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ECONOMIC AND FINANCIAL AFFAIRS

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Inflation in the euro area

Technical note for the Eurogroup[1]

[1] This is a technical background paper prepared by the Commission services. It does not represent the Commission position and does not bind the Commission in any way. It was prepared for the Eurogroup Working Group meeting of 30 October 2026 and it is based on the figures that were available at the time.

Key Messages

- Euro area headline inflation increased from 1.9% in February to around 3% in subsequent months, jumping further from 3.2% in August to 3.8% in September (flash estimate). The global energy shock remains the dominating force behind euro area inflation dynamics. Its initial impulse has been swift, as expected, with higher energy (fuel) price growth mechanically adding to headline inflation since March 2026. Indirect effects appear to have been muted so far, and underlying inflation has remained broadly stable. This core inflation stability masks some offsetting movements of manufactured goods inflation, which was largely driven up by idiosyncratic factors, and services inflation, which remains elevated but has shown signs of slow moderation.
- Some price pressures are building up at higher echelons of the supply chain, which may eventually be passed down to consumers and broaden inflation. While the prospect of inflation remaining aligned to the ECB target of 2% appeared plausible at the start of the year, it now seems improbable over the near term, notably as the energy shock is still ongoing and the conflict causing it remains unresolved.
- An ongoing and open question is whether the apparently mild indirect effects on inflation reflect a weak or a delayed pass-through of the energy price shock. A weaker pass-through – or the offsetting effects of coincident disinflationary forces – would suggest that the higher energy costs have been partly absorbed by firms and would hence attenuate near-term price pressures. Food inflation is a case in point: having unexpectedly declined thanks to high yields in 2025 and despite higher energy and fertiliser prices, it is possible to see deferred effects of higher input prices in the near term, as well as upside pressures on food commodity prices due to a strong El Niño phenomenon. More generally, any intensification or prolongation of the energy shock would ultimately break firms' capacity to absorb it and contain indirect inflation effects.
- There are no compelling indications of second round effects in wage dynamics, although it is acknowledged that it may be too early to be reflected in the data. The mechanism by which temporary inflation caused by a relative-price shock transforms into broad-based inflation requires behavioural changes in wage-bargaining and price-setting, as wage earners try to recover some of the losses in purchasing power and firms try to maintain profits. Its strength would depend on both on inflation expectations and the initial state of the economy.
- While households are still scarred by the post-pandemic inflation surge, the reflexive rise in household inflation expectations at the start of the war has reverted swiftly and medium-term expectations of households and market participants generally appear well-anchored. Moreover, with the global hiking cycle and tighter financing conditions weighing on demand, the current economic environment seems less propitious for second round effects than the post-pandemic recovery phase, during which the 2022 energy shock occurred, and which was characterised by tight labour markets and policy stimulus. Also, structural transformations in the European gas market, notably the shift towards liquefied natural gas (LNG), have helped dampening the impact of the energy shock.
- Despite its dominance, the ongoing energy shock comes alongside other global disruptions and risks from geopolitics, climate change, international trade policies and tighter financial conditions, which will shape the euro area inflation profile.
- In a special feature, this note presents a model-based analysis of the transmission of energy commodity price shocks to euro area inflation. A standard oil price shock would be stagflationary. Its direct effects on energy prices and by implication headline inflation would be concentrated in the first year, while indirect effects typically remain limited. The overall effects of a standard gas price shock are more muted but more drawn out. Overall, the model explains the inflation dynamics in the initial months after the outbreak of the war quite well but underpredicts it afterwards. This reflects the untypical persistence of the current shock, resulting from the unresolved underlying conflict and the war-induced destruction of energy production and refining capacity.

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1 Introduction[2]

This regular note assesses recent evidence on factors driving inflation in the euro area. Since the previous note in March 2026, euro area inflation has been fluctuating around 3% on account of the global energy shock triggered by the outbreak of the still ongoing war in Iran. Headline inflation jumped further to 3.8% in September (flash estimate). While the propagation of the shock is the dominant driver of euro inflation dynamics, it overlaps with other ongoing major disruptions and risks, related to geopolitics, international trade, the AI rollout and climate change. The multitude and ongoing nature of these shocks make it harder to gauge at what stage of the propagation the euro area economy finds itself and to form a view on near term inflation dynamics and risks.

This note is structured as follows: it first reviews recent inflation developments in the euro area and its main trading partners (Section 2). It then discusses the role of inflation drivers, notably the global energy price shock and wages (Section 3), before commenting on inflation expectations (Section 4). The note concludes with some considerations on the inflation outlook. This note also contains a special feature on the transmission of energy commodity price shocks to euro area inflation.

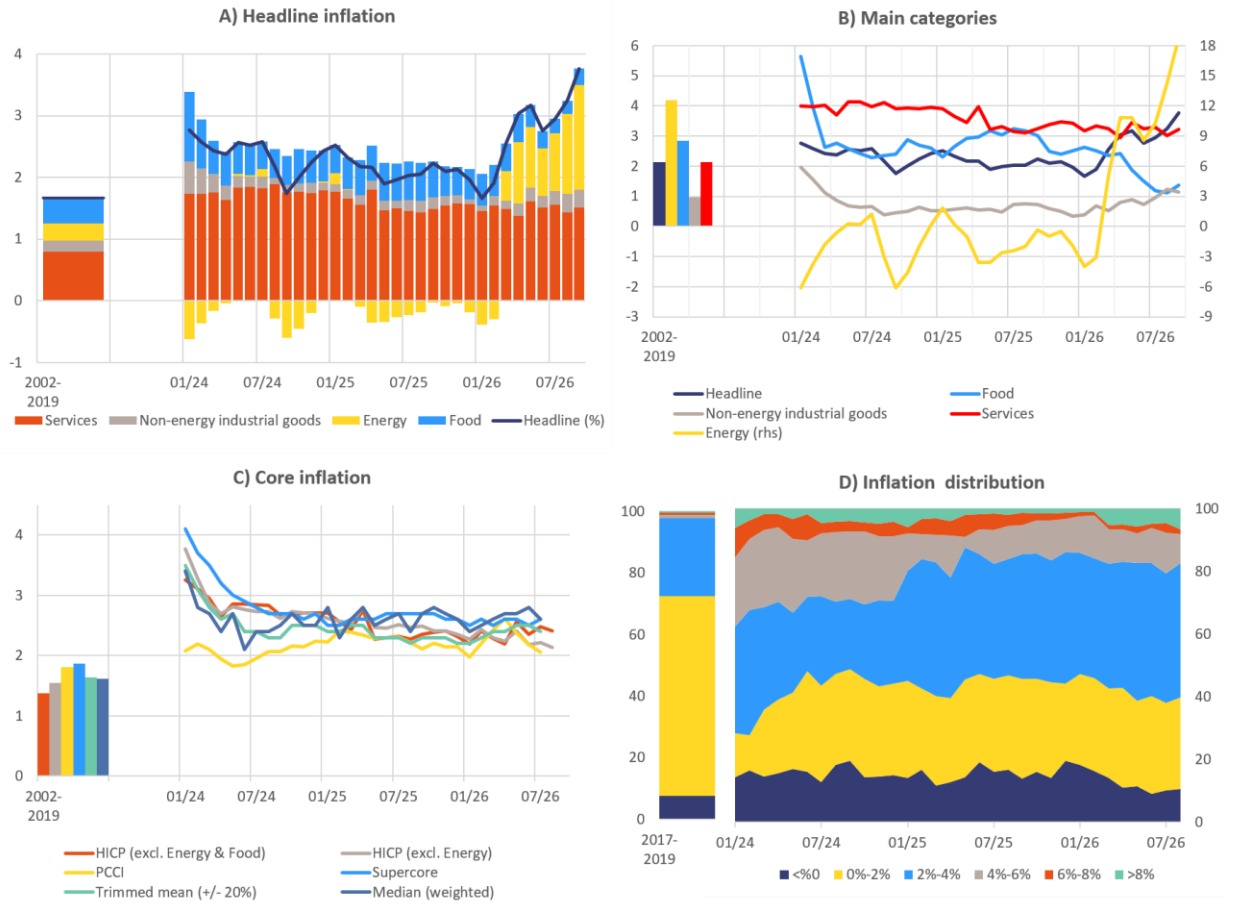
2 Recent inflation developments

2.1 Recent developments in headline and core inflation in the euro area

Direct effects of the global energy shock are shaping the euro area inflation profile, while indirect effects are not clearly apparent (yet).[3] The prospect of inflation remaining aligned with the ECB target of 2% has been upended in the wake of the US-Israeli attacks on Iran and the impact of (yet) another adverse supply shock. Headline inflation since March has clearly been shaped by the direct impact of the energy shock, increasing from 1.9% in February to around 3% in subsequent months, jumping further to 3.8% in September (from 3.2% in August) according to the Eurostat flash estimate (Figure 1, Panels A and B). The profile reflects major stepwise surges in the energy component at the start of the conflict (March/April) and again in the Summer after its re-escalation following the breakdown of the memorandum of understanding between the US and Iran (see Section 3.1). After three years of price contraction, energy inflation rose from -3.1% in February to around 10% as of April and 18.8% in September. The direct impact of higher energy inflation on headline was partly offset by a steady decline in food inflation from 2.5% in February to 1.1% in August, followed by a slight rebound to 1.4% in September.[4] Measures of underlying inflation have mostly moved sideways since March, pointing to limited indirect effects of the energy shock so far. In August 2026, the main exclusion-based inflation measures, which omit the volatile categories, i.e. energy and food, from the consumer basket, stood at around 2.1-2.4%, an order of magnitude like that seen at the beginning of the year (Figure 1, Panel C). Various statistical indicators support the view of stable underlying inflation. However, the core inflation stability masks some offsetting movements in manufactured goods inflation, largely driven up by AI-related products, and services inflation, which remains elevated but has shown signs of moderation. High energy inflation and elevated services inflation however imply that high inflation remains broad based, with prices of about 60% of the items in the consumer basket growing at rates above 2% (Figure 1, Panel D).

[2] The note reviews the period since March 2026. The cut-off date is 9 October 2026.
[3] Direct effects refer to the mechanical impact of higher energy (commodity) prices on headline inflation, as consumers directly purchase energy items (e.g. fuel, electricity, heating). Indirect effects occur when higher energy prices raise production and distribution costs of other consumer items, which are then in turn passed on to consumers.
[4] Energy and food account for 9% and 19% of the euro area consumption basket.

