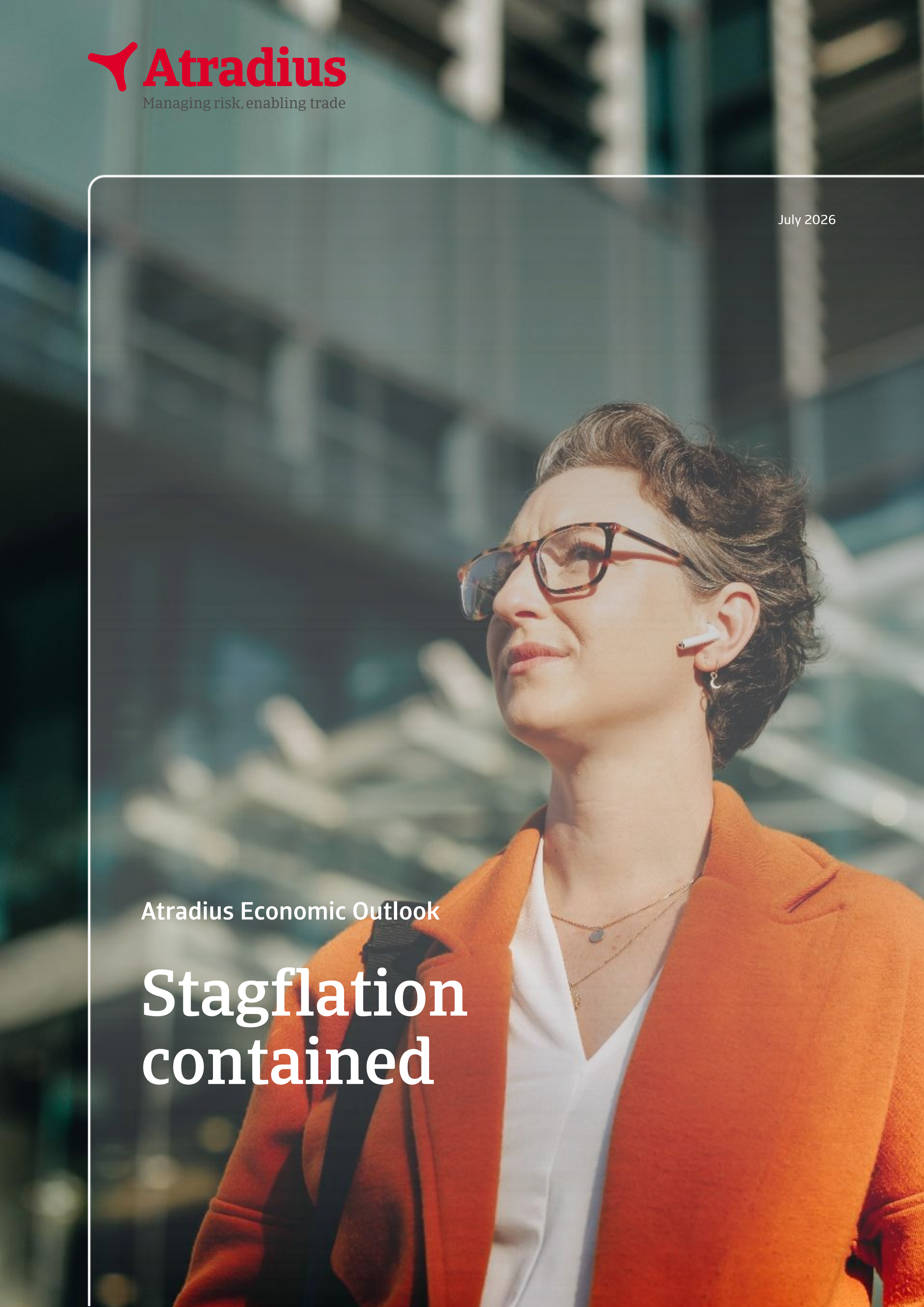
Atradius
Managing risk, enabling trade

July 2026



Atradius Economic Outlook

# Stagflation contained

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# Executive summary

The global economy has absorbed the initial shock from the war in Iran better than feared, but the outlook rests on fragile assumptions. The disruption to energy flows through the Strait of Hormuz since the start of the conflict pushed up oil, gas and fertiliser prices just as growth was already slowing down amid trade friction and geopolitical uncertainty. Since the June ceasefire, energy prices have fallen back markedly and inflation expectations remain broadly anchored, reducing the risk of a sustained spiral of higher prices and weaker growth. At the same time, the global economy continues to benefit from the US-led AI and technology investment boom. However, the ceasefire remains fragile and the renewed military strikes between the US and Iran in early July highlight how quickly disruption to energy markets could re-emerge. While our baseline assumes a gradual reopening of the strait and further easing in energy prices, downside risks to the outlook remain elevated.

- **Global GDP growth is forecast to slow to 2.4% in 2026, from 3.0% in 2025, before recovering to 3.1% in 2027**. The impact of the Iran war and the closure of the Strait of Hormuz pushed up energy and fertiliser prices, creating a mild stagflation shock. This is being partially offset by the AI boom, a less severe trade war and continued fiscal support. Under our baseline assumption that the strait continues gradually reopening a sharper downturn is prevented.
- **Global trade growth is expected to slow after a stronger than expected 2025**. Trade grew by 4.6% last year, supported by tariff frontloading and strong demand for AI-related goods, especially from Asia. This momentum is unlikely to be repeated. Higher energy prices, weaker import demand and ongoing trade-policy uncertainty are expected to keep trade growth below 2% in 2026, before it recovers to around 3% in 2027.
- **Advanced economies are set for slower and more uneven growth**. GDP growth is forecast to ease to 1.5% in 2026, from 1.9% in 2025, before improving to 2.0% in 2027. The US remains the strongest performer, helped by AI investment, fiscal support and domestic energy production, but growth is increasingly concentrated in fewer sectors. The eurozone is more exposed to imported energy and weak manufacturing competitiveness, while the UK and Japan face country-specific fiscal and confidence constraints.
- **Emerging market economies remain the main source of global growth, but momentum is weaker than usual**. EMEs are forecast to grow by 3.7% in 2026 and 4.2% in 2027. China's growth is expected to slow from 4.8% in 2026 to 4.6% in 2027, as export resilience only partly offsets weak domestic demand. India remains the fastest-growing major economy, despite being the most exposed to energy supply disruptions through the Strait of Hormuz.
- **A re-escalation of the US-Iran conflict is the main downside risk to the outlook**. If fighting resumes and the Strait of Hormuz remains closed until Q4, energy prices would spike again, inflation would rise and global GDP growth would slow to recessionary levels of 1.9% in 2026 and 1.4% in 2027.

**Note on interpretation:** This report presents Atradius Economic Research's analytical views based on selected assumptions, data sources and scenarios. Outcomes may differ materially from those described.

# 1. Global economic environment

## 1.1 Here we go again

Here we go again. That may have been the reaction of many of our fellow economists after the outbreak of war in Iran on 28 February 2026. Having endured the Great Financial Crisis of 2008, the pandemic in 2020-2021, the Russian invasion of Ukraine in 2022 and the US trade war of 2025, one might have thought it time for a period of relief for the global economy.

Indeed, in early 2026 there was a deceptive period of calm before the proverbial storm. Clearly, at a human level, the large-scale Israeli/US bombardments of Iran under the banners of Operation Epic Fury or Operation Roaring Lion, which took their toll on precious human lives as well as on the Iranian infrastructure, are disturbing. However, it is the economic fallout which concerns us here.

While in many other wars the direct impact on economic activity is usually limited to the warring parties, this time that is not the case. In particular, the threat which is now on everybody's lips, but which we only accounted for to a limited extent in a number of our scenarios has materialised: the Iranian Revolutionary Guard (IRG) closed off the Strait of Hormuz. Moreover, various production facilities in the Middle East were attacked by the IRG, demonstrating the fact that they hold powerful trump cards in this conflict.

The impact of the closure was immediate. Instead of about 100 cargo ships daily, only a handful were allowed passage through the narrow sea strait. This implies that about 10 million barrels per day, or some 10% of the global energy supply, has been prevented from reaching its markets. In addition, fertilisers are directly exposed: Iran, Qatar, Saudi Arabia, the UAE and Bahrain account for one-third of global urea trade, while countries upstream of the Strait of Hormuz accounted for almost half of global sulphur trade. No wonder prices of oil, gas and fertiliser shot up. Fears of another energy crisis, hot on the heels of the crisis triggered by the Ukraine war mounted, risking another round of inflation in combination with lower economic activity.

Are these fears justified? Are we facing another period of stagflation, where the global economic growth is below 2% and inflation is in the range of 7%-8%? While a ceasefire remains in effect at time of writing, we’re not out of the woods yet. If we take the Ukraine war, we see that this occurred while the effects of the pandemic supply chain imbalances were still at play, with tight labour markets and a lot of money saved during the pandemic floating around seeking a destination. That is not the case now. There are much softer labour markets, more balanced firm and household balances and less cash available. This should give less reason for concern. That said, there is one proviso. With the experience of the Ukraine war energy crisis in mind, the sensitivity to inflation of firms and households may be higher. This is because a lower inflation rise than before may now be enough to trigger second-round effects such as wage rise demands, leading to another round of inflation. In other words, with a more limited rise in energy prices, a similar level of inflation can be the result.

Let us consider this more closely. Price rises of energy, as well as of other commodities, filter into the economy in various ways. We immediately feel the higher fuel price at the pump, and higher fertiliser prices increase our food bills, albeit with a time lag. Thus, consumers face a hit to their purchasing power, affecting consumption. Moreover, energy is an input for the production process. One only must consider rising transport costs, shrinking margins of firms and thus reduced ability to invest. A disrupted supply chain as we have seen exacerbates this effect. If certain goods are less available, they become more expensive, reinforcing other price rises in the economy and their impact on demand.

