Inflation Focus Q1

19 March 2026

Key Points

- Inflation has been contained globally, but surging oil prices will disrupt further progress near term, driving headline inflation higher
- Growth should remain resilient, supported by fiscal expansion and AI investment, though rising oil prices pose a downside risk
- Labour markets are soft, helping to contain wage growth and a broadening out of price pressures
- The global rate cutting cycle is disrupted, with central banks remaining vigilant and ready to take action should it be needed

Iran war disrupts a benign outlook for growth and inflation

At the start of the year, the outlook for the global economy was favourable, with growth at a trend-like pace and contained inflation. A constructive mix of monetary easing, expansionary fiscal policy, AI related investment and low oil prices underpinned a resilient growth outlook while the US-China trade truce kept global trade open, with more disruptive developments, including those around inflation, likely to be avoided. Until recently, data was supportive of this positive outlook, with solid economic activity and downside inflation surprises in many regions.

Higher oil prices will trigger a rebound in headline inflation

This benign outlook has now been shaken by events in the Middle East. Oil and gas prices have surged, shipping and air transportation have been disrupted, with renewed uncertainty around inflation and central bank actions. At over USD 100 a barrel, oil prices have risen by close to 50% since war started, with even larger moves in natural gas prices. The duration of the conflict and future oil prices are highly uncertain, with large oil price gyrations depending on the news flow, but current market pricing implies that oil prices will stay elevated for at least a quarter, before partially reverting. Under this trajectory, rising energy costs will inevitably push energy CPI inflation higher, potentially by around ½ to 1 percentage point globally. In addition, there will be upward pressure on food prices, also reflecting surging fertiliser prices, while producers may pass on part of their higher energy costs to the consumer, potentially leading core measures of inflation higher.

While negative growth impact will provide some offset, the current oil price should be manageable for businesses and households, and is not expected to tip the global economy into recession.

Oil price impact should fade, unless prices rise more broadly

Over time, as oil prices stabilise or even fall back, we would normally expect the impact on inflation to fade. However, a more persistent and troubling increase in inflation could be experienced if inflation expectations and wage dynamics adjust higher, or if supply disruptions broaden out, amplifying the inflationary impact from higher oil prices.

Soft labour markets should limit second round effects

While the global economy is robust, there are pockets of weakness that are likely to limit broader second round effects from higher oil prices. Unemployment is relatively low by historical standards, but job growth has slumped and job security is weak, with downbeat household sentiment in many regions. AI developments are additionally having an impact, weighing on job creation in specific segments and creating uncertainty around future prospects. This is in stark contrast to the post-Covid period when labour markets were dislocated and extremely tight, spurring strong wage gains as consumer prices rose. Given this, the risk of a broader pickup in wage pressure as a result of higher energy prices appears limited.

Fiscal and AI related factors provide upside risk to the outlook

There are, however pockets of supply driven price pressures in the global economy which warrant attention. AI related price pressures have emerged, reflecting surging demand for key components in combination with tight supply. Memory chips have been particularly impacted, with a tripling of prices during the last quarter of 2025. These cost pressures could be amplified by elevated energy prices and geopolitical events that boost demand for military spending, including on electronics. A further esclation to the Middle East crisis could also disrupt the sourcing of key raw materials for the memory sector, paticularly those that are currently sourced from the Middle East.

In addition, 2026 is a year of fiscal expansion in major economies, including the US, Germany, China and Japan. This is a key reason why economic activity should hold up reasonably well, but there is a risk that that expansion will add to price pressures and pockets of labour market tightness, especially against the backdrop of rapidly weakening demographics.

Central banks need to be vigilant and ready to act

Central banks remain vigilant, following a prolonged period of above target inflation, and are expected to tighten policy if there are signs that underlying inflation trends are changing. Indeed, the oil price shock has already disrupted the global rate cutting cycle, with central banks currently staying on hold. We view this as appropriate, given elevated uncertainty regarding the outlook for energy prices, but expect central banks to take action, should it be needed.

