

## **Gabriel Makhoul: Monetary policy and the economic outlook**

Speech by Mr Gabriel Makhoul, Governor of the Central Bank of Ireland, at the European Chamber of Ireland, Dublin, 16 June 2026.

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Good afternoon and thank you for inviting me to speak today.

Last week, the ECB's Governing Council decided to raise interest rates by 0.25%. This is the first change since June 2025 – the first increase since 2023 – and brings the main policy rate, the Deposit Facility Rate, to 2.25%.

Our decision is a response to inflation pressures from higher oil prices and other supply disruptions arising from the war in the Middle East. My colleagues and I on the Governing Council were unanimous in making the decision; all of us are committed to a monetary policy that delivers our 2% inflation target over the medium term.

In the first part of my speech, I set out the context for last week's decision, outlining the economic outlook for the euro area. The experience of inflation in 2022 showed that net energy importers like Europe - and Ireland in particular, where 80% of our energy is imported, compared to an EU average of 60% - are very exposed to energy price shocks. As our latest [Financial Stability Review](#) put it, if the conflict in the Middle East is unresolved, rising inflation and slower growth will be acutely felt by households and businesses.

In the second part of my remarks I focus more closely on Ireland, covering the implications of the energy price shock for the Irish economy and my take on the extremely volatile GDP data we saw recently. On Thursday this week, we will publish our second Quarterly Bulletin of the year which will set our views on the outlook for the Irish economy more fully.

### **The outlook for the euro area economy**

The conflict in the Middle East has delivered a significant supply-side shock to the global economy. Oil prices rose sharply at the onset of the war and remain exceptionally volatile, driven in-part by reporting around how an agreement to end the war might work in practice. The price of energy-intensive products, particularly where production is concentrated in the Gulf region such as fertiliser and helium have also jumped. More generally, rising petrochemical prices, a key factor in the production of many everyday items we consume from food packaging to cosmetics and clothing, are contributing to upward price pressures across the supply chain.

The direct effects of the energy shock have already shown up in consumer prices, while the indirect effects are beginning to emerge. The flash estimate for euro area headline inflation in May was 3.2%, up from 3% in April and 1.9% in February. Energy inflation alone was close to 11% in May.

Global supply chain pressures intensified in March and April, pointing to further upward pressure on goods prices in the months ahead. Other upstream indicators reinforce this picture: surveys show rising input prices and lengthening supplier delivery times and firms are telling us they expect selling prices to increase in the next three months. All of this shows that the initial energy shock is spreading and, notably, these patterns are broad-based, across all sectors, that is, retail, services, industry, and construction.

These are not comfortable numbers, and they are moving in the wrong direction. The question is whether this is a repeat of the 2022 experience that followed Russia's invasion of Ukraine. The two shocks rhyme – in that they are both geopolitical events that push up energy prices – but it is also that case that starting economic backdrop today is quite different, and this could matter for how the initial shock transmits to the broader economy.

In 2022, the energy shock arrived into an economy recovering strongly from the pandemic, with demand momentum and labour markets exceptionally tight. The inflation that followed was a combination of supply disruption and demand pressure. The policy response was a rapid sequence of rate increases calibrated to cool demand as well as anchor expectations.

Today, demand is well below the levels we experienced coming out of the pandemic. And since the start of the war, euro area GDP growth has been revised down. Consumer confidence has fallen and private investment is hesitant in the face of ongoing uncertainty. The latest shock also arrives at a challenging time for European manufacturers, who are impacted by China's transition to a producer and exporter of complex, high-tech goods that directly compete with Europe's core industrial sectors.

This relatively weaker economic matters, because we know from [previous episodes Opens in new window](#) the pass-through of oil shocks to consumer prices tends to be weaker in low-inflation or weaker demand environments. This can happen because, in the face of weaker demand, firms find it harder to pass-on extra costs and workers have weaker bargaining power when it comes to wage demands.

The timing and scale of the impact on core consumer goods and services will also depend on the persistence and scale of the shock itself, which remains highly uncertain, notwithstanding this weekend's news. In addition, how wages and profit margins respond to the initial inflation shock - so-called 'second-round effects' - could contribute to stickier services inflation.

While conscious of the economic backdrop, I am also wary of taking too much comfort from a 'this time is different' narrative, for a few reasons. As I already indicated, the incoming hard and soft data shows clear upward price pressures. Another concern I have is the potential for longer-term energy supply disruption relating to the destruction of infrastructure, on which we have little clarity at this stage.