Figure 1: Recent euro area inflation developments



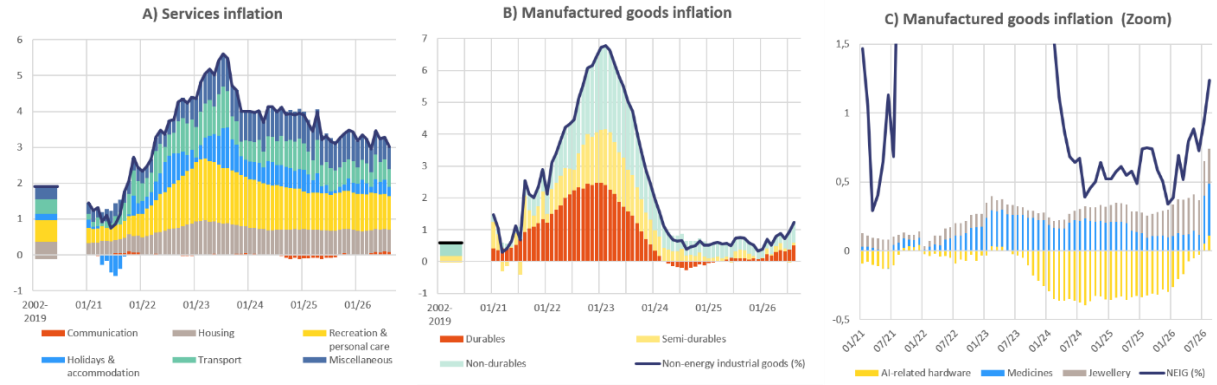
Note: Last observation in Panels A and B: September 2026 (Flash estimate). Panel C: Supercore and Permanent and Common Component of Inflation (PCCI) discussed in ECB Economic Bulletin No. 4, 2018. Panel D: bands include aggregate share of items falling into a given inflation range. Analysis based on 292 COICOP items. Last observation in Panels C and D: August 2026.
Source: Eurostat, ECB and own calculations

2.1.1 Services inflation

Services inflation pursues its slow downward trend but remains elevated compared to pre-pandemic times. This dynamic in turn reflects a steady downward trend in recreation services, which account for a quarter of all service items (Figure 2, panel A). Transport services on the one hand and package holidays and accommodation services on the other hand led to a brief spike in services inflation in May (3.5%), amid higher fuel prices and concerns about the availability of jet fuel. Inflation in both sub-categories has eased since, to levels comparable or lower than pre-war. At 3% in August, services inflation saw its lowest rate since the post-pandemic inflation peak. With services inflation being typically slow-moving,[5] the return to historical averages is still likely to be drawn out. However, easing wage pressures (see Section 3.3) still support projections of falling services inflation going forward.

[5] See also The stickiness of services inflation in the euro area, Quarterly Report on the Euro Area (QREA), Vol. 23, No. 4 (2024), 20 February 2025.

Figure 2: Services and manufactured goods prices



Note: AI-related hardware includes Fixed telephone equipment (cp0811), Mobile telephone equipment (cp0812), Information processing equipment (cp0813), Equipment for the reception, recording and reproduction of sound and vision (cp0814), Unrecorded recording media (cp0815), Other information and communication equipment and accessories (cp0819), Heaters and air conditioners (cp05313). Last observation: August 2026.
Source: Eurostat, own calculations

2.1.2 Manufactured goods inflation

AI-related hardware, medicines and jewellery are driving up manufactured goods inflation. Manufactured goods inflation has steadily trended upwards from 0.3% in late 2025 to 1.3% in August, twice the long-term average of 0.6% (Figure 2, panel C). This increase partly reflects various idiosyncratic factors rather than a joint indirect effect of the energy shock. The global AI-related investment notably appears to have a direct – but low – impact on consumer inflation, driving up prices of goods that rely on technological inputs also used in AI datacentres, such as information and communication equipment and air conditioners. While these items still dragged down manufactured goods inflation in the last two years (average contribution of -0.3 pp. in 2024 and 2025), they now add a modest 0.1 pp.[6] Meanwhile jewellery inflation quadrupled in the space of two years to 13% in August, close to its historical maximum of 14% in May 2026. This is likely a byproduct of flight to safety flows in a context of global uncertainty, which have driven up price of precious metals in recent years, keeping them at elevated levels notwithstanding some price stabilisation during the year. Finally, medicines constitute a third push factor, which moreover is concentrated in individual Member States (Belgium and Germany).

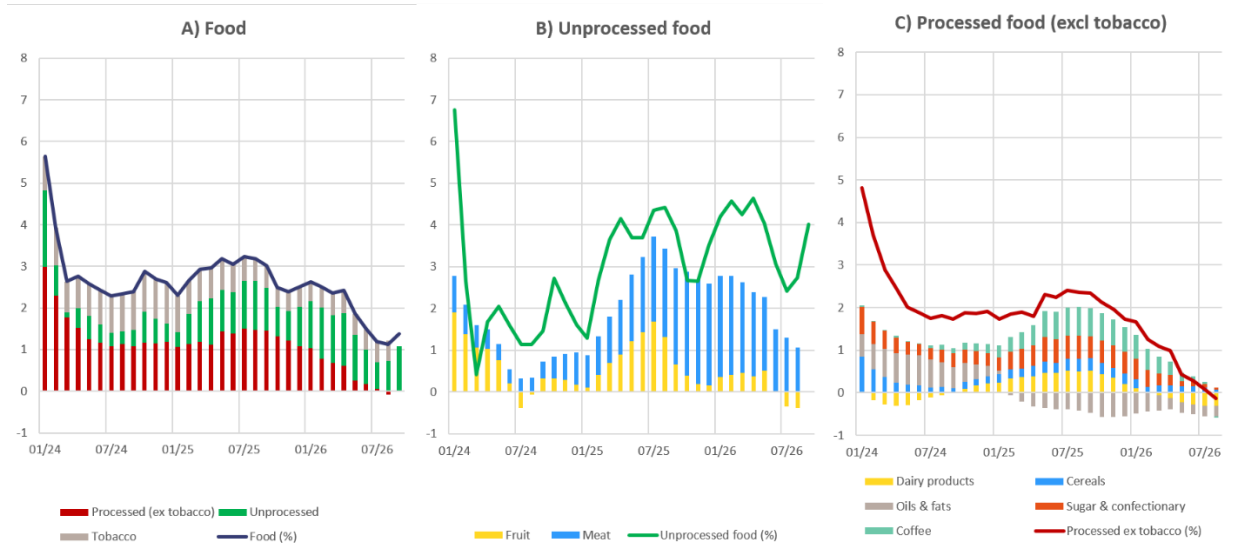
2.1.3 Food inflation

Food inflation has been on an unexpected downward trend since early 2026, moderating to multi-year lows recently, but geopolitical uncertainty, droughts and the incipient El Niño phenomenon could drive food prices up in the near to medium future. At 1.1% in August, food inflation is well below its historical mean (2.6%) and median (2.1%) and has thus contributed to offsetting the upward pressures on headline inflation stemming from energy. Food disinflation has mainly been concentrated

[6] Note that such direct effects are unrelated to the broader inflation effects of AI adoption, which tend to be viewed as having both disinflationary effects if AI raises productivity and inflationary ones through wealth effects (see, e.g. Aldasoro et al., 2024, The impact of artificial intelligence on output and inflation, BIS Working Paper No 1179). These effects are also separate from the possible impact on energy prices stemming from demand by data centres (see Scalera, C, V Bosetti and F Pecci (2026), Large-Load Electricity Customers and Spillovers on Household Prices: Evidence from U.S. Data Centers, CEPR Discussion Paper No. 21854).

in processed food items,[7] i.e. those which tend to undergo more transformation stages and for which the share of non-commodity costs tends to be higher. At 0.5% in August, it is close to historical lows (excluding tobacco, processed food prices even fell slightly: -0.1%).[8] Meanwhile, unprocessed food inflation rose from 2.7% in August to 4% in September, a rise that likely reflects lower crop yields due to the summer heatwaves in Europe.

Figure 3: Food prices



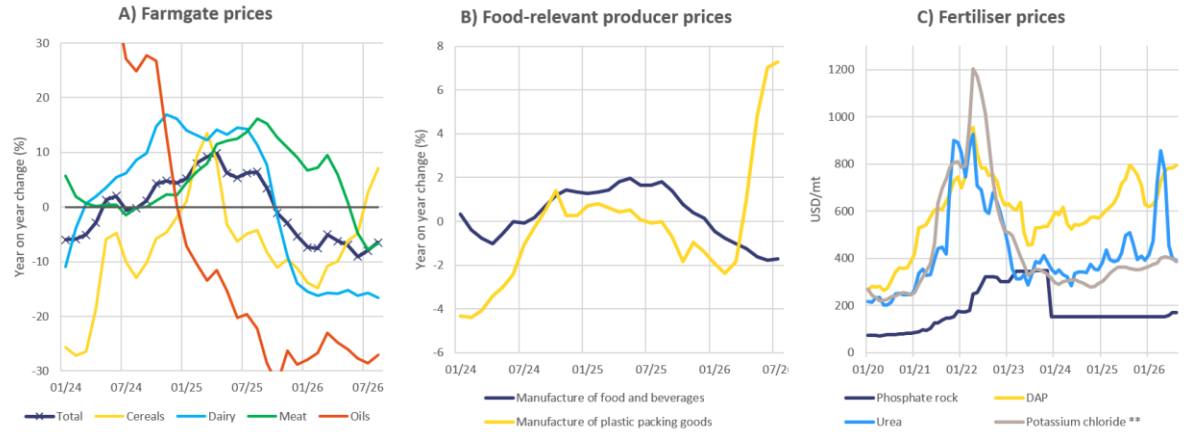
Note: Panel B and C only display selected components of unprocessed and processed food, respectively. Last observation: August and September (flash estimate) 2026. The flash estimate is only available for some special aggregates.
Source: Eurostat, own calculations

Both the trend and the level of food inflation have surprised on the downside. Following the outbreak of the war in Iran, food prices were expected to be significantly pushed up indirectly both through higher energy costs and, more specifically to food production and distribution, higher fertiliser and packaging costs, respectively. However, the actual food inflation profile fell short of what was generally anticipated.

Different broad hypotheses could explain the weaker-than-expected food price inflation: a) a delayed impact of the cost shocks, b) a weaker pass-through; c) the offsetting effects of coincident disinflationary forces. Zooming into processed and unprocessed food baskets shows that the moderation in inflation within each food sub-aggregate was broad based, reflecting favourable supply conditions and other supportive factors: in the processed food categories, a good harvest for cereals globally, and in the EU in 2025, resulted in high stocks and lower prices. Likewise, high milk supply in 2025 has been pushing down prices of dairy products. In the case of coffee, where price growth fell from about 20% in summer 2025 to -1.1% in August 2026, abundant global supply has eased inflationary pressures. In the unprocessed food categories, price growth of meat has eased, reflecting idiosyncratic factors by animal type, while fruit prices have contracted over the summer.

[7] Food makes up 19% of the euro area consumption basket. It can be split into non-processed (5.1% - 27% of food) and processed food (13.9% - 73% of food), respectively.
[8] Processed food inflation, including tobacco, declined from 0.5% in Ausgust to 0.4% in September. A breakdown is not yet available.

