# Gabriel Makhlouf: Inflation, growth, and monetary policy in a fractured world

Speech by Mr Gabriel Makhlouf, Governor of the Central Bank of Ireland, at MNI Connect, Dublin, 1 April 2026.

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Good morning.

Ongoing events in the Middle East are a stark reminder of the challenges policy makers face in a world increasingly characterised by geoeconomic fragmentation.

For central banks tasked with preserving price stability, supply shocks pose both analytical and strategic challenges: understanding their persistence, their impacts on supply chains, and their effects on inflation and growth; and determining how to respond when supply and demand move in opposite directions. My speech today explains how I am thinking about both challenges.

The ECB Governing Council held rates unchanged at 2 per cent in March. I want to explain not just what was decided, but how I am thinking about the challenges, including where genuine uncertainty calls for caution and how we communicate this through scenarios.

My remarks are organised around three themes: the impact of the shock on the economy; calibrating the monetary policy response; and the key indicators that I will be monitoring.

## Impact of the shock

A significant disruption at one of the world's key energy supply chokepoints pushes prices up and output down, playing out over different time horizons.

The initial supply shock shows up in higher energy commodity prices, passing quickly into consumer and business energy costs. This is the direct effect. Indirect effects follow as businesses pass on higher input costs, contributing to cost-push inflation and broader supply chain disruption, which the 2021-23 period taught us can be difficult to identify in real time. Second-round effects occur when nominal wages adjust to the new, higher price level.  In the euro area, where collective bargaining is widespread, wage formation can be slow, lagging the initial shock by several quarters. Countries that index wages to inflation – such as Belgium – or where annual wage agreements are the norm – such as France – see quicker adjustment.

The conflict also impacts demand through real incomes, investment, confidence, financial conditions, and global trade. Typically, this moves slower than the initial energy price shock, creating a growth headwind that could, over time, pull inflation down.

There is wide uncertainty about the conflict's duration, which significantly affects the shock's scale and persistence.

Initially, futures pricing suggested a short, sharp shock, with energy prices reverting to pre-war levels through late 2026 and 2027, closer to the baseline scenario in the ECB staff March projections (cutoff: 11 March).[1] However, as the conflict persists without clear resolution, a more prolonged period of higher prices becomes likely. This approaches the adverse scenario in the staff projections. The projections also include a severe scenario with bigger, more prolonged energy price increases.

The baseline scenario has oil and gas peaking around $90/barrel and €50/MWh in Q2 2026, then declining gradually. Under the adverse scenario, oil and gas peak at $119 /barrel and €87/MWh in Q2, converging to baseline by Q3 2027. In the severe scenario, oil peaks at $145/barrel and gas at €106/MWh in Q2 2026, declining much more slowly and remaining significantly above both other scenarios.

Chart 1 places these scenarios in historical context. Currently, energy prices sit between baseline and adverse scenarios. However, genuine uncertainty remains. Both oil and gas volatility is well above long-run averages (Chart 2), though below historic highs. Risks are on the upside for inflation and on the downside for growth, especially through 2026.

Chart 3 illustrates how these scenarios feed through to inflation and growth. For inflation, the baseline shows 2.6 per cent in 2026 before returning to around 2 per cent in 2027/28. The adverse and severe scenarios see much stronger headline inflation at 3.5-4.4 per cent in 2026. In the severe scenario, reflecting the more enduring shock, inflation remains well above target through 2027 (4.8 per cent) and 2028 (2.8 per cent). Core inflation shows less pass-through initially as it excludes energy and food prices, but indirect and second-round effects (mainly through wages) emerge significantly in 2027 and 2028.

GDP growth reacts quickly to higher energy prices, falling sharply in 2026. Compared to December projections expecting growth around 1.2 per cent in 2026 – near the euro area's growth potential – in the severe scenario, this falls by two-thirds to just 0.4 per cent. Weaker growth lingers through 2027 before recovering somewhat in 2028.

The baseline projections include the market-implied path for policy rates as at the cutoff date of around two 25 basis point increases during 2026. However, the adverse and severe scenarios make no further assumptions about the policy rate path. The Governing Council is determined to ensure inflation stabilises at our 2 per cent target in the medium term but we are not on a pre-determined path and have adopted, as I hope you all know, a meeting-by-meeting approach.

## Monetary policy and supply shocks

Let's turn to the monetary policy response.

