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Scenarios concerning the possible consequences of the Iran war for euro area inflation: Update July 2026

IMFS Working Paper Series, No. 242

Provided in Cooperation with:
Institute for Monetary and Financial Stability (IMFS), Goethe University Frankfurt am Main

Suggested Citation: Hegemann, Hendrik; Wieland, Volker (2026) : Scenarios concerning the possible consequences of the Iran war for euro area inflation: Update July 2026, IMFS Working Paper Series, No. 242, Goethe University Frankfurt, Institute for Monetary and Financial Stability (IMFS), Frankfurt a. M.

This Version is available at:
https://hdl.handle.net/10419/343085

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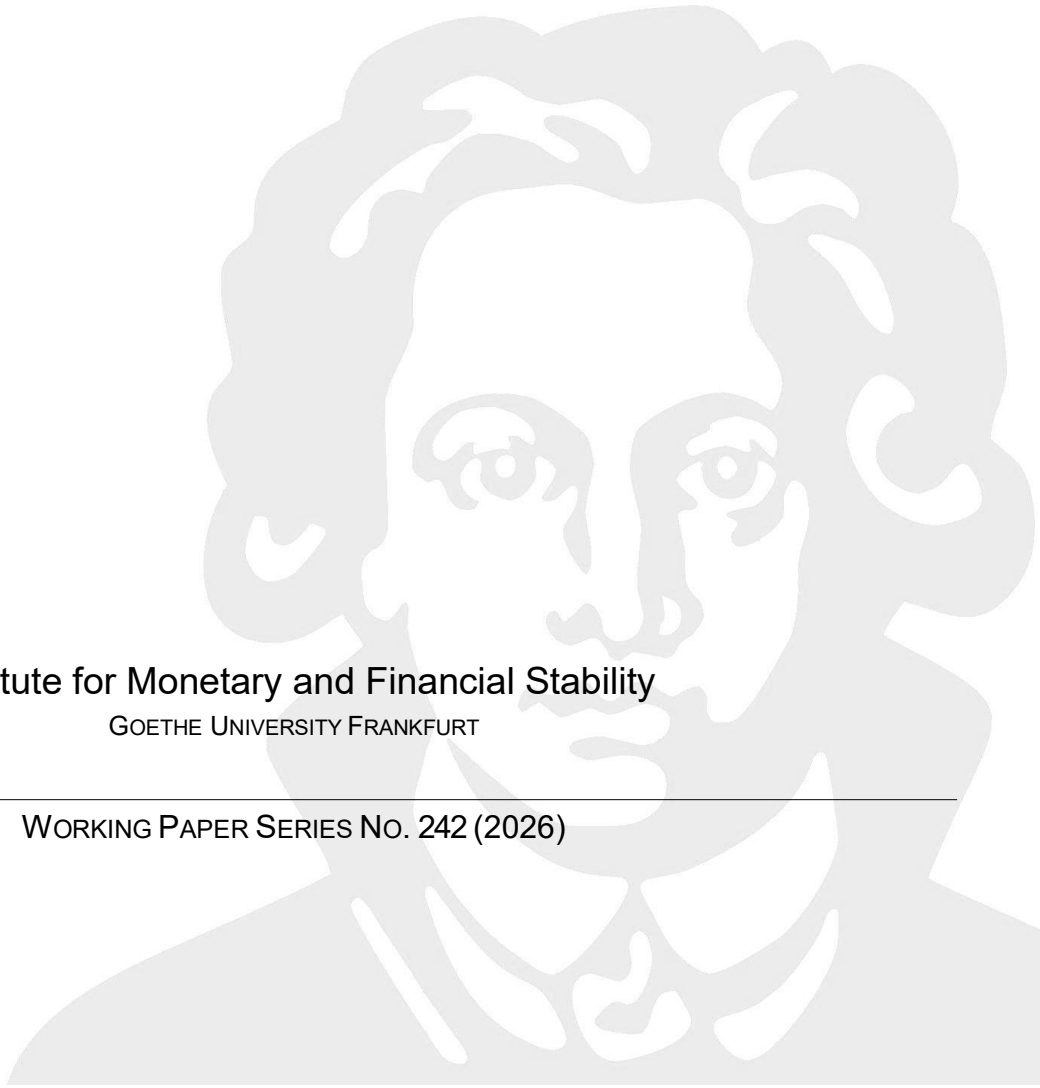
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Hendrik Hegemann und Volker Wieland

