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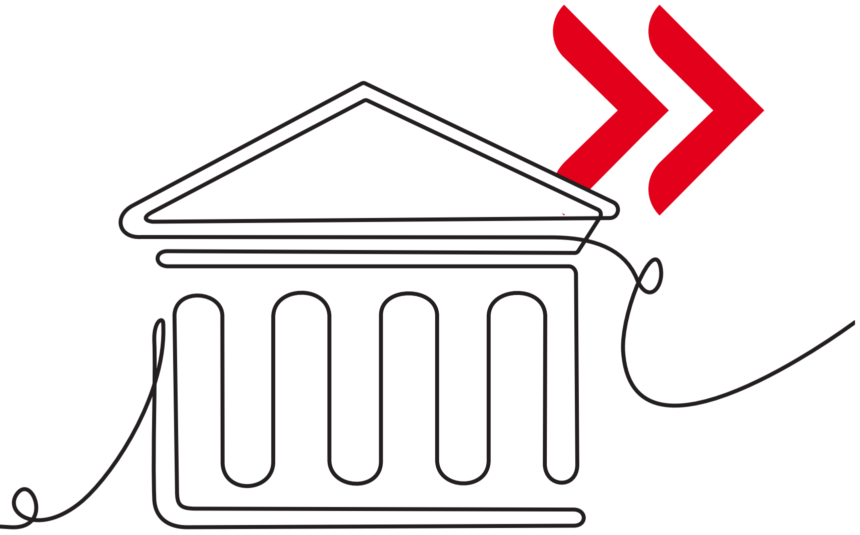
Central Banks Watch

ECB Review



Pervasive hawkishness

10 September 2026

ECB hikes 25bp and sounds hawkish

As widely expected, today the ECB raised interest rates by 25bp, lifting the deposit rate to 2.50%. The tone of the press conference was hawkish, reflecting a more persistent inflation shock and resilient economic activity.

We expect a final rate increase in December

Unless energy prices fall rapidly and significantly from current levels, the ECB is likely to continue its tightening campaign at the December meeting. We expect the deposit rate to peak at 2.75%.

Today, the ECB delivered a widely anticipated 25bp rate hike, raising the deposit rate to 2.50%. This level corresponds to the upper bound of the ECB's estimated range for the neutral rate. The decision was unanimous. The key message from today's meeting was one of pervasive hawkishness. While the ECB refrained from providing any forward guidance, sticking to its data-dependent and meeting-by-meeting approach, several aspects of its communication tilted in a hawkish direction.

First, the staff projections point to a more persistent inflation shock than previously envisaged, with risks to price stability still judged to be tilted to the upside. While food inflation has been weaker than the ECB expected and wage developments do not show any meaningful second-round effects from the energy shock, the central bank's staff projects headline inflation to remain well above target through 1H27, returning to 2% only towards the end of next year – broadly in line with our own forecast. In yearly terms, the ECB expects inflation to average 3.0% in 2026, 2.5% in 2027 and 2.1% in 2028. The projected path for core inflation remains above 2% throughout 2028, not only in the baseline scenario but also in a more favourable scenario in which energy prices decline faster and more significantly than currently assumed. It is important to note that energy prices have already risen above the levels assumed in the ECB's forecasting exercise, posing upside risks to the central bank's inflation projections already now.

Second, the ECB has become more constructive on the growth outlook. GDP projections have been revised upwards, and the recurring theme throughout the press conference was economic resilience. Increased infrastructure and defence spending, a stronger contribution from AI-related investment activity, continued growth in private consumption and a "robust" labour market have strengthened the Governing Council (GC)'s confidence that the eurozone economy can withstand higher energy prices and higher interest rates without suffering major damage.

The ECB's updated GDP forecast envisages quarterly growth of 0.3-0.4% throughout 2028, implying that the eurozone economy will expand at a pace close to, or slightly above, potential over the next two and a half years.

Third, during the press conference, ECB President Christine Lagarde described today's decision as a "robust" hike across a range of scenarios, echoing the language used in June. This reinforces the hawkish message from the meeting, as it suggests that the GC does not view today's move as a risk-management hike. Such an interpretation indicates a high degree of confidence in the underlying rationale for further policy tightening, while a risk-management decision would seem more suitable for the end of a tightening cycle, when policymakers may choose to buy some insurance against the risk of persistent inflation.

Fourth, Ms. Lagarde downplayed the significance of policy rates being at the upper end of estimates of the neutral range, stressing that the level of the neutral rate is inherently uncertain and evolves over time. In our view, this remark lowers the bar for the GC to push policy rates into (mildly) restrictive territory, if warranted.

Fifth, the GC appears relatively relaxed about the recent rise in bond yields. Ms. Lagarde emphasized that higher yields are largely a global phenomenon, reflecting supply-demand dynamics and increased financing needs associated with stronger investment spending. Since part of the increased demand for funding is linked to productive investment, particularly in infrastructure and technology, the ECB does not currently regard higher yields as a source of concern.

Overall, today's meeting strongly suggests that the ECB is not done tightening yet. Unless energy prices experience a rapid and substantial correction, or economic activity comes under meaningful pressure, the ECB's reaction function would clearly point towards another rate increase, most likely before year-end. We therefore continue to expect one final 25bp hike in December, which would take the deposit rate to 2.75%.

Author
Marco Valli, Head of Macroeconomic Analysis and Chief Economist (UniCredit, Milan), marco.valli@unicredit.eu

Editor
Edoardo Campanella, Director and Chief Editor of The Investment Institute (UniCredit Milan), edoardo.campanella@unicredit.eu

UniCredit S.p.A
Client Solutions, Group Investment Strategy, Piazza Gae Aulenti, 4, I-20154 Milan
www.the-investment-institute@unicredit.eu

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