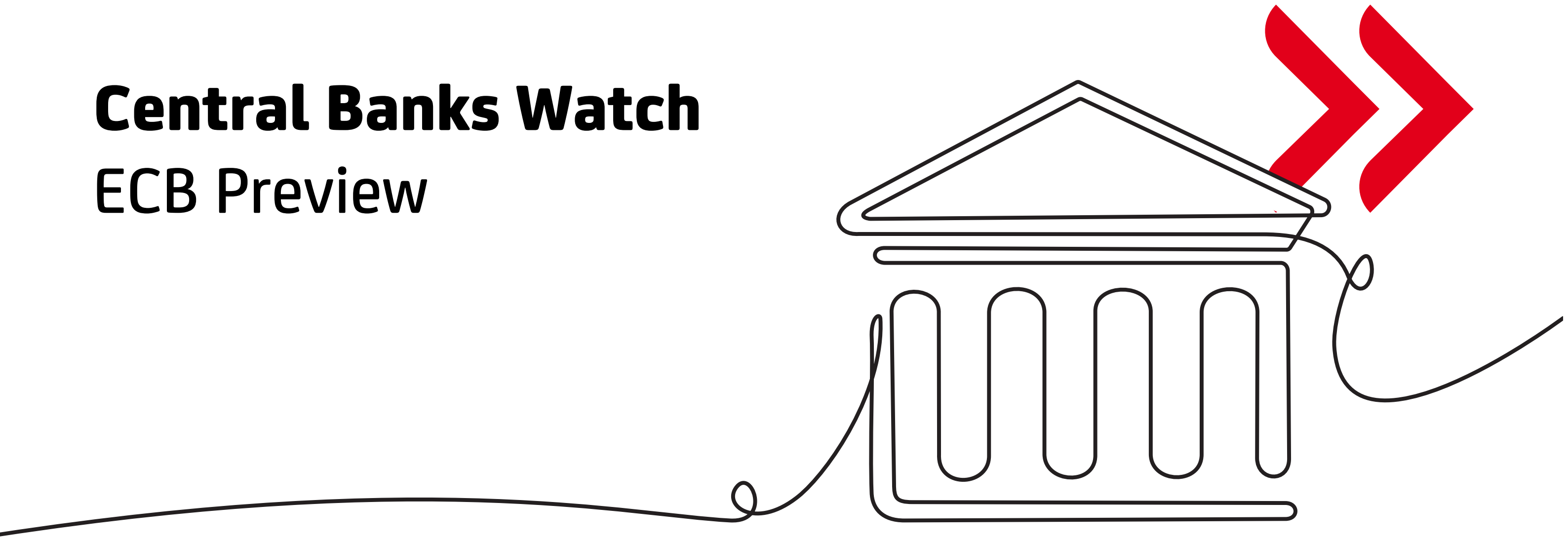
Central Banks Watch
ECB Preview



Hike a done deal, mission not yet accomplished

7 September 2026

A hike is baked in; we expect more to come

A 25bp hike on Thursday is a virtual certainty. We do not expect any meaningful policy signals in the press conference, but economic resilience and upside risks to the inflation outlook suggest that the ECB might still have work to do. We forecast a final 25bp hike in December.

ECB is unlikely to bring relief to eurozone fixed-income markets

With the energy shock continuing to exert upward pressure on inflation, the ECB is set to reiterate its cautious stance, remaining open to future hikes if inflation does not slow. This limits room for a recovery in EGBs.

No tailwinds for EUR-USD

An ECB rate hike is already widely expected and is therefore unlikely to provide fresh support for EUR-USD, as investors remain firmly focused on the Fed's next move. The pair is therefore likely to remain close to 1.16 ahead of the crucial FOMC meeting on 16 September.

In all likelihood, the ECB will raise interest rates by 25bp on Thursday, taking the deposit rate to 2.50%, the upper end of the central bank's estimated neutral range. With inflation running above 3% and likely to accelerate further, and with activity indicators generally surprising to the upside, we expect the decision to be unanimous.

