BBVA Research

The ECB near the end of the rate cutting cycle

Carlos Castellano, Maria Martinez

- **The ECB cut rates by 25bp to 2.0%, with broad support across the Governing Council and only one dissent.**
- **ECB remains dovish on growth, with risks still tilted to the downside; shows strong confidence on inflation path**
- **Lagarde signaled the cycle is likely nearing its end and the current stance puts the ECB in a good position to face uncertainties**
- **The ECB has presented alternative scenarios dependente on tariffs, a clear signal that uncertainty is exceptionally high and that they are waiting for the outcome of trade negotiations to declare the end of this rate cycle**

At today's ECB monetary policy meeting, **the Governing Council decided to cut key interest rates by 25 basis points**, marking the eighth reduction since the easing cycle began and bringing the total adjustment to 200 basis points. As a result, the deposit rate was lowered to 2.0%, while the rates for the main refinancing operations and the marginal lending facility were reduced to 2.15% and 2.40%, respectively. **The decision was taken by a very broad consensus,** with only one dissenting member.

Asked whether today's move signaled the **end of the rate-cutting cycle, President Lagarde remarked that the current policy stance puts the ECB in a "good position to face future uncertainties."** She acknowledged that **the institution is likely approaching the end of the monetary policy cycle, but stressed that it would be "far-fetched" to express full confidence about the road ahead**. Lagarde reiterated that future decisions will remain data-dependent and will be taken meeting by meeting, particularly in light of unresolved geopolitical risks and trade tensions that are not yet reflected in the ECB's baseline scenario.

On growth, the ECB remained dovish, with risks still tilted to the downside. It highlighted the slowdown in services and the one-off nature of the current manufacturing momentum, driven by frontloading of exports to the US ahead of new tariffs. **Still, the economy shows resilience**, supported by strong employment, rising incomes, solid private sector balance sheets, and easier credit conditions. Additional support should come from increased defense and infrastructure spending in the medium term. **The new ECB's staff projections (see table below) were little changed**: GDP growth for 2025 is unchanged at 0.9%, as solid Q1 data offsets trade frictions and a stronger euro; 2026 was revised slightly down to 1.1%, while 2027 remains at 1.3%.

On inflation, the ECB sounded relatively confident of the deceleration process coming to an end, noting that underlying inflation is already broadly in line with the target, **though risks remain wide and two-sided**. External price pressures are expected to stay moderate, assuming no changes in EU tariff policy, with some downward pull from the recent decline in energy prices and the stronger euro. Lagarde emphasized that the low 2026 inflation projection mainly reflects these factors, but headline inflation is expected to return to 2.0% in 2027—a slightly hawkish signal. The ECB also noted that potential supply chain disruptions, not factored into their projections, could pose upside risks. The ECB now sees headline inflation at 2.0% in 2025 (from 2.3%), falling to 1.6% (1.9%) in 2026, before rising again to 2.0% in 2027 (see table below). Core inflation is also expected to ease, with wage growth projections revised down.

In addition to the baseline scenario—which assumes US tariffs of 10% globally, 40% for China, no EU retaliation, and gradually easing uncertainty— **the ECB´s staff presents two alternative scenarios to address the high uncertainty linked to tariff negotiations**. In the mild scenario, a US-EU tariff elimination, lower China tariffs (20%), and faster unwinding of uncertainty would lift euro area GDP growth by +0.3-0.4pp in 2025-26, with inflation marginally higher, reaching 2.1% in 2027. In the severe scenario, US tariffs return to the high levels announced on 2 April (up to a 28% average effective tariff rate on total US imports), the EU retaliates (below 10%), and uncertainty remains elevated. This would reduce GDP growth by about -1pp cumulatively, bringing it down to 0.5% in 2025 and 1.1% in 2027, while inflation would be 0.2pp lower, at 1.8% in 2027.

