The ECB in 2026: Hodor for another year

February 3, 2026

Research

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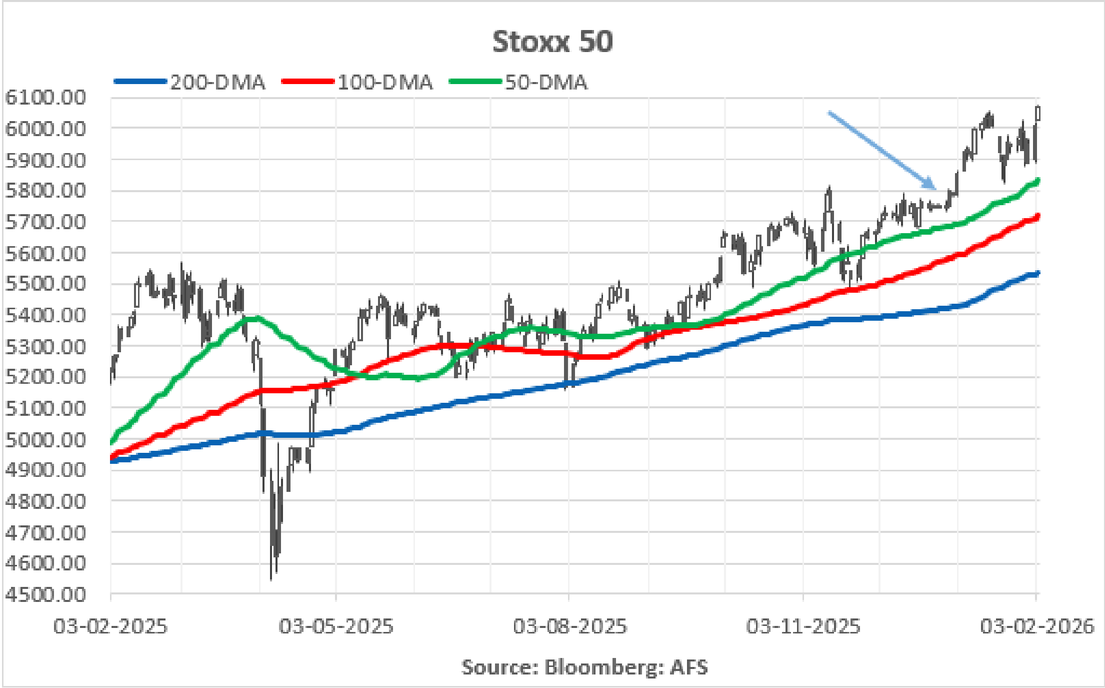
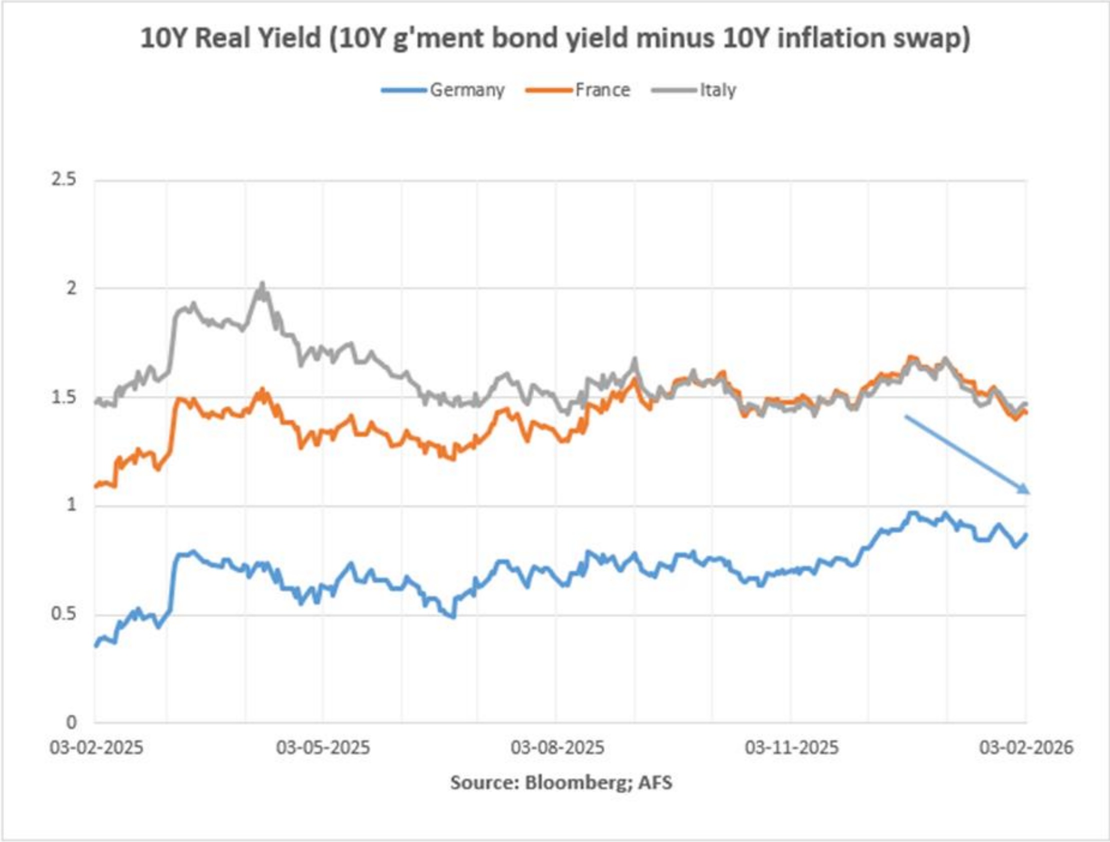
Stuck like a deer in the headlight

