

Could the ECB be done with rate hikes?

Gathered in Sintra, Portugal, from 29 June to 1st July, the members of the ECB Governing Council adopted a notably cautious stance, just three weeks after raising key interest rates. This unanimous decision was in response to the energy shock triggered by the conflict in the Middle East. Since then, energy prices have fallen sharply, and the inflation and survey data from June have shown positive trends. However, the indirect effects of the energy shock are still difficult to assess fully. We maintain our scenario of an additional ECB rate hike in September, despite the easing of inflation risks, which makes such a move less likely.

A DELIBERATELY CAUTIOUS APPROACH

In her opening remarks in Sintra, Christine Lagarde reminded the audience that the conduct of monetary policy now takes place in a more volatile and less predictable environment, characterised by a larger number of and more diverse economic shocks. Faced with this uncertainty, the ECB president advocated for a communication style she referred to as “framework guidance”: an approach centred around scenarios and less prescriptive regarding the future rate paths compared to traditional “forward guidance”. This aligns with the new monetary policy strategy the ECB introduced exactly one year ago in Sintra¹. The strategy provides the ECB with increased flexibility to manage deviations from the 2% target when they are limited and temporary, without causing a significant de-anchoring of inflation expectations. The current shock is precisely the kind of situation the new framework is designed to address.

ECB chief economist Philip Lane summed up the common line – with only minor nuances – that emerged from the various Governing Council members during the forum: do not lock yourself into a specific rate path until the impact of the shock on other components of inflation is better understood. For her part, Christine Lagarde, participating in a panel discussion alongside Andrew Bailey (Bank of England), Kevin Warsh (U.S. Fed) and Tiff Macklem (Bank of Canada), defended the June rate hike as fully justified, while acknowledging that the risks to inflation and growth now appear more balanced (less upside risks to inflation, less downward risks to growth).

DESINFLATIONARY SURPRISES DO NOT INVALIDATE THE JUNE HIKE

At this stage, the indirect effects of the energy shock on economic activity and prices within the euro area are limited to a small number of goods and sectors that are directly exposed. European Commission surveys show that expected price indices are overall at historically high levels, but have been falling for the past two months (after reaching levels already below the peaks seen at the outset of the war in Ukraine; see table, page 4). Moreover, the harmonised inflation rate fell more than expected in June, to 2.8% y/y (0.4 pp). This slowdown was driven in particular by French and German data (0.8 and 0.4 pp, respectively). Price pressures on non energy industrial goods remain modest (+0.9% y/y), as do those on food (+1.6% y/y, the lowest in five years). By contrast, services inflation – which evolves with a certain inertia and also fell in June – remains firmly above 3% (3.2%). Households' one year inflation expectations have also eased (with the median falling from 4.0% to 3.5%). In addition, the alternative indicators tracked by the ECB are still within a range that the central bank will likely find acceptable (see chart 1).

That does not mean the June hike was a mistake. A return to the 2% inflation target will remain a challenge in the short to medium term.

¹ [The ECB's monetary policy strategy statement \(2025\)](#).

ALTERNATIVE INFLATION MEASURES: NO CLEAR TRACE OF THE SHOCK

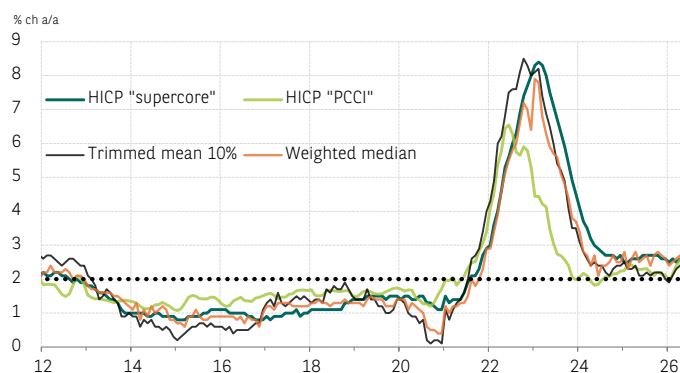
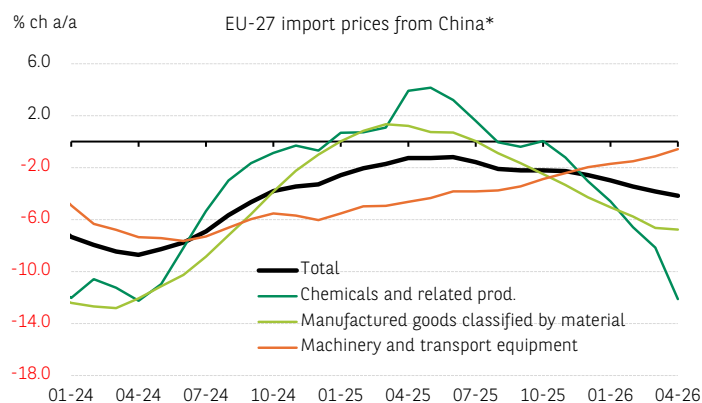


