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Inflation near a three-year high but still limited signs of any second-round effects

18 September 2026

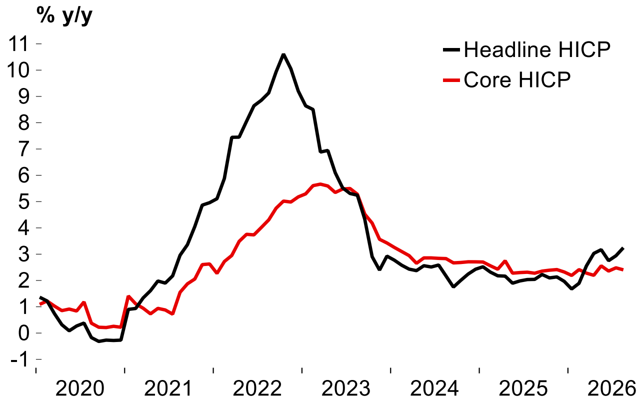
- The increase in August headline HICP inflation to 3.2% is notable, but was driven primarily by energy inflation, while core inflation declined slightly.
- There is currently little evidence of significant second-round effects. Services inflation is on a downward path, just above 3%, while the rise in core goods inflation is concentrated in selected categories, and the share of items experiencing high inflation remains limited. Labour market tightness is nowhere near its last peak, and wage indicators do not point to a renewed acceleration.
- Risks are tilted to the upside. Energy prices remain under pressure, with refined oil product prices decoupling from crude oil and natural gas markets vulnerable to a cold winter. Food inflation is currently low, but disruption in fertiliser markets and a strong El Niño could alter the outlook by year-end.
- While the ECB delivered a rate hike at its September meeting as expected, policymakers adopted a more hawkish stance than anticipated amid the renewed surge in energy prices. If higher energy prices keep headline inflation significantly above target for an extended period, the ECB may choose to tighten further even before clear evidence of second-round effects emerges. We have regarded a 2.5% deposit facility rate as the likely endpoint of the tightening cycle, but the risk of additional rate hikes has risen materially in recent months.

Higher euro area inflation is still mostly driven by energy

Euro area headline HICP inflation rose to 3.2% y/y in August, up from 2.9% in July, the highest reading since September 2023. As expected, the acceleration was driven mainly by energy inflation, which increased by 14%. With energy representing around 9% of the headline HICP, the sharp rise in energy prices is important for the near-term path of the headline index. In principle, however, this alone should not be a cause for concern unless inflationary pressures begin to spread more broadly across the consumption basket.

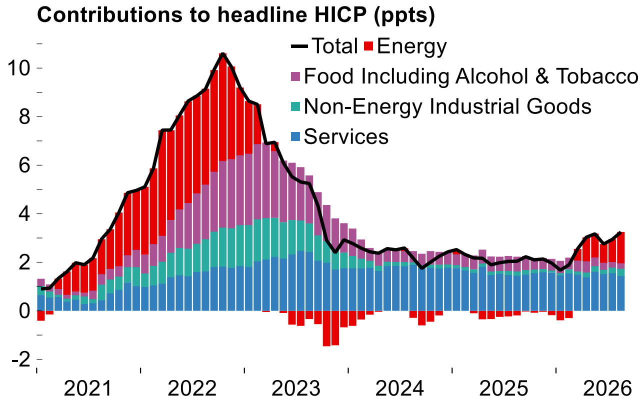
Core inflation, by contrast, declined marginally to 2.4% from 2.5%. The moderation was mainly due to services inflation, which fell to 3.0% from 3.3%, because of volatility in holiday-related prices. Core goods inflation moved in the opposite direction, rising to 1.2% from 0.9%. The increase deserves closer examination, particularly because the modest rise in core inflation since the start of the year has been concentrated in non-energy industrial goods. Even so, the August data does not provide much evidence that higher energy costs are affecting the broader inflation basket.

