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EcoFlash

Monetary policy: three central banks, three decisions, the same caution

While the Fed eased its monetary policy on 10 December for the third consecutive FOMC meeting, without making any guarantees about future action, the Bank of England (BoE), the ECB and the Bank of Japan (BoJ) are holding their respective meetings this week. The BoE is expected to cut its key interest rate, the ECB to keep it steady, and the BoJ to raise it. These decisions come amid resilient growth performance despite shocks, which should lead central banks to remain cautious, whether in terms of easing (a residual cut expected for the BoE and none for the ECB) or raising key rates (which should remain a gradual process in Japan). This climate of monetary policy neutrality could be accompanied by greater pressure on long-term sovereign rates than during the period of monetary easing.

Unsurprisingly, the ECB is expected to keep its key rates unchanged, as it has done since June, and this is likely to continue. Inflation continues to hover close to the 2% target (2.2% y/y in November) and is expected to fall below this threshold in January, and for the whole of 2026. The current strong growth momentum (+0.3% q/q in Q3 and we also anticipate +0.3% in Q4), which is set to strengthen in 2026 (+1.6% annual average, according to our estimates, with a stable q/q rate of 0.5%), has contributed, over the course of recent monetary policy meetings, to reinforcing a more conservative bias within the Governing Council. This was already evident in Christine Lagarde's Q&A at the 31 October meeting ("*the downside risks to growth have abated*") and in recent statements by Governing Council members (Schnabel and Simkus). **The publication of the new macroeconomic projections should also confirm the upward revision of growth forecasts for 2026**. Against this backdrop, we believe that the ECB is unlikely to cut its policy rate any further and that its next move could even be an increase (in Q3 2027). This environment, against a backdrop of more expansionary fiscal policy in Germany, should lead to additional upward pressure on bond yields in 2026, with the 10-year Bund exceeding 3% in the second half of 2026, according to our forecasts.

The BoE is expected to cut its key interest rate by 25 basis points to 3.75%, but the vote is likely to be close. This cut would come against a backdrop of economic fragility (GDP contracted again in October, by 0.1% m/m, and the unemployment rate reached 5.1% in October (three-month rolling average). This decision would mark the sixth rate cut in the current cycle, a loosening that remains very gradual, given the slow pace of disinflation. This cut would keep the key interest rate in restrictive territory (our estimate of the neutral rate is (2.25-3.25%)), leaving the BoE room to continue its easing. In our view, this will be done in stages and at intervals, with a single rate cut in 2026 (in Q1) and two further cuts in the first half of 2027, when inflation will have fallen sufficiently and moved closer to the target. UK long-term rates are likely to remain constrained at the start of the year (4.5% in Q1 for 10-year rates) due to political uncertainty surrounding the local elections in May, before easing more significantly in the second half of the year (4.3% in Q4 2026).

The BoJ is set to raise its policy rate to +0.75% (+25bp) at its 18–19 December meeting. The central bank faces multiple dilemmas, which is why the process of "adjusting the degree of monetary accommodation" has been slow. Firstly, although inflation has been exceeding the +2% y/y target since 2022, the BoJ is seeking to avoid a subsequent return to a deflationary spiral. Therefore, it is proceeding cautiously with rate hikes, against a backdrop of sluggish growth (0.7% for 2026, according to our forecasts). However, the concerns that characterised 2025, whether direct (customs tariffs) or indirect (activity in the United States), to which the BoJ responded by interrupting its cycle of rate hikes, seem to have eased. The uncertainty around this seems to have been lifted, with Governor Kazuo Ueda agreeing that the Japanese economy has "weathered" the US tariff shock. In addition, the BoJ seems to have gained confidence in the anchoring of wage growth (see its latest report on this), an important factor in its rate decisions. One final major issue is bond pressure, with 10-year (+1.95%) and 30-year (+3.35%) rates reaching historic highs, which complicates the BoJ's task. In 2024, the BoJ suspended yield curve control (YCC) and reduced its pace of Japanese Government Bond (JGB) purchases. However, raising the key interest rate may add to the pressure on long-term yields, but at the same time, appearing to be "behind the curve" while continuing to pursue an accommodative policy may have the same effect. Under these circumstances, bond pressure is, paradoxically, an argument in favour of raising rates. In 2026, the adjustment would remain cautious, with one increase (+25bp) per half-year.

Stéphane Colliac, Anis Bensaidani and Guillaume Derrien
Economists, advanced economies
stephane.colliac@bnpparibas.com anis.bensaidani@bnpparibas.com guillaume.a.derrien@bnpparibas.com