Flash Economics

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Is there a risk that the ECB may need to raise its interest rates?

Participants in financial markets now expect the European Central Bank (ECB) to raise its interest rates twice in 2026 (by 25 basis points each time). Under what circumstances would this expectation prove correct?

- First of all, an increase in ECB interest rates in 2026 could possibly occur if productivity growth in the euro zone remains nil. In that case, the relatively tight labour market would lead to a significant rise in wages, unit labour costs, and prices—particularly in services.
- The ECB would also need to raise its interest rates if energy prices (oil and natural gas) remain high and if this increase in energy prices leads to an acceleration in wage growth.

The only scenario in which the ECB could lower its interest rates would be if—as in the United States—the introduction of artificial intelligence leads to rapid productivity gains in the euro zone, thereby slowing the growth of unit labour costs and prices. However, such an impact of artificial intelligence is not currently noticeable in the euro zone. This scenario would also require the war in the Middle East to be short-lived, with a rapid normalisation of oil and natural gas production.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

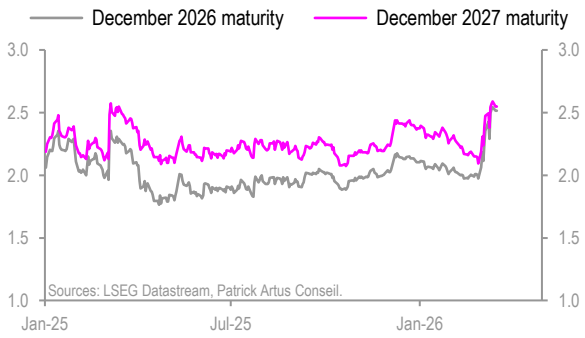
Isabelle Gravet
Research Assistant
isabelle.gravet-ext@ossiam.com

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Financial market participants expect an ECB interest rate hike

Chart 1 shows the market's expectations for 3-month interest rates in the euro area.

Chart 1
Euro zone: Euribor contracts (3-month)

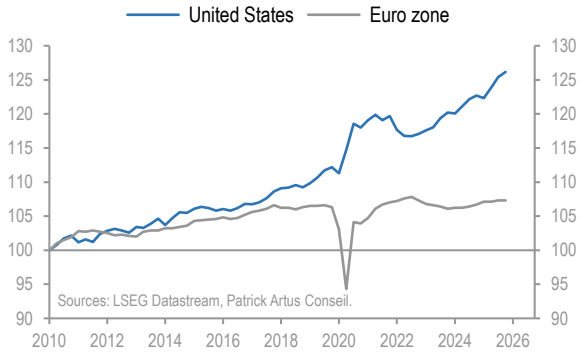


It shows that investors anticipate an increase of approximately 50 basis points in the ECB's key interest rates. We examine under which conditions this expectation would be vindicated.

First scenario for an ECB rate increase: no productivity gains and rapid wage growth

Unlike the United States, the euro area is characterised by stagnant labour productivity (Chart 2).

Chart 2
Productivity per head (2010.Q1 = 100)



Even if economic growth is weak, job creation, combined with the absence of productivity gains (Charts 3A/B), leads to continued significant tension in the labour market (Chart 4).

Chart 3A
Euro zone: Real GDP and employment (Y/Y as %)



Chart 3B
Euro zone: Real GDP and employment (Y/Y as %)

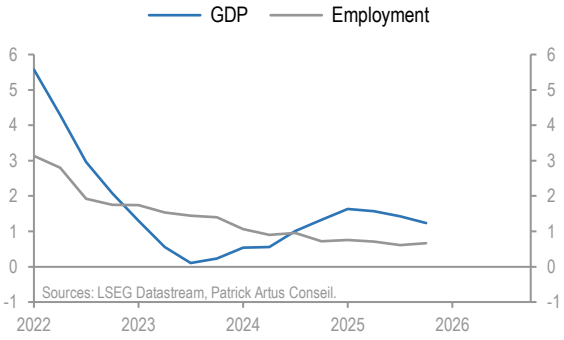
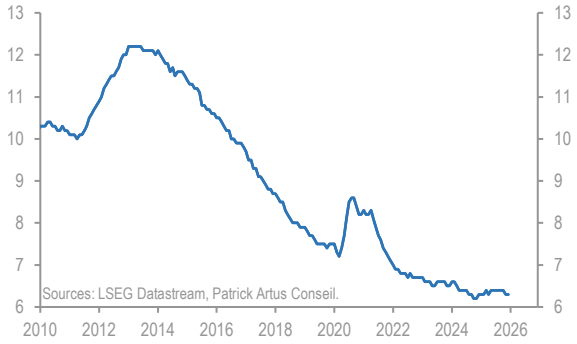


Chart 4
Euro zone: Unemployment rate (as %)



This results in **persistently rapid wage growth** (**Chart 5**) and, consequently, higher unit labour costs, since productivity gains are nil. **This keeps underlying inflation above the ECB's target** (**Chart 6**), particularly through substantial increases in service prices (**Chart 7**).