Headline inflation near three-year high as core moderates…



Source: Eurostat, MUFG Bank Economic Research Office

… the former driven by energy and the latter by services



Source: Eurostat, MUFG Bank Economic Research Office

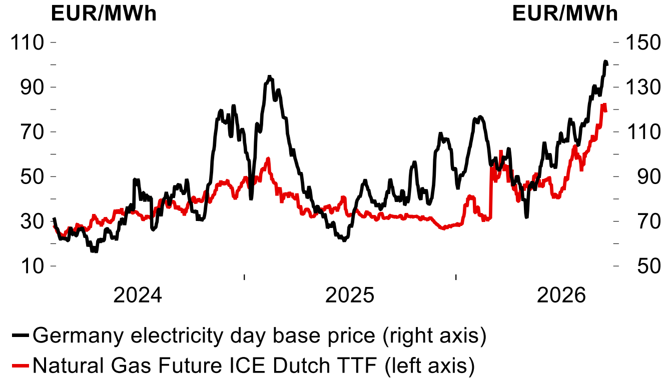
Renewed pressure in energy prices

Energy in the HICP basket comprises two categories. The first, "electricity, gas and other fuels", which falls under housing, accounts for 5.3% of the total index. The second, "fuels and lubricants for personal transport equipment", which belongs to transport, represents 3.8% of the aggregate index. The former is mostly affected by the price of natural gas, while the latter is driven primarily by the price of oil products.

Since the start of the conflict in the Middle East, natural gas prices have remained elevated, with TTF futures having reached their highest level since January 2023. Electricity prices in Germany and across the euro area are tracking these elevated gas prices, although the transmission to household energy bills tends to occur with a lag, as many consumers are shielded in the near term by fixed-price contracts.

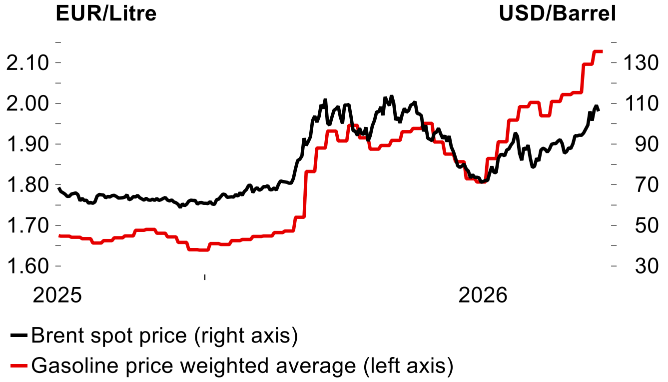
On the other hand, the prices of refined oil products are no longer following movements in Brent crude as closely as before. Diesel and petrol prices have remained well above the levels implied by crude oil prices, which have now surged again past USD 100/barrel on the back of a new escalation in the Middle East. The conflict has damaged refining infrastructure and disrupted exports from key producers, tightening global product markets beyond the impact of crude flow disruptions alone. These pressures have been compounded by Ukrainian drone attacks on Russian refining capacity, which have particularly affected diesel supplies. As a result, much of the previous decline in crude costs had been absorbed by higher crack spreads rather than being passed through to end users, limiting the extent to which lower oil prices translated into cheaper fuel at the pump.

Electricity prices have been tracking the price of natural gas in the past year…



Source: Intercontinental Exchange (ICE), EEX (European Energy Exchange), MUFG Bank Economic Research Office

… while refined product prices have decoupled from crude oil prices and continued to rise amid tight refining capacity



Source: European Commission (DG ENERGY), Macrobond Financial AB, Macrobond, MUFG GMR

