Macro Outlook

IMMACULATE, MAYBE

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Incoming macro data suggest the global economy may experience a period of immaculate expansion characterised by solid economic activity and modest inflationary pressures.

Risks surrounding the growth-inflation trade-off, however, differ among regions:

1) The US economy faces the most prominent overheating risk. Growth could continue to surprise to the upside for cyclical and/or exogenous reasons. Should this lead to an increase in labour demand, wage pressures could accelerate amid a "small" labor market heavily constrained on the supply side by President Trump's immigration policies. Against this backdrop, any AI productivity boom is unlikely to be sufficiently strong or rapid to rein in near-term labour costs and inflationary pressures.

2) Overheating risks are less acute in the EA, for several reasons. Firstly, the labour market balance is skewed towards excess supply, as demand continues to weaken while supply is on the rise. Secondly, while aggregate fiscal impulse is positive this year, defense measures account for almost two-thirds of the projected reduction in the cyclically adjusted primary balance, suggesting that neither near-term nor medium-term inflationary risks appear significant over the forecast horizon.

3) China continues to be in a different league. As growth remains driven essentially by external demand, inflation risks are limited and, in the absence of a substantial switch in government priorities away from R&D and toward consumer spending, risks remain tilted to the downside.

Against this backdrop our monetary policy baseline is unchanged. We continue to expect both the Fed and the ECB to ease policy this year for disinflationary reasons. We remain of the view that the Fed will cut rates three times (with risks skewed towards fewer cuts) and the ECB once. Finally, we maintain our forecasts that the PBoC will deliver around 40bps of rate cuts (OMO 7-day reverse repo-rate) and possibly one 50bp RRR cut.

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GROWTH & INFLATION

US – Americans dream on

The US data flow continues to prove resilient. Our above-consensus baseline for real GDP growth in 2026 remains unchanged. We continue to expect US real GDP growth of 2.7% in 2026 (vs a 2.1% consensus). Meanwhile, we expect inflation to converge towards target by Q4 this year. The latest inflation data indicate that the pass-through from tariffs remains limited. Moreover, we continue to believe that services inflation is following a soft underlying trend. Risks, however, are pro-cyclical in both areas. A tariff ruling and/or potential policy actions by the Trump administration could put further upside pressure on both economic activity and inflation.

The data remains resilient. Although we continue to expect growth to moderate in Q4 (mainly due to a 1.1pp drag on government spending caused by the shutdown and a prolonged slowdown in residential investment) after an extraordinary gain of 4.3% q/q SAAR in Q3, incoming data are in line with our estimate for real GDP growth to print at a solid 2.1% q/q SAAR in Q4.

The consumer remains in the driver's seat. The November retail sales report showed solid and resilient growth, with monthly headline retail sales increased by 0.6% and core retail sales rising by 0.4% in both nominal and real terms. Although sales data for December came in softer than expected, we note that the seasonal factor was particularly negative in punishing the print in SA terms. Other spending indicators have also been positive, with real PCE spending increasing by 0.3% on a monthly basis and by 3.0% on a six-month annualised average basis in November. Moreover, the momentum in credit card spending data remains supportive. Finally, big tax refunds at the start of the year will be an added boost to consumer spending.

CAPEX spending also remains solid. New orders for durable goods increased in November, exceeding expectations and largely reflecting an increase in commercial aircraft orders. Moreover, October growth was revised upwards (+0.1pp to -2.1%). Durable goods orders ex-transportation (+0.5%), core capital goods orders (+0.7%) and core capital goods shipments (+0.4%) all came in above consensus expectations.

The new year has started on a positive note. Although the economic calendar is still affected by the backlog of hard data due to the Government shutdown, the most timely soft data confirm that domestic demand remains broadly resilient.

The ISM manufacturing index for January came in higher than expected at 52.6 from 47.9 in December, entering expansionary territory for the first time in 12 months. The new orders index rose to 57.1 from 47.0 in December. Other demand-side components also surprised to the upside, with new export orders and the order backlog both increasing. Customer inventories declined at a faster pace in January, typically signalling stronger demand in the months ahead. In response to firmer demand, the production index also increased. In addition, the employment index rose, although it remains in contractionary territory. Finally, price increases continued to moderate. This component surged following tariffs, but the impulse to goods prices now appears to be slowing. Although commentary in the report tempers the optimism, as firms remain hesitant to increase headcount amid trade policy uncertainty, we believe January may represent an early sign that momentum in the manufacturing sector is beginning to improve. Other manufacturing sentiment indicators for January (mainly Fed survey data) confirm the outlook outlined by ISM data.

