

ECB Watcher

US tariff policy gives ECB more leeway for further rate cuts

HCOB Economics

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Executive Summary: US tariff policy gives ECB more leeway for further rate cuts (I)

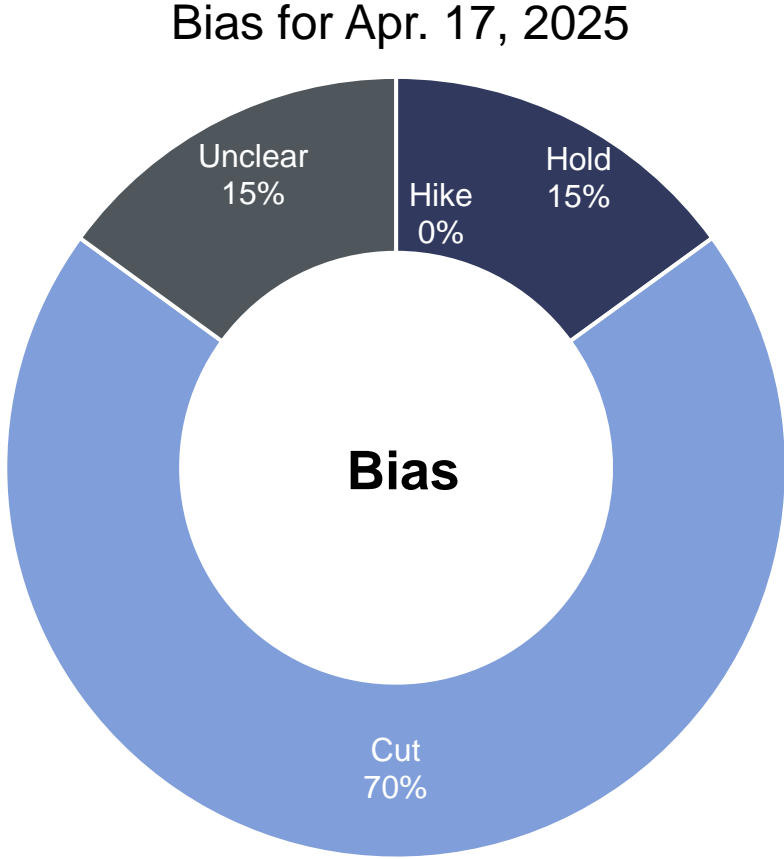
- The next meeting of the ECB Governing Council will take place on April 17, 2025, at which an interest rate cut of 25 basis points is very likely. According to our assessment, around 70% of Council members could be in favour of a further easing of monetary policy in the euro area, while around 15% are likely to be in favour of a pause in cuts. This assessment is based on our analysis of recent speeches and interviews of the ECB Governing Council members.*
- In response to the latest developments, we have adjusted our interest rate forecast downwards and now expect four further rate cuts of 25 basis points each in the upcoming ECB meetings (April, June, July, September). After that, the ECB is likely to leave the rate for the deposit facility rate (currently 2.50%) unchanged at a level of 1.50% until the end of the year. With this assessment, we are more bullish than the financial markets, which have so far only priced in three further interest rate cuts by the end of the year.
- We consider it possible that some of the more hawkish members of the ECB Governing Council (such as Wunsch, Makhoulouf, or Müller) could argue in favour of a pause in rates cuts. Given the multitude of uncertainties – such as the recent announcement on US trade policy, potential inflation risks from fiscal stimulus in Europe and the general geopolitical situation – they could argue that further data should be awaited before monetary policy is tweaked.
- The macroeconomic environment remains challenging for the ECB. The US tariffs – although significantly lower at "only" 10% compared to those announced on Liberation Day – could lead to a global negative demand shock, which will burden exporters in the Eurozone. As China continues to face significant US tariffs, Chinese exporters might increasingly turn to the European market. This trade diversion could lead to increased competition and thus to a disinflationary development in the Eurozone. Therefore, we have lowered our inflation forecast but consider a resurgence of the inflation rate in 2026 quite possible, as tariff policies also have inflationary effects (supply chains need to be reorganized) and structural reasons (demographics, climate change) as well as a more expansive fiscal policy are likely to come into play.