No evidence of second-round effects so far

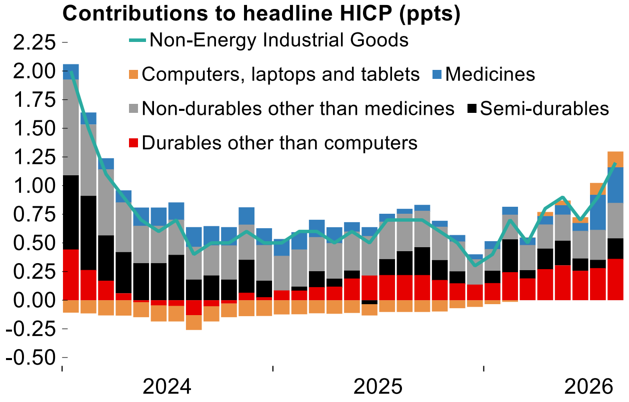
The central question for the inflation outlook is whether these persistent energy price pressures are spreading to other prices. So far, there is no clear evidence that energy inflation is becoming entrenched in the core components of HICP. Service prices have moderated and remain relatively stable, while the rise in core goods inflation appears to be concentrated in specific categories. Measures of inflation breadth also suggest that very high inflation remains confined to a comparatively small part of the consumption basket.

Services inflation has behaved relatively well following the high-inflation episode of 2022. It is now slightly above 3% and contributes around 1.5 percentage points to headline inflation. This is particularly important because services inflation may be more persistent than goods or energy inflation and is more closely connected to domestic cost pressures.

The increase in core inflation from 2.2% to 2.4% since the start of the year has been driven mainly by core goods rather than services. Computers and medicines stand out as important drivers in the durable and non-durable goods categories, respectively. In August, computer prices increased by 10.4% y/y (up from 3.8% y/y in June), while medicine prices rose by 7.2% y/y (from 1.6% y/y in June). Higher computer prices are likely due to the shortage of memory components, a consequence of the build-up of data centres across the world. The spike in medicine prices is entirely due to an adjustment to regulated prices in Germany.

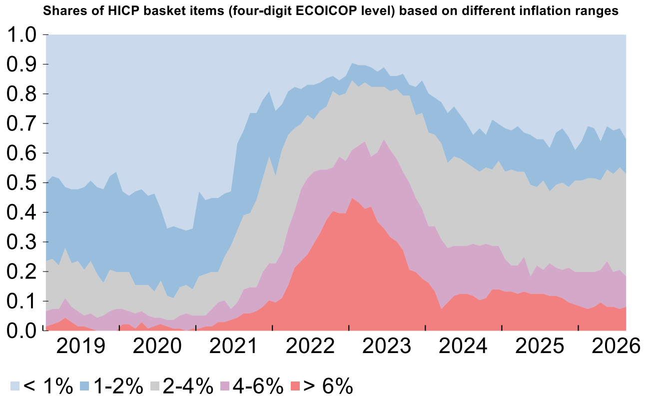
The distribution of inflation rates across the HICP basket provides an additional indication of whether inflationary pressure is becoming broad-based. The share of items in the 2% to 4% inflation range has increased from 31% at the start of the year to 35%, but this can mostly be attributed to the energy shock. There is not yet much evidence of a generalised inflationary expansion. Among the items that were growing at 2% or less in February, beyond energy, computers and medicines, only four now record inflation above 2.5%: vegetables (2.7%), furniture services (2.9%), water (3.1%) and mobile communication services (3.6%). The share of items with inflation above 4% remains limited, and a substantial proportion of the basket continues to record inflation below 2%.

Core goods are putting upward pressure on HICP, driven mostly by a couple of items…



