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# MONETARY AFFAIRS

## REVIEW: ECB Keeps Rates Unchanged In July, and Prepares For a Hike In September

By

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23 July 2026

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## Executive Summary

- **Decision Made:** *The European Central Bank (ECB) decided to maintain its three key rates unchnaged*i.e. its *i)* interest rate on the 'main refinancing operations' at 2.40%; *ii)* interest rate on the 'marginal lending facility' at 2.65%; and the key *iii)* 'deposit facility' at 2.25%.

  Future decisions will be taken meeting-by-meeting, following its usual three-pronged approach about its reaction function confirmed. Easing inflation supporting a pause but renewed energy price pressures keeping another rate hike likely in September.
- **Policy Discussion**: *Today's decision to hold rates follows the ECB's June rate hike, its first since 2023, with markets continuing to expect further tightening later this year, contingent on incoming inflation data and geopolitical developments.* Lagarde stressed that June's increase was a response to a genuine inflation threat rather than an "insurance hike", while ECB projections show inflation returning to the 2% target only in late 2027 under further policy tightening. She also reiterated that the ECB stands ready to adjust interest rates as needed to return inflation to target.

  During the press conference, Lagarde struck a more hawkish tone while avoiding an explicit commitment to a September rate hike. She highlighted increased upside risks to inflation and downside risks to growth, revealing that some Governing Council members had favoured an immediate hike.

  Although second-round inflation effects have not yet emerged, renewed US-Iran tensions have pushed Brent crude back above $90 per barrel, increasing the risk that higher energy costs feed into broader inflation. Markets are now pricing in a 25bp rate hike in September unless energy prices retreat or inflationary pressures ease, despite euro area inflation slowing to 2.8% in June.

### Key Picture: European Central Bank Key Forecasts – 2024-2028

| | | **2026*f*** | | **2027*f*** | | **2028*f*** | |
|---|---|---|---|---|---|---|---|
| | Latest reading | June Projections | March Projections | June Projections | March Projections | June Projections | March Projections |
| GDP *(real growth, y-o-y)* | 0.3 | **0.9** | **0.9** | **1.2** | **1.3** | **1.5** | **1.4** |
| Inflation *(%, y-o-y)* | 2.8 | **2.6** | **2.6** | **2.3** | **2.0** | **2.0** | **2.1** |
| Core-inflation *(%, y-o-y)* | 2.4 | **2.5** | **2.3** | **2.5** | **2.2** | **2.2** | **2.1** |
| Unemployment *(%, y-o-y)* | 6.2 | **6.3** | **6.3** | **6.2** | **6.3** | **6.0** | **6.2** |

*Source:* ECB '*Macroeconomic projections' March and June 2026. Note:* Latest readings: 1. GDP for Q1 2026; 2. Unemployment for May 2026; 3. Inflation for June 2026. *Inflation = Harmonized Index of Consumer Prices (HICP).

## Analysis

- **DECISION MADE**: *On July 23, the ECB kept its interest rates unchanged.* In line with consensus, the European Central Bank (ECB) to maintained its main policy rates unchanged i.e. its *i)* interest rate on the 'main refinancing operations' at 2.40%; *ii)* interest rate on the 'marginal lending facility' at 2.65%; and the key *iii)* 'deposit facility' at 2.25%. High uncertainty persists as the energy shock unfolds. The GC will monitor its effects closely to keep inflation on track toward its 2% target.

  Despite the uncertainty, the Governing Council said today's decision leaves it well positioned to respond to evolving conditions. Policymakers will continue to assess incoming economic and financial data on a meeting-by-meeting basis and stressed that they are not pre-committed to any specific path for interest rates.

  *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. Policymakers will continue to assess incoming economic and financial data on a meeting-by-meeting basis and stressed that they are not pre-committed to any specific path for interest rates.

