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ECB Hike Likely in June to Signal Focus on 2%, Demarco Says

By Jana Randow

(Bloomberg) -- The European Central Bank will likely raise interest rates next month to underline its commitment to deliver on its mandate, according to Governing Council member Alexander Demarco.

With medium-term inflation expectations still “quite well anchored,” there’s currently no need for many follow-up steps, he said Friday on the sidelines of a meeting of European finance chiefs in Nicosia, Cyprus. Fresh projections will show whether that assessment may have to change.

“In June we probably might need to hike,” said Demarco, who also heads Malta’s central bank. “We need to send a signal that we are committed to our medium-term target. It’s about preserving credibility — we can’t be seen to be behind the curve.”

Economists are convinced that an increase in borrowing costs is imminent, to ensure that higher inflation due to the war in Iran won’t set off a self-reinforcing spiral leading to ever stronger price gains. Even some of the Governing Council’s more dovish officials such as Yannis Stourmaras have signaled they’d support such a move, aware that memories of the past shock are still fresh among consumers and firms.

“Inflation has climbed to 3% — that’s the bad news — and the risk that energy prices will stay high for longer is now a certainty,” Demarco said. “The good news is that we’re still seeing underlying inflation returning toward 2%, there is not much evidence of indirect effects and medium to long-term expectations have remained quite well anchored.”

That’s one reason why the deposit rates may not have to rise much from the current 2%.



“At the moment I don’t see a need to go far,” Demarco said. “But I need to see the projections and what they say about the medium term. That may tell us whether one hike could be enough or there maybe need to be two or whether more is needed.”

In March, the ECB’s baseline showed price gains averaging 2.6% this year. That forecast “will probably be revised up given the likelihood of higher energy prices for longer,” the Maltese said, while expressing concern about the economy.

“Downside risks have increased given the conflict has now lasted for three months, and recent signals haven’t been great in terms of prospects for economic activity,” he said.

President Christine Lagarde recently sounded less certain on the prospect of a June hike, after she said following the last ECB press conference that she knew where policy was headed “directionally.”

On Friday, she refused to give “much indication” on the ECB’s upcoming decision, while pointing to “broadly well anchored” inflation expectations and the Governing Council’s commitment to follow a data-dependent and meeting-by-meeting approach.

Earlier in May, she argued that officials face “massive uncertainty,” need “a lot more data” to understand the repercussions of the conflict, and are “constantly torn between the risk of reacting too quickly or the risk of reacting too late.”

Demarco added another dimension to the Governing Council’s balancing act.

“We don’t want to increase interest rates too much or too fast, so we need to be patient and wait for incoming data,” he said. “The meeting-by-meeting approach is still valid.”