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Preview: ECB To Cut Rates in April, Amid US Tariffs and A Stronger Euro

by

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Executive Summary

- **Expected Decision**: *We expect the ECB to deliver another rate cut in April.* In line with consensus, at the April Governing Council (GC) meeting, we expect the European Central Bank (ECB), to cut its main policy rates by 25 bps, i its *i)* interest rate on the 'main refinancing operations' to 2.40%; *ii)* interest rate on the 'marginal lending facility' to 2.65%; and especially the key *iii)* 'deposit facility' to 2.25%.

  We expect no changes to its *balance sheet policy*. In terms of *forward guidance*, the ECB will stress that it remains data-dependent and the decisions will be still taken meeting-by-meeting. Nonetheless, if the ECB cuts rates in April, another 25bps rate cut in June is extremely likely.

- **Policy Discussion:** *The case for an ECB rate cut in April has strengthened amid the trade war and mounting global volatility.* Downside risks have materialized, inflation is near target, and growth is weakening—prompting policymakers like Olli Rehn to call for easing to maintain price stability. Although divisions remain, the ECB's balance is tilting toward further cuts.

  Trump's new 20% tariffs on EU exports—part of his "Liberation Day" package—have shaken business sentiment and could shave 0.2–0.3 percentage points off eurozone GDP. While most ECB officials agree the tariffs are a drag on growth, they differ on inflation risks: doves like Panetta expect deflationary effects from weaker demand and Chinese export redirection; hawks like Vujcic warn of long-term inflation from deglobalization and rising input costs. The strengthening of the EUR after "Liberation Day" has clearly shifted the balance towards easing in April.

  Germany's proposed €500bn fiscal package and the EU's ReArm plan could reduce the need for aggressive monetary easing, but political hurdles and timing uncertainties persist. Lagarde has avoided firm commitments, waiting on clearer fiscal signals. Without Berlin's stimulus, markets expect rate cuts in April and June, with further easing possible if weakness continues.

  A compromise is emerging: cut in April and June, then pause at the 2% floor (in the deposit rate). This path offers flexibility while addressing immediate risks. Ultimately, the ECB's direction will depend on trade fallout, fiscal action, and internal consensus—but a continued easing cycle appears likely in the near term.

Key Picture: European Central Bank Key Forecasts – 2024-2027

		2024*f*		2025*f*		2026*f*		2027*f*	
	Latest reading	March Projections	December Projections	March Projections	December Projections	March Projections	December Projections	March Projections	December Projections
GDP *(real growth, y-o-y)*	1.2	0.8	0.7	0.9	1.1	1.2	1.4	1.3	1.3
Inflation *(%, y-o-y)*	2.2	2.4	2.4	2.3	2.1	1.9	1.9	2.0	2.1
Core-inflation *(%, y-o-y)*	2.6	2.8	2.9	2.2	2.3	2.0	1.9	1.9	1.9
Unemployment *(%, y-o-y)*	6.1	6.4	6.4	6.3	6.5	6.3	6.3	6.2	6.1

Source: ECB '*Macroeconomic projections*' December *2024 and* March *2025 Note:* Latest readings: 1. GDP for Q4 2024; 2. Unemployment for February 2025; 3. Inflation for March 2025. *Inflation = Harmonized Index of Consumer Prices (HICP).

Analysis

- **EXPECTED DECISION**: *We expect, in line with consensus, the ECB to deliver another rate cut in April.* At the Governing Council (GC) meeting on April 17th, we expect the European Central Bank (ECB), to cut its main policy rates by 25 bps, i.e. its *i)* interest rate on the 'main refinancing operations' to 2.40%; *ii)* interest rate on the 'marginal lending facility' to 2.65%; and the key *iii)* 'deposit facility' to 2.25%.

  In terms of *forward guidance*, the ECB will stress that it remains data-dependent and the decisions will be still taken meeting-by-meeting, with its usual three-pronged approach about its reaction function confirmed. Markets are eagerly watching for signals on the pace of easing beyond April, as tariffs threaten an economic slump, but Lagarde will avoid being cornered by her own words.

  In terms of *Balance Sheet policies*, the GC has decided to move forward with the normalization of the balance sheet. GC confirmed that it will reduce the Eurosystem's holdings of securities under the PEPP. As of December 2024, the ECB has stopped re-investing the PEPP proceedings. The process for reducing PEPP holdings will generally follow the same approach as the APP.

