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ECB in focus: why we're raising our interest rate forecast



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We are adding a fourth rate hike to our forecast for the European Central Bank (ECB) this monetary cycle, taking the terminal rate to 3% in March 2027.

Our upward revision follows the ECB's 10 September meeting, where Christine Lagarde, ECB president, raised

interest rates by 25 basis points to 2.5% and warned of upside risks to inflation.

President Lagarde did not endorse market pricing of future rates – the ECB is not currently providing “forward guidance” – but nor did she push back against pricing derived from the ECB's “framework guidance.”

The ECB's staff projections show growth at or above trend and inflation above target for an “extended period”, lasting into 2028 – as we expected. Since those projections assume a 3% terminal rate, the ECB cannot credibly argue that a lower rate would be sufficient. Our own oil price assumptions, and our growth and inflation forecasts, are broadly aligned with the ECB's and likewise point to a 3% terminal rate.

Could the ECB turn restrictive?

Ms Lagarde described the 1.75–2.50% “neutral band” as “work in progress”, implying the policy rate could rise further higher while still being seen as neutral. But with growth surprising to the upside, the case for restrictive policy is strengthening – not just at the ECB. This would ultimately favour flatter yield curves and wider spreads.

Despite persistent headwinds and above-target inflation, our view is that economic growth should pick up in the second half of the year, with the outlook in Europe stronger than consensus expectations.

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