The ISM services index for January came in slightly higher than expected at 53.8, unchanged from December. After a strong spike in December, demand moderately normalised in January, remaining in expansionary territory: the new-orders index eased to 53.1 from 56.5 prior (the strongest print in more than two years). The employment sub-index declined close to neutral territory. Despite softer demand and slower growth in headcount, producers ramped up output: the output index rose to 57.4 from 55.2. Moreover, anecdotal evidence was broadly positive. Comments from survey respondents were mixed but mostly constructive, reflecting expected strength in activity driven by AI-related data-centre investment, expansion of the electricity grid, resilient consumer demand, and lower tariff-related uncertainty compared with last year.

Consumer sentiment data were mixed but not concerning. The Conference Board's consumer confidence index unexpectedly fell by 9.7 points in January to 84.5, below December's upwardly revised 94.2. However, we believe that the drop was distorted by internal political disputes. That came amid elevated geopolitical tensions, including President Donald Trump's pressure for concessions on Greenland ahead of the Davos conference. We note that the main driver of the confidence deceleration has come at the expense of the Democrats, while Republican sentiment remains stable. To alleviate doubts, the timeliest survey from the University of Michigan reported an increase in the consumer sentiment index by 0.9pt to 57.3 in the February preliminary report, hitting the highest level since August (58.2).

Against this backdrop, our above-consensus baseline for real GDP growth in 2026 remains unchanged. We continue to expect US real GDP growth of 2.7% in 2026 (vs a 2.1% consensus).

Resilience ahead. We still expect that solid spending growth will extend into 2026 as tax cuts from the OBBBA add roughly $100bn to household tax refunds during the Feb-April filing season. We continue to anticipate that income growth will remain supportive, on the back of balanced job growth, new tax cuts, and a fading inflation headwind from tariffs. Moreover, financial conditions continue to normalise, reflecting higher equity prices, a weaker dollar, and lower interest rates. This should help boost CAPEX spending - particularly AI-related infrastructure investment – allowing it to further increase.

Hot without heat. Despite our above-consensus baseline for the US economy, we still expect inflation to head towards target by Q4 this year. The latest data indicate that pass-through from tariffs remains limited, and with some tariff rates recently adjusted downwards by the Trump administration, we believe that core goods inflation has room to normalise. Moreover, we continue to believe that services inflation remains on a soft underlying trend. Labour market turnover numbers remain anchored at historically low levels, and when set against the backdrop of softening demand for new hires, a slow labour-market churn suggests limited wage or inflationary pressure.

ANIMA baseline. On growth, for Q4-25, we continue to expect real GDP to decelerate to 2.1% q/q SAAR from 4.3% in Q3-25 - mainly due to a drag of 1.1pp on government spending caused by the shutdown and a prolonged slowdown in residential investment. This is now consistent with an annual growth rate of 2.2%.

For 2026, we expect growth to pick up to 2.8% q/q SAAR (unchanged from the prior baseline) in Q1-26. The rebound here is mainly linked to the recovery of the government-spending drag in Q4-25. For Q2, Q3 and Q4-26, we expect growth to average 2.2% q/q SAAR (unchanged from the prior baseline). This is consistent with an annual growth rate of 2.7%. In Q4/Q4 terms, our forecast stands at 2.4% (vs 2.3% in the latest FOMC projection, and the 2.1% consensus).

The inflation baseline remains unchanged. For H1-26, we expect core CPI to average 2.8%, and 2.2% in H2-26. This is consistent with an annual average of 2.6%. We expect the y/y rate to reach 2% at the end of Q3-26. In core PCE terms, for H1-26, we expect core PCE to average 2.6%, and 2.2% in H2-26. This is consistent with an annual average of 2.5%.

EA – Right direction

Incoming data have shown a quicker than expected catch up to our projected growth baseline rather than setting the preconditions for an acceleration. Downside risks related to the implementation and effectiveness of the German fiscal package remain, albeit slightly lower than before. Meanwhile, the projected inflation outlook is unchanged: we continue to expect core momentum to ease amid weakening services inflation.

