VALIDUS

Risk Insight

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ECB in focus: Change on the horizon?

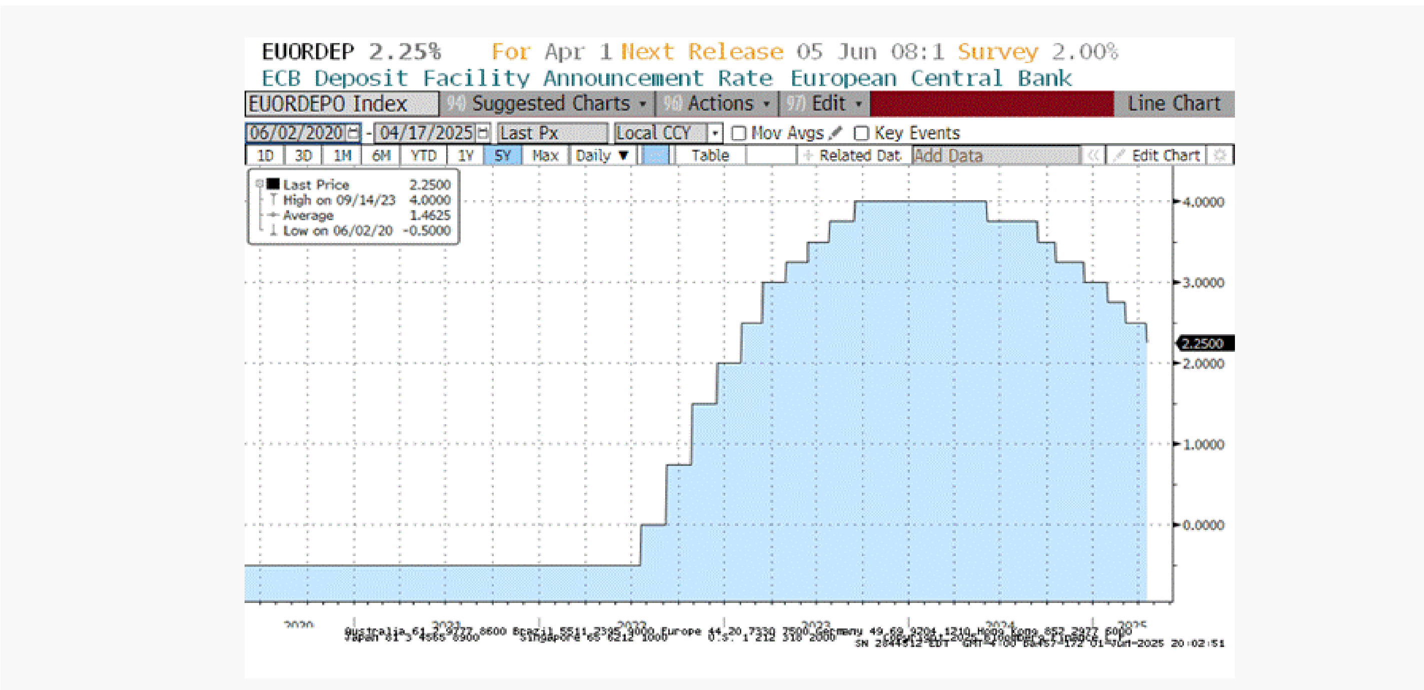
Authored by **Harun Thilak, Head of Global Capital Markets NA**

As the European Central Bank (ECB) prepares for its upcoming monetary policy meeting on June 5, 2025, the outlook for the Euro remains a focal point for investors and policymakers. The interplay of recent macroeconomic data, trade policy uncertainties and the ECB's cautious approach to monetary policy will shape the trajectory of the Euro in the near term. We examine these dynamics, incorporating insights from recent ECB projections, macroeconomic indicators and the evolving EU-US trade landscape.

Cautious approach remains

The ECB has adopted a cautious approach to monetary policy, reflecting heightened uncertainty driven by global trade tensions and a shifting macroeconomic environment. At its April 2025 meeting, the ECB lowered its key interest rates by 25 basis points, bringing the deposit facility rate to 2.25%. This marked the seventh consecutive rate cut since June 2024, reducing rates from a 2023 peak of 4%. The ECB's rationale hinges on a disinflationary trend, with headline inflation declining to 2.2% in March 2025 and core inflation falling to 2.4%, the lowest since early 2022. ECB staff project headline inflation to average 2.3% in 2025, 1.9% in 2026, and 2.0% in 2027, aligning closely with the ECB's 2% target.

Figure 1 : ECB Deposit facility rate



Source: Bloomberg

Trade tensions could see aggressive monetary easing

With regards to forward guidance, while the ECB has maintained a data-dependant approach, its recent decision to remove references to restrictive monetary policy suggests a shift toward a less contractionary stance. Current market expectations, based on OIS pricing, indicate roughly 50 basis points of additional rates cuts for the remainder of 2025. However, sluggish economic growth amidst a backdrop of persistent EU-US trade tensions could alter this trajectory and embolden the ECB into aggressive monetary easing to support domestic growth.

