

War fuels a hawkish outlook

Carlos Castellano, Maria Martinez

- **The ECB kept rates unchanged, with Lagarde framing policy as “well positioned” to deal with the energy shock.**
- **In this energy shock, Lagarde stressed that persistence and second-round effects, rather than the initial price spike, will determine the policy response.**
- **The ECB’s new baseline revises inflation up and growth down, with two more scenarios adding an upside bias to inflation via market-implied oil prices and persistent shocks.**

As expected, **the ECB kept key interest rates unchanged**, with the deposit rate at 2.00%, **in a unanimous decision**. The backdrop, however, has shifted. **The war in the Middle East and the resulting oil and gas shock now frame the policy outlook**. Lagarde avoided describing the ECB as being in a “good place”, instead stressing that it is **“well positioned” to deal with the shock**. Inflation, expectations and rates are all close to 2%, leaving policy broadly neutral and with room to react if needed.

The meeting was dominated by the new scenarios built around the energy shock (see table). The key issue is no longer the initial jump in oil and gas prices, but how long it lasts and how far it spreads. Lagarde pointed clearly to **indirect and second-round effects as the central risk**. Inflation risks are now to the upside, while growth risks are to the downside, as higher energy prices erode real incomes, weaken confidence and delay investment. The ECB is focusing on the transmission channels: commodities, supply bottlenecks, wages, demand and firms’ pricing behaviour.

Three scenarios structure the outlook. The baseline uses market-implied oil prices as of March 11, unusually close to the meeting, effectively embedding a weighted average of possible outcomes with an upward bias. **The adverse and severe scenarios mainly differ in persistence**. In both, prices rise sharply, and in the severe case they remain elevated for longer. Across all scenarios, the energy shock fades only gradually, pointing to a more prolonged impact on inflation. Lagarde noted that the alternative scenarios assume no policy response, unlike the baseline.

Other issues, including financial stability **risks linked to US private credit, remained in the background**. De Guindos noted that euro area exposure is limited, although concerns around leverage, liquidity, transparency and increasing redemption pressures continue to be monitored.

Overall, **the scenarios tilt the outlook in a more hawkish direction**, reflecting the risk that the energy shock proves persistent. **If the conflict drags on, higher rates cannot be ruled out**. At the same time, uncertainty is exceptionally high, and policy remains firmly data dependent.

■ Negative driver ■ Positive driver

Baseline scenario		2026		2027		2028	
Annual. var. (%), unless otherwise indicated	2025	ECB Mar.	ECB Dec.	ECB Mar.	ECB Dec.	ECB Mar.	ECB Dec.
Real GDP	1.5	0.9	1.2	1.3	1.4	1.4	1.4
HICP	2.1	2.6	1.9	2.0	1.8	2.1	2.0
HICP excluding energy and food	2.4	2.3	2.2	2.2	1.9	2.1	2.0
Oil price (in USD/barrel)	69.1	81.3	62.5	72.1	62.6	70.2	64.0
Natural gas prices (EUR/MWh)	36.2	46.4	29.6	36.6	27.5	26.1	25.0

Source: ECB

Alternative scenarios		2026		2027		2028	
Annual. var. (%), unless otherwise indicated	2025	Adverse ECB Mar.	Severe ECB Mar.	Adverse ECB Mar.	Severe ECB Mar.	Adverse ECB Mar.	Severe ECB Mar.
Real GDP	1.5	0.6	0.4	1.2	0.9	1.6	1.9
HICP	2.1	3.5	4.4	2.1	4.8	1.6	2.8
HICP excluding energy and food	2.4	2.4	2.6	2.7	3.9	2.1	2.9
Oil price (in USD/barrel)*	69.1	100-110	120-130	75-85	105-115	70.0	100.0
Natural gas prices (EUR/MWh)*	36.2	60-70	80-90	35-45	60-75	24-30	40-50

Source: ECB. Ranges approximate annual averages derived from ECB scenario paths.

PLEASE NOTE: TRACKING CHANGES IN FOLLOWING STATEMENTS

i in grey, wording common to both the current and previous statements, in light grey and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE).

Christine Lagarde, President of the ECB,

Luis de Guindos, Vice-President of the ECB

Frankfurt am Main, ~~5 February~~ 19 March 2026

Good afternoon, the Vice-President and I welcome you to our press conference.

