BBVA Research

Hawkish pause sets the stage for a September hike

Carlos Castellano, Miguel Jiménez, Maria Martinez

- **The ECB paused unanimously, although several members saw a case for another hike, putting a possible September move firmly on the agenda.**
- **Lagarde struck a more hawkish tone, dropping the "more balanced" assessment used at Sintra and warning that the energy shock has yet to fully feed through the economy.**
- **Softer recent inflation and no second-round effects gave the ECB room to wait, but renewed Middle East tensions have increased our bias towards a September hike.**

As expected, the **ECB left its three key interest rates unchanged**, with the deposit facility rate remaining at 2.25%. The **decision was unanimous**, although Lagarde acknowledged that **some Governing Council members had considered the case for another rate increase**. Ultimately, the Council judged the current stance to be appropriate while it waits for more data and monitors developments in the Middle East and energy markets.

The economic picture was somewhat more encouraging, with activity indicators pointing to a modest improvement. The message on inflation, however, remained cautious. Despite June's downside surprise, the **ECB believes the full impact of the energy shock has yet to feed through the economy**. Short-term inflation expectations remain elevated, although longer-term expectations are still anchored around 2%. The **balance of risks is unchanged from June**, tilted to the downside for growth and to the upside for inflation.

Looking ahead, Lagarde reiterated that there is **no forward guidance** or pre-set path for interest rates, with decisions continuing to be taken meeting by meeting. By September, the ECB will have received a substantial amount of new information and, as Lagarde put it, the **"burden of proof is on the data"**. The Council will continue to assess the intensity, duration and propagation of the energy shock within its usual reaction function.

Even so, **Lagarde's tone was clearly more hawkish**. She confirmed that the "more balanced" assessment presented at Sintra had been dropped and acknowledged that the **milder scenario looks unlikely**. At the same time, she repeatedly stressed that the **ECB is not currently seeing evidence of second-round effects**.

On minimum reserve requirements, Lagarde said the issue had not been discussed at this meeting. However, she added that this "does not mean it will not be considered in the future", leaving the topic open for discussion at a later stage.

Overall, the ECB chose to pause after June's 25bp hike, as softer-than-expected inflation and the absence of second-round effects gave the Governing Council room to wait for more evidence. However, the **renewed escalation of the conflict**, the risk of disruption to shipping through the Red Sea and the rebound in energy prices **keep inflation risks tilted to the upside**. Against this backdrop, **our bias towards a September hike has increased**, particularly if the disruption linked to Iran remains unresolved over the summer.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

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,

Boris Vujčić, Vice-President of the ECB

Frankfurt am Main, ~~11 June~~23 July 2026

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

The Governing Council ~~is~~today decided to keep the three key ECB interest rates unchanged. The outlook for energy prices, while highly volatile, currently stands close to the baseline of the June Eurosystem staff projections and well above the levels recorded prior to the conflict in the Middle East. Uncertainty remains high and the full inflationary impact of the energy shock has yet to play out. We are therefore closely monitoring the intensity and duration of the shock, as well as its indirect and second-round effects. We are committed to setting monetary policy to ensure that inflation stabilises at our two per cent target in the medium term. ~~In line with this commitment, we today decided to raise the three key ECB interest rates by 25 basis points. The war in the Middle East is generating inflation pressures, and the decision to raise rates is robust across a range of scenarios mapping out how the shock might evolve and affect the medium-term outlook for the euro area.~~

~~In the baseline of the new Eurosystem staff projections, headline inflation is expected to average 3.0 per cent in 2026, 2.3 per cent in 2027 and 2.0 per cent in 2028. For inflation excluding energy and food, the baseline foresees an average of 2.5 per cent in 2026 and 2027 and 2.2 per cent in 2028. Compared with March, staff have revised up their baseline projection for inflation in 2026 and 2027 owing to a higher path for energy prices, which, to some extent, is expected to feed into food, goods and services inflation. The baseline sees economic growth at an average of 0.8 per cent in 2026, 1.2 per cent in 2027 and 1.5 per cent in 2028. This is a downward revision for 2026 and 2027, reflecting a more pronounced impact of the war on commodity markets, real incomes and confidence.~~

~~The outlook remains uncertain, with upside risks for inflation and downside risks for economic growth. The full implications of the war for medium-term inflation and growth will depend on the intensity and duration of the energy price shock, as well as the scale of its indirect and second-round effects. This uncertainty is also reflected in the broad range of outcomes for inflation and growth in the updated illustrative scenarios put together by Eurosystem staff. These will be published with the staff projections on our website.~~

With today's decision, we remain well positioned to navigate the uncertainty caused by the ~~war~~conflict. We will ~~closely monitor the situation and~~ 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

~~Adjusting for a temporary factor~~Recent information points to some improvement in ~~Ireland, the euro area economy grew~~ economic activity in the ~~first~~second quarter, ~~supported by domestic demand and exports. Yet the war~~even though the conflict in the Middle East ~~is weighing on~~remained a headwind. Surveys suggest that activity ~~and surveys are pointing to a slowdown, especially~~ in the services~~.~~ sector has partly recovered, after weakening markedly in the immediate aftermath of the energy shock. Digital services have been robust, in part owing to the increasing contribution from AI-related activity. Manufacturing has ~~held up so far. In part, this is because~~ continued to hold up, supported by firms ~~have been~~ building up stocks to ~~cope with~~ guard against supply chain ~~pressures. It also reflects~~ risks, as well as by higher defence spending.

