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FLASH REPORT

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ECB Holds Ahead of December Hike

- **The ECB left all its policy settings unchanged in today's announcement, as expected, keeping the deposit facility rate at 2.50% following 25bp increases in each of June and September.**
- **We forecast a 25bp hike to the deposit facility rate to 2.75% at the December 17th meeting, with additional tightening conditional on developments in energy prices and financial conditions.**
- **The ECB noted that "financing conditions have tightened since the Governing Council's last meeting, which is likely to weigh on inflation and growth" and that "energy prices have continued to rise, posing upside risks to the inflation outlook."**
- **Lagarde said that the ECB's direction of travel is quite clear unless there's a surprise, implicitly guiding that expectations for additional hiking remain valid—with a December hike also teed up by post-presser media reports.**
- **Ahead of the rate announcement, the ECB published a press release saying that Lagarde intends to step down from the role in early-February. The EU will now hold auditions for the ECB's presidency, with an aim to announce Lagarde's replacement before year-end.**

As expected by economists and markets, the ECB left all its policy settings unchanged in today's announcement, keeping the deposit facility rate at 2.50% following 25bp increases in each of June and September. The inter-forecast rounds announcement was naturally short of colour ahead of the December decision when the ECB's new projections will show the combination of tighter financial conditions against higher-for-longer energy prices.

The announcement, Lagarde's press conference, and "ECB sources" comments to media published after the official communications combined for a roughly as expected if maybe somewhat less hawkish ECB decision day, with market rate hike expectations for 2027 slightly trimmed though with the EUR marginally gaining on the day amid broad USD losses.

We forecast a 25bp hike to the deposit facility rate to 2.75% at the December 17th announcement. This increase should be the last in the cycle as per our latest forecast update, though additional hikes are more likely than the ECB having already concluded its tightening cycle. Developments in European debt markets and global energy prices, as well as evidence (or lack of it) of second-round inflationary pressures will determine the ECB's next steps.

Without the latest selloff in European sovereign and corporate debt since July–August (amid a broad tightening of financial conditions), the energy prices backdrop would likely motivate the ECB to roll out additional hike(s) in Q1-27. Markets are pricing in 21–22bps of a December rate increase (~85% odds, broadly unchanged), with a total of ~55bps penciled in by next June's decision compared to yesterday's close at ~60bps (around which hike bets have chopped for the past few days).

The policy statement was somewhat more cautious than possibly anticipated, which triggered a decline of up to 5bps in German 2s upon its release. The ECB noted that "financing conditions have tightened since the Governing Council's last meeting, which is likely to weigh on inflation and growth" and that while "energy prices have continued to rise, posing upside risks to the inflation outlook and downside risks to the growth outlook" and "are still unfolding," that "underlying inflation has remained broadly stable so far and wages do not show a material response at this stage."

'Supercore' Eurozone inflation (HICP ex energy, food, alcohol, tobacco, air transport, and package holidays) printed a 2.4% y/y increase in September and has generally held around the mid-2s since early-2025 with the exception of a couple of lower readings in January and March of this year; recently hotter m/m readings for this measure have mostly owed to core goods (possibly due to AI-related pressures) rather than services that would reflect higher wages. On wages, there hasn't been a clear change in the growth trend for either of the ECB's indicator of negotiated wages or its wages tracker.

President Lagarde's press conference partially balanced the more cautious tone of the statement, or at least the market's interpretation of it, with German 2s yields bouncing back by 2–3bps between the release of the statement and the end of her presser.

On the more guidance neutral side of things, Pres Lagarde highlighted that the ECB is not seeing material second-round effect risks currently, nor on top of those already incorporated in the September forecast round. According to Lagarde, today's ECB decision was unanimous. She also pointed to the tightening of financial conditions since the September decision and that fiscal uncertainty may further tighten these and that risks to growth are tilted to the downside.

Regarding the latest tightening of financial conditions, a Reuters report citing ECB sources published after the presser noted that "ECB estimates circulated before Thursday's meeting showed that the recent increase in bond yields would lower economic growth by a cumulated 100 basis points and inflation by 90 basis points in 2027–28 compared to the September baseline projection." How this impact is spread out is not detailed, nor does it note how much is offset by higher energy prices compared to September, but the ECB projected GDP growth at 1.4% and 1.5% and headline inflation at 2.5% and 2.1%, in 2027 and 2028, respectively, in last month's projections—so, all else equal the new forecasts would show somewhere around low-1s growth and low-2s/sub-2s headline inflation for these years.

As for the more hawkish-leaning comments that back up expectations for a rate hike in December, Lagarde said that the ECB's direction of travel is quite clear unless there's a surprise, implicitly guiding that expectations for additional hiking remain valid. This was reinforced by the same Reuters report, which stated that "ECB policymakers expect to increase interest rates in December to fight high, energy-led inflation and then pause as a rise in bond yields is set to weigh on growth and inflation." A hike was also debated in today's meeting according to Lagarde, though this is a reasonable discussion to have and she did not qualify whether this was seriously under consideration. On inflation, she said that it will be well above target in the coming quarters, that energy prices have increased beyond the September baseline, and that early stages of the production chain point to upside pressure.

Ahead of the rate announcement, the ECB published a press release saying that Lagarde intends to step down from the role in early-February (ahead of the end of her term in October). At the press conference, Lagarde said that she wants "to have the freedom of speech, the freedom of expression, and the freedom to engage on matters that are not monetary policy matters," with no nod to her possible next steps. The EU will hold auditions for the next ECB president over the next two months, aiming to reach a decision before year-end, with former Bank of Spain/now BIS head De Cos and former Bank of Netherlands head Knot being floated as possible candidates.

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