And of course, a channel I pay close attention to is what is happening to inflation expectations. We track expectations because the prices that businesses and consumers expect in the future can shape price-setting and wage demands today.

[ECB researchOpens in new window](#) shows that after the outbreak of the latest Middle East conflict in February, euro area consumers revised their short-term inflation expectations upward sharply while simultaneously marking down their growth expectations. At the median, consumers' twelve-month ahead expected inflation rose from just over 2.5 to 4 per cent in March and has remained there since. Short-term inflation expectations tend to react quickly to spikes in energy prices, and if the initial shock fades, these expectations can revert. This is why we also pay attention to medium-term expectations, which have been more stable of late, across consumers, firms, and financial markets. For example, data from inflation swaps that allows us to gauge average inflation over the coming five years showed little movement since the onset of the war, currently sitting just above 2.1%.

Despite this, we also need to account for the fact that households are encountering this new shock already carrying the memory of the post-pandemic inflation surge. That accumulated experience has made them more sensitive to price developments: even as inflation had returned close to our 2% target last year, close to 41% of consumers surveyed in the ECB Consumer Expectations Survey said they were still paying close attention to price changes. When the conflict escalated at the end of February, that figure rose again to 50%. The message is clear: consumers have not forgotten, and they are watching closely.

Let me be clear about what raising rates in this environment does and does not mean.

It does not automatically mean we are embarking on a new extended tightening cycle equivalent to 2022 and 2023. The context is different, the starting point is different, and the calibration should be different. Yet we know from the past, as well as from the incoming data, that supply shocks cannot simply be accommodated when they risk being persistent and when expectations are as sensitive as the data suggest they currently are.

It does mean that the path ahead remains genuinely uncertain and, for policy, data-dependent. The latest staff projections have inflation in the baseline averaging 3% in 2026 but peaking in the second half of the year at 3.4%. For 2027 and 2028 it averages 2.3 and 2.0%, respectively. It is worth comparing these with the projections from June 2022, where the communication from the Governing Council at the time was that this was the start of a hiking cycle: inflation was projected to average 6.8% in 2022, 3.5% in 2023, and 2.1% in 2024.

Reflecting uncertainty around energy prices, the June 2026 projections also consider the impact of *milder*, *adverse*, and *severe* energy scenarios on inflation. In these scenarios, inflation ranges from 2.9 to 4.0% in 2026, 1.8 to 5.0% in 2027, and 1.8 to 3.0% in 2028.

Prior to the weekend's announcements, my view was that we were tracking closer to a scenario where oil prices only come down slowly through 2027 and 2028 but remain above pre-war levels. The 'milder' scenario had a faster decline through the second half of 2026, returning to pre-war levels by mid-2027.

While much remains unclear, I welcome news of the proposed memorandum of understanding to end the war, in particular for the people and families in the region directly impacted by the conflict.

But let me be clear: an end to the conflict does not necessarily mean an immediate end to the shock. The balance of risk in staff projections – that is considering the mild-to-severe scenarios I outlined – showed that a rate increase in June was the right approach to bring inflation back to our 2% target over the medium term. It remains to be seen how quickly supply chains normalise and energy prices adjust. The direct price pressures might not fade so quickly if the infrastructure damage from the war means production only recovers with a lag. Then there is the question of shipping through the Strait of Hormuz, on which there remains little clarity.

So, despite the recent and relatively positive news, we really need clarity around energy supply. And until then, I continue to monitor the pass-through of the shock, focusing on the indirect and second-round effects I have described.

## **What might this latest shock mean for Ireland?**

For Ireland, Modified Domestic Demand, our preferred measure of underlying activity, is expected to slow to a more moderate pace compared to more recent years.

Our March projections incorporated the initial effects of the Middle East war on international energy prices. This resulted in inflation being revised significantly higher, prompting knock-on downward revisions to households' real disposable income and consumption.

Working in the opposite direction, the outlook for modified investment has improved on the strength of double digit, broad-based growth in 2025 and a continued robust performance in the first quarter of 2026.

Compared to our projections from March, and up until the recent announcement, we had been moving closer to the oil price assumptions embedded in the 'adverse' scenario set out in those projections. That is, where oil prices remain about \$90/barrel through 2026, and only come down very gradually to around \$70/barrel through 2027 and 2028. In this scenario, inflation was closer to 3.6% on average in 2026 as opposed to the baseline projection of 2.9% (2.3%) from March (December). Growth was also marginally weaker in a more adverse energy scenario, averaging 2.7% in 2026. Later this week, we will publishing our updated projections and fuller assessment of the outlook for the Irish economy.