Figure 4: Upstream food price pressures



Last observation: July (Panel B), August (Panels A and C).
Source: ECB, DG AGRI, Eurostat, World Bank, own calculations

Food inflation outlook. Looking ahead, food price dynamics are expected to be influenced by three main factors: i) the ongoing war in Iran and its effects on prices of energy and other commodities; ii) the lagged effects of the summer 2026 droughts in Europe and iii) the announced El Niño phenomenon. Pipeline pressures so far send mixed messages on near-term food inflation (Figure 4). Farmgate prices, except for cereals, and producer prices generally point to further moderation, while upward pressures will likely be felt through higher energy prices, as well as other input costs, such as packaging. Given the importance of the latter in food distribution, low inflation is unlikely to persist. Still, the magnitude of the energy price shock, in particular natural gas, is considerably smaller than in 2022 and the ultimate food inflation outturn should stay clear of the double-digit readings observed then.

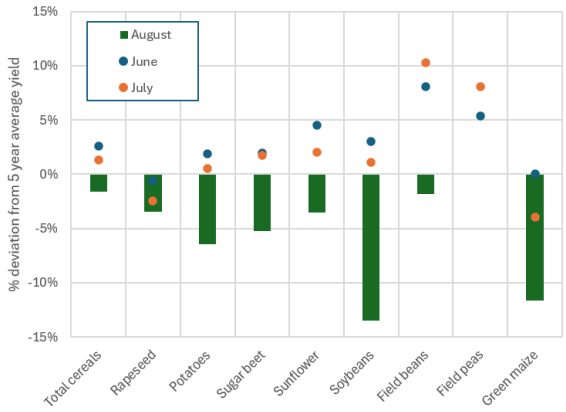
Fertilisers, which are an essential agricultural input determining crop yields and quality,[9] are another risk factor linked to the conflict in the Middle East. Fertiliser input prices rose after the closure of the Strait of Hormuz heavily disrupted trade, but the subsequent evolution was fertiliser-specific, depending on the ease of supply-side substitution and policy support[10]: urea prices have fallen back to pre-war levels, while those of diammonium phosphate (DAP) and potash remain high, albeit below their level in 2022. While fertiliser bottlenecks tend to have price effects in advanced economies, albeit partly slowed down by the existence of long-term contracts, they are more likely to imply outright shortages in developing countries that would in turn pressure global prices upwards.

The combination of multiple heatwaves and water deficit in Europe during summer 2026 have caused agricultural production losses, which are expected to exert upside pressures on food prices. A comparison of yield forecasts before (June) and after (August) the summer heatwaves illustrates the likely damage to harvests across the EU (Figure 5). The impact differs significantly by type of crop (varying crop conditions by location, differences in harvesting periods): while forecasts where broadly in line with 5-year averages ahead of the summer, yield forecasts between June and August have been revised downward by between 1% and 16%, thus reducing current supply and stocks.

[9] E.g. Brunelle, T., Dumas, P., Souty, F., Dorin, B. and Nadaud, F. (2015), Evaluating the impact of rising fertilizer prices on crop yields. Agricultural Economics, 46: 653-666. https://doi.org/10.1111/agec.12161
[10] For example, the Commission adopted its Fertiliser Action Plan in May 2026, which aims to ease short-term cost pressures while bolstering long-term resilience, in addition to the dedicated temporary State Aid Framework.

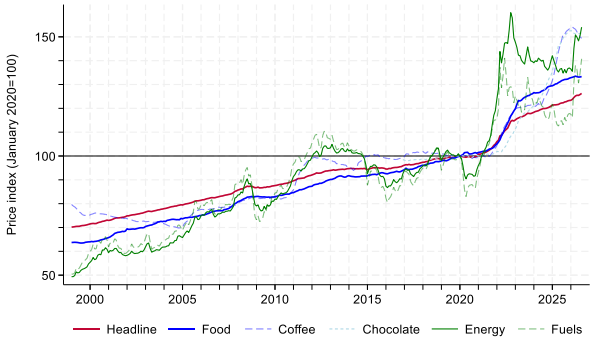
Everything else equal, this is expected to add to food inflation.[11] Another consequence of the summer climate events are the impairments of water transport ways, which may have created bottlenecks in the distribution of food commodities.

Figure 5: Revisions of yield forecasts over the summer



Note: The Figure shows the revision of yield forecasts over the summer, as a proxy for the drought impact. Yield forecasts are expressed as deviations from the 5-year average yield.
Source: Joint Research Centre (MARS Bulletin), own calculation.

Figure 6: Long-term evolution of selected food prices



Note: Price level indices are seasonally adjusted.
Source: Eurostat, own calculations.

A strong El Niño phenomenon and upcoming extreme weather events are expected to disrupt agricultural production and push up food commodity prices. More frequent occurrences of extreme weather events linked to climate change are expected to increase the unpredictability of agricultural production and consequently increase food price volatility going forward. At the global level, adding to other effects of global warming, the occurrence of an El Niño phenomenon of unprecedented intensity by the end of 2026, is widely expected to severely disrupt agricultural production in many parts of the world. El Niño's impact is likely to vary across agricultural commodities both in terms of sign and size of the impact, which is subject to high uncertainty.[12] However, the aggregate effect on food prices is expected to be positive.[13]

There are various factors that could mitigate or amplify upside price pressures. One factor is the ability of firms along the food supply chain to pass on higher input costs to consumers in view of protecting their margins. On the one hand, low margins would limit firms' ability to absorb cost increases; on the other hand, in a competitive environment firms would risk losing customers by passing on higher costs, a motive that has been advanced as a potential explanation for low food inflation.[14] Another factor regards the substitutability of lost production through imports or alternative products. For example, ample global inventories would mitigate any losses in domestic production, say due to droughts.

[11] JRC MARS Bulletin - Crop monitoring in Europe - August 2026 - Vol. 34 No 7
[12] Acosta Navarro et al., 2026, From forecast to risk: an anticipatory analysis of the 2026-27 El Niño, Joint Research Centre, https://data.europa.eu/doi/10.2760/8279279, JRC147365.
[13] Adolfsen and Lappe, 2023, Risks to global food commodity prices from El Niño, ECB Economic Bulletin, Issue 6/2023.
[14] https://www.abnamro.com/research/en/our-research/spotlight-a-perfect-storm-for-food-inflation

2.2 National inflation developments in the euro area

The energy-driven pick-up in aggregate euro area inflation is geographically broad based (Figure 7, Panel A)**.** Only Estonia (1.7%) and Malta (2%) recorded inflation below or around the ECB inflation target in Q3 2026.[15] Lithuania (5.4%), Bulgaria (4.9%) and Cyprus (4.6%) recorded the highest inflation (Figure 7, Panel B). In many countries, energy has become the main inflation driver, reflecting the combination of high consumption weights and high price increases (Figure 7, Panel C). In most countries, core inflation has remained stable since the outbreak of Iran war (Figure 7, Panel D). While services inflation remains substantial everywhere, the contribution of manufactured goods and food inflation, respectively, is moderate across the euro area.

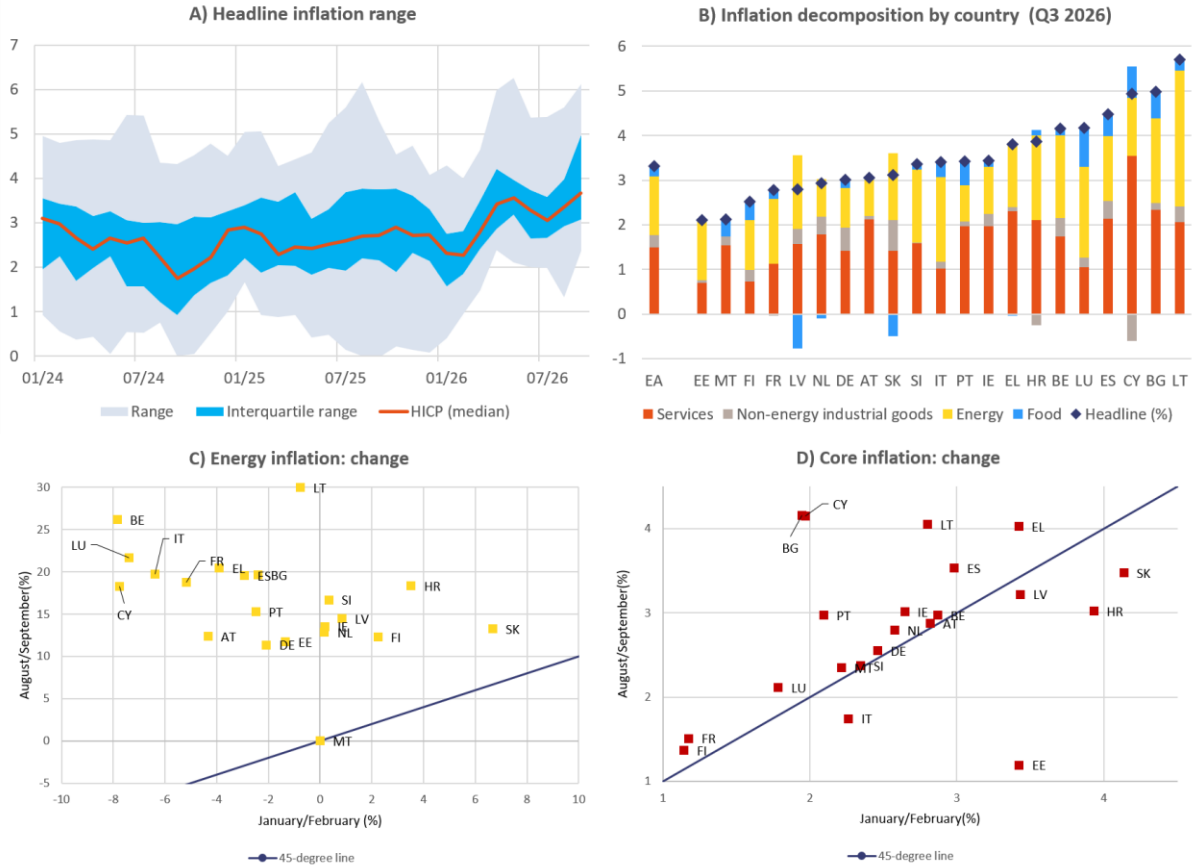
The surge in energy prices has also widened inflation divergences somewhat, which however remain low in a historical perspective. As seen in 2022-2023, energy price shocks can be an important driver of inflation dispersion in the euro area. The ongoing global energy shock has the potential to exacerbate the asymmetric impact across the euro area observed so far, which reflects differences in energy consumption,[16] as well as structural factors that have been influencing the country-specific pass-through from energy commodity to retail prices. The latter include the energy mix, energy intensity, energy regulation and national policy measures aimed at containing the shock to purchasing power.

2.3 Inflation in non-euro area EU countries and beyond

The global energy shock has led to a broad monetary policy hiking cycle across advanced economies. Many major advanced economies were still on a disinflation path with above-target inflation when the Iran war broke out, which was consequently slowed or interrupted (Figure 8). While the balance between higher energy costs and pre-existing domestic demand pressures varies across economies, many central banks tightened their stance at recent meetings, by raising interest rates (e.g. ECB, US Federal Reserve, Bank of Japan) or signalling their intent to do so (e.g. Bank of England).

[15] The three-month average between June 2026 and August 2026.
[16] The share of energy in the consumer basket ranges from 6% (Malta) to 13% (Latvia).