Since the beginning of the so-called "quiet period" on April 10, ECB Governing Council members are no longer allowed to make public statements. However, all statements by ECB Governing Council members cited in this publication date from before the surprising announcement by US President Donald Trump on April 9 to suspend additional US tariffs (except against China) for the next 90 days and only apply the base tariff rate of 10%. This development could naturally change positions within the ECB Governing Council. Additionally, US President Trump's trade policy remains a significant uncertainty factor for the ECB's further decision-making.

Executive Summary: US tariff policy gives ECB more leeway for further rate cuts (II)

- At 2.2% (HICP, YoY), the inflation rate in the euro area is currently only just above the ECB's target of 2%. A too restrictive monetary policy therefore carries the risk of undershooting the 2% target, which is why we expect the ECB to take its foot off the monetary policy brake more significantly in the coming months. The dovish ECB Governing Council members (such as Villeroy, Stournaras, Centeno, or Demarco) have long warned of undershooting the inflation target and are likely to feel reinforced in their stance by recent developments.
- However, there are also risks in the opposite direction: For example, the Dutch central bank president Klaas Knot argued in early April about potential inflationary impulses associated with “the change in fiscal policy in Germany and the rearm programme of the EU where we will have more fiscal spending again.”
- With each further rate cut, the ECB may be getting closer to the neutral interest rate r^* , i.e., the interest rate that neither slows down nor stimulates the economy. The median estimate of the ECB Governing Council members puts r^* at between 2 and 2.75%, while a recent ECB study puts it even lower, in the range of 1.75 to 2.25%. With a policy rate level of 1.50% predicted by us by September, the ECB would thus be clearly below the estimated r^* – in this case, monetary policy would be classified as expansionary.
- However, it is difficult to say how far the ECB is actually still away from r^* , since the neutral interest rate is not directly observable. Its estimation is fraught with considerable uncertainty – and therein lies the real challenge. The Italian Central Bank President Fabio Panetta aptly summed it up in our favorite quote chosen this time: “Think of a GPS with a 5km margin of error. If you're 500km away from your destination it provides clear direction. At 50km it is still useful. But when you're just a few kilometres away, its inaccuracy becomes a liability.”

Around 70% of the ECB Governing Council members (with voting rights) are likely to support a key interest rate cut at the meeting on April 17.

