The S.P.E.C.T.R.E. of Stagflation:

Shocks, **P**rices, **E**nergy, **C**onflict, **T**hreat, **R**ecession, and **E**xpectations

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The global economy has entered a new era of heightened geopolitical risk. From Russia's invasion of Ukraine in February 2022 to the outbreak of war in Iran in February 2026, geopolitical shocks have repeatedly demonstrated their capacity to destabilize not only energy markets and trade flows, but also the beliefs, sentiments, and decisions of households and firms.

The central point of this project is that geopolitical shocks do not merely operate through conventional supply-side channels — disrupting energy supply, raising commodity prices, and inhibiting trade. They also work through a powerful and often underappreciated propagation channel: expectations. For instance, when households revise their beliefs about future inflation and growth in response to geopolitical events, those revised beliefs can themselves become a source of macroeconomic instability, feeding into elevated uncertainty, wage demands, spending decisions, and ultimately into actual inflation dynamics. In this sense, expectations are not merely a passive reflection of economic reality — they are an active force that shapes it. As a result, the conventional policy prescription to “look through” supply-side shocks may be not a good advice.

The project will draw on rich microdata from the ECB's Consumer Expectations Survey (covering eleven euro-area countries) and potentially comparable surveys for other countries, to document in granular detail how households (and potentially firms) revised their inflation and growth expectations in the immediate aftermath of both the Russian invasion and the Iran war. Our preliminary findings are striking. In both episodes, consumers rapidly and significantly revised their inflation expectations upward and their growth expectations downward, tracing out a pattern of stagflationary beliefs that mirrors the worst fears of macroeconomic policymakers. Moreover, our preliminary evidence documents that this pattern was amplified in the second episode by what we provisionally call a "double scar" — the cumulative psychological and economic legacy of the post-pandemic inflation surge and the prolonged geopolitical tensions that preceded the Iran conflict.

Three interconnected themes will run through our analysis. First, geopolitical shocks are powerful drivers of expectations, operating rapidly and heterogeneously across households/firms and countries. Second, the propagation of these shocks through expectations poses a genuine risk of de-anchoring medium-term inflation expectations, particularly when households with already-elevated inflation concerns extrapolate short-term price pressures into longer horizons. Third, and perhaps most importantly from a policy perspective, trust in the central bank can act as a significant moderating force, buffering the impact of geopolitical shocks on inflation expectations and underscoring the value of central bank credibility in turbulent times.

Preliminary results

Below we provide some preliminary findings (based on the ECB's Consumer Expectation Survey) to show that we have enough proof-of-concept results to support our main arguments.

In March 2022, the first survey month following Russia's invasion of Ukraine, the average of one-year-ahead inflation expectations rose by 2.2 percentage points compared with February (Figures 1 and 2), while growth expectations fell by approximately 2.3 percentage points, moving from slightly positive territory to a deeply negative expected growth rate of around -1.8%. The simultaneous deterioration in both inflation and growth expectations — the hallmark of stagflationary beliefs — was rapid, large, and widespread across euro area countries and demographic groups.

Four years later, the pattern repeated itself with remarkable consistency. In March 2026, in the immediate aftermath of the Iran war outbreak, mean one-year-ahead inflation expectations rose by approximately 2.5 percentage points, while growth expectations fell by around 1.2 percentage points. While the growth expectation revision was somewhat smaller in the Iran war than in the Russian invasion, the inflation expectation revision was actually slightly larger, suggesting that households may have become more sensitive to the inflationary implications of geopolitical conflict as a result of their recent lived experience.

Several important differences between the two episodes deserve attention. Prior to the Russian invasion, inflation expectations were already on a rising trajectory, reflecting the post-pandemic price surge. Prior to the Iran war, inflation expectations had been on a slowly declining path, approaching the inflation target. The Iran war thus effectively interrupted and reversed a hard-won process of expectation normalization, "freezing" the downward adjustment in inflation perceptions that had been underway since the peak of the 2022-2023 inflation episode. This asymmetry is significant: it suggests that the Iran war shock arrived at a particularly delicate moment, when the credibility gains from successful disinflation were still fragile and easily disrupted.