~~The labour market remains resilient.~~ Unemployment~~,~~ stood at 6.~~3 per cent~~2% in ~~April, remains~~May, close to historical lows. ~~The first quarter saw additional jobs being created, although at a slower pace than in the last quarter of 2025. Labour demand has cooled further, and~~ At the same time, job postings have continued to decline and both firms and households expect the labour market to ~~weaken.~~

~~Looking ahead, staff now expect domestic demand to be~~ remain weaker than ~~they projected in March as the war weighs on confidence and higher energy costs erode real incomes. At the same time, household balance sheets are solid overall, and consumption should remain the main driver of growth. Higher energy costs and lower confidence will dent private investment in the short run, but it should be underpinned by firms investing in new digital technologies. Governments spending more on defence and infrastructure should continue to support public investment. These factors are expected to provide some cushioning against the fallout from the war~~before the conflict.

Forward-looking indicators suggest that economic growth will remain modest in the near term, weighed down by the energy shock and related uncertainties. Yet the fundamental drivers of medium-term growth remain intact. Private consumption, investment in new digital technologies, government spending on defence and infrastructure, and some recovery in exports should all contribute to overall growth momentum.

The Governing Council ~~highlights the~~ reiterates its call for urgent ~~need~~action to strengthen the euro area economy while maintaining sound public finances. ~~Fiscal sustainability is a crucial anchor for broader economic stability.~~Simplifying and harmonising rules across the EU's Single Market, accelerating the energy transition and completing the savings and investments union are key building blocks. Fiscal responses to the energy ~~price~~ shock should be temporary, targeted and tailored~~, as emphasised~~. The positive vote in the European ~~Commission's 2026 European Semester Spring~~Parliament earlier this month was a significant milestone on the path to establishing the digital euro. We welcome the shared objective of the Parliament, EU Council and Commission of reaching agreement by the end of this year on the Single Currency Package. ~~Reforms to enhance the euro area's growth potential and accelerate the energy transition to reduce reliance on fossil fuels are more vital than ever. Completing the savings and investments union is key to funding innovation, supporting the green and digital transitions and improving productivity.~~ 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 swiftly adopt the Regulation on the establishment of the~~ will complement physical cash with its digital ~~euro. Simplifying and harmonising rules across the EU's Single Market will help European firms grow faster~~equivalent, providing a means of payment for any digital transaction throughout the euro area.

Inflation

Inflation ~~rose~~declined to ~~3.~~2.8 per cent in June, from 3.2 per cent in May~~, from 3.0 per cent in April.~~. Energy price inflation ~~ticked up~~declined to ~~10.9~~8.5 per cent, after 10.8 per cent in ~~April~~May, while food price inflation fell from ~~2.4~~1.9 per cent to ~~2.0~~1.5 per cent. Inflation excluding energy and food ~~picked up~~eased to 2.~~5~~4 per cent, from 2.~~2~~6 per cent in ~~April, as~~May, with goods inflation ~~edged up to~~decreasing from 0.9 per cent to 0.7 per cent and services inflation ~~increased~~ from 3.~~0~~5 per cent to 3.~~5~~2 per cent.

~~Domestic cost pressures eased in the first quarter, supported by slower growth in wages and profits. The ECB's wage tracker and surveys on wage expectations continue to indicate that wage growth should ease over the year. However, it~~The energy shock continues to feed into higher prices. It is becoming more expensive for firms to source ~~other~~ inputs and they therefore expect to put up their selling prices. ~~Moreover, some indicators of~~ While developments in underlying inflation have ~~already been driven higher by the energy shock.~~remained contained, the full effects of the energy shock have yet to play out. The ECB's wage tracker and surveys on wage expectations continue to indicate moderate wage growth over the coming quarters. Rising labour productivity has also helped contain growth in unit labour costs. Inflation expectations over shorter horizons remain ~~well above~~at elevated levels ~~before the outbreak of the war in the Middle East. At the same time, most~~. Most measures of longer-term inflation expectations stand at around 2 per cent, supporting the stabilisation of inflation around target in the medium term.

~~The increase in~~While energy ~~prices will lift~~price inflation ~~further over~~declined in June, its rise since the ~~summer~~start of the conflict – and its impact on food, goods and services price inflation – is likely to keep ~~it~~inflation well above target into the first half of 2027. ~~It will also have an impact on food, goods and services inflation.~~ Inflation should then ~~return to target in the second half of 2027, supported by falling~~decline, as energy prices are expected to fall and ~~slower increases in~~ other prices~~.~~ should rise more slowly. However, the ~~war in the Middle East~~conflict remains a major source of uncertainty. ~~The longer energy prices stay high, the more likely they are to drive up broader inflation through indirect and second-round effects.~~ We ~~will~~are therefore closely ~~monitor~~monitoring the size and persistence of the energy price increase, and how it feeds through to price and wage-setting, inflation expectations and overall economic dynamics.

