

ECB cuts, emphasises trade impact on growth outlook

The April meeting of the ECB Governing Council saw the central bank cut interest rates for a third consecutive time this year. It reduced them by 25bps, with the Deposit rate lowered to 2.25%, while the Re-fi rate was decreased to 2.40%. This marked the seventh 25bps rate cut since the ECB started its easing cycle in June 2024. The changes to official interest rates were in line with market expectations. The decision was unanimous, with no discussion of a 50bps cut, as some ECB Watchers had speculated on.

The meeting statement outlined the ECB's rationale for its decision to cut interest rates again, based on the updated "assessment of the inflation outlook, the dynamics of underlying inflation and the strength of the monetary policy transmission". In this regard, the Governing Council noted that "the disinflation process is well on track", with inflation continuing to develop "broadly as staff expected". However, the ECB dropped any reference to the restrictiveness of monetary policy. President Lagarde explained at the press conference that this was due to the uncertain economic backdrop, with the world economy currently facing a number of shocks.

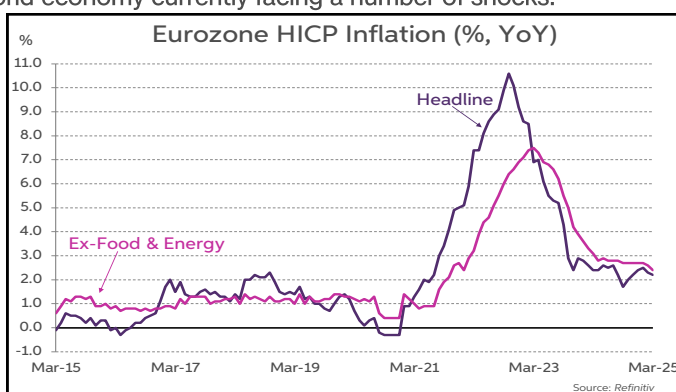
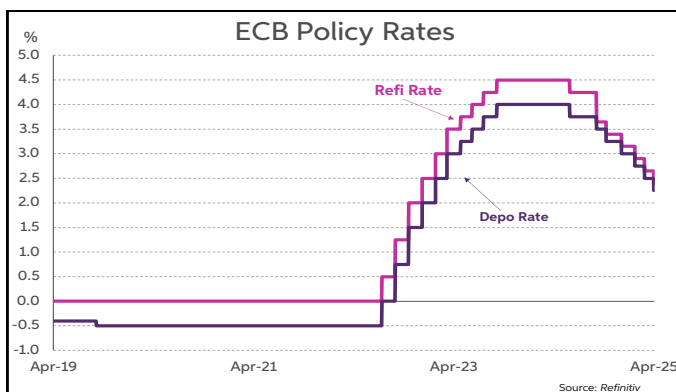
The previous March ECB meeting had seen the release of the latest set of macro forecasts. Growth expectations were downgraded at that point. The ECB is forecasting GDP growth of 0.9% (from 1.1%) for this year. It sees GDP averaging 1.2% in 2026 (was 1.4%) and is pencilling in growth of 1.3% for 2027 (unchanged). This is a very subdued growth outlook. At the April press conference, President Lagarde highlighted that the macro data have been trending in line with the March forecasts, but the outlook was now clouded by uncertainty around future global trade policy, as well as upside risks from higher defence and infrastructure spending.

In terms of the outlook for headline inflation, the March forecasts saw modest revisions. The ECB expects inflation to average 2.3% this year and 1.9% in 2026. For 2027, it sees inflation averaging 2.0%. However, the core rate is expected to average 2.2% this year. The projection for 2026 was revised marginally higher to 2.0% (was 1.9%), while further out, it is anticipating core inflation to average 1.9% during 2027. Overall, it is clear that the ECB maintains a benign outlook for inflation in the Eurozone, with recent developments suggesting inflation might undershoot these forecasts in the near term.

As referenced above, the 25bps rate cut was fully priced in by markets. Therefore, investors were focused on what guidance, if any, was provided by the Governing Council in relation to the outlook for official Eurozone interest rates. In this regard, the meeting statement continued to emphasise 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 then states that "these factors may further weigh on the economic outlook for the euro area".

In terms of market expectations, futures contracts have softened in the aftermath of today's policy announcement.

Current pricing suggest traders expect the ECB to cut rates by 25bps again in June. In total, around 65bps of further policy easing from the ECB is anticipated over the remainder of this year. **This would see the Deposit rate end the year at circa 1.50%.** In our view, the Deposit rate settling in and around the 2.0% level by end-2025 remains our central expectation, albeit tariff policy uncertainty means the risks are to the downside of this, given the potential negative impact on Eurozone growth.



ECB Macroeconomic Forecasts for the Euro Area

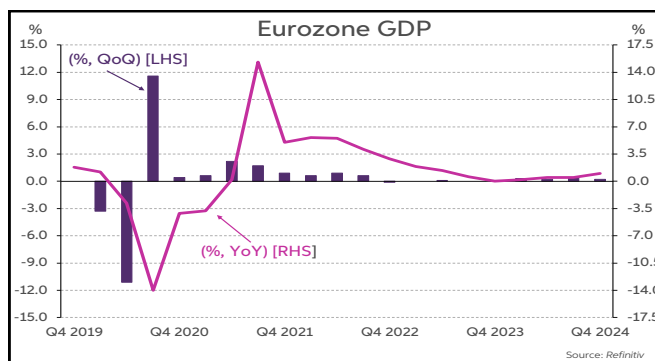
(%)	2024	2025	2026	2027
HICP	2.4	2.3	1.9	2.0
Real GDP	0.7	0.9	1.2	1.3

Forecasts are mid-point of a range and based on the assumption that Brent crude oil prices will average \$74.7 in 2025, \$70.3 in 2026, and \$68.7 in 2027.