US

A more challenging path towards target

Headline and core CPI inflation were unchanged at 2.4% and 2.5% respectively in February, while the Fed's favoured PCE measure for January continues to run hotter at 2.8% for headline and 3.1% for the core. Clearly the job of the Fed has been made more difficult given the jump in energy prices. While the US is a net energy exporter nowadays, the rise in prices still impacts consumers and businesses. Gasoline prices are now running more that 30% above prices at the start of the year, and this is before the start of the driving season, while truckers are starting to feel the jump in diesel costs. ISM prices readings for both services and manufacturing are also elevated, with the latter jumping in February to the highest reading since 2022.

So far survey measures of inflation expectations are largely stable, but they are likely to move higher given recent developments at a time where there is already growing frustration about the elevated and still rising cost of living. Given that the labour market is holding up better than some feared, the Fed will put more emphasis on the path of inflation making further rate cuts unlikely in the near term.

UK

Higher for longer for inflation

Headline CPI inflation slowed from 3.4% YoY in December to 3.0% in January while core inflation ticked down to 3.1% YoY. Core goods prices were flat over the month but service inflation proved to be stickier, although this could have been driven by price adjustments at the beginning of the year. The rate of input price inflation eased to a three-month low according to the latest PMI survey though there were reports of rising raw material costs and technology expenses.

These already existing price pressures will now be amplified by surging oil and gas prices and further progress on inflation will be disrupted. While weakening employment conditions are likely to keep a lid on wage growth and service costs in the coming months, preventing a broader rebound in price pressures, inflation has overshot target for a protracted period of time and it is appropriate that the BoE adopts a wait-and-see approach. This was also the strategy that was communicated in the March policy meeting. The outlook is dependent on the path for oil and gas prices but, for now, market pricing implies no further easing from the BoE.

Eurozone

Disinflation challenged by energy uncertainty

Eurozone inflation has been steadily normalising sustainably towards the ECB's 2% target. Headline inflation is already below, at 1.9% YoY for February. Disinflation in the core measure has stalled, however, accelerating to 2.4% in February. Goods inflation has slowed to a subdued 0.4% YoY, while services price increases remain sticky at 3.4%. Wage growth dynamics are cooling, a welcome development. Before the Middle East crisis, we had anticipated disinflationary pressure to continue to weigh on both core and headline CPI.

The path downwards for inflation is now challenged by energy price increases. Estimating the impact of the shock is difficult given current volatility. Historic episodes indicate that a 10% increase in oil and natural gas prices lead to a 0.15pp and 0.1pp increase in headline Eurozone inflation respectively. The oil-related increases tend to be faster than gas, given lagged pricing structures in electricity. Based on oil and gas prices in the middle of March, this is consistent with inflation around 1pp higher over the next 18 months. Government intervention through subsidies or price caps could reduce this. Euro weakness bears watching, although gains from early 2025 have held. Further uncertainties include downstream impact of higher fertiliser prices on food. We take some comfort in weaker wage dynamics decreasing the risk of second-round effects and a broadening out of price pressures. The current situation is manageable, but a prolonged conflict risks higher inflation and lower growth.

Switzerland

Disinflationary pressures to persist

Annual CPI inflation was unchanged at 0.1% in February, despite prices rising sharply on the month, up 0.6% MoM. This was a repitition of the pattern from prior years which saw large price increases in February, reflecting annual price resets. The underlying inflation trend is weak and continues to reflect deflationary import prices, while domestic inflation is still runing at around 0.6% YoY. That said, CPI excluding rent inflation is in deflation, confirming broader weakness, which is also reflected in deeply deflationary producer prices. Before the recent surge in oil prices, we had anticipated inflation to move largely sideways in 2026, averaging 0.2%, with risk to the downside.

