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To the point!

Cross-Asset- and Strategy-Research

## The greedy beast: inflation is back

Price pressures are rising, but this time the ECB will be on guard

Memories of the inflation surge after the pandemic and Russia's invasion of Ukraine are still fresh. In the euro area, annual inflation peaked at about 10% – a long way from the ECB's 2% target. At the time, Bundesbank president [Joachim Nagel](#), head of Germany's central bank and a member of the ECB's Governing Council, said inflation, that greedy beast, could be brought back under control and pushed "back into its cage". He was right. Last year, the rate of inflation moved back to around 2%, broadly in line with the ECB's objective. The central bank had managed to reassert control and prove the pessimists wrong.

Now, however, the conflict involving Iran has pushed inflationary pressures higher again. According to a [flash estimate](#) by Eurostat, the EU's statistics agency, annual inflation in April rose to [3%](#), up from just 1.7% in January, shortly before the war began. As one would expect, energy prices have risen most strongly as a result of the blockade of the Strait of Hormuz – the narrow chokepoint through which a large share of global oil shipments passes. But further strains are likely. [Food prices](#) in particular are expected to rise further.

### No quick relief in sight

And even if the parties to the conflict in the Gulf were to agree to reopen this crucial shipping lane, oil and gas prices would probably not fall significantly in the near term, for several reasons discussed [here](#). In addition, current oil prices are still being held down by releases of strategic [petroleum reserves](#) worldwide. That cannot continue indefinitely. Our forecast – broadly in line with market consensus – is that average inflation in Germany will reach about 2.7% this year (see fig. 1). And every extra day the conflict continues raises the risk of a higher outcome.

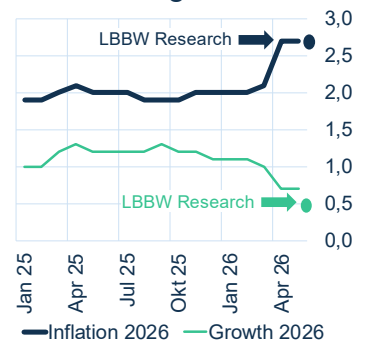
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## The return of inflation

Fig. 1: Forecast German inflation and growth 2026



Source: Consensus Forecast, LBBW Research

## Rising prices are no flash in the pan

According to ECB surveys, households now expect inflation to be running at around [4%](#) in a year's time (see fig. 2). Historically, consumers have not been particularly accurate in assessing inflation trends (some people still convert prices into deutsche marks and other legacy currencies and then complain about today's price level). Even in 2020, when the euro area briefly flirted with deflation, the average respondent was convinced that prices had risen by 2%!

It is therefore worth looking at those who actually set prices: firms. The share of companies planning to raise prices has recently increased sharply, both in Germany and in the euro area as a whole (see fig. 3). Their "selling price expectations" are already higher than at any time since the launch of the single currency – with the exception of the period after the end of Covid restrictions and the early stages of the war in Ukraine. There is clearly more upward pressure in the pipeline.

### A pause in Frankfurt – until June

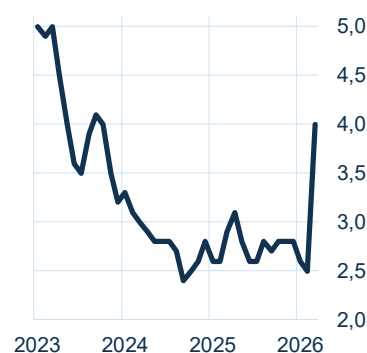
Like other major central banks, the Frankfurt-based ECB opted for a pause earlier this month. The level of uncertainty, it argued, was still too high to justify a rate hike at this point. By the June meeting, however, a 25-basis-point hike will almost certainly be on the table. The ECB has no interest in seeing inflation shoot up again only a short time after the loss of control in 2022. ECB president [Christine Lagarde](#) recently – and rightly – pointed out that economic agents respond differently to a bout of high inflation when the previous episode is still a fresh memory. For the ECB, the guiding principle is clear: better safe than sorry.

The rate hike that markets (and I) expect at the June meeting should be easier for Lagarde, Isabel Schnabel and the rest of the all-male Governing Council to implement because, unlike the Federal Reserve in the U.S., the ECB does not operate under a dual mandate. While the Fed in Washington is also tasked with promoting maximum employment, the ECB's sole mandate is to maintain price stability.

Even though Lagarde firmly rejected the term "stagflation" at her latest press conference, if economic stagnation and high inflation were to occur simultaneously, the ECB would still be expected to focus on bringing inflation down rather than supporting growth. And it will act accordingly. LBBW Research therefore currently assumes that, after the June move, another rate hike is likely in the third quarter.

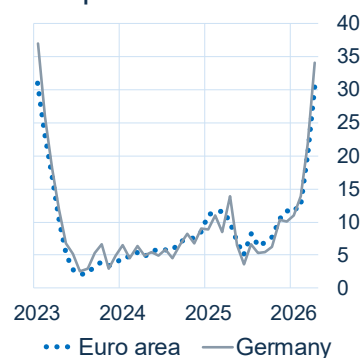
To the point: Inflation is making a comeback, but it is unlikely to reach the extremes seen in 2022-23. The ECB is aware that it cannot afford a repeat of that episode without risking lasting damage to the euro's credibility. It will respond faster and more forcefully than it did last time.

Fig. 2: Households' inflation expectations 12 months ahead.



Source: ECB, LBBW Research

Fig. 3: Share of companies that plan to raise prices



Source: European Commission, LBBW Research

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## ECB's first rate move in June

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