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European Economic Outlook

What will the tariffs bring?

EY Economic Analysis Team

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Topics

U.S. tariffs cast a shadow over the European economy, but their current impact is limited. The EU is experiencing modest growth, with Poland and Spain leading the way*, while Germany lags behind.

Economic impact of trade tariffs:

- **A key theme in recent months for both the European and global economies has been the U.S. government's shift in trade policy.** The U.S. administration has applied a tariff to most goods from all countries, alongside additional tariffs on imports from Canada, Mexico, as well as on steel, aluminum, and motor vehicles. Although retaliation from other nations has been limited, these rapid fluctuations in tariff rates have resulted in the highest effective tariff levels since World War II, significantly increasing economic uncertainty.
- **The impact of these tariffs on trade relationships is complex. While uniform tariff rates apply to most countries, effective rates vary considerably due to sectoral exemptions and differences in export structures.** The most significant impact is expected on China, where initial tariffs exceeded 100% on exports, but ongoing negotiations have reduced this to the estimated effective rate of 25%. In Europe, countries heavily reliant on automobile manufacturing or steel production, such as Slovakia, Luxembourg, Hungary, and Romania, are particularly vulnerable to U.S. trade policies.
- **Under our baseline scenario, tariffs are projected to reduce GDP growth in the EU by approximately 0.5 percentage points next year. This negative impact would double if President Donald Trump's recent threat to impose a 50% tariff on goods from the EU were to come into effect. However, these negative effects are expected to fade in the long term.** The decline in GDP would primarily result from reduced exports and investment, with a limited impact on private consumption. Additionally, the global economic slowdown and increased uncertainty are likely to lead to a drop in commodity prices, particularly oil. This decline, coupled with subdued economic activity, will be disinflationary. Central banks are expected to remain cautious in the short term due to increased uncertainty but may reduce interest rates further in the medium term.

Economic activity in recent quarters:

- **The euro area's economy has continued to expand at a modest quarterly rate of 0.2-0.4% q/q.** Growth disparities persist among EU countries, with Poland, Croatia, and Spain leading in GDP growth, while Germany and several Central and Eastern European nations (Austria, Romania, Hungary) face stagnation. The manufacturing sector is struggling in underperforming countries, with exports and investment contracting as a result.
- **Private consumption has gained momentum in the latter half of 2024**, becoming a key driver of growth alongside steady government spending and a recovering inventory cycle. Growing real incomes are finally translating into increasing consumer spending, although saving rates remain elevated. Despite decreasing interest rates and increasing external demand, investment and exports continue to stagnate, with housing investment contracting even further. The challenges in these categories can be attributed to ongoing tariff-related uncertainties, stagnant profits, and reduced capacity utilization.
- **Manufacturing activity appears to be stabilizing**, although production continues to decline in key sectors such as automotive and energy-intensive industries. The pharmaceutical sector remains a standout performer. The services sector is experiencing modest to moderate expansion, particularly in consulting and ICT.
- **Employment growth in the euro area is declining**, accompanied by a decrease in vacancy rates, indicating a cooling labor market. Although nominal wage growth has gradually slowed, it continues to exceed the rates aligned with the 2% inflation target. The primary driver of this deceleration in wage growth is the reduction in inflation, while tight labor market conditions are sustaining elevated wage levels.

* We focus on large and medium-sized economies. Among other EU countries projected to experience significant growth in 2025 are Ireland, which shows considerable GDP volatility due to the substantial influence of multinational corporations on its economy, as well as Malta and Croatia, both of which are smaller economies.

In 2025, we anticipate a modest rebound in the eurozone, with growth projected at 1.1% y/y. Inflation is expected to remain close to 2% y/y.

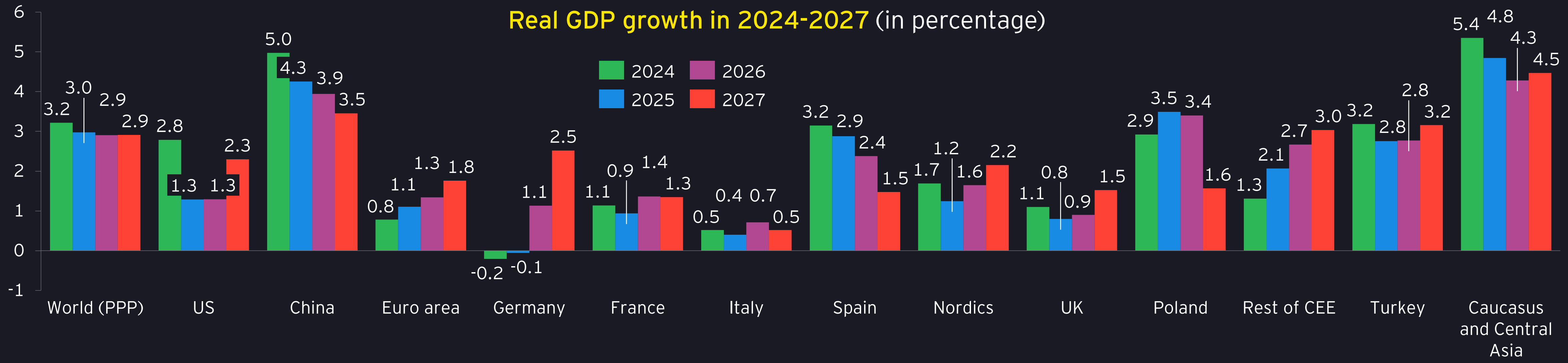
GDP growth outlook

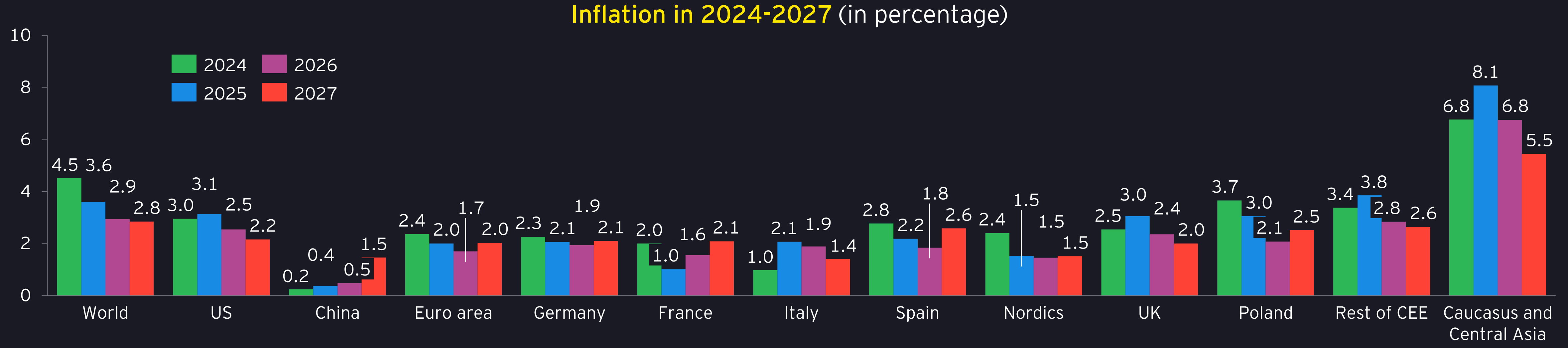
- **The imposition of tariffs, along with the associated uncertainty, has led us to revise our GDP forecasts for the eurozone for the current year, decreasing the projection from 1.3% y/y (as per our January outlook) to 1.1% y/y.** The forecast for the following year has been further downgraded from 1.8% y/y to 1.3% y/y. Exports and investment are expected to be the most adversely affected by these tariffs and the prevailing uncertainty; however, the negative impact may be partially mitigated by lower interest rates and fiscal expansion measures in Germany.
- Nevertheless, when compared to last year's growth rate of 0.8% y/y, our forecast for 2025 can still be considered a rebound in growth. **Factors previously identified as key contributors to growth, such as lower interest rates, NextGenerationEU spending, and stronger consumer demand, remain in place.** Additionally, a new factor has emerged: the easing of German fiscal policy. While the effects of this recent measure may not be immediately evident in this year's growth figures, its impact is anticipated to become significantly more pronounced in the longer term.
- **Performance disparities among countries are expected to persist**. We project Spain's GDP to grow by 2.9% in 2025, while Germany's growth is anticipated to remain weak at -0.1%. Other major EU countries show minimal variation compared to last year, with France's growth forecast at 0.9% y/y (down from 1.1% y/y in 2024) and Italy at 0.4% y/y (down from 0.5% y/y in 2024). Central and Eastern European (CEE) countries are likely to experience relatively high growth, with Poland and Bulgaria projected to achieve GDP growth of 3.5% and 2.8% y/y, respectively. The Nordic countries are also anticipated to experience a slight rebound in underlying economic activity, although this will not be uniform across the region.

Inflation outlook:

- **According to data for April, headline and core inflation in the euro area remain slightly above 2%, driven by elevated services inflation**. Recent declines in commodity prices and euro appreciation have contributed to reduced costs for food and energy products. However, inflation rates across Europe are diverging, influenced by disparities in wage growth and regulatory pricing.
- **The inflation outlook remains broadly unchanged. We anticipate that euro area headline inflation will hover around 2% throughout 2025**. Core inflation is expected to be slightly higher than our previous forecasts (though still declining to 2.4% y/y by the end of the year), but this will be offset by lower commodity prices. Simultaneously, inflation for food, alcohol, and tobacco may remain elevated at approximately 2.9%, driven by past supply shocks and tax increases. By 2026, both headline and core inflation are projected to stabilize around 2% and remain close to these levels throughout 2027 and 2028.
- **The inflation landscape beyond the eurozone exhibits considerable divergence**. In CEE, some countries, such as the Czech Republic and Poland, are anticipated to make progress towards their inflation targets, while others, including Romania and Bulgaria, will remain significantly distant from these targets, primarily due to ongoing core inflation challenges. The Nordic countries and Switzerland are expected to experience the least price pressure. Elevated inflation will continue to present challenges in the Caucasus and Central Asia.

GDP growth and inflation forecasts





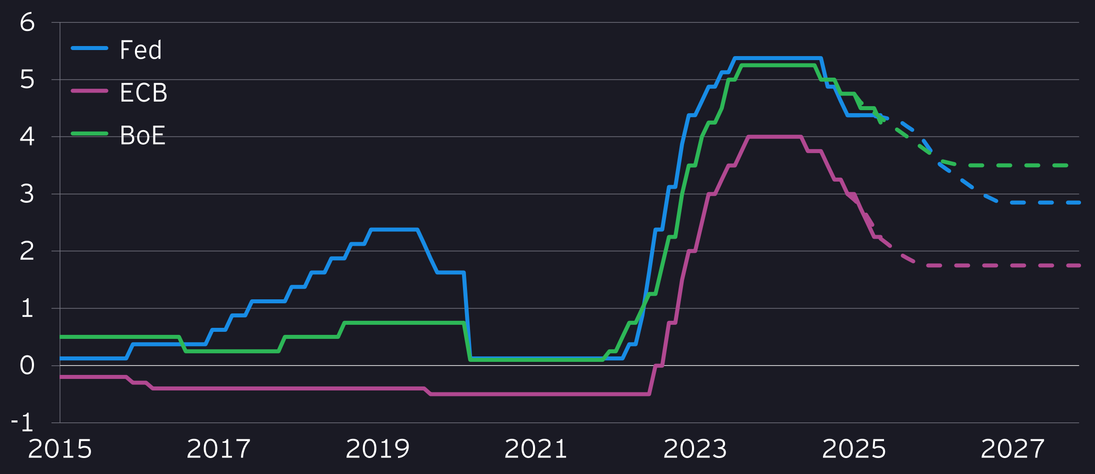
Source: Oxford Economics, Eurostat, EY EAT forecast, IMF (for Caucasus and Central Asia).
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Estonia, Latvia, Lithuania, Czechia, Slovakia, Hungary, Romania, Bulgaria, Croatia, Slovenia; Caucasus and Central Asia includes Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan, Azerbaijan, Armenia and Georgia.

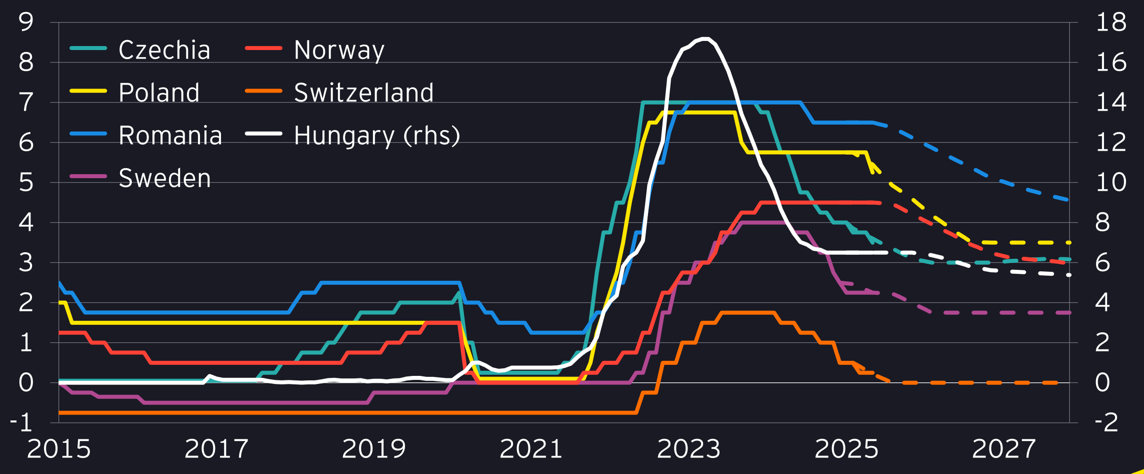
The ECB is likely concluding its cutting cycle, while monetary policy easing continues at varying rates across Europe, resulting in persistent disparities in interest rates.

Monetary policy:

- In response to modest GDP growth, stable price pressures, and global trade risks, the ECB reduced interest rates by 25 basis points at each meeting this year, bringing the deposit rate to 2.25% in April. We expect two more cuts, reaching a terminal rate of 1.75% by September.
- The Bank of England has maintained its cut-and-hold strategy by reducing rates at every other meeting, with the bank rate reaching 4.25% in May. We anticipate three additional cuts of 25 basis points each over the next three quarters.
- The Swiss National Bank continued to ease monetary policy, lowering the policy rate to 0.25% in March. We expect one more cut at the next meeting. In contrast, the Swedish Riksbank has maintained its rate at 2.25% since January, while the Norges Bank has kept its rate at 4.5% due to rising food inflation, delaying any monetary easing.
- Monetary policy diverges across Central and Eastern Europe, with the Czech National Bank easing at a slower pace and possibly nearing the end of its rate cuts. The central banks of Hungary and Romania have maintained rates at 6.5% since late 2024 amid rising price pressures and political uncertainty, and are expected to keep this stance until at least Q4 2025. Conversely, the National Bank of Poland cut rates by 50 basis points in May after lower-than-expected inflation. Although this was presented as a one-off recalibration of monetary policy, we expect further cuts totaling 75 basis points this year and 100 basis points next year.
- The Turkish central bank halted its easing cycle, raising rates by 3.5 percentage points to 46% following the detention of Istanbul’s mayor, which led to capital outflows. Meanwhile, Kazakhstan increased rates by 1.25 percentage points to 16.5% due to rising inflation, likely maintaining this level through the end of the year.

Central bank interest rates (In percentage)





Source: Oxford Economics, ECB, Fed, BoE, BIS, stooq.pl, EY EAT forecast.
For Hungary, BUBOR 1M interbank rate.

Chapter 1

Economic impact of trade tariffs

Over the past few months, the U.S. administration has imposed tariffs on imports from China, Canada, Mexico, as well as on steel, aluminum, and motor vehicles. Additionally, a 10% tariff has been applied to most goods from all countries. So far, retaliation from other nations, excluding China, has been limited.

US tariff threats and actions

Target	Tariff	Status
China	20% on goods (with some exceptions, esp. electronics)	Took effect on May 13
China	145% on goods (with some exceptions, esp. electronics)	Paused until August 12
Canada, Mexico	25% on goods not covered by the USMCA; 10% on Canada energy; 10% on Canada and Mexico potash	Took effect on March 4
All nations but Canada and Mexico	10% on most goods, except pharmaceuticals, semiconductors, lumber, copper, electronics, and goods covered by sectoral tariffs	Took effect April 5 (exemption for smartphones, computers and other electronics on April 11)
All nations	25% on steel and aluminum	Took effect on March 12
All nations	25% on cars and auto parts (with some exceptions)	Took effect on May 3 (exemption for USMCA compliant goods)
All nations	Tariffs on pharmaceuticals, semiconductors, lumber, copper, movies produced outside the US	Investigated under Section 232, not effective
All nations that import Venezuelan, Iranian or Russian oil	25-50% on all goods	Threatened, not effective
~ 50 nations	"Reciprocal" tariffs (country-specific rates higher than 10%, e.g., 20% on EU, based on trade deficit)	Paused until July 8
EU	"Reciprocal" 50 % tariffs	Paused until July 9

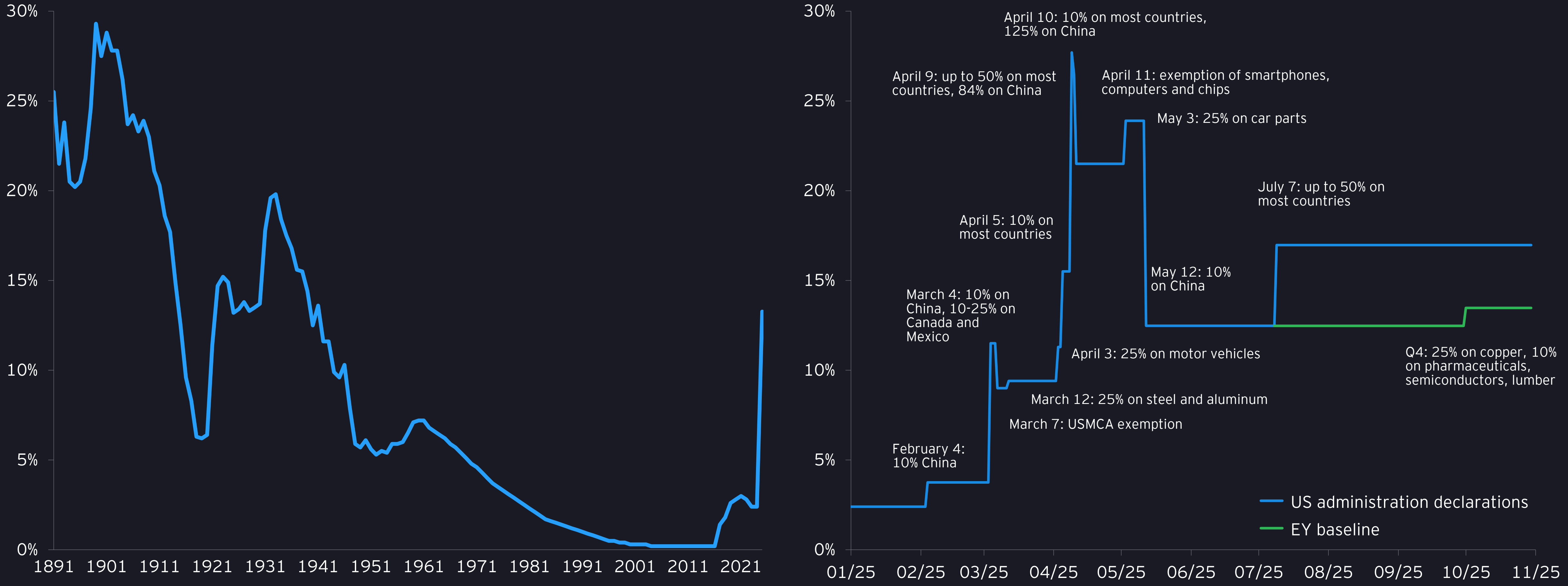
Retaliatory threats and actions

Country	Tariff	Status
China	10% on goods (with some exceptions)	Took effect on May 13
China	125% on goods (with some exceptions)	Paused until August 12
China	Non-tariff countermeasures	Paused until August 12
Canada	25% tariffs products totaling $29.8 billion (e.g., steel, aluminum), 25% tariffs on non-USMCA compliant vehicles; additional tariffs on $30 billion in goods	Partly paused until October 15 (with some exceptions)
Mexico	Threats on retaliatory tariffs (without details)	Threatened, not effective
EU	~ 25% on various goods (total amount of US imports worth up to 21 billion EUR)	Paused until July 8
EU	Additional tariffs on various goods (total amount of US imports worth up to 95 billion EUR)	Threatened, not effective (in public consultation)

Source: EY-Parthenon Macroeconomic Executive Briefing, governments websites.

Tariffs have been changing rapidly, and while they have been reduced recently, the expected effective tariff rate in the U.S. remains at its highest level since World War II.

Average effective tariff rate in the US
(in percentage)

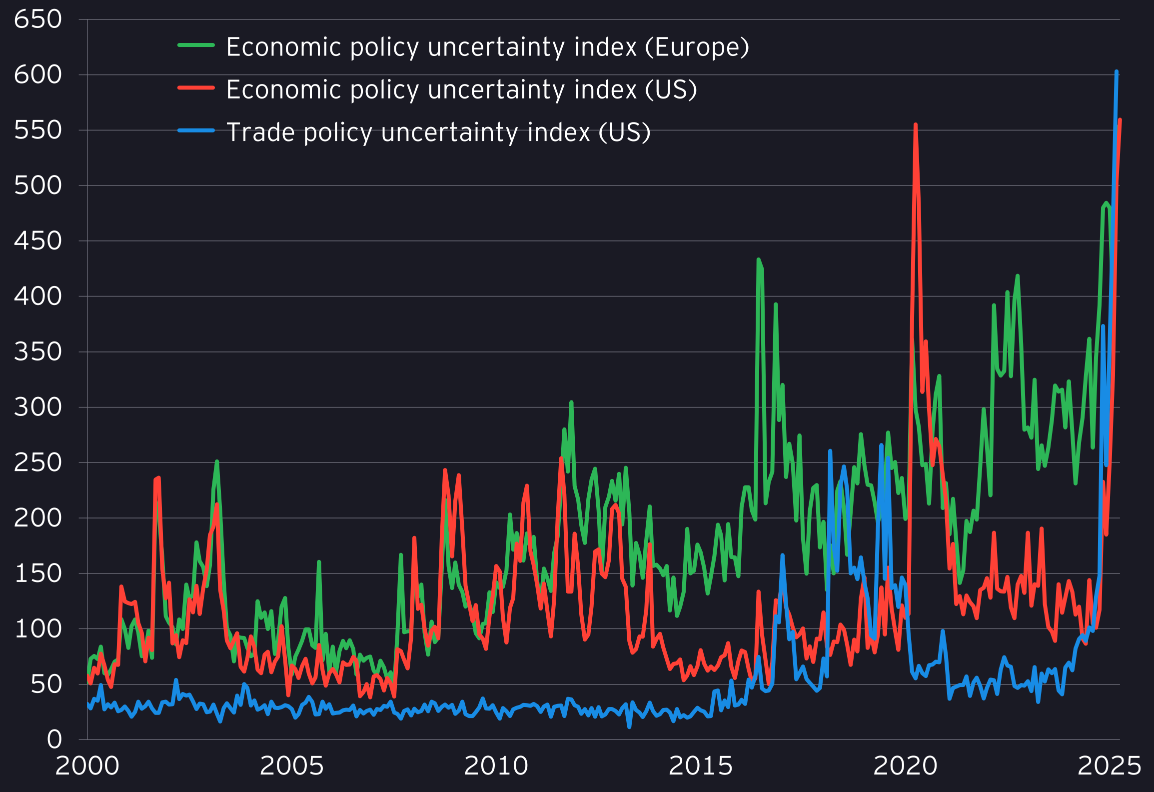


Source: EY EAT calculations, FRED, Oxford Economics.

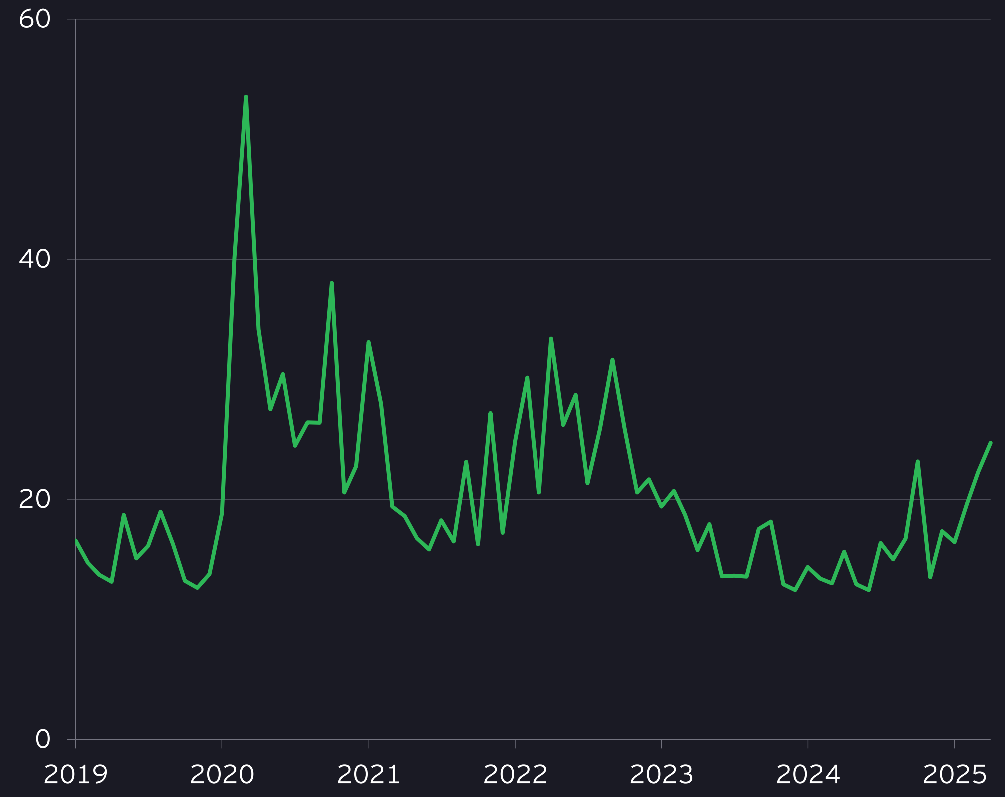
As a result of unprecedented volatility in trade policy and the scale of the shock, the perception of uncertainty has increased significantly.

- While uncertainty related to economic policy is at a record high, overall economic uncertainty, as indicated by the VIX, remains lower than during previous shocks
- Nevertheless, the rise in uncertainty and the associated tightening of financing conditions are key channels for the transmission of the trade shock, alongside the direct impact of tariffs on trade.

Economic and trade policy uncertainty indices



S&P 500 Volatility Index

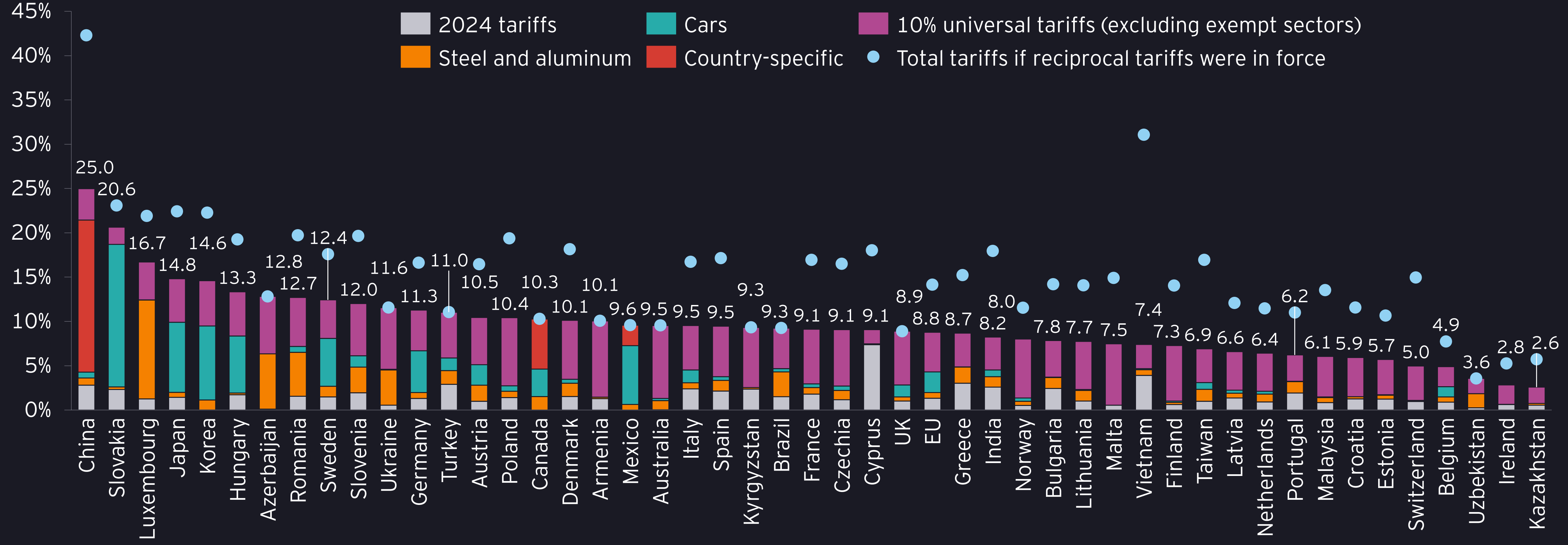


Source: FRED, investing.com.

Although the same tariff rates currently apply to most countries, excluding China, Mexico, and Canada, effective tariff rates vary significantly due to sectoral exemptions and differences in the sectoral structure of exports.

- The US initially imposed an effective tariff rate exceeding 100% on Chinese exports. However, bilateral negotiations have facilitated a de-escalation of the conflict, resulting in a reduction of tariffs to an effective rate of 25%.
- Other countries experiencing a significant increase in tariff rates include those with a relatively large share of their exports to the U.S. concentrated in the automotive industry (Slovakia, Japan, Korea, Hungary) or in the steel and aluminum sectors (Luxembourg, Azerbaijan, Romania).

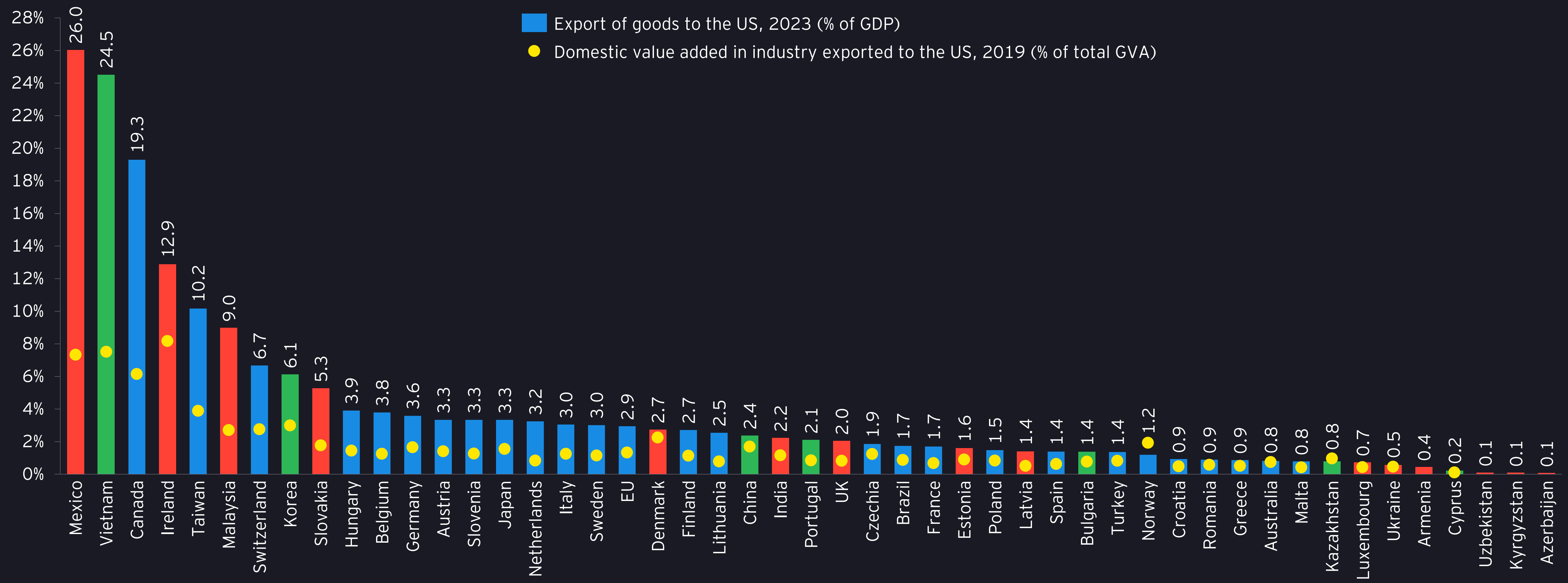
Average effective tariff rate in exports to the US
(in percentage)



Source: EY EAT calculations, WITS database.

The economic impact of tariffs is influenced not only by the effective tariff rates but also by the goods trade relationships with the United States. Mexico, Canada, Ireland, and Vietnam are particularly vulnerable to any increases in tariffs, while most European countries exhibit a lower level of exposure.

Exports of goods and domestic value added in industry exported to the US

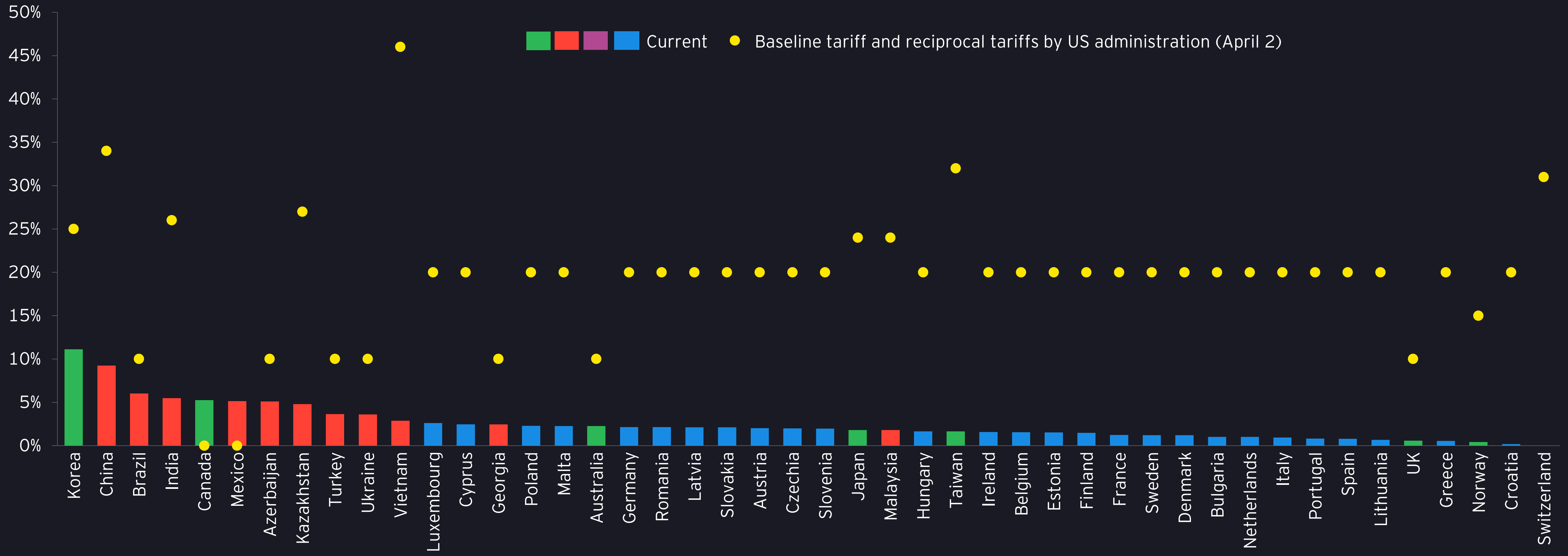


Source: EY EAT calculations, OECD, World Bank, Oxford Economics.

There is no reciprocity in the (currently partially suspended) 'reciprocal' tariffs, as most countries impose significantly lower tariffs on products from the United States.

- Reciprocal tariffs have been determined based on trade deficits in goods with specific countries (refer to the next slide), rather than on tariffs or any non-tariff trade barriers.

Average effective tariffs on US products (in percentage)

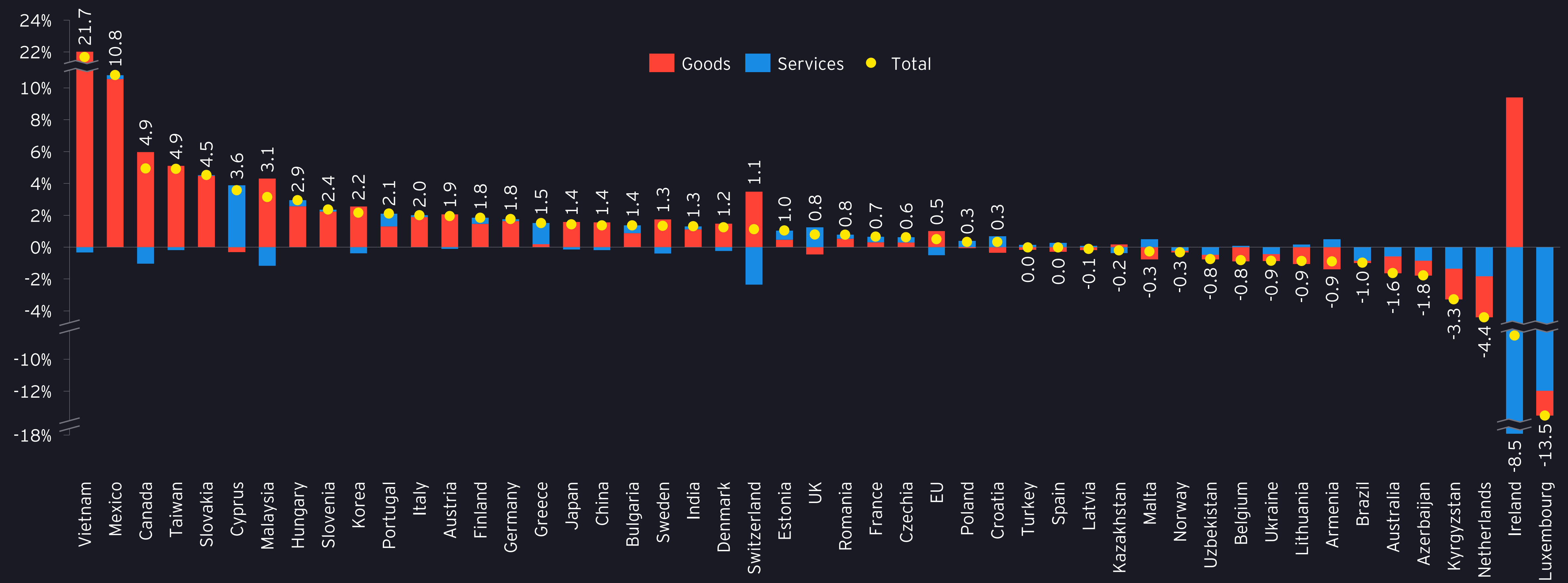


Source: EY EAT calculations, WITS, the White House.
Notes: Latest effective tariffs available in WITS database. Canada's and China's tariffs adjusted for their response to the US administration's trade policy.

The U.S. administration has focused on countries with which the United States has the largest trade deficits in goods, while overlooking trade in services.

- While the European Union maintains a goods trade surplus of 1% of GDP with the United States, this is partially offset by a services deficit of 0.5% of GDP.
- Services imports from the United States is predominantly concentrated in Ireland, Luxembourg, and the Netherlands, where many technology giants and other service firms are headquartered.