~~We would like to begin by congratulating Bulgaria on joining the euro area on 1 January 2026. We also warmly welcome Dimitar Radev, the Governor of Българска народна банка (Bulgarian National Bank), to the Governing Council. Membership of the euro area has almost doubled since 1999 and is testimony to the attractiveness of the single currency and the enduring benefits of European integration.~~

~~We will now report on the outcome of today's meeting.~~

~~The Governing Council today decided to keep the three key ECB interest rates unchanged. Our updated assessment reconfirms that inflation should stabilise at our two per cent target in the medium term. The economy remains resilient in a challenging global environment. Low unemployment, solid private sector balance sheets, the gradual rollout of public spending on defence and infrastructure and the supportive effects of our past interest rate cuts are underpinning growth. At the same time, the outlook is still uncertain, owing particularly to ongoing global trade policy uncertainty and geopolitical tensions.~~

The Governing Council today decided to keep the three key ECB interest rates unchanged. We are determined to ensure that inflation stabilises at our two per cent target in the medium term. The war in the Middle East has made the outlook significantly more uncertain, creating upside risks for inflation and downside risks for economic growth. It will have a material impact on near-term inflation through higher energy prices. Its medium-term implications will depend both on the intensity and duration of the conflict and on how energy prices affect consumer prices and the economy.

We are well positioned to navigate this uncertainty. Inflation has been at around our two per cent target, longer-term inflation expectations are well anchored, and the economy has shown resilience over recent quarters. The incoming information in the period ahead will help us assess how the war will affect the inflation outlook and the risks surrounding it. We are closely monitoring the situation, and our data-dependent approach will help us set monetary policy as appropriate.

The new ECB staff projections exceptionally incorporate information up to 11 March, a later cut-off date than usual. In the baseline, headline inflation is seen to average 2.6 per cent in 2026, 2.0 per cent in 2027 and 2.1 per cent in 2028. Inflation has been revised up compared with the December projections, especially for 2026. This is because energy prices will be higher owing to the war in the Middle East. For inflation excluding energy and food, staff project an average of 2.3 per cent in 2026, 2.2 per cent in 2027 and 2.1 per cent in 2028. This is also higher than the path in the December projections, mainly owing to higher energy prices feeding into inflation excluding energy and food. Staff expect economic growth to average 0.9 per cent in 2026, 1.3 per cent in 2027 and 1.4 per cent in 2028. This implies a downward revision, especially for 2026, reflecting the global effects of the war on commodity markets, real incomes and confidence. At the same time, low unemployment, solid private sector balance sheets, and public spending on defence and infrastructure should continue to underpin growth.

In line with our monetary policy strategy commitment to incorporate risks and uncertainty into our decision-making, staff also assessed how the war in the Middle East could affect economic growth and inflation under some alternative illustrative scenarios. These scenarios will be published with the staff projections on our website. The scenario analysis suggests that a prolonged disruption in the supply of oil and gas would result in inflation being above, and growth being below, the baseline projections. The implications for medium-term inflation depend crucially on the magnitude of indirect and second-round effects of a stronger and more persistent energy shock.

We will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance. In particular, our interest rate decisions will be based on our assessment of the inflation outlook and the risks surrounding it, in light of the incoming economic and financial data, as well as the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

The decisions taken today are set out in a ~~press release~~ [press release](#) available on our website.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

The economy grew by 0.32 per cent in the fourth quarter of 2025, ~~according~~ driven by stronger domestic demand. Households increased their spending as real incomes rose and unemployment remained close to Eurostat's preliminary flash estimate - its historical low. Construction and housing renovation strengthened, and firms invested more, particularly in areas such as research and development, software and databases. Growth ~~has~~ was no longer weighed down by net exports as it had been in the previous two quarters. It was underpinned ~~mainly~~ been driven by services, notably in the information and communication sector. Manufacturing has been resilient despite the headwinds from global trade and geopolitical uncertainty. Momentum in construction is picking up, also supported by public investment.

