Nordea

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ECB Watch: 2.5% isn’t high enough to catch 2% inflation

Marketing communication

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The ECB raised rates, and although it refused to say much about the future, the upward revisions to its inflation forecasts are a clear signal that further rate hikes lie ahead. We think the next 25bp hike will take place in December.

The ECB raised rates by 25bp, in line with expectations. While the policy-related paragraph in the press release was left unchanged, emphasizing the ECB’s data-dependent, meeting-by-meeting approach and no pre-commitments to a particular rate path, **baseline forecasts showing inflation above target throughout 2026, 2027 and 2028 clearly signal a bias towards further rate hikes**. We expect to see 25bp rate increases at the December meeting and in March 2027, but there are risks in both directions to this view, given the uncertainty created in particular by elevated geopolitical risks.

The conflict in the Middle East continues to generate inflation pressures, and inflation is set to remain well above target for an extended period. The outlook remains highly uncertain, with risks to the upside for inflation and to the downside for economic growth.

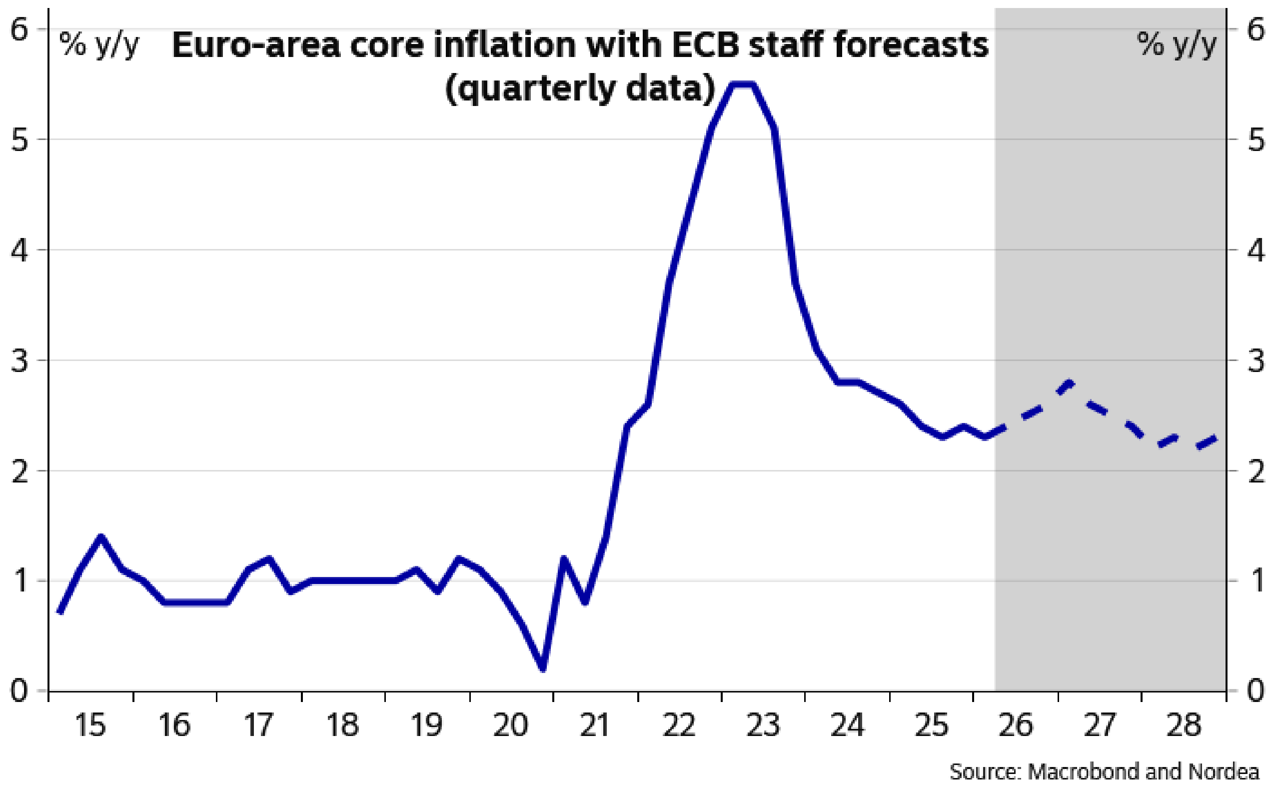
At the press conference, Lagarde said the ECB was focused on today’s decision and had not held any broader discussions about the future path of interest rates, again refusing to provide firmer forward guidance. She added that the Governing Council was not taking a stance on which direction to move at the following meeting. On the neutral rate, Lagarde said that such considerations were not important at this point. **The September decision had been a no-brainer, robust across all the ECB’s scenarios and was taken unanimously.**