The accompanying macroeconomic projections will provide the context for the rate move. We expect the updated forecasts to carry a hawkish tilt, reflecting upward revisions to both this year's GDP growth outlook and next year's inflation trajectory, with a later convergence of inflation to the 2% target as the energy shock proves more persistent than the ECB had previously assumed. With the Strait of Hormuz unlikely to fully reopen anytime soon and gas prices reaching their highest level since late-2022, the Governing Council (GC) will likely continue to regard risks to the inflation outlook as tilted to the upside.

As the rate decision is likely to be a non-event, markets will focus on any clues regarding the path of monetary policy beyond September. We doubt that ECB President Christine Lagarde will send any strong signals in this respect, instead reiterating the ECB's data-dependent and meeting-by-meeting approach. That said, if the September hike is described as "robust across a range of scenarios", echoing the language used in June, the communication would be slightly hawkish, compounding the signal from the balance of risks to medium-term price stability.

Last Friday, we updated our baseline scenario and added one final ECB hike in December, to 2.75%. This implies that the GC will take policy rates into mildly restrictive territory by year-end. Our new forecast reflects better-than-expected resilience of economic activity to the energy shock, and a higher inflation trajectory amid upward revisions to our path for energy prices, particularly natural gas. We now expect inflation to peak at around 4% at the turn of the year, before gradually converging back to the ECB's 2% target, but not until 4Q27. We think that a stronger and more persistent inflation shock and increased confidence about the resilience of the real economy will convince the GC to seek additional insurance against the risk of inflation remaining above target for an extended period. We still expect a rate cut in the final months of next year as the inflation shock subsides.

Market reaction

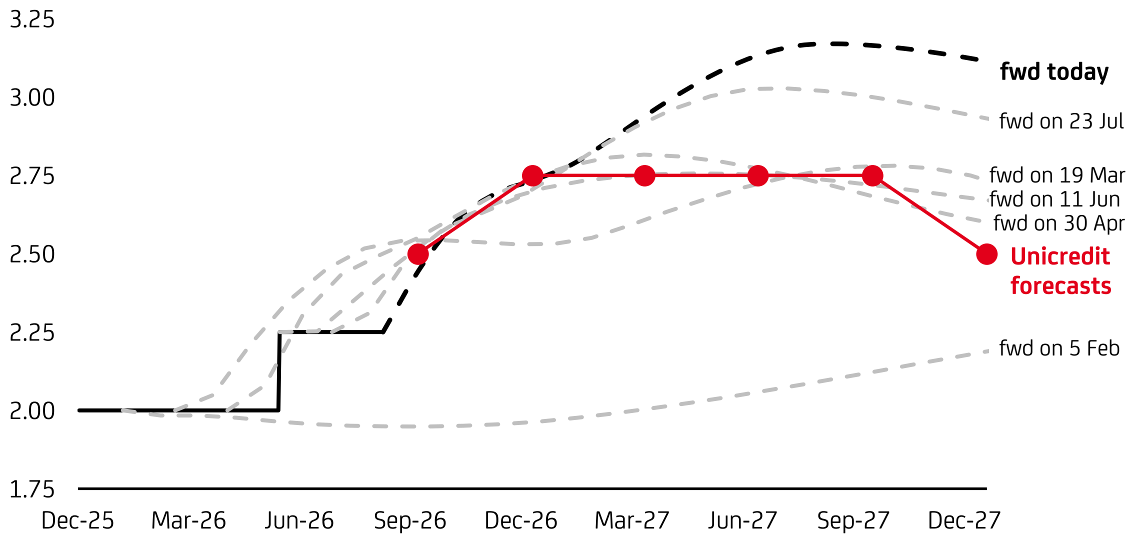
RATES

Eurozone rates have moved higher since the 23 July ECB meeting, with the 2Y OIS rate rising by around 10bp. The increase in nominal rates has been driven by both rising market-based inflation expectations and a higher real-rate component, with the 5Y swap-implied real rate now close to 1%. Curves have steepened moderately.