If the price rises remain contained, the above impact should be limited. That said, this may not be the case with higher inflation sensitivity of consumers and firms. If they expect rising inflation, central banks may have to use more forceful rate hikes to put the genie back in the bottle. This means preventing wages from rising as well as averting second-order effects. This would then hit demand again as higher borrowing costs also depress demand among consumers and firms.

While we are witnessing all these effects of the energy crisis unfolding in inflation and lower economic activity, it is not yet clear what the ultimate impact on the global economy will be. That impact will be determined by how long it takes for trade through the Strait of Hormuz to resume. At the time of writing, this is beginning to gradually increase since the mid-June US-Iran peace agreement. Less than one-third the prewar level of ships is travelling the strait as of early July and we assume a gradual reopening to continue through the remainder of the year. Under this baseline, in the absence of a re-escalation of hostilities, the stagflation impact of the closure should remain limited, but downside risks are high.

Apart from this major question mark, one may argue, there are other reasons to be more optimistic about avoiding stagflation. The AI boom, which we made central to our December Outlook, remains powerful, feeding into stock market gains at unprecedented levels. The trend started in the US, and spillovers are now starting to be felt in Europe and China. If successfully adopted, productivity gains could depress inflationary tendencies. Then there is the US trade war. Despite the US Supreme Court decision limiting the policy freedom of the US administration, tariffs have not disappeared and remain a lot higher than during the Biden administration. But the extraordinary levels presented in the Rose Garden in April 2025 are off the cards. It is telling that the US administration has so far not availed of the possibility to raise the overall tariffs, in order to raise tariffs from 10% to 15%.

The trade war is simply not as bad as initially envisaged. The final note of encouragement can actually be found in the often gloomy science of economics. During previous times of crisis, the global economy has proved to be more resilient than forecast by our models. Households and, especially, firms find ways to adjust to new situations and they seem to adapt more easily than we might envisage.

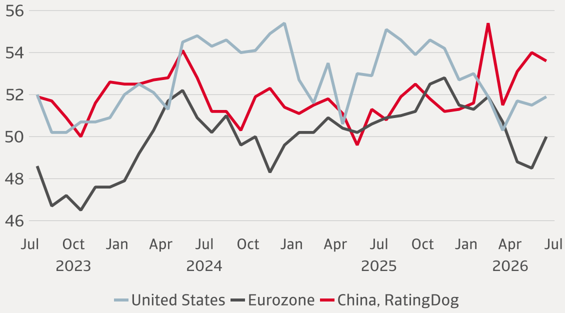
## 1.2 Manufacturing PMI strong as forecast revisions remain mild

Assuming a gradual reopening of the Strait of Hormuz over the summer, combined with a continuation of the AI boom and a trade war that is not further intensified, the revisions of the forecast stay relatively mild. Confidence indicators in the main economic regions, divergent and somewhat under pressure, broadly support this view.

The composite PMI has fallen in the US in recent months but has recently recovered, while remaining above 50, signalling growth. For China the picture is even stronger: robust growth is indicated. On the other hand, the PMI in the eurozone has fallen in recent months, to a level significantly below 50 (figure 1.1).

**Figure 1.1 PMI down in eurozone**

**Composite PMI, seasonally adjusted**

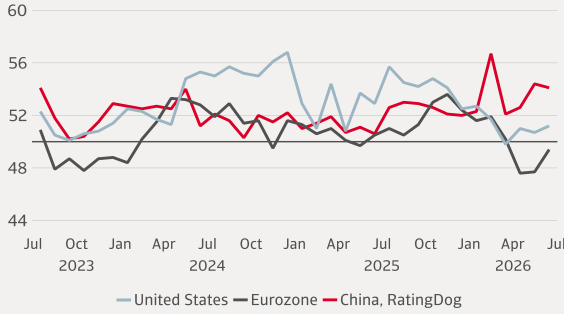



Source: Macrobond, S&P Global

If we break down the composite indicator into services and manufacturing, we observe that it is especially the services PMI that drags down the eurozone PMIs (figure 1.2). The services PMI in the US has also fallen, but remains positive. This comes as no surprise, as higher inflation reduces household demand for restaurants, travel, leisure, retail, professional services and personal care. It is nonessential spending that households first save on. This effect is more prominent in the eurozone than in the US. The eurozone is an energy importer with weak economic growth and is more sensitive to energy price rises than the US. China is the outlier with a relatively robust increase in the index. Inflation is less of a worry there as the level is still very low.

**Figure 1.2 Services PMI in eurozone the odd one out**

**Services PMI, seasonally adjusted, 50 = neutral**

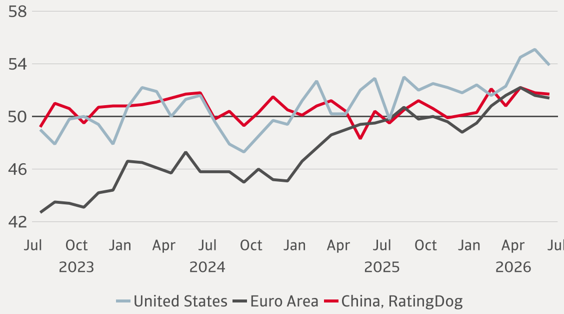



Source: Macrobond, S&P Global

As opposed to the heterogeneity in services PMIs, manufacturing PMIs show a synchronised pattern across the regions (figure 1.3). They are improving and are all in positive territory, even in the eurozone. The picture may be misleading though, especially for the eurozone. As was the case after the Ukraine crisis, anecdotal evidence suggests firms are placing orders before the input prices really start to bite and supply chain disruptions become manifest.[1] To the extent that this is true, a mini stock-building boom should be followed by a slump. Manufacturing in the eurozone is also supported by stepped up defence spending. For the US and China matters are slightly different; these regions are less vulnerable to energy prices while their economies are growing faster. In the US, the AI boom plays a prominent role, buttressing manufacturing growth. Chinese manufacturing is supported by exports of electric vehicles, batteries and other energy-transition related goods.

**Figure 1.3 Solid manufacturing PMIs**

**Manufacturing PMI, seasonally adjusted, 50 = neutral**



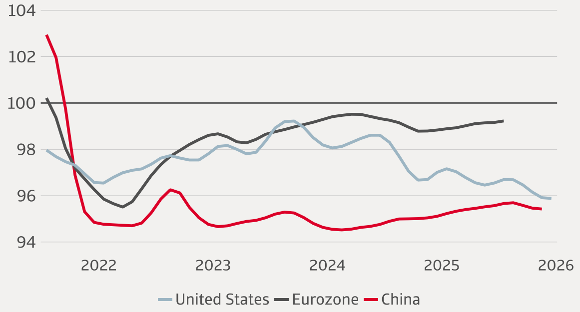

Source: Macrobond, S&P Global

[1] FT 5-6-2026, Manufacturing sputters in search of 'golden age'

The picture of consumer confidence is in line with the services PMIs, especially for the eurozone and the US (figure 1.4). The indices are below the 100 benchmark of spending growth, and are even declining in the US. The latter is a bit of a surprise, because the labour market and GDP growth are relatively strong. Chinese consumer confidence is also weak, although somewhat improving. The upshot is that in all major regions the indices suggest cautious consumer spending. Combined with the services PMI this indeed suggests that nonessential spending is concerned.

**Figure 1.4 Consumer confidence under pressure**

**OECD consumer confidence index, 100 = neutral**

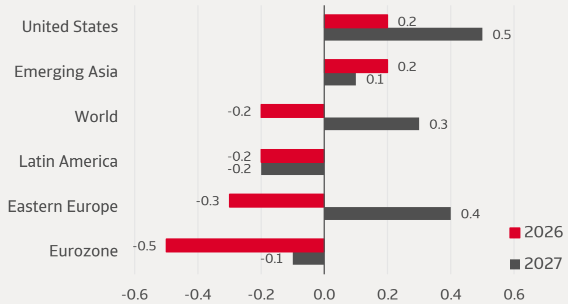



Source: Macrobond, OECD

The forecast revisions that we have made since our December 2025 Economic Outlook broadly reflect the above picture sketched by PMIs (figure 1.5). In our baseline scenario, GDP growth in 2026 for the global economy is revised downward by a modest 0.2 percentage points. The dispersion of revisions is rather wide though, reflecting the impact of the various determining factors, the US Iran war, the AI boom as well as the less intense trade war.

**Figure 1.5 US forecast improves**

**ppt change real GDP growth forecast since Dec-25**




Source: Oxford Economics, Atradius

The US is an oil producer and therefore stands to gain from the higher energy prices, whilst the less intense trade war and continued AI boom contribute positively as well. Europe is mainly an energy importer, and stands to gain only in a limited way from the less intense trade war and is yet to see stepped up large-scale investments in AI.

The forecast revision of 0.2ppt of an already meagre growth therefore does not come as a surprise. For the emerging economies, the overall impact is negative, although Emerging Asia stands to gain somewhat, helped by an upward revision for China (0.2ppt). For Latin America the downward revisions of 0.2ppt for Mexico and Brazil, though both oil producers, weigh in. In Emerging Europe the war-affected economy of Russia and energy importing Türkiye contribute to the negative revision. As the impact of the energy price rise under our baseline scenario wanes in 2027, the forecast revision for the global economy turns positive (0.2ppt) and the dispersion of the revisions gets larger. This is particularly driven by a considerable upward revision for the US (0.5ppt). Counterweight is given by downward revisions for the eurozone recovery, and Emerging Asia due to a downward China revision (0.3ppt). The relatively large upward revision for Eastern Europe (0.4ppt) is supported by positive revisions for Russia and Türkiye.