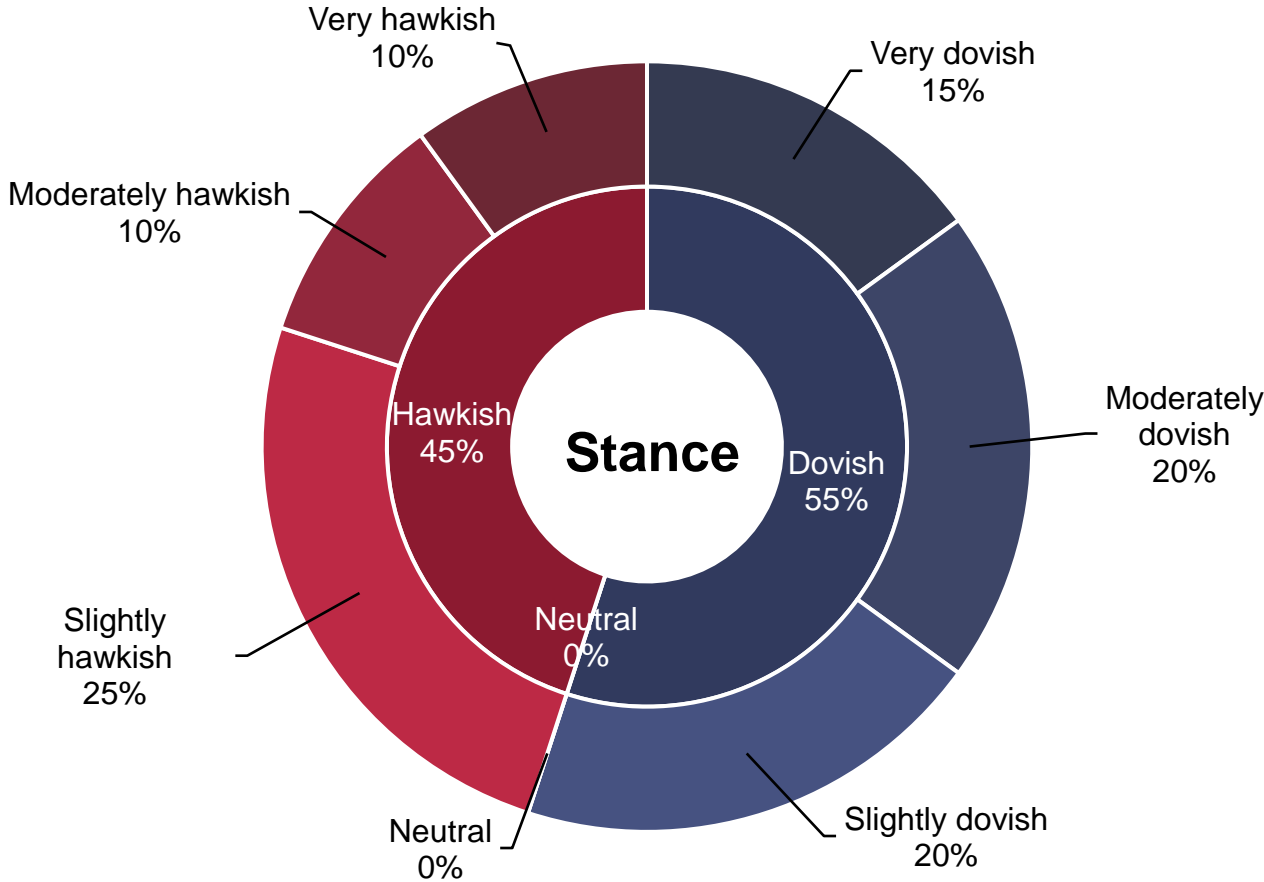


Source: HCOB Economics

Note: We take the following into account when assessing a Governing Council member's bias: Statements since the last Governing Council meeting, previous statements, general stance, group dynamics, and the current economic situation of the eurozone and the respective country that the member represents. Only members with a voting right are considered.

General stance of the ECB Governing Council: At the meeting on April 17, there are marginally more “doves” than “hawks” represented.

Doves and Hawks in the ECB Governing Council



Source: HCOB Economics

Definition of „dovish“: certain tolerance when exceeding the inflation target.

Definition of „hawkish“: very limited tolerance when exceeding the inflation target.

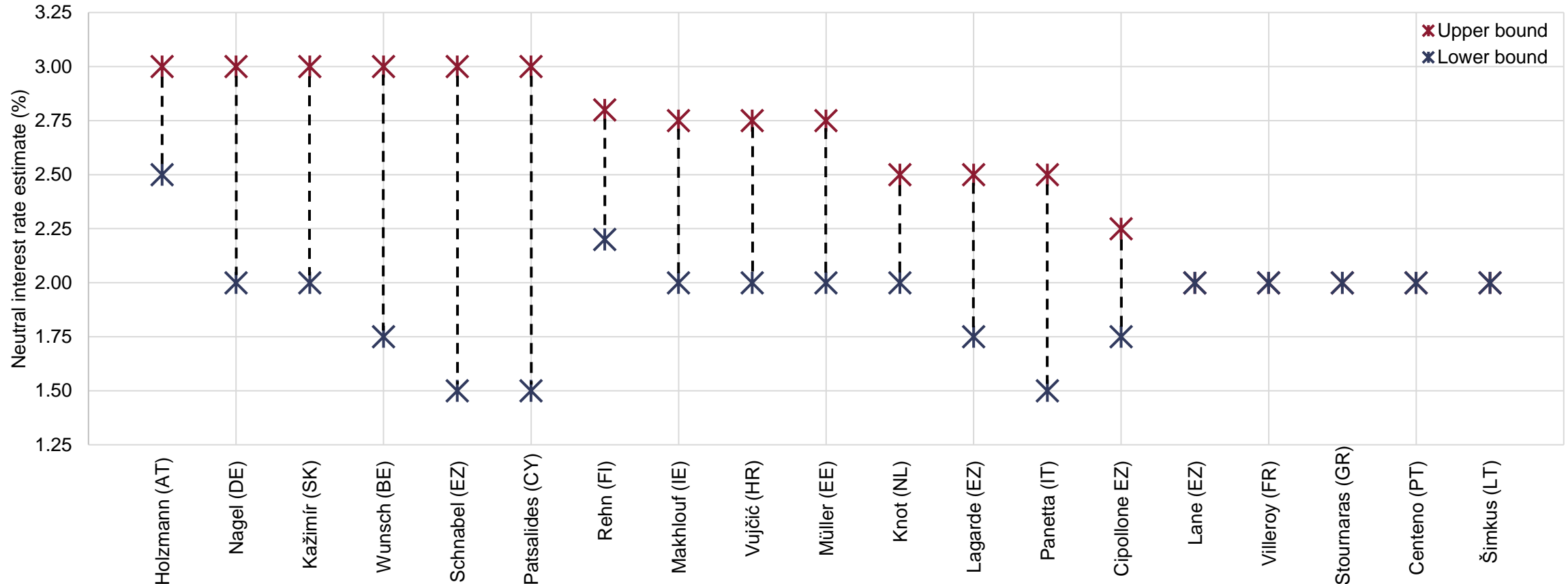
Note: With “stance” we mean a member’s general stance, which is rather static and likely not to change that much from meeting to meeting. The categorization of each ECB Governing Council member is based on an subjective qualitative judgement from HCOB Economics. Only members with a voting right are considered in this figure.