Scenarios Concerning the Possible Consequences of the Iran War for Euro Area Inflation: Update July 2026



Institute for Monetary and Financial Stability
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WORKING PAPER SERIES NO. 242 (2026)

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Scenarios Concerning the Possible Consequences of the Iran War for Euro Area Inflation: Update July 2026

Hendrik Hegemann* und Volker Wieland †

August 10, 2026

Abstract

This note updates our March 2026 scenario analysis of the inflationary consequences of the energy-price shock associated with the Iran war. Using the same Bayesian VAR specification and posterior estimates, we incorporate observed energy prices through July 2026. Despite a different monthly price profile, the implications of the July baseline for euro area consumer prices are broadly similar to the March baseline. A significant share of the effect is still to materialize: relative to July, the contribution to year-on-year headline HICP rises by a further 0.6–0.7 percentage points to a peak of around 1.75 percentage points in February 2027. The contribution to core HICP rises by about 0.4 percentage points to a peak of approximately 0.5 percentage points by mid-2027. By contrast, a scenario with "gradual normalization" would unwind most of the remaining headline pressure within a few months, whereas a "renewed supply disruptions" scenario with a temporary return of oil-product prices to their earlier peaks would add moderately to the July baseline. More persistent disruptions, however, could generate larger effects than the three-month scenarios considered here.

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In March 2026, we provided an early scenario analysis of the inflationary consequences of the energy price shock associated with the Iran war using a Bayesian Vector-Autoregression (BVAR) model.[1] At that time, only the first increase in energy prices was visible. Magnitude and persistence of the shock remained highly uncertain.

With energy price and inflation data now available through July 2026, this note updates the original scenarios using the realized energy price path. We compare the March baseline with a July baseline incorporating the realized energy price path and with two conditional alternatives for August to October. Despite a different monthly price profile, the July baseline implies inflation effects that are broadly similar to the original March baseline. The effect on year-on-year headline HICP inflation peaks at around 1.75 percentage points in February 2027, while the effect on core HICP reaches its peak of around 0.5 percentage points later in June 2027. A gradual normalization of energy prices would rapidly unwind most of the remaining headline inflation pressure, whereas renewed supply disruptions would raise it moderately above the July baseline. Across all scenarios, the effects on core HICP are smaller than the headline effects and materialize with a longer lag.

Observed Energy Price Developments and Conditional Scenarios

The analysis considers one historical benchmark and three scenarios based on current data for energy-price paths. For the purpose of comparison, we retain the original March baseline (MB), under which energy prices remained elevated through April 2026 and then evolved endogenously according to the BVAR model from May onwards.