The evidence for the existence and significance of inflation "scars" is already visible in the data. In January 2023, at the peak of the inflation episode, 47% of consumers reported high attention to price changes, consistent with the well-established finding that inflation attention rises sharply in high-inflation environments (Figure 3). By August 2025, with inflation back close to the ECB's target, this share had declined only modestly to 41% — far above the levels that would typically be observed in a low-inflation environment. This persistently elevated attention suggests that the inflation experience of 2021-2023 left a lasting imprint on how consumers monitor and process price information, making them more alert and more reactive to any new inflationary signals.

After the outbreak of the Iran war, despite actual inflation remaining close to the ECB's definition of price stability, consumers' attention to price developments bounced back sharply to almost 50% in March 2026. This rapid re-activation of inflation attention suggests that households

quickly drew on their memories of the Russian war on Ukraine, in which a geopolitical shock led directly and rapidly to a surge in energy prices and broader inflation. The scar from the previous inflation episode effectively lowered the threshold at which consumers became alarmed by new geopolitical developments, creating a form of heightened sensitivity or hypervigilance with respect to inflation risks.

The second scar — from prolonged geopolitical tensions — is equally evident in the data. Even before the Iran war broke out, a substantial fraction of euro area consumers reported being highly concerned about the impact of geopolitical events on their household's financial situation (Figure 4). In December 2025, 25% of consumers still reported high concern about geopolitical risks, compared with 35% in May 2022. While this represented some improvement from the peak of the Russian invasion, it still reflected a baseline level of geopolitical anxiety significantly elevated above pre-2022 norms. Consumers thus entered the Iran war episode already primed for adverse geopolitical scenarios, making their expectation revisions faster, larger, and potentially more persistent than they would have been in the absence of this background scarring.

The interaction between the two scars appears to be mutually reinforcing. Consumers who experienced the inflation surge and associate it with geopolitical conflict are more likely to anticipate that a new geopolitical shock will generate a new inflation surge. This anticipation itself can become self-fulfilling if it leads to higher wage demands, accelerated purchases, or reduced confidence in the central bank's ability to keep inflation anchored. The "double scar" thus represents not merely a psychological curiosity but a genuine macroeconomic risk factor — one that amplifies the transmission of geopolitical shocks through the expectation channel and potentially undermines the hard-won credibility gains of the disinflation period.

Building on these results, we aim to provide systematic evidence that geopolitical shocks generate precisely the pattern of belief revisions most conducive to stagflationary dynamics, and that these beliefs pose a genuine risk of becoming self-fulfilling through their effects on spending, wages, and longer-term inflation expectations. In a nutshell, households and firms form their inflation expectations partly by extrapolating from recent experience with highly visible prices — usually energy and food — and partly by updating on news about macroeconomic conditions. Geopolitical conflicts affect both inputs simultaneously: they raise energy prices directly, and they generate macroeconomic news that is almost universally negative. The combination produces rapid and large upward revisions in short-term inflation expectations, which in turn tend to spill over into medium-term expectations through a process of extrapolation.

Our preliminary analysis suggests that households with high geopolitical concerns systematically report higher three-year-ahead inflation expectations for any given level of one-year-ahead inflation expectations, compared with households with low geopolitical concerns. This means that elevated geopolitical risk does not merely shift the level of inflation expectations but also steepens the relationship between short-term and medium-term beliefs — in effect, making

the extrapolation mechanism more aggressive and the risk of de-anchoring more acute as well as the tradeoff between inflation and unemployment less favorable.

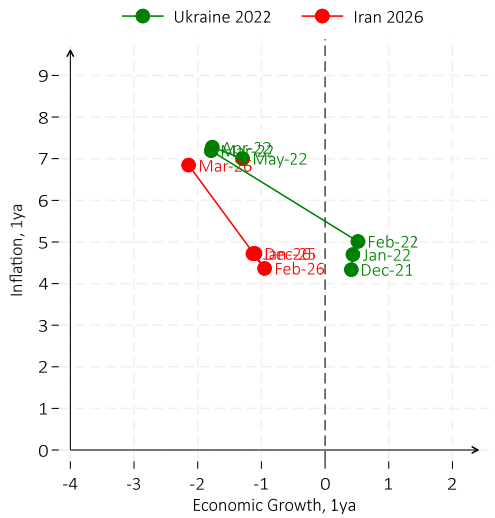
The implications for aggregate demand are equally sobering. Preliminary survey evidence indicates significant declines in consumers' spending plans following the Iran war outbreak, with intentions to purchase durables, cars, and holidays all falling in March 2026 (Figure 5). This pattern mirrors the spending deterioration observed following Russia's invasion of Ukraine and is consistent with the broader literature showing that geopolitical uncertainty acts as a drag on consumer expenditure. Moreover, the paper's experimental evidence — based on randomized hypothetical scenarios asking households about the expected impact of conflicts of different durations on their financial situation — reveals that the negative sentiment effects intensify strongly with conflict duration (Figure 6). The share of consumers expecting a deterioration in their financial situation rises sharply when moving from a "conflict ends soon" scenario to a "conflict persists for three or more years" scenario, and this pattern intensifies over time, suggesting that prolonged geopolitical risk creates a structural drag on consumer confidence that goes well beyond temporary uncertainty.

