Macro Outlook

CLEARER WHEN DECONSTRUCTED

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In the US, economic growth displayed resilience in Q2, in line with our narrative that consumers are healthy, without igniting a demand-driven inflation resurgence. Our forecast remains unchanged at 2.1% average growth for 2026. The labour market is resilient, with no clear signs of moving away from the low-fire-low-hire equilibrium that has characterised this year. August CPI and PPI releases featured relatively strong headline numbers. However, upon close inspection of the contribution from different categories, we notice that there is no evidence of renewed pipeline pressure in the economy. We still attribute those growth rates to one-off factors rather than to a new upward inflation trend.

In the EA, the real GDP growth in Q2 confirmed the broad-based resilience of the economy, with accelerating private consumption and net exports. Looking ahead, private consumption momentum is likely to be increasingly tied to the development of the energy crisis. Similarly, higher energy imports, the Rhine drought, and the intensifying manufacturing competition with China will probably tame the net trade momentum in H2 data. We maintain our growth forecast profile unchanged for 2026 and 2027. The headline HICP for August accelerated to 3.2% y/y. However, core inflation slightly surprised to the downside, with services slowing to 3.0% y/y. The focus remains on energy prices, with an increasing weight on natural gas. We still do not observe evidence of indirect or second-round effects in the HICP basket. We maintain our inflation forecasts unchanged.

The economic growth narrative for China does not change in August. Internal demand is sluggish, and policy support is not yet effective in promoting growth. In this context, August data confirmed that exports and AI investments are the drivers of economic growth in 2026. Despite prices accelerating in August, we still do not find evidence that demand is fuelling inflation. Upside risks to inflation are connected to developments in energy prices in the Middle East.

We expect the Fed to deliver a further one to two rate hikes by March 2027 (vs. an extended pause before). That said, we do not view the latest move as the beginning of a sustained tightening cycle and continue to believe that the Fed is unlikely to deliver the full three additional rate hikes currently priced by markets through July 2027.

The ECB Governing Council raised rates by 25bp, taking the depo rate to 2.5%. Although inconsistent with our macro baseline, we do not rule out that the ECB may provide one more hike by December, provided 1) energy prices remain close to the adverse scenario levels projected by the ECB and 2) growth momentum stays resilient (vs no more hikes previously). We continue to believe that the ECB will not be able to deliver in full the amount of hikes markets are currently pricing (three and a half by July 2027).

Concerning the PBoC, we stick to our call for no policy rate or RRR cuts in 2026, with near-term policy support more likely to come through faster fiscal policy execution. Broad-based monetary easing is more likely to come later (in 2027), if growth weakens further or fiscal support proves insufficient.

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GROWTH & INFLATION

US – Healthy without overheating

Real economic growth in the US remains resilient in Q2, confirming our narrative that consumers are healthy, without pushing demand high enough to ignite a demand-driven inflationary spiral. Our growth forecast remains unchanged as we expect the economy to grow at 2.1% y/y in 2026, before mildly slowing to 1.9% in 2027.

The labour market remains resilient, with no clear signs of distancing from the low-fire-low-hire equilibrium that has characterised this year. The latest NFP print surprised to the upside, even if the job growth pace is half that seen in spring. The unemployment rate is constant and aligned with expectations.

August CPI and PPI releases featured relatively strong headline numbers. However, upon close inspection of the contribution from different categories, we notice that there is no evidence of renewed pipeline pressure in the economy. However, a few categories exhibited high growth rates m/m and drove the overall services CPI and PPI numbers higher in the current month. We still attribute those high growth rates to one-off factors rather than to a new upward inflation trend.

Healthy growth without overheating. The latest real GDP growth data available for Q2 are at 1.5 % q/q SAAR, declining from 2.1% in Q1. Thus far, the broad narrative on the US economy is validated by the incoming data. Consumers are healthy and sustaining the economy via the demand channel. The ISM manufacturing index for the month of August declined to 54.6 (from 55.6 in July), while still reaching the second-highest value since 2022. Similarly, and even more positively, ISM services came in higher than expected at 55.4 (from 54.1 in July). Overall, these prints describe an economy resilient to the energy shock, without demand representing a source of overheating (more on this below).

