European Economic Outlook

EY Economic Analysis Team

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Topics

The economic outlook is shaped by a range of factors that create uncertainty and directly influence economic activity

Key forecast drivers:

1. Tariffs: a manageable shock, but still a drag.

US trade policy remains a key external headwind in 2026. Following the Supreme Court's invalidation of IEEPA-based tariffs, the administration has shifted to Section 122 of the Trade Act to impose a 10% baseline tariff on all trading partners, with plans to raise the rate to 15% in the near term. Although Section 122 measures can remain in place for only up to 150 days without Congressional approval, our base case assumes that comparable measures will continue thereafter—most likely through Sections 301 and 232. Importantly, the ruling does not affect existing non-IEEPA tariffs, including those on cars, steel, and aluminum.

Bottom line for Europe: while the Supreme Court's verdict is material for China, it changes little for the EU, as the baseline rate remains at 15%. Even though the growth impact in 2025 looked limited, we estimate tariffs will shave 0.5 pp off EU's GDP growth in 2026, with the most negative effects concentrated in Ireland and Nordic countries.

In this edition of the outlook, we also examine the recently announced EU-India Free Trade Agreement. While the aggregate macro impact on Europe is negligible, sectoral effects are somewhat more meaningful. For example, minerals sector may benefit from improved access to production inputs, while clothing industry could face stronger competitive pressure from Indian producers.

2. Geopolitics: contained impact so far

The recent escalation of the conflict in Iran underscores that geopolitics remains one of the major factors shaping the economic outlook. While the current conflict has substantial impact on the Middle East, its global economic repercussions are likely to be limited – we estimate that a temporary increase in energy prices, weaker business and consumer sentiment, and some trade disruptions could raise euro area inflation by 0.3 pp in 2026 and reduce GDP by 0.2%. However, the situation remains fluid, and further escalation could lead to more severe consequences. If the Strait of Hormuz is blocked, triggering a persistent surge in energy prices, euro area GDP could be about 1.3% lower by 2027 relative to a no-escalation scenario, while HICP inflation could rise to around 5%.

3. Fiscal and monetary policy will provide a limited offset to the drag from tariffs.

Germany's fiscal stimulus is starting to filter through, visible in improving industrial orders. That said, implementation is likely to be gradual and more delayed than planned. We still see the peak impact on growth occurring next year at +0.8 pp in Germany and +0.3 pp at the euro area level. Some spillovers should lift growth modestly in CEE, Austria, and the Netherlands.

At the euro area level, fiscal policy is expected to be broadly neutral in 2026, as easing in Germany, the Netherlands, and Nordics is broadly offset by tightening in France, Italy, and Romania. At the same time, past monetary policy easing continues to support activity, adding around 0.2 pp to euro area growth in 2026.

The economic outlook is influenced by a series of factors that generate uncertainty and directly influence economic activity

Key forecast drivers:

4. Demographics are a rising constraint on Europe's potential growth.

Over the next 4 years, euro area labor supply is expected to rise only marginally, reflecting a stagnant working-age population and only a modest increase in labor force participation.

Cross-country divergence is striking:

- Labor supply is still expanding in Ireland, the Nordics, Spain, the Netherlands, the UK, and Switzerland, largely due to immigration.
- Germany, Greece, and most CEE countries face declining labor supply due to decreasing working-age population, which won't be fully offset by increasing labor force participation.

Over the longer term, European economies increasingly confront demographic pressures—though the severity differs—characterized by declining working-age populations and limited remaining room for further gains in participation. Consequently, labor supply becomes a persistent drag on trend growth. The pressure is most acute in CEE and Southern Europe.

5. Productivity and AI: the opportunity Europe can't afford to miss

Given tightening labor supply, productivity becomes the decisive lever. Investment in productivity-enhancing technologies, especially AI, will be critical. Our analysis suggests AI could raise Western Europe's GDP by up to 4% by 2033. Yet current indicators do not point to an AI investment boom comparable to the US. In that sense, Europe risks losing momentum in the AI race before it fully begins.

Investment in AI-related technologies and AI adoption rates also vary widely across Europe, with Nordic and Benelux economies leading the way, while CEE (notably Poland), Germany, and Italy are lagging.

Activity trends: Underlying growth is improving, even as headline numbers distort

Euro area growth has been distorted by Ireland's outsized contribution. Excluding Ireland, the underlying pace of real GDP growth has been gradually strengthening despite tariffs: to 0.3% q/q in 2025 Q3 and 0.4% in Q4, as investment and exports began to recover.

In 2025, euro area GDP rose 1.5%, inflated by a staggering 13.3% increase in Ireland, largely linked to tariff frontloading effects. Ex-Ireland, underlying growth reached 1.0%, up from 0.8% in 2024.

The structure of growth is shifting:

- Government spending and private consumption slowed as tariffs weighed on consumer sentiment.
- Exports resumed growth but still lag world trade amid euro appreciation and competitiveness challenges (including pressure from China).
- Manufacturing has returned to stagnation after an early-2025 uptick driven by tariff frontloading.
- Services continue to expand moderately, led by ICT.

While cross-country disparities persist, growth in laggard economies, including Germany, seems to be picking up.

- Ireland still shows strong momentum even on alternative activity measures (e.g., modified final domestic demand), with 2025 Q4 growth exceeding 4% y/y.
- Poland remains among the strongest in Europe at 3.6% GDP growth in 2025 Q4, supported by real income gains, expansionary fiscal policy, and NextGenEU spending.
- Spain continues to grow strongly (2.6% y/y in 2025 Q4), benefiting from a booming tourism sector, NextGenEU, and robust immigration.
- Other relatively solid performers include Bulgaria, Czechia, and Croatia in CEE, alongside Greece and Portugal in Southern Europe.
- Denmark's growth remains robust but volatile (pharma-driven). Sweden and Norway are in cyclical recovery, supported by lower interest rates.
- The Netherlands remained one of the stronger performers among Western European economies, expanding at a steady 1.7% y/y, supported by fiscal expansion and robust exports.
- France saw growth pick up in the second half of 2025 but at 1.1% y/y it still lagged the euro area average, as ongoing political uncertainty continued to weigh on economic activity.
- Among slow growers—Germany, Italy, Switzerland, Austria, Finland, Hungary, Slovakia— recent data suggest that the trough may be behind them, even if the industrial base remains under pressure. Romania stands out as stagnant due to fiscal tightening and energy price hikes.

Labor market is stabilizing, though still cooling at the margin. With inflation close to the target, ECB has kept rates on hold

Labor market: stabilizing, cooling at the margin

- Euro area employment growth is steady at 0.7% y/y (driven largely by Spain). Nominal wage growth is stable around 4% y/y. Yet the labor market is still cooling: vacancy rates continue to decline and fewer firms report labor hoarding. This can be explained by normalization in labor demand after past negative supply shocks, pandemic-era distortions, and labor hoarding. AI may also be contributing to softer labor demand, with early indications of a correlation between AI adoption and youth unemployment across countries.
- Despite some labor market cooling, unemployment remains near historical lows in the euro area: continued declines in Spain and Italy have offset modest increases in Germany and France. Substantial cross-country differences in labor market slack persist, featuring looser conditions in Southern Europe and the Nordics, and tighter in many CEE economies. This, alongside differences in inflation as well as minimum wage and public sector wage policies, feeds into meaningful cross-country differences in nominal wage growth.

Inflation and monetary policy: close to target, rates on hold

- Headline inflation in the euro area has stabilized near 2% amid falling energy prices, stagnant core goods prices, and still slightly elevated services inflation. Inflation divergence persists across Europe due to differences in wage growth, administered prices, and tax changes. Price growth continues to be elevated in some CEE countries, particularly Romania, while in Switzerland, France, Italy, and Finland, inflation is subdued.
- With inflation near target and GDP growth close to potential, the ECB has kept the deposit rate at 2.0% since June 2025. Most other European central banks are also in wait-and-see mode, as rates are either close to their neutral level (Switzerland, Sweden, Czechia) or monetary policy remains restrictive in the face of persistent price pressures (Romania, Norway). Only a couple of central banks (the Bank of England and the National Bank of Poland) have continued to cut rates in recent months, although not at every policy meeting. In February, the National Bank of Hungary restarted its easing cycle following a lengthy pause.
- At the same time, central banks continue to reduce bond holdings, which effectively softens the impact of past interest rate cuts. Quantitative tightening, alongside expectations of looser fiscal policy, is one of the reasons why bond yields have moved largely sideways in recent quarters despite rate cuts. Still, steady yields do not mean that interest rate cuts are not influencing economic activity: bank lending has picked up in recent quarters, broadly returning toward pre-pandemic growth rates.
- That said, cross-country divergences are visible in the euro area. Bond yields have been trending higher in Germany (fiscal easing) and France (political gridlock). Conversely, Italian yield spreads over German bonds have been gradually narrowing, supported by the country's successful fiscal consolidation efforts.
- The euro remains strong versus the USD. Meanwhile, Swedish krona, Hungarian forint, and Czech koruna appreciated against the euro in 2025 following earlier weakness. In contrast, the sterling depreciated.

Excluding Ireland, we expect growth in the euro area to continue gradually accelerating, supported by fiscal policy and lower interest rates

We expect underlying euro area growth (excluding Ireland) to continue gradually accelerating, driven by:

- Ongoing investment recovery, supported by lower interest rates, improved profits, and higher government spending
- Reacceleration in consumption as saving rates stop rising
- Continued (if challenged) export growth

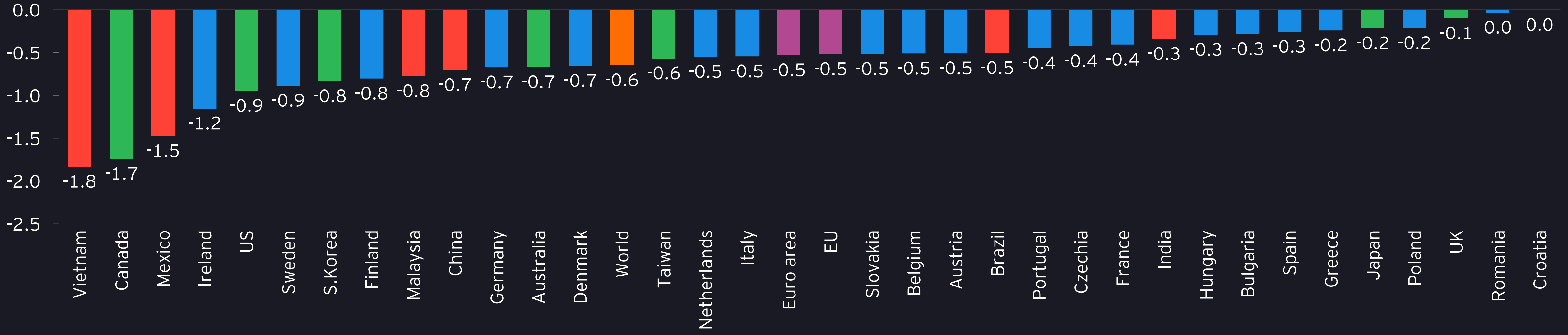
Despite the improvement in these underlying trends, headline euro area growth is expected to slow to 1.3% in 2026 from 1.5% in 2025, primarily because Ireland's 2025 surge unwinds. Growth should re-accelerate to 1.4% in 2027 and 1.5% in 2028-29.

Country highlights:

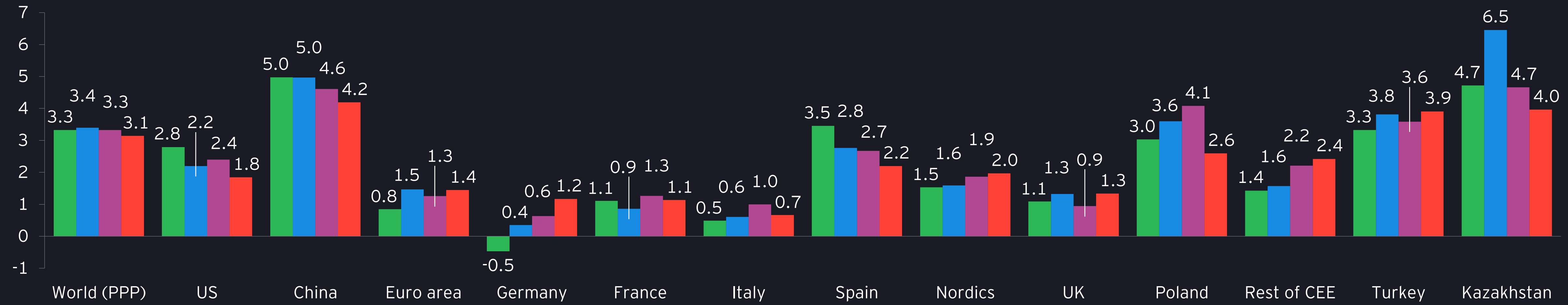
- **Germany:** expected to exit stagnation, but growth should remain moderate, as fiscal expansion does not address underlying structural issues. We forecast 0.6% growth in 2026 constrained by tariff headwinds and a slower-than-planned stimulus rollout. Growth is then expected to accelerate to 1.2-1.3% in 2027-29 as the fiscal package reaches its peak impact, but structural constraints (unfavorable demographics, reduced industrial competitiveness) will continue to weigh on performance.
- **UK:** growth is expected to slow in 2026 following the 2025 acceleration, reflecting weaker household income growth and ongoing global uncertainty. It is then anticipated to recover to 1.3-1.4% as these headwinds ease.
- **France and Italy:** projected to grow steady around potential: 1.1-1.3% and 0.7-1.0%, respectively, over 2026-29.
- **Spain:** projected 2.7% growth in 2026, supported by immigration and tourism; anticipated to gradually slow as these tailwinds fade (2.2% in 2027, 1.8% in 2028, 1.4% in 2029).
- **The Netherlands:** GDP growth is expected to slow to 1.3% in 2026 as exports and private consumption lose momentum after earlier gains, reflecting the impact of US tariffs and moderating wage growth. From 2027 onward, growth should recover to ~1.7% as investment accelerates.
- **Nordics:** expected cyclical recovery following earlier housing and labor market busts, with GDP growth fluctuating around 2% across the region. Activity in Norway and Denmark is likely to remain volatile due to fluctuations in the oil and gas and pharmaceutical sectors.
- **Poland:** strongest among large European economies at 4.1% growth in 2026, supported by real income gains, NextGenEU, and military investment, before slowing toward ~2.5% as public investment plateaus and demographic constraints increasingly weigh on potential growth.
- **Other CEE economies:** expected robust GDP growth in the 2-3.5% range, supported by continued expansion of real incomes and industrial recovery. Croatia and Bulgaria should be among stronger performers, while Romania is anticipated to remain weaker due to fiscal tightening but improving from the current very slow growth.
- **Turkey:** growth is projected to fluctuate in the 3-4% range as potential growth is lower than in the past due to less favorable demographics. GDP growth is likely to strengthen in 2027 as pre-election spending is expected to rise (increasing social benefits and public sector wages).

Impact of tariffs and GDP growth forecasts

Real GDP level – deviation from the no-tariff scenario in 2026 (in per cent)



Real GDP growth in 2024-2027 (in percentage)



Source: Oxford Economics, Eurostat, EY EAT forecast, EY Parthenon (US forecast), UK Item Club (UK forecast).
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.

Inflation is expected to remain close to 2% y/y in the euro area, with cross-country disparities gradually diminishing

Inflationary pressures are expected to remain contained in the euro area, with headline and core inflation staying close to 2% throughout the forecast horizon:

- Core and food inflation are expected to ease to 2% by mid-2026 from ~2.5%.
- Services inflation is projected to gradually slow down alongside wage growth normalization.
- Energy inflation near 0% should keep headline inflation in the 1.7-2.0% range.

In 2028, energy inflation may rise if the planned ETS extension takes effect, potentially pushing headline inflation slightly above 2%.

Country highlights

- In Romania, inflation is projected to stay high in the first half of 2026 due to large energy price and VAT hikes implemented last year, but should ease toward 3% thereafter supported by subdued demand and more conservative government wage policy.
- Inflation should also remain above 3% in several other CEE economies (Slovakia, Bulgaria, Croatia) due to energy price increases and persistent price pressures in services driven by strong wage growth.
- In contrast, Switzerland is flirting with deflation due to weak wage growth and a strong Swiss Franc, while low wage growth keeps France's inflation near 1%.
- Negative output gaps and indirect tax cuts are likely to push inflation below 2% across most Nordic economies, with Norway as an exception, where price pressures remain stubborn.
- In Turkey, gradual disinflation is expected, from 31% at end-2025 to around 14% by 2029, though a return to full price stability may remain challenging under the current monetary policy framework.
- For most other countries, we anticipate inflation within the 1.5-3% range, with Germany's price growth easing and stabilising just below 2%.

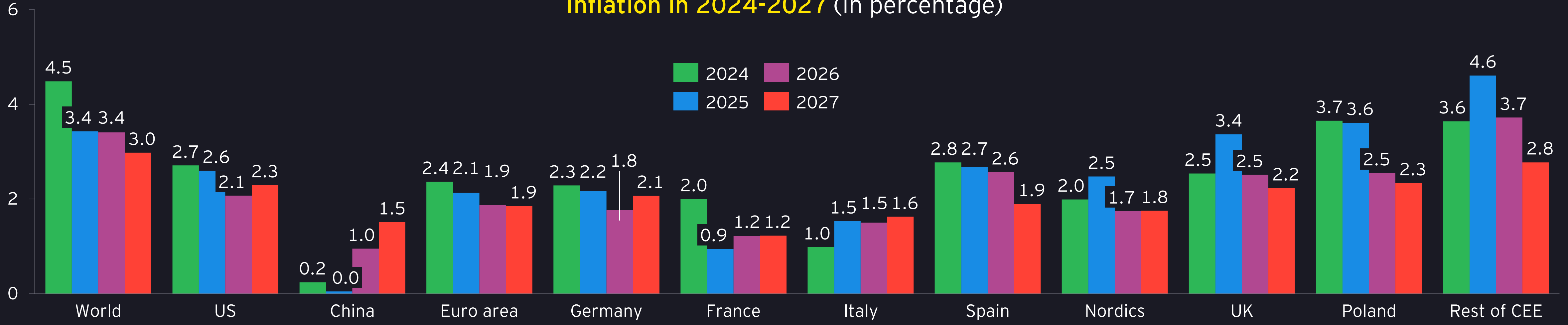
While we expect no further moves from the ECB, most other central banks in Europe will deliver some additional rate cuts

Monetary policy:

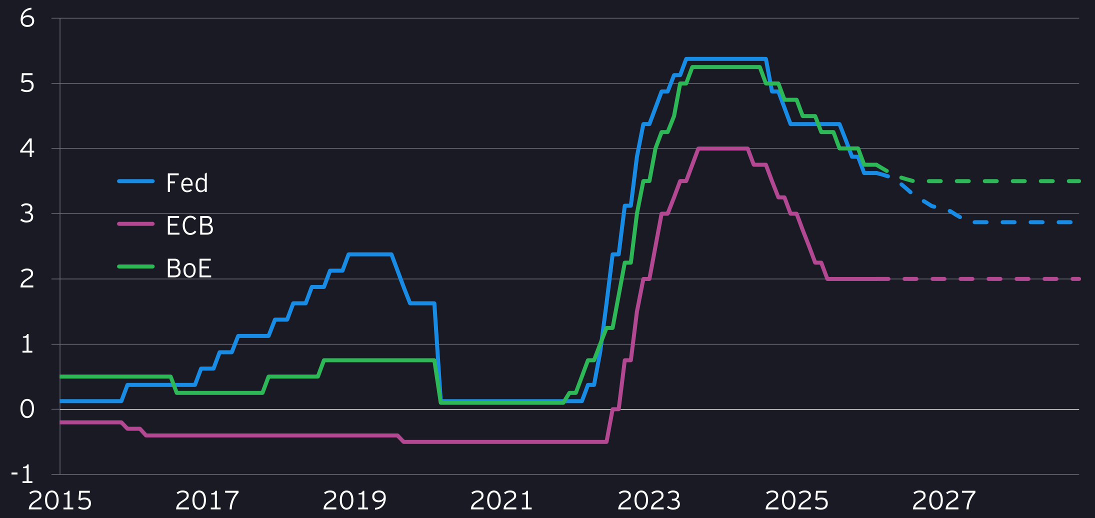
- **Fed**: We expect the Fed to remain on hold in the first half of 2026, before delivering additional 50 bps of cuts in in the second half of the year.
- **ECB**: With inflation near target and GDP growth holding steady, the ECB is likely to keep rates unchanged. Risks are tilted to the downside if growth weakens or inflation undershoots materially.
- **BoE**: We expect the Bank of England to deliver its final 25 bps cut in April, with rates held at 3.5% thereafter. Risks are tilted toward more easing if growth continues to disappoint and labor market softens further.
- **SNB**: We anticipate the Swiss National Bank to keep the policy rate at 0% through end-2027. Rates may increase toward the neutral level of 0.5% afterwards.
- **Norway**: We expect the central bank to resume gradual cuts in 2H 2026, bringing the policy rate to 3% only by 2028 due to slow core inflation easing.
- **Sweden**: We expect one additional cut by Riksbank as inflation should undershoot the target amid negative output gap.
- **CEE**: Some further policy easing is expected.
  - **Poland**: The National Bank of Poland (NBP) is anticipated to deliver cuts in March and April (in total 50bps), bringing the policy rate to 3.5%.
  - **Czechia**: The CNB rates should be maintained in 2026, followed by 50 bps easing in 2027 when core inflation falls to 2%.
  - **Hungary/Romania**: The central banks are expected to proceed with interest rate reductions as price pressures finally subside. In Hungary, we project a total of 100 bps of easing in 2026, including the initial cut already delivered, followed by 150 bps of additional easing in 2027. In Romania, we expect 50 bps of cuts in 2026, with a further ~100 bps likely in 2027.
- **Turkey**: We expect continued cuts with gradual disinflation. Rates may fall to 27% by year-end.

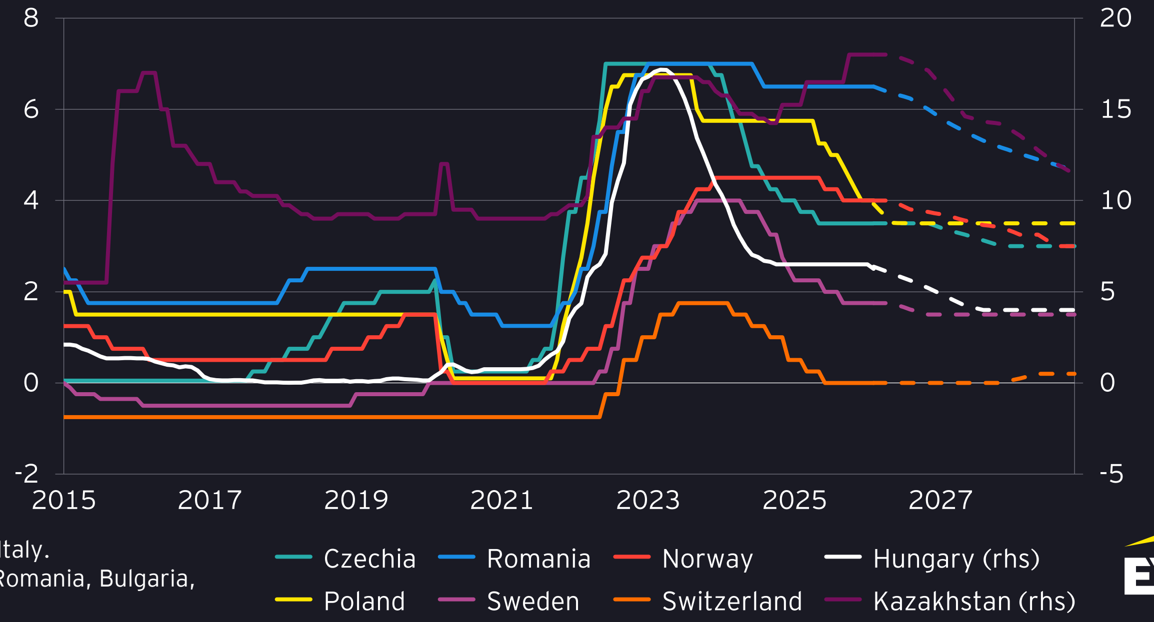
Inflation and interest rate forecasts

Inflation in 2024-2027 (in percentage)



Central bank interest rates (In percentage)





Source: Oxford Economics, EY EAT forecast, EY Parthenon (US forecast), UK Item Club (UK forecast), EY Italy.
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.

Despite lower baseline tariff risk, Europe's 2026–2029 balance of risks remains exposed to episodic trade tensions, geopolitics and competitiveness headwinds

Europe's recovery is underway but fragile. Underlying growth is improving, inflation is near target, and policy settings are broadly supportive. But tariffs, geopolitics, and structural issues keep the balance of risks tilted to the downside.

Key risk factors:

1. **Geopolitics:** Escalating US–Iran tensions have become the key near-term global risk, raising uncertainty through potential impacts on energy prices, confidence, investment decisions, and cross-border flows. Russia's war against Ukraine and broader geopolitical frictions further weigh on the outlook. De-escalation in either region would reduce uncertainty, compress risk premia, and support investment.
2. **Tariffs and Trade Policy:** The US-EU trade deal reduces the probability of sustained escalation, but uncertainty remains due to political and legal shocks. Tariffs continue to impact the economy, leading to structural reconfiguration of trade patterns.
3. **Fiscal Dynamics:** Expected boost in defense and infrastructure spending should support activity, but uneven fiscal positions, especially risks in France and Italy, could weigh on growth.
4. **Exchange Rate and Competitiveness:** A stronger euro helps ease inflation but hurts export competitiveness. While we expect exports to gradually improve, risks of stagnation remain due to structural challenges, including increasing competition from China.
5. **Energy and commodity prices:** Geopolitical shocks could quickly push prices higher and erode real incomes—especially for energy-sensitive CEE economies—while uncertainty around the inflationary impact of the EU Emissions Trading System adds another layer of risk. Conversely, easing tensions or improved supply conditions could lower risk premia and support growth.
6. **Asset Prices and Financing Conditions:** Corrections in asset prices can reduce confidence and delay investment. Tighter financial conditions would raise capital costs and limit credit availability for firms.
7. **Structural Risks and Opportunities:** Europe's long-term competitiveness is constrained by high costs and an aging workforce. Growth could improve if the region accelerates automation/digitalization and expands investment in skills and infrastructure. However, stronger resistance to immigration would further tighten labor supply and worsen demographic headwinds.

EY Global Economic Outlook

- For more information on economic developments around the globe, explore our bi-annual EY 'Global economic outlook', developed in partnership with various EY economics teams and experts.
- The report includes EY forecasts and views on the US, Canada, EU, UK, Japan, Australia, India, China, ASEAN, Latin America, Middle East and Northern Africa (MENA), and Sub-Saharan Africa (SSA).
- EY article summarizing the key findings of the latest report can be accessed here.
- A global webcast covering the key insights and conclusions can be accessed here.

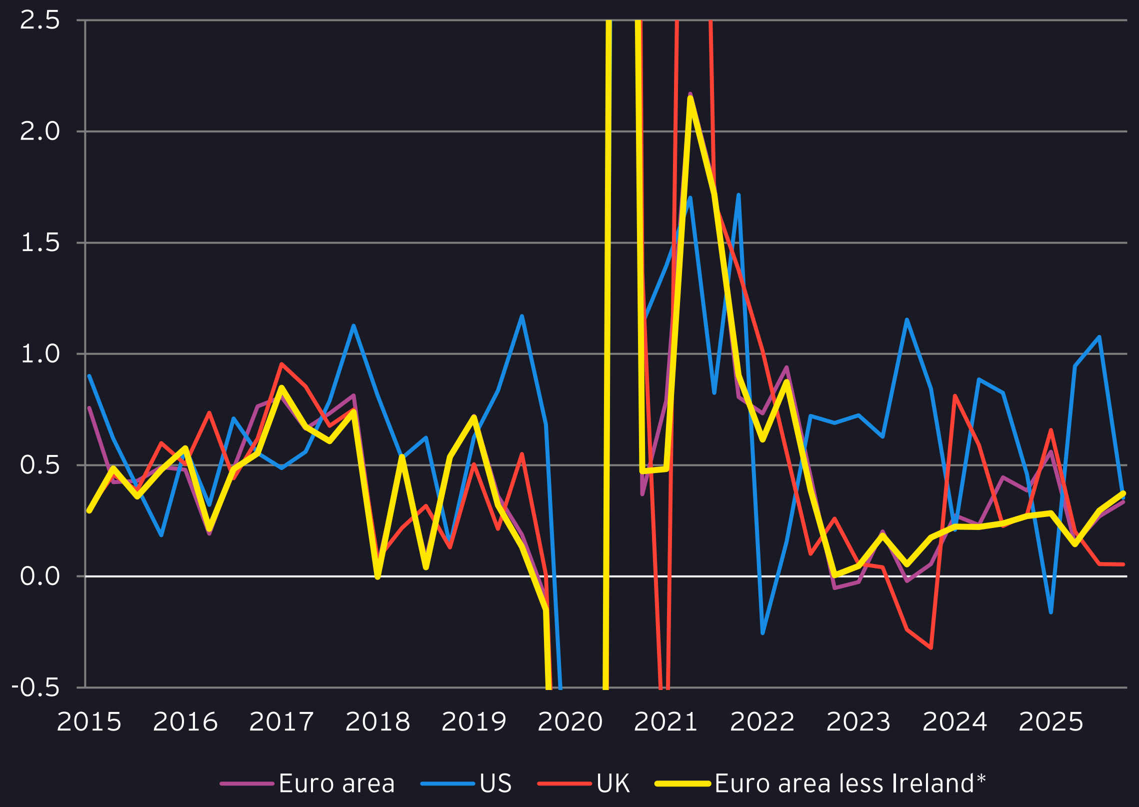
Chapter 1

Economic activity in recent quarters

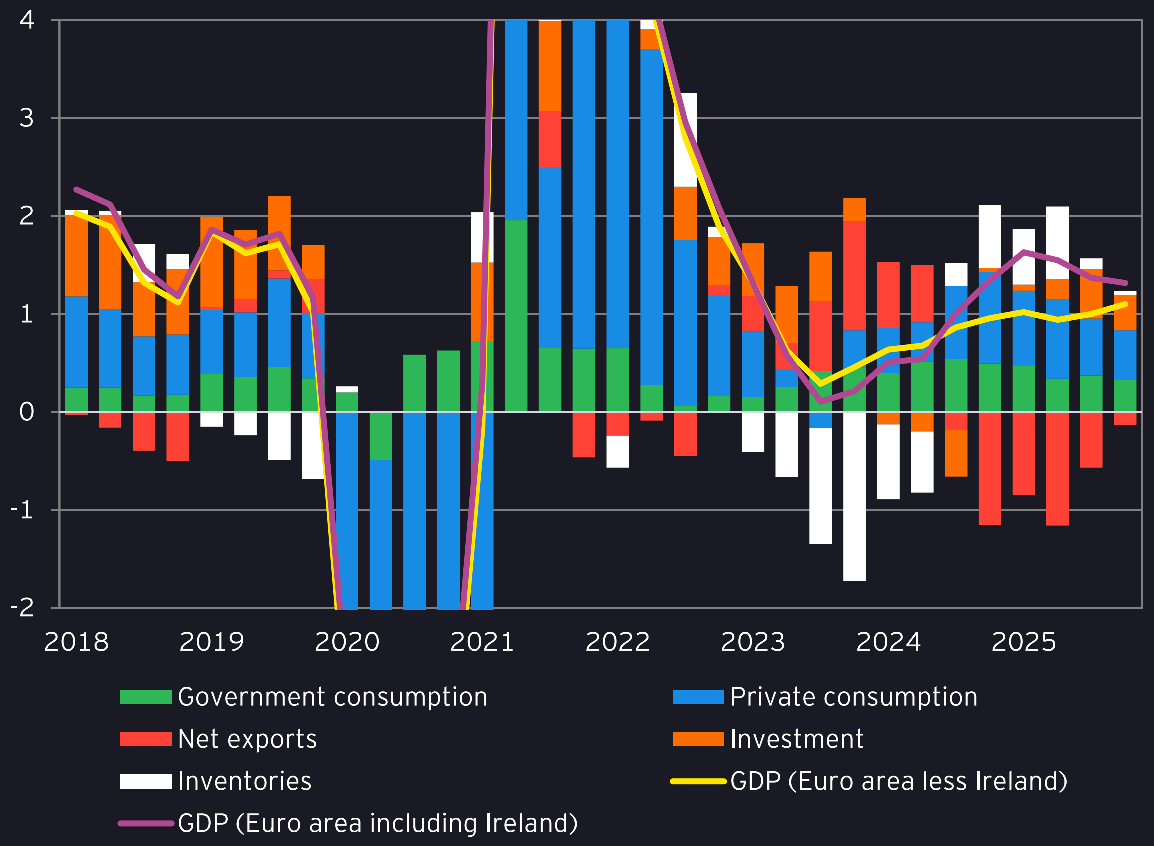
Euro area headline GDP growth remains inflated by Ireland, while underlying activity continues to gradually strengthen

- Despite US tariffs, the euro area's underlying real GDP growth (i.e., excluding Ireland) accelerated to 0.3% q/q in 2025 Q3 and 0.4% in Q4, supported by a recovery in investment and exports.

Q/q real GDP growth
(in percentage, seasonally adjusted)



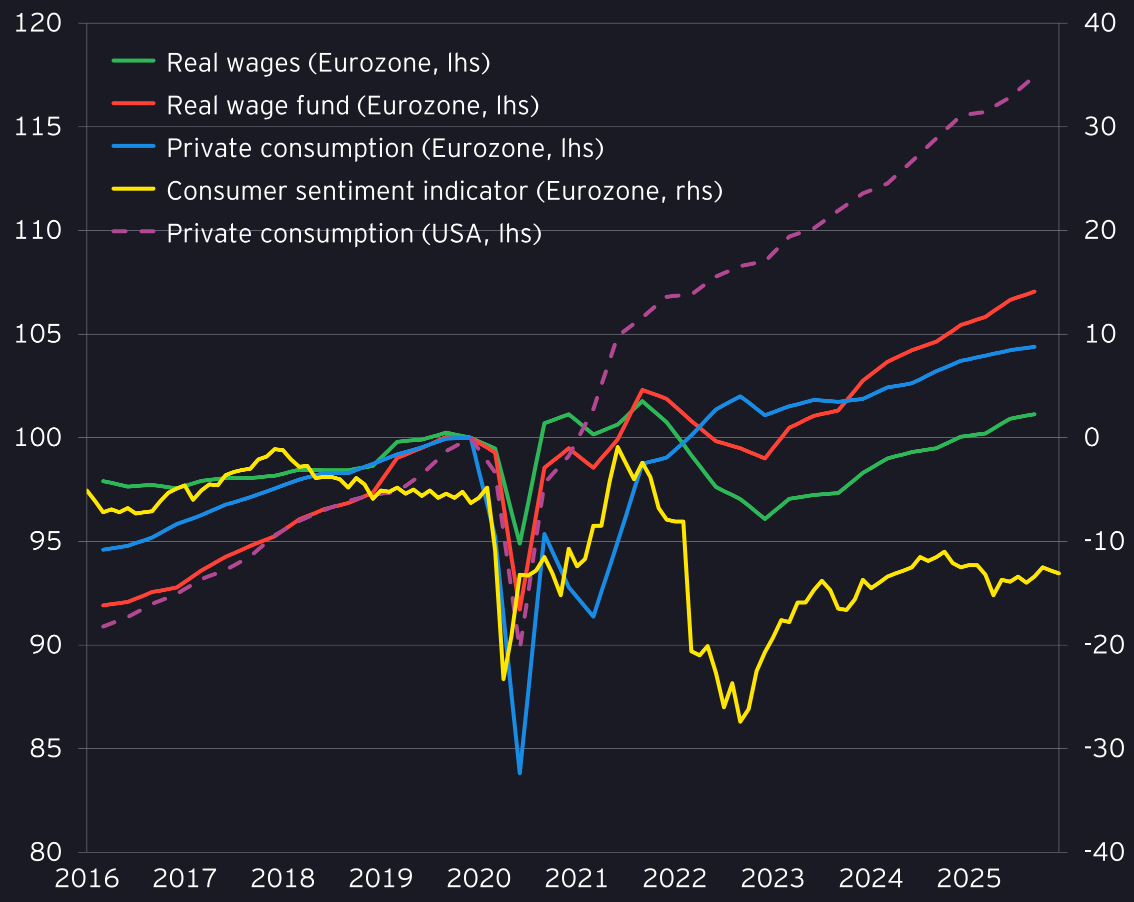
Decomposition of y/y GDP growth in the euro area less Ireland*
(in percentage)



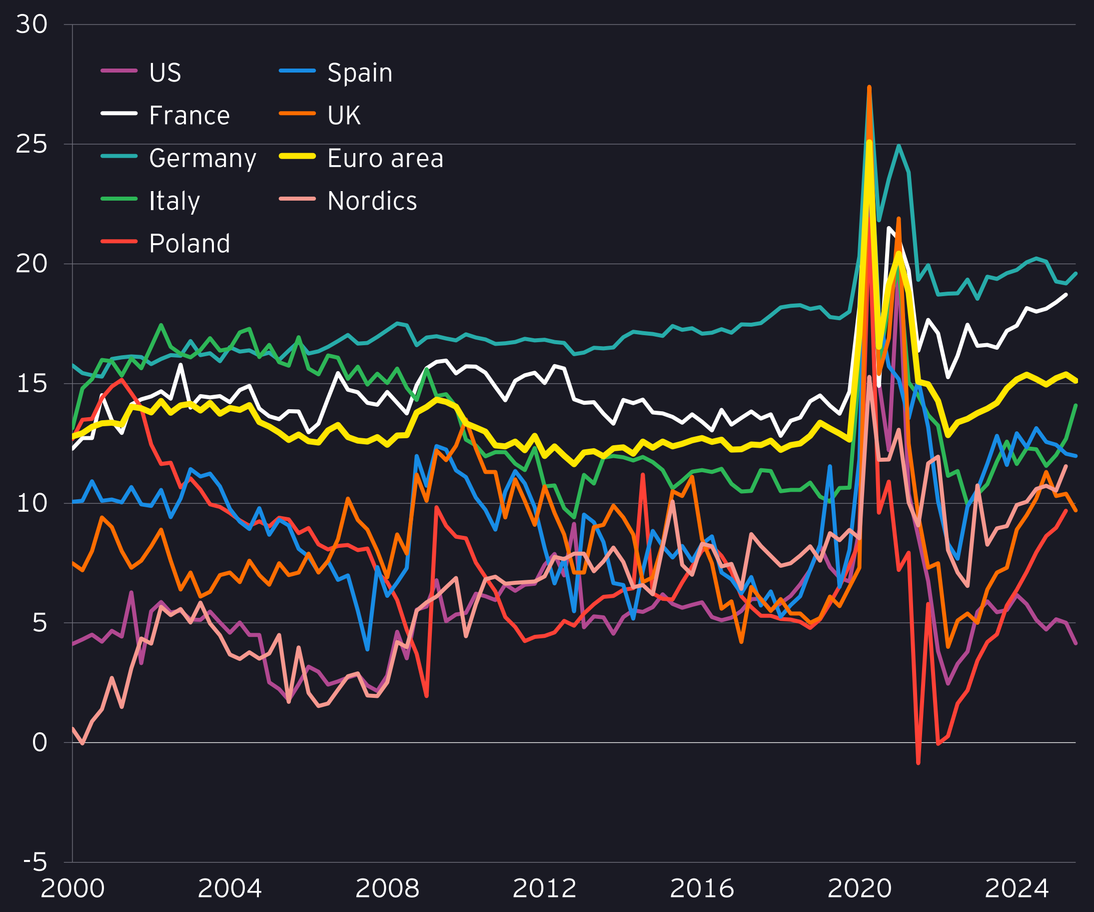
Source: Eurostat, Fred, ONS.
* Ireland is excluded as its GDP tends to be very volatile, reflecting the outsized role multinational corporations play in the economy.

Consumer spending continued to grow, though at a slower pace than in 2024, as households remained cautious and savings rates stayed elevated

Real wages, real wage fund, consumer sentiment and real private consumption in the euro area and the US
(2019 Q4 = 100)



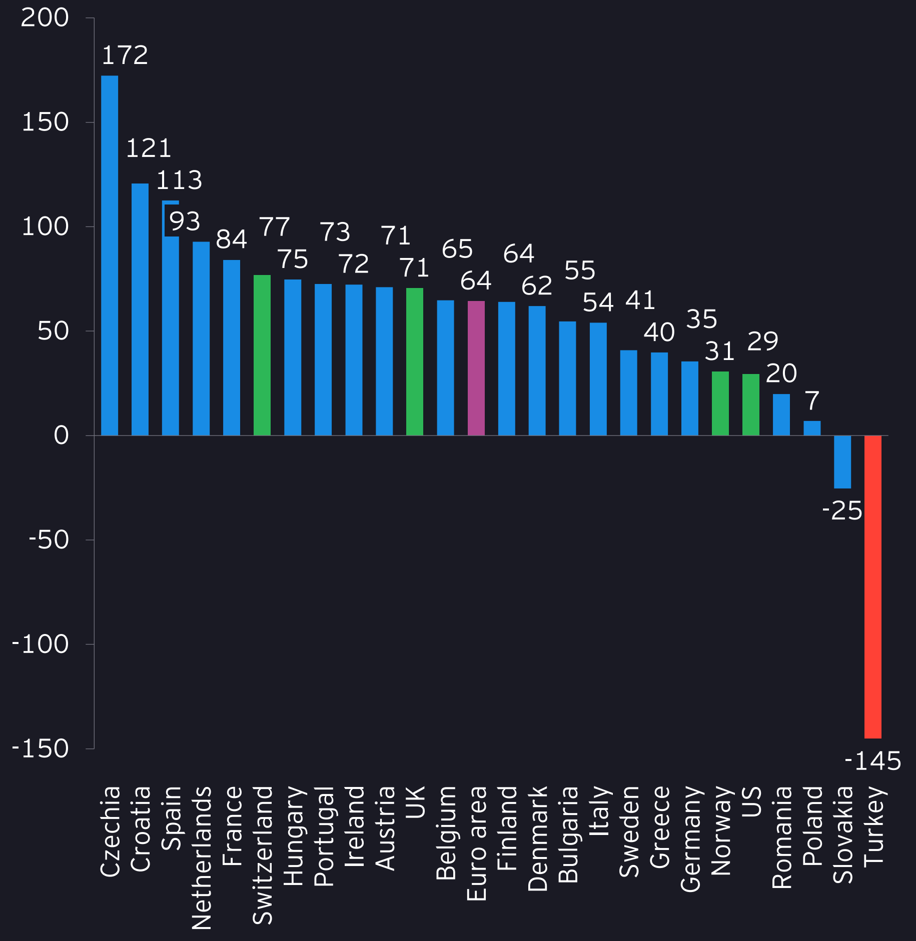
Household saving rate
(In percentage)



Source: Eurostat, Oxford Economics, FRED.

Czech, Croatian, and Spanish households accumulated the largest excess savings, in contrast to Slovak households. The share of compensation of employees in GDP has increased in most EU countries. By comparison, the US has seen a long-term decline in the labor-compensation share of GDP

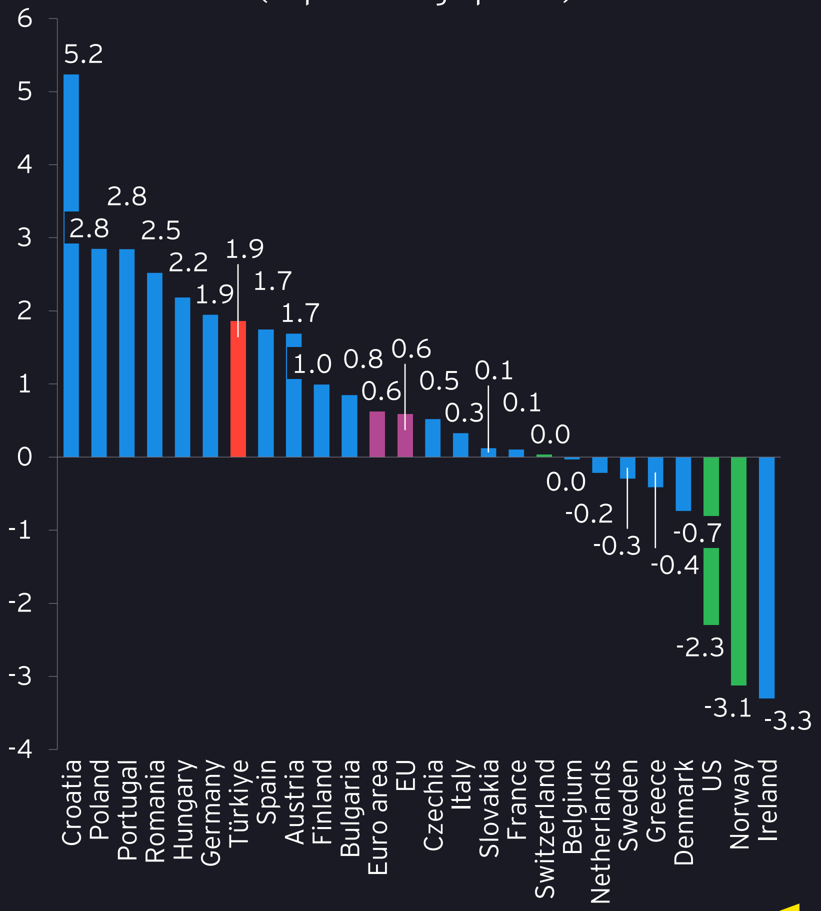
Accumulated post-pandemic excess savings* (In percentage of quarterly disposable income)



Share of compensation of employees in GDP (In percentage of disposable income)

Over time (In percentage)

Change, 2025Q3 vs. 2019Q3 (In percentage points)



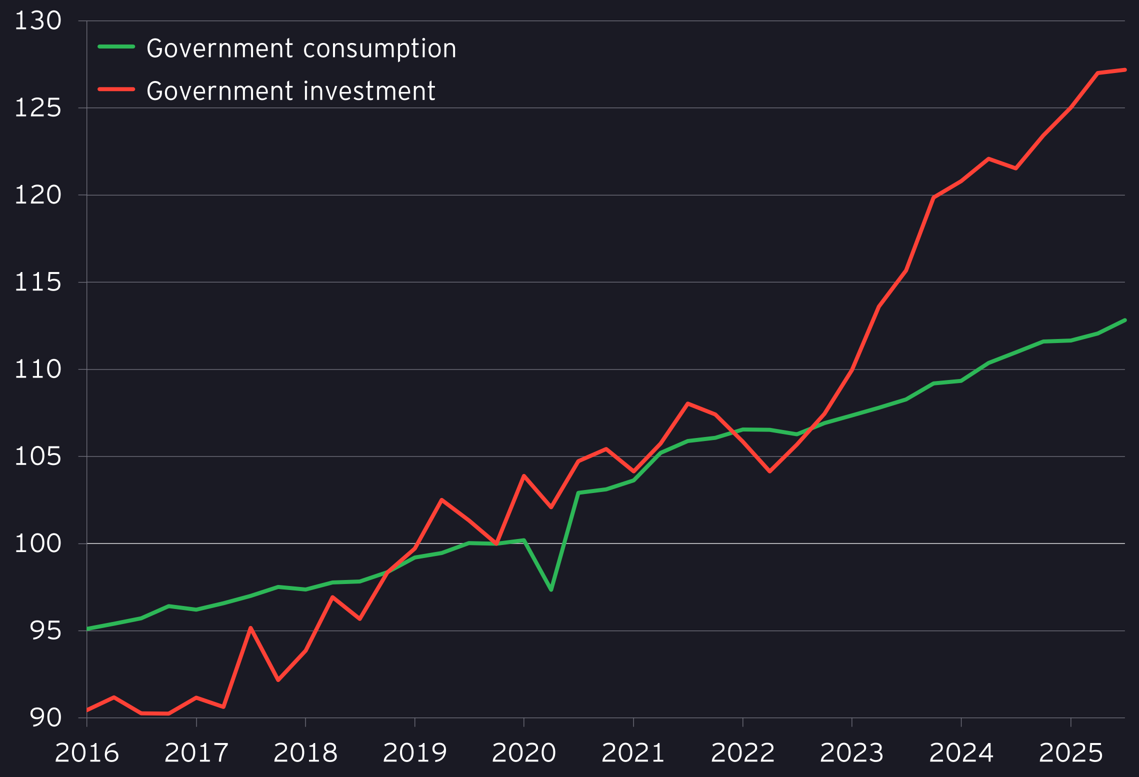
Source: Oxford Economics; Eurostat; FRED.

* Excess savings defined as an accumulated difference in saving rates between 2020Q1-2025Q4 and 2015Q1-2019Q4.

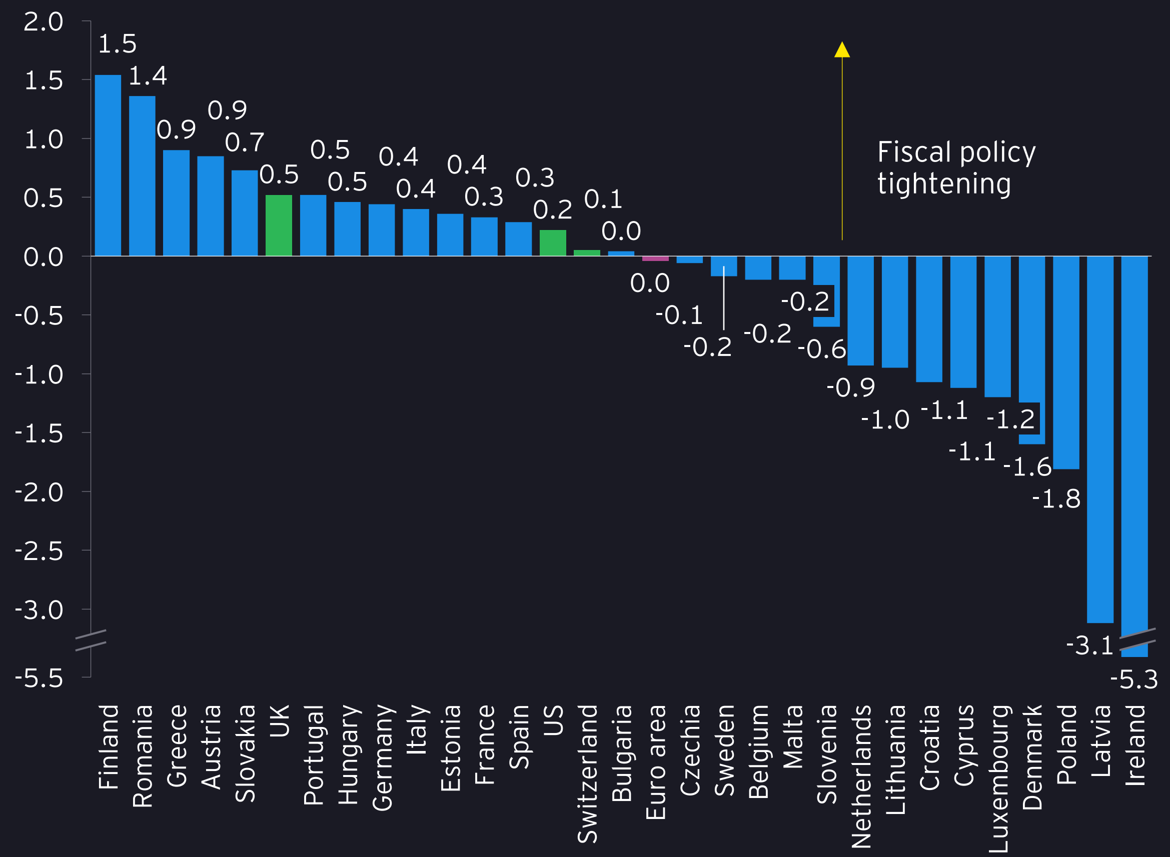
While government consumption and investment continue to support growth, though more moderately than in 2024, the overall fiscal stance is broadly neutral for economic activity

- Over the past three years, government investment has grown faster than government consumption, supported by NextGenEU funding and, in some countries, rising military spending.
- Fiscal stances vary across the EU. Some governments with strong fiscal positions are expanding spending (e.g., Ireland, Denmark, the Netherlands) or continuing to increase military and social outlays despite already high deficits (e.g., Poland). Others are tightening policy (reducing spending or increasing taxes) due to elevated deficits and financial market pressures (e.g., Romania).