Trade balance with the US in 2023 (in percentage of GDP)



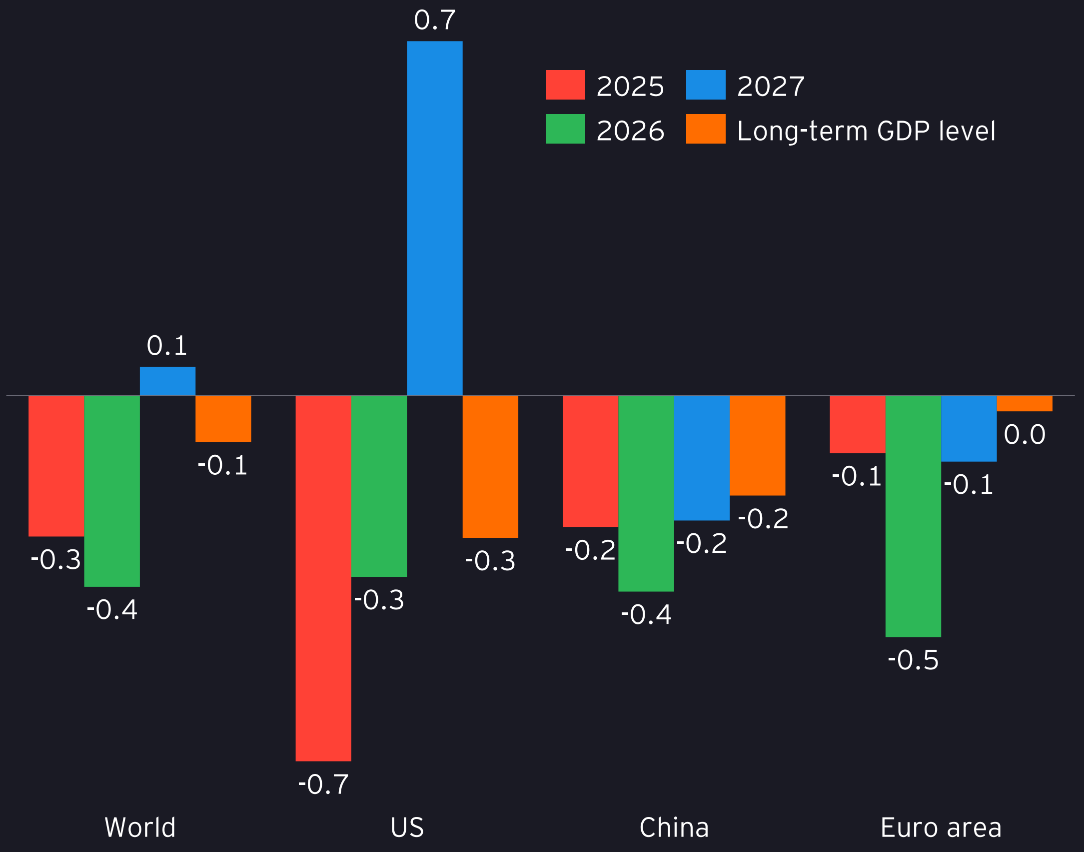
Source: EY EAT calculations, OECD, Oxford Economics.

Under our baseline scenario, tariffs are projected to reduce GDP growth in the European Union by approximately 0.5 percentage points next year. However, the negative effects are expected to fade in the long term.

In our baseline scenario, we assume:

- **Reciprocal tariffs will not return** after a 90-day suspension (including those related to China), with the baseline tariff remaining at 10% and existing sectoral exemptions continuing indefinitely.
- **Additional sectoral tariffs will be imposed from 2025 Q4**, with effective tariff rates of 25% on copper and 10% on semiconductors, pharmaceuticals, and lumber. These tariffs are likely to be structured as a 25% standard rate with product exemptions, resulting in lower effective tariff rates.
- **The EU will impose retaliatory tariffs** on the US from 2025 Q4, with the effective tariff rate set at 50% of the rate charged by the United States.
- **No retaliatory tariffs will be imposed by other countries**, aside from those already established by China and Canada.
- **All other tariffs** (including those on steel and aluminum, motor vehicles, 20% tariffs on China, and tariffs on non-USMCA compliant goods from Canada and Mexico) **will remain unchanged in their current format.**

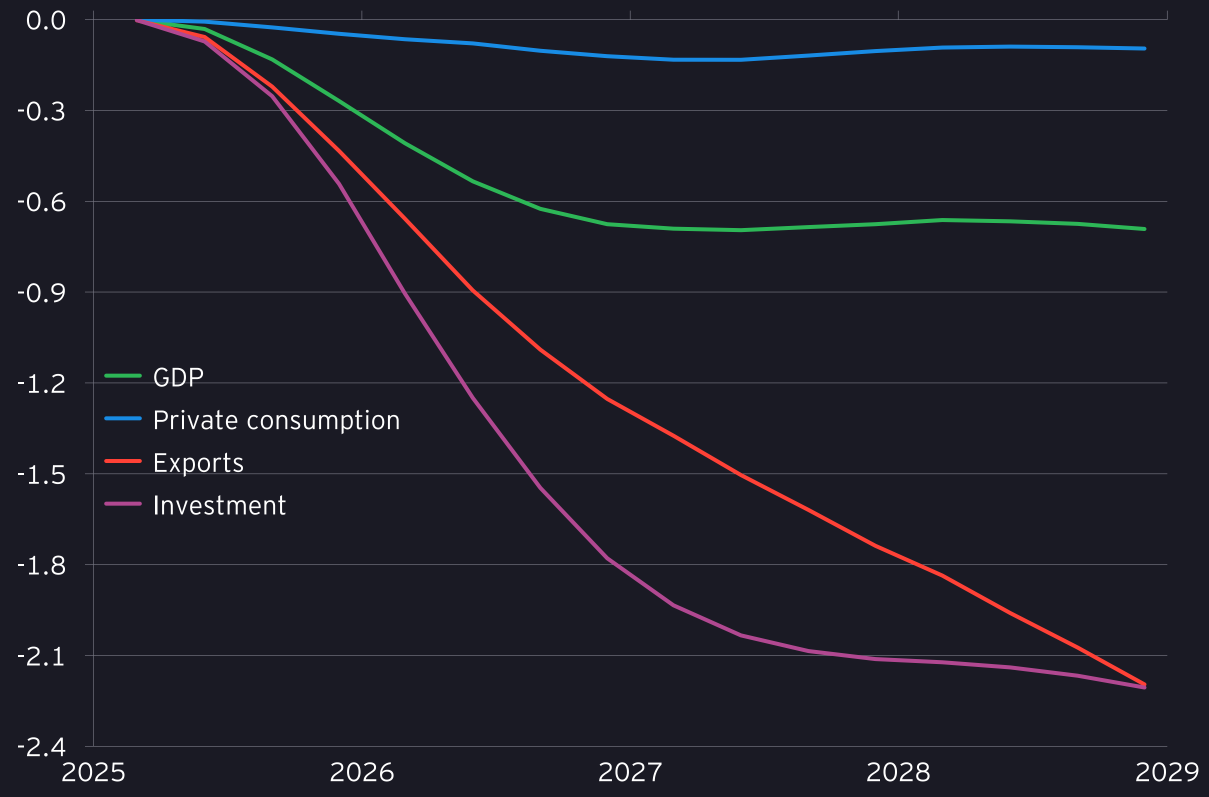
Y/y GDP growth – deviation from the no-tariff scenario (in percentage points)



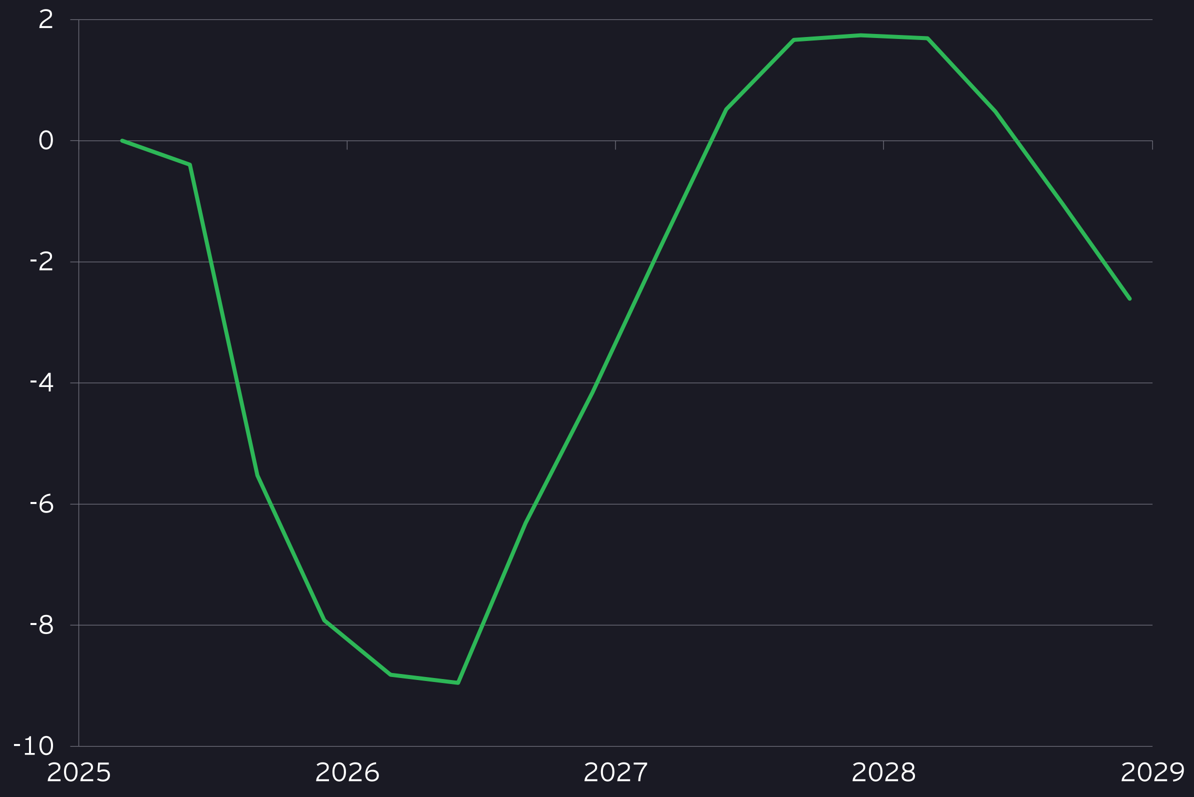
Source: EY EAT calculations.

In Europe, the decline in GDP will primarily result from reduced exports and investment, with a limited impact on private consumption. Additionally, the global economic slowdown and increased uncertainty lead to a drop in commodity prices, particularly oil.

GDP and its main components in the EU – deviation from the no-tariff scenario (in percentage points)



Oil price – deviation from the no-tariff scenario (in percentage points)

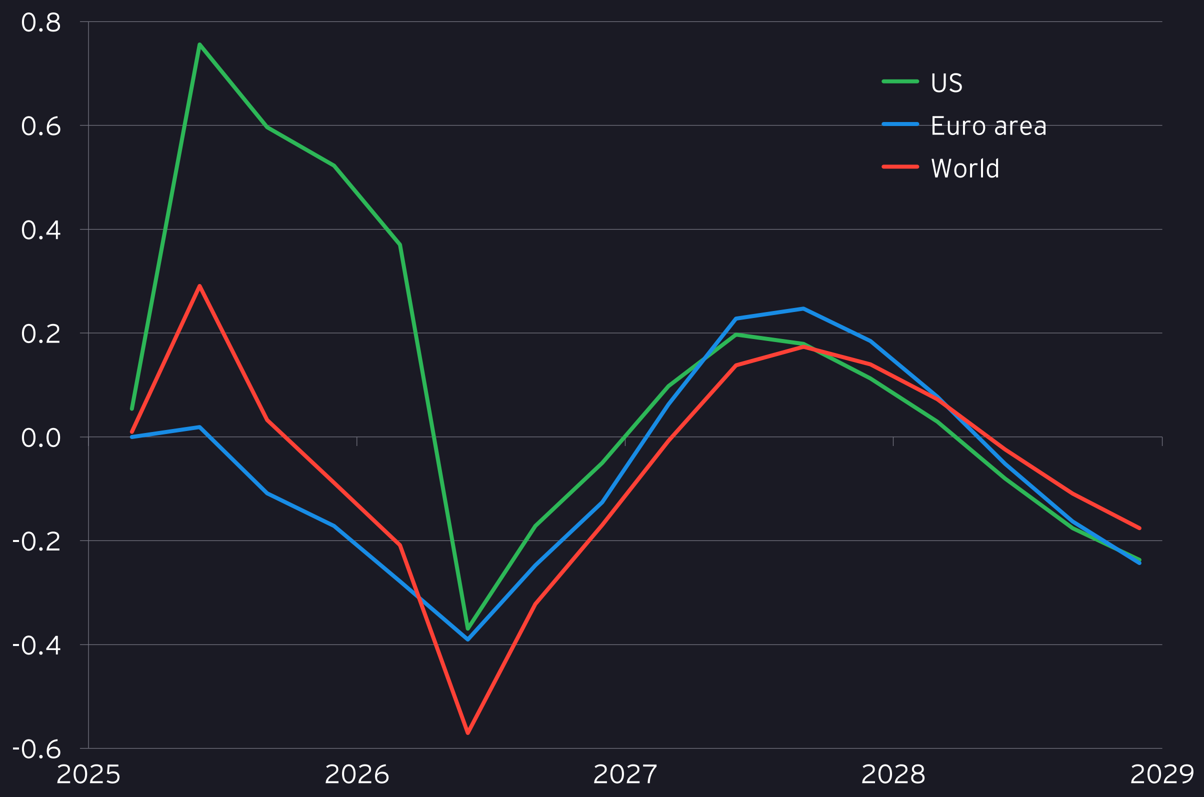


Source: EY EAT calculations.

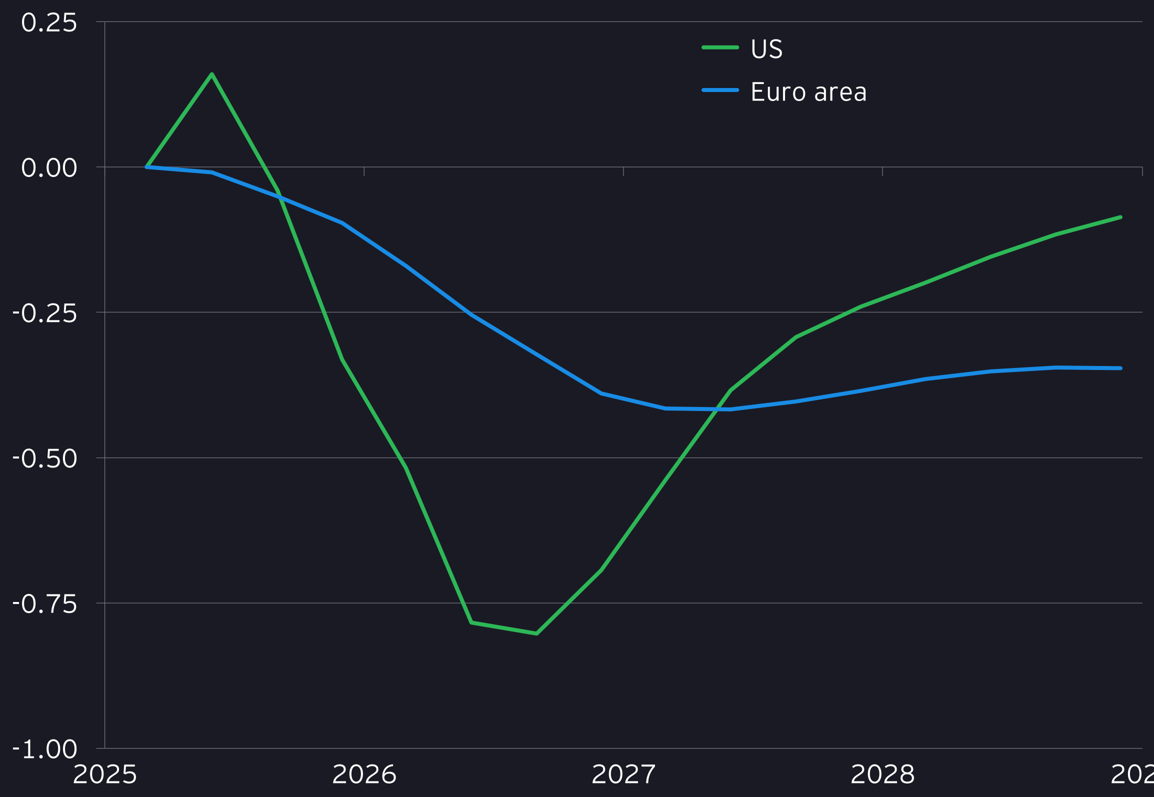
Lower commodity prices and subdued economic activity will be disinflationary. Central banks are likely to remain cautious in the short term due to increased uncertainty but may reduce interest rates further in the medium term.

- In contrast to Europe, tariffs in the U.S. are expected to lead to a transitory reacceleration of inflation.

Y/y CPI inflation – deviation from the no-tariff scenario (in percentage points)



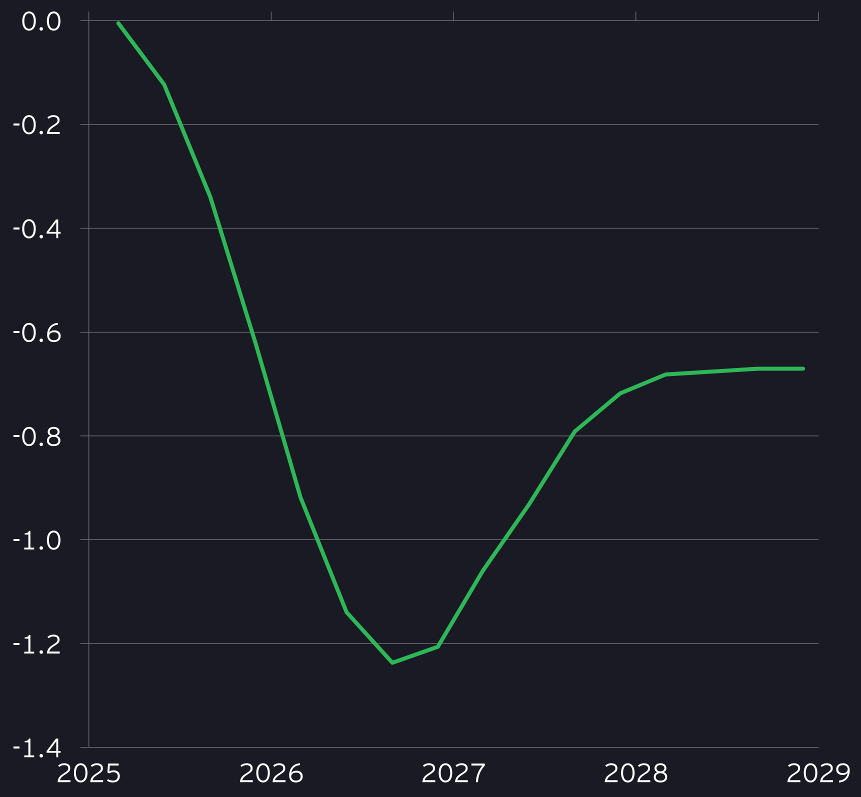
Central bank interest rates – deviation from the no-tariff scenario (in percentage points)



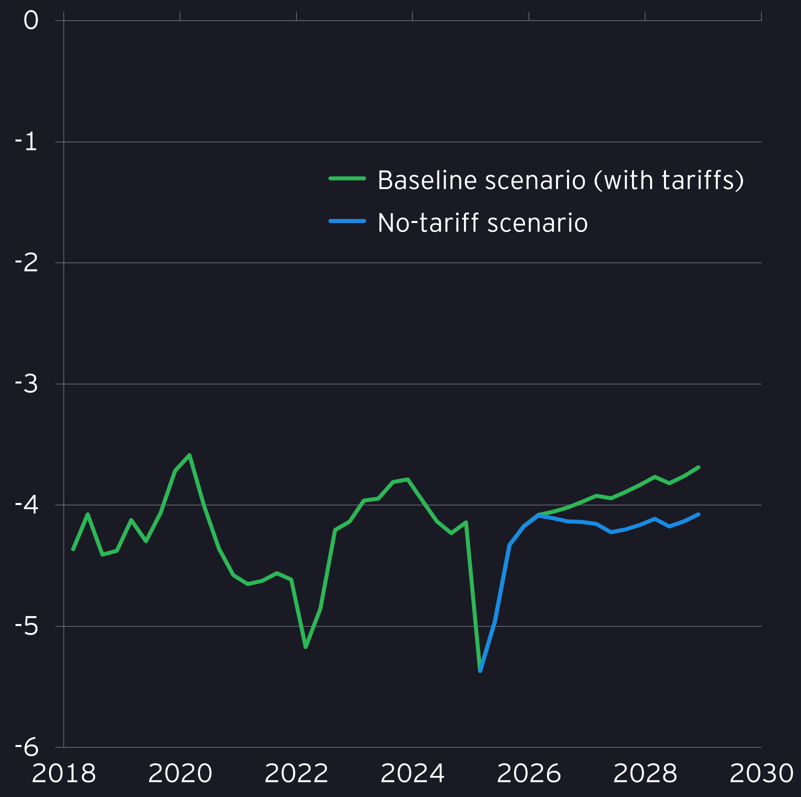
Source: EY EAT calculations.

World trade growth is projected to slow by approximately 1 percentage point as a result of tariffs. The U.S. trade deficit is expected to improve only marginally, indicating that the U.S. administration is unlikely to achieve its objectives of neutralizing the deficit.

Y/y world trade – deviation from the no-tariff scenario (in percentage points)



US trade deficit under baseline and no-tariff scenarios (in percentage of GDP)

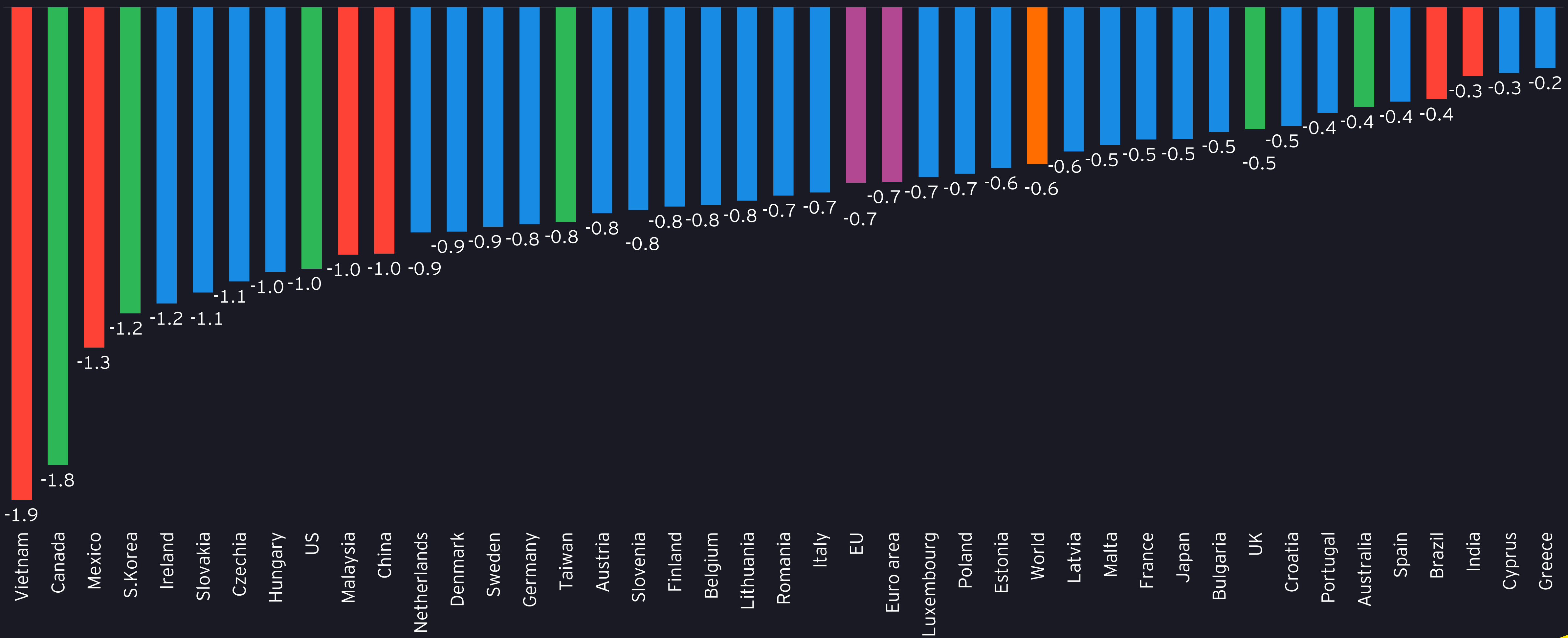


Exports to GDP in the US - deviation from the no-tariff scenario (in percentage of GDP)

Source: EY EAT calculations.

The effects of a trade war will be felt most strongly by countries that are heavily reliant on exports to the U.S., such as Vietnam and Canada, followed by Mexico, manufacturing-intensive European nations, the United States, and China. The impact on Southern European countries and India is expected to be limited.

Peak tariff impact on GDP (in per cent)

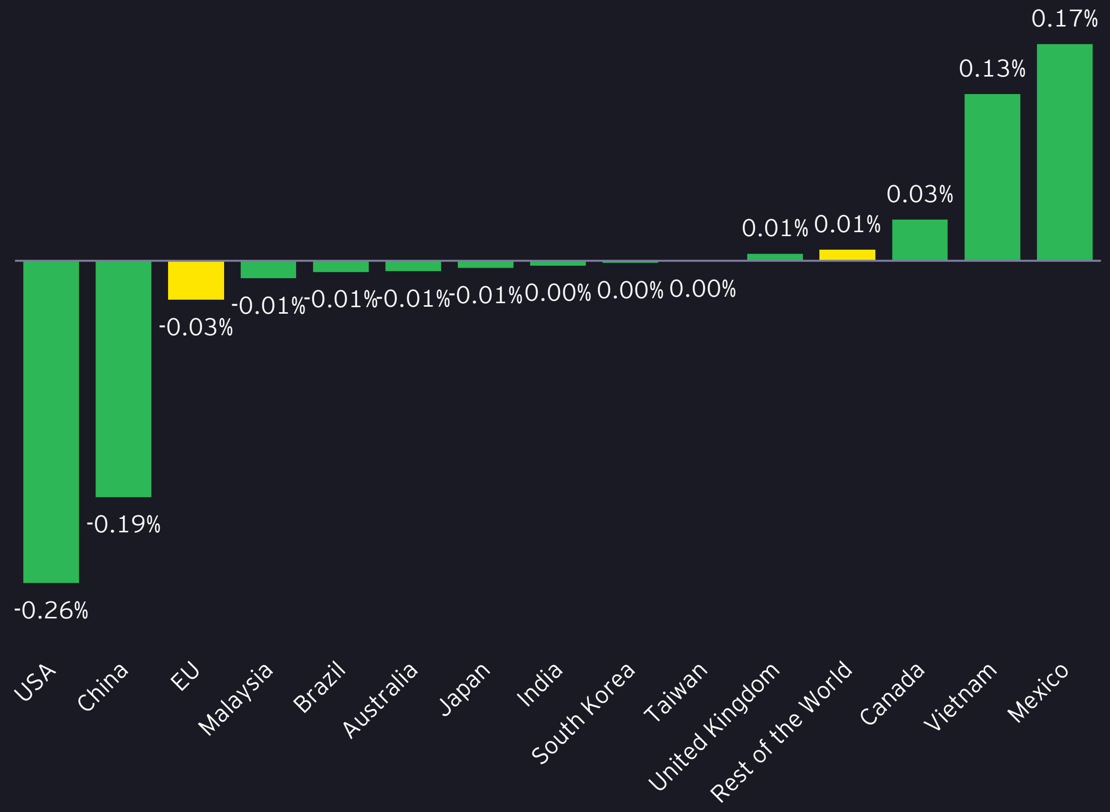


Source: EY EAT calculations

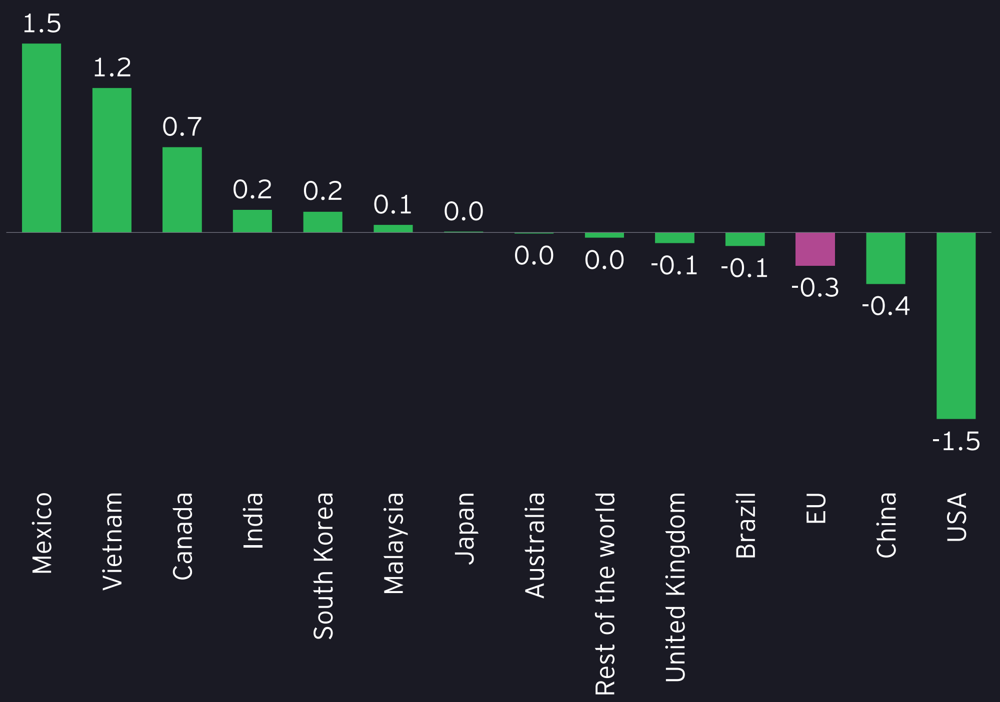
In the long run, the United States and China are expected to be among the economies most affected by tariffs, while the EU is likely to experience only a slight decline in GDP. Global supply chain adjustments may convert short-term challenges into long-term opportunities for certain countries.

- Countries that are most negatively affected by tariffs are also likely to experience a decline in trade openness.

Long-run impact of tariffs on real GDP of selected countries and the EU (percentage deviation vs. no tariff increase scenario)



Long-run change in the share of exports in GDP (percentage point change vs. no tariff increase scenario)



Source: EY EAT calculations using the EY UPGRADE model

Global trade flows are expected to undergo a significant reshuffle, with the most substantial decline in exports and imports occurring in trade between the United States and China.

- Due to lower tariffs compared to other countries on exports to the United States, Canada and Mexico are expected to increase their exports to the U.S. at the expense of other markets. Similarly, Vietnam and Taiwan are likely to experience increased exports to the U.S., effectively replacing Chinese producers who are facing higher tariffs.
- Most countries will attempt to reroute their exports to the U.S. through Canada and Mexico, which are anticipated to see a substantial increase in imports from various sources, excluding the U.S. Additionally, China is projected to experience a 10% increase in exports to most destinations, diverting its exports away from the United States.

Long-run change in trade between countries and regions

(percentage deviation vs. no tariff increase scenario)

EXPORTS FROM	IMPORTS TO														
	Australia	China	Japan	Korea	Taiwan	Malaysia	Vietnam	India	Canada	USA	Mexico	Brazil	UK	EU	ROW
Australia		-0.18	0.23	-0.11	-0.17	-0.21	0.35	0.30	13.35	-8.55	14.57	0.78	2.89	3.21	0.57
China	8.25		7.66	8.78	9.92	7.95	9.47	8.21	34.66	-51.01	30.73	10.81	10.84	12.61	8.87
Japan	2.39	1.47		1.48	2.36	1.06	0.30	1.13	30.01	-12.30	20.98	3.74	3.76	4.69	2.18
Korea	2.08	1.37	-0.03		1.53	0.28	-0.25	0.54	28.45	-10.97	20.48	2.88	2.69	3.62	1.37
Taiwan	-2.54	-1.94	-3.25	-1.66		-1.65	-2.50	-2.47	18.26	13.37	15.16	-0.86	-1.18	0.56	-2.17
Malaysia	-0.45	0.14	-1.00	-0.19	0.39		-1.11	-0.36	22.78	-4.64	19.79	1.09	1.13	3.12	0.12
Vietnam	-6.17	-4.23	-7.94	-5.45	-4.84	-4.62		-5.78	10.89	25.84	13.06	-3.74	-4.84	-2.93	-5.08
India	-0.74	-1.93	-1.02	-1.15	-0.68	-1.80	-0.86		13.09	5.02	16.29	0.14	0.02	1.08	-0.84
Canada	-11.30	-10.50	-8.93	-8.20	-8.77	-12.64	-9.31	-6.71		6.19	0.77	-10.23	-10.30	-5.21	-4.02
USA	-10.89	-34.92	-9.83	-10.36	-11.29	-13.10	-10.65	-9.40	-7.55		-0.14	-7.27	-8.17	-30.04	-9.69
Mexico	-22.00	-21.58	-20.46	-11.89	-21.44	-21.34	-22.06	-11.73	-4.16	11.17		-21.10	-22.25	-17.17	-22.26
Brazil	-0.24	0.53	0.63	-0.26	0.35	-0.54	0.16	-0.19	15.91	-8.19	16.09		1.56	1.25	-0.28
UK	-0.76	-2.52	-1.45	-1.52	-0.19	-2.09	-0.68	-1.61	12.33	-2.87	12.35	-0.04		1.11	-1.30
EU	-1.12	-2.90	-2.29	-2.24	-0.46	-2.61	-1.46	-1.79	16.15	-5.87	14.67	-0.22	-0.31		-1.42
ROW	0.15	-0.58	-0.43	-0.21	-0.14	-0.57	-0.02	0.14	10.10	-4.46	15.08	0.94	1.34	1.73	

Source: EY EAT calculations using the EY UPGRADE model
The results in the table include both trade in goods and services.

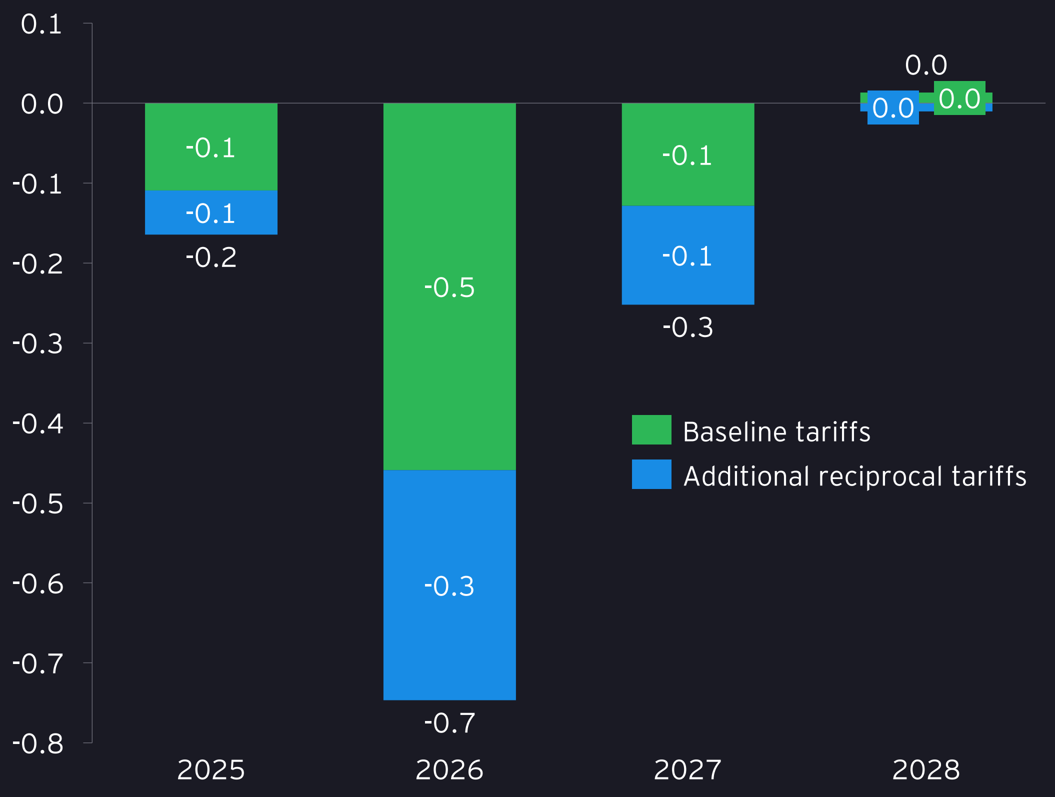
EU industries, such as motor vehicles, iron and steel, and textiles, are likely to be among the most adversely affected by tariffs. However, even 'minor' policy tweaks, such as sectoral exemptions or changes in relative tariffs, may be game changers for selected industries.

Long-run impact of US and retaliatory tariffs on real value added in selected sectors
(percentage deviation vs. no tariff increase scenario)

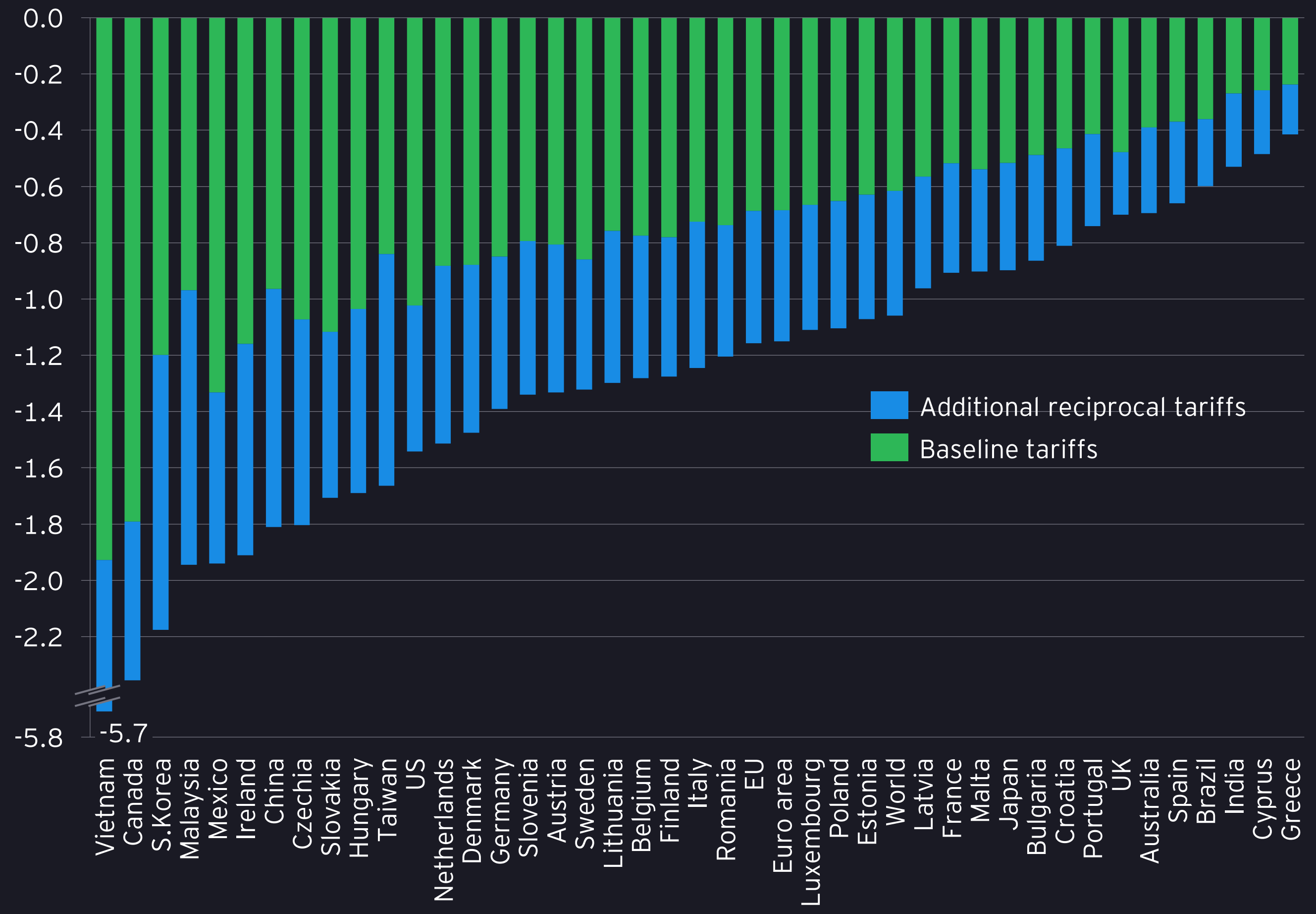
Source: EY EAT calculations using the EY UPGRADE model. The above chart only presents the sectors where substantial long-term economic impact is expected. These include industries where in at least one of the countries we anticipate

If the reciprocal tariffs announced on April 2, which are currently partially suspended for 90 days, were to be fully reinstated in July, the GDP effects of these tariffs would increase by approximately two-thirds in most countries, with a notable exception being Vietnam.