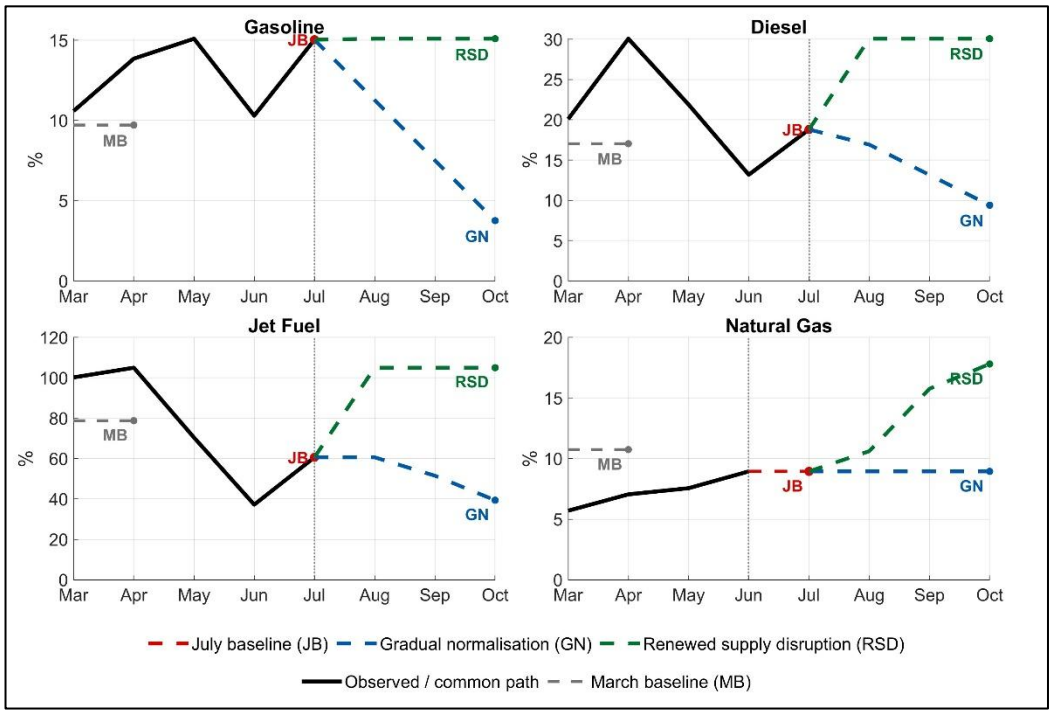
The three scenarios based on currently available data share the same energy-price path up to the latest available observations. Gasoline, diesel, and jet-fuel prices are observed through July 2026. Natural-gas producer prices are available through June, and the June level is carried forward to July. The scenarios differ only in the assumed energy-price developments from August to October 2026:

- **July baseline (JB):** No additional energy-price assumptions are imposed after July. From August onward, gasoline, diesel, jet-fuel, and natural-gas prices evolve endogenously as determined by the estimated coefficients of the BVAR model.
- **Gradual normalization (GN):** Gasoline, diesel, and jet-fuel prices gradually decline from August to October. Gasoline normalizes most rapidly, while diesel and particularly jet fuel remain elevated for longer, consistent with the stronger product-specific pressures indicated by recent crack spreads (margins between refined-product prices and crude-oil costs). Natural-gas producer prices remain at their July baseline level over the conditioning period, reflecting their slower adjustment relative to spot prices. From November onwards, all energy prices evolve endogenously according to the BVAR.

[1] See Hegemann and Wieland (2026). The empirical findings were also discussed by the Scientific Advisory Circle on Economic Policy of the German Minister of Economic Affairs in its report on the economic effects of the Iran war and resulting economic policy options (Grimm, Haucap, Kolev and Wieland 2026).

- **Renewed supply disruption (RSD):** Renewed disruptions to regional transport, export, or refining infrastructure cause gasoline, diesel, and jet-fuel prices to return to their highest monthly levels observed between March and July 2026 and remain there through October. Natural-gas producer prices increase with a lag, reflecting the limited scope for rerouting LNG supplies and the gradual pass-through to producer prices. From November onwards, the BVAR again determines all energy-price developments endogenously.

Figure 1: Energy Price Assumptions and Updated Realizations Relative to February 2026



Note: Energy prices are expressed relative to February 2026. Solid black lines show the common observed path underlying the three current scenarios: gasoline, diesel, and jet-fuel prices are observed through July 2026, while natural-gas producer prices are observed through June. For natural gas, the June level is carried forward to July, as shown by the red dashed segment. The July baseline (JB) imposes no additional energy-price assumptions after July. Dashed blue and green lines show the assumptions under gradual normalization (GN) and renewed supply disruption (RSD) from August through October 2026. Grey dashed lines show the original March baseline (MB). After the respective conditioning periods, energy prices evolve endogenously in the BVAR.

