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**REVIEW: After a “Hawkish Hold,” the ECB Starts From
“A Good Base”, If Policy Action Were Required**

By

Brunello Rosa and Nato Balavadze



19 March 2026

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Executive Summary

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- ✎ **Decision Made:** *The European Central Bank (ECB) remained on hold*, and kept its i) interest rate on the ‘main refinancing operations’ at 2.15%; ii) interest rate on the ‘marginal lending facility’ at 2.40%; and the key iii) ‘deposit facility’ at 2.00%. Future decisions will be taken meeting-by-meeting, following its usual three-pronged approach about its reaction function confirmed. It said the economy is well positioned, with inflation near 2% and expectations anchored, but will rely on incoming data to assess the war’s impact and adjust policy accordingly.
- ✎ **Policy Discussion:** *The ECB kept rates on hold in a unanimous decision, reflecting a calm and focused Governing Council.* However, the tone has clearly shifted. Lagarde no longer describes the economy as being in a “good place,” instead stressing that it is “well-positioned and equipped” to deal with the unfolding shock. Her remarks highlighted rising risks from the Iran conflict, second-round effects, and upward revisions to inflation. As a result, the ECB starts from “a good base” of 2% inflation, 2% inflation expectations, and 2% interest rates (near neutral) if policy action were required, in either direction.

The macro backdrop has worsened, driven by energy prices. Short-term inflation expectations have surged, with one-year swaps rising from below 2% to 4%, while markets have sharply repriced the policy path. Investors now expect up to two rate hikes by October, compared to expectations of no change before the conflict. Risks to inflation are tilted to the upside, particularly if elevated energy prices persist and feed into wages and expectations.

At the same time, the growth outlook is weakening. The war is weighing on real incomes, confidence, and investment, especially into 2026, creating a clear trade-off between inflation and activity. The ECB will remain data-dependent and proceed meeting by meeting, but the overall tone has turned more hawkish, with markets even pricing a roughly 50% chance of a hike as early as next month.

- ✎ **Changes To Economic Forecast:** *ECB staff now expect inflation to rise to 2.6% this year (from 1.9%), before returning to around 2% in 2027–28.* Projections, based on data up to 11 March, reflect higher energy prices, with core inflation also revised slightly higher. Growth has been revised down, especially for 2026 (0.9%), due to weaker confidence, lower real incomes, and global conditions, though supported by low unemployment and public spending. Scenario analysis suggests that a prolonged energy shock would push inflation above and growth below baseline, with medium-term outcomes depending on second-round effects.

Key Picture: European Central Bank Key Forecasts – 2024-2027

	Latest reading	2026f		2027f		2028f	
		March Projections	December Projections	March Projections	December Projections	March Projections	December Projections
GDP (<i>real growth, y-o-y</i>)	1.3	0.9	1.2	1.3	1.4	1.4	1.4
Inflation (% <i>y-o-y</i>)	1.9	2.6	1.9	2.0	1.8	2.1	2.0
Core-inflation (% <i>y-o-y</i>)	2.3	2.3	2.4	2.2	1.9	2.1	2.0
Unemployment (% <i>y-o-y</i>)	6.2	6.3	6.2	6.3	6.1	6.2	5.9

Source: ECB ‘Macroeconomic projections’ [December](#) and [September](#) 2025 Note: Latest readings: 1. GDP for Q4 2025; 2. Unemployment for December 2025; 3. Inflation for December 2025. *Inflation = Harmonized Index of Consumer Prices (HICP).

Analysis

- ✦ **DECISION MADE:** *On March 19, the ECB remained on hold.* In line with consensus, in an unanimous decision, the European Central Bank (ECB) to keep its main policy rates i.e. its *i)* interest rate on the ‘main refinancing operations’ at 2.15%; *ii)* interest rate on the ‘marginal lending facility’ at 2.40%; and the key *iii)* ‘deposit facility’ at 2.00%.

In its forward guidance, the ECB stated that the decisions will be still taken meeting-by-meeting, with its usual three-pronged approach about its reaction function confirmed. According to the statement, the Governing Council is well positioned to navigate current uncertainty. Inflation is around the 2% target, inflation expectations remain well anchored around 2%, and policy rates at 2%, i.e. near neutral. Incoming data will help assess how the war affects the inflation outlook and risks. The Council will continue to monitor developments and adjust policy in a data-dependent manner.

In terms of *Balance Sheet policies*, the APP and PEPP portfolios are gradually and predictably shrinking, as the Eurosystem has stopped reinvesting principal payments from maturing securities.

- ✦ **POLICY DISCUSSION:** *Lagarde struck a cautious tone, no longer describing the economy as being in a “good place,” and highlighted risks from the Iran conflict, second-round effects, and upward revisions to inflation.* This reinforced expectations that the ECB may need to raise rates later this year. The overall tone was more hawkish, supporting the view that hikes are more likely than cuts, which now seem unlikely. However, heightened uncertainty makes the outlook less predictable. With markets pricing roughly a 50% chance of a hike as early as next month, the euro remains supported despite rising energy prices.

The ECB delivered a unanimous decision to hold rates, reflecting a calm, determined, and focused Governing Council. At the same time, the tone of communication has shifted. While Christine Lagarde had previously described the euro area as being “in a good place,” she now stresses that the economy is not in a good place, but rather “well-positioned and equipped” to deal with the unfolding shock.