The Middle East crisis has led to further currency appreciation, particularly against the euro, amplifying imported deflation while hampering the ability of domestic producers to raise prices and wages. Higher oil prices will push up inflation near term, reducing deflation risk, but is unlikely to bring inflation materially higher over the medium term. As a result, we have raised our 2026 forecast to 0.5% but expect underlying weakness to persist. As expected, the SNB left monetary policy unchanged in the March decision, while raising its inflation forecast to account for the impact of higher oil prices. We do not expect any further SNB rate cuts, but risk to the rate outlook remains to the downside.

Japan

Inflation risks flare anew

Headline CPI fell from 2.1% to 1.5% YoY in January, hardly a surprise given large base effects due to last year's food price spike. Extended government energy subsidies have played a pivotal role in keeping inflation subdued. Yet, core inflation ex fresh food and energy stayed above the BoJ's target at 2.6% YoY, signalling price pressures are not easing as quickly as the headline suggests. The structure of Japan's inflation is increasingly nuanced. While subsidies and base effects are anchoring CPI lower, domestic price drivers remain potent, with wage growth firm at 2.3% YoY and structural labour shortages still central. The upcoming spring Shunto wage negotiations are a critical gauge for wage momentum. The LDP's snap election victory gives PM Takaichi a solid majority and notable leeway for fiscal manoeuvring, opening doors for further stimulus and tax cuts to keep demand buoyed.

The Iran conflict introduces a clear upside risk: Japan imports over 90% of its crude, mostly via the Middle East. Surging oil prices and a weaker yen fuel imported inflation, while subsidies only help delaying pass-through to consumers. Hence, the BoJ faces stronger calls for an April rate hike given the renewed inflation risk.

China

Unshaken by the Iran conflict

China's inflation showed signs of life early this year, with February's CPI rising 1.3% YoY and core CPI at 1.8% YoY, mainly due to seasonal holiday factors that are likely to fade. Producer price deflation eased to –0.9% YoY, supported by higher metal prices. Policy efforts such as the anti-involution campaign may help reduce PPI declines, but a sustained recovery needs stronger demand. Despite being the world's largest net oil importer, China's near-term exposure to the Iran conflict is manageable. Imports via the Straits of Hormuz are significant, but China's strong reserves, which are sufficient for several months, and diversified energy mix of coal and renewables enhance its energy security.

Oil and gas to GDP is over 2%, notably lower than global peers, and mostly used for industry, making any price increases more evident in PPI while overcapacity and weak demand will contain the spillover to CPI. China's use of electrical vehicles also limits the pass-through of higher oil prices to consumers. We don't think the current geopolitical tensions will shift China's policy direction significantly in the absence of a prolonged war in the Middle East.

Australia

Inflation continues to run hot

Core CPI in Australia has remained stubbornly high relative to the Reserve Bank's 2-3% target range, the most recent data showing an annualised 4% rate. Much of this has been underpinned by strong public spending, effectively driving growth in the absence of consumer spending and business investment. Coupled with this has been a very strong labour market with unemployment levels tracking well below the estimated neutral unemployment rate (NAIRU)—the rate at which inflation is estimated to remain stable—adding further wage pressure. As a consequence, the RBA raised the cash rate by 25bps in early February and followed up by a further 25bp hike to 4.1% in March.

The Middle East conflict has also laid bare a structural weakness for Australia in respect to the supply and reserves of crude oil products, specifically gasoline, diesel and A1 jet fuel. Ninty percent of Australia's oil consumption is underpinned by imports, whilst reserves are well below the IEA's 90-day recommendation. Although crude oil prices are not typically a focus for monetary authorities, the supply disruption and limited storage capacity will undoubtedly create higher transport costs and put pressure on farmers ahead of winter crop planting.

EM Asia

Oil complicates the disinflation story

Across ASEAN and India, inflation remains broadly benign, with downside surprises in Malaysia and Thailand, reflecting muted demand despite ongoing food and energy volatility. Indonesia's February CPI rose to 4.8% YoY from 3.5%, but was primarily distorted by a base effect. Core CPI remained contained at 2.6%. In India, February data suggests the disinflation cycle is approaching its floor. Headline CPI inched up to 3.2% due to a mild rebound in food prices, yet remains well within the RBI's 2–6% band and below the 4% target. The key risk for India now stems from the sharp rise in crude oil prices, which could gradually feed through to fuel, transport and food inflation. Without a prolonged energy shock, however, inflation should be contained and remain within the 3.5–4.5% range over the coming quarters.

