



Rate hike – what is key for the ECB

The ECB is expected to keep interest rates unchanged next week. However, a rate hike is not entirely off the table, especially if second-round effects continue to drive inflation over the long term. Following the last monetary policy meeting, ECB President Christine Lagarde cited indicators that the ECB will be monitoring. We have supplemented these with additional useful indicators and are analyzing the signals.

Dr. Marco Wagner ^{AC}

"Hold" in April ...

The members of the ECB Governing Council are unlikely to raise interest rates at next week's monetary policy meeting. According to their latest statements, the central bankers remain "vigilant." However, they do not want to act hastily; rather, monetary policy must be conducted with a steady hand. Furthermore, the rise in bond yields is already having the effect of a certain degree of monetary tightening. Individual Governing Council members, such as Greek central bank governor Stournaras and his Lithuanian counterpart Šimkus, have recently spoken out clearly against an interest rate hike. After all, since the talks between the U.S. and Iran, there is a real chance of an early end to the war. Already, crude oil and gas prices have shown a slight downward trend (title chart), which is also becoming noticeable at the gas pumps. This has made the ECB's baseline scenario more likely, in which ECB economists project only a temporary rise in inflation and no lasting effects on core inflation.

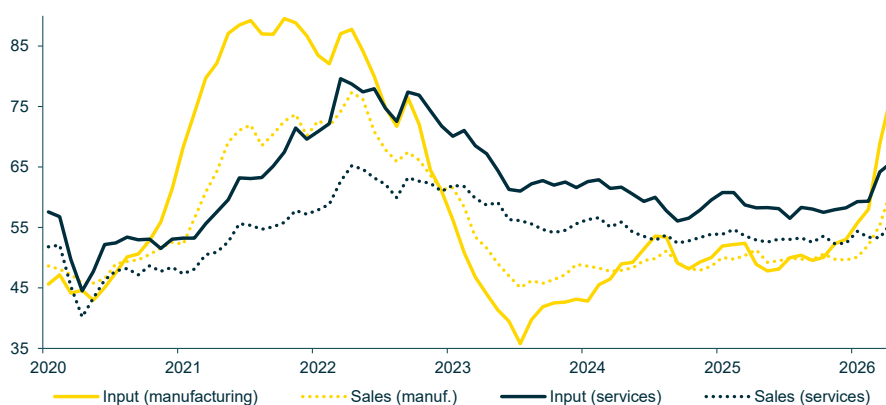
... and "secure" in June

However, we still consider an interest rate hike in June to be likely, especially if the stalemate around the Strait of Hormuz continues, which yet remains completely blocked (title chart). After all, memories of the 2022 surge in inflation are still fresh. Some of the indicators cited by ECB President Lagarde at the last press conference also point to increased inflation risks.

Companies are already passing on higher prices

The subcomponents of the Purchasing Managers' Index (PMI) for the eurozone point to upside risks for inflation (Chart 1). According to these figures, companies in both the manufacturing and services sectors are now reporting higher input prices. The manufacturing PMI, in particular, bears a striking resemblance to its rise a few years ago. At the same time, more companies, especially in the manufacturing sector, report having raised their selling prices as well. In addition, the quarterly telephone survey of companies mentioned by ECB President Lagarde was conducted in early April. Plans for price increases will play a decisive role in this. Lagarde is expected to comment on the results at next week's press conference.

Chart 1 - Companies are feeling the impact of higher input prices and are already passing them on
Purchasing Managers' Index for the Eurozone, sub-components on input prices and sales prices



Source: S&P Global, Commerzbank Research

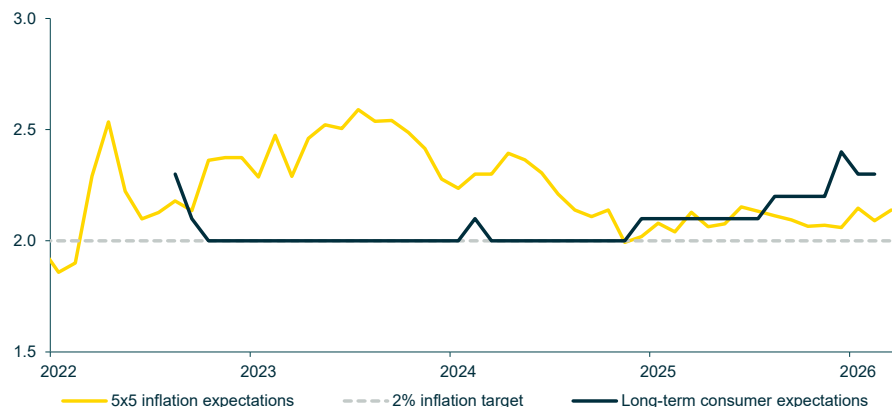
Consumer inflation expectations are trending upward ...

A further rise in inflation—possibly across a broad range of goods and services—could further unsettle consumers. Consumers still vividly remember the inflation spike in 2022/23, which could raise their long-term inflation expectations. While long-term market expectations remain close to the ECB's inflation target, consumers expect inflation to reach 2.3% in five years, according to an ECB survey (Chart 2). While this is not alarmingly above the ECB's 2% target, it is noteworthy for two reasons: First, consumer expectations in 2023 were exactly at the inflation target despite an annual average inflation rate of 5.4%. Second, these expectations have been trending slightly upward since 2025 and are gradually moving away from the ECB's target. In particular, low- to middle-income groups appear to be gradually



losing confidence in the ECB. The ECB is likely eagerly awaiting the March figures, which will be released two days before the interest rate meeting—on April 28.

