MARKET COMMENTARY

ECB: Energy shock's intensity and duration hold the key

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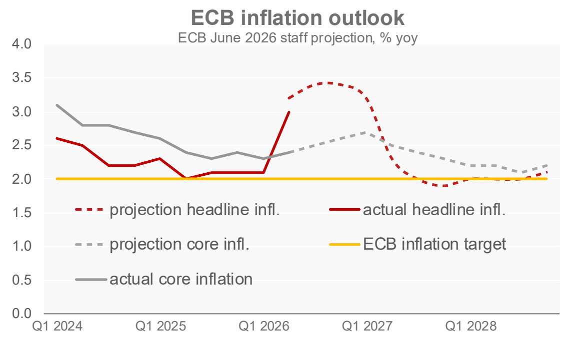
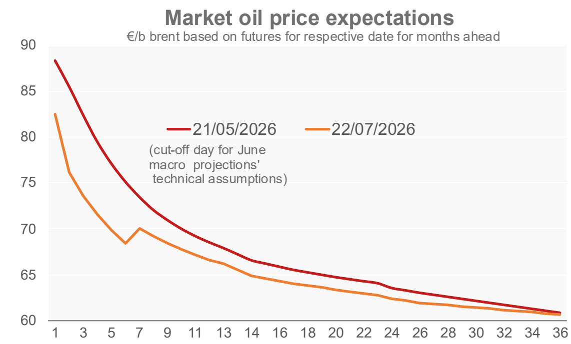
- **The Governing Council (GC) unanimously decided to keep the key rate at 2.25%, as widely expected, noting that energy prices remain close to the baseline scenario of the June projection.**
- **Still, the ECB again stressed unusually high uncertainty: the full impact of the energy shock has yet to play out, keeping its intensity, duration and possible second-round effects firmly in focus.**
- **President Lagarde said the latest flare-up in the conflict had again worsened the balance of risks, while some GC members initially put a rate hike on the table.**
- **Markets are now pricing almost two additional 25 bp hikes this year. Our call of no further rate hike hinges largely on timely geopolitical de-escalation; the risk of a September move has risen markedly.**

The ECB kept rates unchanged today, but its message was clearly not dovish. The Governing Council kept the door open to further hikes, making the intensity, duration and pass-through of the energy-price shock central to the policy outlook. The latest escalation around Iran therefore challenges our call for unchanged key rates. Without timely de-escalation, a September rate hike would become increasingly likely.

Energy prices still broadly match the June baseline… After energy prices eased in the aftermath of the Iran-US ceasefire, the renewed escalation has pushed the issue back into focus. For now, however, the Governing Council noted that energy prices remain broadly in line with the June projection baseline, which assumed annual oil prices of €83, €70 and €66 per barrel in 2026, 2027 and 2028, respectively. Current futures imply annual averages closer to €74, €67 and €63 while headline inflation in Q2 also



Source: ECB, Datastream, GenAM



Source:Datastream, GenAM

came in slightly below the June projection. Importantly, there are still no clear signs of second-round effects: neither the ECB's wage tracker nor its telephone survey currently gives reason for concern.

… but the risks have shifted back to the upside. That said, President Lagarde made clear in the Q&A that the short-lived easing in geopolitical tensions has changed the risk picture. The risks are no longer "more balanced", and the benign scenario presented in June now looks much less likely. She also pointed to this morning's Houthi threat to attack tankers in the Red Sea, stressing that this development had not been factored into today's decision.

A hawkish wait-and-see stance. The discussion within the Governing Council appears to have had a clear hawkish tilt. According to Lagarde, some governors put the possibility of a rate hike on the table before ultimately backing the unanimous decision to keep rates unchanged. At the same time, she strongly reaffirmed the ECB's data-dependent approach, noting that for instance two more inflation prints, Q2 GDP data and fresh wage indicators will be available before the September meeting.

Geopolitics now hold the key. if the Iran conflict is contained quickly and energy prices retreat again, the ECB can stay on hold despite near-term volatility. If the shock proves more persistent, however, the case for another hike strengthens. Lagarde referred to her March 2026 speech at the ECB Watchers Conference, where she argued that a persistent and significant deviation of inflation from target would require a forceful and persistent policy response, while a large but temporary overshoot would call only for a measured adjustment. She also noted that markets understood the ECB's reaction function well. Markets are currently pricing almost two additional 25bp hikes this year.

Risks tilted towards a September hike. Our call for unchanged ECB rates is increasingly under pressure. If energy prices remain elevated and geopolitical risks continue to build, September could become live for another rate increase.