Government consumption and investment in the euro area
(2019 Q4 = 100)



Change in structural balance* to GDP: 2025 vs. 2024
(in percentage points)

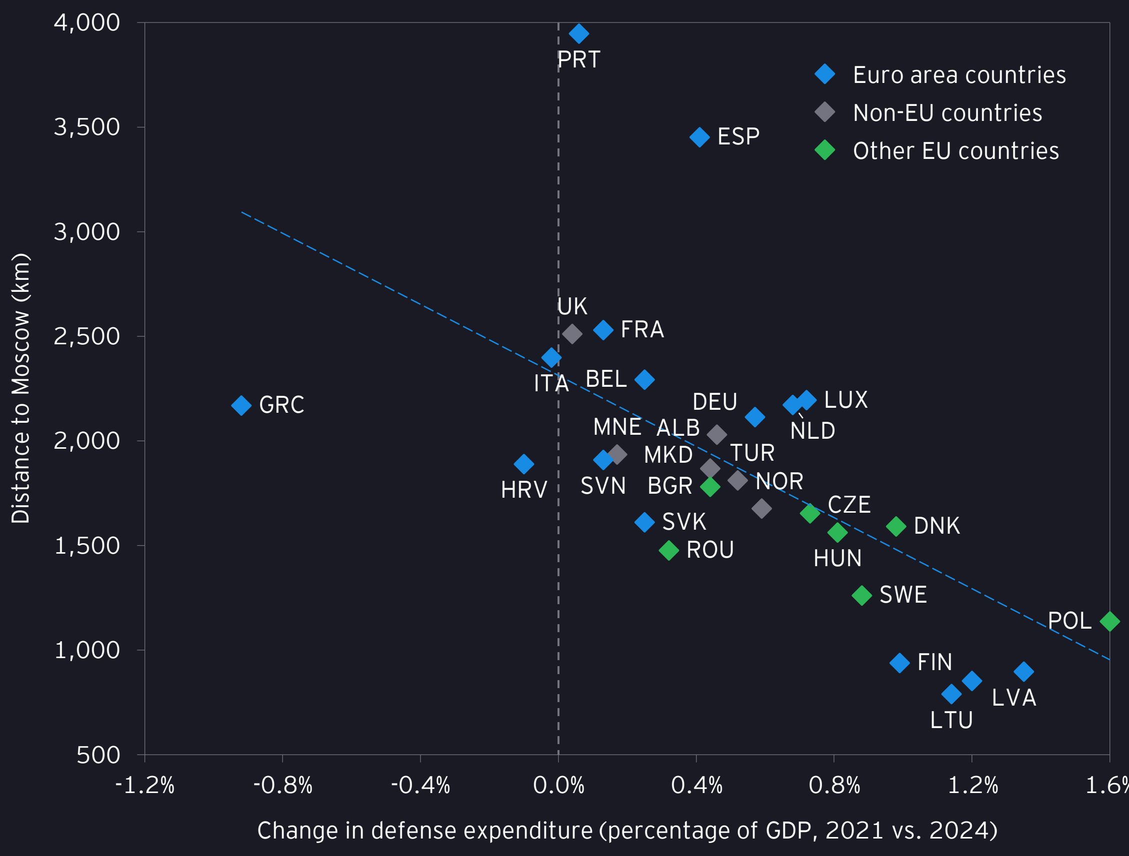


Source: Eurostat, Oxford Economics, FRED.
* Structural balance is general government balance corrected for cyclical and one-off factors.

While proximity to Russia is strongly correlated with higher defense spending across Europe, highly indebted economies are less likely to increase their defense outlays

Government debt of EU NATO members and defense expenditures (percentage change relative to GDP) 2021 vs. 2024

Proximity of European NATO member capitals to Moscow and defense expenditures (percentage change relative to GDP) 2021 vs. 2024

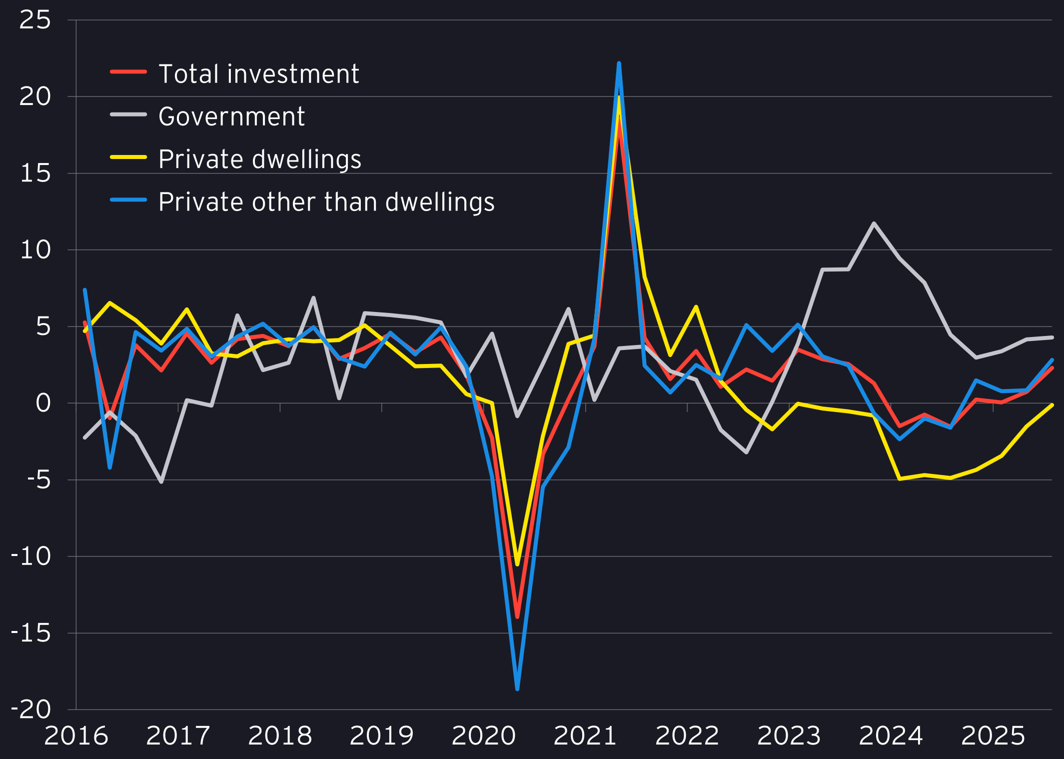


Source: NATO; SIPRI Military Expenditure Database; Oxford Economics; EY analysis

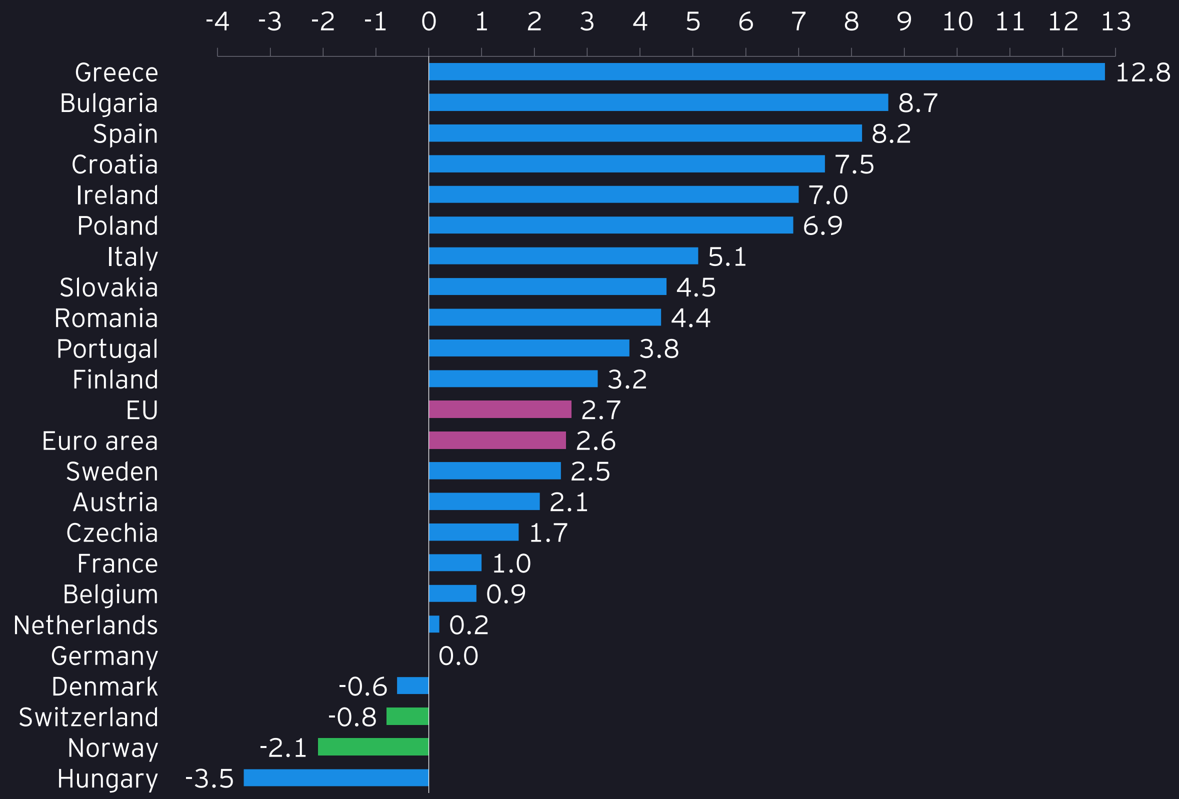
As residential investment bottoms out, overall investment has begun to grow

- Housing investment is finally turning a corner, supported by past interest rate cuts.
- Government investment continues to grow at a healthy pace, driven by rising NextGenEU disbursements and increased military spending.
- Non-residential private investment is showing tentative signs of improvement.

Real fixed capital investment by type in the euro area less Ireland* (% y/y)



Y/y real fixed capital investment in 2025 Q3 (%)

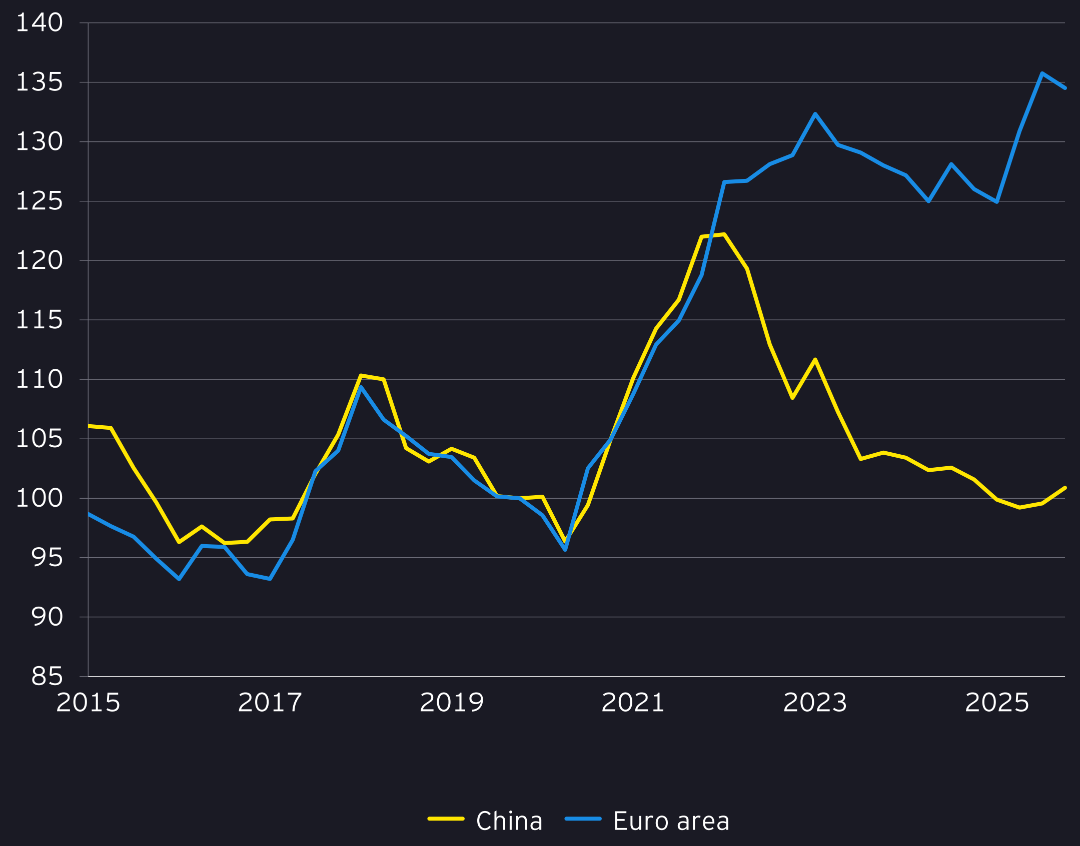


Source: Eurostat.
* Investment in Ireland are excluded since they are very volatile, influenced by the global activities of multinational corporations, and do not appropriately reflect the underlying investment in the domestic economy.

Export growth is gradually accelerating but continues to lag world trade—European producers lose market share due to exchange rate appreciation and intensifying competition from China

Global real GDP, world trade, external demand of euro area's trading partners for non-fuel goods** and euro area less Ireland* real exports (y/y, in percentage)

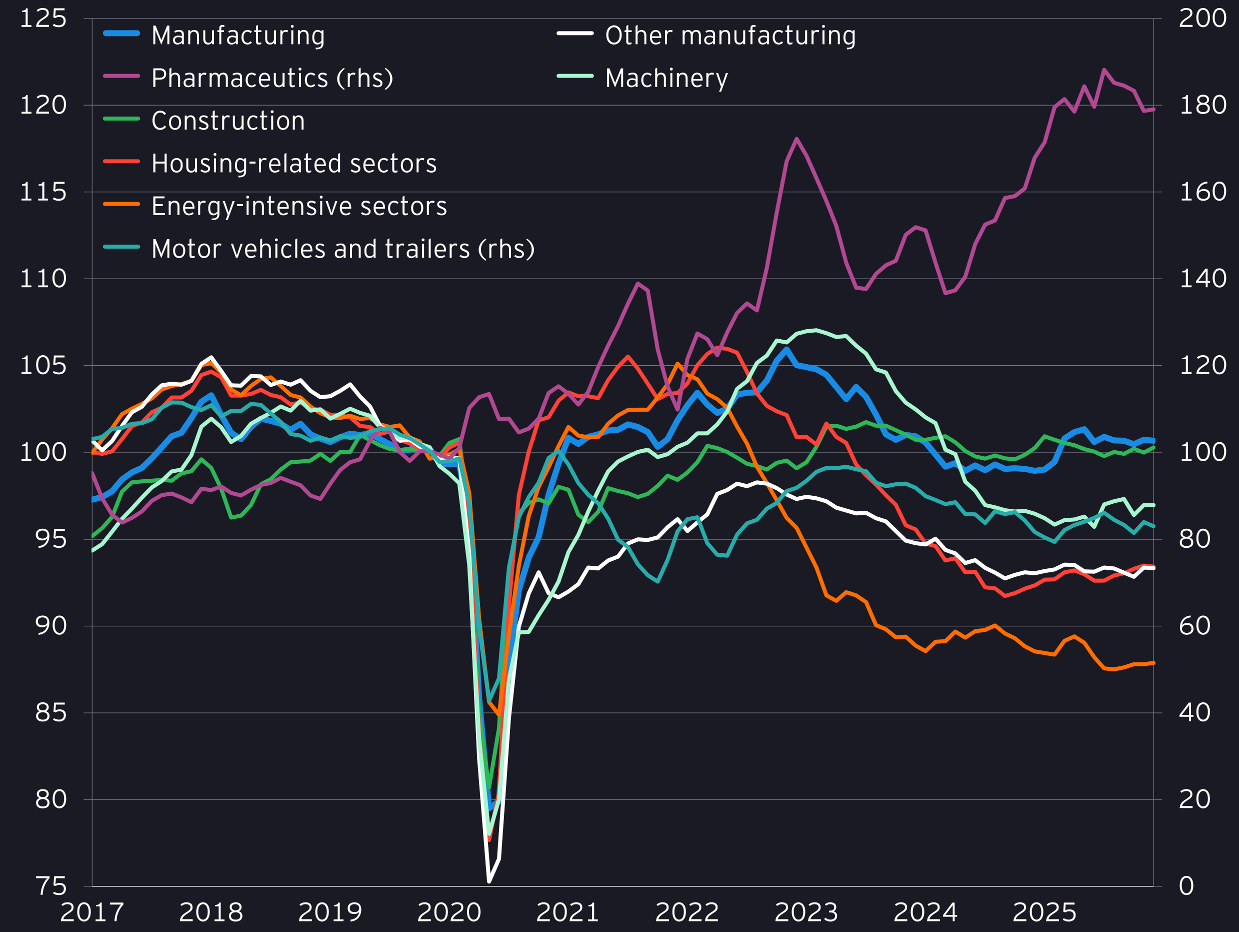
Producer price index expressed in USD (2019Q4=100)



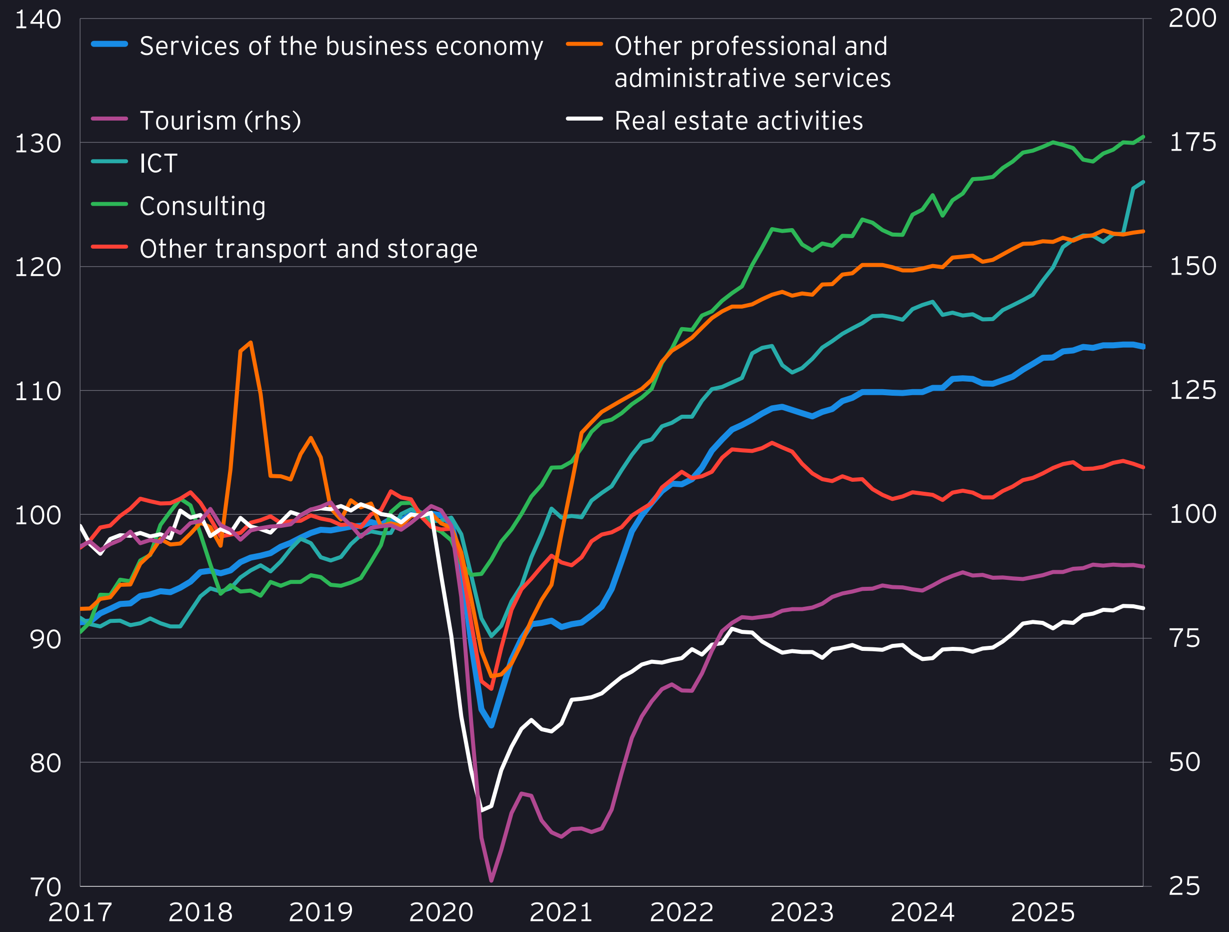
Source: : Eurostat, Oxford Economics, CPB.
* Exports in Ireland are excluded since they are very volatile, influenced by the global activities of multinational corporations, and do not appropriately reflect the underlying exports in the domestic economy.
** External demand of euro area's trading partners for non-fuel goods is equal to real imports of trading partners, weighted by shares of those trading partners in the euro area exports.

Following an early-2025 uptick driven by tariff frontloading, manufacturing has slipped back into stagnation. The services sector continues to expand at a modest to moderate pace, with ICT leading the growth

Manufacturing production in the euro area
(3-mth moving average, index, 2019 Q4 =100, seasonally adjusted)



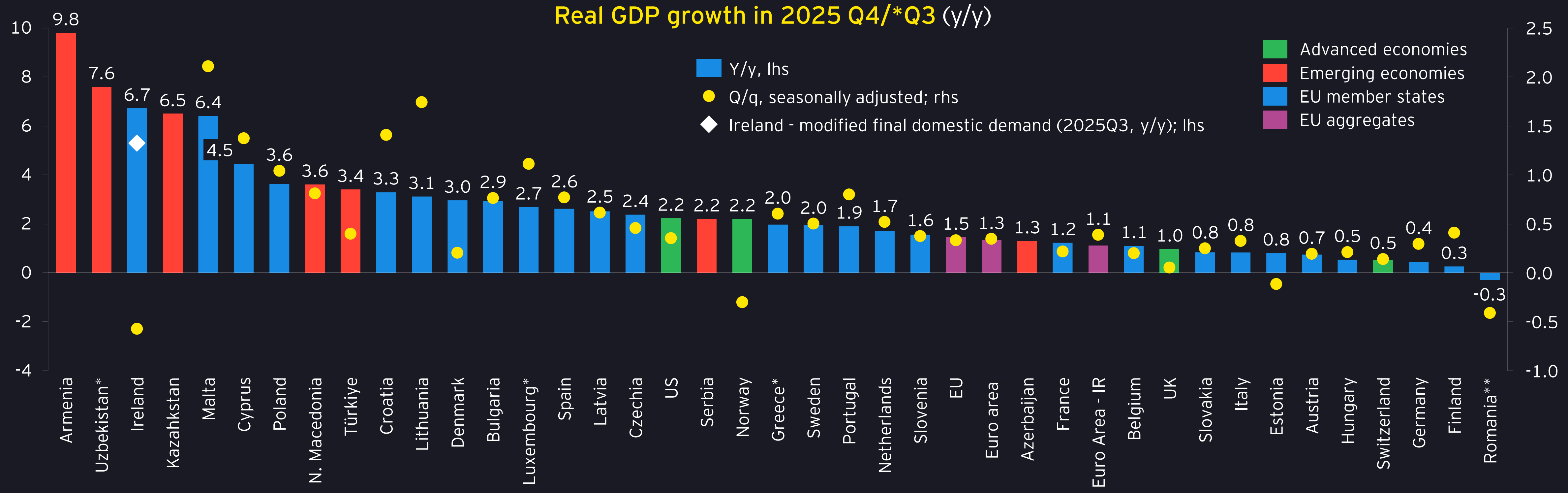
Services activity in the euro area
(3-mth moving average, index, 2019 Q4 =100, seasonally adjusted)



Source: Eurostat.
Notes: Energy-intensive sectors: paper, chemicals, basic metals and non-metallic mineral products. Housing-related sectors: wood, furniture and electric equipment. Other manufacturing is an arithmetic average of the remaining manufacturing NACE divisions. Services of the business economy except for trade and financial activities. Tourism includes accommodation and food service activities, air transport, travel agencies and related activities.

While cross-country disparities persist, growth in several lagging economies, including Germany, appears to be picking up

- In Ireland, GDP remains a flawed measure of activity, but alternative indicators such as modified final domestic demand also point to strong momentum exceeding 4% y/y.
- Poland and several other CEE economies (Bulgaria, Czechia, Croatia) are also recording strong growth, supported by robust real income gains, expansionary fiscal policy, and substantial NextGenEU spending.
- Most Southern European economies, especially Spain, still outpace the rest of the EU, benefiting from a booming tourism sector, strong immigration flows, and NextGenEU disbursements.
- Denmark maintains robust but volatile growth, driven by the expansion of a major pharmaceutical company. Meanwhile, Sweden and Norway are experiencing a cyclical recovery, supported by lower interest rates.
- Germany, Italy, Switzerland, Austria, Finland, Hungary, and Slovakia remain among the slowest-growing economies due to weak industrial performance, though relatively solid 2025 Q4 outturns suggest that the worst may now be behind them.
- In contrast, economic activity in Romania is stagnating, held back by fiscal tightening and energy price increases.

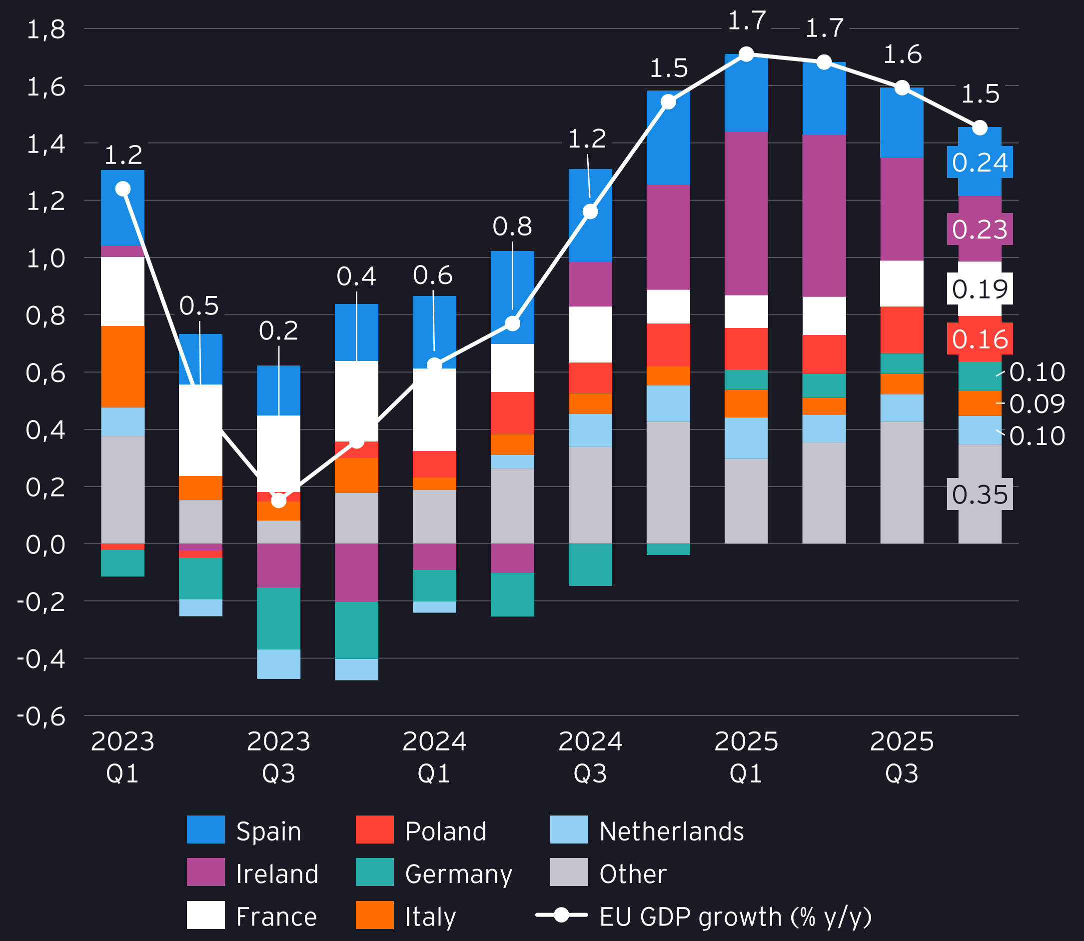


Source: Eurostat, Oxford Economics, Trading Economics.
**Romania's GDP growth seasonally adjusted by EY.

Main contributors to EU GDP growth remain broadly unchanged

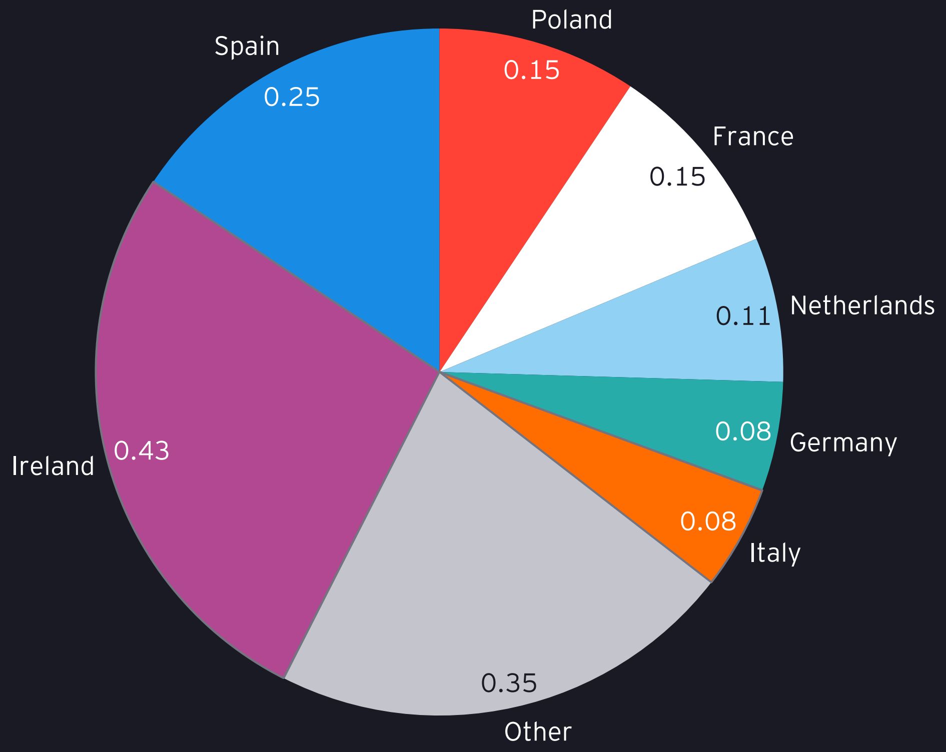
- Spain and Ireland continue to lead EU growth, followed by France and Poland. Together, these four economies accounted for over half of EU GDP growth in 2025.
- Germany returned to positive contributions in 2025, though this reflects its large economic size rather than a strong growth rebound.

Contribution to real GDP growth y/y in the EU quarterly (in percentage points)



Source: Eurostat.

Contribution to real annual GDP growth y/y in the EU in 2025 (in percentage points)



Labels sum to total EU GDP growth in 2025, amounting to 1.6% year on year.

Early indications suggest that fiscal stimulus is gradually feeding through to the German economy, helping improve business sentiment

- Manufacturing new orders surged in December, driven by strong demand for metal products, machinery, and electrical equipment.

Business sentiment indicators

New orders in German manufacturing

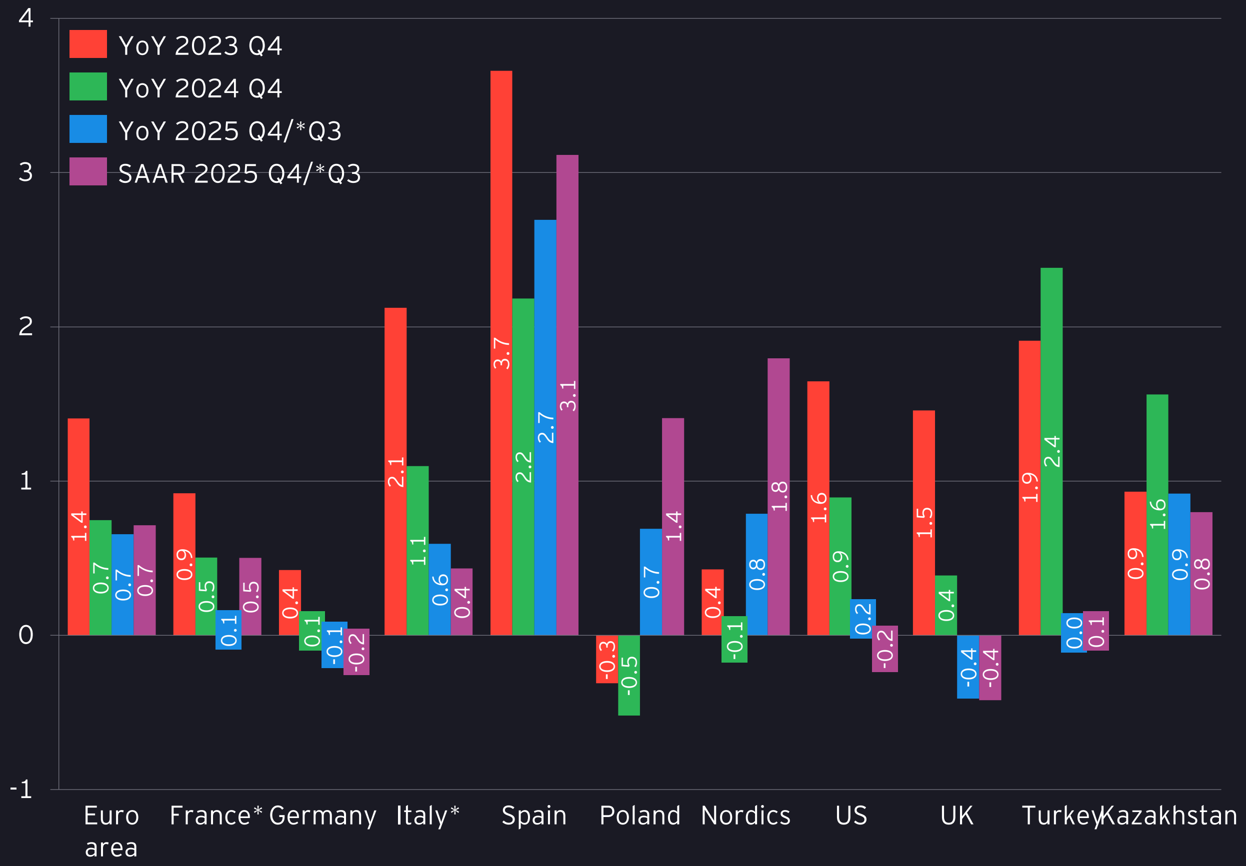
(2021=100; seasonally and calendar adjusted)

Source: Trading Economics, Investing.com, Destatis.

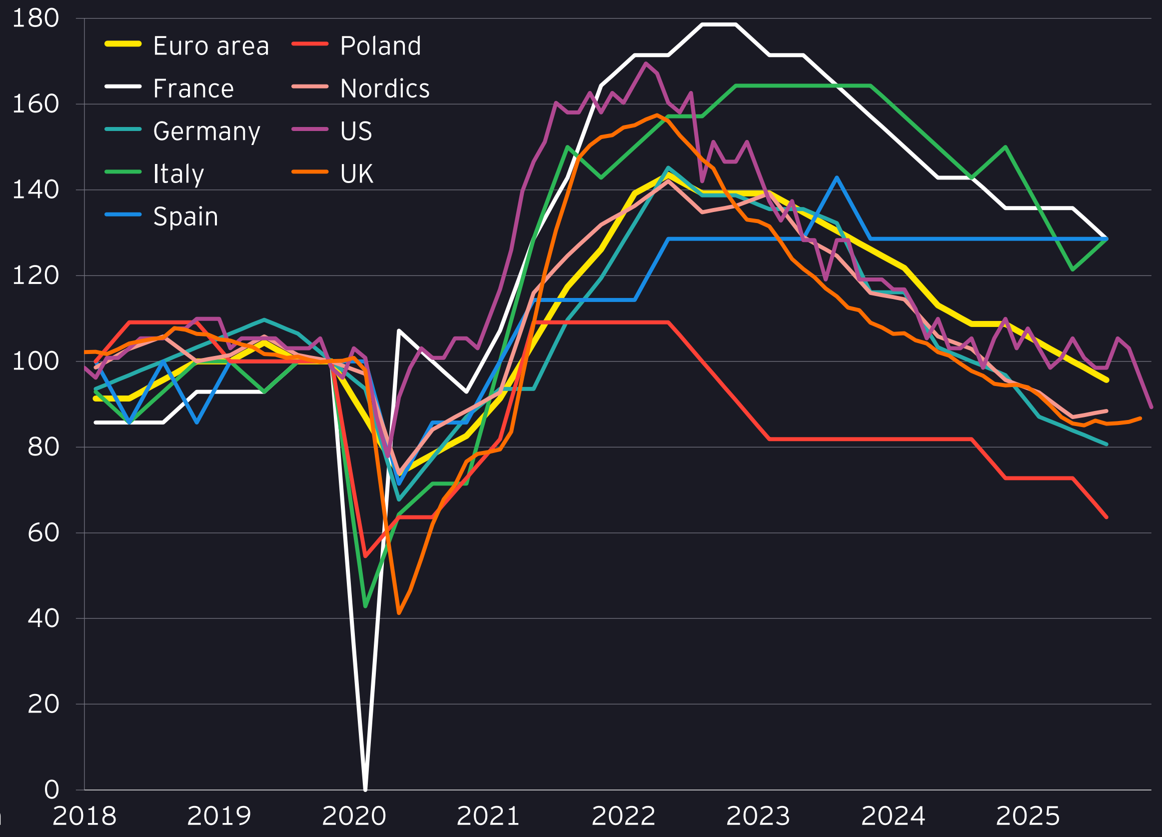
Euro area employment growth remains modest at 0.7% y/y, with Spain acting as the primary driver in an otherwise subdued labor market

- Many major European economies are seeing stagnant or declining employment, while Spain stands out thanks to strong immigration inflows from Latin America and North Africa.
- Declining vacancies point to a continued labor market cooling.
- In the US, job growth stalled in 2025, with nearly all gains coming from education, healthcare, and leisure—sectors that represent only 25% of total nonfarm employment.

Employment growth
(in percentage)



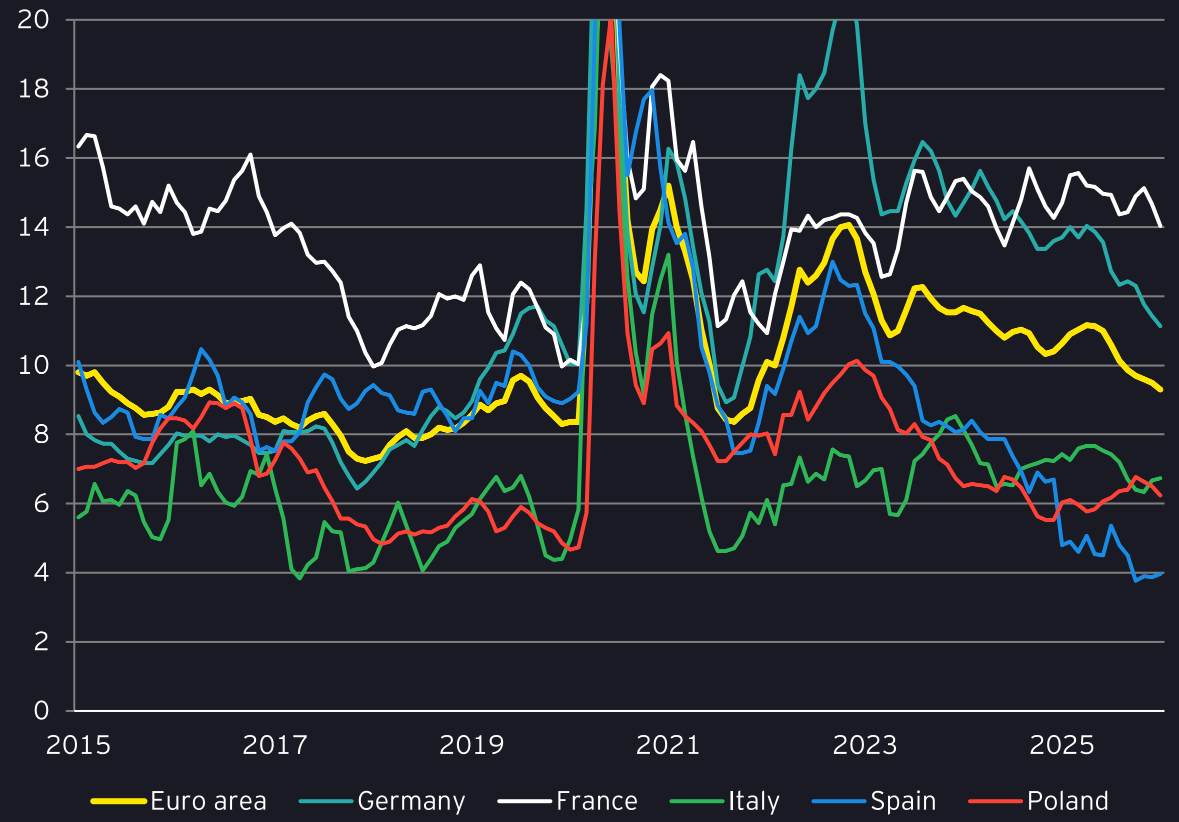
Vacancy rate
(Index, 2019 Q4 =100)



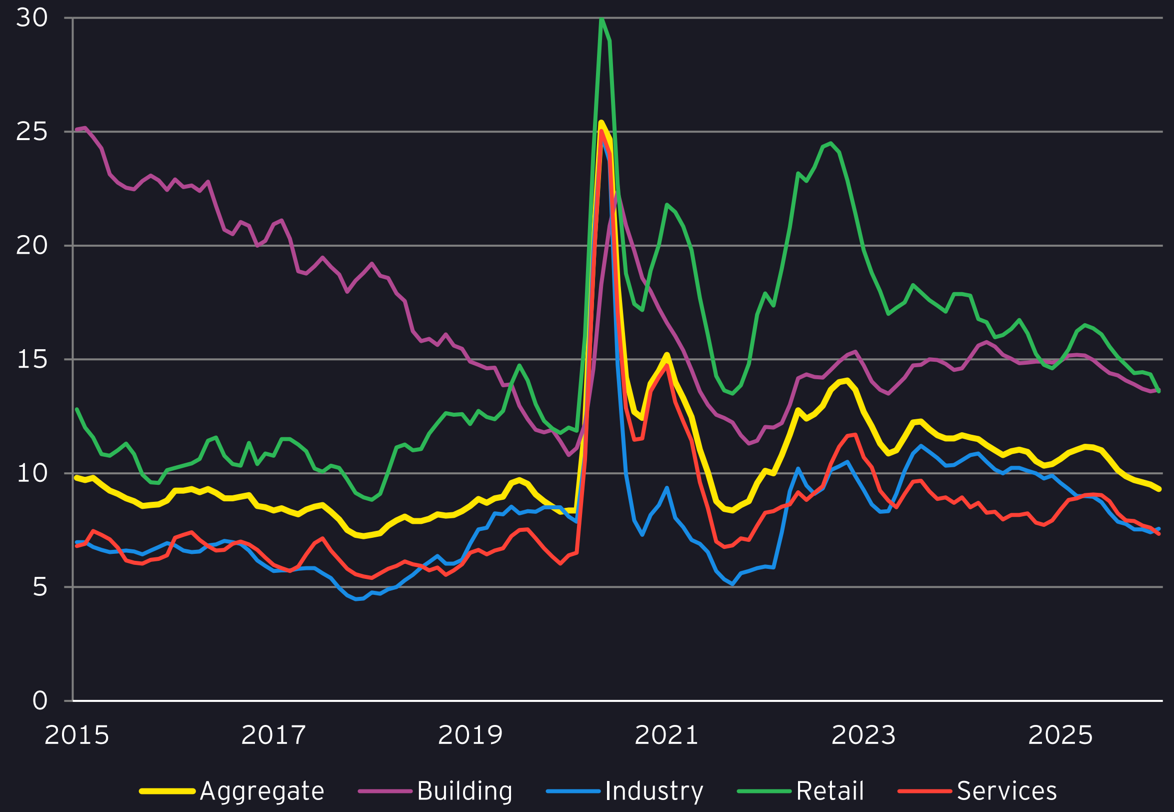
Source: Eurostat, FRED, ONS.
Notes: SAAR = Seasonally Adjusted Annual Rate of growth. Nordics = Denmark, Finland, Sweden and Norway.

A declining willingness of firms to "hoard" labor is contributing to the cooling in labor demand

Labor hoarding by region*
(3-month moving average; in % of firms)



Labor hoarding by euro area sectors*
(3-month moving average; in % of firms)

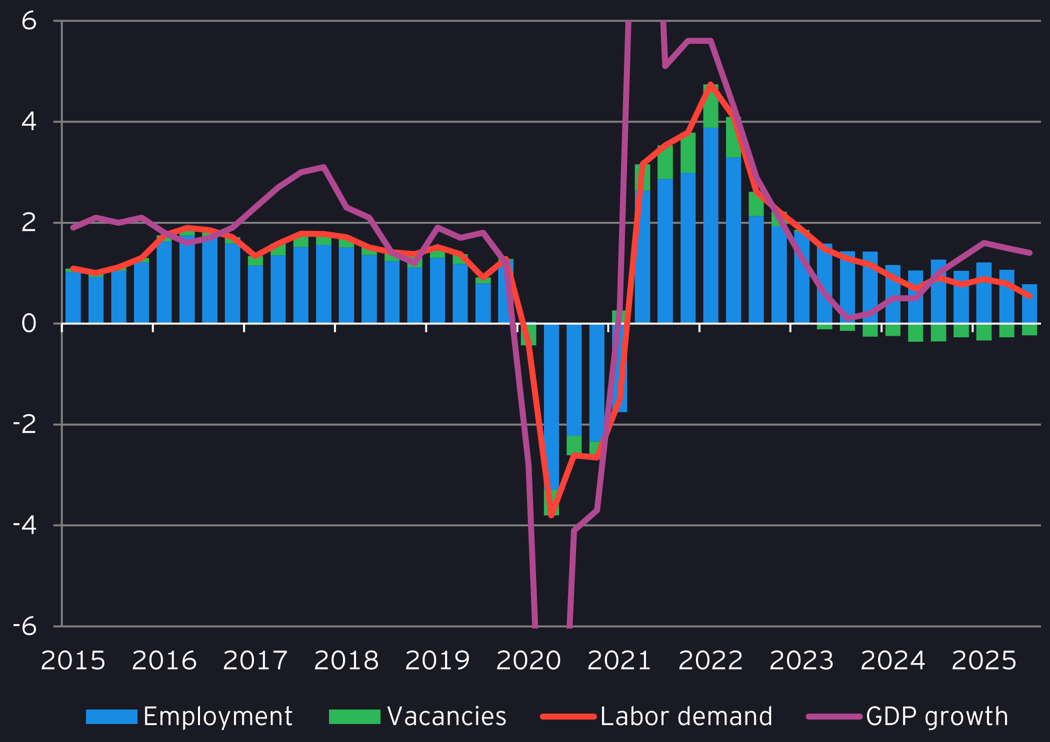


Source: European Commission.
*Share of firms expecting weaker output but planning to maintain or increase employment over the next three months.

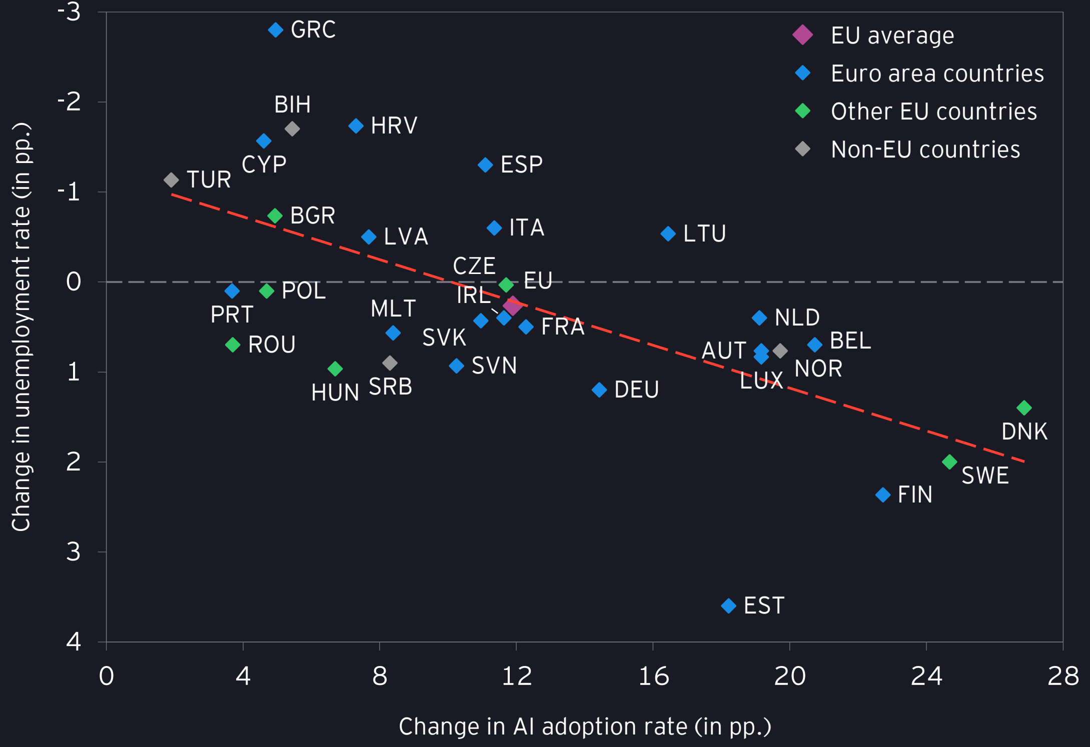
Labor demand growth in Europe continues to slow despite an uptick in GDP growth

- Much of the slowdown reflects a normalization in labor demand following past negative supply shocks, pandemic-era mismatches, and earlier labor hoarding.
- AI adoption may be contributing to weaker labor demand, with early evidence suggesting links between higher AI usage and rising youth unemployment across countries.

Labor demand vs. real GDP growth in the euro area
(Y/y, in percentage)



Change in AI adoption rate[1] compared to change in unemployment rate among young educated adults[2]
2025* compared to 2023



Cyclical headwinds, such as slow economic growth and weaker demand across labor-intensive sectors, can also exert pressure on youth unemployment by reducing entry-level job opportunities. However, the relationship with AI adoption remains significant after controlling for GDP growth.

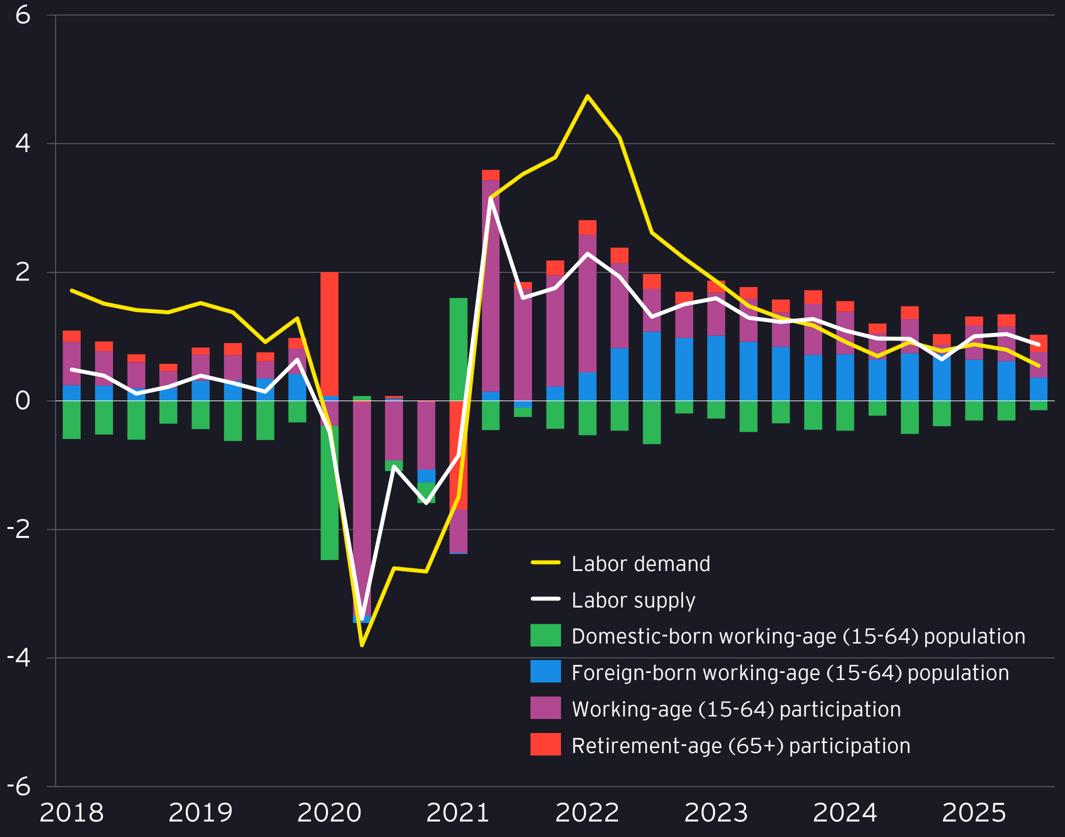
Source: Eurostat.

* For unemployment rate, 2025 Q1-Q3 average.
1. Enterprises with 10 or more employed persons using at least one AI technology.
2. Persons with tertiary education aged 15-39.