Source: Eurostat, MUFG Bank Economic Research Office

… but the share of prices rising by more than 4% remains limited

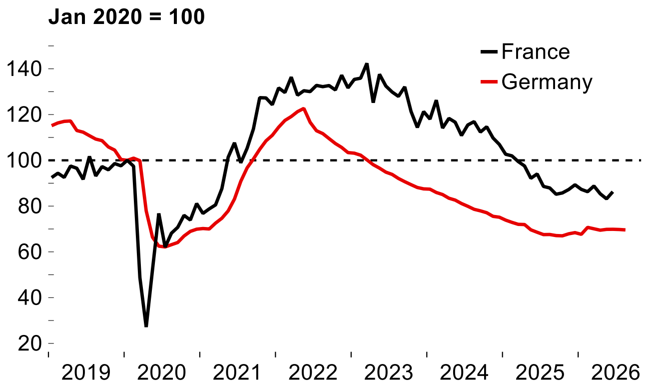


Source: Eurostat, MUFG Bank Economic Research Office

Finally, the labour market does not currently appear exceptionally tight, as it did during the 2022 inflation episode. The ratio of vacancies to unemployed has fallen significantly from its previous peak. In France and Germany, the ratio is now below its pre-pandemic level. Both the ECB negotiated wages indicator and the wage growth indicator by Indeed are also low by the standards of the post-2022 period. Taken together, the tightness and wage data do not point to a renewed wage-price dynamic capable of producing generalised price increases.

It is worth noting that the euro area unemployment rate remains close to historically low levels and has been broadly unchanged over the past two years. However, this stability conceals notable cross-country differences, with rising unemployment in Germany and France offset by historically low rates in Italy and Spain. At the same time, the euro area Indeed wage growth indicator increased to 3.3% in August, supported in large part by Italy and Spain. It is still too early to draw firm conclusions, and official data will be needed to assess whether this strength is sustained.

The vacancy to unemployed ratio shows a labour market that has cooled substantially since the last inflation crisis



Source: German Federal Employment Agency (Bundesagentur fuer Arbeit), MUFG Bank Economic Research Office

Most measures of Euro area wage pressures and labour market tightness agree

	Q2 2026	Q1 2026	Q4 2025	Q3 2025	Q2 2025
ECB indicator of negotiated wages	2.44	2.56	2.91	1.95	4.02
Nominal unit labor cost	2.59	3.41	2.88	3.39	3.36
Unemployment rate	6.40	6.40	6.30	6.30	6.30
Vacancy rate	2.10	2.20	2.30	2.30	2.30

Conditional formatting is based on z-scores calculated over the period since 2022. Red indicates tighter labour-market conditions and greater wage-related inflationary pressure, while blue indicates looser conditions and lower pressure.

Outlook and risks

Our baseline outlook of average HICP inflation of 2.8% in 2026, followed by 2.2% in 2027, is consistent with headline inflation remaining slightly above 3% for the rest of the year, and the August inflation release does not materially alter that assessment. The key message from the data is that the increase in headline HICP inflation reflects a renewed energy shock rather than a broad-based reacceleration in underlying inflation.

The most important upside risk to our outlook is further disruption to the European natural gas market. With gas storage levels entering winter at their lowest level in 15 years, a particularly cold winter could lead to renewed upward pressure on gas and electricity prices. This is relevant not only for household energy costs. Natural gas and electricity are fundamental inputs across the manufacturing sector, and also affect agriculture and services, meaning that a prolonged shock could have broader implications for production costs and more easily result in second-round effects. Consequently, this is both the most likely and the most impactful risk to the inflation outlook, and the one to which the ECB is likely to attach the greatest importance.

A second risk arises from the divergence between Brent crude and refined oil product prices. Diesel and petrol prices have remained significantly higher than implied by movements in crude oil markets, creating sustained upward momentum on the transport component of HICP. While this could keep pushing headline inflation higher, the broader inflationary implications are likely to be smaller and less persistent than those of natural gas and electricity. Oil affects production costs primarily through transportation. As a result, increases in fuel prices would generally be expected to generate more limited spillovers to non-energy prices, although transport-intensive sectors could still face a meaningful surge in costs.[1]

