core inflation, before the two measures converge at 1.9% in 2026.

Less restrictive. By removing the reference to keeping rates "*sufficiently restrictive for as long as necessary*" from its announcement, the ECB is adopting an openly more accommodative tone, but it is not letting its guard down, in view of the pockets of stubbornly high inflation in services, which should gradually disappear in 2025. Unsurprisingly, the ECB's new projections reflect downward revisions to growth in 2025 (1.1%, compared to 1.3% forecast in September) and 2026 (1.4%, compared to 1.5% previously), which, however, do not pose a risk to the scenario of activity strengthening slightly compared to 2024. These figures are higher than our own forecasts of limited and stable 1.0% annual average growth in 2025-2026. Unlike our estimates, the ECB does not include any effects of the anticipated US protectionist measures on trade (as noted by Christine Lagarde during the Q&A).

Control, but no proactive measures. The ECB continues to prefer a gradual approach to its monetary easing, which contrasts with the decisions taken this week by the Bank of Canada and the Swiss National Bank, which both decided to make cuts of 50 basis points to their key rates, bringing them down to 3.25% and 0.5%, respectively. During its first cut in September, the Fed also went for a big cut of 50 basis points. Interest rates are returning to neutral deliberately more quickly in Canada and Switzerland than in the eurozone, because, in Switzerland in particular, inflation has already fallen significantly below the 2% target.

This gradualist approach embraced by the ECB gives it room for manoeuvre should there be a more significant turnaround in the economic cycle.

Productivity to the rescue. The ECB is also relying on a bounce in productivity per employee in 2025-2026 (+0.8% and +0.9%), which may appear optimistic given the current trend and the uncertain investment trajectories in Europe. Investment, particularly investment under the European recovery fund, undoubtedly needs to be

[1] -0.1 percentage points for headline inflation in 2025 and -0.1 pp for core inflation (excluding energy and food) in 2026.

ramped up. It should also be increased in order to make Europe more appealing and in order to respond to rising protectionism and the risk of capital flow to countries with the highest growth potential (the United States first). If the trajectory of short-term disinflation is not threatened in particular, a recovery in productivity gains would also help to ease pressures on unit labour costs and, ultimately, inflation.

Four in 2024, four in 2025. The scenario of core inflation gradually coming down to the 2% target is still intact at this stage. Against this backdrop, we expect rate cuts of 25 bp at each upcoming monetary policy meeting, until the deposit facility rate stabilises at 2.0% in June 2025, which w uld be the midpoint of our neutral rate range.

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