Figure 2 : EU Policy Rate Projection

World Interest Rate Probability

Enable Overrides

Region: Eurozone » | Instrument: Overnight Index Swaps »

Target Rate	2.2500	Pricing Date	06/02/2025
Effective Rate	2.1610	Cur. Imp. O/N Rate	2.170

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
06/05/2025	-0.994	-99.4%	-0.248	1.921	0.250
07/24/2025	-1.247	-25.3%	-0.312	1.858	0.250
09/11/2025	-1.828	-58.1%	-0.457	1.713	0.250
10/30/2025	-1.990	-16.2%	-0.498	1.672	0.250
12/18/2025	-2.246	-25.6%	-0.562	1.608	0.250

Source: Bloomberg

Impending economic slowdown

Recent data paints a mixed picture for the Eurozone. Real GDP is projected to grow at around 1% over the next two years, revised downward from December 2024 forecasts due to weaker exports and investment amid trade uncertainties. The Eurozone economy showed resilience in Q1 2025, driven by robust government consumption and private consumption fueled by rising real incomes. However, recent survey indicators suggest an impending slowdown, with manufacturing contracting and services growth decelerating especially if EU-US trade tensions continue to linger for the remainder of 2025 and impact export driven economies in the EU such as Germany.

Trade tensions ahead of inaugural meeting

Trade talks between the European Union and the US are at a delicate point. While many tariffs were paused for 90 days, ongoing volatility has already tightened financial conditions and dampened business confidence. Tensions resurfaced recently when the US administration threatened to impose 50% tariffs on EU imports as of June 1, only to move the deadline back to July 9 after a productive phone call with the European Commission. The EU has said it's willing to negotiate with the White House but will retaliate if a satisfactory solution can't be found.

Amidst this backdrop, recently elected German Chancellor Friedrich Merz will meet with the US President at the White House this week for the first time. The meeting presents a crucial opportunity for Merz to discuss key issues such as tensions pertaining to Germany and EU's persistent trade surplus with the US and hopefully soften the stance on both sides of the Atlantic.

Euro's strong performance at risk

The EUR has been one of the strongest performing currencies in 2025 and has risen by almost 11% YTD vs the USD. This strength stems mainly from capital inflows into the bloc on the back of expected fiscal policy expansion and increased government spending while trade policy uncertainties have so far weighed on the USD. A stronger EUR is a challenge for the export-driven economies in the EU especially amidst a backdrop of heightened volatility from persistent trade uncertainties which affect EU business outlook and confidence. While current macroeconomic data shows resilience in consumption and labor markets, growth projections remain modest, clouded by export and investment weaknesses.

The Euro's recent strength therefore faces risks from potential trade disruptions, sluggish growth and a subsequent aggressive accommodative policy from the ECB to support the domestic economy.