Our estimate of Q3 and Q4-26 real GDP growth is unchanged at 2.2% q/q SAAR. We still expect average 2026 growth at 2.1% and an average of 1.9% for 2027.

Payback dynamics and seasonality add noise to the latest NFP print. Overall, the August NFP print came in at 162k, much higher than the consensus estimate of 55k. For a better overview of the underlying job gains pace, the three-month average accelerated to 71k, from 38k in July. However, this is roughly half the value seen in spring, at 142k. At the sectoral level, we believe that the strong print in leisure and hospitality (+62k) is exaggerated by the effect of the seasonal adjustment filter, following usual declines in June and July. Government payrolls rebounded strongly (+35k) after a big drop of -50k in July. Although federal and state government shed jobs (-5k and -10k respectively), local government saw a job gain of 50k, more than offsetting July's -62k print. Instead, information and financial activities saw the largest payroll drops, at -23k and -11k respectively. Overall, the unemployment rate remained constant at 4.1%, aligned with expectations, and unchanged from the previous month.

Wages aligned with expectations. AHEs upticked at 0.3% m/m, after an upwardly revised 0.2% m/m in July (up from the previous 0.1% m/m print). We attribute this modest increase to a positive calendar effect, consistent with historical patterns. At the sectoral level, financial services rebounded from -0.2% m/m in July, to +0.8% in August.

Low-fire-low-hire holding ground. The latest JOLTS print indicates 7.27 million job openings in July. Despite being slightly lower than expectations, the value upticked from the June data, and it remains broadly in line with the annual prints so far.

Vacancy-wise, the sectors that accelerated the most were durable manufacturing, local government (excluding education), education, and health services. Construction accelerated to 326k, from 298k in the previous month. This is the highest monthly value of the year, after Q2 growth of 28% q/q, likely testifying to the sustained pace of the sector, including data-centre construction. At the same time, the layoff and discharge rate declined to 1.0% in July, consistent with the low level of jobless claims. Indeed, the two latest prints of the four-week moving average of initial jobless claims resumed their decline, following a relatively small but persistent increase in August, and a sharp decline in July.

The labour market continues to remain balanced, without signs of overheating and with no indication of transition out of the low-fire-low-hire equilibrium. At the same time, real wage growth remains in check and significantly below the growth rates that dominated in 2025.

Inflation-wise, the CPI and PPI prints for August did not change the broad narrative of the last few months. We focus on the CPI numbers first, which determine more than 80% of the core PCE basket, versus the comparatively less relevant PPI numbers. The August CPI print was at 0.4% m/m overall, aligned with expectations, but up from 0.1% m/m in July. Core shelter momentum kept normalising, below its pre-Covid trend. Core CPI slightly surprised to the upside, printing at 0.3% m/m, 0.1 p.p. higher than the July print and consensus. Within core CPI, core goods CPI decelerated from 0.2% to 0.1% m/m, while core services CPI accelerated from 0.2% to 0.3% m/m. Supercore CPI surprised the most to the upside, printing at 0.5% m/m, the highest value since January. A closer look at the contributions reveals that almost all the surprise is due to Education and Communications Services. Within this category, wireless telecom services printed the highest value on record at 5.9% m/m, which likely represents a one-off. Together with a few notoriously volatile components that exhibited strength (such as airfares and hotels), this print adds noise to a fundamentally benign (albeit slowing) trend of easing pressure in the economy.

August PPI accelerated in line with expectations. August PPI printed at 0.4% m/m in August, from 0.1% m/m in July. Some PCE-relevant PPI categories exhibited strong growth rates. For instance, hospital services, domestic, and international airline fares grew by 0.6%, 0.7%, and 1.7% m/m respectively. Taken together, these components contribute roughly 10% of core PCE. Thus, large increases were concentrated in a few categories, but we do not see broadening or overly persistent pipeline pressure building up in the economy.

ANIMA baseline. Our baseline for H2-26 remains unchanged: we continue to expect real GDP growth to average 2.2% q/q SAAR. Our annual forecast for 2026 remains at 2.1%, together with an annual average growth expected at 1.9% in 2027.