The overall picture for 2026 then, is one of a rather meagre growth of 2.4% down from 3% in 2025. US GDP growth is upheld vis-à-vis 2025, whereas the eurozone takes a considerable hit, with growth less than one-third that of 2025 (table 1.1). In the emerging market economies (EMEs), Emerging Asia continues to press the growth button, although a slowdown as compared to 2025 is unmistakable. Latin America as well as Eastern Europe can also not escape this picture. In 2027 as recovery sets in, more robust growth of 3.1% is forecast, with all regions represented, except Emerging Asia. The lower GDP growth of China weighs in. That is insufficiently compensated for by somewhat higher growth in India and other emerging Asian economies.

**Table 1.1. Stagnation in 2026**

**Real GDP growth, % y-o-y**

| | 2025 | 2026* | 2027* |
|---|---|---|---|
| Eurozone | 1.5 | 0.4 | 1.5 |
| United States | 2.1 | 2.2 | 2.6 |
| Emerging Asia | 5.3 | 5.0 | 4.9 |
| Latin America | 2.4 | 1.7 | 2.2 |
| Eastern Europe | 2.6 | 2.0 | 2.6 |
| **World** | **3.0** | **2.4** | **3.1** |

Source: Oxford Economics, Atradius (* forecast)

## 1.3 Fragile truce assumptions

Our forecast rests on several assumptions, most notably those related to the opening of the Strait of Hormuz, the AI boom, the trade war and policy reactions.

First, as to the developments in the US-Iran war, the critical question is if the fragile ceasefire will hold and how long it will take for normal traffic to resume through the Strait of Hormuz. Our current assumption is that the gradual reopening since the mid-June ceasefire will continue, bringing shipping back to normal levels by the end of the year. The implication is that energy prices have peaked in the second quarter and are falling back to prewar levels. Volatility will likely persist though as during negotiations, military strikes and uncertainty could emerge.

Second, inflation has increased in response to the energy (and food) price shock. But we expect it to remain a lot lower than after the outbreak of the Ukraine war, when a peak of 8%-10% was reached. This is because the economy is weaker, labour markets softer and we are not seeing as much supply chain disruption as we saw when emerging from the pandemic. We are now facing inflation levels below 4% for the eurozone, the US and China. This implies that the so-called second round effects where wages rise, feeding further into inflation, are contained.

Third, in this environment, with a mild inflation increase and some growth impediments, central banks will tread carefully. They will assess the extent of damage to inflation and, in the Fed's case, economic activity. Policy actions will be implemented accordingly. These may consist of delayed rate cuts – such as in the case of the Fed, reflecting a somewhat higher tolerance for inflation – and rate hikes by the ECB that focus solely on inflation control. Other central banks may choose differently, depending on the impact of the energy price rises.

Fourth, providing counterweight to the stagflation forces emanating from the energy price, we anticipate the AI boom continuing over the forecast horizon. This means that investment growth continues, especially in the US, with limited dissemination to other regions. Crucially, it is not only the so-called hyperscalers like Amazon, Alphabet and Microsoft that will spend on AI. We also expect to see the rest of the business community such as financial institutions and industrial firms pick up their spending, particularly on adaptation. This should allow for productivity gains from AI in the broader economy, permitting wages to rise without inflation. So far, these gains have not been included in our forecast.

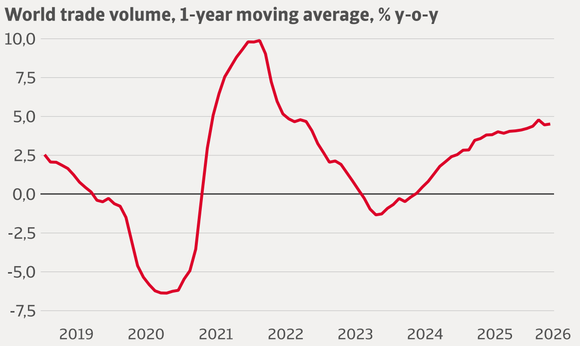
Fifth, we expect the role of governments to remain active in support of their economies. This implies that in a crisis such as the current one, governments take action to soften the impact and support demand. Such action is possible now that fiscal consolidation has occurred in a number of countries. Where that is not the case, such as in the US, China and France, we assume limited fiscal consolidation over the forecast horizon. An active government role in a period of geopolitical tensions, where spending on defence and value chain security is essential, is simply mandatory.

Sixth, as to the trade war, we assume that the Supreme Court decision to cap the US import tariffs at 10% across the board (50% for steel, aluminium and copper) will be maintained. This implies that the effective tariff will remain around 10%-12%. This effective status quo in the trade war reflects the high level of uncertainty after the decision, with the current tariff regime set to expire by end-July. After this date, continuation will require Congress approval. We assume that the administration will either obtain approval or find ways to justify continuing the current regime. No meaningful thawing in the US-China relationship is assumed, with the US continuing to apply larger tariffs on imports from China. We also assume that negotiations on the renewal of the USMCA continue without a comprehensive agreement. The resulting uncertainty is expected to persist, although a disruptive breakdown of the framework is avoided. The upshot of this picture is that the trend of decline in global trade as a share of GDP is set to continue.

## 1.4 Global trade to slow down

When the trade war unfolded in April 2025, we saw heavy clouds hanging over global trade. But in our December Economic Outlook we already acknowledged having been too pessimistic. This was not without reason. The trade war turned out to be less intensive than envisaged, and firms anticipated higher tariffs and frontloaded transactions as much as possible, especially in the first quarter of the year. Most importantly, as we stressed in that Outlook, the relevance of AI investments had been underestimated. AI-related goods trade grew by more than 35%. This was above still decently growing trade (around 5%) in sectors such as electronics and electrical equipment, pharmaceuticals and chemicals, agriculture, food and beverages and machinery (figure 1.6). Due to a strong fourth quarter, 2025 trade growth reached 4.2% by the year-end. Again, our expectations were beaten. Based on the available data (three months lagging) we had expected lower growth, of 3.5%.

**Figure 1.6 Global trade losing momentum**




Source: Netherlands CPB, Macrobond

Forecasting trade growth appears to be a hazardous endeavour in the current global environment, and not only for us.[2] Nevertheless, we venture to forecast now that it is very likely the growth figure of 2025 will not be repeated. True, the AI boom may continue supporting growth. But another round of frontloading is unlikely as the trade war is unlikely to escalate again and (trade) policy uncertainty remains very high. Moreover, there is another elephant in the room, i.e., the energy crisis. The hit to GDP from that as described above will simply have a knock-on effect on trade, via reduced import demand.[3] We therefore estimate that global trade growth will not surpass 2%, with recovery to close to 3% in 2027, as by then the crisis will have abated and effects such as creeping protectionism not yet felt.[4]

Let us take a closer look first at the developments and secondly, the underlying drivers. In 2025, for the second year in a row, Asian economies (including China) were the largest contributors to trade growth, accounting for 3.2%, or 71% of the total growth of 4.6%. Europe also made a positive contribution, albeit marginal, after two years of contraction. Other regions, Latin America as well as Eastern Europe, made a positive contribution as well. Despite the trade war, the US also contributed. Frontloading, ahead of 'reciprocal' tariffs to be imposed later in the year, included frontloading in the US. The US import index (2023 = 100) shot up to 120 in Q1 from 105 in the previous quarter. This was reflected in increased exports from Latin America, the Middle East, Europe, and, most prominently, Asia in that quarter. Asian exports continued to surge during the rest of the year, led by China with 9.2% growth. US imports continued to grow as well after Q1, driven by strong demand for AI investment-related trade. The US import composition has changed notably, implying trade diversion. Imports from China fell off a cliff – to 7% of total US imports in 2025 as compared to 14% in 2024. Rerouting took place via India, Vietnam and Taiwan. The latter country has now the same US import share as China.

Data for the first four months of 2026 shows still strong trade growth, with global trade running at above 4% (figure 1.7). The regional picture is not fundamentally changing as compared to last year. US imports remain strong. This is entirely due to capital imports related to AI investments, especially computers. Imports of food, industrial supplies, consumer goods and autos are weak, which can be expected in view of the current tariffs. Chinese exports were very strong, as were those from other Asian countries, although to a lesser extent. These countries are largely supplying the AI boom in the US, continuing the trade diversion pattern seen in 2025. Chinese export growth was particularly strong to the EU. China-made solar panels, EVs and batteries were markedly robust, ahead of the announced export rebate cuts on 1 April. It is therefore expected that Asia will continue to drive global trade growth.

**Figure 1.7 Strong trade in Asia and China**


We have identified three factors affecting global trade growth over the forecast period: the energy crisis, the trade war and – most prominently – the AI boom. We will now detail how these factors affect our trade growth forecast.

## Energy price rises take a toll on trade

First, the energy crisis. The impact of the rise of energy (and fertiliser) prices on global trade runs primarily via lower economic activity. In very rudimentary terms, this can be explained as follows. Reduced purchasing power via higher energy prices hits overall import volumes of energy importers, simply because less money can be spent on other goods if more goes to the same volume of energy imports. Energy exporters gain, in value terms, which allows them to raise the volume of imports. This, one might argue, could be a zero-sum game, meaning that the rise in import volume of energy

[2] Indeed, we appear to be in good company. The leading global institution on international trade, the World Trade Organisation, forecast in October 2025 global trade growth of 2.4%.

[3] This may cut trade growth by 0.6%-0.9% point in 2026 according to Oxford Economics.

[4] Such as the record number of trade defence investigations, the carbon adjustment tax on imported goods and proposed 'Made in Europe' restrictions on foreign content in Europe.