The labour market continues to support incomes, even though demand for labour has cooled further. Unemployment stood at 6.2 per cent in December, after 6.3 per cent in November. Growing labour incomes together with a lower household saving rate ~~should bolster~~ Staff still see private consumption. Government spending - as the main driver of growth over the medium term. Investment should also continue to grow, with governments spending more on defence and infrastructure - should also contribute to domestic demand. Business investment should strengthen further, and surveys indicate that firms are, and firms increasingly investing in new digital technologies. At the same time, ~~the~~ The external environment remains challenging, ~~owing to higher tariffs and including in light of volatile global trade policies.~~

The war in the Middle East is disrupting commodity markets and weighing on real incomes and confidence. This has led to a downward revision of consumption and investment in the baseline staff projections, especially for 2026. The impact would be even more pronounced in alternative scenarios with a stronger euro over the past year - more severe and prolonged energy shock.

The Governing Council ~~stresses~~ highlights the urgent need to strengthen the euro area ~~and its economy~~ in the present geopolitical context. Governments should prioritise sustainable while maintaining sound public finances, strategic investment and growth-enhancing structural reforms. Unlocking the full potential of the Single Market remains crucial. It is also vital to foster greater capital market integration by completing. Any fiscal responses to the energy price shock should be temporary, targeted and tailored. The current energy crisis underscores the imperative to further reduce dependence on fossil fuels. Completing the savings and investments union and the banking union to an ambitious timetable, and is vital to fund innovation and support the green and digital transitions. The digital euro and tokenised wholesale central bank money will enhance Europe's strategic autonomy, competitiveness and financial integration, and will boost innovation in payments. It is thus essential to rapidly/swiftly adopt the Regulation on the establishment of the digital euro. Simplifying and harmonising rules across the EU's Single Market will help European firms grow faster.

Inflation

Inflation declined ~~rose~~ to 1.9 per cent in February, from 1.7 per cent in January, ~~from 2.1 per cent in January~~. Energy prices were 3.1 per cent lower than a year ago, after being 4.0 per cent lower in December and 2.1 per cent in November. Energy ~~January~~. Food price inflation dropped ~~edged down~~ to -4.1 per cent, after -1.9 per cent in December and -0.2.5 per cent in November, while food price inflation increased to 2.7 per cent, from 2.5 per cent in December and 2.4 per cent in November. Inflation excluding energy and food ~~eased~~ increased to 2.4 per cent in February, from 2 per cent, after 2.3 per cent in December and 2.4 per cent in November. Goods ~~January~~. The increase reflected goods inflation edged up ~~rising~~ to 0.7 per cent from 0.4 per cent, whereas ~~and~~ services inflation declined ~~moving up~~ to 3.24 per cent, from 3.42 per cent in December and 3.5 per cent in November.

Indicators of underlying inflation have changed little over recent months and remain consistent with our two per cent medium-term target. ~~Corporate profits recovered further in the fourth quarter of 2025, while unit labour costs rose at a similar rate as in the previous quarter. Growth in compensation per employee slowed to 3.7 per cent, from 4.0 per cent in the third quarter. Negotiated wage growth and forward-looking indicators, such as the ECB's wage tracker and surveys on wage expectations, point to a continued moderation in labour costs. However, the contribution to overall wage growth from payments over and above the negotiated wage component remains uncertain~~ suggest that labour costs will ease further in the course of 2026, which should support the return of inflation to target.

Most measures of longer-term inflation expectations continue to ~~The increase in energy prices caused by the war will drive inflation above 2 per cent in the near term. If persistent, higher energy prices may lead to a broader increase in inflation through indirect and second-round effects, a situation which requires close monitoring. Inflation expectations in the financial markets have moved up significantly over shorter horizons. Most measures of longer-term inflation expectations~~ stand at around 2 per cent, supporting the stabilisation of inflation around our target.

Risk assessment

The risks to the growth outlook are tilted to the downside, especially in the near term. The war in the Middle East is a ~~downside risk to the euro area~~ ~~continues~~ ~~economy~~, adding to ~~face a~~ the volatile global policy environment. A ~~renewed~~ ~~prolonged~~ war could increase in ~~uncertainty~~ ~~could~~ energy prices further and for longer than currently expected, and also weigh on ~~demand~~ ~~confidence~~. These factors would erode incomes and make firms and households more reluctant to invest and spend. A ~~deterioration~~ ~~in~~ ~~worsening~~ of global financial market sentiment could ~~also~~ ~~further~~ dampen demand. ~~Further~~ ~~Additional~~ frictions in international trade could disrupt supply chains, reduce exports and weaken consumption and investment. ~~Geopolitical~~ ~~Other geopolitical~~ tensions, in particular Russia's unjustified war against Ukraine, remain a major source of uncertainty. By contrast, ~~growth could turn out to be higher if the economic repercussions of the war in the Middle East proved to be more short-lived than currently expected. Moreover, planned defence and infrastructure spending, together with the adoption of reforms to enhance productivity-enhancing reforms,~~ and the adoption of ~~euro area firms adopting~~ new technologies by euro area firms, may drive up growth by more than expected, ~~including through positive effects on business and consumer confidence.~~ New trade agreements and a deeper integration of ~~our European~~ ~~the~~ Single Market could also boost growth beyond current expectations.

