

MARKET COMMENTARY

ECB easing cycle approaching its end but mind trade war risks

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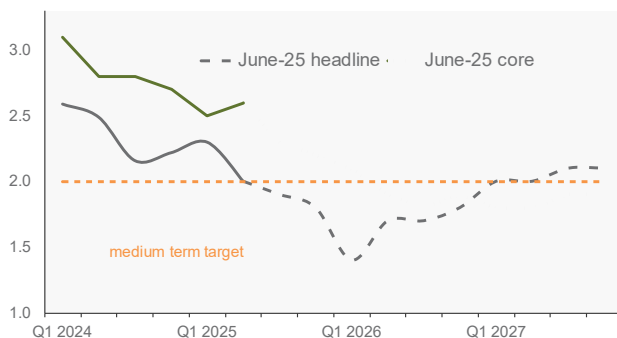
June 5, 2025

- At today's meeting the ECB's Governing Council (GC) again decided to cut its key rate by 25 bps (depo rate to 2.00%), in line with latest market expectations.
- The updated macro projections see inflation dipping to 1.6% in 2026 but bouncing back thereafter towards 2% while core inflation is set to stay stable around target. Growth is projected to gain momentum towards the end of 2025 and to reach 1.3% in 2027.
- A trade war is seen as the major risk giving rise to still *"high uncertainty"* and all in all, the growth and inflation risks are seen on the downside.
- The GC has not discussed the neutral policy rate at today's meeting. That said, President Lagarde sees the ECB well positioned to navigate uncertainties over the next months again emphasizing data-dependency. Today's decision was taken *"virtually unanimously"* with just one GC member not supporting it.
- Given inflation at target amid trade war risks we still see another 25 bps to 1.75%. But we acknowledge that the air is getting thinner as Lagarde stated that the ECB was *"getting to the end of a monetary-policy cycle that was responding to compounded shocks"*. A final cut might occur only by September amid the next update of the macro projections.

ECB cut by 25 bps today: At today's meeting the GC cut its key rate, the deposit rate, for the eighth consecutive time to 2.00%. It continues with fully non-reinvestments of its APP and PEPP purchases.

Inflation to stay around target

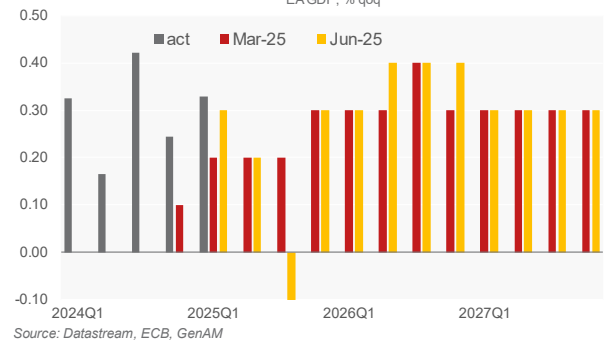
HICP, % yoy, quarterly data, ECB staff projections



Source: Datastream, ECB, GenAM calculations

Recovery ahead

EA GDP, % qoq



Source: Datastream, ECB, GenAM

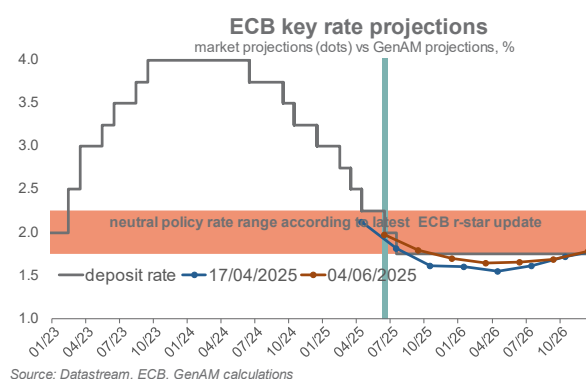
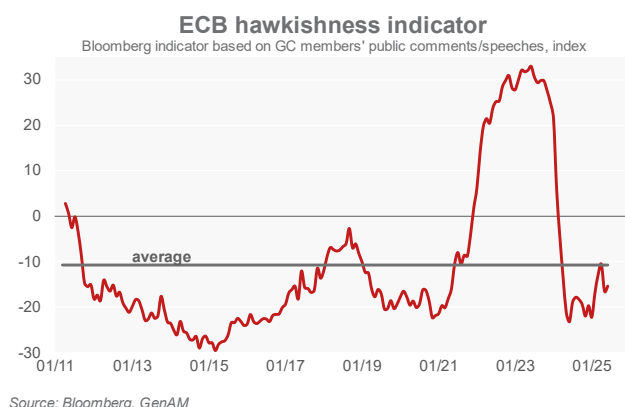
Inflation sustainably around target: Headline inflation (flash May reading was 1.9% yoy) is back towards target and set to stay there medium-term according to the latest ECB staff projections (2025: 2.0% yoy, from 2.3%; 2026: 1.6% yoy, from 1.9%; 2027: 1.9% yoy, from 2.0%). Behind this stands the expectation of receding domestic inflation amid moderating wage growth. The downward revision compared to the last projection mainly reflects lower assumptions for energy prices and a stronger euro. Core inflation is set to stay above headline initially but to come down further too (2025: 2.4% yoy, from 2.2%; 2026: 1.9% yoy, from 2.0%; 2027: 1.9% yoy, from 1.9%). From that the GC concludes “*that inflation will settle at around the Governing Council’s 2% medium-term target on a sustained basis*”.

