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The ECB is making a mistake by raising rates



The European Central Bank has decided to raise **interest rates** in the middle of an energy and geopolitical shock, presenting this move as a necessary response to inflation.

However, the decision looks far too similar to past mistakes: reacting to an energy shock that cannot be corrected by making credit more expensive and scarcer, but which can certainly worsen the economic slowdown.

Moreover, the ECB's apparently "hawkish" stance hides enormous flexibility, as it continues to mask sovereign debt risk through intervention mechanisms.

Raising rates does not reduce the price of natural gas, lower oil prices, resolve a geopolitical crisis, or reverse higher energy costs. Instead, it increases financing costs for households and businesses, restricts credit, and heightens the risk of an economic slowdown in a euro area that already shows a weak growth structure compared with the United States.

To make matters worse, this move comes at a time when commodity prices are already correcting.

A classic diagnosis error

The ECB is once again placing the emphasis on the inflation threat while doing nothing to limit fiscal excess, uncontrolled spending and the indebtedness of governments, which are precisely the factors that increase the quantity and velocity of money and help explain persistent inflation.

No euro area government is going to halt its spending plans and, therefore, the full cost of the ECB's decision falls on **households and small businesses**.

Governments retain almost total ease to waste resources and perpetuate inflation, while the ECB penalises the private sector

The increase in sovereign borrowing costs will be passed on to taxpayers, while governments continue to enjoy abundant liquidity and the cost of debt disguised by the anti-fragmentation mechanism.

This leads to a clear crowding-out effect. Governments retain almost total ease to waste resources and perpetuate inflation, while the ECB penalises the private sector.

This is a classic diagnosis error. The ECB is treating a rise in individual prices driven by the energy component as if it were an overheating of domestic demand caused by excess money creation.

This approach was seen in previous episodes and ended with rate hikes that later had to be reversed as the economy deteriorated. In all those episodes, the ECB's policy was soft on wasteful governments and harsh on the productive sector.

The emphasis on the inflation threat

Capital Economics summarised it clearly. "Faced with rising energy prices and a slowing economy, policymakers have once again, in line with past **ECB** practice, put the emphasis on the inflation threat; if previous similar episodes are a guide, today's rate hike – and any further hikes at coming meetings – will probably be reversed before long; and that suggests that euro area government bond yields will fall in the coming months and that the euro will lose further ground against the dollar".

Other analyses had already warned that monetary tightening would not support the euro when the real problem is economic deterioration.

That is why this rate hike is doubly ineffective: it does not restrain the original cause of inflation, namely fiscal excess, but instead helps perpetuate it; it does nothing about commodity prices, which are already falling as

geopolitical risk eases; and, on top of that, it damages growth.

The sad part is that the ECB will claim the moderation in some individual **nominal prices** in June as a success, without addressing the real cause of persistent aggregate price increases: doping and disguising sovereign debt risk, thereby encouraging governments to keep spending without restraint.

When interest rates rise, the impact on the real economy is immediate

What the ECB should do, if it genuinely wanted to fight inflation, is keep rates unchanged or allow them to float freely, reduce its balance sheet more quickly by selling bonds, eliminate the anti-fragmentation mechanism and remove liquidity facilities that merely disguise sovereign risk.

If the economic, fiscal and bond-market environment is as robust as policymakers claim, there should be no problem, and aggregate prices would moderate quickly.

As things stand, by raising rates while maintaining all the mechanisms that encourage governments to continue inflationary fiscal policies, the ECB harms the private sector while handing favours to predatory states.

Many people say that a **25-basis-point hike** is irrelevant. It is not. For many companies and households, it is the difference between accessing credit and having no access at all, because many banks find it riskier to lend to the productive sector than to prioritise capital ratios, solvency and current net interest margins, which is entirely logical.

When interest rates rise, the impact on the real economy is immediate. Variable-rate mortgages become more expensive, consumer loans rise, corporate refinancing becomes more costly and credit slows, while governments continue spending and borrowing comfortably.

The great inconsistency of the current strategy

Most striking of all is that the ECB is tightening the price of money while keeping in place mechanisms that support public debt and prevent full monetary normalisation.