Holding up. The preliminary estimate for area-wide Q4 GDP came in stronger than consensus expectations but in line with our forecast at 0.3% (vs 0.2% consensus), unchanged from Q3. Based on available data, the internals of the print look firmer than expected amid broad-based improvements in domestic demand.

Drawing on the country-level data and qualitative indications currently in hand, we infer the following:

- **Germany**: The strongest growth rate since Q1-25 (0.3 q/q) was boosted by tariff front-loading. The press release mentions that Q4 growth was driven in particular by household and government consumption (likely helped by large increases in defence-related spending).
- **Italy**: The press release mentions that growth (0.3%) was driven by domestic demand and that net exports were negative.
- **Spain**: Q4 growth (0.8%) was driven by household consumption, and fixed investment grew strongly (1% q/q and 2.2% q/q, respectively), while government consumption was up moderately (+0.1% q/q). Import growth (+1.4% q/q) outpaced that of exports (+0.8% q/q). Taken together, domestic demand contributed 0.9pp to q/q GDP growth, while net trade was a drag (-0.2pp).
- **France**: Despite slowing to 0.2% in Q4 from 0.5% in Q3, the INSEE noted that final domestic demand growth excluding inventories was firmer at +0.3%. Total consumption rose by +0.3% (unchanged from Q3), with household consumption rising +0.3% in Q4 (vs +0.1% in Q3). Meanwhile, total gross fixed capital formation fell to 0.2% (from a very strong 0.7% gain in Q3). Net trade contributed +0.9pp (from +0.5pp in Q3) reflecting positive export growth and a sharp decline in imports. This was more than offset by a negative -1.0pp contribution from inventories, which reflected ongoing destocking of aerospace and naval products following heavy stockpiling earlier in the year.

Start of the year with a mixed bag of data. Leading indicators for January were more mixed, with the PMIs and national surveys moving broadly sideways. On the other hand, the EC economic sentiment indicator rose by a marked 2.2 points to 99.4, its highest level since January 2023. Geographically, the improvement was broad based across major economies. From a sector perspective, confidence strengthened in both manufacturing and services, with firms becoming increasingly optimistic about the demand outlook in both sectors.

In all, we think incoming data have shown a quicker than expected catch up to our growth baseline rather than setting the preconditions for an acceleration. Taken together, we have left our forecast unchanged and continue to look for sequential growth of 0.3% in Q1/Q2 and 0.4% for the second half of the year. Our two main drivers for improving growth momentum for 2026 continue to progress in line with our expectations: 1) German fiscal expansion continues to progress; 2) peripheral economies continue to grow at a pace above the average for core countries.

Our two cents on Germany are still on the table. The German fiscal data for December reported a sharp acceleration in spending. Within the main budget, spending stood at EUR 50.8bn in December, EUR 13.9bn more than in November. In terms of contributions, one major factor was higher defence spending, which increased by EUR 6.5bn relative to November, in line with historical patterns of defense spending ticking up by year-end.

Decent numbers also in the off-budget funds. Spending in the off-budget military fund (implied by the fund's issuance activity) also increased by EUR 5.1bn to EUR 6.7bn, while spending in the off-budget infrastructure and climate fund declined marginally by EUR 0.6bn to EUR 5.4bn. Against this backdrop, the increase in monthly expenditures (main budget + the two special funds) from EUR 41.4bn to EUR 55.0bn after the 2025 budget was approved in September represents a step in the right direction.

Same words of warning. We also remain of the view that two risks surrounding the implementation of the German fiscal package - implementation and effectiveness - remain to the downside

Our aggregate risk assessment has slightly improved, though. On the implementation risk front, we acknowledge that the 2025 fiscal target has been met. However, we estimate that it represents only 20% of the fiscal package approved. Meanwhile, on the effectiveness front, the jury is still out on this. Incoming data suggest activity momentum is improving in Germany, though it is too early to call this fiscal-led green shoots in our view.