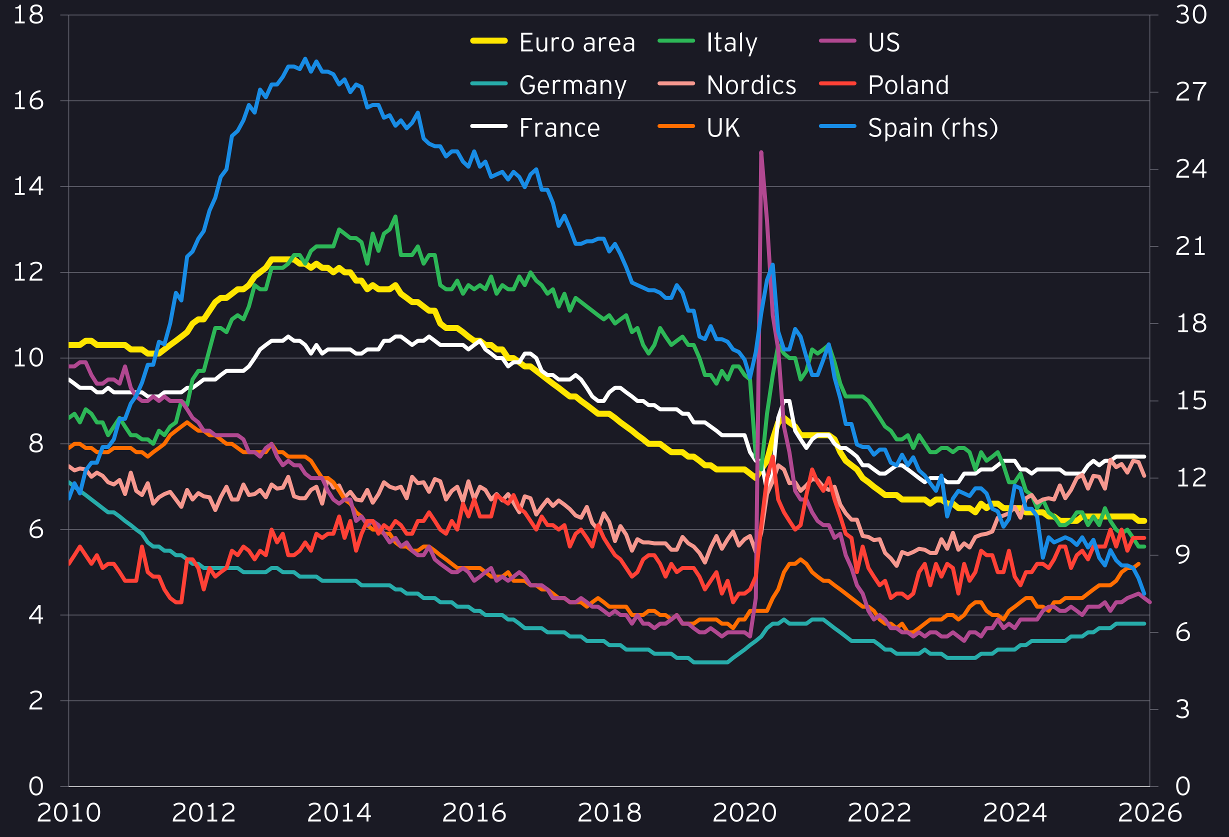
Labor supply growth picked up through 2025, driven by rising labor force participation, outpacing labor demand growth. Despite this, the unemployment rate has remained stable, hovering near historical lows

- The unemployment rate continues to fall in Southern Europe, while it is edging up in Germany and the UK.
- In the Nordics, following notable increases in previous years, the unemployment rate appears to be stabilizing.

Labor supply and demand change in the euro area
(% y/y, in percentage)



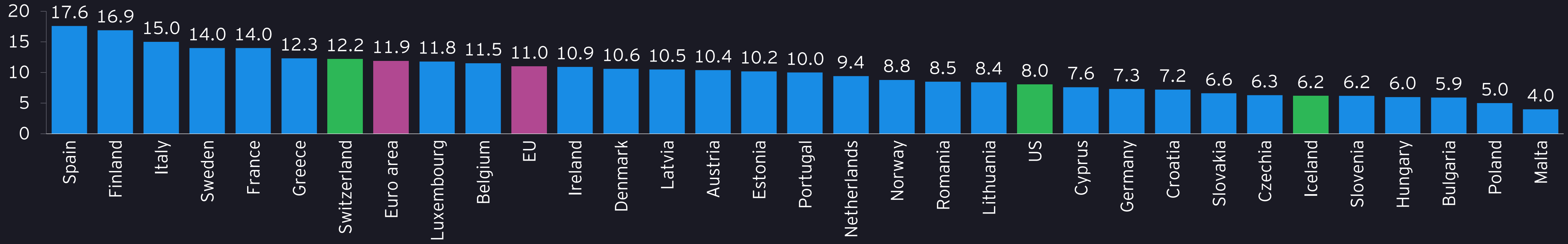
Unemployment rate (in percentage)



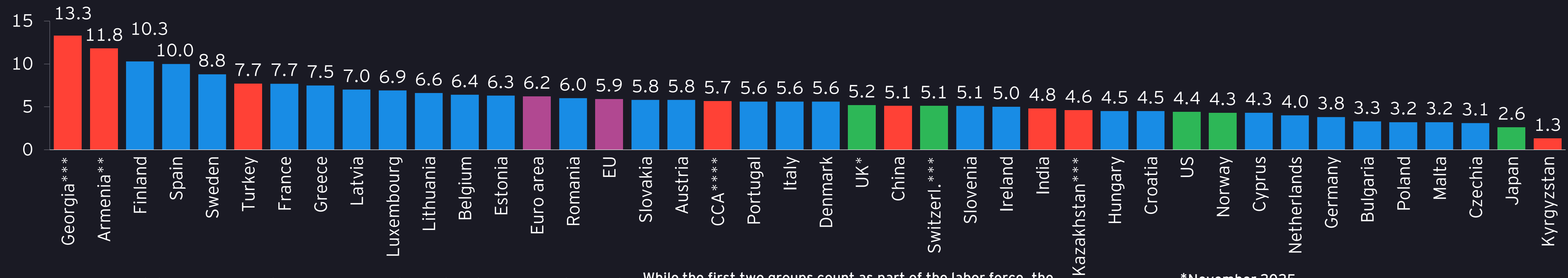
Source: Eurostat, BLS, FRED, ONS.
Notes: Labor demand is a sum of supply employment and vacancies.

Substantial cross-country differences in labor market slack persist, with looser conditions in Southern Europe and the Nordics, and much tighter conditions in many CEE economies

Labor market slack, 2025 Q3
(In percentage of the extended workforce aged 20-64)



Unemployment rate in December 2025
(In percentage of population in the labor force)



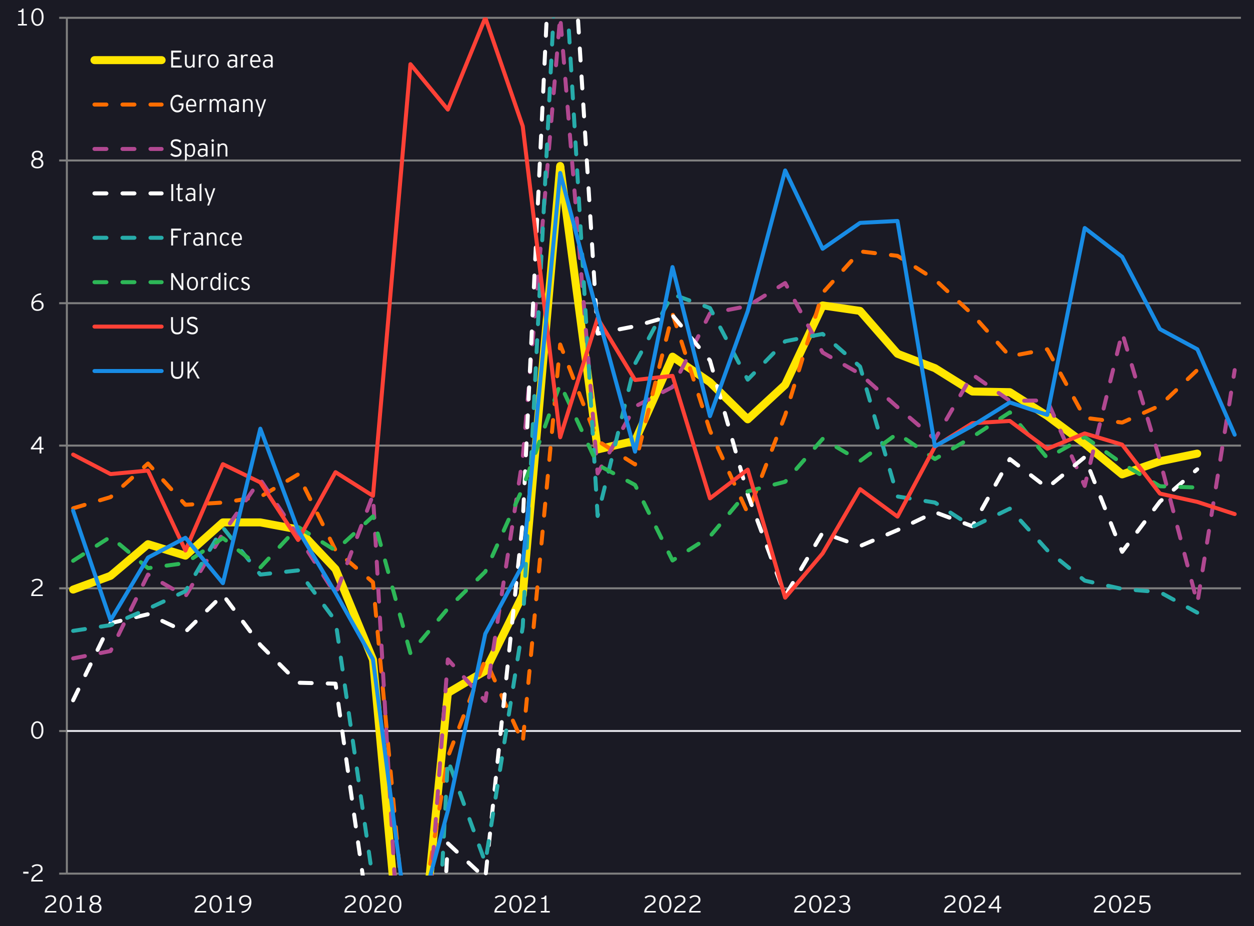
Source: Eurostat; ONS; BLS; Trading Economics.
Note: Labor market slack includes four groups:
1. Unemployed persons, as defined by the ILO
2. Underemployed persons working part-time
3. Persons available to work but not seeking
4. Persons seeking work but are not immediately available

While the first two groups count as part of the labor force, the other two, also referred to as potential additional labor force, are outside the labor force. For this reason, the 'extended labor force,' consisting of both the labor force and the potential additional labor force, has been used for this analysis. For the US, the labor slack is the U-6 unemployment rate. For the US and UK, the unemployment rate for those aged 16-64.

*November 2025
** Q3 2025
*** Q4 2025
**** CCA includes Armenia, Georgia, Kazakhstan and Kyrgyzstan. (Q3 2025)

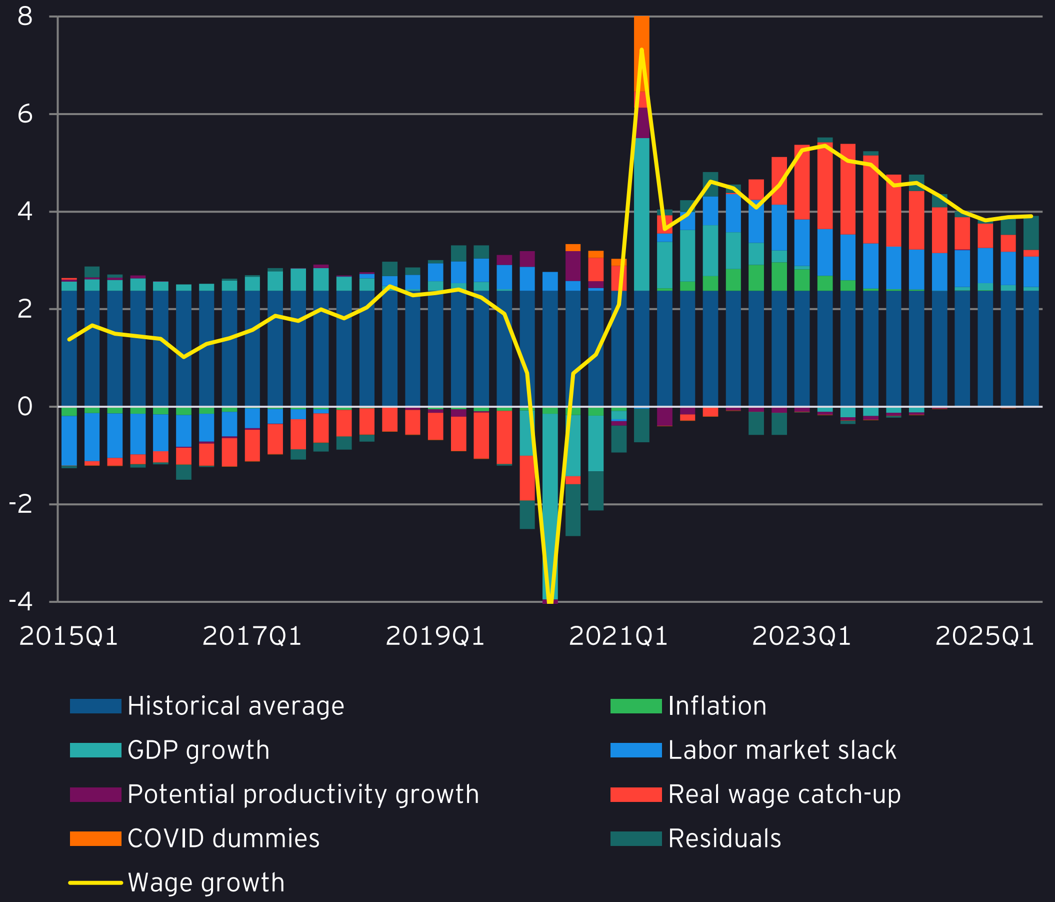
Nominal wage growth has slowed as real wages have caught up with productivity, but remains above pre-pandemic levels due to structurally tight labor markets

Nominal wage growth (y/y, in percentage)



Source: Eurostat, ONS, FRED, Oxford Economics.
For the euro area countries, wages and salaries per employed person; for the UK, average weekly earnings in the whole economy, total pay; for the US average hourly earnings of All Employees, Total Private. Nordics as Norway, Sweden, Finland, and Denmark arithmetic average.

Model-based decomposition of y/y wage growth in the euro area (in percentage)

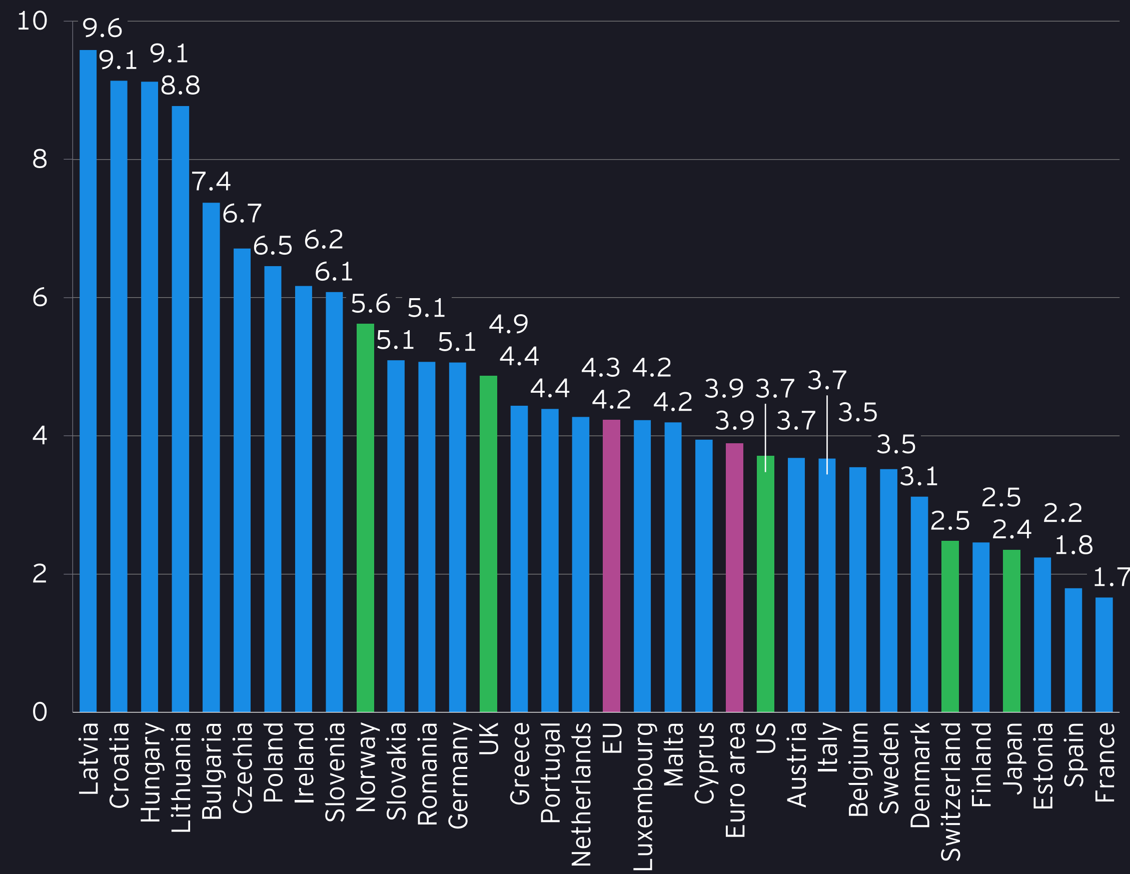


Source: own calculations based on Oxford Economics and Eurostat data.
Error correction model of q/q nominal wage growth. Contributions of all variables are expressed in terms of deviation from the sample mean (2006 Q1 - 2025 Q3). Slack includes deviation of unemployment rate from NAIRU and the vacancy rate. Potential productivity is defined as potential GDP over employment at NAIRU.

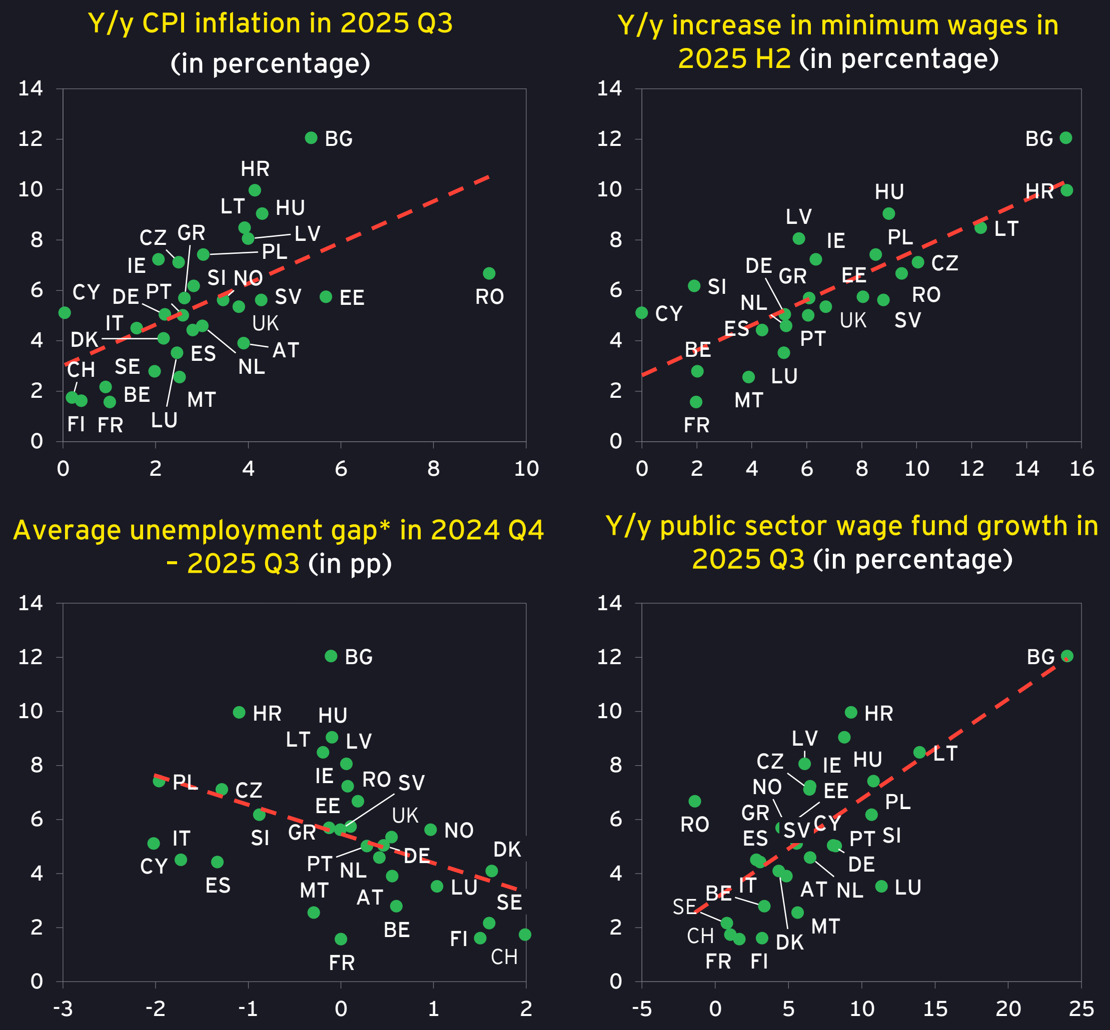
Significant cross-country disparities in wage growth persist, reflecting differences in inflation dynamics, public sector pay policies, minimum wage growth, and labor market slack

- CEE economies continue to record much faster wage growth than Western and Southern Europe. Within broadly defined Western Europe, wage-growth differentials are narrowing, with most economies moving toward more sustainable wage dynamics.

Nominal wage growth in 2025 Q3 (y/y, in percentage)



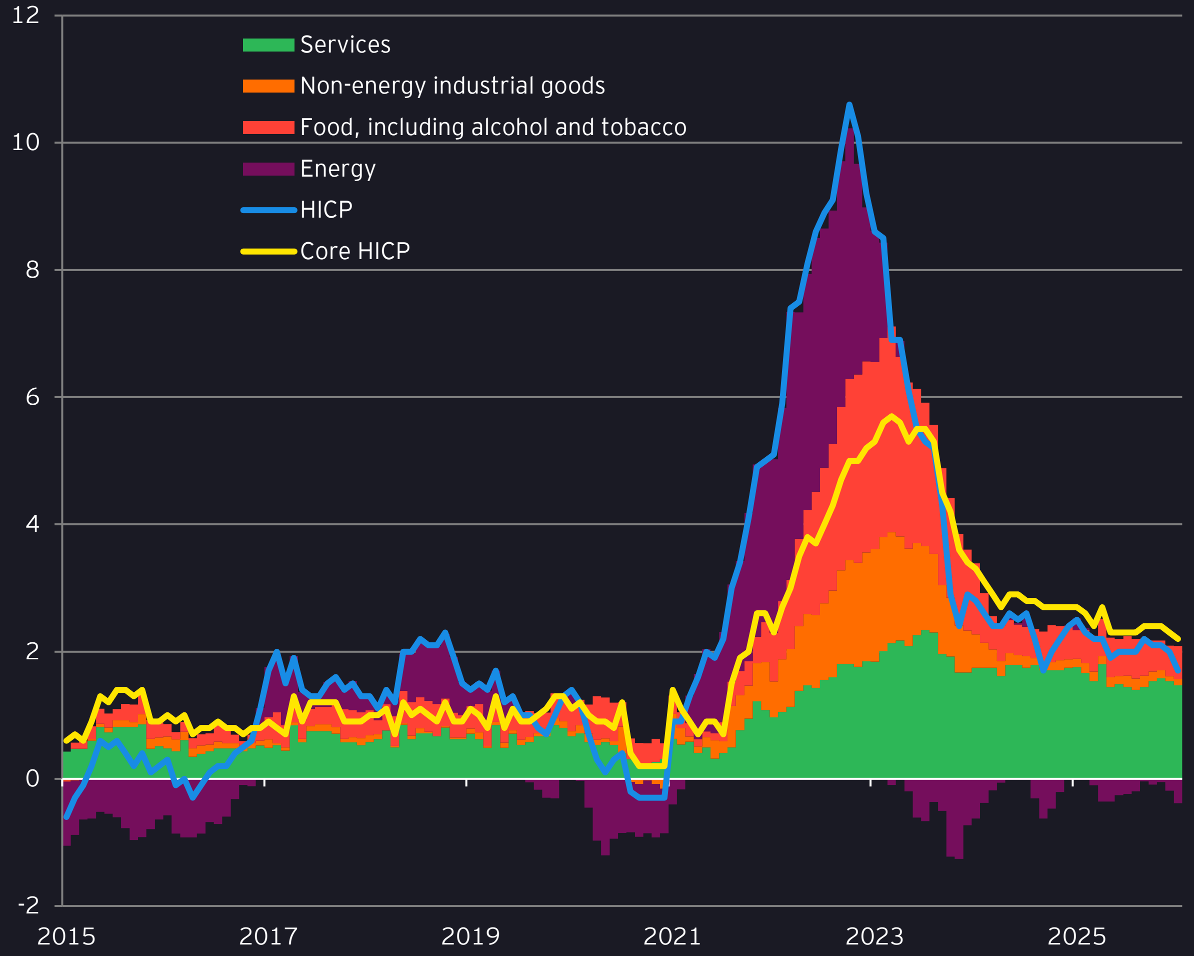
Y/y nominal wage growth in 2025 Q3 (y axis, in percentage) vs.:



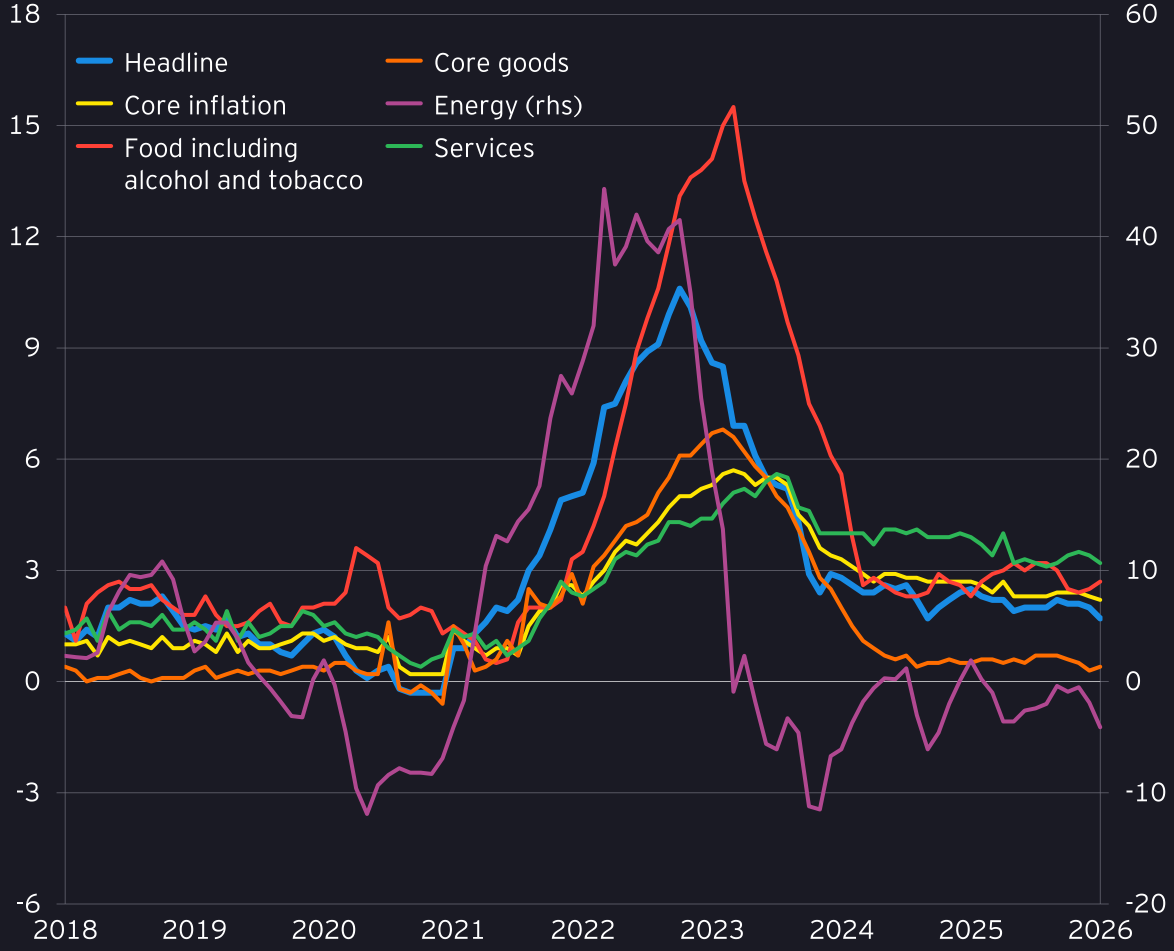
Source: Eurostat, ONS, FRED, Oxford Economics
For the euro area countries, wages and salaries per employed person; for the UK, average weekly earnings in the whole economy, total pay; for the US average hourly earnings of All Employees, Total Private. Nordics as Norway, Sweden, Finland, and Denmark arithmetic average.
* Unemployment gap is the difference between the Unemployment rate and NAIRU (non-inflation accelerating rate of unemployment).

Headline inflation in the euro area has stabilized close to 2% amid falling energy prices, flat core goods prices, and still slightly elevated services inflation

Statistical decomposition of y/y HICP inflation in the euro area (in percentage)



HICP inflation in the euro area (y/y, in percentage)

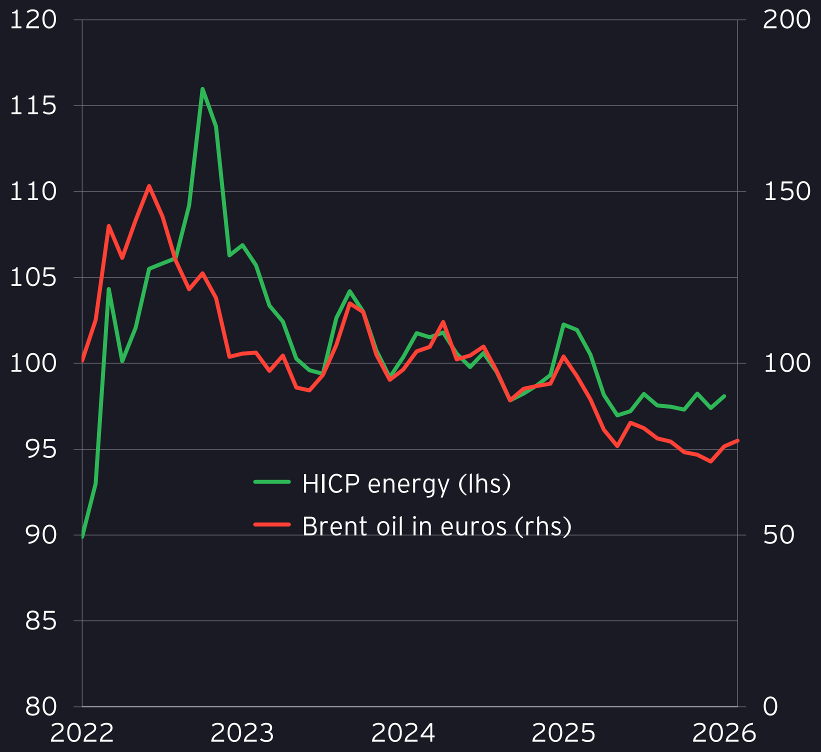


Source: Eurostat.

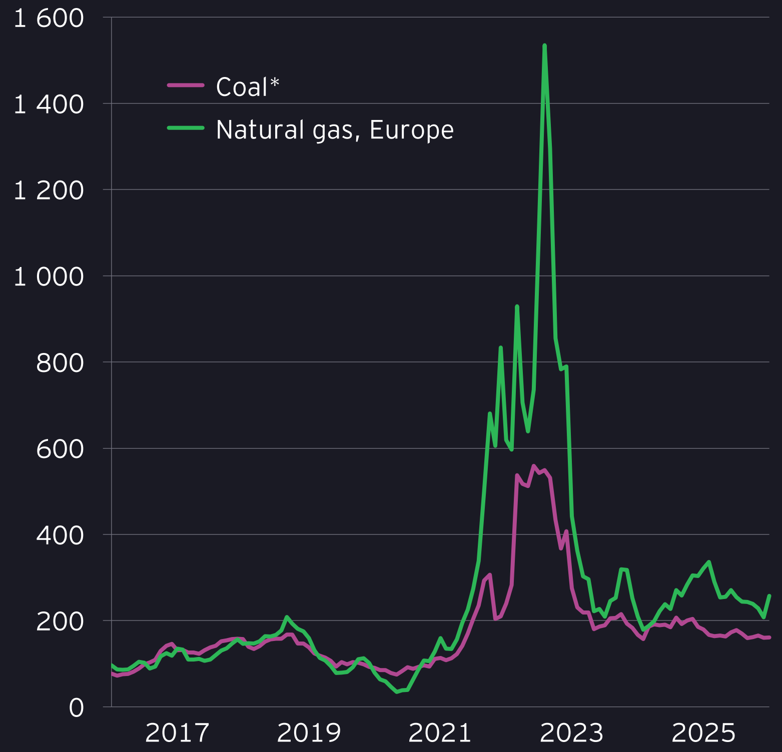
Declines in commodity prices and euro appreciation supported disinflation in energy products, though a recent increase in oil prices suggests this trend may reverse in the coming months

- Energy disinflation was reinforced by lower oil prices in 2025 Q4, except in Romania (+14.1% y/y) and Austria (12.4%), where the removal of administrative price caps pushed prices higher.
- Oil prices have risen in recent months amid heightened tensions and the subsequent escalation of the conflict in Iran. If this persists, energy prices will cease to act as a disinflationary force.
- After a summer spike, food and non-alcoholic beverages inflation eased to 2.5% in the euro area, helped by falling fruit prices due to favorable weather. However, prices of meat, coffee, and chocolate continue to grow at a robust pace.
- Inflation in the tobacco and alcohol category continues to slow, following earlier increases driven largely by excise taxes on tobacco.

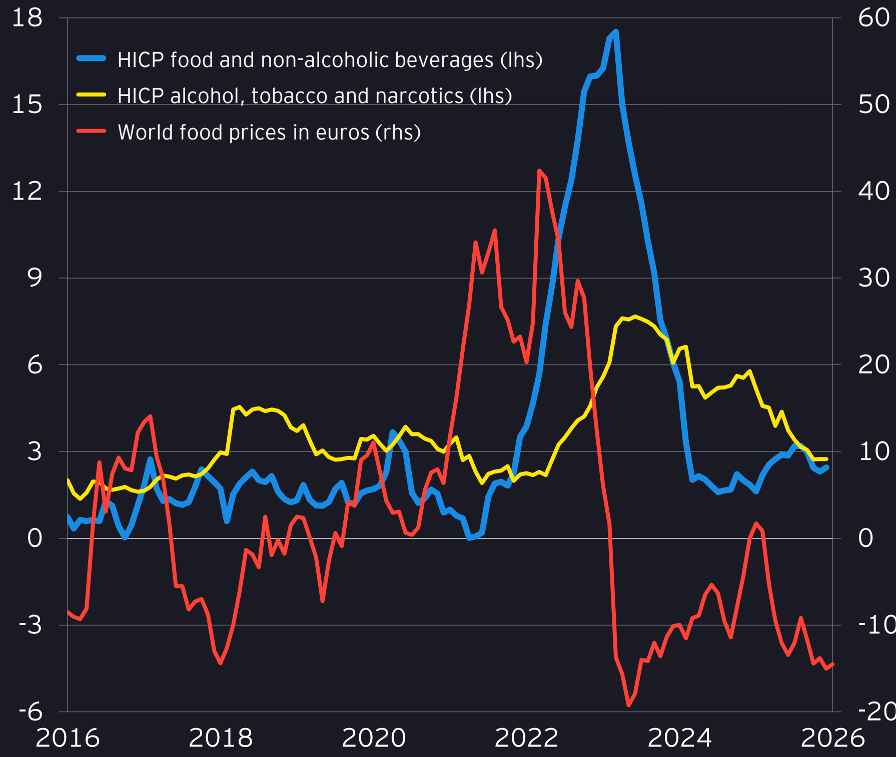
HICP energy in the euro area vs. oil prices (index, 2024 = 100)



Natural gas and coal prices (index, 2016 = 100)



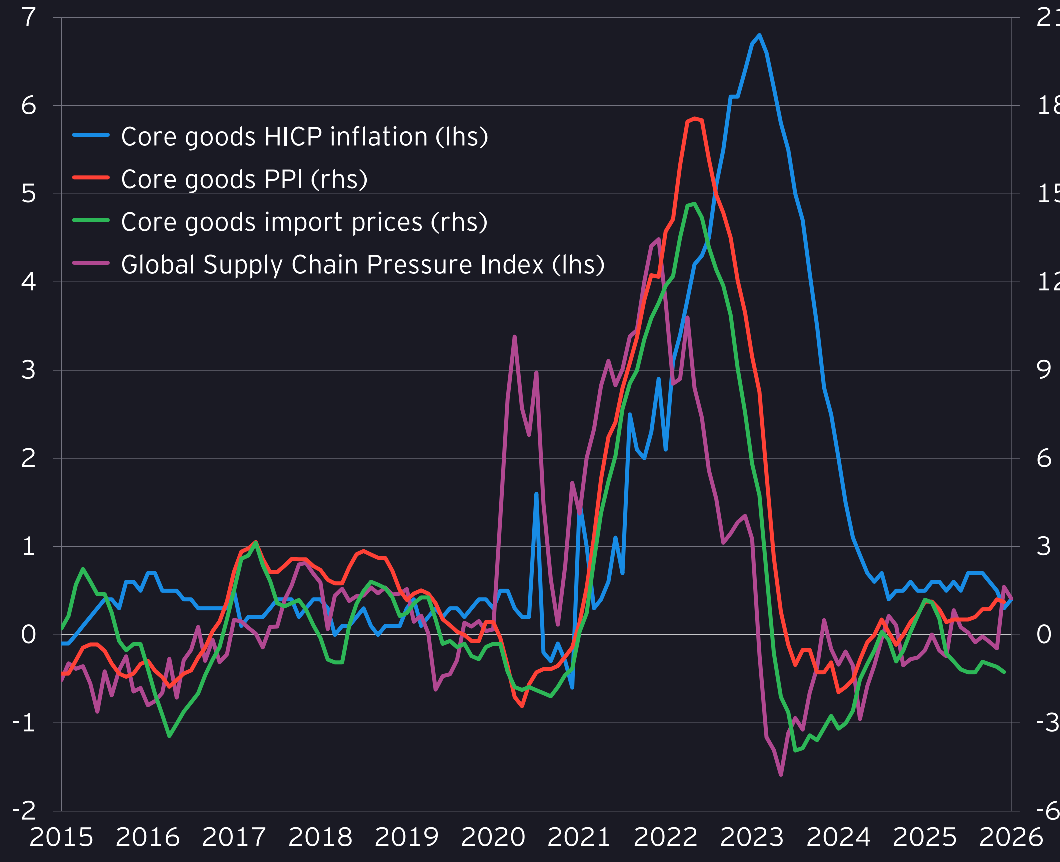
HICP food measures in the euro area vs. world food prices (y/y)



Source: World Bank Commodity Prices; BIS; Eurostat; stooq.pl.
* ICE Rotterdam coal price.

Core goods inflation in the euro area has fallen to 0.4%, helped by the appreciation of the euro. Services inflation has stabilized at a somewhat elevated level, broadly consistent with underlying wage growth

Y/y core goods inflation in the euro area vs. y/y core goods PPI and import prices in the euro area (in percentage) and global supply chain pressures



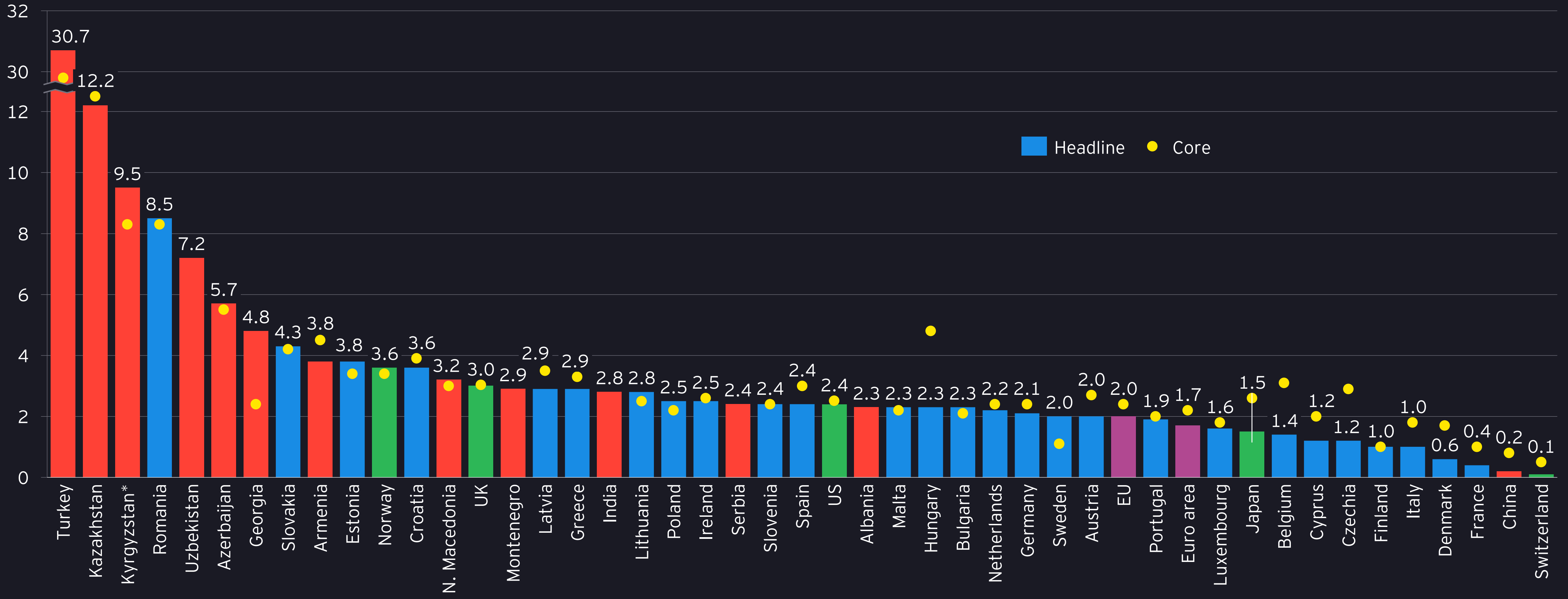
Y/y services inflation vs. y/y nominal wage growth in the euro area (in percentage)

Source: Eurostat, Oxford Economics, Federal Reserve Bank of New York.

Inflation rates across Europe continue to diverge, influenced by differences in wage growth, regulated prices, and excise tax adjustments

- Several CEE economies still record elevated Inflation, notably Romania (partly due to energy price and VAT hikes).
- In contrast, Switzerland, France, Italy, Denmark, and Finland are experiencing subdued price growth, largely due to low wage growth.

HICP inflation in January 2026 (y/y, in percentage)



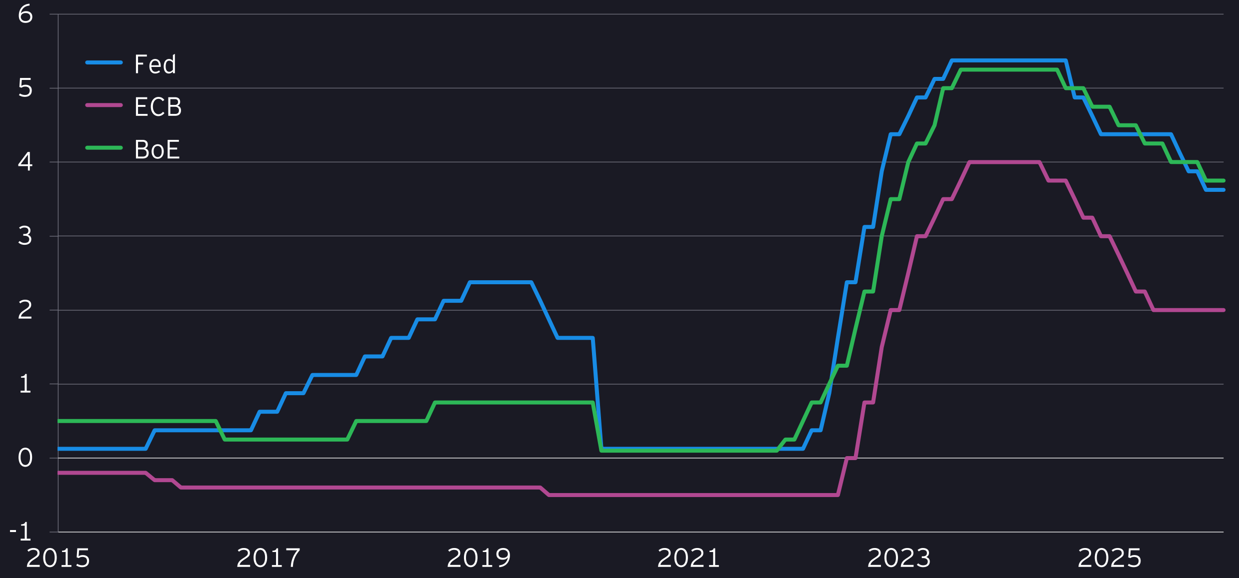
Source: Eurostat, FRED, ONS, Trading Economics, national statistical bureaus.
Note: For non-EU countries, CPI inflation.
*December 2025 – Core CPI only

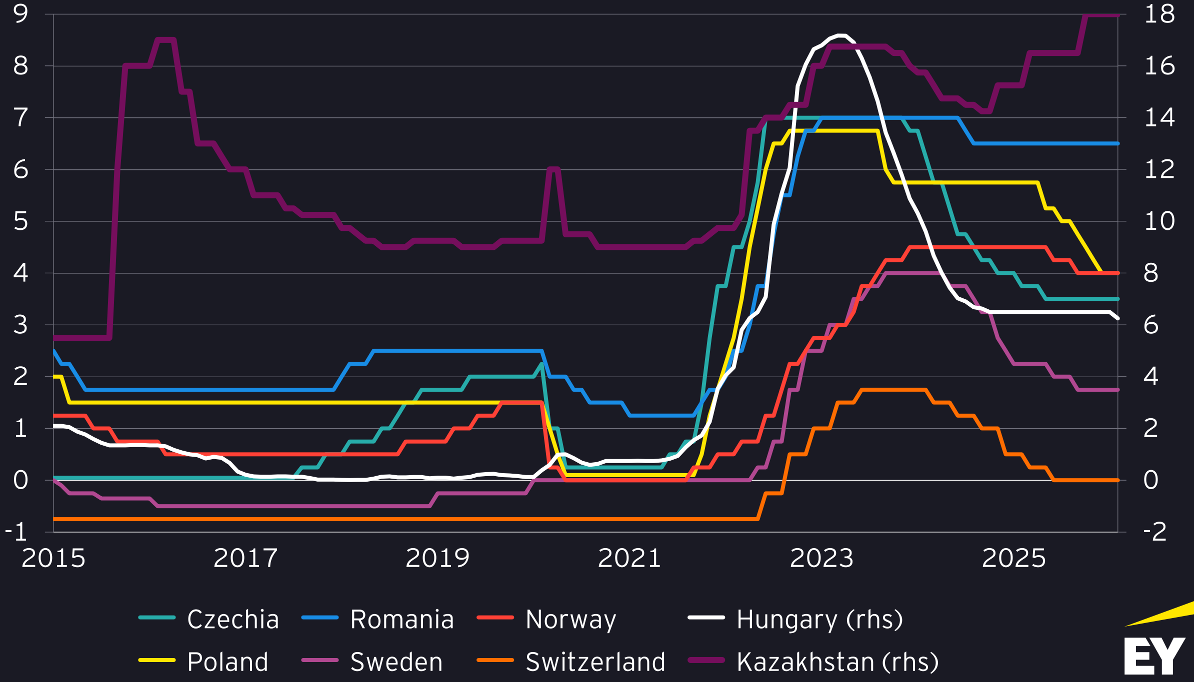
EY

The ECB and most other central banks in Europe are in wait-and-see mode, with only a few continuing to ease policy

- The Federal Reserve cut rates by 75 bps between September and December 2025 (to 3.5-3.75%) in response to slowing employment growth. Rates were held steady in January as they approached neutral level and the labor market appeared to be stabilizing.
- With inflation near target and GDP growth close to potential, the ECB has kept the deposit rate at 2.0% since June 2025.
- As inflation and wage growth decelerated from summer heights and GDP growth slowed, the Bank of England cut the Bank Rate to 3.75% in December 2025 but held steady in February.
- The SNB has kept rates at 0.0% since June 2025 despite weak price and growth dynamics, showing reluctance to return to negative territory unless deflation risks intensify.
- The Riksbank signalled it has completed its easing cycle, holding rates at 1.75% since September, consistent with improving growth and inflation at target. The Norges Bank paused its easing cycle, maintaining rates at 4% since September amid persistently elevated inflation.
- In CEE, monetary policy continued to diverge. The CNB has kept rates at 3.5% since May. Romania maintained rates at 6.5% throughout 2025 amid persistent price pressures. In Hungary, elevated inflation kept policy unchanged through 2025; the easing cycle resumed in February 2026 with a 25 bp cut. The Polish NBP cut rates by 175 bps in 2025, bringing the policy rate to 4.0% in December, as inflation returned to the 2.5% target; rates were held steady in January and February while policymakers awaited new inflation data.
- The central bank of Turkey has gradually reduced rates since July, reaching 37% in January, in line with falling inflation.
- The National Bank of Kazakhstan raised rates to 18% in October amid accelerating GDP growth and elevated inflation.

Central bank interest rates (in percentage)

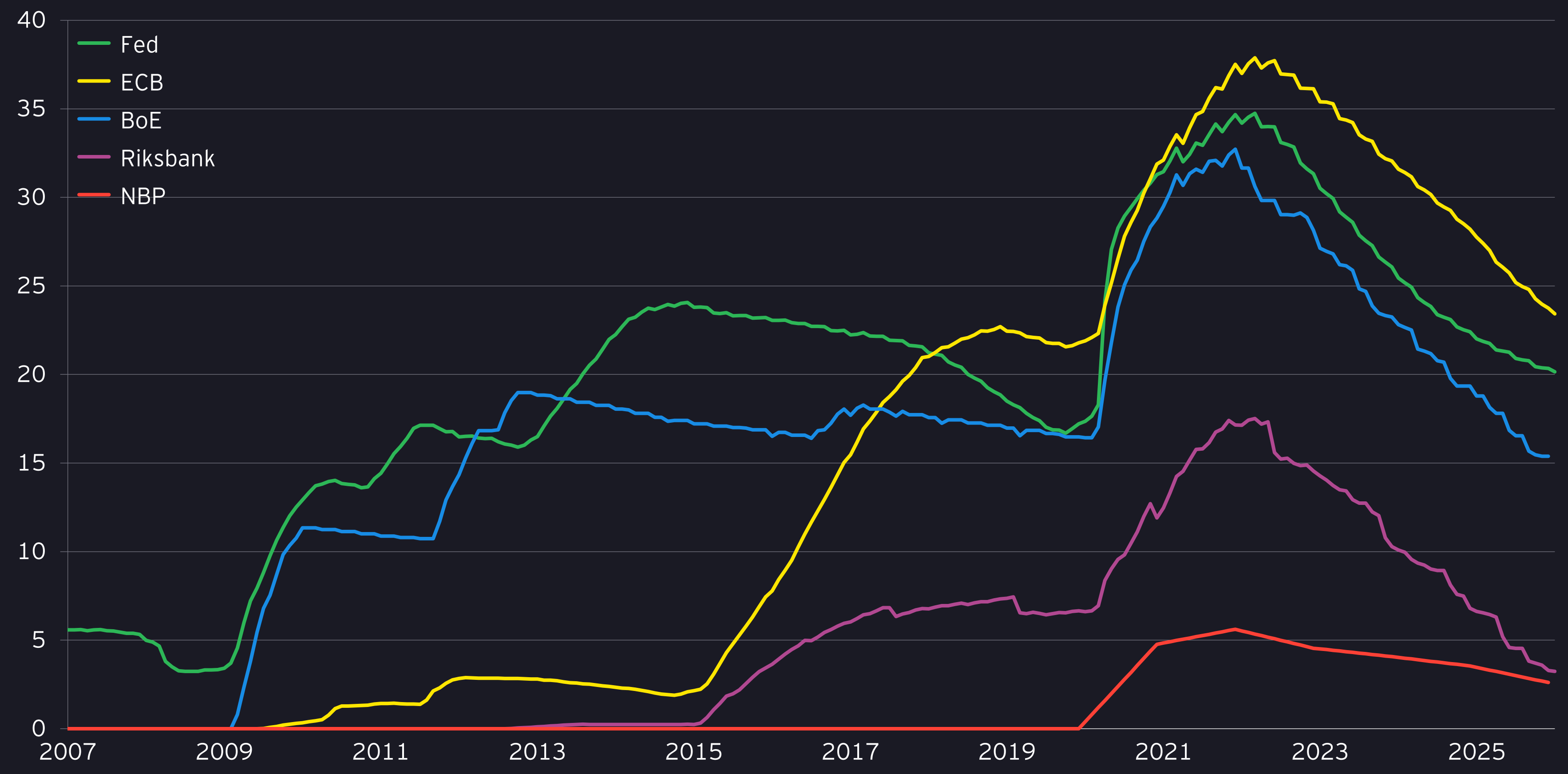




Source: ECB; Fed; BoE; BIS, Trading Economics.

At the same time, central banks continue to reduce bond holdings, which effectively offsets part of the impact of interest rate cuts

Central bank holdings of assets related to large-scale purchases (in percentage of GDP)

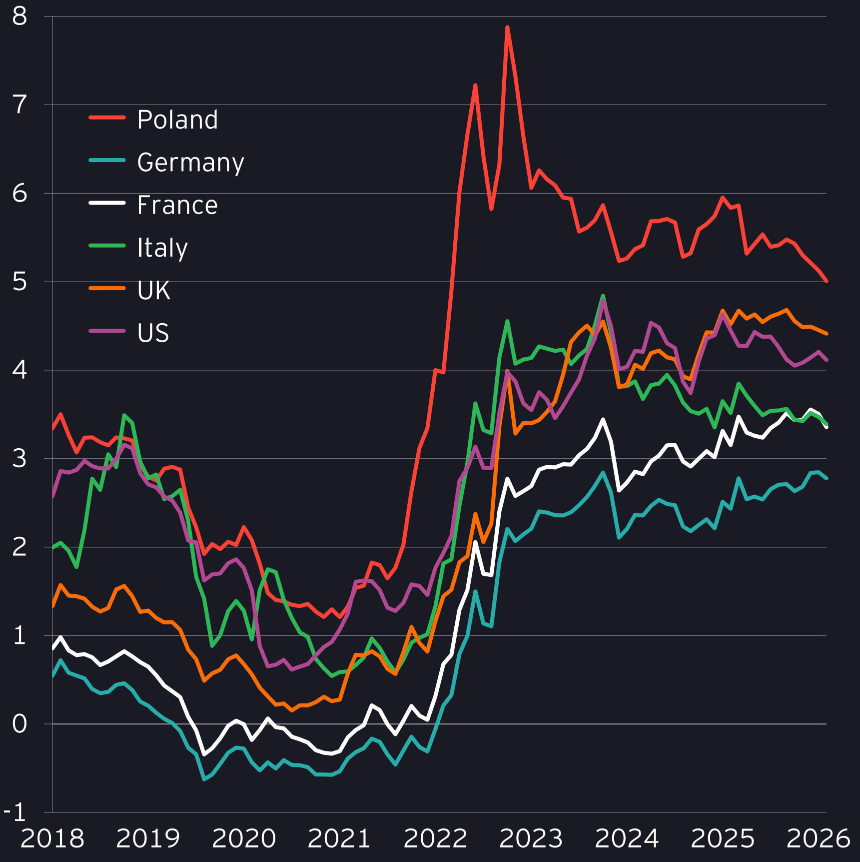


Source: Eurostat, Oxford Economics, FRED, ECB, ONS, Riksbank, NBP.

