

MARKET COMMENTARY

ECB is in a good place, but we still expect a final cut in September

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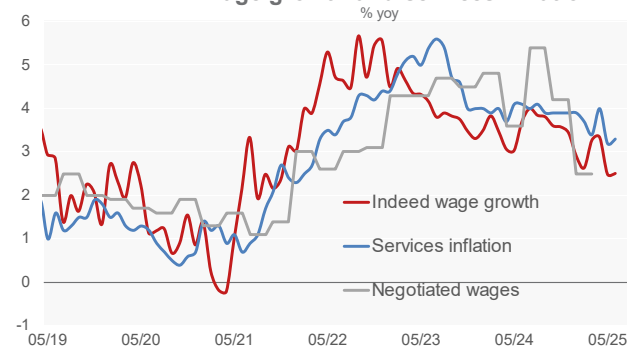
July 24, 2025

- At today's meeting, the ECB's Governing Council (GC) unanimously decided to keep its key rate unchanged at 2.0%, in line with market expectations.
- Inflation is now seen at target, with recent data being broadly in line with the GC's inflation outlook. The economy is assessed as *"resilient"*, though the GC emphasized that the trade dispute keeps the environment *"exceptionally uncertain"*.
- President Lagarde reiterated that the ECB was *"in a good place"* and declared *"disinflationary cycle"* closed, while again stressing the importance of data dependency and the meeting-by-meeting approach.
- Improving sentiment indicators at the outset of Q3 and encouraging signs of a potential resolution in the trade dispute with the US limit the scope for further rate cuts. Still, we expect the updated September ECB macro projections to allow room for a final cut to 1.75% to insure against prevailing downside risks.

ECB kept key rate unchanged today: At today's meeting, the GC left its key rate - the deposit rate - at 2.00%. It continues with full non-reinvestment of its APP and PEPP purchases.

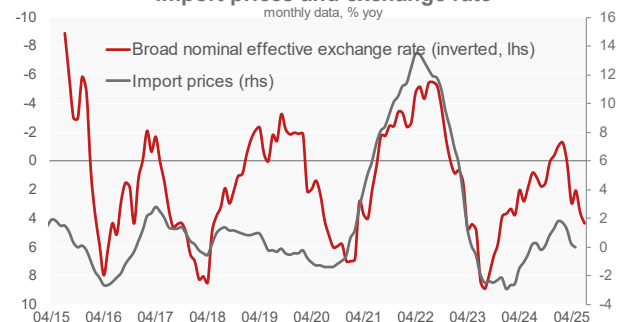
Inflation back to target with downside risks due to strong EUR: At today's meeting, the GC painted a benign picture of the inflation outlook. Headline inflation (June reading was 2.0% yoy) is at target and the decline of underlying inflation (of 2.3% yoy) is continuing with moderating wage growth being a main driver. The GC stated that *"inflation is currently at the 2% medium-term target"*, implying that underlying inflation is not a concern at current level. It noted that recent data are *"broadly in line with the Governing Council's previous assessment of the inflation outlook"*. The ECB's June projections see annual headline inflation at or

