European Economics Analyst

Lower Growth, Inflation and Rates Across Europe Despite the Tariff Pause

- While President Trump's decision to pause the implementation of the country-specific reciprocal tariffs has provided some relief, the European economic outlook has weakened further since our forecast update last Friday. The US administration raised tariffs on China sharply further; financial conditions are notably tighter on the week, with European currencies materially stronger; our US and China teams have downgraded their growth projections; and the EU has been notably more cautious in its approach to retaliation.
- We therefore downgrade our Euro area real GDP forecast by an additional 0.2%, implying a contraction in Q3 and essentially no growth for the rest of the year. We now forecast Euro area growth of 0.7% in 2025 (vs 0.8% before) and 1.0% in 2026 (vs 1.1%). Looking across the Euro area, we downgrade GDP by 0.3% in Germany and Italy and by 0.1% in France and Spain.
- Given weaker growth, more cautious EU retaliation, a stronger Euro and more trade diversion from Asia, we downgrade Euro area core inflation by 0.2pp to 1.9% in 2025Q4, 0.2pp to 1.8% in 2026Q4 and 0.1pp to 1.9% in 2027Q4. Given weaker growth and a modest inflation undershoot, we add an ECB rate cut to our forecast to reach a terminal rate of 1.5% (versus 1.75% previously). We now forecast 25bp cuts in April, June, July and September, with risks skewed towards more rate reductions if the trade tensions continue to build.
- We cut our UK real GDP forecast by a further 0.3% given tighter financial conditions and weaker growth abroad. We lower our GDP growth forecast for 2025 by 0.1pp to 0.95% and for 2026 by 0.1pp to 1.0%. We now also expect faster disinflation in the UK given lower energy prices, weaker demand and more trade diversion. As a result, we expect the BoE to lower Bank Rate to 2.75% (vs 3% previously). Quarterly steps remain our baseline given elevated inflation, but we see a low hurdle towards sequential cuts (including in June) if the outlook continues to weaken.
- We lower our real GDP forecast for Switzerland by 0.3% and maintain our forecast for two more cuts to a terminal rate of -0.25%. We likewise downgrade our GDP forecasts by 0.3% in Sweden and 0.2% in Norway. We now expect two more Riksbank rate cuts to 1.75% (vs 2% previously) and maintain our forecast for three rate reductions by Norges Bank in 2025 and a terminal rate of 3% in 2026Q3, with risks for more easing.

Sven Jari Stehn
+44(20)7774-8061 | jari.stehn@gs.com
Goldman Sachs International

Filippo Taddei
+44(20)7774-5458 |
filippo.taddei@gs.com
Goldman Sachs International

Alexandre Stott
+33(1)4212-1108 |
alexandre.stott@gs.com
Goldman Sachs Bank Europe SE - Paris Branch

James Moberly
+44(20)7774-9444 |
james.r.moberly@gs.com
Goldman Sachs International

Niklas Garnadt
+44(20)7051-7722 |
niklas.garnadt@gs.com
Goldman Sachs International

Katya Vashkinskaya
+44(20)7774-4833 |
katya.vashkinskaya@gs.com
Goldman Sachs International

Giovanni Pierdomenico
+44(20)7051-6807 |
giovanni.pierdomenico@gs.com
Goldman Sachs International

- Taken together, our updated forecasts put us further below consensus for growth across Europe and imply more rate cuts than currently priced. That said, the outlook is highly uncertain, and we will continue to make adjustments with more information.

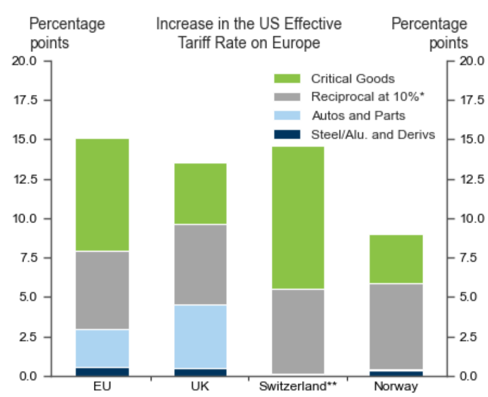
Lower Growth, Inflation and Rates Across Europe Despite the Tariff Pause

President Trump's decision to pause the implementation of the country-specific reciprocal tariffs for 90 days has provided relief for the European economic outlook. We now expect that only the minimum 10% baseline reciprocal tariff is implemented for European countries. While we now assume that the US will impose a 25% tariff on critical US imports (instead of 10% previously), the pause on the country-specific reciprocal tariffs results in a smaller effective tariff rate than we had previously assumed, except in the UK (Exhibit 1). For example, we now expect the effective US tariff rate on EU goods to cumulatively rise by 15pp (vs 16pp before) and by 15pp in Switzerland (vs 20pp before). We expect a larger increase in the effective tariff rate on the UK (13pp vs 11pp before).