Figure 7: Inflation dispersion across the euro area

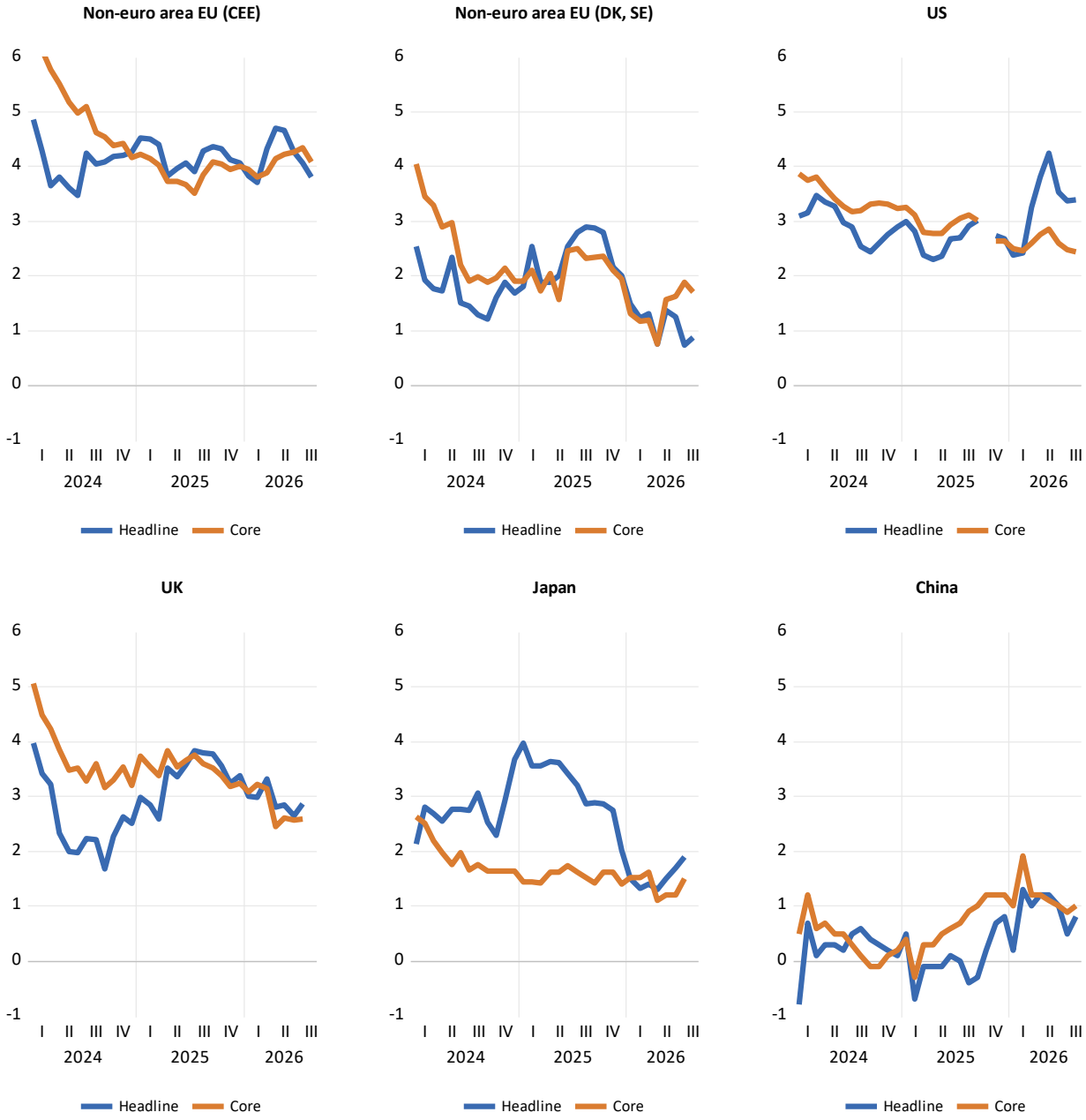


Note: Panel A: Last observation: September 2026. Panels C and D: Points above the 45-degree line indicate that inflation has increased. Core inflation refers to headline inflation excluding energy and food.
Source: Eurostat and own calculations.

The easing of inflation in non-euro area EU countries has been slowed or held back by the energy shock. In the four non-euro area countries in Central and Eastern European (CEE)[17], which experienced a particularly strong inflation surge in 2022-2023, headline inflation increased from 3.7% in February to 4.7 in May, before falling back to 3.7% by August (Figure 8). While energy inflation was the main upside driver of inflation in all four countries, dispersion in energy inflation has been substantial in August (latest observation), ranging from 1.6% (Hungary) and 2.2% (Czechia) to 10.3% (Poland) and 11.9% (Romania). On the other hand, like in the euro area, food inflation, which accounts for a large share of the CEE countries' consumer baskets, and services contributed significantly to easing price pressures. So far there a no clear signs of a broadening of the energy shock. Romania remains the outlier, with 6.3% inflation in August, after a temporary peak of 9.7% in May, while Czechia (1.5%) and Hungary (1.8%) remain below their inflation targets. Higher fuel prices and extreme-weather related disruptions to energy production are likely to further push up energy inflation in the near term. Inflation in Denmark and Sweden has trended in opposite directions during the year. Inflation in Sweden fell from 1.7% in February to 0.3% in August, while in Denmark it increased from 0.5% to 2% over the same period. The low inflation in Sweden mainly reflects negative food inflation, supported by a reduction in the VAT rate on food from 12% to 6% in April.

[17] Czechia, Hungary, Poland and Romania.

Figure 8 Headline and core inflation in selected economies, January 2024- August 2026



Source: Eurostat, Data Insight and own calculations

3 Inflation drivers

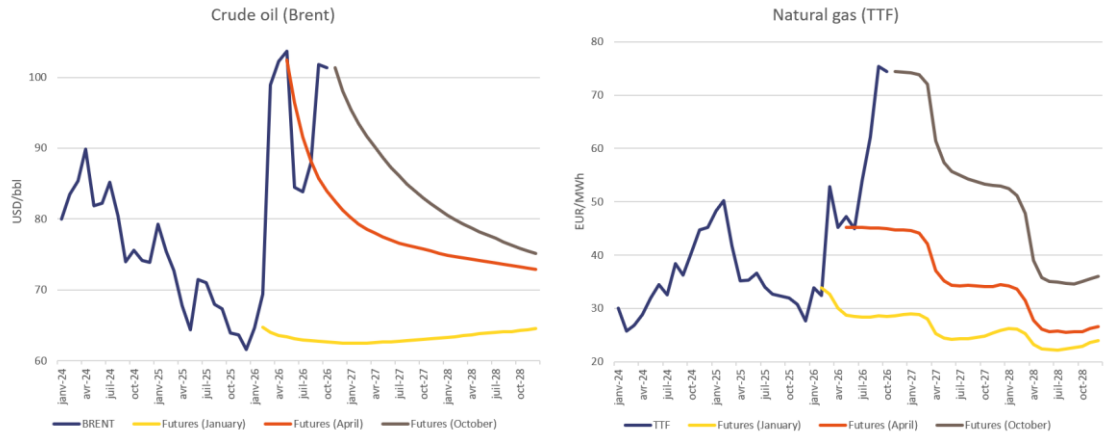
3.1 Global energy price shock

The global energy shock triggered by the Iran war has proven stronger and more enduring than initially expected, pushing up the current and prospective energy inflation profile. Crude oil prices surged when the war broke out. Risks of lasting disruptions of energy commodity markets were a realistic, albeit adverse, scenario after the effective closure of the Strait of Hormuz, the only maritime

distribution route for shipments of oil and liquified natural gas (LNG) out of the Persian Gulf,[18] and attacks on production facilities, such as refineries, and storage sites. Nonetheless, futures markets projected oil prices to fall rapidly. Since the start of the war, Brent crude oil prices have been highly volatile – fluctuating between around USD 70/bbl and USD 120/bbl – and sensitive to news about the dynamics and resolution prospects of the conflict. The failure to uphold the memorandum of understanding between the US and Iran to end the war and renewed hostilities since the summer, have pushed up prices again. That said the crude oil market remains in "backwardation", with market participants essentially rolling over their expectation of an eventual de-escalation of the conflict.

The impact of the war on crude oil prices has been mitigated both by supply-side adjustments and by demand suppression.[19] Given the size of the Middle East supply shortfall, the observed crude oil prices need to be viewed through the lens of various adjustment channels, including the use of commercial and strategic reserves, the by-passing of the Strait of Hormuz (e.g. the East-West crude oil pipeline connecting Saudi Arabia to the Red Sea) and supply expansion elsewhere, as well as demand reduction, notably from China, the world's largest crude oil importer.[20] Clearly, buffers are finite and highly vulnerable to the duration of the conflict. At an average USD 102/bbl in September, the spot crude oil price was almost 60% up from January 2026. On average, the futures markets expect the oil price in 2027 and 2028 to remain about 40% and 20% above the levels expected in January. Relative to the April average – roughly corresponding to the period of the Commission's Spring Forecasts – futures for 2027 point to a 15% higher oil price.

Figure 9 Energy price outlook at selected dates



Note: the futures represent monthly averages in a given month. The October futures are the average of daily observations until 6 October 2026. Source: Data Insight and own calculations

The pass-through from crude oil to retail energy prices depends on the transformation of crude oil into consumable and heterogeneous oil products, as well as policy measures to provide relief to households and firms. Oil refineries are typically calibrated for a particular type of fuel. War-induced damages to refining facilities have recently create bottlenecks downstream, which are untypical. An

[18] It accounts for about a 25% of global oil trade and about 19% of global LNG trade (IEA).

[19] See IEA commentary, Oil markets strain to plug the gap left by Middle East supply shortfall, 18 September 2026, and D'Orazio et al., 2026, Energy markets under chokepoint stress: The 2026 Hormuz shock, VoxEU 17 September 2026.

[20] The counterpart of the decline in China's crude oil imports are reduced contributions to storage, squeezed margins for refiners and lower final demand for fuel, partly substituted by a greater use of electric vehicles (see Downs and Meidan, 2026, How China Is Managing Lower Oil Imports, Centre on Global Energy Policy at Columbia, Blog entry 13 August 2026).