We maintain our baseline of two further 25bp rate hikes at quarterly intervals, with the next one in December and the second in March 2027. We have so far argued that the risks to our baseline were tilted towards fewer hikes, but given the renewed escalation of the war in the Middle East and another notable increase in gas prices in particular, **a scenario involving faster rate hikes should not be excluded**

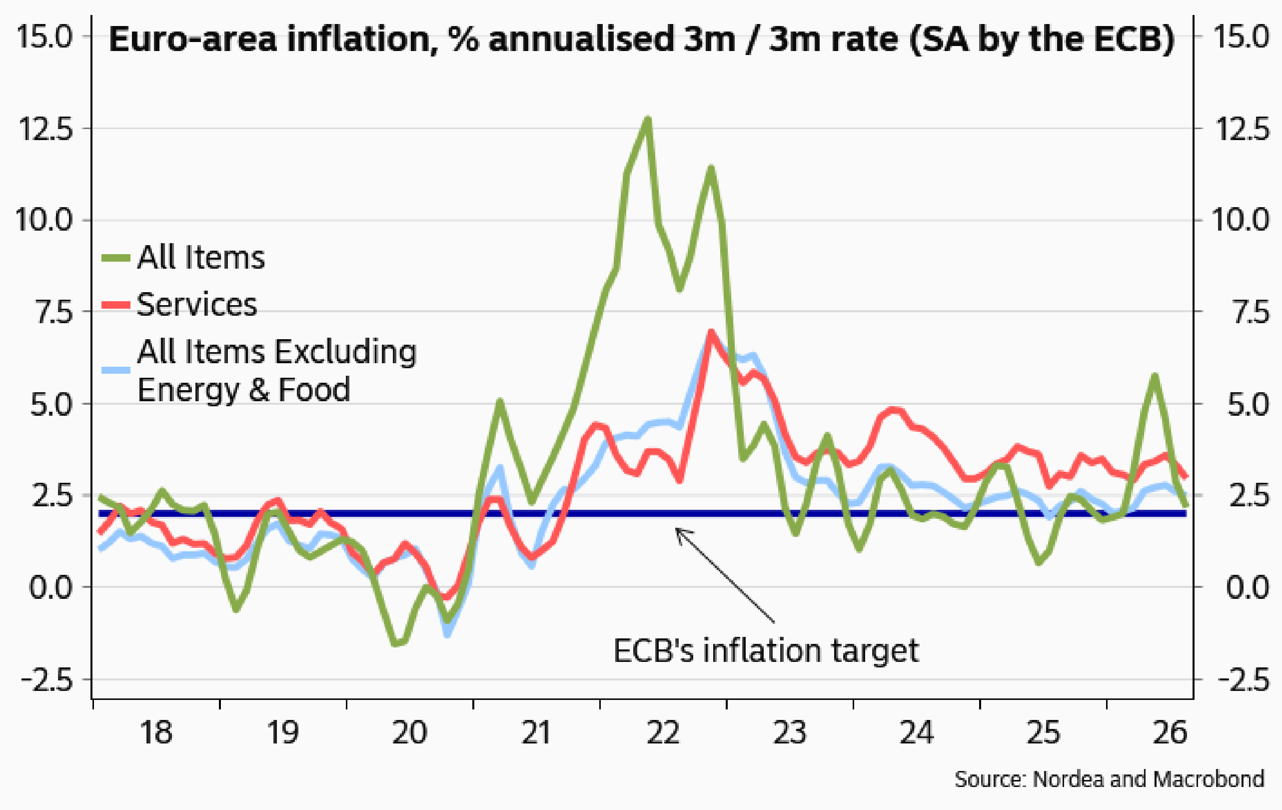
either. However, given the limited signs of broader inflationary pressures so far and a weakening in inflation momentum, we still think the ECB has time to monitor how the situation evolves before raising rates again.

Financial market pricing has recently shifted towards faster and more numerous rate hikes, and those moves continued today. Another 25bp hike in December is more than fully priced in, while the probability of the ECB raising rates as early as the October meeting has risen to more than 50%. **As we still think the December meeting is the more likely timing for the next hike, we see some room for these expectations to correct lower, though a lot naturally hinges on the development in energy prices.**

A very extended period of inflation above target strongly supports the case for more rate hikes



Inflation momentum does not look alarming yet



Financial markets moved to price in a faster increase in rates compared to our baseline