In short, the stagflationary spectre is not merely a theoretical concern: rising inflation expectations, worsening growth outlook, deteriorating consumer sentiment, and reduced spending plans — all simultaneously triggered by geopolitical shocks and amplified by accumulated scarring — create precisely the conditions under which stagflation can transition from a belief to a reality.

Against this backdrop of compounding geopolitical shocks, scarred households, and fragile expectation anchoring, we want to explore the role of central bank trust and communication in attenuating the adverse effects of geopolitical shocks. Our tentative evidence (Figure 7) suggests that trust in the central bank can act as a buffer against the de-anchoring of inflation expectations in response to geopolitical shocks. Specifically, households with higher trust in the ECB revise their inflation expectations significantly less in response to both the Russian invasion and the Iran war, and this moderating effect is larger at longer horizons — precisely where de-anchoring would be most damaging.

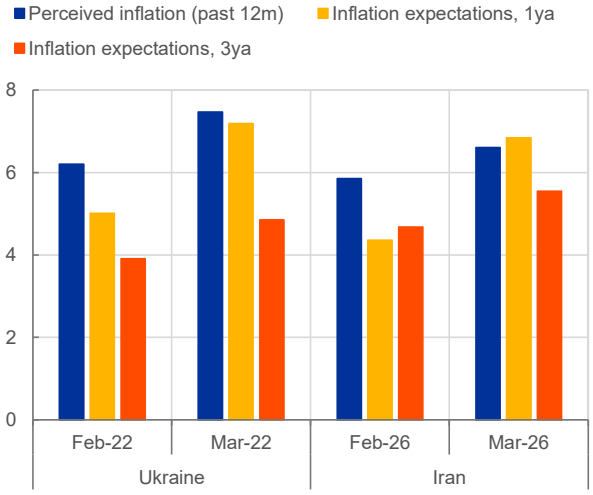
These findings have direct implications for monetary policy communication. The current environment — characterized by high consumer attention to inflation, elevated sensitivity to geopolitical news, and accumulated scarring from previous shocks — creates both a challenge and an opportunity for central bank communication. The challenge is that consumers are more reactive to any signal that might suggest inflation is returning, making it harder to prevent expectation revisions from spiraling. The opportunity is that heightened attention means that central bank communications are more likely to be noticed and processed by households than in normal low-inflation times, when most consumers pay relatively little attention to monetary policy. Thus, the spectre of stagflation can be kept at bay, but only if central banks maintain the credibility and communication effectiveness needed to anchor beliefs even when geopolitical reality is pushing hard in the opposite direction.

Figure 1: Inflation and growth expectations around the onset of two wars
(means, percentage points)



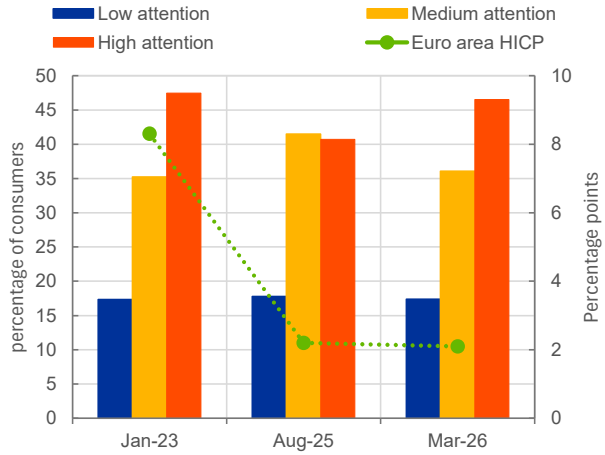
Source: ECB Consumer Expectations Survey (CES: EA-11); authors' calculations.
Notes: Population weighted data. The chart depicts EA average expectations about changes in prices in general and economic growth one year ahead. Both expectation series have been winsorised at the most extreme two percentiles to account for outliers. The underlying data is collected as part of the monthly CES survey module.

