

ECB cuts again and views its policy to be in a good position

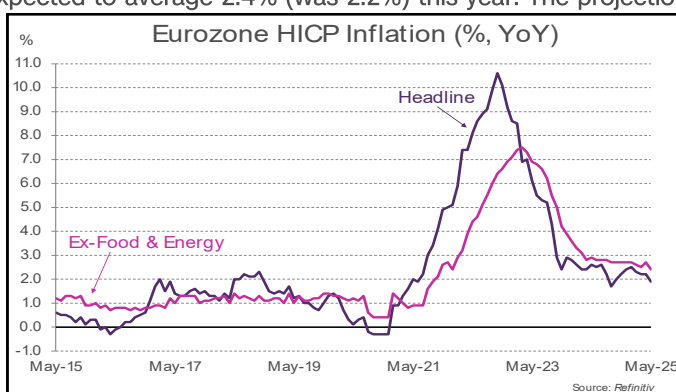
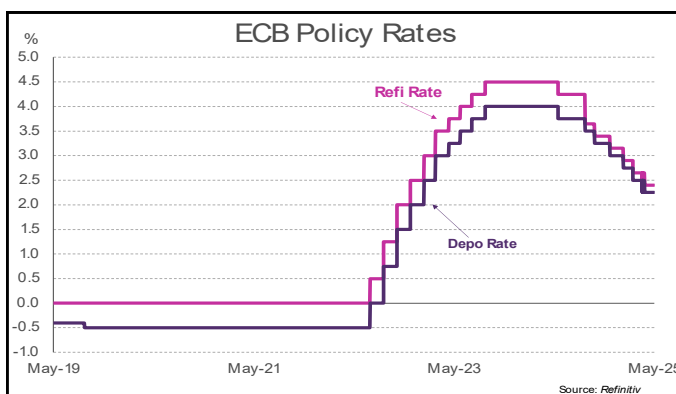
The ECB's Governing Council meeting for June saw the central bank lower interest rates for a fourth consecutive time this year. It once again reduced them by 25bps, with the Deposit rate lowered to 2.00%, while the Re-fi rate was decreased to 2.15%. **This marked the eighth 25bps rate cut since the ECB started its easing cycle in June 2024.** The central bank has now reduced the Deposit rate by a total of 200bps over this period. Today's rate cut was very much in line with market expectations. The decision to cut had a "broad consensus" but was not unanimous, with one Governing Council member dissenting on the rate reduction.

The Governing Council's decision to cut rates today were aided and informed by having the latest set of detailed macro staff forecasts. In terms of the outlook for headline inflation, the June forecasts saw downward revisions. This is mainly due to "lower assumptions for energy prices and a stronger euro". The ECB expects inflation to average 2.0% (was 2.3%) this year and 1.6% (was 1.9%) in 2026. For 2027, it sees inflation averaging 2.0% (no change). The core rate is expected to average 2.4% (was 2.2%) this year. The projection for 2026 was revised marginally lower to 1.9% (was 2.0%). It is anticipating core inflation to average 1.9% during 2027. Overall, these projections suggest that the ECB maintains a benign outlook for inflation and it believes "inflation will settle at around" its 2% medium term target on a sustained basis.

Meanwhile, its latest GDP projections saw only minimal changes. It is continuing to forecast GDP growth of 0.9% for this year. It sees GDP averaging 1.1% in 2026 (was 1.2%) and is pencilling in growth of 1.3% (no change) for 2027. This is a very subdued growth outlook. The ECB also commented today that it views the risk to its economic outlook as remaining tilted to the downside. President Lagarde stated that the outlook is 'more uncertain than usual' against the backdrop of elevated trade tensions and geopolitical risks. **Indeed, given the heightened uncertainty regarding trade policies, the ECB also published alternative scenarios in this regard.** In the "further escalation of trade tensions" scenario, GDP is projected at 0.5%, 0.7% and 1.1% over the period 2025-2027. Inflation is seen averaging 2.0%, 1.5% and 1.8% over the same time horizon. Meanwhile, under a resolution to trade tension scenario, GDP is projected at 1.2%, 1.5% and 1.4%, while inflation is seen at 2.0%, 1.7% and 2.1% during the 2025-2027 horizon.

With today's 25bps rate cut fully priced in by markets, the focus for investors was on what guidance, if any, would be provided by the Governing Council in relation to the prospect of further rate cuts from the ECB over the coming months. In this context, President Lagarde continued to emphasise that the central bank will follow a "data-dependent" and "meeting-by-meeting approach". She did remark in the press conference that the ECB was getting near to the end of its current monetary cycle and also remarked on a number of occasions that the central bank is in a "good position" regarding its current interest rate levels to "face uncertainty" over the coming months. Overall, these comments suggests that another near term rate cut is unlikely and barring a major economic shock, the extent of additional easing may be limited.

In terms of market expectations, futures contracts have firmed by around 5bps in the aftermath of today's policy announcement. Current pricing suggest traders do not now expect another rate cut until December, with the Depo rate ending the year at 1.75%. A terminal level of 1.75% seems a plausible assumption for the market to hold given today's communications from the ECB.