The upcoming ECB meeting is likely to consolidate the current picture for eurozone fixed income markets. A hike on Thursday is widely anticipated, and new economic forecasts are unlikely to weigh on EGBs, especially as the GC will presumably reiterate ongoing macroeconomic uncertainty. The central bank rhetoric is likely to remain hawkish, keeping market expectations of further hikes lively. OIS forward rates are currently pricing in more than 75bp of rate hikes in the next twelve months. We expect the ECB to be less aggressive in its hiking cycle, pencilling in a peak of 2.75%. This should bring some relief to EGBs, at least in the medium/long term. In the near future, as we highlighted in our *Coffee Break* – Bunds: the picture remains fragile, we expect current headwinds, such as the energy shock and heavy issuance activity, to continue to weigh on EGBs, keeping yields elevated.

CHART 1: OUR NEW DEPO RATE TRAJECTORY VERSUS MARKET EXPECTATIONS

UNICREDIT FORECASTS VS. OIS FORWARD RATES TODAY AND FOLLOWING THIS YEAR'S ECB MEETINGS (%)



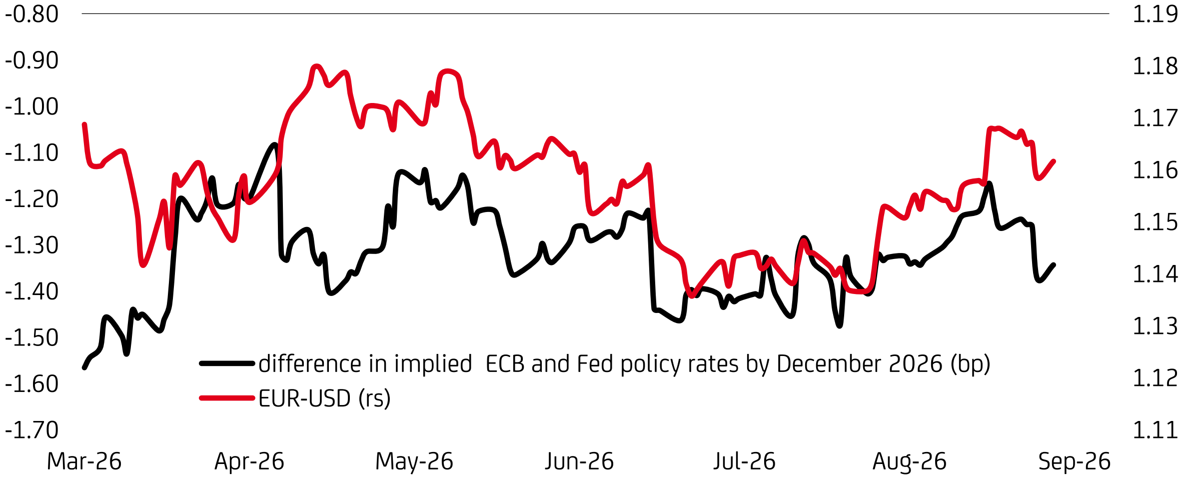
Source: Bloomberg, The Investment Institute by UniCredit

FX

An ECB rate hike to 2.50% is so widely expected that is unlikely to provide EUR-USD with significant tailwinds. The scope for a further recovery of the common currency will probably depend more on how explicitly Lagarde signals possible additional tightening at her press conference. However, she will probably refrain from laying her cards on the table. Moreover, with forward curves already pricing in a further 25bp rate hike from the ECB by December and another by October next year, EUR-USD is unlikely to receive much support from this channel. The outcome of the FOMC meeting on 16 September will probably play a more important role in determining the near-term behaviour of the pair, although US forward curves have already adjusted to reflect further rate hikes following recent remarks by Fed Chair Kevin Warsh in Jackson Hole. On balance, we still expect EUR-USD to remain range-bound around 1.16.

CHART 2: EUR-USD STILL SENSITIVE TO ECB AND FED INTEREST RATE HIKE EXPECTATIONS

EUR-USD AND THE DIFFERENCE IN POLICY RATES IMPLIED BY FORWARDS FOR THE ECB AND THE FED BY 4Q26



Source: LSEG, the Investment Institute by UniCredit

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