Flash Economics

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Has the ECB's interest-rate hike been a monetary policy mistake?

The ECB is currently faced with:

- inflation above its target (in May 2026, year on year: 3.2% for headline inflation, 2.4% for inflation excluding energy, 3.5% for services prices);
- very weak euro zone growth since the second quarter of 2025, which turned negative in the first quarter of 2026 (-0.2% for the euro zone as a whole); adjusted for Ireland's erratic growth, however, euro zone GDP growth has remained stable at 0.2% quarter on quarter;
- household inflation expectations three years ahead of 2.9% in April 2026, against 2.6% in January 2026.

If the ECB focuses on its inflation target, raising interest rates is the logical course, which it did on 11 June 2026 with a 25 basis point increase. This decision nonetheless risks proving counterproductive over the medium term. If the Strait of Hormuz reopens, energy prices will fall and there will be no acceleration in wages. Investment is already declining in the euro zone; and where underinvestment prevails, future inflationary pressures and a deterioration in the external balance will be all the greater.

Moreover, the unemployment rate remains low in the euro zone (6.3% in April 2026) despite weak growth. To restrain wages (average wages are rising by more than 3% year on year at end-2025), a highly restrictive monetary policy capable of pushing unemployment back up would be required. The euro zone's economic configuration — inflation, zero growth, yet still-low unemployment — makes monetary policy decisions particularly difficult.

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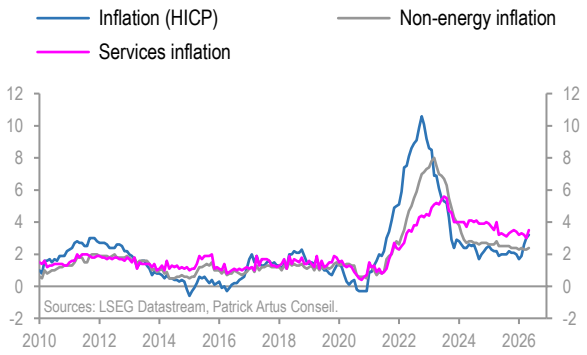
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What is the economic situation in the euro zone?

The euro zone is currently characterised by:

- **Inflation above target** (**Chart 1**): in May 2026, year-on-year headline inflation stands at 3.2%, inflation excluding energy at 2.4%, and services prices (HICP) at 3.5%.

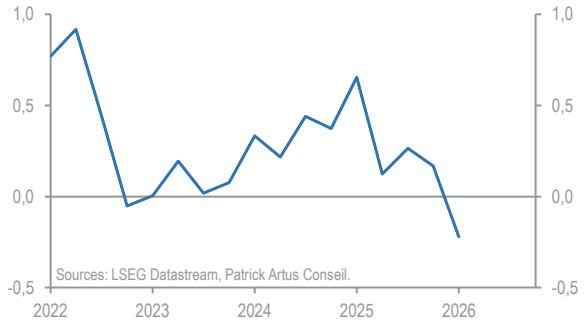
Chart 1
Euro zone: headline, non-energy and services inflation
(%)



Core inflation (excluding energy and food, or excluding energy and unprocessed food) **nonetheless remains stable**, and the ECB's wage tracker — a forward-looking indicator based on prevailing wage agreements — points to continued wage moderation (2.6% expected by end-2026, compared with 3% by end-2025);

- **Very weak growth since the second quarter of 2025** (**Chart 2**). Adjusted for Ireland's highly volatile growth, euro zone GDP growth has been stable since the start of 2025 at 0.2% per quarter, whereas the euro zone as a whole recorded growth of -0.2% in the first quarter of 2026;

Chart 2
Euro zone: Real GDP (Q/Q, %)

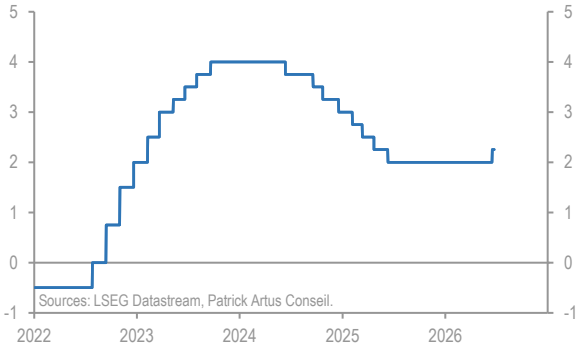


- **household inflation expectations above 2%**: in April 2026, they reached 2.9% at the three-year horizon (compared with 2.6% in January 2026), and 2.4% at the five-year horizon . **Market-based inflation expectations**, as measured by the 10-year inflation swap, edged up, from 2% at the start of 2022 to 2.2% as of 24 June 2026.

What are the implications for ECB policy decisions?

The **ECB's primary objective is to maintain inflation at** around 2% . **This explains the 25 basis point increase in its key policy** rates on 11 June 2026, with the deposit facility rate rising **from 2% to 2.25%** (**Chart 3**). One may nevertheless question whether this was a monetary policy mistake.

Chart 3
Euro zone: ECB Deposit facility rate (%)



A monetary policy mistake?

Several arguments support the view that the ECB's rate hike increase was a monetary policy mistake.