Y/y GDP growth in the EU – deviation from the no-tariff scenario (in percentage points)



Peak impact of tariffs on GDP (in percentage)

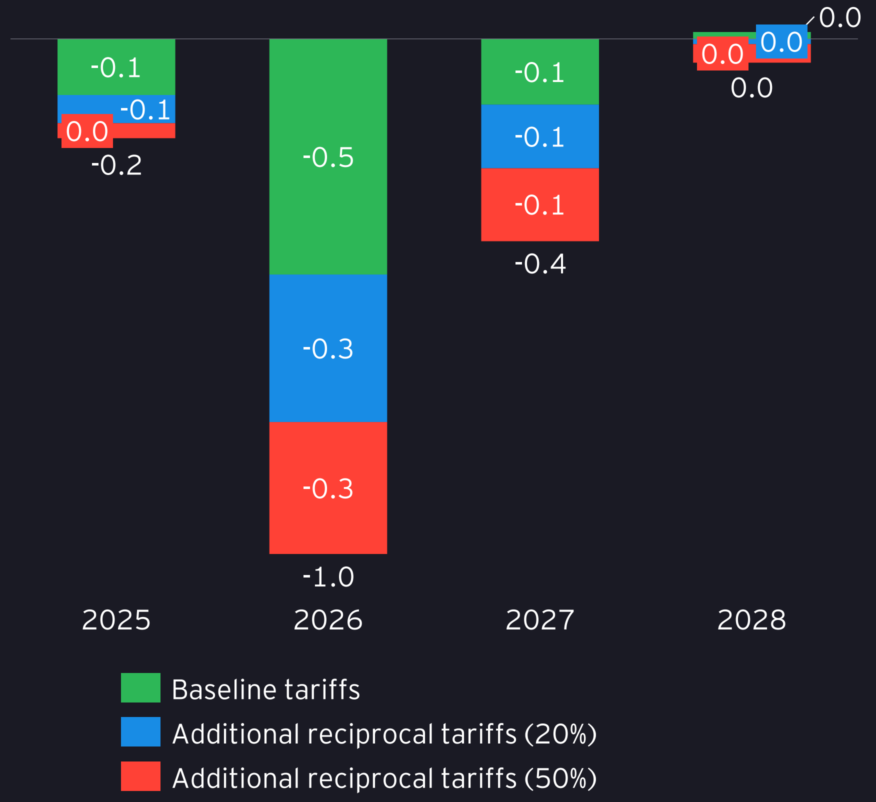


Source: EY EAT calculations.
In addition to US 'reciprocal' tariffs, we assume full immediate Chinese retaliation and a 50% (of the rate charged by the U.S.) retaliation from the EU from 2025 Q4.

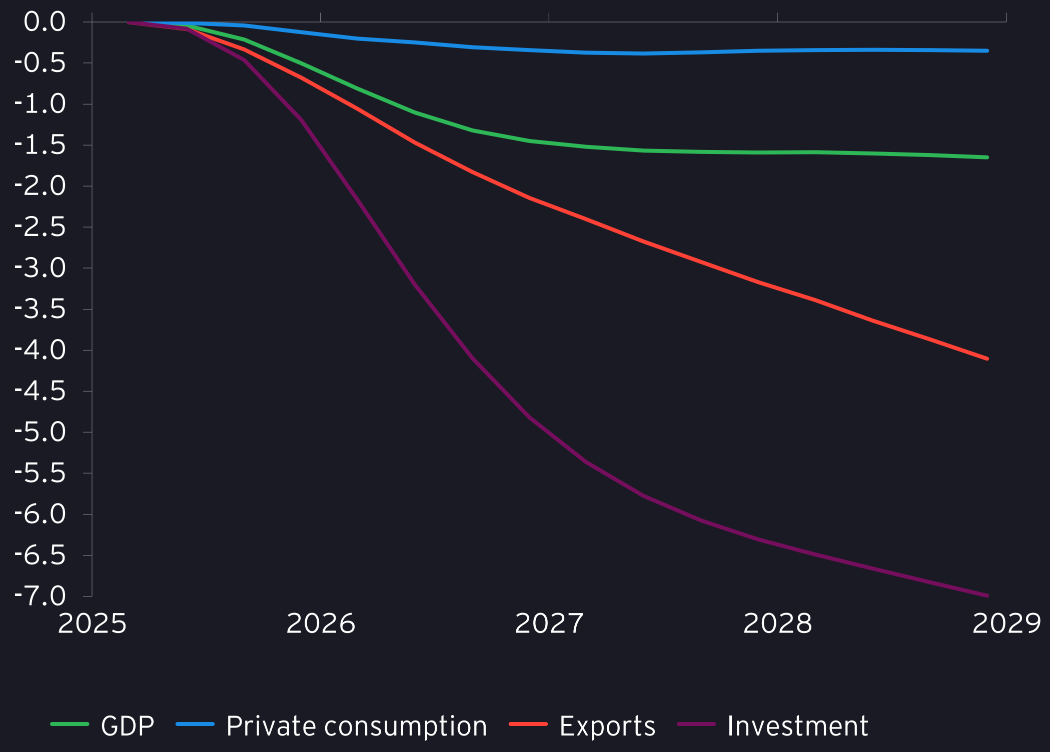
WHAT IF President Donald Trump's recent threat to impose a 50% tariff on goods from the EU were to come into effect, and the EU partially retaliate?

- If the U.S. administration proceeds with the imposition of 50% tariffs on goods from the EU, and the EU responds with retaliatory tariffs at half that rate, we project that eurozone GDP growth would be further reduced by 0.3 percentage points in 2026 and 0.1 percentage points in 2027, compared to a scenario involving 20% reciprocal tariffs.

Y/y GDP growth in the Eurozone – deviation from the no-tariff scenario
(in percentage points)



GDP and its main components in the EU – deviation from the no-tariff scenario
(in percentage points)



Source: EY EAT calculations.
In addition to US 'reciprocal' tariffs, we assume a 50% (of the rate charged by the U.S.) retaliation from the EU from 2025 Q4.

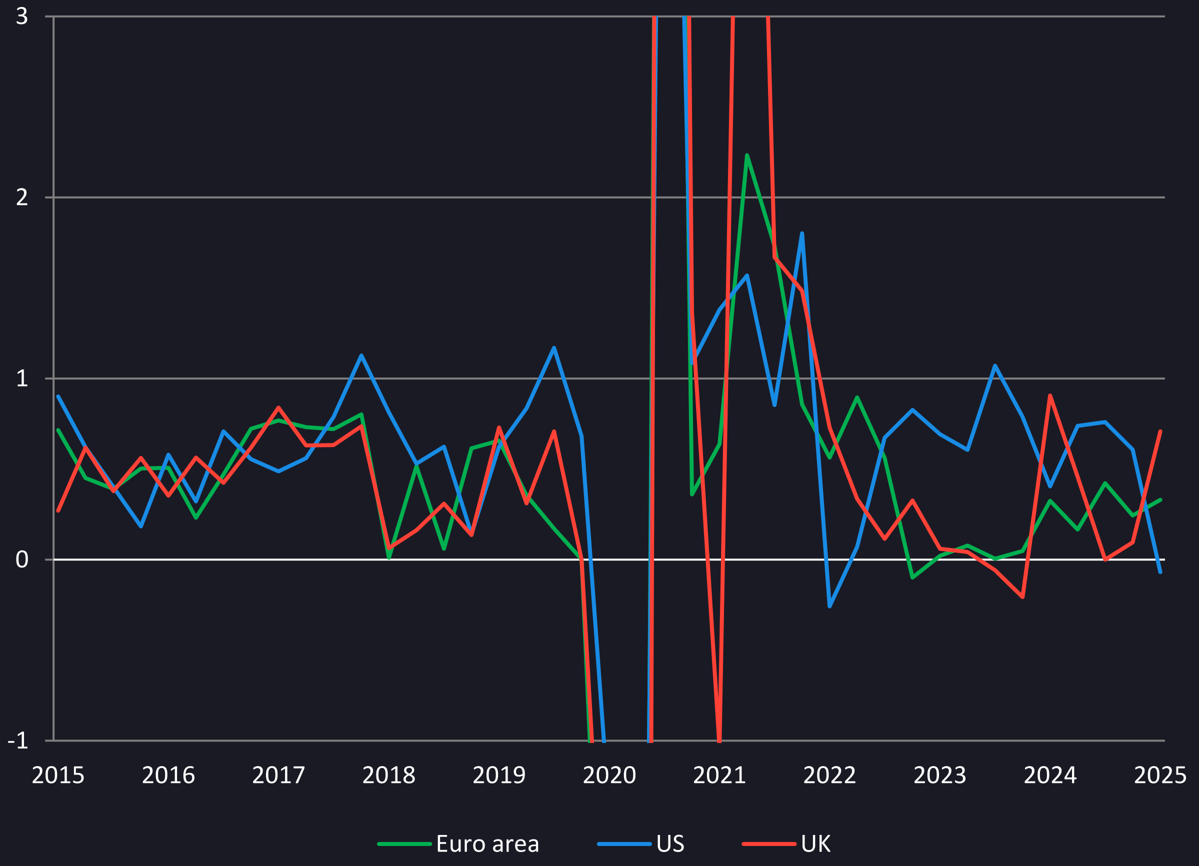
Chapter 2

Economic activity in recent quarters

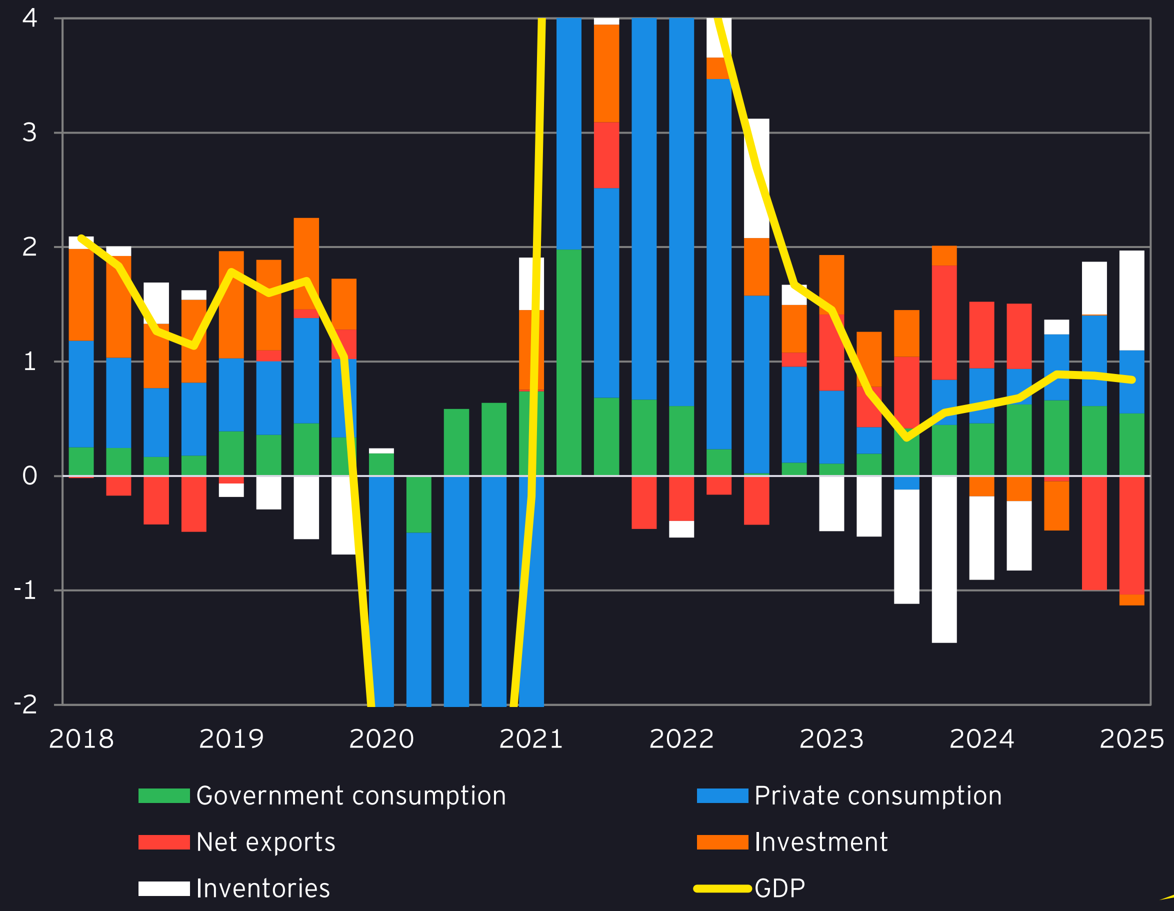
The euro area's economy has continued to expand at a modest quarterly rate of 0.2-0.4%, while the U.S. experienced a notable slowdown in Q1 2025, diverging from its previously consistent growth

- Private consumption picked up in the second half of 2024, emerging as a key driver of growth, alongside a steady increase in government spending and a reverting inventory cycle. In contrast, exports and investment have remained stagnant.

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



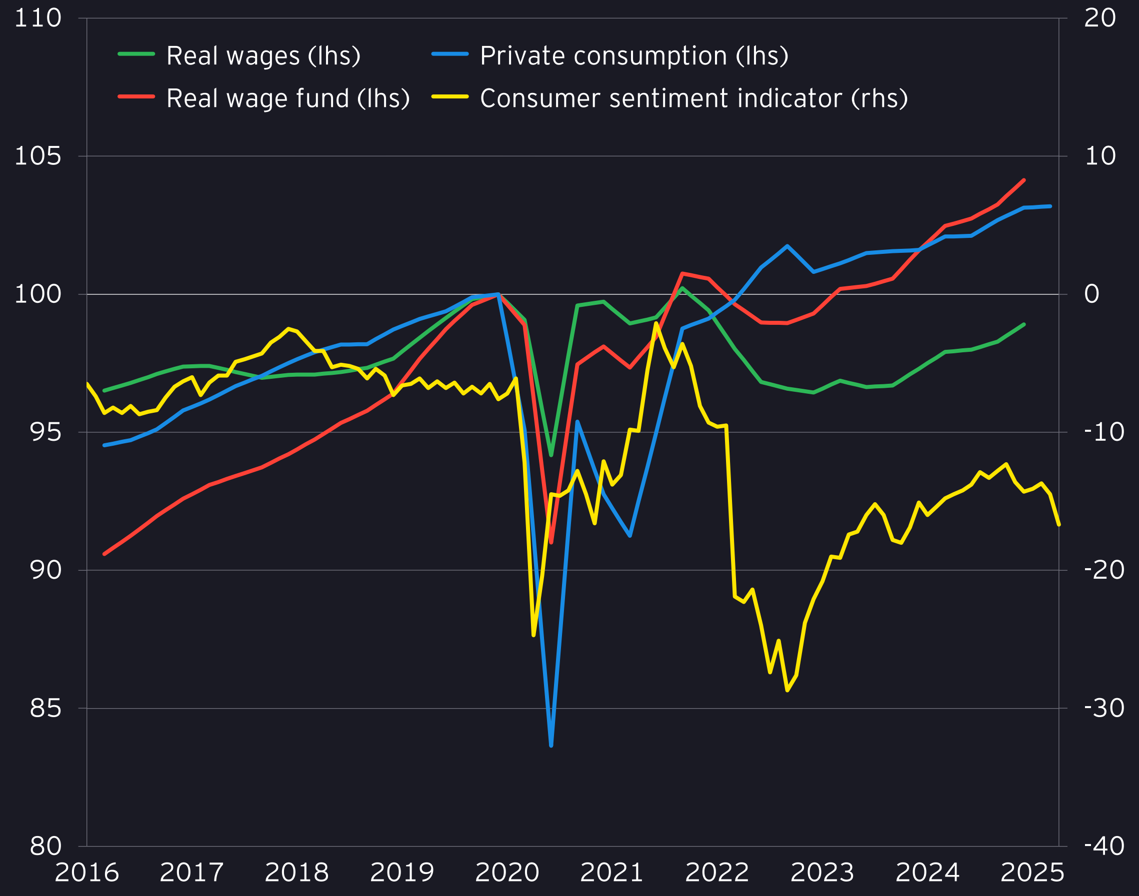
Decomposition of y/y GDP growth in the euro area less Ireland* (in percentage)



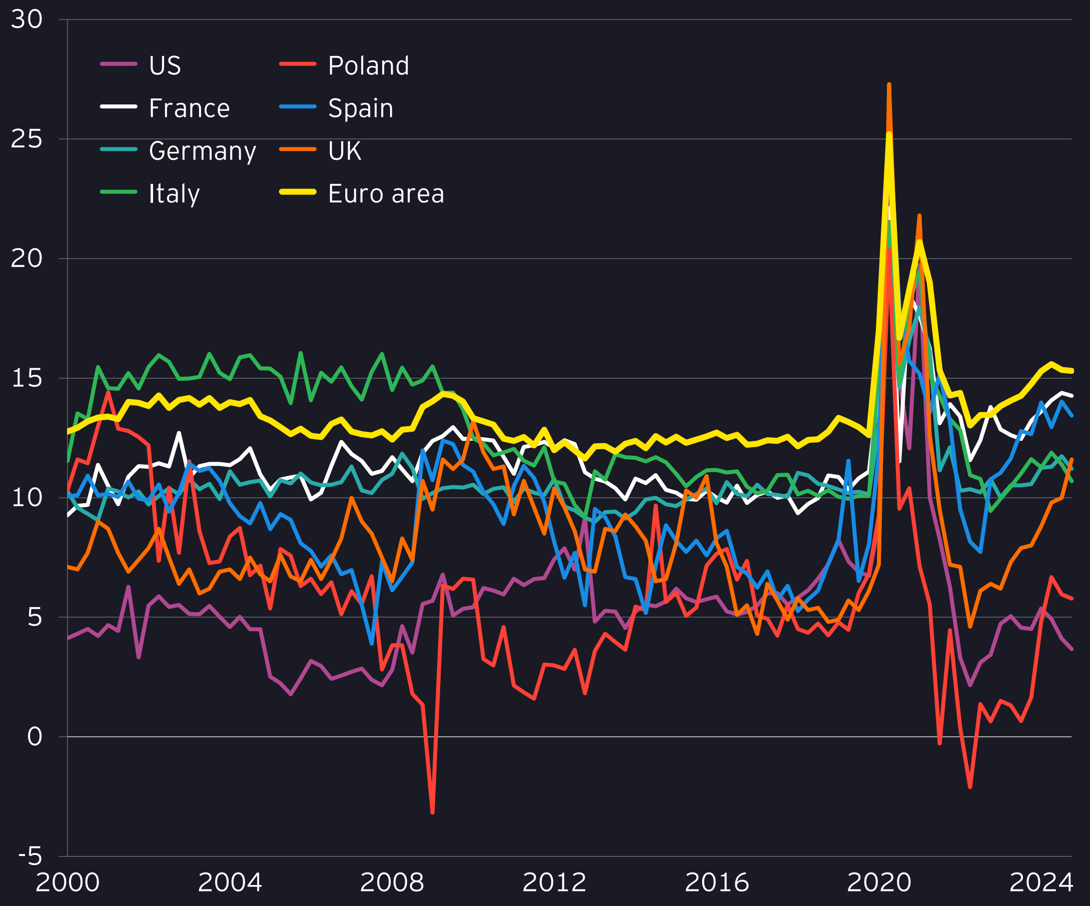
Source: Eurostat, Fred, ONS.
* Ireland is excluded as its GDP tends to be very volatile, reflecting the outsized role multinational corporations play in the economy. GDP components for 2025 Q1 based on EY estimates.

Growing real incomes are finally translating into increased consumer spending, although savings rates remain elevated. However, consumer confidence has declined due to concerns surrounding tariffs.

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



Household saving rate
(In percentage)

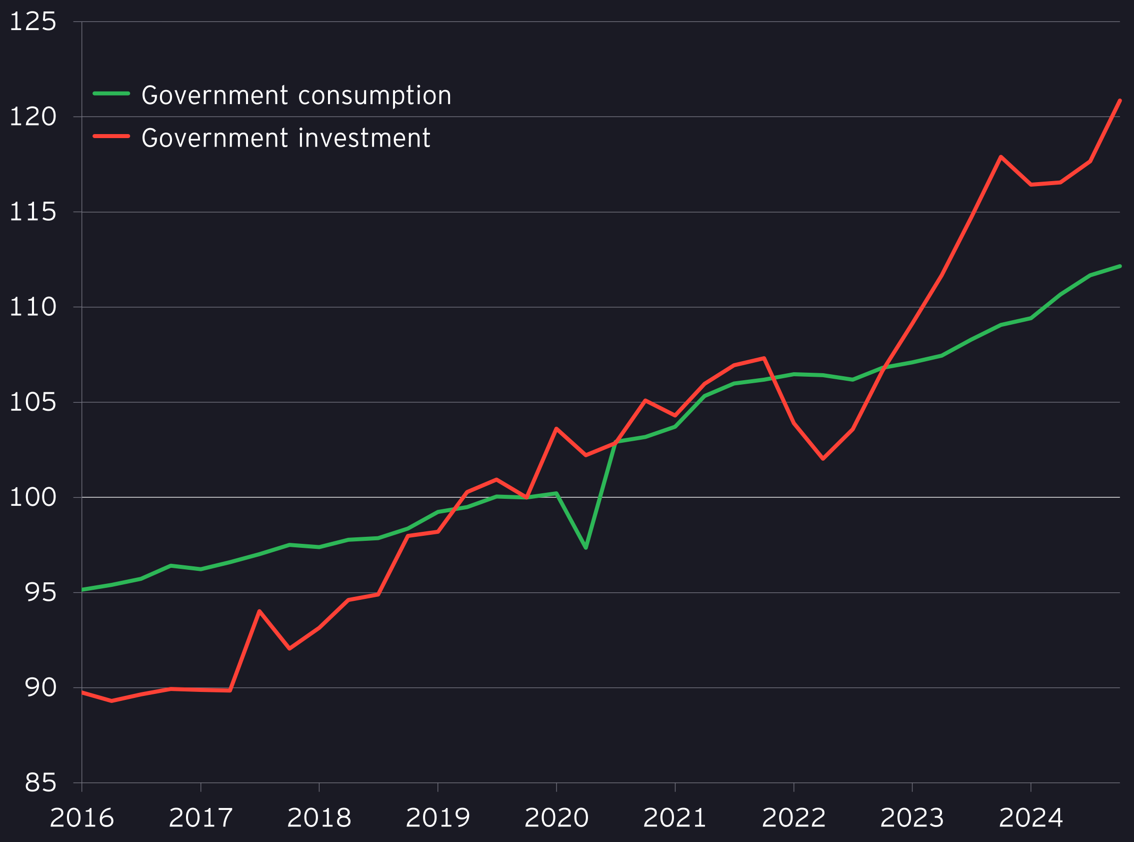


Source: Eurostat, Oxford Economics, FRED.
* Private consumption in 2025 Q1 based on EY estimates.

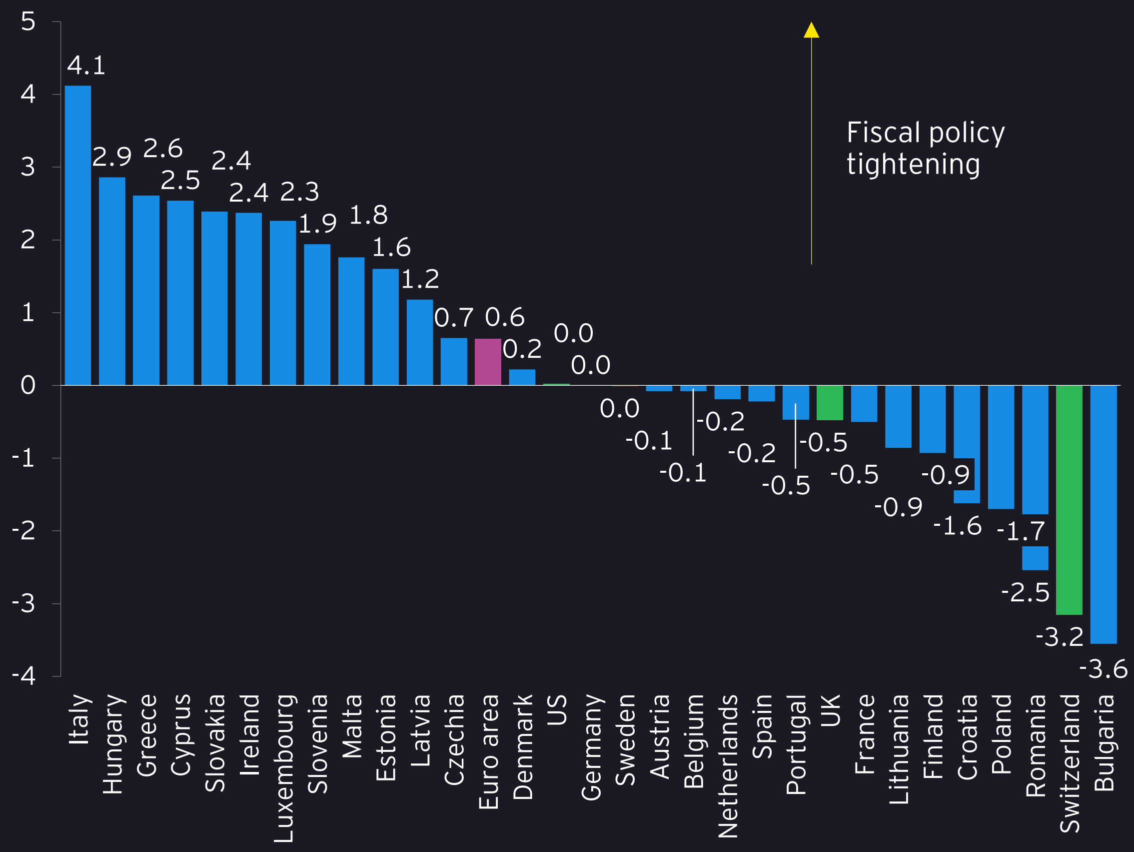
While government consumption and investment continue to support growth, broader fiscal policy is currently constraining economic activity. This is expected to change soon due to the newly announced fiscal expansion in Germany.

- For a detailed analysis of the fiscal expansion in Germany, please refer to slide 44.

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



Change in structural balance* to GDP: 2024 vs. 2023 (in percentage points)



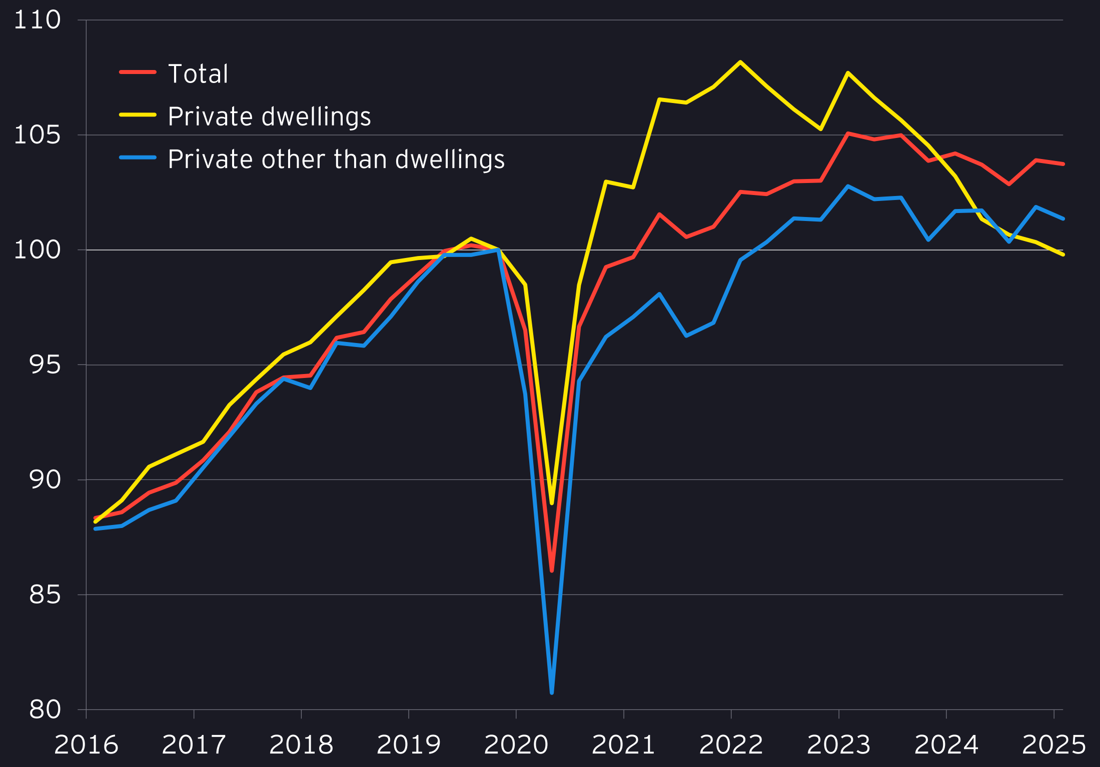
Source: Eurostat, Oxford Economics, FRED.

* Structural balance is general government balance corrected for cyclical and one-off factors.

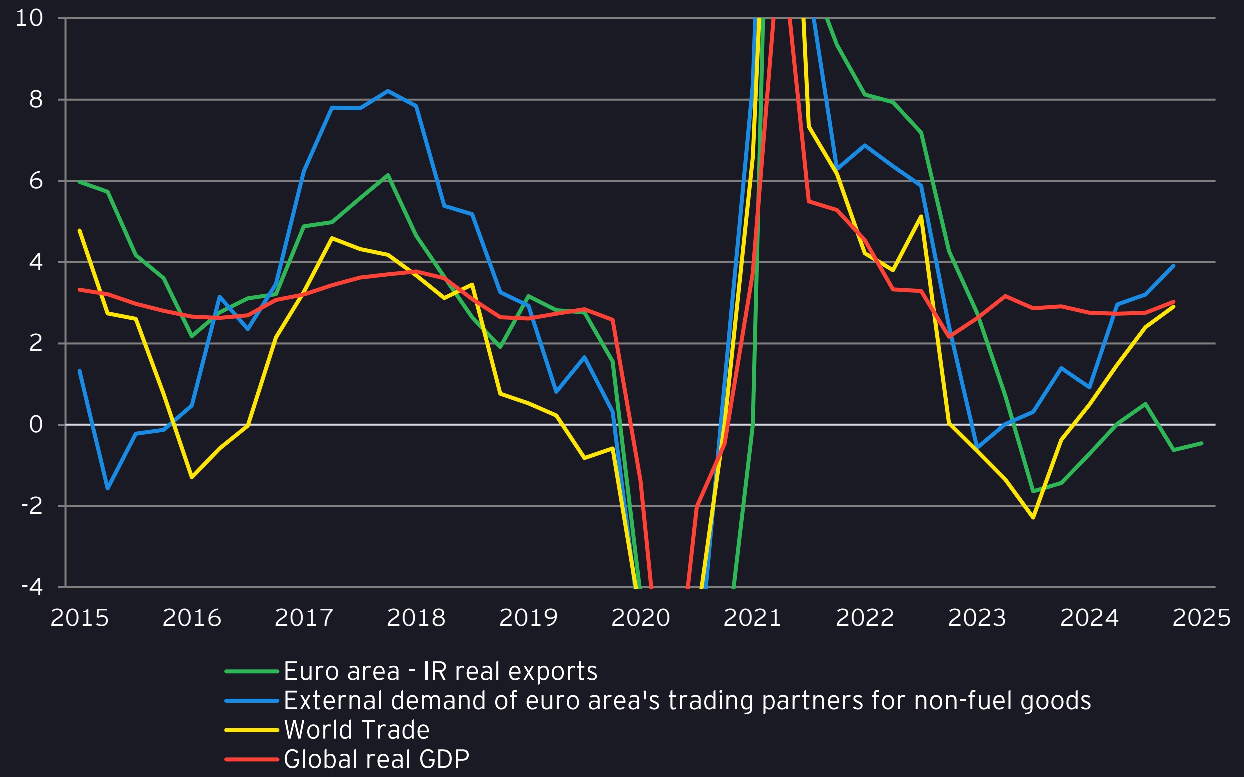
Investment and exports continue to remain stagnant, despite a decrease in interest rates and an increase in external demand. In the short term, recovery appears unlikely due to ongoing tariff uncertainties.

- Despite the decline in interest rates, housing investment continues to contract. Non-residential private investment is facing additional pressure due to stagnant profits and reduced capacity utilization. Furthermore, the deterioration in sentiment induced by tariffs will further constrain business spending in the short term.
- Exports are growing at a slower pace than external demand and global trade, resulting in European producers losing market share.

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



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)



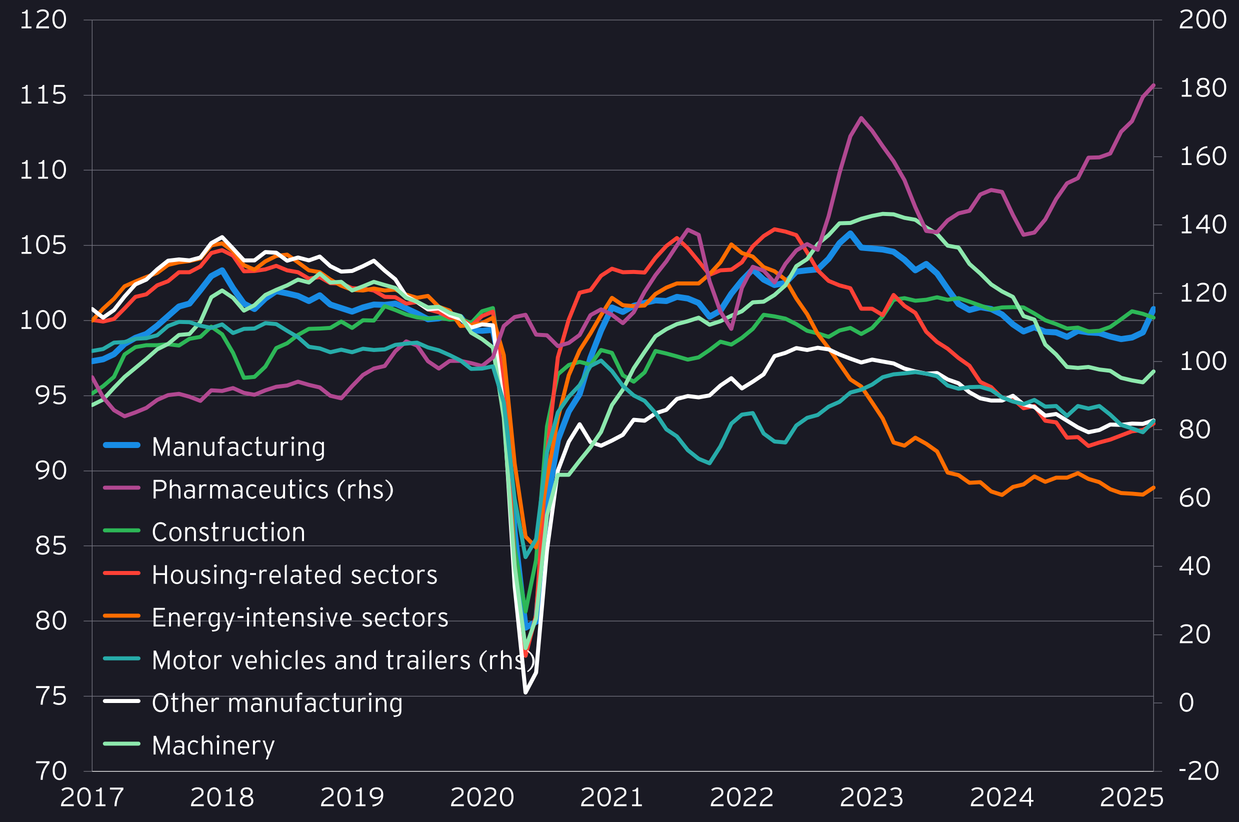
Source: : Eurostat, Oxford Economics, CPB.
* Investment and exports in Ireland are excluded since they are very volatile, influenced by the global activities of multinational corporations, and do not appropriately reflect the underlying investment and exports in the domestic economy.
** External demand 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.
*** Real export in 2025 Q1 based on EY estimates

Manufacturing activity appears to be bottoming out, while the services sector continues to experience modest to moderate expansion, with consulting leading the growth

- Manufacturing production seems to be bottoming out; however, it continues to decline in the automotive, machinery, and energy-intensive sectors. The pharmaceutical sector remains a standout performer
- The construction and housing-related manufacturing sectors have somewhat rebounded in response to monetary policy easing
- Services continue to grow, driven by consulting, ICT, and a recovery in transport. However, the recovery in tourism seems to have run its course

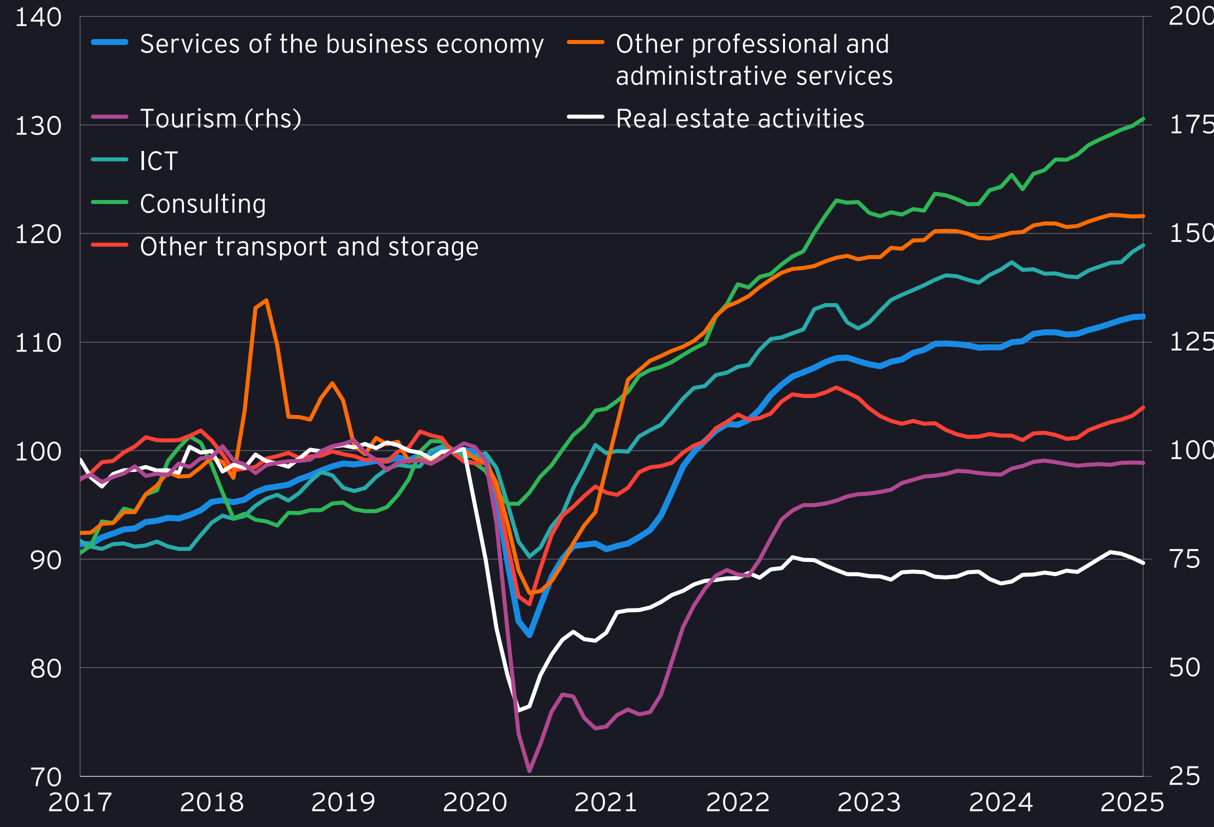
Manufacturing production in the euro area

(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)

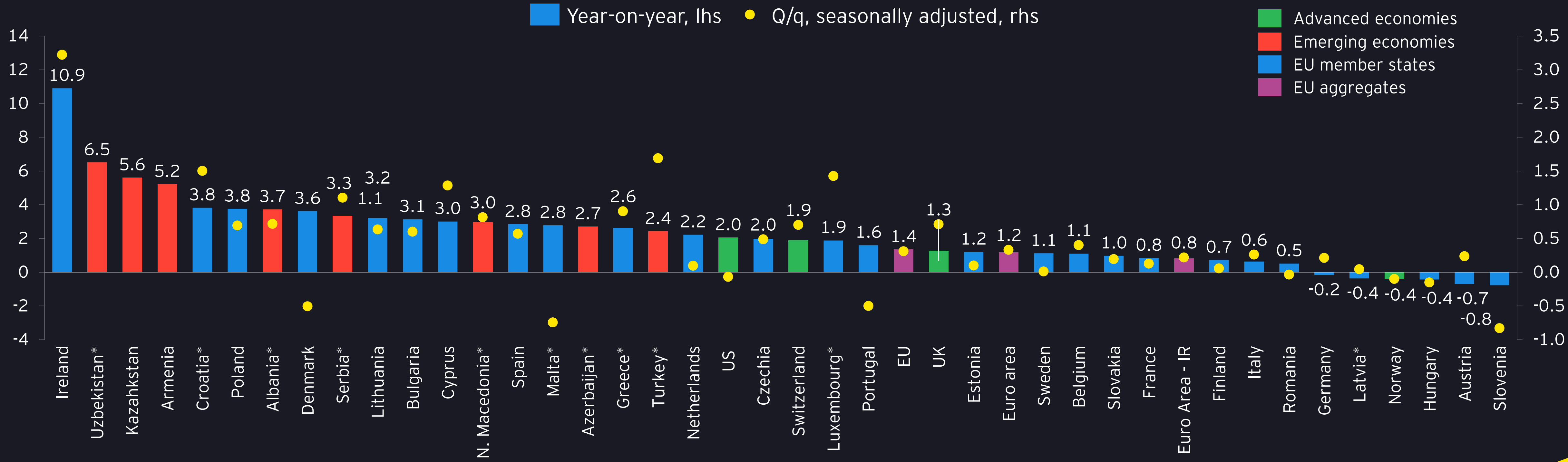


Source: Eurostat.
Notes: Energy-intensive sectors: paper, chemicals, basic metals and non-metallic mineral products. Housing-related sectors: wood, furniture and electric equipment. Other manufacturing is an arithmetic average of the remaining manufacturing NACE divisions. Services of the business economy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

Growth disparities persist among countries, with Poland and Spain leading, while Germany lags behind

- Within the EU, Ireland and Denmark have exhibited strongest GDP growth in recent quarters; however, GDP in Ireland is heavily impacted by activities of multinational corporations, while in Denmark, it is boosted by an expansion of a major pharmaceutical company. The underlying growth in economic activity for both nations is more subdued, ranging from 1% to 2%.
- Aside from these unique cases, Poland and Croatia have experienced the fastest GDP growth in the EU, approaching 3.5%, supported by strong real income growth and fiscal expansion.
- Most Southern European countries, including Spain, continue to exhibit robust growth of 2.5% to 3.0%, benefiting from a booming tourism sector, NextGenEU spending, robust immigration, and relatively low energy costs.
- Outside the EU, countries in the Caucasus, Central Asia, and the Western Balkans have achieved healthy growth rates of 3% to 5%, in light of continued convergence.
- Conversely, Germany remains in stagnation, along with Austria, Hungary, and Romania. The manufacturing sector in all these countries is struggling, with exports and investment contracting as a consequence. In Hungary, growth is further hindered by fiscal tightening and limited access to EU funding.
- Norway has also experienced a contraction in recent quarters due to a decline in the oil and gas sector, although the non-oil economy has been gradually gaining momentum.