Aside from Malaysia and partly Indonesia, which are large oil exporters, most economies within ASEAN are small, open, oil importing and highly exposed to Middle Eastern supply risks. Absent a prolonged conflict, the shock is unlikely to trigger rate hikes but will keep further rate cuts off the table. The bigger risk now is growth and currency pressure. If currency depreciation accelerates, central banks may be forced to tighten policy, which would hamper growth. Conditions haven't reached that point yet, however.

Brazil

BCB policy easing to continue despite energy price pressures

The record tight monetary stance maintained by the BCB throughout 2025, together with a weakened US dollar that supported a BRL appreciation of 10% YoY and softer economic activity, have delivered disinflation progress. Headline inflation fell from around 5.5% in mid-2025 to 3.8% in the February 2026 CPI print. Core inflation remains more stubborn, especially in services, though it has also improved, with inflation expectations re-anchoring and moving closer to target for the relevant horizons. This backdrop supported the start of the BCB's easing cycle this week.

However, the oil shock has become a challenging risk. Brazil's position as a major net oil exporter provides some cushion to limit the pass-through of higher energy costs, as evidenced by the recent government diesel subsidy policy. A prolonged period with higher oil prices may still add inflationary pressure, although we continue to project inflation to remain below the 4.5% upper bound for the central bank's target. Very tight monetary policy, with ex-ante real rates still at 10%, about 500bps above neutral levels, allows easing to continue. Still, if oil prices remain at current high levels, our 12% policy rate forecast (end 2026) could be at risk, as the BCB may adopt a more cautious and gradual easing path ahead.

