ECB Watch

AIB Treasury Economic Research Unit

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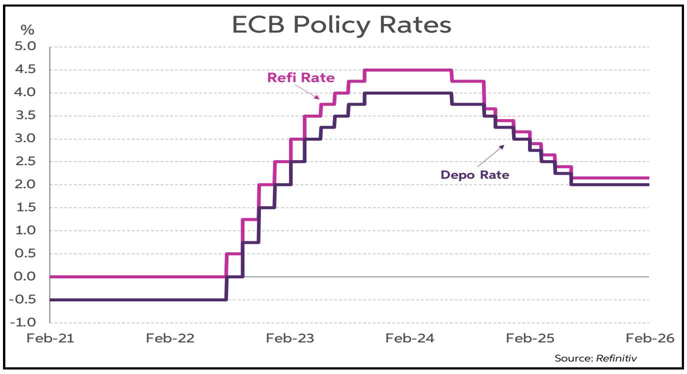
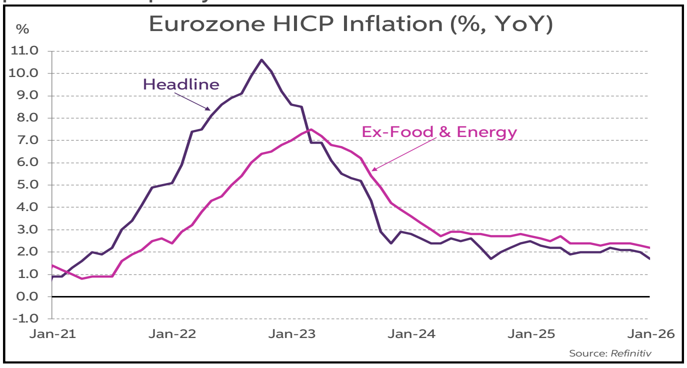
ECB likely to be on hold for 2026

The first ECB Governing Council policy setting meeting of 2026 saw the central bank leave interest rates on hold. The deposit and refi rates were maintained at 2.00% and 2.15%, respectively. This outcome was very much in line with market expectations. Its marks the fifth consecutive meeting that the central bank has left its official rates unaltered. The last time the ECB eased policy was last June when it cut rates by 25bps. In total, the central bank cut rates by 200bps during its easing cycle.



The February meeting statement was broadly similar to its previous version in December. It remained short, and continued to offer little in the way of forward guidance. The context of today's decision to keep policy on hold was that its "updated assessment reconfirms that inflation should stabilise at its 2% target over the medium term". The ECB once again emphasised a "data-dependent" and "meeting-by-meeting" approach to its policy deliberations.



The most recent detailed assessment by the ECB on the economic outlook was published back in December. These forecasts showed a more upbeat view from the ECB regarding the Eurozone's economic outlook compared to their September projections. This was reflected in upward revisions to its growth forecasts for the region. It is forecasting Eurozone GDP to average 1.2% this year (was 1.0%). For 2027, growth of 1.4% is being pencilled in (was 1.3%). Further out, it sees this growth rate being maintained in 2028. Despite the upgrades, these GDP projections continue to embody a fairly subdued growth outlook for the Eurozone economy. **In regard to the risks to the outlook, the ECB statement no longer explicitly states where it views the balance of risks.** Instead it merely lists both the downside and upside risks. However, in the press conference President Lagarde elaborated, commenting that the ECB believes the risks are in a "broadly balanced situation at the moment" and that the ECB is not "seeing a reduction of the range of risks". **In terms of its inflation outlook,** the December macro forecasts show that it expects stickier inflation in the near term, with headline HICP anticipated to average 1.9% (was 1.7%) this year. For 2027, it sees inflation at 1.8% (was 1.9%), and 2% in 2028. These projections suggest that the ECB maintains a benign outlook for inflation. In today's statement it commented again that the outlook for inflation "continues to be more uncertain than usual on account of the volatile global policy environment".

The post-meeting press conference for February was uneventful and offered no new insight on the ECB's outlook for interest rates. President Lagarde's comments indicate that the central bank is very content that its current interest rate settings are appropriate. There was no indications that the Governing Council is considering any interest rate changes in the near term. She repeated the ECB's 'meeting-by-meeting, data-dependent' mantra. President Lagarde also repeated her view that its current policy stance remains "in a good place".

ECB Macroeconomic Forecasts for the Euro Area

(%)	2024	2025	2026	2027
HICP	2.4	2.1	1.9	1.8
Real GDP	0.9	1.4	1.2	1.4

Forecasts are mid-point of a range and based on the assumption that Brent crude oil prices will average $69.2 in 2025, $62.5 in 2026, and $62.6 in 2027. *Source ECB, December 2025*

Market expectations for the ECB rate outlook have been relatively stable over recent months. While at different stages over this period, futures contracts have not fully ruled out an additional 25bps rate cut, the market has tended to attach a low probability to such an outcome. Current pricing suggests the market's judgement is that the ECB's easing cycle is complete. **Our view since the start of last year has been that the deposit rate will settle at 2%.** Today's ECB meeting outcome reinforces our outlook that 2% will prove to be the trough for the Depo rate and rates will remain unchanged throughout 2026.