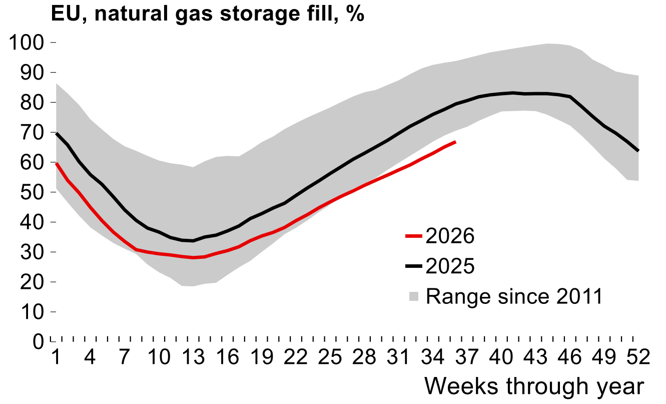
Finally, we are closely monitoring food prices. Although food inflation has remained subdued and has supported euro area disinflation in recent years, persistent disruptions in fertiliser markets linked to the closure of the Strait of Hormuz are putting upward pressure on global food commodity prices. European food prices have so far been largely insulated, but historical experience suggests that increases in global food commodity prices typically feed through to euro area food inflation with a substantial lag, often peaking more than a year later. Risks could be amplified by a stronger-than-usual El Niño weather pattern, though the historical evidence of its impact on food prices is mixed. Some studies find that it tends to boost global food and non-energy commodity prices[2], while others suggest that effects vary across commodities and periods and may be mitigated by adaptation measures, changing weather patterns and agricultural policies[3]. At the same time, a stronger El Niño could reduce inflationary risks stemming from natural gas markets if it leads to a milder winter and, consequently, lower heating demand. Nevertheless, given the existing strains in commodity markets, food prices could become a more significant source of euro area inflation pressure, particularly over the next year.

[1] The different effects of oil and gas supply shocks on euro area inflation, CEPR VoxEU, 13 May 2026

[2] Risks to global food commodity prices from El Niño, ECB, 2023

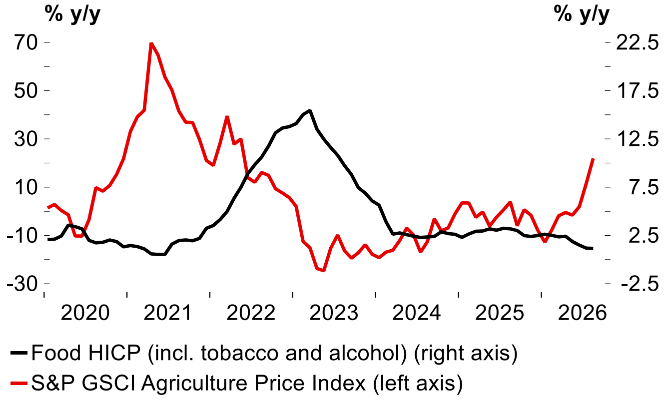
[3] El_Nino_La_Nina_impact_prices_euro_area.pdf, Banco de Espana, 2024

Low natural gas storages could result in new inflationary pressures later in the year



Source: GIE, Macrobond, MUFG GMR

Food prices so far have not tracked global agricultural commodity prices



Source: S&P Global, Eurostat, MUFG Bank Economic Research Office

Monetary policy implications

The ECB hiked the deposit facility rate to 2.5% in September, as widely expected. However, the future path of policy is now less clear, as the Governing Council continues to emphasise its meeting-by-meeting approach and data dependence. Markets are currently pricing a significant probability of further tightening at both the October and December meetings. Until recently, our baseline assumption was that a 2.5% deposit facility rate would mark the peak of the cycle. However, the renewed surge in energy prices has materially increased the risk of additional rate hikes, and we are currently reassessing that view.

In principle, additional tightening would be difficult to justify unless there is evidence that supply-driven inflation is feeding into broader domestic price pressures, or that inflation is becoming increasingly demand-driven[4]. However, the ECB may prove willing to tighten further even in the absence of such evidence. If elevated energy prices keep headline inflation well above target for an extended period, policymakers may become increasingly concerned that second-round effects will eventually emerge. In that environment, more rate hikes could be used to help keep inflation expectations and price-setting behaviour anchored.

[4] Why the drivers of inflation matter for monetary policy, ECB Blog, 1 September 2026

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