The analysis of the 2021-23 inflation episode, carried out as part of the 2025 strategy assessment, contains important lessons.[2] The initial supply shock – pandemic-era

bottlenecks, energy prices – led to more persistent inflation through indirect effects working through supply chains and lagged wage adjustment. With hindsight, policy models suggest interest rates could have risen slightly earlier – around one or two quarters – and more forcefully.[3]

So far, most attention has been on the direct effects of higher energy prices. This is expected, but we must also monitor downstream effects, particularly on energy-intensive goods production. Much of this passes through the Straits of Hormuz chokepoint, including chemicals, metals, fertilisers, and helium (crucial for semiconductor chips).

Our 2025 strategy statement builds on the learnings from the previous episode, including new data sources to understand how shocks pass through direct and indirect channels and second-round effects. The expansion of the wage tracker toolkit is one example.

The explicit incorporation of scenario analysis into the projection framework to better convey uncertainties is another. One question I've been asked recently is how exactly scenarios are used for calibrating euro area monetary policy.

First, a scenario differs fundamentally from a forecast. A forecast is our best estimate given available information. Scenarios are internally consistent illustrations of what could happen if energy prices evolve differently from the baseline. This distinction matters. When we have low confidence about a shock's scale and persistence, including whether inflation dynamics have shifted structurally, a single point forecast gives a false impression of precision.  Scenarios reflect our assessment of current uncertainty.

How should scenarios be read? For me, it's not about choosing a preferred scenario but ensuring robustness, that our monetary policy approach performs well across potential outcomes. Scenarios also signal our intention to calibrate responses as the shock develops, showing the Governing Council has thought carefully about each calibration. This aligns with President Lagarde's 'three cases' approach: if the shock is limited and short-lived, look through to avoid doing more harm than good; if it causes a large but not overly persistent target overshoot, take a measured approach; and if inflation is expected to deviate significantly and persistently from target, respond more forcefully.[4] However, data is noisy and signals can conflict, so I caution against an overly mechanistic reading. This is why our March monetary policy statement emphasised "a data-dependent and meeting-by-meeting approach."[5]

## The data I am monitoring

Before discussing specific data, it's important to note that the macroeconomic backdrop at the start of 2026 differs somewhat from early 2022. This matters when thinking about the shock's potential impact. Even before the invasion of Ukraine, inflation was 5 per cent by December 2021, reflecting supply bottlenecks, pent-up demand, and higher gas prices. Monetary policy was accommodative, with a deposit rate of minus 0.5 per cent, below even the low end of the neutral rate range. Time-based forward guidance on asset purchases, coupled with sequencing commitments on rates, limited our agility in

responding to inflationary shocks. Indeed, this was another change in the 2025 ECB Monetary Policy Strategy Assessment, to avoid commitments that limit agility when states of the world change.[6]

Contrast this with now. In February 2026, inflation was around our 2 per cent target and has been for much of the past year; the policy rate was within the neutral rate range – neither accommodative nor restrictive – and longer-term inflation expectations are well-anchored. Another important difference for second-round effects is that the labour market is in a different place than in early 2022. Back then, strong post-pandemic labour demand pushed job openings to record highs. The labour market has cooled markedly since, with job openings returning to close to pre-pandemic levels for many countries (Chart 4).

If the central policy challenge is preventing the temporary from becoming persistent, the natural next question is: how will we know if that's happening?

Let me highlight information I'll be monitoring, grouped by direct, indirect, and second-round effects.

## Direct effects

We need to monitor energy commodity prices closely. The war has disrupted the physical supply chain for energy significantly, including considerable infrastructure damage. When delivery is more uncertain and shipping and insurance costs rise, this adds upward pressure on prices. Oil freight rates have spiked sharply since the war started and remain exceptionally high with little sign of easing (Chart 5).

Gas storage levels in Europe are another important factor for supply-demand balance. Current storage levels at 28 per cent (24 March) are the lowest for this point in the year since 2022 (Chart 6). Reaching typical EU targets of 90 per cent storage by November could support higher gas prices through spring and summer, further amplifying geopolitical price pressures.