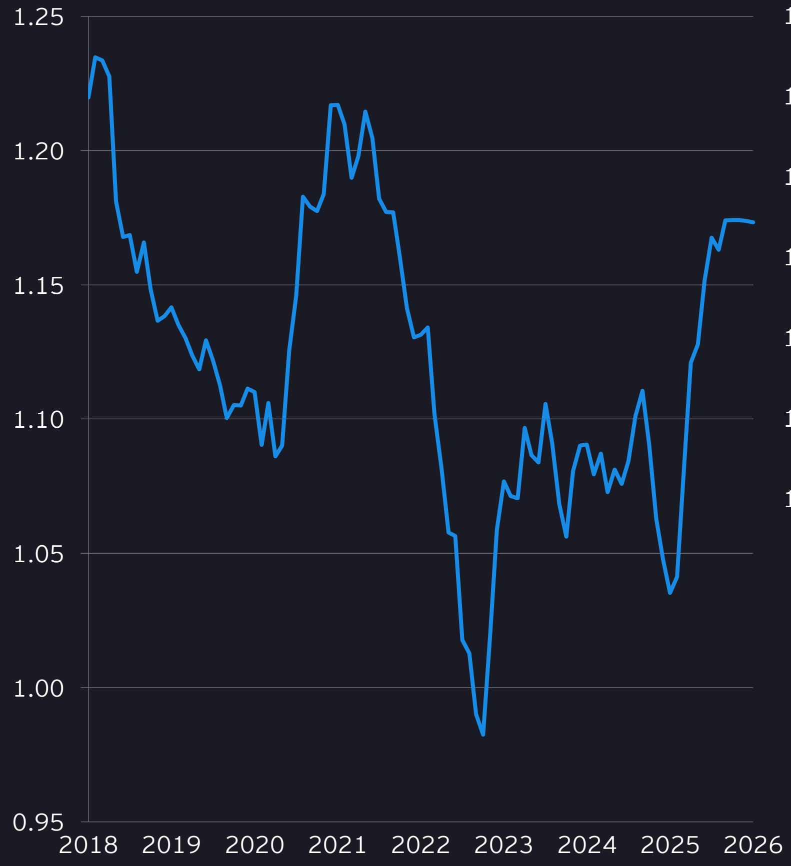
Quantitative tightening, alongside expectations of looser fiscal policy, has contributed to bond yields moving largely sideways in recent quarters despite rate cuts. The euro remains strong against the USD, supported by policy dynamics and uncertainty generated by the US administration

- Bond yields have trended higher in Germany (fiscal easing). Yield spreads over Bunds have narrowed in Italy, reflecting progress in fiscal consolidation. Polish bond yields have fallen reflecting monetary policy easing and improved risk appetite, despite sizeable fiscal deficits.
- The Swedish krona, Hungarian forint, and Czech koruna appreciated against the euro in 2025 following earlier weakness, while sterling depreciated.

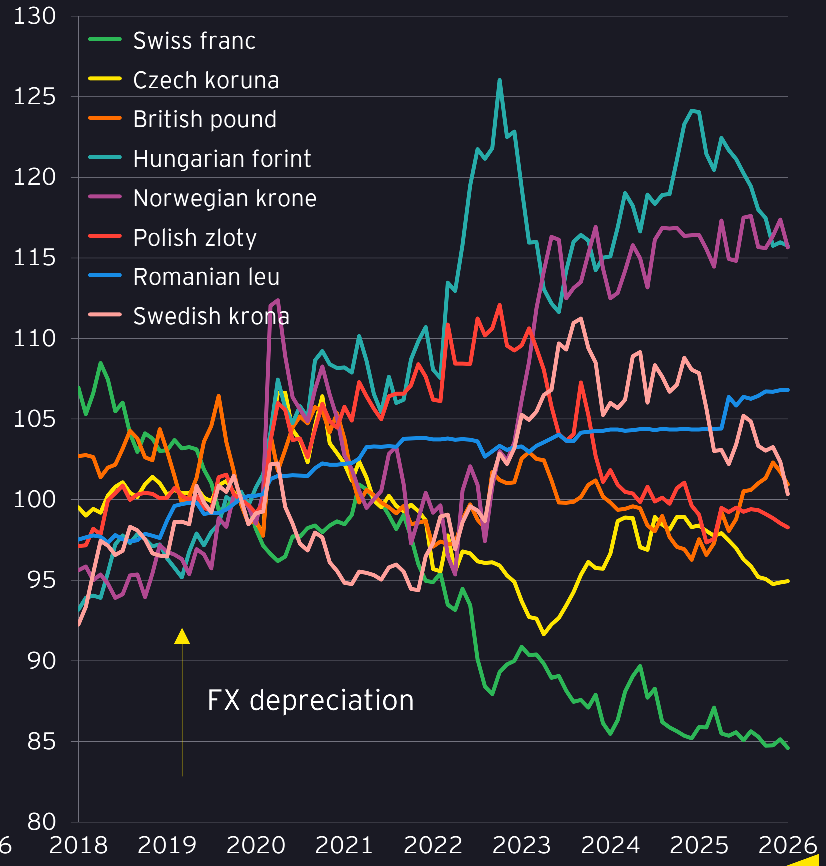
10-year government bond yield (in percentage)



EUR/USD exchange rate



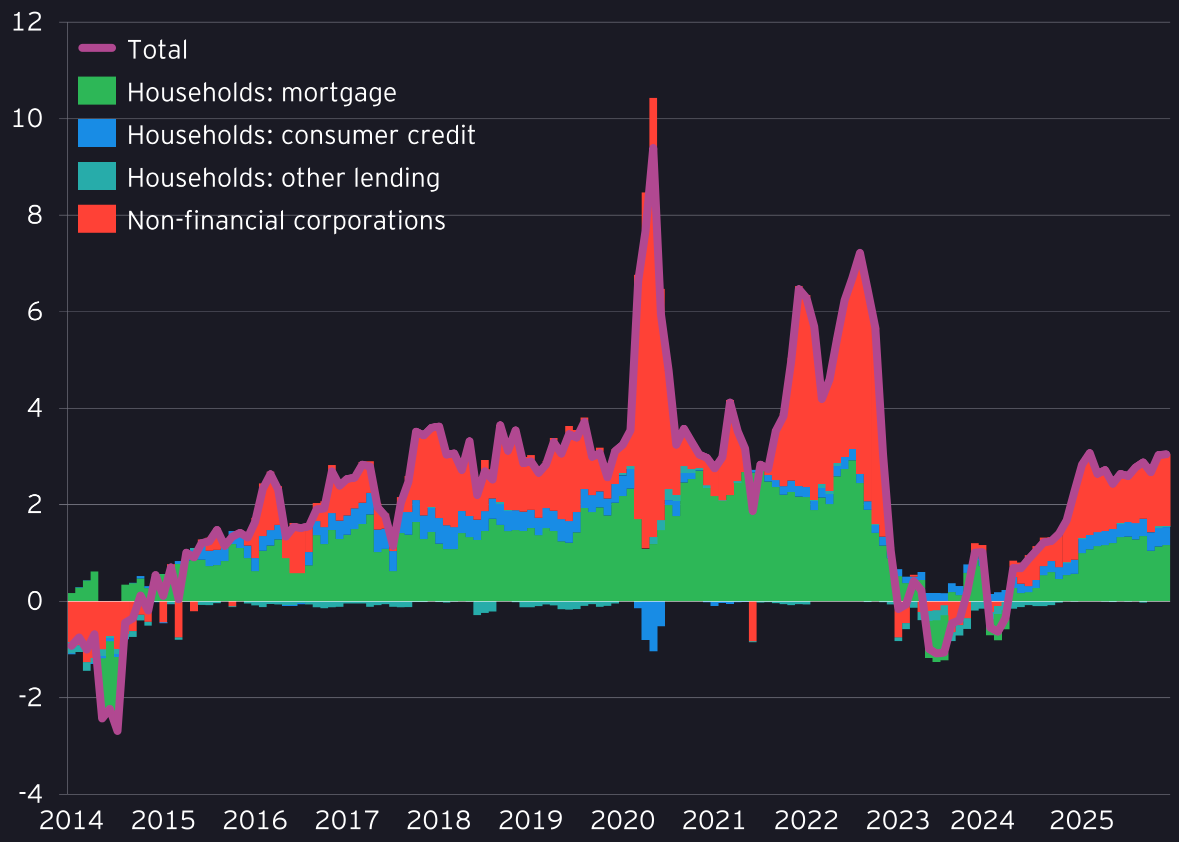
Exchange rates vs. EUR
(2019-Q4= 100)



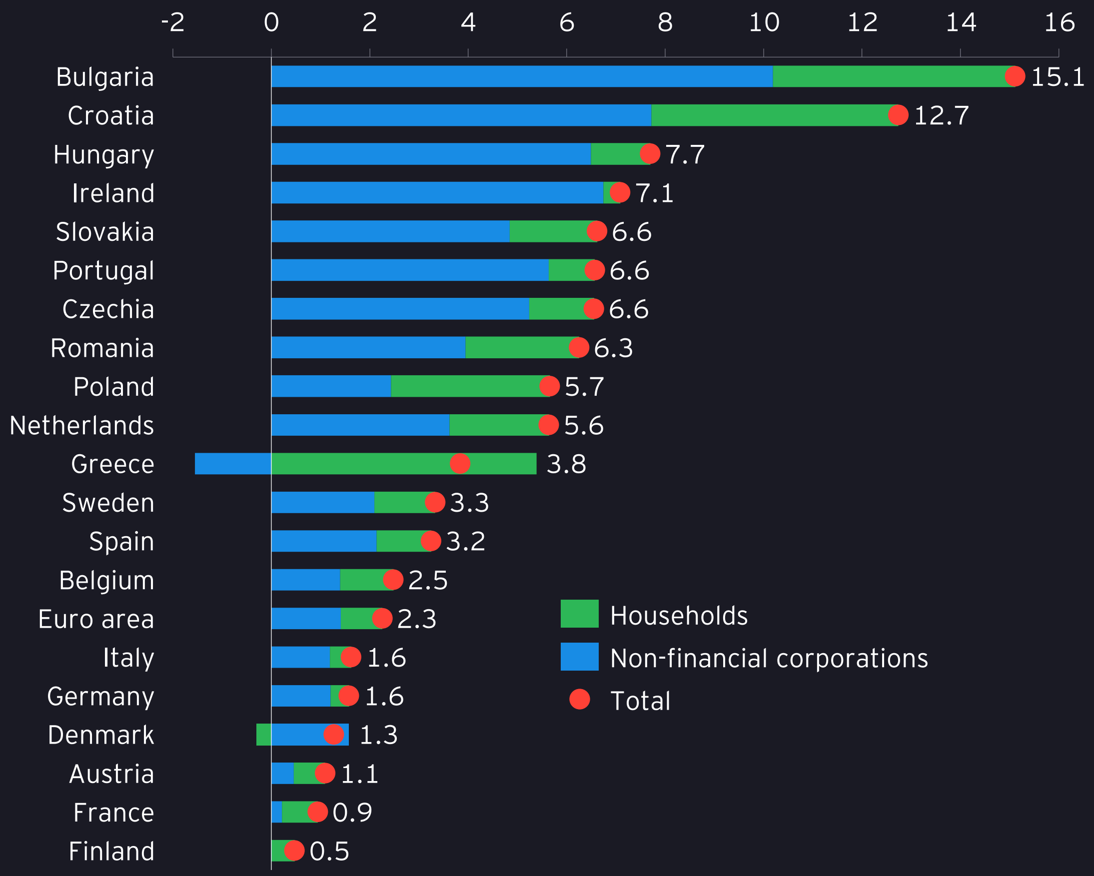
Source: investing.com, Bank for International Settlements (BIS), Stooq.pl.
* British pound as EURGBP

Supported by easier monetary conditions, bank lending has returned to pre-pandemic growth rates. Credit is expanding strongly in CEE but remains weak in the Nordics and the euro area "big four"

Monthly growth in loans to households and non-financial corporations in the euro area (in percentage, annualized and seasonally adjusted, 3-mth moving average)



Stock of loans to households and non-financial corporations (2025 Q4; % y/y)

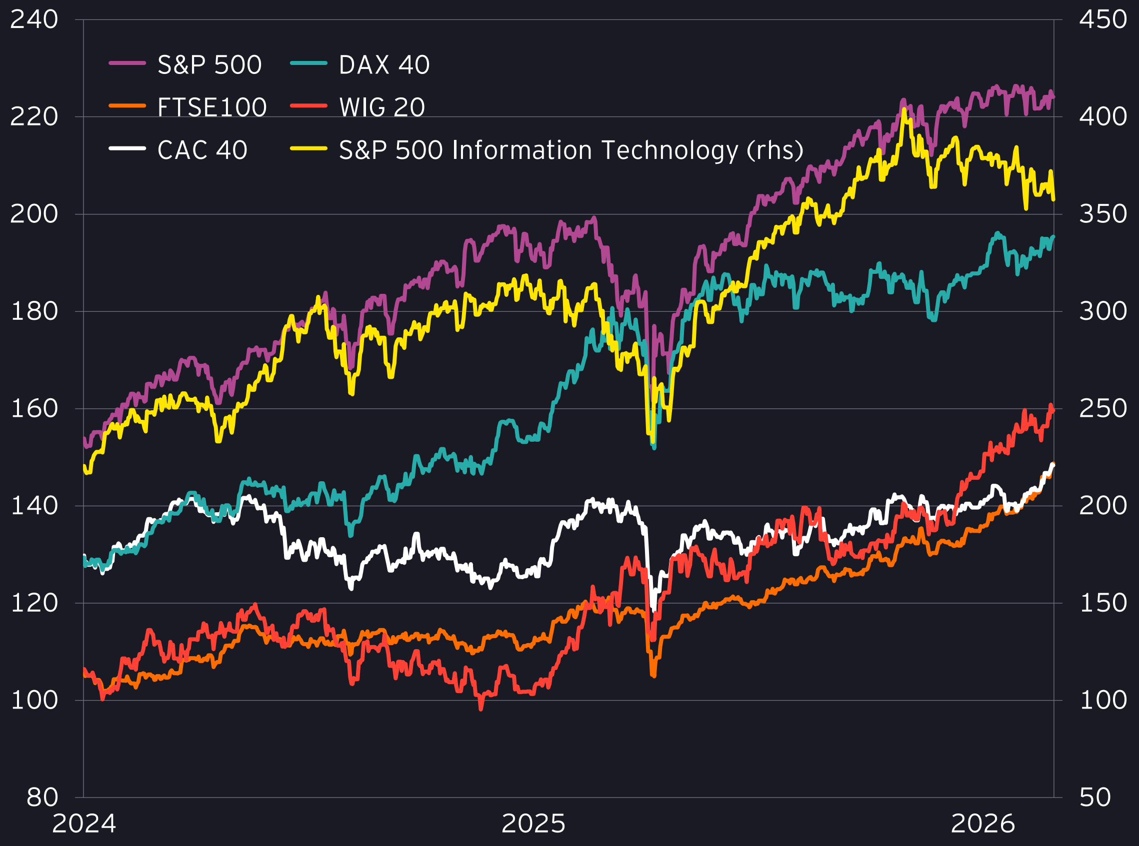


Source: ECB, EY calculations.
Note: Series for households include NPISH.

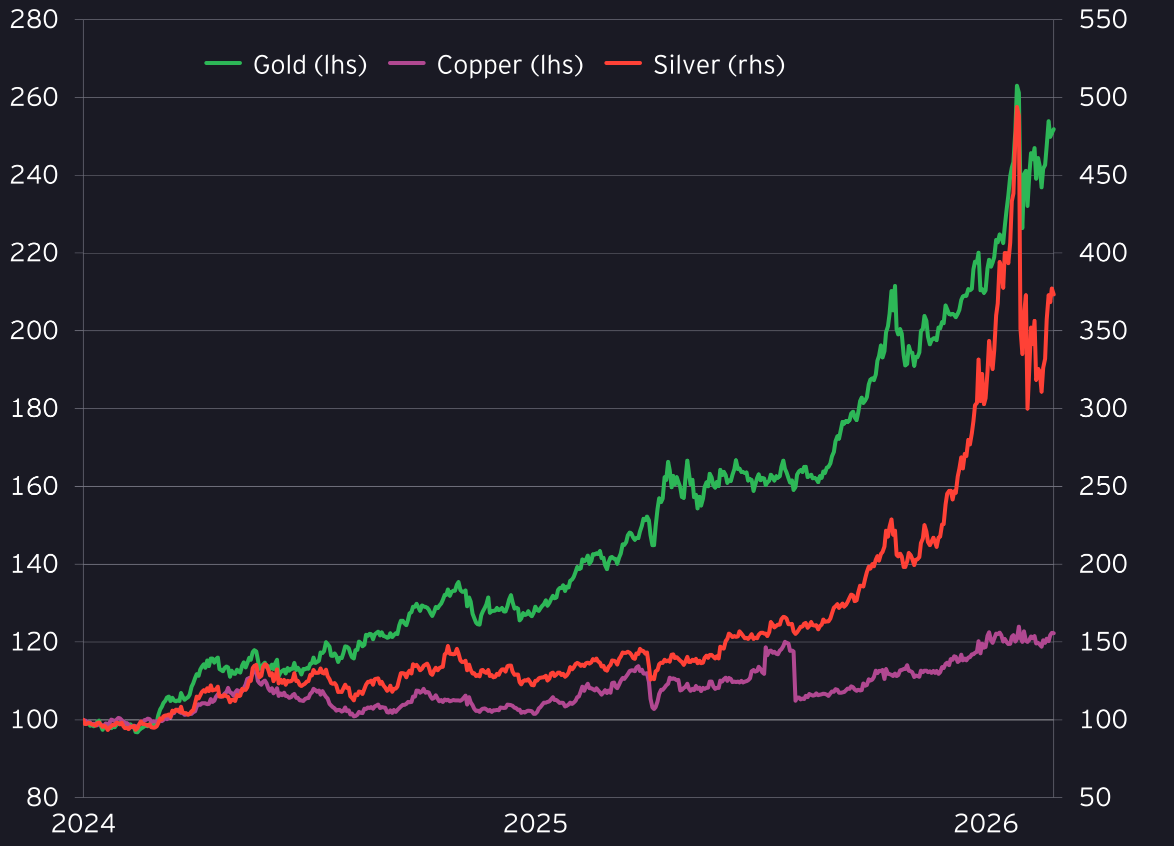
The AI-driven stock market rally has moderated in recent months. Meanwhile, metal prices remain highly volatile

- Most European stock markets have again outperformed the US in recent months as investors looked to diversify the AI-heavy portfolios.
- While rising demand from central banks, industry, and investors plays a role in pushing metal prices higher, speculative activity appears to be an increasingly important driver.

Major stock price indices
(index, 2019Q4=100)



Gold, silver and copper prices
(January 1st 2024 = 100)



Source: Bank for International Settlements (BIS), Stooq.pl, investing.com.

Chapter 2

Key forecast drivers

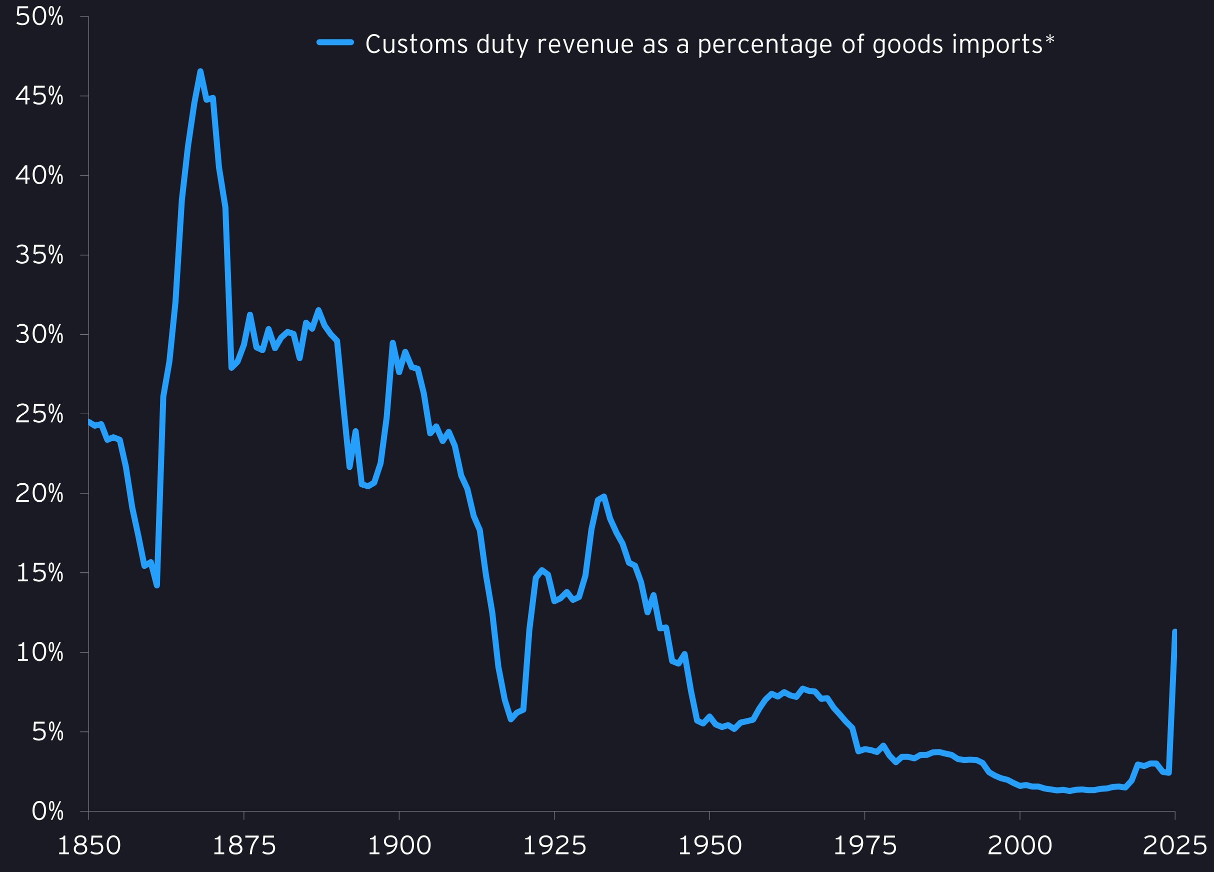
The economic outlook is shaped by a range of factors that create uncertainty and directly influence economic activity

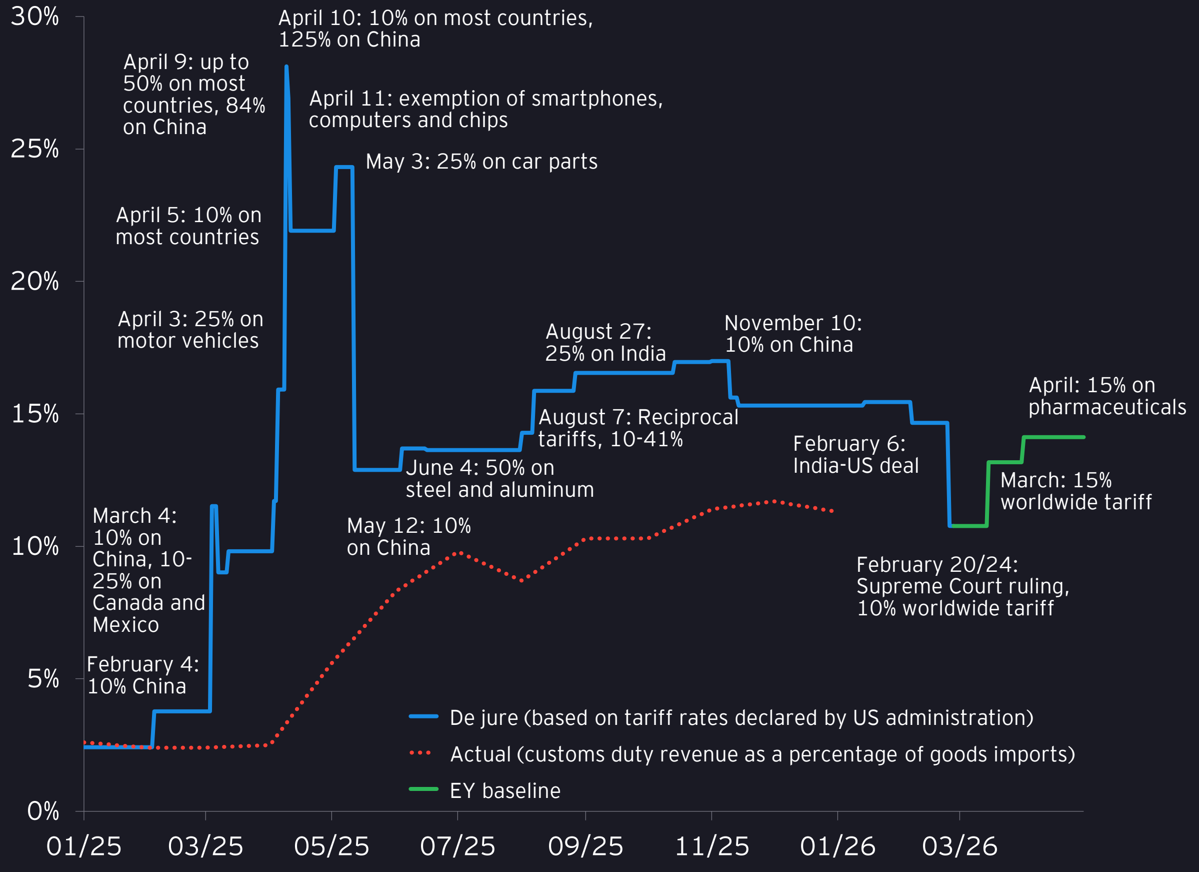
- Trade Policy & Tariffs
- Geopolitical Volatility
- Immigration & Demographics
- Fiscal Policy & Interest Rates
- AI & Productivity

The average effective tariff on US imports has exceeded 11%, reaching its highest level since 1941

- The *de facto* tariff rate (customs revenues relative to imports) remains significantly below the *de iure* rate implied by imposed tariffs and import composition, due to trade rerouting and product reclassification. These two measures are unlikely to converge.

Average effective tariff rate in the US
(in percentage)





Source: The Budget Lab at Yale, WITS, the White House, EY EAT calculations.
* An estimate for 2025.

While the Supreme Court ruled against the IEEPA tariffs, they were swiftly replaced with a 10% baseline tariff on all trade partners, with plans to raise this to 15%

US tariff actions and statements *(as of February 24, 2026)*

Trade partner	Tariff		Status
China	10% IEEPA "fentanyl" tariff on goods	⛔	Removed by Supreme Court ruling against IEEPA-based tariffs, February 20
	IEEPA 34% on goods (with some exceptions)	⛔	
	Additional tariff hike in response to China's rare earths export controls	?	
Canada, Mexico	35%/25% IEEPA "fentanyl" tariff on goods from Canada/Mexico not covered by the USMCA; 10% on Canada energy; 10% on Canada and Mexico potash	⛔	
Brazil	40% IEEPA "free speech" tariff on most goods[1]	⛔	
All nations	50% on steel and aluminum (25% on the UK)	✓	Effective March 12, adjusted on June 4
	25% on cars and auto parts (15% on the EU, Japan, and Korea; 10% on the UK)	✓	Effective May 3, adjusted on August 7
	50% on semi-finished copper products and intensive copper derivative products	✓	Effective August 1
	10% on lumber and 25% on wooden furniture (10% on the UK, 15% on the EU)	✓	Effective October 14
	25% on trucks and truck parts, 10% on buses	✓	Effective from November 1
	Tariffs on pharmaceutical, commercial aircraft, wind turbines	?	Investigated under Section 232, not effective
	40% on shipments rerouted to avoid tariffs	✓	Effective August 7
	25% on re-exported semiconductors	✓	Effective January 14
	10% on most goods[2] (declared additional 5% raise in the near future)	✓	Effective for 150 days from February 24
All nations importing Iranian or Russian oil	IEEPA 25%-50% on all goods	⛔	Removed by Supreme Court ruling against IEEPA-based tariffs, February 20
All nations but Canada and Mexico	April 2 country-specific IEEPA tariffs (rates of 10%-41%, based on trade deficit) on most goods[2]; tariff on Switzerland and India lowered to 15% and 18% as a result of bilateral deal	⛔	

Trade partner actions and statements — to US *(as of February 24, 2026)*

Trade partner	Tariff		Status
China	10% on goods (with some exceptions)	✓	Effective May 13
	34% on goods (with some exceptions)	⏸	Paused until November 2026
	Non-tariff countermeasures	⏸	Paused until November 2026
	Rare-earth export controls	⏸	Paused until November 2026
Canada	25% on United States-Mexico-Canada Agreement (USMCA) noncompliant goods	⛔	Removed on September 1
	25% on steel and aluminum, and USMCA noncompliant vehicles	✓	Effective March 12
EU	Threats on retaliatory tariffs on various goods	⛔	Withdrawn
Mexico	Threats on retaliatory tariffs (without details)	?	Threatened, not effective
Brazil	50% on goods	?	Threatened, not effective

Note: The US Supreme Court ruled that President Donald Trump violated federal law when he unilaterally imposed sweeping tariffs globally under the International Economic Emergency Powers Act (IEEPA). The administration subsequently replaced the IEEPA tariffs with a 10% worldwide baseline tariff under Section 122, effective for 150 days, and intends to raise it further to 15%.

✓ Effective ⏸ Paused ? Threatened ⛔ Removed/withdrawn

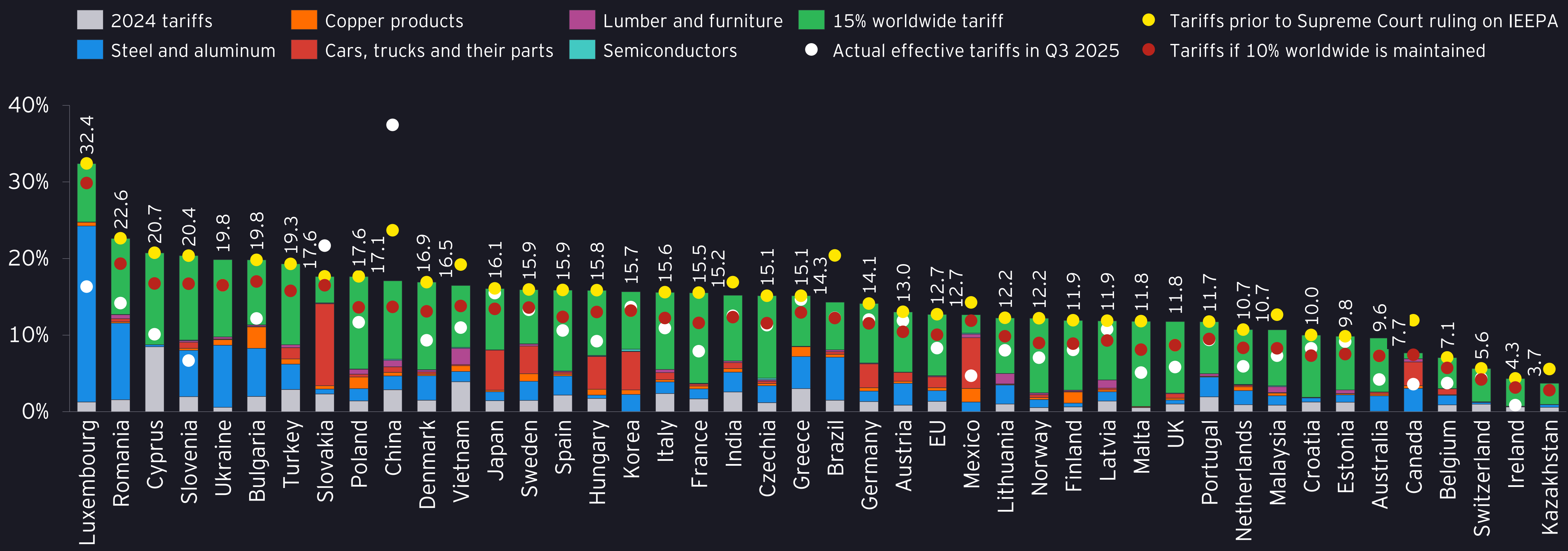
1. Tariff does not apply to energy, aviation, industrial materials, and certain food products.
2. They do not apply to pharmaceuticals, semiconductors, lumber, copper, electronics, and certain food products and goods covered by sectoral tariffs.

Source: Government websites; EY analysis

De iure effective tariff rates declined following the Supreme Court ruling and the shift to Section 122 tariffs, but in most countries, they will return to prior levels if the worldwide tariff rises to 15%

- Exceptions include countries that previously faced tariffs above 15% (e.g., China, Brazil, Canada, Mexico) as well as those with lower prior rates such as the UK.
- Since early 2025, the largest increases in *de iure* tariff rates have occurred in countries with a high share of exports to the US in steel and aluminum, including Luxembourg, Romania, Bulgaria, and Slovenia—though for these, *de facto* tariff rates remain far below the *de iure* levels.
- For most countries, *de facto* tariff rates in 2025 Q3 were substantially lower than *de iure* tariff rates.

De iure effective tariff rate in exports to the US (in percentage)

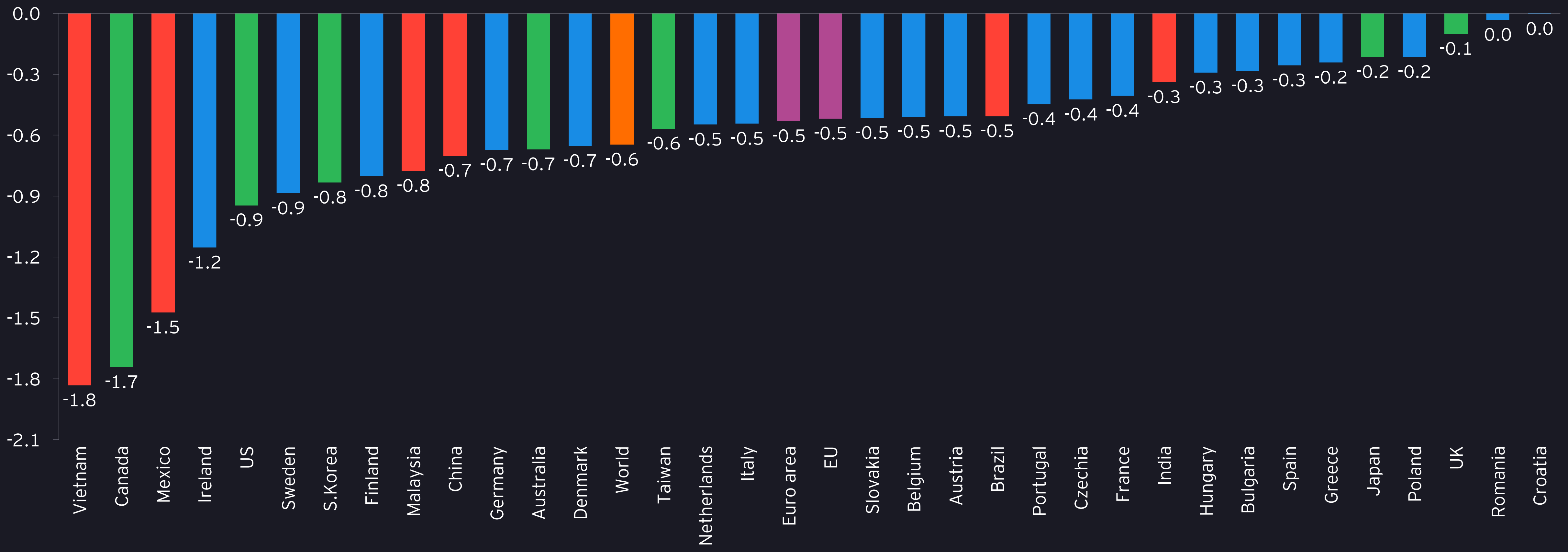


Source: EY EAT calculations, WITS database, Oxford Economics.
Notes: Effective tariff rates calculated by multiplying new sectoral and regional tariffs by country's structure of exports to the US.

While the impact of tariffs was modest in 2025, we project negative effects to materialize in 2026, with euro area GDP 0.5% lower compared with a no-tariff scenario

- The impact will be felt most strongly in economies heavily reliant on exports to the U.S. such as Vietnam, Canada, and Mexico, whereas the UK, most of Southern Europe, and CEE are expected to see only limited effects.

Real GDP level – deviation from the no-tariff scenario in 2026 (in per cent)

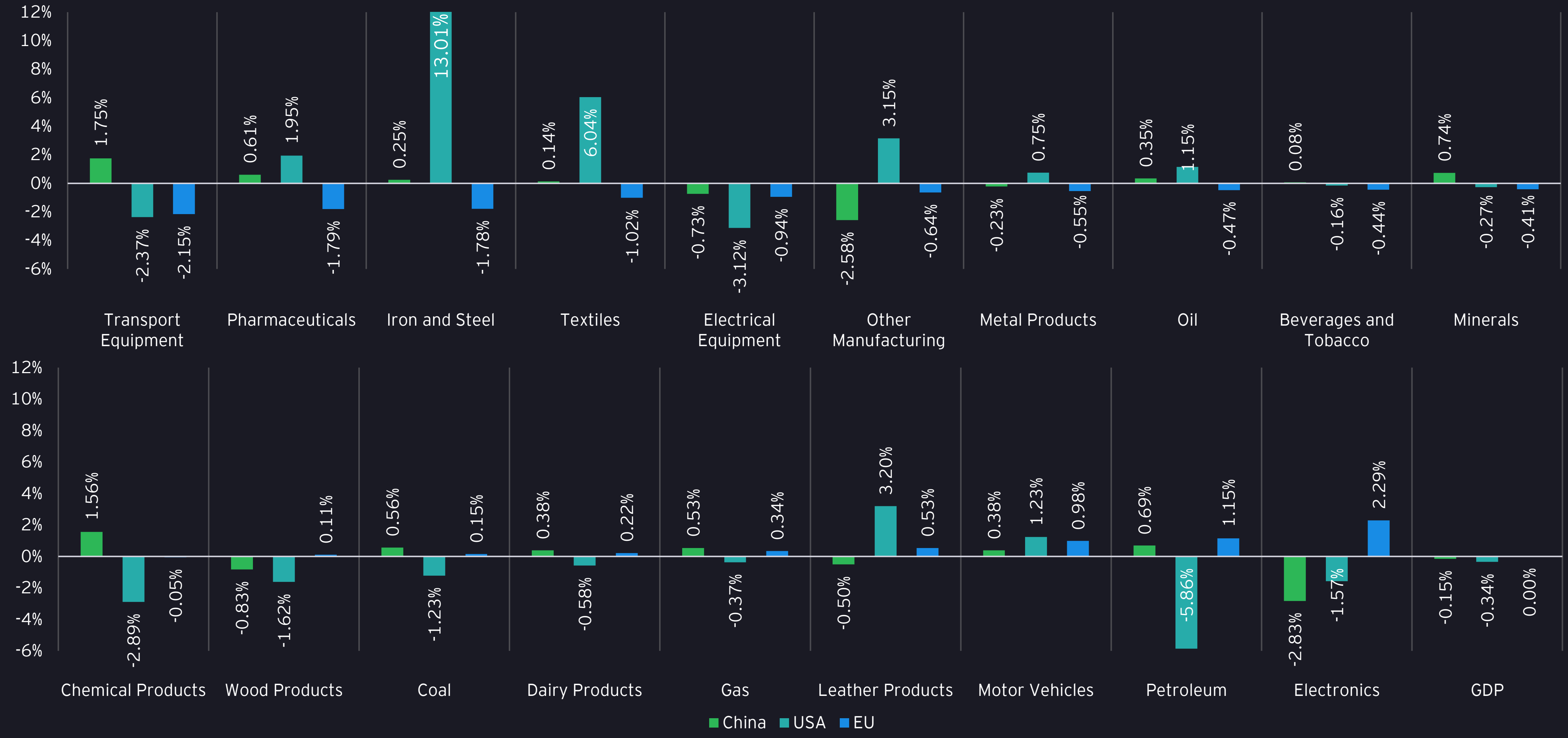


Source: EY EAT calculations.

Tariff rate adjustments may generate divergent effects across industries. In the EU, the motor vehicles sector is likely to benefit, while the pharmaceuticals industry could face headwinds. In the US, higher tariffs on imported goods may encourage reshoring across several manufacturing sectors.

Long-run impact of US and retaliatory tariffs on real value added in selected sectors

(percentage deviation vs. no tariff increase scenario)

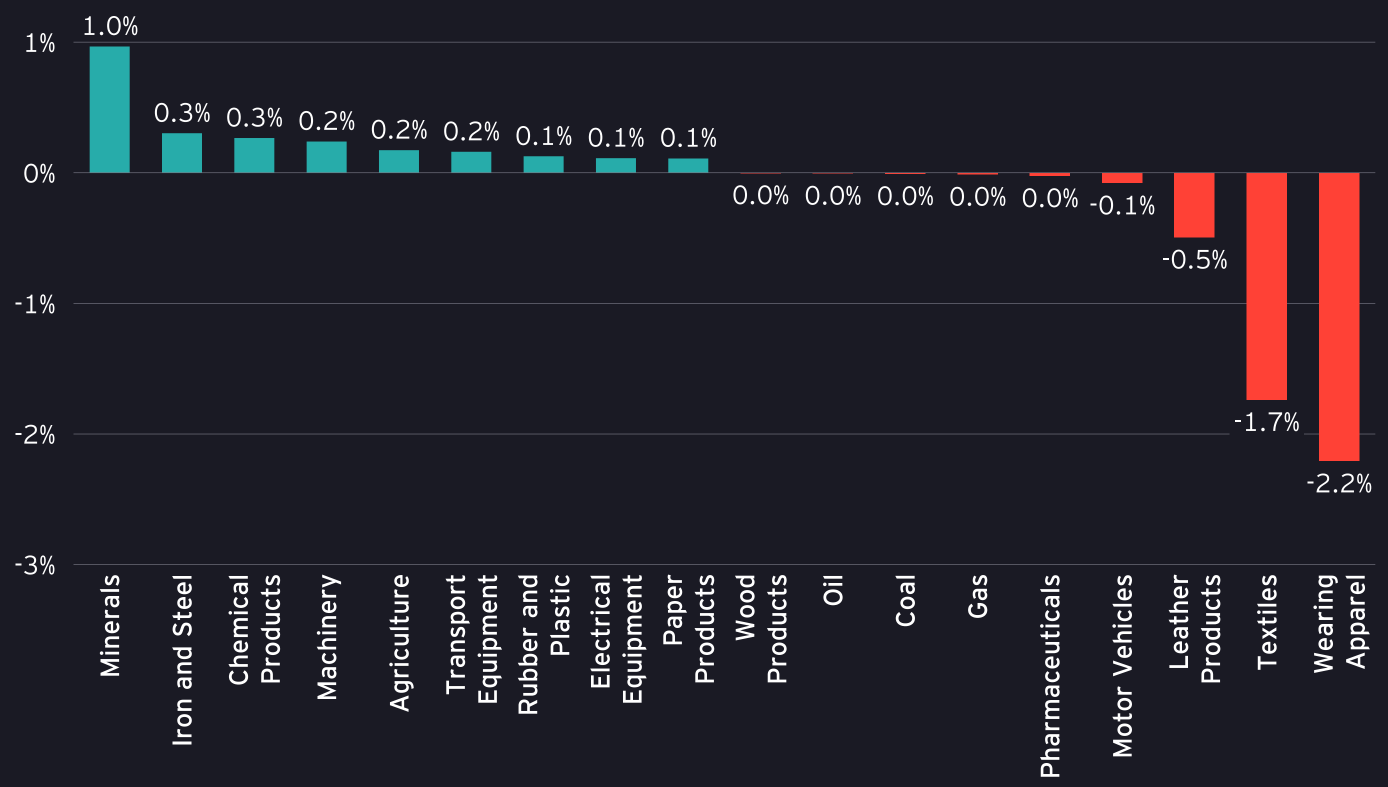


Source: EY EAT calculations using the EY UPGRADE model. The above chart only presents the 20 sectors with the most substantial long-term economic impact expected

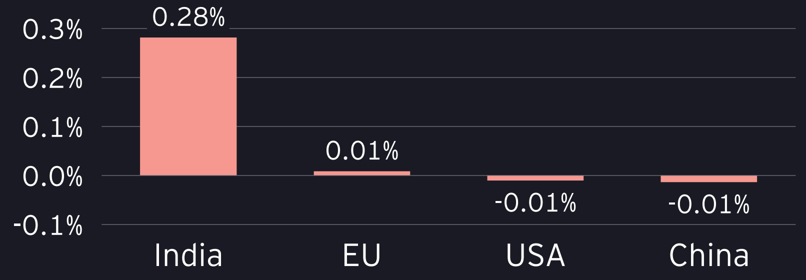
Goods-tariff removal as part of the EU–India FTA provides sector-specific benefits but is not a macro-level gamechanger for the EU

- The removal of goods tariffs between the EU and India is expected to support India's long-term growth, while the impact on EU GDP is roughly neutral.
- Some EU extraction and manufacturing sectors—such as minerals and iron and steel—are likely to benefit from better access to Indian inputs and stronger export potential.
- More exposed EU sectors, such as textiles and clothing, may face pressures due to stronger Indian competition.

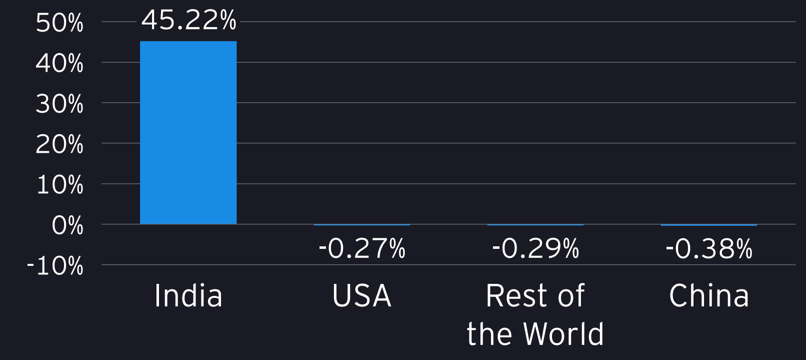
Long-run impact on real value added in selected EU sectors
(percentage deviation vs. no deal scenario)



Long-run impact on real GDP of selected economies
(percentage deviation vs. no deal scenario)



Long-run impact on EU exports to selected economies
(percentage deviation vs. no deal scenario)

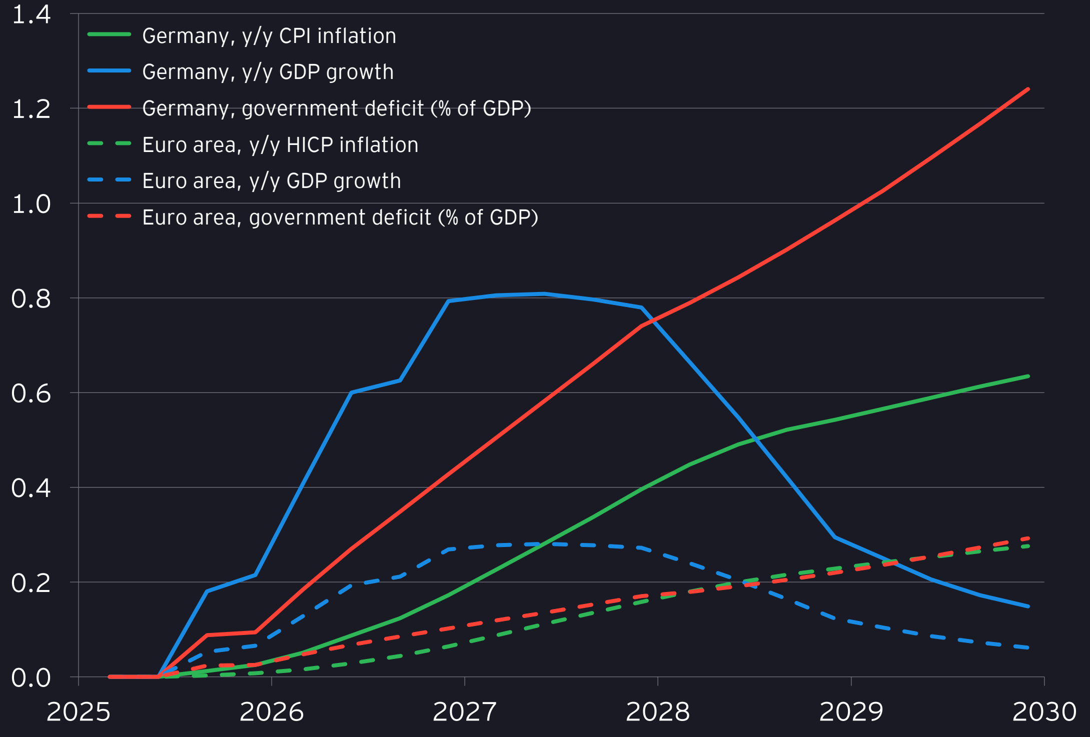


Source: EY EAT calculations using the EY UPGRADE CGE model. The presented impacts of the FTA relate only to the reduced tariffs on goods imports, not to other measures of the EU-India agreement, for instance easing the access to financial services for maritime shipping. Long-run impact refers to the year 2040.

The blow from US tariffs will be partly offset by fiscal expansion in Germany, though we expect the growth impulse to peak only next year

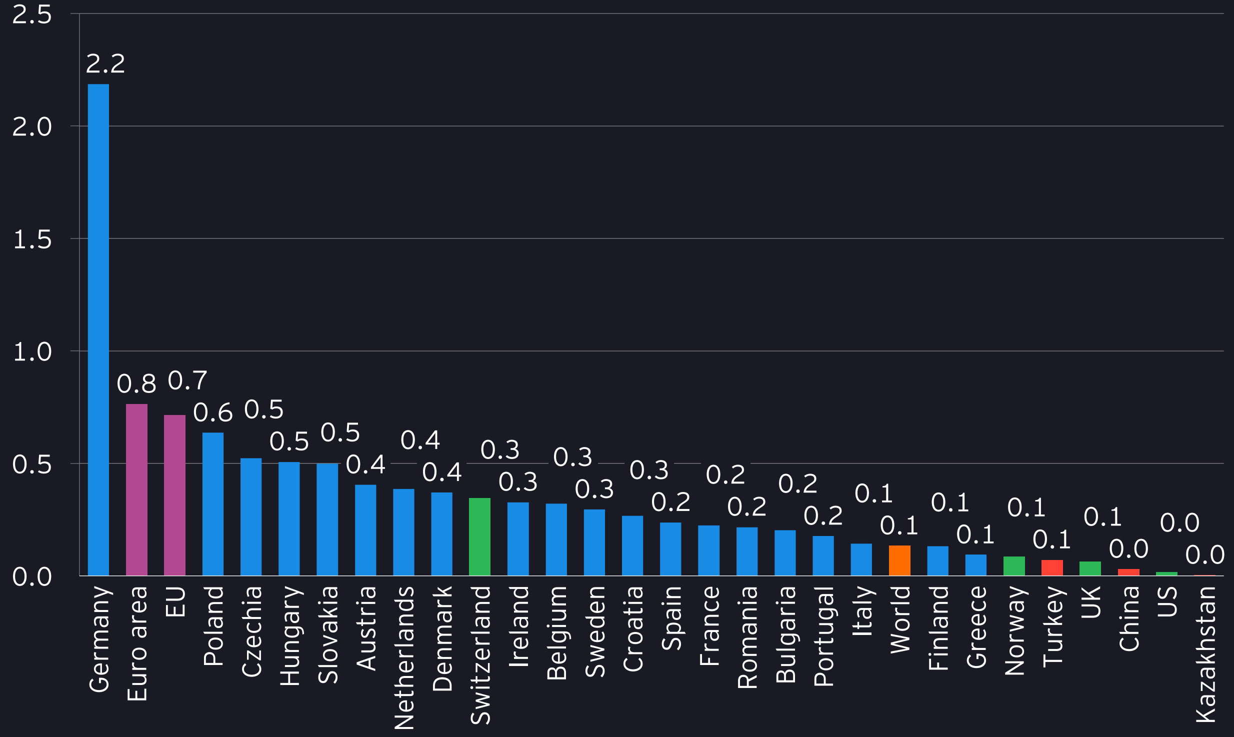
- In March 2025, the German Parliament adopted a fiscal package marking a clear shift from its previously conservative stance
  - A EUR500 billion infrastructure fund (~11.5% of 2024 GDP) spread over 12 years, with €100 billion for the Climate Transition Fund and the remainder for infrastructure investments—€300 billion for the federal government and €100 billion for state governments. The fund operates outside the 'debt brake' constraints.
  - Defence spending above 1% of GDP will not count toward the 'debt brake'.
  - Each of Germany's 16 federal states is now allowed to run a structural deficit of 0.35% of their economic output, ending the previous prohibition on state deficit.
- The impact will be gradual: by 2029, fiscal expansion is expected to raise German GDP by 2.2% and euro area GDP by 0.8%.

