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PREVIEW: ECB To Cut Rates In June, Leaving the Door Open to More Easing, Without Pre-Committing

By

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Executive Summary

- **Expected Decision**: *We expect the ECB to deliver another rate cut in June.* 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.e. its *i)* interest rate on the 'main refinancing operations' to 2.15%; *ii)* interest rate on the 'marginal lending facility' to 2.40%; and the key *iii)* 'deposit facility' to 2.00%.

  The ECB is expected to maintain its data-dependent, meeting-by-meeting approach, reaffirming its three-pronged reaction function. While a July cut remains possible, the ECB is unlikely to pre-commit, while waiting for more clarity on US tariffs and legal outcomes. The market is likely to shift towards pricing a quarterly rate-cut pace, with September and December the more likely dates.

- **Policy Discussion:** *Markets have fully priced in a 25bps ECB rate cut in June, but the outlook beyond remains uncertain.* The ECB is expected to pause after June to assess incoming data, with just a 25% chance priced in for a follow-up cut in July. Markets anticipate a total of roughly 2.35 cuts (about 59bps) by April 2026, with the implied rate falling from 2.17% to around 1.58%. The forecasted terminal deposit rate is 1.75%, with the final cut likely in September—though a July move remains possible if conditions shift.

  Recent data suggests the ECB faces less urgency to act swiftly. Wage growth has slowed, disinflationary forces are building, and the euro's strength alongside lower oil prices is easing price pressures. U.S. trade policy, however, remains a key uncertainty. Even after a May 28 court ruling, some tariffs will likely stay in place, and their disinflationary effect is now widely acknowledged—even by hawkish figures like Austria's Robert Holzmann. A 10% baseline tariff could justify a pause in cuts, but a 50% hike would likely force a more aggressive ECB response. Against this backdrop, the ECB is expected to proceed cautiously, maintaining a dovish tone while avoiding surprises in a volatile global environment.

- **Expected Changes to Economic Forecasts:** *Inflation and growth forecasts are expected to be revised downward, with risks to both still tilted to the downside.* While a strong first quarter may lead to a slight upward adjustment to the 2025 growth outlook, projections for 2026 are likely to be cut due to the impact of U.S. tariffs, with a modest recovery anticipated in 2027. On inflation, easing cost pressures, slower wage growth, and disinflationary forces from lower oil prices and cheaper Chinese imports could prompt downward revisions. Core inflation is expected to follow the same path, with softer projections in the coming years.

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)*	6.2	**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 March 2025; 3. Inflation for April 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 June.* At the Governing Council (GC) meeting on June 5th, 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 2.15%; *ii)* interest rate on the 'marginal lending facility' to 2.40%; and the key *iii)* 'deposit facility' to 2.00%.

  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. Looking ahead, the ECB is expected adopt a cautious, data-dependent approach. While a further cut in July remains possible, the Governing Council is likely to wait for more clarity on US tariff developments and related court rulings before committing. This suggests the ECB may shift to a quarterly pace for rate moves, with September and December now the key meetings to watch for potential further easing. The market has already moved in that direction, in terms of pricing.

  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:** *While markets have fully priced in a June cut, the path beyond remains less certain.* The ECB is expected to pause after the widely anticipated June rate cut, taking time to assess the need for further easing. Markets assign a roughly 25% chance to a July cut, aligning with their view that the ECB will wait for more clarity on trade developments. Additional cuts are expected through the year, totaling around 2.35 cuts (about 59bps) by April 2026. The implied rate is seen falling steadily from 2.17% to around 1.58%, reflecting expectations of continued disinflation, weak growth, and external pressures such as US tariffs and lower oil prices. The forecast for a terminal deposit rate is at 1.75%, expecting the final cut in September—though a July move remains possible if conditions were to warrant such a move.

  ECB policymakers have emphasized stability, aiming to avoid surprises in a volatile global environment. This steady approach contrasts with uncertainty around the Fed, where Chair Jerome Powell faces political pressure from President Trump and conflicting signals on inflation.

  The euro area no longer appears to face a serious inflation problem. Recent data on wage growth, their forecasts, and the disinflationary impact of US tariffs all point to easing price pressures. Additonally, falling oil prices and a stronger euro have helped ease inflationary pressures in the eurozone. As a result, we expect the ECB to maintain a dovish tone, keeping the door open for further rate cuts later this year (with July being a possible but not probable outcome at this stage).

  US trade policy remains a major source of uncertainty. Even after the May 28 court ruling, some tariffs are likely to stay in place and will likely dominate the ECB's June discussions. Notably, even Austria's Robert Holzmann—typically a hawk—acknowledges the disinflationary net impact of tariffs. ECB Executive Board member Piero Cipollone has expanded on this view, while we note dovish shift within the Governing Council.

  Trade tensions with the US introduce asymmetric risks. If only a 10% baseline tariff materializes, the ECB may opt to pause further cuts. But if the US imposes the full 50% tariff, the ECB may be forced to respond more aggressively.