Exhibit 1: Some Tariff Rate Relief

Tariff	Status	EU Exports Affected (bn €)	Tariff Increase on EU (pp)	Effect on US Effective Tariff Rate on the EU (pp)
Steel/ Aluminium	Announced, Incorporated	28*	25	0.6
Autos	Announced, Incorporated	53	25	2.5
Critical Goods	GS Expected, Incorporated	156	25	7.3
10% Flat Reciprocal	Announced, Incorporated	266	10	5
Incremental Country-Specific Reciprocal	Paused, GS Risk	266	10	5

* The EC identified in 8bn EUR the value of steel and aluminium exports to the US and in 18bn EUR the value of exports to the US of derivative products affected by the new US tariffs. That said, US tariffs on derivatives should be applied only to the steel/aluminium content of derivative products. Note: The mechnical effect on the effective tariff rate is shown.



* Net of exemptions. ** Exemption of gold bars could reduce the increase in the effective tariff rate further.

Source: Goldman Sachs Global Investment Research, Haver Analytics, European Commission, Census Bureau

The uncertainty around the trade outlook, however, remains very high because the country-specific reciprocal tariffs have merely been postponed, not cancelled. Moreover, the European economic outlook has weakened along several other dimensions since our last forecast update on April 4.

First, the US raised the tariff rate on China to 145%, sharply higher than announced on April 2. As a result, our China team downgraded their growth forecast from 4.5% to 4% this year and 4% to 3.5% in 2026, down a total of 1pp. The higher China tariffs, moreover, point to more trade diversion towards Europe, which could weigh more notably on inflation.

Second, the EU has been notably more cautious in its approach to retaliation than we had anticipated. In particular, the EU responded to President trump's announcement of a pause with a similar 90-day pause for the retaliatory measures to US tariffs on steel and aluminium. Additional EU countermeasures are still planned if current US tariffs remain in place, but we expect Europe to eventually respond with lower tariffs on the US than we previously assumed (Exhibit 2).

Exhibit 2: More Cautious EU Retaliation

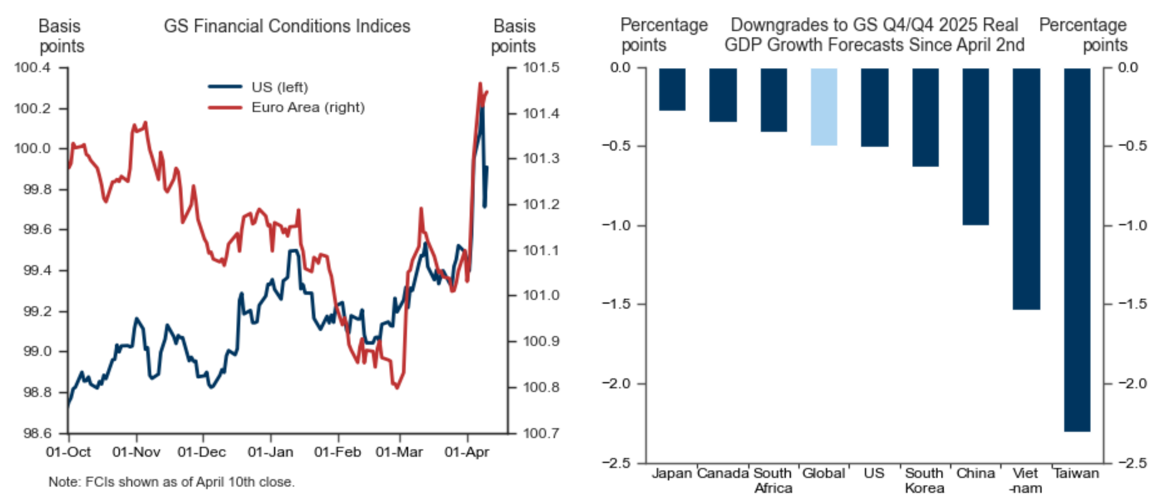
Status	US Tariff	US Tariff (%)	EU Exports Affected (bn €)	EU Response	EU Tariff (%)	US Exports Affected (bn €)
Announced	Steel and Aluminium	25	8	New EU List**	10-25	22
Announced	Steel and Alu. Derivatives*	25	18			
Announced	Auto + Parts	25	53	Tit-for-Tat Retaliation***	25	40
Announced	Reciprocal Tariff - Base	10	266	Retaliation on All EU Imports from US ex. Energy****	5	181
GS Expected	Critical Goods	25	156	Tit-for-Tat Retaliation***	25	ca. 100
GS Risk	Reciprocal Tariff - Regional Add-on	20	266	Retaliation on All EU Imports from US ex. Energy****	10	181
GS Risk	VAT-Matching	17	532	Retaliation on All EU Imports from US ex. Energy****	17	181
				Services Retaliation	N/A	460

* The EC identified in 8bn EUR the value of steel and aluminium and in 18bn EUR the value of steel and aluminium derivative products exported to the US and affected by the new tariffs. That said, US tariffs should be applied only to the steel and aluminum content of derivative products. ** List to be published by the EC by April 15th. *** We expect the EC to identify a set of goods imported from the US worth slightly less than the amount affected by US tariffs and apply the same tariff rate as the US on them. **** We assume retaliation occurs on products not affected by previous retaliatory measures.