On inflation, we keep our core CPI forecasts unchanged at 2.5% in 2026 (annual average) and 1.9% in 2027. For core PCE, we maintain our forecast of 2.7% in 2026 and 2.2% in 2027.

EA – Dodging the storm

The real GDP growth in Q2 confirmed the broad-based resilience of the EA economy. Besides the large contribution of Ireland to the headline number, private consumption and net exports accelerated in Q2, surprising to the upside. Looking ahead, private consumption momentum is likely to be increasingly tied to the development of the energy crisis as we head into the winter season. Similarly, higher energy imports, the Rhine drought, and the intensifying manufacturing competition with China will probably tame net trade momentum in H2 data. We maintain our growth forecast profile unchanged for 2026 and 2027.

The headline HICP for August accelerated to 3.2% y/y. However, core inflation slightly surprised to the downside, with services slowing to 3.0% y/y. The focus remains on energy prices, with increasing attention on natural gas as winter approaches. We still do not observe evidence of indirect or second-round effects in the HICP basket. We maintain our inflation forecasts unchanged.

Resilient but noisy. The final release of Q2 real GDP growth at 0.6% q/q (vs. 0.0% in Q1) highlights the remarkable resilience of the EA economy amid the energy shock. The positive Irish payback from Q1, originating from a surge in net exports, boosted EA growth by around 0.3 p.p. However, despite the noise introduced by Irish volatility, the real GDP growth in the EA excluding Ireland printed at 0.3% q/q, preserving the momentum achieved in Q1.

Private consumption strongly supported growth in Q2. When excluding the volatile Irish data, and looking at contributions to GDP growth, private consumption accelerated strongly in Q2. The overall component's contribution to growth (0.2 p.p. when considering EA excluding Ireland) is the second highest since the beginning of 2025 and is significantly larger than in Q1. This channel is the main source of growth in Italy and Spain, and it turned positive in Germany and France, after a negative Q1. At the EA level, consumer confidence steadily improved from May onwards, after having reached a multi-year low in April 2026. Consumption was mostly supported by services and durables. While the positive consumer outlook is generally also reflected in Q3, the prolonged conflict may weigh negatively on consumer confidence toward the end of Q3, into Q4. EA consumers are eroding their saving rate, and the current trend is unlikely to prove sustainable unless a sharp improvement in the energy crisis takes place.

Net trade accelerated, boosting headline growth in Q2. The net trade contribution was particularly strong in France (0.6 p.p., rebounding from -0.9 p.p. in Q1) and Germany (0.2 p.p., down from 0.7 p.p. in Q1). In Italy, net trade acted as a drag on growth (-0.3 p.p.). The positive net trade developments in major EA economies have often been connected to the reduction in imports, amid the stabilisation of exports. While export momentum in Q2 was relatively strong, we point out a few reasons why further acceleration is at risk. First, although Germany's performance in H1 is quite broad-based at the sectoral level (including chemical, optical equipment, and electricals), the summer Rhine drought acted as a drag on exports in Q3. Second, a sustained increase in imports (manufacturing products from China, and energy) depicts a dimmer outlook for Q3 at the EA level. Product-wise, energy imports exerted the largest drag on Extra-EU net trade in Q2 since Q3-22. Furthermore, Eurostat monthly data do not show broad-based growth momentum in trade volumes, both within the EA and outside the EA, albeit the former is stronger than the latter. With the conflict far from resolution, we do not see scope for further trade acceleration from here onward, with risks tilted to the downside due to a possible increase in imports, especially of energy and raw materials.

We maintain the profile of our quarterly and annual GDP forecasts unchanged. Since headline EA real GDP growth printed 0.2 p.p. higher than expectations, we marginally adjust our Q3 real GDP forecasts, accounting for a partial negative Irish payback in the second half of the year. However, the rounded q/q growth profile remains constant at 0.3% q/q in Q3 and Q4, with yearly real GDP growth expected to hit 0.9%. Current consensus estimates point to 0.9% y/y growth for 2026. Growth-wise, we identify the balance of the risks as tilted to the downside.