- **EXPECTED CHANGES TO ECONOMIC FORECASTS:** *Inflation and growth forecasts expected to be revised downward, with prevailing risks to both variables remaining skewed to the downside.* The ECB may revise its 2025 GDP forecast up slightly (from 0.9% to 1.0%) following a strong Q1, but projections for 2026 could be lowered due to tariff impacts, with a recovery expected in 2027. Risk assessments on both inflation and growth are likely to remain tilted to the downside in June, consistent with the April policy stance.

On inflation, weakening cost pressures and external disinflationary forces could prompt the ECB to lower its projections. The ECB's March inflation forecasts did not account for the April 2 US tariff announcement and are likely to be revised down. External disinflationary forces—including a potential influx of low-cost Chinese goods and lower oil prices—further weigh on price pressures. A softer economic recovery is also likely to dampen wage growth.

In March, ECB staff forecasts showed inflation at 2.3% in 2025, 1.9% in 2026, and 2.0% in 2027. However, with downside risks across the board, the forecasts could be lowered to 1.9%, 1.5%, and 1.6%, respectively. The same trend applies to core inflation: sharper declines are likely in the following years—1.8% in 2026 and 1.7% in 2027, compared to the ECB's 2.0% and 1.9%.

Negotiated wage growth in the eurozone slowed sharply in Q1 2025 to 2.4% year-over-year, down from 4.1% in Q4 2024—below the 3% level considered consistent with price stability. This marks the most significant price-related data release since April and adds to signs of easing cost pressures even before the full disinflationary impact of US tariffs is felt.

- **ECONOMIC ANALYSIS:** *Eurozone economy showed renewed momentum in early 2025, growing 0.3% in Q1 after a late-2024 slowdown.* The Eurozone economy grew by 0.3% q-o-q in Q1 2025, slightly below the initial 0.4% estimate but marking the fifth consecutive quarter of expansion. Growth was driven by stronger domestic demand, supported by easing inflation, lower borrowing costs, and Germany's move to relax fiscal constraints. Optimism over expected increases in defense spending also helped offset concerns about volatile US trade policies. Still, momentum may slow as new US tariffs begin to weigh on EU exports and uncertainty dampens investment and consumer spending.

Eurozone inflation held at 2.2% in April, just above the ECB's target, as rising services prices offset falling energy costs driven by slumping oil markets amid Trump's tariff moves. While analysts expected a dip to 2.1%, the data is unlikely to shift ECB policy, with inflation still forecast to ease to 2% later this year—helped by a stronger euro. Officials see potential disinflation ahead as trade uncertainty weighs on spending. Meanwhile, eurozone manufacturing continued to contract in April, though at the slowest pace in nearly three years, with concerns growing over Chinese competition.

The eurozone's composite PMI fell to 49.5 in May, signaling a return to stagnation. Worryingly, the decline is led by the services sector—long the region's growth engine—likely due to rising uncertainty from the trade war rather than direct trade impacts. While manufacturing output rose and new orders stabilized, the weak services data adds to growth concerns. Inventory trends suggest a possible turnaround in manufacturing, but overall momentum has slowed after a strong Q1, which was partly driven by front-loaded US exports. Near-term risks remain tilted to the downside.

- **MARKET IMPLICATIONS:** *The cut is anticipated, but Lagarde may surprise during the press conference.* The rate cut is widely expected, so little market reaction should we expected about that. The market will look for clarity regarding next moves, but the ECB is unlikely to pre-commit to a specific date for more action, while keeping the door open to further easing. Clearly during the press conference, President Lagarde may surprise in either direction. *From a dovish side*, she may emphasise that the job is not done, and further easing is likely in the near term (July/September). *From a hawkish side*, she may provide indication that for now the ECB does not see reason for any further action.

To put things into context, *In the bond market,* German bond yields are set for their biggest weekly drop since April, driven by concerns over the long-term economic impact of US trade policy. The 10-year Bund yield is down 5bps, with Thursday's decline reflecting fears of prolonged policy and economic uncertainty.

Meanwhile, the yield spread between Greek and German 10-year bonds hit a five-year low. Despite global bond market volatility, Germany's safe-haven appeal is helping contain long-term borrowing costs in the euro area. Since the last meeting on April 17 and as of May 30 the yields on a: *i)* 10y German bund increased by 5 bps to around 2.51% (+14 bps y-t-d); and *ii)* 2y German bund edged up by 11 bps to 1.78% (-5 bps y-t-d). In the periphery of the Eurozone, the 10y Italian bonds decreased by 16 bps and trades around 3.48% since the last meeting. The gap between Germany and Italy's 10Y yields fell to 98 bps. *In the currency space,* since last meeting in April and as of June 30, EUR/USD fell by 0.2% to 1.135 (+2.8% y-t-d). The euro continued to weaken toward as the U.S. dollar strengthens, following a court ruling against Trump's retaliatory tariffs. *In the equity space,* European stocks rise after US tariff ruling. The Eurostoxx 500 rose by 8.7% since the last meeting in April to 5366,59 as of May 30 (+9.1% y-t-d). European equities rose after President Trump delayed the planned 50% tariffs on EU goods, giving more time for trade talks. Easing inflation in key economies also boosted expectations of an ECB rate cut. The STOXX Europe 600 gained 0.65%, with Germany, Italy, and the UK posting stronger gains, while France saw a modest rise.

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