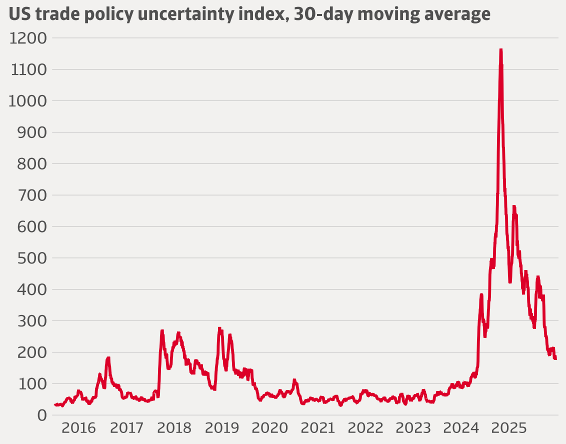
exporters equals the decline of the importers. It is not. This is simply because the volume of imports gets lower. Energy imports are lower as the market adjusts to higher energy prices; energy is saved, with other import volumes unchanged. This is why global trade falls or grows at a lower pace.[5]

In numerical terms the impact of the current crisis on global trade can be as large as 0.5ppt. The losses are largest for Europe (1ppt) and Asia (0.7ppt) while the impact on the US is marginally negative. The rest of the world, which includes oil exporters, see trade gains, but not sufficient to compensate for the losses in the other countries.[6]

## Trade war frozen

Second, the trade war. The trade war has been more or less frozen since the US Supreme Court decision in February that the legal basis used for levying tariffs under the International Emergency Powers Act was not sound. Only Congress is allowed to levy tariffs under that law. This meant the presidential powers to levy tariffs were limited, not eliminated. They would remain valid if based on national security, unfair trade practices and safeguards according to the decision. The impact was nevertheless substantial as it removed the possibility for imposing sweeping tariffs as was done on so-called 'Liberation Day' in April 2025. This was immediately visible in the Trade Policy Uncertainty Index, which declined substantially, albeit remaining at a high level (figure 1.8).

**Figure 1.8 Uncertainty stays high**



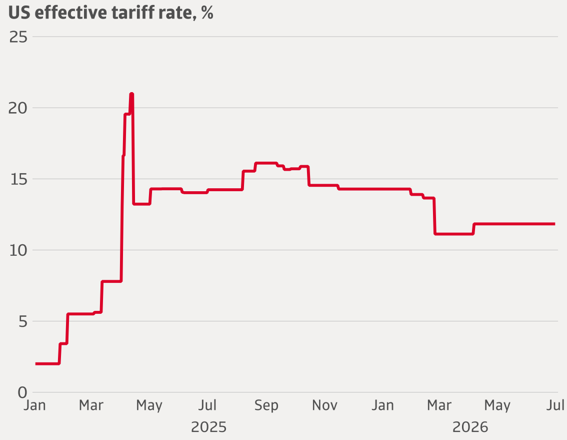

Source: Macrobond

The administration then pivoted to another legal basis, allowing it to levy tariffs up to 15% for a period ending June 2026.[7] It chose to impose 10% for the time being and decided to explore the legal means provided by the Supreme Court ruling for the period after expiration of the current levies.

Recent announcements from the administration show that it has been successful in this attempt. Specifically, 60 countries were investigated for alleged failure to take action on forced labour. This means the tariff can be raised to 12.5%. Others, such as Canada, Mexico and the EU will likely keep a 10% rate. Taking exemptions into account, the effective tariff moves up marginally to 11.8%.

It is worth noting that several investigations are still ongoing. One of them is the probe into structural excess capacity and manufacturing production in China, the EU and a host of other countries, including many in Asia such as Vietnam. This underlines the fact, that while the intensity of the trade war has lessened, trade policy uncertainty has not disappeared. Moreover, since the start of 2025, effective tariffs have more than quadrupled. While an all-out trade war may have been put on hold, we are in a much more protectionist world (figure 1.9).

**Figure 1.9 Effective US tariffs five times higher**




Source: Yale Budget Lab, Macrobond

## AI boom impact slows

The third, and by no means least, factor impacting trade growth, is the AI boom. In our December Outlook we highlighted the large impact of the AI boom on global trade figures during 2025. We argued this effect would remain strong, but unlikely to the same extent as in 2025 when the boom added up to 0.5ppt to global trade (50% of trade growth) according to WTO calculations. It is time to consider this more closely and assess whether our view still holds.

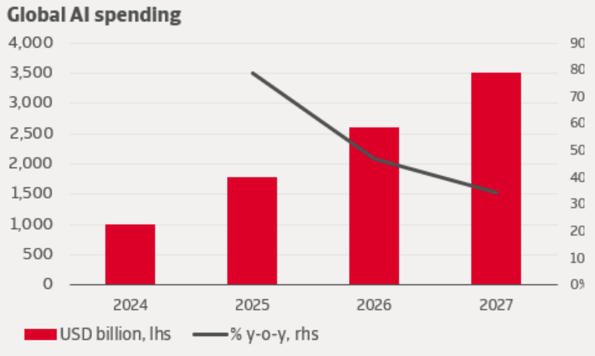
[5] We extrapolate here from differences in savings rates between oil exporters and oil importers that were prominent during the energy crisis in the seventies. If the oil exporters save more, global demand takes an additional hit because the additional US $ paid by the importer leads to less spending by the exporter than what the importer would have spent.

[6] These are import changes in a scenario, comparable to our baseline, presented by the WTO. See WTO, Global Trade Outlook and Statistics, March 2026.

[7] Section 122 of the Trade Act of 1974.

AI spending in 2025 was about USD 1.7 trillion, mainly taking place in the US. This implies a growth rate of about 70%. Growth is set to continue over the forecast period, but at a lower pace (figure 1.10).[8] One can thus expect that, if the trade intensity of the AI investments remains the same, the boost to trade growth will be significant but declining. Moreover, the composition of AI investments is expected to change over the forecast period. This is because the first phase of AI spending is gradually scaling down over the forecast period. In this phase, AI investment predominantly takes place in physical goods, such as processing units, servers, network equipment and power systems. That is very trade intensive. In the next phase, AI spending moves towards software subscriptions, AI services, integration into firms, agent deployment and the like. These activities, though contributing significantly to economic growth, are much less trade intensive. For these reasons, we expect AI investments will continue to contribute to global trade growth over the forecast horizon, but not to the extent as in 2025.

**Figure 1.10 AI spending remains high**




Source: Gartner

## 1.5 Iran war pivots commodity prices

In our December Economic Outlook we highlighted the downward trend in commodity prices as they moved to a new lower equilibrium determined by the trade war, frontloading and the AI boom. As we observed, frontloading is no longer expected, as the trade war has come to some sort of standstill. The AI boom continues albeit at a lower intensity while its composition is gradually changing.

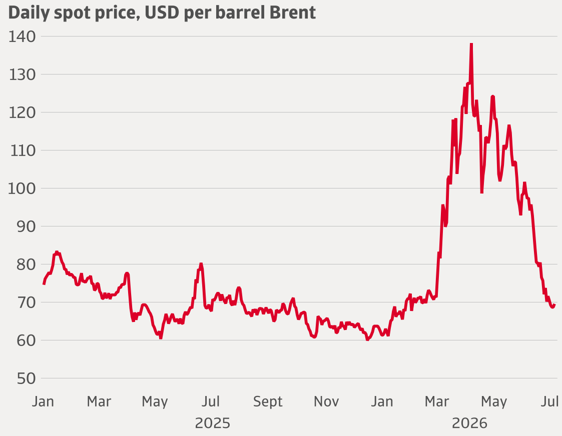
Of course, we now have the said elephant in the room, the war in Iran, which keeps the Strait of Hormuz closed. Prior to the conflict, vessels passing through the strait accounted for some 35% to 50% of global seaborn trade in crude oil and refined petroleum products, as well as 20% of trade in LNG. The route is also a critical source of fertilisers, especially urea, plus chemical inputs for many industries, such as helium and sulphur, as well as being a large contributor to aluminium supplies.

As a result, we observe commodity prices rising, for the first time since 2022.[9] The rise is not confined to oil and gas, but is more widespread, affecting fertiliser prices as well as many other commodities. Under our baseline scenario this is a temporary rise; in 2027 prices will fall, seeking new equilibrium levels. We will take a closer look at these developments and at our forecast for the relevant commodities now.

### The largest oil supply shock on record

The closure of the strait amounts to a supply reduction of 10 million barrels per day (mb/d) of oil, implying the largest supply shock on record.[10] It led to a peak oil price of nearly USD 140 per barrel Brent, from an average of USD 70 per barrel in the first two months. After the first announcement of a ceasefire in April, the price fell but remained at about 50% above the pre-war levels, at just below USD 100 per barrel (figure 1.11). Since the ceasefire agreement in mid-June, the oil price dropped further, back to USD 70 per barrel. The fragility of the truce is evident with hostilities pushing the price back to nearly USD 80 on 8 July. But assuming the peace agreement remains in place, we expect oil to average in the lower USD 70s per barrel in the second half of 2026 and to average USD 67 in 2027.

**Figure 1.11 Oil price drops**




Source: Macrobond

As of early July, the number of vessels transiting through the strait rose to about 28% pre-war volumes. While sporadic attacks on ships are still happening, markets have reassessed

[8] Figures taken from https://www.gartner.com/en/newsroom/press-releases/2025-09-17-gartner-says-worldwide-ai-spending-will-total-1-point-5-trillion-in-2025

[9] This section draws on Commodity Market Outlook, World Bank, April 2026.

[10] For comparison, the Iranian Revolution (1978-1979) and Arab Oil Embargo (1973-1974) reduced supply by 4 and 5 million barrels respectively per day.

the likelihood of a prolonged disruption, rapidly unwinding the geopolitical risk premium embedded in pricing. We expect occasional flare-ups to spark short-run volatility but assuming the ceasefire stays in effect, the oil price trend should remain closer to prewar levels.

