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ECB hikes interest rates by 25bp to bring deposit rate to 2.5%

The European Central Bank has hiked interest rates by 25bp. At 2.5%, the main policy rate is now at the upper bound of what the central bank considers its neutral interest-rate range

The ECB hiked rates by 25bp today, as expected

They might not like the term, but the just-announced second rate hike, bringing the ECB's deposit rate to 2.5%, still falls into the category of an 'insurance' rate hike. Or to put it in terms the Bank might prefer, it is a hike to stay ahead of the curve, demonstrating the ECB's high level of vigilance, and an attempt to prevent higher energy prices from feeding through to the broader economy.

While the stage was set for a rate hike, even under a more benign energy price outlook, the recent escalation in the Middle East and surge in oil prices have clearly strengthened the case for an increase. This is despite the fact that other inflation measures, like core and services as well as survey-based inflation expectations, still suggest there are hardly any second-round effects from higher energy prices.

This picture is mainly reflected in the newest round of staff projections, which show inflation unchanged at 3% this year. For 2027 and 2028, the inflation forecast was revised upwards to 2.5% and 2.1%, respectively. Core inflation is expected to come in at 2.5%, 2.6% and 2.3% in

2026, 2027 and 2028, respectively. Growth was revised upwards slightly to 0.9% this year and 1.4% in 2027 (and 1.5% in 2028). Don't forget that the recent surge in bond yields and oil prices has not been fully incorporated in these forecasts.

With the latest developments, today's rate hike was almost a no-brainer and not controversial. In light of higher actual and projected headline inflation, bringing the policy rate to the upper end of the range that the ECB itself calls 'neutral' did not pose any risk of being too activist or too restrictive. The harm of doing nothing, at least for the ECB's credibility, is clearly larger. However, looking beyond today's hike paints a very different picture and is much more complicated.

Going further would mean that the ECB sees restrictive monetary policy as necessary. But there is a big difference between an economy that has shown resilience, and an overheating economy that needs restrictive monetary policy. We still find it hard to see – amid public finance woes and surging bond yields – that the ECB would really be willing to add more fuel to the fire. In other words, it's difficult to envisage the ECB being willing to risk a recession to tackle what is still a textbook supply-side shock. However, admittedly, the ECB has made policy mistakes before.

Let's see whether ECB President Christine Lagarde sheds some light on how the central bank is currently thinking about the next steps. The press conference will start in just a few minutes, at 2.45pm CET.

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