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ECB remains focused on the here and now

At today s press conference, ECB President Christine Lagarde didn t give away any hints about what will be next for the central bank. Details of the ECB s staff projections, however, have left a hawkish aftertaste

Today's meeting left a slightly hawkish aftertaste, but we still struggle to envisage the ECB being willing to add more fuel to the fire

Lagarde's comments at today's press conference stressed that the ECB remains on high alert but also indirectly admitted it is in no better position than anyone else in financial markets; the only thing that's currently clear about the outlook (for monetary policy) is that nothing is clear. In other words, the outlook for the ECB's monetary policy remains highly dependent on both the external environment (mainly energy prices) as well as the pass-through of high energy prices into the rest of the economy.

Today's rate hike was a no-brainer

Even if the ECB doesn't like the term, today's rate hike decision – which brought the central bank'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 reflected mainly in the latest 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). Looking at the quarterly profile of the forecasts, inflation would only drop below 2% by the end of 2027. In the ECB’s mild scenario, inflation would already be below 2% by the second quarter of 2027 – but in an adverse scenario, it would remain close to 3% by the end of 2028. Still, don't forget that the recent surge in bond yields and oil prices has not been fully incorporated into these forecasts.

Hawkish aftertaste

Considering the latest developments, today’s rate hike wasn't controversial; it was almost a no-brainer. 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. Even if Lagarde tried to downplay the concept of neutral interest rates during the press conference, at least as a guiding concept. In any case, the harm of doing nothing, at least for the ECB’s credibility, is clearly more significant here. 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. However, we have to admit that, looking at the ECB’s staff projections, forecasting inflation above target for too long and the fact that these forecasts are based on interest rates pricing in between one and two more rate hikes, the risk of at least another rate hike is high. The counterargument to that view is that, with the highly volatile situation in energy markets, oil prices could also easily swing back in the other direction – which, in turn, would lead to significant changes in the ECB’s inflation forecasts. In other words, if the situation in the Middle East were to ease before year-end and any indirect effects from higher energy prices remain absent, the need for the ECB to deliver additional rate hikes would disappear.

All in all, today’s meeting left us with a slightly hawkish aftertaste. Even if 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. Admittedly, though, the ECB has made policy mistakes before.

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