CHART 1

SOURCE: ECB, BNP PARIBAS

EUROPE CONTINUES TO IMPORT DEFLATION FROM CHINA



* Import unit value index, data smoothed over twelve months

CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

We now anticipate a more modest rebound in inflation in 2026 (2.7%), but still no return to the target in 2027, with inflation remaining well above it (2.6%). The factors contributing to this include an increase in activity that sustains core inflation and the persistence of relatively high energy prices (around USD 80 per barrel on average in 2027).



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EUROPEAN COMMISSION INDEX - PRICE EXPECTATIONS NEXT THREE MONTHS (Z-SCORE)

	01/2026	02/2026	03/2026	04/2026	05/2026	06/2026	06/2022
Manufacturing	-0.11	-0.05	0.42	1.05	0.84	0.54	2.89
Food products	-1.03	-0.76	-0.20	0.52	-0.09	-0.32	3.04
Beverages	-0.20	-0.50	-0.25	0.07	-0.05	-0.35	3.02
Textiles	-0.06	-0.12	0.36	1.29	1.66	1.10	2.49
Wearing apparel	-0.21	0.15	0.37	0.48	0.42	0.37	3.91
Leather and related products	0.15	0.01	-0.04	0.96	0.46	0.41	2.73
Wood and wood products, ex-furniture	0.65	0.37	0.39	1.27	1.18	0.79	0.92
Paper and paper products	-0.44	-0.55	0.34	0.94	0.95	0.82	1.53
Printing and reproduction of recorded media	-0.01	-0.04	0.66	1.34	1.50	0.71	3.59
Coke and refined petroleum products	-0.61	-0.61	2.74	1.76	1.35	0.44	1.63
Chemicals and chemical products	-0.71	-0.48	0.75	2.26	1.90	1.16	2.34
Basic pharmaceutical products and pharmaceutical preparations	-0.40	0.78	0.28	1.35	1.37	1.09	4.02
Rubber and plastic products	0.17	0.00	0.43	1.49	1.37	0.72	2.36
Other non-metallic mineral products	-0.29	-0.36	0.10	0.89	0.85	0.21	2.47
Basic metals	0.51	0.52	0.81	1.32	1.55	0.97	0.35
Fabricated metal products, except machinery and equipment	0.30	0.35	0.62	1.21	1.02	0.89	2.44
Computer, electronic and optical products	0.48	0.40	0.62	1.00	0.86	0.89	3.54
Electrical equipment	-0.16	0.15	0.19	0.68	0.83	0.89	3.00
Machinery and equipment n.e.c.	-0.21	-0.17	-0.11	0.34	0.34	0.37	3.19
Motor vehicles, trailers and semi-trailers	-0.17	0.09	-0.09	0.18	0.20	0.19	3.70
Other transport equipment	1.16	-0.02	0.51	-0.31	1.67	1.08	2.37
Furniture	-0.20	0.00	0.20	1.07	1.30	1.34	2.23
Other manufacturing	0.78	1.13	1.12	1.20	0.39	0.70	3.47
Repair and installation of machinery and equipment	0.27	0.26	0.23	0.25	1.16	0.47	3.50
Construction	-0.07	-0.22	0.08	0.63	0.48	0.20	2.78
Construction of buildings	-0.17	-0.06	0.21	0.71	0.66	0.26	0.00
Civil engineering	0.02	-0.18	0.34	0.70	0.40	0.36	2.67
Specialised construction activities	-0.13	-0.25	-0.01	0.43	0.49	0.21	2.95
	01/2026	02/2026	03/2026	04/2026	05/2026	06/2026	06/2022
Retail	0.06	0.09	0.26	0.71	0.66	0.64	3.77
Wholesale and retail trade and repair of motor vehicles and motorcycles	-0.17	0.09	0.26	0.50	0.57	0.51	3.35
Retail trade, except of motor vehicles and motorcycles	0.11	0.07	0.32	0.79	0.74	0.66	3.91
Services	0.31	0.26	0.35	0.63	0.48	0.24	3.34
Land transport and transport via pipelines	0.78	0.83	1.24	1.50	1.22	0.43	2.71
Warehousing and support activities for transportation	0.36	0.53	0.91	1.42	1.31	0.64	2.32
Accommodation	-0.53	-0.37	-0.23	-0.04	-0.04	-0.18	2.63
Food and beverage service activities	-0.48	-0.54	-0.44	0.23	-0.26	-0.71	3.98
Programming and broadcasting activities	0.42	1.85	-0.21	0.03	1.08	-0.43	-0.65
Telecommunications	1.96	0.83	1.24	1.42	1.14	1.08	1.57
Computer programming, consultancy and related activities	-0.27	-0.23	-0.12	0.22	0.19	0.36	3.42
Information service activities	0.45	0.37	0.18	0.28	0.45	0.82	2.83
Real estate activities	-0.07	0.47	0.18	-0.03	-0.63	0.11	3.08
Legal and accounting activities	0.72	0.40	0.30	0.64	0.32	0.23	3.50
Activities of head offices; management consultancy activities	-0.01	-0.76	-0.42	-0.61	0.03	-0.34	2.93
Architectural and engineering activities; technical testing and analysis	0.25	0.07	0.10	0.22	0.05	-0.42	3.03
Advertising and market research	1.09	0.89	0.10	0.70	1.09	0.87	1.36
Other professional, scientific and technical activities	0.47	-0.26	0.50	0.08	-0.20	-0.16	2.87
Rental and leasing activities	-0.18	-0.36	-0.60	0.54	0.21	-0.05	3.51
Employment activities	-0.20	-0.53	-1.06	-1.04	-0.31	-0.06	2.49
Travel agency, tour operator reservation service and related activities	0.69	0.36	1.03	1.24	1.01	0.17	2.95
Security and investigation activities	0.63	0.07	-0.14	-0.41	-0.10	-0.58	3.75
Services to buildings and landscape activities	0.69	0.33	-0.26	0.51	0.69	0.33	4.05
Office administrative, office support and other business support activities	0.37	0.29	1.04	0.29	0.24	0.15	3.02
Repair of computers and personal and household goods	1.45	0.48	0.21	0.55	0.31	-0.33	3.10