Real GDP growth in 2025 Q1** (y/y)

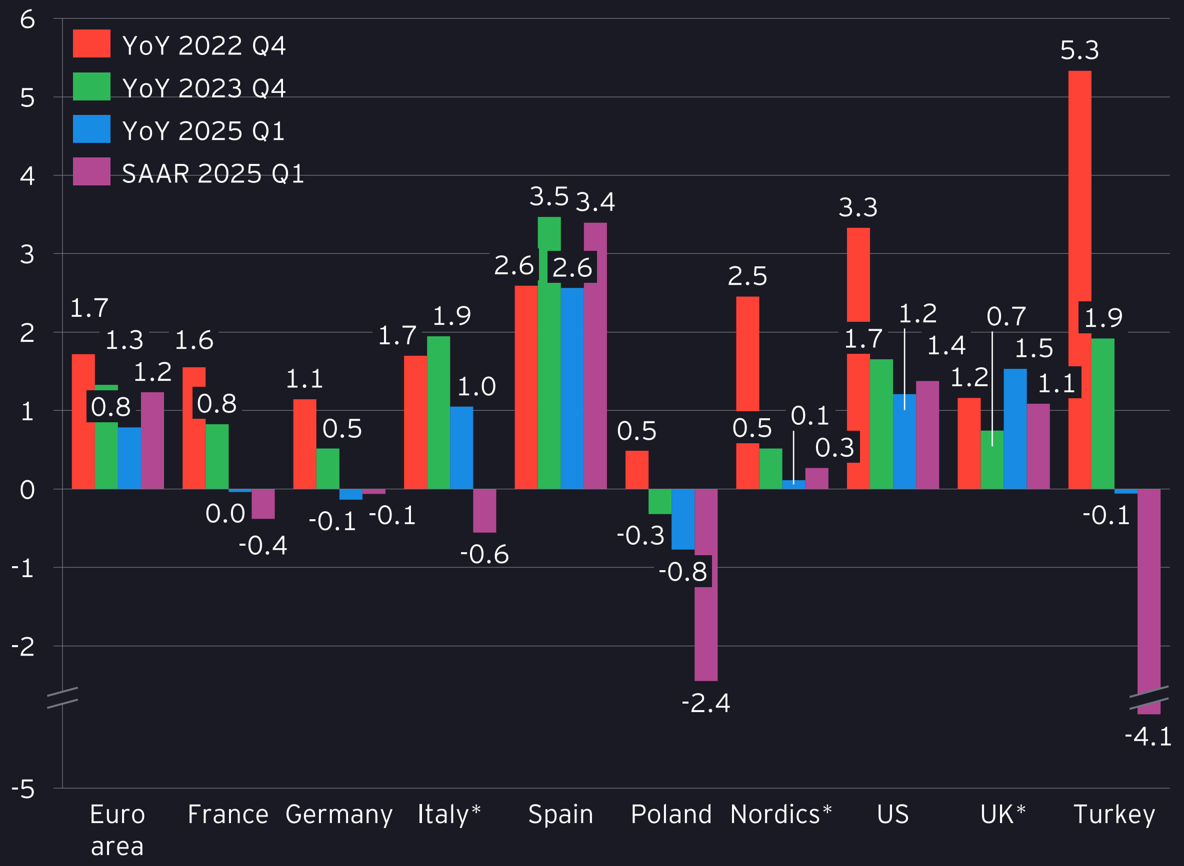


Source: Eurostat, Oxford Economics, Trading Economics.
Notes: * In Ireland, GDP is heavily distorted by activities of multinational corporations, while in Denmark, it is boosted by an expansion of a major pharmaceutical company.
* *2024 Q4

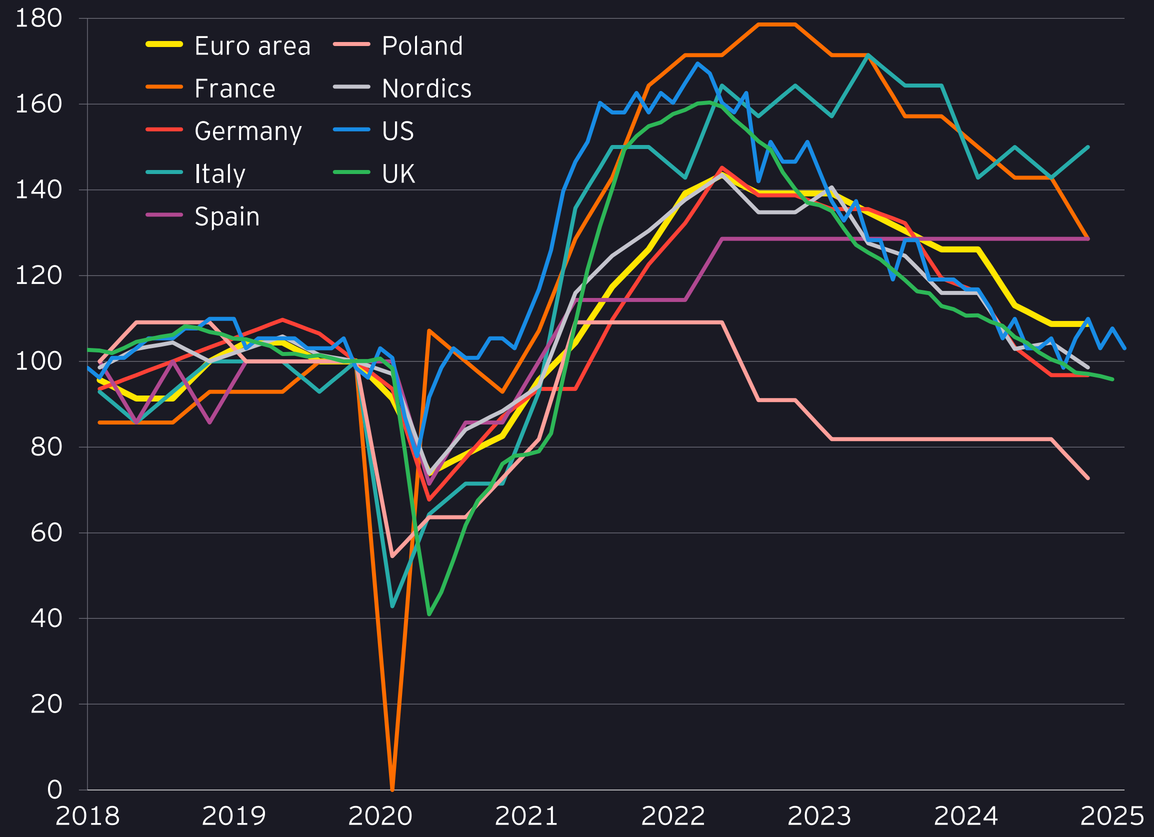
Employment growth in the euro area has been steadily decelerating, despite an unexpected increase in 2025 Q1. Concurrently, a decrease in vacancy rates indicates a cooling in labor market demand.

- In the first quarter of 2025, employment in the euro area experienced an unexpected increase of 0.3% q/q; however, the source of this surprise remains unclear, as available national data indicates a much slower growth rate of 0.1% q/q. This latter figure aligns with the decelerating trend observed in previous quarters.
- Many major European economies are experiencing stagnant or even declining employment, with Spain standing out as a significant positive outlier.

Employment growth
(in percentage)



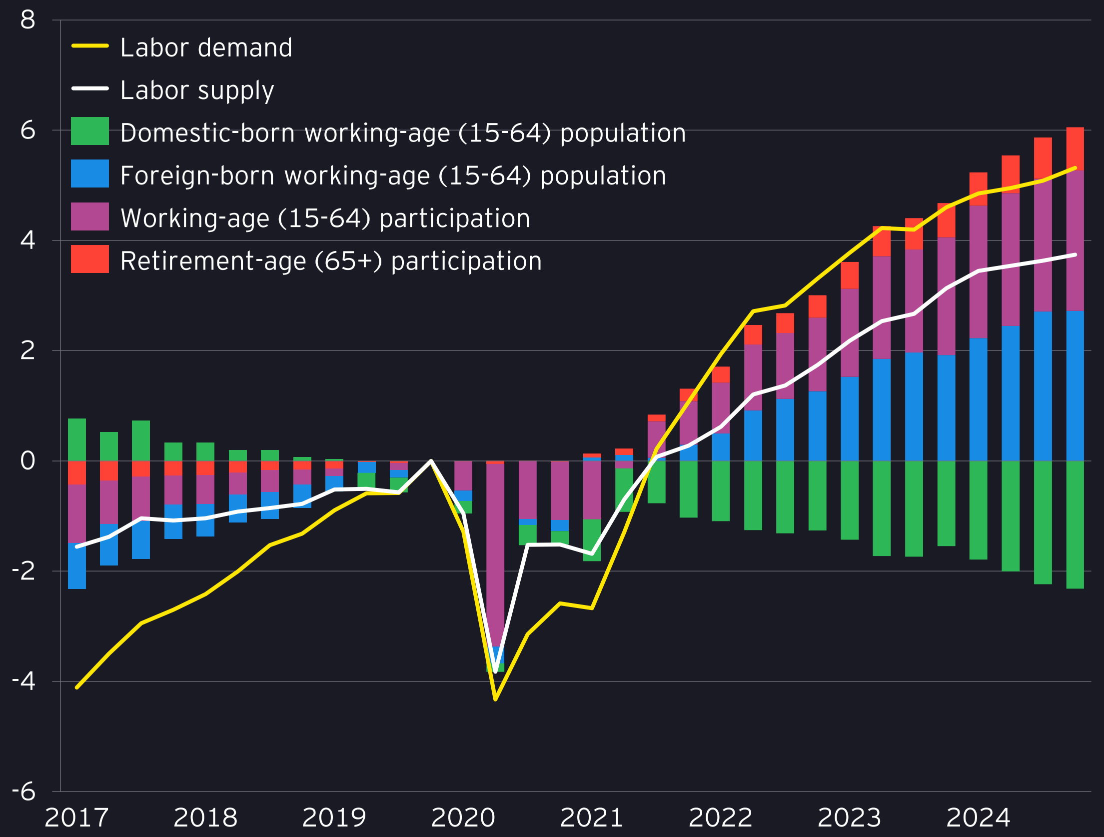
Vacancy rate
(Index, 2019 Q4 =100)



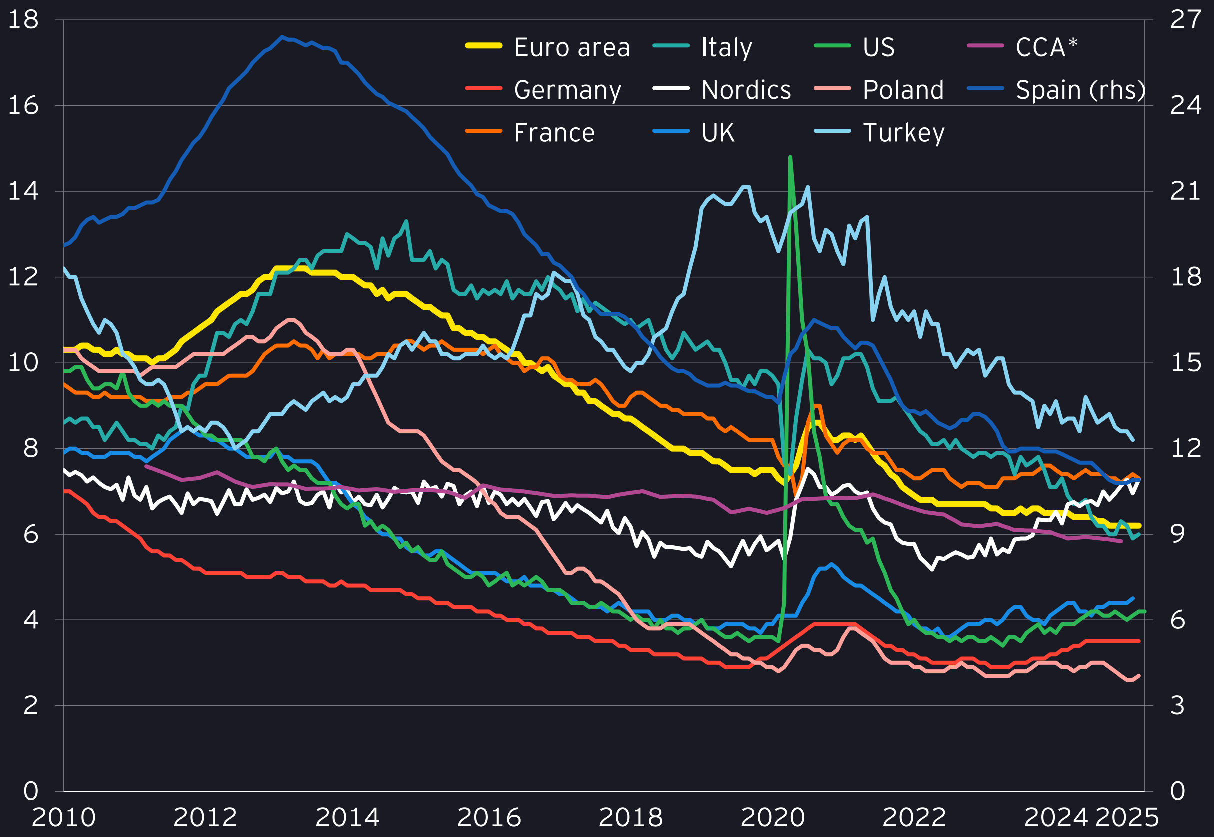
Source: Eurostat, FRED, ONS, trading economics.
Notes: SAAR = Seasonally Adjusted Annual Rate of growth.
* Growth rates for 2024 Q4 instead of 2025 Q1.

Simultaneously, the pace of labor supply growth has slightly decelerated due to more modest gains in labor force participation and accelerated declines in the domestic working-age population. Consequently, unemployment rates have stabilized near historical lows, and the labor market remains structurally tight.

Labor supply and demand change in the euro area compared with 2019 Q4 (in percentage)



Unemployment rate (in percentage)

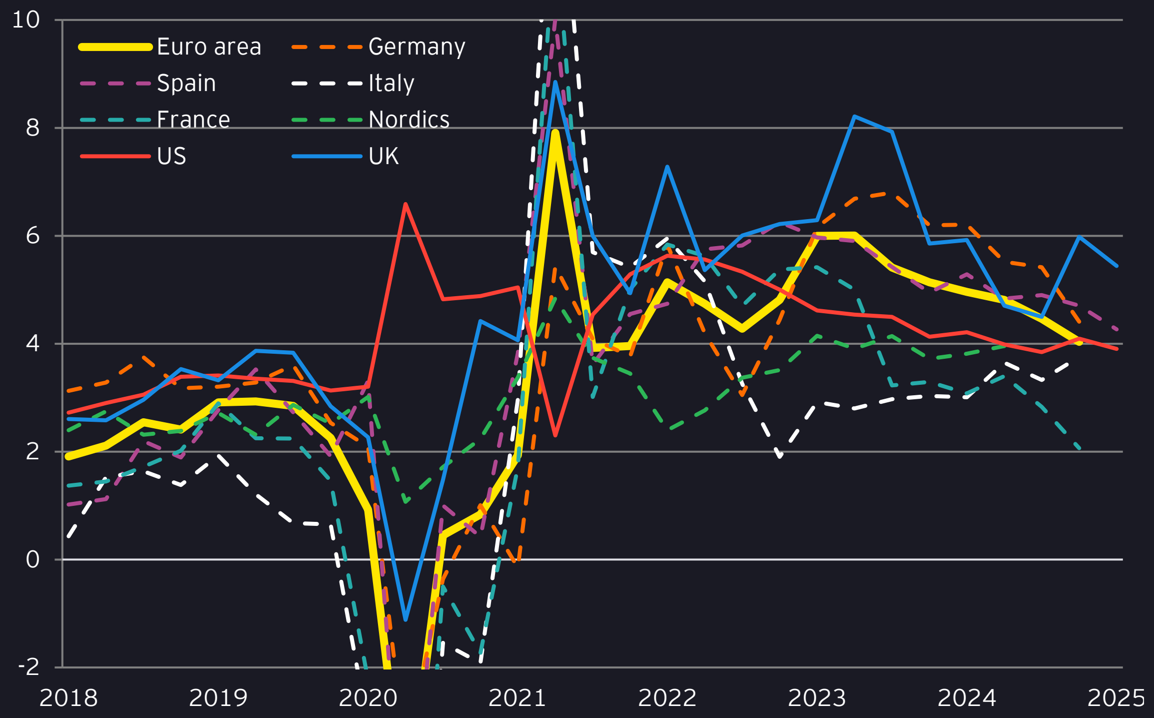


Source: Eurostat, BLS, FRED, ONS.
Notes: Labor demand is a sum of supply employment and vacancies.
* CCA is an average of unemployment rates for Armenia, Georgia, Kazakhstan, and Kyrgyzstan, weighted by GDP.

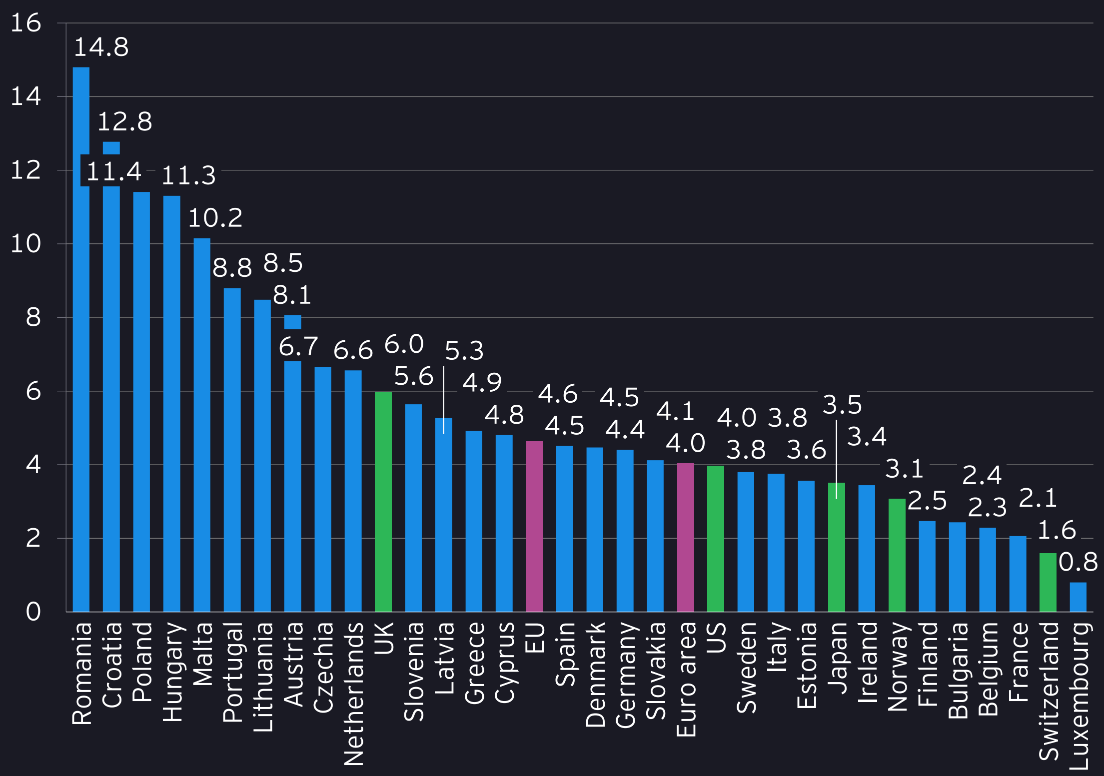
Nominal wage growth has gradually slowed; however, it continues to exceed the rates consistent with the 2% inflation target.

- The primary catalyst for the deceleration in wage growth is reduced inflation, while tight labor market conditions—albeit with some softening—are keeping wage levels elevated.
- Significant disparities in wage growth persist among countries, with inflation and public sector wage growth acting as key drivers behind these differences. CEE economies exhibit significantly higher wage growth compared to their counterparts in Western and Southern Europe. Within (broadly defined) Western Europe, wage growth disparities are also substantial; for instance, while wages in Portugal, Austria, and the Netherlands are growing at rates of 6% to 9% y/y, wage growth in France, Belgium, and Finland remains below 3%.

Wage growth (y/y, in percentage)



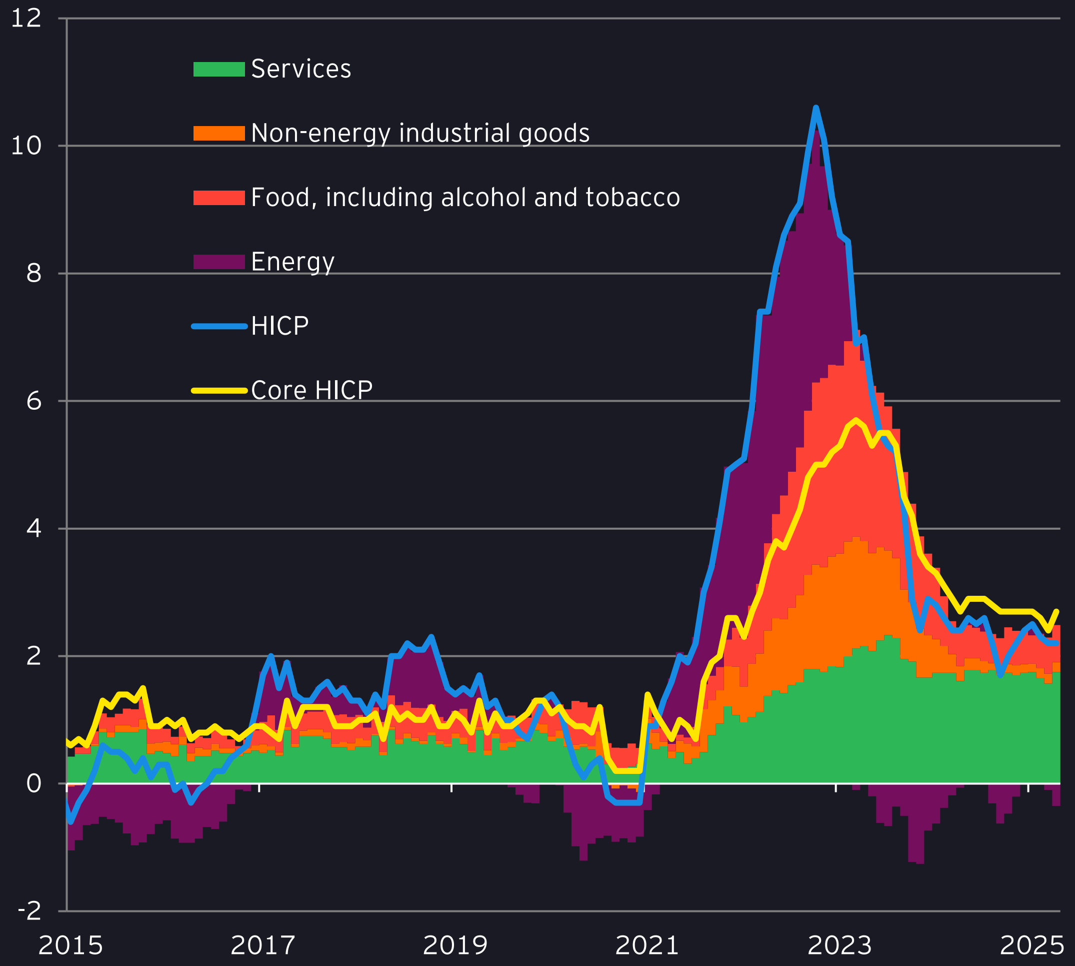
Wage growth in 2024 Q4 (y/y, in percentage)



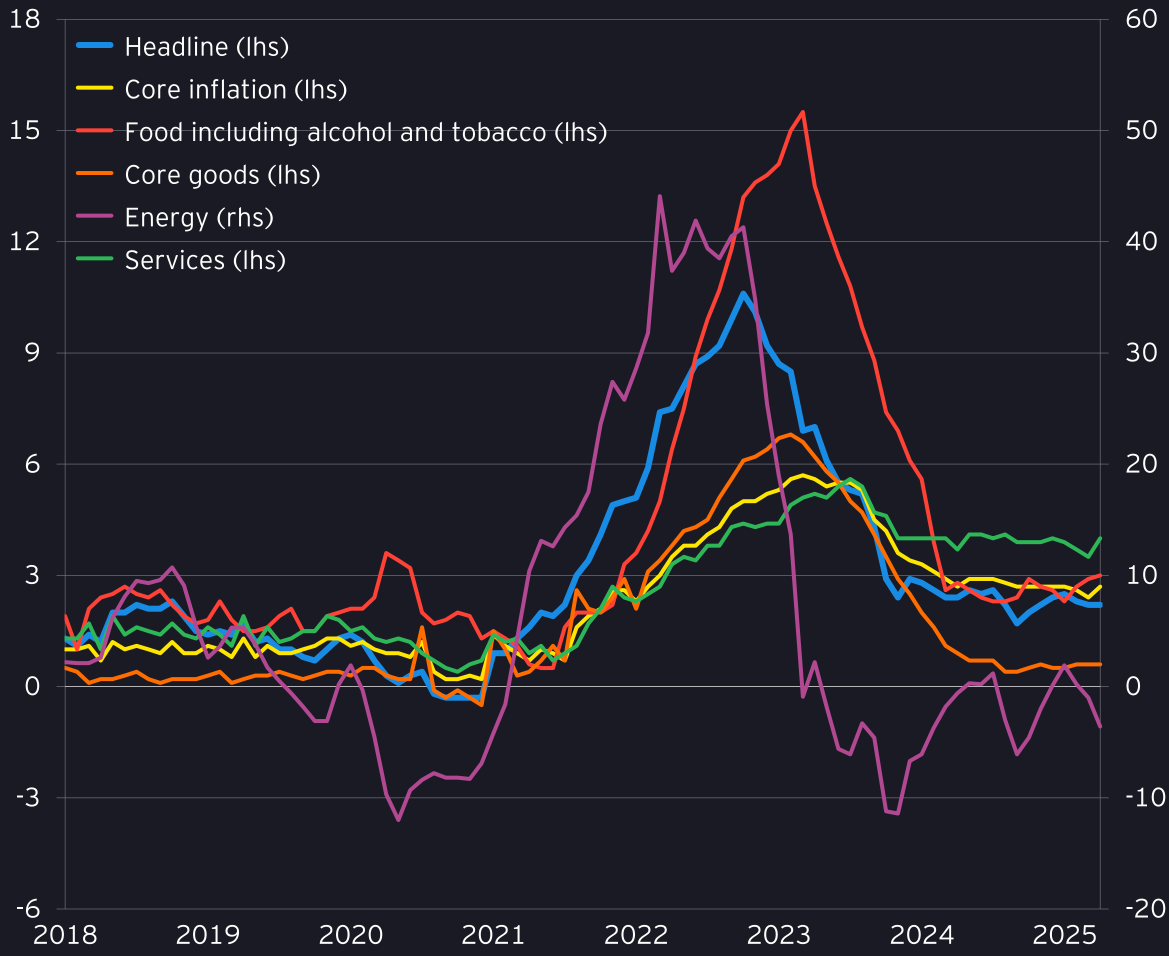
Source: Eurostat, ONS, FRED, Oxford Economics
For the euro area countries, wages and salaries per employed person; for the UK, average weekly earnings in the whole economy, total pay; for the US average hourly earnings of All Employees, Total Private. Nordics as Norway, Sweden, Finland, and Denmark arithmetic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

In the euro area, both headline and core inflation remain slightly above 2%, amid still 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)

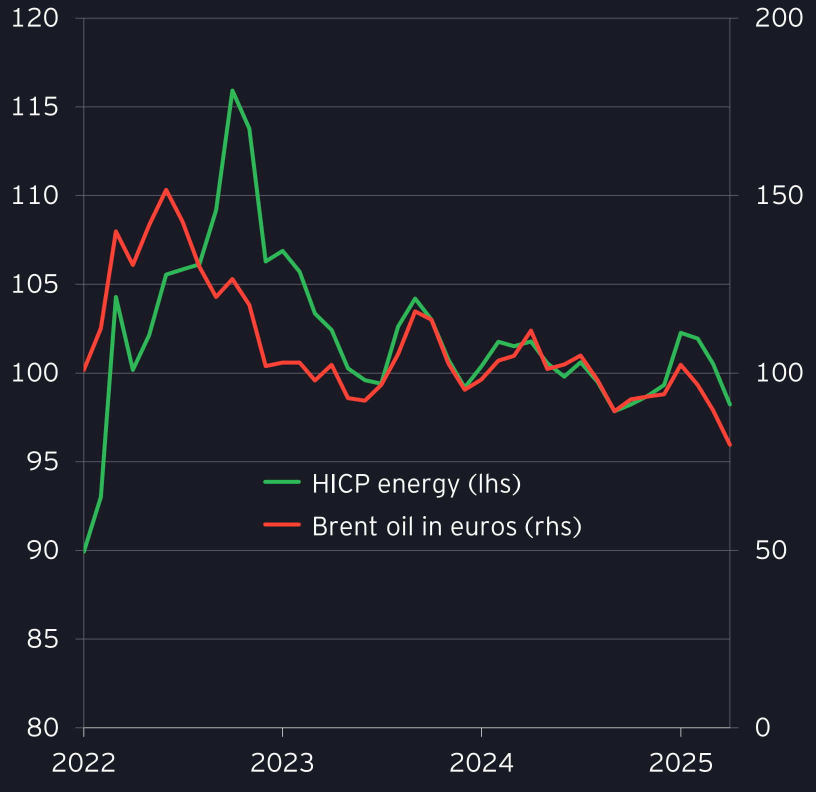


Source: Eurostat.

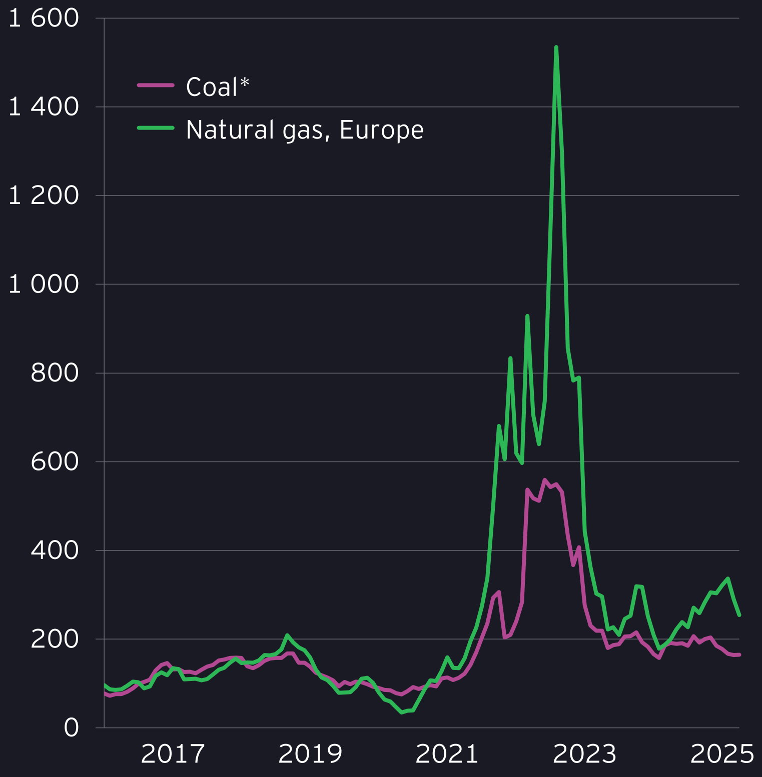
Recent declines in commodity prices, coupled with euro appreciation, are contributing to a reduction in the cost of food and energy products for European households.

- In light of recent declines in oil prices, energy prices continue to exert disinflationary pressure. Nevertheless, electricity prices increased in several countries at the beginning of 2025 due to the removal of price cap in Austria and in response to the rise in natural gas prices throughout 2024 in Belgium, Spain, and Sweden.
- Inflation in the food, alcohol, and tobacco category has been fluctuating within the 2.5% to 3.0% range, despite a decline in global food commodity prices. This fluctuation is attributed to local supply shocks that have driven up the prices of fruits and vegetables, as well as ongoing increases in tobacco excise taxes.

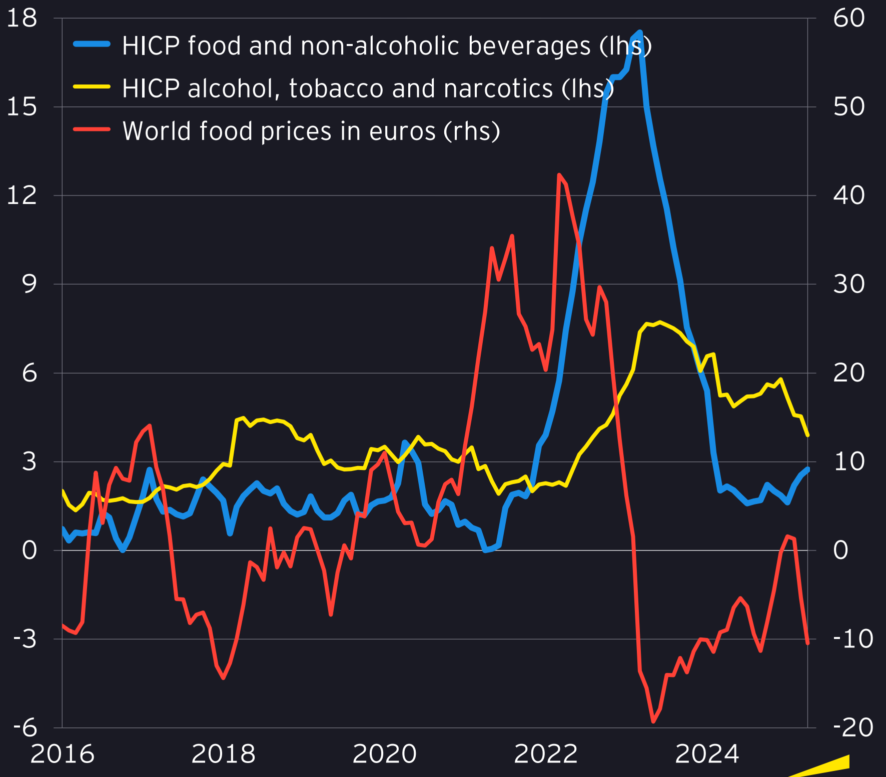
HICP energy in the euro area vs. oil prices (index, 2024 = 100)



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



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

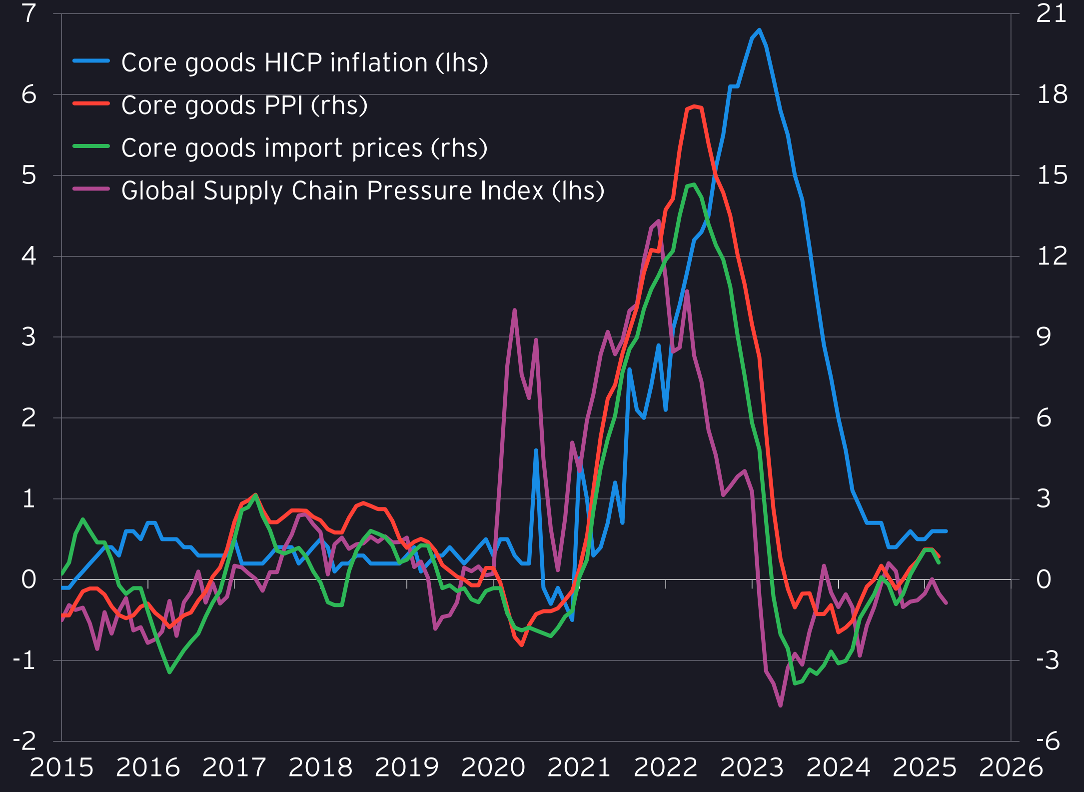


Source: World Bank Commodity Prices; BIS; Eurostat; stooq.pl.
* ICE Rotterdam coal price.