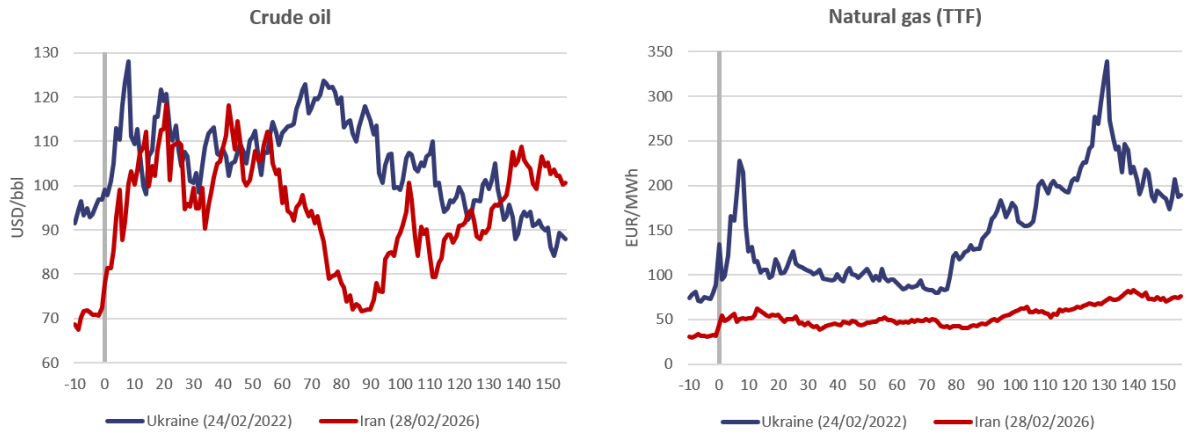
implication of this is that the margin ("crack spread") between crude oil and oil products may fluctuate and that price dynamics may vary across differentiated petroleum products. In such a situation, fluctuations in prices of crude oil, which is more fungible, may carry less information for retail oil products. For example, the average price of diesel in the euro area has reached an all-time peak of EUR 2.27 per litre (with tax) (Figure 12). Another factor affecting the impact on retail energy prices is the reliance on energy measures to provide relief to households and firms. Since the start of the Iran war, most EU countries have implemented measures, such as lower excise duties or reduced value added tax rates on energy items, which have fiscal costs and imply other trade-offs, depending on their design.[21] The largest part, around two thirds has been spent on (untargeted) price measures, while the remaining third were income support (i.e. non-price) measures.[22]

The outlook for natural gas prices has followed a more escalatory pattern. Natural gas prices have moved up after the start of the war, trading at about 40% above their pre-war level during the Spring. Against a background of low gas inventories, futures markets reassessed the price outlook during the Summer, as captured in a significant upward shift of the entire forward price schedule, which however remains "backwarded". Futures markets' price expectations in October for 2027 and 2028 respectively are now about 60% and 40% higher than in April (130% and 70% higher than in January).

Despite the many parallels, the commodity specific impact of the wars in Iran and Ukraine differs. While both conflicts have led to surging oil and natural gas prices, the initial levels at the eve of Russia's attack on Ukraine were significantly higher in 2022, in a context of post-pandemic recovery and the weaponisation of energy export by Russia in the run-up to the war. The impact of the Iran war has so far disproportionately affected crude oil prices and some refined products, while the impact on natural gas prices remained less extreme than in 2022, easing risks of non-linear effects in the pass-through to consumer prices. This notably reflects structural transformations in the European gas market, which reduced its dependence on Russian gas transported via pipeline infrastructure, instead shifting to liquefied natural gas (LNG) which is more fungible even if its distribution has also been affected by the closure of the Strait of Hormuz and physical damages to LNG facilities around the Persian Gulf.

[21] While price measures may be motivated by the need to ensure administrative simplicity and political economy considerations (e.g. visibility), their untargeted nature mutes price signals, limits their effectiveness in protecting vulnerable households and increases their fiscal cost.
[22] Note to the attention of the Eurogroup, DG ECFIN, Impact of energy markets on euro area economy, 25 September 2026.

Figure 10 Energy commodity prices after outbreaks of wars in Ukraine and Iran



Note: Day 0 (vertical line) refers to the event or first day of a conflict – or the first weekday following it. Last observation: 6 October 2026.
Source: Data Insight and own calculations

The impact of the energy commodity price shock is so far concentrated in the energy component with limited indirect effects. The direct impact on consumer prices has so far been concentrated in fuel prices, which picked up rapidly following the outbreak of the war and are at historical peaks (Figure 12), with a potential of climbing even further, while the reaction of electricity and gas prices has been more gradual and milder. A mechanical exercise based on the latest commodity futures curve (6 October) suggests that energy inflation, driven by fuel, would peak at around 18% in Q4, while its decline would be partly offset by the growth of retail gas and electricity prices, which is expected to reach its peak later, in the first half of 2027.[23] According to the exercise, energy inflation would rise to about 10% in 2026 (up from 1.4 % in 2025), before falling back to about 6% in 2027 and contracting slightly in 2028. Indirect effects of the commodity shock, via changes in firms' production costs seem contained so far (see Section 3.2). Indeed, spillovers to core and food inflation are generally low in normal times, and the smaller size of the shock, with respect to 2022, provides less justification for non-linear pass-through, as cost increases may not have reached thresholds beyond which firms need to pass them on to final consumers.[24] However, its persistence raises the prospect of indirect effects.

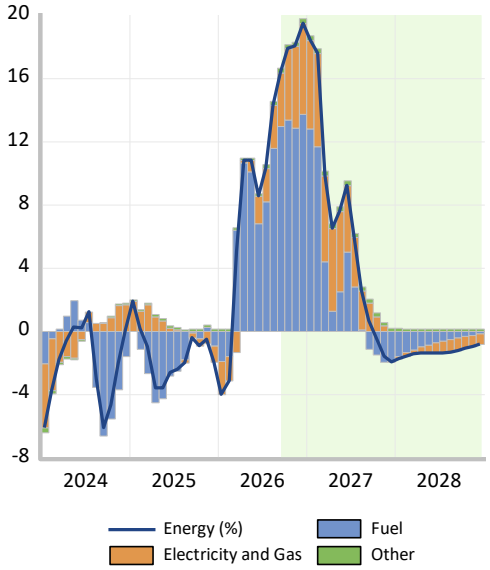
[23] For this exercise, energy inflation is divided into three sub-components: Fuel, Electricity and Gas (as a single category) and the remaining categories (Other, including solid fuels). For each subcomponent an auto-regressive distributed lag model (ARDL) of the following form is estimated:

$$dlog(P^H)_t = \beta_0 + \sum_{i=1}^{m} \beta_i dlog(P^H)_{t-i} + \sum_{j=0}^{n} \delta_j dlog(Commodity)_{t-j}$$

where P^H is the (seasonally adjusted) price index of HICP sub-component H and $dlog$ is its rate of change (first difference of the log-transformed index). The lag order of each model (i.e. m and n) is determined by minimising the Akaike Information Criterion. In the case of Fuel and "Other" the relevant $Commodity$ is crude oil (Brent in USD). In the case of electricity and gas, the relevant $Commodity$ is natural gas (Dutch TTF). The model is estimated at monthly frequency over the period 1996-2026 (Brent) and 2012-2026 (TTF). For each series forecasts are produced on the basis of futures and the aggregated to obtain the energy component, using 2026 weights.

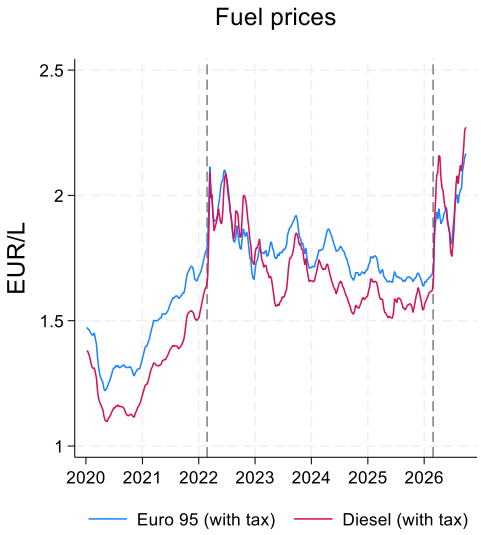
[24] Corsello, F. and Tagliabracci, A. (2023), Assessing the pass-through of energy prices to inflation in the euro area, *Occasional Paper Series*, No 745, Banca d'Italia.

Figure 11: Mechanical energy inflation forecast as at 6 October 2026 ***(% yoy and pp contributions)***



Note: green shaded area = forecast
Source: Eurostat, IHS Markit, own calculations

Figure 12: Fuel price per litre (Euro 95 and Diesel)



Note: weekly prices. The vertical lines indicate the start of the wars in Ukraine and Iran, respectively. Last observation: 28 September 2026.
Source: DG ENER, weekly oil bulletin

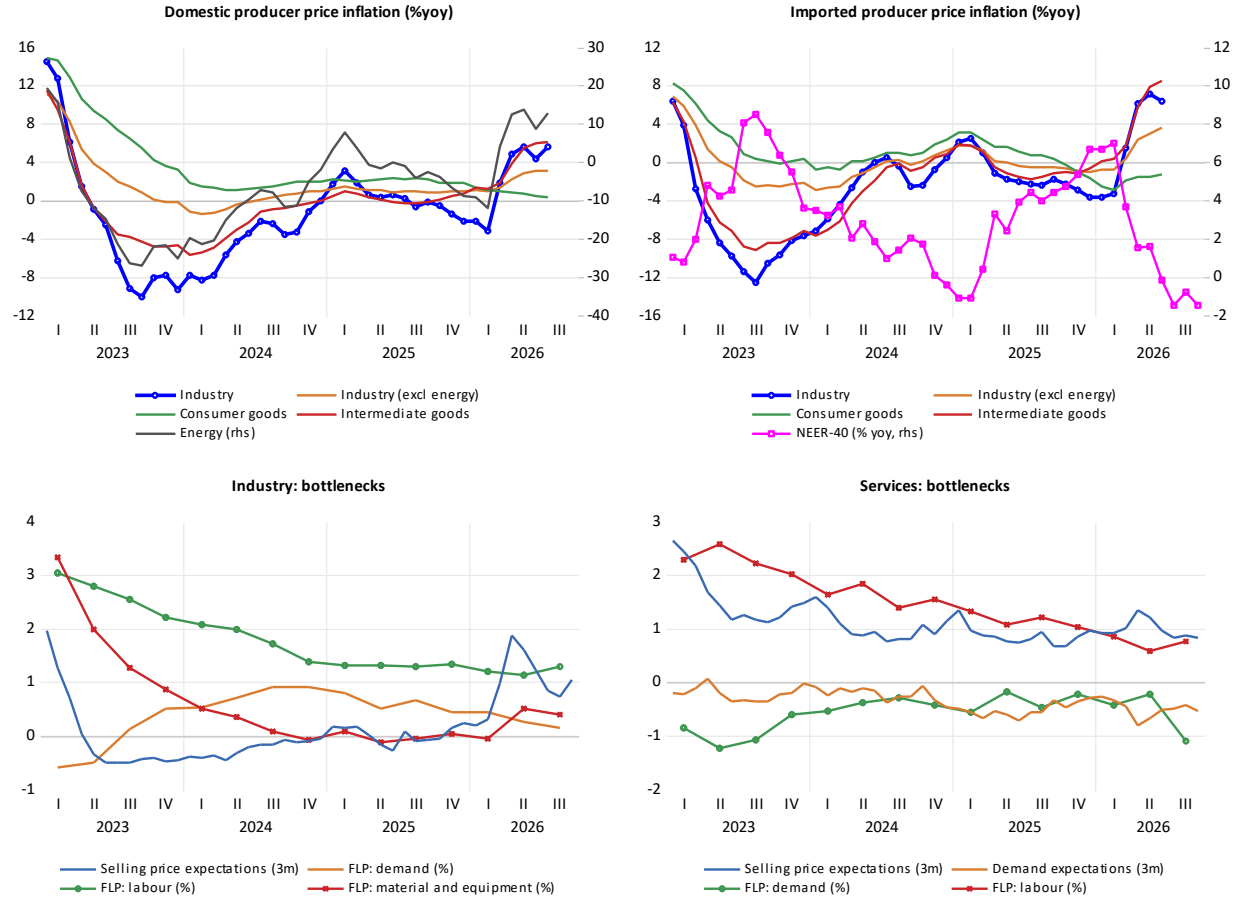
3.2 Upstream price pressures

The global energy shock has led to a rebound in upstream price pressures. Domestic producer price inflation (PPI) contracted steadily throughout 2025 to bottom out -3.1% in February at the eve of the war (Figure 13). Both this downward trend, and the dynamics after the strong rebound in March, were led by energy. Domestic PPI picked up to 5.7% in July, from 4.4% in June. Upstream price pressures for non-energy industrial and intermediate goods also intensified after March, while consumer goods inflation continued its downward trend. A broadly similar pattern holds for import prices, reinforced by a broad-based weakening of the euro, albeit with those of imported consumer goods still contracting.[25]