Overview of the ECB Governing Council: Due to the current uncertain macroeconomic environment, some members could argue in favour of a pause in rate cuts.

ECB Council Member	Position	Voting on Apr. 17, 2025	Bias for Apr. 17, 2025	General stance	Inflation (HICP, YoY, latest)	GDP (share of EZ in %)
Christine Lagarde	ECB President	Yes	Cut	Slightly hawkish	2,2	100
Luis de Guindos	ECB Vice-President	Yes	Cut	Moderately dovish	2,2	100
Isabel Schnabel	ECB Board Member	Yes	Cut	Moderately hawkish	2,2	100
Piero Cipollone	ECB Board Member	Yes	Cut	Very dovish	2,2	100
Philip R. Lane	ECB Board Member	Yes	Cut	Slightly dovish	2,2	100
Frank Elderson	ECB Board Member	Yes	Unclear	Slightly hawkish	2,2	100
NCB Official of						
Joachim Nagel	Germany	Yes	Cut	Very hawkish	2,3	26,8
François Villeroy de Galhau	France	Yes	Cut	Moderately dovish	0,9	20,5
Fabio Panetta	Italy	Yes	Cut	Very dovish	2,1	15
José Luis Escrivá	Spain	Yes	Unclear	Slightly dovish	2,2	11,3
Klaas Knot	The Netherlands	No	Unclear	Slightly hawkish	3,4	7,1
Pierre Wunsch	Belgium	Yes	Hold	Very hawkish	3,6	3,9
Gabriel Makhlouf	Ireland	Yes	Hold	Slightly hawkish	1,8	3,5
Robert Holzmann	Austria	No	Hold	Very hawkish	3,1	3
Olli Rehn	Finland	Yes	Cut	Moderately dovish	1,9	1,8
Yannis Stournaras	Greece	Yes	Cut	Very dovish	3,1	1,9
Mário Centeno	Portugal	No	Cut	Very dovish	1,9	1,8
Peter Kažimír	Slovakia	Yes	Cut	Slightly hawkish	4,3	0,8
Boris Vujčić	Croatia	Yes	Cut	Slightly dovish	4,3	0,5
Gaston Reinesch	Luxembourg	No	Unclear	Neutral	1,5	0,5
Vacant	Slovenia	No	Unclear	Neutral	2,2	0,4
Gediminas Šimkus	Lithuania	Yes	Cut	Slightly dovish	3,6	0,4
Christodoulos Patsalides	Cyprus	Yes	Unclear	Moderately dovish	2,1	0,2
Mārtiņš Kazāks	Latvia	Yes	Cut	Moderately hawkish	3,6	0,2
Madis Müller	Estonia	Yes	Hold	Slightly hawkish	4,3	0,2
Alexander Demarco	Malta	No	Cut	Slightly dovish	2	0,1

Neutral interest rate r^* : The median estimate of the ECB Governing Council members for the neutral interest rate r^* is between 2 and 2.75 %.