Core goods inflation has stabilized at close to 0.5%, whereas services inflation remains sticky near 4%.

- Global supply chain pressures and price pressures in global manufacturing remain muted, although they have been gradually increasing over the past few quarters. In this context, core goods inflation in the euro area has stabilized at a low level.
- Services inflation decreased in February and March but rose again toward 4% in April, driven by an Easter-related uptick in package holiday and air transport prices. Despite the overall decline, elevated wage growth continues to exert cost pressures within the services sector.

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



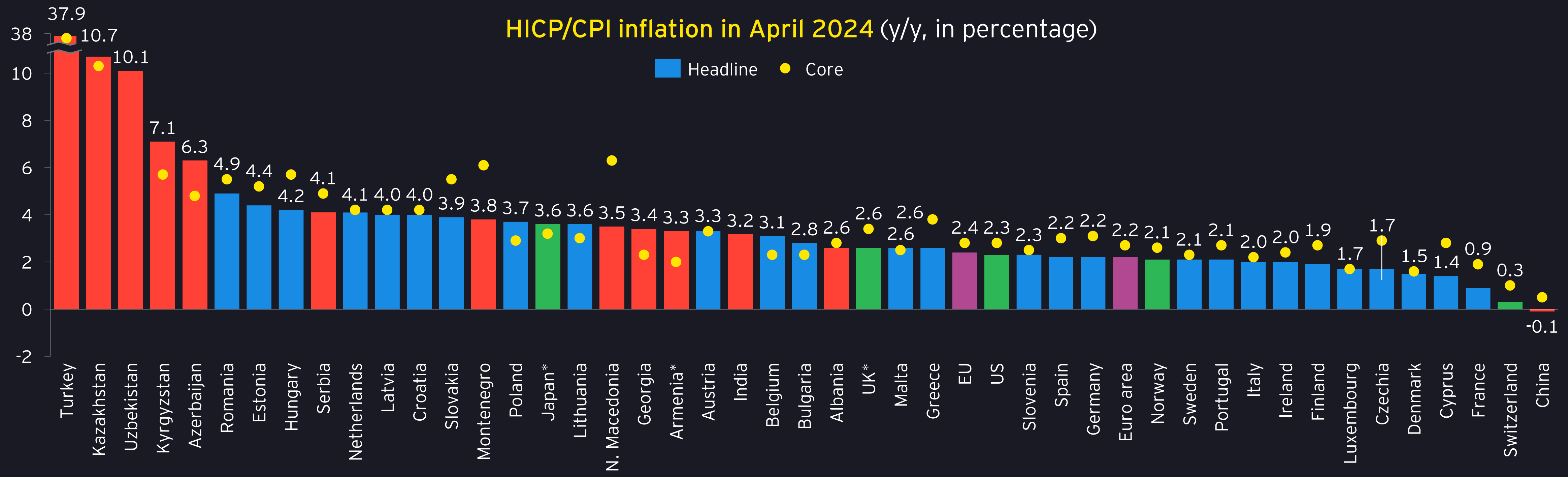
Y/y services inflation vs. y/y nominal wage growth in the euro area (in percentage)

Source: Eurostat, Oxford Economics, New York Fed.

Inflation rates across Europe continue to diverge, influenced by disparities in wage growth, regulatory pricing, and excise tax hikes.

- Within the EU, price pressures remain somewhat elevated in most Central and Eastern European (CEE) countries, where high wage growth sustains services inflation in the range of 6% to 8%. Additionally, unfavorable supply conditions and strong consumer demand have driven food inflation to approximately 5%.
- In Western Europe, the highest inflation is observed in the Netherlands, attributed to a combination of significant tobacco excise tax hikes and strong wage growth, which are pushing up prices for both services and goods. Conversely, the lowest inflation is found in Switzerland, followed by France, where subdued wage growth has kept services inflation in check and food prices remain stable.
- Outside the EU, disinflation has been progressing in Turkey in recent months; however, a renewed increase in price pressures is likely in the near term due to the depreciation of the lira following the detention of Istanbul's mayor. Inflation has been rising in Kazakhstan and remains elevated in Uzbekistan, driven by currency depreciation, VAT tax hikes, and increases in regulated energy prices.

HICP/CPI inflation in April 2024 (y/y, in percentage)

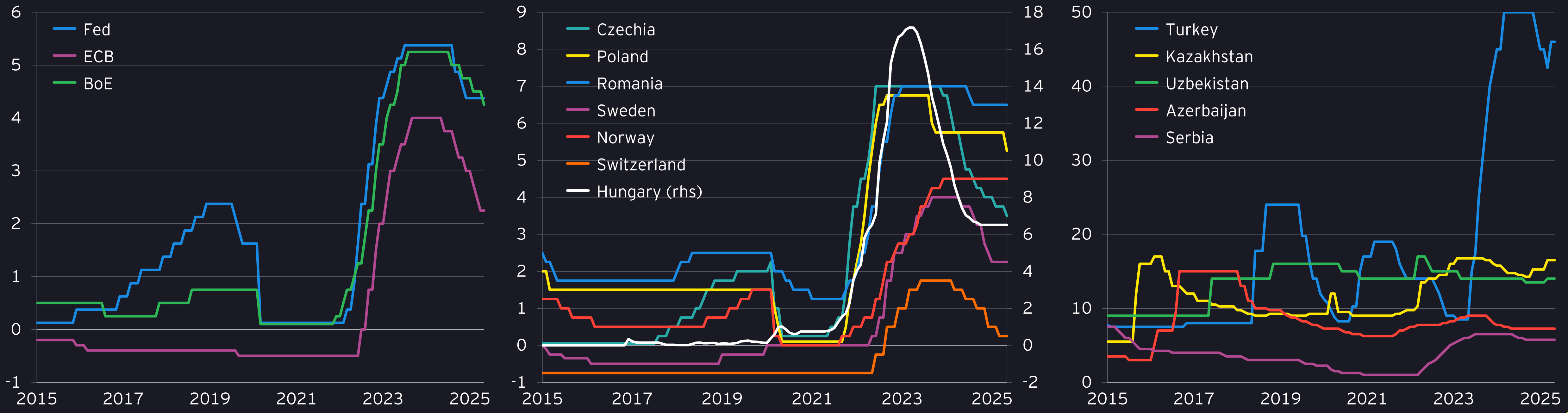


Source: Eurostat, FRED, ONS, Trading Economics, national statistical bureaus.
Note: HICP inflation for EEA countries and CPI inflation for the remainder.
*March 2025

While most central banks have been reducing interest rates, the pace and timing of monetary policy easing vary significantly across different jurisdictions.

- The US Fed has maintained interest rates at 4.25% to 4.5% since December 2024, adopting a "wait and see" approach amid conflicting risks related to trade policies, inflation, and economic activity.
- In light of modest GDP growth, stable price pressures, and risks to economic activity stemming from global trade tensions, the ECB has reduced interest rates by 25 basis points at each meeting this year, with the deposit rate reaching 2.25% in April. However, the ECB has not provided any guidance on the future trajectory of its monetary policy.
- Given slowing growth on one hand and still elevated services inflation and wage growth on the other, the Bank of England has maintained its cut-and-hold strategy by reducing rates at every other meeting, with the bank rate reaching 4.25% in May.
- Amid stagnant prices, the Swiss National Bank continued its monetary policy easing, reducing the policy rate to 0.25% in March. In contrast, the Swedish Riksbank has kept interest rates unchanged at 2.25% since January, while Norges Bank has yet to reduce rates from 4.5%, as surging food inflation has convinced Nordic central banks to delay monetary policy easing.
- Monetary policy continues to diverge across CEE, with the Czech National Bank progressing with monetary policy easing, albeit at a reduced pace. Meanwhile, the central banks of Hungary and Romania have kept interest rates unchanged at 6.5% since August-September 2024, amid resurging price pressures and political uncertainty. In contrast, the National Bank of Poland altered its policy course after inflation surprised slightly to the downside in the early part of the year, delivering a 50 basis point cut in May, which was presented as a one-off recalibration of monetary policy.
- The central bank of Turkey was compelled to break the easing cycle, increasing interest rates by 3.5 percentage points to 46% following the detention of Istanbul's mayor, which led to capital outflows. Meanwhile, interest rates in Kazakhstan were increased by 1.25 percentage points to 16.5% amid resurging inflation.

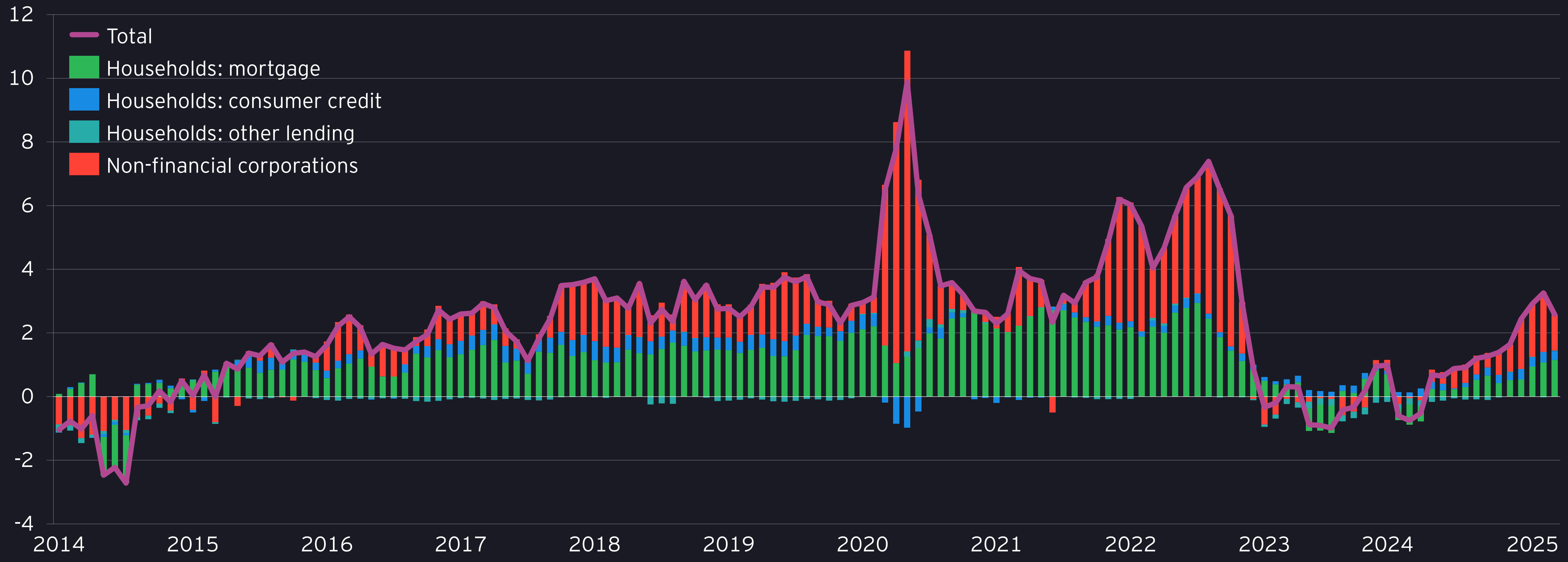
Central bank interest rates (in percentage)



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

With the easing of monetary policy, credit growth is gradually picking up.

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

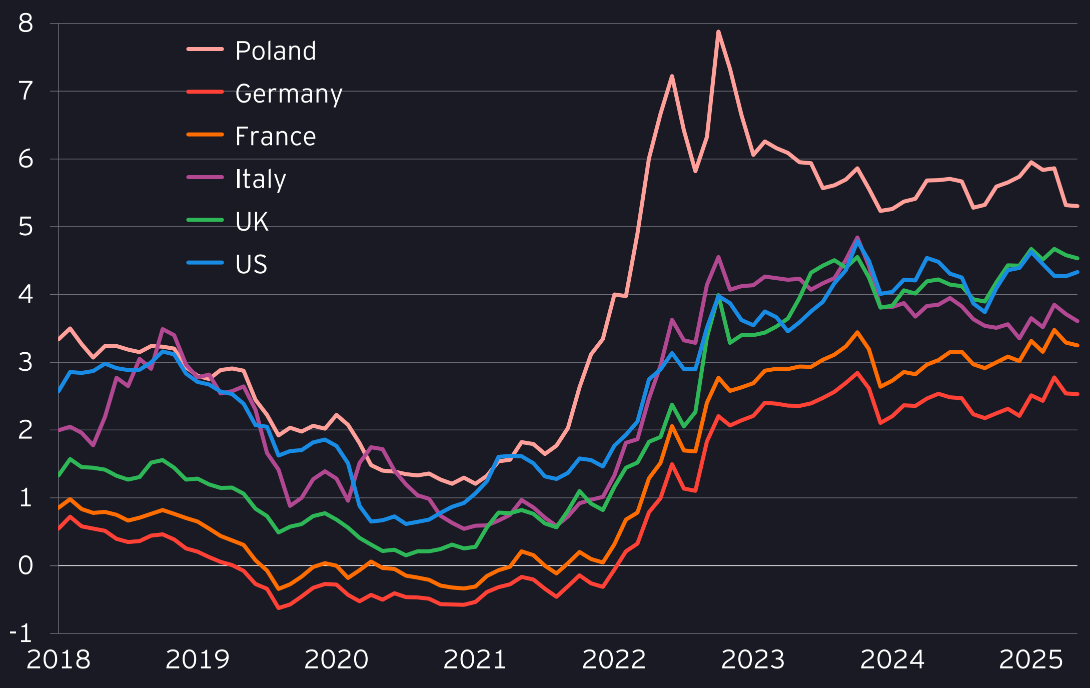


Source: ECB, EY calculations.
Note: Series for households include NPISH.

Financial markets have been volatile in recent months, driven by tariff developments and German fiscal expansion. However, the overall reaction of financial markets to tariffs has been more benign than expected

- The election of Donald Trump as president was initially met with a positive response from markets, resulting in rising stock prices and bond yields in anticipation of more expansionary fiscal policy and deregulation.
- However, the mood began to shift in January, as investors rotated from US tech stocks to European equities. This trend intensified following the announcement of tariffs on China, Canada, and Mexico in February, leading to a decline in US stocks while European equities gained.
- In early March, plans for a significant fiscal expansion in Germany were announced, resulting in euro area 10-year bond yields increasing by 30 to 40 basis points in the aftermath. This increase proved temporary, as bond yields returned to previous levels by late April.
- This reversal was linked to the announcement of reciprocal tariffs on April 2, which triggered a global stock market crash, with valuations dropping by over 10%. Since then, amid a partial suspension of reciprocal tariffs and the commencement of trade negotiations with multiple countries, stock prices have gradually recovered. As of mid-May, stock prices are above pre-April 2 levels, despite the continued presence of substantial tariffs and a less favorable outlook for global economic activity compared to a few months ago.

10-year government bond yield (in percentage)



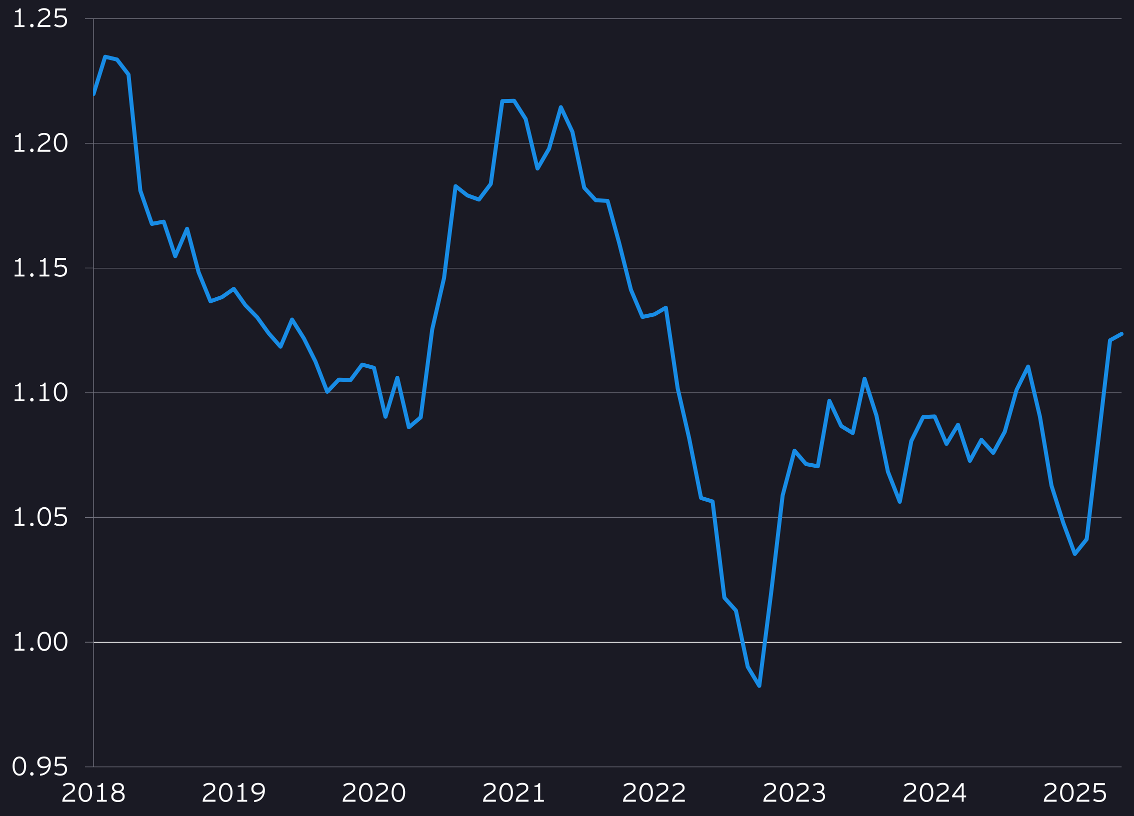
Major stock price indices (index, 2019Q4=100)

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

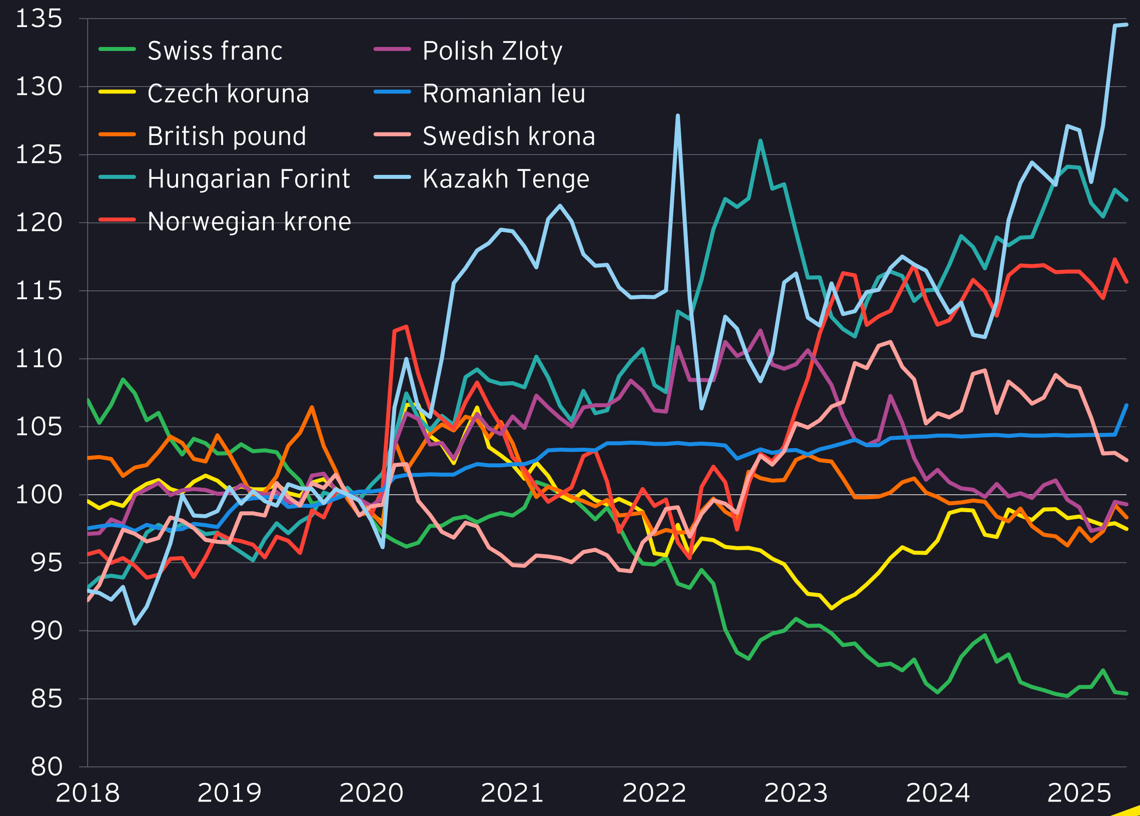
Exchange rates have been similarly volatile, with the euro depreciating significantly following the US elections, only to regain value after the announcement of German fiscal expansion and reciprocal tariffs.

- Initially, investors anticipated that the US economy would net benefit from the policies of the new administration, leading to an appreciation of the USD. However, as German fiscal expansion improved the outlook for Europe and trade policies began to negatively impact the US more than Europe, the euro appreciated.
- Despite some volatility, as of mid-May, most European currencies remain at similar levels against the euro as they were in early January. A notable exception is the Swedish krona, which has appreciated by approximately 5%. This increase follows a period of pronounced currency weakness and can be interpreted as a return toward its fair equilibrium value.

EUR/USD exchange rate



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



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

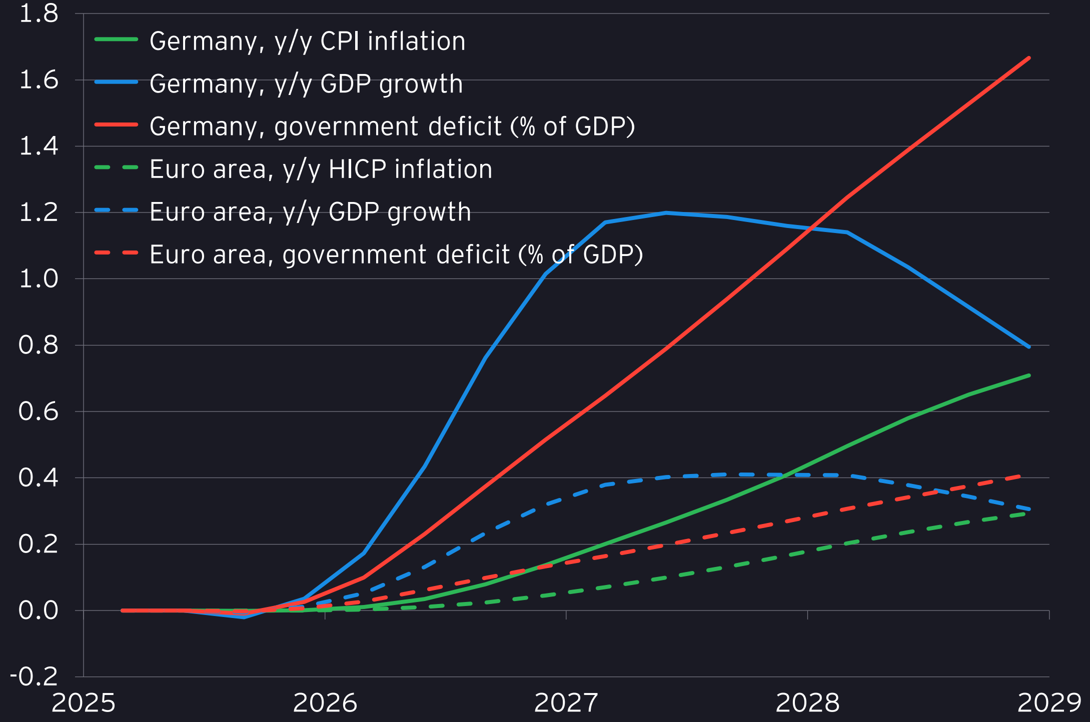
Chapter 3

Economic outlook

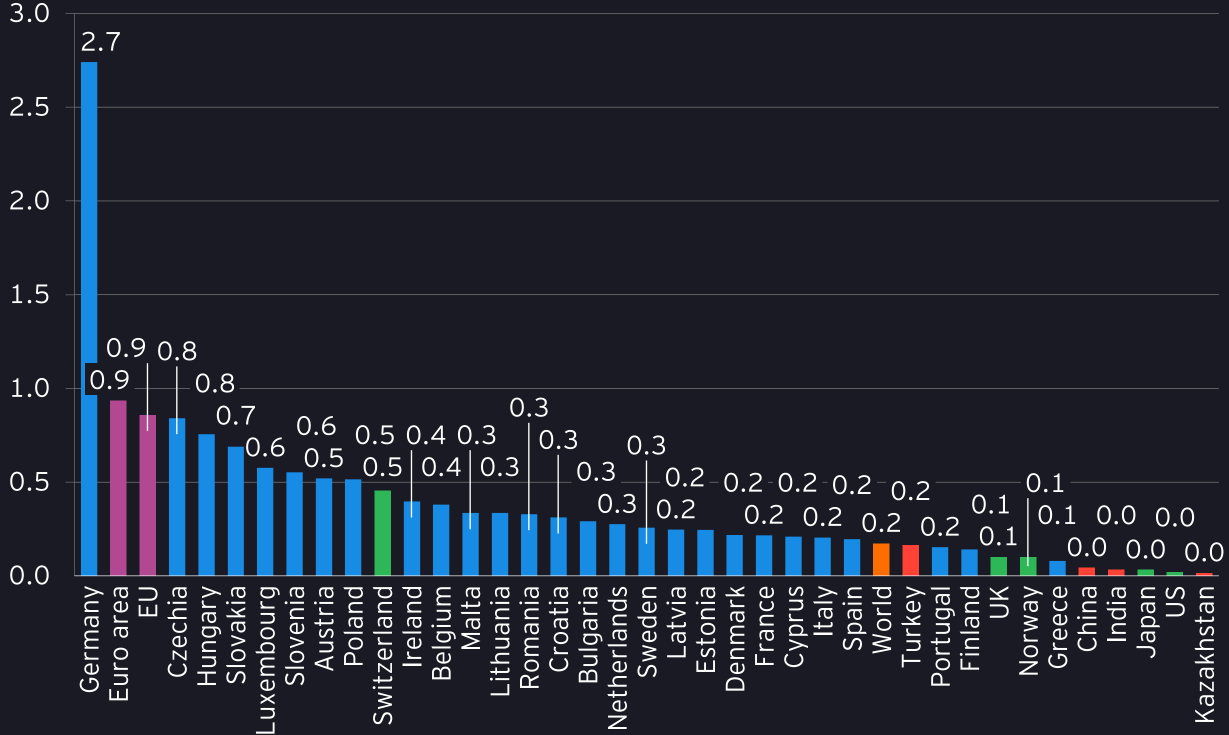
The blow from tariffs will be partially offset by fiscal expansion in Germany…

- In March, the German Parliament adopted a fiscal package that departs from the previous conservative approach, consisting of three main components:
  - A new infrastructure fund of EUR 500 billion (~11.5% of the 2024 GDP) over 12 years, with €100 billion allocated to the Climate Transition Fund and the remainder designated for infrastructure investments—€300 billion for the federal government and €100 billion for state governments. This fund operates outside the 'debt brake' constraints.
  - Defence spending above 1% of GDP will not count towards the 'debt brake'.
  - Each of Germany's 16 federal states can now maintain a small structural deficit of 0.35% of their economic output, a change from the previous prohibition on state debt.
- The impact of these actions will not be immediate; by 2028, fiscal expansion is expected to increase German GDP by 2.7% and euro area GDP by 0.9%.

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



Impact of German fiscal expansion on 2028 GDP level (in percentage)

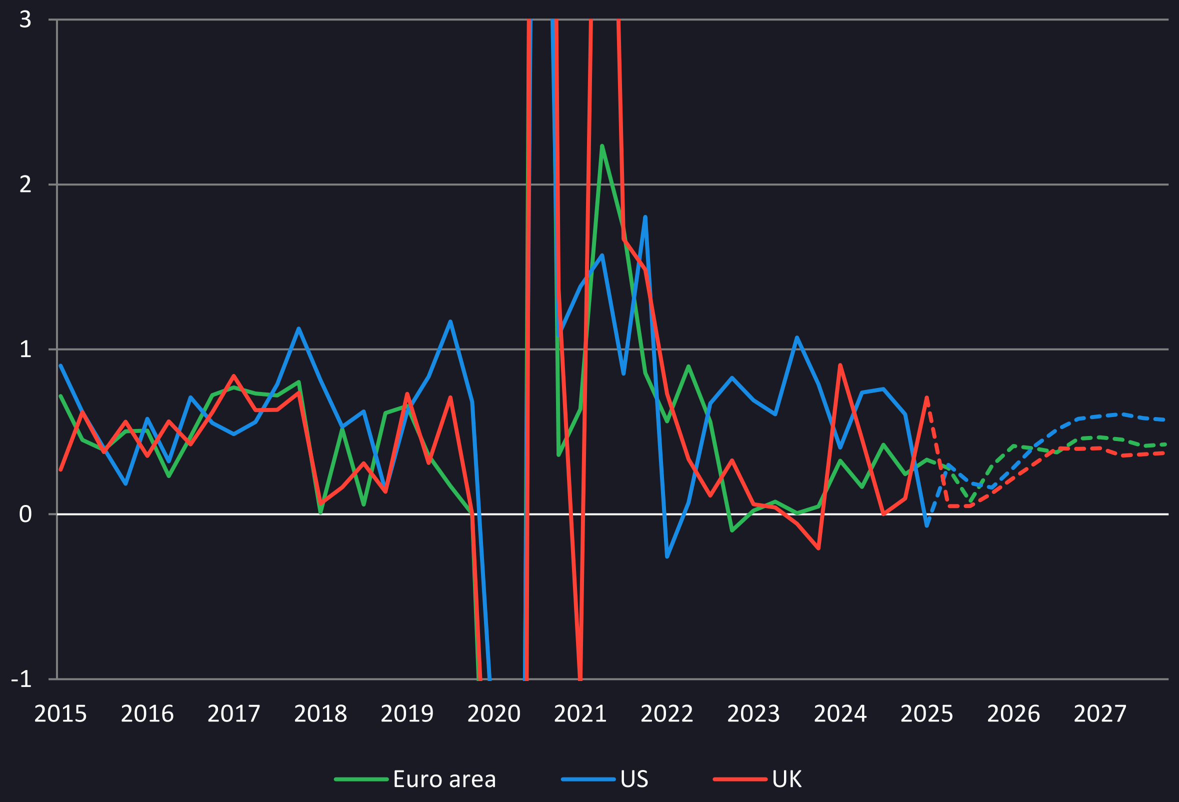


Source: EY EAT calculations.

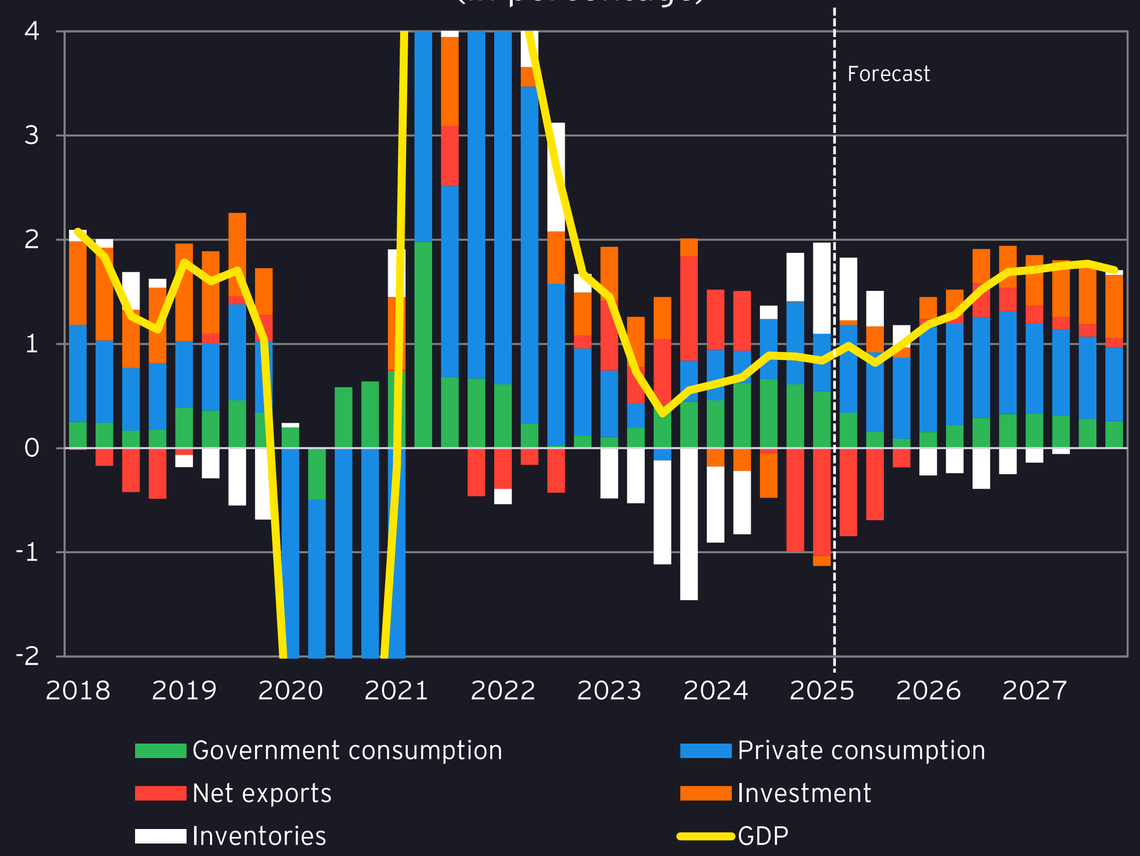
… which is one of reasons why we still expect the euro area's economic growth to gradually accelerate. However, the recovery is anticipated to be more protracted than expected in January.

- In the short term, recovery will continue to be driven by private consumption, which reacts with a delay to increased real incomes, while uncertainty and tariffs weigh on investment and exports. From 2026, investment is expected to gradually pick up, supported by reduced interest rates, rebounding profits, and an expansion of government spending. Additionally, exports are anticipated to gain momentum despite a challenging environment.

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



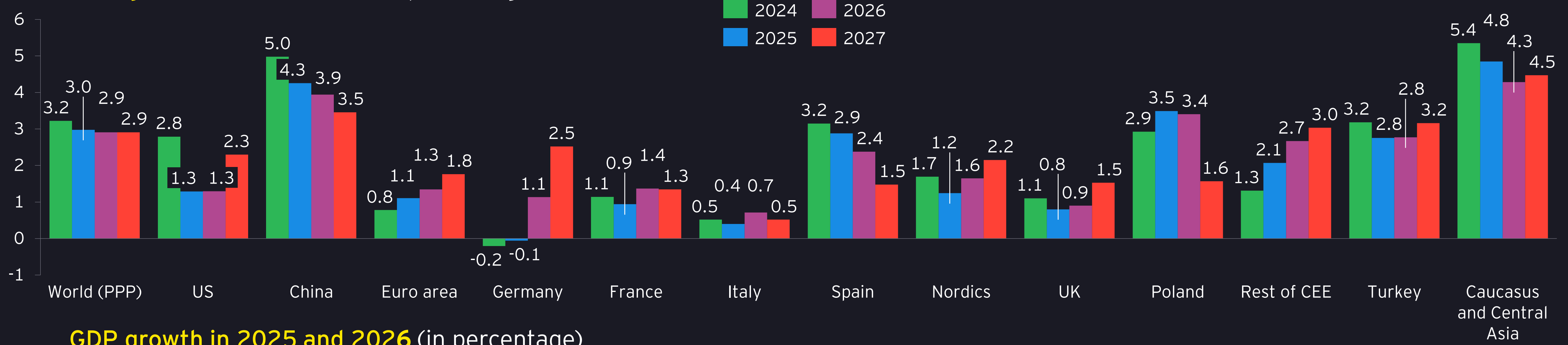
Decomposition of y/y GDP growth in the euro area less Ireland* (in percentage)



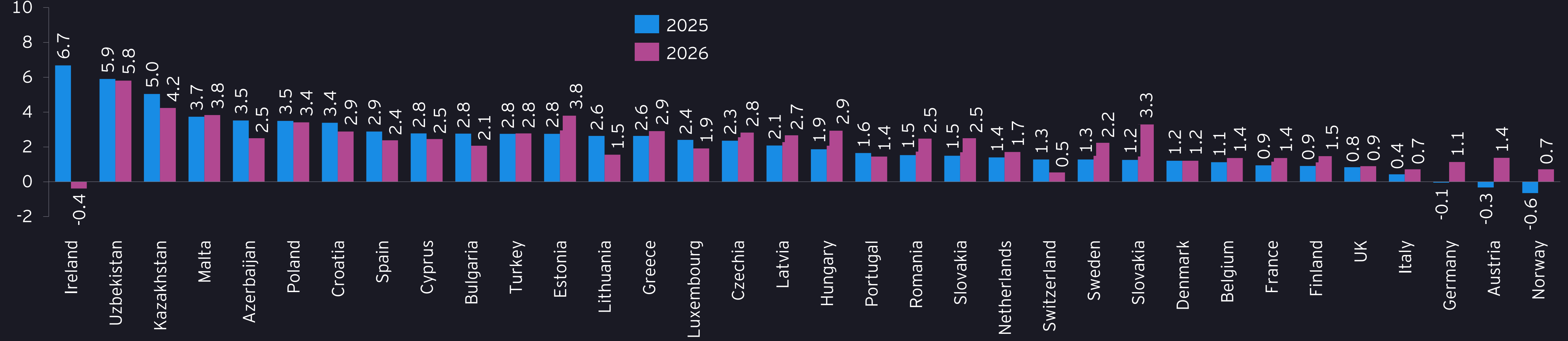
Source: Eurostat, Fred, ONS.
Dashed lines denote EY EAT forecast
* Ireland is excluded as its GDP tends to be very volatile, reflecting the outsized role multinational corporations play in the economy. GDP components for 2025 Q1 based on EY estimates.

Growth disparities between tourism-oriented and industry-heavy economies will persist this year but are expected to gradually diminish from 2026, aided by fiscal expansion in Germany.