Chart 2 - Consumers' long-term inflation expectations are trending slightly upward
Market expectations of what inflation will be in five years for the following five years—so-called 5x5 inflation expectations derived from inflation swaps; consumer expectations of inflation in five years (median), in %



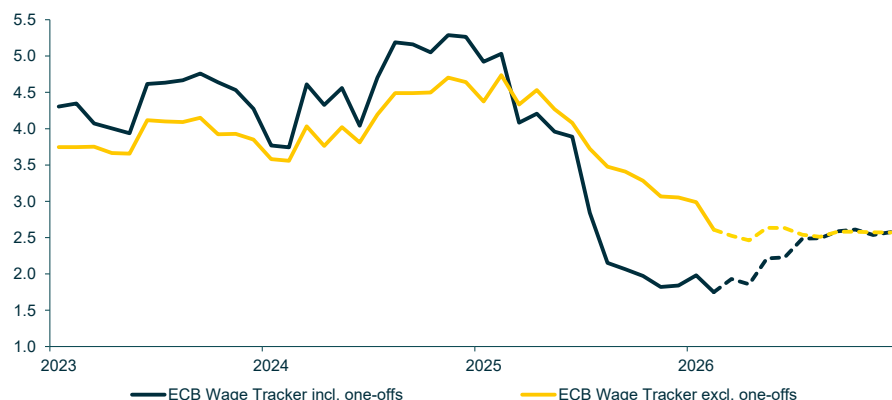
Source: Bloomberg, ECB, Commerzbank Research

... which could result in larger pay raises

In particular, rising long-term inflation expectations, combined with the loss of purchasing power already caused by higher energy prices, could easily prompt workers and unions to demand higher wages. In fact, several collective bargaining agreements are due for renegotiation starting in July. At that point, the currently favorable outlook could quickly change. For now, projected wage growth still points to a favorable environment. According to the ECB's Wage Tracker, which is based on collectively agreed wages across a total of eleven euro area countries, wage growth has slowed over the past twelve months (Chart 3). The outlook for the coming months—which, unlike a forecast, reflects the negotiated wages in current collective agreements—also points to only a moderate rise in wages.

Chart 3 - Wage trackers point to moderate wage increases

ECB wage trackers, with and without one-time payments, based on wage agreements in 11 eurozone countries, as a percentage of the previous year



Source: ECB, Commerzbank Research

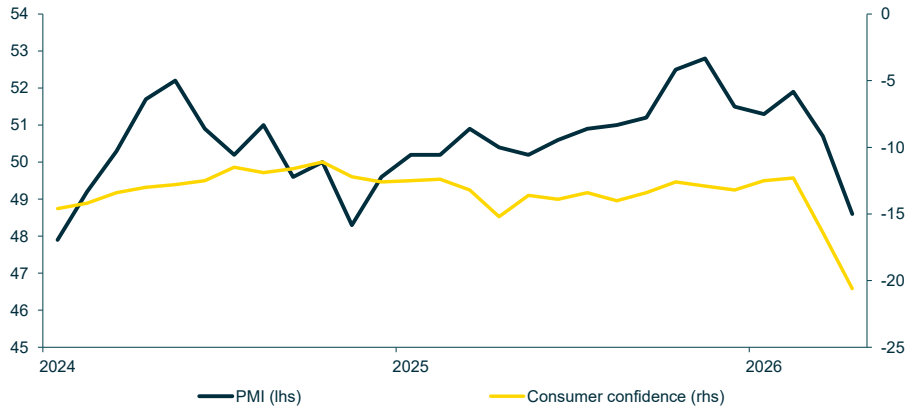
A weak economy could curb inflation in the medium term

Given the inflation risks mentioned above, we expect the ECB to raise interest rates in June, provided the Strait of Hormuz is not fully and permanently reopened by then. However, we do not go as far as the financial markets, which expect not just one but roughly two and a half rate hikes by the end of the year. This is because other indicators cited by President Lagarde point to certain downside risks for inflation. For instance, leading economic indicators such as the Purchasing Managers' Index (Chart 4) point to a significant slowdown in economic growth in the coming months, which could dampen inflation in the medium term.



Chart 4 - Leading indicators on the decline

European Commission survey on consumer confidence in the euro area; composite Purchasing Managers' Index (PMI) for the overall euro area economy



Source: EU Commission, S&P Global, Commerzbank Research



Analysts

^{AC}
Dr. Jörg Krämer
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

^{AC}
Bernd Weidensteiner
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

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Frankfurt

Commerzbank AG
DLZ - Gebäude 2, Händlerhaus
Mainzer Landstraße 153
60327 Frankfurt
Tel: + 49 69 136 21200

London

Commerzbank AG
PO BOX 52715
30 Gresham Street
London, EC2P 2XY
Tel: + 44 207 623 8000

New York

Commerz Markets LLC
225 Liberty Street, 32nd floor,
New York,
NY 10281-1050
Tel: + 1 212 703 4000

Singapore

Commerzbank AG
128 Beach Road
#17-01 Guoco Midtown
Singapore 189773
Tel: +65 631 10000