Range of neutral interest rate (r^*) estimates by ECB Governing Council members

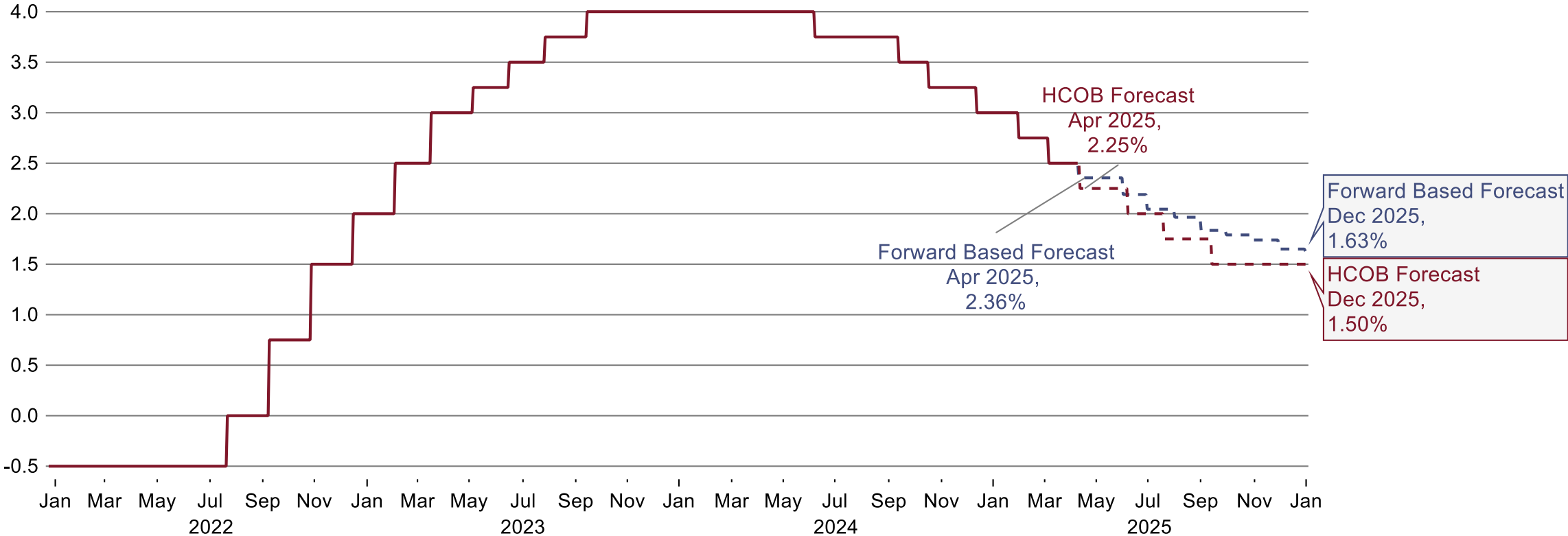


Source: HCOB Economics

The neutral interest rate (r^*) is the key interest rate that has neither an expansionary nor a restrictive effect on the economy. A recent publication by the ECB suggests an estimate of 1.75–2.25% for r^* . The members of the ECB Governing Council have often commented on r^* in recent times and in many cases have given differing estimates.

Interest rate forecast from HCOB Economics: We expect four more interest rate cuts by the end of the year until the deposit facility rate reaches 1.50%.

ECB Deposit Facility Rate Forecast of HCOB Economics and Forecast based on ESTR Futures

