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ECB: Quarter-Point Cut with Stale on Arrival Projections in An Uncertain World

- The ECB delivered a widely-expected and fully priced-in 25bps rate cut today with an updated (but stale on arrival) set of projections that have inflation a touch higher and growth a touch lower; today, that would likely be unchanged inflation forecasts and even lower GDP projections.
- We expect the ECB to go again in April as trade uncertainty and the possible imposition of US tariffs next month drag an already-weak economy even lower while additional defence spending will not come soon enough to prevent continued near-term weakness. After April's 25bps cut we expect two more ECB cuts over the balance of the year to leave the deposit rate at 1.75%.
- Today's statement and press conference clearly centered on 'uncertainty', reflected in a more reserved guidance stance, with the communiqué noting that "especially in current conditions of rising uncertainty, (the ECB) will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance."

As was widely expected and fully priced in, the ECB cut its three key interest rates by 25bps this morning, taking the deposit facility rate to 2.50% from 2.75% as the "disinflation process is well on track". No ECB member voted for a rate hold, though the unanimous 25bps cut decision excluded Austria's Holzmann who abstained (practically a 'hold'). Given the cautious tone of today's statement and Lagarde's presser, the April decision looks like a bit higher than toss-up odds in favour of a cut that will depend on tariffs action. Auto, reciprocal, etc. US tariffs imposed in early-April on the EU would seal the deal on a 25bps cut in April of which the market currently has about 19bps priced in.

Briefly, European yields have been all over the place, the EUR is marginally stronger on the day, and Euro Stoxx is flat. Good luck trying to get a clean read of what today's decision meant for yields, with German 2s initially jumping 3bps, then falling the same on weak US layoffs data, then rising about the same as US yields normalized, but now on net trading flat on the day given risk-off sentiment in equities (and maybe a dovish 'ECB sources' story). Europe's long-end remains under pressure from defence spending plans, but the 4bps rise in German 10s is 7bps less than the 10bps+ increase these were tracking about an hour ago. Year-end ECB pricing implies about two more cuts left (we expected three due to Trump damages) which is practically unchanged from yesterday or pre-statement.

There's more ECB cuts coming, but the Bank's statement suggested that officials are close to seeing the light at the end of the tunnel of rate cuts. In today's statement, the ECB highlighted that "monetary policy is becoming meaningfully less restrictive", noting that "loan growth is picking up". This compares to the late-January communiqué simply saying that "monetary policy remains restrictive and past interest hikes are still transmitting to the stock of credit."

Language around inflation was left generally intact amid small revisions (see below), but the outlook for growth has worsened, with the statement noting that "the economy faces continued challenges and staff again marked down their growth projections" (see below, also) compared to January's "the economy is still facing headwinds but rising real incomes" and easier policy should lift demand "over time".

With the economy in poor shape and inflation looking well-behaved—if one sets aside energy price volatility and tariff risks—there's clear room for additional easing by the ECB. However, this is no time to give in to uncertain expectations and guide a particular path for rates, or, in the words of the ECB, "especially in current conditions of rising uncertainty, (the ECB) will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance."

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Today's statement and press conference clearly centered on 'uncertainty'. The ECB does not yet know the breadth or the ramp-up speed in defence spending and how that may impact their macroeconomic forecasts. On the flip side, it does not yet know what shape Trump's protectionism will take and how much it could depress the bloc's economy or its inflation path. These factors are not fully (nor closely) reflected in the ECB's updated projections presented today which, to boot, also incorporate possibly stale energy price assumptions.

The latter are an important driver of the revision higher to the staff's 2025 inflation forecast, taken to 2.3% from 2.1%, while that for 2026 was left unchanged at 1.9% (with inflation reaching the 2% goal early next year) and for 2027 it was lowered to 2.0% from 2.1%. On energy prices, the ECB's natural gas price forecast for 2025 of €50.2/MWh compares to a €34.4/MWh average for 2024 and €38.8/MWh this morning; in the case of Brent oil, these numbers are, in the same order, \$74.7/bbl, \$82/bbl, and \$69/bbl.

Meanwhile, core inflation forecasts saw minimal changes, remaining on a downtrend. The ECB sees annual average inflation falling from 2.8% in 2024 to 2.2% this year, 2.0% the next, and 1.9% in 2027; 0.1ppts lower and 0.1ppts higher in 2025 and 2026, respectively, when compared to the December round.

As for growth, the 0.9% and 1.2% expansions projected for 2025 and 2026 represent a 0.2ppts negative revision versus the prior round, with 2027 growth left unchanged at a (still-underwhelming) 1.3%. The ECB does incorporate a drag from global trade uncertainty, with even a marginal impact from China-US tariffs (but only the first round, not this week's), that they note accounts for about half of the reduction in the 2025 and 2026 GDP growth forecasts.

This is actually quite an optimistic scenario as their modeling does not include US/Canada/Mexico tariffs, steel, aluminum, pharmaceutical, autos, semiconductors, copper, reciprocal tariffs, EU-specific tariffs—you name it. Even a projection exercise that incorporates currently higher economic uncertainty (sans tariffs) would result in a lower GDP growth forecast.

Increased EU defence spending would certainly be a push in the other direction, but a 40bps rise in German 10s over the past two days and a broad European yields surge should come with higher borrowing costs for firms and households that dampen demand to pull back in the other direction. The rolling out of this additional spending may also be slow, while the yields pain would come sooner and at a time when firms are highly reticent to ramp up investment and hiring given global uncertainties, and this spending would likely be narrow-based and unlikely to support long-term potential growth.

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