Source: Goldman Sachs Global Investment Research, Haver Analytics, European Commission, Census Bureau

Third, financial conditions remain significantly tighter even after the post-pause market rebound. Our Euro area financial conditions index (FCI) is around 30bp tighter than for our last forecast update (and 60bp compared to early March). Notably, European currencies are materially stronger, with the trade-weighted Euro up about 2% since April 2 (and 4% since early March).

Exhibit 3: Tighter Financial Conditions, Weaker Global Growth



Source: Goldman Sachs Global Investment Research, Haver Analytics

Fourth, our US team expects 0.5% growth on a Q4/Q4 basis for this year, down 0.5pp since our last forecast update, and indicated that growth could be a further 1.5pp weaker this year if the reciprocal tariffs are implemented.

Given these shifts, we update our growth, inflation and monetary policy forecasts across Europe.

Euro area: Little Growth and Weaker Inflation for the Rest of 2025

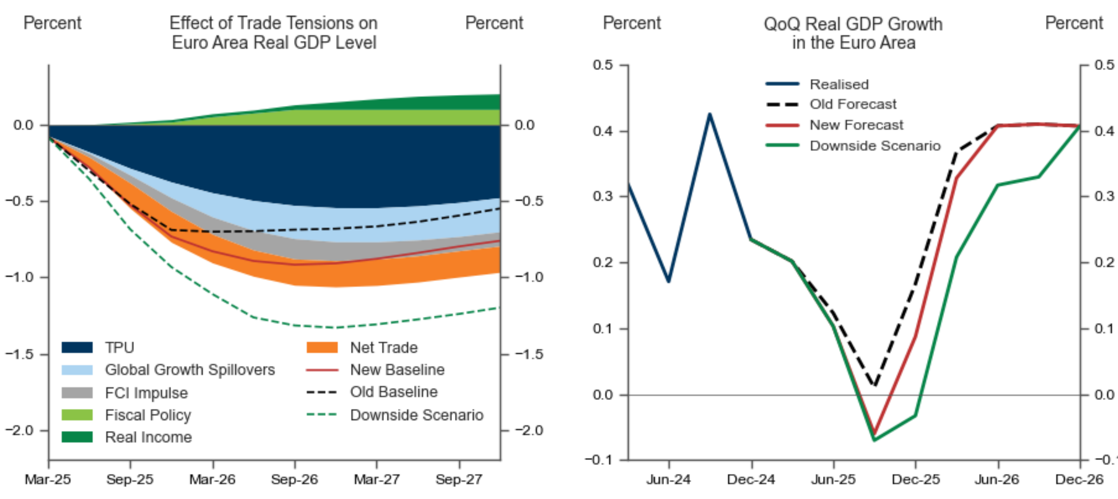
Growth prospects in the Euro area have weakened further for the rest of 2025.

We estimate that slower global growth and tighter global financial conditions will weigh on foreign demand for Europe goods and on interest-sensitive activity, shaving off around 0.3% from area-wide real GDP in coming quarters. Furthermore, we continue to expect a 0.5% drag on GDP resulting from elevated trade policy uncertainty, which is likely to weigh on global demand for capital goods and on European investment and hiring decisions.

Partly offsetting the less supportive global backdrop, our updated tariff assumptions imply a slightly smaller net trade drag on area-wide GDP in 2025. Furthermore, we now expect a greater share of tariff revenues to be recycled into fiscal support. Under our assumptions on the share of tariff revenue that is spent, and its likely multiplier on activity, we estimate this fiscal offset could reduce the drag on Euro area real GDP from trade tensions by just under 0.1%.

Taken together, our updated assumptions point to another 0.2% hit to Euro GDP, for a total model-based hit from trade tensions of 0.9% (Exhibit 4, left). We downgrade our quarterly (non-annualised) growth forecast to -0.1% in Q3, +0.1% in Q4, and 0.3% in 2026Q1. This corresponds to 2025 growth of +0.7% (vs. +0.8% previously) on an annual average basis and +0.3% (vs. +0.5%) on a Q4/Q4 basis, below consensus and ECB expectations (Exhibit 4, right). We now expect the area-wide unemployment rate to rise by 0.4pp to 6.6% in 2026Q2. In a downside scenario where US and global growth deteriorate further and FCIs tighten further, we see an incremental drag on real GDP of around 0.4% (for a total trade hit of 1.3%), tipping the Euro area into a technical recession in 2025H2.

