Snap | 8 October 2026

ECB's September minutes reveal full support for 25bp rate hike

The just-released minutes of the ECB's September meeting confirm that the decision to raise interest rates by 25bp was driven by a deteriorating inflation outlook



Christine Lagarde, President of the ECB

By the time the ECB met in September, a 25bp rate hike had already come to be seen as the most likely outcome. The just-released minutes of that meeting show that the ECB's Governing Council was united in its view that a worsening inflation outlook and economic resilience called for a hike. The minutes, however, give a less hawkish picture than ECB president Christine Lagarde's comments at the press conference.

Here are the most relevant phrases from the minutes:

Worsened inflation forecast the reason for the rate hike. *The updated staff projections indicated that inflation was set to remain well above target for an extended period. Increasing the deposit facility rate from 2.25% to 2.50% was a robust decision across a wide range of scenarios. While measures of underlying inflation had shown little change so far, the full inflationary impact of the energy shock had yet to play out.*

Some ECB members pointed to less inflation drama. *It was pointed out that the energy shock*

could be less persistent than assumed, as it was essentially a politically driven shock that could disappear as quickly as it had appeared.

And not all members were fully supportive of the resilience narrative. *It was still too early to draw a firm conclusion about the degree of resilience of the economy on the basis of the latest growth figures.*

The risk of the knock-on effects of higher energy prices on the rest of the economy remains. *Rising energy prices could also transmit to food prices. In addition, higher fertiliser prices precipitated by the energy shock, together with the impact of El Niño and recent heatwaves, could put upward pressure on food commodity prices.*

But there have been few indirect effects so far. *Indirect effects had remained contained and second-round effects had not been seen. It was also suggested that a cooling labour market and moderating wage growth could limit the risk of second-round effects.*

On France. Not a single word. Only that a further rise in long-term interest rates could adversely affect growth.

The concept of a neutral interest rate does exist. *While it was noted that the response should remain proportionate, it was also pointed out that a deposit facility rate of 2.50% remained in the range of neutral interest rates estimated by staff.*

No forward guidance. *Against this backdrop, communication should remain neutral, neither suggesting that the current decision was another step in a predetermined tightening cycle nor that it was the last rate hike. At the same time, continued vigilance was vital.*

All in all, the minutes show an ECB that saw no risk in hiking rates at the September meeting, but looking ahead was more balanced than the comments at the press conference suggested.

French fiscal situation will push ECB to be more dovish

The next ECB meeting is in three weeks. So far, there is little reason to believe that the bigger macro picture will change significantly until then. Maybe with one exception: the rise in bond yields and the fiscal situation in France. The surge in German bond yields since the September meeting has already had the same impact on growth and inflation as an additional 25bp rate hike. For France, it's closer to a 50bp hike. With bond markets doing the ECB's job, some officials might be less keen to continue hiking than they were at the September meeting.

The ECB's October meeting doesn't look like a meeting to discuss further rate hikes. This will be for the December meeting. However, the October meeting could facilitate a more general discussion on how to react to the current French situation and speculations by some market participants on a new eurozone sovereign debt crisis. Here, we see three potential policy responses: the first was already prepared by Lagarde during her comments at the European

Parliament: easing the hawkish tone and possibly agreeing on fewer rate hikes than markets had priced in. The second is the end of Quantitative Tightening and a restart of reinvesting matured bonds. This could bring some relief to bond markets. The ECB could even decide to purchase eurozone debt but not French debt, in case France is not able to pass a budget compliant with the European fiscal rules. And the third, and more distant, option would be to start the Transmission Protection Instrument. It would be more outright asset purchases, aiming at narrowing spreads.

In any case, it looks as if the hawks from the September meeting might find themselves as more collateral damage from the French fiscal mess.

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