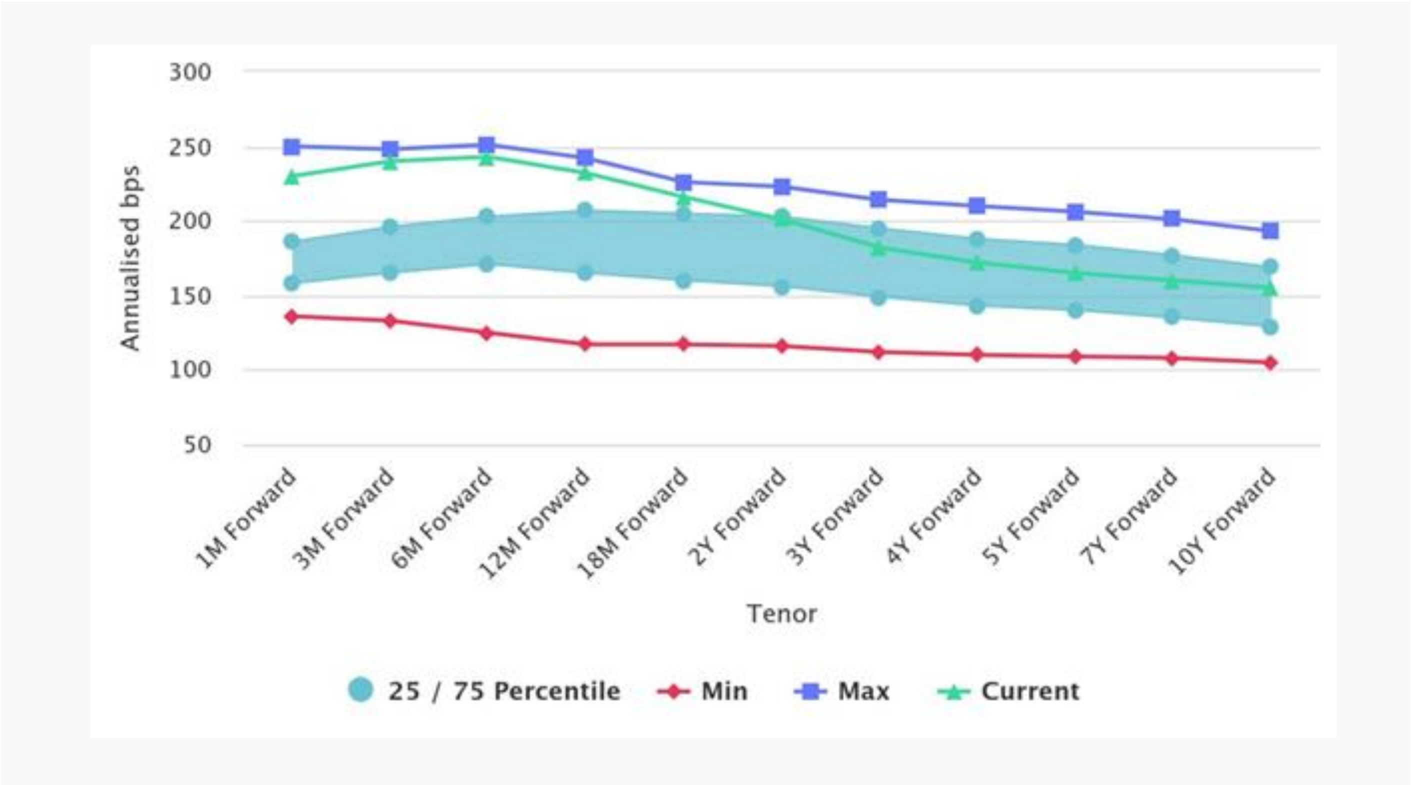
Figure 3 : EURUSD YTD Chart

Source: Bloomberg

Attractive hedge against future weakness

USD based investors can hedge for EUR weakness via FX forwards with FX forwards carry at extremely attractive levels.

Figure 4 : EURUSD FX Forwards Carry (in annualized bps)



Source: Bloomberg, Validus

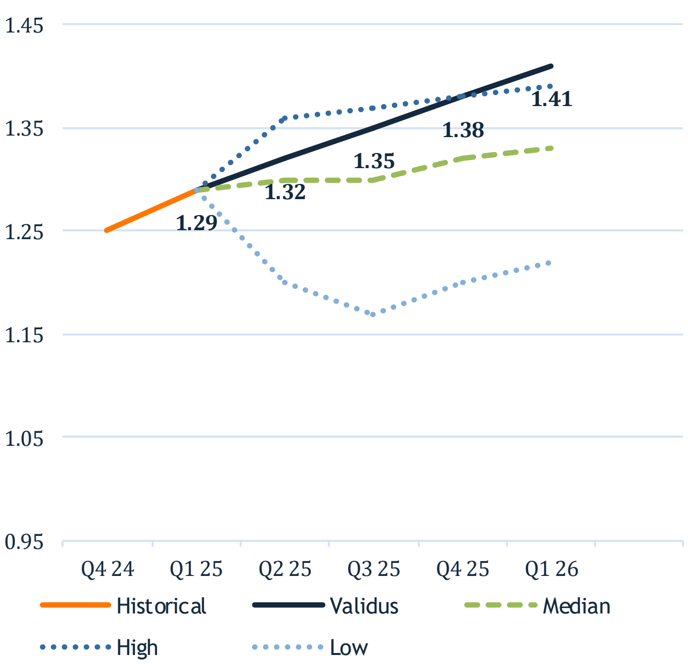
GBP USD

GBPUSD finished the week up +0.44%. In the US, initial jobless claims rose to 240k (for the week ending May 24), above forecasts of 230k. ADP data later then came in at +37k, far under forecasts of +114k payrolls. That raised concerns that the labour market may be beginning to soften off the back of US tariff policy. Traders added an additional 10bps worth of Fed cuts by December, with futures now implying -56bps of cuts for the rest of 2025. That move was bolstered by a weak ISM services print, which fell into contractionary territory at 49.9 (vs 52.0 forecast).