Exhibit 4: Our Model Points to a 0.9% Hit to GDP from Trade Tensions, Resulting in Essentially No Growth in the Euro Area for the Rest of 2025

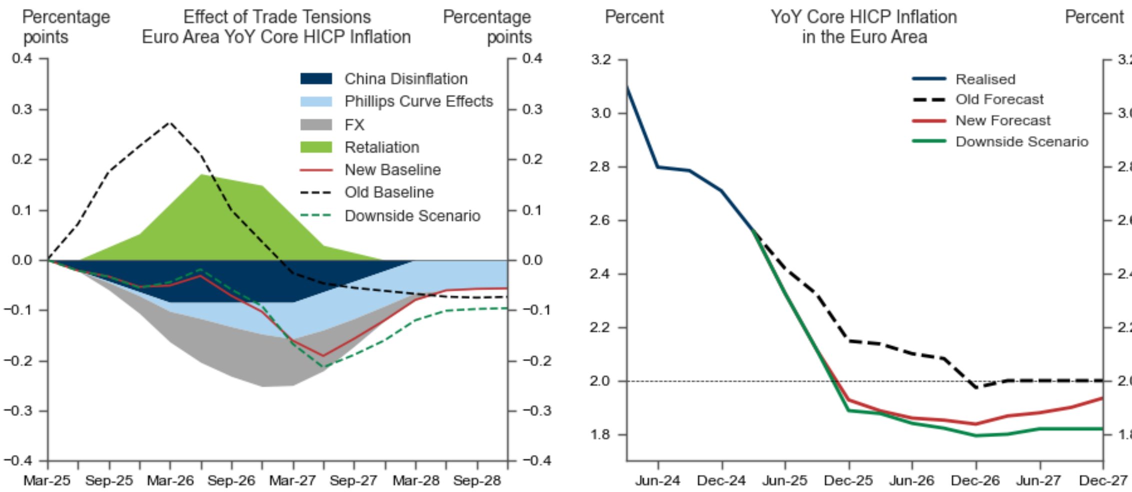


Source: Goldman Sachs Global Investment Research, Haver Analytics

Our model also points to materially lower inflationary pressures given our assumptions of more cautious and backloaded EU retaliation, a stronger Euro, and more trade diversion from Asia (Exhibit 6, left). As a result, we downgrade our year-over-year core

HICP inflation forecast by 0.2pp to 1.9% in 2025Q4, 0.2pp to 1.8% in 2026Q4, and 0.1pp to 1.9% in 2027Q4 (Exhibit 6, right).

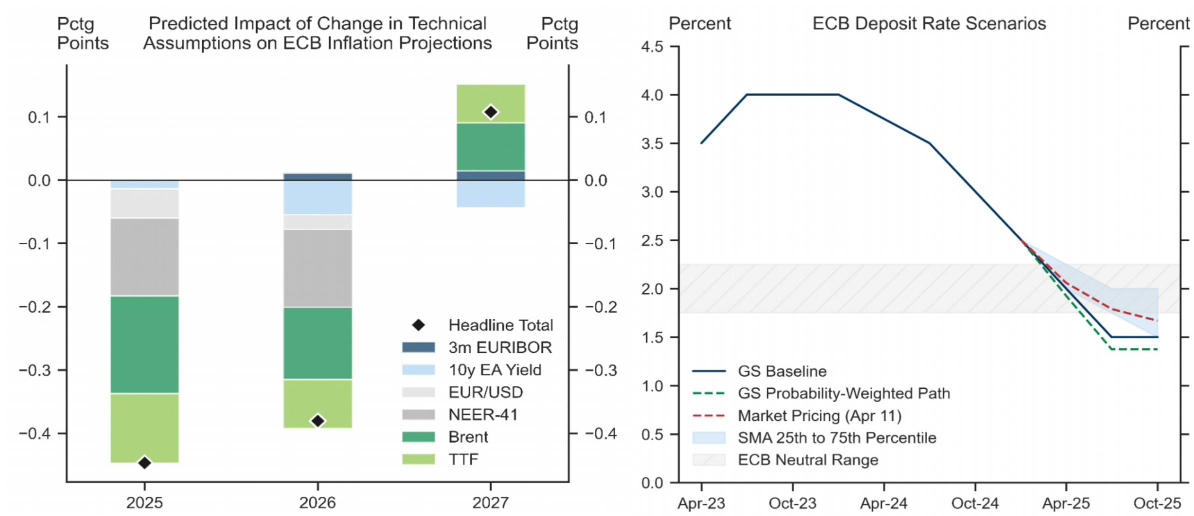
Exhibit 5: We Now See Core Inflation Falling to 1.9% by End-2025 and to 1.8% in 2026



Source: Goldman Sachs Global Investment Research, Haver Analytics

The ECB is very likely to cut at next week's meeting given the materialisation of downside risks to the growth outlook. We see a further 25bp cut in June as highly probable given the likely downgrade to the staff projections, and then expect the Governing Council to follow through with a cut at the July meeting (Exhibit 6, left). But our downgrades to growth and medium-term inflation call for lower rates than we had been anticipating. We are therefore adding a last 25bp cut in September to a lower terminal rate of 1.5%, from 1.75% previously (Exhibit 6, right), below market pricing.