Figure 2: Inflation perceptions and expectations
(means,percentage points)



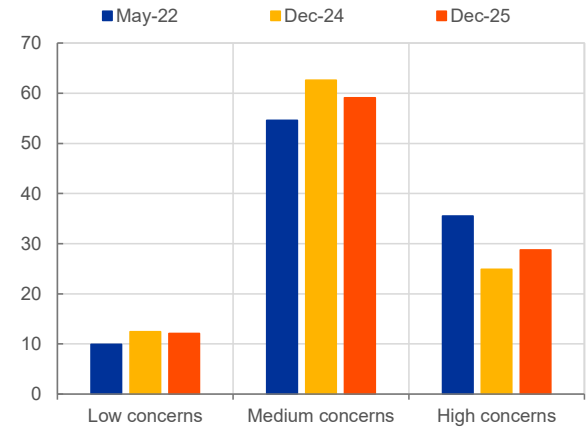
Source: ECB Consumer Expectations Survey (CES: EA-11); authors' calculations.
Notes: Population weighted data. Each bar reports the average for EA consumers. All series have been winsorised at the most extreme two percentiles to account for outliers. From April 2022 onwards, the sample also includes data from five new countries included in the survey: Austria, Finland, Greece, Ireland, and Portugal. Chart A.9. reports the results also including the Gaza conflict.

Figure 3: I Inflation attention over time
(percentage of consumers (lhs) and percentage points (rhs))



Source: ECB Consumer Expectations Survey (CES: EA-11); experimental data, European Commission (Eurostat) and European Central Bank calculations based on Eurostat data, authors' calculations, Notes: Population weighted data. Each bar depicts the share of consumers for each self-assessed level of inflation attention. Consumers are asked how much attention they currently pay to changes in prices in general. Respondents can choose out of five options. 1 – Almost no attention, 2 – A little attention. 3 – Some attention, 4 – Much attention and 5 – A great deal of attention. Data is collected as part of special purpose survey modules. The bars show the share of respondents by attention level on the right axis: low (1–2), medium (3) and high (4-5). The dots represent EA HICP inflation rates in each of the respective survey months.

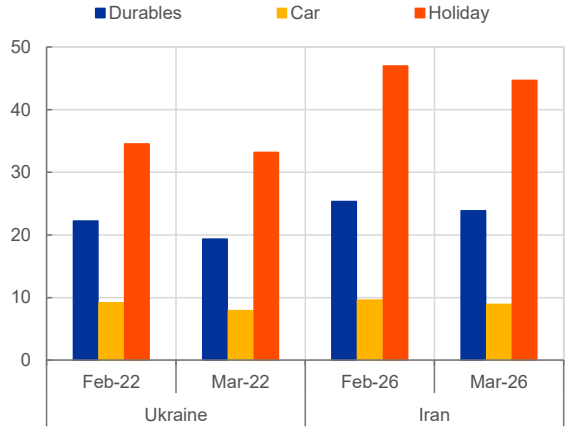
Figure 4: Consumers' concerns about geopolitical conflict
(percentage of consumers)



Source: ECB Consumer Expectations Survey (CES, EA-11); experimental data; authors' calculations. Notes: The chart reports population-weighted shares of respondents by the level of geopolitical concern. In December 2024 and December 2025, respondents were asked how concerned they are about the impact of current geopolitical events on their household's financial situation over the next 12 months. In May 2022, the question refers specifically to the war in Ukraine and its expected impact on the household's financial situation. Responses are recorded on an 11-point scale from 0 (not concerned at all) to 10 (extremely concerned) and grouped as follows: low (0–2), medium (3–7), and high (8–10). Data are collected in special-purpose modules.