EA wage growth and services inflation



Source: Datastream, indeed, GenAM

Import prices and exchange rate



Source: Datastream, GenAM calculations

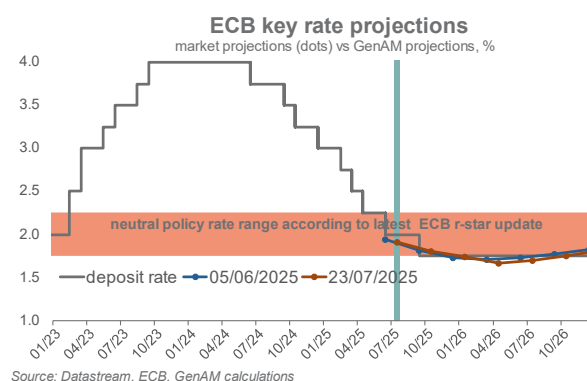
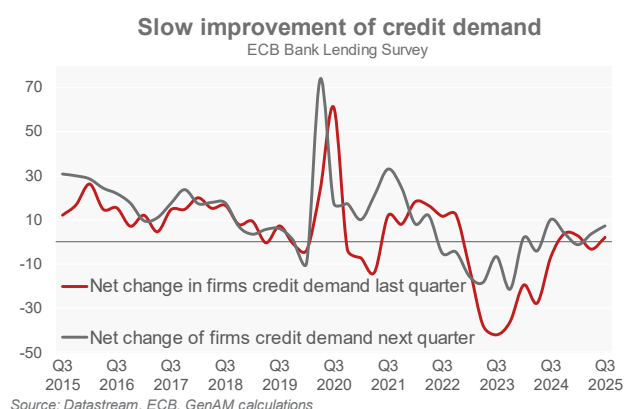
below target until 2027 (2025: 2.0% yoy, 2026: 1.6% yoy, 2027: 1.9% yoy). However, the latest appreciation of the EUR introduces downside risks to inflation. President Lagarde, however, downplayed the risk of undershooting, stating that the ECB would not be swayed by minor deviations. She also pointed out that inflation expectations remain consistent with the 2% target. That said, the GC also acknowledged that trade policy risks make the inflation outlook more uncertain than usual.

Less downside risks to growth: Likewise, the latest news on activity were supportive for the ECB's view of recovering activity. The frontloading of the German fiscal spending plans and improving sentiment (e.g. today's flash composite PMI at highest since August 2024) should bolster confidence that growth will regain momentum following weakness during the summer half of 2025. The GC's sounded cautiously optimistic by stating that the *"economy has so far proven resilient overall in a challenging global environment"*. We see leeway for the staff growth projections (2025: 0.9%, 2026: 1.1%, 2027: 1.3% in 2027) to be revised up. In the Q&A, President Lagarde echoed this view, noting that first quarter growth as well as its breakdown was *"mostly if not a little better"* than expectation.

ECB's benign trade war assumption could all in all prove right: Looking ahead, the elephant in the room are US import tariffs and the question whether they will be fully implemented after the August 1st deadline, or if a compromise can be reached. For the time being, uncertainty remains high but by the September meeting, tariff uncertainty will likely have gone. At the June meeting, the ECB's central scenario assumed that US tariffs stay at 10% for all countries except for China (about 40%), China retaliates symmetrically while the EU does not retaliate, and trade uncertainty is set to decline. While this outlook may seem optimistic, recent developments – such as reports of a likely 15% US import tariff on EU products and US trade agreements with other countries (e.g. Japan) - broadly support this benign view.

Air for further rate cuts is getting thinner: At the current level of 2.0% the policy rate is in the middle of the neutral range (of 1.75% to 2.25%) that ECB staff had derived. Today, President Lagarde again stated that the ECB was *"in a good place"* and well positioned to deal with turbulent waters. There was no urgent need for action as the disinflationary cycle was considered as closed. Hence, all eyes will be on the further development of the trade conflict and how it translates into the September update of the growth and inflation projections. A likely increase of the activity outlook with rates at neutral reduces the need for further cuts.

We still expect a final 25 bps cut in September: The ECB sticks to its data-dependent approach and following its strategy review, it introduced inflation risks as a new determinant for rate decisions. While we expect a solution in the tariff conflict, we also think that exchange rate induced downside risks to inflation will persist. There is also the risk of re-routing of exports away from the US to the euro area. Amid easing wage growth this tilts inflation risks more to the downside and should trigger a final 25 bps cut to the lower bound of the neutral policy range. But we acknowledge that the air for this final cut is getting thinner. We deem the bar to cut below 1.75% very high and expect such a step only in case of for instance a severe trade scenario surprisingly materializing.



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