Exhibit 6: We Are Adding a Last 25bp Cut in September to a Lower Terminal Rate of 1.5%



Source: Goldman Sachs Global Investment Research, Haver Analytics, Bloomberg

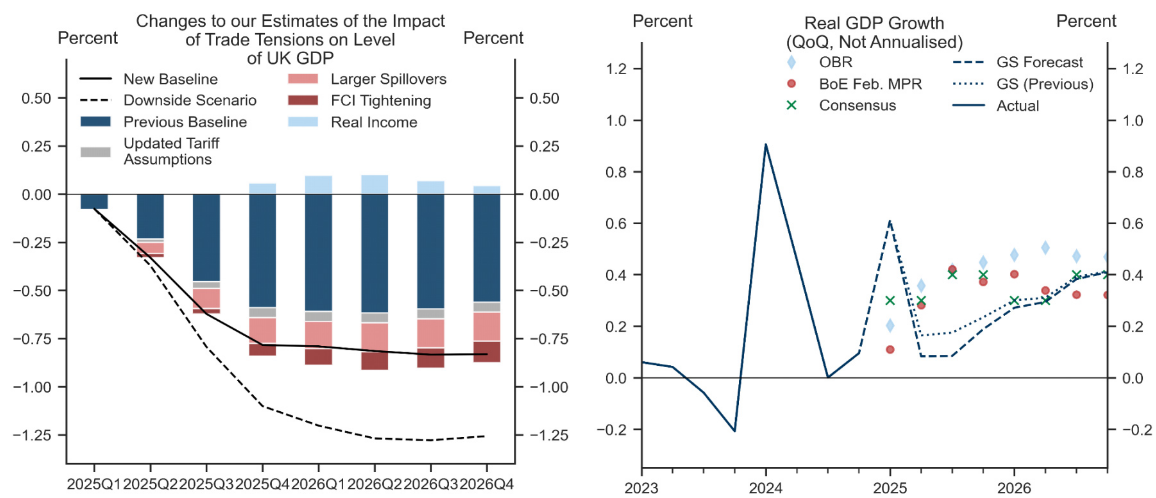
The materialisation of our downside scenario where the economy enters into recession and inflation falls further below target would likely require two additional ECB cuts, to a terminal rate of 1%.

UK: Faster Disinflation, Further Policy Easing

The latest developments point to a larger hit to UK GDP than we had previously expected, for three reasons. First, the downgrades to our growth estimates for the US, Euro area, and China imply larger negative spillovers to the UK through weaker exports. Second, we now assume a 25% tariff on US critical goods imports, versus 10% previously, which should further reduce UK export growth. Third, although equities have rebounded since Wednesday, financial conditions remain tighter than before the April 2nd tariff announcements. Overall, we now expect the impact of trade tensions on the level of UK GDP to be roughly 0.3% larger than our previous estimates, for a total tariff-related hit of 0.8%. We lower our GDP growth forecast for 2025 by 0.1pp to 0.95% and for 2026 by 0.1pp to 1.0%.

If the reciprocal tariffs were reimposed after 90 days, then we would expect that the hit to UK GDP would be notably larger—reducing the level of GDP by an additional 0.5%—because a further weakening in the global economy would lead to even more pronounced spillover effects.