- **POLICY DISCUSSION:** *The case for an ECB rate cut in April has strengthened amid the trade war.* The ECB meets amid ongoing global volatility and new tariffs. Downside risks have now materialized, reinforcing the call for an April rate cut. With inflation near target and growth weakening due to the trade war, policymakers, including Olli Rehn, argues that easing is needed to keep price stability on track. There have been growing divisions over the timing of the next rate cut; the key points are outlined below. While the March stance leaned toward easing with room to pause, the latest night's tariff announcements have significantly raised the likelihood of a cut in April.

  As mentioned, ECB Governing Council has remained split, but the balance is shifting toward further easing, particularly as new risks emerge from both the U.S. and within Europe. The recent imposition of 20% U.S. tariffs on EU exports—part of President Trump's "Liberation Day" measures—has shaken confidence, weakened business sentiment, and is expected to shave 0.2–0.3 percentage points off eurozone GDP over the next two years. ECB officials broadly agree the tariffs are a drag on growth, but views diverge on their inflationary impact. Dovish members like Panetta argue that deflationary effects—such as weakened demand and possible price competition from redirected Chinese exports—will outweigh any short-term price spikes. Conversely, hawks such as Vujcic warn that deglobalization, higher input costs, and reduced competition could stoke inflation longer term.

  Complicating matters further is Germany's proposed €500 billion fiscal package and the EU's ReArm Europe plan. While these suggest a shift toward more expansionary fiscal policy, their timing and political feasibility remain uncertain. Germany's initiative—currently facing legal and coalition challenges—came too late for inclusion in the ECB's March forecasts. Still, the central bank acknowledged rising fiscal uncertainty as a key risk.

  President Lagarde has so far avoided firm commitments, preferring to wait for clarity on fiscal developments. However, without firm stimulus from Berlin, the ECB is widely expected to cut rates in April and June. Additional cuts in July or September remain possible if growth remains weak and inflation continues to decline. Should the German package be implemented quickly, the ECB may adopt a slower pace, arguing that fiscal support reduces the need for aggressive monetary easing.

  A compromise is taking shape: cut rates in April and June, then pause. This approach would move rates to 2%—a level some officials view as the lower bound for now—while addressing current economic softness. It also allows flexibility if fiscal stimulus disappoints or inflation continues to ease.

  In sum, the ECB's next steps will be shaped by three forces: the evolving fallout from U.S.-EU trade tensions, the fiscal path in Germany and Brussels, and internal divisions over how quickly to ease. While the medium-term outlook remains uncertain, a near-term continuation of the easing cycle appears increasingly likely, especially given the recent strengthening of the EUR, with its likely dis-inflationary impact.

- **ECONOMIC ANALYSIS:** *Eurozone growth forecasts are cut as US tariffs cloud outlook.* Revised GDP figures show it In Q4 2024, seasonally adjusted GDP rose by 0.2% in the euro area and 0.4% in the EU, following 0.4% growth in both regions in Q3, according to Eurostat. Eurozone inflation declined for a second consecutive month in March, falling to 2.2% from 2.3% in February, aligning with economists' expectations and reinforcing the case for an ECB rate cut. While still above the ECB's 2% target, policymakers view the recent uptick since the autumn as temporary. Services inflation — a key concern for the ECB — eased to 3.4% in March, its lowest level in nearly three years, down from 3.7% in February.

  Although the ECB has cautioned that trade tensions and rising defence spending could slow future cuts, it lowered rates last month to 2.5% — its sixth cut since last summer — while noting that policy is "becoming meaningfully less restrictive," a sign of a more cautious approach.

  Economists are lowering eurozone growth projections following President Trump's 20% tariffs on EU exports. The tariffs have dampened trade, business confidence, and investment, raising expectations for an ECB rate cut as early as April. Inflation concerns have faded for now. The new tariffs could reduce eurozone GDP growth by 0.2–0.3 percentage points, with ECB officials warning of broader impacts. Greece's central bank governor, Yannis Stournaras, estimates growth could slow by as much as 0.5–1 percentage points. While full EU retaliation is unlikely, targeted countermeasures—potentially hitting $28 billion in U.S. goods—are under consideration.

