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REVIEW: ECB Keeps Rates Steady, With “No Set Date For Any Move”

By

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Executive Summary

- **Decision Made:** *The European Central Bank (ECB) remained on hold,* and kept its *i)* interest rate on the 'main refinancing operations' at 2.15%; *ii)* interest rate on the 'marginal lending facility' at 2.40%; and the key *iii)* 'deposit facility' at 2.00%. Future decisions will be taken meeting-by-meeting, following its usual three-pronged approach about its reaction function confirmed. During the press conference, President Lagarde said that the ECB is in no rush to change rates anytime soon and the economy is in good place.
- **Policy Discussion**: *Lagarde said there is "no set date for any move," underscoring the ECB's unanimous, data-dependent, meeting-by-meeting approach and its refusal to give forward guidance amid high uncertainty.* With rates unchanged since June, the ECB sees itself in a neutral "good place," implying a high bar for either cuts or hikes, with all options still open.

  While some market speculation about a 2026 rate hike was fuelled by Isabel Schnabel's comments on persistent services inflation and wages, other policymakers, including François Villeroy de Galhau, stressed that downside inflation risks remain significant. Markets price only modest odds of a hike, and most economists expect rates to stay unchanged through 2026–27.

  Lagarde also said decisions on frozen Russian assets rest with EU leaders and must respect Treaty rules, confirmed the ECB's work on the digital euro is complete and now with lawmakers, and reiterated that her 2027 succession will be decided by the European Council, with no preferred candidate.
- **Changes to Economic Forecasts:** *ECB staff see domestic demand driving growth, supported by rising real incomes,* lower savings, stronger investment and higher public spending, while weak global trade remains a drag. Growth forecasts were revised up to 1.4% in 2025, 1.2% in 2026 and 1.4% in 2027–28.

  Inflation is expected to ease in the near term as energy effects fade, average below 2% in 2026–27, and return to target in 2028, partly due to the delayed start of ETS2. Core inflation is projected to converge toward 2% over the medium term, with the 2026 forecast revised up on slower services disinflation. Lagarde noted that recent upside surprises in growth are increasingly driven by investment, particularly AI-related spending in computing, telecoms and intangible capital.

Key Picture: European Central Bank Key Forecasts – 2024-2027

		2025*f*		**2026*f***		**2027*f***		**2028*f***
	Latest reading	December Projections	September Projections	December Projections	September Projections	December Projections	September Projections	December Projections
GDP *(real growth, y-o-y)*	1.4	**1.4**	**1.2**	**1.2**	**1.0**	**1.4**	**1.3**	**1.4**
Inflation *(%, y-o-y)*	2.1	**2.1**	**2.1**	**1.9**	**1.7**	**1.8**	**1.9**	**2.0**
Core-inflation *(%, y-o-y)*	2.4	**2.4**	**2.4**	**2.4**	**1.9**	**1.9**	**1.8**	**2.0**
Unemployment *(%, y-o-y)*	6.4	**6.3**	**6.4**	**6.2**	**6.3**	**6.1**	**6.1**	**5.9**

Source: ECB '*Macroeconomic projections*' December *and* September *2025 Note:* Latest readings: 1. GDP for Q3 2025; 2. Unemployment for October 2025; 3. Inflation for November 2025. *Inflation = Harmonized Index of Consumer Prices (HICP).

Analysis

- **DECISION MADE**: *On December 18, the ECB remained on hold in December.* In line with consensus, in a unanimous decision, the European Central Bank (ECB) kept unchanged its main policy rates i.e. its *i)* interest rate on the 'main refinancing operations' at 2.15%; *ii)* interest rate on the 'marginal lending facility' at 2.40%; and the key *iii)* 'deposit facility' at 2.00%.

  In its forward guidance, the ECB stated that the decisions will be still taken meeting-by-meeting, with its usual three-pronged approach about its reaction function confirmed. The Governing Council reiterated it is not pre-committing to a particular rate path and offered no forward guidance given high uncertainty.

  In terms of *Balance Sheet policies,* the APP and PEPP portfolios are gradually and predictably shrinking, as the Eurosystem has stopped reinvesting principal payments from maturing securities.

- **POLICY DISCUSSION:** *Asked whether the ECB's next rate move was more likely to be up or down, President Christine Lagarde said there is "no set date for any move".* As expected, the ECB left its guidance unchanged, reiterating its data-dependent, meeting-by-meeting approach to keep options open in a unanimous vote. Lagarde stressed that high uncertainty—from geopolitics to trade shifts and border dynamics—means the ECB cannot provide forward guidance and will remain fully data-dependent. The ECB last cut rates in June, and holding them steady for over six months signals a high bar for further cuts, requiring a sharp deterioration in inflation or growth. This "good place" effectively reflects a neutral policy stance rather than active easing. Lagarde reinforced this at the press conference, describing a broadly benign but uncertain outlook and emphasising optionality. She pushed back on suggestions that the next move would be a hike, stressing that cuts, hikes or holding rates all remain possible.

  Ahead of the ECB's data release, markets speculated about a possible rate hike in 2026, driven in part by comments from board member Isabel Schnabel, who highlighted stronger-than-expected services inflation and wage growth and said she was comfortable with investor expectations of a hike. Her stance contrasted with the more cautious tone of the Governing Council, underscoring internal differences. Other policymakers struck a more balanced note. François Villeroy de Galhau said downside risks to inflation remain significant and warned against a persistent undershoot of the 2% target.

