

FLASH REPORT

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ECB: Getting Closer, but Trade Risks Loom

- The European Central Bank (ECB) announced another widely expected seventh consecutive 25bps cut. Our forecast remains for the ECB to cut only once more to a 1.75% deposit rate in 3Q25, but we wouldn't rule out further easing were the U.S. to reimpose hefty tariffs on the E.U. (see you in a month).
- The ECB's relatively dovish statement highlighted that inflation is around target and that wages growth is clearly moderating. On the flip side, Lagarde noted that today's decision was not unanimous and also stated that they have nearly concluded the policy cycle.
- Forecasts for GDP growth were left practically unchanged with only a minor negative revision to 2026 growth, with refreshed tariff risks offsetting a better start to the year for 2025 GDP growth, left unchanged at 0.9%.
- The ECB's updated projections, compared to their March pre-Liberation Day estimates, see lower prices growth in 2025 and 2026 which, alongside the 2027 projection, forecast headline inflation at or below 2% across the horizon.

The European Central Bank (ECB) announced another widely expected seventh consecutive 25bps cut to its key policy interest rates, taking the closely watched deposit facility rate to a 2.00% level that is approaching the likely endpoint for the bank's easing cycle. In its statement, the ECB seems to be claiming victory in the fight against inflation, saying that "inflation is currently at around the Governing Council's 2% medium-term target", and it also laid out strong confidence in muted inflationary pressures as wage growth "continues to moderate visibly."

The ECB's updated projections, compared to their March pre-Liberation Day estimates, see lower prices growth in 2025 and 2026 which, alongside the 2027 projection, forecast headline inflation at or below 2% across the projection horizon. Inflation is seen dipping to 1.6% in 2026 on a weaker oil prices outlook and a stronger EUR, but bounces back to 2% in 2027.

Forecasts for GDP growth were left practically unchanged with only a minor negative revision to 2026 growth while the economy is still seen expanding by 0.9% in 2025 as a better 1Q25 than expected offsets a weaker second half of the year. At 1.3% in 2027, Eurozone GDP growth is still expected to remain sluggish. The ECB published alternative scenarios of lessened trade tensions (3Q25 elimination of bilateral tariffs) or a return to Liberation Day tariffs (with reciprocal duties) that show firmer/weaker growth, naturally, that leads to firmer/weaker inflation (as demand effects outweigh the price shock of tariffs).

At the post-statement press conference, ECB President Lagarde highlighted that it was an almost unanimous decision, with only member (likely Austria's Holzmann) preferring no cut today. While the market reaction to the ECB's statement and updated projections was relatively muted to perhaps somewhat dovish given inflation and wages confidence, Lagarde's comment on the non-unanimous vote as well as saying that they have nearly concluded the policy cycle prompted sharp moves higher in European yields while giving the EUR a lift.

At writing, markets are only pricing in one additional 25bps rate cut by year-end and to close out the easing cycle, from about 35bps in additional cuts priced in for this year as of yesterday. Markets also have a 'residual' 10bps in additional easing into 2026. Our forecast remains for the ECB to cut only once more to a 1.75% deposit rate in 3Q25, but we wouldn't rule out easing to 1.50%, or even 1.25%, were the U.S. to reimpose hefty tariffs on the E.U.

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The yield on 2yr German debt has risen almost 10bps from its post-statement lows on the back of Lagarde's press conference, and taking international yields which had fallen on higher than expected U.S. jobless claims for the ride. Meanwhile, the EUR is on track for a 0.6% rise against the USD that leaves it among the best performing major currencies on the day and well richer against the JPY that is off 0.2% this morning. European equities were enjoying small gains following the release of the ECB's statement but fell into small declines during Lagarde's relatively hawkish press conference.

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