The quick return to prewar price levels is reinforced by a range of interventions designed to compensate for the supply shortfall after the closure of the strait. These included the temporary lifting of sanctions on shipments from Iran, Russia and Venezuela, as well as tapping the emergency reserves of International Energy Agency (IEA) countries amounting to 400 million barrels (mb). That has so far contained the oil price rise to about 50%. That price rise created some demand destruction in advanced economies, Asia and the Middle East. Production of oil rose marginally in Q1 2026, as supply was hit by the shock from the strait closure in March. Production was particularly hard hit in Kuwait, Qatar, Saudi Arabia and UAE. 2025 had shown a production rise of 1.4 mb/d, due to OPEC stepping up production, creating a supply surplus that was absorbed by the market as the conflict broke out. Supply constraints have also been compensated for by higher oil & gas production from non-Middle East producers, especially in North and South America.

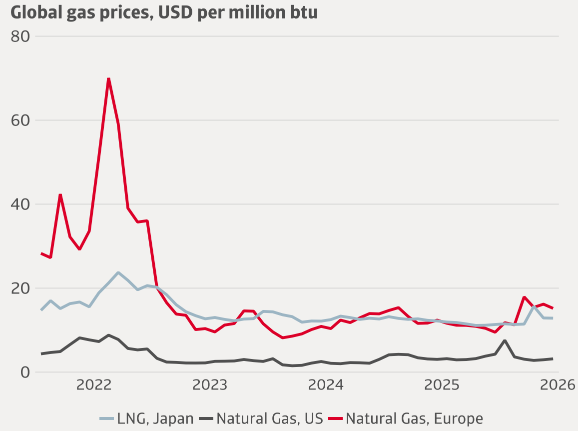
Our expectation that the oil price falls back to pre-war levels is predicated on the assumption that the proportion of the oil supply that is normally shipped through the strait will be materially compensated for. According to the IEA, 3.5-5.5 mb/d are supplied via Saudi Arabia's East-West pipeline to the Red Sea and the UAE's Fujairah route to the Gulf of Oman. In addition, about 2.9 mb/d pass via controlled passage arrangements. This leaves a shortfall of between 1.6-3.6 mb/d that have been compensated for by drawing on stocks and demand destruction. As the strait reopens, the supply deficit Q2 peak of 3.7 mb/d should then gradually revert to a significant supply surplus by the end of 2026.

## Natural gas demand destruction in Asia

The price of natural gas and liquefied natural gas (LNG) surged with the closure of the strait, through which one fifth of global LNG normally transits, compounded by long-term damage done to Qatar's infrastructure.

The Asian LNG benchmark rose 88% in March, while in Europe a 59% rise was seen. The European gas price fell back by around 15% in the following three months, while the Asian price fell back by 20%. In price-sensitive southeast Asian countries significant demand destruction was visible. Europe received a small share of its gas supply from the Middle East but the fear of competition with Asian buyers, though more limited, kept prices elevated. Levels reached are by no means comparable to those during the early days of the Ukraine war though. In the US, the gas price declined as domestic supply remained ample, inventories robust and export capacity capped (figure 1.12). Prior to the Iran war, prices had trended upwards due to unusually wintry temperatures in Europe and the US.

**Figure 1.12 Asian and European gas prices higher**




Source: Macrobond

Inventory levels have diverged across regions. In the US, storage was just above the 5-year rolling average (2017-2021) by late June. EU inventories were at the low end of that average, close to the levels after the Ukraine war. High summer prices in 2025 had prevented the re-building of these inventories, and more regulatory flexibility allowed for lower levels. The EU needed additional imports from Norway or other sources to accommodate a buildup.

As we expect that over the coming months LNG exports from the Middle East resume and no additional damage to the infrastructure is done, gas prices should gradually come down during the second half of 2026. The upshot is that on average prices will likely remain higher in 2026, most prominently in Europe and Asia and to a much lesser extent in the US. For 2027, the increase for Europe and Asia is forecast to unwind, with the US continuing its upward trend.

The outbreak of the war has lowered the prewar expectation of higher gas consumption in 2026. This is driven by demand destruction in Asia, particularly China and southeastern countries like the Philippines. Demand for residential and industrial usage takes precedence over demand from the power sector. Structural transition in Europe to more renewable energy generation reinforces this.

During 2026, gas production is expected to increase moderately. It should come from expanding existing capacity as well as from new capacity coming onstream in Australia, Congo and the US. Besides the demand destruction, the US is expected to contribute significantly to compensation for the supply disruption due to the closure of the strait as well. Then, in 2027 production in the Middle East is expected to go up, as the first phase of the expansion of the North Field in Qatar and related LNG terminal are expected to come into production. That should help prices to come down in 2027.

## War effects spill over to coal

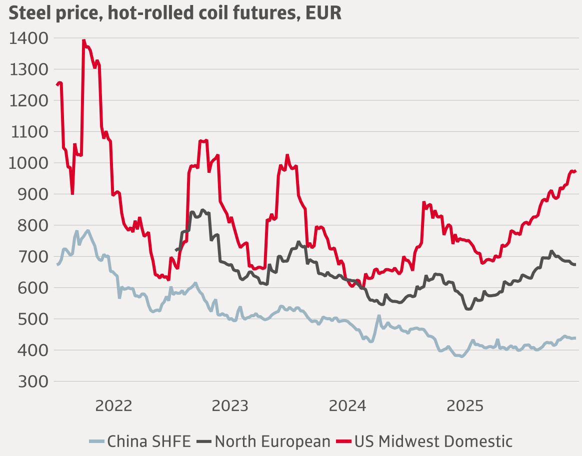
After a calm start to 2026, the disruption in the Middle East spilled over to the coal market. Not that coal itself was affected directly. It was the higher gas prices that raised demand for coal in the power sector, particularly in East Asia and Europe. This is expected to lead to a significantly higher coal price over 2026, before falling back in 2027. Coal consumption is forecast to remain stable in 2026, despite growing renewable electricity consumption due to increased power demand from EVs, air conditioning and data centres. Higher demand is expected in India and China, with stabilisation in the US after the 10% increase in 2025,[11] compensated for by a decline in Europe. This regional pattern is reflected in the forecast for supply development as well.

## Diverging steel prices

In our December Outlook we reported a rise in steel prices in the US and Europe, whereas in China, the dominating force in steel (47% of global consumption in 2025), there was limited movement in prices. What we observe is that in China the prolonged construction slump reinforced still existing overcapacity, putting pressure on prices as exports became increasingly distorted by tariffs in foreign markets. The US tariff on steel is currently 50% and the EU is following up with its own protective measures, such as reduced tariff-free import quotas, higher duties above quotas and other requirements.

The result of these measures is local price support and a global steel market that is becoming increasingly fragmented. As global steel consumption is set to rise, especially in India, China's steel prices are expected to increase mildly over the forecast period. US steel prices are the highest globally and are dominated by the tariffs. As these tariffs are not likely to be abolished, prices are expected to remain high. Now that protectionist measures in the EU are on the rise as well, a similar conclusion holds for EU steel prices (figure 1.13)

**Figure 1.13 Steel prices go up**




Source: Macrobond

The war in the Middle East has no direct impact on these prices. Indirectly, however, it does, with steel production input prices on the rise. This is because it is energy intensive, and raw materials shipped through the strait are more expensive, as are insurance and shipping costs, as vessels need to be rerouted for security reasons. That said, the impact on prices is much smaller than the impact from increased protectionism.

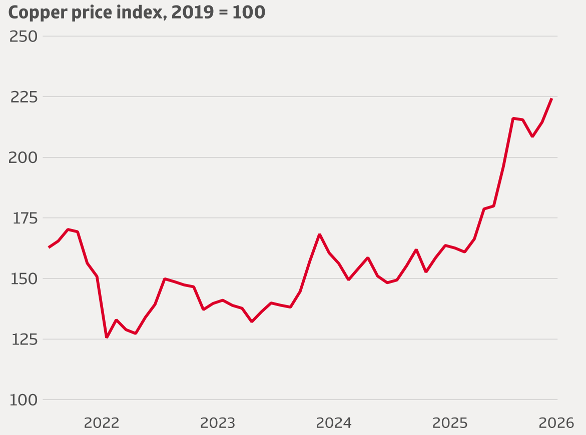
Some good news for steel input prices comes from the developments in iron ore prices, which remained relatively unaffected by the war because the main trading routes are Australia-Brazil-China. Inventories of this major raw material for steel production are currently elevated at Chinese ports, putting downward pressure on prices. Together with additions to new production from Australia and Brazil, as well as new capacity in West Africa, supply has become ample. This should lead to continued downward pressure on iron ore prices over the forecast horizon.

## Copper price rise continues

Copper prices increased in Q1 2026 by 15% (figure 1.14, reflecting the impact of the war in the Middle East, as critical input, sulphur, was disrupted, and other factors played a part. These concern uncertainty about US tariff levies and setbacks in key mines, while demand arising from the energy transition (EVs amongst others), defence and data centres continued to be buoyant.

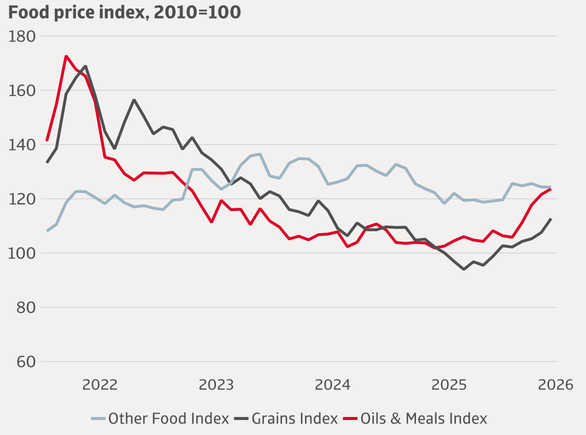
[11] This increase came after a 60% decline of coal usage over a period of 15 years.