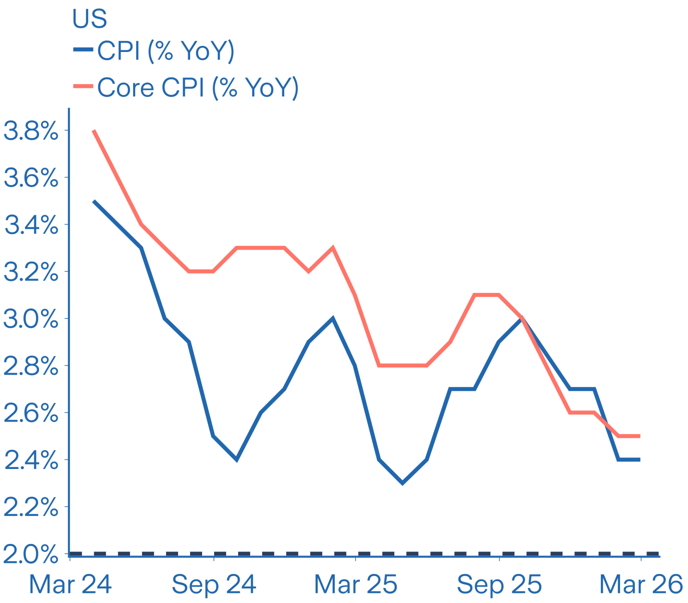
LatAm

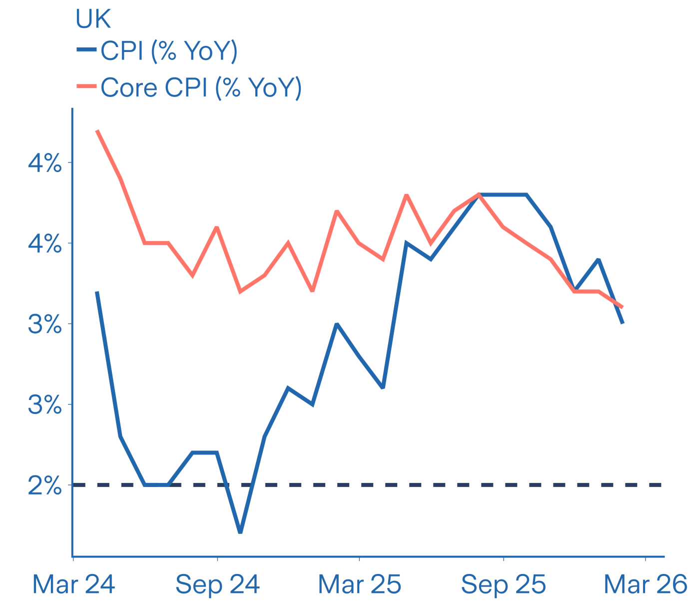
Further cuts at risk as oil shock clouds the outlook

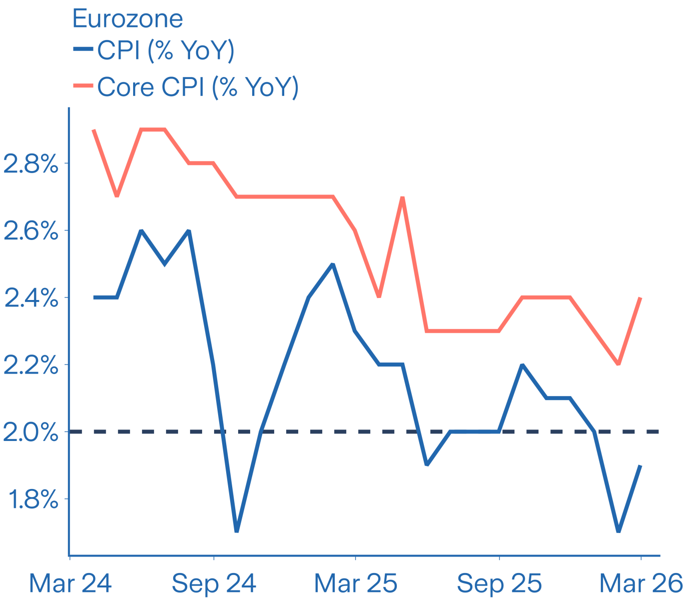
Mexico's disinflation stalled in February, with headline inflation back at 4% YoY, after seven months running below Banxico's 4% upper tolerance band. The rebound reflected a correction higher in the previously subdued non core components, while core inflation kept trailing above the headline pace. Although Mexico is an oil producing economy, it relies heavily on imported refined fuels. The government is expected to adjust gasoline excise taxes to smooth pass through effects. Even so, if oil prices stay elevated for longer, inflation will likely end the year way above the 4% level, limiting Banxico's scope to keep easing, despite its dovish Board.

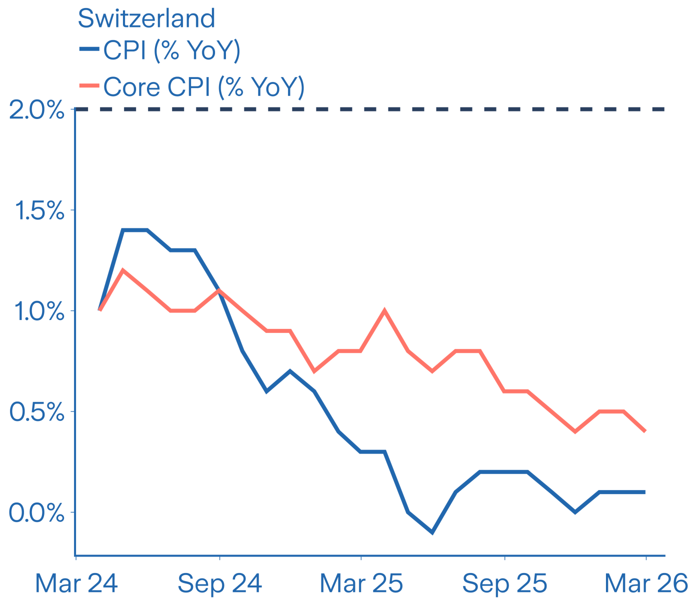
Chile has been one of the region's strongest disinflation performers, with inflation running below the 3% target since early this year. However, the economy remains highly exposed to the oil shock due to its heavy reliance on imported oil. Even so, inflation running below target provides some cushion to absorb current energy pressures. If oil prices stay near current levels for an extended period, inflation may accelerate but would likely remain below the 4% upper tolerance band by year end. With the policy rate already within the neutral range, we expect the Central Bank to stay on hold until the external environment becomes more certain.