ECB Macroeconomic Forecasts for the Euro Area

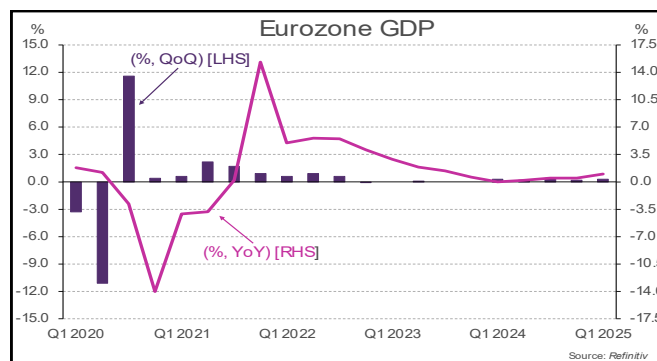
| (%) | 2024 | 2025 | 2026 | 2027 |
|----------|------|------|------|------|
| HICP | 2.4 | 2.0 | 1.6 | 2.0 |
| Real GDP | 0.8 | 0.9 | 1.1 | 1.3 |

Forecasts are mid-point of a range and based on the assumption that Brent crude oil prices will average \$66.7 in 2025, \$62.8 in 2026, and \$64.2 in 2027.

Source ECB, June 2025

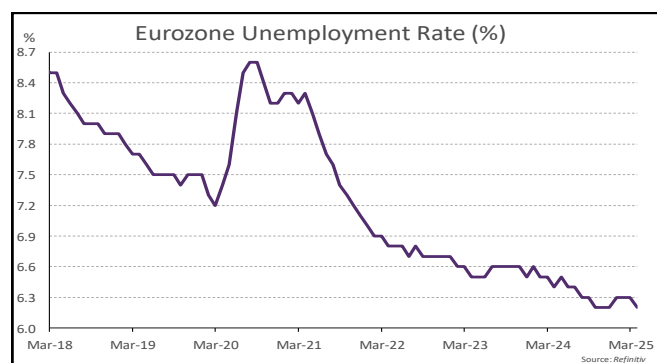
Eurozone growth remains subdued

The Eurozone economy registered modest growth in 2024. Overall, the economy expanded by 0.8% in 2024, up from 0.5% in 2023. Furthermore, growth remained at a modest pace at the start of 2025, with GDP rising by 0.3% q/q in Q1. In year-on-year terms, Eurozone GDP was up by 1.2% in the quarter. Among the largest national economies in the region, growth continued to be uneven. Germany returned to growth, with output rising by 0.4% in Q1, the fastest pace of expansion since Q3 2022. Meantime, the French and Italian economies saw growth of 0.1% q/q and 0.3% q/q, respectively, while Spain continued to register the strongest rate of increase, with GDP up by 0.6% in the opening three months of the year.



Meanwhile, the available survey data for Q2 suggest that economic conditions have deteriorated somewhat. The manufacturing PMI remains firmly in contraction mode, where it has been since July 2022, albeit, it has been trending higher throughout the first five months of the year. Having averaged 47.6 in Q1, it rose to 49.0 in April and to 49.4 in May, consistent with a slower pace of contraction in the sector. The services PMI has declined so far in Q2. Indeed, the May reading of 49.7 marked the first contraction in activity levels in the sector since last November. Furthermore, industrial, services and consumer sentiment have dropped in Q2, amid increased concerns on the economic outlook, largely stemming from US trade policy uncertainty. It should be noted though, that the EC sentiment metrics did move off their lows in May.

Regarding the labour market, conditions remain tight. Employment expanded for a sixteenth successive quarter in Q1, up by 0.3% q/q and by 0.9% y/y. It means that the number of people at work has risen by 78.6m or 5.2% since the end of Q4 2019. At the same time, the unemployment rate remained at its all-time low of 6.2% in April. Despite tight conditions though, wage growth has cooled somewhat. Wages in the Eurozone rose by 2.5% y/y in Q1, down from 4.3% y/y in Q1, and 5.2% y/y a year earlier. Furthermore, the Indeed wage tracker - a more frequent measure of wage pressures - indicates that wages have risen more slowly in recent months. It shows that wages rose by 3.0% y/y on average in the three months to April, down from 3.5% y/y during the same period in 2024.



On the inflation front, a gradual downtrend has re-emerged this year. The headline rate fell to 1.7% last September, its lowest level since April 2021, but re-accelerated to 2.5% in January. However, it declined throughout the remainder of the quarter, falling to 2.2% in March, before staying at that level in April and falling below target to 1.9% in May. Meantime, underlying inflation, which had been proving to be quite sticky, stuck between 2.6-2.9% since April '24, eased to 2.4% in March and further to 2.3% in May. This is partly due to a drop in services inflation, which slowed to 3.2%. Looking ahead, the ECB expects inflation to average 2.0% this year, before falling to 1.6% in 2026, and at 2.0% in 2027. Core inflation is seen as running at 2.4% this year, and at 1.9% in the period 2026-27.

In summary, the Eurozone economy saw a modest uplift in activity last year, and at the start of 2025, but economic growth remains muted. On a positive note, the labour market is strong, with employment rising and unemployment at an all-time low. Secondly, the resumption of the disinflationary trend this year and further rate cuts should support real incomes and consumer spending. At the same time, political uncertainty in France and Germany have subsided for now. Indeed, the announcement of higher fiscal spending in Germany on defence and infrastructure, as well as higher defence spending at the EU level could support growth in the medium-term. **Overall though, the outlook for the Eurozone remains challenging.** The potential for the US to implement significant tariffs on its trading partners will weigh on growth in the Eurozone. US trade policy is already generating significant uncertainty which could harm the Eurozone export sector. Against this backdrop, the ECB sees GDP expanding by 0.9% this year and by 1.1% in 2026.

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