On the **role of the euro, Lagarde noted that there is currently a window of opportunity to strengthen its standing as an international currency**—potentially paving the way for it to become the global reserve currency of choice. However, she cautioned that this outcome should not be taken for granted. Realizing it will depend on decisive actions by Member States and EU institutions, particularly in reinforcing the EU's economic and geopolitical presence and advancing the development of a true savings and investment union. Lagarde underscored the importance of ensuring that investors and businesses see Europe as a stable and reliable place to operate. She also acknowledged the complexity of the issue, which the Governing Council has actively discussed, and made clear that while the ECB has a role to play, progress will ultimately require coordinated efforts from both national and European authorities.

Overall, **the ECB delivered another widely anticipated rate cut, bringing the deposit rate down to 2%, and signaled that inflationary pressures are now broadly consistent with the target.** Still, the prevailing uncertainty—on both the data and geopolitical fronts—means the Governing Council **is not ready to rule out further moves, maintaining its now-familiar stance of "data dependency" and avoiding any form of precommitment.** The broad consensus behind today's decision—likely including the traditionally more hawkish German members who had recently argued for a pause at 2.25%—suggests a tacit agreement to hold rates at 2% for now, pending developments in trade dynamics and incoming data. **If conditions unfold in line with the ECB's projections, which are closely aligned with our own**—and barring major surprises, including political ones from across the Atlantic—**this could well mark the endpoint of the easing cycle. Nevertheless, the level of uncertainty remains exceptionally high.**

TABLE 1: ECB MACROECONOMIC PROJECTIONS

Annual. var. (%), unless otherwise indicated	2023	2024	2025 ECB Jun.	2025 ECB Mar.	2026 ECB Jun.	2026 ECB Mar.	2027 ECB Jun.	2027 ECB Mar.
Real GDP	0.5	0.8	**0.9**	0.9	**1.1**	1.2	**1.3**	1.3
HICP	5.4	2.4	**2.0**	2.3	**1.6**	1.9	**2.0**	2.0
HICP excluding energy and food	4.9	2.8	**2.4**	2.2	**1.9**	2.0	**1.9**	1.9
Unit labour costs	6.3	4.7	**2.8**	3.0	**2.1**	2.0	**2.0**	1.7
Compensation per employee	5.3	4.5	**3.2**	3.4	**2.8**	2.8	**2.8**	2.6
Labour productivity	-0.9	-0.1	**0.4**	0.4	**0.7**	0.8	**0.8**	0.9
3-month EURIBOR	3.4	3.6	**2.1**	2.2	**1.9**	2.0	**2.2**	2.1
10-year government bond yields	3.1	2.9	**3.1**	2.9	**3.4**	3.0	**3.6**	3.2
Oil price (in USD/barrel)	83.7	82.0	**66.7**	74.7	**62.8**	70.3	**64.2**	68.7
Natural gas prices (EUR/MWh)	40.6	34.4	**38.0**	50.2	**33.2**	40.4	**29.3**	31.7
USD/EUR exchange rate	1.08	1.08	**1.11**	1.04	**1.13**	1.04	**1.13**	1.04
World real GDP (excl. EZ)	3.7	3.6	**3.1**	3.4	**2.9**	3.2	**3.2**	3.2
Global trade (excl. EZ)	1.3	4.2	**3.1**	3.5	**1.7**	3.1	**3.1**	3.2
Euro area foreign demand	0.8	3.5	**2.8**	3.2	**1.7**	3.1	**3.1**	3.1
World CPI (excl. EZ)	4.8	4.0	**3.3**	3.3	**2.8**	2.7	**2.5**	2.5

Source: ECB. *In this baseline scenario, US tariffs on goods imports are assumed to be 10% for all countries (except China, where they increase by 20 points to an effective 40%), compared to March 2025 projections. Tariff pauses remain in place, the EU does not retaliate, and China responds symmetrically. Trade policy uncertainty stays high but gradually declines to 2018 levels by end-2027.

BBVA Research

PLEASE NOTE: TRACKING CHANGES IN FOLLOWING STATEMENTS

i in grey, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB

Frankfurt am Main, ~~17 April~~5 June 2025

~~**Jump to the transcript of the questions and answers**~~

Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. In particular, the decision to lower the deposit facility rate – the rate through which we steer the monetary policy stance – is based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission.

