



Euro area – a 2022-style inflation shock?

The war in Iran has caused energy prices to rise sharply, leading many to fear another surge in inflation similar to that seen in 2021 and 2022, when the inflation rate in the euro area exceeded 10% at times. While there are indeed some parallels between then and now, we believe the differences outweigh the similarities. The inflation rate is unlikely to climb nearly as high as it did back then.

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Fears of a surge in inflation like in 2021/22

Since the attack of the U.S. and Israel on Iran, energy prices have risen sharply. As a result, the inflation rate in the euro area is likely to rise significantly in March. At around 2.5%, we estimate it will once again exceed the ECB's 2% target.

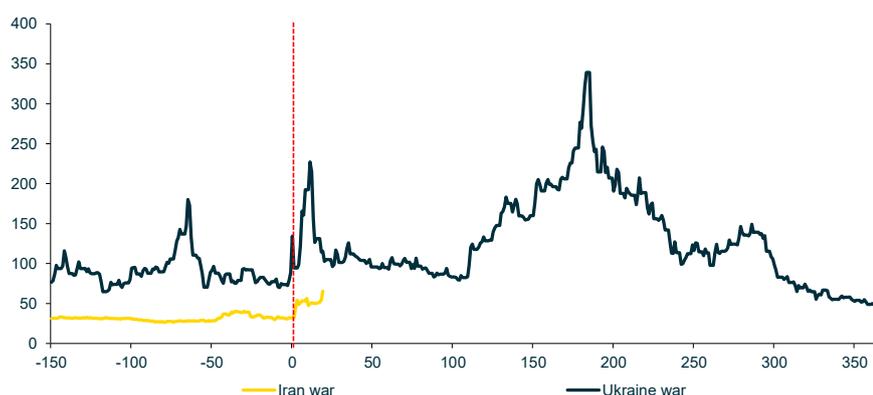
For many, this brings back memories of 2021 and 2022, when the inflation rate spiked due to sharply rising energy prices. At the end of 2022, the inflation rate even briefly reached double digits. The ECB responded to this surge in inflation with sharp interest rate hikes starting in mid-2022. How great is the risk that this scenario will repeat itself?

The clearest parallel: significantly higher energy prices

The sharp rise in energy prices is the strongest parallel to the developments back then. A considerable share of this increase materialized as early as 2021, that is, before Russia's attack on Ukraine. This was because demand for energy, recovering after the COVID-19 slump, met with supply that was still constrained. Added to this were initial restrictions on gas supplies from Russia. As Russia's attack became increasingly likely, natural gas prices in particular rose sharply.

So far, the rise in gas prices in particular has remained well below that three and four years ago (Chart 1), but this could change in the coming months depending on the course of the war and the situation in the Strait of Hormuz. The impact of higher energy prices on consumer prices will also depend on whether governments or the EU intervene to curb the rise in prices. Italy and Spain have already pledged temporary measures.

Chart 1 - The natural gas price rises less than it did in 2022
Prices for a megawatt hour (TTF) of natural gas, in Euro



Source: Bloomberg, Commerzbank-Research

Possible parallels: Higher food prices ...

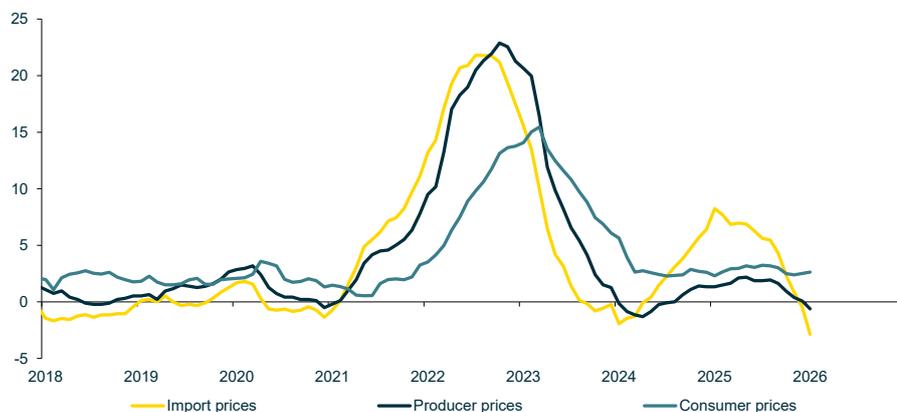
By the end of 2021, food prices had also risen significantly. This was due, on the one hand, to higher energy prices. On the other hand, the war in Ukraine sparked concerns that grain shipments from Russia and, in particular, from Ukraine – which were major suppliers to the global market – might be disrupted. At times, exports via the Black Sea were indeed impossible, resulting in a significant decline in Ukraine's shipments.