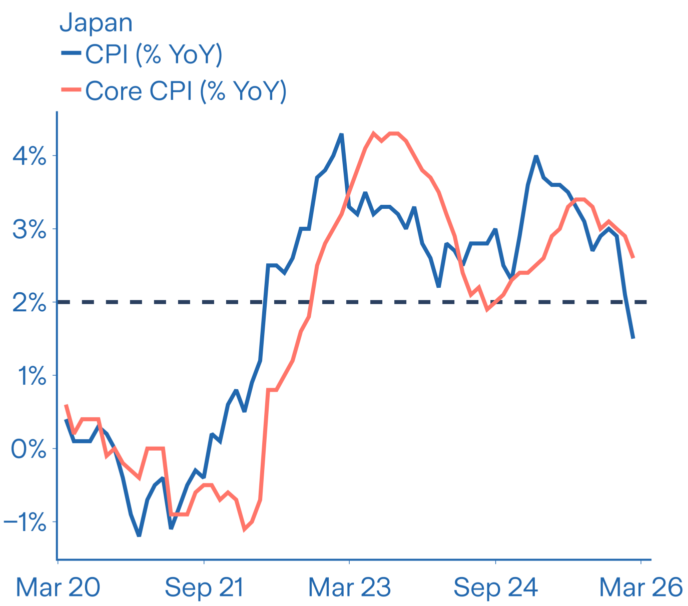
Current and historic inflation

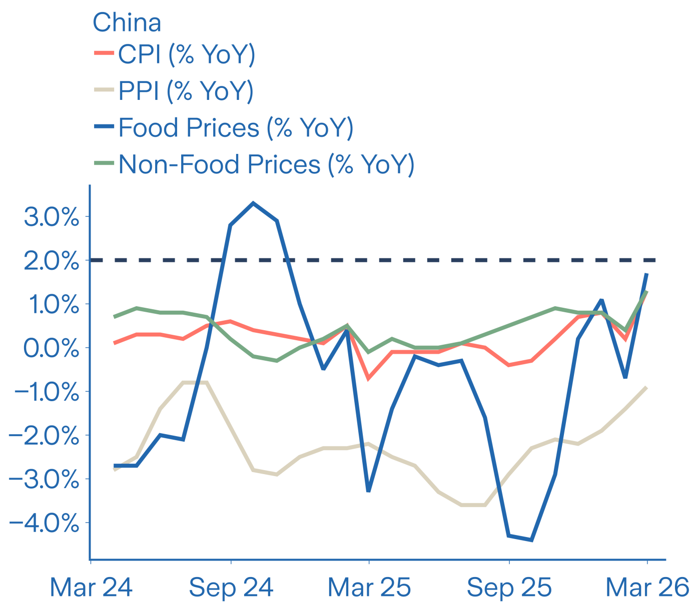






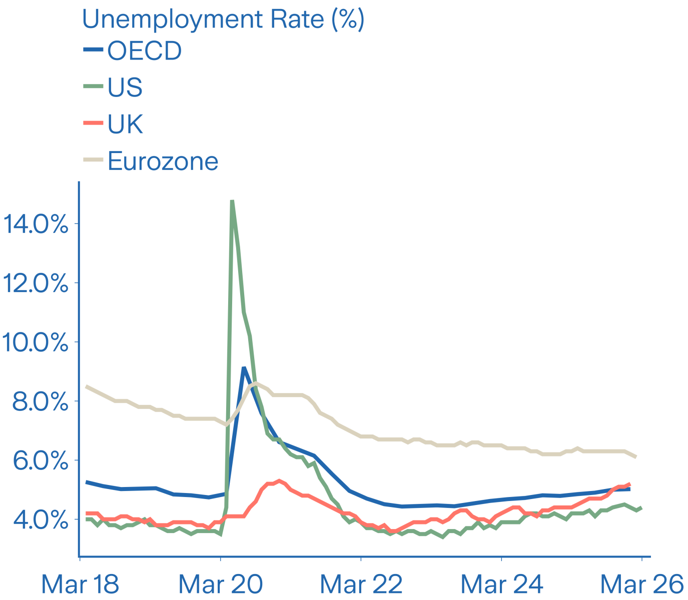