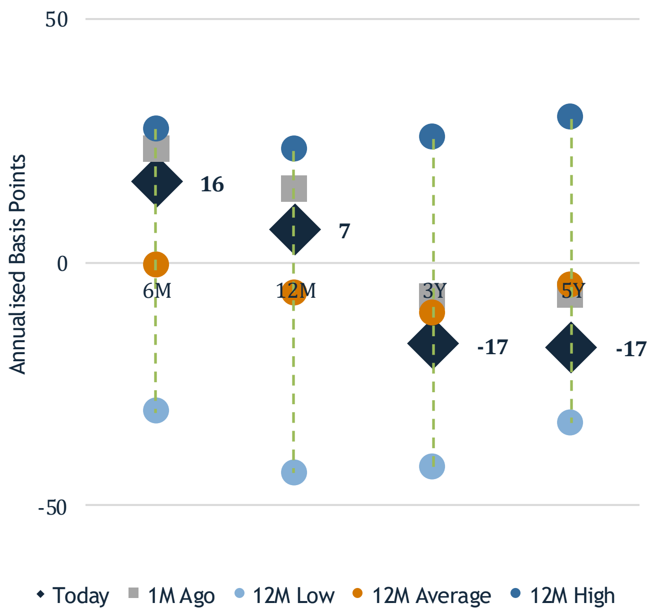
In the UK, house prices rose more than expected at +0.5% MoM (vs no expected change), and S&P services rose slightly to 50.9 (vs 50.2 expected). Manufacturing PMIs also beat expectations (46.4 vs 45.1) but remained lacklustre overall.

This week will see markets focused on NFPs and unemployment data out of the US. Tariff developments (and UK exemptions) will also remain in focus.

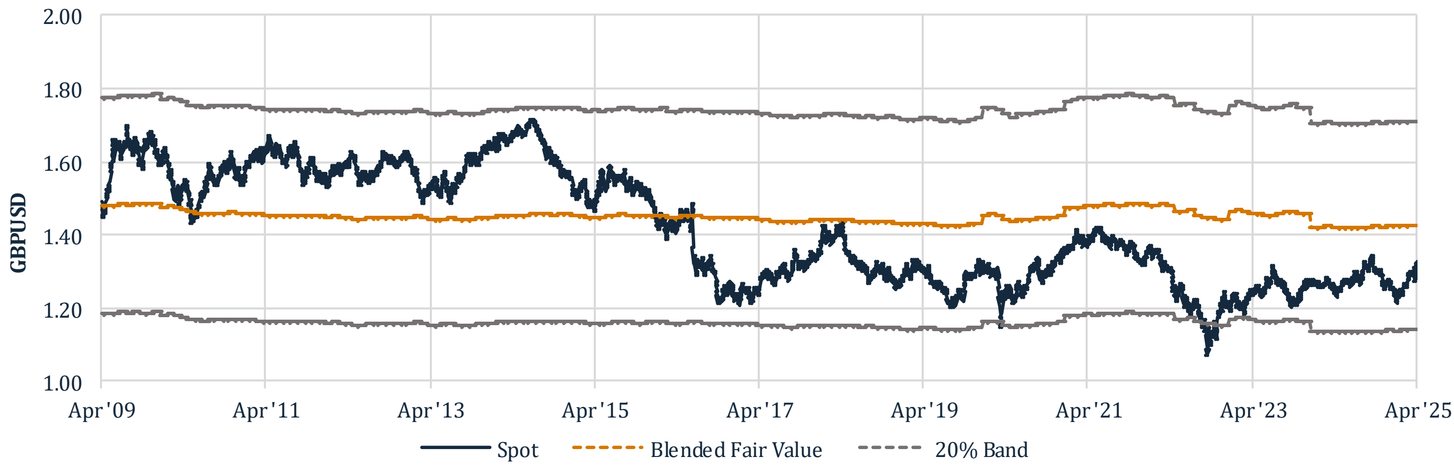
FX Forecasts (Updated 25 April 2025)



Hedging Cost/Pickup* (Impact to sell GBP Forward)



PPP Valuation



According to Purchasing Power Parity, GBPUSD is currently **-5.3% undervalued**.

(To determine whether a currency pair is over- or undervalued, we employ a proprietary valuation methodology incorporating CPI, PPI and other metrics)