## **Ireland's Q1 GDP in the spotlight**

Finally, I want to highlight recent developments in the Irish economic data which have been the subject of much discussion among economists and others.

Ireland's Q1 2026 GDP figures showed a striking 12.1 per cent quarterly decline, which was significant enough to drag overall euro area GDP growth into negative territory for the quarter. But as is often the case with Irish data, the headline figure reflects the

outsized role of foreign-owned multinationals in the Irish accounts rather than a genuine deterioration in domestic economic conditions. Foreign multinationals account for around half of measured Irish GDP, and trade equates to 230 per cent of GDP, reflecting Ireland's role as a globalised production and export hub, particularly in pharmaceuticals and ICT.

The Q1 decline had two distinct drivers. First, a base effect: an exceptional surge in exports of polypeptide hormones (a high-value input into diabetes and weight-loss medicines) during Q1 2025 made for a difficult comparison this year, an effect that had already been anticipated. Second, and more of a surprise, was a sharp fall in net trade related to "merchandising" and contract manufacturing (activity undertaken abroad on behalf of Irish-resident companies as part of their global value chains). This is the main driver of the decline.

Importantly, Modified Domestic Demand, the measure that strips out these globalised factors and captures consumer spending, investment, and government spending within Ireland, actually rose by 0.6 per cent over the same quarter. This divergence underlines why modified measures, rather than headline GDP, are the better guide to underlying conditions facing Irish households and businesses, and why this volatility, while dramatic, does not, in my view, signal a material change in the fundamentals relevant to the broader economic outlook.

## **The financial sector**

My speech this evening focuses on economic developments.

But, before I conclude, allow me to say a word about our approach to regulating the financial sector. The volatile and uncertain environment I have just described has direct implications for how we think about regulation and supervision.

Our [Regulatory and Supervisory Outlook \(PDF 1.85MB\)](#) report set out our priorities for the year ahead, shaped by three themes: building resilience to geopolitical risk and macro-financial uncertainty, protecting consumers and investors in a rapidly changing world, and responding to technology-driven transformation across the financial sector. These are, in many respects, the same forces I have been describing throughout this speech, viewed through a different lens.

Alongside this, we continue to deliver on our roadmap for [regulating and supervising well \(PDF 440.55KB\)](#), making our framework more effective, more proportionate, and easier to navigate, without compromising resilience. We will shortly consult on a refreshed framework for how we assess the impact of our regulatory decisions, to ensure that approach is evidence-based and transparent. In a world that is becoming less predictable, firms and consumers need a regulatory environment that is a source of stability, clear, and proportionate and consistent in its approach to managing evolving risks.

## **Conclusion**

Let me close by connecting the threads of what I have covered this evening.

Europe is navigating a serious near-term shock. The energy price surge driven by the Middle East conflict has pushed near-term inflation higher, is softening growth and putting real pressure on households and businesses. This is acutely so in Ireland, given our energy import dependency. Last week's rate rise was necessary to prevent temporary energy-driven inflation from becoming embedded in wage and price expectations, reflecting the ECB's primary mandate to maintain price stability across the eurozone.

This latest shock is a reminder of just how exposed a small open economy such as Ireland is to these sorts of increasingly frequent geoeconomic fragmentation shocks. The volatility I highlight, in energy prices and in our own national accounts, underlines why building economic resilience domestically remains so important, and increasingly urgent.

Earlier this year, in my [letter to the Tánaiste \(PDF 3.24MB\)](#), I set out a number of domestic priorities for exactly this reason: growing the supply-side capacity of our economy (including energy infrastructure), strengthening the indigenous business sector alongside FDI, building fiscal buffers for the investment still needed, and enabling greater household participation in financial markets.

None of those priorities were written with these particular events in mind, but they illustrate precisely why they matter. An economy with deeper buffers, energy independence, and more diversified sources of growth is better placed to absorb shocks, whatever their origin.

I will return to these themes, and to the outlook for the public finances specifically, in my annual pre-budget letter to the Minister. For now, the lesson from recent weeks is a familiar one, but worth repeating: resilience is not something built once and then set aside. It needs to be tended to and reinforced, particularly in a world where the shocks keep coming, and where their origin is increasingly hard to predict.