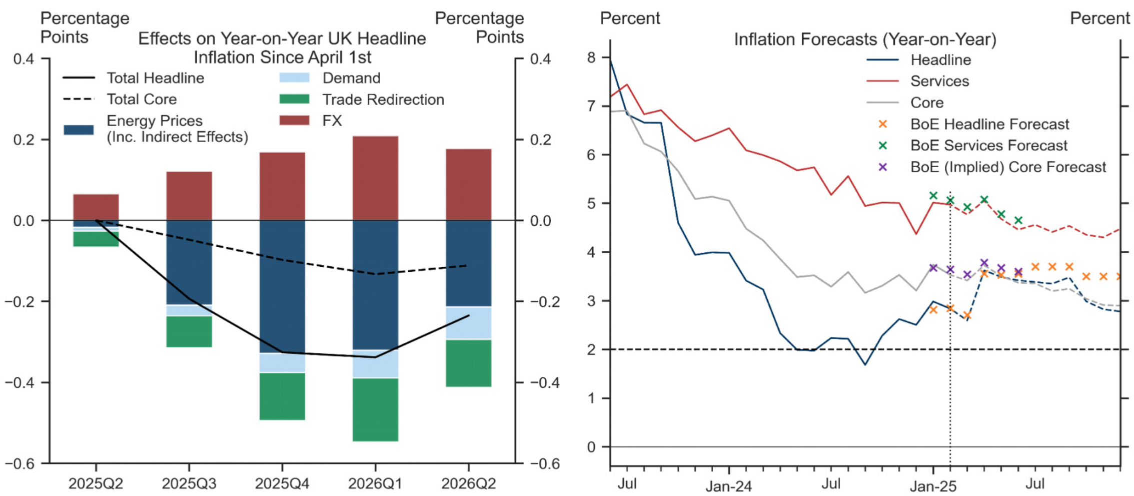
Exhibit 7: A Larger UK Growth Hit



Source: Goldman Sachs Global Investment Research, Haver Analytics, Bloomberg, Bank of England

We now also see faster disinflation. The decline in energy prices should result in a steeper decline in headline inflation in late 2025. But core inflation is also now likely to be somewhat lower, on the back of weaker demand and a stronger disinflationary effect from trade redirection from China. Moreover, the latest government commentary indicates that the UK is unlikely to respond to the reciprocal tariff, reducing the risks of upward pressure on prices from import duties. It is true that these factors are likely to be partially offset by the weakening of the sterling effective exchange rate in recent days. But on net, we have lowered our core and headline inflation forecasts. We now see greater downside risks to the BoE's headline inflation projections for late 2025 and early 2026.

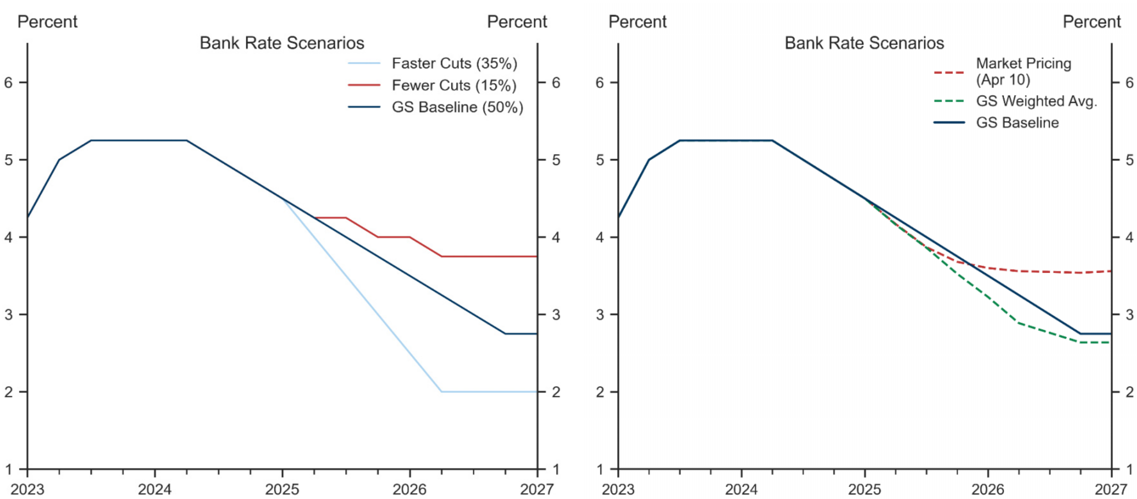
Exhibit 8: Downside Risks to the BoE's Inflation Forecasts for Late 2025 and Early 2026



Source: Data compiled by Goldman Sachs Global Investment Research, Bloomberg, Bank of England

Nonetheless, headline inflation is likely to remain notably above target in the near term, and so we continue to see a quarterly pace of cuts as baseline. But with growth set to weaken further, upside risks to the inflation outlook receding, and Bank Rate still very restrictive, we now see the MPC cutting further to 2.75% in 2026Q4 (versus 3.00% in 2026Q3 previously). Moreover, we think that the latest developments further skew the risks around our baseline towards a faster pace. While we assign a 50% probability to our baseline path, we now see a 35% chance that the Committee cuts in sequential steps (versus 30% previously), with a June cut possible with a further deterioration in the outlook. We revise down the probability that we attach to a slower pace to 15% (from 20%).