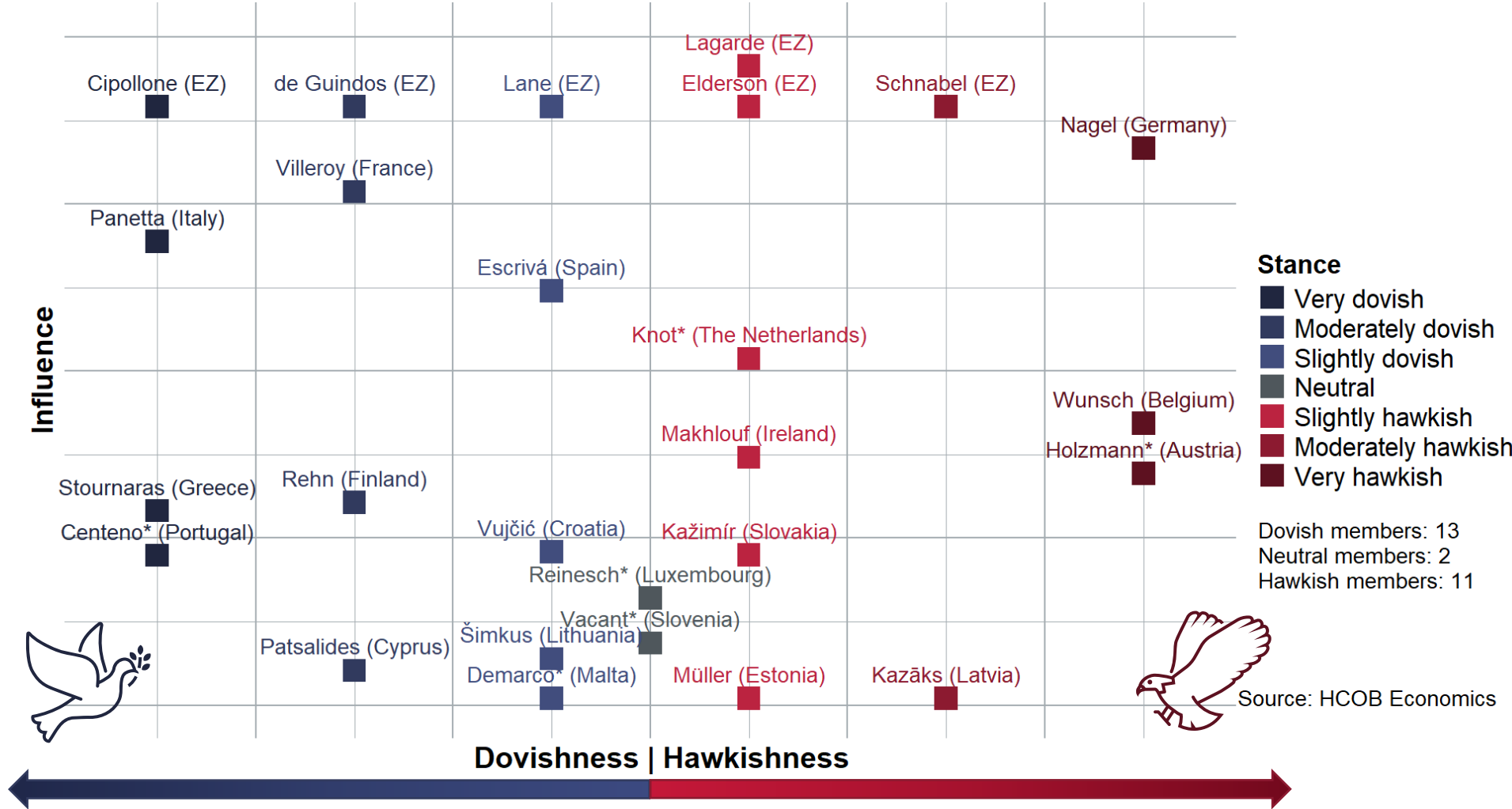


Source: Macrobond, HCOB Economics

Appendix

- Influence and stance
- “One person, one quote”

Influence and stance: In total, we classify 13 members as “dovish”, 11 as “hawkish” and two as “neutral”.



Note 1: Influence gauge is based on share of eurozone GDP. Governing Council members with no voting rights for the next meeting are marked with a superscript star.

Note 2: With “stance” we mean a member’s general stance, which is rather static and likely not to change that much from meeting to meeting. The categorization of each ECB Governing Council member is based on an subjective qualitative judgement from HCOB Economics.

“One person, one quote”: quotes made since the last meeting on March 6, 2025 (I)

- **Christine Lagarde (ECB President):** “[...] we are now very close to target. So, the disinflationary process is well underway. We are not quite at target yet. There is still a bit of work to do, But we are, we are really, I think, you know, quite satisfied with the work that we have done.”
- **Luis de Guindos (ECB Vice-President):** “I am relatively optimistic [about Europe’s chances of navigating trade tensions with the United States].”
- **Isabel Schnabel (ECB Board Member):** “Euro area economy is gradually recovering while disinflation remains on track. [...] qualitatively the new fragmented world would have a negative impact on economic growth and a positive impact on inflation simply due to the fact that supply chains become less efficient.”
- **Piero Cipollone (ECB Board Member):** “Since [our March meeting], not only has this narrative [of inflation converging towards our target at the beginning of 2026] been confirmed, but key issues have arisen that have strengthened the arguments in favour of continuing to lower rates.”
- **Joachim Nagel (NCB Official of Germany):** “ We are already well on track to achieve our inflation target this year. At the upcoming meeting of the ECB Governing Council next week, we will make responsible decisions based on the data and news available, as we have always done.”
- **François Villeroy de Galhau (NCB Official of France):** “[Euro area inflation falling to 2.2% in March] should give us more confidence to cut interest rates again soon.”