On a disinflationary footing. The flash headline HICP for January fell to 1.7% y/y from 1.9% in December. The main driver here was further deflation in the energy space: energy HICP decelerated to -4.1% y/y from -1.9% in December. Underlying details are not yet available. However, our take is that the main driver is a sizable base effect, as energy HICP rose by 3.0% m/m NSA in January last year. Sequentially, we expect gas HICP to fall by 1.4% m/m NSA, as pass-through from the recent increase in wholesale prices should be gradual and exert only a limited impact on the January release. Food, Alcohol and Tobacco (FAT) inflation ticked up marginally to 2.7% y/y (+0.2pp), mainly on the back of unprocessed food prices. Beyond January, however, we expect FAT momentum to ease again, consistent with early signals from the EC survey’s food and beverage selling price expectations, which continue to fall, as well as declines in the year-over-year inflation rates of both domestic and import prices of food and beverages, and the fact that farm gate prices have now moved into outright deflation.

Core inflation has further room for deceleration. The flash core HICP for January decelerated to 2.2% from 2.3% in December. The most awaited component, services inflation, decreased to 3.2% y/y - the lowest level since September 2025. Wage-sensitive services CPI items decelerated markedly in January: details from the German Länder (NRW) show that restaurants and hotels CPI decelerated to 3.8% y/y from 4.6% in December, insurance CPI decelerated to 5.4% y/y from 5.9% in December (supporting the view that the reset mechanism has adjusted downward compared to last year) and communication services decreased to -0.6% y/y from -0.1% in December.

Our inflation baseline is unchanged. The reason is threefold:

1) The release for January does not change our forecast structurally. For services inflation, we continue to expect further decline from here: the key reason for this is that we expect wage growth to cool because real incomes are finished catching up. Moreover, we believe that soft goods inflation is likely to provide further downward pressure, given the effects of the stronger euro, pass-through from lower energy prices, and prospects of a negative inflation effect from Chinese trade rerouting.

2) The labour market balance is skewed towards abundance as demand continues to weaken while supply is on the rise.
3) Although the EA fiscal stance will turn expansionary this year consistent with a 0.25pp y/y change in the cyclically adjusted primary-balance, about 70% of that fiscal impulse is projected to come from defence measures. Recent literature suggests that neither wage-related inflationary risks look imminent nor meaningful over the forecast horizon as spending is heavily concentrated in the military sector. However, caution is warranted given the significant uncertainty surrounding model-based estimates.

ANIMA baseline. On growth, we project real GDP growth at 0.3% for Q1-26 and Q2-26 (quarter-on-quarter) and 0.4% for H2 2026. This results in an annual 2026 forecast of 1.2%.

On inflation, our baseline for 2026 remains unchanged: we expect core inflation to be 2.0% in H1 and 1.9% in H2, consistent with an annual average of 1.9%.

CHINA – A weak start

The Chinese economy started 2026 on the wrong foot. Most high-frequency indicators of domestic demand show no signs of a turnaround. Against this backdrop, we are slightly lowering our growth forecast for 2026. Our annual forecast for 2026 now stands at 4.8% (vs 5.0% previously). Meanwhile, lights at the end of the below-zero inflation tunnel remain off: we have refined downward our baseline for headline inflation in 2026. We now expect headline CPI at 0.7% (vs. 0.8% in prior baseline).

Domestic engine is still weak. The Chinese economy started 2026 on the wrong foot. Production and demand side indicators both eased from December. The manufacturing production PMI fell by 1.1pp, to 50.6, while on the demand side, the new orders PMI eased to 49.2 in January following a brief expansion at 50.8 in December. Against that backdrop, we note that the gap between the new orders and new export orders PMIs narrowed to its smallest level in almost one-and-a-half years, which may signal further softening in domestic demand as the economy enters 2026. The NBS new export orders PMI pulled back to 47.8 from 49 in December. That said, the more export-oriented RatingDog China manufacturing PMI showed a modest gain, with its new export orders sub-index returning to expansion territory, supported primarily by increased demand from ASEAN and other overseas markets. The services PMI eased by 0.2pp to 49.5 in January, marking its lowest level since the September 2024 policy pivot. Meanwhile, the construction PMI slipped back into contraction territory, marking its fifth contraction in the past six months. According to the NBS, cold weather and the approaching Chinese New Year holiday contributed to the slowdown in construction activity.