Energy goods exert pressure on the disinflation process. The headline HICP inflation rate for the EA came in at 3.2% y/y, up from 2.9% in July. However, core inflation slightly surprised consensus to the downside, printing at 2.4%. Energy prices rebounded in August following a calmer July, exerting pressure on headline inflation.

Service inflation was the focus for this month, and it decreased from 3.3% y/y in July to 3.0% y/y in August, confirming our view of no indirect effects visible for the moment. Overall, core inflation in August printed 2.4% y/y, increasing by 0.21% m/m. Compared to the July print, core inflation slowed by 0.08 p.p. in August: services contributed to a -0.17 p.p. fall in core inflation, while core goods added 0.08 p.p. Among the goods contributing the most are visual and recording media, information processing equipment, and clothing accessories. We do not see any pattern pointing to broadening inflation in goods. In August, our indicator of underlying inflation momentum recorded an increase in negative pipeline pressure, and a stabilisation of the positive momentum. We still believe that the EA economy is not strong enough to originate strong second-round effects amid the prolonged energy inflation shock.

Our baseline for inflation remains unchanged. As we head into Q4, the balance of risks to inflation is tilted to the upside. Gas prices remain the most significant source of concern for two reasons. First, gas storage in the EA is lower than in the previous year, and the building-up of new stocks may keep prices at the highest levels since the end of 2022. Secondly, gas prices in the EA have a stronger impact on inflation through indirect effects than oil prices. We still do not find evidence of indirect or second-round effects in the economy, but we are carefully monitoring sensitive categories.

ANIMA baseline. Our 2026 real GDP growth forecast is unchanged at 0.9% y/y. This projection is consistent with:

1) A stronger-than-expected Q2 growth fuelled by Irish net trade and strong momentum in private consumption and net exports.
2) A negative Irish payback in H2 2026, the absence of evidence of reinforcing momentum in net trade, and the normalisation of private consumption in a context of a prolonged energy inflation shock.

On inflation, our annual average forecast for core HICP remains unchanged at 2.2%.

CHINA – Weak inside, strong outside

The economic growth narrative for China does not change in August. Internal demand is sluggish, and policy support is not yet effective in promoting growth. In this context, August data confirmed that exports and AI investments are the drivers of economic growth in 2026. Despite prices accelerating in August, we still do not find evidence that demand is fuelling inflation. Upside risks to inflation are connected to developments in energy prices in the Middle East.

China's growth remains hampered by subdued domestic demand. Retail sales y/y have been trending down during the last year, underscoring the structural weakness of domestic demand. We argued last month that the policy support deployed is not translating into visible internal demand acceleration yet. External demand, together with AI investments, has been performing well since the beginning of the year. The latest export data point to 25% y/y growth in August, up from 23.9% y/y growth in the previous month. Overall, the three-month moving average of y/y export growth highlights a clear acceleration in activity since the beginning of the year, with the latest value at 25.3%.

Industrial production surprised to the upside, accelerating from 4.5% to 5.2% y/y. Strong external demand drove these performances amid the latest retail sales print, which disappointed, decelerating from 0.6% y/y to 0.4% y/y, well below the consensus of 0.8% y/y.

Inflation in China rose broadly as expected in August. The acceleration in CPI, from 0.5% y/y in July to 0.8% y/y in August, is mostly due to higher energy costs amid the escalation of tensions in the Middle East. PPI accelerated as well to 3.8% y/y, slightly higher than market expectations of 3.6% y/y. However, as domestic demand remains subdued, we do not find evidence that pipeline pressure is mounting in the economy from the demand side, and inflation should remain subdued. Upside risks remain connected to the development of energy prices.

ANIMA baseline. We keep our 2026 annual average real GDP growth **forecast** unchanged at 4.6% y/y. Annual growth in 2027 is at 4.8%.

On inflation, our annual forecast for headline CPI remains unchanged at 1.0%.

MONETARY POLICY

Fed – More, not too much

The Fed raised the federal funds rate by 25bp to 3.75-4.00%, in line with expectations. The decision was unanimous. The statement, the Summary of Economic Projections (SEP), the dot plot, and Chair Warsh's press conference all conveyed a somewhat hawkish message, consistent with the rhetoric articulated at Jackson Hole.

