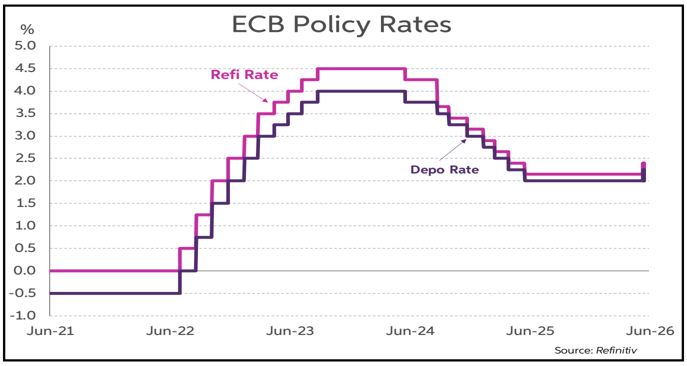
ECB Watch

AIB Treasury Economic Research Unit

11th June 2026

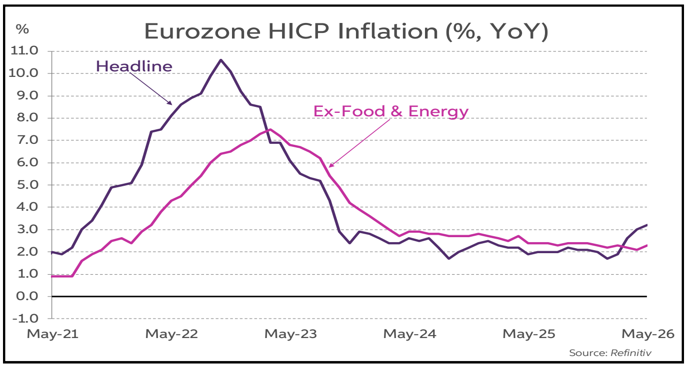
ECB hikes by 25bps and indicates further tightening ahead

The fourth ECB Governing Council policy setting meeting of 2026 saw the central bank hike rates by 25bps. The deposit and refi rates were raised to 2.25% and 2.40%, respectively. This outcome was very much in line with market expectations, and marks the first change in policy since the ECB cut rates last June. It is the first rate hike since September 2023.



The Governing Council's decision to hike rates today was aided and informed by having the latest set of detailed macro staff forecasts. In terms of the outlook for headline inflation, the June forecasts contained upward revisions. This was largely due to "a higher path for energy prices". The ECB now expects inflation to average 3.0% this year (was 2.6%), 2.3% next year (was 2.0%), and 2.0% in 2028 (was 2.1%). Furthermore, the ECB now expects that core inflation will run above the 2% target over the forecast period, averaging 2.5% this year and next, before easing slightly to 2.2% in 2028. This suggests that the ECB anticipates some level of second-round inflationary effects to emerge. Indeed, during the press conference President Lagarde stated that they are already seeing a "broadening" of price pressures. In terms of growth, the ECB revised lower its baseline GDP projections to 0.8% (was 0.9%) in 2026 and to 1.2% in 2027 (was 1.3%). The downward revisions reflected "a more pronounced impact of the war on commodity markets, real incomes and confidence". The meeting statement noted that the "outlook remains uncertain", but that there are upside inflation risks and downside risks for economic growth.

The ECB also provided a number of alternative macro scenarios in its latest projections. This analysis outlined two downside scenarios, "adverse" and "severe", and an upside, "milder" scenario. In the worst-case scenario (in which oil peaks close at $166 per barrel) growth slows to just 0.5% this year and to 0.4% in 2027, with inflation averaging 4.0% and 5.3% over the same period. Meanwhile, in the "milder" scenario, growth would be 0.9% this year and 1.3% next year, as inflation averaged 2.6% and 2.0%, respectively. **However, President Lagarde was keen to highlight that the ECB decision to hike rates today was "robust" across the scenarios.** In other words, even if the upside scenario were to occur in the coming months, monetary policy tightening would still be appropriate.



Given the decision to hike rates was widely anticipated, the market focus was very much on any guidance offered by the ECB. At the post-meeting press conference, President Lagarde stressed that the ECB will take a "meeting-by-meeting" approach to its future policy decisions. She also stressed that the outlook is highly uncertain, due to the war in the Middle East. However, President Lagarde refuted the idea that today's decision to raise rates was "an insurance hike", and she repeatedly emphasised the upside risks to inflation from "broadening" price pressures. **This suggest that today's rate hike is unlikely to be a "one and done" increase, but rather it is the start of a hiking cycle.**

Market expectations for the ECB rate outlook had already shifted in a hawkish direction before the June meeting, which limited the overall reaction to today's decision. The market is still fully pricing in another rate hike in September, albeit current pricing suggests there is just a 30% chance of an increase at the next meeting in July. Overall, the market is of the view that the ECB may hike rates twice more this year in total. **Given today's communications from the ECB, two more rate hikes this year seems highly plausible.**

ECB Macroeconomic Forecasts for the Euro Area - June 2026

(%)	2025	2026	2027	2028
HICP	2.1	3.0 (4.0)	2.3 (5.3)	2.0 (3.0)
Real GDP	1.5	0.8 (0.5)	1.2 (0.4)	1.6 (1.6)

Base forecasts based on Brent oil prices avg. $97 in 2026, and $82 2027, and $77 in 2028. Severe (in brackets) has Brent peaking at $166 in Q3 2026, and remaining elevated at $124 in Q4 2027.