Source ECB, March 2025

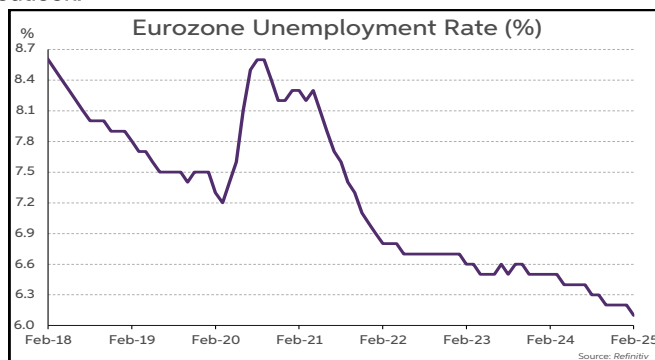
Eurozone outlook remains challenging

The Eurozone economy registered modest growth in 2024. However, the expansion in activity levels was marginal, with GDP rising by 0.2-0.4% q/q throughout the year. **Overall, the economy expanded by 0.8% in 2024, up from 0.5% in 2023.** Among the largest national economies in the region, growth continued to be uneven. Germany remained in the doldrums, with GDP contracting for a second consecutive year, by 0.2% in 2024, amid a continued slump in the manufacturing sector and weak consumer spending. In contrast, the Spanish economy registered robust growth of 3.1% last year, while the French and Italian economies recorded more modest expansions of 1.1% and 0.5%, respectively.



The available hard data for Q1 indicate growth may have gained some momentum. Retail sales rose by 0.3% in February, having flat-lined since November. In year-on-year terms, retail sales were 2.3% higher in February. Meantime, industrial production increased by 0.6% in January and by 1.1% in February, the fastest pace of consecutive monthly gains since the same period in 2023. **Likewise, survey data suggest the economy may have gathered steam in Q1.** The manufacturing PMI remains firmly in contraction mode, where it has been since July 2022, but it rose to 48.6 in March, its highest level in two years. Overall, it averaged 47.6 in Q1, up from 45.4 in Q4, consistent with a slower pace of contraction in the sector. Meanwhile, the services PMI has stayed in expansion territory, averaging 51.0 in Q1, broadly similar to the reading of 50.9 in Q4. At the same time, the EC Economic Sentiment index trended upwards in the first quarter, supported by broad-based improvements in consumer, industrial and services sector confidence. However, in April, it fell sharply to -19.5, its lowest level since October 2023, as US trade policy uncertainty weighed on the outlook.

Regarding the labour market, conditions remain tight. Employment expanded for a fifteenth successive quarter in Q4, up by 0.1% q/q and by 0.9% y/y. It means that the number of people at work has risen by 7.9m or 4.9% since the end of Q4 2019. At the same time, the unemployment rate fell to a new historic low of 6.1% in February. Tight conditions are contributing to elevated wage growth. Wages in the Eurozone rose by 4.1% y/y in Q4, up from 3.8% y/y a year earlier. However, the Indeed wage tracker - a more frequent measure of wage pressures - indicates that wages have risen more slowly in recent months. It shows that wages rose by 2.7% y/y on average in Q1, the slowest rate of increase since January 2022.



On the inflation front, a gradual downtrend has re-emerged in Q1. The headline rate fell to 1.7% last September, its lowest level since April 2021, but re-accelerated to 2.5% in January. However, it declined throughout the remainder of the quarter, falling to 2.2% in March. Meantime, core inflation, which has been proving to be quite sticky, stuck between 2.6-2.9% since April '24, eased to the bottom of this range in February, and moved lower again in March, to 2.5%. This is partly due to a drop in services inflation, which slowed to 3.4%, its lowest level since June 2022. Looking ahead, the ECB expects inflation to average 2.3% this year, before falling to 1.9% in 2026, and to 2.0% in 2027. Similarly, core inflation is seen as running at 2.2%, 2.0% and at 1.9% over the same period.

In summary, the Eurozone economy saw a modest uplift in activity last year but economic growth remained muted. On a positive note, the labour market is strong, with employment rising and unemployment at an all-time low. Secondly, a resumption of the disinflationary trend this year and further rate cuts should support real incomes and consumer spending. At the same time, political uncertainty in France and Germany have subsided for now. Indeed, the announcement of higher fiscal spending in Germany on defence and infrastructure, as well as higher defence spending at the EU level could support growth in the medium-term. **Overall, the outlook for the Eurozone remains challenging.** The potential for the US to implement significant tariffs on its trading partners will weigh on growth in the Eurozone. US trade policy is already generating significant uncertainty which could harm the Eurozone export sector. Against this backdrop, the ECB sees GDP expanding by 0.9% this year and by 1.2% in 2026, although the risks are skewed towards the potential for weaker growth in the near-term.

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