Higher energy prices will also have an impact on food prices this time around. However, unlike four years ago, there is no threat of a general disruption from a major food producer. However, observers fear that the Gulf states could fail as major producers of fertilizer and its precursors. Furthermore, fertilizer production in some Asian countries appears to have been curtailed due to a shortage of natural gas, leading some to fear that fertilizer could become scarce. In Europe, the risk of major scarcity is likely to be relatively low, as there appears to be sufficient production capacity here and there is currently no shortage of natural gas. Consequently, fertilizer will certainly become more expensive, and like higher energy prices, this will drive up producers' costs and, consequently, prices for consumers. However, there should be no crop failures due to a lack of fertilizer that could further drive prices up. Consequently, food prices in the coming months



are unlikely to rise nearly as sharply as they did four years ago. This is also supported by the fact that import and producer prices for food had barely risen in the months leading up to the outbreak of the Middle East war and had even fallen recently (Chart 2).

Chart 2 - Until recently, the signs pointed toward falling food prices
Euro area, import, producer and consumer prices, change on year in percent



Source: Eurostat, Commerzbank Research

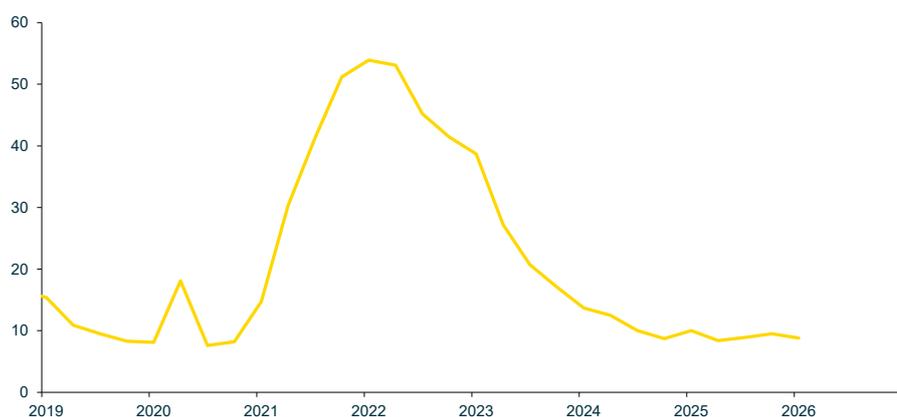
... and certain supply chain issues

A key driver of prices for goods (excluding energy and food) in 2022 was supply chain issues, which made intermediate goods more expensive and scarce, thereby driving up the cost of final products.

There are already initial reports of production disruptions in Asia. For instance, the Association of German Chemical Companies (VCI) is highlighting a shortage of chemical intermediate products, as some Chinese companies are currently unable to export certain products due to energy shortages.

However, these production declines are unlikely to be nearly as severe as they were in 2021 during the various lockdowns in China. At the peak of those lockdowns, more than half of industrial companies reported that a shortage of raw materials was hindering their production (Chart 3).

Chart 3 - More than half of industrial companies reported material shortages in early 2022
Percentage of companies where a shortage of materials or equipment has hindered production



Source: EU commission, Commerzbank-Research

Significant differences: No shift in demand ...

Some factors that contributed significantly to the sharp price increases back then are completely absent this time around. For instance, during the pandemic, frequent lockdowns and restrictions in many sectors worldwide led to a significant shift in demand from services to goods, as many services were not available. Furthermore, demand in many countries was additionally fueled by expansionary fiscal policies intended to offset the negative consequences of the pandemic (and which often went too far). This further exacerbated the shortages.

... and no explosion in freight rates



The strong demand for goods, which are often produced in Asia, also drove up demand for shipping capacity, while at the same time the pandemic and the resulting lockdowns noticeably disrupted operations at ports. Together, these factors caused freight costs to rise significantly. At its peak, shipping a container from Asia to Europe cost 12,000 US dollars (Chart 4). These costs were passed on to customers. While shipping to and from the Persian Gulf is obviously disrupted and some surchargers for higher fuel prices exist, nothing similar to 2022 is currently being observed for the major trade routes.

Bottom line: Higher inflation likely, but not a repeat of 2022

All in all, the inflation rate is likely to rise further in the coming months if a prolonged war causes energy prices to rise further and higher gas prices gradually reach private households. Food inflation could also pick up again in the medium term.

However, the surge in energy prices is unlikely to be quite as strong as in 2021 and 2022, and some of the factors driving prices at that time are likely to be present either to a much lesser extent (supply chain issues and food shortages) or not at all (shift in demand toward goods and skyrocketing freight rates). Consequently, even if the war drags on, the inflation rate is unlikely to rise nearly as sharply as it did four years ago. We do not expect double-digit peaks as we did back then, but rather inflation rates of around 3%; if the war escalates further, rates could reach 4%.

ECB likely to intervene only if the situation escalates further

In light of the significant rise in oil and gas prices, discussions have evidently begun how the ECB should respond. One thing is certain: unlike in 2021 and 2022, this time the central bank will not wait until the inflation rate has risen to 8% before raising interest rates. However, we assume that the figure of around 2.5% emerging for March will not yet prompt the ECB to act; even with an inflation rate of 3%, it will likely point to the temporary nature of the stronger price increase (see also [here](#)). However, if inflation reaches 4% as a result of a further escalation of the war, it is likely to act, as significant second-round effects would then be a threat.



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