  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:** *Today's decision to hold rates follows June's first rate hike since 2023, with markets continuing to expect further tightening later this year, contingent on incoming inflation data and geopolitical developments.* The ECB's pause comes just six weeks after its first rate hike in nearly three years, prompted by a war-driven energy shock that pushed inflation to its highest level since September 2023. President Lagarde cautioned that prolonged energy supply disruptions could keep prices elevated and trigger broader second-round inflationary effects. The ECB reiterated that it stands ready to adjust interest rates as needed to return inflation to target

  During the press conference, Lagarde stressed that June's increase was a response to a genuine inflation threat, not an "insurance hike", with ECB projections showing inflation returning to the 2% target only in late 2027 under further policy tightening.

  Lagarde struck a more hawkish tone while avoiding an explicit commitment to a September rate hike. She highlighted increased upside risks to inflation and downside risks to growth, while revealing that some policymakers had favoured an immediate hike. Although second-round inflation effects have not yet emerged, oil prices near $100 per barrel make further tightening increasingly likely. Unless energy prices fall significantly or inflation pressures ease over the coming weeks, a September rate increase now appears close to inevitable.

  Therefore, renewed tensions between the US and Iran have pushed Brent crude back above $90 per barrel, raising the risk that higher energy costs feed into household prices and broader inflation through second-round effects. Markets are pricing in a 25bp rate hike in September as Lagarde warned that renewed Middle East tensions and higher oil prices pose upside risks to inflation. While euro area inflation eased to 2.8% in June (from 3.2% in May), the ECB expects it to remain well above its 2% target until the first half of 2027.

- **ECONOMIC ASSESSMENT:** *Economic activity showed signs of improving in Q2 despite the Middle East conflict,* with services recovering, digital and AI-related activity remaining resilient, and manufacturing supported by inventory building and higher defence spending. However, labour market conditions softened, and growth is expected to remain modest near term due to the energy shock and elevated uncertainty, although consumption, digital investment, infrastructure and defence spending, and recovering exports should support medium-term growth. The ECB reiterated the need for structural reforms, deeper EU market integration, and targeted fiscal support while welcoming progress on the digital euro.

Inflation eased to 2.8% in June (from 3.2%), driven by lower energy, food, goods, and services inflation. However, the energy shock continues to feed through to broader prices, and inflation is expected to remain above target into the first half of 2027 before gradually returning toward 2%. Wage growth remains moderate, long-term inflation expectations are anchored, but the ECB continues to monitor second-round effects closely.



The balance of risks remains tilted to the downside for growth and to the upside for inflation. Further energy supply disruptions, geopolitical tensions, trade fragmentation, and climate-related shocks could weigh on activity while keeping inflation elevated. Conversely, faster adaptation to the energy shock, a lasting resolution of the Middle East conflict, stronger investment, and productivity-enhancing reforms could improve the outlook.

- **OUR TAKE: We expect another rate hike in September.** Following that, the ECB will leave the door open to a potential rate hike in December, depending on economic and geopolitical developments.
- **MARKET REACTION AND IMPLICATIONS**: A rebound in oil prices toward $100 a barrel pushed eurozone government bond yields to long-term highs, as renewed inflation concerns and hawkish ECB signals offset the decision to keep rates unchanged. *In the bond market*, German 10-year bond yields reached their highest level since 2011 as surging energy prices and rising inflation expectations strengthened bets on further ECB tightening. At the time of writing, Germany's 10-year Bund yield is trading at around 3.20%, while the 2-year Bund yield is trading at approximately 2.88%. *In the currency space,* the euro extended its losses after the decision, while the US dollar strengthened as escalating Middle East tensions boosted demand for safe-haven assets. The dollar index rose 0.2%, with the euro falling 0.3% against the dollar to around $1.14. *In the equity space,* European equities extended losses after the ECB left rates unchanged but signalled that a September hike is becoming increasingly likely and as the absence of a clear dovish signal and mounting energy-price pressures unsettled investors. The STOXX 600 fell 0.9%, while Italy's FTSE MIB led regional declines, dropping 2.3%.