Chart 5
Euro zone: Nominal per capita wage (Y/Y as %)



Chart 6
Euro zone: Inflation and core inflation

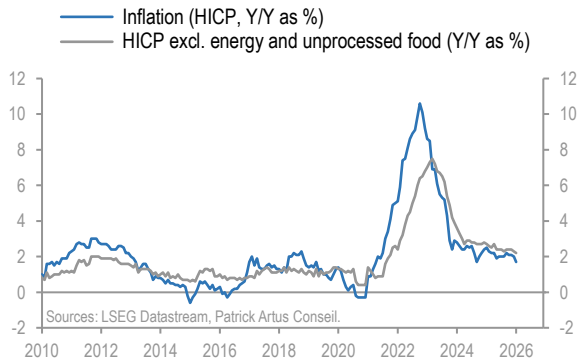
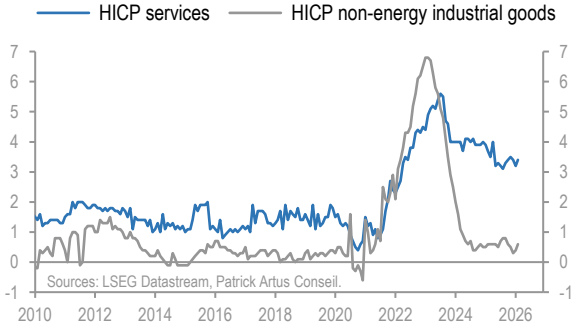


Chart 7
Euro zone: Consumer price indices of services and non-energy industrial goods (Y/Y as %)



If inflation remains consistently above the target, the ECB may be compelled to raise its interest rates.

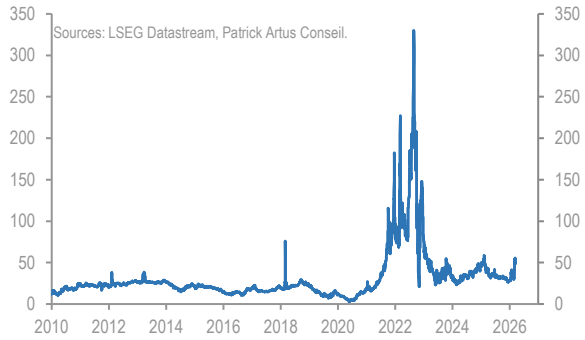
Second scenario for an ECB rate increase: rising energy prices triggering a wage-price spiral

The war in the Middle East has caused **a sharp rise in oil** (**Chart 8**) **and natural gas prices** (**Chart 9**).

Chart 8
Oil price (Brent, $/bbl)



Chart 9
Europe: Natural gas price (€/MWh)



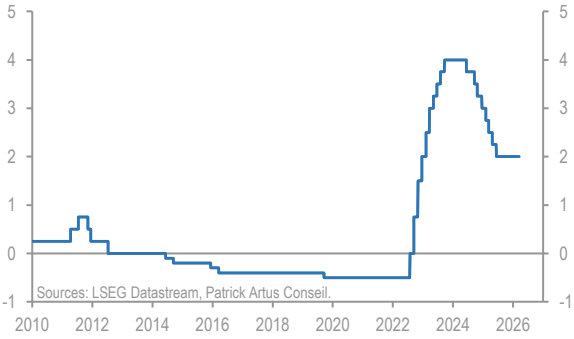
This increase in fossil fuel prices is expected to lead to **higher consumer energy prices starting in March–April 2026** (**Chart 10**).

Chart 10
Euro zone: Energy consumer price index (Y/Y as %)



By comparison with the oil and gas price spikes observed in 2022 at the outset of the Ukraine war, we can anticipate an 18% rise in energy prices if current levels persist, which would add 1.6 percentage points to overall inflation (energy accounts for 9% of the euro area price index). This additional inflation **would likely trigger further increases in wages, unit labour costs, and overall consumer prices, if the energy price bump persists long enough**. If the war in the Middle East does not end quickly, **the ECB is expected to respond to the rise in underlying inflation** (**Chart 6 above**), as it did starting in summer 2022 (**Chart 11**).

Chart 11
Euro zone: European Central Bank Deposit Rate (as %)



Summary: under what conditions would the ECB not raise rates in 2026?

The ECB could refrain from raising interest rates if:

- The war in the Middle East ends quickly, with a rapid normalisation of oil and natural gas production;
- The development of artificial intelligence, as seen in the United States, leads to productivity gains and a reduction in inflation.

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