GDP growth in 2024-2027 (in percentage)



GDP growth in 2025 and 2026 (in percentage)

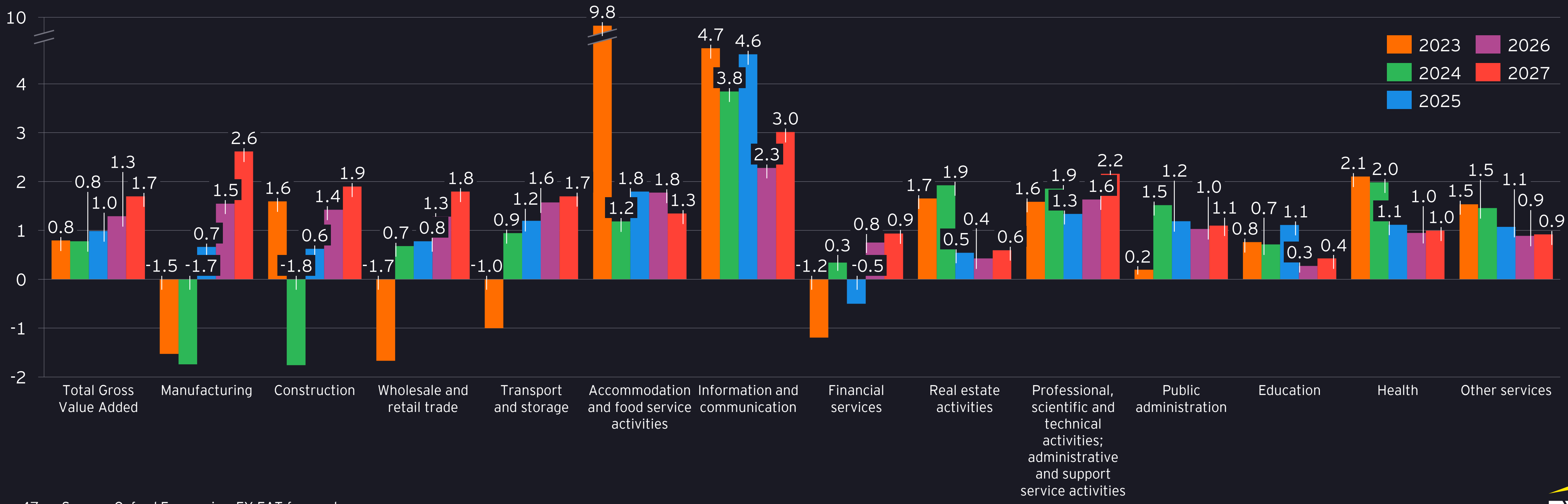


Source: Oxford Economics, EY EAT forecast; IMF (for Caucasus and Central Asia).
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Estonia, Latvia, Lithuania, Czechia, Slovakia, Hungary, Romania, Bulgaria, Croatia, Slovenia; Caucasus and Central Asia includes Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan, Azerbaijan, Armenia, and Georgia.

Sector-wise, manufacturing and construction are expected to experience a gradual cyclical recovery, while the ICT sector should continue to grow at the fastest pace.

- The information and communication category has consistently led in terms of growth rate of Gross Value Added (GVA) over the past years. We expect this trend to continue in the coming years, with this sector remaining the fastest-growing category, albeit at a slightly reduced pace compared to previous years.
- Construction is anticipated to experience a cyclical recovery supported by reduced interest rates and an expansion of government investment. Similarly, we expect the tide to finally turn for manufacturing, despite ongoing trade tensions.

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

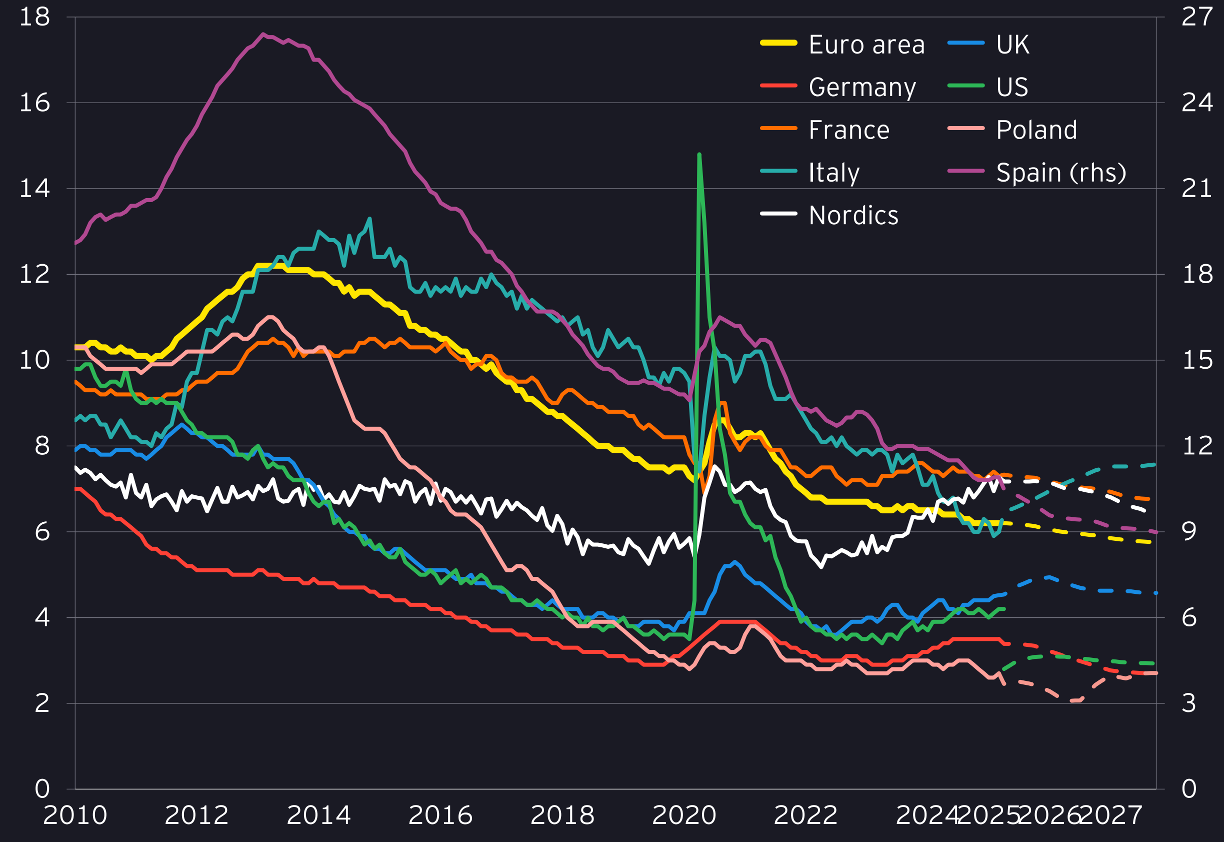


 Source: Oxford Economics, EY EAT forecast.

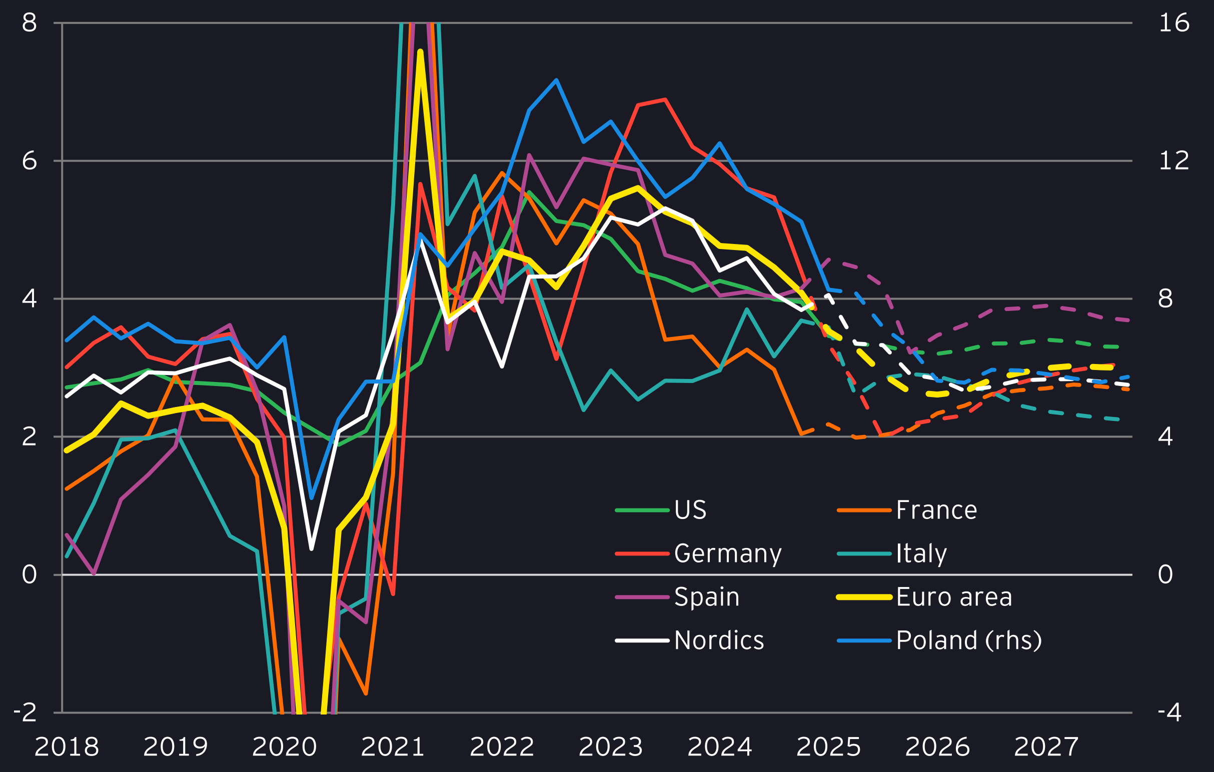
Labor market conditions in the euro area are expected to further stabilize, with wage growth gradually declining towards 3%—still higher than pre-pandemic levels due to a structurally tighter labor market.

- Labor market trends continue to be influenced by demographic factors. Employment growth is expected to stabilize at approximately 0.1% q/q following an upside surprise in the first quarter. This growth rate is anticipated to be adequate for maintaining the euro area unemployment rate within the range of 6.1% to 6.3% in 2025, with a slight decrease expected thereafter.
- Employment growth is projected to remain robust in Spain and to experience a cyclical recovery in the Nordic countries. In contrast, stagnation is anticipated in Germany and CEE countries. Wage growth in CEE is likely to stabilize at an elevated level above 5%, while euro area economies are heading toward the 2.5-3.5% range

Unemployment rate (in percentage)



Wage growth (y/y, in percentage)

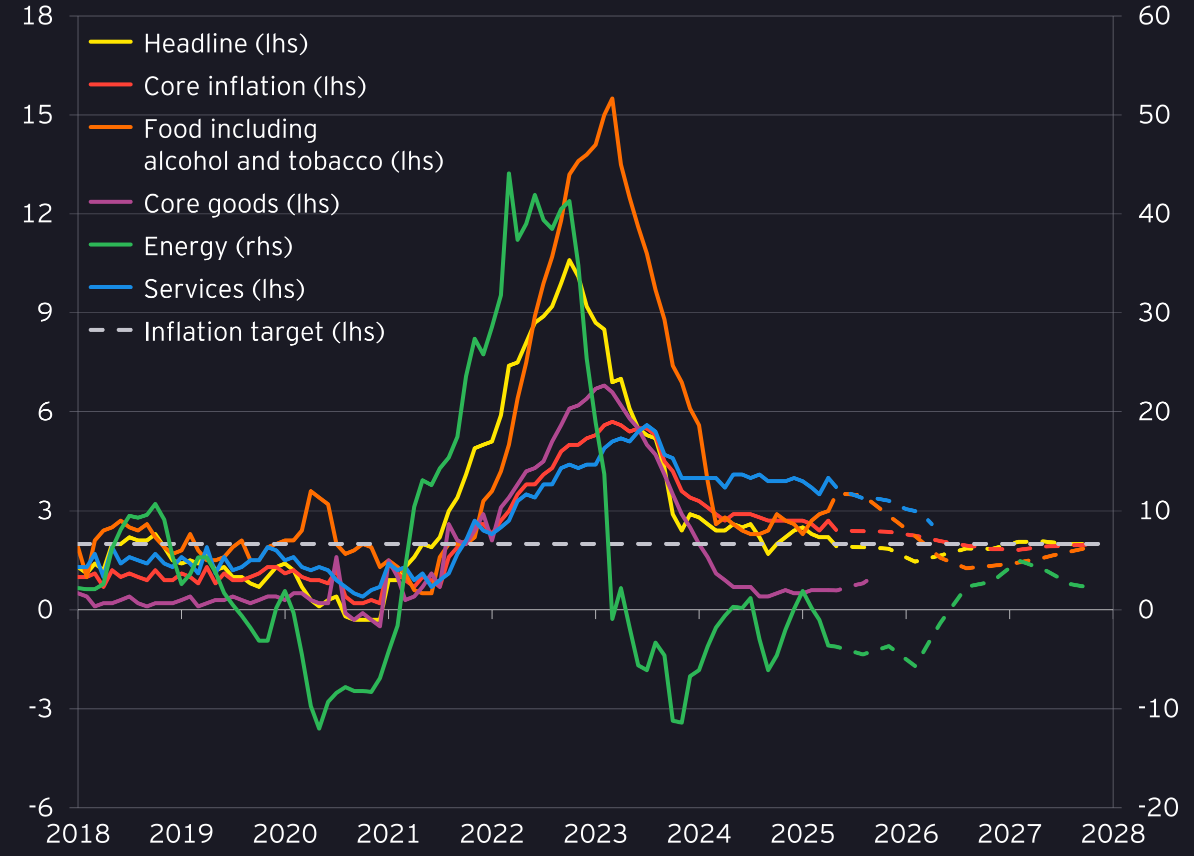


Source: Eurostat, Oxford Economics, EY EAT forecast.
Dashed lines denote EY EAT forecast.

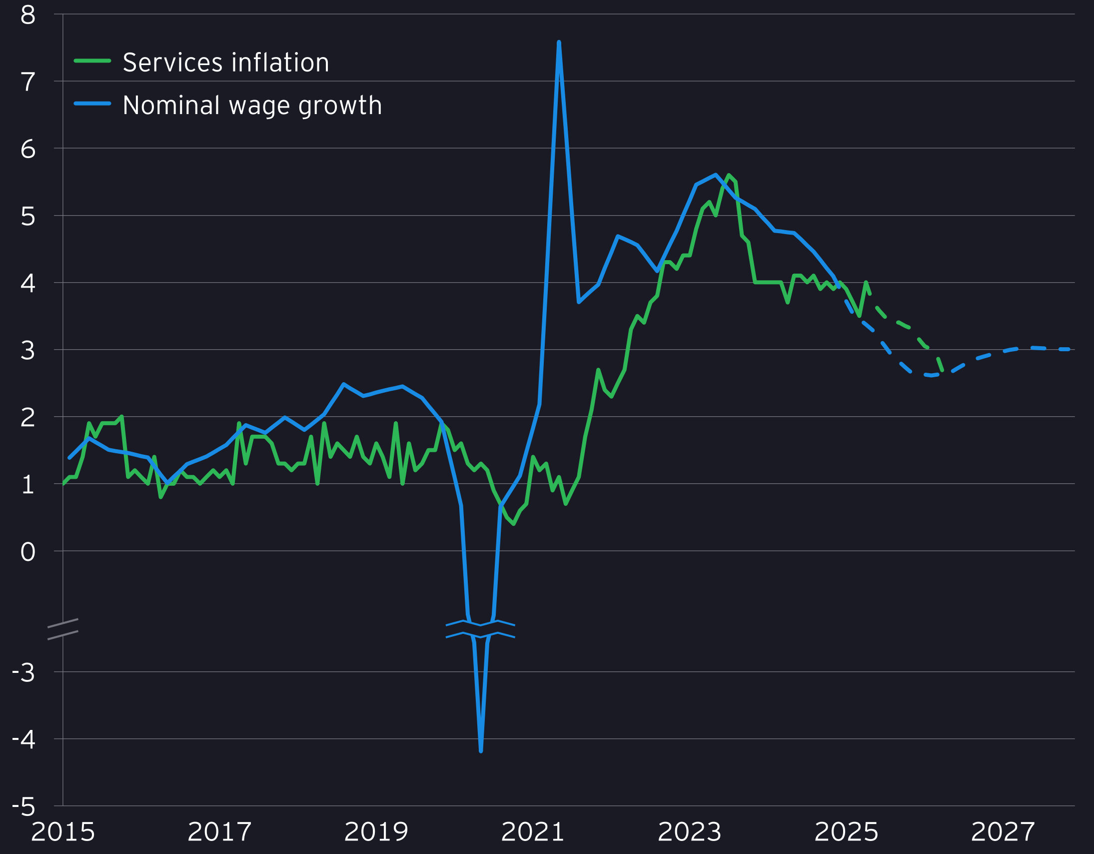
Headline inflation is expected to remain close to 2%.

- In 2025, core, services, and food inflation are expected to remain slightly elevated. However, this will be offset by declining energy prices, maintaining headline inflation within the range of 1.5% to 2.0%. Inflationary pressures in the services sector are anticipated to further diminish as wage growth normalizes, bringing core inflation back toward 2% by mid-2026. Additionally, food inflation is expected to normalize by 2026, aligning with the timeline to keep headline inflation close to 2% when energy prices are no longer disinflationary.

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



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

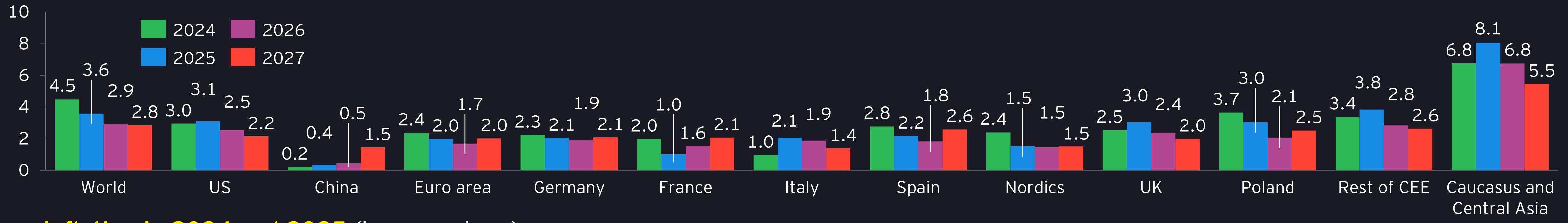


Source: Eurostat, Oxford Economics, EY EAT forecast.
Dashed lines denote EY EAT forecast.

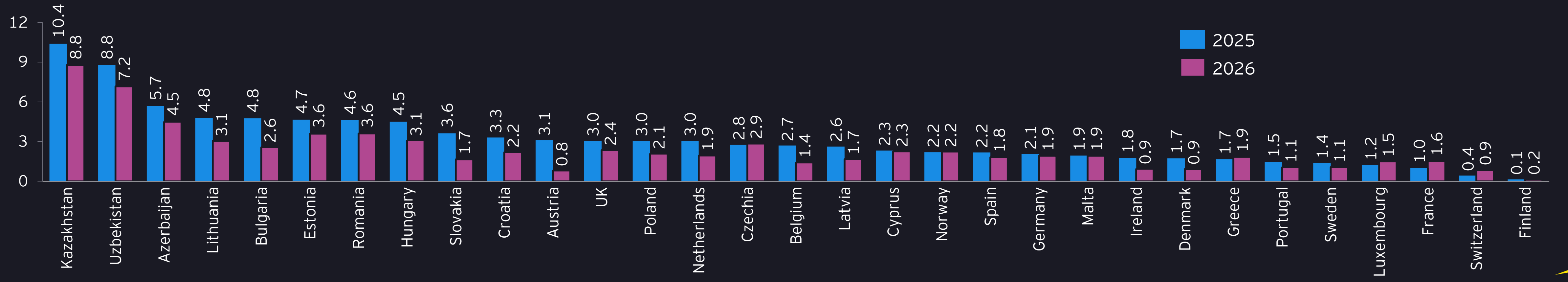
In 2025, CEE countries are expected to struggle with the 'last mile' toward the inflation target, whereas euro area economies will have already curbed inflation.

- In CEE, headline inflation is expected to remain above 3.5% in several countries, driven by elevated service and food inflation. Nevertheless, slowing wage growth and declining fuel and energy prices will facilitate a return to the target, with only Estonia and Romania balancing above the upper target band in 2026.
- Finland and Sweden, amid weak underlying price pressures, are projected to have subdued headline inflation in 2025 due to methodological issues*. Switzerland is expected to temporarily undershoot the target due to low wage growth and a strengthening Swiss Franc. For most other countries, we anticipate inflation to fluctuate within the 1.5-3% range.

Inflation in 2024-2027 (in percentage)



Inflation in 2024 and 2025 (in percentage)

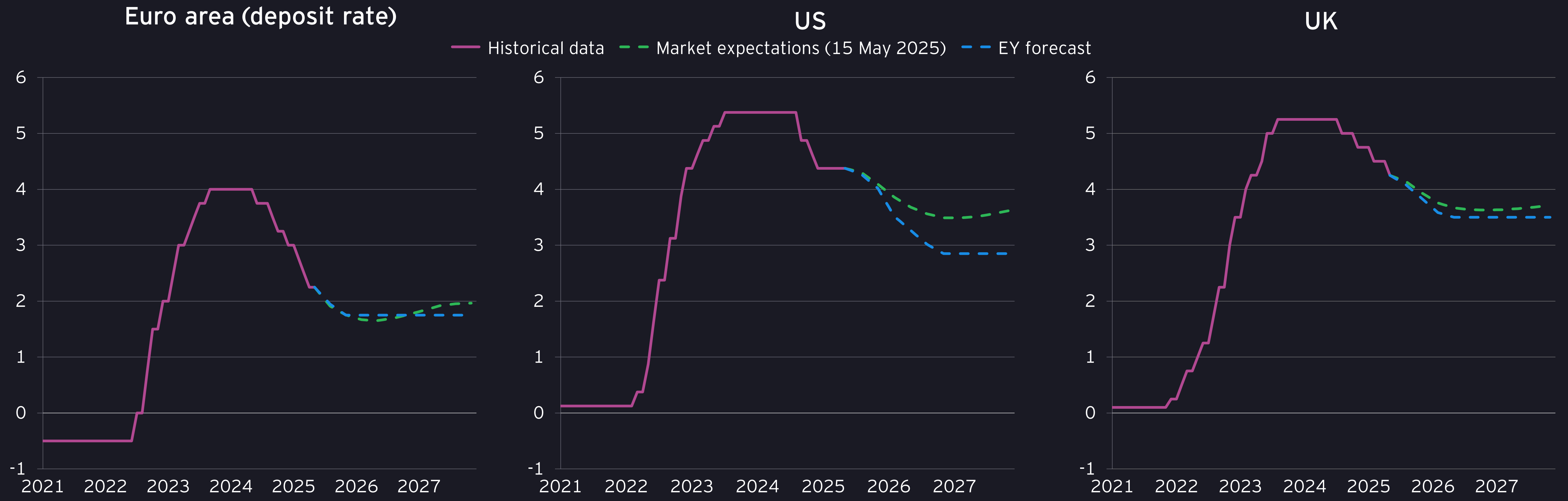


Source: Oxford Economics, EY EAT forecast.
* In Finland and Sweden, mortgage interest payments enter CPI. For this reason, interest rate cuts will have a strong negative impact on headline CPI inflation in 2025.

We expect the ECB to cut rates in June and September, with the deposit rate reaching 1.75%.

- The ECB will continue easing monetary policy amid declining commodity prices, a stronger euro, and downside risks to economic activity and inflation from trade tensions, reaching a terminal rate of 1.75% by September.
- We expect the US Fed to remain cautious in the near term, considering policy uncertainty, a robust labor market, and inflationary risks from tariffs, delaying further cuts until September. Deteriorating economic activity is anticipated to lead to a 50 bp of cuts in the latter part of this year, followed by an additional 100 bp decrease in 2026.
- We anticipate that the Bank of England (BoE) will maintain its cut-and-hold strategy, ultimately settling the interest rate at 3.5% by the first quarter of 2026.

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

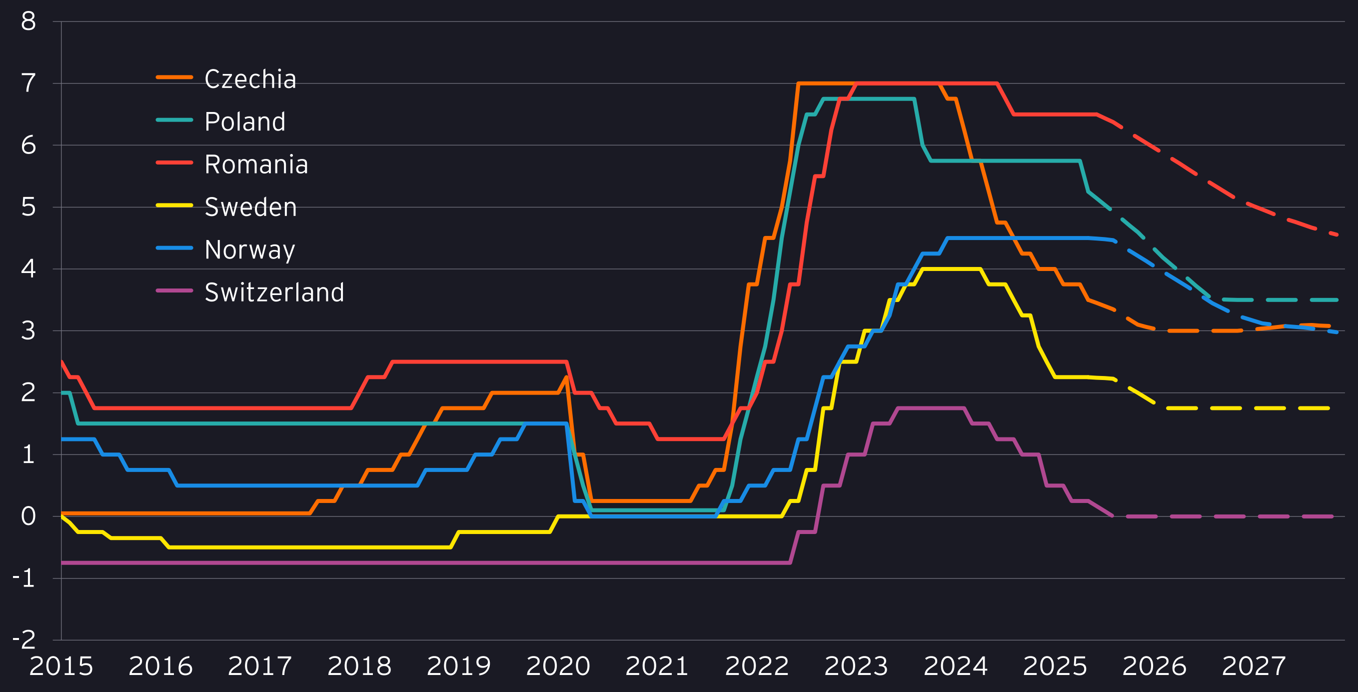


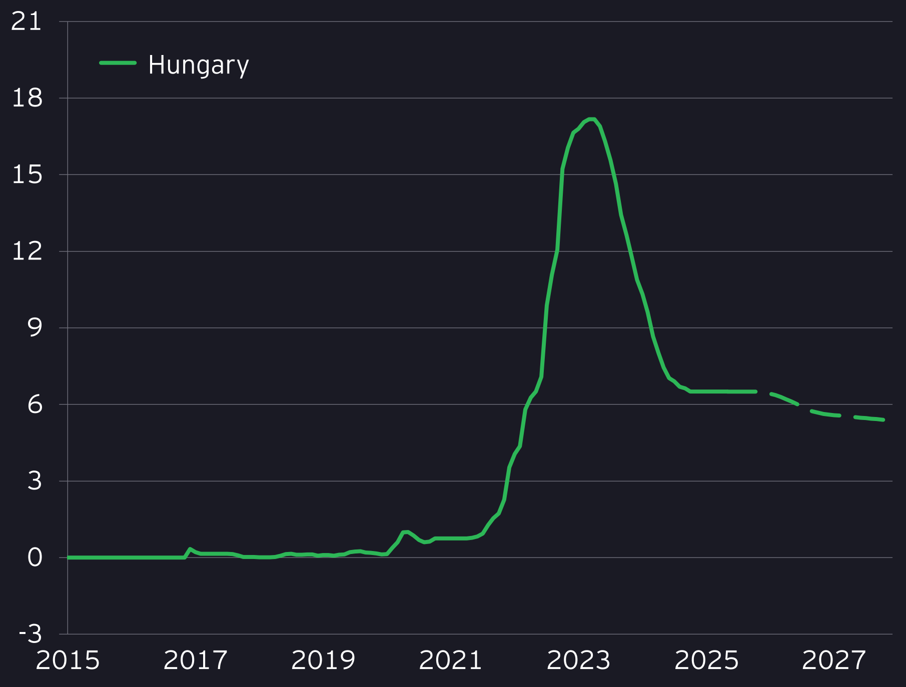
Source: ECB; Fed; BoE; CME group; EY EAT forecast.
* For the euro area and the UK, expected interest rates implied from SOFR (EA) and SONIA(UK) futures from CME group; for the US, expected interest rates from Atlanta Fed Market Probability Tracker.

Other central banks in Europe remain in easing mode, though the pace of rate cuts and the stage of the easing cycle differ significantly among them.

- The SNB is expected to deliver a final 25 bp cut, decreasing the interest rate to 0% amid low inflation, pressure on the Swiss Franc, a deteriorating labor market, and weak domestic demand.
- In CEE, monetary policy continues to diverge. The National Bank of Poland (NBP) is anticipated to continue loosening monetary policy with 75 bp of further cuts in 2025 and an additional 100 bp in 2026. In Hungary and Romania, amid robust inflationary pressures, we expect central banks to restart gradual easing cycles in 2026Q1 and 2025Q3, respectively, but interest rates are likely to remain above 5% at least until the end of 2026. In contrast, Czechia is close to the end of its loosening cycle; we expect two more 25 bp cuts before reaching a terminal rate of 3%.
- The central banks of Sweden and Norway are expected to decrease interest rates in September after a pause related to upside inflation surprises. In Sweden, we anticipate two additional 25 bp cuts, while Norway is expected to take a cautious approach with a rate cut every other meeting until a terminal rate of ~3% is reached.

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: A focus on tariffs

Radical shift in U.S. trade policy adds further uncertainty to an already volatile global landscape

The economic outlook has become increasingly uncertain, with the balance of risks tilting towards lower GDP growth and lower inflation in Europe. Key risks include:

1. Tariffs – will they stay, or will they go?

- A recent threat by President Donald Trump to impose a 50% tariff on goods from the EU indicates that trade uncertainty is here to stay. This uncertainty raises critical questions about the long-term implications of tariffs for the global economy. It remains unclear whether these tariffs are merely a one-off incident, albeit spread over several months, or indicative of a fundamental reshaping of the global economy and a regime change in attitudes toward international trade. Should the latter be the case, the potential for further protectionism could lead to significant consequences, including:
  - **Direct Economic Effects**: The imposition of tariffs is likely to result in a decrease in external and domestic demand, adversely impacting economic growth.
  - **Sectoral Reorganization:** Various sectors of the economy may be affected differently. Industries previously viewed as having a lower comparative advantage may gain prominence, leading to shifts in their relative significance within the economy. This reorganization could reshape welfare distribution, resulting in job losses for some workers while creating opportunities for others.
  - **Supply Chain Transformations**: Companies may engage in nearshoring practices (an additional incentive following post-pandemic supply chain problems), leading to substantial changes in supply chains and necessitating the identification of new trade partners.
  - **Geostrategic Risks**: Weaker trade links between nations could diminish the stakes involved in potential conflicts, thereby increasing the likelihood of geopolitical tensions. Additionally, the exodus of manufacturing from countries previously regarded as having a cheap labor force may result in social disturbances within those regions.

2. Tariffs - even if their return is temporary, they still pose considerable risks to the European economy.

- Below, we enumerate not only the risks of temporary tariffs but also those that are not substantial enough to be considered a regime change in global trade:
  - **Upside Risks**: In response to tariffs, companies may choose to frontload production to circumvent these additional costs. This strategy could lead to temporary spikes in both production levels and prices. However, such actions may also result in supply chain bottlenecks, complicating logistics and operational efficiency.
  - **Downside Risks**: A decrease in production may occur as a direct consequence of increased trade barriers and reduced external demand, which could be exacerbated by heightened uncertainty regarding long-term economic conditions. This uncertainty may lead to a cautious approach among businesses and consumers, negatively impacting investment and spending decisions.

Radical shift in U.S. trade policy adds further uncertainty to an already volatile global landscape

3. Changes in fiscal policy attitude:

- The new German government's shift towards a less restrictive fiscal policy will probably have significant implications for the European economy. Exceptions for military expenditures within existing EU fiscal rules may also lead to increased government spending levels. Furthermore, discussions regarding new spending initiatives at the EU level have emerged in response to reduced U.S. engagement in European affairs. However, short to medium-term benefits from increased military spending will be restricted by high import intensity.

4. Geopolitical risks:

- The war in Ukraine continues, and the conflict in the Middle East remains unresolved despite ongoing ceasefire discussions and some partial implementations. Additionally, other geopolitical tensions intensified (India vs Pakistan). Any escalations in these conflicts could amplify uncertainty, trigger commodity price spikes, increase shipping costs, and create bottlenecks in global trade. These developments could reignite inflation and adversely affect global economic activity, with Europe being particularly vulnerable to such shocks due to its high degree of openness.

5. Cyclical risks persist:

- The downturn in manufacturing may be prolonged if the structural loss of competitiveness among European producers is more acute than currently anticipated. The outlook for consumption is unclear; while current savings rates are higher than pre-pandemic levels, which could serve as a foundation for increased spending in the future, this potential has not materialized in recent quarters. Additionally, with wage growth continuing to decline and consumer sentiment remaining weak, private consumption may fall short of expectations. Conversely, growth could rebound if improved financing conditions and declining inflation stimulate domestic consumption and investment.
- Spikes in energy and food prices due to adverse weather conditions or local political unrest, which could reduce supply or increase demand for these commodities, would lead to higher inflation and diminished economic activity.

6. Structural and long-term risks and opportunities also remain unchanged:

- The structural loss of competitiveness among European producers, exacerbated by higher energy prices and intensifying competition from China.
- Stronger productivity growth, partly driven by advancements in AI, which could enhance the economic outlook.
- Strong immigration flows that may alleviate demographic pressures and support potential growth; however, the likelihood of this benefit materializing is reduced by the increasingly prevalent anti-immigrant attitudes in many European countries.

Chapter 5

Country-specific outlooks

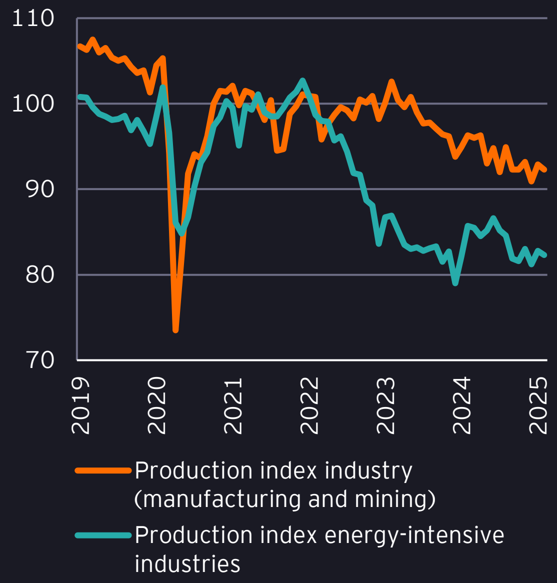
Germany: Economic activity remains stagnant amid negative risks from global trade uncertainties and positives from fiscal expansion

	GDP growth	Inflation	Current account balance	Unemployment rate
2024	-0.2%	+2.2%	+5.7%	6.0%
2025F	-0.1%	+2.1%	+4.6%	6.1%
	Real GDP growth (y/y)	Headline CPI Inflation (y/y)	In % of GDP	In % of civilian labor force
	Source: EY EAT forecast.	Source: EY EAT forecast.	Source: EY EAT forecast.	Source: EY EAT forecast.

Ifo business climate indicators (2015=100)

Source: Ifo

Energy-intensive industrial production (2021=100)

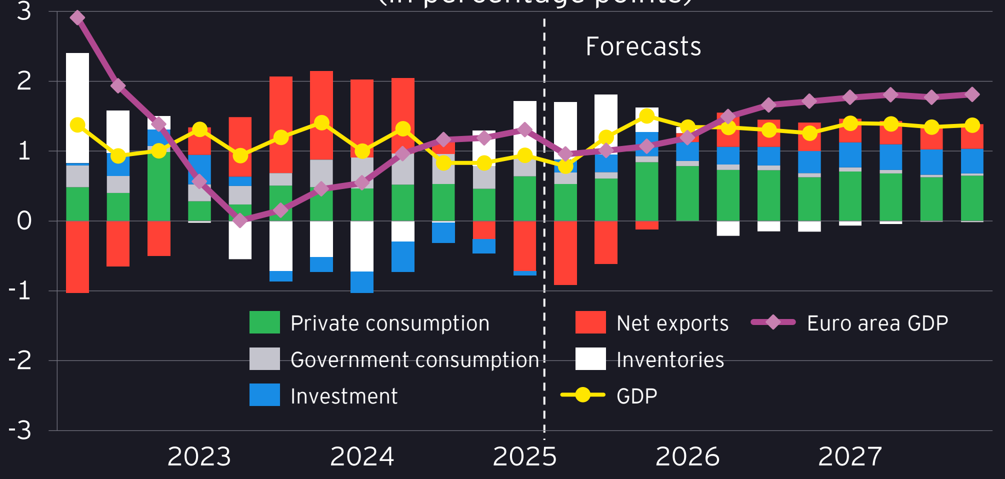


Source: Destatis

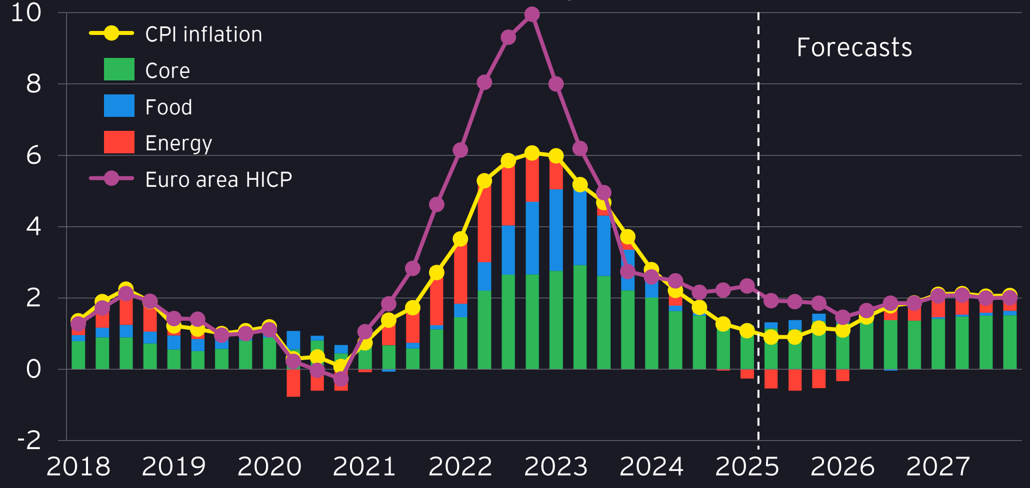
- A new chancellor, Friedrich Merz, has been elected to office forming a new government to bring an end to the recent political turmoil in Germany.
  - The recently signed coalition agreement contains plans to boost economic activity, including by (i) promoting investments through tax incentives, (ii) reducing energy prices by lowering electricity taxation and introducing a subsidized electricity price for industry, (iii) reducing bureaucracy costs for businesses by 25%, (iv) investing in digital infrastructure, or (v) attracting skilled labor.
  - Germany's recent ambitious fiscal reform eases the debt brake for infrastructure and defense purposes. The establishment of a EUR 500bn fund aims at bolstering national security and modernize infrastructure while maintaining long-term fiscal stability (for analysis of macroeconomic effects of German fiscal plans, see slide 44)
- Continuous global tensions and conflicts, such as the war in Ukraine, the Gaza-Israel conflict, and a second term of the Trump administration continue to pose uncertainty.
  - While US tariffs have been partially suspended until 9 July 2025, export-driven German economy is among the European countries most vulnerable to US tariff hikes.
  - High US tariffs on China could redirect some Chinese goods into the European market, impacting prices and production.
- The business climate index for the German economy slightly improved in April 2025 by 0.2 points compared to March 2025 as companies were more positive about their current situation and showed greater optimism for the future. However, business expectations remain cautious with rising uncertainty among companies as the German economy prepares for potential turbulence.
- The German economy remains in stagnation, with real GDP having declined by 0.2% in 2024. Real GDP growth is expected to remain stagnant also in 2025, with an anticipated decrease of 0.1%.
- After previously high levels, inflation in Germany continues to approach the 2%-target, supported by reductions in energy prices. Inflation is expected to remain slightly above 2% throughout 2025. Fiscal stimulus may reignite price pressures in the longer term.
- Germany's current account surplus increased slightly by 0.2 pp to 5.7% of GDP in 2024, which remains lower compared to levels prior to outbreaks of the Ukraine war and the COVID-19 pandemic. Germany's current account balance as % of GDP is expected to decrease in 2025 due to increasing protectionist measures imposed by the US.
- As a result of subdued economic activity, unemployment is on the rise – compared to 2023, the average unemployment rate increased by 0.3 ppt to 6.0% in 2024. For 2025, unemployment is likely to gradually rise to 6.1% given soft demand.