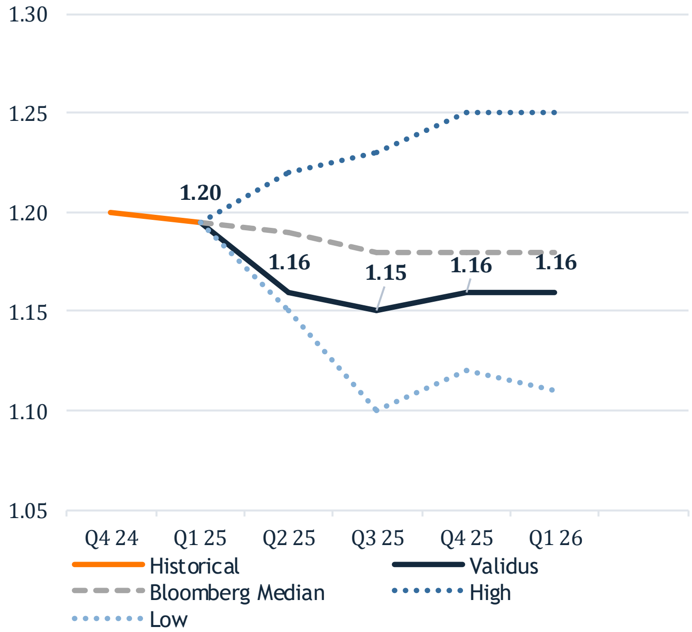
GBP EUR

GBPEUR ended the week down -0.34%. In the UK, house prices rose more than expected at +0.5% (vs no expected growth), while mortgage approvals declined to 60.5k. UK services PMI came out at 50.9, above forecasts of 50.2. Manufacturing PMIs were also above forecasts (46.4 vs 45.1), but remained in contractionary territory. In Europe, inflationary pressures appear to be easing. German CPI remained flat at +2.1% (YoY), and Swedish core inflation fell to a 5-month low of +2.50%.

Eurozone manufacturing PMIs remain in contractionary territory (49.4), with Germany in particular falling slightly to 48.3 (just below forecasts of 48.8). Easing inflation and concerns over US tariff impacts on growth saw the ECB cut rates by 25bps (as widely expected)

This week will see the release of German industrial production data, as well as EU GDP figures.

FX Forecasts (Updated 25 April 2025)



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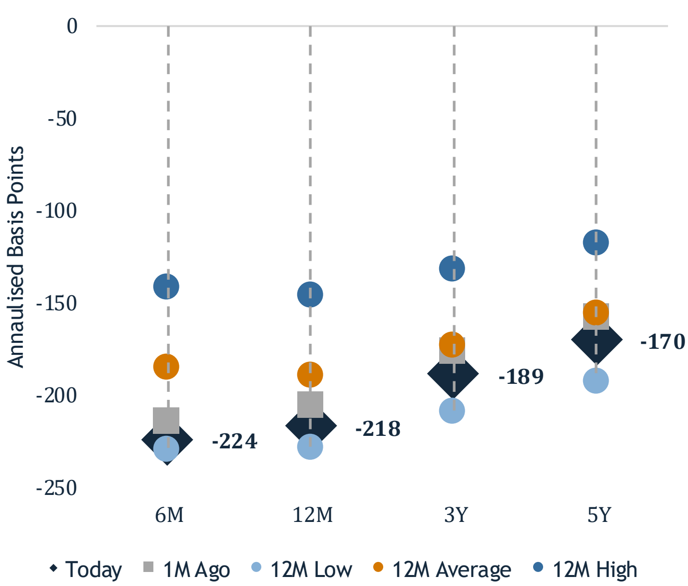
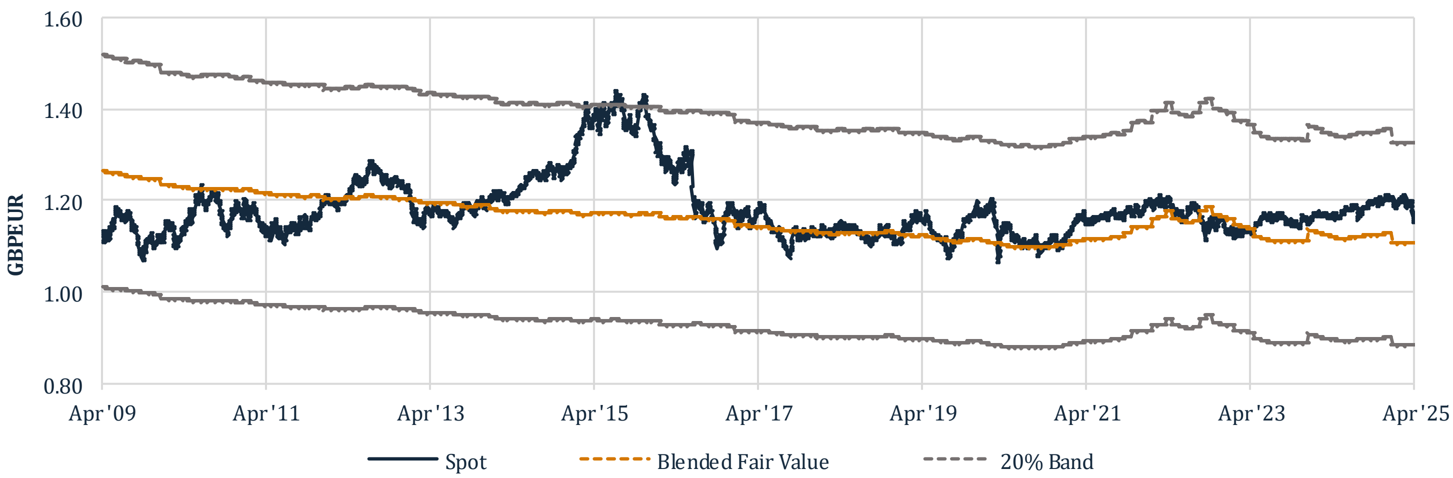


PPP Valuation



According to Purchasing Power Parity, GBPEUR is currently +**2.0% overvalued**.