Impact of German fiscal expansion on y/y GDP growth, CPI inflation, and government deficit in Germany and the euro area (in percentage points)



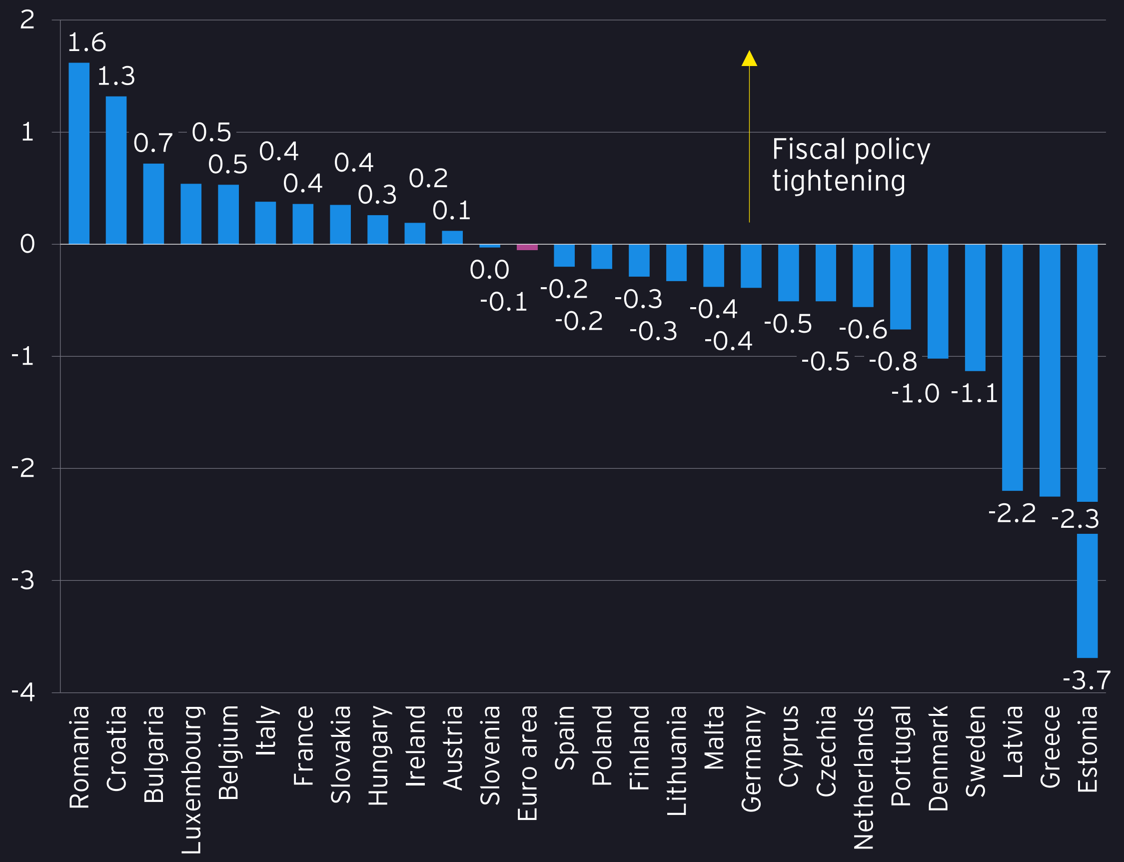
Source: EY EAT calculations.

Impact of German fiscal expansion on 2029 GDP level (in percentage)

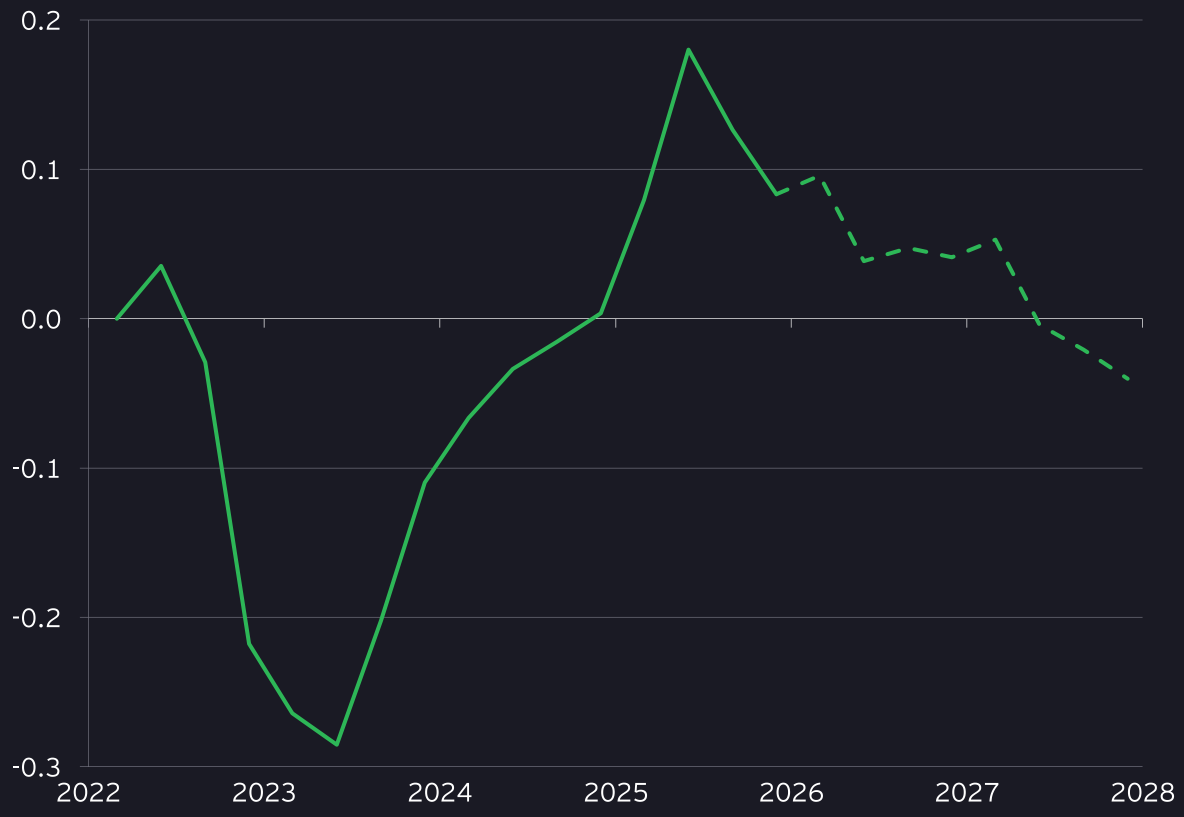


Despite easing in Germany, fiscal policy across Europe is expected to be broadly neutral on average in 2026, while the boost from interest rate cuts will be fading

Expected change in structural fiscal balance* in 2026
(In percentage of potential GDP)



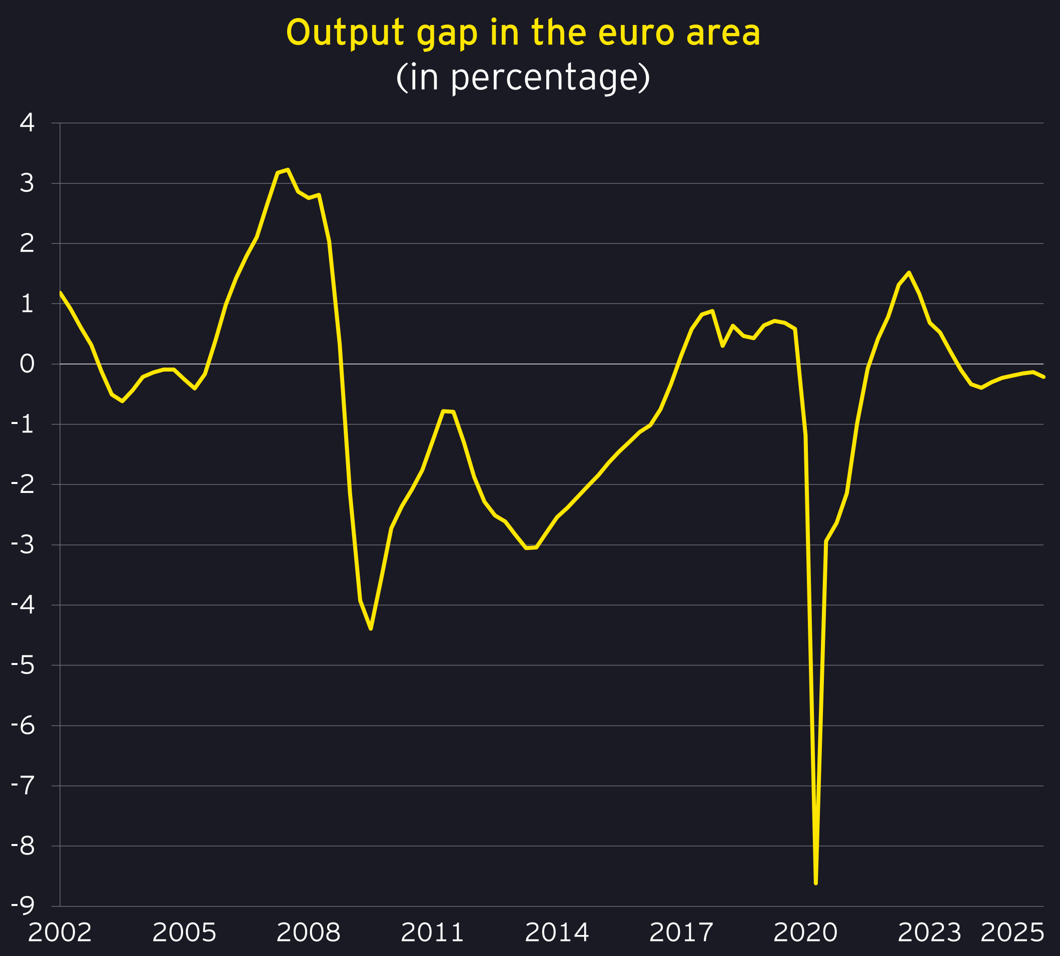
Impact of monetary policy on the euro area real GDP q/q growth
(in percentage)

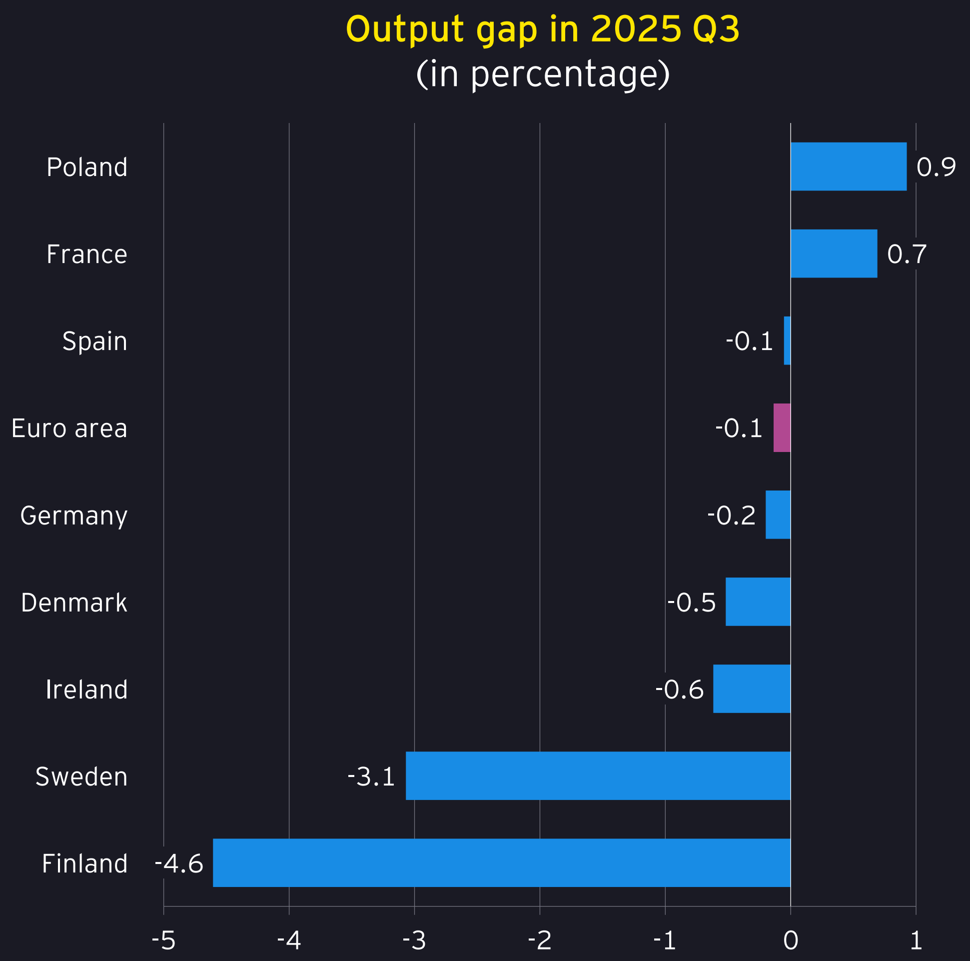


Source: Oxford Economics, EY calculations.
Dashed line denotes forecast.
* Structural balance is general government balance corrected for cyclical and one-off factors.

We estimate that the euro area economy is operating close to potential, leaving limited scope for a cyclical recovery

- Nordic economies, particularly Finland, are an exception, with substantially more room for cyclical rebound

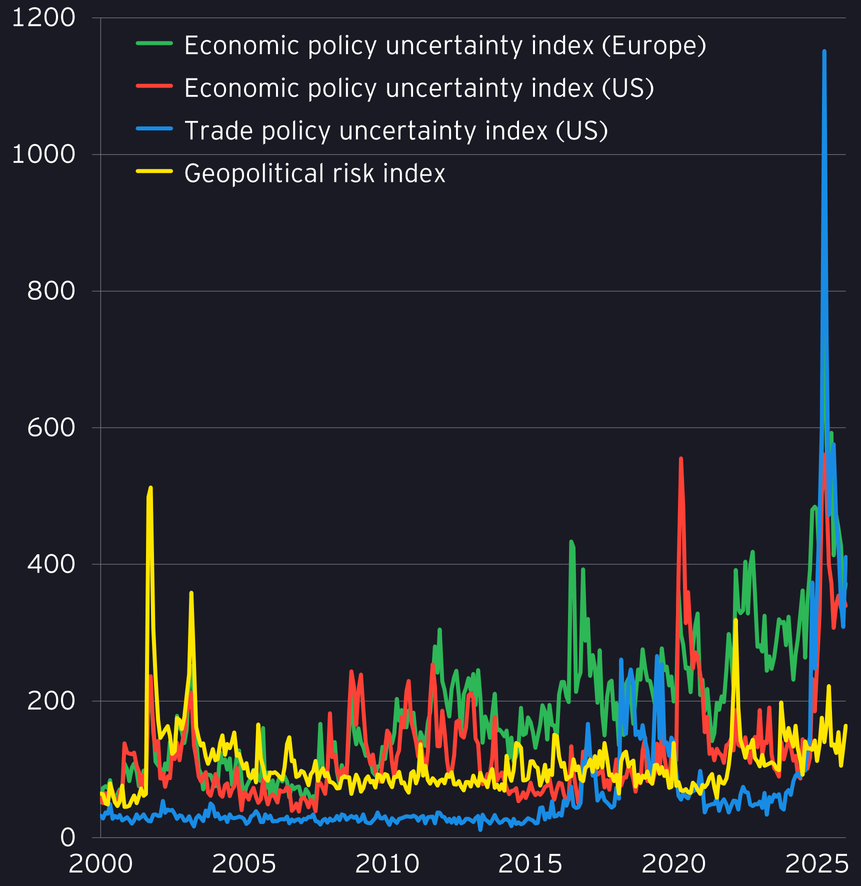




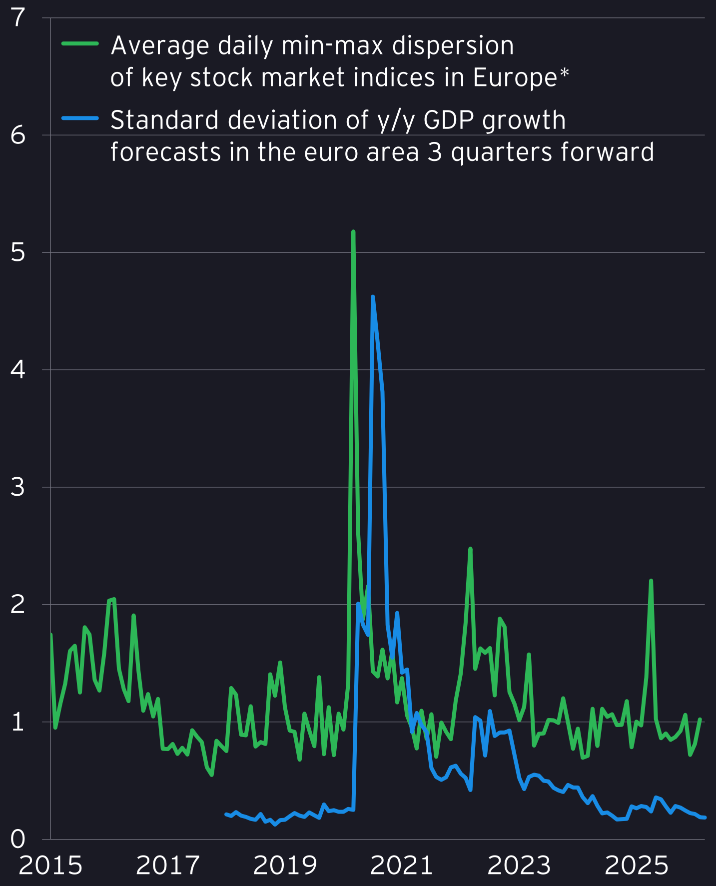
Source: EY calculations based on Eurostat and Oxford Economics data.

While perceptions of trade, economic policy, and geopolitical risks remain elevated, broader measures of uncertainty (e.g., stock market volatility, GDP growth dispersion, business surveys) are close to post-pandemic lows, suggesting uncertainty may be less of a headwind than in recent years

Economic and trade policy uncertainty indices



Stock market volatility and GDP growth dispersion (in percentage points)



Survey measure of uncertainty in the EU**

Source: Baker, Scott R., Bloom, Nick and Davis, Steven J., Economic Policy Uncertainty Index for Europe and United States, retrieved from FRED; Caldara et al. (2020), "The Economic Effects of Trade Policy Uncertainty," Journal of Monetary Economics, 109, pp.38-59, data downloaded from https://www.matteoiacoviello.com/tpu.htm; stooq.pl; FocusEconomics; European Commission Business Survey.

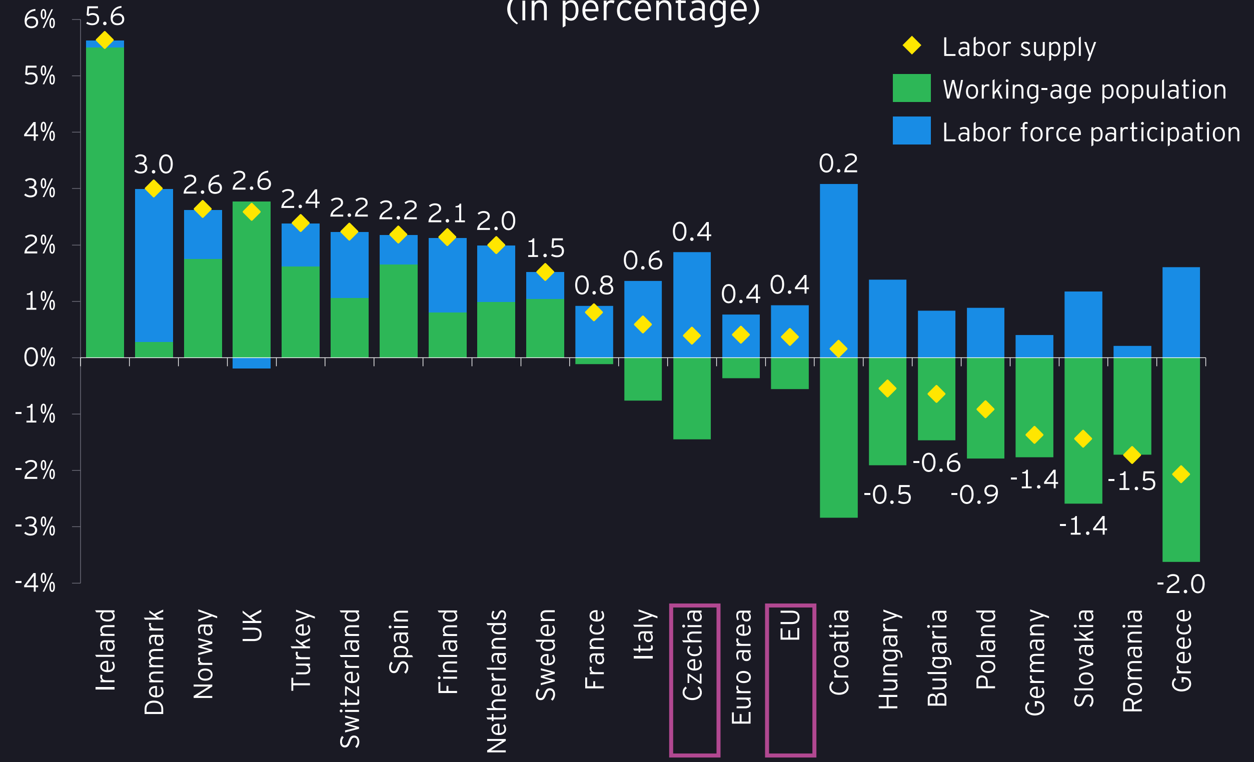
* DAX, CAC40 and FTSE250.

** Balance statistic based on answers of to questions "indicate how difficult it is to make predictions about your business situation/household finances" ask to business managers and consumers.

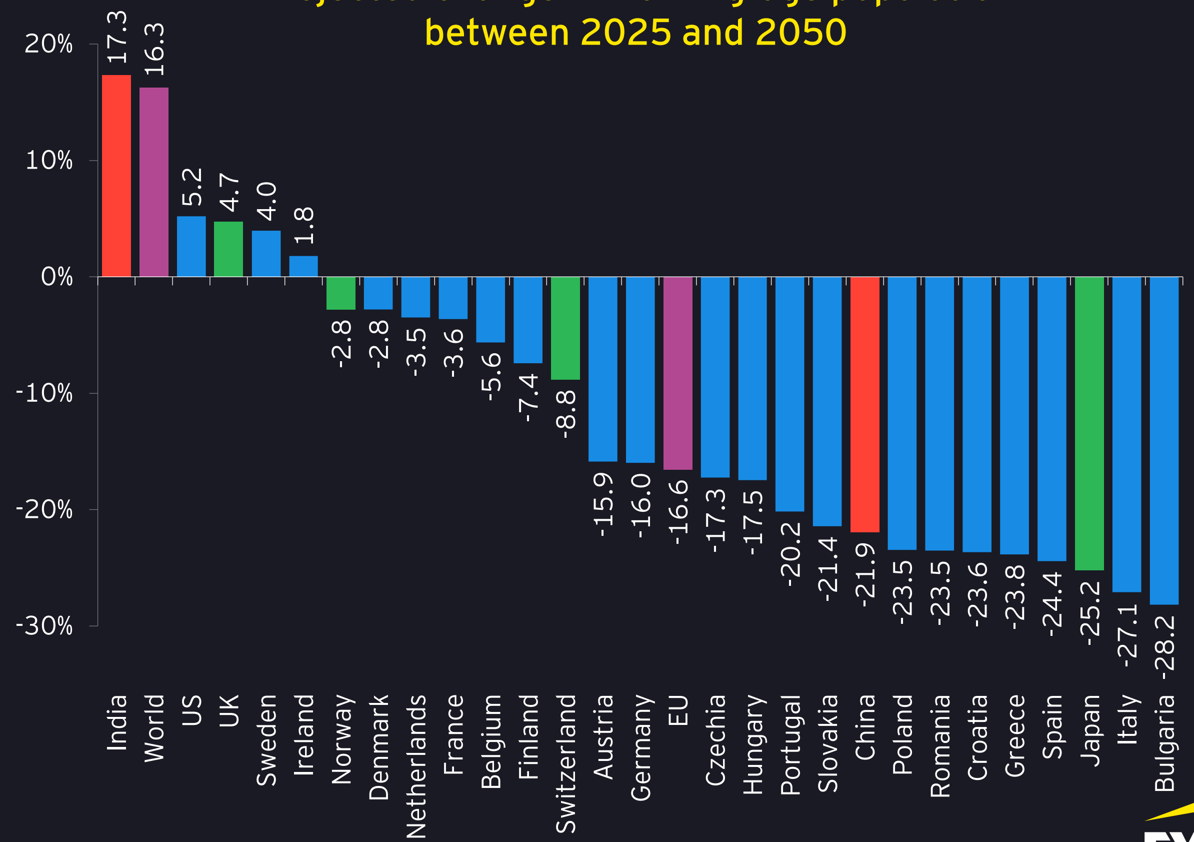
The EU's labor supply is expected to remain broadly stagnant in the medium term, with strong cross-country divergence and a long-term decline driven by demographic pressures

- On average, labor supply in the EU is expected to increase only slightly by 2029, as the working-age population remains stagnant and labor force participation rises only modestly. Labor supply growth will differ markedly across countries: it is set to increase robustly in Ireland, the Nordics, Spain, the Netherlands, the UK, and Switzerland, driven primarily by immigration and further improvement in labor force participation. In contrast, Germany, Greece, and most CEE economies are projected to see declines in labor supply, as falling working-age populations outweigh gains in labor force participation.
- Over the long term, most European countries are expected to face a decline in working age population, and as the scope to raise labor force participation diminishes, this is expected to translate into shrinking labor supply. Demographic pressures will be most acute in CEE and Southern Europe.

Projected change in labor supply between 2025 and 2029 (in percentage)



Projected change in working-age population between 2025 and 2050

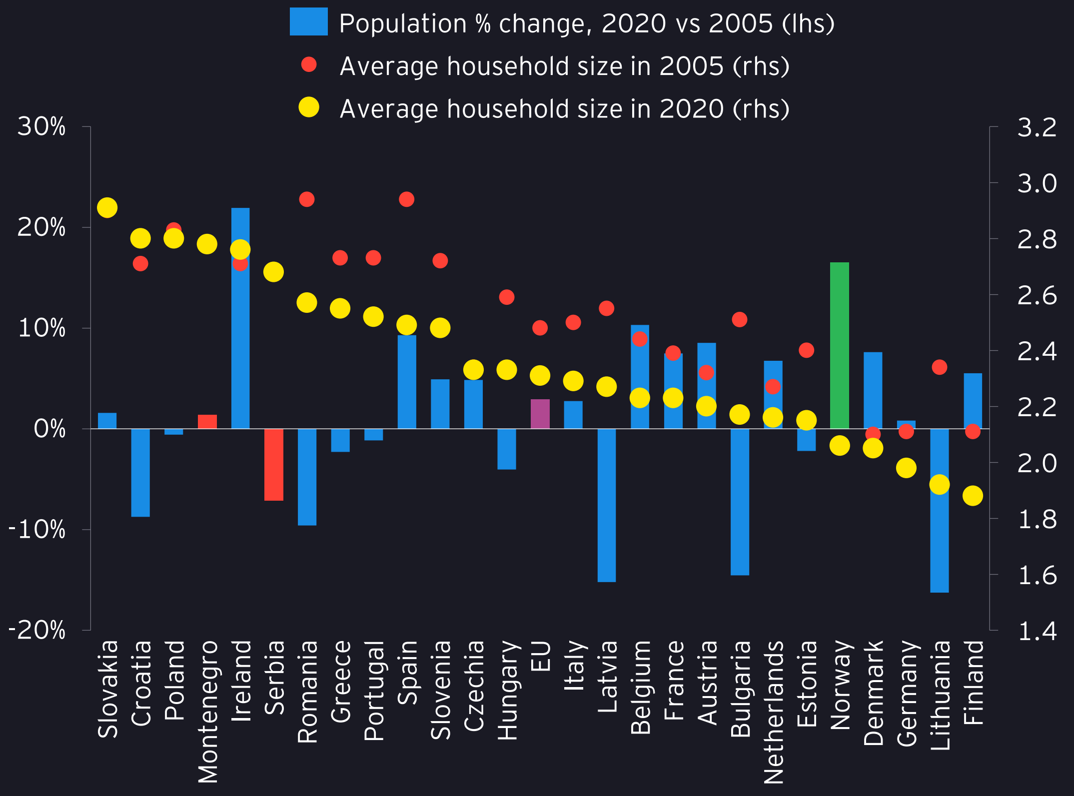


Source: EY EAT forecast, UN World Population Prospects 2024.

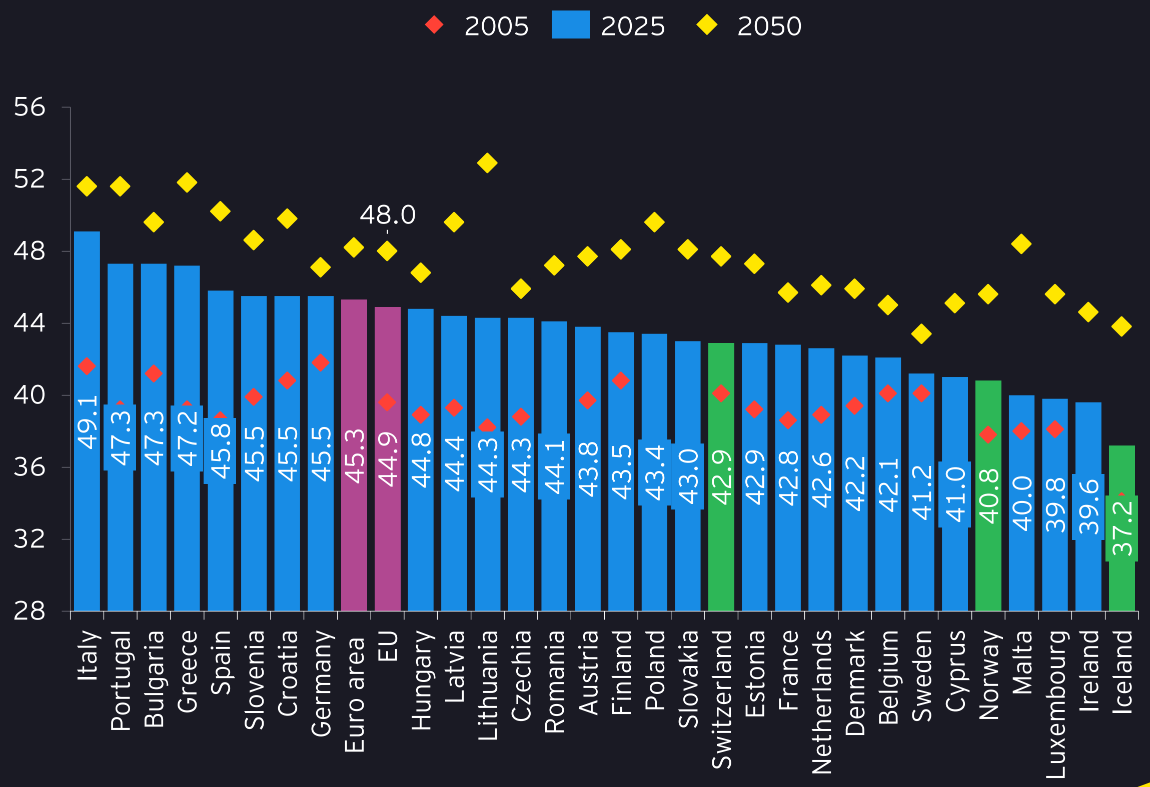
Across Europe, household size is shrinking and average age rising, regardless of population trends

- The average household size in the EU declined from 2.5 persons in 2005 to 2.3 in 2020, with the smallest households (below 2 persons on average) in Finland, Lithuania, and Germany, and the largest (approaching 3 persons) in Slovakia, Croatia, and Poland. Most European countries show a continued downward trend in household size, and this decline appears largely uncorrelated with overall population growth or decline. From a labour-market perspective, the rise in single-person households may support higher labor force participation over the medium term, as smaller household units tend to be associated with greater individual labour-market attachment.
- At the same time, Europe is undergoing rapid demographic ageing: the EU median age is projected to rise from 44.9 years in 2025 to 48 years by 2050, with all member states expected to experience significant ageing and several exceeding a median age of 50.

Change in population and household size



Estimated/projected median age in 2005, 2025, and 2050

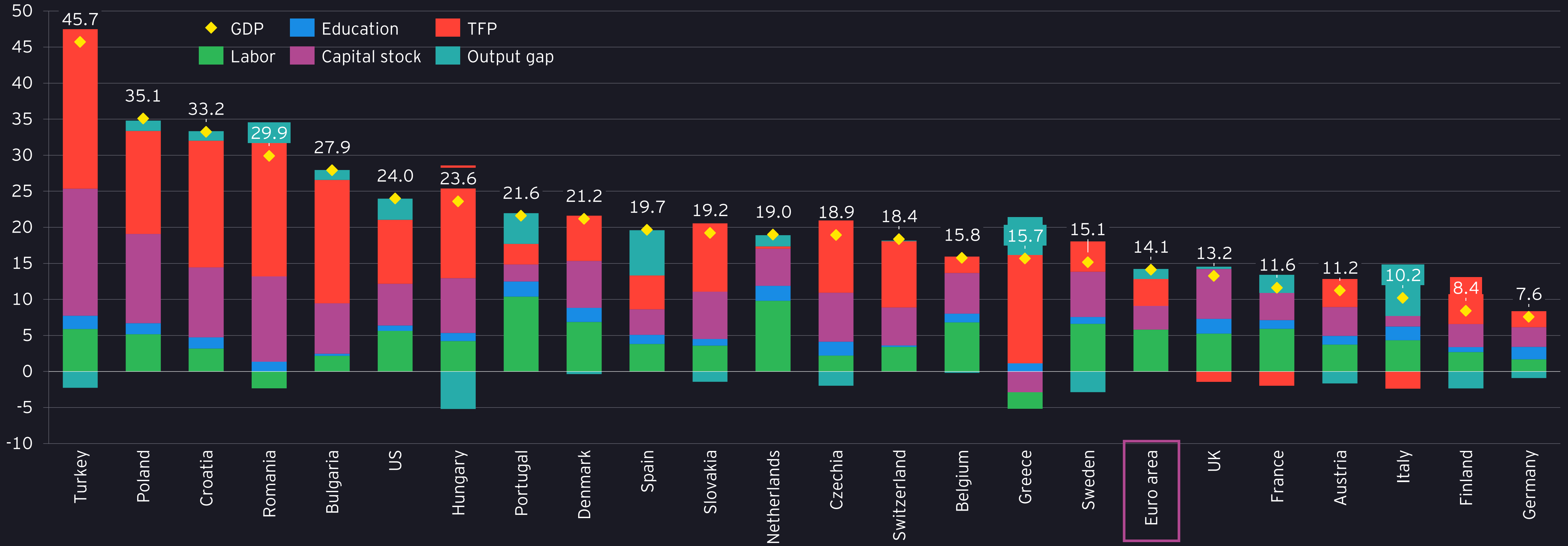


Source: Eurostat.
Note: Average household size measured as an average number of persons in a household.

With demographic conditions deteriorating, maintaining growth will increasingly require higher investment and stronger productivity gains, as labor input becomes a constraint

- Over the past decade, Europe's growth underperformance relative to the US has stemmed primarily from weaker total factor productivity growth, followed by lower investment. In Germany, which has recorded the slowest growth, demographic headwinds have also reduced labor supply growth.
- In contrast, CEE economies (especially Poland) and Turkey have achieved strong growth through rapid productivity catch-up and capital deepening. However, as these economies converge toward Western Europe in productivity and capital intensity, sustaining high growth rates will become increasingly challenging.

Decomposition of cumulative GDP growth, 2015-2025
(in log points)

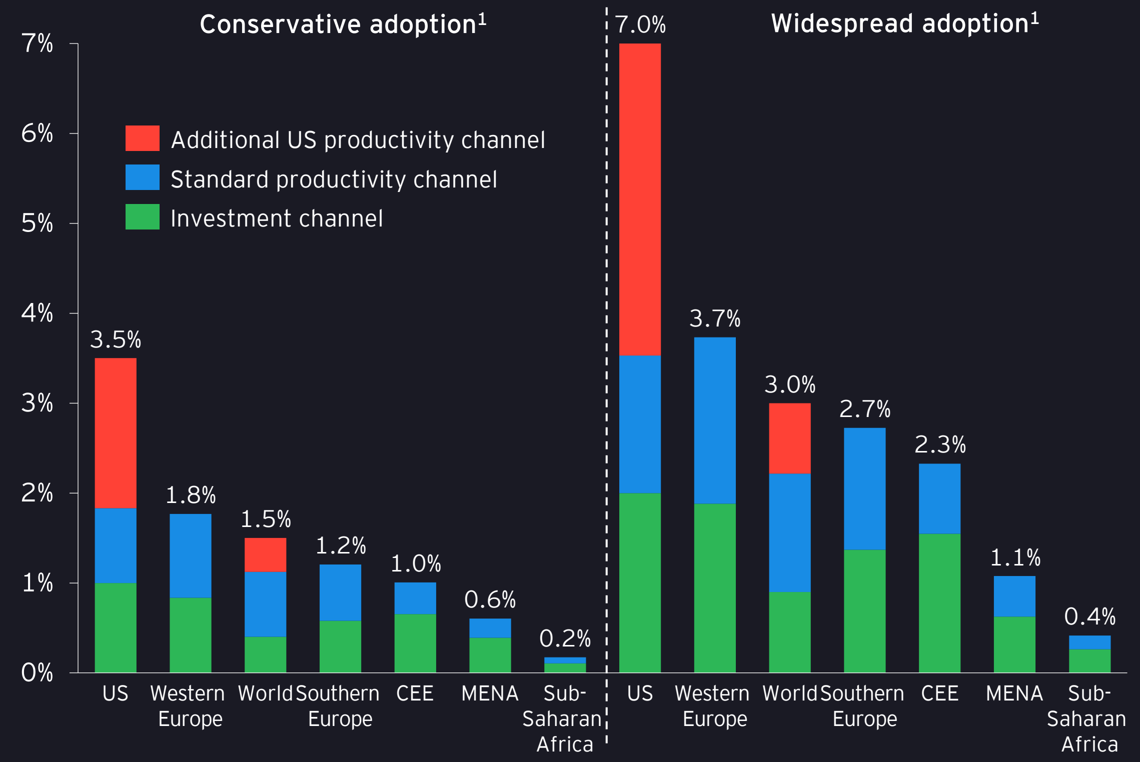


Source: Oxford Economics, EY EAT analysis.

In this context, investment in productivity-enhancing technologies is crucial. The generative AI (GenAI) revolution could add one to two years of global growth over the next decade, though its effects will vary significantly across countries and sectors

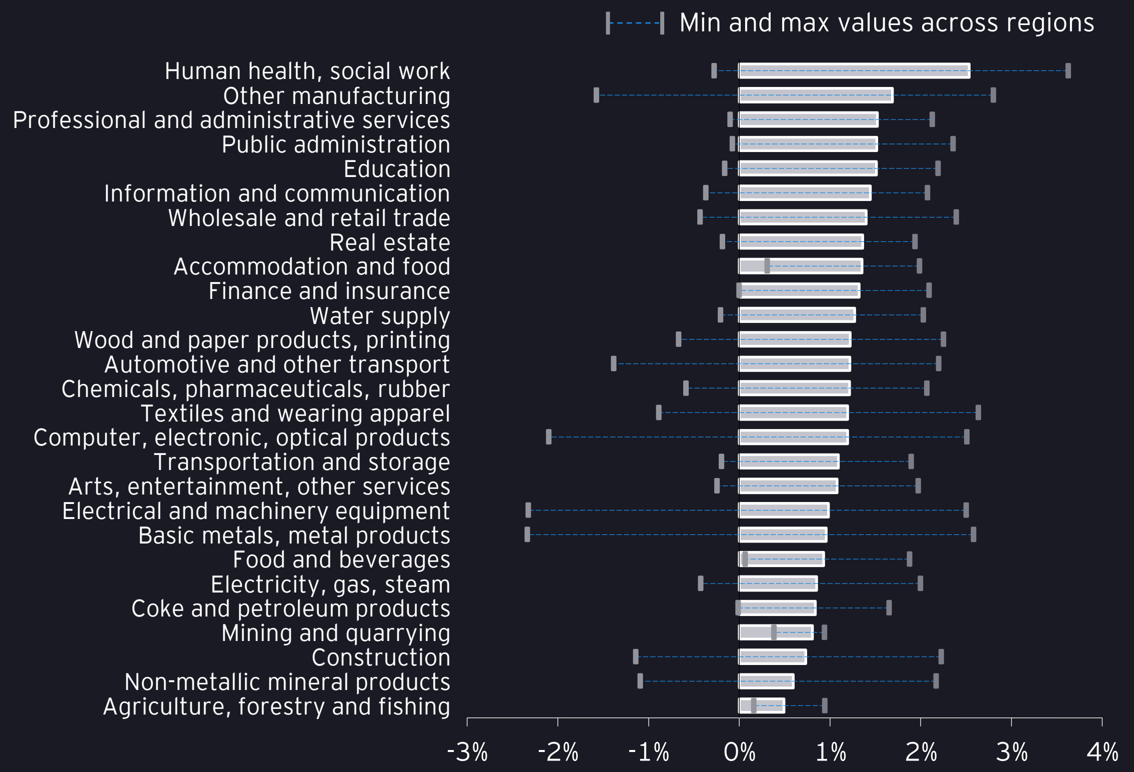
Impact of artificial intelligence (AI) on real GDP level in 2033[2]

Relative to no-AI scenario; in percentage



Global aggregate impact of AI on real value added by sector in 2033[3]

Relative to no-AI scenario; in percentage; widespread adoption scenario



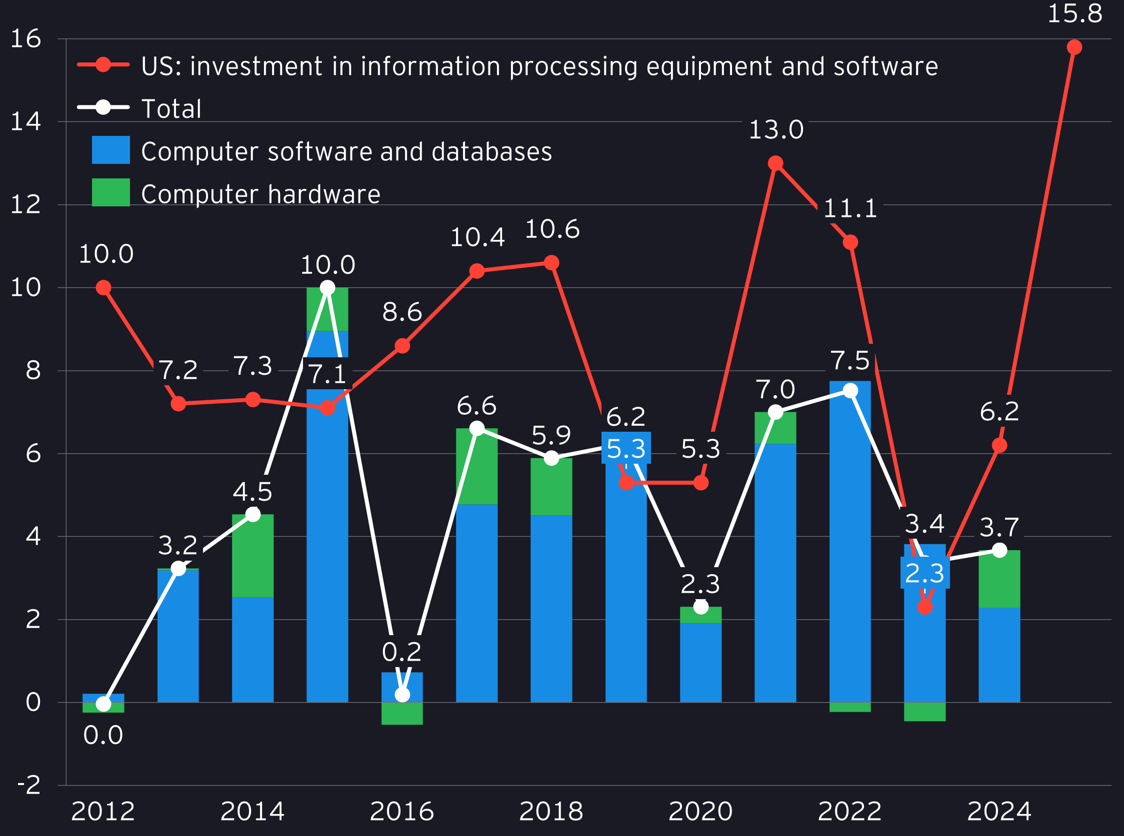
Explore our series on the economic impact of AI for business leaders here as well as a regional and sectoral perspective here.

1. The widespread AI adoption scenario follows the 1990s-2000s adoption rate of information and communications technology (ICT). The conservative scenario assumes 60% slower integration, based on existing relationship between AI and ICT adoptions.
2. The standard productivity channel is computed using a refined approach of Acemoglu (2024) as described here. The US productivity impact is computed by analogy to the ICT revolution as described here. The additional US productivity channel denotes the difference between the latter and former approach.
3. AI's impact on real value added by sector captures investment and sector-specific productivity shocks. Sectoral results were estimated based on the EY UPGRADE CGE model, which accounts for crowding-out effects that temper the net impact of AI on overall investment and the economy.

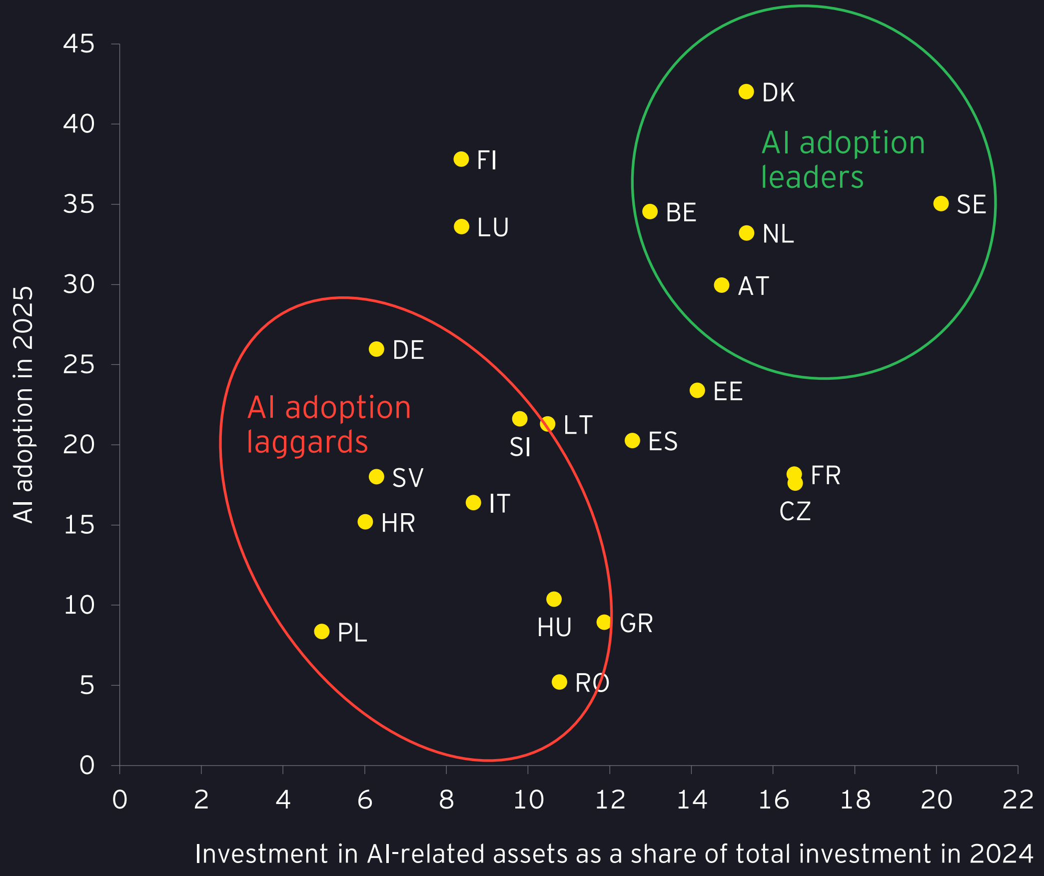
Source: EY UPGRADE CGE model; EY analysis

While timely data on AI adoption and investment in Europe are limited, available indicators suggest that AI-related investment is not booming, and there are large cross-country disparities in AI adoption, with the Nordics and Benelux leading and CEE countries, Germany, and Italy lagging

Real investment growth in AI-related categories in the EU* and the US (in percentage points)



Investment in AI-related assets as a share of total gross fixed investment in 2024 compared to AI adoption rate[1] in 2025



Source: Eurostat.

* EU excluding Bulgaria, Latvia and Portugal, for whom data is not available.

1. Enterprises with 10 or more employed persons using at least one AI technology.

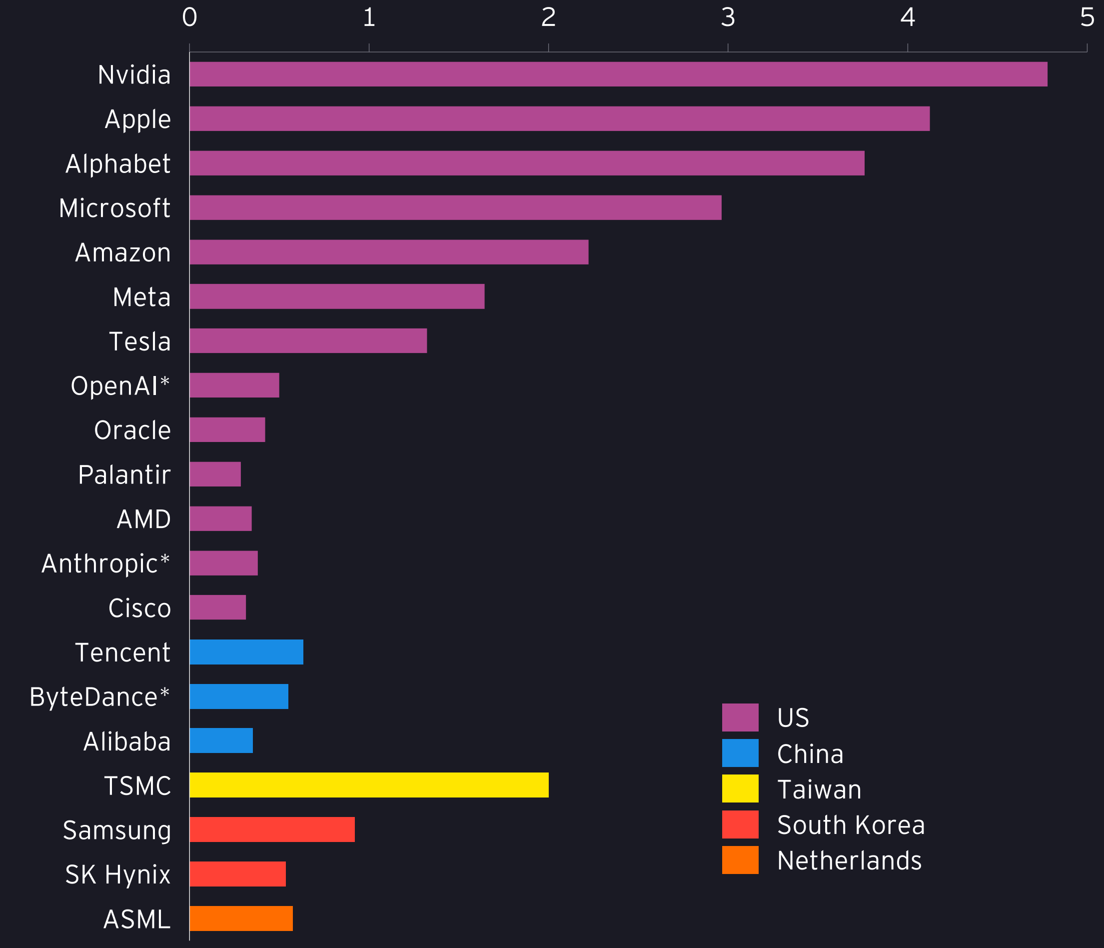
With AI leadership centered in the US, Europe is positioned to benefit less from the AI revolution than the US

Activity of AI companies across different layers of the AI supply chain

	Compute	Infrastructure	Data tools	Models	Applications
Nvidia	●	●	●	●	●
Apple	●	○	●	●	●
Alphabet	●	●	●	●	●
Microsoft	○	●	●	●	●
Amazon	●	●	●	●	●
Meta	○	○	●	●	●
Tesla	○	○	○	○	●
OpenAI*	○			●	●
Oracle		●	●	●	●
Palantir			●		●
AMD	●		●		
Anthropic*				●	●
Cisco	●				
Tencent		●	●	●	●
ByteDance*	○	●	●	●	●
Alibaba	●	●	●	●	●
TSMC	●				
Samsung	●			○	●
SK Hynix	●				
ASML	●				

● Marketed product or service ○ Internal use only

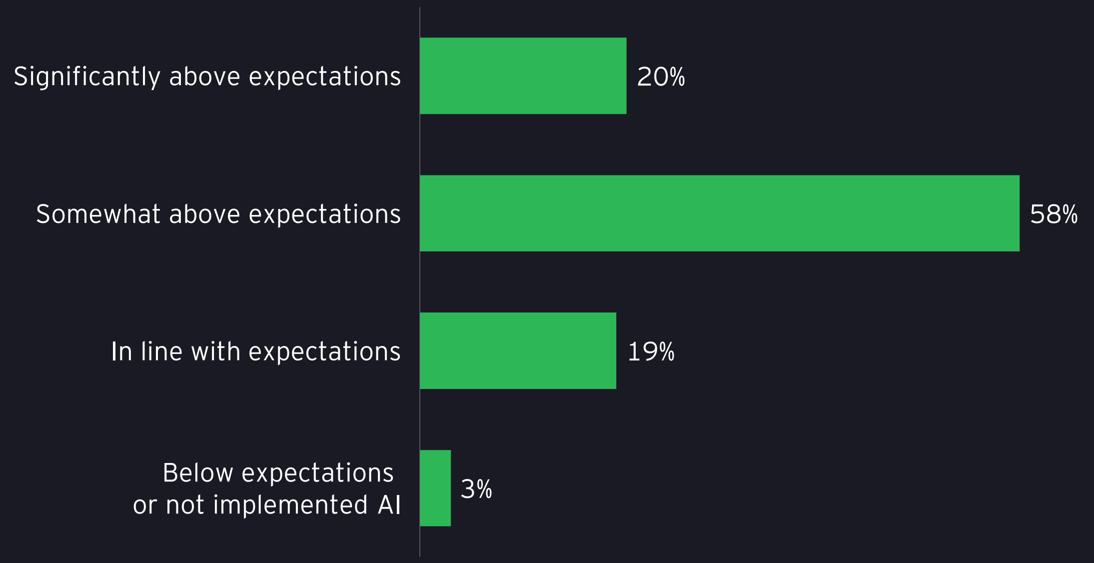
Valuations of the top 20 global AI companies at the end of February 2026 (USD trillion)



Source: Bank for International Settlements (BIS Bulletin 122, Global giants in the AI supply chain), Trading Economics, The Associated Press.