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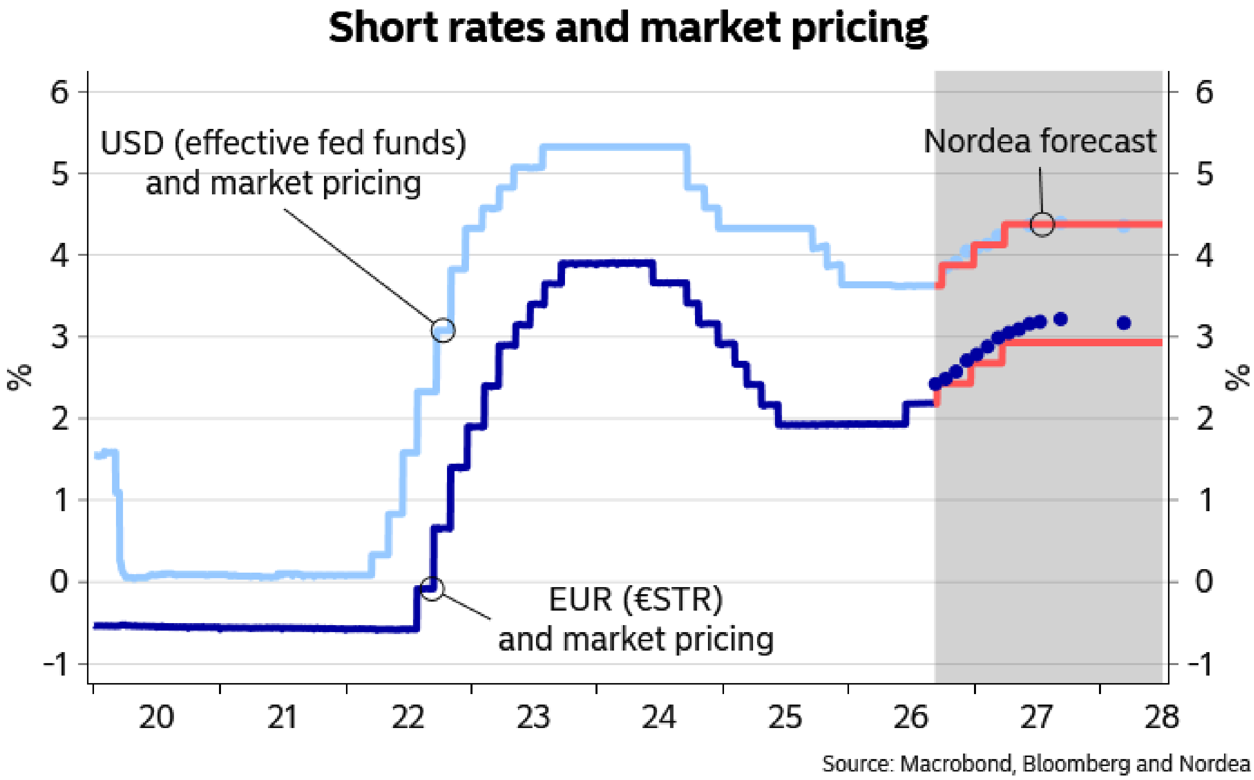

Projections support further rate hikes

The ECB revised its inflation forecast upward more than we had expected. Headline inflation is now expected to remain at 2.5% in 2027 and 2.1% in 2028, whereas the June projections assumed a steeper decline to 2.2% and 2.0%, respectively.

The main reason for the higher headline inflation projection was the assumption of higher energy prices. While the oil price assumption was lower than in June, projections for both natural gas and electricity prices were revised upwards. In addition, the exceptionally high refinery margins, which Lagarde also discussed during the press conference, likely contributed to the inflation profile. Food prices surprised the ECB on the downside during the summer, but over a longer horizon, assumptions for food prices increased somewhat.

The upward revisions to GDP growth and core inflation projections were more modest. As expected, the growth profile was revised slightly upward, as the euro-area economy has remained resilient despite geopolitical uncertainty, and the latest PMI readings point to somewhat stronger growth in 2026 and 2027 than projected in June.

As a result of the slightly stronger growth profile and the longer-lasting energy and food price shocks which are expected to have both indirect and second-round effects at the end, **the ECB now projects a somewhat higher core inflation path for 2027–2028.** However, the revisions were only 0.1 percentage point in each year and do not alter the overall picture of how the ECB expects core inflation to evolve. **In any case, the**

ECB expects underlying price pressures to remain above the target level until the end of the forecast horizon.

ECB staff revising all forecasts higher

	GDP		Headline inflation		Core inflation	
	June 26	Sept 26	June 26	Sept 26	June 26	Sept 26
2026	0.8	0.9	3.0	3.0	2.5	2.5
2027	1.2	1.4	2.3	2.5	2.5	2.6
2028	1.5	1.5	2.0	2.2	2.2	2.3

Source: ECB and Nordea

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