Flash Economics

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What are the effects of a shock on the price of fossil fuels?

The war in the Middle East has led to a sharp increase in the prices of oil and natural gas. We analyse the impact on the European economy of the significant rise in natural gas prices in 2022, caused by the outbreak of the war in Ukraine and the halt in Russian gas imports. One can attempt to predict the effects of today's rise in energy prices by studying the impact of a similar increase in 2022.

In 2022, in the euro area, we observe:

- A very strong surge in inflation;
- Which feeds through into wages and core inflation after a few quarters;
- A decline in business investment and manufacturing output, with the negative effect of higher natural gas prices on Europe's competitiveness;
- A slowdown in growth, which troughs five quarters after the rise in natural gas prices following the start of the war (February 2022);
- An increase in long-term interest rates;
- A fall in stock market indices.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Isabelle Gravet
Research Assistant
isabelle.gravet-ext@ossiam.com

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Rise in fossil fuel prices, with the war in the Middle East in 2026, as with the war in Ukraine in 2022

Oil prices rose sharply from the beginning of 2022 (with the war in Ukraine) and again from the end of February 2026 (with the war in the Middle East, Chart 1). In Europe, natural gas prices increased considerably from February 2022 and have risen significantly again since February 2026 (Chart 2).

Chart 1
Oil price (Brent, $/bbl)

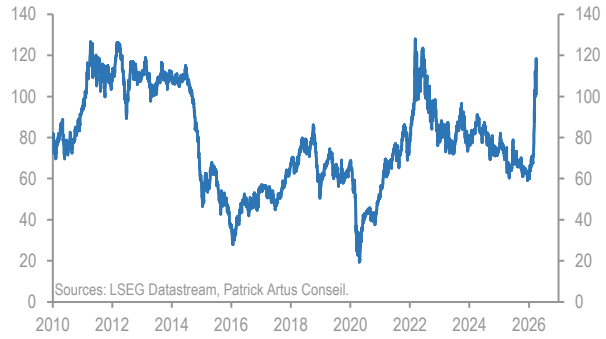
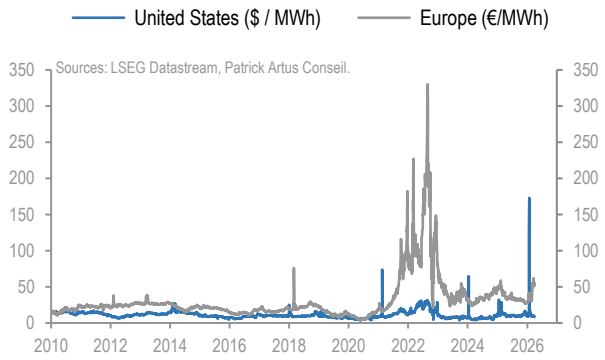


Chart 2
Natural gas price



If we weight oil and gas prices according to their share in Europe's energy imports, we see that the weighted price of fossil fuels:

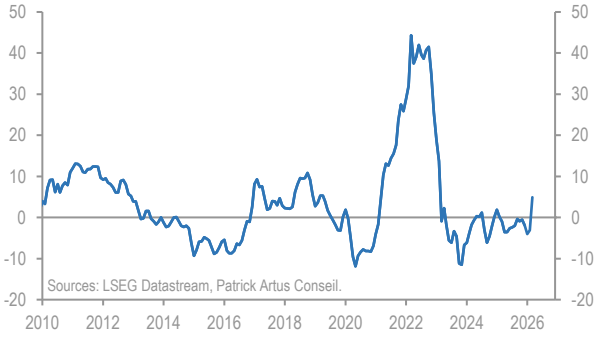
- increased by 100% between February 2022 and its peak in summer 2022;
- increased by 70% between February 2026 and today.

We aim to analyse the effects on the economy of the rise in fossil fuel prices in 2022, and to infer the likely effects on the economy of the increase observed from the end of February 2026.

Effects on inflation and wages

The 100% rise in the weighted price of fossil fuels between February and September 2022 led to a 43 percentage points increase, at its peak, in the growth of energy consumer prices (Chart 3) in the euro area.

Chart 3
Euro zone: Energy consumer price index (Y/Y as %)



Energy accounts for 9% of the euro area consumer price index, so the rise in overall inflation in the euro area resulting from the increase in energy price growth was 3.9 percentage points. Today, the observed rise in the weighted price of fossil fuels (70%) is therefore expected to cause a 27 percentage point increase in energy consumer price growth, which translates into a 2.4 percentage point increase in overall euro area inflation. Looking at wage growth (Chart 4), we see that in 2022 a second-round effect from the rise in energy prices appeared after 6 to 9 months, with an acceleration in wages and, consequently, a 6.5 percentage point increase in core inflation (Chart 5) after one year.

Chart 4
Euro zone: Nominal per capita wage (Y/Y as %)



Chart 5
Euro zone: Core inflation
(HICP excl. energy and unprocessed food, Y/Y as %)



Oil and gas prices fell sharply in 2022 from the summer onwards (**Charts 1 and 2**). Even with this decline, **a response in wages and core inflation to the initial rise in energy consumer prices was observed**.