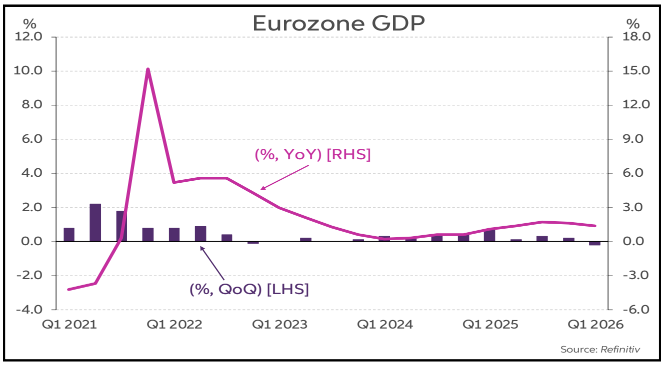
David McNamara
Chief Economist
david.g.mcnamara@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

Daniel Noonan
Economist
daniel.x.noonan@aib.ie

Eurozone growth forecasts revised lower

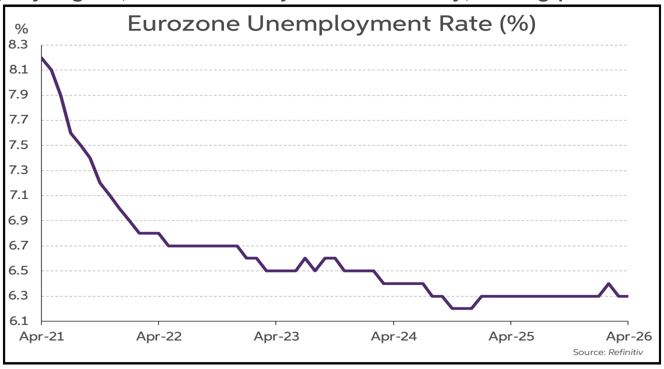
The Eurozone economy expanded by a solid 1.5% last year, up from just 0.8% and 0.5% in the two years prior. However, the economy has lost some momentum at the start of 2026. GDP contracted by 0.2% q/q in Q1 of this year. It was the first quarterly contraction since Q4 2022. Furthermore, the deterioration in performance was broad based. Personal consumption and government expenditure both expanded more slowly, meaning each component contributed just 0.1 percentage points (p.p.) to growth in Q1. At the same time, fixed investment declined by 0.3% q/q, clipping 0.1 p.p. from the total. In terms of external trade, imports increased and exports fell. As a result, net trade knocked 0.3 p.p. off GDP. Changes in inventories also reduced GDP by circa 0.1 p.p. in the quarter. However, it should be noted that excluding the volatile Irish GDP data (which fell by 12.1% in Q1), the Eurozone economy would have expanded by 0.2% q/q in Q1.



Meanwhile, the available survey data for Q2 indicate that economic conditions softened in the quarter. The services PMI moved back into contraction territory in April, falling to 47.6 in the month, its lowest level since the early part of 2021. It was little changed in May also, printing at 47.7. In contrast, the manufacturing PMI has stayed in expansion territory, albeit the headline index fell from 52.2 to 51.6 in May, suggesting the pace of growth in the sector slowed during the midpoint of Q2. Meanwhile, economic sentiment has weakened across the board, amid the onset of the war in the Middle East. Consumer, industrial sector, services sector and investor sentiment as measured by the European Commission all dropped in April and remained at subdued levels in May also. Retail sales, the only hard data release so far in Q2, contracted by 0.4% m/m in April.

Regarding the labour market, conditions remain solid though. Employment expanded for a twentieth successive quarter in Q1, up by 0.1% q/q and by 0.5% y/y. It means that the number of people at work has risen by 5.8% since the end of Q4 2019. Meanwhile, the unemployment rate averaged 6.3% for a second consecutive year in 2025. Furthermore, it has averaged 6.3% once again in the first four months of 2026. Despite ongoing tight conditions, wage growth has cooled somewhat. The Indeed wage tracker indicates that earnings rose by just 2.3% y/y on average in three months to April, down from 2.8% y/y during the same period in 2025.

On the inflation front, price pressures appeared to be relatively stable in the Eurozone ahead of the recent surge in energy prices. Following a gradual downtrend in the first half of 2025, inflation remained in and around the ECB's 2% target rate for a number of months. Indeed, the headline rate averaged just 2.1% overall in 2025. Meantime, underlying inflation proved to be somewhat sticky, with the core rate averaging 2.5% last year. It should be noted though, that it printed between 2.2-2.4% throughout the final nine months of 2025. **However, amid the war in the Middle East, headline inflation has increased sharply in the past three months.** It rose from 1.9% in February to 2.6% in March, and to 3.0% in April, before moving higher again to 3.2% in May. In contrast though, the core rate has edged only slightly higher, and stood at just 2.3% in May, having printed at 2.1% in April, its lowest level since October 2021.



In summary, the Eurozone economy gathered some momentum last year, albeit the pace of growth remained moderate. Meantime, the labour market stayed in robust shape and inflation returned to target. However, the economy appears to have lost some momentum in the early part of 2026. Furthermore, it should be noted that the Eurozone faces a number of challenges. Geopolitical tensions between the EU and US in Q1 serve as a reminder that relations with the bloc's main trading partner are less certain than they have been in the past. **Meanwhile, the ongoing war in the Middle East and the surge in wholesale energy prices now pose a clear stagflationary risk to the economic outlook.** Against this backdrop, growth projections for this year have been revised lower. The IMF now sees GDP rising by 1.1% this year (was 1.3% previously) and by 1.2% next year (was 1.4%). The updated staff projections today indicate that the ECB expects the economy to expand by just 0.8% this year and by a subdued 1.2% in 2027.

AIB, 10 Molesworth Street, Dublin 2 Tel: 353-1-6600311 https://aib.ie/investorrelations/economic-research-unit