**Figure 1.14 Copper prices continue rising**




Source: Macrobond, IMF

**Figure 1.15 Food prices move up again**




Source: IMF, Macrobond

Global mine output is forecast to rise in 2026, but will likely be constrained, as large mines in Australia and South America face operational disruptions. In Indonesia, one of the world's largest copper mine's restart is set to alleviate supply constraints. This is badly needed because demand for copper is expected to remain solid over the forecast horizon. The result is a significant price rise in 2026, followed by a mild decline in 2027 as production disruptions unwind and market tightness eases.

### Food prices raise inflation concerns

Food price falls were due to come to an end as we reported in our December Outlook, after reaching levels prior to the Ukraine war and prices were expected to remain relatively stable. Not so. After the closure of the Strait of Hormuz, food commodity prices went up 3% in March month-on-month, against 11% in March 2022, one month after the Russian invasion. The main difference is that at the time, there were direct disruptions of export volumes, whereas now it is the price of inputs such as energy and fertiliser that triggered the rise. The largest increase was for oil and meal, rising by 6% month-on-month, with the grains index rising by 5% (figure 1.15). A strong El Niño over the forecast period also adds further upside risk to food inflation, especially in economies where food carries a large weight in the consumer price basket.

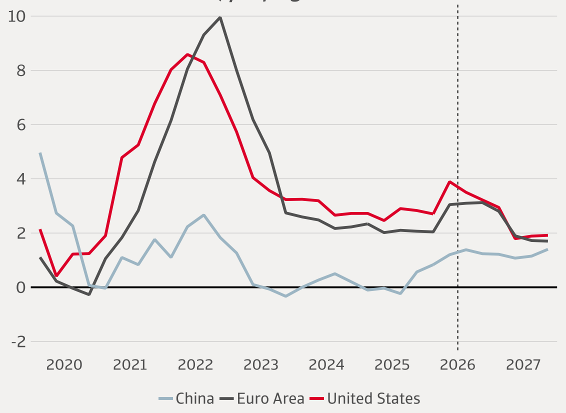
The implication of these developments is that, as opposed to an expected decline, food price indices are now expected to rise over the forecast horizon, albeit marginally. This has important implications for inflation. As opposed to energy prices, which tend to fluctuate, food prices tend to be stickier. This means that a significant food price rise remains, even if followed by lower prices afterwards. Consequently, the risk of a vicious wage spiral is larger for food price fluctuations than for energy price fluctuations.

## 1.6 Inflation pushed up temporarily

The picture we have detailed so far is one where forecast global growth has taken a hit due to the impact of the Iran war. Specifically, the closure of the Strait of Hormuz with the accompanying energy or broader commodity price rises dominate, despite the stalling trade war and the positive impact of AI investments. These developments have pushed up inflation in 2026, but we argue that rise will be temporary, with 2027 inflation resuming its path to pre-Iran war levels (figure 1.16).

**Figure 1.16 Inflation to ease from Q2 peak**

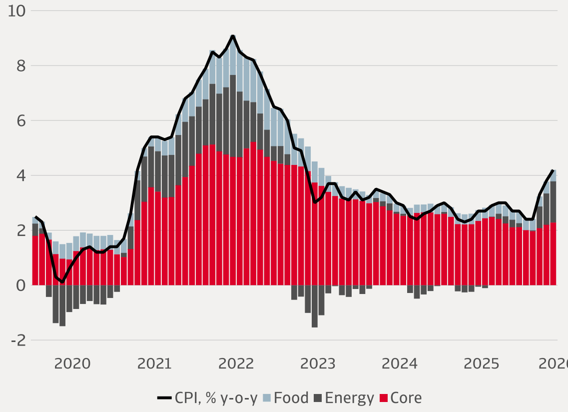
Headline inflation indices, y-o-y % growth




Source: Macrobond, Oxford Economics

**Figure 1.17 Energy dominant in US inflation rise**

United States: Contributions to inflation




Source: Macrobond

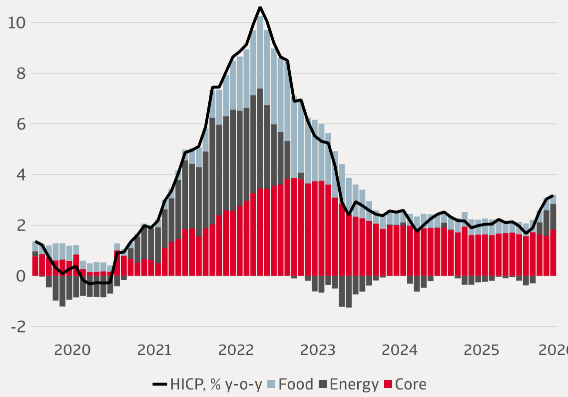
Before the Iran war, inflation was on a gradually declining path, although services inflation in the US remained somewhat sticky, as did the headline figure. But the post-pandemic highs of above 10% were long behind us. They were caused by, on the demand side, spending of accumulated household and firm savings that put pressure on restrained value chains plus, on the supply side, the energy and food crisis after the Ukraine war broke out. Households and firms had rebalanced, and energy and food markets were slowly trending down. The Iran war and the related energy and other commodity price rises stopped all that, pushing inflation upwards across the globe.

US headline CPI inflation climbed to a multi-year high of 4.2% y-o-y in May, from 2.4% in January. Core inflation, which strips out energy and food, was also high at 2.9% y-o-y. (figure 1.17). The rise, by no means comparable with that observed during the pandemic, was boosted by gasoline prices, with electricity prices sharply up as well. Energy inflation was 23.5% y-o-y, contributing 1.5 ppt to May inflation. Food price rises associated with higher fertiliser prices, transportation and packaging are increasingly finding their way into the headline figure as well, a process that has not ended yet. It means that a decline in inflation as the energy price rise impact fades will meet with resistance. Spillovers from the energy costs, showing up in core inflation as well, will become more visible, for example in airfares, as airlines will have to recover higher fuel costs. The AI infrastructure buildout puts in its bid as well. It has led to a memory chip shortage, showing up in computer software and accessories. On the positive side, tariffs are most visible in apparel prices, which continue to rise. But this feedthrough is expected to wind down. Importers and consumers have largely absorbed the tariffs.[12]

Eurozone headline inflation went up to 3.2% y-o-y in May, from 1.7% in January. Core inflation was at 2.5% y-o-y (figure 1.18). Energy prices were up 10.9% y-o-y, a lot lower than in the US, where the transmission of wholesale energy prices to the consumer is a lot faster. This reflects a mix of reasons, including government policies to moderate the price shock, such as are in place in Germany, France and Italy, related to VAT and other taxes. Generally higher taxes as such in the eurozone play a role as well. They create a higher consumer price with a fixed component that does not change with the oil price. That moderates the wholesale energy price rise impact.[13] We note that it is not the services inflation that causes the inflation levels to be different. Indeed, at 3.5% in the eurozone and 3.6% in the US, they are rather similar.

**Figure 1.18 Eurozone inflation more contained**

Contributions of components to HICP inflation, eurozone




Source: Macrobond

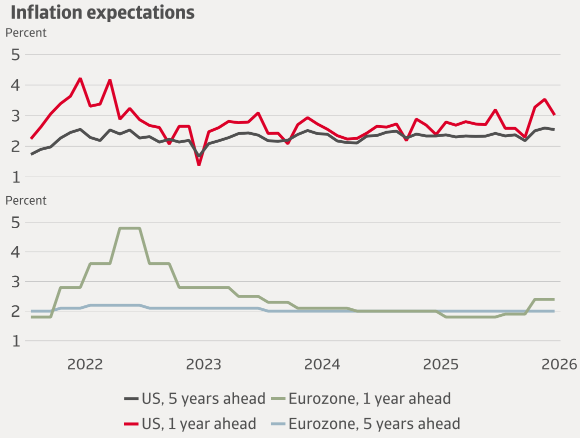
[12] See for example Gopinath, G, and Neiman, B., The Incidence of Tariffs, Rates and Reality, NBER Working Paper 34620, 2026.

[13] A simple example to clarify this: If the oil price is USD 1 per litre and the tax per litre is USD 0.5, we get a pump price of USD 1.5. If the oil price goes up 50%, to USD 1.50, the price at the pump becomes USD 2, and energy inflation is 33%. If there is no tax, energy inflation is simply 50%.

China's headline inflation is emerging from the doldrums with a still very low level of 1.2% y-o-y in May, up from 0.2% in January. China's core inflation was not much different, at 1.1%. Compare this with the other two major regions. The main issue is that while the gasoline price rise there was similar to the US in May, 23.5% y-o-y, its impact is much lower. This is due to the low weight in the index, government measures to restrict the impact, and weak consumer demand. The weakness is highlighted by the fact that producer prices have risen, by almost 4% y-o-y. Moreover, services inflation is very low at 0.8%. Food prices, especially pork, are even falling. In such an environment, the energy price shock is easily absorbed.