Exhibit 9: We Lower Our Terminal Bank Rate Forecast to 2.75%



Source: Goldman Sachs Global Investment Research, Bank of England, Bloomberg

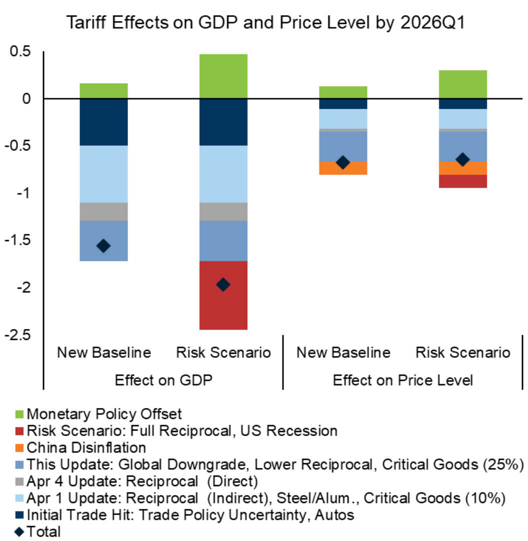
Switzerland: Franc Appreciation Weighs on Inflation; We See Higher Risks of Deeper

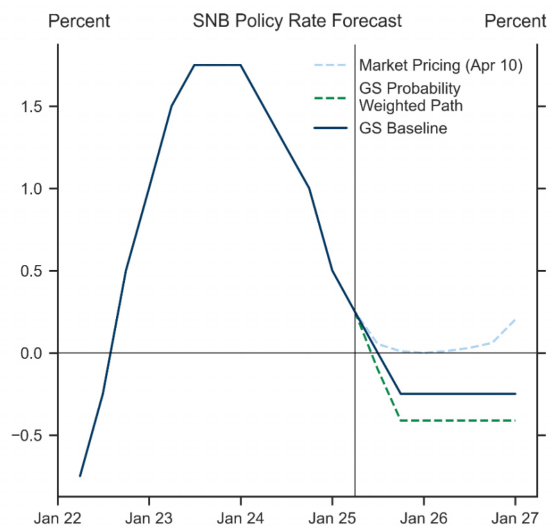
SNB Cuts

Switzerland will benefit more from the 90-day pause than other European economies because of the higher initial reciprocal tariff rate of 31%. That said, the outlook for the Swiss economy has still deteriorated further. First, the downgrades to the global growth outlook, particularly for the US and the Euro Area, Switzerland's most important trading partners, will weigh heavily on demand for Swiss exports. Second, our US team now assumes that a 25% tariff (instead of 10%) is levied on critical goods, which make up about 40% of Swiss exports to the US. We therefore downgrade the level of real GDP by an additional 0.3%, for a total tariff-related hit to GDP of 1.6% (Exhibit 11, left). Overall, we cut our growth forecast by 0.1pp to 0.7% in 2025 and 0.2pp to 1.0% in 2026.

Since April 2, the Swiss Franc has appreciated by more than 4% on a trade weighted basis, substantially above the 1% we initially expected. We therefore lower our inflation forecast by 0.1pp to 0.2% in 2025Q4 and by 0.2pp to 0.5% in 2026Q4.

Exhibit 10: A Bigger Hit to Swiss Growth and Inflation, Higher Risks of Deeper SNB Cuts





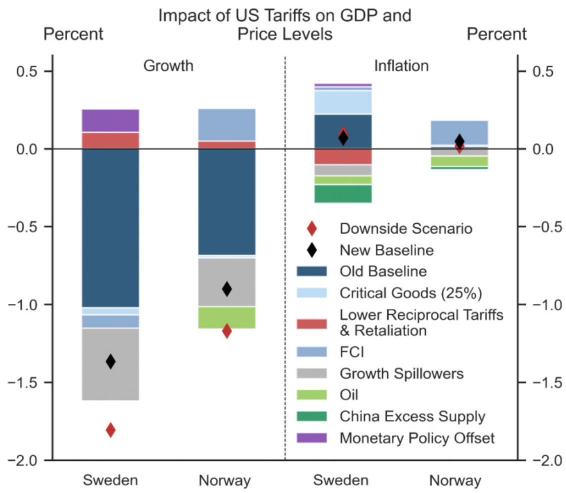
Source: Goldman Sachs Global Investment Research, Bloomberg, Haver Analytics

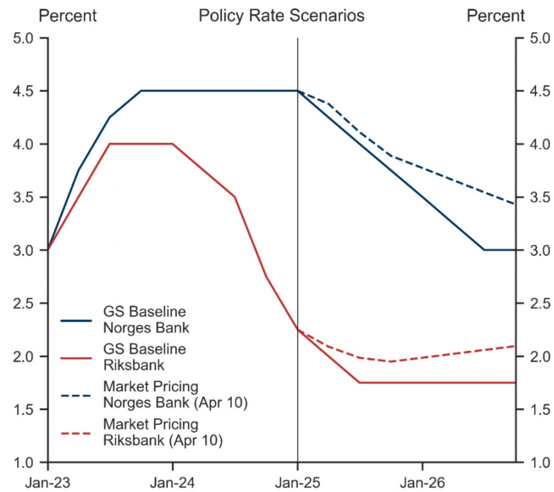
We maintain our SNB forecast for two 25bp cuts in June and September, for a terminal rate of -0.25% (Exhibit 11, right). In our downside scenario, we would expect an additional 0.4% hit to GDP, a trade drag on inflation, and two additional SNB cuts to a -0.75% terminal rate.

