

SPEECH

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SPEAKER: Governor Erik Thedéen
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Monetary policy challenges in war-related supply shocks*

The past year illustrates quite well how political decisions in large countries can have consequences for the entire global economy. The tariffs imposed by the US administration at the beginning of 2025 seem to have been handled relatively well by the global economy – as does the uncertainty and various twists and turns surrounding them. The economic impact of the war in Iran, the prolonged disruption of key global supply chains and the continued political tensions in the region may prove to be more significant. More broadly, it is also possible that the ‘Pax Americana’ – the world order that has provided relative stability and predictability since the Second World War – is now coming to an end. In such a world, it is likely that the global economy will be subject to more and larger disturbances or shocks, i.e. rapid and unexpected developments. These disruptions will inevitably have economic consequences.

How should monetary policymakers act when the economy is hit by shocks, and how should they view the current situation? These are the issues around which my discussion will centre. At the same time, I would like to make it clear that some of the arguments I will present are my own reflections and assessments and are not necessarily shared by my colleagues on the Executive Board.

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Difficult monetary policy trade-off in the event of supply shocks

A natural starting point is to draw on basic economic theory. An economy is continually subjected to shocks – some small, some large. Disruptions can affect either the demand side or the supply side. A supply-side shock refers to events that affect companies' costs and ability to produce. The classic textbook example of an adverse supply shock is a sharp increase in the price of oil in response to a reduction in supply. Many economists believe that negative supply shocks may become more common in the future, due to increased geopolitical instability and climate change.

If inflation rises because demand increases, the remedy is simple, at least in theory: the central bank raises the policy rate, thereby curbing both inflation and demand. This reduces the risk of the economy overheating.

A negative supply shock reduces economic activity and puts upward pressure on inflation. In other words, the effect is stagflationary – a combination of stagnation and inflation. For central bank policymakers, supply shocks are more difficult to handle than demand shocks. These require the central bank to make a trade-off between curbing inflation and supporting demand.

If the effect on inflation is expected to be short-lived, the problem need not be so great. The central bank can then often wait until inflation falls back – it can “see through” the rise in inflation, so to speak. But one risk that always exists is that the inflationary impulse spreads to other prices and may also start to feed into expectations. This makes inflation more persistently high. The larger the disturbance and the longer it lasts, the greater the risk of spillover effects.

More than a traditional oil shock

The conflict in the Persian Gulf can be seen as a negative supply shock, and a significant one at that. Around 20 per cent of the world's oil production and much of the global trade in liquefied natural gas passes through the Strait of Hormuz.

But the region is also central to other important products, such as fertilisers. Natural gas is an important input in the production of fertilisers and the Persian Gulf countries account for about one third of the fertilisers traded globally. They also export natural gas used in fertiliser production elsewhere in the world. In the same way, these countries are an important global hub for the production and export of raw materials for plastic products. The world's supply of helium – used,

for example, in semiconductor manufacturing – is also severely affected. Overall, many industries and products are affected.¹

Trying to predict what will happen to traffic in the Strait of Hormuz and the conflict itself is of course difficult. The situation is extremely fragile and uncertain. A few days ago, both the US and Iranian sides declared that the strait had opened, but it was closed again shortly afterwards. It is difficult to draw any firm conclusions that the situation has improved until one actually sees a greater number of ships passing through again.

The return to more normal conditions will take time, even in the case that the strait would open fairly soon. The disruption will then become a more protracted process. Factors such as mine clearance, massive queues of ships and damaged oil infrastructure are likely to create continued sluggishness for some time. These are reinforced by the fact that insurance premiums are likely to remain high as the uncertainty surrounding future shocks will be priced into the market. What this means for the global economy is that the inflationary pressures brought about by the adverse supply shock will not level off at the stroke of a pen, but will fade away slowly over a protracted normalisation phase. There is therefore no immediate prospect of a return to the pre-war conditions.

Wars often have wider supply effects

A war or geopolitical crisis is also a different type of supply shock than, for example, a ship getting stuck in the Suez Canal or a security incident leading to the shutdown of a nuclear power plant. Such events can usually be resolved quickly, and therefore often only affect inflation and economic activity to a limited extent and for a short period of time.