Why can we expect just a temporary higher inflation level? We think there are several reasons to justify that. First, and foremost of course is our assumption that the fragile ceasefire agreement holds and the Strait of Hormuz gradually reopens. That takes away any further impetus from energy and fertiliser price rises. On the contrary, lower energy prices will have a deflationary impact. Then, given the current state of the trade war and the limitations in the levying of tariffs that the US administration is facing, we do not expect to see an inflation boost coming from that source. Not that we expect tariffs to go down; tariffs are expect to be broadly stable and therefore neutral to inflation. Furthermore, as we argued in the December Outlook, the atypical USD depreciation alongside the tariff imposition that we have seen during the spring of 2025 is unlikely to be repeated.[14] We do not expect a new tariff shock, and certainly not like the one we saw back then. In the wake of the Iran war, the US dollar has somewhat appreciated, suggesting its role as a safe haven is still there. Last, but not least, we observe inflation expectations in the US and in the eurozone going up, especially for the short term (figure 1.19). But that rise should stay contained. This suggests there is confidence in the capability of central banks to manage inflation.[15] It is supported by the developments in the labour market, where wage growth has remained contained as well. That limits an inflationary impulse from the labour market, and thus a vicious circle where wage rises and inflation feed into each other.[16]

**Figure 1.19 Inflation expectations still under control**




Source: Macrobond

# 1.7 Monetary easing on hold

A straightforward look at the development of inflation suggests that at least some monetary policy tightening is needed, in both the US and the eurozone. In China, with its ultra-low, but now somewhat increasing inflation, matters may be different. Such a conclusion, as clear as it might be, requires a somewhat more nuanced analysis.

The underlying broader issue here is that we are dealing with a phenomenon that is two-pronged. There is elevated inflation and stagnation. This forces monetary policymakers to make a choice. Either address stagnation by lowering interest rates, broader monetary easing; or else tackle inflation by raising interest rates, monetary tightening. The delicacy of this task, and the resulting care central banks take, has become evident in the moves they have made since our last Economic Outlook. In that report we documented our view that looser monetary policy was on the way, especially in the US and China.

No surprise that the energy crisis has fundamentally changed that perspective, with the ECB having moved already with a 0.25ppt hike, and the US delaying the rate cuts. China, with its deflationary setting, had moved already earlier in the year. Now that a sustained energy price spike is not in our baseline, we anticipate a delay to monetary easing, with less risk for further tightening. We expect the ECB to pause rate hikes in the remainder of 2026, while the Fed is expected to keep rates on hold until 2027, once the inflation spike is securely faded.

[14] In case of tariff levies, textbook economics predicts that the import volume will decline and the current account deficit will narrow. That would give rise to demand for the US dollar and lead to an appreciation. Precisely the opposite occurred in April 2025, reflecting fears for a US sourced financial market crisis.

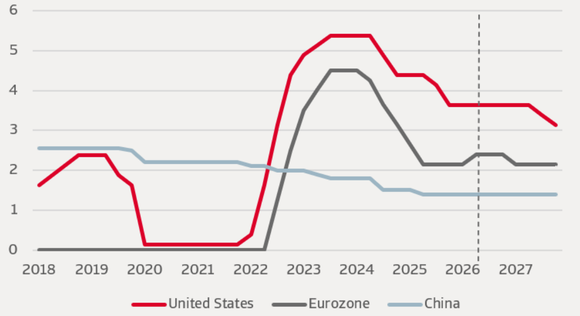
[15] We note here that inflation expectations are currently more vulnerable, because the US and eurozone, as well as other economies, faced a period of inflation after the pandemic that was initially thought to be transitory. But it turned out more persistent and required significant interventions from central banks.

[16] Widespread application of AI will potentially limit such a vicious circle. If wage growth is based on productivity growth, such as AI based, then it has no inflationary impact. This element is not taken into account in our forecast.

China is expected to remain in a loose position. Let us now take a closer look at the regions (figure 1.20).

**Figure 1.20 Central banks on hold**

Central bank interest rate, average of period, %




Source: Oxford Economics, Atradius

In the US, the newly appointed Fed chair, Kevin Warsh, has plans for sweeping changes in monetary policy setting, particularly related to communication. Forward guidance, meant to give some clarity about the direction of policy rate setting, is to be abandoned. Communications about policy are to be brief. The bias towards lower rate setting was removed, perhaps surprisingly in view of the pressure on the previous chair to lower rates. Addressing inflation is (re)confirmed as a major Fed objective.[17] A review should clarify what the future Fed balance sheet should look like.

The inflation objective is especially relevant for our forecast of lower rates. The current policy rate is about 3.7%. With 2.5% medium-term inflation expectations, we get a real interest rate of 1.2%. Taking into account that the so called neutral (real) policy rate is between 0.5%-1.5%, we may conclude that monetary policy is neutral, but on the upper bound towards tightening. From this point of view, our forecast of mild rate cuts depends on inflation expectations remaining anchored, giving room for the Fed to support the economy. But if inflation expectations go up, with incoming high inflation readings, the real rate goes down and the probability of a rate cut becomes lower. With the persistency in services inflation, this is not an unlikely scenario.

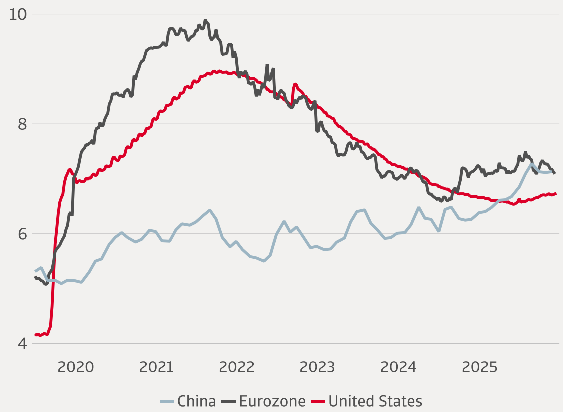
The ECB had hiked its main policy rate in its June meeting – by 0.25ppt – and has indicated that further hikes may follow. With its current level of 2.25% and inflation expectations for the medium term at 2%, in the eurozone, the real rate comes out negative, at -0.25%. As the neutral (real) interest rate in the eurozone is between 0% and 0.5%, the ECB is pursuing a neutral monetary policy. This is reflected in the ECB's singular objective of price stability but does little for the weak eurozone economy. However, with the energy price shock fading, we expect the ECB to remain on hold in July and probably also the rest of 2026.

The People's Bank of China (PBOC) announced in early 2026 that it would maintain a 'moderately loose' monetary policy stance during the year to support growth. This is done via cuts in the reserve requirement ratio for banks and interest rate cuts to keep up liquidity. In particular, the stepped-up control over the seven-day reverse repo rate, the main Chinese policy rate, marks a continuation of the gradual shift in the monetary policy framework towards an interest rate-based, rather than liquidity maintenance-based policy. In that sense monetary policy setting is getting closer to the Fed and ECB. The Chinese policy rate stands at 1.4%, inflation at 1.2%, giving a real rate of 0.2%. With estimates of the neutral policy rate of 1%-2%, the 'looseness' of the policy is underlined and reinforced if one considers that inflation is expected to run up further during the year.

Meanwhile, the process of quantitative tightening (QT), or shrinking of the central bank balance sheets by letting assets run off without or with only partial reinvestment continues to hum in the background (figure 1.21). It is largely a normalisation process after the pandemic crisis effort, but it now supports the mild monetary policy tightening as well. Less money in the system would indeed allow less money to pursue a given amount of goods and services.

**Figure 1.21 Fed and ECB balance sheets steadying**

Central bank balance assets, USD trillion




Source: Macrobond

In the US we observe limited QT since the beginning of the year with a broadly stable balance sheet trend. This may be a pause, as the outcome of the recently launched review process of the Fed may lead to a reduction of about USD 1-2 trillion of the current USD 7.6 trillion. The ECB is letting its Asset Purchase Programme and Pandemic Emergency Programme run off without reinvestment. This implies the ECB balance

[17] The reader may be reminded that the Fed has a double mandate: promoting stable prices and maximum employment.

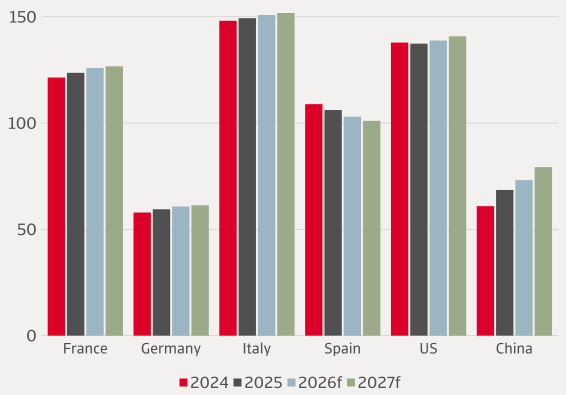
sheet could shrink by EUR 500 billion during 2026. PBOC policy seems to run counter to the Fed and ECB QT, as it is providing additional liquidity to the system to support weak demand. But it is consistent with the currently low real rate, which is in expansionary territory.

## 1.8 Only weak support from governments

In our previous Outlook we sketched a picture of fiscal policy support for the economy that has come under stress. This is the result of government support in the wake of crises during this decade, particularly during the pandemic and the energy crisis after the Ukraine war. That has stretched what we called our affordability indicator, the debt-to-GDP ratio,[18] of quite a number of major economies to unprecedented levels (figure 1.22).

