How far will the ECB raise rates?

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The ECB is expected to raise its key interest rates next week. Further rate hikes, as anticipated by the market, are possible but unlikely. This is because the inflation rate is likely to continue to evolve in line with the ECB's baseline scenario for the time being, to which the central bank has announced only a modest response. Furthermore, according to the ECB's assessment, the deposit rate—at 2.5% starting next week—will be close to the upper end of its neutral range, a level that the monetary policy doves—who, according to our updated Hawkometer, remain clearly in the majority on the ECB Governing Council—are unlikely to want to exceed.

The ECB will raise interest rates next week, ...

The ECB is expected to raise key interest rates by 25 basis points for the second time next week, bringing the deposit rate to 2.50 percent. Even representatives of the dovish camp on the ECB Governing Council have expressed views along these lines. According to Primož Dolenc, governor of the Slovenian central bank, the case for a rate hike is currently strong, especially since the "inflation situation is not resolving itself." Olli Rehn, governor of the Finnish central bank, considers market expectations to be "understandable." In light of these clear signals from the ECB Governing Council, the futures markets have fully priced in this rate hike, and nearly all economists surveyed by Bloomberg also expect a rate hike.

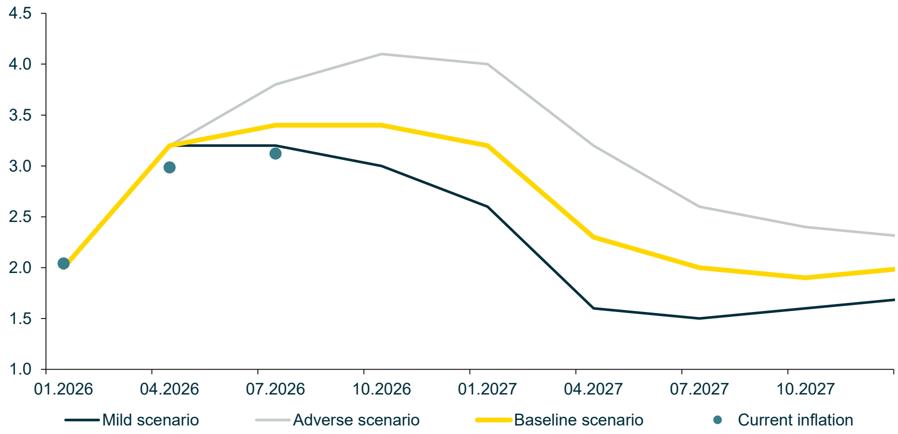
... but that should be it for now

It is less certain what will happen after the rate hike in September. Investors in the futures markets expect two more rate hikes by the middle of next year. However, we consider it more likely that key interest rates will remain unchanged in the coming months (see title chart).

Inflation close to the ECB's baseline scenario

In our view, the strongest argument is the ECB's statements regarding its expected monetary policy response to certain scenarios. At its June meeting, the ECB presented additional scenarios alongside its usual baseline scenario: In the baseline scenario, the inflation rate would peak at just under 3½% this year, before falling significantly in the spring of 2027 and eventually converging toward the 2% inflation target (Chart 1). In the adverse scenario, however, it would rise to just over 4% by the end of 2026 and would not approach the inflation target until toward the end of 2028. Finally, in the mild scenario, inflation would peak at 3¼% as early as the third quarter, gradually decline thereafter, and even fall below the 2% inflation target starting in the spring of next year.

