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Macro Rapid Response

A September ECB rate rise looks all but certain

At its meeting on 9–10 September, the Governing Council of the European Central Bank is expected to raise official interest rates by 25 basis points, bringing the deposit rate to 2.50%, in line with an inflation picture that remains above target and with risks linked primarily to the persistence of the energy shock. We believe the ECB will continue to avoid providing genuine *forward guidance*, maintaining a meeting-by-meeting, data-driven approach, with communication centered on the reaction function: the intensity and duration of the shock, its transmission to underlying prices, inflation expectations, wages and the resilience of growth. The balance of risks could also justify *precautionary* rate rises in the future.

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The markets have consistently interpreted the 22–23 July meeting as merely a pause in the European Central Bank's cycle of rate rises. Whilst the Governing Council had indeed left the three key interest rates unchanged, the subsequent statements and the minutes of the meeting published on 27 August made it clear that a further rate rise would probably be necessary, barring a significant improvement in the inflation outlook: literally, the minutes state that "it was important not to give the impression that the suspension of rate rises at the current meeting meant that the cycle of monetary tightening had come to an end". At the same time, given the uncertainty of the outlook, the Governing Council had deemed it appropriate not to make binding commitments, in order to preserve flexibility in the event that data on inflation, energy and the transmission of the shock improved convincingly: "the Governing Council had not yet committed to raising rates in September, *to allow for the possibility that the medium-term inflation outlook might improve*".

It has not improved, alas. Subsequent **statements** by members of the Governing Council are **broadly consistent with market expectations of a 25-basis-point rise on 10 September**. Members more sensitive to inflationary risks, such as Schnabel, Nagel, Kažimír and Radev, emphasised the possibility of second-round effects and the need to act if inflation were to remain above 2% for too long. Overall, the tone of the communication therefore remains consistent with a gradual rise, accompanied by the now customary caution regarding the future course of monetary policy: the ECB is expected to accompany the decision with an indication that any further move will depend on the evolution of the new projections, energy prices and evidence of pass-through to core prices and wages. **There is no predetermined path for official interest rates**.

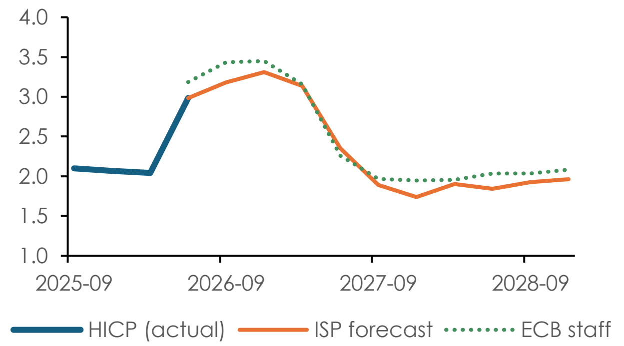
The ECB's new projections: *technical assumptions* and realised inflation

Moreover, the data did not show the improvement that would have been necessary to prevent a rise in interest rates. The June forecast incorporated an unfavourable outlook for energy, with headline inflation expected to be 3.0% in 2026, 2.3% in 2027 and 2.0% in 2028, and core inflation at 2.5% in 2026–27 and 2.2% in 2028. The technical assumptions updated at the end of August point to a different composition of the shock compared with June: **oil prices** are **lower** across most of the horizon compared with the June assumptions, **whilst gas prices are significantly higher** (by 20 to 40% in 2027), the euro is stronger against the dollar and in real terms, and **market rate assumptions are higher across the entire yield curve**.

In the short term, the lower oil price trajectory and the stronger exchange rate tend to reduce pressure on imported inflation, whilst much higher gas prices have the opposite effect, with knock-on effects via electricity prices. Conversely, higher interest rates make the outlook less favourable for real income and demand, with dampening effects on medium-term underlying inflation. However, this latter aspect is mitigated by the better-than-expected performance of real growth in the first half of the year and by signs that economic activity remained resilient even [during the summer quarter]. The September projections are likely to maintain a high *headline* inflation outlook, although a downward revision to the shorter-term component is probable.

