Flash Economics

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The risk of stagflation in the euro zone

Even before the outbreak of the war in the Middle East, the euro zone economy was moving towards a stagflationary equilibrium (with relatively high inflation and weak growth), due to:

- The absence of productivity gains;
- The sharp rise in the prices of metals and semiconductors.

Of course, the war in the Middle East, if it persists, heightens the risk of tipping into stagflation, given the negative supply shock resulting from higher oil and natural gas prices. The European Central Bank would likely respond to the emergence of stagflation by shifting to a more restrictive monetary policy, especially if the conflict in the Middle East continues and rising fossil fuel prices lead to stronger increases in wages and in the prices of all goods and services.

Finally, it should be noted that while stagflation poses a threat to the euro zone, this is not the case in the United States.

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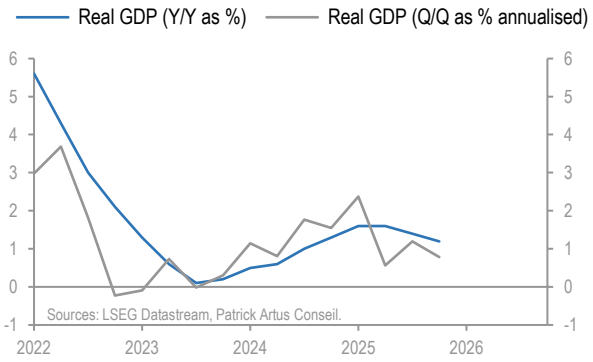
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Before the outbreak of the war in the Middle East, the euro zone was moving towards a stagflationary equilibrium

Let us recall **that stagflation is a situation of weak growth combined with high inflation**.
Prior to the outbreak of the Middle East war, the euro zone was characterised by:

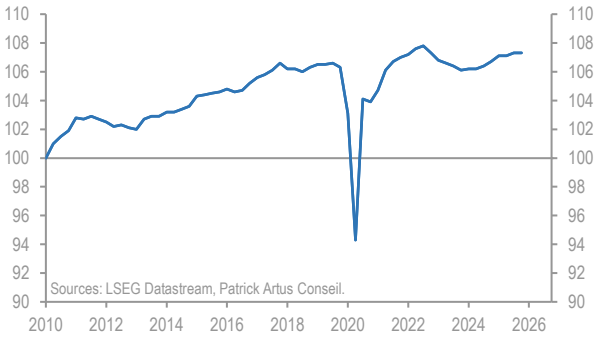
- **Weak growth** (1.1% in 2025, but only 0.9% if Ireland is excluded, where strong growth of 12.3% is driven by the weight of exports of technological services and pharmaceutical products), see **Chart 1**;

Chart 1
Euro zone: Real GDP



- **The absence of productivity gains** (**Chart 2**), **which contributes to weak growth and is inflationary through several channels**:

Chart 2
Euro zone: Productivity per head (2010.Q1 = 100)



  - A rapid rise in unit labour costs equivalent to the increase in wages per worker (Chart 8, below);
  - Sustained tightness in the labour market (**Chart 3A**) because, even though growth is weak, the lack of productivity gains leads to continued job creation (**Chart 3B**);

Chart 3A
Euro zone: Unemployment rate (as %)

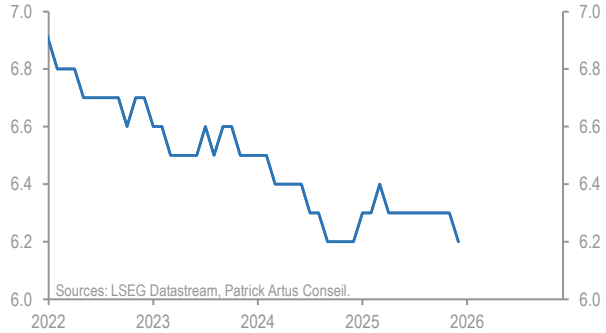
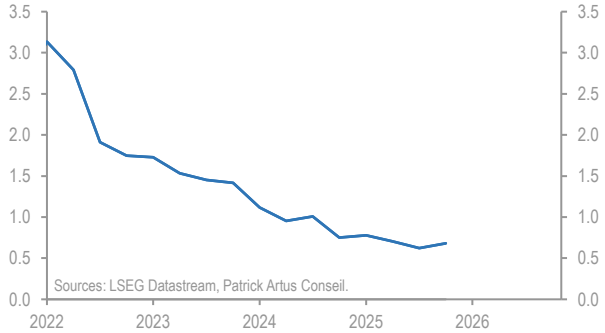


Chart 3B
Euro zone: Employment (Y/Y as %)



- **A sharp rise in the prices of industrial metals** (**Chart 4A**) **and semiconductors** (**Chart 4B**), driven in particular by strong demand related to the development of artificial intelligence, which is clearly inflationary.