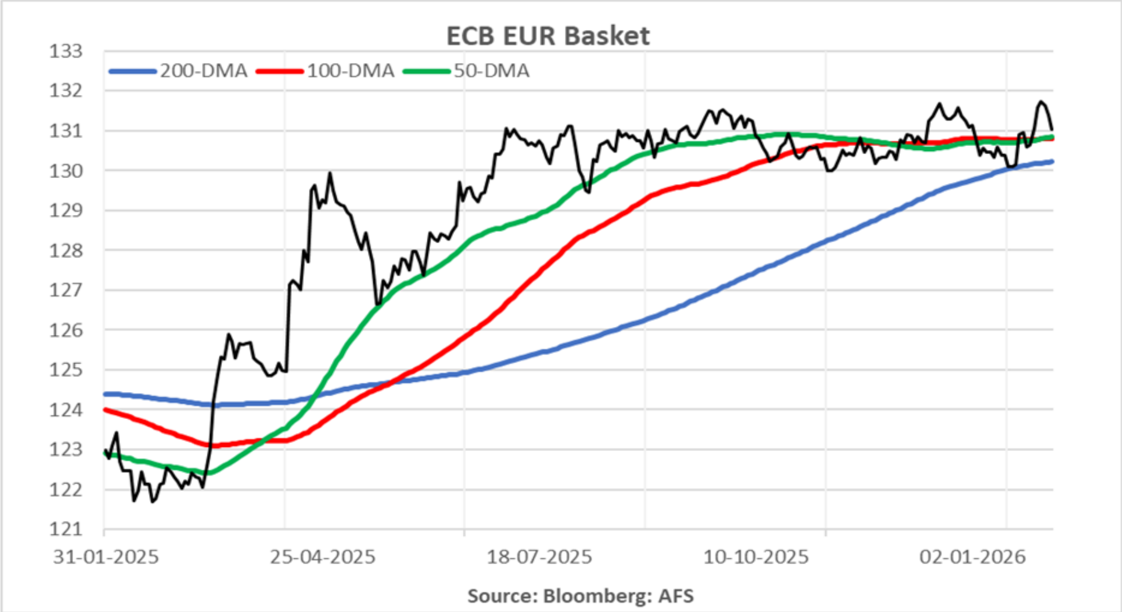
- **I particularly dislike central bankers reverting to jargon and say that they're going to hold rates for a while because they have no clue what will happen next: "monetary policy is in a good place."** If someone had paid me 10 euros every time that a central banker has said that monetary policy is in a good place, you wouldn't have seen research pieces from me any longer. I'd retire comfortably and start writing history books. But I must admit, albeit grudgingly, that ECB policy is in a good place indeed. Underlying economic growth is picking up gradually in the face of stiff headwinds from foreign trade. The labor market isn't too shabby. And inflation is likely to grind lower over the course of the year. Survey data point to budding price pressures though. But at the same time, 2026 is likely going to be a good year for productivity while wage growth is easing as workers lose bargaining power – vacancies are falling and hiring plans remain tepid. Bottom line: there's plenty of reason for Lagarde & Co to be happy – and to remain cautious at the same time. Translated to monetary policy for the meetings this year: hold, hold, hold. Hodor.
- **I also do not see any reason for the ECB to show bias towards either easing or tightening further down the road.** That includes ECB-speakers' threats of FX-driven rate cuts, which are truly a long shot. Yes, EURUSD trading consistently above 1.20 is guaranteed to invoke more jawboning by ECB-speakers. Especially if the move is particularly rapid. But such a contentious rate cut would require FX-driven disinflation of perhaps half a percentage point and for no letdown in exchange rate appreciation. I do not see the bottom falling out under the greenback.
- **Furthermore, the past two ECB Bank Lending Survey point to modest demand growth for bank loans**. And, in the case of corporate lending, tighter credit standards and terms and conditions. There is no bank lending boom for the ECB to sniff out. Not even close.
- **This goldilocks scenario – a relatively benign economic backdrop that does not require an ECB rate hike further down the road – has definitely boosted Eurozone equities**. 2025 was a solid year for the Stoxx 50 and we're off to a great start this year. Since the December ECB meeting, the index is up more than five percent as financial conditions ease:



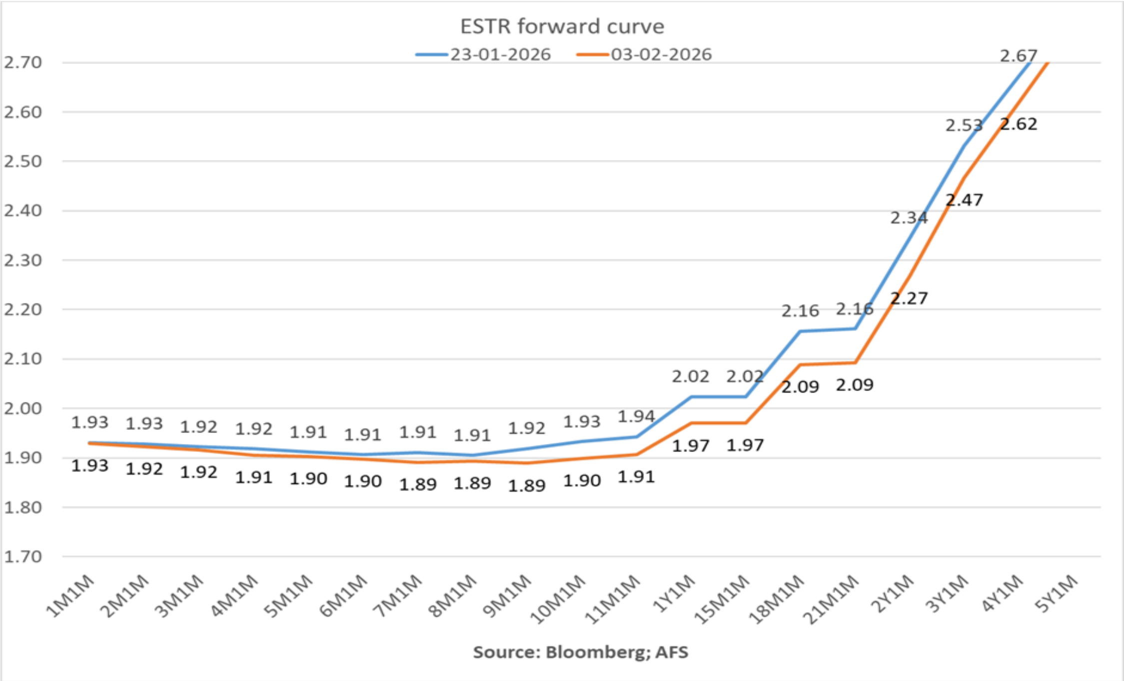
…and real yields have moved decidedly lower:



- **The only fly in the ointment is the strong euro.** The trade-weighted euro (nominal effective exchange rate) remains close to its all-time high:



- **One ECB-speaker, the Austrian central bank head Kocher, has put rate cuts on the table to counter FX-driven disinflation**. Those remarks have reinverted the ESTR forward curve:



- **Mind you that by the end of the year, I forecast that the ESTR-DFR spread will be 6bps on average.** So, we've priced in 5bps in cuts. Small but significant. It is also the reason why we should take rate hike pricing two years out with a grain of salt. It reflects the 'natural' bias towards an upward sloping yield curve, not some kind of conviction that the economy will run hot enough for the ECB to put its foot on the brake two years from now.
- **And speaking of the economy, we had a surprisingly strong reading for the European Commission's Economic Sentiment Index for January**. The better-

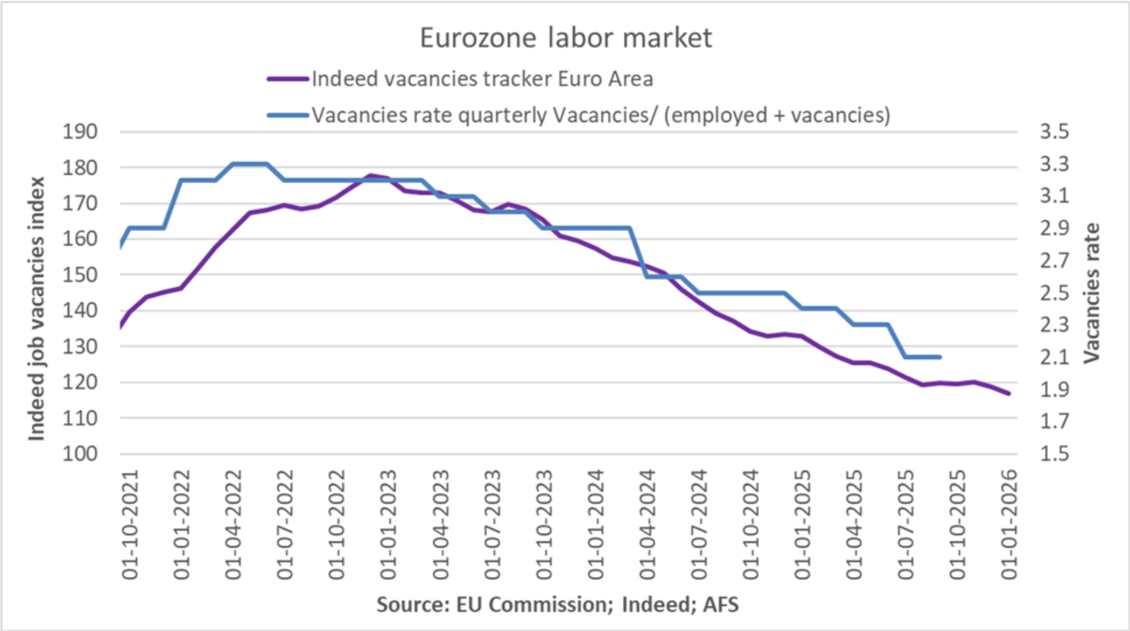
than-expected reading is consistent with annual GDP growth of 1.3 percent. Soft compared to US growth, but for the Eurozone it doesn't get much better.

Month	Eurozone Composite PMI	Economic Sentiment Index implied YoY% GDP growth
30/11/2024	48.1	0.7
31/12/2024	49.6	0.3
31/01/2025	50.2	0.6
28/02/2025	50.2	0.7
31/03/2025	50.9	0.6
30/04/2025	50.4	0.3
31/05/2025	50.2	0.5
30/06/2025	50.2	0.4
31/07/2025	50.9	0.7
31/08/2025	51.1	0.6
30/09/2025	51.3	0.7
31/10/2025	52.5	0.9
30/11/2025	52.4	0.9
31/12/2025	51.5	0.9
31/01/2026	51.5	1.3

- **While it appears that the upturn in sentiment in January wasn't confirmed by the composite PMI, the details of the PMI were indeed optimistic.** Business confidence rose to a 20-month high last month.
- **The January PMI survey pointed to weak hiring, which is also what we see in the EU Commission survey**. Except for construction (which is not part of the PMI), hiring plans remain tepid. On balance, the net percentage of firms in manufacturing and services expect more or less stable employment while a slightly greater number of construction firms expect employment to increase going forward.

