



L'Éco en court – Episode 13:

What exactly do key interest rates control?

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Introduction

Monetary policy covers all the decisions taken by central banks to maintain price stability, in other words, neither too much nor too little inflation.

In the euro area, monetary policy is decided by the European Central Bank and the national central banks, which include the Banque de France. It aims to keep medium-term inflation at 2% a year.

Central banks have several tools at their disposal to achieve this objective.

François Villeroy de Galhau *The main tool is interest rates, known as key interest rates, which are those set by the central bank.*

But what is the difference between our own banks' interest rates and the central bank's key interest rates, and what do these key interest rates actually control? How do they affect inflation?

My name is Lucile and in this episode, together with François Villeroy de Galhau, Governor of the Banque de France, we will open up the central banks' toolbox.

Welcome to L'Éco en court.

Refinancing

A rate of interest is the price that people who borrow money pay to those who lend it. We pay interest to the banks with which we contract loans, and the banks pay us interest on our savings. A key interest rate is an interest rate that applies to dealings between banks and central banks.

Just as we have accounts with commercial banks, commercial banks have accounts with the central bank. The central bank is the bankers' banker.

Moreover, just as we use the money in our bank account to pay someone else – probably customers of other banks – banks use the cash they hold in reserve in their accounts at the central

bank to settle payments between themselves. These accounts are therefore used either to deposit or to borrow cash. Let me explain:

- When the payments a bank receives from other banks exceed the payments it has to make, it has available liquidity. It may decide to lend this cash to banks that need it on the “interbank market”, or deposit it in its account at the central bank to earn interest on a daily basis. Let's call this operation No. 1.
- Conversely, when a bank has to make more payments to other banks than it receives, it must find the liquidity to be able to honour these payments. To do this, it may need to refinance – in other words, borrow short-term liquidity, either from other banks (again on the interbank market), or directly from the central bank. A bank may borrow cash from the central bank in two ways:
 - Overnight, i.e. it borrows cash for 24 hours or even less. This is operation No. 2
 - Or, it borrows cash for a week in a pre-planned manner. This is operation No. 3

Key rates

It is through the commercial bank accounts opened in its books that the central bank implements monetary policy, via the rates at which each transaction bears interest. These are the key interest rates. And since we mentioned three transactions, there are three key interest rates, including a floor and a ceiling rate, which guide – or rather frame – the rate at which banks lend money to each other on the interbank market.

- The floor rate is the deposit facility rate and it is the rate of interest for transaction No. 1. In practical terms, it is what a bank earns when it places its liquidity with the central bank for 24 hours or less. This is what they were referring to on Radio Classique on 5 June 2025.

Radio Extract: Today's key figure: 2%. The ECB is expected to announce further monetary easing measures today. Barring any surprises, it is expected to cut its deposit rate to 2%.

This is referred to as a floor rate because it is not in a bank's interest to lend cash to another bank on the interbank market at a lower rate. Indeed, just as we seek to optimise the return on our savings, banks look to optimise the return on their available cash. Therefore, the interbank market rate is generally above the deposit rate. In February 2026, in the euro area, this is considered the benchmark rate when we say that interest rates are rising or falling.

François Villeroy de Galhau: *If I take today's situation, interest rates were negative in early 2022 (-0.5%), and they were raised to 4% in the summer of 2024. Since then, they have been lowered again to 2%, their current level.*

A deposit rate of 2% in February 2026 means that cash deposited for 24 hours by commercial banks with the central bank earns interest of 2%. But remember, this is an annual rate, which must be converted to a daily rate of 0.005%.

- The ceiling rate is the marginal lending facility rate and it is the cost of operation No. 2. It is what a bank must pay to the central bank when it borrows cash for 24 hours. It is called a ceiling rate because it is not in a bank's interest to borrow cash from other banks on the interbank market at a higher rate. The interbank market rate is therefore generally below the marginal lending facility rate.
- The third key interest rate is the main refinancing operations rate, usually just referred to as the MRO. It is the cost of planned refinancing – operation No. 3, when commercial banks borrow cash from the central bank for a week. For a long time, this was the reference rate. But in February 2026, banks already have a lot of cash, so they borrow little from the central bank. The MRO and the marginal lending facility are therefore quite close, and it is the deposit rate that guides the interbank market.

Christine Lagarde, President of the European Central Bank, 18 December 2025:

The Vice-President and I are pleased to welcome you to our press conference. The Governing Council today decided to keep the three key ECB interest rates unchanged. Our updated assessment reconfirms that inflation should stabilise at our 2% target in the medium term.

By changing key interest rates, the central bank influences refinancing costs for commercial banks and the rates at which commercial banks in turn lend money to their customers, including businesses and households, in other words you and me. The aim is to influence the economy as a whole in order to stabilise price levels.

But what is the link between the cost of refinancing, economic activity and inflation?

When a bank grants you a loan, it credits your account: it creates money but will then need to have the necessary liquidity when you use that money to pay someone else – often a customer of another bank. That is when it may need to refinance itself.

When key interest rates rise, refinancing becomes more expensive. Banks pass on this cost in the interest rates they charge households and businesses on loans. Borrowing becomes more expensive, and demand for credit falls.

Banks may also choose to lend less. Credit becomes more selective and therefore scarcer. The supply of credit decreases.

In both cases, increasing key interest rates slows down lending – which in turn slows down consumer and investment spending, and reduces pressure on prices. We say that monetary policy becomes less accommodative, or even more restrictive.

François Villeroy de Galhau: *In 2022, few people were prepared to bet that we would be able to defeat inflation so quickly while maintaining growth that, although insufficient, remained positive.*

It is often said that when a central bank raises interest rates, it will cause a recession – well there has been no recession.

Conversely, a cut in key interest rates boosts economic activity when inflation is too low. We talk about monetary policy easing.

François Villeroy de Galhau: *There have been periods when interest rates have been brought very low – to 0% or even temporarily to negative rates – and so the interest rate weapon could no longer be used. So we used what we call non-standard measures, particularly by adjusting the size of the central bank's balance sheet using the ability to purchase public assets, known as quantitative easing (QE).*

Non-standard monetary policy instruments will be the topic of our next episode.

Conclusion

Thank you all for listening. A big thank you also to Claire Orliac for proofreading. If you enjoyed this episode, either subscribe or leave us your comments and stars. You can also email us your questions on economic issues at podcasts@banque-france.fr Till next time!