Firm surveys point to higher price pressures than prior to the war, albeit less than initially feared. Selling price expectations of firms in industry jumped in March, before easing again afterwards, although remaining higher than before the war. Meanwhile, the pickup in selling price expectations for services firms was milder and has fully reverted since to levels that remain above historical averages, consistent with the continued persistence in services inflation. This reversion of selling price expectations may point to limitations in firms' ability to pass-through higher costs, despite slight improvements in their reported demand. Firms in industry and services continue to view the availability of labour as a production limit, while industrial firms' reference to materials and equipment as limiting production factor has increased after the closure of the Strait of Hormuz.

[25] See Special Feature 1 on the spillovers from Chinese producer prices in March 2026 inflation note.

Figure 13: Upstream price pressures and factors limiting production, January 2023- Q3 2026

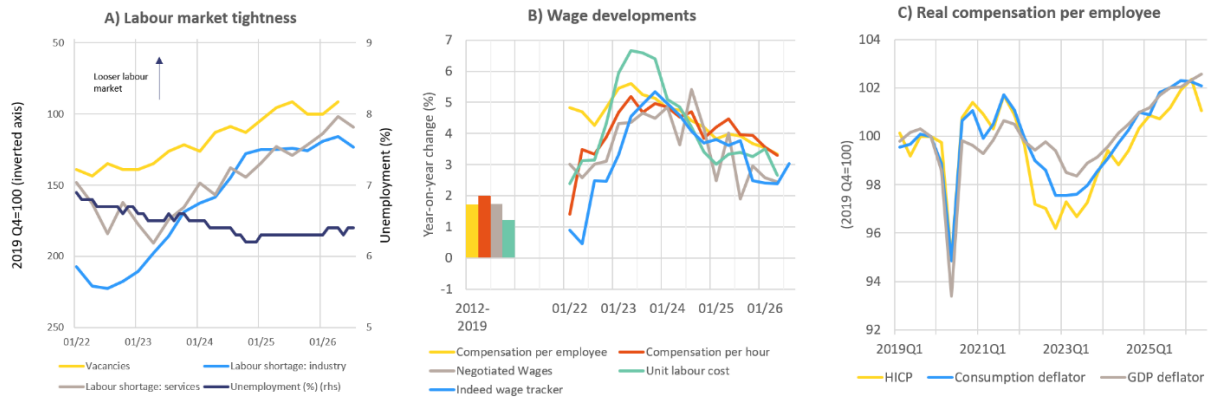


Note: FLP stands for factors limiting production. The charts on bottlenecks display the z-scores.
Source: Eurostat, ECB, European Commission (BCS) and own calculations

3.3 Labour markets and wages

Euro area labour markets remain resilient. At 6.4%, the euro area unemployment rate is marginally above its historical lows (Figure 14, Panel A), but well below pre-pandemic levels (7.5% at the end of 2019). The recent evolution of other indicators of labour market tightness has been mixed. The declining trend in job vacancies (across sectors) observed in recent years continued until Q2 2026 (last observations), signalling a softening of labour markets. In slight contrast, the share of managers in industry and services who reported labour shortages as a factor limiting production in Q3 2026 has picked up slightly. However, worker shortages reported by firms have been declining for more than three years.

Figure 14 Labour markets and wages



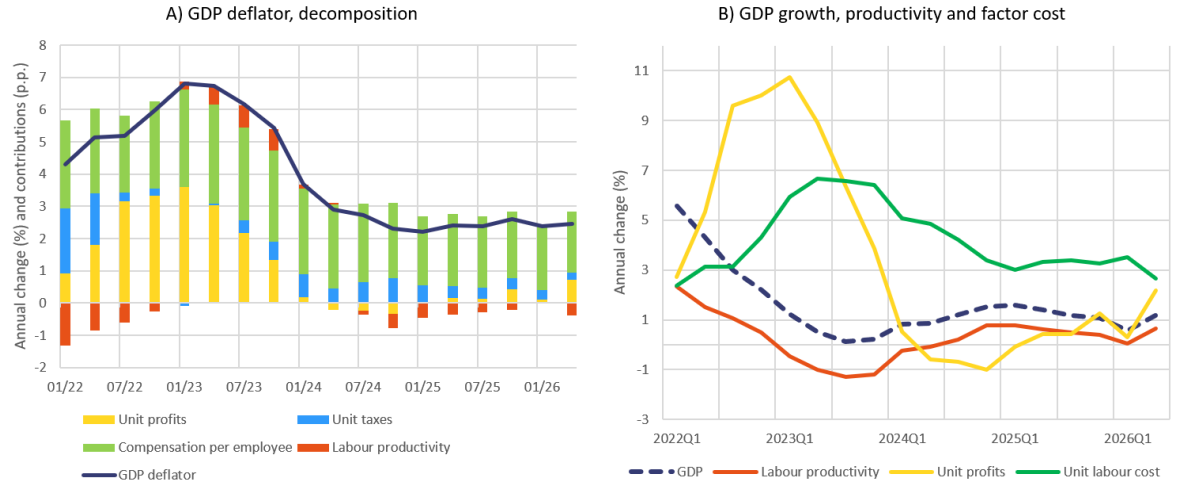
Notes: Panel A: Note: vacancies and the share of firms reporting labour shortages are indexed such that Q4 2019=100. The first Y-axis is inverted. Panel C: Nominal compensation per employee using different price deflators.
Sources: Eurostat, ECB, Adrjan and Lyndon (2022) and own calculations

Wage pressures still exceed pre-pandemic averages but have continued to ease gradually. Nominal wage growth is still elevated compared to the pre-pandemic years but is progressively declining (Figure 14, Panel B). Annual growth in compensation per employee stood at 3.3% in Q2 2026, after averaging 3.8% in 2025. The path for compensation per hour is similar. Likewise, negotiated wage growth fell for a third quarter in a row to 2.5% in Q2. A different signal is provided by online job postings on the website 'Indeed.com',[26] which suggest a rebound in wage growth from 2.4% in Q2 to 3% in Q3.[27]

While nominal wage growth is expected to slow, second round effects from the energy price shock cannot be ruled out. Given the sizeable share of wages in firms' cost, the reaction of wages to the energy price shock is critical for the general inflation process. The absence of a discernible wage reaction so far is not surprising, because of the slow-moving nature of wage growth, lag in the data, and the fact that indirect effects of the shock have been muted. However, the pickup in inflation has implied a fall in real wages (Figure 14, Panel C), which could in turn strengthen attempts to maintain purchasing power through higher wage demands. That said, with wages growth still exceeding pre-pandemic rates and labour markets showing signs of cooling, nominal wage pressures are expected to abate further.[28]

[26] Pawel Adrjan and Reamonn Lydon, 2022, Wage Growth in Europe: Evidence From Job Ads, Central Bank of Ireland Economic Letter No. 7
[27] Two caveats regarding this wage growth tracker are worth noting: as these wage estimates focus on new hires/job switchers, they include a premium to induce job- switching, while incumbents' wages tend to be sticky due to contractual arrangements. Moreover, aggregate figures could thus be driven by individual sectors (no sectoral breakdown is available for European countries).
[28] The ECB wage tracker (updated with wage agreements signed up to end-May 2026) projects stable negotiated wage growth at around 2.6% by end-2026.

Figure 15 GDP deflator and growth, 2022Q1-2026Q2



Notes: Unit labour cost and unit profits are adjusted for self-employment. Compensation per employee and (inverse) labour productivity per employee add up to unit labour cost.
Sources: Eurostat and own calculations

Domestic price pressures continue to mainly stem from compensation of employees but have broadened to unit profits.[29] In the first two quarters of 2026, the GDP deflator growth hovered around 2.4%, at similar rates than in 2025 (Figure 15). However, the drivers of the deflator have changed somewhat in Q2: while compensation per employee remains the main driver, the contribution of 'unit profits' (gross operating surplus per unit of GDP) has picked up, while labour productivity has moderately contributed to the easing of domestic price pressures. The unit profit dynamic resembles the one observed after the 2021/22 energy shock. It should be noted that the growth in unit profits, which remains well below the rates seen in 2022 and 2023 does not necessarily imply a higher growth of economy-wide mark-ups.[30] Indeed, price movements likely reflect cost increases, and possibly the protection of profit margins, rather than an increase of the latter. Another explanation for the relatively fast growth in unit profits may also be found in the higher flexibility of prices relative to wages. While wages are generally set contractually or renegotiated at fixed intervals, they adjust more slowly to shocks than prices.

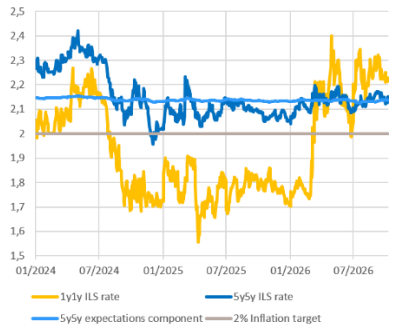
4 Inflation expectations

Financial markets expect inflation to remain above the inflation target in the near-term, while long-term expectations remain anchored. Markets' reassessment of the near-term inflation outlook after the start of the Iran war remains consistent with the expectation of a temporary disruption (Figure 16), in line with commodity futures markets. With the prolongation of the conflict, however, the near-end of the term structure of market-based inflation expectations has shifted up (Figure 17). The 1-year inflation-linked swap (ILS) surged from about 1.7% in February to 2.9% in March, then fluctuating in

[29] Prices of domestically produced goods and services are measured by the GDP deflator. The GDP deflator can be broken down into the contributions of labour costs, gross operating surplus (often referred to as profits or capital cost, see next section) and net taxes, thus showing how each domestic factor is related to domestic price pressures.
[30] Colonna, F., Torrini, R., and Viviano, E., 2023, The profit share and firm markup: how to interpret them?, Bank of Italy Occasional Paper, (770).