Lower Growth and More Easing in Sweden; Norway Still Set for Three Cuts in 2025

In Sweden, we downgrade our real GDP forecast by an additional 0.3%, for a total tariff-related hit to GDP of 1.4%, primarily reflecting spillovers from lower global growth. We therefore reduce our 2025 growth forecast to 1.7% (from 1.9%) and our 2026 forecast to 1.6% (from 1.7%), below consensus and Riksbank's expectations. We see smaller effects on inflation than previously assumed given excess supply out of China, weaker growth, and lower energy prices. We now expect two more 25bp cuts this year from the Riksbank in June and August (from one cut in June before) to a terminal rate of 1.75% (vs 2% before). In the event our downside scenario materialises, we would expect an additional 0.4% hit to GDP, lower inflation, and two additional Riksbank cuts to a terminal rate of 1.25%.

Exhibit 11: Further Growth Downgrades Across Sweden and Norway Support Our Below Pricing View





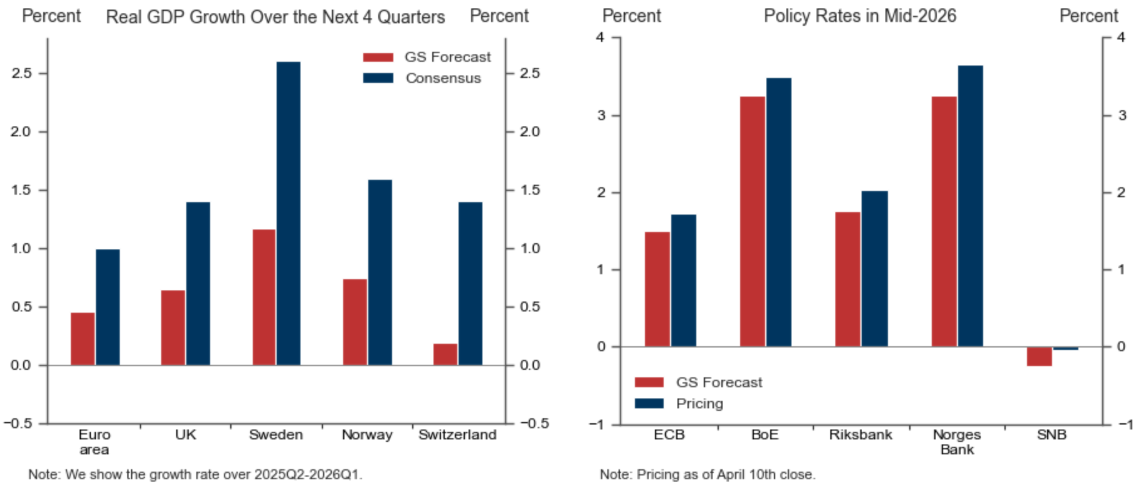
Source: Goldman Sachs Global Investment Research, Haver Analytics, Bloomberg

In Norway, we lower real GDP by a further 0.2%, for a total tariff-related hit to GDP of 0.9%, partly because of lower energy prices. We downgrade our 2025 growth forecast to 0.7% (from 0.8%) and our 2026 forecast to 1.1% (from 1.2%), below consensus and Norges Bank's expectations. We now expect no "in kind" retaliation from Norway to the US "reciprocal" and product-specific tariffs, and therefore see close to no impact on the price level, also because the impact of FX weakening since the beginning of April should be offset by weaker growth and lower energy prices. As a result, we maintain our call for three more 25bp cuts this year to a terminal rate of 3% in 2026Q3. But we see risks skewed towards more easing; in the event our downside scenario materialises, we would expect an additional 0.3% hit to GDP, an even smaller impact on inflation, and faster Norges Bank cuts to a lower terminal rate of 2.75%.

An Uncertain World

Taken together, our updated forecasts put us further below consensus for growth across Europe and imply more rate cuts than currently priced.

Exhibit 12: Weaker Growth and More Cuts than Priced Across Europe



Source: Goldman Sachs Global Investment Research, Haver Analytics, Bloomberg

That said, the outlook is highly uncertain and we will continue to make adjustments with more information.

European Economics Team

Disclosure Appendix

Reg AC

We, Sven Jari Stehn, Filippo Taddei, Alexandre Stott, James Moberly, Niklas Garnadt, Katya Vashkinskaya and Giovanni Pierdomenico, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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