~~The disinflation process is well on track. Inflation has continued to develop as staff expected, with both headline and core inflation declining in March. Services inflation has also eased markedly over recent months.~~ Inflation is currently at around our two per cent medium-term target. In the baseline of the new Eurosystem staff projections, headline inflation is set to average 2.0 per cent in 2025, 1.6 per cent in 2026 and 2.0 per cent in 2027. The downward revisions compared with the March projections, by 0.3 percentage points for both 2025 and 2026, mainly reflect lower assumptions for energy prices and a stronger euro. Staff expect inflation excluding energy and food to average 2.4 per cent in 2025 and 1.9 per cent in 2026 and 2027, broadly unchanged since March.

Staff see real GDP growth averaging 0.9 per cent in 2025, 1.1 per cent in 2026 and 1.3 per cent in 2027. The unrevised growth projection for 2025 reflects a stronger than expected first quarter combined with weaker prospects for the remainder of the year. While the uncertainty surrounding trade policies is expected to weigh on business investment and exports, especially in the short term, rising government investment in defence and infrastructure will increasingly support growth over the medium term. Higher real incomes and a robust labour market will allow households to spend more. Together with more favourable financing conditions, this should make the economy more resilient to global shocks.

In the context of high uncertainty, staff also assessed some of the mechanisms by which different trade policies could affect growth and inflation under some alternative illustrative scenarios. These scenarios will be published with the staff projections on our website. Under this scenario analysis, a further escalation of trade tensions over the coming months would result in growth and inflation being below the baseline projections. By contrast, if trade tensions were resolved with a benign outcome, growth and, to a lesser extent, inflation would be higher than in the baseline projections.

Most measures of underlying inflation suggest that inflation will settle at around our two per cent medium-term target on a sustained basis. Wage growth is ~~moderating~~still elevated but continues to moderate visibly, and profits are partially buffering ~~the~~its impact ~~of still elevated wage growth~~ on inflation. The ~~euro area economy has been building up some resilience against global shocks, but the outlook for growth has deteriorated owing to rising trade tensions.~~

~~Increased~~concerns that increased uncertainty ~~is likely to reduce confidence among households~~ and ~~firms, and the adverse and~~a volatile market response to the trade tensions ~~is likely to~~in April would have a tightening impact on financing conditions~~. These factors may further weigh on the economic outlook for the euro area~~ have eased.

We are determined to ensure that inflation stabilises sustainably at our two per cent medium-term target. Especially in current conditions of exceptional uncertainty, we will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance. ~~In particular, our~~Our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

The decisions taken today are set out in a ~~press release~~press release available on our website.
I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

The ~~economic outlook is clouded by exceptional uncertainty. Euro area exporters face new barriers to trade, although their scope remains unclear. Disruptions to international commerce, financial market tensions and geopolitical uncertainty are weighing on business investment. As consumers become more cautious about the future, they may hold back from spending as well.~~

~~At the same time, the euro area~~ economy ~~has been building up some resilience against the global shocks. The economy is likely to have grown in the first quarter of the year, and manufacturing has shown signs of stabilisation.~~grew by 0.3 per cent in the first quarter of 2025, according to Eurostat's flash estimate. Unemployment ~~fell to~~, at 6.~~1~~2 per cent in ~~February,~~April, is at its lowest level since the launch of the euro~~. A strong labour market, higher real incomes and the impact of our monetary policy should underpin spending. The important policy initiatives that have been launched at the national and EU levels to increase defence spending and infrastructure investment can be expected to bolster manufacturing, which is also reflected in recent surveys~~, and employment grew by 0.3 per cent in the first quarter of the year, according to the flash estimate.

In line with the staff projections, survey data point overall to some weaker prospects in the near term. While manufacturing has strengthened, partly because trade has been brought forward in anticipation of higher tariffs, the more domestically oriented services sector is slowing. Higher tariffs and a stronger euro are expected to make it harder for firms to export. High uncertainty is expected to weigh on investment.