Chart 4A
Industrial metals price index (01.01.2022 = 100)

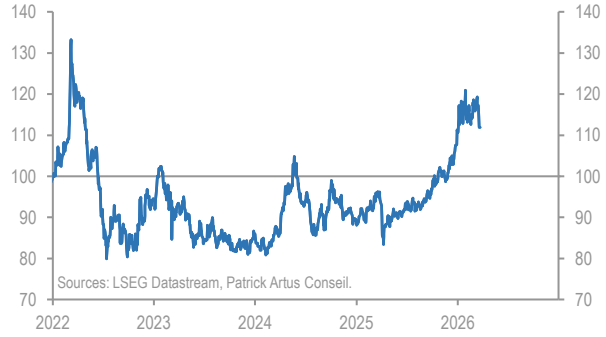
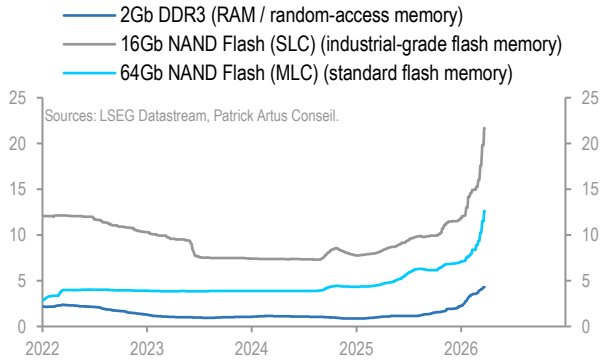


Chart 4B
Semiconductor prices (in USD)



Industrial goods prices are being pushed down by competition from China and by weak demand for industrial products, but service prices reflect the rapid growth of wages (**Chart 5**), so that overall underlying inflation remains above 2% (**Chart 6**).

Chart 5
Euro zone: Consumer price indices of services and non-energy industrial goods (Y/Y as %)

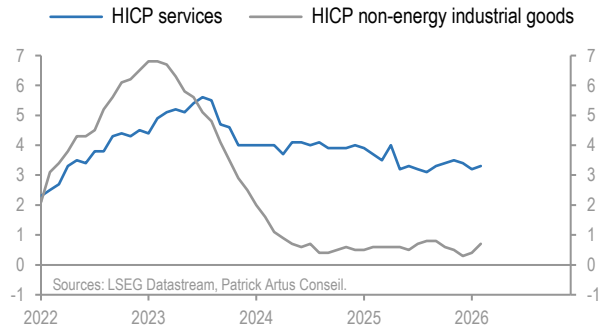
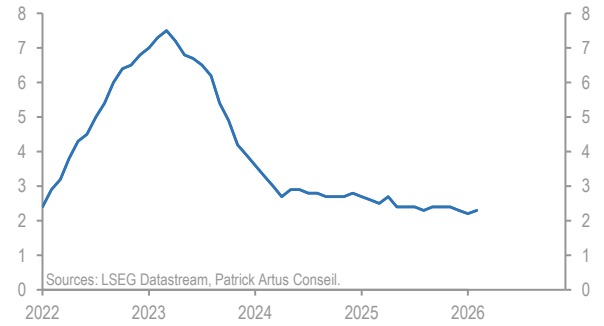


Chart 6
Euro zone: Core inflation (HICP excl. energy and unprocessed food, Y/Y as %)



The war in the Middle East increases the risk of stagflation in the euro zone

The war in the Middle East could last for a considerable period. **If this occurs, the euro zone will face an adverse supply shock due to higher oil and natural gas prices** (**Charts 7A/B**).

Chart 7A
Oil price (Brent, $/bbl)

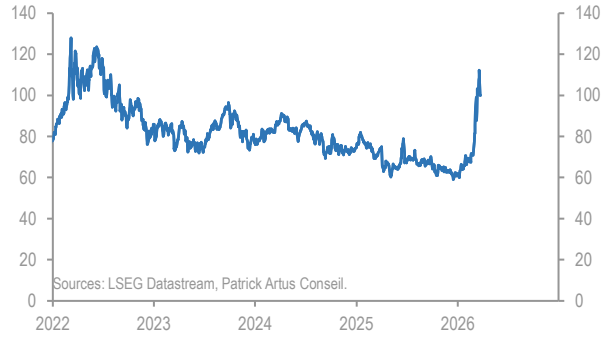
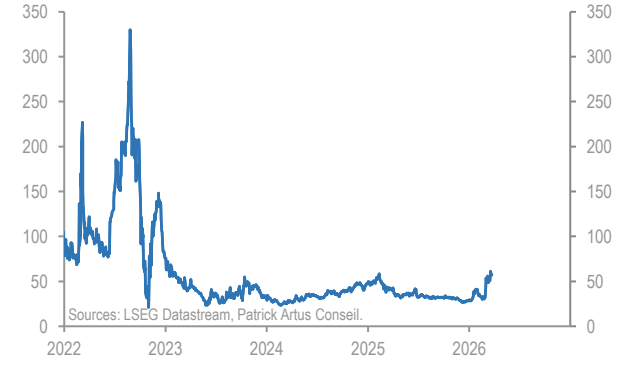