Moreover, we note that most high-frequency indicators of domestic demand show no signs of a turnaround. In particular, new property sales in 30 major cities continued to fall at double digits, declining by approximately 20% y/y in January following a roughly 30% y/y decline in Q4-25. While auto sales volume showed signs of stabilisation in January (+0.4% y/y), the print was still visibly below the 2025 full-year growth of 3.7% y/y. Box-office revenue, a gauge of services consumption, also fell in January.

Exports remain the mainstay of the Chinese economy. Export activity for January is likely to remain strong as growth in port cargo throughput edged higher to 7.7% y/y in January from 7.2% in December.

Against this backdrop, we are slightly lowering our growth forecast for 2026. We now expect growth for Q1-26 to be 4.5% y/y (unchanged from Q4-25, and -0.1pp relative to the prior baseline). For Q2-26, we now expect growth to be 4.7% y/y (-0.1pp from the prior baseline) and we expect growth at 5.0% and 5.1% for Q3 and Q4-26 (vs 5.1% and 5.2% prior baseline, respectively). Our annual forecast for 2026 now stands at 4.8% (vs 5.0% previously).

Local "Two Sessions" point to a lower national growth target this year than last year. We note that 29 out of the 31 mainland Chinese provinces have officially unveiled their 2026 growth targets during their local "Two Sessions". Among the 29 provinces, 19 have lowered their growth targets for 2026. Given recent policy communications, media reports, and signals from local "Two Sessions", we now expect policymakers to lower the national real GDP growth target to "4.5-5.0%" for this year from "around 5%" last year. Consequently, despite the latest data coming in weaker than expected, we do not expect the Chinese authorities to do more than they have already done with the recently announced front-loading policies.

January CPI inflation fell on late Lunar New Year Holiday. China's headline CPI fell to +0.2% y/y in January from +0.8% in December, mainly on lower food prices and tourism-related services prices. Meanwhile, the core CPI inflation eased to a 6-month low of 0.8% in January from 1.2% in December. The decline in CPI in January, in our view, reflects a combination of factors, including 1) the high base a year ago due to the difference in the timing of the Lunar New Year holidays (17 February this year versus 29 January 2025); and 2) the continued weakness in domestic demand, which weighed on both goods and services CPI.

We think the downward trend in core CPI will continue in 2026 in view of continued housing deflation and low services CPI on subdued wage growth and potential deterioration in the labour market. Based on January's weaker than expected CPI print, we are slightly lowering our baseline for headline inflation in 2026: we now expect headline CPI at 0.7% (vs. 0.8% in prior baseline).

ANIMA baseline. We now expect growth for Q1-26 to be 4.5% y/y (unchanged from Q4-25, and -0.1pp relative to the prior baseline). For Q2-26 we now expect growth to be 4.7% y/y (-0.1pp from the prior baseline), and we expect growth of 5.0% and 5.1% for Q3 and Q4-26 (vs 5.1% and 5.2% in the prior baseline, respectively). Our annual forecast for 2026 now stands at 4.8% (vs 5.0% previously).

We slightly lowered our baseline for headline inflation in 2026: we now expect headline CPI at 0.7% (vs. 0.8% in prior baseline).

MONETARY POLICY

FED – It could be WARSH (than that)

As widely expected, the FOMC kept rates at 3.50-3.75% at the January meeting. While the rhetoric was more hawkish than in December, the Fed kept a strong easing bias, indicating that it will resume cutting rates as soon as it is reasonably confident that tariff-induced inflation will reach its peak. Against this backdrop, we stick to our baseline of three additional rate cuts this year and we expect the next rate move in H1. Risks remain skewed toward fewer rate cuts should the economy overheat amid a "tight" labour market. If confirmed, President Trump's Fed Chair nominee, Kevin Warsh, does not change our monetary policy call.

Hitting the pause button. As widely expected, the Fed left rates unchanged at 3.50-3.75%, after delivering three consecutive cuts.

Both the statement and Powell's rhetoric were more hawkish than in December, for the following reasons:

1) The statement describes economic activity as having expanded at a "solid" pace compared to the "moderate" language used in December, while it characterises the unemployment rate as having shown some signs of stabilization, no longer highlighting mounting downside risks to employment creation.

2) Both in the statement and during the press conference, risks to unemployment were characterized as more balanced.

3) The Chair also argued that household spending remains strong even though surveys of consumer confidence remain downbeat, noting that fiscal easing approved last year is yet to reach consumers.