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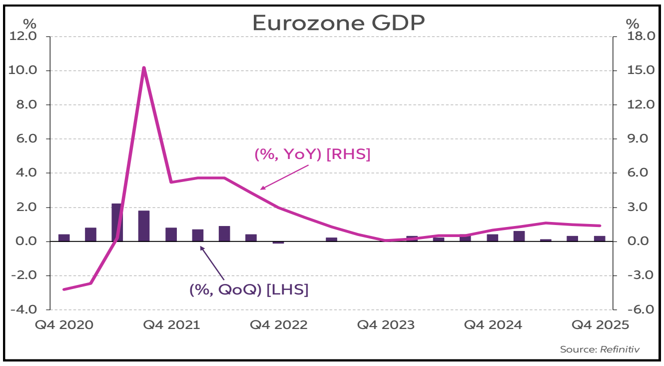
Moderate growth expected in the Eurozone

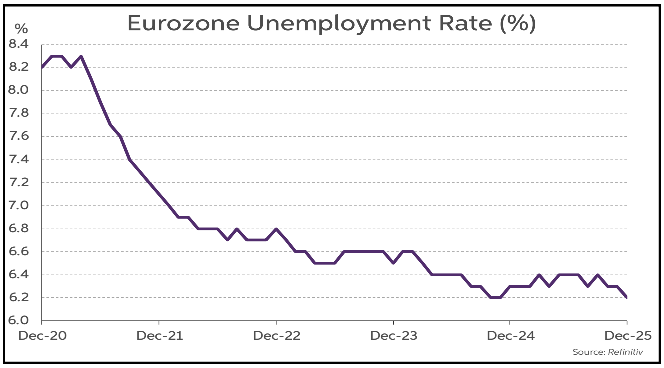
Having returned to growth in 2024, the Eurozone economy gathered some momentum in 2025. However, growth remained modest overall, with GDP rising by 0.6% q/q in Q1, just 0.1% q/q in Q2, and by 0.3% q/q in the final two quarters of the year. Overall, the economy expanded by 1.5% in 2025, up from 0.9% in 2024. Among the largest national economies in the Eurozone, Germany remained the worst performing, albeit the economy ended two years of contraction by expanding by 0.4% in 2025. In contrast, the Spanish economy continued to register robust growth of 2.8% last year. The French and Italian economies recorded modest expansions of 0.9% and 0.7%, respectively in 2025.



Meantime, the limited data available for January have been mixed. The services PMI remained above the key 50 threshold, but fell to 51.6, which is consistent with a slower pace of expansion in the sector, and is its lowest level since the end of Q3. Meantime, the manufacturing PMI improved marginally to 49.5, meaning the sector has printed in contraction territory in all bar two months since April 2022. However, economic sentiment rose sharply, amid a broad-based increase in optimism at the start of the year. Industrial sector sentiment improved to –6.8 in January, its highest level since May 2023, while services sector sentiment rebounded to 7.2, its highest reading since January 2024. Consumer confidence also recovered from a weak ending to 2025 by recovering to –12.4 in January, which is the second best outcome in the last twelve months.

Regarding the labour market, conditions remain solid. Employment expanded for a eighteenth successive quarter in Q3, up by 0.1% q/q and by 0.2% y/y. It means that the number of people at work has risen by 5.4% since the end of Q4 2019. Meanwhile, the unemployment rate fell to 6.2% in December, matching the all-time low recorded last winter. However, the unemployment rate averaged 6.3% in 2025 compared to 6.4% in 2024. Despite tight conditions though, wage growth has cooled somewhat. Wages in the Eurozone rose by 3.0% y/y in Q3, down from 3.8% y/y in Q2, and from 4.5% y/y a year earlier. Furthermore, the Indeed wage tracker - a more frequent measure of wage pressures - indicates that wages rose by just 4.1% y/y on average in Q4, down from 4.9% y/y during the same period in 2024.

On the inflation front, a gradual downtrend emerged in the first half of 2025. Furthermore, inflation has moved lower once again over the winter. The headline rate stood at 2.5% at the start of last year, before falling to a low of 1.9% in May. However, it crept marginally higher, printing in a 2.0-2.2% range, in the second half of 2025. Meantime, underlying inflation was quite sticky, stuck between 2.6-2.9% since April '24, but it printed at 2.3-2.4% between May-December. Overall, headline and core inflation averaged 2.1% and 2.5% in 2025, down from 2.4% and 2.9% in 2024. Meanwhile, the flash estimate indicates that both rates fell, to 1.7% and 2.2%, in January of this year.



In summary, the Eurozone economy gathered some momentum last year, albeit the pace of growth remained moderate. Meantime, the labour market stayed in robust shape and inflation returned to target. Looking ahead, the recent bout of disinflation and rate cuts in the first half of 2025 should support real incomes and consumer spending in the near-term. Increased fiscal spending in Germany, as well as higher defence spending at the EU level could also begin to support growth this year. For now though, modest rates of growth are expected to remain the norm in the Eurozone. The IMF sees GDP expanding by 1.3% this year and by 1.4% next year. It should also be noted that the Eurozone continues to face a number of challenges and potential downside risks. Recent geopolitical tensions between the US and Euro-area countries serve as a reminder that relations with the bloc's main trading partner are less certain than they have been in the past. At the same time, the muted pace at which recommendations from the much vaunted Draghi and Letta reports are being implemented, indicate that structural headwinds (lack of competitiveness, low productivity & a fragmented internal market) will continue to weigh on the Eurozone economy.

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