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RATES SPARK

## Rates Spark: Oil still key to ECB outlook

We had our 25bp ECB hike, though markets were probably expecting more commitment to future moves during the meeting. But lower oil prices turn out to be the bigger dovish driver. If tensions with Iran were to re-escalate, we could still see rates rise significantly higher



If oil prices remain above \$100 per barrel for a sustained time frame, we could see three rate hikes from the European Central Bank

### ECB ready for more hikes but oil still the big unknown

[The ECB hiked](#) yesterday, as expected, but during the meeting markets were probably looking for a clearer commitment to future hikes to sustain the hawkish pricing. Nevertheless, [the broader rates picture](#) hasn't really changed. Markets continue to see a considerable chance of a July hike and are sticking to the view of two to three hikes in total. We still think two hikes are more realistic, but until we have more clarity on second-round inflation risks, we won't push hard against current pricing. And July seems like a realistic possibility too for the second hike, especially given the latest comments from governing council members who don't seem to push against that idea.

The big unknown remains oil, which continues to make big swings every day. This morning we're below \$90 for the first time. Even though just yesterday, US President Donald Trump threatened a military escalation. We think Brent oil can also still easily [make a move above \\$100](#) again. The longer the conflict remains unresolved, the more supply shortages will feed

into higher prices. This could already happen in July and potentially be a trigger for the next ECB hike.

In [our scenario](#) where oil surges far above \$100 for sustained periods, we see three hikes by the ECB. But we shouldn't discount the associated growth risks with tightening monetary policy. Higher oil prices will initially pose upward pressure on rates, but as inflation starts coming down in 2027, we will likely face a worsening economic outlook. In that case, the ECB would have to consider a steep easing path in 2027 and 2028, which would also bring longer rates down sharply.

### Friday's events and market view

Data-wise, we have the University of Michigan sentiment indices, which consensus sees improving slightly in June. Apart from the headline index, the inflation components should be of interest. One-year inflation expectations are expected to rise slightly to 4.9%. We'll also be listening for comments from ECB speakers as these usually add more nuance to the official press conference. ECB speakers on the agenda include Finland's Olli Rehn and Germany's Joachim Nagel.

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