Month	Employment expectations manufacturing net percent.	Employment expectations services net percent.	Employment expectations construction net percent.
30/11/2024	-5.0	3.2	5.1
31/12/2024	-6.6	2.0	4.5
31/01/2025	-5.0	2.6	5.9
28/02/2025	-6.1	1.0	4.9
31/03/2025	-5.7	0.5	4.5
30/04/2025	-4.5	0.6	4
31/05/2025	-4.2	0.3	4.5
30/06/2025	-6	1.0	6.6
31/07/2025	-6	1.9	6.4
31/08/2025	-5.2	1.7	6.6
30/09/2025	-4.5	0.3	6.4
31/10/2025	-5.2	1.1	7.1
30/11/2025	-4.8	0.6	8.9
31/12/2025	-4.1	-0.2	8.3
31/01/2026	-3.4	1	7.8

- **The Indeed vacancies tracker shows that total outstanding vacancies fell in December, and then again in January, reaching the lowest level in years:**



- **Employment growth eased last year, averaging a quarterly annual rate of 0.51 percent (Q1 through Q3), down from 0.66 percent in 2024**. Wage growth eased only marginally last year to 3.86 percent according to the ECB wage tracker estimate. That should fall to 2.63 percent this year, a disinflationary rate if productivity growth picks up as expected.
- **Euro Area unemployment is stable despite cooling employment growth and the decline in vacancies.** The strong labor market in Italy and Spain is offset by softening in the north:

Month	Unemployment Euro Area	Unemployment Germany	Unemployment France	Unemployment Italy	Unemployment Spain	Unemployment Netherlannds
30/09/2024	6.3	3.4	7.4	6.1	11.1	3.7
31/10/2024	6.2	3.4	7.3	6.1	10.8	3.7
30/11/2024	6.2	3.4	7.3	6.2	10.7	3.7
31/12/2024	6.3	3.5	7.3	6.4	10.8	3.7
31/01/2025	6.3	3.5	7.3	6.4	10.8	3.8
28/02/2025	6.3	3.6	7.5	6.1	10.8	3.8
31/03/2025	6.4	3.6	7.6	6.3	10.8	3.9
30/04/2025	6.3	3.7	7.5	6.1	10.7	3.8
31/05/2025	6.4	3.7	7.6	6.5	10.6	3.8
30/06/2025	6.4	3.7	7.6	6.2	10.5	3.8
31/07/2025	6.4	3.8	7.7	6.1	10.5	3.8
31/08/2025	6.4	3.8	7.7	6.0	10.5	3.9
30/09/2025	6.4	3.8	7.7	6.1	10.5	4.0
31/10/2025	6.3	3.8	7.7	5.8	10.2	4.0
30/11/2025	6.3	3.8	7.7	5.6	10.1	4.0
31/12/2025	6.2	3.8	7.7	5.6	10.0	4.0

- **Turning to foreign demand, there was good reason for the ECB to fret about foreign demand, given the Trump administration cavalier use of tariffs**. Since April 2025, EU exports are down 26 billion euros while imports fell by only 9 billion euros (note: there is no such data for the Eurzoone):

Month	EU exports to US monthly absolute change (EUR billion)	EU exports to China monthly absolute change (EUR billion)	EU imports from US monthly absolute change (EUR billion)	EU imports from China monthly absolute change (EUR billion)
30/04/2025	-20.5	-1.0	-0.3	-4.2
31/05/2025	-0.4	-0.2	-1.5	-1.0
30/06/2025	-4.5	0.3	2.7	3.6
31/07/2025	-0.6	0.0	0.2	-2.3
31/08/2025	-3.3	-0.4	-1.8	-0.9
30/09/2025	13.2	0.6	1.8	1.3
31/10/2025	-13.8	-0.8	-2.9	-2.1
30/11/2025	0.5	0.7	-0.7	2.9

- **On the other hand, there is no China shock**. Or at least not yet. Instead, an important article from the AP pointed out that Chinese exports are being rediverted to Latin America.
- **Turning to inflation, core inflation has bottomed out a few tenths of a percent above two percent:**