Chart 1 - The ECB's inflation scenarios
Inflation scenarios from the ECB's June projections, current inflation figures (Q3 = July/August), in percent

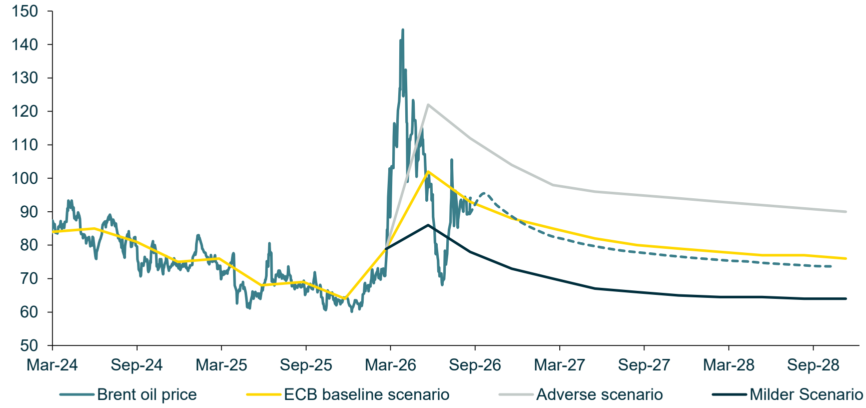


Source: ECB, Eurostat, Commerzbank Research

In recent months, the inflation rate has largely followed the pattern outlined in the mild scenario. However, the inflation rate is not expected to decline for the time being and is therefore likely to move closer to the baseline scenario. The trends in oil prices and oil futures also largely correspond to the baseline scenario (Chart 2), while gas prices are actually more in line with the adverse scenario.

Chart 2 - Oil price hovers around the ECB's baseline scenario

Brent oil price and futures; ECB's baseline, mild, and adverse scenarios for the oil price, in dollars per barrel



Source: ECB, Bloomberg, Commerzbank Research

Consequently, the ECB is likely to view the base scenario as the most probable outcome in the coming months. In this regard, ECB economists are likely to make only "cosmetic" adjustments to their projections (Table 1).

Table 1 - ECB is unlikely to make significant changes to its projections

Commerzbank's perception of ECB experts' September projections; in parentheses: ECB June projection; growth and inflation rates in percent

	2026	2027	2028
GDP growth	0.8 (0.8)	1.2 (1.2)	1.5 (1.5)
Inflation	2.9 (3.0)	2.3 (2.3)	2.0 (2.0)
Core rate	2.5 (2.5)	2.5 (2.5)	2.2 (2.2)

Source: ECB, Commerzbank Research

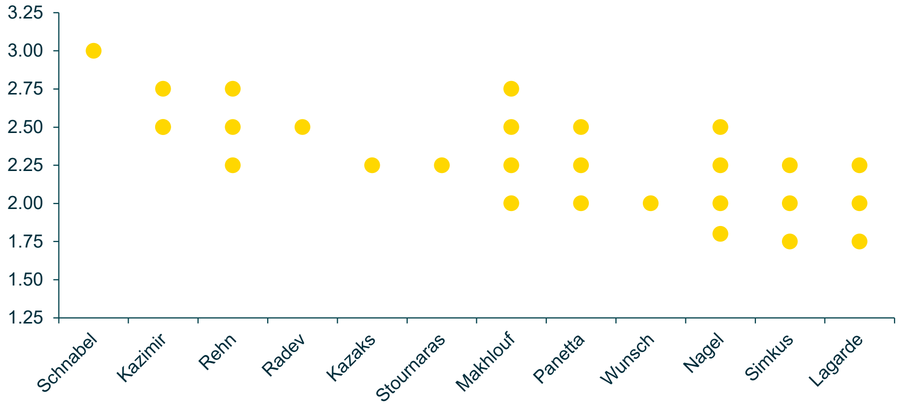
ECB President Lagarde commented on the monetary policy implications of such a development in her **speech at the "ECB Watchers Conference"**: "if the shock gives rise to a large though not-too-persistent overshoot of our target, some measured adjustment of policy could be warranted. The optimal response to such a deviation is smaller when the cause is exogenous supply disruptions rather than strong demand". In our view, this suggests that, in the baseline scenario, interest rate hikes are more likely to be sporadic.

