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ECB Hikes and Will Again Soon

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- We think the ECB is not done and will announce another 25bps hike at its July (or September) decision, with risks tilted toward a third rate increase much more than today's being a one-and-done hike.
- According to ECB President Lagarde, today's decision was unanimous and there was no option other than a hike that was debated among policymakers.
- The bank revised higher its inflation forecasts, with small negative revisions to growth. Of note, the 2027 core inflation call was lifted by 0.3ppts to 2.5%, reflecting greater knock-on effects from energy prices on the broader economy.
- The market reaction was relatively limited with small moves lower in European yields as traders perhaps expected an even more hawkish decision; year-end hikes pricing sits at 42bps (a 4bps decline from yesterday).

Today, the ECB delivered a widely expected 25bps rate hike, taking its deposit facility rate to 2.25% after sitting at 2.00% since the bank's last rate cut in June 2025. Developments in energy markets over the past three months have quickly lifted inflation in the currency bloc, with growing worries about possible second-round effects across the broader economy that require adjustments to policy settings. We think the ECB is not done and will announce another 25bps hike at its July (or September) decision, with risks tilted toward a third rate increase much more than today's being a one-and-done hike.

According to ECB President Lagarde, today's decision was unanimous and there was no option other than a hike that was debated among policymakers. Lagarde's press conference was more direct than usual, clearly suggesting that the ECB will not stop here, highlighting that the outlook for the economy in all of the bank's four scenarios (more below) requires monetary tightening. The President also stated that today's move was not an 'insurance' hike, saying that without tighter policy inflation would be above target in the medium-term and that they are seeing signs of broadening inflation in the economy—while she does not believe that growth is “under significant threat”.

The main changes in the statement correspond to the bank's updated forecasts and the justification for today's hike, stating that “the war in the Middle East is generating inflation pressures, and the decision to raise rates is robust across a range of scenarios mapping out how the shock might evolve and affect the medium-term outlook for the euro area,” with the outlook remaining uncertain “with upside risks for inflation and downside risks for economic growth.” Forward guidance kept to its usual “data-dependent and meeting-by-meeting approach”, while noting that “the Governing Council remains well positioned to navigate the uncertainty caused by the war.”

From the get-go, the ECB's decision statement suggests that more tightening is needed, as the text highlighted that core inflation is expected to average above 2% over the 2026-28 forecast horizon in its baseline scenario, an outcome that would be incompatible with a marginal quarter-point hike. This is despite a lower growth path responding to higher commodity prices, and weakened real incomes and confidence. However, one could see the impact on economic activity or sentiment as more transitory in nature and possibly quick to rebound once geopolitical risks and commodity prices normalize, but initial inflationary shocks could prove more pervasive and create a self-reinforcing loop (mainly via wages growth) that lengthens the period of above-target inflation—alike what occurred in the aftermath of Russia's invasion of Ukraine (although this coincided with the post-pandemic recovery).

June 11, 2026

Turning to the numbers, the ECB's baseline projection is that headline inflation will average 3.0/2.3/2.0% in 2026/27/28 (up from 2.6/2.0/2.1%) and core inflation will average 2.5/2.5/2.2% in 2026/27/28 (up from 2.3/2.2/2.1%). The most noteworthy update is that for core inflation, particularly for 2027 which was lifted by 0.3ppts and reflects a clear assessment by the ECB that there will be a greater pass-through into other segments of the prices basket—although indirect and second-round effects are less pronounced than in the 2021-24 episode not only due to a net smaller energy shock but also due to a weaker economic and labour backdrop. Nonetheless, headline inflation is projected to remain above 2% through mid-2027 and core inflation does not converge to the 2% target until late-2027/early-2028. Compared to the March round, roughly one-third to half of the revision higher in headline CPI forecasts owes to an updated view for core prices while the remainder comes from energy and food inflation. GDP growth was downgraded only marginally, now at 0.8/1.2/1.5% in 2026/27/28 (from 0.9/1.3/1.4%).

In the March forecast round, the ECB included two alternative scenarios (Adverse and Severe) that represent higher energy prices paths and greater second-round inflationary impacts. In today's update, they refresh these two scenarios but also take a more balanced approach by showing a Milder scenario where prices normalize more rapidly than in the baseline. Though they may be called the same, today's Adverse scenario shows a more dragged out period of higher inflation than that presented in March, with headline inflation for 2026/27 seen at 3.3/3.0% compared to the March Adverse scenario's 3.5/2.1%. The main change here was that the ECB switched from a scenario that assumed "acute energy supply disruptions persist until Q3-2026" with "no significant further destruction of energy infrastructure" to one that simply takes that "energy commodity prices follow the 75th percentile of the market-implied probability distributions," which ultimately results in a more persistent (and we think more reasonable) assumption for the outlook in energy prices under worsening conditions. In the Milder scenario, inflation averages 2.9% in 2026, i.e. only 0.1ppts below the baseline, but a quicker normalization of prices means that inflation would only average 1.8% in 2027, compared to the 2.3% pencilled in for the baseline; core inflation in 2027 is also seen 0.2ppts lower (for more details see the [full report](#)).

The market's reaction to the full suite of ECB communications (statement, projections, and the presser) was relatively narrow. Despite Lagarde striking a hawkish tone that pointed to more hikes coming, European yields dipped throughout her appearance, possibly reflecting that traders were going into the decision expecting that the ECB's President would more clearly tee up another increase at the July meeting. The usual post-decision leaks to the press were mixed. Reuters reported that policymakers could eye a pause at the July announcement if energy prices stay where they are, so a hike then would require a "material surge" in energy prices. But, the report also noted that the projections embed two more rate hikes—which we believe would be better to be rolled out in quick succession rather than waiting and risking greater second-round effects. Meanwhile, Bloomberg reported that "officials aren't ruling out a second increase in interest rates as soon as their next monetary-policy meeting," with the article's headlines prompting a small rebound in European yields. At writing, markets are pricing in a cumulative 42bps in additional ECB rate hikes by year-end (4bps less than at yesterday's close), assigning about a one-in-three chance that the next hike comes in July, with fully priced-in certainty that the ECB will hike by September.

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