TABLE

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS



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STRUCTURAL FORCES AT WORK

The uncertainty surrounding the spread of the energy shock should not overshadow other inflationary pressures arising from the conflict (e.g., higher maritime freight rates) or from the robust demand for components related to the AI sector, which are driving up import prices for IT, electronic and optical equipment (+6.8% in April). Conversely, the downward trend in import prices from China has accelerated in recent months, especially in sectors where Chinese overcapacity is most pronounced, such as chemicals (see chart 2). The recent appreciation of the renminbi against the euro has not yet mitigated this effect: faced with a commercial decoupling from the United States, China appears to be intensifying its market share winning price strategy, a stance likely to continue in a context of weak domestic demand.

The deflationary impact of cheaper Chinese imports is not neutral for euro area inflation dynamics because the monetary union remains heavily dependent on imports (16.9% of euro area imports came from China in April). According to our calculations, a 10% drop in Chinese import prices would cut headline inflation by around 0.3 percentage points – a finding that aligns closely with a recent ECB research note².

Wage moderation is another factor supporting disinflation, at least in the short term. The ECB's wage tracker currently shows no signs of a second round effect by the end of the year, with base salary growth expected to stabilise at around 2.5% in the second half of 2026. The ECB will monitor this situation closely until September.

In summary, the overall balance of inflation risks now appears to lean slightly more towards the downside than it did a few weeks ago, but not enough to warrant a change in monetary policy direction. Our central scenario therefore remains unchanged: a further rate increase is likely in September, albeit with less conviction than a month ago. In Sintra, true to its new framework, the ECB neither ruled out a pause in policy rates nor fully embraced it.

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² [What has kept goods inflation low? The role of the import exposure to China](#), ECB Economic Bulletin, June 2026. According to this study, a 10% drop in import prices from China would result in a reduction in inflation for non-energy industrial goods by 0.4 to 0.7 percentage points. Given the significance of this component in the HICP (25.7%), it would bring headline inflation down by 0.1 to 0.2 percentage points.