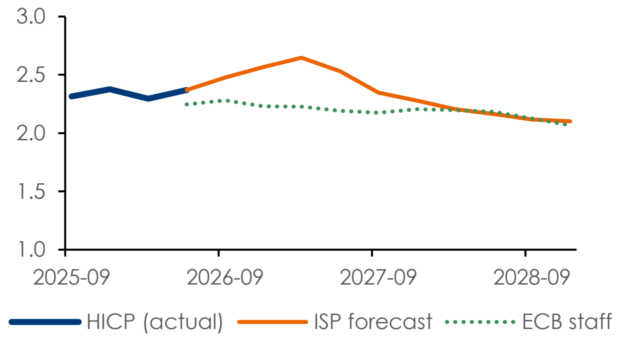
The inflation data published after the July meeting improve the very short-term picture. [The August flash estimate] points to a rise to 3.3% year-on-year, with *core inflation* at 2.4%, following two months of data that fell short of expectations. As the June projections indicated an acceleration in headline inflation to 3.4% in the third and fourth quarters of 2026, the July and August data appear marginally more benign than the expected trajectory. The breakdown is also more favourable than expected for the core component, which stood at 2.4% in August, slightly below the annual average of 2.5% forecast for 2026; this suggests that, so far, the shock remains dominated by energy and has not yet fully propagated to underlying prices.

Inflation projections compared: the short-term outlook is better than expected



Source: Intesa Sanpaolo Research calculations and ECB Staff Macroeconomic Projections – June 2026.

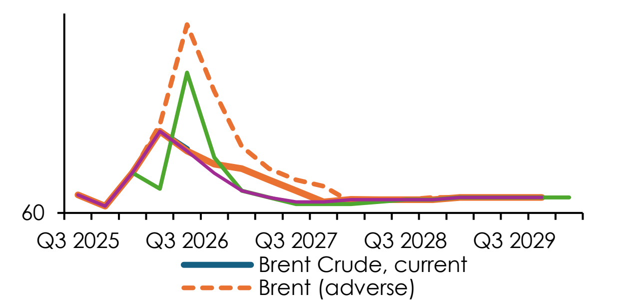
A comparison of *core* inflation projections



Source: Intesa Sanpaolo Research calculations and ECB Staff Macroeconomic Projections – June 2026. For the ECB, the chart shows projections for the Euro area HICP – excluding food and energy; for our projections, the index also excludes tobacco.

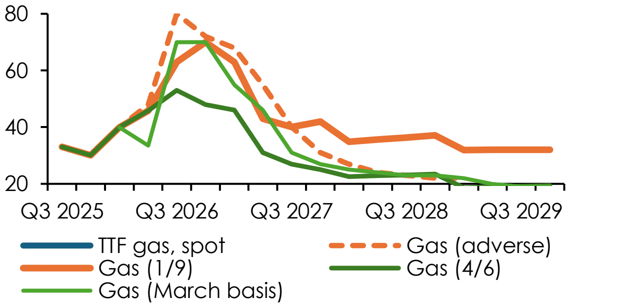
The most negative aspect of the new information received by the Governing Council over the past month is the evidence that the Gulf crisis has reached an impasse and that the energy market will not return to normal any time soon: the reduction in oil and gas exports from the region could continue for months to come, keeping energy prices higher than expected in 2027.

We now expect a much slower return to normal for oil…



Source: Intesa Sanpaolo – Research.