1) Weak investment

The investment rate is declining in the euro zone (**Charts 4 and 5**), and underinvestment is chronic, which accounts for **the absence of productivity gains since 2018** (**Chart 6**). In the long run, this underinvestment will prove inflationary and will weigh on the external balance. Raising interest rates is entirely counterproductive in a context of underinvestment.

Chart 4
Euro zone: Investment (Q/Q, %)

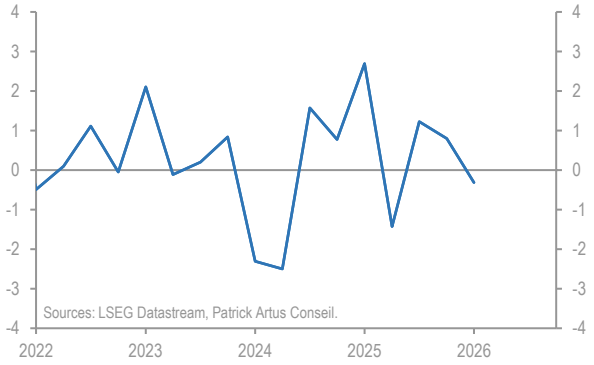


Chart 5
Euro zone: Corporate investment (% of GDP)

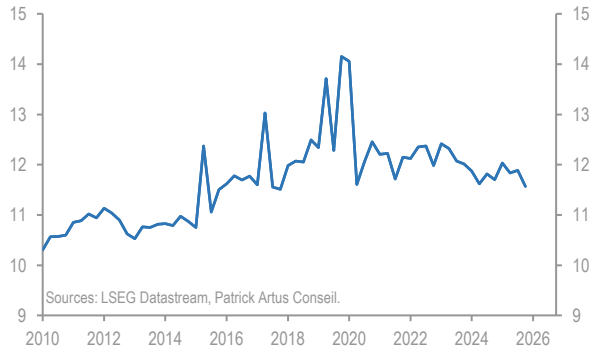


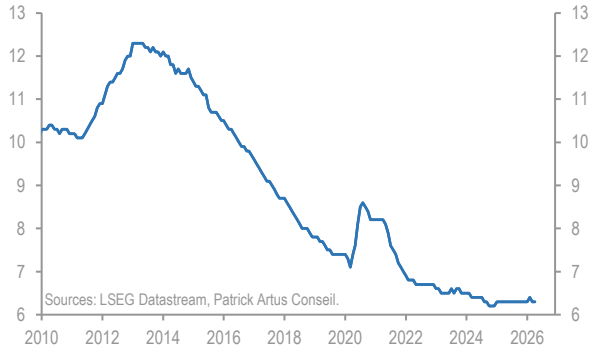
Chart 6
Euro zone: Labour productivity per person employed
(2010Q1 = 100)



2) The need to shift to a highly restrictive monetary policy to push up the unemployment rate and curb inflation

Owing to the stagnation of productivity, **the unemployment rate has remained low in the euro zone**, despite weak growth (**Chart 7**).

Chart 7
Euro zone: Unemployment rate (as %)

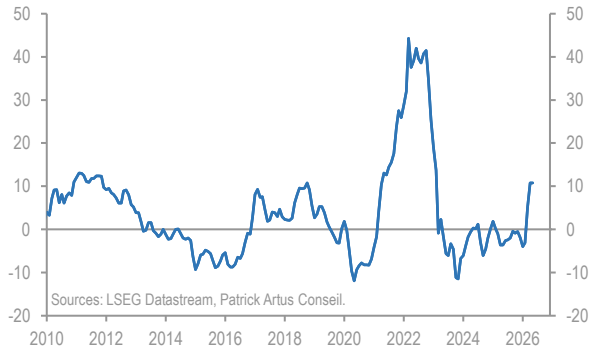


A far more restrictive monetary policy would therefore be required to push unemployment back up and restrain wage growth and inflation. A modest rise in interest rates will have no effect on wages or employment.

3) Reopening of the Strait of Hormuz

Should the reopening of the Strait of Hormuz be confirmed, **oil prices will return to initial levels** (the price stands at $73 per barrel on June 24th, 2026, compared with a peak of $120 per barrel in March–April 2026). This decline in oil prices will lead to **a fall in energy consumption prices** (**Chart 8**), which will in turn imply very low headline inflation. **Under these circumstances, it is highly unlikely that wage increases will become substantial.**

Chart 8
Euro zone: Energy consumer price index (Y/Y as %)



Summary: the ECB's June 2026 interest rate rise was probably unnecessary

The ECB's rate rise on 11 June 2026 was probably counterproductive or unnecessary for several reasons:

- the euro zone suffers from chronic underinvestment and reinforcing it is potentially inflationary. However, the ECB's rate hike did not increase long-term interest rates, and therefore had no adverse effect on investment decisions;
- there are currently no signs of faster wage growth or rising core inflation: to date, no second-round effects of the inflationary shock have been detected;
- with unemployment in the euro zone remaining low — and staying low due to the absence of productivity gains — a 25-basis point rise in ECB rates is wholly insufficient to restrain wages or bring inflation down;
- the inflation problem and the risk of wage acceleration will dissipate if the reopening of the Strait of Hormuz is confirmed and oil and natural gas prices fall.

However, one should not overstate the effect of a modest, largely symbolic increase in the ECB's interest rates.

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