France: Economy stagnated in 2024Q4-2025Q1 as political gridlock weighed on sentiment. Fundamentals remain robust, though, hence we expect steady growth in 2025 and beyond, despite headwinds from tariffs

Decomposition of y/y GDP growth in France
(in percentage points)



Decomposition of y/y CPI inflation in France
(in percentage points)

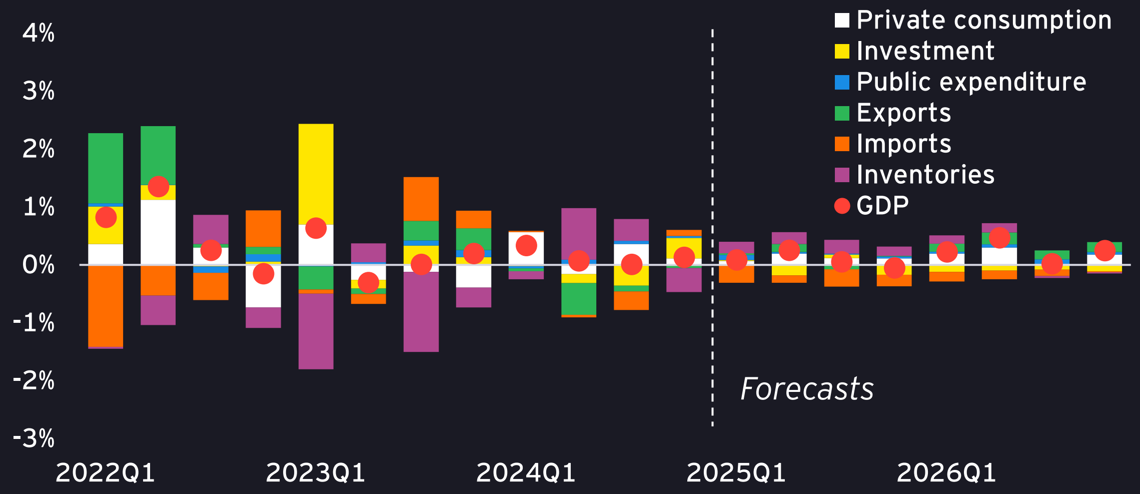


Source: Eurostat; Oxford Economics; EY EAT forecast.

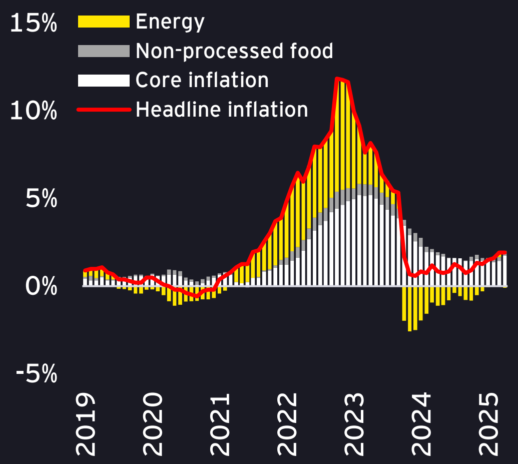
- **GDP fell by 0.1% in 2024 Q4 and increased by 0.1% q/q in 2025 Q1.** Consumption and investment stagnated as political gridlock weighed on sentiment. Growth in government spending slowed amid attempts to reduce government deficit that exceeds 6% of GDP. Exports have been stagnant despite recovering world trade. Wage growth continued to decelerate, reaching 2.1% y/y in 2025 Q1, amid slowing inflation and public sector wages. Employment stagnated, though this has not translated into increasing unemployment due to a steady working-age population and labor supply.
- **The worst is likely behind the French economy, despite headwinds from tariffs and fiscal tightening.** Business sentiment improved in April, which is likely to mark the beginning of a recovery in investment, supported by declining interest rates and improving profits. The outlook for consumption remains robust as real incomes continue to increase—inflation remains lower than nominal wage growth. We also expect productivity to continue improving as the large influx of employees from 2021-22 is further integrated into firms' operations. That said, headwinds from tariffs and gradual fiscal tightening are anticipated to cap **growth at 0.9% in 2025 and 1.3-1.4% in 2026-27**, compared to 1.1% in 2023-24. Growth in 2026 would be slower if recently announced plans of spending cuts are implemented, though this seems unlikely given the lack of political support.
- **Price pressures are subdued, with inflation dropping below 1% in recent months.** CPI inflation dropped significantly over the past year, from 2.2% y/y in 2024 Q2 to 1.3% in 2024 Q4, and further to 0.8% in February-April 2025, staying well below the euro area average of 2.2% in April. While the drop in energy prices (including regulated electricity prices) explains much of the slowdown, underlying price pressures have been consistently more subdued in France than in the rest of the euro area due to lower nominal wage growth and more benign food supply conditions. HICP services inflation was at 2.5% y/y in April (compared to 3.9% in the euro area), and food inflation was at 1.3% (2.7% in the euro area). **We expect CPI inflation to stay close to 1.0% this year and increase to 1.6% in 2026 and 2.1% in 2027 as energy and core inflation gradually recover.**
- **The political outlook remains unstable.** François Bayrou`s minority government faces the challenge of fiscal consolidation, increasing the chance of no-confidence motions. Simultanously Marine Le Pen, leader of the National Rally and the main opposition party, was banned from the 2027 presidential election after being convincted of embezzlement. Consequently, the 10-year sovereign yield spread with Germany remains elevated, despite a small tightening to 70 bps. The ongoing political uncertainty increase downside risks for investment and growth potential in the medium-term.

Italy: Italy's GDP recorded positive growth of 0.2-0.3% in 2024Q4-25Q1; however, trade tensions and fiscal tightening are expected to weigh on activity in the short term

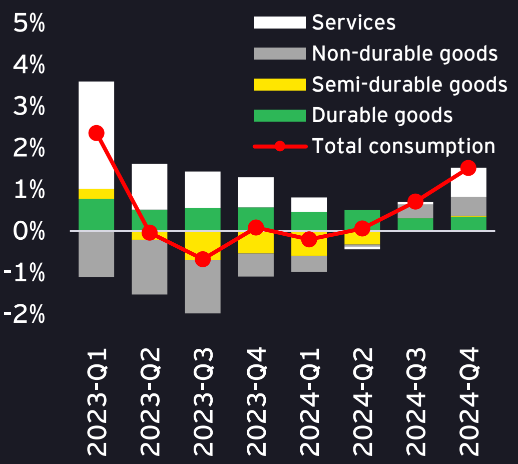
GDP growth decomposition in Italy
(q/q, in percentage points)



Headline inflation decomposition in Italy
(y/y, in percentage points)



Household consumption by expenditure item
(y/y, in percentage points)

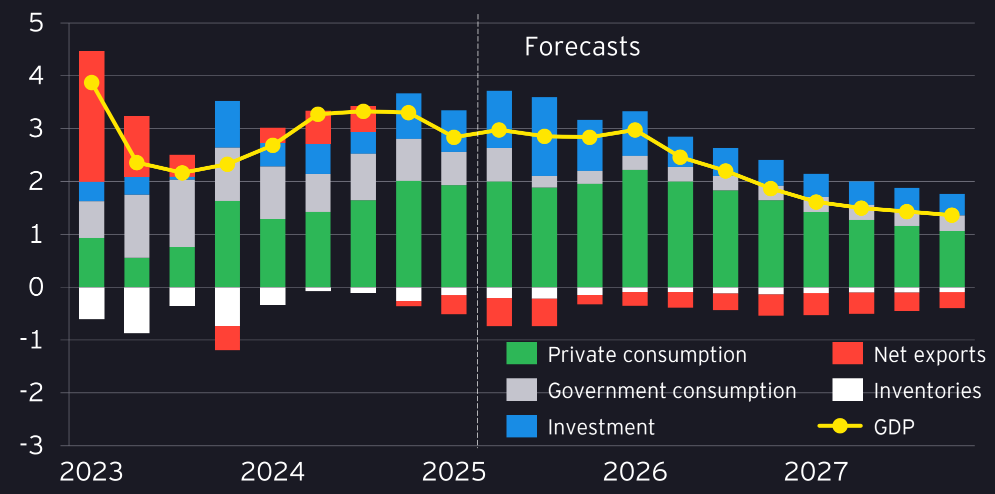


- The q/q growth of 0.2% in 2024Q4 led to an overall GDP growth of 0.7% in 2024, primarily driven by private consumption and a contraction in imports.
- The Italian economy began 2025 on a relatively strong footing, expanding by 0.3% q/q in Q1. However, this strength is expected to be temporary due to trade tensions and fiscal tightening. The economy is projected to grow by only 0.4% in 2025, driven by private consumption, while investment and foreign demand are anticipated to contract. In 2026, growth is expected to accelerate slightly to 0.7%.
- Investments in 2025 and 2026 are projected to decline by 0.4% and 1.8%, respectively, primarily due to a contraction in investments in dwellings, which are expected to decrease by 9.5% in 2025 and 8.5% in 2026. This decline is linked to the end of fiscal incentives, such as the "Superbonus 110%" program. However, private investment in machinery, intangibles, and non-residential structures is expected to increase.
- Inflation stood at 1.9% in April 2025, influenced a reduced negative contribution from the energy component and persistent core inflation at 2.1%, particularly from the services sector.
- Italy's labor market continues to show positive momentum, with record-high employment levels (~24 million) and rebounding real wages. Household consumption accelerated in the last two quarters of 2024 in y/y terms, mainly driven by the consumption of services and non-durable goods.
- Key risks to the Italian economy include potential global recession risks, overall uncertainties stemming from trade-distorting measures, the potential acceleration of inflation—also driven by second-round effects from faster wage growth—and higher commodity prices amid geopolitical tensions (Russia-Ukraine war, Middle-East conflicts).

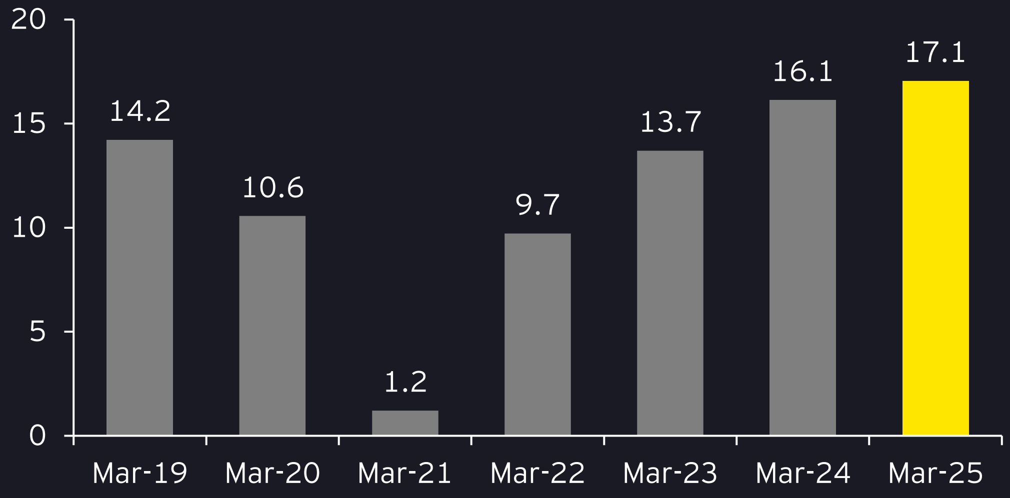
Source: EY Italian Macroeconomic Bulletin; ISTAT.

Spain: Spain stands out as one of Europe's strongest economies, with solid growth, record tourism, and a resilient labor market, despite global uncertainties

Decomposition of y/y GDP growth in Spain
(in percentage points)



Total tourists (millions, Jan-Mar)

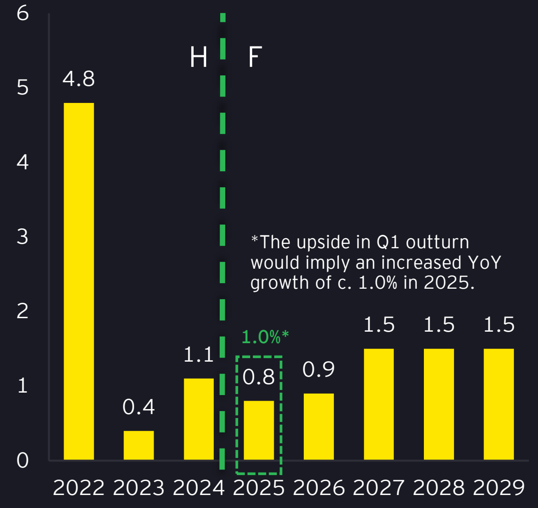


- **In 2025 Q1, real GDP growth slowed to 2.8% y/y, down from 3.3% in the previous quarter, significantly outpacing the Eurozone's growth of 1.2%.** Job creation (primarily in services) accelerated slightly, and service exports remained resilient. Immigration continues to drive the growth of the labor force, despite a decline in the activity rate.
- **Both the manufacturing and services sector PMI indicators** have declined in recent months amid tariff-related uncertainties, reaching 48.1 and 53.4, respectively, in April. The services indicator has remained in the expansion zone (above 50) for over 20 consecutive months, reinforcing Spain's position as one of the strongest economies in Europe.
- **Tourism reached new highs**, with more than 17 million tourists visiting from January to March 2025, far exceeding pre-COVID levels. It remains a cornerstone of Spain's economic recovery and GDP growth, showing a strong increase in both domestic and international visitors. However, the sector faces challenges from rising operational costs and shifting traveler preferences.
- **After increasing from 1.5% in September 2024 to 3.0% in February, inflation has dropped in recent months, decreasing to 2.2% in April 2025, although challenges in sustaining this trend remain.** Disinflation has been driven by declining fuel and olive oil prices. Meanwhile, prices for tourism-related services (packages holidays, accommodation, air transport) surged in April, potentially due to a later Easter compared to last year.
- **Following a forecast GDP growth of 2.9% in 2025, a slowdown in activity growth to 2.4% is expected in 2026**, amid a likely deceleration in employment and tourism growth, as well as uncertainties linked to changes in U.S. trade policy.
- **Spain is strengthening its defense capabilities.** Amid uncertainties regarding the U.S. commitment to NATO and the Russian threat, Europe is increasing its military spending. This situation may present an opportunity for Spain, which has a strong presence in the defense sector.
- **The Spanish stock market has shown renewed vigor, outperforming several major European indices this year.** A favorable economic outlook and the reduction of interest rates have propelled Spanish equities to a 23.1% increase YTD, surpassing the EuroStoxx50's 10.3% as of May 22.

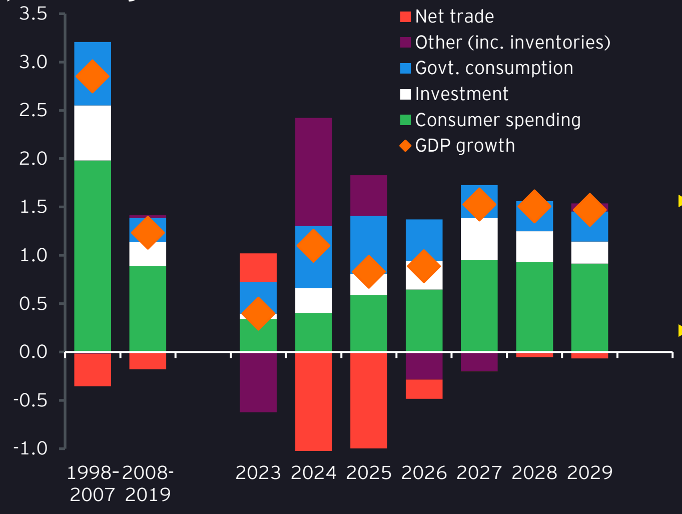
Source: Instituto Nacional de Estadística (INE).

UK: A positive outturn in Q1, but trade uncertainty is set to weigh on growth over the next two years

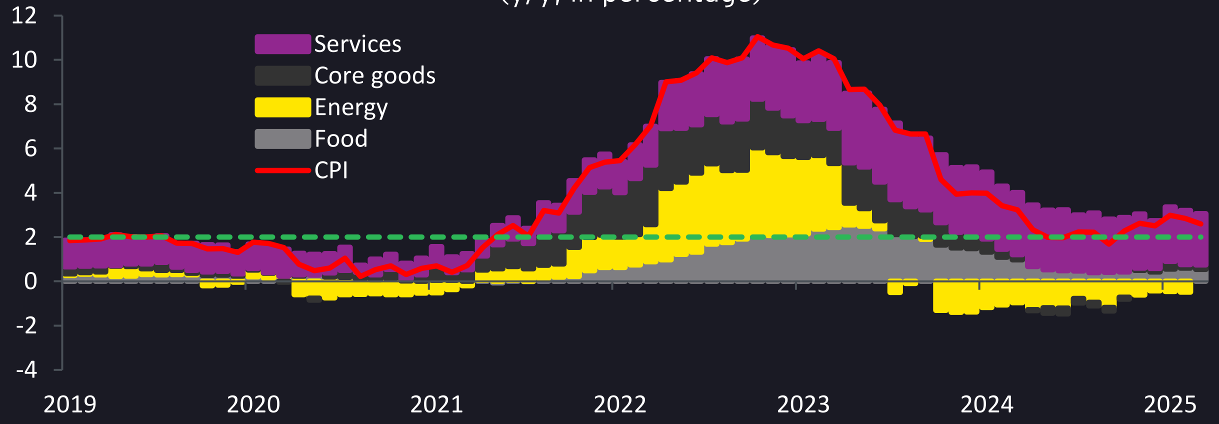
Real GDP growth (y/y, in percentage)



UK: Contributions to GDP Growth (y/y, in percentage)



UK: Contributions to CPI inflation
(y/y, in percentage)

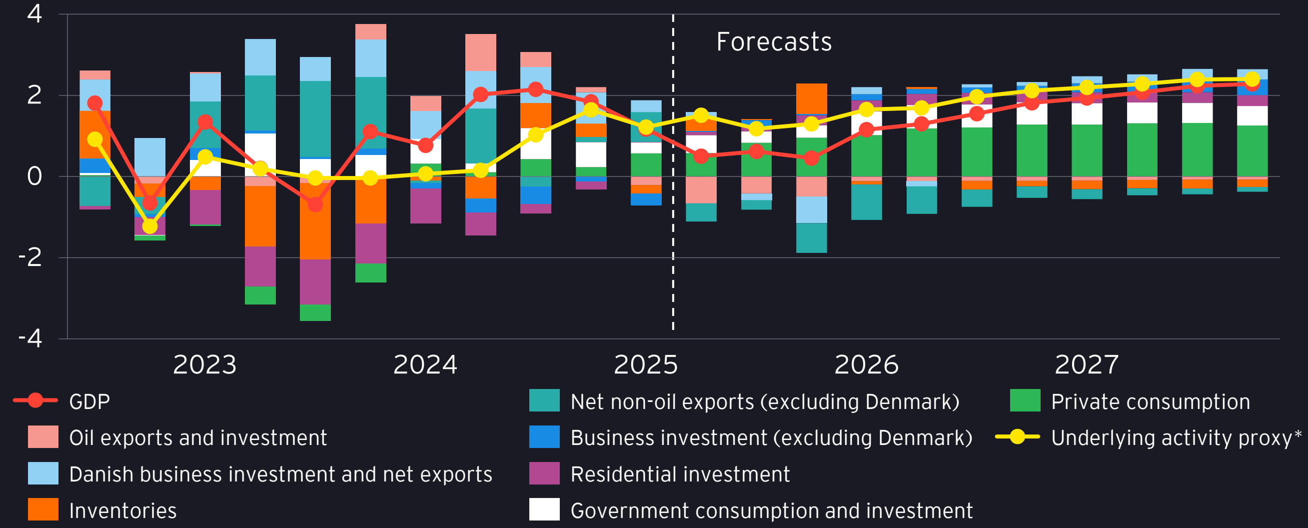


- **The outlook for 2025 remains weak, despite strong GDP figures for Q1 (0.7% q/q). Uncertainty surrounding tariffs is expected to drive a slowdown into Q2 and Q3. The recent announcement of a US-UK trade deal represents some upside: however, it only marginally reduces effective tariff rate with the US to approximately 9%.** Recent economic and market uncertainties will weigh on consumers and businesses causing them to delay major spending decisions. Tariffs will also make access to one of the UK's key export markets more difficult. Combined with weaker global growth, this will result in diminished foreign demand for UK goods and services.
- **Soft growth is anticipated to continue into 2026 before normalising in 2027.** The direct and indirect impacts of tariffs (e.g., weaker growth in the EU) are expected to lead to a slowdown in growth by mid-2025, with GDP growth projected at 0.8% in 2025 and 0.9% in 2026. Growth is expected to stabilise at around 1.5% from 2027 onward.
- **Consumer price inflation (CPI) is expected to rise and remain above 3% for most of this year.** Domestic inflationary pressures will remain sticky. Annual changes in utilities (e.g., energy, water, telecoms) contributed to rising prices in April. Firms will also face elevated labor costs from the rise in the National Living Wage and employers' National Insurance Contributions, despite a cooling labor market. We anticipate inflation will remain above the 3% mark for most of this year, only falling back to near the 2% target towards the end of next year.
- **Tariffs could weigh on inflation.** While the impacts of tariffs on UK growth are clearly negative, their effect on inflation is less certain. However, on balance, we expect it to be disinflationary, as energy prices have fallen and there is potential for Chinese goods to be diverted to the UK at lower prices, which would have previously been sold to the US.
- **Interest rates are expected to continue falling in 2025.** The Monetary Policy Committee (MPC) has cut interest rates once every quarter since the middle of last year, with the May meeting reducing the rate to 4.75%. We expect this trend to continue as the MPC balances a weak growth outlook with persistent inflation. We anticipate the Bank Rate will fall to 3.75% by the end of this year and settle at 3.5% in early 2026. However, there is a possibility that the BoE may cut rates faster to support the growth outlook.
- **Shifting trade policy has made a fiscal reset in the Autumn increasingly likely.** The Government's tax and spending plans currently allow little margin for error, and the impact of tariffs will have already eliminated most of it. The Spring Statement left a lot of the big questions around government spending unanswered. With a weaker growth outlook, there is potential for a broader change in policy, including the possibility of further tax increases or adjustments to fiscal rules being up for debate.

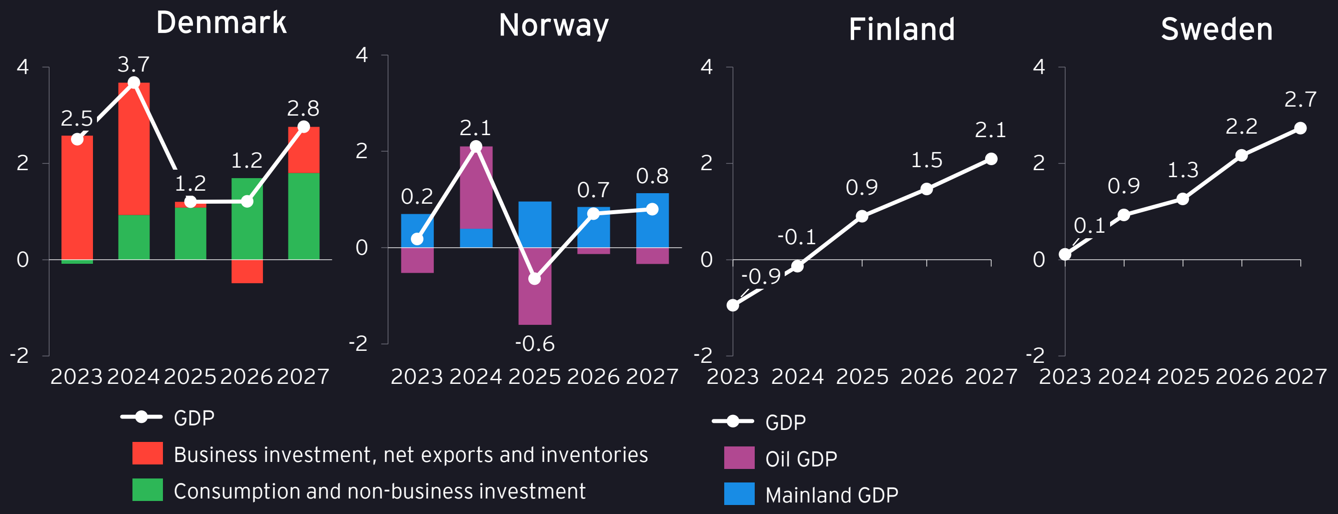
Source: Haver Analytics; Refinitiv; EY ITEM Club, EY analysis

Nordics: Underlying economic activity has been gradually picking up. While trade tensions will prevent further acceleration in growth this year, the medium-term outlook remains favorable

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



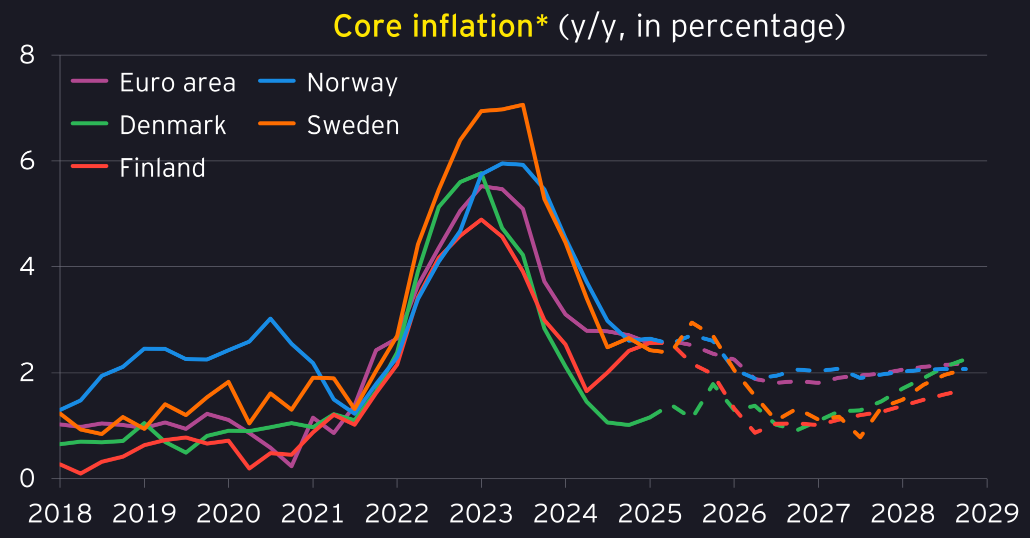
Real GDP growth (y/y, in percentage)

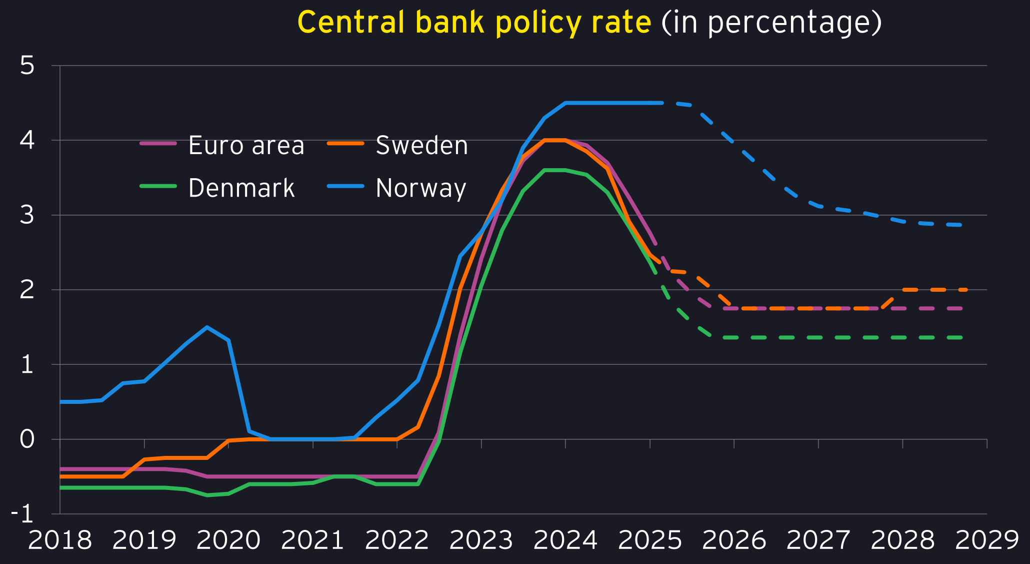


- **Underlying economic growth across the Nordics picked up over the course of 2024.** Consumer spending began to increase, albeit with a delay relative to real incomes. Residential investment, which experienced a deep contraction in previous years, has bottomed out. However, business investment remains a weak link amid depressed capacity utilization. Despite the uptick in GDP growth, employment continued to contract in all countries except Norway. Consequently, unemployment has been rising, reaching levels 1-3pp above the lows of 2022. In Finland and Sweden, unemployment rates are already close to post-global financial crisis peaks. Amid declining inflation and increasing labor market slack, nominal wage growth has slowed to an average of around 4% y/y across the region.
- **While underlying trends have been similar across all countries in the region, sector-specific factors have continued to distort GDP in Denmark and Norway.** Denmark's GDP growth is being propelled by the expansion of a major pharmaceutical company, boosting exports and business investment, resulting in a GDP growth of 3.6% y/y in 2025 Q1. We estimate the underlying pace of growth* to be a solid 1.7% y/y. Meanwhile, Norway's GDP contracted by 0.6% y/y in 2025 Q1 due to reduced fossil fuel production, although non-oil GDP growth accelerated to 1.4% y/y. Sweden and Finland grew at 1.1% and 0.7%, respectively, in 2025 Q1.
- **Underlying growth is expected to stabilize in the near term.** Growth fundamentals in the Nordics remain robust, supported by respectable real income growth and monetary policy easing. The potential for cyclical recovery is significant, given the highly negative output gaps and elevated unemployment, especially in Finland and Sweden. However, Denmark and Sweden have experienced one of the largest drops in business and consumer confidence in Europe in response to tariff announcements, which is likely to weigh on consumer spending and investment in the near term. Together with the direct impact of tariffs—that Nordic countries are moderately exposed to—this is likely to cap underlying growth at close to current levels throughout 2025. Additionally, the pharmaceutical sector's support for activity in Denmark is expected to diminish, leading to a sharp deceleration in GDP growth.
- **Growth is expected to gradually accelerate over 2026-27.** After the sentiment shock fades, an increase in consumption and residential investment should spur a recovery in business investment and the labor market, driving GDP growth above 2% by 2027 in all countries except Norway. In Norway, the scope for cyclical recovery is more limited, and with the oil sector acting as a drag, GDP growth is not expected to exceed 1%.

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 surprised to the upside at the beginning of 2025, prompting central banks to delay interest rate cuts





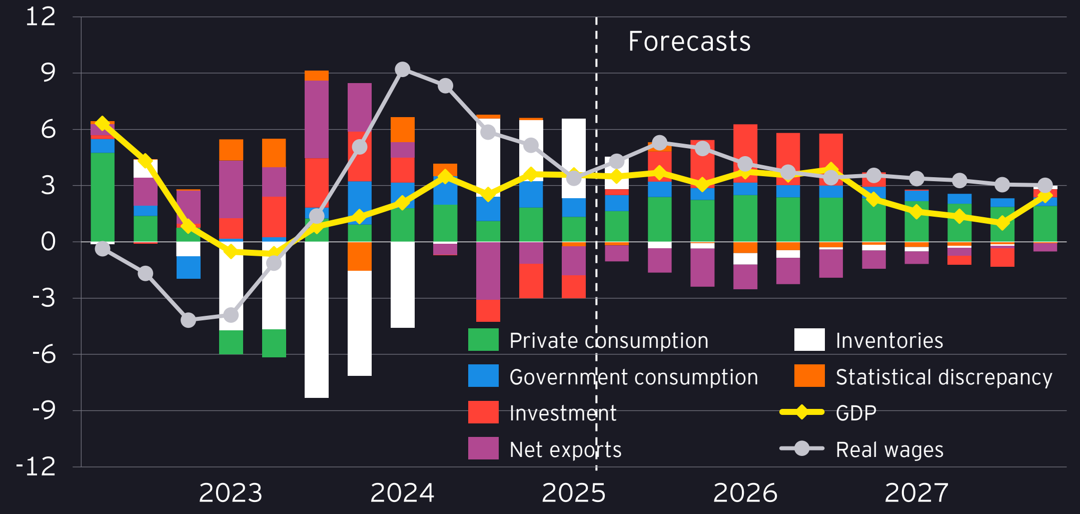
- **Inflation surprised to the upside at the beginning of 2025, running slightly above 2% in Sweden and Norway.** In February and March, food price inflation surged across most of the region, exceeding 5% y/y in Sweden and 8% y/y in Norway. Core inflation has been more stable, remaining slightly above 2% in all countries except Denmark, on the back of somewhat elevated services inflation. Despite the strongly disinflationary impact of energy prices, headline inflation remained around 2.5% in Norway and increased back above 2% (at fixed interest, CPIF) in Sweden. Denmark continued to have the lowest inflation rate at 1.5%, despite elevated food inflation and rising price pressures in services.
- **Faced with higher-than-expected inflation, central banks have delayed monetary policy easing.** After reducing the repo rate to 2.25% in January, the Swedish Riskbank kept rates unchanged at subsequent meetings. The Norges Bank, which had previously signaled an intention to initiate the easing cycle in March, ultimately opted against a rate cut, maintaining the key interest rate at 4.5%.
- **While price pressures are expected to persist this year, inflation is likely to fall towards 1% in 2026-27 due to subdued, albeit recovering, demand.** We anticipate that it will take time for declining wage growth to filter through to services inflation, keeping core inflation above 2% in Sweden and Norway until the end of the year. Although food inflation will remain elevated until the early 2025 shock is accounted for, it will continue to be offset by significantly negative energy inflation. As a result, headline inflation is expected to stay slightly above 2% in Norway and Sweden this year, while dropping towards 1.5% in Finland and Denmark. In 2026 and 2027, as food and wage cost shocks fade, we expect both headline and core inflation to decline towards 1% due to a negative output gap, even though GDP growth accelerates. Norway will be an exception, with a balanced output gap leading to core inflation stabilizing close to 2%.
- **Central banks are expected to (re)start monetary easing in September.** Given the slightly elevated inflation, the Swedish Riskbank and Norges Bank are likely to maintain their current rates in the very near term. However, downside risks to growth and inflation from tariffs, soft but recovering demand, and anticipated disinflation should prompt the Swedish Risksbank to restart its easing cycle and the Norges Bank to initiate its own in September. We expect two additional interest rate cuts in Sweden, with the repo rate reaching 1.75% by early 2026. The Norges Bank is likely to adopt a cautious approach, cutting rates at every other meeting until a terminal rate of approx. 3% is reached. We maintain the view that the Norges Bank has fallen behind the curve, with its monetary policy stance becoming too tight relative to economic conditions. Therefore, risks remain tilted towards a faster pace of easing.

Source: Eurostat; Oxford Economics; EY EAT forecast.

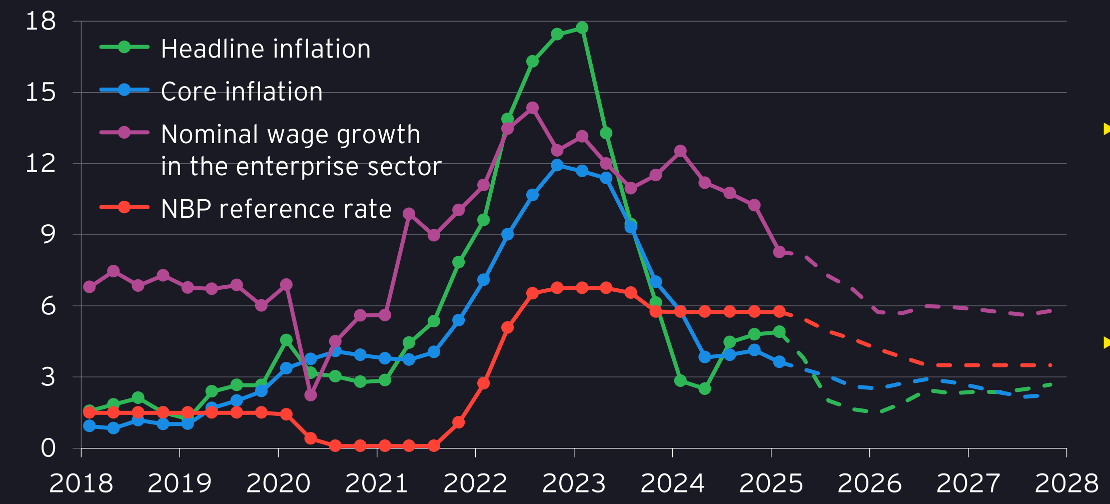
* Core inflation excluding food and energy. For Denmark and Norway, CPI. For Finland and Sweden, HICP, which excludes mortgage interest payments (unlike CPI for these countries)

Poland: Robust economic growth is expected to continue in 2025-26. Inflation surprised to the downside, and with the achievement of the 2.5% target now in sight, monetary policy easing has begun

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



Inflation, wages, and interest rates (in percentage)

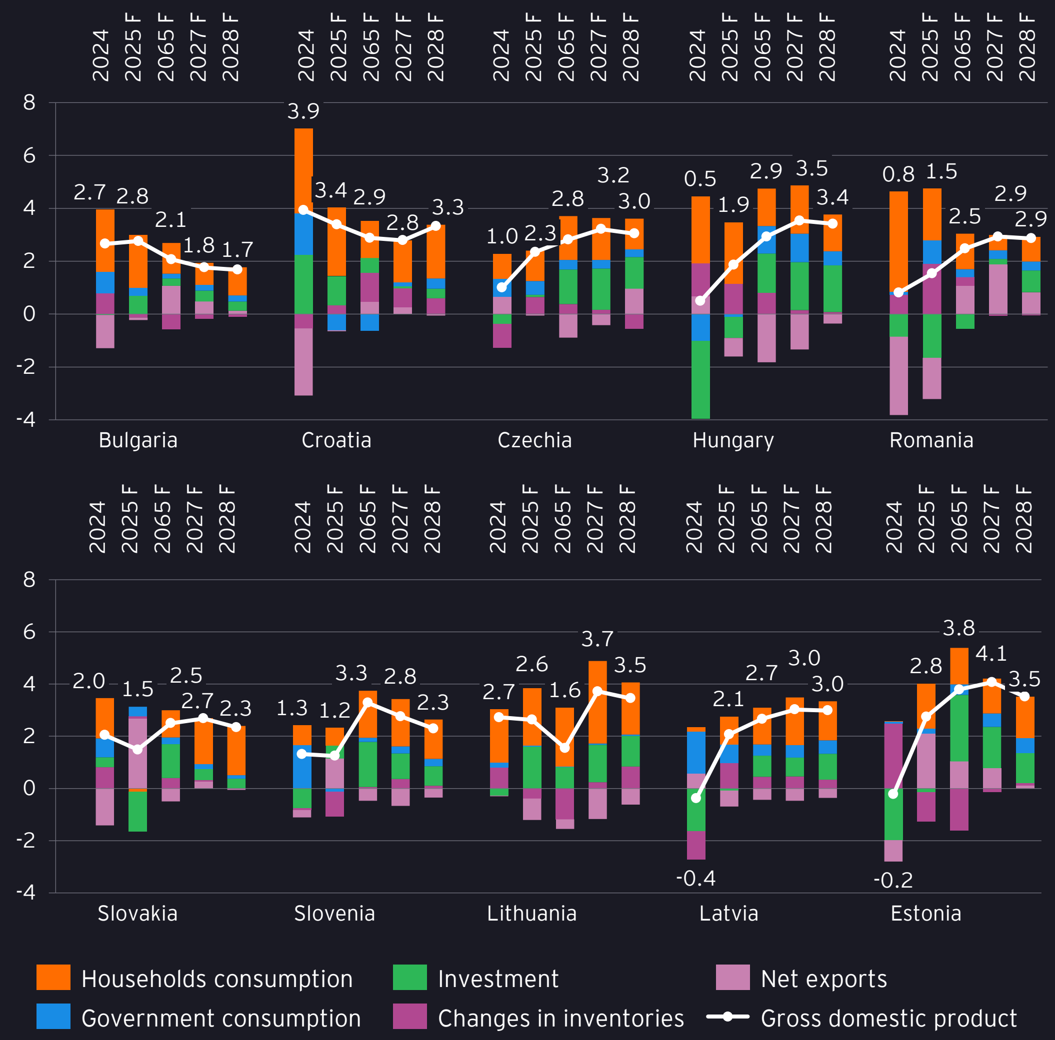


- **Relatively strong but uneven GDP growth continued in 2024 Q4 and 2025 Q1.** Poland was among the fastest-growing EU countries, with y/y GDP growth reaching 3.6% in chain-linked value terms, according to our estimates*. Economic activity is driven by private consumption, government spending, and a reversal in the inventory cycle, while exports remain stagnant due to weak demand from the euro area. Investment declined in 2024 due to reduced profit margins, high interest rates, and the conclusion of the EU funding cycle.
- **Wage growth is slowing down.** Available vacancy statistics indicate that labor demand remains moderate. Employment is contracting due to labor supply constraints, while the LFS unemployment rate has fallen to a record low of 2.6%. Wage growth slowed in 2025 Q1 due to a less pronounced minimum wage hike, yet it remains strong at 8-9% y/y in the enterprise sector. Looking ahead, employment is expected to stagnate amid supply constraints, while wage growth is projected to slow to 6% y/y due to smaller public and minimum wage hikes, declining inflation, and moderate labor demand.
- **Core inflation surprised to the downside in early 2025 and is expected to converge to 2.5% by year-end.** It declined to 3.4% in April from 4% in December, despite excise tax hikes, indicating decelerating price pressures amid slowing wage growth and currency appreciation. Headline inflation also declined in April but remained higher at 4.3% due to elevated food inflation and last year's increase in regulated energy prices. Core inflation is expected to moderate further as wage growth slows, falling to 2.5% by the end of 2025. Headline inflation is projected to drop below 2% in 2025 Q4-2026 Q1 as regulated energy price hikes fall out of calculation, fuel prices remain subdued, and food inflation normalizes. From the second half of 2026, both headline and core inflation are expected to stabilize around 2.5%.
- **GDP growth is expected to remain robust at close to 3.5% through 2026 Q3**, with investment anticipated to pick up strongly as EU Recovery Fund spending accelerates. Consumption will rise as inflation decreases, supporting real incomes. However, government consumption and inventories will no longer significantly boost growth. Export growth is expected to accelerate slightly with improving activity in Western Europe but will remain low by historical standards due to trade tensions and reduced cost competitiveness.
- **The central bank (NBP) cut interest rates by 50 bp to 5.25% after a long pause**, citing lower-than-expected core inflation and disinflationary trade risks. This was framed as a one-off adjustment rather than the beginning of an easing cycle, reducing the likelihood of immediate further cuts. However, given the inflation outlook, a gradual easing cycle is expected, with the next cut anticipated in July or September. The terminal rate of 3.5% is expected to be reached by July 2026.