Figure 1 illustrates the common observed energy-price path and the subsequent scenario assumptions. The solid black lines show the realized prices underlying all three current scenarios. The dashed-colored lines show the conditional assumptions from the common July starting point. The July baseline imposes no additional assumptions after July, while gradual normalization and renewed supply disruption constitute favorable and adverse alternatives for the following three months. The grey dashed lines show the original March baseline as a historical benchmark.

Empirical Approach

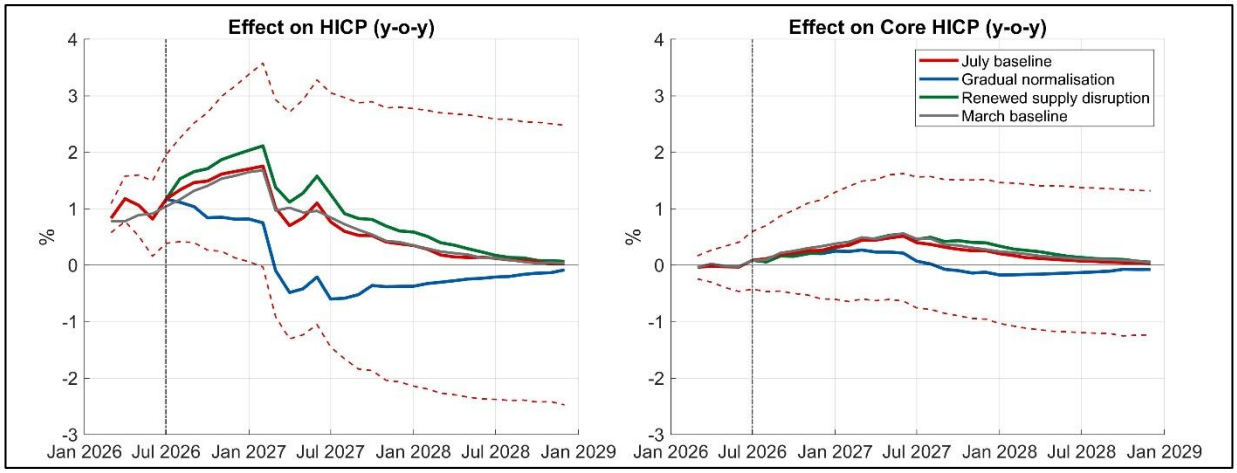
To ensure direct comparability with the March analysis, we retain the same BVAR specification and posterior estimates and update only the conditioned energy price path. The model is estimated using monthly euro-area data from January 2005 to December 2025 and includes gasoline, diesel, jet fuel, natural gas, electricity, headline HICP inflation, and core HICP inflation. The use of final-consumer energy prices rather than crude oil prices links the scenario assumptions more directly to consumer-price developments. For a detailed description of the model, see Hegemann (2026) and Hegemann and Wieland (2026).

For each scenario, the paths of gasoline, diesel, jet fuel, and natural-gas prices are imposed over the respective conditioning period. The reported effects are measured relative to an unconditional BVAR forecast initialized with information available through February 2026, before any subsequent energy-price path is imposed. The comparison therefore shows how conditioning on the different post-February energy-price paths changes the model-implied inflation path relative to the same pre-war benchmark. It should be interpreted as a conditional scenario analysis rather than as an inflation forecast.

Updated Inflation Effects and Remaining Inflation Pressure

Figure 2 compares the model-implied inflation effects of the July baseline and the two alternative energy-price scenarios with the original March baseline. Despite a different monthly energy-price profile, the July baseline produces effects that are broadly similar to the March baseline. Accordingly, there remains a material amount of headline inflation pressure from the energy shock that is to be realized in the next months: the contribution to year-on-year HICP inflation rises from around 1.1 percentage points in July 2026 to a peak of approximately 1.75 percentage points in February 2027 and then declines gradually.