  The inflation impact of U.S. tariffs is hard to gauge and will depend heavily on the EU's response. Even if the EU managed to reduce the "reciprocal tariff" to 10%, it would still be subject to a 25% tariff on steel and aluminium and a 25% on car imports. Retaliation could raise prices in Europe, but U.S. tariffs may also lead to excess inventories and low capacity use—conditions that typically cause disinflation as firms cut prices to destock. Meanwhile, other affected exporters, like China, may lower prices to boost sales to Europe, adding further downward pressure. In the long run, a full-scale trade war could prove disinflationary for Europe. Limited countermeasures on steel and aluminum take effect mid-April, but broader actions have yet to be announced.

- **MARKET IMPLICATIONS:** *Eurozone bond yields fell as investors flocked to safe havens amid rising EU-U.S. trade tensions. The EU proposed counter-tariffs to Trump's measures, adding to market uncertainty. German yields were volatile, Italian yields edged lower, and expectations for an ECB rate cut grew.* Since the last meeting on March 6 and as of April 14 the yields on a: *i)* 10y German bund fell by 33 bps to around 2.55% (+18 bps y-t-d); and *ii)* 2y German bund edged down by 50bps to 1.77% (-31 bps y-t-d). In the periphery of the Eurozone, the 10y Italian bonds decreased by 17bps a and trades around 3.75% since the last meeting. The gap between Germany and Italy's 10Y yields rose to 120 bps. *In the currency space,* euro rallies to multi-year high —its highest level since the war in Ukraine began—making one euro equal to $1.14. *In the equity space,* European shares ended lower last week as trade tensions intensified. The STOXX Europe 600 fell 1.92% as trade tensions escalated but trimmed losses after President Trump delayed reciprocal tariffs. Major indexes also declined: Germany's DAX (-1.30%), Italy's FTSE MIB (-1.79%), France's CAC 40 (-2.34%), and the UK's FTSE 100 (-1.13%).

- **APPENDIX (MACRO ASSESSMENT):** *The Eurozone sees slight GDP growth despite stagnation forecasts.* In Q4-2024, according to the final estimate, the eurozone GDP expanded by 0.2% q-o-q (*c:* 0.1%; *p*: 0.4%). On an annual basis, GDP advanced by 1.2% (*c:* 0.9%; *p:* 1.0%), marking the highest growth since early 2023. Among the largest economies in the bloc, German economy contracted by -0.2% q-o-q (*p:* 0.1%). France's GDP shrank by -0.1% q-o-q (*p:* 0.4%), while Italian economy advanced marginally by 0.1% q-o-q (*p:* 0.0%).

  Private sector grew for a third month, marking the strongest—though still modest—expansion since last August. In March, the *HCOB Eurozone Composite* PMI increased to 50.9 (*c:* 50.4; *p*: 50.2). *Services PMI* also increased to 51.0 (*c:* 50.4; *p:* 50.6). *Manufacturing PMI* increased to 48.6 (*c*: 48.7; *p*: 47.6).

  Eurozone unemployment fell. In February, *unemployment rate* edged down to 6.1% (c: 6.2%; *p:* 6.2%). The number of unemployed decreased by 70K to 10.58mn. Amongst the largest Euro Area economies: *i)* the unemployment in Italy edged down to 5.9% (*p:* 6.2%) in February; *ii)* the unemployment rate edged down to 7.3% (*p:* 7.4%) in Q4 in France; and *iii)* in Germany the seasonally adjusted jobless rate rose to 6.3% (*p*: 6.2%) in March. The 'youth unemployment rate' – measuring job-seekers under 25 years old – increased to 14.2% (*c:* 14.1%) in February. Wages and salaries in the EZ rose by 4.1% y-o-y (*p*: 4.3%) in Q4-2024.
  Eurozone inflation falls for second consecutive month. In March, flash estimates showed that: *i) headline inflation* eased off to 2.2% y-o-y (*c:* 2.3%; *p:* 2.3%); and *ii) core inflation* – which excludes food and energy prices – cooled off to 2.4% y-o-y (*c:* 2.5%; *p:* 2.6%). In Germany, annual CPI inflation slowed at 2.2% y-o-y as expected. In France, the inflation rate remained unchanged at 0.8% y-o-y. In Italy prices inflation rose to 2.0% (c: 1.6%; p: 1.6%).