Month	Headline inflation YoY %	Services inflation YoY %	Core inflation YoY %	Goods excluding energy YoY %	Core inflation excluding package holidays YoY%
30/11/2024	2.26	3.93	2.75	0.68	2.63
31/12/2024	2.46	4.02	2.75	0.55	2.60
31/01/2025	2.49	3.88	2.65	0.51	2.54
28/02/2025	2.30	3.65	2.51	0.54	2.41
31/03/2025	2.17	3.44	2.42	0.61	2.40
30/04/2025	2.14	3.91	2.71	0.59	2.61
31/05/2025	1.89	3.20	2.28	0.65	2.31
30/06/2025	2.00	3.33	2.33	0.56	2.34
31/07/2025	2.05	3.26	2.34	0.72	2.34
31/08/2025	2.08	3.20	2.32	0.75	2.29
30/09/2025	2.24	3.27	2.37	0.77	2.27
31/10/2025	2.10	3.37	2.38	0.64	2.43
30/11/2025	2.14	3.46	2.41	0.56	2.38
31/12/2025	1.95	3.38	2.31	0.39	2.29

- **When I strip out the extremely volatile package holiday from core inflation, the same picture of inflation running a bit above target re-emerges.** But when I shift to a 3-month annualized rate, a different and more benign picture emerges. Recent readings have been benign, with core rising at a two percent annualized rate:

Month	Headline inflation 3m/3m ^	Services inflation 3m/3m ^	Core inflation 3m/3m ^	Goods excluding energy 3m/3m ^
30/11/2024	1.70	2.14	1.65	0.70
31/12/2024	2.75	2.93	2.19	0.88
31/01/2025	3.40	2.99	2.19	0.81
28/02/2025	3.55	3.68	2.62	0.84
31/03/2025	2.78	3.46	2.45	0.63
30/04/2025	1.35	4.97	3.30	0.35
31/05/2025	0.26	3.42	2.26	0.25
30/06/2025	1.05	3.74	2.49	0.35
31/07/2025	1.91	1.82	1.63	1.34
31/08/2025	2.87	3.65	2.76	1.20
30/09/2025	2.42	3.05	2.38	1.23
31/10/2025	1.78	3.79	2.45	0.07
30/11/2025	1.94	3.16	2.01	-0.03
31/12/2025	1.59	3.35	1.94	-0.62

- **But households are not convinced.** Inflation expectations remain elevated and inconsistent with the ECB meeting its target:

Month	ECB Household expectations 1-year ahead	ECB Household expectations 3-year ahead
30/09/2024	2.4	2.1
31/10/2024	2.5	2.1
30/11/2024	2.6	2.4
31/12/2024	2.8	2.4
31/01/2025	2.6	2.4
28/02/2025	2.6	2.4
31/03/2025	2.9	2.5
30/04/2025	3.1	2.5
31/05/2025	2.8	2.4
30/06/2025	2.6	2.4
31/07/2025	2.6	2.5
31/08/2025	2.8	2.5
30/09/2025	2.7	2.5
31/10/2025	2.8	2.5
30/11/2025	2.8	2.5
31/12/2025	2.8	2.6

- **Households' views of inflation are notably more bearish than official data**. That is: households believe that inflation will run hotter than the current trend in both headline and core inflation suggest. The ECB targets Eurostat's consumer price index, not inflation as it is (rightly or wrongly) perceived by households. Still, these surveys, together with the undercurrent of budding price pressures in business survey data, effectively bar a resumption of rate cuts. Soft bank lending conditions and the slowing labor market suggest that policy is a bit too tight, but there is nothing that the ECB can do at this stage.
- **Finally, you may have missed ruminations about fiscal policy in the Euro Area**. There is the much-vaunted German fiscal easing. And, I must admit, the easing

of the fiscal stance[1] in Germany is without precedent. Before the pandemic, the German cyclically adjusted primary surplus was about two percent of GDP. For the 2026-2030 period, the IMF forecasts structural primary deficits of more than four percent of GDP. That's a simply huge swing equal to four percent of GDP.

- **Germany's fiscal stance will ease by about one percent of GDP this year compared to last year**. But that's just a forecast. It does not take into account the notoriously slow and cumbersome German bureaucracy. And believe me when I complain about German bureaucracy – I can share more than a few stories over drinks or diner. Regardless, easier German fiscal policy is being offset by tighter policy in France and elsewhere in the Euro Area. Thus, according to the EU Commission, the consolidated Eurozone fiscal stance is unchanged this year. This German driven boom benefitting the broader Euro Area would require high multipliers, significant cross-border spillovers, and no bureaucratic delays. So, a fairytale come true.

[1] Measured as the change in the cyclically adjusted primary balance.