In contrast, research based on historical data shows that wars and adverse geopolitical events tend to push up inflation more significantly, and inflation remains elevated on average for several years.² Nor is it necessary for a war to actually break out; increased geopolitical threats and tensions can also push up inflation. The mechanism works largely via the supply side. In the event of war or geopolitical tensions, producing and transporting goods becomes more difficult

¹ For a compilation of non-oil products where the region plays a central role, see Geldard (2026).

² See Caldara et al. (2026). However, this is not obvious. At the same time, it is conceivable that demand could be negatively affected by, for example, weakened consumer confidence and lower willingness to invest among companies. This would provide a countervailing downward pressure on inflation. Klein et al. (2025) examine the impact of geopolitical risk on Swedish inflation. They find that geopolitical risk specific to Sweden contributes to increased inflationary pressures. Sweden-specific geopolitical risk is measured as the proportion of articles in major international news agencies that mention negative geopolitical situations and also mention Sweden or one of Sweden's largest cities. The impact on Swedish inflation of global geopolitical risk (where Sweden is not mentioned) is less clear.

and expensive, which can create shortages of everything from energy to food.³ Geopolitical risks also tend to lower economic growth and increase uncertainty about the future path of inflation.

Of course, when studying long historical time series, they span different monetary policy regimes. During the 1970s and 1980s, the world experienced a period of high and sustained inflation. Here, the two oil crises in 1973–1974 and 1979–1980 played an important role, and they were both related to war and unease in the Middle East.

But of course, the economic policies pursued also influenced developments. For various reasons, it became too expansionary or, as is usually described, accommodative. The inflationary impulses were thus allowed to take hold, and high inflation was able to become entrenched.⁴ During the period when central banks have been guided by a numerical inflation target – since the early 1990s – we have in practice experienced only one clear inflation peak, namely the one that occurred just a few years ago, in 2021–2022.

What happened then was that the inflationary impulse, which was initially largely supply-driven, spread through the economy and began to gain a stronger foothold in Sweden and other countries. In that case, too, the rising inflation was partly war-related – then as a consequence of Russia’s invasion of Ukraine. Central banks needed to act to bring inflation back on target. Not all countries have reached this stage yet either. In Norway, the United Kingdom and the United States, for example, inflation has remained above target and policy rates there are about two percentage points above those in Sweden. The supply disruption caused by the Persian Gulf conflict has not made the task any easier.

Both differences and similarities to 2021-2022

In Sweden, there are both similarities and differences between the situation now and then, and these partly work in different directions. At the beginning of 2022, the policy rate was 0 per cent and the Riksbank continued to buy securities. The krona had been depreciating for some time, resource utilisation was assessed to be slightly higher than normal and households had pent-up demand after the pandemic, particularly for services. Overall, this should have contributed to underlying upward pressures on inflation, which are likely to be less pronounced

³ Merendino and Monacelli (2026) find that oil prices act as an information signal for companies concerning broader logistics disruptions. As a result, even temporary oil price shocks can push up inflation more strongly and sustainably when uncertainty in supply chains is high. They find that this uncertainty is currently at a record high.

⁴ See, for example, Apel and Ohlsson (2022), who provide a historical review from the year 1900 of episodes when war was associated with high inflation in Sweden.

today. Today, the policy rate is 1.75 per cent, the krona appreciated significantly last year and resource utilisation is still relatively low after a few years of weak economic activity.

However, one factor that may work in the opposite direction is that fiscal policy is currently more expansionary. Moreover, the period of high inflation may have affected the perception of inflation as a phenomenon. Once it is recognised that inflation indeed *can* rise quickly and sharply – something that entire generations had not experienced until recently – it may become more natural to react faster by raising prices and demanding higher wages in response to an inflationary impulse.⁵ One factor that probably also played a role in the rise in inflation in 2021–2022 is that consumers seem to find it easier to accept price increases when they perceive them as the result of increased costs that are beyond the control of the companies themselves.⁶ With an initial impulse of supply-driven cost increases, the situation is not dissimilar.