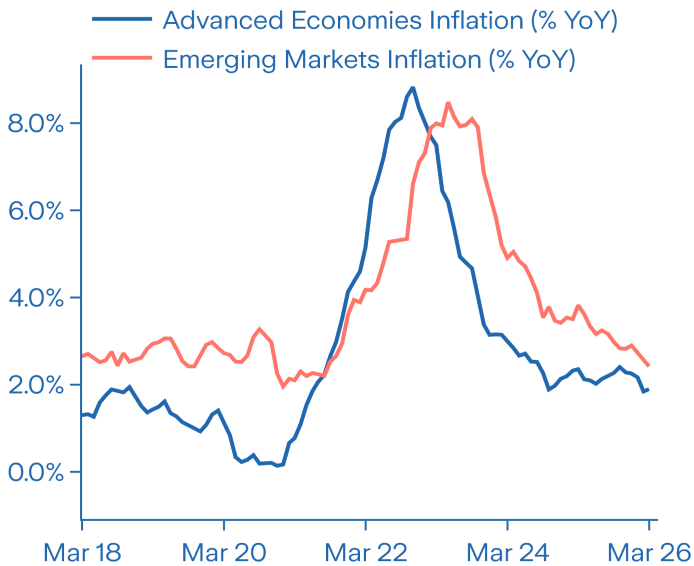


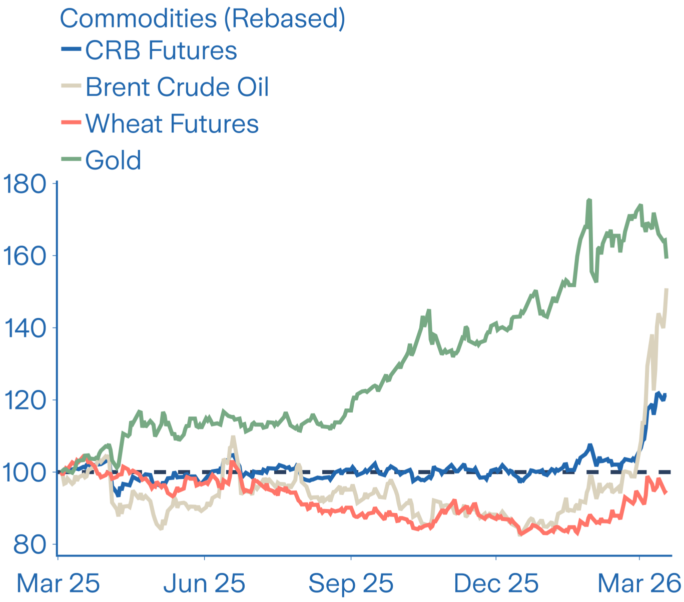


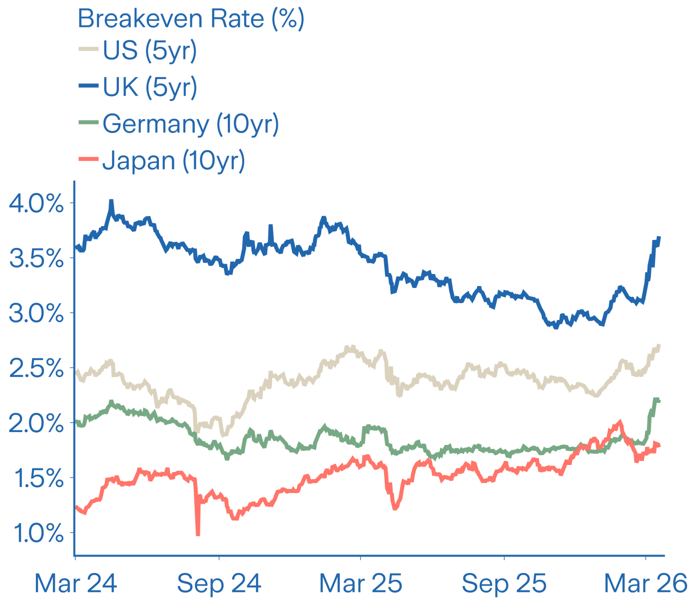
Source: Bloomberg, ZIG