While Chair Warsh refrained from providing explicit guidance regarding the future policy path, he indicated that the decision to tighten policy was motivated by four considerations: (1) resilient and strengthening economic growth; (2) continued strength in the labour market; (3) the absence of meaningful improvement in underlying inflation dynamics; and (4) geopolitical developments that have increased upside risks to the inflation outlook.

Against this backdrop, we now expect the Fed to deliver a further one to two rate hikes by March 2027, compared with our previous expectation of an extended pause. That said, we do not view the latest move as the beginning of a sustained tightening cycle and continue to believe that the Fed is unlikely to deliver the full three additional rate hikes currently priced by markets through July 2027.

Beyond Trends: A Broader Framework for Assessing Inflation. While the FOMC judged in July that it could afford to wait and assess incoming data before tightening further, policymakers unanimously supported a rate increase at this meeting. Chair Warsh highlighted three key factors behind the decision:

1) Economic activity has remained resilient despite elevated geopolitical uncertainty, while underlying growth momentum appears to be improving. Labour market conditions continue to be broadly supportive.

2) Underlying inflation dynamics have yet to exhibit convincing signs of moderation. Consistent with his Jackson Hole remarks, Chair Warsh emphasised that the share of prices increasing by more than 3% over both six-month and twelve-month horizons has not declined sufficiently to provide confidence that core PCE inflation is on a durable path back to target. Against a backdrop of resilient activity and labour market conditions, the Committee's attention appears increasingly focused on the price stability component of its mandate.

3) Geopolitical risks have become more prominent. Renewed tensions in the Middle East have contributed to higher energy prices, increasing upside risks to inflation and potentially delaying the convergence of inflation to its target level.

Higher Policy Rates Alongside Continued Economic Resilience. The median dot plot shifted upward by 50bp across the forecast horizon. Relative to the June SEP, FOMC participants now expect one additional rate increase in 2026, followed by a pause in 2027 rather than a rate cut. The Committee continues to project one rate cut in 2028 and a further cut in 2029, leaving the federal funds rate at 3.50-3.75% at the end of that year. The longer-run policy rate was also revised higher, from 3.1% to 3.2%, reinforcing the view that policymakers no longer regard the current stance as restrictive.

Notwithstanding a policy-rate path that is approximately 50bp higher than that projected in June, the FOMC continues to forecast above-potential growth throughout the forecast horizon, while core PCE inflation remains modestly above target even at the end of 2028. All else equal, such a macroeconomic configuration is consistent with a continued tightening bias. Compared with the June SEP, FOMC participants revised their growth forecasts moderately higher for 2026 and 2027, while inflation projections were revised upward for 2026 and 2028.

We Now Expect a Further One to Two Rate Hikes by March 2027. Against this backdrop, we now expect the Fed to deliver a further one to two a rate hikes by March 2027, compared with our previous expectation of no further tightening.

Our revised baseline is subject to an unusually high degree of uncertainty, reflecting both a potential evolution in the Fed's reaction function and several inherently unpredictable developments:

1) First, we believe the Fed has broadened the framework through which it assesses inflation risks. While Chair Warsh continues to emphasise the importance of inflation trends, he appears to have introduced an additional dimension to the policy assessment, namely the breadth and distribution of price pressures across the consumption basket. Inflation trends remain important, but the dispersion and persistence of inflation across categories now appear to play a more prominent role in policy deliberations. For further discussion, see FEDlosophy, September 2026.

2) Geopolitical developments in the Middle East will remain an important determinant of the inflation outlook.

3) The interaction between labour market conditions and underlying inflation dynamics will be critical. Should inflation moderate more rapidly than currently anticipated, or should labour market conditions soften materially, we would expect the FOMC to pause further policy tightening.

4) Uncertainty surrounding the ongoing task force reviews of areas central to the conduct of monetary policy could also influence future policy decisions.

Not the Beginning of a Sustained Tightening Cycle. While we have revised our expected policy path higher, we do not view the latest move as the beginning of a sustained tightening cycle (which we define as a rate path that prioritises inflation control over growth) and continue to believe that the Fed is unlikely to deliver the full three additional rate hikes currently priced by markets.