Chart 7B
Europe: Natural gas price (€/MWh)



This negative supply shock is likely to be amplified, if fossil fuel price increases persist, by:

- **Faster rises in wages** (**Chart 8**) and in the prices of all goods and services;
- **The response of the European Central Bank**, which would probably move to a more restrictive monetary policy (as anticipated by financial market participants, **Chart 9**), thereby slowing growth, particularly business investment.

Chart 8
Euro zone: Nominal per capita wage (Y/Y as %)

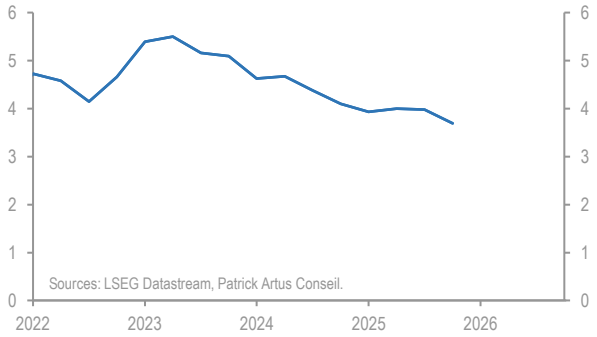
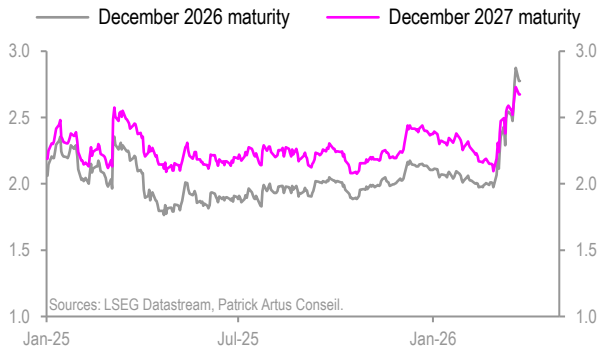


Chart 9
Euro zone: Euribor contracts (3-month)

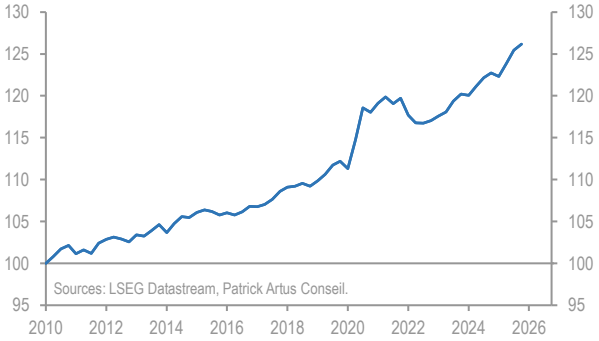


Summary: a situation in the euro zone very different from that of the United States

The euro zone is therefore heading towards a stagflationary equilibrium (relatively high inflation, weak growth), especially if the war in the Middle East proves prolonged. The situation in the euro zone is very different from that in the United States:

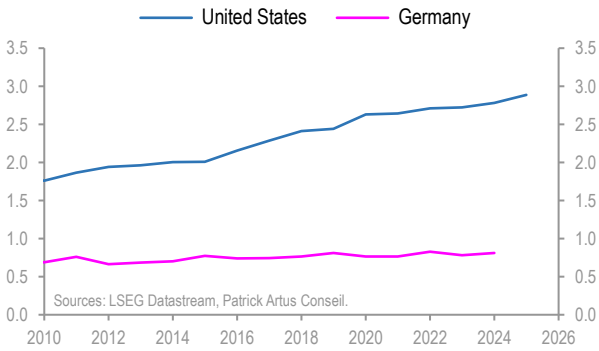
- The United States benefits from significant productivity gains, likely linked to the development of artificial intelligence (**Chart 10**), which exerts a disinflationary effect;

Chart 10
United States: Productivity per head (2010.Q1 = 100)



- The United States is an exporter of oil and natural gas, so rising prices do not hinder US growth;
- US growth is driven by the development of artificial intelligence and investment in software, which is not the case in the euro zone (**Chart 11**).

Chart 11
Investment in software (as % of nominal GDP)



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