Upper end of neutral interest rate reached with September rate hike

In addition, with a deposit rate of 2.5%, the ECB believes it has reached the upper end of the neutral interest rate—which neither stimulates nor slows the economy and is consistent with a medium-term inflation rate of 2 percent. Even though the neutral interest rate cannot be observed and is therefore a vague concept, members of the ECB Governing Council occasionally comment on it. Statements by central bankers over the past two years suggest that most central bankers place the neutral interest rate between 2% and 2.50% (Chart 3). Even Dimitar Radev, the governor of Bulgaria's central bank—whom we consider a monetary policy hawk—places the neutral interest rate in the range of 2.50%. For many representatives of the dovish camp, monetary policy at such an interest rate level is likely already moderately restrictive, and they are unlikely to want to tighten monetary policy further—especially since, in the view of some Governing Council members, the rise in long-term bond yields over the past few weeks is helping to combat inflation.

Chart 3 - Neutral interest rate between 2% and 2,5%

ECB council members' omments on the neutral interest rate since 2024



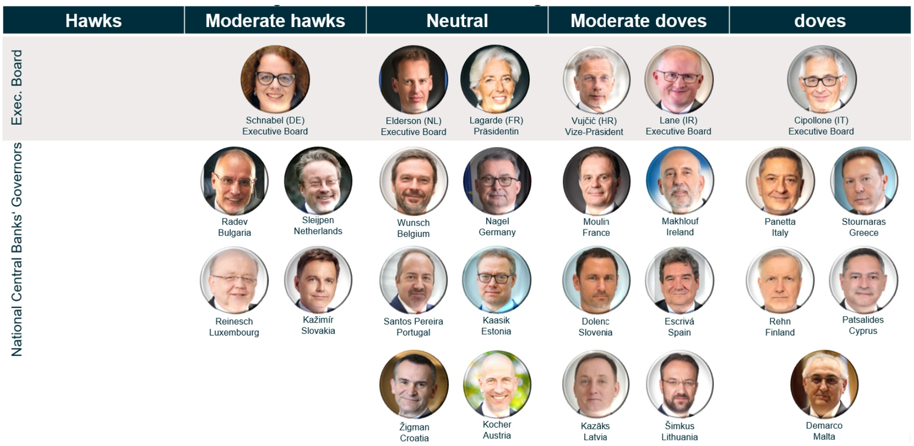
Source: Commerzbank-Research

Hawkometer: doves still hold clear majority on the ECB governing council

In the end, the doves' assessment is likely to prevail on the ECB Governing Council. Even after Bulgaria's accession to the eurozone and leadership changes at numerous national central banks, the doves still constitute a clear majority on the Governing Council. This is shown by our revised "Hawkometer," which we use to classify ECB Governing Council members as monetary policy hawks or doves. We have updated the methodology behind this tool by now using a Large Language Model (LLM) to analyze the speeches and comments of ECB Governing Council members, in order to achieve the greatest possible objectivity (see **Economic Insight "Hawkometer – AI Edition"**). This analysis shows that there are currently 14 doves on the ECB Governing Council—who tend to favor an accommodative monetary policy—versus five hawks.

Chart 4 - Monetary policy doves outweigh hawks

Commerzbank's assessment of the ECB governing council cembers' stance on monetary policy



Source: Commerzbank Research

Growing awareness of the challenges faced by finance ministers?

In addition, many members of the ECB Governing Council are likely keeping an eye on the impact of higher interest rates on government finances, which are already under strain from rising interest expenses. An analysis by **Stefan Gerlach**, the former deputy governor of the Central Bank of Ireland and chief economist of the Hong Kong Monetary Authority, shows that in the early 2000s, not a single one of the 18 Governing Council members at the time had previously held a ministerial post, but that this has changed over time. Shortly before the surge in inflation triggered by the COVID-19 pandemic in 2021, seven of the 25 Governing Council members had previously held ministerial positions, including President Lagarde and then-Vice President de Guindos. According to our tally, twelve of the 28 Governing Council members now have experience in top political offices—such as minister, state secretary, or chief of staff—in their professional careers.

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