Our view reflects three considerations:

1) We continue to believe that the FOMC's assessment of inflation risks is somewhat too pessimistic. The August inflation report was broadly encouraging, with the increase in supercore inflation concentrated in a limited number of volatile components. At the same time, core goods inflation continued to soften, while shelter inflation remains below its pre-pandemic trend.

2) We believe the FOMC's growth assumptions remain somewhat optimistic. While growth is likely to remain around potential during 2027, support from private consumption and non-AI capital expenditure is likely to fade as the fiscal impulse embedded in the One Big Beautiful Bill Act (OBBBA) gradually diminishes during the second half of 2026 before becoming modestly restrictive in 2027. Wage growth also continues to moderate.

3) Chair Warsh characterised the latest decision as the removal of "a dose of accommodation," arguing that policy rates remain outside restrictive territory. In our view, this characterisation is more consistent with a limited recalibration of the policy stance than with the onset of a prolonged tightening cycle that could ultimately jeopardise growth and labour market conditions.

FEDlosophy

We believe that the Fed has somewhat enriched its approach to the inflation component of its mandate. Since Powell, both we and the market have become accustomed to a Fed focused on specific narratives within the subcomponents of core inflation to assess whether developments are consistent with its target.

A few examples: to answer the question of whether tariffs could lead to a persistent rise in the price level, the FOMC used to dissect the core goods basket. To judge whether the economy was overheating, the Fed under the leadership of Powell tended to analyse momentum in the ex-housing core services basket to assess whether labour market conditions were spilling over into prices via wages. And so on and so forth.

While Warsh keeps saying that trends still matter, the new Governor has introduced an orthogonal dimension to inflation analysis. Trends are important, but the way inflation spreads across the basket matters too. Therefore, while the old way of looking at inflation (call it the "trend approach") would support no further tightening under our macro baseline and, for some time, under the market baseline, we have also had to incorporate the new "orthogonal inflation approach" into our thinking.

According to our calculations, as of July, the share of prices within the core PCE basket rising above 3% (6m saar) was 59%, down from 64% in June, yet still well above the 32% average recorded between 2016 and 2019. While we do not expect the new Fed to strive for that level of inflation participation in the core basket (otherwise, the rate-hike path would have to be much more aggressive), we must assume that some additional tightening is coming.

A few words of warning. Moreover, among the reasons why we believe that the Fed will not embark on an overly aggressive rate cycle (defined as a cycle that is willing to take the risk of severely hurting growth to deliver on the inflation mandate), there is an important caveat and a fallacy.

The former is that we believe the labour market must hold up at its current level of strength. If it does not, we would expect, at this juncture, the FOMC to return to taking comfort from the benign inflation trend alone and to pause further tightening.

The latter is the following: what will this Fed do if a few prices fall sharply, for whatever reason, bringing core PCE inflation well below its baseline, without, however, satisfying the orthogonal approach to inflation?

ECB – Maybe (one) more

The Governing Council raised rates by 25bp, taking the depo rate to 2.5% - the upper range of the neutral range estimated by the ECB. Although inconsistent with our macro baseline, we do not rule out that the ECB may provide one more hike by December provided 1) energy prices remain close to adverse scenario levels projected by the ECB and 2) growth momentum stays resilient (vs no more hikes previously). That said, we continue to believe that the ECB will not be able to deliver entirely the amount of hikes markets are currently pricing (three and a half by July 2027), as 1) *taking policy rates into restrictive territory would require an overheating economy (not our baseline) and 2) we believe ECB's core inflation forecasts are still overly aggressive amid neither indirect nor second-round effects stemming from the energy shock.*

Another 25bp hike. The ECB raised rates by 25bp, as widely expected, taking the depo rate to 2.5%. This is the second hike since the beginning of the Middle East war after the one delivered in June. The decision was unanimous.

Balanced tone. The tone of the press conference was broadly balanced. President Lagarde reiterated that risks to inflation remain to the upside, but that indirect effects are still very contained, while second-round effects have not materialised. Meanwhile, risks to the growth outlook remain to the downside, even if growth has recently held up better than anticipated.