The so-called Transmission Protection Instrument, known as the **TPI** or anti-fragmentation mechanism, was designed to allow purchases of sovereign bonds when the ECB believes that spreads in some countries are widening in a disorderly way.

In theory, it aims to avoid dysfunctions in the transmission of monetary policy; in practice, it acts as a safety net for the most irresponsible and indebted governments.

The ECB has not fully eliminated the monetary conditions that fuelled inflation

That is the great inconsistency of the current strategy. On the one hand, credit for the private sector becomes more expensive; on the other hand, extraordinary support for public financing remains in place. The ECB punishes households and businesses while continuing to cushion the cost of governments' fiscal excesses.

It is also worth remembering that Europe's inflation problem did not emerge out of nowhere. After years of extraordinary balance-sheet expansion, asset purchases and excess liquidity, the euro area money supply has not normalised, and the balance sheet has not been reduced as quickly as it should have been.

In other words, the ECB has not fully eliminated the monetary conditions that fuelled inflation, but it has shifted a large part of the adjustment onto productive credit and the pockets of households and businesses.

Fragile and only moderate

credit expansion

There is another reason why this decision looks misguided. **Euro area credit growth** in April 2026 hardly points to an overheating economy. According to the ECB, the annual growth rate of adjusted loans to the private sector stood at 3.5%, unchanged from the previous month.

Within that total, adjusted loans to households remained at 3.0%, while adjusted loans to non-financial corporations rose only modestly to 3.4% from 3.2% in March. This is not the profile of an economy suffering from runaway private-sector leverage; it is the picture of a fragile and only moderate credit expansion.

The composition of credit matters as well. Lending for house purchase grew at 3.0% in April, while consumer credit rose at 5.2%, and loans to firms with maturities of up to one year increased at 3.9%.

These are not explosive figures. If anything, they suggest that financing conditions were already restrictive enough to prevent any broad-based credit boom. Raising rates further into such an environment risks squeezing the weakest parts of the productive economy without delivering any meaningful correction in the drivers of energy-led inflation.

The ECB's own growth projections also cast doubt on the wisdom of additional tightening. In its June 2026 **macroeconomic projections**, the ECB warned that the war in the Middle East would weaken economic growth this year as purchasing power, confidence and demand come under pressure, while growth is expected to recover only in 2027 and strengthen again in 2028.

The impact of higher rates on small and medium-sized businesses will be significant

The June projections indicate that euro area GDP growth for 2026 was cut to 0.9%, with 2027 growth projected at 1.2%. If the central bank itself recognises a weak near-term

growth backdrop, then pressing harder on rates while keeping sovereign backstops in place only deepens the contradiction at the heart of its policy.

According to the ECB, the annual growth rate of the broad monetary aggregate M3 fell to 2.7% in April 2026, from 3.2% in March. This indicates that the monetary aggregates are consistent with stagnation, not recession, but certainly not with an overheating economy.

The annual growth rate of the narrower monetary aggregate M1, which includes currency in circulation and overnight deposits, fell to 3.8% in April, from 4.7% in March, revised from 4.6%.

The annual growth rate of adjusted loans to households stood at 3.0% in April, unchanged from the previous month. This is precisely where the ECB will do the most damage, without having a real impact on M3 while estimates of public spending and debt continue to rise.

The annual growth rate of adjusted loans to non-financial corporations increased to 3.4% in April, from 3.2% in March. The impact of higher rates on small and medium-sized businesses will be significant.

Sacrificing the real economy to appear tough

The main mistake of central banks was not only moving rates too late but flooding the system with liquidity and then pretending that small adjustments in the price of money would solve a problem created over many years.



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Raising rates while preserving the doping of public debt is not normalisation. It is a contradictory policy.

The ECB once again confirms the central problem of its strategy: it tightens late, loosens early and leaves intact the incentives that perpetuate debt, unproductive money creation and the weakness of the productive economy.

Raising rates in response to a temporary geopolitical event, just as oil prices are falling, is a mistake because it does not fix energy, does not tackle the root of inflation and does hurt those who produce, invest and consume.

Doing so while preserving the mechanisms that dope public debt and with monetary expansion still visible makes the decision especially misguided.

The ECB is stumbling over the same obstacle again: sacrificing the real economy to appear tough while perpetuating unproductive spending and the sovereign debt bubble.