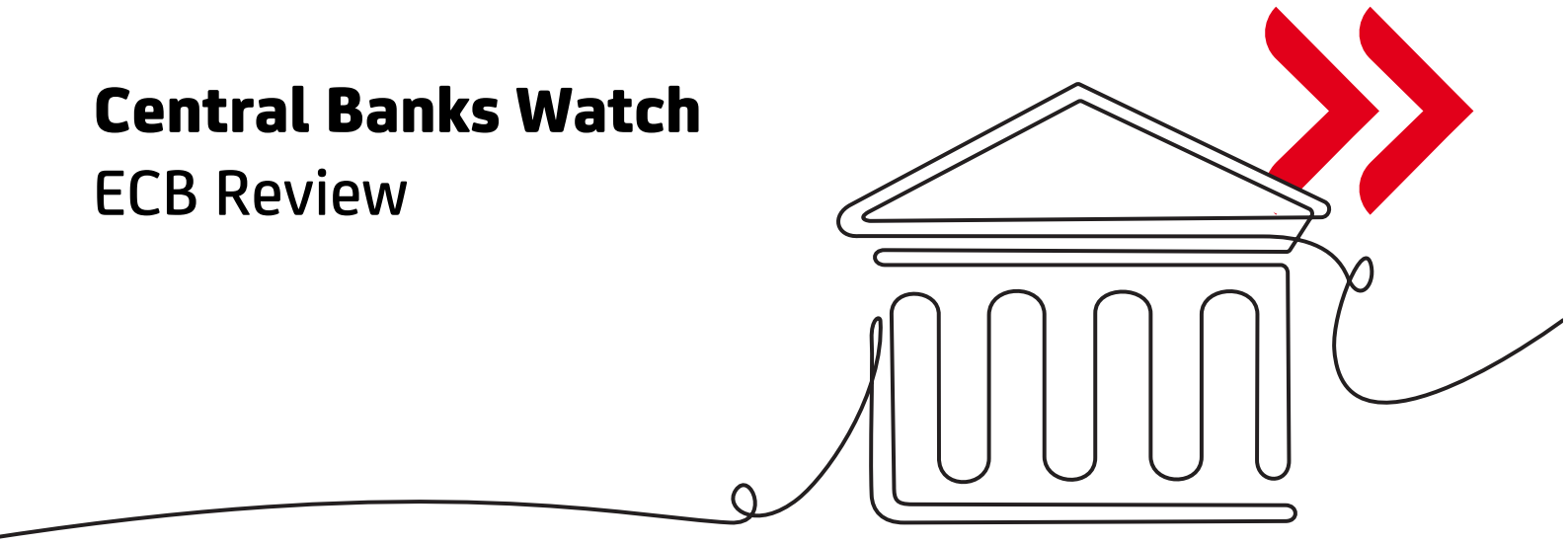
Central Banks Watch
ECB Review



December hike in sight as Lagarde heads for the exit

29 October 2026

Larger and more-persistent energy shock makes a December hike very likely

Today, the ECB left interest rates unchanged while signalling that rising energy price pressures make a December rate hike highly likely.

Lagarde to step down in February

ECB President Christine Lagarde also announced that she will step down on 7 February 2027 for personal reasons. Klaas Knot and Pablo Hernández de Cos currently appear to be the leading contenders to succeed her, although an alternative compromise candidate cannot be ruled out.

With a unanimous decision, today the ECB left all its policy rates unchanged. Both the policy statement and Lagarde's press conference struck a broadly balanced tone. The Governing Council (GC) acknowledged that higher energy prices pose upside risks to inflation while weighing on growth, but also noted the broad stability of underlying inflation, the absence of a meaningful wage response, and the tightening in financial conditions resulting from higher market rates and lower equity prices. While the ECB continues to stress its meeting-by-meeting, data-dependent approach, today's communication strongly suggested that a December rate hike remains the most likely outcome, barring a material change in the outlook.

Two issues featured prominently in the GC discussion. First, the increase in energy prices well above the ECB's September technical assumptions, driven by higher oil and gas prices as well as widening refining margins. The "increased magnitude and duration" of the energy shock points to likely upward revisions to inflation and downward revisions to growth forecasts in the December projections. Second, the sharp rise in long-term yields, which have increased by around 35bp since the cut-off date for the September staff projections, contributing to a significant tightening in financial conditions. Lagarde revealed that a rate increase was actively discussed at this meeting, with a number of GC members open to back-to-back hikes. However, given elevated uncertainty and the broadly unchanged picture for underlying inflation, policymakers unanimously opted for a more measured approach and decided to wait for additional information ahead of the December forecasting round. Nonetheless, as Lagarde put it, the "direction of travel" for rates is clear.

Looking ahead, the Governing Council will focus on two key variables: the evolution of underlying inflation, particularly the risk of second-round effects, and developments in long-term interest rates. Importantly, the ECB

currently sees no material deviation from the assumptions embedded in its September projections regarding wage dynamics and second-round inflation pressures.

There was little new information regarding the implications for monetary policy of wider sovereign spreads. As expected, Lagarde noted that the increase in long-term yields is a global phenomenon, pointed out that the ECB looks at the entire sovereign curves – not just the longer tenors – when assessing risks to the transmission of monetary policy, and argued that highly indebted euro area sovereigns must adapt their budgetary plans to a higher-for-longer interest rate environment. Compliance with the EU fiscal framework remains a prerequisite for any ECB intervention. Should sovereign bond markets become disorderly and disconnect from underlying fundamentals, impairing the transmission of monetary policy, the ECB retains the tools to respond. In the current environment, we believe the Transmission Protection Instrument (TPI) would be the most likely instrument of choice. Lagarde also confirmed that the balance sheet normalization process remains on autopilot, with no changes planned to the current quantitative tightening strategy.

With a December hike looking increasingly likely, and assuming energy prices remain near current levels, we suspect that the inflation trajectory might ultimately justify additional tightening in early 2027. The ECB's ability, and willingness, to deliver further tightening will ultimately hinge on conditions in sovereign bond markets. We maintain our baseline view that 2.75% will mark the peak of this tightening cycle, while acknowledging that risks are skewed towards one final 25bp hike in March.

Lagarde also announced that she will step down ahead of the end of her term, leaving office on 7 February. She explained that the decision reflects her desire to regain the freedom to speak publicly and engage on a broader range of issues beyond monetary policy at a critical juncture for Europe and the global economy.

The decision comes as little surprise and effectively ensures that the appointment of her successor will form part of a broader political bargain among EU leaders over three key vacancies on the ECB's Executive Board due to arise next year. In chronological order, Isabel Schnabel, who oversees market operations, will leave the ECB on 3 January, followed by Lagarde on 7 February, while the term of chief economist Philip Lane will expire in May.

The outcome of the race to succeed Lagarde remains highly uncertain. Klaas Knot (former Dutch central bank governor who is generally regarded as hawkish) and Pablo Hernández de Cos (former Spanish central bank governor, now heading the BIS and considered as centrist) are widely seen as frontrunners, a view we broadly share. However, we note that Lagarde's appointment in 2019 defied expectations. Ultimately, the decision will be political, shaped by factors that may not be visible yet at this stage. We have two convictions. First, the current distribution of high-level EU posts makes a German pick unlikely. Second, a package deal would likely aim to maintain the current internal equilibrium: a dove (currently Lane), a centrist (Lagarde) and a hawk (Schnabel). Bundling the three appointments would simplify the search for balance across monetary-policy views and national origins.

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