The backdrop has deteriorated, with short-term inflation expectations rising sharply alongside energy prices. One-year inflation swaps have jumped from below 2% to 4%, while headline inflation stood at 1.9% in February. Markets have significantly repriced the policy path, now expecting two 25bp rate hikes by October, compared to expectations of unchanged rates prior to the conflict. The ECB sees risks to inflation as tilted to the upside in the near term, particularly if a prolonged Middle East conflict keeps energy prices elevated and triggers second-round effects through wages and expectations.

At the same time, the growth outlook is weakening. While activity remains supported by services and private consumption, the war is disrupting commodity markets and weighing on real incomes and confidence, leading to downward revisions in consumption and investment, especially for 2026. This creates a clear policy trade-off between rising inflation and slowing growth. In response, the ECB will remain data-dependent and proceed meeting by meeting, closely monitoring energy markets, supply bottlenecks, pricing behaviour, demand indicators, and wages. Any fiscal response to the energy shock, it argues, should be temporary, targeted, and tailored.

- ✦ **CHANGES TO ECONOMIC FORECASTS:** *ECB staff now expect inflation to rise to 2.6% this year, up from 1.9% previously, before returning to around the 2% target in 2027-28.* The ECB’s latest projections use a later cut-off date (11 March) to reflect heightened uncertainty. Staff also assessed scenarios for the Middle East conflict, showing that a prolonged energy supply disruption would push inflation above and growth below baseline. The medium-term impact will depend largely on the scale of indirect and second-round effects from a persistent energy shock.

In the baseline, inflation is projected at 2.6% in 2026, 2.0% in 2027, and 2.1% in 2028, revised up due to higher energy prices from the Middle East war. Core inflation is also slightly higher. Growth is expected

at 0.9% in 2026, rising to 1.3-1.4% thereafter, but revised down, especially for 2026, reflecting weaker confidence, real incomes, and global conditions. Still, low unemployment, strong private balance sheets, and public spending should support activity. Scenario analysis shows that a prolonged energy supply disruption would push inflation above and growth below baseline. In an “adverse” scenario, inflation would return to pre-conflict conditions by the end of the forecast horizon, while in a “severe” scenario inflation would return to pre-crisis levels well beyond the end of the projection horizon (suggesting inflation persistence and second round effects. So, the medium-term impact will depend on the scale of indirect and second-round effects from a persistent energy shock.



ECONOMIC ASSESSMENT: *The Middle East war has increased uncertainty, raising upside risks to inflation and downside risks to growth.* The economy grew modestly (0.2% in Q4 2025), driven by domestic demand, with stronger consumption, investment, and services activity. Growth is expected to remain supported by household spending and investment, though the external environment is challenging. The Middle East conflict is weighing on confidence and real incomes, leading to weaker consumption and investment, especially in 2026. Policymakers stress the need for targeted fiscal support, reduced fossil fuel dependence, and deeper EU integration to support long-term growth.

Inflation rose to 1.9% in February, with core inflation increasing due to higher services and goods prices. Underlying inflation remains broadly consistent with the 2% target, supported by easing wage growth. However, higher energy prices from the conflict are expected to push inflation above target in the near term, with risks of second-round effects. While short-term inflation expectations have risen, long-term expectations remain anchored.

Risks to growth are tilted to the downside, mainly due to the war, higher energy prices, weaker confidence, and global trade tensions. Inflation risks are skewed to the upside in the near term, particularly if energy shocks persist or spill over more broadly. However, weaker demand or a short-lived shock could ease inflation pressures.

✦ **OUR TAKE:** *ECB Getting Ready To Increase Rates Sooner than Otherwise:* The ECB provided two scenario analyses, an “adverse” and a “severe” scenarios. But in reality, in both of them the risk of inflation overshooting the target seems larger than that of growth falling below potential. So, the ECB seems more ready to hike rather than cutting rates. While April seems premature, by June the ECB may have sufficient information to decide what to do: remain on hold for longer (which means that the shock has been temporary), or hiking rates. The ECB needs to be cautious: with higher inflation, the risk is that of a severe weakening in economic activity – are they ready to hike rates when the Eurozone economy slips into a recession (and so repeated the 2008 infamous “Trichet Mistake?” Clearly the ECB does not want to repeat the mistake that was made more recently, which was waiting too long before raising rates in 2022. So the tolerance to mistake is clearly asymmetric.

✦ **MARKET REACTION AND IMPLICATIONS:** *Global markets faced renewed selling pressure amid concerns over the Middle East conflict. In the bond market,* the Germany’s 10-year bond yield, the region’s benchmark, fell to around 2.96%, while the two-year yield declined to around 2.52% at the time of writing. BTP-Bund spread fell to the lows. *In the currency space,* the euro was little moved after the widely expected decision, up 0.3% on the day against the dollar at \$1.148. *In the equity space,* European stocks extended losses. European equities were sharply lower, with the Stoxx 600 down 2.2%, Germany’s DAX falling 2.5%, France’s CAC 40 dropping 2.9%. Eurostoxx 50 fell over 2.5% to below the 5600 mark.



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