Source: Oxford Economics, EY EAT forecast.
Notes: In the bottom chart, solid lines represent historical data, and dashed lines are the EY forecasts.
* Official chain-linked volume numbers point to 3.8-3.9% y/y GDP growth in 2024Q4 and 2025Q1 but continue to be plagued by seasonal adjustment issues. Growth in previous year prices – headline number provided by Statistics Poland – was slightly lower at 3.2-3.4% y/y.

Other CEE countries*: We expect slightly lower GDP growth in 2025 across most economies compared to earlier forecasts, but still better than in 2024. Inflation is stabilizing, with some exceptions.

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

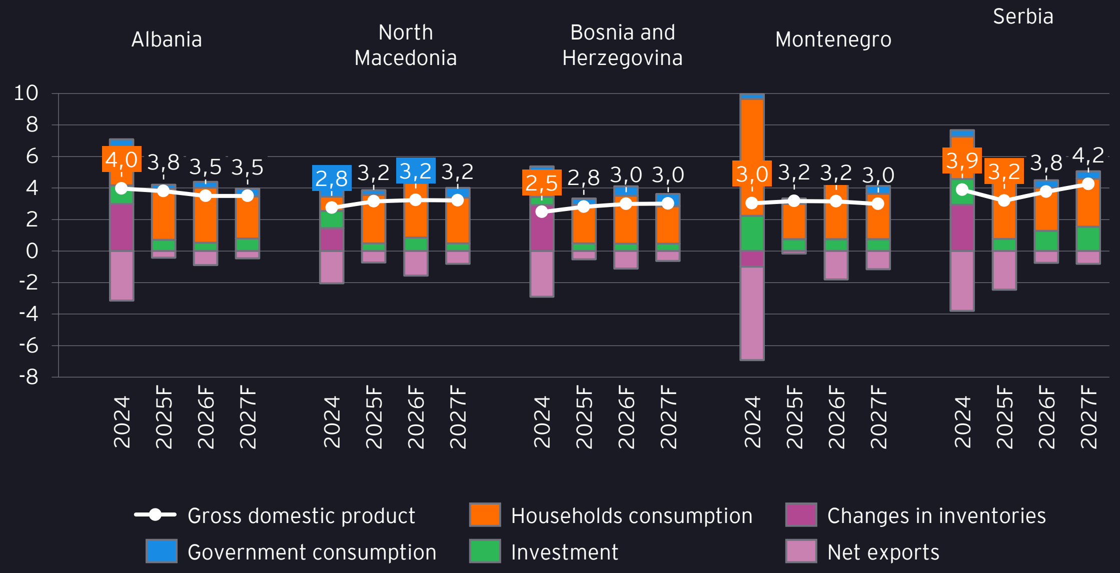


Source: EY EAT forecast.
* Poland is not included to avoid overlap with the previous slide.

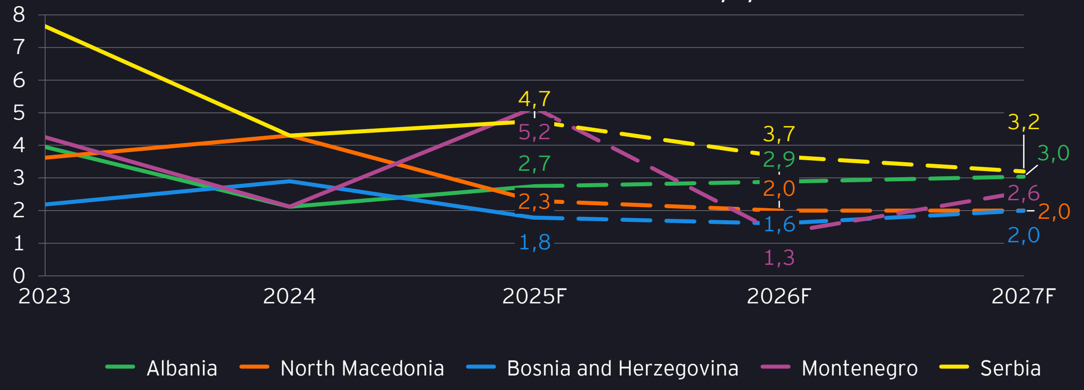
- **According to preliminary estimates, GDP growth underperformed in the first quarter**, falling below consensus forecasts in the majority of Central and Eastern European (CEE) countries. The only positive exceptions were Czechia, which met expectations, and Bulgaria, which slightly exceeded them. In contrast, the outcomes in Hungary, Romania, Slovakia, and Slovenia were significantly below expectations (for other countries, either the flash estimates are not yet available, or consensus forecasts have not been published). Notably, with the exception of Bulgaria, GDP growth was below our forecasts from the previous edition of the European Economic Outlook.
- In response to the relatively weak GDP growth in the first quarter, **we have slightly revised our forecasts for annual GDP growth in 2025 downward for most countries**, with the exception of Slovenia and Estonia. The GDP performance in the first quarter was not the only factor considered; we also took into account the new U.S. tariff policy, GDP growth in the fourth quarter of 2024, persistent inflation in certain countries, and uncertain industrial prospects.
- Despite the downward revisions in forecasts, **2025 is still anticipated to be a year of higher GDP growth for many CEE economies**, particularly those that experienced weak performance in 2024, such as Czechia, Hungary, Romania, Slovakia, Latvia, and Estonia. The expected recovery is primarily driven by robust consumer spending, supported by significant growth in real disposable income. This growth is likely to result from relatively high wage increases, although nominal wage growth is expected to be weaker compared to the previous year, alongside generally stable inflation across most of the analyzed countries.
- **Hungary and Romania remain notable exceptions in terms of inflation**. While inflation in most other countries in the region is approaching the target (albeit remaining slightly above), it continues to be significantly elevated in these two countries, primarily due to core inflation. This situation impacts the behavior of central banks. In Hungary, we expect interest rates to remain unchanged until the end of the year. In Romania, we anticipate a total reduction of 50 basis points in the second half of the year. However, in both cases, interest rates will still be relatively high. Conversely, in Czechia, the Czech National Bank (CNB) is likely to only fine-tune its rate as inflation approaches the target.

Western Balkans: Economic growth slows down amid intensifying global and local uncertainties

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



Annual inflation (in % y/y)

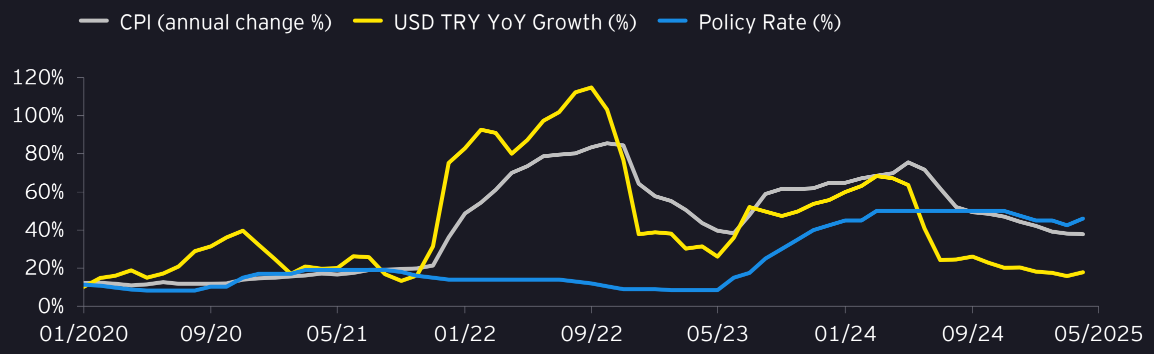


- **Serbia's growth remained strong in 2024 but appears to be losing momentum since Q3 2024 and into early 2025.** GDP expanded by 3.9% y/y in 2024, but growth has been slowing since mid-2024, with rates dropping to 3.3% in H2 2024. Household consumption increased by 4.2% y/y in 2024, driven by rising wages and pensions; however, early 2025 retail sales data indicates a slowdown. Public investment has stalled since late 2024, and housing construction has cooled after a previous boom. Net exports negatively impact growth due to stagnating exports amid weak EU demand, although this is somewhat offset by increasing exports to China.
- **The economies of other Western Balkans countries also expanded at a relatively strong pace in 2024.** GDP of the five non-EU Balkan economies grew by 3.5% in 2024, with the strongest growth recorded in Albania at 4%. North Macedonia and Bosnia and Herzegovina saw marginal growth increases to about 2.5%, while Montenegro's GDP grew by 3.3%. However, this consumption-driven growth slowed down in late 2024 and early 2025, as a mix of local and global uncertainties emerged. Serbia has experienced mass protests since late 2024, while Bosnia and Herzegovina has been in a political gridlock, adding to global trade and geopolitical risks.
- **In the near term, we expect growth to slow down in Serbia and Albania, while remaining at about at the same level in the other countries**. Household consumption is expected to remain the key growth driver across all countries, as investment and export demand in the EU—the key trade partner—will remain subdued for the remainder of 2025. Some economies may benefit from the construction of large-scale investment projects: for example, Serbia is preparing for the EXPO 2027 world exhibition, while Albania is expanding its infrastructure network and upgrading its waterfront tourist facilities in Durres and other coastal areas.
- Inflation resurged in late 2024 due to a combination of mostly global factors. As a result, although growth has been softening across much of the Western Balkans in recent quarters, local central banks have been prudent: policymakers in Albania and Serbia have kept rates unchanged since late 2024, while North Macedonia has only slightly reduced them. **Going forward, inflationary pressures are likely to subside in the coming months, which may provide room for the region's central banks to embark on a more tangible easing cycle.**

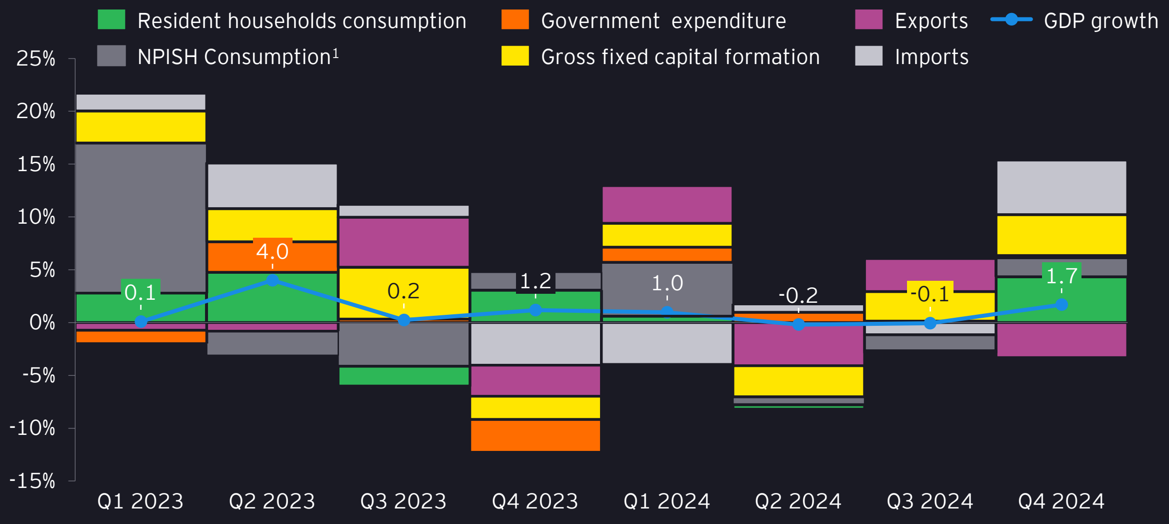
Source: IMF, EY, Eurostat. Forecast: EY and IMF

Türkiye: Türkiye's macro-outlook is set to stabilize with an improving current account and easing inflation, but FX volatility and cost pressures necessitate the continuation of tight monetary policy

CPI, Policy Rate, and Exchange Rate Changes (%)



QoQ change of GDP by expenditure approach (%)

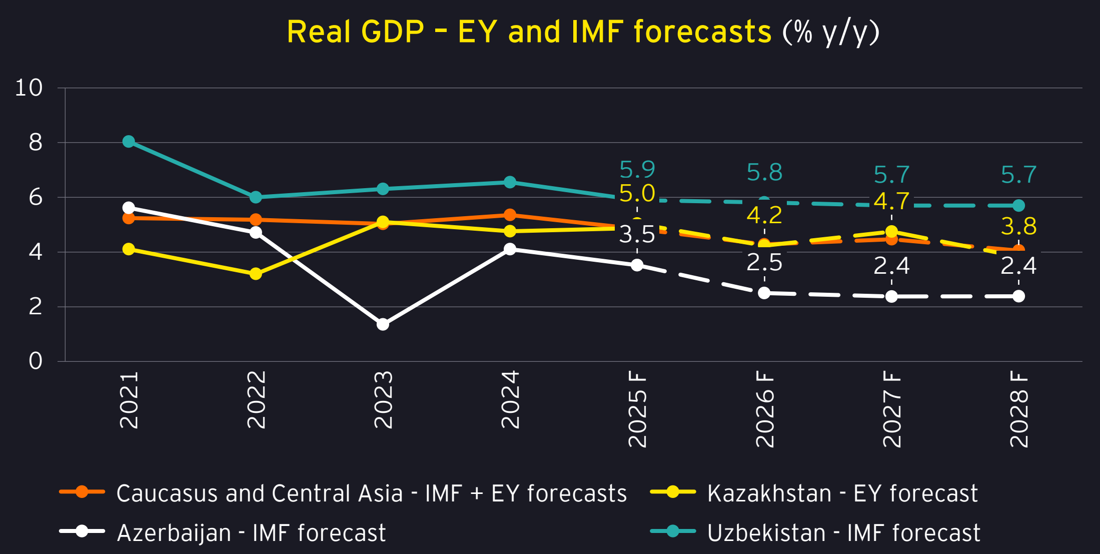


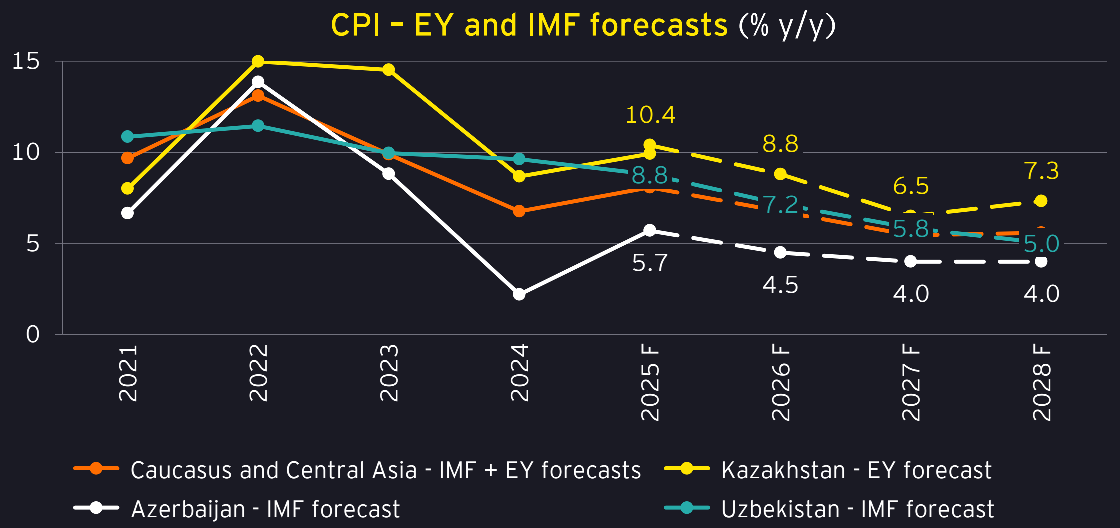
1. Non-profit institutions serving households

Source: CBRT, Turkstat, IMF, ISO, EY-Parthenon analysis.

- **Headline annual CPI eased to 37.9% in April 2025** (3.0% MoM), supported by lower food inflation, although housing and clothing prices continued to rise. The depreciation of the Turkish lira (TRY), elevated inflation expectations, and food price risks added upward pressure, while lower oil prices, tight policy, and softer demand provided some relief for the CPI.
- **The Turkish lira weakened sharply in March and April**, with USD/TRY increasing by 2.4% and 2.8% MoM, respectively, following the detention of Istanbul's mayor, Ekrem İmamoğlu. The Central Bank of the Republic of Türkiye (CBRT) intervened through FX sales, reducing reserves from USD 171 bn to USD 141 bn.
- In response to FX pressures, **the policy rate**, which had fallen from 50% to 42.5%, **was raised to 46% in March**. The CBRT is expected to maintain a tight monetary policy until inflation shows a sustained decline, with the first policy rate cut anticipated in June or July.
- **GDP growth surprised to the upside in 2024 Q4, growing by 1.7% q/q and 3.0% y/y,** driven by a 4.3% q/q rise in household consumption and a 3.9% q/q increase in fixed capital investment. This outturn followed two quarters of stagnation in q/q terms, marking a robust return to growth. **We expect GDP to increase by 2.8% in both 2025 and 2026, following a 3.2% expansion in 2024.**
- The Turkish manufacturing PMI remained unchanged at 47.3 in April, marking the 13th consecutive month of contraction, although declines in output, new orders, and exports eased slightly.
- **On a positive note, Türkiye's current account deficit narrowed from 5.1% of GDP in 2022 to 0.8% of GDP in 2024**, aided by falling energy prices. Excluding energy, the current account was positive, increasing from USD 12bn in 2023 to USD 39bn in 2024. From 2025, the current account deficit is expected to be between 1.2% and 1.6% of GDP, although Trump-era tariffs and Türkiye's import dependency pose risks.
- **Unemployment declined from 10.1% in March 2023 to 7.9% in March 2025**, reflecting the government's efforts to promote sustainable employment.

Caucasus and Central Asia*: While GDP growth remains robust, inflation levels are also elevated. In response to persistent inflationary pressures, central banks have decided to hike interest rates.





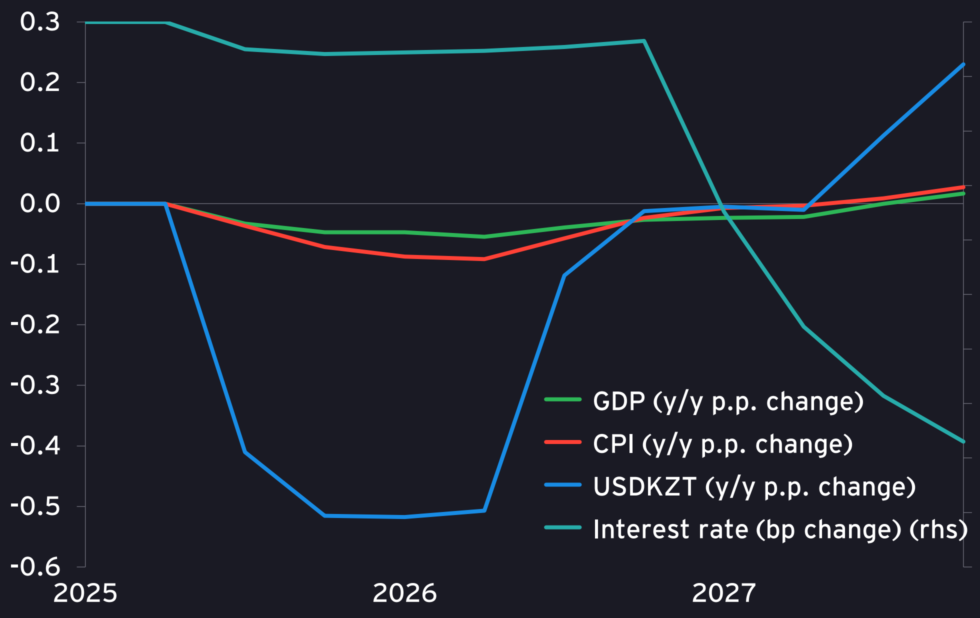
- This is the first edition of European Outlook, in which **we present in-house forecasts for Kazakhstan** derived from a model we have developed (additional details regarding the model's properties are provided on the next slide). Forecasts for other Central Asian countries are based on the latest edition of the IMF World Economic Outlook.
- **The flash estimate for Kazakhstan's GDP in 2025 Q1 indicates a robust performance, with a growth rate of 5.6% y/y.** While detailed information from the expenditure side is not yet available, significant annual growth observed in sectors such as construction, transport, and wholesale trade suggests that this growth is largely driven by investments. **Even higher growth figures were recorded in Uzbekistan, where the annual growth rate for Q1 reached 6.8% y/y.** Similar to Kazakhstan, construction emerged as the primary driver of this growth. **In Azerbaijan, much weaker growth figures were observed, with GDP increasing by only 0.3% y/y.** This subdued performance is primarily attributed to a decline in output from the oil and gas sector, which contracted by 3.8% y/y. In contrast, the non-oil GDP performed significantly better, rising by 2.5% y/y.
- **We project Kazakhstan's GDP growth for the current year to reach approximately 5% y/y,** primarily driven by the industrial and mining sectors, particularly with the initiation of oil production at the Tengiz field. In the following years, economic expansion will largely be supported by ongoing investment projects and robust consumer spending.
- In Azerbaijan, economic growth is anticipated to decelerate in the coming years, mainly due to a decline in hydrocarbon production; however, the service sectors are expected to perform well. Meanwhile, growth in Uzbekistan is expected to stabilize just below 6%, supported by stable investment and private consumption growth. Increased public and private spending on infrastructure, manufacturing, healthcare, and education is projected to drive overall investment.
- **Inflation in Kazakhstan is expected to remain elevated** due to increases in utility prices, the end of petroleum price regulation, and high service prices. **The Central Bank's actions, including a rate hike in March to 16.5%,** and expectations to maintain this rate throughout the year should contribute to a gradual decrease in inflation over the following years.
- **Central banks in Uzbekistan and Azerbaijan, as well as in Armenia, have also responded to rising inflationary pressures by increasing interest rates.** In Azerbaijan, inflation is projected to rise in 2025 as a result of higher fuel prices and increased utility tariffs. However, it is anticipated to stabilize as economic growth slows and the effects of previous price hikes diminish. In Uzbekistan, energy prices are one of the key drivers of high inflation.

Source: stat.gov.kz data, IMF.
* CCA region covers Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, weighted by GDP share.

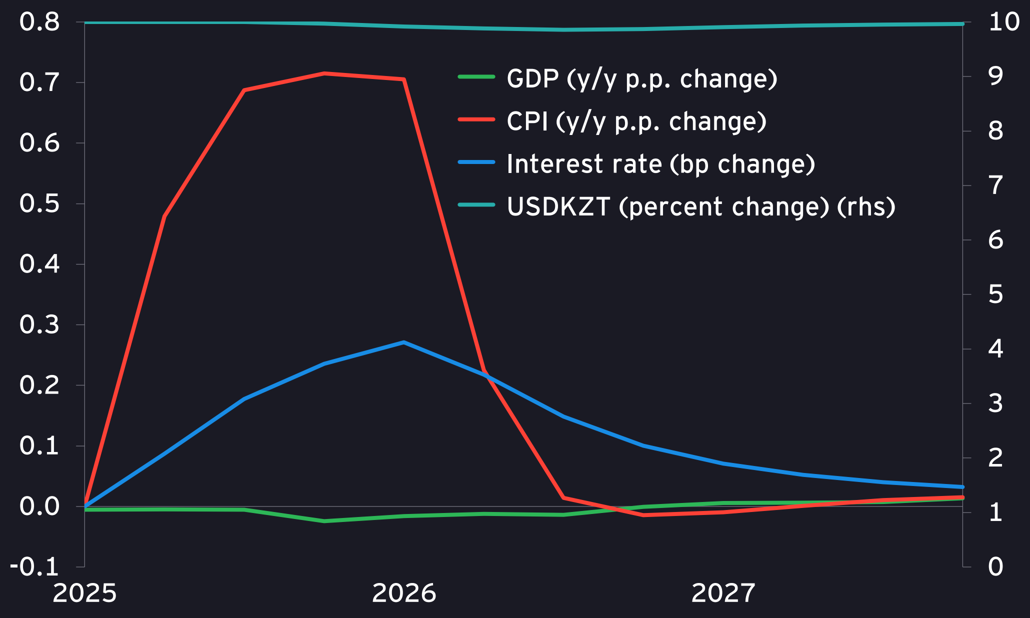
Model expansion: Kazakhstan

- We have developed an economic model for Kazakhstan and integrated it into the EY-amended version of the Oxford Global Economic Model. This integration allows us to effectively model key economic indicators, including GDP growth, output gap, inflation, interest rates, exchange rates, and labor market metrics such as wages, employment, unemployment, and participation rates, within a global economic context.
- The model operates on quarterly data, with GDP, inflation, labor markets, interest rates, and the exchange rate influencing each other, as well as being affected by developments in the oil sector, economic trends in major economies and trade partners, world commodity prices, and the effects of economic uncertainty. Forecasts for GDP and inflation generated by the model are presented on the Caucasus and Central Asia slide.
- To illustrate the analytical capabilities of our model, we present the results of two simulations: a 100 bp central bank interest rate hike and a 10% depreciation of the currency against the USD. We set the interest rate shock for 2025-2026, with secondary effects steadily fading away through 2027. In terms of the currency shock, secondary effects are stronger, and the exchange rate remains approximately 10% above the baseline in 2027.
- The interest rate shock leads to 0.5% appreciation of the tenge within a year. The impact on GDP and CPI is minor and aligns with existing literature regarding the Kazakhstani economy. Conversely, the exchange rate depreciation shock results in a higher inflation rate (0.7% after a year), prompting a 25 bp increase in interest rates. GDP is hardly affected.

Interest rate shock (100 bps)



Exchange rate depreciation shock (10%)



 Source: EY EAT calculations

Summary: GDP forecasts (% y/y)

Location	2023	2024	2025 F	2026 F	2027 F	2028 F
Albania	3.9	4.0	3.8	3.5	3.5	-
Austria	-0.9	-1.3	-0.3	1.4	1.9	1.5
Belgium	1.2	1.0	1.1	1.4	2.3	2.2
Bosnia and Herzegovina	2.0	2.5	2.8	3.0	3.0	-
Bulgaria	2.0	2.7	2.8	2.1	1.8	1.7
Croatia	3.3	3.9	3.4	2.9	2.8	3.3
Cyprus	2.8	3.4	2.8	2.5	2.6	2.7
Czechia	0.1	1.0	2.4	2.8	3.2	3.1
Denmark	2.5	3.7	1.2	1.2	2.8	3.2
Estonia	-3.1	-0.2	2.8	3.8	4.1	3.5
European Union	0.6	1.0	1.2	1.5	1.9	1.8
Eurozone	0.5	0.8	1.1	1.3	1.8	1.6
Finland	-0.9	-0.1	0.9	1.5	2.1	2.1
France	1.1	1.1	0.9	1.4	1.3	1.2
Germany	-0.1	-0.2	-0.1	1.1	2.5	2.2
Greece	2.3	2.3	2.6	2.9	1.5	0.8
Hungary	-0.7	0.5	1.9	2.9	3.5	3.4
Ireland	-5.6	1.2	6.7	-0.4	2.5	3.7
Italy	0.8	0.5	0.4	0.7	0.5	0.6

Location	2023	2024	2025 F	2026 F	2027 F	2028 F
Kazakhstan	5.2	4.8	5.0	4.2	4.7	3.8
Latvia	2.2	-0.4	2.1	2.7	3.0	3.0
Lithuania	0.4	2.7	2.6	1.5	3.7	3.5
Luxembourg	-0.7	1.0	2.4	1.9	2.1	2.0
Malta	6.8	6.0	3.7	3.8	3.7	3.0
Montenegro	6.3	3.0	3.2	3.2	3.0	-
Netherlands	0.1	1.0	1.4	1.7	1.7	1.3
North Macedonia	2.1	2.8	3.2	3.2	3.2	-
Norway	0.2	2.1	-0.6	0.7	0.8	0.7
Poland	0.2	2.9	3.5	3.4	1.6	2.3
Portugal	2.6	1.9	1.6	1.4	1.5	1.4
Romania	2.4	0.8	1.5	2.5	2.9	2.9
Serbia	3.8	3.9	3.2	3.8	4.2	-
Slovakia	2.2	2.0	1.5	2.5	2.7	2.4
Slovenia	2.4	1.3	1.3	3.3	2.8	2.3
Spain	2.7	3.2	2.9	2.4	1.5	1.1
Sweden	0.1	0.9	1.3	2.2	2.7	2.4
Switzerland	0.7	1.3	1.3	0.5	1.4	1.5
Turkey	5.1	3.2	2.8	2.8	3.2	3.3
United Kingdom	0.4	1.1	0.8	0.9	1.5	1.5

Source: EY Forecasts

Summary: Inflation forecasts (yearly average, % y/y)

Location	2023	2024	2025 F	2026 F	2027 F	2028 F
Albania	4.0	2.1	2.7	2.9	3.0	-
Austria	7.8	2.9	3.1	0.8	1.4	1.6
Belgium	4.0	3.1	2.7	1.4	1.8	1.9
Bosnia and Herzegovina	2.2	2.9	1.8	1.6	2.0	-
Bulgaria	9.5	2.4	4.8	2.6	2.4	2.6
Croatia	7.9	3.0	3.3	2.2	2.1	2.5
Cyprus	3.9	2.3	2.3	2.3	2.1	1.8
Czechia	10.6	2.4	2.8	2.9	3.2	2.7
Denmark	3.3	1.4	1.7	0.9	1.1	1.5
Estonia	9.1	3.7	4.7	3.6	2.0	1.4
European Union	6.4	2.6	2.1	1.7	2.0	1.9
Eurozone	5.4	2.4	2.0	1.7	2.0	1.9
Finland	6.3	1.6	0.1	0.2	1.2	1.4
France	4.9	2.0	1.0	1.6	2.1	1.9
Germany	5.9	2.3	2.1	1.9	2.1	2.2
Greece	3.5	2.7	1.7	1.9	3.0	2.1
Hungary	17.1	3.8	4.5	3.1	2.4	2.5
Ireland	6.3	2.1	1.8	0.9	1.3	1.5
Italy	5.6	1.0	2.1	1.9	1.4	0.7

Location	2023	2024	2025 F	2026 F	2027 F	2028 F
Kazakhstan	14.5	8.8	10.4	8.8	6.5	7.3
Latvia	9.0	1.3	2.6	1.7	2.9	2.4
Lithuania	9.1	0.7	4.8	3.1	1.9	1.9
Luxembourg	3.7	2.1	1.2	1.5	2.1	1.8
Malta	5.6	2.4	1.9	1.9	2.3	2.4
Montenegro	4.3	2.1	5.2	1.3	2.6	-
Netherlands	3.8	3.3	3.0	1.9	2.4	2.3
North Macedonia	3.6	4.3	2.3	2.0	2.0	-
Norway	5.5	3.1	2.2	2.2	2.6	2.1
Poland	11.4	3.7	3.0	2.1	2.5	2.5
Portugal	4.3	2.4	1.5	1.1	1.6	1.4
Romania	10.4	5.6	4.6	3.6	2.6	2.0
Serbia	7.6	4.3	4.7	3.7	3.2	-
Slovakia	10.5	2.8	3.6	1.7	2.8	2.7
Slovenia	7.5	2.0	2.7	2.7	2.6	2.3
Spain	3.5	2.8	2.2	1.8	2.6	2.4
Sweden	8.5	2.8	1.4	1.1	1.0	1.4
Switzerland	2.1	1.1	0.4	0.9	1.1	0.9
Turkey	53.9	58.5	34.1	20.0	12.6	9.9
United Kingdom	7.3	2.5	3.0	2.4	2.0	2.0

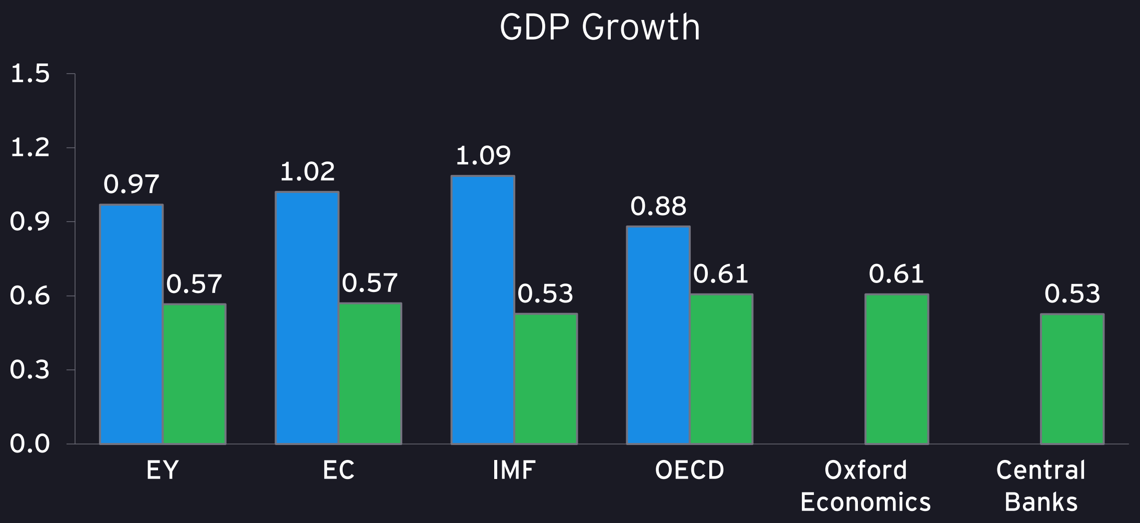
Source: EY Forecasts

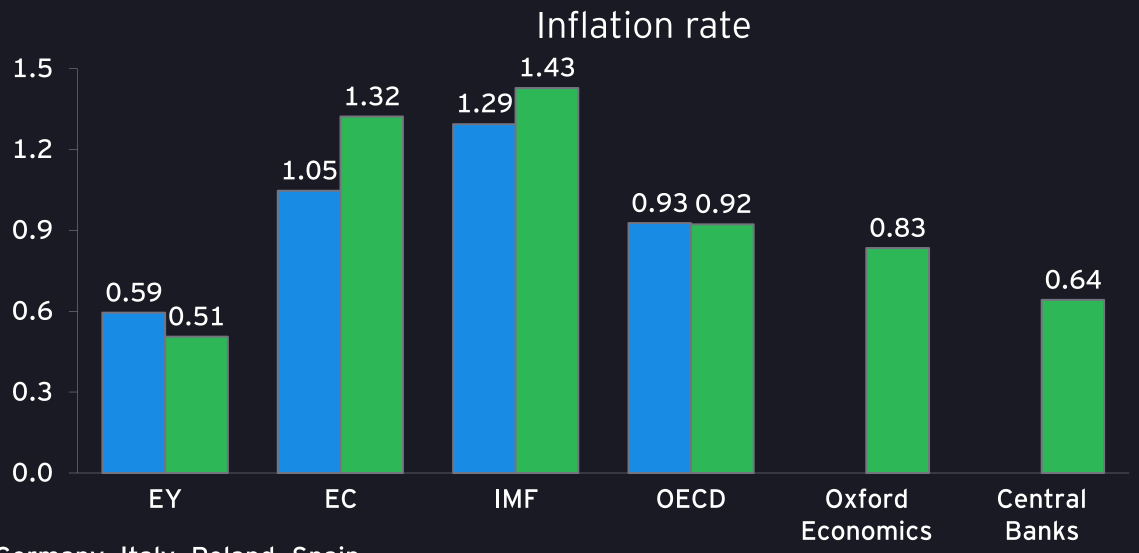
In terms of average forecast errors across EU countries, the EY EAT forecasts for 2024, formulated in January 2024, were significantly more accurate than institutional benchmarks for inflation and similarly accurate for GDP.

2024 forecasts for the euro area, formulated around January 2024*, vs actual realizations

Euro area forecast	Official print	EY	European Commission (EC)	IMF	OECD	Oxford Economics	ECB
GDP Growth	0.9	0.8	1.5	1.2	0.9	0.6	0.8
Inflation rate	2.4	2.0	2.5	3.3	2.9	1.6	2.7

Average absolute error for 2024 forecast formulated around January 2024*





EU economies** France, Germany, Italy, Poland, Spain

*Compared forecast: EY EAT: European Economic Outlook: 2024 January; Oxford Economics: Country Economic Forecast January 2024; for central banks, December projection except Poland (November 2023), EC: Autumn 2023 Economic Forecast, IMF: WEO October 2023 except main 5 economies GDP estimation (January 2024 update); OECD: Economic Outlook November 2023.

**EU economies excluding Cyprus and Malta for GDP, and excluding Cyprus, Malta, and Slovenia for CPI, due to discrepancies in the basket of forecasted economies among international institutions.

Sources: EY EAT analysis, Eurostat, Oxford Economics, OECD, IMF, Banco de Espana, Banque de France, Bundesbank, National Bank of Poland, Banca d'Italia

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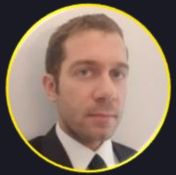

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For more information on other regions, reach out to economists from across the EY network

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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 2025-26 have been prepared by EY Italy
  - Contact: alberto.caruso@it.ey.com
- Forecasts for Serbia have been prepared by EY Serbia
  - Contact: jasna.atanasijevic@parthenon.ey.com
- Country-specific outlooks for Germany, Italy, Spain, the UK, Western Balkans, and Turkey have been provided by economists listed on slide 74.

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