The European Central Bank cut its benchmark interest rate to a record low after a drop in inflation to the slowest pace in four years threatened its mission to keep prices stable.

Policy makers meeting in Frankfurt today reduced the main refinancing rate by a quarter point to 0.25 percent. The decision was predicted by three of 70 economists in a Bloomberg News survey. The ECB kept its deposit rate at zero and trimmed the marginal lending rate to 0.75 percent. ECB President Mario Draghi will hold a press conference at 2:30 p.m.

The ECB now has just one more quarter-point cut left before reaching zero, increasing the likelihood of unconventional tools such as quantitative easing or a negative deposit rate if prices slow further or the economic recovery stalls. Euro-area inflation is less than half the ECB’s target and unemployment is at the highest level since the currency bloc was formed in 1999.

“There comes a point where inflation is so weak, and coming in weaker than anticipated, that the case for loosening policy becomes too hard to resist,” said Richard Barwell, senior European economist at Royal Bank of Scotland Group Plc in London, who predicted the cut. “Bad unemployment numbers only make the case stronger.”

**Euro Falls**

The euro declined as low as $1.3354 after the decision from $1.351 before the announcement.

The Bank of England kept its benchmark rate at a record-low 0.5 percent in London today, while its bond-purchase plan stayed at 375 billion pounds ($603 billion).

Inflation in the 17-nation euro area fell to 0.7 percent in October. The ECB aims to keep price gains close to and under 2 percent over the medium term. When inflation slumped to 1.2 percent in April, Draghi cut rates a month later.

After exiting its longest-ever recession in the second quarter, the euro-region’s economy is showing signs of fragility. Unemployment is at 12.2 percent and the currency has climbed almost 5 percent against its major peers this year, curbing the competitiveness of exporters and
depressing prices.

“Both traditional and unconventional monetary-policy tools have become impotent to kick-start the euro-zone economy,” said Carsten Brzeski, senior economist at ING Groep NV in Brussels. “Nevertheless, there is little worse for a central bank than having to admit that it has reached the limits of its zone of influence.”

**December Forecasts**

Draghi has consistently said that he has multiple policy tools at his disposal, including providing more **liquidity** to euro-area financial markets. A technical committee tasked with considering liquidity options met for two weeks last month.

New measures could include longer-term refinancing operations with fixed or floating rates, different maturities or rules on how banks must use the cash. Other possible measures include changes to reserve or collateral requirements, the suspension of liquidity-absorbing operations, or the extension of full-allotment loans.

The rate cut leaves the ECB in an “uncomfortable position,” said Reinhard Cluse, chief European economist at UBS AG in London, who predicted the move. “The only easy solution left would be for the ECB to signal that it will stay in ‘full-allotment mode’ even after July 2014, the commitment it has given so far.”

Beyond this, the ECB would have to resort to unorthodox measures on which “a consensus in the Governing Council might be harder to reach,” he said.

**Quantitative Easing**

A Fed-style quantitative easing program has repeatedly been ruled out by ECB policy makers. The central bank is barred by European Union treaties from financing state debt, making large-scale purchases of government bonds open to a legal challenge.

While Draghi has floated the prospect of a negative deposit rate, the rate for commercial lenders who park excess cash at the central bank, policy makers have said that its effects can’t be adequately predicted. A negative deposit rate could hurt banks’ profitability by lowering money-market rates, potentially hampering credit supply to companies and households and reducing banks’ incentive to lend to other financial institutions.

“If inflation stays low, as seems likely, and the threat of inflation expectations becoming unanchored to the downside increases significantly, then all the tools in the box can come into play,” said Ken Wattret, chief euro-area economist at BNP Paribas SA in London. “But knowing the way the ECB operates and how long it has taken to try and get support for a refi rate cut,
doing the big stuff could take some time.”

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