(To determine whether a currency pair is over- or undervalued, we employ a proprietary valuation methodology incorporating CPI, PPI and other metrics)

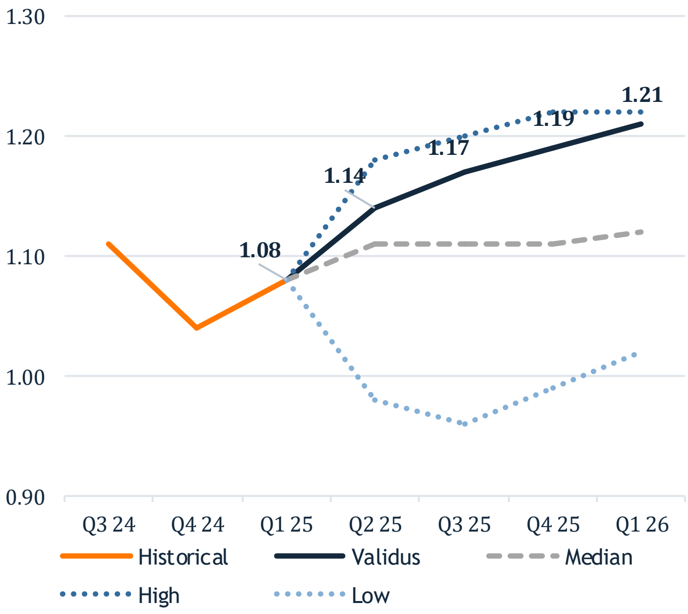
EUR USD

EURUSD finished the week up +0.79%. In the US, softer labour data raised concerns that tariff impacts are beginning to filter through. Initial jobless claims rose to 240k (vs 230k expected), while ADP data showed private payrolls growing by 37k. That was well below forecasts of +114k and the smallest rise in two-years. The ISM services index also showed signs of slowing, slipping just into contractionary territory at 49.9 (vs 52.0 expected). In Europe, price pressures are easing, with German inflation staying flat at +2.1% YoY, while flash Eurozone price estimates (HICP) fell to +1.9%.

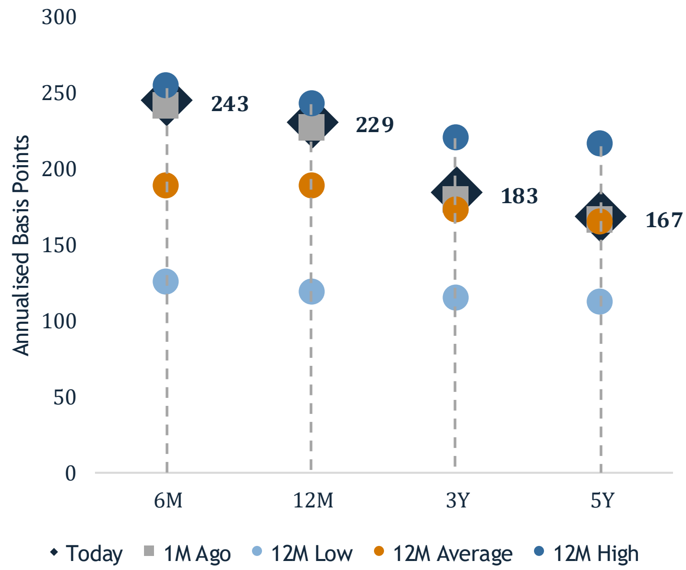
The ECB cut rates by 25bps down to +2.00%, in a move that was widely anticipated by markets.

German industrial production figures are due later in the week. In the US, labour data by way of NFPs and unemployment will be watched closely.