  Lagarde made comments on the use of frozen Russian assets, she said EU leaders would find a solution but stressed that the ECB cannot violate Treaty rules on monetary financing. She also addressed her 2027 succession and speculation around Isabel Schnabel, noting that legal advice has consistently held that Executive Board members cannot return in a new role. While the Treaties clearly set a non-renewable eight-year term, Lagarde added that the issue may need to be revisited to clarify what is and is not legally possible, recalling past debate around Christian Noyer's incomplete term rather than a full reappointment. While some comments have fuelled speculation about a rate hike late next year, markets price only modest odds and most economists expect rates to stay unchanged through 2026–27.

  Regarding the digital euro, Lagarde said the ECB has completed its work and responsibility now lies with EU lawmakers to turn the Commission's proposal into legislation. She stressed the need for a digital euro as a digital form of central bank money to anchor financial stability and monetary sovereignty in the digital age.

- **CHANGES TO ECONOMIC FORECASTS:** *Staff projections see domestic demand driving growth, supported by rising real incomes,* a gradual fall in savings, stronger investment, and higher public spending on infrastructure and defence, while weak global trade remains a drag. In its updated forecasts, the ECB now sees headline inflation at 2.1% in 2025, easing to 1.9% in 2026 and 1.8% in 2027 before returning to 2.0% in 2028, while core inflation is projected at 2.4% in 2025, 2.2% in 2026, 1.9% in 2027 and 2.0% in 2028. The 2026 inflation forecast was revised up, reflecting a slower decline in services inflation. Growth projections were revised higher on stronger domestic demand, to 1.4% in 2025, 1.2% in 2026 and 1.4% in 2027–28.

During the press conference, Lagarde also noted signs of change in the euro area economy, with growth surprises increasingly driven by investment, not just public spending. She said recent investment strength is largely driven by AI, particularly in computing power, telecommunications and intangible capital rather than traditional physical capex.

Staff projections see domestic demand driving growth, supported by rising real incomes, a gradual fall in savings, stronger investment, and higher public spending on infrastructure and defence, while weak global trade remains a drag. Inflation is expected to ease in the near term as past energy price rises fade, stay below 2% in 2026–27, and return to target in 2028, partly reflecting the delayed start of ETS2. Core inflation is projected to stabilise around 2% toward the end of the forecast horizon.

- **ECONOMIC ASSESSMENT:** *The economy has remained resilient, growing 0.3% in Q3 on stronger consumption and investment, with exports also rising, led by chemicals.* Growth was driven mainly by services—especially information and communication—while industry and construction were flat, a pattern likely to persist. Labour markets remain strong, with unemployment near historic lows at 6.4% and employment up 0.2% in Q3, even as labour demand cooled and vacancies fell to post-pandemic lows. Inflation has been stable at around 2.1%, with lower energy and food inflation offset by rising services prices. Core inflation held at 2.4%, as goods inflation eased but services inflation climbed to 3.5%.

  Underlying inflation indicators remain consistent with the 2% target. Unit labour costs rose slightly faster in Q3, with compensation per employee increasing 4.0% due to extra payments beyond negotiated wages. Forward-looking measures point to easing wage growth in coming quarters, stabilising just below 3% by late 2026. Despite easing trade tensions, a volatile global environment still poses risks to supply chains, exports, and domestic demand, while financial market stress could tighten conditions and slow growth. Geopolitical risks—especially Russia's war in Ukraine—remain elevated, though higher defence and infrastructure spending, reforms, and improved confidence could lift growth more than expected.

  Inflation risks remain unusually uncertain. Downside risks include weaker export demand from higher US tariffs, excess global capacity, a stronger euro, and tighter financial conditions. Upside risks stem from fragmented supply chains, higher import and raw material costs, persistent wage pressures in services, increased public spending, and climate-related shocks pushing up food prices.

- **OUR TAKE:** *ECB on Hold For Now, With an Eye on The Fed.* Lagarde's rhetoric was consistent with an ECB remaining on hold for the foreseeable future. But the reality is that the ECB may be forced to move sooner than they may possibly want on the back of Fed's actions. If the Fed starts cutting rates aggressively, as is possible after the departure of Jay Powell, the ECB may be forced to cut rates to prevent excessive currency appreciation and a persistent undershooting of the inflation targets. The key month for this assessment will be the March meeting.

- **MARKET REACTION AND IMPLICATIONS**: *Initially the markets initially interpreted the ECB's message as slightly more hawkish.* Bunds are slightly lower on the day. *In the bond market*, the Germany's 10-year bond yield, the region's benchmark, fell to around 2.86%, while the two-year yield declined to 2.14%. BTP-Bund spread fell to the lows. *In the currency space,* the euro pared losses after the ECB kept rates unchanged and raised its inflation and growth forecasts, reiterating a data-dependent stance. EUR/USD rose to $1.1739 from $1.1721 ahead of the decision. After the press conference, EUR/USD trades around $1.1720. *In the equity space,* the Euro Stoxx 50 rose 0.5% and the Stoxx 600 gained 0.4% after the decision. Eurostoxx 50 closed at 5757,45.

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