

Monthly Cash Review – EUR

State Street · 2026-10-01 · English original

Persistent inflation, renewed ECB tightening and resilient eurozone growth continue to shape opportunities for euro cash investors.

September's defining development was the European Central Bank's return to tightening. On September 10, the Governing Council unanimously raised all three policy rates by 25 basis points, taking the deposit facility rate to 2.50%, the main refinancing rate to 2.65% and the marginal lending rate to 2.90%, effective September 16. The increase itself was fully expected; the more important message was that inflation was likely to remain above target for longer and that stronger growth gave policymakers less reason to tolerate that risk. The ECB has not promised another hike, but it is no longer treating "energy-driven" as a polite synonym for "someone else's problem."

The reaction function has consequently become more preventative. The ECB remains focused on the inflation outlook, underlying inflation and monetary-policy transmission, but it is placing greater weight on the duration and propagation of the energy shock. August headline inflation was finalized at 3.2%, up from 2.9%, as energy inflation accelerated to 14.3%. Yet core inflation eased to 2.4%, services inflation declined to 3.0% and compensation per employee slowed to 3.3%. The ECB therefore tightened not because second-round effects were already obvious, but because waiting for them to become obvious could prove rather expensive.

Growth strengthened that argument. September's flash composite PMI rose to 53.1 from 52.0, its highest level since April 2023, with services at 53.0 and manufacturing output at 53.4. New orders expanded at their fastest pace since May 2022, while both input costs and selling prices increased at their strongest rates since May. The eurozone economy had apparently not received the stagflation memorandum: activity accelerated even as energy costs rose, giving the ECB more room — and arguably more reason — to lean against inflation persistence.

Euro money markets accepted the message. By September 29, €STR had risen to 2.44% from 2.19% one month earlier, closely reflecting the policy increase. Three-month €STR swaps moved to 2.52% from 2.41%, one-month Euribor increased to 2.49% from 2.29%, and three-month Euribor reached 2.62% from 2.57%. The modest additional rise in three-month Euribor beyond the completed hike suggested that markets were pricing continued policy risk rather than treating September as the cycle's final installment.

Government bonds delivered the same message rather more loudly. Two-year Bund yields rose approximately 35 basis points during the month to 3.26%, while ten-year yields increased roughly 31 basis points to 3.59%, reflecting tighter ECB expectations, persistent energy inflation, heavy sovereign financing requirements and global duration pressure. France added a distinctly domestic complication: the ten-year OAT–Bund spread widened from around 80 basis points at the end of August to approximately 111 basis points on September 29 as fiscal projections deteriorated and political uncertainty intensified. European bond investors were already charging more for duration; French politics ensured they also charged a cover fee.

Credit markets were more composed than sovereign rates, although hardly indifferent. September began

with expectations for €70-80 billion of euro investment-grade issuance, supported by large maturities, tight spreads and substantial hybrid supply. High-quality corporate cash spreads initially absorbed the selloff surprisingly well, even as credit indices became more volatile; French banks underperformed as sovereign risk increased, while many high-quality corporates remained comparatively resilient. In the ECP market, liquidity became somewhat thinner approaching quarter-end, supply was selective and investors continued to favor issuers and maturities offering genuine compensation rather than merely higher headline yields.

For institutional euro cash investors, September improved prospective income but also raised the cost of being overly certain. Higher ECB and €STR-linked yields support attractive carry, while the repricing in Euribor and government bills may create selective maturity-extension opportunities. However, the combination of uncertain energy pass-through, further ECB tightening risk, widening French sovereign spreads and increasingly differentiated credit performance reinforces the importance of liquidity, disciplined maturity ladders and issuer selection. Flexibility is not an absence of conviction; it is recognition that the ECB, the Strait of Hormuz and French fiscal arithmetic are currently producing rather different versions of the same forecast.

September therefore ended with a clearer policy rate but no simpler outlook. Growth is stronger, inflation is more persistent and the ECB has demonstrated that it is prepared to respond before an energy shock becomes fully embedded. Euro cash investors are being paid more to remain liquid, but the reward for extending maturity increasingly depends on timing, structure and credit quality. The ECB may still insist that each decision will be taken meeting by meeting — but after September, markets understand that "data dependent" no longer means "inclined to wait."

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