At the same time, several factors are keeping the economy resilient and should support growth over the medium term. A strong labour market, rising real incomes, robust private sector balance sheets and easier financing conditions, in part because of our past interest rate cuts, should all help consumers and firms withstand the fallout from a volatile global environment. Recently announced measures to step up defence and infrastructure investment should also bolster growth.

In the present geopolitical environment, it is even more urgent for fiscal and structural policies to make the euro area economy more productive, competitive and resilient. The European Commission's Competitiveness Compass provides a concrete roadmap for action, and its proposals, including on simplification, should be swiftly adopted. This includes completing the savings and investment union, following a clear and ambitious timetable~~, which should help savers benefit from more opportunities to invest and improve firms' access to finance, especially risk capital.~~. It is also important to rapidly establish the legislative framework to prepare the ground for the potential introduction of a digital euro. Governments should ensure sustainable public finances in line with the EU's economic governance framework ~~and prioritise~~, while prioritising essential growth-enhancing structural reforms and strategic investment.

Inflation

Annual inflation ~~edged down~~declined to 1.9 per cent in May, from 2.2 per cent in ~~March.~~April, according to Eurostat's flash estimate. Energy ~~prices fell by 1.0 per cent, after a slight rise in February, while food~~price inflation remained at -3.6 per cent. Food price inflation rose to ~~2.9 per cent in March, from 2.7~~3.3 per cent ~~in February.~~, from 3.0 per cent the month before. Goods inflation was ~~stable~~unchanged at 0.6 per cent~~.~~, while services inflation dropped to 3.2 per cent, from 4.0 per cent in April. Services inflation ~~fell again in March, to 3.5 per cent, and it now stands half a percentage point below the rate recorded at~~had jumped in April mainly because prices for travel services around the ~~end of last year~~Easter holidays went up by more than expected.

Most indicators of underlying inflation ~~are pointing to a sustained return of~~suggest that inflation ~~to~~will stabilise sustainably at our two per cent medium-term target. ~~Domestic inflation has declined since the end of 2024. Wages are~~ Labour costs are gradually moderating~~. In the last quarter of 2024 annual growth in~~, as indicated by incoming data on negotiated wages and available country data on compensation per employee ~~stood at 4.1 per cent, down from 4.5 per cent in the previous quarter. Rising productivity also meant that unit labour costs grew more slowly.~~. The ECB's wage tracker ~~and information from our contacts with companies point to a decline in~~ points to a further easing of negotiated wage growth in 2025, ~~as also indicated in~~while the ~~March~~ staff projections~~. Unit profits fell at an annual rate of 1.1~~ see wage growth falling to below 3 per cent ~~at the end of last year, contributing to~~ in 2026 and 2027. While lower ~~domestic inflation~~energy prices and a stronger euro are putting downward pressure on inflation in the near term, inflation is expected to return to target in 2027.

~~Most~~Short-term consumer inflation expectations edged up in April, likely reflecting news about trade tensions. But most measures of longer-term inflation expectations continue to stand at around 2 per cent, which supports the ~~sustainable return~~stabilisation of inflation ~~to~~around our target.

Risk assessment

~~Downside risks~~Risks to economic growth ~~have increased. The major~~remain tilted to the downside. A further escalation in global trade tensions and associated uncertainties ~~will likely~~could lower euro area growth by dampening exports~~,~~ and ~~it may drag~~dragging down investment and consumption. ~~Deteriorating~~A deterioration in financial market sentiment could lead to tighter financing conditions~~, increase~~ and greater risk aversion, and make firms and households less willing to invest and consume. Geopolitical tensions, such as Russia's unjustified war against Ukraine and the tragic conflict in the Middle East, ~~also~~ remain a major source of uncertainty. ~~At the same time, an~~By contrast, if trade and geopolitical tensions were resolved swiftly, this could lift sentiment and spur activity. A further increase in defence and infrastructure spending, together with productivity-enhancing reforms, would also add to growth.