Growth to strengthen in 2026 and 2027: In the ECB’s base scenario growth is set to gain momentum following weakness over the further course of 2025 and to recover towards normal thereafter. The key drivers are the boost from defence and infrastructure spending, monetary policy support and the expectation that higher real incomes translate amid a robust labour market into higher spending. Annual growth is set to be at 0.9% in 2025 (unchanged), 1.1% in 2026 (from 1.2%) and 1.3% in 2027 (unchanged) thereby remaining broadly unchanged from the March projections.

A benign trade war assumption: Looking ahead, the elephant in the room are US import tariffs and the question whether they will in the end be fully implemented triggering also the implementation of retaliation measures or whether a full-blown trade war can be avoided. Today’s policy decision assumes that US tariffs stay at 10% for all countries except about 40% for China, China retaliates symmetrically while the EU does not retaliate, and trade uncertainty declines.

Trade war risks skewed towards lower inflation: The June [macro projections](#) also contain a mild (trade deal in Q3 on elimination of tariffs) as well as a severe trade war scenario (US tariffs return to elevated levels announced on April 2 amid retaliation). While a further escalation of trade tensions would push growth (2025: 0.5%, 2026: 0.7%, 2027: 1.1%) and inflation (2027: 1.8% vs base case of 2.0%) below the baseline projection, the benign outcome would lift growth especially in 2025/26 but not impact much inflation. Overall, the risk hence remains tilted towards lower inflation. Moreover, these projections do not consider the disinflationary effect from a potential impact of a redirection of Chinese exports to Europe. Mrs Lagarde seemed to be aware of these shortcomings by stating that the scenarios “*encapsulate some transmission channels*”. She also added that the GC extensively discussed supply-chain disruptions that were not included in these scenarios either. And a potential tightening of global financial conditions (e.g. via higher UST yields) is not considered either.

ECB easing cycle is approaching its end: With today’s key rate cut to 2.0% the policy rate is in the middle of the neutral range (of 1.75% to 2.25%) that ECB staff had derived. Yet at today’s policy meeting the neutral rate has not been discussed and President Lagarde again referred to the difficulties to detect them. Nevertheless, she implied that the ECB was largely done as she stated that the ECB was “*getting to the end of a monetary-policy cycle that was responding to compounded shocks*”. By empha-



sizing that underlying inflation was expected to hardly move and to stay around target, the need for further policy action is clearly reduced. Stating that the economy was responding quite well to monetary policy goes in the same direction. And she sees the ECB “*in a good position to navigate the uncertainties*”. Lastly, today’s decision was “*virtually unanimously*” with one GC member not supporting it. We take this as an indication that within the GC the headwinds to further cuts will mount.

We still expect a final 25 bps cut: That said, for good reasons the ECB sticks to its data-dependent approach. Looking ahead we deem the expectation about the tariff war as too optimistic and think that in the end the GC will cut further given the stronger downside risks to inflation that currently depicted in the projections. We therefore still have a final 25 bps cut in our books but acknowledge that the risk for a halt of the easing cycle rose. We would expect the ECB to cut below 1.75% in case a severe trade scenario would gain the upper hand.

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