Easing bias still there. Despite these language improvements, Powell signaled that the Fed retains a clear easing bias:

1) To start with, the Chair strongly pushed back against the possibility of a rate hike, arguing that this move is not in anyone's baseline scenario.

2) Powell indicated that further progress on disinflation would be a sufficient condition for the Fed to resume cutting rates. While acknowledging that aggregate progress towards the inflation target has been limited over the past year, the Chair said it was essentially because of tariffs, justifying the easing bias by saying that the FOMC expects the peak in tariff inflation to be reached around mid-year. "If we see that, that would be something that tells us that we can loosen policy."

3) More conceptually, Powell dismissed strong growth as a reason to keep rates on hold arguing that rising productivity should lift potential growth, keeping inflationary pressures at bay.

Against this backdrop, we stick to our view of three additional rate cuts in 2026. For the following reasons:

1) While our growth baseline for this year is very similar to the Fed, we are less sanguine on inflation, expecting core PCE to reach target by the end of the year (Q4/Q4). Similarly to the Fed we think that services inflation is on a downward path, but we believe that the peak of tariff pass-through has been reached. That said, given the surprising performance of both the economy and consumer spending we can't rule out that businesses may try to take advantage by squeezing in some more tariffs, which seems to be the baseline of the Fed.

2) While most of Powell's comments suggested that rates could remain at their current level for a while, he did signal that the base case involves additional cuts. The argument that the rise in productivity will prevent solid growth from creating inflationary pressures suggests that the FOMC has a strong easing bias.

3) Finally, given the Fed's theoretical baseline described above, we continue to believe that the next Fed Chair will likely lean into political pressures provided wage inflation doesn't accelerate.

We have fine-tuned, though, the timing of the next rate cut. Given that the economy has surprised to the upside lately and Powell's mandate expires in May, we believe that the timing of the next move has become more uncertain, and we now expect it in H1, as opposed to March before.

Risks remain skewed towards fewer cuts. We continue to see risks for fewer rate cuts if the economy overheats. The labour market remains "small" and rigid on the supply side. Should the economy overperform our already above-consensus baseline amid cyclical and/or policy-induced pressures, including Trump and court rulings on

IEEPA tariffs, wage inflation could re-accelerate. We think that, in such a scenario, even a politically biased Chair would have to act to prevent inflation from taking off.

If confirmed, President Trump's Fed Chair nominee, Kevin Warsh, does not change our monetary policy call. Within the shortlisted candidates, the nomination of Warsh has been welcomed by markets as a "safe" choice. Recent speeches suggest that Warsh believes the recent rise in productivity is not a one-off, but rather a trend and will allow the economy to grow while disinflation progresses; this in turn should open the door to additional rate cuts. That said, Warsh has also been a strong supporter of a leaner Fed balance sheet, criticising QE as a tool that led to asset-price inflation. Against this backdrop, and taking into account the technical constraints and lack of consensus on a smaller Fed's balance sheet, we tentatively see Warsh's appointment as consistent with our macro baseline for the US, as well as our Fed call, with the caveat that it is difficult at the moment to forecast which direction he will take once he assumes leadership of the Fed in May.

ECB – The dove is in the details

The ECB left rates unchanged for the fifth consecutive meeting. The decision was unanimous, but the tone of the press conference sounded less hawkish than the market expected. Despite recent positive developments in growth, President Lagarde stressed the wide, albeit stable, range of risks surrounding the euro area economy. Moreover, regarding the exchange rate, she gave the impression that, above current levels, the euro could become an outright downside risk. Against this backdrop, we stick to our baseline and continue to expect a rate cut this year, though the timing remains very uncertain.

On hold, as expected. As widely anticipated, the ECB kept rates unchanged for the fifth consecutive meeting. The decision was unanimous, and the statement was broadly unchanged compared to December. President Lagarde reiterated that the ECB remains in a good place and will continue to adopt a data-dependent, meeting-by - meeting approach.

