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REVIEW: ECB Remains on Hold, In Spite of the Strong Euro

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**: *The ECB offered no guidance on its next move, reinforcing expectations that policy will remain on hold amid steady growth and inflation near target.* The ECB said inflation and the broader economy are "in a good place," and markets see rates staying unchanged through this year and likely into 2026, with only a ~20% chance of a cut by September and a ~10% chance of a hike by April 2027. Attention has increasingly shifted to the euro, which has risen about 13% against the dollar over the past year; while not a policy target, its appreciation since March 2025 was discussed for its implications for growth and inflation. President Christine Lagarde downplayed the impact of recent dollar weakness, saying the inflation outlook remains broadly unchanged.

  Lagarde also said the ECB will share a reform "checklist" with EU leaders ahead of an informal retreat, covering priorities such as the savings and investment union, the digital euro, tokenised wholesale central bank money, deeper single-market integration, innovation, and regulatory simplification—echoing long-standing recommendations, including those associated with former ECB chief Mario Draghi. Despite external uncertainties—from commodity volatility to geopolitical tensions linked to U.S. politics under Donald Trump—investors remain broadly constructive on the euro area outlook, citing economic resilience and the expected boost from higher German spending.

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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)*	1.3	**1.4**	**1.2**	**1.2**	**1.0**	**1.4**	**1.3**	**1.4**
Inflation *(%, y-o-y)*	1.9	**2.1**	**2.1**	**1.9**	**1.7**	**1.8**	**1.9**	**2.0**
Core-inflation *(%, y-o-y)*	2.3	**2.4**	**2.4**	**2.4**	**1.9**	**1.9**	**1.8**	**2.0**
Unemployment *(%, y-o-y)*	6.2	**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 Q4 2025; 2. Unemployment for December 2025; 3. Inflation for December 2025. *Inflation = Harmonized Index of Consumer Prices (HICP).

Analysis

- **DECISION MADE**: *On February 5, the ECB remained on hold.* In line with consensus, in an unanimous decision, the European Central Bank (ECB) to keep 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:** *ECB gave no guidance on its next move, reinforcing expectations that policy will stay on hold amid steady growth and inflation near target.* The ECB views inflation and the broader economy as being "in a good place." Markets remain confident that the European Central Bank will keep interest rates unchanged through this year and likely into 2026, with investors increasingly focused on the implications of a stronger euro rather than near-term policy shifts. Traders see policy rates staying on hold into 2026, with only a ~20% chance of a rate cut by September and a ~10% chance of a hike by April 2027.

  The euro has risen about 13% against the dollar over the past year, drawing closer scrutiny from policymakers, though analysts say the bar for further easing remains high. As a result, the Governing Council discussed the exchange rate, noting that while it is not a policy target, the euro has strengthened against the dollar since March 2025, with implications for growth and inflation. Lagarde played down the impact of recent dollar weakness on policy and said the inflation outlook remained broadly unchanged, even as the Governing Council acknowledged that exchange rate developments matter for growth and inflation.

  Speaking after the ECB's policy meeting, Lagarde said the checklist—covering issues such as the savings and investment union, the digital euro, tokenised wholesale central bank money, single-market deepening, innovation, and regulatory simplification—will be shared ahead of an informal EU leaders' retreat. The move follows years of stalled progress, despite geopolitical shocks and overlapping recommendations with reports such as those by former ECB chief Mario Draghi. Lagarde said reforms must now be deepened or accelerated to unlock Europe's growth and productivity potential.

  Despite external uncertainties—from commodity volatility to geopolitical tensions linked to U.S. politics under Donald Trump—investors remain broadly constructive on the euro area outlook, pointing to economic resilience and the expected boost from higher German spending.

- **ECONOMIC ASSESSMENT:** *Low unemployment, strong private balance sheets, defence and infrastructure spending, and the effects of past rate cuts are supporting growth, though uncertainty remains elevated due to global trade tensions and geopolitical risks.* The euro area economy grew by 0.3% in Q4 2025, driven mainly by services, particularly information and communication, while manufacturing remained resilient and construction gained momentum, supported by public investment. The labour market continues to underpin incomes despite cooling demand, with unemployment edging down to 6.2%. Rising labour incomes, a lower saving rate, defence and infrastructure spending, and stronger business investment—especially in digital technologies—should support domestic demand, though higher tariffs and a stronger euro weigh on the external outlook.

  Inflation fell to 1.7% in January, down from 2.0% in December, led by a sharp drop in energy prices. Core inflation eased to 2.2%, with services inflation declining further, while food inflation rose modestly.

Underlying inflation indicators remain consistent with the 2% medium-term target, wage growth is moderating, and longer-term inflation expectations remain anchored around 2%, though uncertainty persists around non-negotiated wage components.

Risks to growth and inflation remain elevated amid global policy uncertainty, trade frictions, and geopolitical tensions. Downside risks stem from weaker external demand, tighter financial conditions and a stronger euro, while upside risks include higher energy prices, supply-chain disruptions, slower wage moderation, and increased defence and infrastructure spending. Structural reforms, deeper Single Market integration, stronger capital markets and new trade agreements could lift growth beyond current expectations.

- **OUR TAKE:** *ECB likely to remain on hold, despite strong euro*. We expect the ECB to remain in hold for the foreseeable future in spite of the euro appreciation, which keeps a lid on inflation. But the bar to cut rates at this stage is still too high.
- **MARKET REACTION AND IMPLICATIONS**: *Muted market reaction.* Traders see policy rates staying on hold into 2026, with only a ~20% chance of a rate cut by September and a ~10% chance of a hike by April 2027. Bund yields eased as investors absorbed signs of slowing inflation across the eurozone. *In the bond market*, the Germany's 10-year bond yield, the region's benchmark, fell to around 2.85%, while the two-year yield increased to around 2.07% at the time of writing. BTP-Bund spread fell to the lows. *In the currency space,* the ECB policy announcements don't seem to be having a noticeable impact on the Euro's performance. At the time of writing, EUR/USD trades around 1.18. *In the equity space,* European stocks extended losses. Both Euro Stoxx 50 and Stoxx 600 fell by 0.6% and 0.7% respectively as a global tech sell-off continued as concerns persist over AI related disruption and elevated valuations. Eurostoxx 50 closed at 5930,85.