“One person, one quote”: quotes made since the last meeting on March 6, 2025 (II)

- **Fabio Panetta (NCB Official of Italy):** “On the one hand, the weakness of the European economy and geopolitical tensions are curbing consumption and investment, holding down inflation. On the other hand, the growing uncertainty – due above all to the sometimes contradictory announcements on US trade policies – requires a prudent approach to policy rate cuts.”
- **José Luis Escrivá (NCB Official of Spain):** “[Tariffs imposed by Donald Trump are] triggering a very significant negative shock on economic activity. [The impact on euro area inflation] will depend, among other factors, on the European response in terms of trade retaliation and, possibly, in terms of a more expansionary fiscal policy.”
- **Klaas Knot (NCB Official of the Netherlands):** “Probably on the short run the most important and dominant shock is a negative demand shock [...]. [However,] it is likely that as time progresses, the impact will become more inflationary rather than deflationary, and definitely if you then also add to the picture the change in fiscal policy in Germany and the rearm programme of the EU where we will have more fiscal spending again.”
- **Pierre Wunsch (NCB Official of Belgium):** “If tariffs have an inflationary impact and a negative impact on growth, it’s going to be a difficult equation, and we might have to consider a pause. I’m not pleading for one, but I think it should be part of the discussion.”
- **Gabriel Makhlouf (NCB Official of Ireland):** “We do need to be cautious about changes to our monetary policy stance where we’re not yet at target, and when quite exceptional events are happening around the world which could have a direct effect on inflation.”

“One person, one quote”: quotes made since the last meeting on March 6, 2025 (III)

- **Robert Holzmann (NCB Official of Austria):** “[I am] always open for good arguments but for the time being, I don’t see a reason for a cut [at the upcoming meeting].”
- **Olli Rehn (NCB Official of Finland):** “I believe the case for further rate cuts at the April meeting has clearly strengthened.”
- **Yannis Stournaras (NCB Official of Greece):** “US tariffs [are] not an obstacle to April rate cut.”
- **Mário Centeno (NCB Official of Portugal):** “The most recent forecasts do not tell us to pause in April. We may need new projections to pause.”
- **Peter Kažimír (NCB Official of Slovakia):** “You know the market’s expectations, but I have to say that I am open to discussing either further interest rate cuts or holding steady.”
- **Boris Vujčić (NCB Official of Croatia):** “[The ECB should] wait for more data to come and then decide in April what to do. [...] Now I see it as a completely open question.”
- **Gediminas Šimkus (NCB Official of Lithuania):** “So, I think 25bp is needed in April, and as June is considered June, let’s see what has changed from April to June, and then make a decision. [...] My thinking is that with the [deposit facility rate] now at 2.5%, policy is currently still more restrictive rather than neutral.”

“One person, one quote”: quotes made since the last meeting on March 6, 2025 (IV)

- **Christodoulos Patsalides (NCB Official of Cyprus):** “Unfortunately, the uncertainty surrounding the course of the global economy not only persists, but is also intensifying, with the emergence of new, complex risks. Under these circumstances, the possibility of a deviation from the baseline scenario becomes more likely.”
- **Mārtiņš Kazāks (NCB Official of Latvia):** “[If the baseline scenario holds, then] we can probably hope for a gradual reduction in rates in the future. [...] The uncertainty at this point is very high and the main source of uncertainty is geopolitics.”
- **Madis Müller (NCB Official of Estonia):** “I really wouldn’t rule out the possibility that perhaps it would be reasonable at least to stop for a moment and evaluate based on new data what the impact of all these factors could be before we make the next rate decisions.”
- **Alexander Demarco (NCB Official of Malta):** “The errors of ECB staff in recent projection exercises were pretty small with respect to inflation. So, it would seem that we are really on track in achieving our goal of 2% inflation. So, if nothing changes, [continuing cutting] is the default.”
- **The following ECB Governing Council members made no relevant public statement since the last Governing Council meeting:**
 - Philip R. Lane (ECB Board Member)
 - Frank Elderson (ECB Board Member)
 - Position currently vacant (NCB Official of Slovenia)
 - Gaston Reinesch (NCB Official of Luxembourg)

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