Figure 2: Effects on Consumer Price Inflation



Note: The figure shows model-implied effects on year-on-year headline HICP and core HICP inflation relative to an unconditional BVAR forecast initialized with information available through February 2026. The solid red line shows the median effect of the July baseline (JB), the blue line gradual normalization (GN), the green line renewed supply disruption (RSD), and the grey line the original March baseline (MB). Dashed red lines show the pointwise 16th and 84th posterior percentiles for the July baseline. The vertical line marks July 2026, the final common month

before the conditional energy-price paths diverge. The alternative assumptions under GN and RSD are imposed from August through October 2026, thereafter, all energy prices evolve endogenously in the BVAR.

However, the upward pressure on inflation does not appear strongly entrenched. Under the gradual normalization scenario, the effect on headline HICP declines quickly and is largely eliminated within a few months. In early 2027, it then turns negative relative to the February benchmark. This indicates that the increase in inflation in July baseline scenario comes primarily from continuingly elevated energy prices rather than self-sustaining consumer inflation dynamics. Under the renewed supply disruption scenario, oil-product prices return to their previous crisis peaks and natural-gas producer prices rise further. In this case, the effect on headline HICP peaks at around 2.1 percentage points, which is moderately above the July baseline. Temporary supply disruptions would therefore add only limited further inflation pressure.

So far, the pass-through to core HICP has not yet materialized to a significant extent. Under the July baseline, the impact on core HICP inflation rises to about 0.5 percentage points by mid-2027. This is very similar to with the March baseline. Gradual normalization of energy prices would reduce the peak and cause the inflationary effect to fade more quickly, while renewed supply disruption raises it somewhat and makes it a bit more persistent.

Implications for Inflation Risks

The July baseline indicates that a significant share of the inflationary effect of the energy price shock due to the Iran war is still to materialize. Relative to July 2026, the model implies a further increase of around 0.6–0.7 percentage points in the contribution to headline HICP and around 0.4 percentage points in the contribution to core HICP before the respective peaks are reached. Accordingly, the energy-price shock is still to be passed through to core consumer price inflation.

Even so, the alternative scenarios show that the remaining contribution to inflation depends importantly on the energy-price path over the next months. If we assume that energy prices normalize gradually till October, then the impact on headline inflation begins to unwind almost immediately and is largely eliminated by early 2027. Furthermore, pass through to core inflation is substantially smaller. Conversely, a return of oil-product prices to their earlier peaks over the next three months adds only moderately to the July baseline. This partly reflects the fact that the baseline already incorporates a sizeable shock and that the additional disruption is imposed for only three months. Longer-lasting disruptions or more severe damage to regional energy infrastructure could therefore generate effects beyond those considered here.

A natural question to ask concerns the implications of the energy price shock and the increase in inflation for real activity and monetary policy. The BVAR model neither includes monthly measures of economic activity such as industrial output nor the central bank interest rate. Thus it does not speak directly to these questions. Even so, it is important to note that the estimated coefficients of the BVAR are likely to embody some average of historical feedback effects. For example, higher energy prices imply higher production costs and may dampen economic activity, which in turn limits companies' ability to pass on higher costs to consumers and thereby

limits inflationary effects. An example for such an effect in the sample period is the slow-down of economic activity following the start of the Ukraine war and energy shock. In the context of the estimation of the BVAR model such effects influence the coefficients governing the lagged dynamics of consumer price inflation. Similarly, a monetary policy tightening following an initial rise of inflation limits its persistence. An example that may have had some influence on the BVAR coefficients is the monetary tightening that occurred in 2022 and 2023. With the benefit of hindsight, however, the central bank reaction function may be a different one today.

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