The ~~outlook for~~ ~~risks to the~~ inflation ~~continues to~~ ~~outlook~~ are tilted to the upside, especially in the near term. A prolonged war in the Middle East could lead to a larger and longer-lasting upward shift in energy prices than currently expected, raising euro area inflation further. This could be reinforced and become more uncertain than usual on account of the volatile global policy environment. ~~persistent if inflation expectations and wage growth were to rise in response, if the energy price increase were to spill over to non-energy inflation to a larger extent than assumed in the baseline, or if the war disrupted global supply chains more broadly. Ongoing trade tensions could also give rise to more fragmented global supply chains, curtail the supply of critical raw materials and tighten capacity constraints in the euro area economy. By contrast, inflation could turn out to be lower if the economic repercussions of the war in the Middle East proved to be more short-lived or if indirect and second-round effects proved less pronounced than currently expected. Inflation could turn out to also be lower if tariffs reduced demand for euro area exports by more than expected and if countries with overcapacity increased further their exports to the euro area. Moreover, a stronger euro could bring inflation down beyond current expectations. More volatile and risk-averse financial markets could weigh on demand and thereby also lower inflation. By contrast, inflation could turn out to be higher if there were a persistent upward shift in energy prices, or if more fragmented global supply chains pushed up import prices, curtailed the supply of critical raw materials and added to capacity constraints in the euro area economy. If wage growth moderated more slowly, services inflation might come down later than expected. The planned boost in defence and infrastructure spending could also cause lower inflation to pick up over the medium term. Extreme weather events, and the unfolding climate and nature crises more broadly, could drive up food prices by more than expected~~ ~~as well~~.

Financial and monetary conditions

~~Market rates have come down since our last meeting, while~~ The war in the Middle East has had a pronounced impact on global trade and geopolitical tensions temporarily increased financial markets. Overall financial conditions have tightened since our last meeting. Stock markets have fallen and market volatility. ~~Bank~~ interest rates in the euro area, especially short-term rates, have risen notably.

~~In January, bank~~ lending rates for firms ticked up to 3.6 per cent in December, from 3.5 per cent in November, as did ~~and~~ the cost of issuing market-based debt. ~~The~~ both remained at 3.6 per cent, while the ~~average interest rate on new mortgages again held steady, at~~ edged up to 3.34 per cent in December.

~~Bank lending to firms grew by 3.0~~ 2.8 per cent on a yearly basis in December, after ~~January, down from~~ 3.40 per cent in November and 2.9 per cent in October. The ~~December. However, this was offset by stronger~~ issuance of corporate bonds rose by 3.4 per cent in December. According to our latest bank lending survey for the euro area, firms' demand for credit was up slightly in the fourth quarter, especially to finance inventories and working capital. At the same time, credit standards for business loans tightened again.

~~with the annual growth rate rising to 4.0 per cent, from 3.5 per cent in December.~~ Mortgage lending grew by 3.0 per cent, after 2.9 per cent in November and 2.8 per cent in October, in response to still rising demand for loans and an easing of credit standards ~~unchanged from December.~~

Conclusion

The Governing Council today decided to keep the three key ECB interest rates unchanged. We are determined to ensure that inflation stabilises at our two per cent target in the medium term. We will follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance. Our interest rate decisions will be based on our assessment of the inflation outlook and the risks surrounding it, in light of the incoming economic and financial data, as well as the dynamics of underlying inflation and the strength of monetary policy transmission. We are not pre-committing to a particular rate path.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation stabilises sustainably at our medium-term target and to preserve the smooth functioning of monetary policy transmission

DISCLAIMER

The present document does not constitute an “Investment Recommendation”, as defined in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (“MAR”). In particular, this document does not constitute “Investment Research” nor “Marketing Material”, for the purposes of article 36 of the Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MIFID II).

Readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data or opinions regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvarresearch.com.