

Monthly Cash Review – EUR

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Persistent inflation, resilient eurozone growth and uncertainty over the ECB's next move continue to shape opportunities for euro cash investors.

August was supposed to be the quiet month in Europe. Policymakers were away, markets were lightly staffed, and large portions of the continent were concentrating on more important matters, such as dinner reservations. The ECB nevertheless managed to keep investors occupied by releasing the account of its July meeting and making clear that the decision to hold rates was a pause, not necessarily the end of tightening. Another hike would “likely be necessary” unless the inflation outlook improved significantly, although the Governing Council carefully avoided formally committing to September. It was classic central-bank communication: sufficiently clear to move markets, sufficiently conditional to preserve deniability.

The deposit facility rate remained at 2.25%, following June's increase, but by late August a September hike to 2.50% was nearly fully priced. ECB officials were increasingly concerned that persistent energy disruption, elevated natural-gas prices and higher refining margins could keep inflation above target long enough to affect wages and expectations. At the same time, policymakers acknowledged that underlying inflation and wage growth remained relatively contained. The debate was therefore not whether higher energy prices were unpleasant. It was whether monetary policy should respond to an inflation shock it cannot produce more gas or reopen a shipping route to solve.

Inflation returns from holiday early

Euro-area inflation increased to 2.9% in July from 2.8% in June, with core inflation at 2.5%. Energy remained the dominant source of pressure, while services inflation continued to run above levels consistent with a comfortable return to target. The ECB's concern was less about the first-round increase in utility and transportation costs than the possibility that these pressures could spread into wages, food and broader selling prices. So far, those second-round effects remained limited. Unfortunately, “limited so far” is not the same phrase as “problem solved,” however much investors may wish otherwise.

Natural gas was particularly troublesome. Low storage levels, constrained supply and renewed Middle East tensions pushed European gas prices sharply higher, even as crude oil occasionally retreated. That divergence complicated the outlook because households and businesses may receive less relief than a simple oil-price chart would suggest. It also explains why ECB rhetoric became more hawkish despite some moderation in underlying price measures. Apparently, central bankers must now monitor oil, natural gas, refining margins, shipping traffic and weather patterns while still pretending their job is mainly about interest rates.

Growth: Inconveniently Resilient

The economic data strengthened the case for further tightening. Euro-area GDP expanded 0.4% in the second quarter and 1.0% from a year earlier, while employment increased 0.1% and unemployment remained at 6.3%. These are hardly boom conditions, but they are stronger than the stagnation narrative that dominated forecasts earlier in the year. The economy was proving capable of absorbing elevated energy costs and tighter financial conditions without immediately falling over, which central bankers tend to view as permission to continue worrying about inflation.

The August flash composite PMI rose to 52.1, its highest in nine months. Manufacturing output reached 53.4, the strongest reading in four-and-a-half years, while services activity held at 51.7. Germany led the improvement in manufacturing, helped by technology, defense demand and precautionary inventory building, while France remained the notable laggard. New export orders expanded for the first time in four-and-a-half years and employment increased for the first time in 2026, although business confidence softened. Europe's recovery was therefore real, uneven and still nervous—an appropriately European combination.

Credit data were also firmer. Bank lending to companies accelerated, with annual corporate-loan growth reaching 4.4% in July, its fastest pace in more than three years. Some of that borrowing reflected working-capital needs created by higher energy and input costs, but longer-term lending was also reasonably robust. This mattered because several ECB members viewed stronger credit creation as evidence that the existing policy rate was not yet meaningfully restricting demand. For borrowers, more credit is usually considered encouraging. For central bankers, it can apparently be evidence that rates need to rise.

The front end accepts the message

Euro money markets adjusted accordingly. Euro Short-Term Rate (€STR) remained well anchored near 2.19%, with the August 27 fixing at 2.188% on €58.3 billion of volume. Term benchmarks carried considerably more policy premium: three-month Euribor stood at 2.60% on the first business day of September, up from 2.46% at the beginning of August, while twelve-month Euribor increased to 3.02% from 2.94%. The overnight market remained orderly; the term market was already preparing for the ECB to do more work.

Government bonds sold off as inflation and rate expectations moved higher. Ten-year Bund yields ended August near 3.32%, approximately fourteen basis points higher over the month and at their highest level since 2011. The shift was not confined to Germany: curves across Europe absorbed the combination of tighter policy expectations, higher inflation compensation and substantial sovereign supply. Risk-free rates rose for both nominal and real reasons, a polite way of saying that investors wanted more compensation for almost everything.

France remained the principal political exception. OATs experienced another difficult summer as investors focused on the autumn budget and the 2027 presidential election, with polling risk becoming an increasingly important driver of the OAT-Bund spread. The first presidential debate was relatively benign, but market participants remained wary around the 90-basis-point area for ten-year debt. French politics did not produce an immediate crisis; it merely ensured that European sovereign spreads retained something interesting to discuss after lunch.

What matters for euro cash investors

For euro cash investors, the environment remains constructive but less forgiving. Overnight liquidity is orderly, €STR remains well anchored and front-end yields provide attractive carry. At the same time, rising Euribor fixings and a nearly priced September hike argue against treating current yields as permanent or reaching indiscriminately for duration. The more sensible approach is to preserve liquidity, use selective term opportunities when compensation is compelling, and avoid building a portfolio around any single forecast for the terminal rate. The ECB itself remains data dependent; investors are allowed the same luxury.

Final thoughts

August confirmed that the euro-area economy is stronger than expected, inflation is more persistent than hoped, and the ECB's July pause was not the monetary-policy equivalent of closing time. Growth, credit creation and employment have held up well enough to keep another hike firmly on the table, while energy markets continue to provide more than enough uncertainty for September.

For euro cash investors, the conclusion remains refreshingly uncomplicated. Liquidity remains valuable. Income remains attractive. Patience remains rewarded.

And somewhere on a Mediterranean beach, an economist is still explaining the ECB's reaction function while everyone else is trying to order dessert.

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