While the ECB's actions remain guided by the usual reaction function (which consists of three factors: inflation outlook and risks, underlying inflation, and the transmission mechanism), the Governing Council did not discuss future moves given the uncertainty surrounding the EA outlook.

Somewhat dovish flavour in the new staff forecasts. The new Eurosystem staff projections conveyed, at the margin, a dovish message, in our view**,** for the following reasons:

1) The ECB upgraded GDP growth in 2026 and in 2027 only marginally. The modest upward revision contrasts with the emphasis placed by the President on the recent resilience of the euro area economy.
2) Headline and core inflation were mildly revised upwards in 2027 and 2028, with inflation still reaching target in H2 2027 despite the new inflation forecasts including a rise in food inflation.
3) Services inflation forecasts were broadly unchanged throughout the forecast horizon compared to the June forecasts, suggesting that even with higher energy prices the ECB does not see, compared to June, increased risks of second-round effects. Moreover, on inflation, the President clearly noted that the evolution has been more benign than previously expected, especially on the food front.

A few hawkish elements to consider, though. Despite the relatively balanced tone of the press conference and the understated dovish flavour embedded in the staff forecasts, a few hawkish elements came up:

1) In the statement, the characterisation on inflation was tilted to the hawkish side as the sentence "The conflict in the Middle East continues to generate inflation pressures, and inflation is set to remain well above target for an extended period" replaced July's "Uncertainty remains high and the full inflationary impact of the energy shock has yet to play out".
2) Answering a question pointing out that, in the Eurosystem staff forecasts, y/y inflation remains above target across the forecast horizon, President Lagarde reiterated that the ECB remains committed to taking inflation back to target.
3) President Lagarde qualified EA growth as broad based across sectors and countries, stressing the upward surprise compared to expectations, adding that the better-than-expected 0.6% q/q EA GDP growth reading was not factored into the new set of forecasts as it was released after the cut-off date.

Another hike could be in the cards, most likely in December (vs no hike previously). While another rate hike would not be consistent with our EA macroeconomic outlook, we think the ECB could hike rates one more time under the following assumptions.

1) GDP growth remains resilient through the rest of the year;

2) Energy prices stay around current levels through Q4. We note that, at the moment, energy prices trade close to the level projected under the updated ECB adverse scenario, while in the baseline scenario oil prices drop to around USD 85 pb and gas prices drop to EUR 60 MWh by Q4. It's hard to imagine the ECB staying on hold in December if energy prices were to stay close to levels consistent with their projected "adverse" levels.

In terms of timing, we think that if the ECB raises rates again, it will most likely hike them at the December meeting, when the forecasts will be updated and extended to 2029. An earlier move should not be ruled out, especially if the situation in the Middle East deteriorates further.

We continue to believe that the ECB will not be able to deliver the entire amount of hikes markets are pricing. For the following reasons:

1) Taking policy rates into restrictive territory would require an overheating economy (not our baseline). The depo rate is now at 2.5%, the upper limit of the neutral range recently indicated by some ECB members. While President Lagarde played down the importance of the neutral rate in an uncertain context, we believe that taking the depo rate much above 2.5% would convey the message that the ECB wants to be in restrictive territory and could lead to rising risks of a sharp economic slowdown.
2) We believe that the ECB's core inflation forecasts are still too sanguine. The ECB did not include the latest inflation print (August) in the forecasts, which marked a decline in core inflation (from 2.5% to 2.4%) and in services inflation (from 3.3% to 3.0%). These numbers validate our forecast, while they indicate that the Eurosystem forecasts are overly aggressive.
3) We remain of the view that, unlike in 2022, the EA economy is not in a cyclical position to absorb the current energy shock into wages and core inflation. The main risk to our call pertains to gas prices. Should they increase towards 2022 levels, we believe the ECB would be forced to continue hiking more than we expect.

PBoC – On hold

We stick to our call for no policy rate or RRR cuts in 2026 with near-term policy support more likely to come through faster fiscal policy execution. Broad-based monetary easing is more likely to come later (in 2027), if growth weakens further or fiscal support proves insufficient.

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