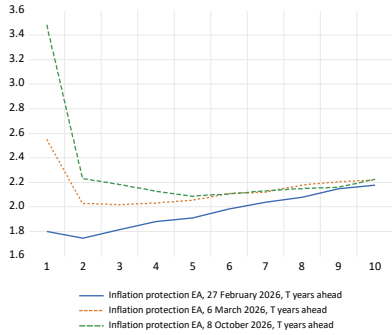
step with energy prices, before climbing to 3.5% by early October. Further out, the 1y1y ILS rate[31] rose from 1.7%-1.8% before the war to about 2.2%-2.3% thereafter. While markets expect inflation to exceed the ECB target at a horizon of two to five years, they also anticipate further monetary policy tightening. The 5y5y ILS rate has hovered about 2.1% over the review period and has been little affected by the war. Correcting the 5y5y ILS rate for inflation risk premia, confirms that longer-term inflation expectations have so far remained well anchored.[32] While the Q3 2026 vintage of the ECB Survey of Professional Forecasters (conducted in early July) foresees a swift return to target inflation (Figure 18), it predates the resurgence in energy commodity prices over the summer, also reminding that the energy price volatility implies a rapid obsolescence of forecasts.

Figure 16: Market-based inflation compensation, January 2024 – October 2026



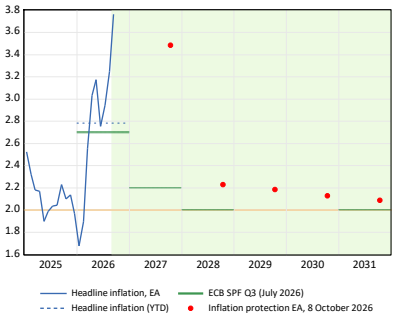
Note: The 5y5y expectations component is obtained from a model-based decomposition of inflation linked swaps. Last observation: 8 October 2026
Source: Bloomberg, Monteiro (2025), own calculations.

Figure 17: Term structure of market-based inflation compensation (selected dates)



Source: Bloomberg and own calculations.

Figure 18: Inflation outlook by financial markets and professional forecasters



Source: ECB Survey of Professional Forecasters, Bloomberg and own calculations.

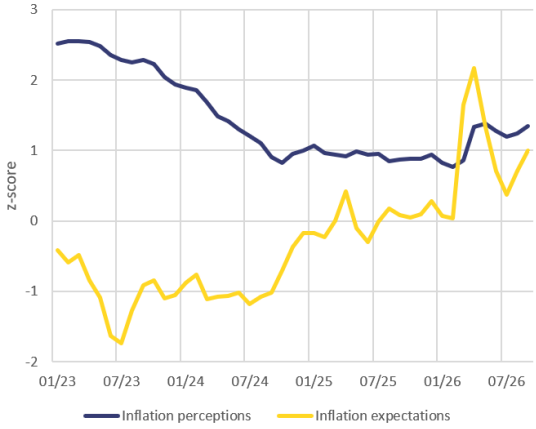
While households perceive inflation to be higher since the start of the war, the initial sharp rise in inflation expectation has partly reverted. However, the Iran war broke out at a time when households' inflation beliefs were still under the influence of the post-pandemic inflation surge.[33] This may partly explain the strong reflexive rise in inflation expectations recorded in the European Commission's consumer survey (Figure 19), which has not been persistent, however, with expectations almost falling back to pre-war levels by the summer. Expectations again increased in August and September, following the renewed rise in energy commodity prices, albeit less dramatically than in March. Longer-term consumer inflation expectations, collected by the ECB, have fluctuated less and remained close to the ECB target.

Elevated inflation remains a risk to the anchoring of inflation expectations. A prolonged period of above target inflation constitutes a fertile ground for the de-anchoring of inflation expectations. Indeed, there is evidence that inflation attention picks up in a non-linear manner once inflation breaches

[31] The 1y1y inflation expectation stands for one-year inflation in one year's time and is calculated from inflation linked swaps. Note that market-based inflation expectations capture both 'true' inflation expectations, as well various risk premia.
[32] The decomposition is based on Monteiro, D. P., 2025, "A PRISM decomposition of euro area interest rates", Quarterly Report on the Euro Area. Volume 24, No 1.
[33] C. Buelens (2026), Gone, But Not Forgotten: Inflation Perceptions And Attention After The Post-Pandemic Inflation Surge, Quarterly Report on the Euro Area (QREA), vol. 25(2).

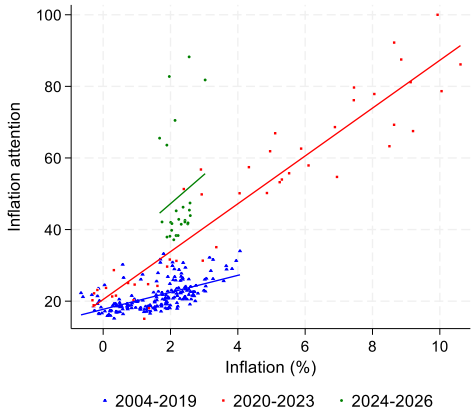
threshold in the 2%-4% range,[34] [35] which in turn spills over to inflation perceptions. Following the post-pandemic inflation, both inflation attention and inflation perceptions have persisted at remarkably high levels, well above levels justified—based on pre-pandemic relationships—by actual inflation. This suggests a shift to a high inflation attention equilibrium (Figure 20). Recent evidence further shows that elevated inflation perceptions increase the likelihood that households form their inflation expectations in a more adaptive manner and place greater weight on perceived recent price developments.[36] The risk of inflation expectations de-anchoring is exacerbated by higher prices of salient ("everyday") products, such as fuel and diesel (Figure 12), which in some euro area countries are at historic highs. The likely acceleration in price growth for food items, which have an outsized influence on inflation perceptions and expectations, would intensify this risk.

Figure 19: Household inflation perceptions and expectations



Note: Inflation perceptions and expectations correspond to the standardised balance statistic (i.e. the z-score. Zero is the long-term average and the units are expressed in standard deviations).
Source: European Commission (BCS) and own calculations.

Figure 20: Structural shifts in inflation attention (internet searches)



Note: Inflation attention is measured by the logarithm of the frequency of internet searches that include the term "inflation". Last observation: April 2026.
Source: Google Trends, Eurostat, DG ECFIN Business and Consumer Survey, own calculations.

5 Inflation outlook and conclusions

The global energy shock remains the dominating force behind current inflation dynamics. Its initial impulse has been swift, as expected, with higher energy (fuel) price growth mechanically adding to headline inflation since March 2026. Indirect effects appear to have been muted so far, and underlying inflation has broadly remained stable, even if some price pressures are building up at higher echelons of the supply chain, which may eventually be passed down to consumers and broaden inflation.

[34] Oleg Korenok, David Munro, Jiayi Chen; Inflation and Attention Thresholds. The Review of Economics and Statistics 2026; doi: https://doi.org/10.1162/rest_a_01402
[35] C. Buelens, 2025, Googling 'inflation': Household inflation attention across the euro area, European Journal of Political Economy, Volume 89; C. Buelens and S. Lindén, 2025, Self-Reported and Revealed Inflation Inattention, DG ECFIN Discussion Paper 225
[36] Bussière, M., et al., 2026, "The Role of Inflation Perceptions in Consumer Inflation Expectations: Evidence from the Euro Area," Finance and Economics Discussion Series 2026-038. Washington: Board of Governors of the Federal Reserve System; De Fiore et al., 2025, Household perceptions and expectations in the wake of the inflation surge: survey evidence, BIS Bulletin 104.

An ongoing question is whether the apparently mild indirect effects reflect a weak or a delayed pass-through of the energy price shock. A weaker pass-through – or the offsetting effects of coincident disinflationary forces – would suggest that the higher energy costs have been partly absorbed by firms and would hence attenuate near-term price pressures. Food prices are a case in point, having grown unexpectedly weakly despite higher energy and fertiliser prices. However, the energy shock – and the conflict causing it – is still ongoing, and any intensification or prolongation would ultimately break firms' capacity to absorb it and contain indirect inflation effects.

Indications of second round effects are weak until now. The transformation of a relative-price shock into a broad inflation process requires behavioural changes in wage-bargaining and price-setting. There are currently no compelling indications in wage data that this would be the case, although it is acknowledged that it may be too early for such changes to be reflected in the data. Second round effects hinge on both intent and ability of economic agents to raise prices and wages, with the former depending on inflation expectations and the latter on the state of the economy. The current energy price shock comes at a time at which households are still scarred by the post-pandemic inflation surge, which translates into high inflation perceptions and attention. While these conditions could trigger higher wage demands, it is noteworthy that the reflexive rise in household inflation expectations after the start of the war was mostly short-lived and that medium-term expectations of households and market participants generally appear well-anchored. Regardless of inflation expectations, the current economic environment seems less propitious for second round effects than the post-pandemic recovery phase, characterised by tight labour market and policy stimulus, during which the 2022 energy shock occurred. This is also supported by survey information of firms' selling price expectations, which only saw a relatively brief spike. However, the longer high energy prices persist, the more likely it is that firms and workers adjust their inflation expectations, wage demands and pricing behaviours.

Despite its dominance, the ongoing energy shock comes alongside other global disruptions and risks from geopolitics, climate change, international trade policies and tighter financial conditions, which will shape the euro area inflation profile. Geopolitical tensions remain high amid major unresolved military conflicts, while adverse weather events amplified by climate change affect food production and economic activity across the globe. Inflation is likely to remain volatile as these different shocks play out or risks materialise. Indeed, risks are two-sided: upward inflation pressures could result from higher costs (e.g. commodity prices), while downside pressures would result from negative demand effects, induced for instance by weaker sentiment and tighter financing conditions leading to cautious consumption and investment behaviour.

Special Feature: Modelling the transmission of energy shock to euro area inflation

This annex presents the results of a modelling exercise illustrating the impact of energy supply shocks in the euro area. The energy shocks are exogenously determined and are separated between oil price shocks[37] and gas price shocks[38], respectively.[39] Employing shocks identified outside of the model, the analysis avoids identification issues.

The analysis uses a standard VAR model including a set of monthly macro and financial market variables. The exogenously identified structural energy shocks are added directly to the VAR specification (with the oil shock entering first and the gas shock second[40]). After the two energy shocks, the other nine variables are used in the following order: 1) real crude oil (Brent) and natural gas prices[41] (in euro, deflated by the HICP); 2) industrial production in manufacturing (IP); 3) HICP energy; 4) headline HICP; 5) core HICP (i.e. HICP excluding energy, food, alcohol and tobacco); 5) the following financial variables: the 1-month euro area money market rate, the 10-year government bond rate (i.e. the 10-year ESTR OIS rate) and stock prices (Euro STOXX50).[42] The VAR is estimated over the period 2002:01 to 2025:12.

The baseline estimates

This section presents the results from the baseline model. Oil and gas price shocks are normalised to produce a 10% (real) price increase on impact. Figure A.1 displays the impulse response functions (IRFs) to an oil price shock (Panel a) and gas supply shock (Panel b) respectively. IRFs are plotted with 90% bootstrap confidence intervals.

