



Central banks face up to new economic reality

Amid the current heightened economic and trade uncertainty, the ECB delivered, as expected, a 25bps rate cut, bringing its main deposit rate to 2.25%. While priced in, the focus was on the accompanying statement from the Governing Council and President Lagarde's press conference. What was clear from the messaging was an emphasis on the downside risks to the economy from the current trade tensions, and in extension, a more dovish outlook for interest rates.

The ECB meeting statement contained most of the recent greatest hits, including an emphasis that the central bank will follow a "data-dependent" and "meeting-by-meeting approach". However, the statement did reflect something of a dovish tilt, stating "the outlook for growth has deteriorated owing to rising trade tensions. Increased uncertainty is likely to reduce confidence among households and firms." It further stated that "these factors may further weigh on the economic outlook". While the ECB did not publish forecasts this time around, the shift in tone is clearly teeing up investors for another rate cut in June, and a downgrade to their economic outlook in forecasts published alongside that monetary policy decision.

The expected downgrade to the global outlook was further underlined by IMF Managing Director Kristalina Georgieva, who in a speech to its Annual Spring Meeting, laid out the stagflationary impacts of the current trade tensions. She noted "our new growth projections will include notable markdowns, but not recession. We will also see markups to the inflation forecasts for some countries." That final sentence likely alludes to the expectation that the largest impact, in terms of inflation, will be on US consumers. Indeed, domestic US forecasters have begun to quantify the Trump tariffs already in place, with some predicting US inflation might top 4% by the end of the year.

This places the Fed in a tight spot ahead of its monetary policy decision in May, a dilemma referred to by Chair Jay Powell in remarks to the Economic Club of Chicago last week. He stated that tariffs are likely to generate "at least a temporary rise in inflation" and warned that they may place the Fed's dual mandate (stable prices and maximum employment) in tension. This has drawn the ire of President Trump, who called for Powell to be "terminated", bringing renewed focus on the Fed's independence as it charts a path for monetary policy amid the current uncertainty.

Turning to the week ahead, the flash PMIs for April in the UK, US and Eurozone will be closely watched for any signs of stress in the private sector from the recent bout of trade uncertainty.

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