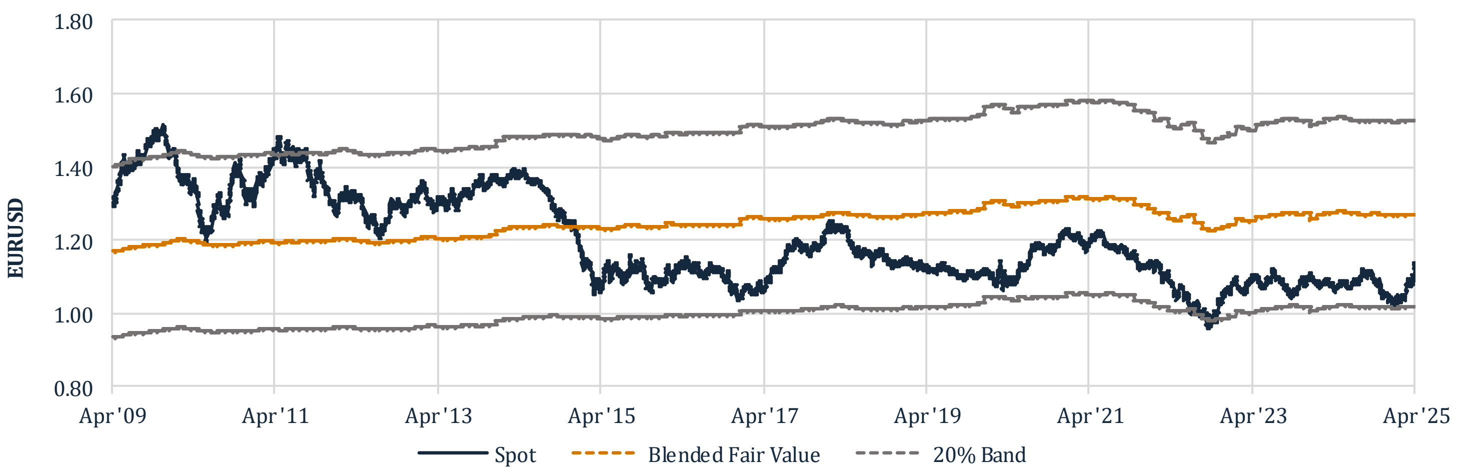
FX Forecasts (Updated 25 April 2025)



Hedging Cost/Pickup (Impact to sell EUR Forward)



PPP Valuation



According to Purchasing Power Parity, EURUSD is currently **11.0% undervalued**.

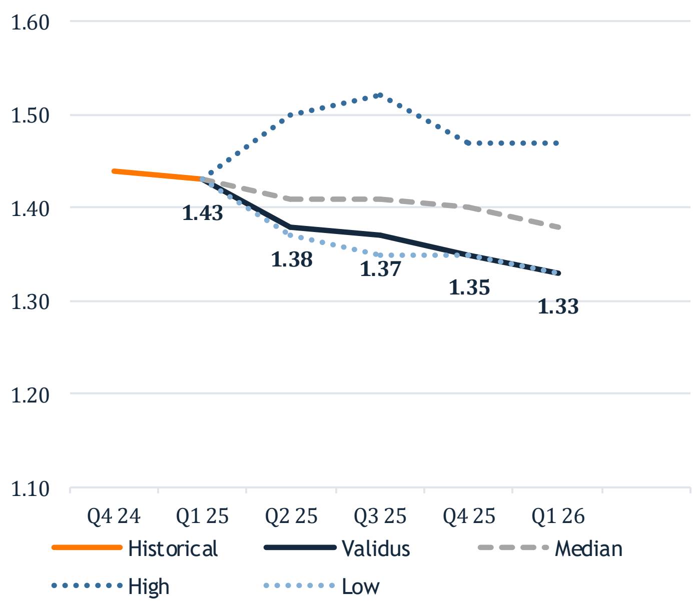
(To determine whether a currency pair is over- or undervalued, we employ a proprietary valuation methodology incorporating CPI, PPI and other metrics)

USD CAD

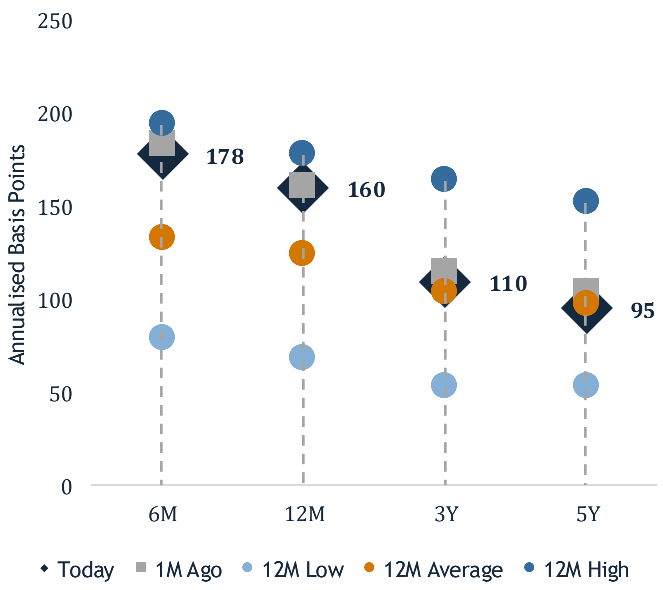
USDCAD finished the week down -1.11%. US labour data turned weaker this week, with initial jobless claims rising above forecasts to 240k (vs 230k expected), while ADP data showed private payrolls growing by just +37k. That was well below forecasts of +114k, and the smallest increase in two years. The ISM services index also slipped to 49.9 this week, below forecasts of 52.0 . This follows from weak Q1 GDP figures from last month, where a recent revision showed a slowing pace of consumer consumption. In contrast, Canadian GDP rose by +2.2%, beating forecasts of +1.7%. However, the increase was largely due to downward revisions of previous data rather than robust growth. The BoC ultimately left rates unchanged this week at +2.75%. They highlighted ongoing uncertainty over US trade policy and hinted at cuts later this year.