To facilitate comparisons with the literature, Tables A.1 and A.2 present the average effects of an oil and gas supply shock, respectively, for the first and second year after the shock.

The shock is stagflationary and the main effect on prices is concentrated in the first year: a 10% price increase in the oil price on impact leads to an increase in HICP relative to the baseline of about 0.2 pps over the first year and no change in the second year. Oil shocks also raise natural gas prices, but their pass-through is less than full and comes with some delay. Energy HICP rises by 1.3 pps in the first year. Core inflation is less affected, rising marginally only by 0.03 pps in both years, indicating that indirect effects typically remain limited in the case of oil shocks. There is a significant decline in industrial production, of -0.1 pps in the first year and -0.64 pps in the second – these changes suggest that GDP will fall by about -0.05 pps and -0.16 pps respectively.

[37] Diego R. Känzig, 2021. "The Macroeconomic Effects of Oil Supply News: Evidence from OPEC Announcements," American Economic Review, American Economic Association, vol. 111(4), pages 1092-1125, April.

[38] Alessandri, Piergiorgio & Gazzani, Andrea, 2025. "Natural gas and the macroeconomy: Not all energy shocks are alike," Journal of Monetary Economics, Elsevier, vol. 151(C).

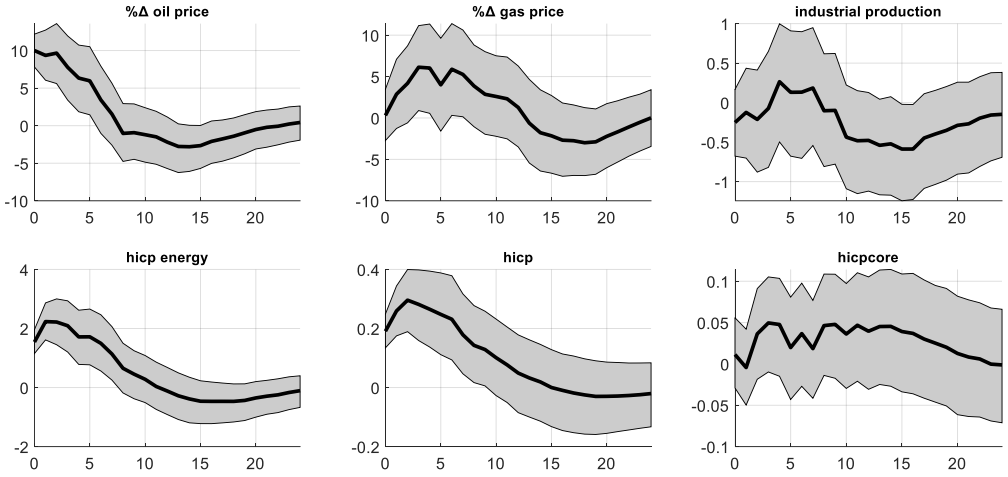
[39] The oil supply shocks are based on OPEC announcements, while the gas supply shocks are based on the responses of TTF prices to news. For estimation purposes, both shocks are updated until the end of 2025. In both papers, the authors use these news shocks as external instruments to identify structural oil and gas shocks in VARs. In essence, they regress the residuals of all other equations of their VARs on the residuals of the oil/gas price equation using the news shocks as instruments. The estimated coefficients are placed in the column of their B matrix of the structural VAR that corresponds to the oil/gas price structural shocks, and they estimate the rest of the structural model using standard SVAR techniques. We employ the resulting structural shocks in our model.

[40] The gas supply shock included in the system is the residual from a regression of the exogenously determined gas shock on the current value and two lags of the oil shock, to ensure that the gas and oil shocks included in the SVAR model are orthogonal.

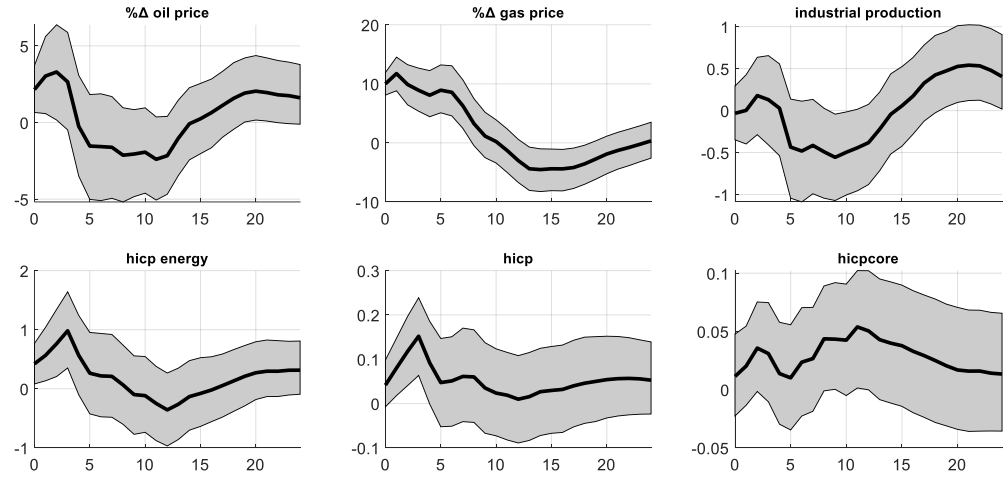
[41] World Bank ('pink sheet' data). The series is converted to €/MWh, which is the standard price of TTF contracts.

[42] Apart from the shocks, most variables are expressed at 100 times the annual log differences (i.e. y-o-y growth rates). The only exceptions are the two interest rates, which are in levels.

Figure A.1: IRFs to oil and gas supply shocks - full sample 2002M1-2025m12 (90% - CI)



(a) Oil shock



(b) Gas shock

A gas shock is also of stagflationary nature, but its overall effects are more muted compared to an oil price shock. Explanations for this include the fact the energy mix is dominated by oil and that the effect of natural gas prices changes affects consumers in a less direct way, e.g. via electricity production. Gas price shocks also raise oil prices, but more moderately compared to the reverse case. The response of industrial production (IP) is negative (-0.25 pps) and limited to first year. Headline and core inflation rise marginally in both years.

TABLE A.1: *OIL SHOCKS - EFFECTS OF 10% INCREASE IN OIL PRICE ON IMPACT*

	OIL PRICE	GAS PRICE	IP	HICP ENERGY	HICP	HICP CORE
YEAR1	**4.12**	3.86	-0.09	**1.30**	**0.20**	0.03
YEAR2	-1.44	-1.67	-0.40	-0.35	-0.01	0.03

The effects are calculated as the average (scaled) IRF for the first 12 periods (YEAR1) and then the remaining 12 periods (YEAR2). Significant responses are marked with ***bold****.*

TABLE A.2: *GAS SHOCKS - EFFECTS OF 10% INCREASE IN GAS PRICE ON IMPACT*

	OIL PRICE	GAS PRICE	IP	HICP ENERGY	HICP	HICP CORE
YEAR1	-0.20	**6.31**	-0.25	0.30	0.06	0.03
YEAR2	0.82	-2.94	0.24	0.06	0.04	0.03

The effects are calculated as the average (scaled) IRF for the first 12 periods (YEAR1) and then the remaining 12 periods (YEAR2). Significant responses are marked with ***bold****.*

Overall, energy shocks thus appear to have a strong impact on inflation and more limited effects on growth. Oil shocks affect energy inflation more strongly on impact and reduce growth more, but with delay, while gas shocks hit in the first year. Importantly, oil shocks have a higher impact on headline inflation, while gas shocks have a much more moderate effect.

Moreover, the model results suggest that indirect and second round effects are typically small, as shown by a muted response of core HICP to both types of shocks. These estimates are broadly in line with the literature.

To check how well the model explains recent inflation and industrial production dynamics in response to a single standard oil shock, which also affects natural gas prices, Table A.3 compares the inflation outturns since February to the model predictions.[43] The shock is calibrated so as to broadly match the oil price increase observed between the beginning of the Middle-East war and the easing in oil prices observed during the second half of May (i.e. a 40% increase). The following observations can be made:

- The model-simulated effect of a 40% oil price shock on headline HICP is close to the actual path observed until July, although the model suggests a comparatively lower contribution of energy inflation and a slightly higher one of core. However, the simulation fails to capture the rebound in energy inflation in July-September, after the re-escalation of the conflict. Indeed, the cumulated effects of superposing one additional oil shock as of July (T=4) would imply a profile closer to the observed inflation pattern.
- The model forecasts a limited impact on core HICP, implying small indirect and second-order effects. The core inflation path has been so far consistent with this result. It remains to be seen whether and when higher energy costs will diffuse to other inflation components.

[43] The focus is on oil shocks as this appear to be the driving force of the current crisis. On the contrary, the 2021-2022 energy shock was predominantly driven by shocks to gas prices.

- The model implies that the usual oil shocks fade rather fast. Such a view was the prevailing one during the initial phase of the crisis and is consistent with the history of oil shocks on which the model is estimated, which are based on markets' reactions to OPEC's announcements. However, recent events suggest that the energy shock (or sequence of shocks) is likely to be more persistent than has been the case in the past. This would also explain the lower inflation impact predicted by the model.
- Furthermore, both in March and in the summer period, gas prices rose by much more than what would be implied by their response to a standard oil shock. This highlights the facts that the closure of the Strait of Hormuz also has a direct impact on gas transport and gas prices. Adding a gas shock on top of shocks to oil supply would therefore help to bridge the differences between model forecasts and observed inflation dynamics.

Beyond its persistence, the shock from the war in Iran is also somewhat different in nature when compared to standard energy shocks. The main reason is that some of the energy production capacity has been destroyed. In addition, the refining industry has also been hit in both the Middle East and Russia, which has resulted in a different transmission of oil prices to refined fuel prices and thus inflation this time. This may help to explain the divergence of the actual energy inflation from the model forecast.

TABLE A.3

	HICP	***HICP core***	***HICP Energy***
26-FEB	1.9	2.4	-3.1
26-MAR	2.6	2.3	5.1
26-APR	3	2.2	10.8
26-MAY	3.2	2.6	10.8
26-JUN	2.8	2.4	8.5
26-JUL	2.9	2.5	10.3
26-AUG	3.2	2.4	14.3
26-SEP	3.8	2.5	18.8
CHANGE RELATIVE TO FEBRUARY			
26-MAR	0.7	-0.1	8.2
26-APR	1.1	-0.2	13.9
26-MAY	1.3	0.2	13.9
26-JUN	0.9	0.0	11.6
26-JUL	1.0	0.1	13.4
26-AUG	1.3	0.0	17.4
26-SEP	1.9	0.1	21.9
VAR BASED SIMULATIONS OF A 40% OIL SHOCK			
T=0	0.8	0.0	6.2
T=1	1.0	0.0	8.9
T=2	1.2	0.1	8.9
T=3	1.1	0.2	8.4
T=4	1.1	0.2	6.9
T=5	1.0	0.1	6.9
T=6	0.9	0.1	6.0