…but above all for natural gas, for which we have also revised our 2–3-year outlook



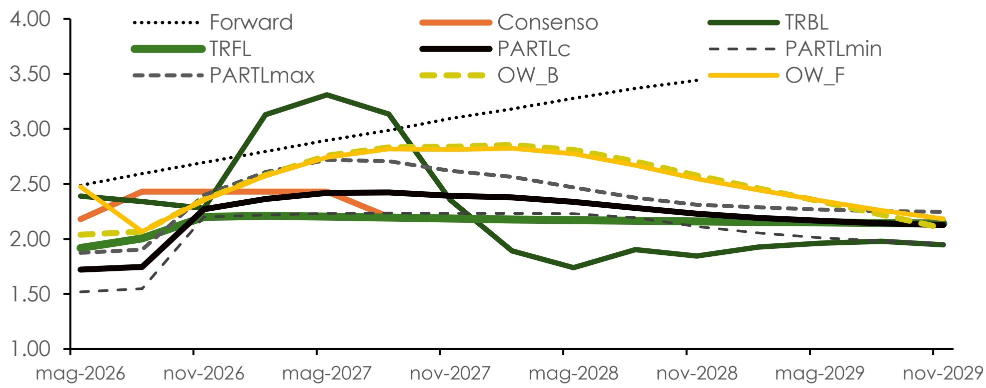
Source: Intesa Sanpaolo – Research.

Our scenario now assumes only a partial normalisation of the market balance, resulting in oil prices above $80 in the first half of 2027 and European gas prices that will not fall below €40 even next year. And the trend in gas prices will also have an impact on electricity prices. **A more prolonged period of energy tensions could make it more likely that the inflationary effects we are not currently observing will spread**.

Uncertainty over the duration of the crisis will continue to shape the monetary policy outlook in the coming months

In our baseline scenario, the partial normalisation of energy prices over the coming months prevents a significant pass-through of price rises to non-energy goods and services, which are not driven by excess demand. The limited or negligible role of demand factors in this inflationary episode was also highlighted in an article on The ECB Blog. Having peaked at 2.6% in the first quarter of 2027, core inflation falls from the second quarter of 2027. Against a backdrop of moderate growth in line with potential, therefore, **the ECB would have no reason to continue tightening financing conditions, and the September rate rise could prove to be the last in the cycle**.

The central forecasts justify a modest tightening of monetary policy



Source: Intesa Sanpaolo – Research calculations. Consensus: ECB Survey of Monetary Analysts; TRBL, TRFL: Taylor rules with parameters estimated on the basis of the ECB's past behaviour, using observed data and forecasts respectively; PARTL: cloud of parametric Taylor rules (min, max and median); OW: Orphanides-Wieland-type rule, fed with historical data (B) or forecast data (F) respectively.

At the same time, the uncertainties in the scenario are such that **it would be unwise to rule out the possibility of a third move to 2.75%.** This is the prevailing indication emerging from the portfolio of monetary policy rules fed with our central projections or with the ECB staff's June projections – rules which we use to guide the forecasting process. The indications provided by these models should be treated with great caution for at least three reasons:

- Firstly, there is evidence of several structural breaks (the most recent of which occurred during the 2022 inflation shock, rendering parameter estimates unreliable). In particular, **some models tended to underestimate the level of official interest rates at the end of 2025 – beginning of 2026**, suggesting DFR levels of 1.75% rather than 2.00%. The ECB could nowadays be more reactive to inflationary pressures than in the past.

- Secondly, we are assuming that decisions are based on the central forecasts: however, as highlighted in the minutes of the July meeting, **it is possible that the Governing Council may decide to raise official interest rates *as a precautionary measure***, with the aim of preventing adverse scenarios from materializing, rather than adjusting the policy stance to the most likely outcome.

- Finally, **higher terminal rates would be justified if adverse scenarios were to materialise**, such as a significant deterioration in the energy market outlook in 2027 or a sudden acceleration in the pass-through of price rises. If we consider the experience of 2021–22, the drastic revision of monetary policy expectations stemmed not only from the failure to implement the rate rises recommended by the policy rules, but also from the drastic revision of the inflation outlook during 2022.

Appendix

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