

ECB makes a hawkish pivot at its March meeting

Rates have been kept on hold, but the European Central Bank has clearly opted for a hawkish pivot at today's meeting



ECB President Christine Lagarde at today's press conference in Frankfurt

Comments by European Central Bank President Christine Lagarde at the press conference gave today's meeting a more hawkish tilt. Even if a rate hike is not imminent, the change in tone and language acknowledges more uncertainty and is meant to demonstrate the ECB's willingness to act, if need be.

The fact that the well-known 'monitor closely' or 'closely monitoring' is back is a clear signal that the ECB has shifted to higher alert. In the past, the term 'monitor closely' had always been a sign of high alertness; the time it was used was during the short-lived banking tensions in March 2023 and before in 2022. In the distant past, 'monitor closely' was followed by 'vigilance' in the run-up to rate hikes. Following the logic of institutional ECB language, today's 'closely monitoring' combined with Lagarde's statement that risks to the inflation outlook were tilted to the upside are both clear signals of increased alertness.

New round of forecasts

Just for the record – though clearly not really relevant for future policy decisions despite a later

cut-off date than usual (March 11) – the latest round of ECB staff projections has GDP growth coming in at 0.9% in 2026, 1.3% in 2027 and 1.4% in 2028. Inflation is expected to come in at 2.6%, 2.0% and 2.1% over the next few years.

In this base case scenario, ECB staff treats the current oil price shock mainly as a one-off – and one that would hardly necessitate a monetary policy reaction. However, in two alternative scenarios ECB staff prepared, the monetary policy reaction could be different as both scenarios worsen the stagflationary impact.

In the adverse scenario, the impact on the economy would be temporary and part of the inflationary impacts unwind. Growth would be some 0.3ppt lower than the baseline in 2026 and 0.1ppt lower in 2027. Inflation would be 0.9ppt higher in 2026 but would come down quickly, pushing headline inflation 0.5ppt lower in 2028.

In the severe scenario, energy prices would have a stronger and longer-lasting effect, reducing GDP growth by 0.5ppt and 0.4ppt in 2026 and 2027 respectively. The eurozone economy would be in a technical recession in the summer of 2026. Inflation would also be much higher, e.g., 3ppt higher than the baseline in 2027.

Decoding the ECB's reaction function

We reflected on the ECB's reaction function to oil price shocks and how it has changed over time [here](#). During the press conference, Lagarde kept it vague, but reading between the lines suggested that the ECB is once again making a distinction between a supply-side and a demand-side shock. Stressing that the central bank would focus on commodity markets, potential supply bottlenecks, selling price expectations of firms, demand indicators and wage trackers, Lagarde gave the impression that the ECB would only start to react with rate hikes if and when higher energy prices and headline inflation would start to be passed through.

This is probably the most important lesson from the 2022 period: not that the ECB was too late to react to an energy price shock, but that it was too late to identify and to react to supply-driven inflation broadening to a fully-fledged and broad inflation problem.

On hold for now but rate hikes cannot be excluded

Looking ahead, an inflation wave is clearly in the making, from the direct impact of higher gas and oil prices on gasoline prices or retail energy prices next winter, to knock-on effects on transportation services, fertilisers and food prices. However, even a somewhat longer-lasting inflation overshoot does not have to be a concern. And, in fact, the only hurdle to calling this a typical supply side shock is the ECB's own institutional memory, its credibility as an inflation fighter and the fact that 'team transitory' turned out to be very wrong in 2022. It's obvious that 'transitory' has become a forbidden word at the ECB.

In a scenario in which the war in the Middle East and soaring energy prices remain limited in time, the ECB will talk like a hawk but not walk like a hawk – or, rather, fly like one. However, if energy prices stay high or higher for longer and find their way into other parts of the eurozone economy, the central bank apparently wouldn't shy away from rate hikes. Even though the bar for a rate hike seems to be higher than markets have currently priced in, given that the starting position for the ECB is currently very different from in 2022 (i.e., interest rates are higher), inflation and inflation expectations are much lower than in 2022.

All in all, a rate hike is not yet on the table, but today's meeting clearly marks a hawkish pivot.

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