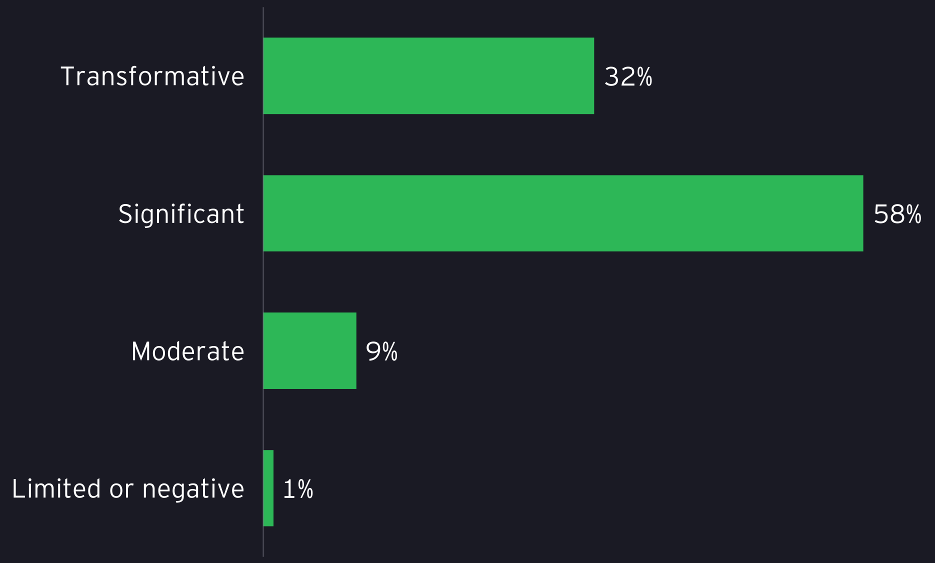
So far, most firms report that the outcomes of their AI initiatives have exceeded expectations

AI outcomes compared to expectations: CEOs remain confident in digital transformation



Question: Thinking specifically about revenue growth or operational efficiency, how have your organization's own AI initiatives performed against expectations so far?

CEOs expect AI to significantly impact business models and operations over the next two years



Question: What impact do you expect AI to have on your business model or operations over the next two years?

Source: EY-Parthenon (CEO Outlook 2026).
Note: Survey conducted on a group of 1200 CEOs worldwide.

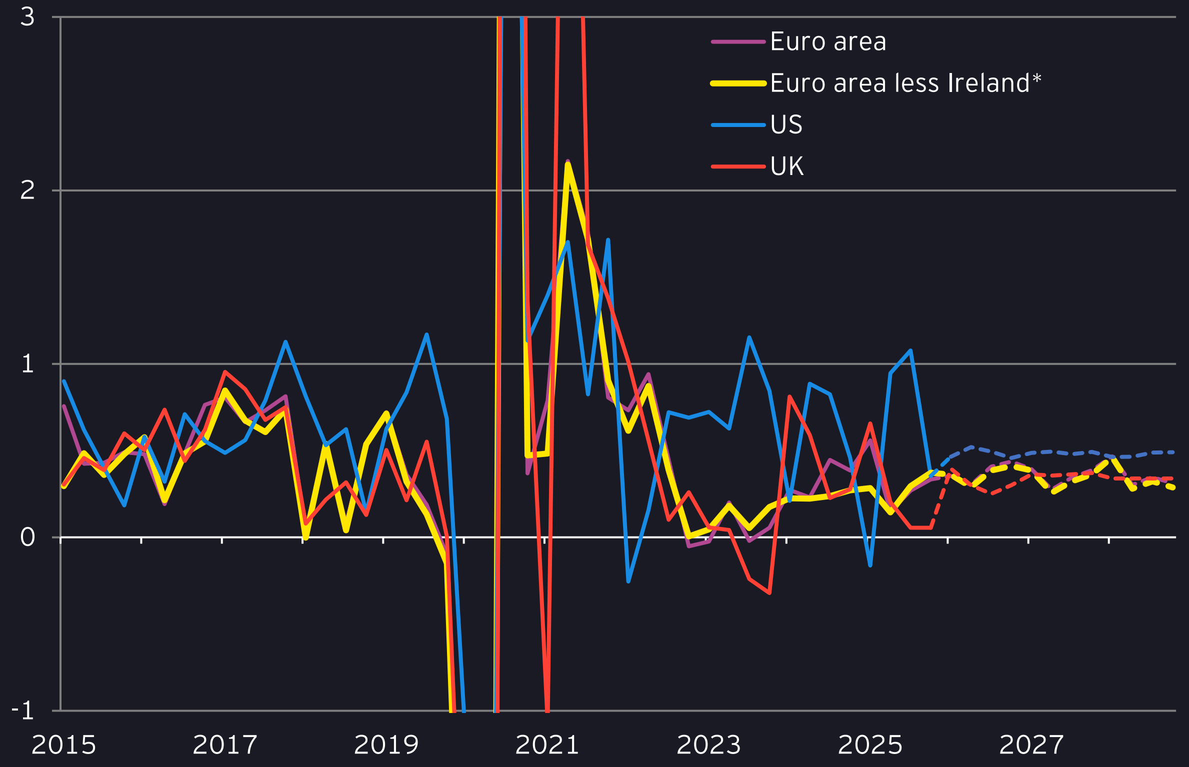
Chapter 3

Economic outlook

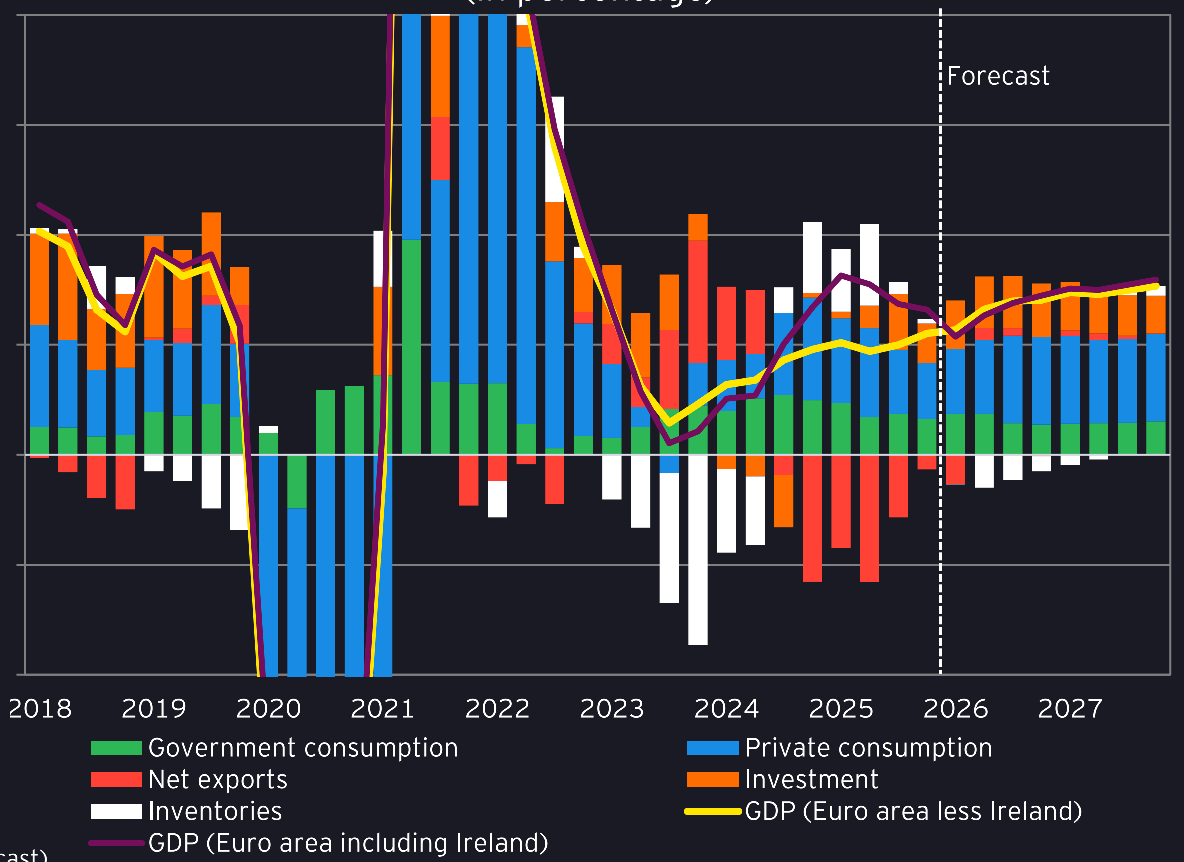
Excluding Ireland, euro area growth is expected to gradually accelerate, supported by fiscal policy and lower interest rates

- Investment is set to continue its recovery, driven by reduced interest rates, rebounding profits, and an expansion of government spending. Consumer spending is projected to reaccelerate as saving rates stop increasing. Exports are expected to keep growing despite a challenging external environment.
- Despite these improving underlying trends, euro area GDP growth is forecast to slow to 1.3% in 2026, down from 1.5% in 2025, primarily due to a sharp normalisation in Ireland following its double-digit GDP increase in 2025.

Q/q real GDP growth (in percentage, seasonally adjusted)



Decomposition of y/y GDP growth in the euro area less Ireland* (in percentage)

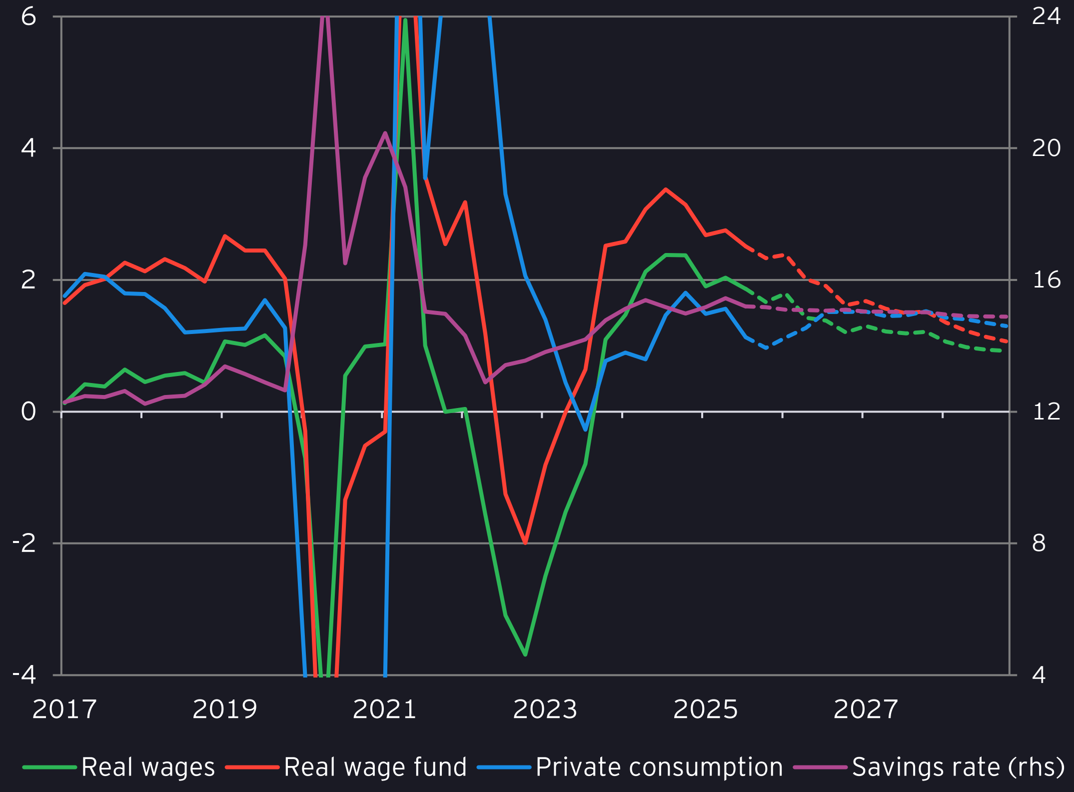


Source: Eurostat, FRED, ONS, EY EAT forecast, EY Parthenon (US forecast), EY Item Club (UK forecast).
Dashed lines denote forecast
* Ireland is excluded as its GDP tends to be very volatile, reflecting the outsized role multinational corporations play in the economy.

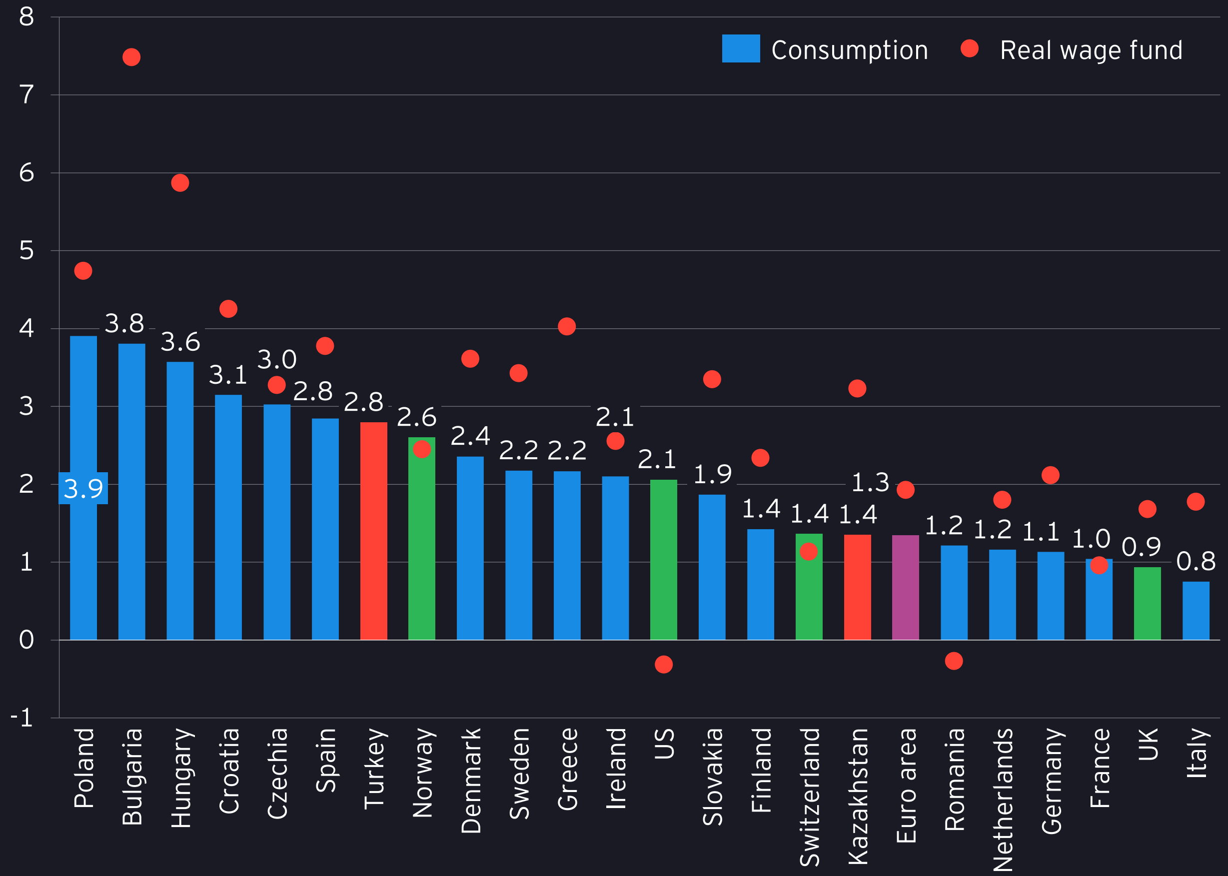
We expect consumer spending to accelerate slightly, even as real income growth slows, as saving rates finally stop increasing

- Lower interest rates and improving consumer sentiment should help bring the rise in saving rates to an end.
- CEE countries (Poland, Bulgaria, Hungary) are set to post the strongest consumption growth, supported by still robust real wage gains. Consumption growth is projected to be slowest in Italy, the UK, and France, though still faster than last year.

Y/y growth in real wages, real wage fund, real private consumption and savings rate in the euro area (In percentage)



Real private consumption and real wage fund growth in 2026 (In percentage)

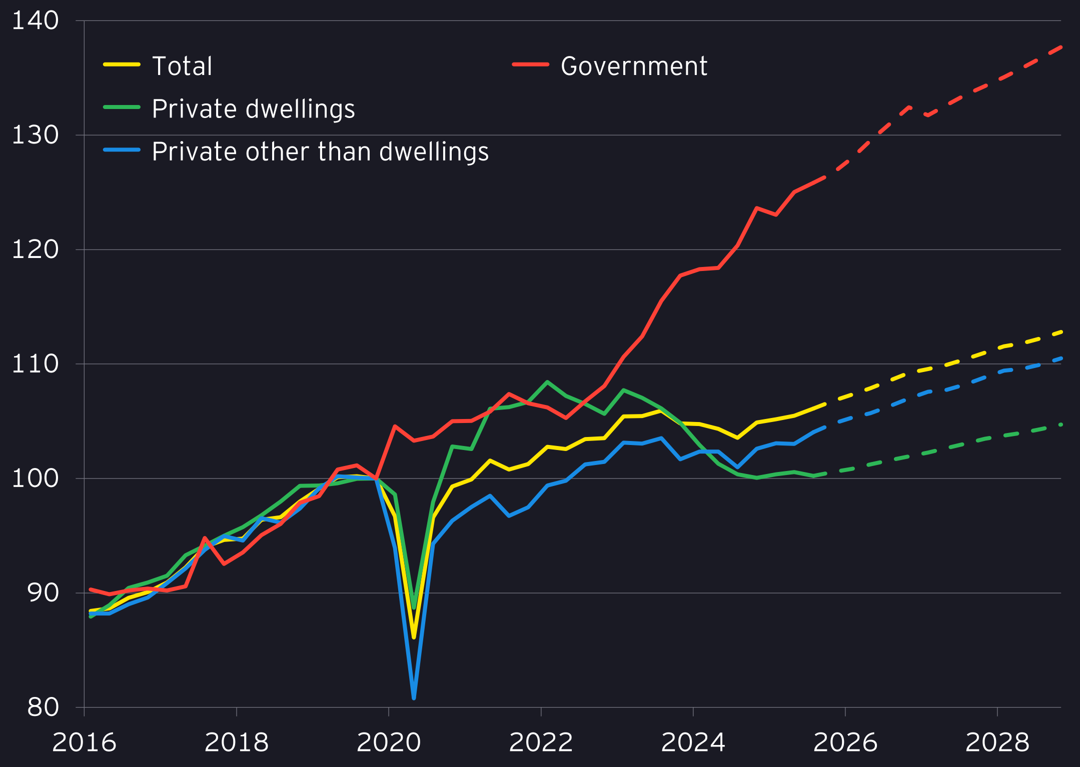


Source: Eurostat, EY EAT forecast.
Dashed lines denote forecast.

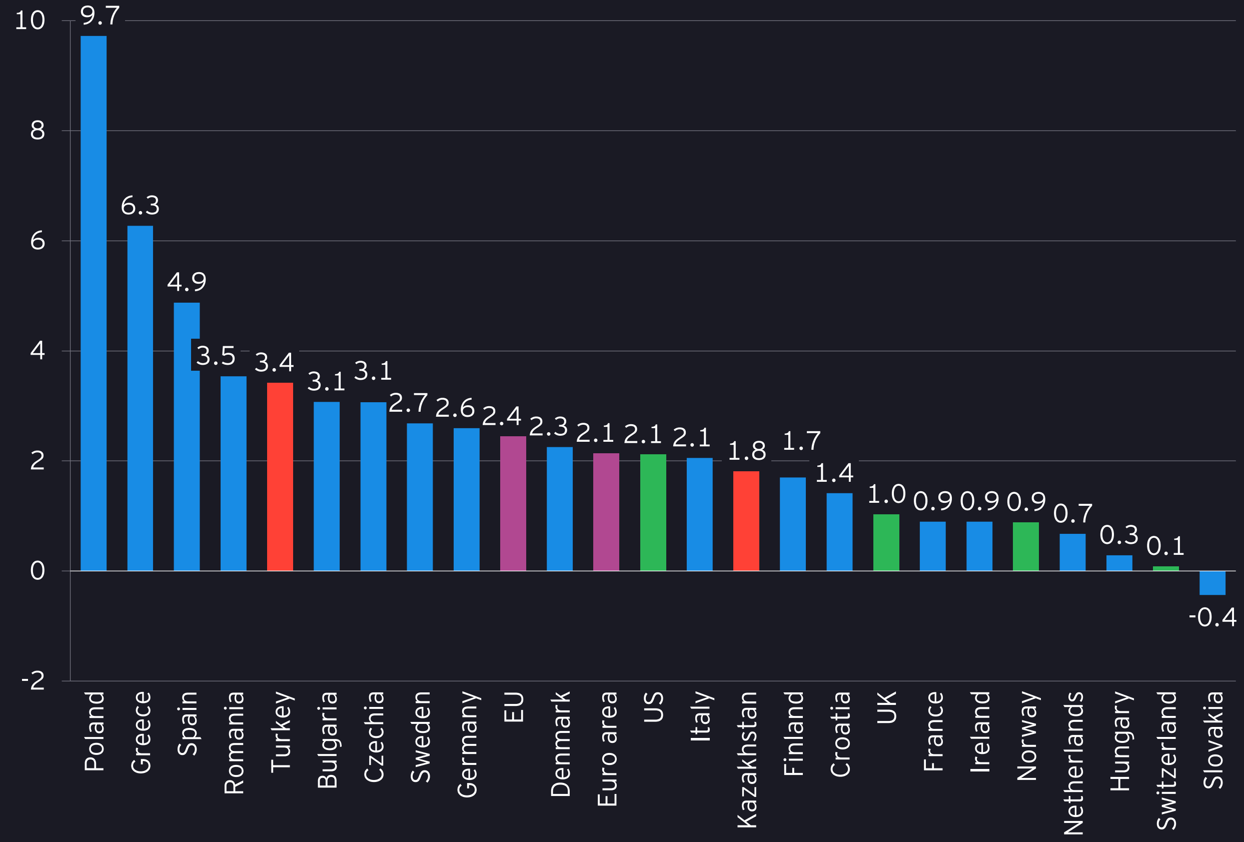
Government spending should continue to drive investment, supported by Germany's fiscal package, while business investment is expected to expand at a moderate pace and residential investment to recover

- Business investment should grow at a moderate pace amid stable domestic and external demand growth, improving business sentiment, rising corporate profits, and an economy operating near a zero output gap. Residential investment is expected to finally pick up, responding with a delay to earlier interest rate cuts.
- Poland is set to record the strongest investment growth, driven by delayed EU Recovery Fund disbursements. Southern Europe should also see robust investment growth for similar reasons. In contrast, investment is expected to stagnate in Switzerland, reflecting uncertainty around pharmaceutical tariffs. In Hungary, investment is forecast to recover following previous sharp declines, but average annual growth will remain modest due to a negative carry-over effect.

Real fixed capital investment by type in the euro area less Ireland (2019 Q4 = 100)



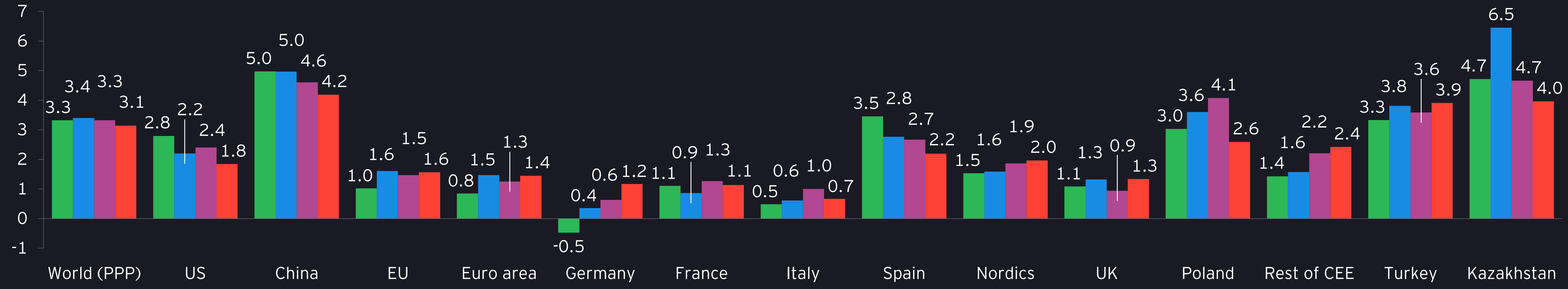
Real fixed capital investment growth in 2026 (In percentage)



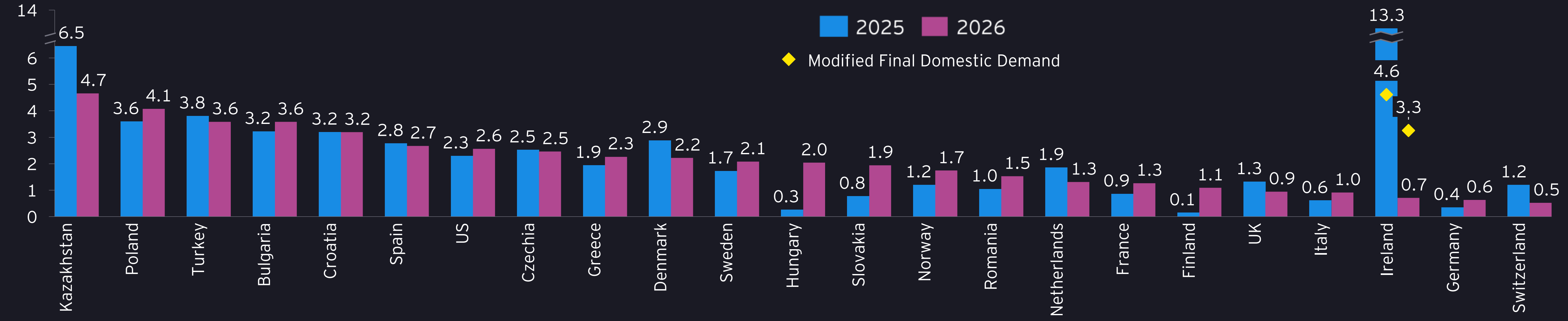
Source: Oxford Economics, EY EAT forecast.
Dashed lines denote forecast.

Poland is set be the fastest growing EU economy in 2026. Germany, Italy, the UK, and Switzerland are expected to be among the slowest growing, although Germany should finally emerge from stagnation

GDP growth in 2024-2027 (in percentage)



GDP growth in 2025 and 2026 (in percentage)

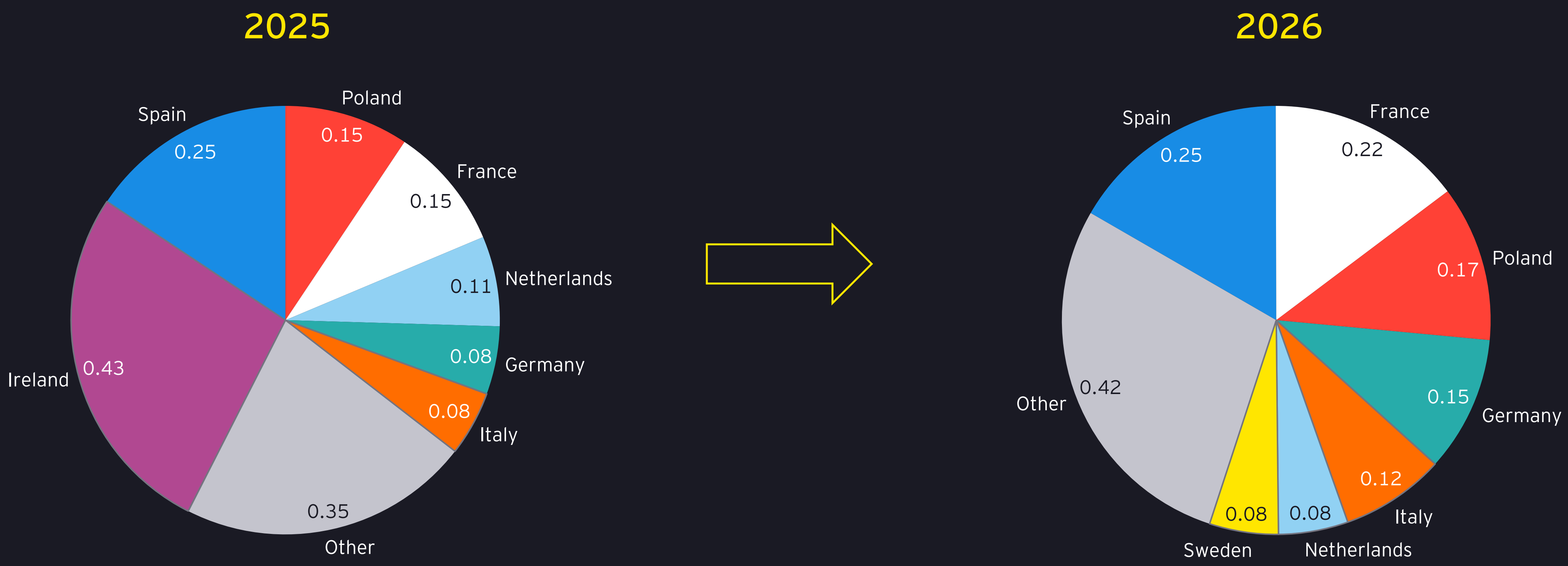


Source: Oxford Economics, EY EAT forecast, EY Item Club (UK forecast), EY Parthenon (US forecast).
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.

Ireland's slowdown sharply reduces its contribution to EU growth in 2026

- Spain, France, and Poland are expected to remain major contributors to EU GDP growth in 2026.

Contribution to real annual GDP growth y/y in the EU in 2025 and 2026
(in percentage points, top 7 countries in terms of contributions In given year)



Labels sum to total EU GDP growth in 2025, amounting to **1.6% year on year.**

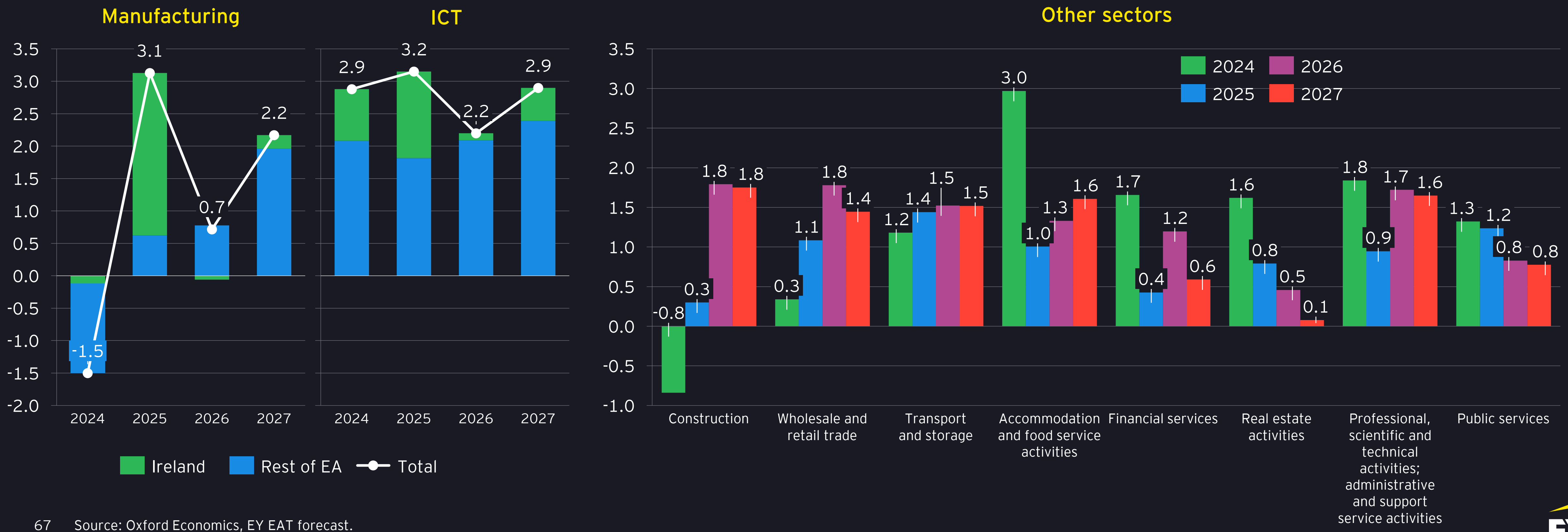
Labels sum to our forecast of total EU GDP growth in 2026, amounting to **1.5% year on year.**

Source: Eurostat, Oxford Economics, Trading Economics.

Setting aside Irish distortions, we expect the recovery in manufacturing, construction, trade, and transport to continue through 2026-27

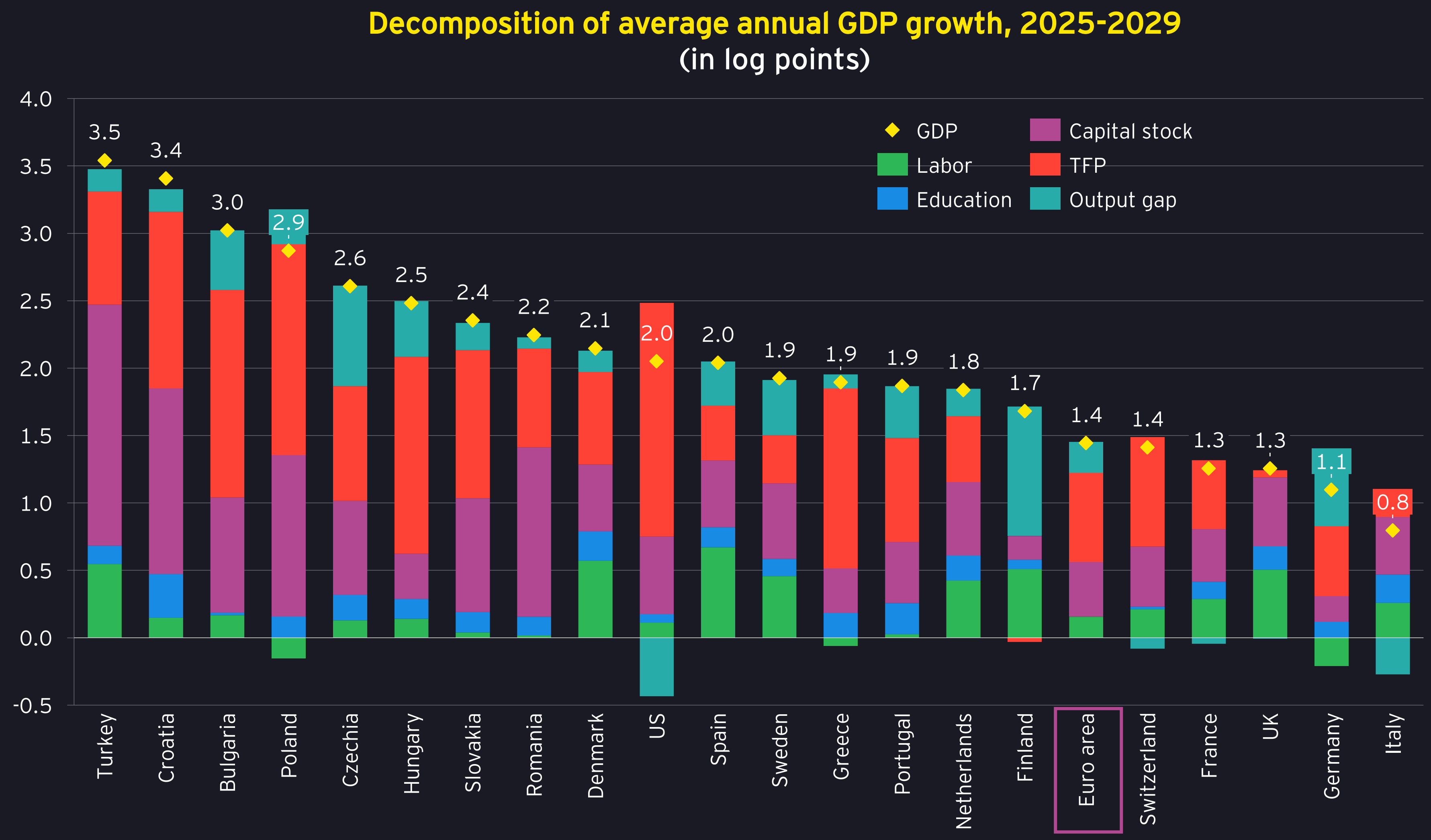
- Manufacturing posted strong growth last year, driven by a tariff-related surge in pharmaceutical production in Ireland. Outside Ireland, the sector has begun to recover gradually, and this momentum is expected to continue in 2026 despite tariff-related headwinds, with a more pronounced growth pick-up in 2027.
- The ICT sector should remain a top performer, though activity by multinationals in Ireland may lead to some moderation this year.
- A cyclical recovery in construction is anticipated to continue, supported by reduced interest rates and expanding government investment.
- Wholesale and retail trade are also expected to strengthen as consumer recovery broadens from services to goods.
- Despite weaker growth last year, tourism-related and professional services are anticipated to remain among the strongest-performing sectors in the medium term.

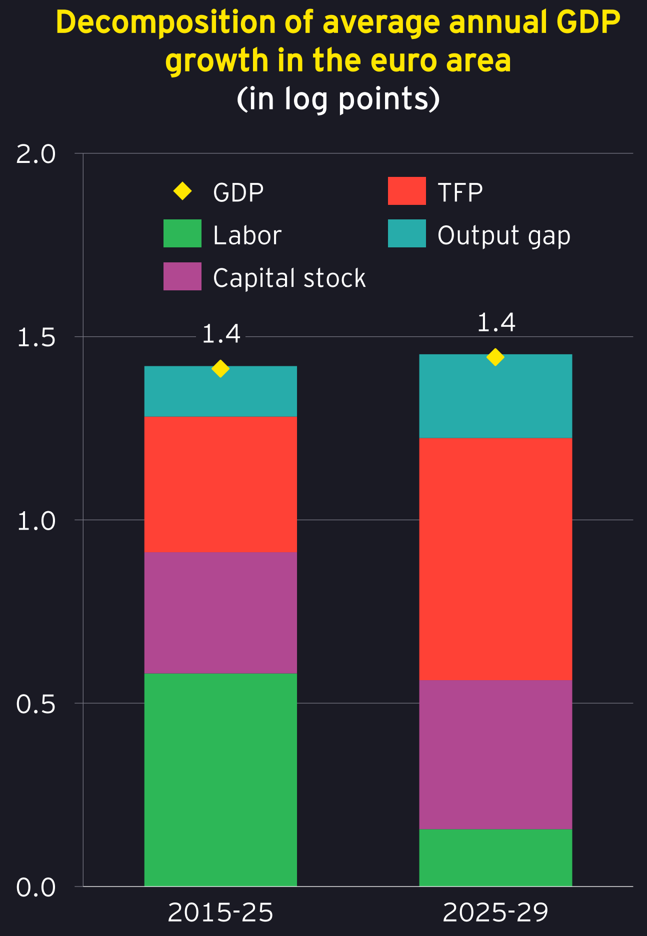
GVA growth by sector in the euro area (y/y, in percentage)



 Source: Oxford Economics, EY EAT forecast.

Over the next four years, euro area growth is projected to match its average pace of the past decade, with productivity playing a larger role as labor input weakens. However, productivity gains in Europe are still projected to lag those in the US



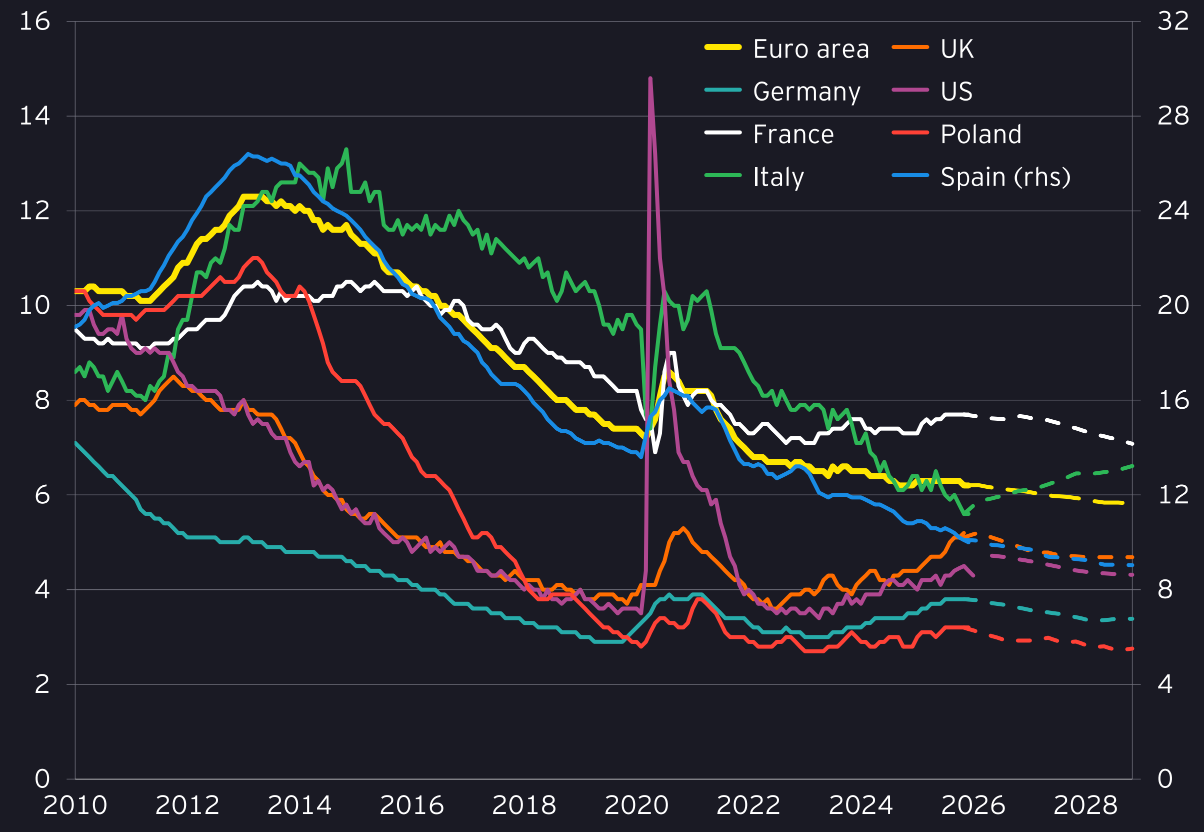


Source: EY EAT forecast.

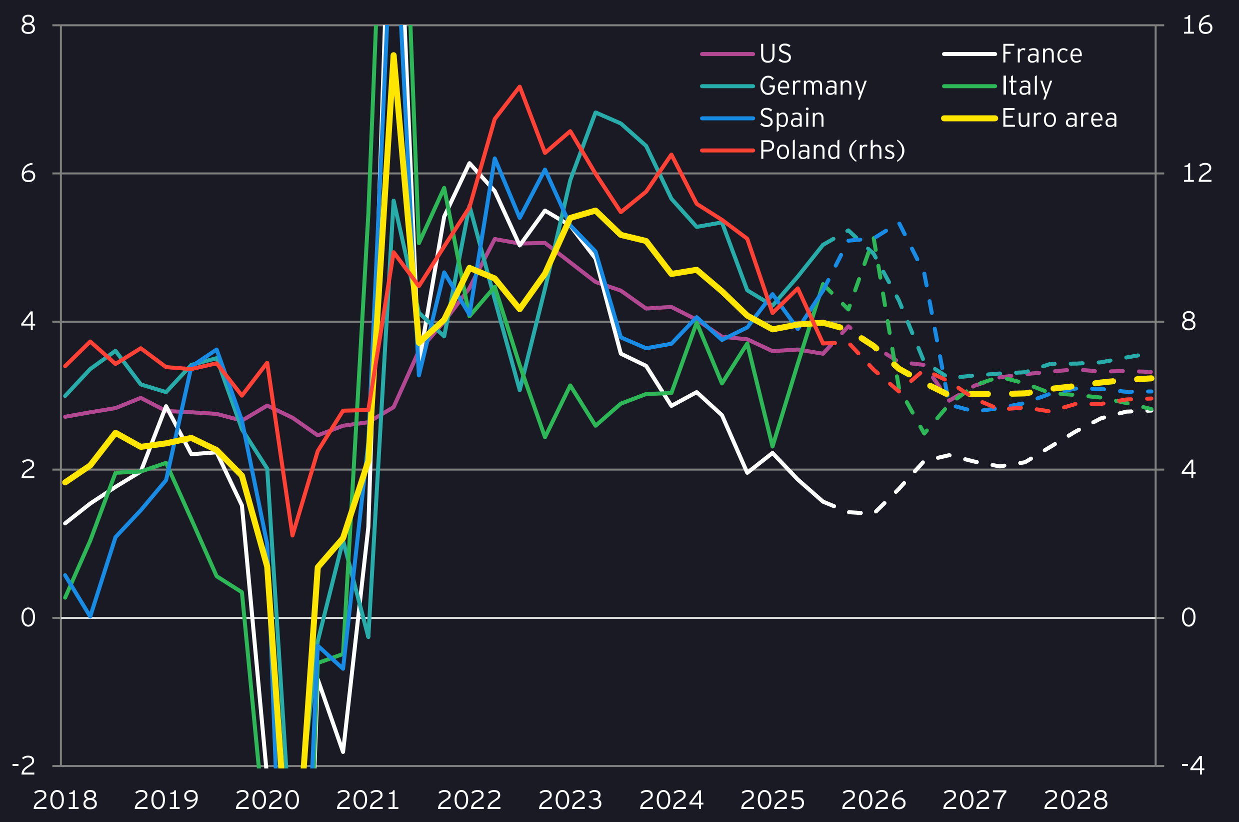
Labor market conditions in the euro area are expected to stabilize further, with wage growth gradually declining toward 3%—still above pre-pandemic levels due to structurally tighter labor markets

- Employment growth in the euro area is expected to slow from 0.7% in 2025 to 0.5% in 2026 and 0.3% in 2027, reflecting growing demographic constraints. Despite this moderation, the unemployment rate is projected to continue its slow, steady decline.
- In Spain, employment growth is projected to decelerate but remain relatively robust, while unemployment should continue to fall. In contrast, in Italy, which has been an overperformer since late 2022, labor-market conditions are expected to soften slightly, with employment stabilizing and unemployment edging higher.
- In Poland, wage growth is expected to stabilize at an elevated level (around 6%), while most euro area economies should move toward the 2.5-3.5% range. Germany is forecast to become a wage-growth overperformer starting in 2027, supported by fiscal stimulus and a declining labor supply.

LFS unemployment rate (in percentage)



Wage growth (y/y, in percentage)

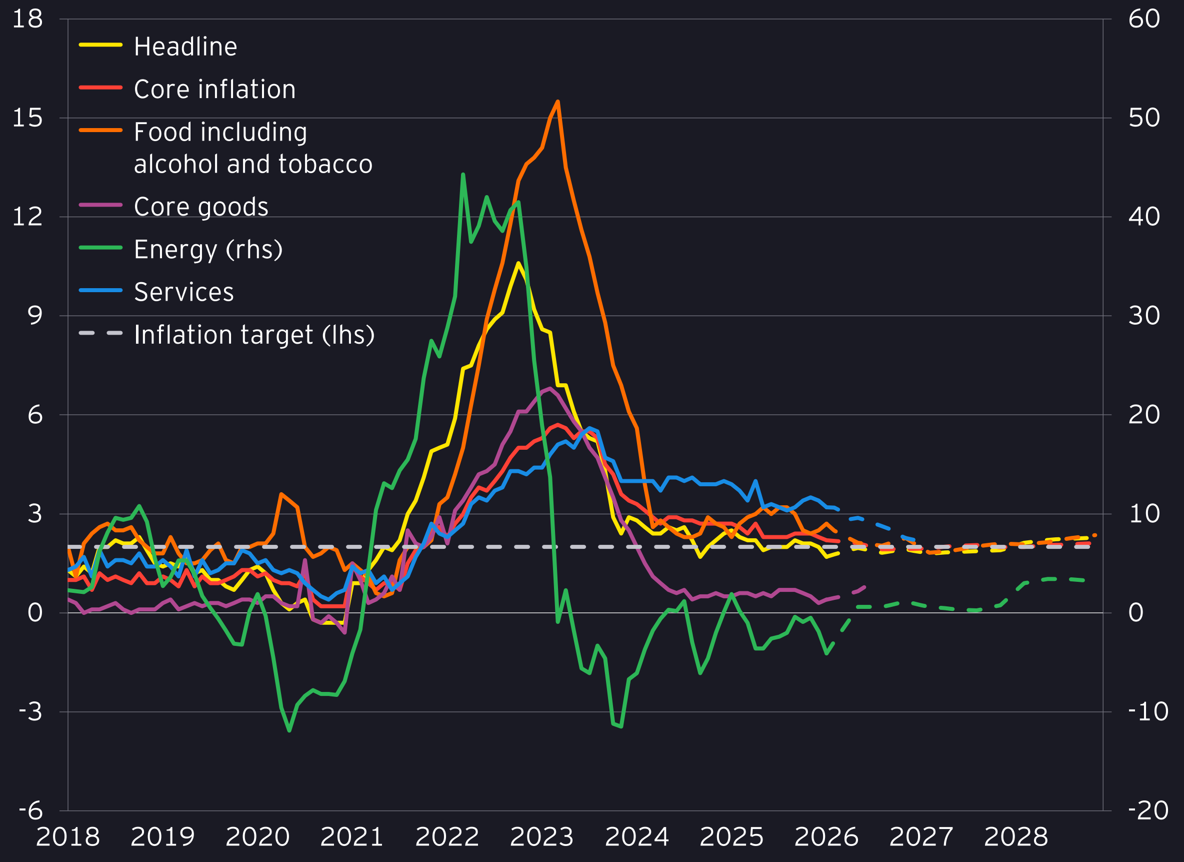


Source: Eurostat, Oxford Economics, EY EAT forecast, EY-Parthenon (US forecast), EY Item Club (UK forecast), EY Italy.
Dashed lines denote EY EAT forecast.

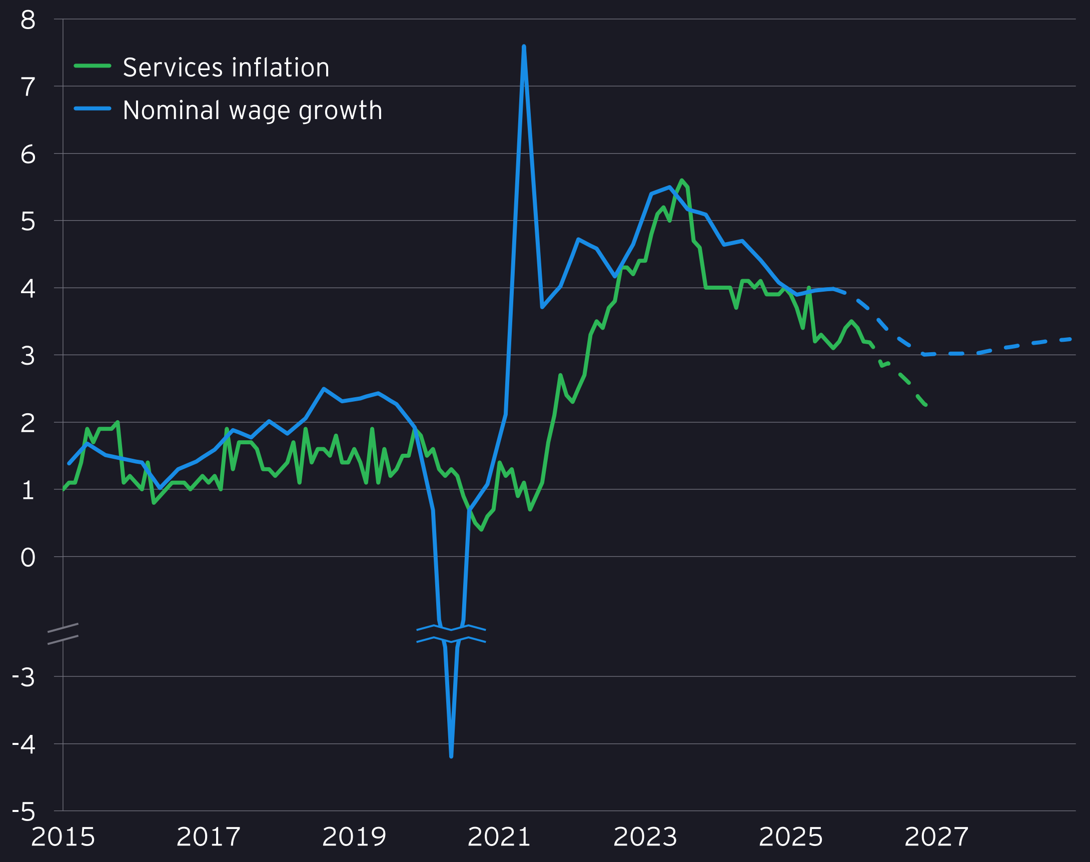
Headline inflation is expected to remain close to 2%, with only a slight undershoot in 2026

- Core and food inflation are projected to decline to around 2% by mid-2026. Services inflation is expected to continue its slow, steady deceleration, consistent with normalizing nominal wage growth. With energy inflation around 0%, headline inflation is likely to fluctuate within the 1.7-2.0% range. However, the recent uptick in oil prices following the escalation of the conflict in Iran introduces upside risks to this outlook.
- In 2028, headline inflation may edge slightly above 2% if the planned ETS extension takes effect and pushes energy inflation higher.