There are also broader aspects to consider. Confidence in the inflation target is well anchored in the Swedish economy, perhaps more so than in some other countries. This is probably an important reason why we did not need to raise the policy rate very much compared with many others in the context of the previous inflationary upswing. We also managed to bring inflation back to target, allowing us to cut the policy rate relatively sharply again. As I have already noted, this has not been the case in all countries. However, we cannot of course just sit back and assume that everything will be fine. But at least we have more possibilities to act less forcefully and more nuanced than we would have if credibility was lower.

To some extent, Sweden is also in a better position than many other countries, as our dependence on oil is not particularly high. This is an advantage both now and in the event that this type of supply disruption becomes more common in the future. At the same time, we are more dependent on foreign trade than many other countries, which means that rising inflation abroad is also likely to spill over to us. All in all, these are factors that we need to weigh up as best we can in our forecasts.

⁵ This possible effect was raised by, among others, Christine Lagarde (2026) in a speech in March.

⁶ The main reference here is Kahneman et al. (1986) who find that it is considered acceptable for companies to raise prices to protect their profits in the face of rising costs, but that it is perceived as unfair if they raise prices to take advantage of increased demand pressures.

Different strategies in the face of a supply-driven inflationary impulse

If there is an adverse supply shock that gives rise to an inflationary impulse, the central bank may initially react in slightly different ways. One option is to 'wait and see'. This seems a fairly reasonable approach if uncertainty is high and the duration of the supply disruption is still unclear. Waiting will provide more information on the extent to which price rises will spill over to other prices, wages and inflation expectations, while avoiding unnecessary aggravation of the economic situation. One risk of this approach is that the response may come too late, if it turns out that the disruption was larger and longer lasting than expected or had significant spillover effects. Inflation could then become high and more difficult to bring back down.

Another option is to raise interest rates relatively sharply as a precautionary measure. In this case, the credibility of the inflation target is given very high priority and even short periods of above-target inflation are seen as undesirable. One problem with this strategy is that if the shock has already subsided and inflation has begun to fall back before the interest rate increase has an impact, there is a risk that monetary policy will be sharply contractionary in a situation where the economy instead needs support. Moreover, it is probably neither possible nor desirable to use monetary policy to completely prevent a very large shock from having an impact on inflation.

A third option is to raise the interest rate, but to a relatively limited extent. This gives the central bank room to manoeuvre to assess how the economy is reacting, both to the shock itself and to the interest rate adjustment, before taking the next step. Here too, of course, there is a risk that the central bank will tighten demand unnecessarily if the supply shock turns out to be small or short-lived. If the disruption turns out to be relatively large instead, the risk of the initial cost shock spreading is reduced to some extent. In practice, the difference between this approach and the 'wait and see' strategy is not very large. It is mostly a question of how quickly and how clearly the central bank signals that it is ready to act, given the uncertainty regarding the size and duration of the shock.

Of course, it is also important to focus on risks and to be open to the possibility that developments may take a completely different direction than anticipated. The Riksbank has a long tradition of working with alternative scenarios, and they are very useful in situations like the current one. In the latest Monetary Policy Report, we included a scenario with a broader and more sustained rise in inflation than in the main scenario. But also one where the negative effects on economic activity are more significant, while inflationary pressures are weaker and more short-lived.

Preparedness for larger effects on inflation

There is still considerable uncertainty about how the conflict in the region and the situation in the Strait of Hormuz will develop. Will political tensions in the region ease or is there a risk of continued unrest? Will the key supply chains be up and running and how big will the lagged effects be? As I have said, it is reasonable to expect that things will not return to normal quickly.

One general insight I have gained in recent years is that it is risky for a central bank to assume that it can always “see through” negative supply shocks. Severe shocks can propagate throughout the economy and give rise to more persistent increases in price growth, probably even after the most acute phase of the shock has passed.

My overall view is that the risk has risen somewhat that inflation could be higher than we expected a few weeks ago. At the same time, our low-inflation starting point means that we have some scope to try to obtain a clearer picture of the economic impact of the disruption on global supply chains, as well as of the prospects for a lasting solution to the conflict. But it is important that we remain vigilant for indications that the inflationary impulse is starting to spread more broadly in the economy. If there is an increased risk of high inflation and a sustained deviation from the target, monetary policy may need to act to prevent this. It feels relevant to repeat what I said in March: We are maintaining a steady course but are ready to swerve if necessary.

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