To the point!

Cross-Asset- and Strategy-Research

The ECB celebrates – and for good reason

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Inflation is now firmly under control

For days, I deliberated on what the focus of this week's column should be. Donald Trump's looming "big, beautiful bill," with its massive risks to public finances and what can only be described as a strikingly regressive redistribution of wealth – from the poor to the rich – was a strong contender. The ongoing heatwave and the growing economic toll of Europe's drought also warrant serious analysis. But I fear there will be more opportunities this summer to discuss these issues in detail.

2% inflation target achieved!

Instead, I've chosen a more uplifting topic: the European Central Bank (ECB). The doomsayers predicting that Europe was heading for a prolonged period of runaway inflation following the price shocks of 2022 have been proven wrong. The ECB has managed to pull inflation back to its target. In June, inflation in both the Eurozone and Germany is expected to hit exactly 2%. A perfect landing! In May, it even came in slightly below that level. All of this gives the ECB good reason to celebrate at its annual monetary policy seminar in charming Sintra.

Looking ahead, we expect inflation to remain near the 2% mark throughout the rest of the year – both in Germany and across the Eurozone. Upstream, inflationary pressures are minimal as import, producer, and wholesale prices hardly budge. The ECB has additional cause for relief: wage pressures are easing as well. Its wage growth index stood at 2.5% in the first quarter of 2025, the lowest level since 2021. Public anxiety about inflation is also subsiding (see Fig. 1) with inflation expectations gradually zooming in on the 2% target.

The recent rise of the Euro (see Figure 2) has also helped to rein in inflation by making imports cheaper. While I – like the broader

Inflation moored at 2% again

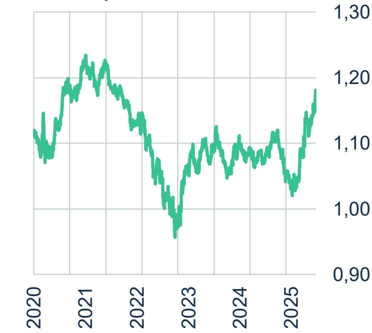
Fig. 1: Relative frequency of Google search „Inflation“ (Germany)

Source: Google Trends, LBBW Research

community of economists – had considered parity between the Euro and the U.S. Dollar plausible before Trump’s reckless policies fully came to light, Europe’s central bankers are now growing increasingly uneasy about the strength of the Euro. Sources in Sintra worried that a Euro exchange rate above $1.20 could pose new challenges. A strong Euro puts pressure on Europe’s export-driven economy, slows growth, and suppresses prices. If the Euro strengthens further, the risk of inflation falling persistently below target would increase. The fact that the ECB is even discussing exchange rates in detail is quite revealing. Normally, the central bank downplays their importance, presenting them as just one among many factors steering monetary policy.

The strong Euro helps—for now

Fig. 2: Exchange rate: Dollar per Euro



Source: ECB, LBBW Research

Overall, the discussions in Portugal support our view that the ECB will likely cut interest rates one final time – probably in September, bringing the deposit rate down to 1.75%.

Reflecting on the past—almost no regrets

This year in Sintra, another item on the agenda was the recently concluded "Strategy Review" of the Eurosystem. This process saw ECB officials and experts from national central banks evaluate how monetary policymaking could be improved further. The resulting insights are presented in voluminous, if not always easily digestible, documents. Ultimately, the ECB seems to hold the view that it got things exactly right. And to a large extent, that’s true. I’m happy to join the chorus of congratulations.

Got everything right? Almost!

That said, a little more self-criticism would have been welcome – particularly regarding the ECB’s expansive bond-buying programs, which, in hindsight, were arguably oversized. Still, a touch of nitpicking might have spoiled the unusually cheerful atmosphere in Sintra – one imagines it paired with bacalhau, vinho verde, and pastéis de nata.

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