HICP inflation in the euro area
(y/y, in percentage)



Y/y HICP services vs. nominal wage growth in the euro area (in percentage)

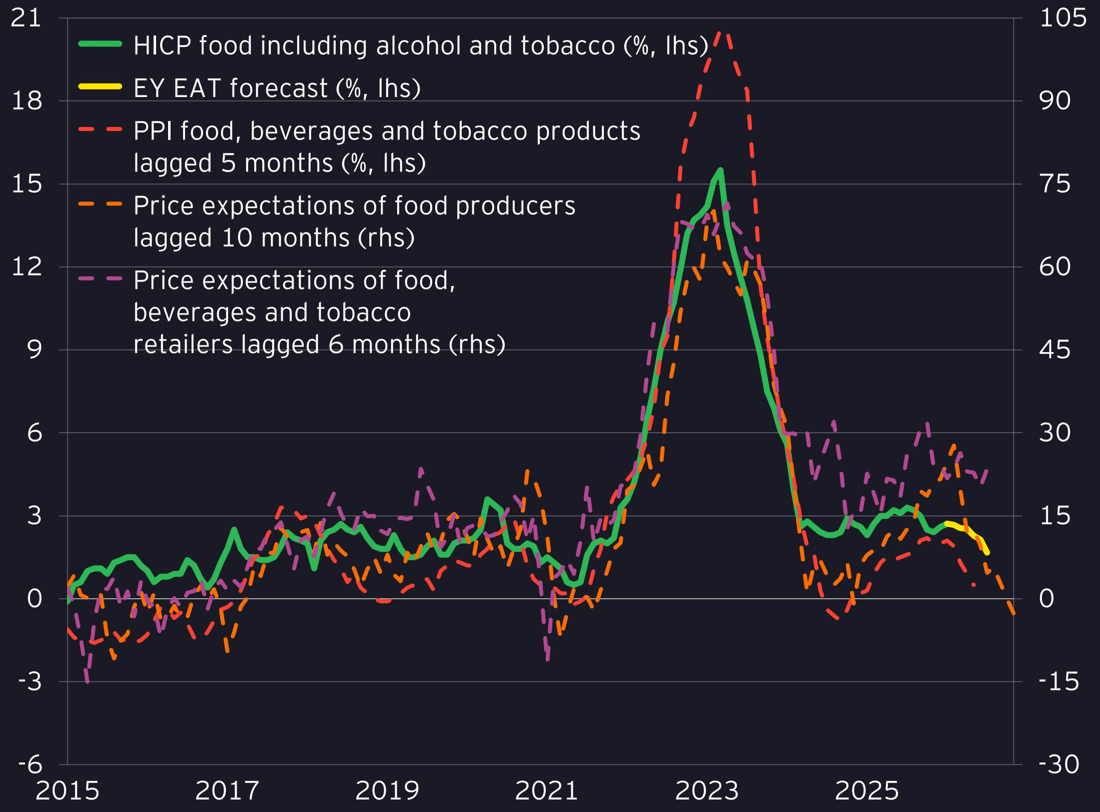


Source: Eurostat, Oxford Economics, EY EAT forecast.
Dashed lines denote EY EAT forecast.

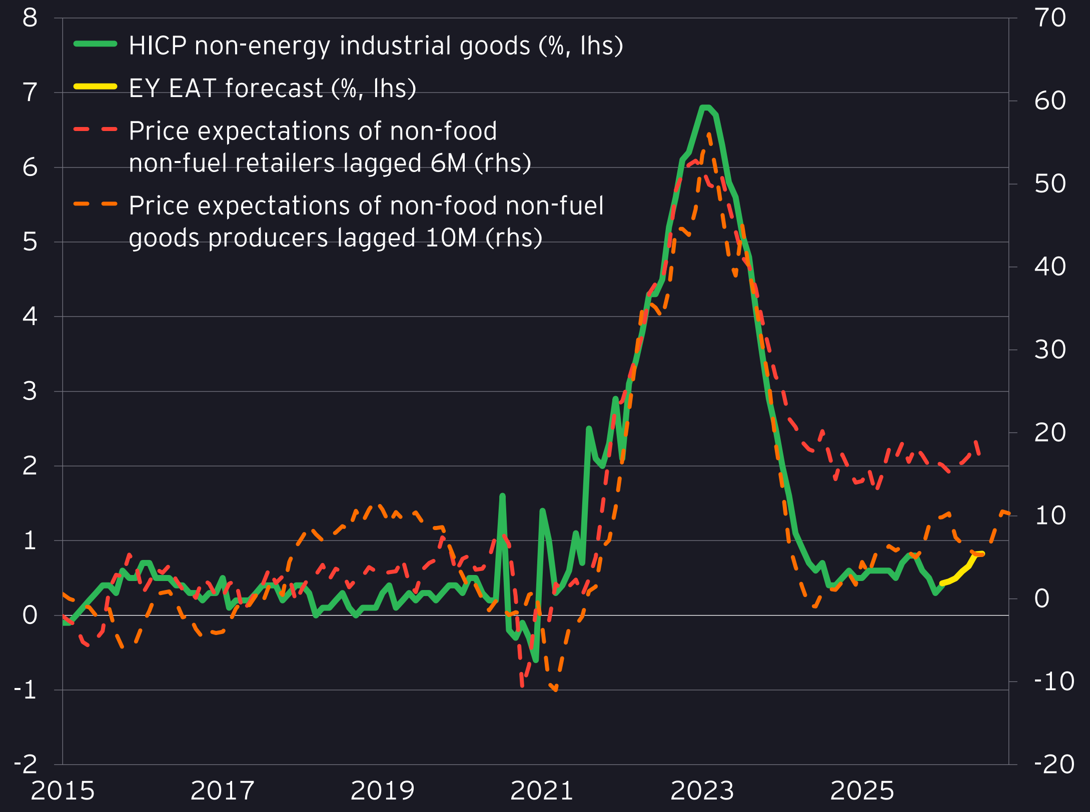
Food inflation is expected to decelerate in the near term, while core goods inflation may pick up

- Expectations of food producers point to a significant slowdown in price pressures as earlier shocks to fruit, coffee, and chocolate prices fade. Food inflation may fall below 2% by mid-year.
- Core goods inflation fell in the second half of 2025 due to significant euro appreciation. As the effects of the euro appreciation gradually fade, core goods inflation may edge up toward 1%.

Food HICP y/y inflation and its leading indicators in the euro area



Core goods HICP y/y inflation and its leading indicators in the euro area

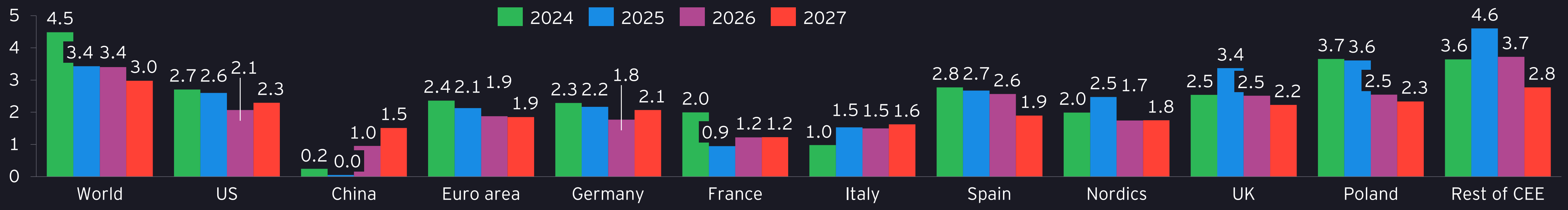


Source: Eurostat, European Commission, Oxford Economics, EY EAT forecast.

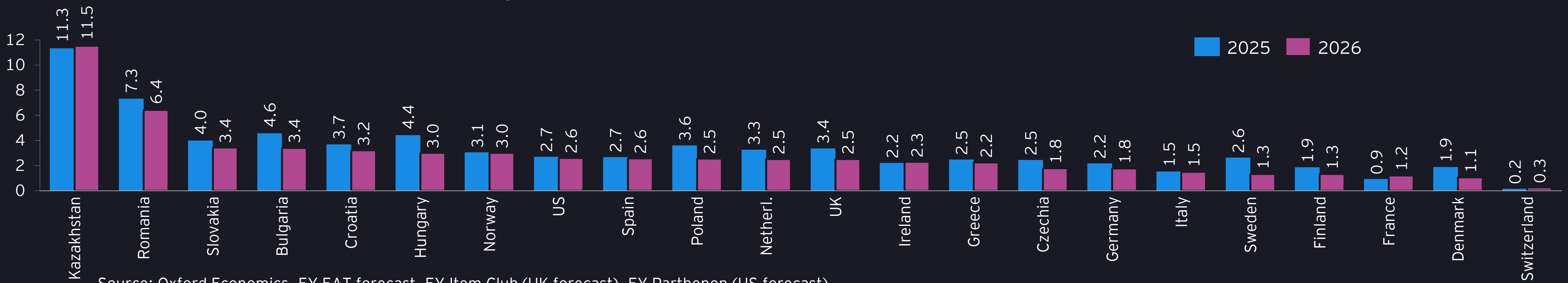
In 2026, inflation is expected to stay elevated in Turkey, Kazakhstan, several CEE countries—particularly Romania—as well as Norway, while remaining subdued in Switzerland, France, Denmark, and Finland

- In Romania, inflation is expected to stay high in the first half of 2026 due to sizeable energy price and VAT hikes implemented in mid-2025. Thereafter, price growth should slow toward 3% helped by subdued demand and a more conservative public wage policy. Inflation is forecast to remain above 3% in several other CEE countries (Slovakia, Bulgaria, Croatia) due to energy price increases and persistent price pressures in services on the back of strong wage growth.
- In contrast, Switzerland is flirting with deflation due to weak wage growth and a strong Swiss Franc. France also experiences low inflation, close to 1%, due to subdued wage dynamics. In the Nordic countries, negative output gaps and indirect tax cuts are likely to push inflation below 2%, with Norway as the notable exception where price pressures remain stubbornly high.
- In Turkey, gradual disinflation is expected to continue, with inflation falling from 31% at end-2025 to around 14% by 2029.
- For most other countries, we anticipate inflation to fluctuate within the 1.5-3% range.

Inflation in 2024-2027 (in percentage)



Inflation in 2025 and 2026* (in percentage)

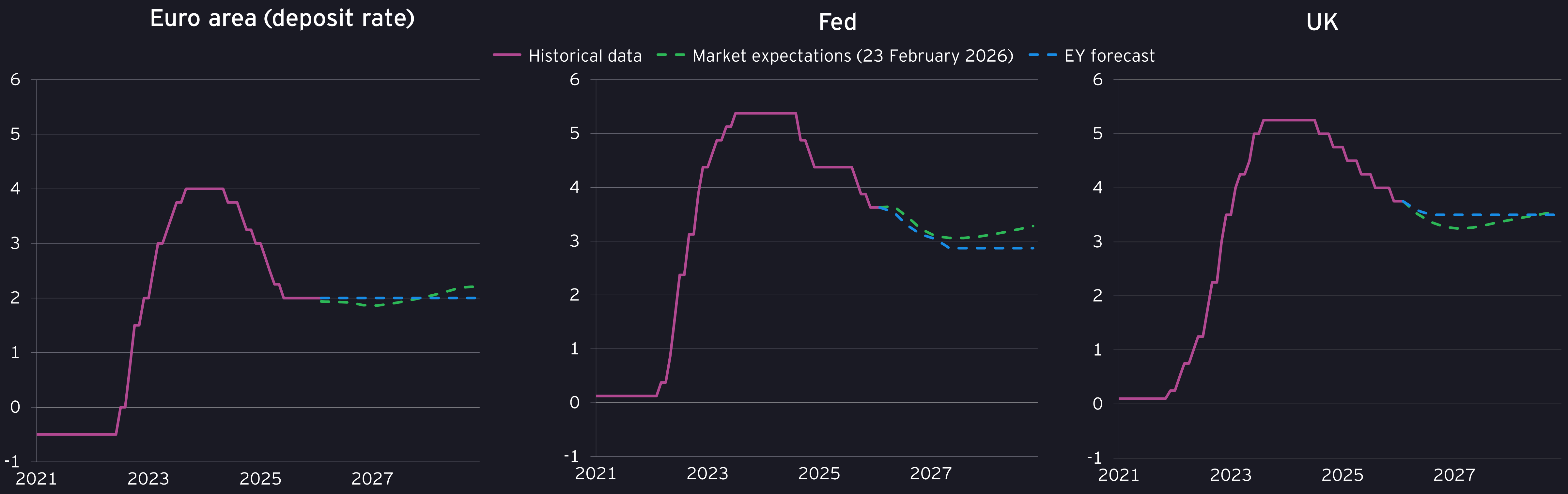


Source: Oxford Economics, EY EAT forecast, EY Item Club (UK forecast), EY Parthenon (US forecast).
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.
* For Sweden, CPIF; for Finland and the euro area, HICP; for others, CPI.

The scale of additional rate cuts in the US and the UK should be smaller than in previous years, while in the euro area the policy stance is expected to remain unchanged, with no further cuts anticipated

- We expect the Fed to remain on hold in the first half of 2026, before delivering additional 50 bps of cuts in the second half of the year.
- With inflation near target and GDP growth holding steady, we expect the ECB to keep rates unchanged, though risks are tilted to the downside if growth weakens or inflation falls materially below target.
- We anticipate the BoE to deliver its final 25 bps cut in April, keeping rates at 3.5% thereafter. However, risks are tilted toward more easing if growth continues to disappoint and labor market conditions soften further.

Historical and expected* central bank interest rates (In percentage)

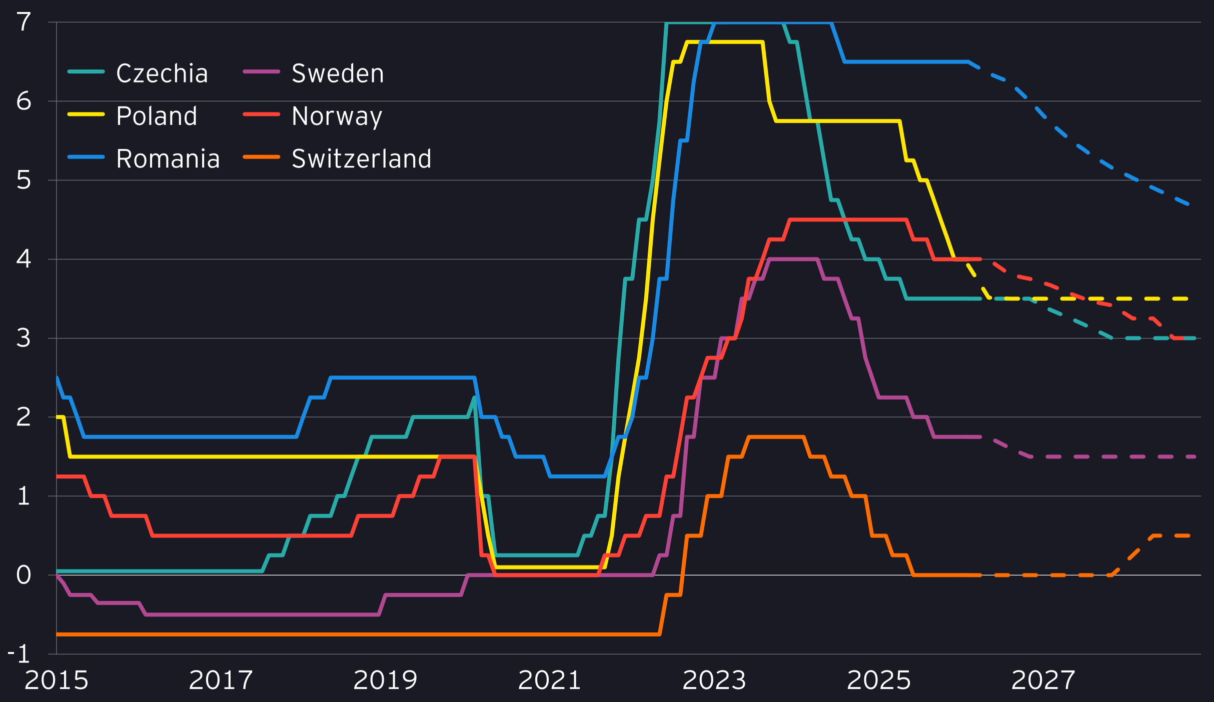


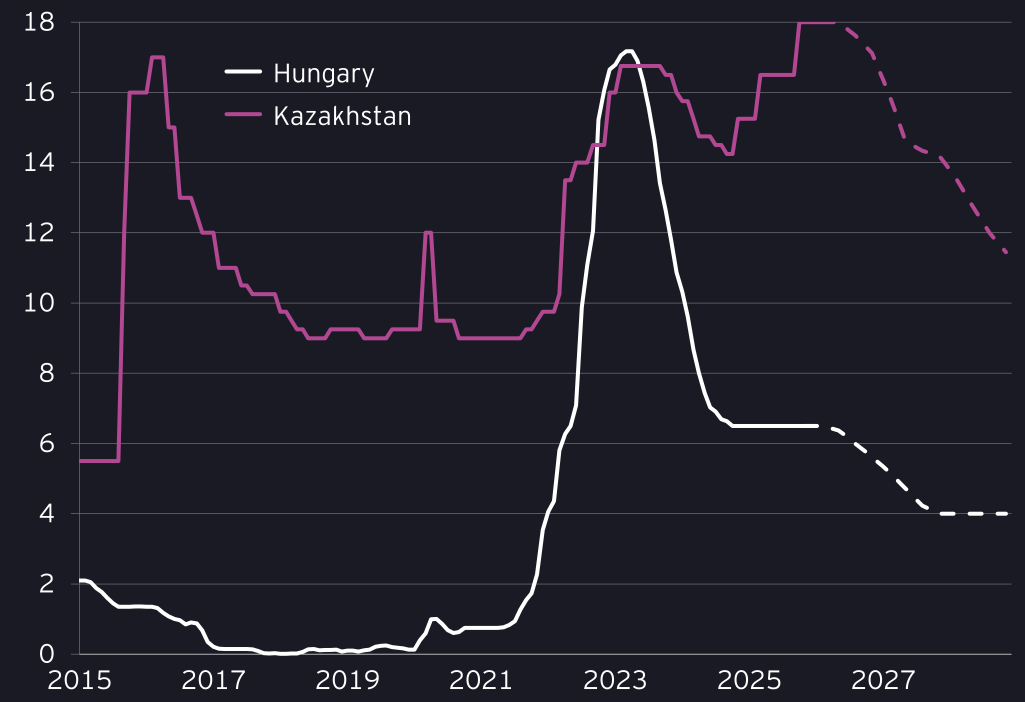
Source: ECB, Fed, BoE, CME group, ICE, EY Item Club (UK forecast), EY Parthenon (US forecast), EY EAT forecast.
* For the euro area and the UK, expected interest rates implied from SOFR (EA) and SONIA (UK) futures from CME group (EA) and ICE (UK); for the US, expected interest rates from Atlanta Fed Market Probability Tracker.

We still expect most central banks in Europe to deliver some additional rate cuts, although the bulk of the easing is already behind us

- We expect the SNB to keep its policy rate at 0% through end-2027, as inflation remains persistently below 1% amid weak GDP growth and a strong Swiss franc. Rates may rise toward the 0.5% neutral level therafter.
- In Norway, gradual rate cuts are expected to resume in the second half of 2026, with the policy rate reaching 3% only in 2028 as core inflation falls very slowly. In Sweden, with inflation expected to undershoot target amid a negative output gap, we anticipate one additional rate cut from the Riksbank.
- In CEE, further easing is anticipated. The National Bank of Poland (NBP) is anticipated to deliver cuts in March and April (in total 50bps), bringing the policy rate to 3.5%. The CNB rates should be maintained in 2026, followed by 50 bps easing in 2027 when core inflation falls to 2%. The central banks of Hungary and Romania are expected to proceed with interest rate reductions as price pressures finally subside. In Hungary, we project a total of 100 bps of easing in 2026, including the initial cut already delivered, followed by 150 bps of additional easing in 2027. In Romania, we expect 50 bps of cuts in 2026, with a further ~100 bps likely in 2027.
- The Central Bank of Turkey: We expect continued cuts from with gradual disinflation. Rates may fall to 27% by year-end.

Historical and forecast central bank interest rates* (In percentage)





Source: Trading Economics, Stooq.pl EY EAT forecast.
Dashed lines denote forecasts.
* For Hungary, 1-month interbank rate.

Chapter 4

Key risk factors

Middle East developments dominate current risk landscape, though the 2026–2029 European outlook may also be shaped by episodic trade tensions, geopolitical headwinds, and competitiveness pressures

Events in the Middle East have become the dominant near-term risk for the global economy. While the US-EU trade deal has reduced the risk of a sustained tariff escalation, it has not materially improved Europe's overall risk profile, as other external shocks have now moved to the forefront.

Overall, the balance of risks to growth is tilted to the downside, as the expected pick-up in underlying activity (excluding Ireland) may not materialize due to structural challenges (external competitiveness, demographic pressures).

1. Geopolitical Risks:

- The escalation of hostilities between the United States and Iran has become the central geopolitical risk, significantly heightening macroeconomic uncertainty through its potential impact on oil and gas prices, confidence, investment decisions, and cross-border flows. The implications of this conflict—particularly for energy markets and global supply chains—are discussed in more detail on the following slide.
- Beyond the Middle East, geopolitical risks also remain elevated. Russia's war against Ukraine continues to weigh on the outlook, while broader geopolitical tensions further add to global fragility.
- Geopolitics also carries upside potential: credible de-escalation or progress toward stabilization—whether in Ukraine or the Middle East—could reduce uncertainty, compress risk premia, and support confidence and investment relative to baseline projections.

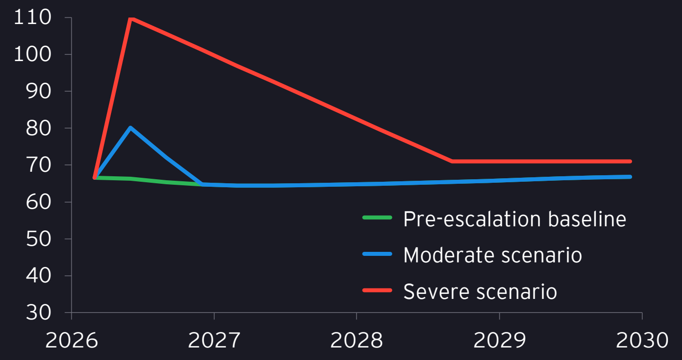
2. Tariffs and Trade Policy:

- The US-EU trade deal reduced the baseline risk of a sustained tariff escalation, but trade-policy uncertainty remains elevated. The 20 February Supreme Court ruling introduced renewed legal uncertainty, followed by a rapid political response from the US administration, including announcements of broad-based tariffs initially set at 10% and later proposed to be raised to 15%. Working assumptions still point to respect for existing trade agreements, supported by recent statements from US officials reaffirming commitments, including the US-EU agreement.
- Even before the ruling, trade tensions were increasingly driven by episodic geopolitical flashpoints rather than unresolved sectoral disputes—illustrated by the Davos episode in January 2026, when tensions over Greenland and Arctic security spilled over into trade rhetoric. Although tariff threats on both sides were eventually withdrawn, the episode confirmed that trade policy has become a flexible bargaining tool, activated in response to non-trade disputes.
- Existing tariffs continue to influence economic activity through gradual sectoral and supply-chain adjustments. Abrupt supply-chain reconfiguration risks have eased, but structural trade diversion is becoming more entrenched, with uneven effects across industries.

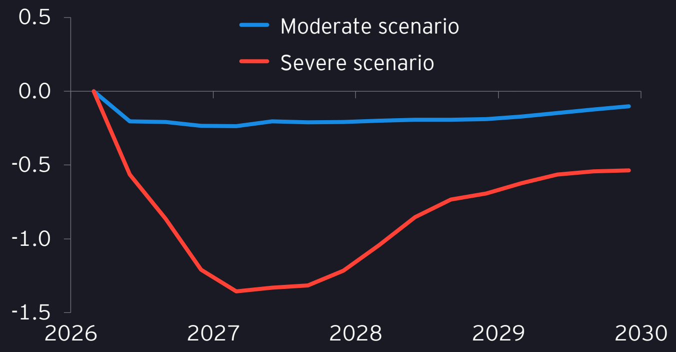
In the scenario of a temporary uptick in energy prices, the conflict in the Middle East could increase euro area inflation by 0.3 pp and reduce GDP by 0.2% in 2026. However, more extreme scenarios remain possible

- If the conflict lasts for a few weeks and results in temporary disruptions to oil supply, we estimate that the increase in commodity prices, the reduction in consumer and business confidence, and some trade disruptions could push euro area inflation up by 0.3 pp in 2026 and reduce GDP by 0.2%. This would likely not be sufficient for the ECB to react.
- However, in a scenario of further escalation and a prolonged conflict, reduced Iranian oil supply and a sustained closure of the Strait of Hormuz could raise oil prices by over USD 40/bbl and European gas prices by USD 20/MMBTU in 2026 Q2, with the shock fading only very gradually over subsequent quarters.
- We estimate that such a scenario would reduce euro area GDP by 1.3% by 2027 and push HICP inflation to around 5%, while core inflation would rise more moderately (by up to 0.5 pp). Given the opposing forces of weaker growth and higher inflation—but with only a limited increase in core inflation—the ECB would tighten policy only modestly. As Europe would be hit harder by elevated gas prices than the US, our simulations indicate that the euro would depreciate by over 8% against the USD.

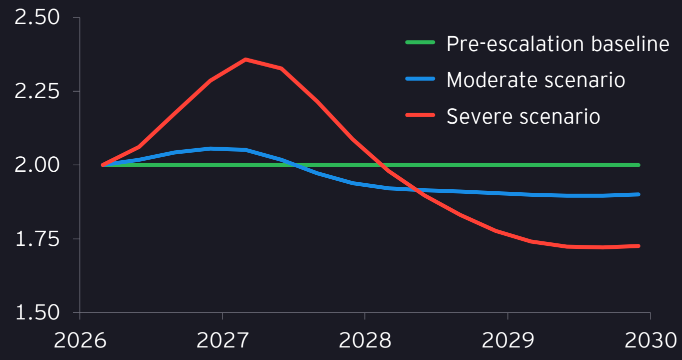
Brent oil price (USD/bbl)



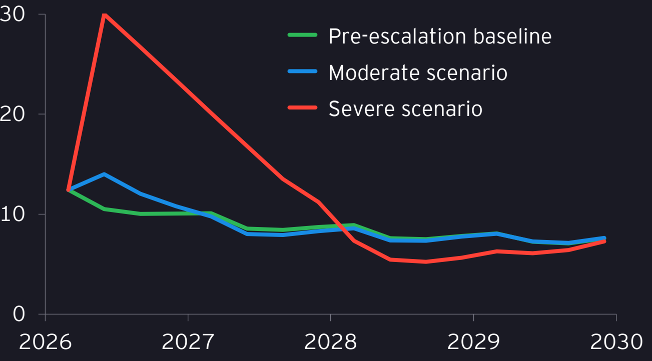
Impact of Middle East conflict on euro area GDP (in percentage)



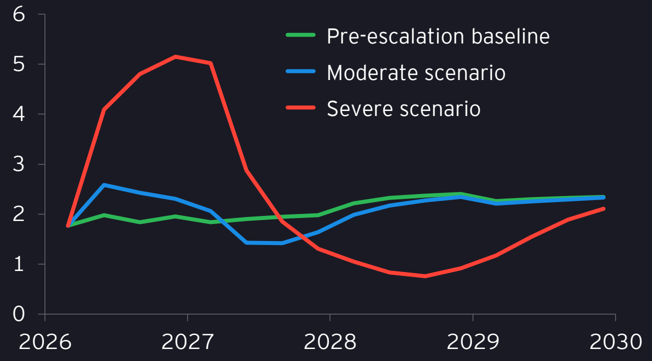
ECB deposit rate (USD/b)



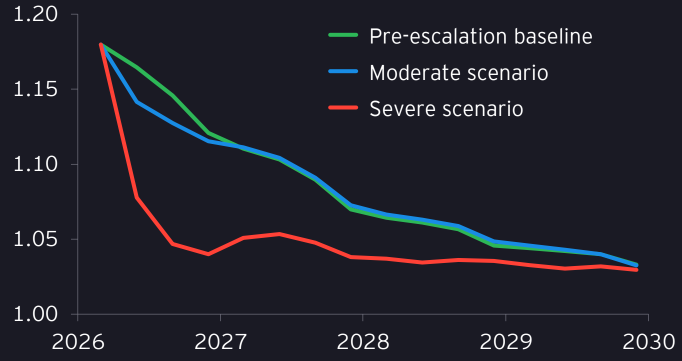
European natural gas price (USD/MMBTU)



HICP inflation in the euro area (in percentage)



EURUSD



Source: EY EAT analysis.

Fiscal policy has become more active, creating two-sided risks for the outlook, while reduced external competitiveness may lead to more subdued export growth than assumed in the baseline

3. Fiscal Policy Shifts:

- Fiscal policy has become a more prominent driver of the euro area outlook. Higher defense and infrastructure spending—especially in Germany—is expected to support domestic demand, although the near-term impact remains uncertain due to procurement and absorptive-capacity constraints. Effective execution, however, could deliver stronger-than-expected multipliers over the medium term.
- Fiscal trajectories remain uneven across countries. In France, elevated deficits and political constraints heighten the risk of fiscal tightening, which could partly offset expansionary effects elsewhere. High-debt countries (e.g., Italy) remain sensitive to any repricing of long-term yields. More broadly, rising sovereign issuance across the euro area, combined with ongoing ECB balance sheet reduction, may place upward pressure on long-term rates and tighten financial conditions, even without changes in policy rates.

4. Exchange rate and external competitiveness:

- Recent exchange-rate developments have highlighted a potential downside risk to Europe's cyclical outlook, even though the initial weakening of the US dollar early in 2026 has partly unwound. The episode illustrated the sensitivity of exchange rates to policy-driven and non-fundamental factors.
- A renewed or persistent appreciation of the euro would ease inflation via cheaper imports but could further dampen export competitiveness and industrial momentum, given the euro area's continued reliance on external demand.
- While euro area exports have recently lagged external demand, our baseline scenario envisages a gradual recovery as the effects of past shocks (energy prices, exchange rate movements, tariffs) fade. However, the balance of risks is tilted to the downside, pointing to a possibility of continued export stagnation due to structural challenges and increasing competition from China.

AI and immigration may help offset Europe's structural challenges—reduced energy competitiveness and adverse demographics—but the scale and timing of these effects remain highly uncertain

5. Energy and commodity prices:

- Energy remains a two-sided risk for Europe. Renewed geopolitical shocks could quickly push prices higher and erode real incomes, with Central and Eastern Europe particularly exposed due to greater energy sensitivity and the risk of accompanying FX depreciation. Uncertainty around the inflationary impact of the EU Emissions Trading System adds another layer of risk, especially as higher carbon prices may increasingly pass through to energy and industrial costs. The magnitude of this pass-through remains uncertain and could complicate the inflation outlook. Conversely, easing geopolitical tensions, improved supply conditions, or a watering down of the planned ETS extension could lower risk premia and provide a meaningful tailwind to growth and inflation dynamics across the region.

6. Asset prices and financing conditions:

- Corrections in select asset price segments could weigh on household and business confidence, curbing consumption and delaying investment, especially as household exposure to financial assets has increased. Tighter market conditions and higher long-term yields could raise the cost of capital and limit credit availability, particularly for more leveraged firms and investment-intensive sectors.

7. Structural and long-term risks and opportunities:

- Europe faces persistent structural competitiveness challenges, including high energy and climate-related costs, an ageing workforce, weaker productivity dynamics, and intensifying competition from China and other emerging economies. These factors weigh on long-term investment attractiveness, particularly in energy-intensive and manufacturing sectors.
- A key upside opportunity is conditional rather than automatic. Higher costs and labor scarcity could accelerate investment in automation, digitalization, and AI, supporting productivity growth over time. However, without sufficient investment in skills, infrastructure, and scale-up capacity, the productivity response may remain too weak to offset structural headwinds.
- Demographic trends reinforce these risks. Immigration is one of the few available channels to stabilize labor supply, particularly in ageing economies across both CEE and Western Europe. However, political resistance to migration and weak integration outcomes represent a material downside risk, as they may constrain labor force growth and limit the economy's capacity to adapt to structural change.

Chapter 5

Country-specific outlooks

Germany: Real GDP grew by 0.3% in 2025, marking the first year of positive growth since 2022, with the outlook for 2026 supported primarily by debt-financed fiscal expansion

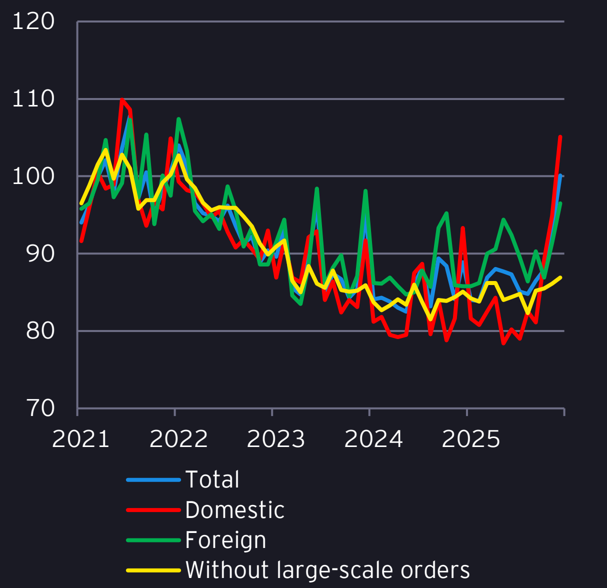
	GDP growth	Inflation	Current account balance	LFS unemployment rate
2026F	+0.6%	+1.8%	+4.6%	3.7%
2027F	+1.2%	+2.1%	+4.3%	3.5%
	Real GDP growth (y/y)	Headline CPI Inflation (y/y)	In % of GDP	% of civilian labor force

Source: EY EAT forecast.

Ifo business climate indicators
(2015=100)

Source: Ifo

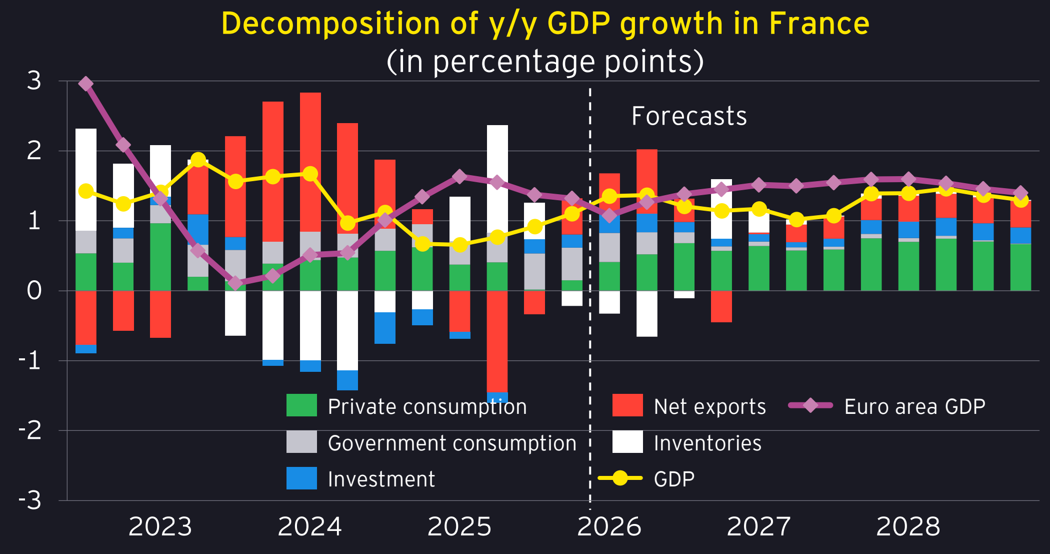
Index of new orders in manufacturing
(calendar and seasonally adjusted, 2021=100)

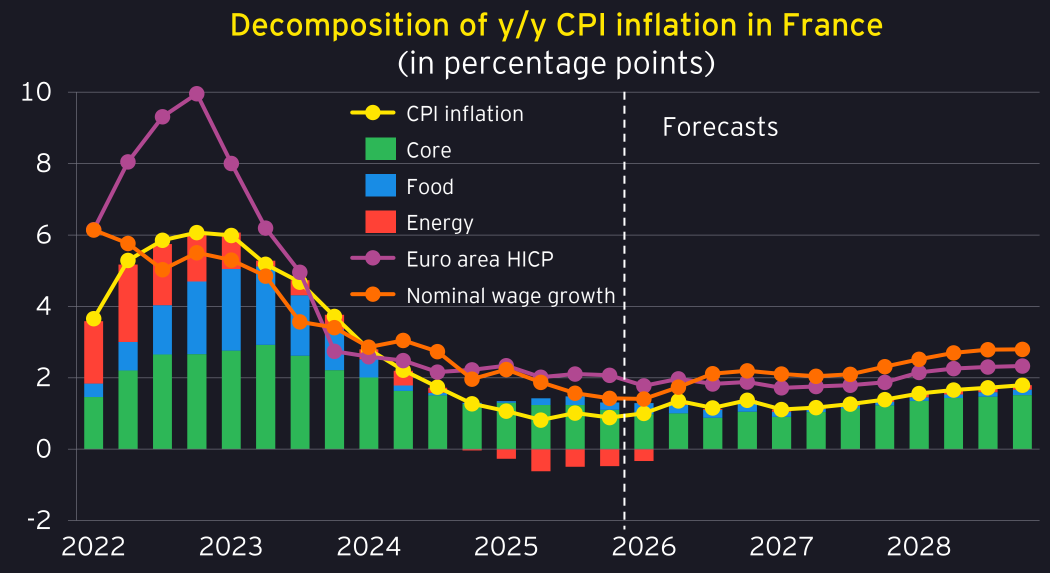


Source: Destatis

- The German economy showed a slight upward trend toward the end of 2025, with moderate growth projected for 2026.
  - According to early estimates from the Federal Statistical Office, **real GDP in 2025** increased by 0.3% (including a 0.3% q/q increase in Q4, seasonally adjusted).
  - **Growth is expected to accelerate to 0.6% in 2026 and 1.2% in 2027**, driven mainly by fiscal expansion (increased spending on infrastructure, defense, and social transfers; tax relief, energy price relief) as well as a recovery in private consumption. Fiscal support should prevent prolonged stagnation, though the overall upturn will remain modest given ongoing demographic pressures and reduced competitiveness.
- While the **business climate index** increased in February 2026, it remained slightly below August 2025 level. Firms continue to report muted demand and competitiveness concerns, limiting prospects for any rapid improvement in growth.
- **New orders in manufacturing** strengthened in December (up 7.8% month-over-month), driven by a surge in domestic large-scale orders. Orders excluding large contracts have stabilized with a slight upward trend. Overall, total manufacturing orders increased 3.0% in 2025.
- In nominal terms, **German exports** rose 1.0% in 2025.
  - December saw a 4.0% monthly increase, the strongest rise of the year. Exports to EU27 partners increased, while exports to the US and China fell by 8.4% and 10.2%, respectively.
  - Prospective FTAs with Mercosur and India improve Germany's medium-term export outlook. Mercosur is set to cut tariffs of up to 35% on key German exports (cars and machinery), and the India-EU FTA—expected to remove over 90% of tariffs—could increase EU exports to India by 45% according to our analysis, offering meaningful upside for German manufacturers.
- **Inflation** has fluctuated around 2%, reaching 2.1% in January. Services inflation remains somewhat elevated at 3.5%, while core goods inflation stays low and energy prices continue to decline. Inflation is forecast to average 1.8% in 2026 as food and services inflation ease, before rising to 2.1% in 2027 due to a firmer contribution from energy and a reacceleration in food prices.
- The **LFS unemployment rate** stabilized at 3.8% in the second half of 2025, reflecting stagnant employment and labor supply. With GDP growth gradually improving and labor supply declining due to demographic pressures, the LFS unemployment rate is expected to fall to 3.7% in 2026 and 3.5% in 2027, even though overall employment is likely to remain broadly flat.

France: a stronger-than-expected second half of 2025 supports cautious optimism for 2026, though risks remain as labor market conditions soften; inflation stays low



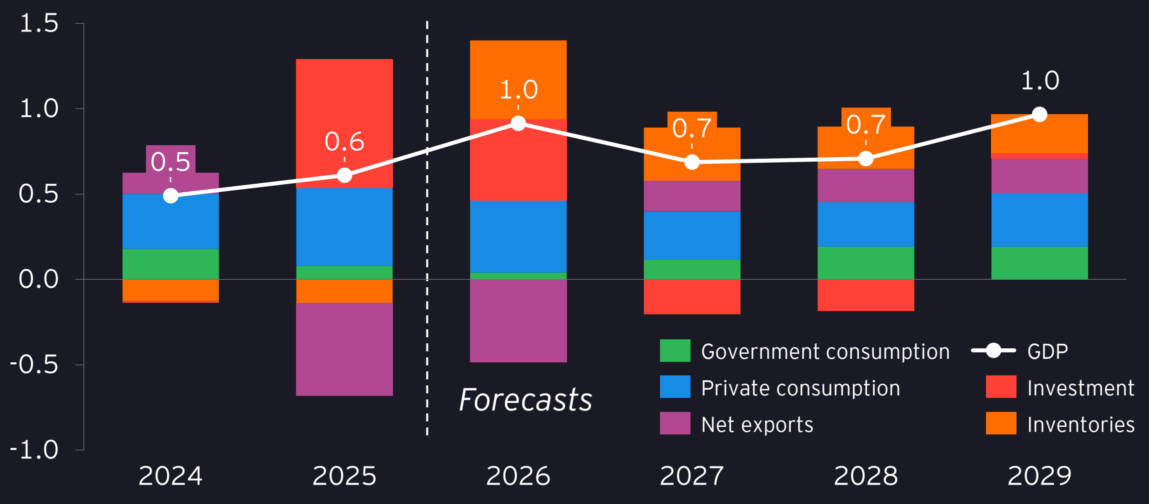


- **Growth picked up in the second half of 2025.** Despite subdued expectations earlier in the year, GDP rose by 0.5% q/q in Q3 and 0.2% q/q in Q4, with y/y growth rising from 0.8% in Q2 to 1.1% in Q4. Growth was supported primarily by a surge in large-ticket export items, but broader-based momentum also improved: investment strengthened, and private consumption in Q4 posted its first notable quarterly gain in several quarters. Business sentiment has improved in recent months, suggesting that growth can be sustained in the near term. **Labor market conditions, however, have continued to deteriorate.** Employment growth has remained weak, unemployment in Metropolitan France rose from 7.2% in 2024 to 7.7% in 2025 Q4, and wage growth slowed further to 1.6% y/y in 2025 Q3. These dynamics temper the otherwise improving short-term outlook.
- **We forecast GDP growth of 1.1-1.4% per year, broadly in line with potential**. We expect labor market conditions to stabilize, supporting a gradual recovery in private consumption. Investment should continue to grow at a modest pace, underpinned by lower interest rates, recovering corporate profits, and improved business sentiment. Exports are likely to expand moderately alongside firmer external demand. Government spending is expected to slow as fiscal consolidation proceeds gradually but should not impede growth significantly. After 2026, we expect unemployment to fall and wage growth to accelerate, helping sustain consumption growth. **GDP is projected to rise 1.3% in 2026, 1.1% in 2027, and 1.4% in 2028.** Risks are two-sided: investment could recover more strongly than anticipated, but weaker labor market conditions or political uncertainty could weigh on growth.
- **Inflation remains notably subdued.** Regulated electricity price cuts and weak wage growth have kept inflation among the lowest in the euro area. Core inflation was 1.0% y/y in January, while headline CPI fell sharply to 0.3% y/y, after hovering around 0.8-1.0% in 2025. We expect this dip to prove temporary: headline inflation should rise to 1.2-1.4% once electricity base effects drop out from Q2 onwards. Nonetheless, inflation is set to remain low, averaging 1.2% in 2026-2027, before gradually increasing to 1.7-1.8% by 2028-29 in line with recovering wage growth.
- **Political conditions have stabilized somewhat**. The Lecornu's government managed to pass the 2026 budget. In response, sovereign bond yields have eased, with 10-year spreads to German Bunds narrowing from 70 to 55 bps, and yields falling below 3.3% for the first time in six months.

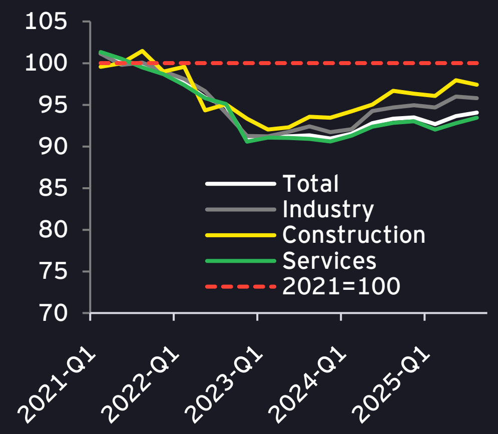
Source: Eurostat; Oxford Economics; EY EAT forecast.

Italy: GDP growth is supported by investment and private consumption; inflation has dropped to 1.0% but is likely to pick up in the coming months

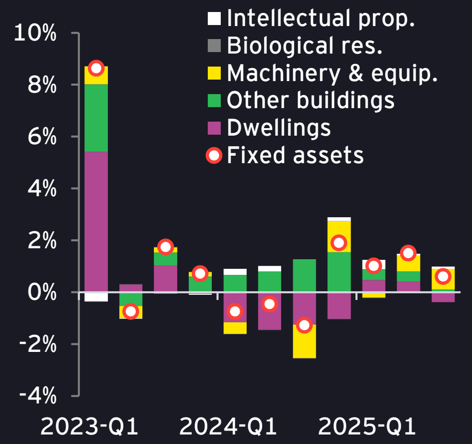
GDP growth decomposition in Italy
(in percentage points)



Real hourly wages by sector
(index 2021=100)



Investment
(q/q, in percentage points)

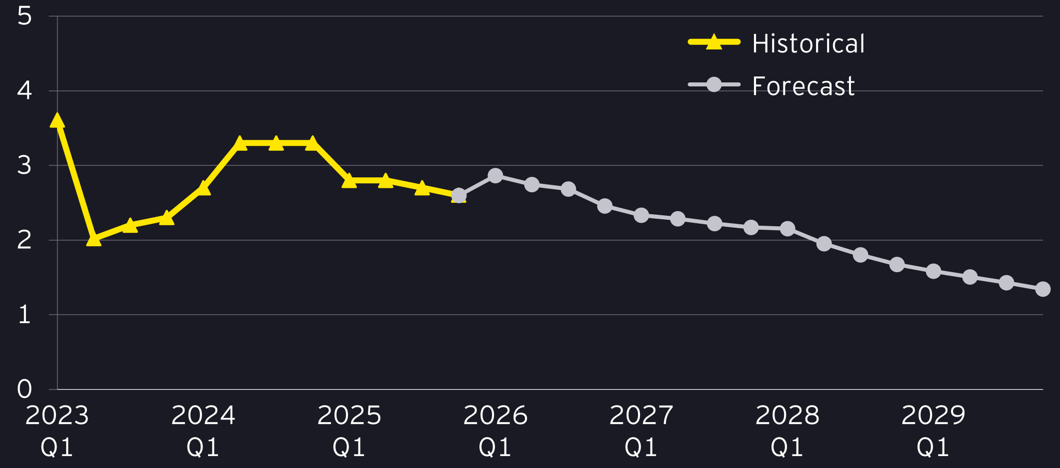


- GDP rose 0.1% q/q in 25Q3 and 0.3% q/q in 25Q4, following a 0.1% contraction in Q2. While full Q4 details are still pending, Q3 growth was driven mainly by a strong rebound in exports (+2.6%) after the sharp decline in Q2 (−1.7%). Imports also increased (+1.2%), resulting in a 0.5pp positive contribution from net exports. Investment rose by 0.6% q/q, while private consumption grew modestly (0.1% q/q).
- For 2025 as a whole, growth was likely led by investment and private consumption, with negative contribution from net exports. Public consumption had a positive impact. Private consumption benefited from favorable labor market dynamics, although real wages remain below their 2021 level, while lower interest rates supported investment.
- In 2026, GDP growth is projected at 1.0%, driven by private consumption (0.9%) and continued, albeit more moderate, investment growth (1.5%). Net exports is expected to subtract 0.4pp from growth as US tariffs weigh on exports.
- Beyond 2026, we expect growth to slow to 0.7%, as government investment declines once the NextGenEU program concludes. Employment is likely to stagnate following earlier gains, which should slow private consumption. Exports, however, is projected to gradually improve, supported by a recovery in Germany.
- Inflation has eased in recent months, falling to 1.0% in January, driven by decelerating food prices and further declines in energy costs. We expect headline inflation to gradually increase over the year as the deflationary impulse from energy fades. We project inflation to average 1.5% in 2026 and 1.7% in 2027, before rising to 1.9% in 2028 as energy prices increase following the planned ETS extension.
- Key risks to the Italian outlook include potential changes in trade policies, elevated geopolitical uncertainty, and the prospect of a faster than expected pickup in inflation—either due to second-round effects of wage growth (given the large share of employees awaiting contract renewal) or higher commodity prices linked to global tensions (the Russia-Ukraine war, Middle-East conflicts). Upside risks are centred on the possibility of a continued improvement in labor market conditions.

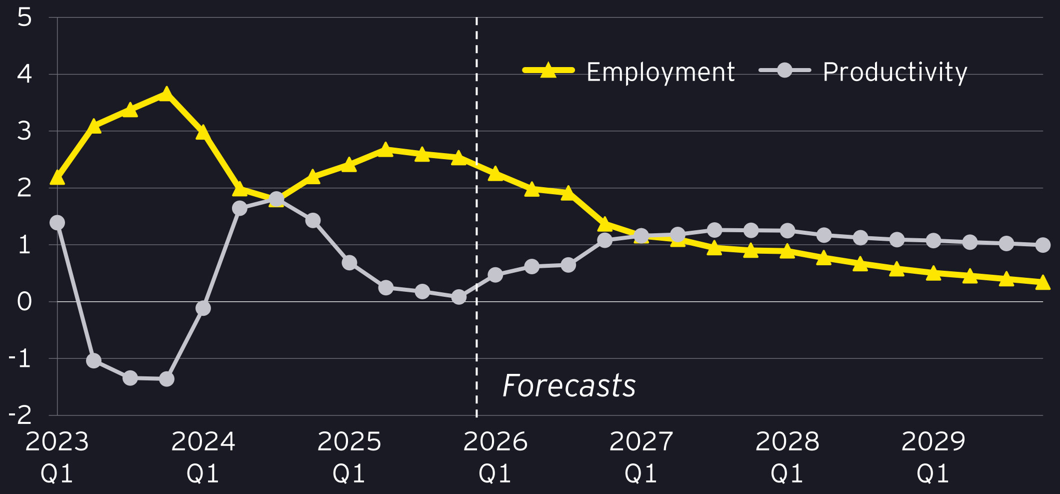
Source: EY-Parthenon calculations based on ISTAT data. GDP figures for 2025 and 2026 reflect the EY Italian Macroeconomic Bulletin (2025q4), incorporating the carry-over effect of the higher-than-expected quarter-on-quarter GDP growth in Q4 2025. From 2027 onward, the forecasts were produced by EY Economic Analysis Team using its Global Macroeconometric Model.