Downstream effects in retail energy prices are already showing up in home heating and transport fuel prices. The Eurostat flash estimate for March headline inflation released yesterday was 2.5 per cent. Unsurprisingly, a large part of the March inflation increase was energy prices, which increased sharply. Core inflation – that is, excluding energy and food – came in at 2.3 per cent, marginally lower than the February reading of 2.4 per cent. Services and goods annual inflation, at 3.2 per cent and 0.5 per cent respectively, are in-line with the path set out in the December projections. It is too early to expect to see indirect and second round effects in these items. Beyond headline and main category inflation rates, measures of dispersion and breadth of price changes in the HICP basket, such as the percentage of items with inflation rates above a certain threshold, will be watched closely as these can be a leading indicator of broadening price pressures.

## Indirect effects

For indirect effects, producer price data indicates pipeline price pressures, but official series like the Producer Price Index (PPI) tend to lag. For some industries, timely data

on prices at different production stages – raw materials, intermediate goods, and final outputs – can provide early indications of future producer price dynamics.

Food production is one example, accounting for almost one-fifth of the average household's spending. We know from 2022-23 that fertiliser prices feed into agricultural input costs with a short lag, usually three to six months, and show up in food commodity prices soon after. Fertiliser prices rose sharply when Russia attacked Ukraine, taking over 18 months to return to pre-war levels. With high concentration of urea fertiliser production in Gulf states, including Iran itself, prices have increased sharply since the conflict started (Chart 7).

I already mentioned the cost of transporting oil as a direct effect I'm monitoring. But increases in fuel and transportation costs contribute to higher marginal costs for goods and services, another source of indirect price pressures. ECB research suggests supply shocks hit goods prices faster but are more persistent for services prices.[7] Diesel and jet fuel prices have risen sharply since the war in Iran started. In both cases, the current spike is not far off previous highs seen at the start of Russia's invasion (Chart 8).

## Second-round effects

For wage dynamics, I pay close attention to both the ECB's Negotiated Wage Tracker and the Indeed Wage Tracker, developed jointly with colleagues here at the Central Bank of Ireland. The latter has higher frequency, broad coverage across sectors with and without collective bargaining agreements, and tends to lead official data on wage growth. I'm watching not just the level of wage growth but its acceleration relative to trend, particularly in domestic, non-tradeable sectors where energy cost pass-through is happening simultaneously. At this stage, it is too early to expect shifts in wage dynamics, as Chart 9 shows, but I will monitor developments closely to compare with expected wage growth in the March projections (Chart 10).[8]

For expectation formation, standard data sources – consumer surveys, market-based inflation break-evens, the Survey of Professional Forecasters, and the Survey of Market Analysts – will be important. But with one caveat: at times of high uncertainty, these sources can tend to confirm what has already happened rather than anticipate what is emerging. This means we need to watch higher-frequency price data more closely than usual.

## Conclusion

Let me close by returning to the decision we took a couple of weeks ago and what it tells us about how policy makers are approaching this moment.

We held rates at 2 per cent because the outlook is genuinely uncertain. But we are learning to live with uncertainty and to not be paralysed by it. We have a framework for monitoring how the outlook evolves and a credible commitment to act when data clarifies the direction of travel. And as I said, we are not pre-committing to a path and not ruling options in or out.

The use of scenarios during exceptionally uncertain times is about ensuring we're ready to respond in a timely manner as the situation develops. The path ahead is uncertain, but the commitment to price stability is not.

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[1] ECB, (2026)Opens in new window "ECB staff macroeconomic projections for the euro area, March 2026". The baseline projections condition on the path of futures prices for energy commodities at the time of the cut-off date of 11 March 2026.

[2] See ECB (2025)Opens in new window for the Monetary Policy Strategy Review material. Occasional paper 371 "A strategic view on the economic and inflation environment in the euro areaOpens in new window" provides an overview of historic inflation dynamics.

[3] See, for example, Lane (2025)Opens in new window, "The 2021-2022 inflation surges and the monetary policy response through the lens of macroeconomic models", speech at the SUERF Marjolin Lecture hosted by the Banca d'Italia.

[4] See Lagarde (2026)Opens in new window "Navigating energy shocks: risks and policy responses", *Speech at 2026 ECB Watchers*.

[5] ECB (2026)Opens in new window "Monetary Policy Decisions: 19 March 2026".

[6] This particular issue is addressed in more detail in the background noteOpens in new window that accompanied the publication of the 2025 Strategy Statement, "An overview of the ECB's monetary policy strategy – 2025".

[7] See Martinez-Hernandez et al. (2025)Opens in new window.

[8] Chartpack for speech (PDF 1.31MB)