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FLASH REPORT
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ECB Holds Ahead of Likely September Hike

- **Today, the European Central Bank (ECB) kept its deposit facility rate unchanged at 2.25%, as widely expected, taking a breather following its quarter-point increase in June. President Lagarde gave very little away, at her post-decision press conference, but noted that today's vote was unanimous and that there was no push for an ECB hike, although some governors asked themselves if a hike was needed.**
- **Current conditions point to a 25bps hike at the bank's next meeting, on September 10th, alongside fresh forecasts. We think that the ECB will stop there, at a 2.50% deposit rate, though today's energy prices holding for several more weeks/months would require additional hikes.**
- **There will be much more information at hand by the September announcement, alongside which the ECB will also update its macroeconomic projections. From now until September 10th, the ECB will get Q2-26 figures on GDP and negotiated wages/ labour costs, July and August CPI and S&P PMIs, while monitoring energy prices developments.**
- **At writing, markets are pricing in a total of ~50bps in hikes by year-end. Markets reacted marginally to the ECB's decision and press conference with higher yields and a weaker EUR on the day reflecting global moves in sovereign debt and the USD responding to the energy prices and market mood backdrop.**

Today, the European Central Bank (ECB) kept its deposit facility rate unchanged at 2.25%, as widely expected, taking a breather following its quarter-point increase in June. The quickly shifting energy prices landscape remains the leading shot caller for ECB expectations, with current conditions pointing to a follow-up 25bps hike at the bank's next meeting, on September 10th, alongside fresh forecasts. We think that the ECB will stop there, at a 2.50% deposit rate, under an expectation that energy prices will normalize (again) in the coming weeks or months. If current prices (Brent at $90–100/bbl and Dutch natural gas at €60–65/MWh) continue for several more months, additional tightening would be in order.

At writing, markets are pricing in a total of 49bps in hikes by year-end, a 2bps increase on the day that mainly owes to the rise in global energy prices that is impacting yield curves worldwide; there is 23bps in implied hikes pricing for the September announcement, with the next 'full hike' pencilled in until the December announcement, skipping October. The EUR also mostly followed the USD-positive mood, with a 0.3% loss on the day roughly in line with GBP, CHF, and JPY losses.

Compared to last month's ECB decision that also included a forecast update, today's policy statement was relatively brief (only two paragraphs) but made sure to note that "the outlook for energy prices, while highly volatile, currently stands close to the baseline" in the June forecast round—"well above the levels recorded prior to the conflict in the Middle East."

President Lagarde gave very little away, much less than usual or possibly expected, at her post-decision press conference, but noted that today's vote was unanimous and that there was no push for an ECB hike, although some governors asked themselves if a hike was needed. Ultimately, it seems the ECB preferred to show a united front and they'll have plenty to go on before the September meeting. On that note, the customary in-the-know Bloomberg story that usually follows Lagarde's press conference highlighted that the ECB is ready to hike in September unless the "inflation outlook improves markedly."

Regarding inflationary risks, Lagarde mentioned that these remain tilted to the upside and that the "longer energy prices stay high, the more likely they are to drive up broader inflation." However, she said that they are not currently seeing second-round effects on inflation, but that they will pay close attention to these ahead of the September announcement.

It is anyone's guess what the inflation backdrop will look like in six weeks. In late-June/early-July, Brent prices at $70–75/bbl—just slightly above pre-conflict levels—had seen markets scale back their year-end deposit rate expectation to as low as 2.42% (or 17bps in additional hikes). Just prior to the ECB's June 11th decision and ahead of the mid-June U.S.-Iran ceasefire agreement, markets were pricing in a year-end rate of 2.71% (or 46bps on top of an expected 25bps hike in June). At yesterday's close, with September Brent oil trading at ~$93.50/bbl, markets were pencilling in 47bps in additional hikes by the ECB by year-end; i.e., the leg higher in oil and natural gas prices in recent weeks has re-added an extra quarter-point hike expected from the ECB.

Today would have been too soon for the ECB to consider an additional hike. As highlighted previously, large swings in crude oil prices make it extremely difficult for officials to have any certainty on what the bloc's economy requires to ensure the convergence of inflation. On the one hand, had the current prices environment of $90-100/bbl Brent and Dutch natural gas at €60–65/MWh lasted throughout the weeks since the June 11th announcement the ECB would have likely hiked today instead of waiting another six weeks. On the other hand, had oil prices remained in a $70–75/bbl band since the last decision may have seen the ECB, today, sound more optimistic on a faster return to inflation—although it would probably be much too soon to declare victory, and there is little to be won from an early change in tone and little to be lost from waiting a bit longer.

Compared to the June forecast update, the Brent oil futures curve is relatively close to the ECB's baseline scenario, with October–December futures contracts averaging ~$90/bbl—compared to the ECB's $90–95/bbl assumption last month that took the Brent futures curve in the days prior to the announcement. Natural gas prices have, however, deviated towards the ranges set out in the ECB's adverse scenario, averaging about €60/MWh for 4Q-26, versus the €45–50/MWh baseline and ~€60/MWh adverse scenario—though still very far from the €110/MWh severe scenario. Natural gas prices have sharply gained in recent weeks on the combination of heightened Middle East supply risks and global heat waves driving demand for natural gas higher. This all comes at a time when Europe is also looking to rebuild its natural gas storage ahead of winter; gas stocks currently sit ~55% full, compared to a seasonal five-year average of ~70%.

There will be much more information at hand by the next announcement, at which the ECB will also update its macroeconomic projections. From now until September 10th, the ECB will get Q2-26 figures on GDP and negotiated wages/labour costs, July and August CPI and S&P PMIs, and a handful of other surveys and macroeconomic data. These will be key to gauging the extent of inflationary pressures that have built up through nearly five months of war in the Middle East, but also how high energy prices have dragged on domestic demand. Alongside the data, they'll monitor developments and risks for global energy markets, of course.