

Philip R Lane: Introductory remarks

Speech by Philip R. Lane, Member of the Executive Board of the European Central Bank, at an exchange of views on "The economic and fiscal implications in Europe of the Middle East crisis", at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 23 June 2026.

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[Presentation](#) accompanying the speech

It is a pleasure to be here for this timely exchange of views on the economic and fiscal implications for Europe of the situation in the Middle East.

I will focus my remarks today on the implications for euro area economic activity and inflation, and for our monetary policy response.

Implications for euro area economic activity and inflation

The peace agreement in the Middle East is welcome, but the situation remains fragile, with risks of setbacks or re-escalation. The full implications of the war for medium-term inflation and growth will depend on the intensity and duration of the energy price shock, and on the scale of its indirect and second-round effects.

Let me start by reviewing the implications of the energy crisis for economic activity and the outlook from this point on.

The euro area economy unexpectedly contracted in the first quarter of this year, by 0.2 per cent, due to a contraction in measured national activity in Ireland. Excluding Ireland, the euro area economy grew by 0.3 per cent, supported by domestic demand and exports. Public and private consumption contributed positively, while investment and inventories declined.

However, the war in the Middle East is weighing on activity. Thus far, there has been a more pronounced weakening in services activity than in manufacturing; however, the support from precautionary inventory accumulation already seems to be fading, as new orders stagnated in May.

The labour market remains resilient. The unemployment rate is still close to historical lows, standing at 6.3 per cent in April. Recent surveys point to some labour hoarding, meaning that firms are holding on to workers despite weaker business conditions. At the same time, labour demand has cooled further, and firms and households expect the labour market to weaken.

Looking ahead, domestic demand is now projected to be weaker than was expected in March. The war is weighing on confidence and higher energy costs are reducing real incomes. Nonetheless, household balance sheets are solid overall, and consumption should remain the main driver of growth.

Higher energy costs and lower confidence will be a drag on private investment in the short run, although it should be supported by firms investing in new digital technologies. In addition, higher government spending on defence and infrastructure should continue to support public investment. These factors are expected to provide some cushioning against the fallout from the war.

The June Eurosystem staff baseline projections foresee real GDP growth of 0.8 per cent in 2026, 1.2 per cent in 2027 and 1.5 per cent in 2028.

Let me now turn to the implications for inflation.

Headline inflation increased to 3.2 per cent in May, from 3.0 per cent in April. Although energy prices declined compared with the previous month, base effects meant that annual energy inflation remained at 10.8 per cent, unchanged from April. Non-energy inflation increased by 0.2 percentage points, to 2.4 per cent. Within this, food inflation decreased to 1.9 per cent from 2.4 per cent, while core inflation increased to 2.6 per cent from 2.2 per cent. Goods inflation inched up by 0.1 percentage points, to 0.9 per cent, and services inflation rose by 0.5 percentage points, to 3.5 per cent.

Domestic cost pressures eased in the first quarter, on the back of slower growth in wages and profits. Profit margins continued to shrink, indicating that profits continued to absorb part of the impact of higher labour costs. The energy shock is not yet feeding into wages. Annual growth in negotiated wages declined to 2.5 per cent in the first quarter of 2026, from 2.9 per cent in the fourth quarter of 2025. Compensation per employee is projected to grow steadily at 3.2 per cent in 2026, 2027 and 2028, implying an increase in real wages in each year.

A range of forward-looking signals point to inflationary pressures in the coming months, notably Purchasing Managers' Index input prices, import prices, pipeline pressures for food, selling price expectations and some supply chain disruptions. In addition, the energy shock has already pushed up some indicators of underlying inflation.

The increase in energy prices is expected to keep inflation well above target into the first half of 2027. On average, headline inflation is projected at 3.0 per cent in 2026, 2.3 per cent in 2027 and 2.0 per cent in 2028. The path of headline inflation is mainly driven by the projected profile of energy inflation.

Inflation expectations over shorter horizons remain well above the levels observed before the outbreak of the war in the Middle East. At the same time, most measures of longer-term inflation expectations stand at around 2 per cent, supporting the stabilisation of inflation around target in the medium term.

The risks to the growth outlook are to the downside while the risks to the inflation outlook are to the upside. Under the adverse and severe scenarios, inflation would remain above target over the entire forecast horizon, while growth would be lower than the baseline in the near term. Under the milder scenario, inflation would peak at a level similar to the baseline but fall below target in the medium term, while growth would be slightly above the baseline in 2027 and 2028.

The ECB's monetary policy

Turning now to our monetary policy response, the incoming information about the intensity and duration of the energy shock, and the likely persistence of its impact on inflation, suggested that a 25 basis point policy rate increase in June was appropriate.

This rate hike was a robust decision. First, as I indicated earlier, we already see first signs that the energy price shock is feeding through to broader inflation. Second, even in the milder scenario considered by Eurosystem staff in preparation in June, inflation is set to remain above target for long enough to warrant a measured response. Third, while recent progress towards a resolution of the conflict in the Middle East is welcome, uncertainty remains elevated and there are continued risks for inflation to stay above our 2 per cent medium-term target for quite some time.

The Governing Council remains well positioned to navigate the uncertainty caused by the war. It will closely monitor the situation and follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance.

In particular, the Governing Council's interest rate decisions will be based on its assessment of the inflation outlook and the risks surrounding it, in light of the incoming economic and financial data, as well as the dynamics of underlying inflation and the strength of monetary policy transmission. The Governing Council is not pre-committing to a particular rate path.

Conclusion

Let me conclude.

The crisis in the Middle East has increased uncertainty and is affecting both inflation and growth in the euro area. Higher energy prices are generating inflation pressures, while weaker confidence and lower real incomes are weighing on activity. However, the labour market remains resilient, household balance sheets are solid, and public investment should provide some support in the future.

In this environment, our focus remains clear: to ensure that inflation stabilises at our 2 per cent target in the medium term. We will continue to take our decisions meeting by meeting, based on the incoming data, and we will remain attentive to the risks on both sides of the outlook.

Thank you.