Figure 5: Consumer spending plans over the next 12 months

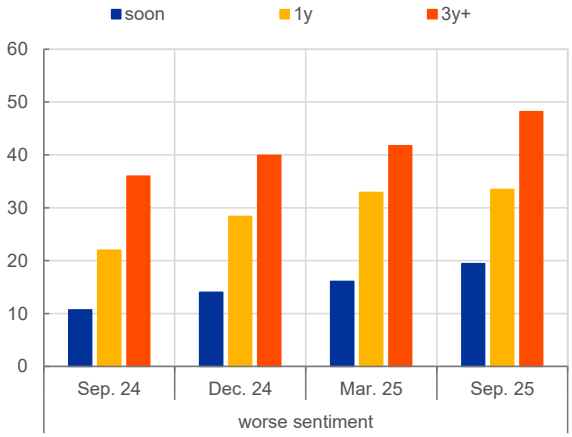
(percentage of consumers)



Source: ECB Consumer Expectations Survey (CES: EA-11); authors' calculations,
Notes: Population weighted data. Each bar depicts the share of consumers reporting to plan purchasing durables, cars, or holidays over the next 12 months. The underlying data is collected as part of the monthly CES survey module. Appendix Chart A.10 also reports results including the Gaza conflict.

Figure 6: Effect of prolonged war on consumers' sentiment

(percentage of consumers)

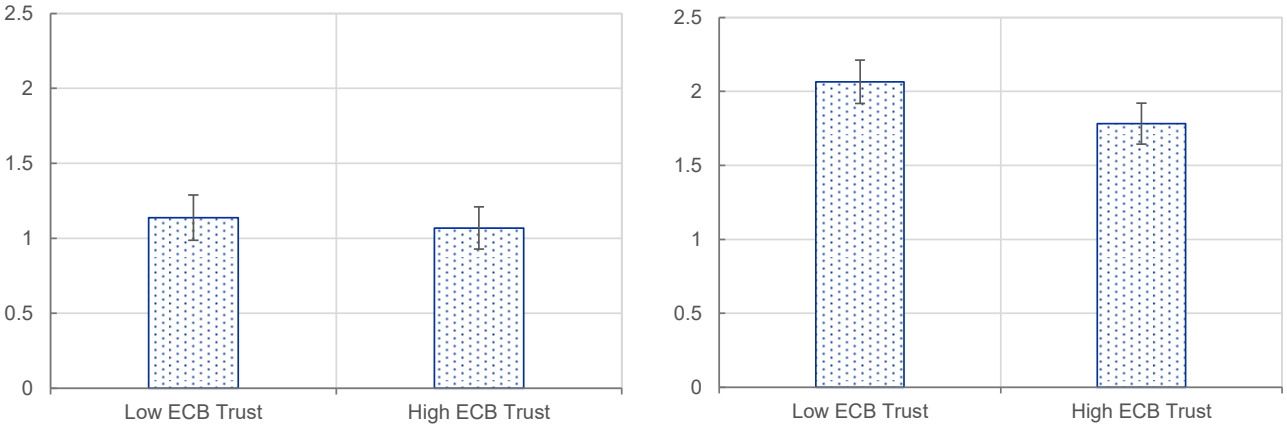


Source: ECB Consumer Expectations Survey (CES, EA-11); authors' calculations.
Notes: The chart reports population-weighted shares of respondents expecting a deterioration in their household's financial situation under alternative scenarios for the duration of the war in Ukraine and the conflict in the Middle East. In a randomised survey experiment (see Gorodnichenko et al. (2025)), respondents are assigned to one of three scenarios: conflicts (i) end soon (by the end of the respective month), (ii) end in one year (1y), or (iii) persist for at least three years (3y+). The random assignment supports a causal interpretation of differences across scenarios.

Figure 7: Moderating effect of trust on inflation expectation

(A) Russian invasion and conflict in Middle East continuing one more year (percentage points)

(B) Russian invasion and conflict in continuing in the next 3 years (and possibly beyond) (percentage points)



Source: ECB Consumer Expectations Survey (CES, EA-11); authors' calculations; see Gorodnichenko et al. (2025).
Notes: The chart depicts the effect of geopolitical conflict duration on consumers one-year ahead inflation expectations (y-axis). Bars report OLS coefficients estimated separately for subsamples with low and high trust in the ECB; whiskers indicate 95% confidence intervals. Panel (A) compares a randomly assigned scenario in which the war in Ukraine and the conflict in the Middle East continue over the next year and end by December 2026 with a baseline scenario in which both conflicts end by December 2025. Panel (B) compares a scenario in which both conflicts persist for at least three years (and possibly longer) with the same baseline. Random assignment of scenarios allows a causal interpretation of the estimated effects. All specifications include socio-demographic controls and country fixed effects. High ECB trust is defined as a trust level above the sample median (6) on a scale from 0 (no trust at all) to 10 (full trust).