Spain: Growth is slowing but remains resilient, supported by strong immigration and tourism. Price pressures are persistent

Y/y GDP growth rate
(In percentage)



Employment and Productivity y/y growth
(In percentage)

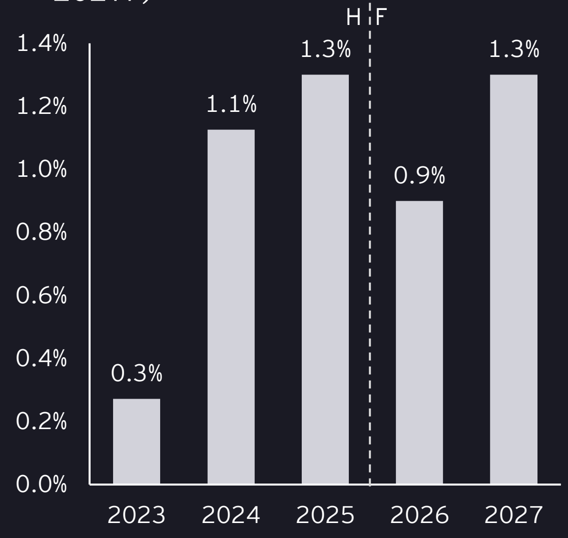


- **The Spanish economy maintained a strong momentum in late 2025.** Real GDP grew by 2.6% y/y in Q4 2025, a slight deceleration from earlier quarters but still consistent with a late-cycle expansion and keeping Spain among the fastest-growing economies in the euro area. Growth remains heavily domestically driven, with net exports acting as a drag due to weaker euro area demand.
- **Labour market conditions remain favourable. Unemployment stayed below 10%, the lowest in nearly two decades.** Strong immigration inflows and the upcoming regularisation process* (expected to affect roughly 500,000 people) continue to expand labour supply, easing labour shortages and supporting consumption and potential growth, even as productivity per worker remains subdued.
- **Early 2026 indicators point to some cooling.** The Manufacturing PMI fell to 49.2 in January, signalling renewed contraction amid weaker new orders and soft external demand. The Services PMI eased to 53.5 from 57.1 in December, still indicating solid expansion but reflecting softer demand and persistent cost pressures.
- **Tourism remains a major growth pillar.** International arrivals reached a record 96.8 million, boosting services activity, employment, and external balances.
- **We expect growth to gradually slow over the next few years.** GDP is forecast to rise 2.7% in 2026, only slightly below the 2.8% recorded in 2025, supported by NextGenEU-funded investment. A more noticeable deceleration is expected thereafter, with growth slowing to 2.3% in 2027 and 1.9% in 2028 as immigration inflows normalize and the tourism boom cools.
- **Inflation fluctuates within the 2-3% range.** After rising in the second half of 2025, headline inflation eased to 2.3% in January, driven by falling energy prices. However, underlying price pressures remain elevated, with core HICP inflation and services inflation steady at 3.0% and 3.9%, respectively. **We expect core and food inflation to remain elevated through 2026, with headline CPI inflation averaging 2.6% before easing to 2.0% as services and food inflation gradually slow.**
- **Political uncertainty continues to weigh on business sentiment.** A fragmented parliament, rejection of key government decrees, budgetary challenges, and tensions over immigration and regional financing all cloud the outlook. Upcoming regional elections and governance frictions further complicate the policy environment.
- **The Spanish stock market significantly outperformed its European peers in 2025.** The IBEX 35 rose by ~46% increase in 2025, far exceeding the EuroStoxx50's ~13%, reflecting a favourable economic outlook and the impact of reduced interest rates.

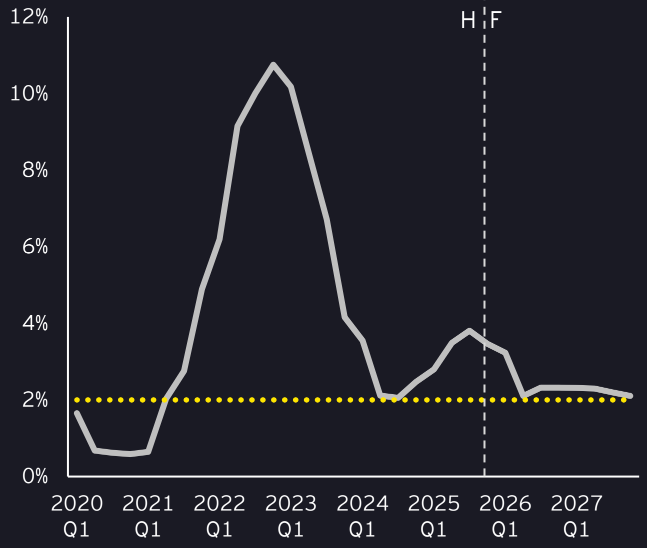
Source: Banco de España, Eurostat, S&P Global, Instituto Nacional de Estadística (INE), EY EAT forecast.
* Spain is implementing an extraordinary regularization process in early 2026 (expected April–June) for approximately 500,000 undocumented immigrants. Eligible individuals who were in Spain before December 31, 2025, and can prove at least five months of continuous presence may receive a one-year residence and work permit, provided they have no criminal record.

UK: After marginally beating forecasts in 2025, GDP growth is set to slow in 2026. UK inflation remains above European peers but is expected to return to 2% this year as the labour market loosens

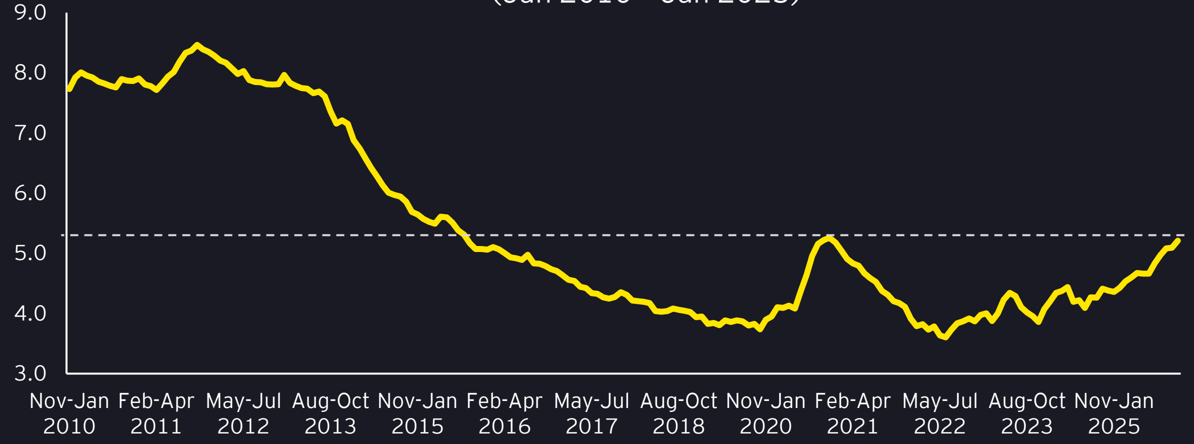
UK GDP Growth (Y/Y, %, 2023 - 2027F)



UK: CPI Inflation (12-month rate%)



UK: Unemployment rate, %
(Jan 2010 – Jan 2025)

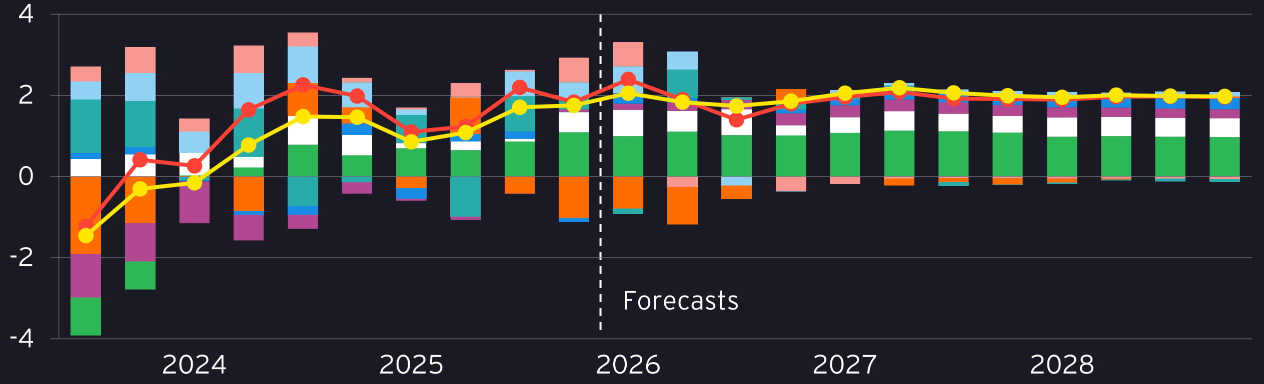


- **After outperforming expectations in 2025, UK GDP growth is set to slow to 0.9% this year.** Despite losing momentum through the year after a strong start, growth in 2025 overall came in at 1.3%, beating many forecasts made at the start of the year. Growth in 2026 is set to moderate however, as slowing household income growth and elevated global uncertainty weigh on activity.
- **The labour market continues to deteriorate.** The impact of increased employment taxes and a higher minimum wage have seen businesses reduce headcount, particularly in lower pay sectors. With hiring weak, unemployment has picked up to 5.2%, matching its pandemic-era peak. The loosening labour market has also contributed to a sharp deceleration in private sector wage growth at the start of 2026.
- **The cooling labour market will help inflation return to target.** After peaking at 3.8% in July-September 2025, inflation fell to 3.0% by January 2026. Inflation's downwards trajectory is expected to gather pace in early 2026. The announcement at the Budget that some levies on utility bills will be removed will reduce energy prices from April, while softer wage growth should help bring down stubbornly high services inflation. We think inflation will temporarily get close to 2% in the middle of 2026, before settling more sustainably toward the end of 2027.
- **The Bank of England is nearing the end of its rate cutting cycle.** The BoE cut interest rates at the December meeting but indicated it's likely getting close to completing the easing phase. Faced with the dilemma of sticky inflation but a weak growth outlook, the MPC has opted to reduce interest rates gradually. We expect one more rate cut, likely in April, though risks are tilted toward additional easing—with the latest soft wage data increasing the chance of a March cut as well.
- **UK Government borrowing costs remain high and sensitive to politics.** UK Gilt yields continue to trade above those of other G7 economies, placing pressure on public finances. While borrowing costs have come down since summer 2025, they remain elevated and reactive to political developments, with speculation over the Prime Minister's position contributing to volatility in Gilt markets through early 2026.

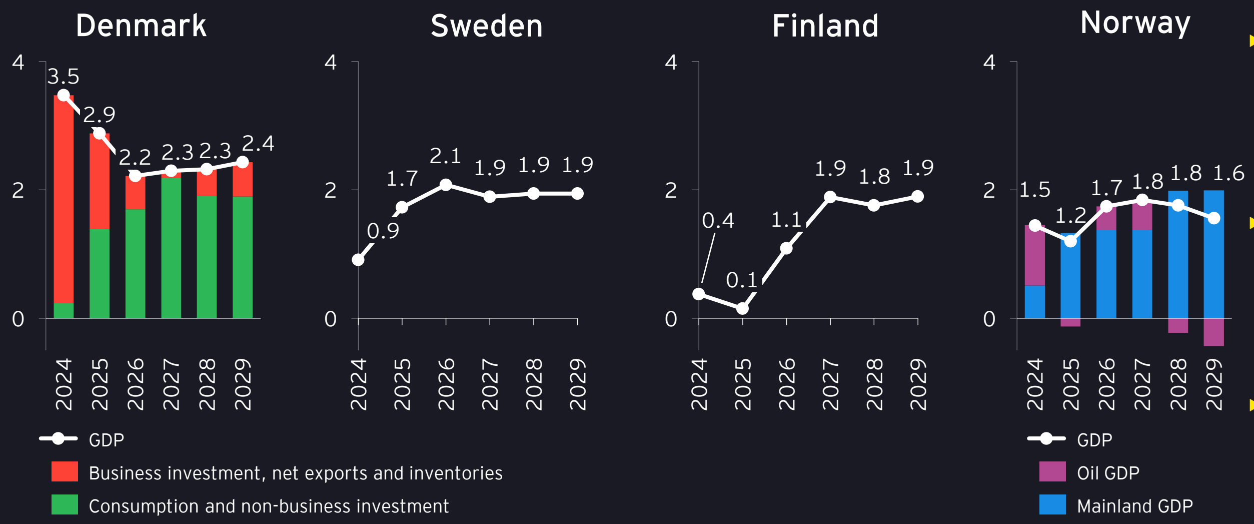
Source: Haver Analytics; EY ITEM Club, EY analysis, ONS.

Nordics: Uneven improvement in 2025, supported by consumption but constrained by inventories and weak investment; outlook points to gradual, domestically driven strengthening in 2026–29

Real GDP growth decomposition in Nordic economies
(y/y, in percentage points)



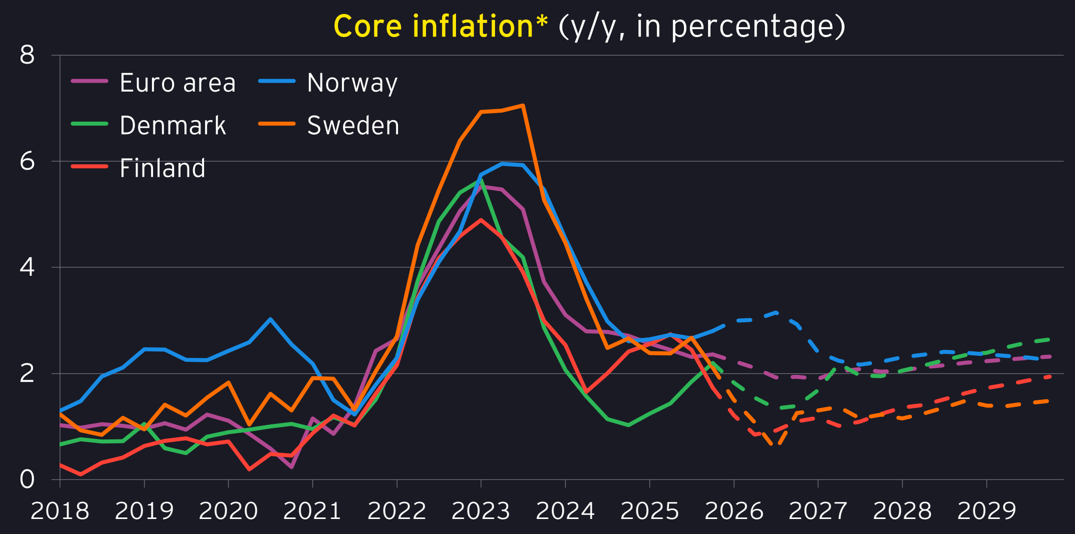
Real GDP growth (y/y, in percentage)

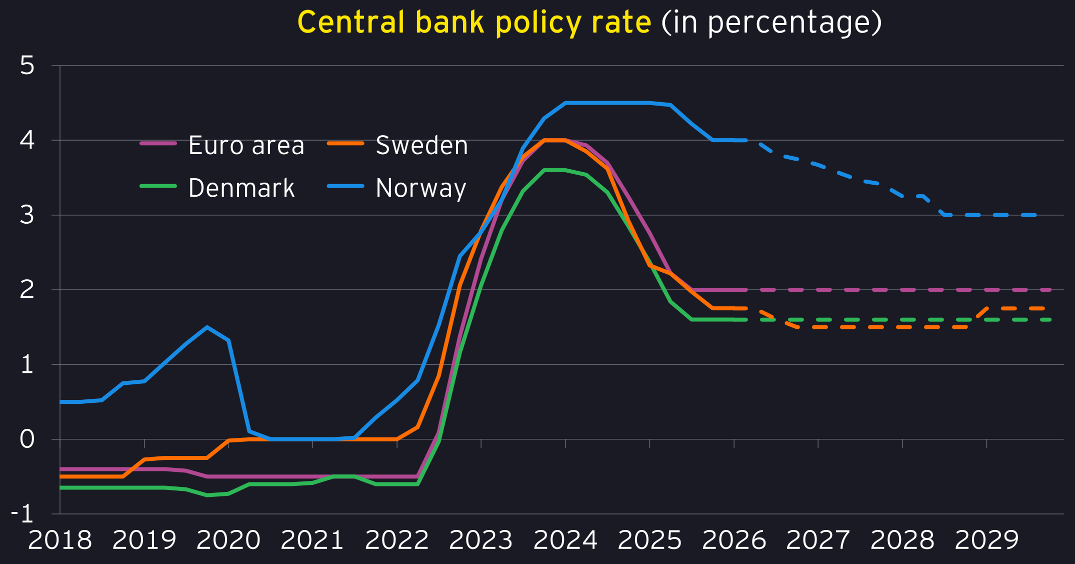


- **Economic conditions across the Nordics improved toward the end of 2025, though the recovery remained uneven.** In 2025 Q4, GDP growth was solid in Denmark and Norway, more moderate in Sweden, and close to flat in Finland, underscoring persistent cross-country differences in cyclical momentum. The upturn was driven mainly by household spending, as private consumption expanded across all four economies on the back of gradually improving real incomes. Residential investment stabilized, with its previously negative contribution largely fading.
- **At the same time, growth was partly constrained by inventory adjustments in several countries, adding volatility to quarterly GDP figures. Business investment remained subdued** outside Norway, limiting the strength of the recovery rather than acting as its primary drag. In Denmark and Norway, sector-specific developments continued to have a significant impact on headline GDP outcomes, making short-term fluctuations harder to interpret.
- **Despite firmer output growth, labor market conditions showed little improvement.** Employment growth remained weak, and unemployment stayed elevated—particularly in Sweden and Finland—indicating that the upturn has yet to translate into stronger labor demand. Much of the adjustment appears to be occurring through hours worked and productivity, rather than headcount. Nominal wage growth continued to slow in line with rising slack in labor markets.
- **Looking ahead, underlying growth across the Nordics is expected to strengthen gradually over 2026–29.** The recovery should remain primarily domestically driven, with private consumption supported by improving real incomes and only a slow recovery in residential investment from low levels. As demand conditions improve, business investment is expected to recover only gradually, rather than rebound sharply.
- Denmark and Sweden are expected to see GDP growth settle around 2% over the medium term. Finland is projected to converge toward similar rates from a weaker starting point. In Norway, weaker contributions from the oil sector are expected to hold back headline GDP growth, while mainland activity should remain relatively robust, supported by consumption and investment.
- Labor markets are expected to heal only gradually, with unemployment declining through 2029 instead of returning quickly to pre-tightening lows. Risks remain skewed toward confidence-sensitive components, particularly investment, while household demand appears more resilient given improving real incomes.

Source: Oxford Economics; EY EAT forecast.
* Underlying activity proxy is a sum of GDP in Sweden and Finland, mainland GDP in Norway and total consumption and non-business investment in Denmark.

Nordics: Inflation is to remain low across the region except in Norway. The Riksbank may deliver one additional rate cut, while an early-year inflation surprise keeps Norges Bank cautious



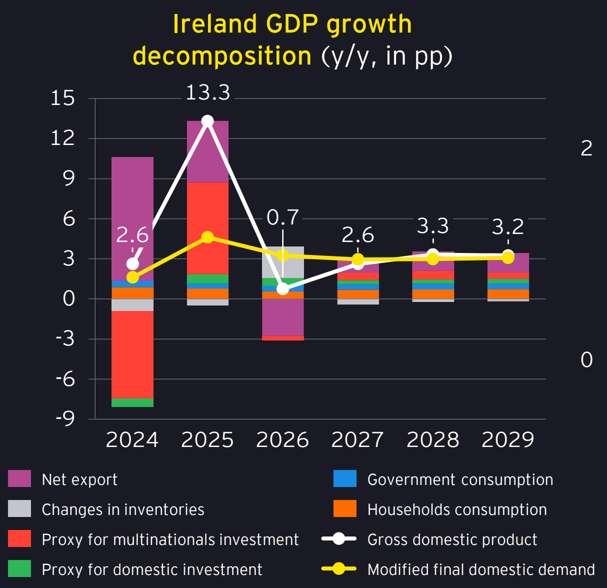


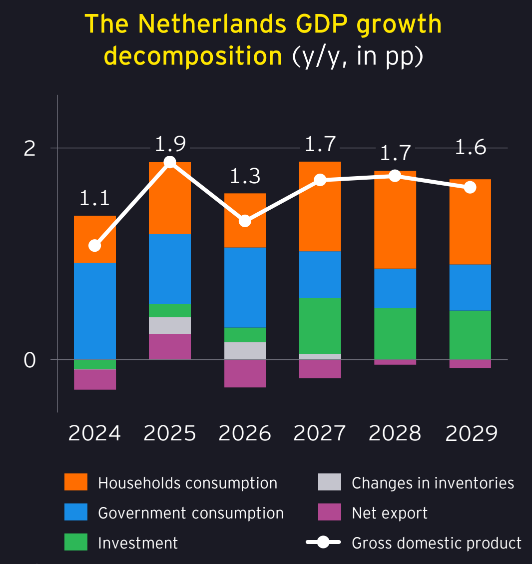
- **January 2026 brought significant inflation surprises across the Nordics.** Inflation fell sharply in Denmark and Finland, dropping to 0.8% (CPI) and 1.0% (HICP), respectively, from close to 2% in December. In Denmark, the decline was partly expected due to reduction in electricity taxes, but inflation excluding food and energy also weakened notably. In Finland, the surprise was driven by a fall in core inflation from 1.7% to 1.0%, as subdued demand and higher unemployment finally filtered through to price dynamics. In Sweden, headline inflation (CPIF) remained broadly unchanged at 2.0%, but this masked a substantial but likely temporary increase in electricity prices caused by severe winter weather and a sharp decline in core inflation (from 1.8% to 1.1%, HICP). Services inflation also eased markedly, reflecting last year's weak wage growth.
- **Norway remains the regional outlier.** Inflation excluding food and energy surprised to the upside, rising to 3.3% in January from 2.6% in December, pushing headline CPI to 3.5%. Stronger mainland activity, a tighter labor market, and **persistent services inflation have kept underlying price pressures elevated**, implying a slower convergence toward target than elsewhere in the Nordics.
- **These January outcomes reinforce our long-held view that inflation will undershoot targets across the Nordics, except in Norway.** Negative output gaps and elevated unemployment—particularly in Finland and Sweden—should keep wage growth and demand price pressures subdued, even when GDP growth accelerates, holding inflation excluding food and energy below 2% for an extended period. Regulatory changes will also support disinflation: alongside Denmark's reduction in electricity taxes, Sweden will lower VAT on food by 6 pp from April. As a result, we expect 2026 headline inflation to average 1.1-1.3% in Denmark (CPI), Sweden (CPIF), and Finland (HICP). Given stronger demand, Denmark is likely to return to 2% inflation relatively quickly, while Sweden and Finland should maintain low inflation through 2027, returning toward 2% only gradually in 2028-29. In contrast, Norway's recent upside surprise in services inflation suggests that core inflation will remain relatively high in 2026, even as headline inflation gradually eases.
- **We expect further rate cuts in Sweden and Norway.** The Swedish Riksbank has held its policy rate at 1.75% since September and has communicated that the easing cycle is complete. However, given our forecast of persistently low inflation, we expect policymakers to reassess this stance and deliver one additional 25bp cut later this year. Norges Bank has paused its easing cycle since September due to persistent domestic inflation pressures. We expect rate cuts in Norway to resume only in the second half of 2026, followed by a very gradual easing cycle toward a policy rate of around 3% over the medium term.

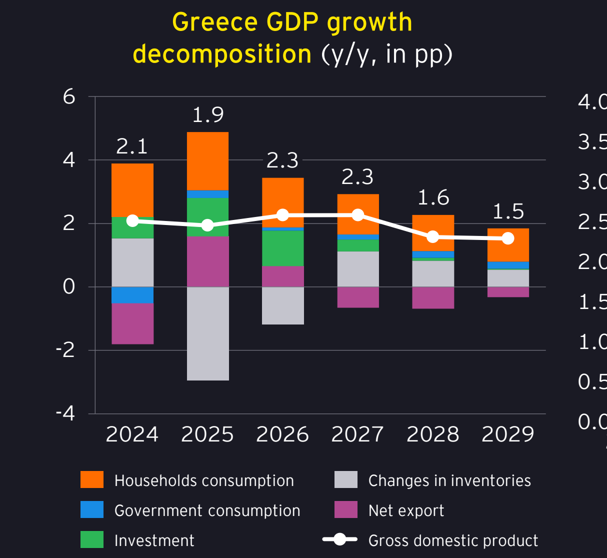
Source: Eurostat; Oxford Economics; EY EAT forecast.

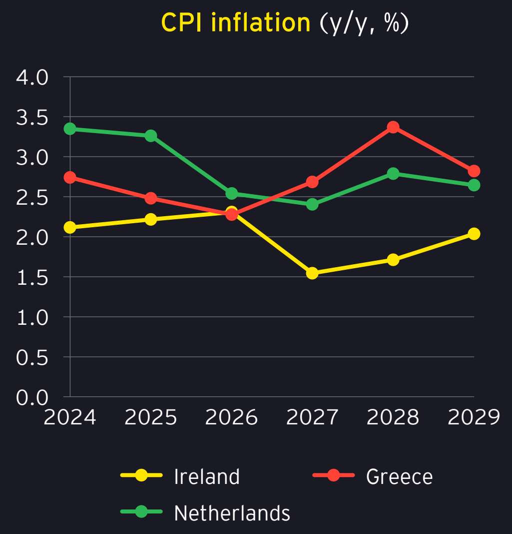
* Core inflation excluding food and energy. For Denmark and Norway, CPI. For Finland and Sweden, HICP, which excludes mortgage interest payments (unlike CPI for these countries)

Other euro area countries: Slight slowdown in the Netherlands, softer domestic momentum in Ireland, and a mild pickup in Greece









Source: EY EAT forecast.

The Netherlands:

- **GDP grew 1.7% y/y in 2025 Q4.** Private consumption continued to grow at a steady pace, while investment contracted. Government spending supported activity amid fiscal expansion. Net exports contributed positively to GDP, driven by a sharp acceleration in exports and a slower response in imports. **Looking into 2026, GDP growth is expected to slow to 1.3%** as exports and private consumption lose momentum following earlier gains, weighed down by US tariffs and slowing wage growth. **Growth should reaccelerate from 2027** onward as investment picks up.
- Inflation remains above target: CPI at 2.9% y/y and core at 3.0% in Q4, reflecting still-firm domestic and services-related pressures. Inflation is expected to ease only gradually through 2026-27, consistent with a slow normalization of wage and services dynamics.

Ireland:

- **In Q4 2025, GDP growth slowed to 6.7% y/y, though headline figures remain distorted by multinational activity:** investment surged (+31.6% y/y) and net trade subtracted from growth as imports rose faster than exports. As usual, Ireland is best assessed through domestic activity excluding the volatile footprint of multinationals. **On this basis, we estimate that modified final domestic demand rose 5.9% y/y, supported by: private consumption (+1.8% y/y), government spending (+3.0%), and still-strong investment growth (~20% y/y).** Modified final domestic demand growth is expected to moderate from 4.6% y/y in 2025 to around 3% in 2026, easing toward the mid-2% range by 2028–29. Investment growth should cool from earlier peaks, while consumption and employment are projected to continue expanding steadily, helped by ongoing immigration.
- Following an uptick in 2025 Q4, inflation is expected to ease gradually in 2026 but remain above 2% for most of the year, before falling below 2% thereafter on the back of subdued energy inflation.

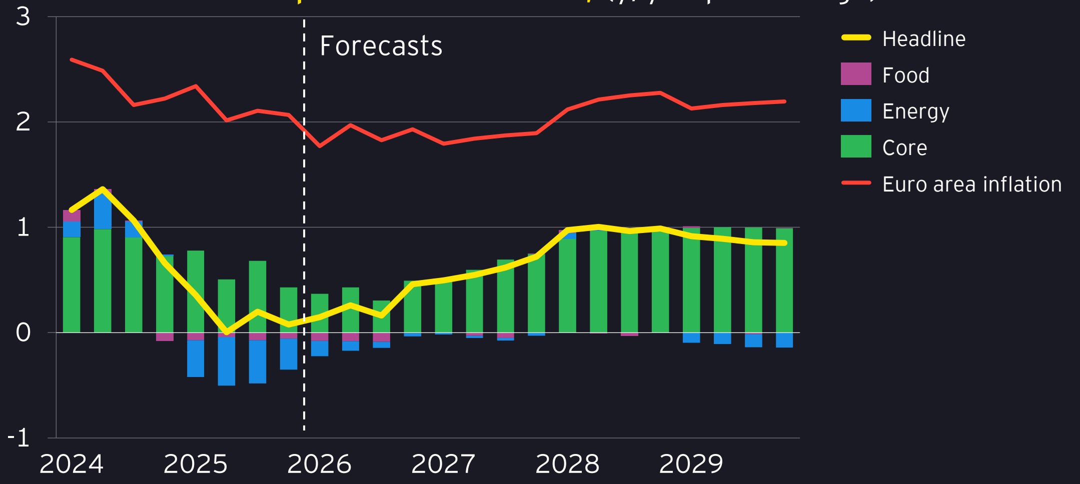
Greece:

- **Q4 GDP is not yet available, but we estimate growth at ~1.8% y/y.** Growth is broad-based, with positive contributions from private consumption, investment, and exports, partly offset by volatile inventory dynamics. **Looking ahead, Greece remains on a mid-2% growth path in 2026–27, though momentum is set to weaken as the investment cycle turns.** The fading of NGEU-funded investment will be only partially offset by other demand components. From 2028, growth is projected to slow further toward the mid-1% range as EU-funded support diminishes.
- Inflation remains above target. CPI was 2.3% y/y in Q4 and core inflation around 2.8%, driven by persistent domestic services pressures, while higher food prices contributed to headline inflation. We expect inflation to remain in the 2.3-2.6% range in 2026-27, briefly pick up in 2028 as energy inflation re-emerges due to ETS2-related carbon-pricing, and ease again in 2029.

Switzerland: GDP is expected to stagnate in early 2026 before recovering in 2027 as external demand and investment improve

Decomposition of GDP growth (y/y, in percentage)

Decomposition of inflation, (y/y in percentage)



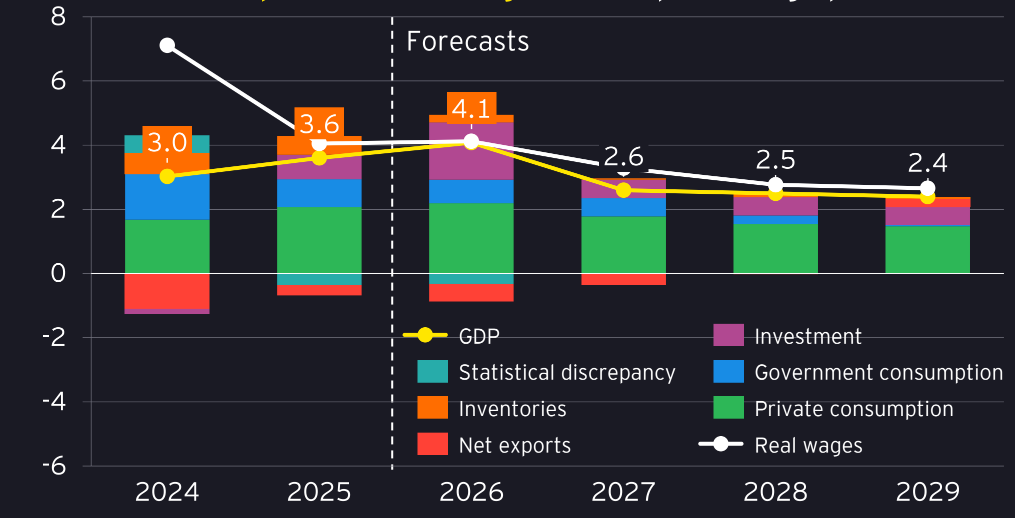
Source: Oxford Economics, EY EAT forecast.

- **Economic growth weakened sharply in the second half of 2025**, weighed down by US tariffs and negative base effects following the previous year's major sporting events.[1] Weak external demand and continued uncertainty surrounding global trade are expected to leave the Swiss economy stagnant in the first half of 2026, with a gradual recovery anticipated in the second half of the year.
- While 2025 GDP growth reached 1.2%, supported by steady consumer demand and inventory accumulation, **growth is forecast to slow to 0.5% in 2026. The economy faces a confluence of headwinds: the unwinding of last year's front-loaded exports ahead of US tariffs, already elevated inventories, which limit further stockbuilding, and subdued investment activity**. From late 2026 onward, these drags should begin to ease as euro area demand strengthens and investment accelerates, although destocking will remain a temporary headwind for growth.
- **Despite the trade agreement signed with the US in November, we continue to expect the introduction of US tariffs on pharmaceutical products**—a critical risk given that pharmaceuticals account for nearly half of Swiss exports to the US. These tariffs are likely to depress exports and manufacturing in the near term before conditions improve alongside global demand. Additionally, Switzerland's commitment to invest USD 200 billion in the US by 2030 is expected to divert part of domestic private investment abroad, further weighing on capital formation in the short run. At the same time, Switzerland continues to benefit from strong global demand for gold—its largest export category—supported by heightened geopolitical uncertainty and increased central bank purchases. This provides a partial buffer against weakness in other export sectors.
- **Inflation remains exceptionally low. Headline inflation has hovered close to 0% y/y**, at the bottom of the SNB's target range, reflecting the strong franc, cheaper imported goods, and falling energy prices. Core inflation eased to 0.5% y/y in January, signalling weaker price pressures in services amid low wage growth. We expect CPI inflation to rise gradually as the disinflationary impact of energy prices fades, but to remain below 1% (the midpoint of the SNB's target) until the end of 2027, given subdued demand and weak wage growth.
- **We expect the SNB will keep its policy rate at 0%**, while the structural appreciation trend of the CHF is likely to persist in an environment of elevated global uncertainty. A modest rate increase could occur in 2028 if inflation moves sustainably toward 1%, supported by firmer GDP growth.

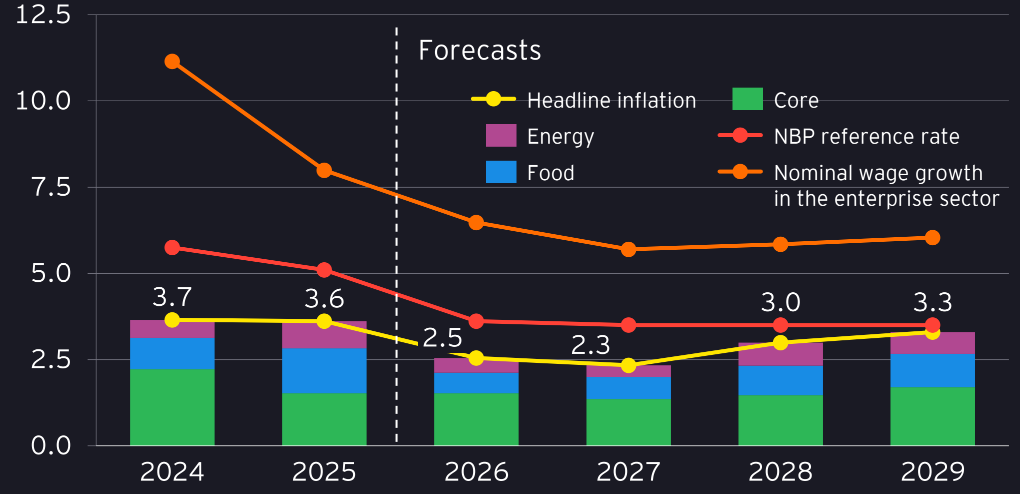
[1] The International Olympic Committee, FIFA, and UEFA are all located in Switzerland. Their revenue and the surge in activity and spending related to ticketing, licensing, and broadcasting for the Olympics, World Cup, and European Championships usually raise Swiss GDP growth by up to 0.5ppts in the years in which these events occur but cause a comparable drag on GDP the following years.

Poland: GDP growth expected to peak at 4.1% in 2026 before decelerating toward ~2.5%. With inflation near target, interest rates should stabilize at 3.5%

Decomposition of GDP growth (in percentage points)



Inflation, wage growth, and interest rates (in percentage)

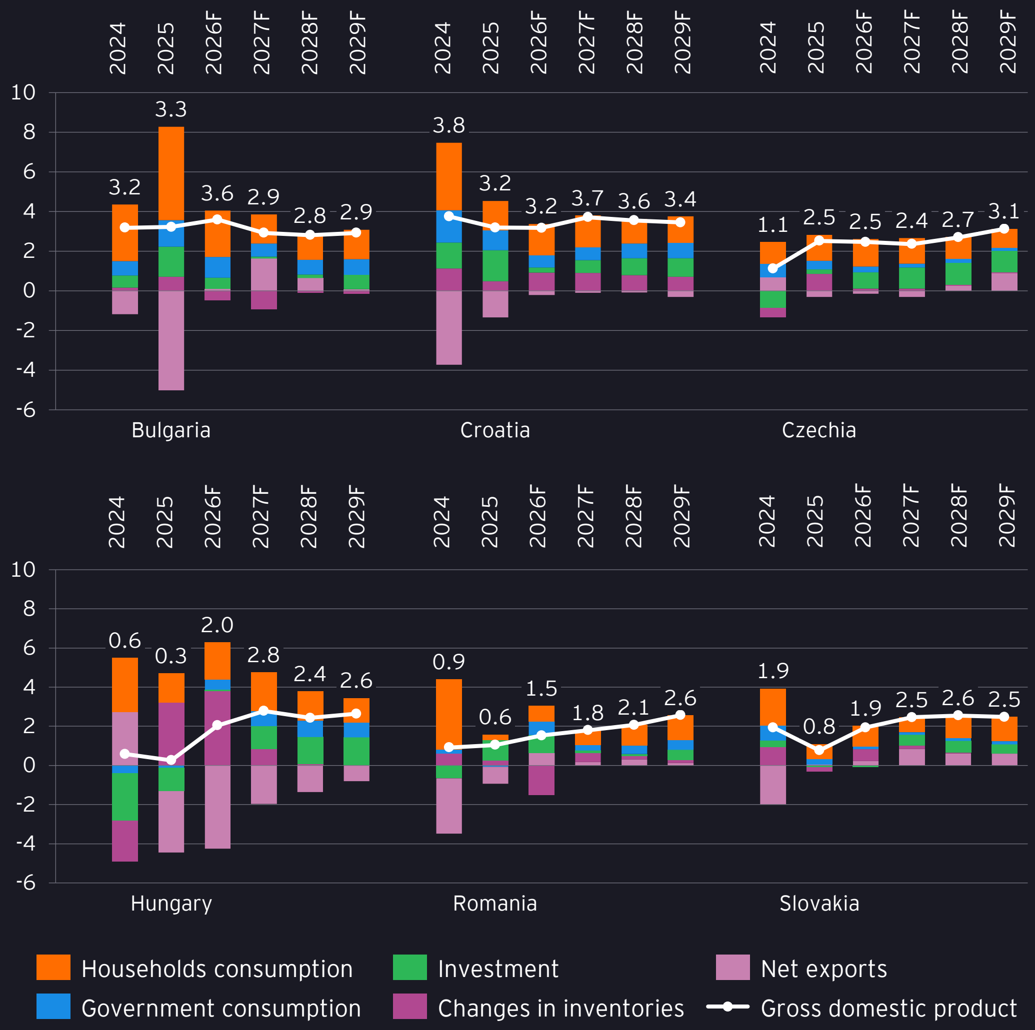


- **The Polish economy accelerated modestly in the second half of 2025, with broad-based growth approaching 4% y/y.** In chain-linked volume terms, GDP expanded by 1.0-1.1% q/q and 3.8-3.9% y/y, slightly faster than in earlier quarters. Private consumption remained the main driver, strengthening to 4.0% y/y as households responded—albeit with a delay—to earlier increases in real incomes. Government consumption continued to grow at a robust 4-5%, and investment picked up to ~6.5% y/y, supported by inflows from the EU Recovery Fund. Exports accelerated to ~5.5% y/y, demonstrating resilience despite increased labor costs, a strong PLN, and US tariffs. Increased domestic and external demand pushed imports up to 6% y/y.
- **While Q1 2026 may look weak due to harsh winter conditions, we expect momentum to remain solid throughout 2026, with GDP growth averaging 4.1%.** Private consumption should remain strong (3.9% y/y), benefiting from robust real wage growth and significant household saving buffers. Investment is projected to surge by 9.7%, as authorities accelerate spending from the EU Recovery Fund ahead of the end-2026 deadline. Exports should slow due to US tariffs, preventing growth from rising more significantly above 4%.
- **Growth is expected to slow substantially from 2027 as fiscal impulses fade and demographic pressures intensify.** The end of Recovery Fund spending will likely trigger a temporary dip in investment in 2027, despite continued support from military spending and "regular" EU funds. Elevated deficits (around 7% of GDP in 2025) imply that government consumption should also slow, especially after the 2027 parliamentary elections. A declining working-age population will reduce labor supply, limiting potential growth even as productivity growth continues to outpace Western Europe. Against this background, we expect growth to stabilize around 2.5% in 2027-29.
- **Inflation has returned to the 2.5% target.** Headline inflation eased to 2.2% in January (preliminary estimate), supported by moderating food inflation and a continued decline in core inflation, which fell to 2.7% in December, helped by slowing wage growth, PLN appreciation, and lower global energy prices. **We expect inflation to stabilize in the coming quarters, with headline inflation averaging 2.5% in 2026 and 2.3% in 2027.** In 2028, inflation may rise as the planned ETS extension pushes energy prices higher.
- As inflation approached target, the Monetary Policy Council continued lowering the reference rate, which reached 4.0% in December. Policymakers paused In January and February while awaiting new inflation data. **We expect two additional 25 bp cuts in March and April, bringing the rate to 3.5%, after which interest rates should stabilise.**

Source: Oxford Economics, EY EAT forecast.

Other CEE countries*: GDP growth is expected to remain moderate. Inflation is easing or stabilizing, enabling gradual rate cuts in Romania and Hungary.

Decomposition of GDP growth (y/y, in percentage)

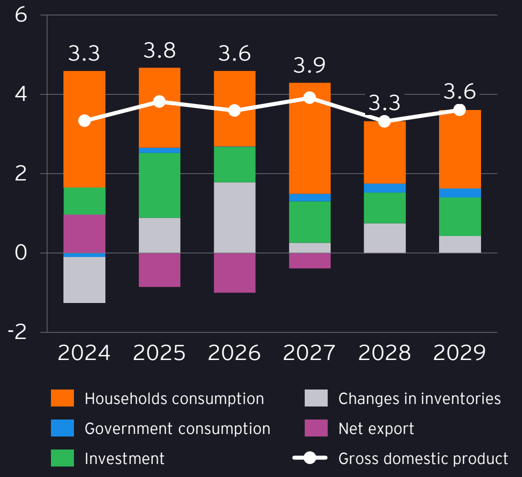


- **GDP performance in 4Q 2025 was mixed across the region. Romania stagnated in y/y terms,** reflecting a sharp loss of momentum late in the year. **Hungary and Slovakia continued to underperform**, with GDP rising only 0.5% and 0.8% y/y, respectively, amid subdued domestic demand driven by fiscal consolidation (and weak exports in Hungary). **Czechia and Bulgaria remained relative bright spots,** posting solid growth of 2.4% and 2.9% y/y, supported by domestic demand. Croatia surprised positively: after a softer Q3, growth rebounded to 3.3% y/y in Q4, with strong support from private consumption.
- **Looking ahead to 2026–2029, growth across the region is expected to remain moderate, with countries following distinct trajectories rather than a synchronized regional cycle**. In Romania, growth is likely to remain driven primarily by domestic demand but constrained by ongoing fiscal tightening. Hungary is projected to rebound in 2026, supported by a gradual recovery in fixed investment after a prolonged downturn. In Slovakia, GDP growth should accelerate in 2026 as household demand strengthens, despite fiscal drag. Czechia is expected to maintain a balanced growth profile, with consumption and investment contributing evenly and external trade remaining broadly neutral. In Bulgaria and Croatia, GDP growth is likely to stay above the regional average, supported by broad-based domestic demand.
- **Inflation is expected to decline or stabilize over 2026–2029**. In Romania, base effects from last year's energy price and VAT hikes will produce a visible drop in headline inflation in Q3, although core pressures should remain elevated. In Hungary, inflation is expected to ease only gradually in 2026 before inching up slightly thereafter. In Czechia, where inflation has already converged close to target, the outlook points to stabilization. In Slovakia, weaker demand and fiscal consolidation should support gradual disinflation in 2026-27. Fears of euro-related price spikes in Bulgaria were not confirmed by January CPI data, but underlying price pressures imply only a gradual decline in inflation. Across the region, EU ETS reform remains the key medium-term risk, expected to push up energy prices and reintroduce upward pressure on headline inflation around 2028.
- In Romania, elevated early-year inflation limits room for monetary policy easing, but rate cuts are still expected from Q2. Hungarian MNB restarted its easing cycle in February, but is likely to proceed cautiously, balancing easing headline inflation against still-high core pressures. **We expect the MNB to deliver a total of 100 bps of easing in 2026 and a further 150 bps in 2027, while Romania is likely to cut rates by 50 bps this year and around 100 bps in 2027**. In Czechia, monetary policy is in fine-tuning mode, with small adjustments expected as driven by inflation stabilizing near target.

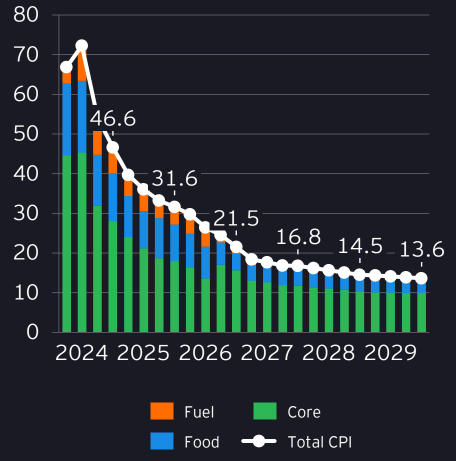
Source: EY EAT forecast.
* Poland is not included to avoid overlap with the previous slide.

Turkey and Kazakhstan: Turkey maintains moderate growth amid gradual disinflation; Kazakhstan is expected to slow after 2025, with investment and oil exports continuing to support growth

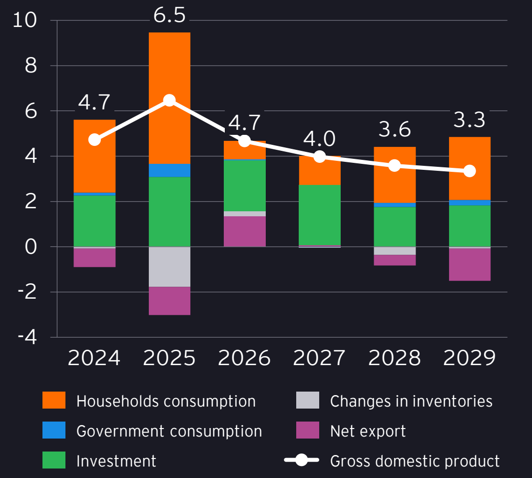
Turkey GDP growth decomposition (y/y, in pp)



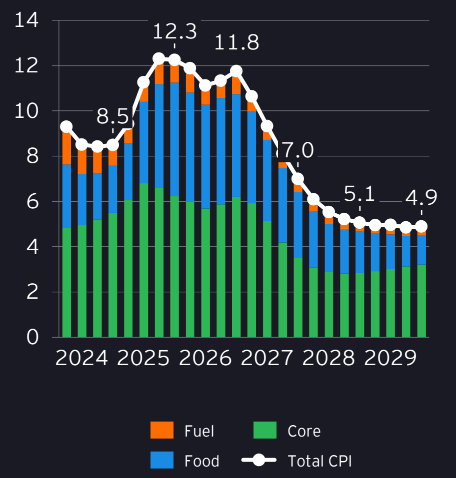
Turkey CPI growth decomposition* (y/y, in pp)



Kazakhstan GDP growth decomposition (y/y, in pp)



Kazakhstan CPI growth decomposition* (y/y, in pp)



* For chart clarity, data labels only for 4Q of each year are shown.

Source: EY EAT forecast.

Turkey:

- **Economic growth in 2025 Q4 appears to have remained moderate.** Activity continued to be supported by domestic demand, although high inflation and restrictive financial conditions limited the strength of the recovery. Investment played a somewhat larger role than consumption, while net exports continued to subtract from GDP growth. Disinflation progressed throughout the year, driven mainly by easing pressures in energy and core goods prices. However, services inflation remained elevated, pointing to persistent price inertia. Monetary conditions stayed firmly restrictive despite cautious rate cuts late in the year, and relative exchange-rate stability against the euro helped contain additional inflationary pressures.
- **Growth is expected to remain in the 3-4% range as potential growth is lower than in previous cycles due to less favorable demographics.** In 2026, GDP growth should remain broadly in line with its 2025 pace. Private consumption is forecast to remain a key driver, supported by gradual disinflation and improving real incomes. Investment should make a secondary contribution, while net exports are expected to remain a modest drag. The pace of growth is likely to increase in 2027, supported by an expected rise in social benefits and public sector wages ahead of parliamentary elections. Inflation and interest rates should decline only gradually. While disinflation will progress, we do not expect a return to full price stability under the current monetary policy framework. The lira is expected to depreciate in an orderly manner.

Kazakhstan:

- **Growth in 2025 Q4 continued at a robust pace**, driven primarily by investment, supported by large-scale infrastructure programs and fiscal stimulus. Oil exports also remained elevated, reflecting earlier expansions in production capacity. Net exports continued to subtract from growth, highlighting the import-intensive nature of domestic demand. Meanwhile, inflation remains high, driven by both food and core prices.
- **Growth is expected to moderate in 2026 as the policy stance becomes less supportive.** Tighter financial conditions and fiscal consolidation are set to dampen domestic demand. The VAT increase implemented at the start of the year is likely to constrain household spending, reducing the contribution of private consumption to growth. As a result, capital expenditure—particularly in infrastructure and energy—should remain the main driver of activity. The contribution of net exports is expected to improve temporarily as weaker domestic demand curbs import growth, while oil exports remain broadly stable. Monetary policy will likely remain tight through most of 2026, with easing proceeding only cautiously once disinflation becomes more entrenched. Medium-term growth is projected at 3.5–4%, with the growth profile gradually becoming more balanced as consumption recovers alongside easing inflation.

Summary: GDP and inflation forecasts

GDP (% y/y)

Location	2023	2024	2025	2026 F	2027 F	2028 F	2029 F
Bulgaria	1.7	3.2	3.2	3.6	2.9	2.8	2.9
Croatia	3.7	3.8	3.2	3.2	3.7	3.6	3.4
Czechia	0.2	1.1	2.5	2.5	2.3	2.6	3.1
Denmark	0.6	3.5	2.9	2.2	2.3	2.3	2.4
European Union	0.5	1.0	1.6	1.5	1.6	1.6	1.6
Euro area	0.5	0.8	1.5	1.3	1.4	1.5	1.5
Finland	-1.3	0.4	0.1	1.1	1.9	1.8	1.9
France	1.6	1.1	0.9	1.3	1.1	1.4	1.3
Germany	-0.7	-0.5	0.4	0.6	1.2	1.2	1.3
Greece	2.1	2.1	1.9	2.3	2.3	1.6	1.5
Hungary	-0.7	0.6	0.3	2.0	2.8	2.4	2.6
Ireland	-2.6	2.6	13.3	0.7	2.5	3.2	3.2
Italy	1.1	0.5	0.6	1.0	0.7	0.7	0.9
Kazakhstan	5.1	4.7	6.5	4.7	4.0	3.6	3.3
Netherlands	-0.6	1.1	1.9	1.3	1.7	1.7	1.6
Norway	0.6	1.4	1.2	1.7	1.8	1.8	1.6
Poland	0.2	3.0	3.6	4.1	2.6	2.5	2.4
Romania	2.3	0.9	0.6	1.5	1.8	2.1	2.6
Slovakia	2.1	1.9	0.8	1.9	2.5	2.6	2.5
Sweden	0.0	0.9	1.7	2.1	1.9	1.9	1.9
Switzerland	0.9	1.4	1.2	0.5	1.5	1.7	2.0
Turkey	5.0	3.3	3.8	3.6	3.9	3.3	3.6
United Kingdom	0.3	1.1	1.3	0.9	1.3	1.4	1.4

Inflation* (yearly average, % y/y)

Location	2023	2024	2025	2026 F	2027 F	2028 F	2029 F
Bulgaria	9.5	2.4	4.6	3.4	2.1	2.5	3.1
Croatia	7.9	3.0	3.7	3.2	2.5	3.3	2.8
Czechia	10.6	2.4	2.5	1.8	2.4	2.7	2.4
Denmark	3.3	1.4	1.9	1.1	2.1	2.5	2.0
European Union	6.4	2.6	2.4	2.0	1.9	2.3	2.2
Euro area	5.4	2.4	2.1	1.9	1.9	2.2	2.2
Finland	4.3	1.0	1.9	1.3	1.3	1.8	1.7
France	4.9	2.0	0.9	1.2	1.2	1.7	1.8
Germany	5.9	2.3	2.2	1.8	2.1	2.4	2.4
Greece	3.5	2.7	2.5	2.2	2.6	3.2	2.7
Hungary	17.1	3.8	4.4	3.0	3.5	4.0	3.7
Ireland	6.3	2.1	2.2	2.3	1.5	1.6	1.9
Italy	5.6	1.0	1.5	1.5	1.6	1.8	1.6
Kazakhstan	14.5	8.7	11.3	11.5	8.7	5.5	4.9
Netherlands	3.8	3.3	3.3	2.5	2.3	2.7	2.5
Norway	5.5	3.1	3.1	3.0	2.3	2.9	2.5
Poland	11.4	3.7	3.6	2.5	2.3	3.0	3.3
Romania	10.4	5.6	7.3	6.4	3.1	3.4	2.8
Slovakia	10.5	2.8	4.0	3.4	2.3	3.2	2.7
Sweden	6.0	1.9	2.6	1.3	1.3	1.9	1.4
Switzerland	2.1	1.1	0.2	0.3	0.6	1.0	0.9
Turkey	53.9	58.5	34.9	25.3	17.4	15.3	14.0
United Kingdom	7.3	2.5	3.4	2.5	2.2	2.0	2.0

Source: EY Forecasts
CPIF for Sweden, HICP for Finland, the euro area and the EU; CPI for others.

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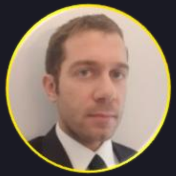

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Forecast and country-specific outlook sources

- Forecasts for most economies have been prepared by EY Economic Analysis Team (EY EAT) using an amended version of the Oxford Global Economic Model (GEM)
  - EY EAT have adjusted GEM equations, assumptions and data inputs
- Forecasts for the US have been prepared by EY-Parthenon Macroeconomics Team
  - Contact: https://www.ey.com/en_us/strategy/macroeconomics
- Forecasts for the UK have been prepared by EY ITEM Club
  - Contact: parnold@uk.ey.com
- Forecasts for Italy in 2026 have been prepared by EY Italy
  - Contact: alberto.caruso@it.ey.com
- Country-specific outlooks for Germany, Italy, Spain, and UK have been provided by economists listed on page 95.

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