

## ECB Raised Interest Rates to Combat Inflation



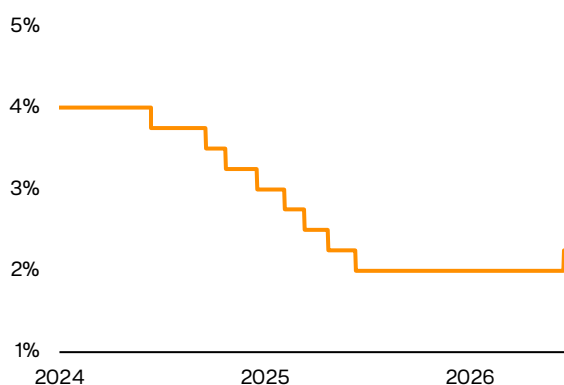
### Summary:

- The ECB raised its policy rates by 25 basis points in response to rising inflation caused by the Middle East energy shock.
- The staff macroeconomic projections expect inflation to remain elevated, accompanied by slightly slower GDP growth for 2026 and 2027.
- Additional rate hikes during the remainder of 2026 remain possible.

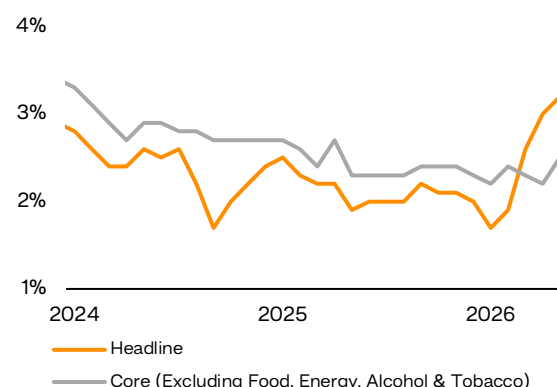
### **The European Central Bank (ECB) delivered a widely expected rate hike to combat rising inflation.**

At its June monetary policy meeting, the ECB decided to raise its three policy rates by 25 basis points (bps) in June. Accordingly, the interest rates on the deposit facility, the main refinancing operations and the marginal lending facility rose to 2.25%, 2.4% and 2.65%, respectively. The move was widely anticipated by global financial markets. ECB President Christine Lagarde stated that the unanimous decision by the Governing Council reflects a strong determination to contain rising upside risks to inflation. Notably, inflation readings have accelerated in recent months. The eurozone's headline CPI inflation advanced to 3.2% year-on-year (YoY) in May, while core inflation (excluding food, energy, alcohol & tobacco) rose to 2.5%, marking the highest rate since April 2025.

The ECB's monetary policy statement emphasised that the rate hike was a direct response to mounting inflationary pressures. These pressures stem from higher energy prices and their ensuing pass through to the broader consumer basket. At the same time, the central bank reiterated its long-standing commitment to follow a data-dependent and meeting-by-meeting approach for future monetary policy decisions.

**ECB's Deposit Facility Interest Rate**


Source: CEIC

**Inflation Rate (YoY)**


Source: CEIC

**The ECB's baseline scenario projects that inflation will overshoot its policy target throughout 2027.** Based on the Eurosystem staff macroeconomic projections released in June, headline inflation was revised upward to an average of 3.0% in 2026 (from 2.6%) and 2.3% for 2027 (from 2.0%), before returning to the 2.0% policy target in 2028 (from 2.1%). These revisions reflect higher energy and food price assumptions as well as stronger indirect effects on other non-energy components. Conversely, the outlook for GDP growth is slightly weaker. Growth projections were revised down to 0.8% for 2026 (from 0.9%) and 1.2% for 2027 (from 1.3%), while the GDP forecast for 2028 was upgraded to 1.5% (from 1.4%). On balance, the updated projections indicate that inflation remains a significantly larger concern for the ECB than sluggish growth.

**ECB's Macroeconomic Projections for Eurozone**

	2026F	2027F	2028F
<b>Real GDP (June)</b>	<b>0.8</b>	<b>1.2</b>	<b>1.5</b>
March's forecast	0.9	1.3	1.4
<b>CPI Inflation (June)</b>	<b>3.0</b>	<b>2.3</b>	<b>2.0</b>
March's forecast	2.6	2.0	2.1

Source: European Central Bank

**President Lagarde adopted a hawkish tone regarding the future monetary policy path.** During the post-meeting press conference, Lagarde pushed back against market commentary that the ECB's move was a pre-emptive or "insurance" hike. Instead, she stressed that the energy shock is enduring longer than initially expected, with rising costs becoming widely visible throughout the economy. Additionally, Lagarde highlighted that the rate hike decision was robust across various scenarios regarding the potential evolution of the Middle East conflict.

**Additional rate hikes for the remainder of 2026 remain possible.** While the geopolitical landscape in the Middle East conflict remains fluid, the energy shock is likely to exert lingering upward inflationary pressures across the eurozone economy. Furthermore, significant uncertainties persist regarding the indirect and second-round effects of higher energy prices. Derivatives markets are currently pricing in one to two additional 25-bps ECB rate hikes before the end of 2026. Such pricing will likely be realised if inflation continues its current upward trajectory.

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