A less hawkish-than-expected rhetoric. While the ECB did not signal any change in its monetary policy stance compared to December, President Lagarde's rhetoric sounded somewhat less hawkish compared to December. For the following reasons:

1. Considering that GDP growth data for Q4 were broadly balanced in terms of geography and sectors, we would have expected President Lagarde to lean more on the hawkish side. Interestingly, she instead chose to emphasize that there has been neither a reduction in the range of risks nor progress in the balance of risks. We interpret this communication choice as marginally dovish.
2. Consistent with point 1, the statement characterises the economy as resilient, but the outlook remains uncertain amid trade policy unpredictability and geopolitical tensions, despite progress on the trade-agreement front (e.g. Mercosur and the EU-India trade deal).
3. On the euro, while reiterating that it is not a policy target, President Lagarde suggested that the exchange rate could become a downside risk to inflation if it were to rise above current levels.
4. On monetary policy, President Lagarde reiterated that the ECB is in a good place, clarifying that this is because the institution remains agile and ready to adjust all its tools if needed. Given the undershooting of the inflation target in the staff forecasts (even if well telegraphed and temporary) and recent exchange rate developments, we believe the ECB's agility is skewed more toward a rate cut than a hike.

We stick to our baseline. Against this backdrop - and consistent with the "flash" inflation data for January, which confirmed that the underlying disinflation trend remains well supported, particularly by the services sector - we continue to expect the ECB to ease one more time this year, taking the deposit rate to 1.75%.

Timing remains uncertain. While we continue to expect one additional rate cut, we acknowledge that it may not occur in the near-term. The reason is twofold:

1. Constructive news on the euro area economy and the German fiscal package supports the ECB's view that monetary policy is in a good place.
2. The ECB continues to downplay downside risks to inflation. During the press conference, President Lagarde noted that the projected undershooting of the inflation target has been present in staff forecasts for some time and remains consistent with the ECB's symmetric interpretation of the target — implying some tolerance for headline inflation below 2%. She also recalled that, in the September staff forecasts, the projected undershoot was even deeper than that outlined in the December projections.

PBoC – One step closer to RRR cut

The PBOC unveiled a package of credit easing measures, including a 25bp cut in rates on various structural monetary policy tools and a broad expansion in both the size and coverage of relending programs. In addition, they signalled that there is now some room for RRR and policy rate cuts. Compared with the earlier reluctance to cut the policy rate and the RRR, we view this as a step closer to broader monetary easing. We maintain our current forecasts of around 40bps of rate cuts (OMO 7-day reverse repo rate) and possibly one 50bp RRR reduction to support 2026 growth on a firm foundation.

During the monetary policy press conference held on January 15, PBoC Deputy Governor Zou Lan unveiled a package of credit easing measures. The major measures include: 1) a 25bp cut in rates on various structural monetary policy tools (e.g., the one-year relending rate was lowered to 1.25% from 1.5% and the PSL rate was reduced to 1.75% from 2.0%); and 2) a broad expansion in both the size and coverage of relending programs, with a total increase in quotas of around RMB 2.1 trillion, including a new RMB 1tn program for private enterprises, an additional RMB600bn quota to support technology innovation and related corporate bond issuance, and an extra RMB 500bn quota for agricultural sectors and small-and-medium-sized enterprises (SMEs).

A more dovish tone on the scope for RRR and policy rate cuts. During the press conference, PBoC officials also addressed the scope for further monetary easing, the rhythm of their CGB purchases, and recent FX movements. In short, they indicated that there is now some room for RRR and policy rate cuts (compared with a degree of reluctance in previous communications), reaffirmed a flexible stance on CGB purchases, and suggested increased comfort with a stronger CNY.

Our view remains unchanged. Deputy Governor Zou Lan highlighted that banks' average RRR now stands at 6.3%, implying "room for further RRR cuts". On policy rate cut constraints, he noted that the CNY has remained relatively stable and that the Fed is still in an easing cycle, arguing that "FX no longer poses a binding constraint". He also observed that banks' net interest margins showed signs of stabilizing in 2025, and that several factors should help reduce funding costs in 2026, notably the repricing of maturing 3- and 5-year deposits at significantly lower rates (roughly 135–145bp lower), alongside recent reductions in relending rates. Compared with the earlier reluctance to cut the policy rate and the RRR, we view this as a step closer to broader monetary easing. We maintain our current forecasts of around 40bps of rate cuts (OMO 7-day reverse repo-rate rate) and possibly one 50bp RRR reduction to support 2026 growth on a firm foundation.

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