Risk assessment

The risks to the growth outlook are to the downside~~, mainly owing to the war in the Middle East, which has added to the volatile global policy environment. Prolonged~~. While the Memorandum of Understanding agreed between the United States and Iran in June constituted a first attempt to resolve the conflict, recent weeks have brought renewed setbacks and the geopolitical situation remains fragile. Renewed disruption of energy supplies could increase energy prices further and for longer than currently expected. ~~These factors would erode real incomes even more and make firms and households more reluctant to invest and spend. The drag on growth would intensify if the closure of major shipping routes were to cause acute shortages of key inputs that forced euro area firms to curtail output.~~This would weigh on real incomes, spending and investment. A worsening of global financial market sentiment or a tighter supply of credit could dampen demand. Additional frictions in international trade could also further disrupt supply chains, reduce exports and weaken consumption and investment. 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 economy and energy markets were to adapt more quickly than expected to the disruption caused by the ~~war~~conflict in the Middle East or if the ~~war~~conflict was resolved ~~promptly and~~ sustainably. Moreover, planned defence and infrastructure spending, and reforms to enhance productivity and complete the Single Market, as well as euro area firms adopting new technologies, may drive up growth by more than expected~~. A deeper integration of the Single Market could also boost growth beyond current expectations~~.

The risks to the inflation outlook are to the upside. ~~If~~The energy ~~prices were to rise by more~~ shock could intensify further and ~~for longer~~ its effects on other prices and wages could be stronger than currently expected~~, euro area~~. The longer energy prices stay high, the more likely they are to drive up broader inflation ~~would increase further. This could be reinforced and become more persistent if higher energy prices were to spill over by more than expected to other prices and to wages, if longer-term inflation expectations were to rise in response, or if global supply chains were disrupted more broadly.~~through indirect and second-round effects. Ongoing trade tensions could ~~also~~ give rise to more fragmented global supply chains, curtail the supply of critical raw materials and worsen capacity constraints in the euro area economy. Extreme weather events~~,~~ – as illustrated by the ongoing heatwaves – and the unfolding climate and nature crises more broadly, could drive up food prices by more than expected. By contrast, inflation could turn out to be ~~somewhat~~ lower if the ~~economic effects of the war~~conflict in the Middle East ~~proved to be more short-lived than currently expected~~was resolved sustainably or if indirect or second-round effects proved less pronounced than anticipated. More volatile and risk-averse financial markets could weigh on demand and thereby lower inflation as well.

Financial and monetary conditions

~~Financial~~ Overall financial conditions ~~are broadly unchanged~~ have become slightly tighter since our ~~last~~previous meeting ~~but remain tighter than before the war. The cost of issuing market-based debt rose to 4.0 per cent in April, from 3.9 per cent in March.~~, consistent with the increase in the key ECB interest rates. Bank lending rates for firms and the cost of issuing market-based debt remained unchanged in May, at 3.6 per cent ~~in April~~ and ~~mortgage rates at 3.~~4.0 per cent~~.~~

respectively. The annual growth rate of bank lending to firms increased to 4.0 per cent, from 3.4 per cent in April, ~~from 3.2 per cent in March, while the~~ but this was partly offset by slower growth ~~rate of~~in corporate bond issuance ~~rose to~~, which fell from 4.~~6~~5 per cent~~. Mortgage lending in April again grew by~~ to 3.~~0~~4 per cent.

~~In line with~~ Credit standards for business loans tightened somewhat in the second quarter, as reported in our ~~monetary policy strategy, the Governing Council thoroughly assessed the links between monetary policy and financial stability. Euro~~latest bank lending survey for the euro area ~~banks are resilient, supported~~. Demand for loans to firms increased slightly, driven by ~~strong~~higher working capital ~~and liquidity ratios, solid asset quality and robust profitability. However, a sudden, sharp drop in asset prices, potentially amplified by the non-bank financial sector and deteriorating asset quality, particularly in energy and trade-sensitive sectors, would pose risks to financial stability. These risks increase the longer the current geopolitical conflicts last. Macroprudential policy remains the first line of defence against the build-up of financial vulnerabilities, enhancing resilience and preserving macroprudential space~~needs but also by borrowing for fixed investment by large firms.

Mortgage rates rose to 3.5 per cent in May, after 3.4 per cent in April, while mortgage lending growth edged up to 3.1 per cent. Credit standards for mortgages tightened in the second quarter as banks became more concerned about the economic risks faced by their customers and less willing to take on risks themselves. Demand for mortgages decreased on the back of deteriorating consumer confidence and higher interest rates.

Conclusion

The Governing Council today decided to ~~raise~~keep the three key ECB interest rates ~~by 25 basis points~~unchanged. We are committed to setting monetary policy 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.bbvaresearch.com.