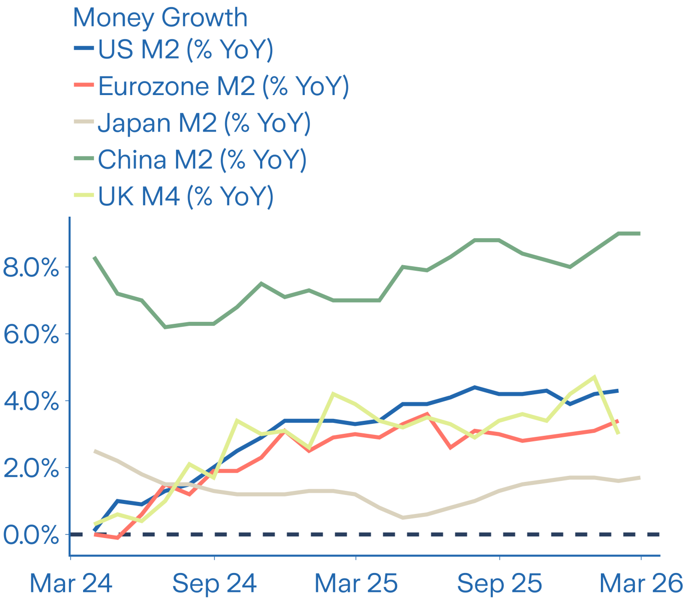
Key Indicators

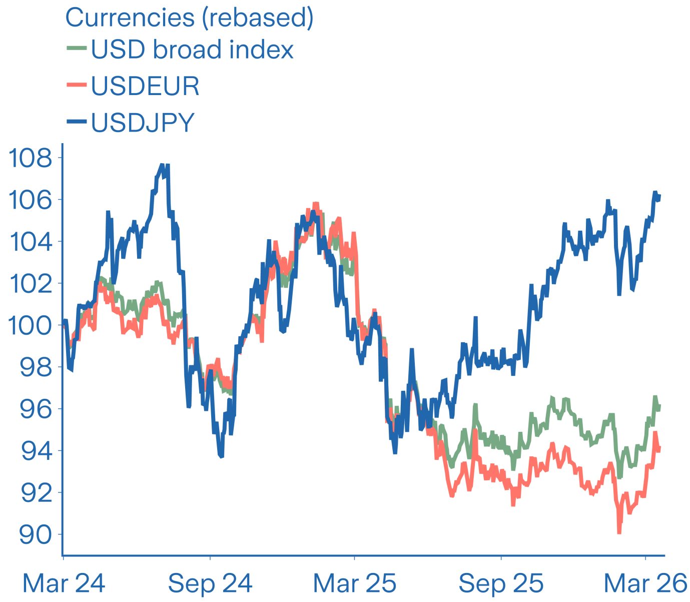












Source: Bloomberg, ZIG

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