~~Increasing global trade disruptions are adding more uncertainty to the~~The outlook for euro area inflation~~.~~ is more uncertain than usual, as a result of the volatile global trade policy environment. Falling ~~global~~ energy prices and ~~appreciation of the~~ a stronger euro could put further downward pressure on inflation. This could be reinforced ~~by~~ if higher tariffs led to lower demand for euro area exports ~~owing to higher tariffs,~~ and ~~a re-routing of exports into the euro area from~~ to countries with overcapacity~~. Adverse financial market reactions~~ rerouting their exports to the ~~trade~~euro area. Trade tensions could lead to greater volatility and risk aversion in financial markets, which would weigh on domestic demand and would thereby also lower inflation. By contrast, a fragmentation of global supply chains could raise inflation by pushing up import prices~~.~~ and adding to capacity constraints in the domestic economy. A boost in defence and infrastructure spending could also raise inflation over the medium term. Extreme weather events, and the unfolding climate crisis more broadly, could drive up food prices by more than expected.

Financial and monetary conditions

Risk-free interest rates have ~~declined in response to the escalating trade tensions.~~remained broadly unchanged since our last meeting. Equity prices have ~~fallen amid high volatility~~risen, and corporate bond spreads have ~~widened around the globe. The euro has strengthened over recent weeks as investor sentiment has proven~~ narrowed, in response to more ~~resilient towards the euro area than towards other economies~~positive news about global trade policies and the improvement in global risk sentiment.

~~The latest official statistics on~~Our past interest rate cuts continue to make corporate borrowing~~, which predated these market tensions, continued to indicate that our interest rate cuts had made it~~ less expensive~~ for firms to borrow.~~. The average interest rate on new loans to firms declined to ~~4.1 per cent in February, from 4.~~3.8 per cent in ~~January. Firms'~~ April, from 3.9 per cent in March. The cost of issuing market-based debt ~~declined to 3.5 per cent in February, but there has been some upward pressure more recently. Moreover, growth in~~ was unchanged at 3.7 per cent. Bank lending to firms ~~picked up again in February, to 2.2 per cent, while debt securities issuance by firms grew at an unchanged rate of 3.2 per cent.~~

~~At the same time, credit standards for business loans tightened slightly again in the first quarter of 2025, as reported in our latest bank lending survey for the euro area. As in the previous quarter, this was mainly because banks are becoming more concerned about the economic risks faced by their customers. Demand for loans to firms decreased slightly in the first quarter, after a modest recovery in previous quarters.~~

~~The average rate on new mortgages, at 3.3 per cent in February, increased on the back of earlier rises in longer-term market rates. Mortgage lending~~ continued to strengthen ~~in February, albeit at a still subdued~~ gradually, growing by an annual rate of ~~1.5~~2.6 per cent in April after 2.4 per cent in March, while corporate bond issuance was subdued. The average interest rate on new mortgages stayed at 3.3 per cent in April, while growth in mortgage lending increased to 1.9 per cent~~, as banks eased their credit standards and demand for loans to households continued to increase strongly~~.

In line with our monetary policy strategy, the Governing Council thoroughly assessed the links between monetary policy and financial stability. While euro area banks remain resilient, broader financial stability risks remain elevated, in particular owing to highly uncertain and volatile global trade policies. Macroprudential policy remains the first line of defence against the build-up of financial vulnerabilities, enhancing resilience and preserving macroprudential space.

Conclusion

The Governing Council today decided to lower the three key ECB interest rates by 25 basis points. In particular, the decision to lower the deposit facility rate – the rate through which we steer the monetary policy stance – is based on our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. We are determined to ensure that inflation stabilises sustainably at our two per cent medium-term target. Especially in current conditions of exceptional uncertainty, we will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance. ~~In particular, our~~Our interest rate decisions will be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation stabilises sustainably at our medium-term target and to preserve the smooth functioning of monetary policy transmission.

DISCLAIMER

The present document does not constitute an "Investment Recommendation", as defined in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse ("MAR"). In particular, this document does not constitute "Investment Research" nor "Marketing Material", for the purposes of article 36 of the Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MIFID II).

Readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data or opinions regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.