The eurozone remains mired in sluggish growth

Recent sentiment data suggests continuing growth in the third quarter, but with difficult budget consolidations in the spotlight, growth is likely to remain subdued. Inflation is still expected to fall below 2% before year-end. As the ECB is likely to see this as a temporary undershoot, we expect it to keep interest rates stable over the next year

Sluggish growth and a brief inflation dip in the eurozone seem unlikely to justify further ECB rate cuts

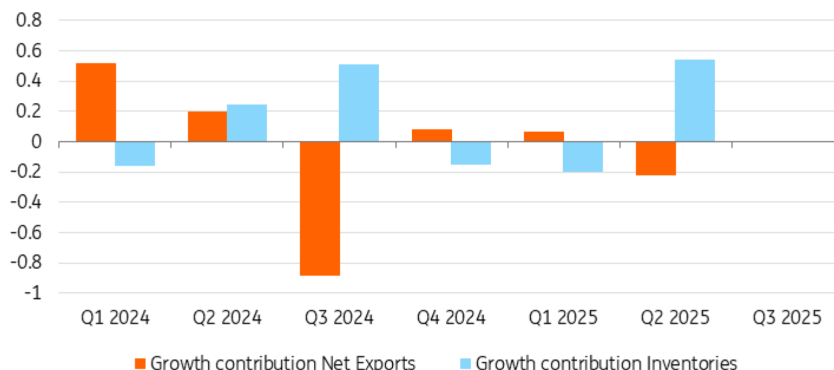
Subdued growth continues

Following a strong first quarter of the year, partially driven by a temporary surge in exports to the US, the eurozone maintained positive momentum in the second quarter, even with net exports detracting 0.2 percentage points from quarterly GDP growth. While this headline figure appears encouraging, a closer look reveals underlying fragility: inventory accumulation contributed 0.5 percentage points, underscoring weak domestic demand. Consumption edged up by just 0.1%, and investment contracted sharply by 1.8%.

Sentiment indicators for the third quarter suggest continued growth, albeit without signs of acceleration. The European Commission's August survey revealed a deterioration in export order books, although the overall level of orders improved. Unemployment remains at a historic low, yet consumer confidence is subdued. Households anticipate a worsening of their financial situation

over the next year, and the 0.5% drop in retail sales in July reflects ongoing consumer caution.

Inventories were an important growth driver in the second quarter



Source: LSEG Datastream

Trade deal remains a headwind

The recent trade agreement with the US presents a mixed picture. On the one hand, newly imposed tariffs are expected to dampen exports, subtracting an estimated 0.25 percentage points from growth over the next 12 to 24 months. On the other hand, the deal provides companies with greater clarity, potentially unlocking investment decisions. That said, this positive effect should not be overstated, as the US administration continues to revise its interpretation of tariff rules constantly, with more product categories now subject to the 50% tariff bracket.

Fiscal policy hardly a boost

Fiscal policy will play a divergent role across member states. In France, fiscal restraint will be necessary to contain budget deficits, likely weighing on consumption. Conversely, Germany is set to implement more stimulative policies in 2026, which may offset tightening elsewhere. However, we do not expect a broadly expansionary fiscal stance across the eurozone, as governments are already retreating from previous commitments to significantly boost defence spending.

Overall, we forecast eurozone GDP growth of 1.3% in 2025, largely attributable to the strong first quarter. Growth is expected to gradually pick up in 2026, resulting in a full-year expansion of 1.2%.

ECB has reached the end of the easing cycle

The latest inflation developments were disappointing, as the August HICP headline inflation rose to 2.1%, while core inflation held steady at 2.3%. That said, lower energy prices are expected to exert downward pressure on headline inflation, likely pushing it below 2% from 4Q 2025 to mid-2026. Nevertheless, the ECB is likely to view this as a temporary undershoot. Longer-term inflation risks remain tilted to the upside, especially as supply constraints may re-emerge in the coming years.

As a result, we expect the ECB to maintain its key interest rate at 2% over the coming year. A faltering recovery or a broader financial crisis –potentially triggered by political instability in France – could still prompt rate cuts, but this is not our base case.

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