This week markets will be focused largely on labour data, both US and Candian data due (including US NFP data).

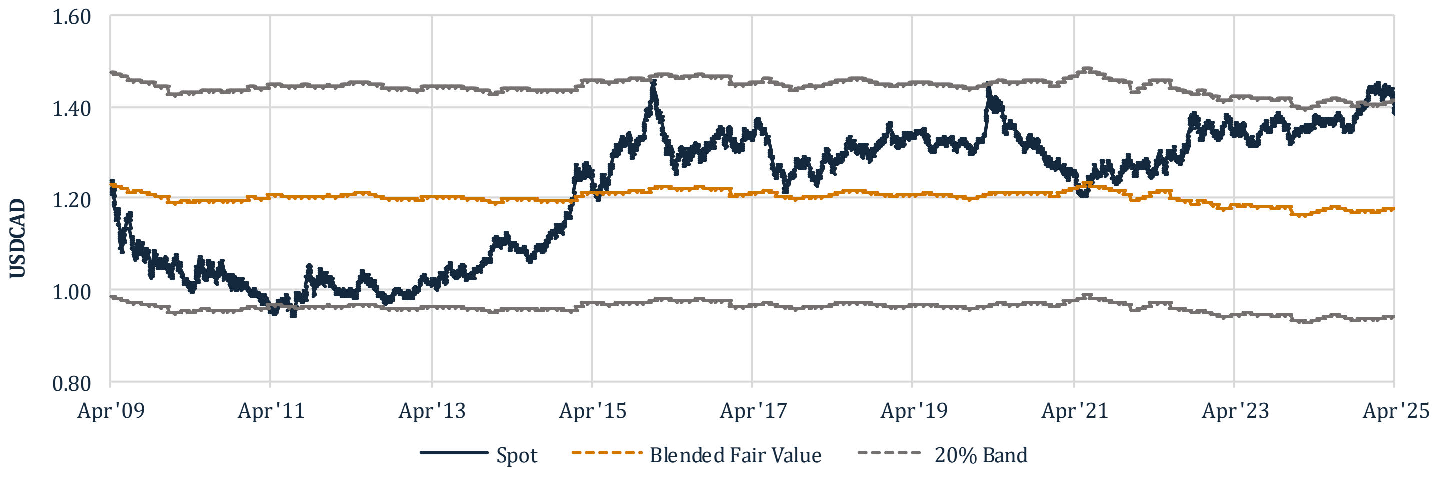
FX Forecasts (Updated 25 April 2025)



Hedging Cost/Pickup (Impact to sell CAD Forward)



PPP Valuation



According to Purchasing Power Parity, USDCAD is currently **17.5% overvalued**.

(To determine whether a currency pair is over- or undervalued, we employ a proprietary valuation methodology incorporating CPI, PPI and other metrics)

Economic Data & Market Indicators

Economic Matrix

	GDP	CPI	Unem-ployment	Industrial Production	Retail Sales	Current Account % GDP	Budget Balance % GDP	10 Year Yield
USD	-0.20%	2.30%	4.20%	1.49%	5.20%	-3.81%	-6.98%	4.34%
EUR	1.20%	1.90%	6.20%	3.60%	1.50%	2.81%	-3.09%	2.49%
GBP	1.30%	3.50%	4.50%	-0.70%	1.30%	-2.66%	-5.13%	4.58%
CAD	2.22%	1.70%	6.90%	1.96%	5.60%	-0.45%	-0.03%	3.24%

Central Bank Bias

	Current Rate	Last Change	Date of Change	Next Meeting	Likely Outcome
USD	4.50%	-0.25%	19 Dec 24	18 June	Hold (99%)
EUR	2.00%	-0.25%	5 June 25	24 July	Cut (55%)
GBP	4.25%	- 0.25%	8 May 25	19 June	Hold (96%)
CAD	2.75%	-0.25%	12 Mar 25	30 July	Hold (54%)

Economic Calendar

EUR	German Industrial Production	Friday, June 06
EUR	GDP (QoQ, YoY)	Friday, June 06
USD	Nonfarm Payrolls	Friday, June 06
USD	Unemployment Rate	Friday, June 06
CAD	Unemployment Rate	Friday, June 06
USD	Wholesale Inventories (MoM)	Monday, June 09
GBP	Average Weekly Earnings	Tuesday, June 10
GBP	Jobless Claims Change	Tuesday, June 10