Effects on business investment, household consumption, and growth

The rise in natural gas prices in Europe relative to their level in the United States (**Chart 2**), **observed in 2022**, led to a decline in **the investment rate** in Europe (**Chart 6**), with a lag of three quarters following the increase in gas prices. This drop in the investment rate can be explained by the loss of competitiveness caused by higher natural gas prices in Europe compared with the United States for the production of chemicals, fertilisers, steel, food products, glass, paper and cardboard, and other sectors.

The impact of the decline in investment on growth is reinforced by **the slowdown in household consumption growth** (**Chart 7**). Overall, GDP growth weakened in the fourth quarter of 2022 (two quarters after the energy price shock) and **reached its lowest point in the third quarter of 2023** (**Chart 8**), six quarters after the rise in energy prices.

Chart 6
Investment of corporations
(in value terms, as % of nominal GDP)

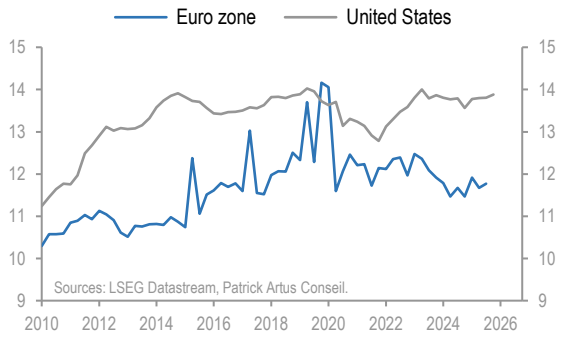


Chart 7
Euro zone: Evolution of household consumption
expenditure (in volume terms, Y/Y as %)

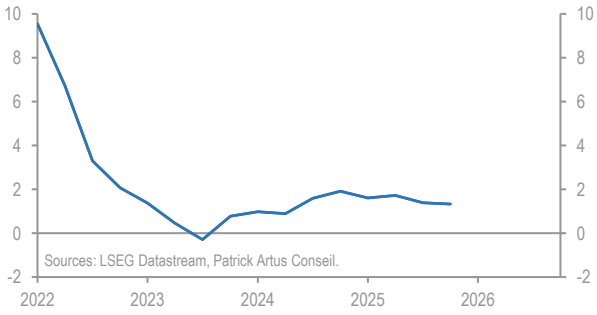
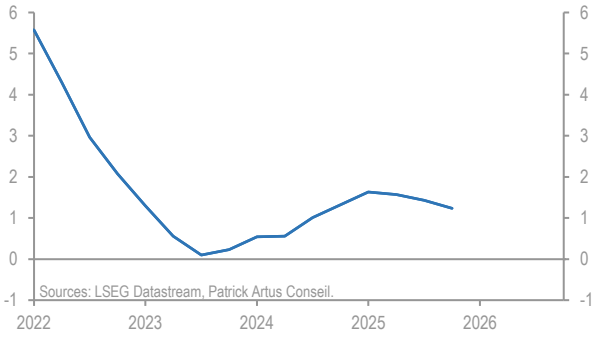


Chart 8
Euro zone: Real GDP (Y/Y as %)



If the same lags occur in 2026–2027, **a slowdown in euro area GDP can be expected from the second quarter of 2026, with growth reaching its lowest point in the third quarter of 2027**.

Effects on financial markets

Long-term interest rates respond immediately to the rise in natural gas prices, both in 2022 and again in 2026 (**Chart 9**). The increase was 270 basis points between February 2022 and February 2023. **The current increase** (from 2.70% to 3.04% for Germany's 10-year rate) is **very small compared with the rise observed in 2022**.

Chart 9
Germany: Interest rate on 10-year government bonds (as %)



The Euro Stoxx index plunged by 17% from the end of February 2022 to the end of September 2022 (its lowest point, Chart 10).

Chart 10
Euro Stoxx 50 (01.01.2002 = 100)



Since the end of February 2026, it has also fallen sharply (by 11%), and given the size of the fossil fuel price shock, this decline is comparable to the 17% drop observed in 2022.

Summary: what can we expect today if the war in the Middle East continues?

Comparing the reactions observed after the rise in fossil fuel prices at the end of February 2022 and the end of February 2026 shows:

- **A wage acceleration** in the euro area can be expected from the end of 2026, lasting until the end of 2027.
- A rapid increase in inflation is likely, followed by a decline in inflation between summer 2026 and summer 2027, though inflation will remain above its previous level.
- **Investment rates, household consumption growth, and GDP growth** will be reduced until the end of 2027. If the response to the energy price rise is similar to that of 2022, the loss of growth could be around 1.2 percentage points, leading to zero GDP growth in the euro area by mid-2027.
- **The response of long-term interest rates took a year to fully unfold after the February 2022 shock;** the current reaction is still very limited compared with what can be expected.
- **The decline in the Euro Stoxx index, given the size of the shock, is comparable to the fall observed in 2022**.

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