**Figure 1.22 Debt levels further stretched**

**Government debt as a % of GDP**



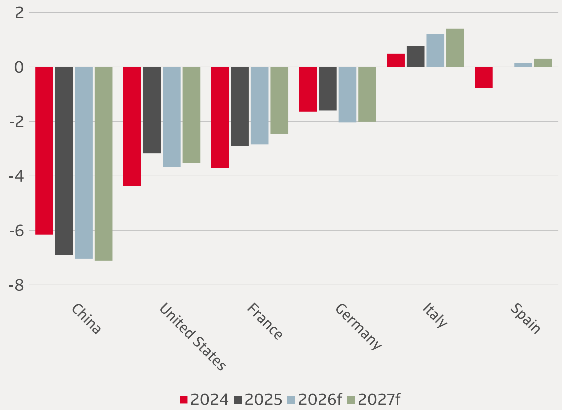

Source: Oxford Economics, Macrobond

We pointed out that only China has a reasonable debt-to-GDP ratio, remaining below the 70% level set for emerging economies by the IMF. Of the group of major advanced economies, only Germany can afford to raise spending significantly. France, the US, certainly Italy and to a lesser extent Spain are way beyond the 85% level that the IMF sets for advanced economies. Moreover, there are no clear signs that the situation is going to improve. Rather, the debt ratio continues to rise, although only mildly over the forecast horizon.[19] [20]

The current energy crisis puts the support by governments for the economy, as measured by the primary balance,[21] under pressure (figure 1.23). This is because, firstly, weaker activity reduces the tax revenues. At the same time, the weaker activity implies higher expenses due to higher unemployment. Cushioning for the higher energy and food prices that many countries provide is another expense that comes with stagflation. There is some mitigation though, due to the unexpected element of inflation.[22] The impact on primary balances is nevertheless negative. That, it should be noted, implies support of economic activity. It is often called the automatic stabiliser, because the government spends more as the economy deteriorates.

**Figure 1.23 Government support weakening**

**Government primary balance, % of GDP**




Source: Macrobond, Oxford Economics, IMF

The point is that this support requires more government borrowing. Precisely meeting this is becoming more expensive because, as we saw above, monetary conditions remain relatively tight, especially in the US and the eurozone. That immediately translates into higher borrowing rates (figure 1.24). But that is not all. Since the additional borrowing needs come in a situation of a relatively high debt-to-GDP ratio, the risk premium demanded by investors goes up as well.

The overall picture is then that the fiscal reaction, as measured by the primary deficit (the budget deficit excluding interest payments), provides some support during the energy crisis. At the same time, it aggravates an already vulnerable fiscal situation. That in turn limits the scope for further government support. Let us now take a closer look at some major economies and colour in this picture.

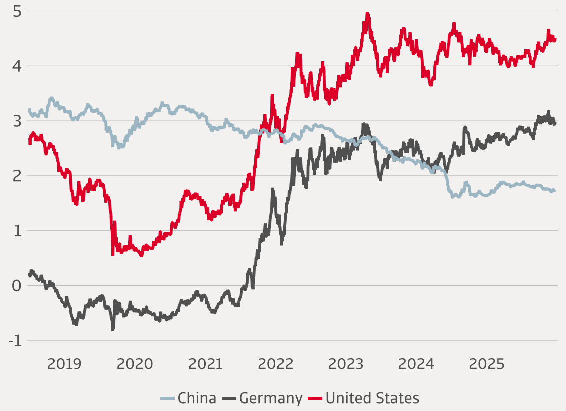
The US primary deficit improved in 2025, as a result of tariff levies, which generated USD 264 billion (0.9% of GDP). However, the sustainability of this revenue is uncertain now

[18] Admittedly a rough indicator, although commonly used. Another one is the interest payment as a percentage of GDP.
[19] See also IMF Fiscal Monitor, April 2026.
[20] For the US the picture is arguably less severe than it looks, because by being the global financial hegemony it holds the 'exorbitant privilege' allowing it to issue debt at a lower interest rate. Moreover, its level indicated here contains debt to itself. Correction for this implies a debt-to-GDP level of 94% instead of the 140% officially reported.
[21] The primary balance is the difference between government income and expenses, without interest payments.
[22] This gives an upward impetus to nominal GDP to which revenues are linked. The expense side is often fixed in nominal terms.

that the Supreme Court decision of February 2026 has questioned the legality of these levies. In 2026 and 2027, additional support for the economy will also come from the One Big Beautiful Bill Act. That will make most 2017 tax cuts permanent, while introducing deductions for tips, overtime pay and interest on automobile loans. Offsets are reductions in entitlement spending (such as Medicare).

**Figure 1.24 Borrowing costs on the rise**

Government bond yields, 10-year




Source: Macrobond

The primary deficits in the major eurozone countries reflect a pattern almost perfectly in line with their affordability. Highly indebted France and Italy have only limited scope for support. Indeed, we see their primary balances improve. This is also the case for fiscally more frugal Spain. This picture arises despite temporary crisis measures and additional defence spending, for which escape clauses under the EU Stability and Growth Pact are invoked. Germany's primary balance worsens, providing some long-awaited support for its weak economy.

The Chinese primary deficit rose in 2025, reflecting a cumulative effect of several modest initiatives to support domestic consumption and a structural shortfall in non-tax and property revenues. The measures include an enhanced programme for trading in appliances, an expansion of minimum urban-rural resident pensions and health insurance schemes, as well as a subsidy for children younger than three. It is only giving modest support to the economy - 0.1% of GDP in total.

## 1.9 Downside scenario: re-escalation

While a peace agreement has been reached, sporadic hostilities between the US and Iran highlight the risk of a re-escalation of the conflict. Therefore we take into account a downside scenario in which fighting resumes at a higher intensity than before and the Strait of Hormuz remains closed in the near term. This re-escalation scenario would assume that the strait reopens only during Q4. Alternative shipping routes, such as those using the Red Sea come under threat as well. This would imply that oil prices rise to an average of over USD 160 per barrel for Brent in Q3, while gas prices also spike higher. Oil prices subsequently fall to around USD 100 per barrel in Q1 2027 and then start to decline to precrisis levels.

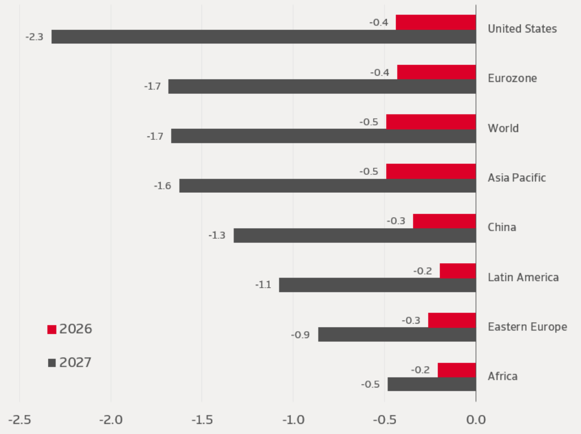
In such a world, households start delaying spending, which puts a brake on travel and shipping activity. Ensuing supply-chain stress peaks at around 80% of the late pandemic level. The result is broader price and cost pressure. The US dollar appreciates by nearly 10% in Q3, raising inflation in the non-USD world. Inflation expectations rise further, although medium- term expectations are limited, as confidence in central banks to contain inflation remains.

Fiscal support continues to mitigate the shock in H2 2026, while affordability comes under more pressure. Investors further raise their inflation risk premium, while tighter monetary policy raises the underlying policy rate, with an impact of 0.75ppt on US yields. All this means that in H1 2027, as the situation normalises, fiscal support would be unwound and additional fiscal consolidation puts a brake on growth in 2027. The S&P 500 enters a bear market with a 20% decline.

In this possible stagflation-plus scenario, business and consumer confidence takes a further hit, impacting domestic demand for investment and durable consumption goods. Global GDP growth slows to a recession value of 1.9% in 2026 and 1.4% in 2027. The US and other major advanced economies would then face recession (figure 1.25).

**Figure 1.25 Iran war re-escalation hits hard**

Annual GDP impact of Iran war re-escalation, ppt




Source: Oxford Economics, Atradius

# 2. Advanced economies

## 2.1 Slower and more uneven growth

Advanced economies are expected to lose momentum in 2026, before growth recovers modestly in 2027. We forecast real GDP growth to slow to 1.6% in 2026, from 1.9% last year, before picking up to 2.0% in 2027. All markets are facing, to varying extents, the effects from the energy shock linked to the war in Iran, still-restrictive monetary policy, weaker trade growth and elevated geopolitical uncertainty. But the growth prospects differ between economies.

The US remains the strongest performer, supported by AI-related investment, expansionary fiscal policy and domestic energy production. However, its growth model is increasingly narrow, with resilience concentrated in technology, high-income consumption and energy exports. The eurozone faces weaker momentum as higher energy prices, tighter credit conditions and subdued external demand weigh on consumption, investment and exports. Growth should improve there in 2027, but only gradually. The UK remains among the weakest major advanced economies, constrained by weak real income growth, fiscal tightening, Brexit-related trade frictions and recurring political uncertainty. Japan's low growth is supported by investment and technology-related exports, but fiscal concerns and higher bond yields are expected to keep growth limited.

Across advanced economies, the key trend is slower and more uneven expansion. While inflation risks have eased with the US-Iran ceasefire deal, elevated energy and trade costs have delayed monetary easing. At the same time, structural divergences are becoming clearer. The US benefits from AI and energy advantages, whereas the eurozone is more exposed to imported energy and weak manufacturing competitiveness. Japan and the UK face country-specific fiscal and confidence constraints.

**Table 2.1 Diverging growth prospects for AEs**

**Real GDP growth, % y-o-y**

| | 2025 | 2026* | 2027* |
|---|---|---|---|
| Eurozone | 1.5 | 0.4 | 1.5 |
| United States | 2.1 | 2.2 | 2.6 |
| United Kingdom | 1.4 | 0.9 | 0.8 |
| Japan | 1.1 | 0.4 | 0.5 |
| **Advanced economies** | **1.9** | **1.6** | **2.0** |

Source: Oxford Economics, Atradius (* forecast)

## 2.2 Eurozone: growth eases on energy price shock

The war in Iran has triggered one of the most significant energy supply shocks in recent history, less than five years after the shock caused by the war in Ukraine. Although less disruptive than the 2022 energy crisis, it is likely to affect the economy through a similar channel of rising price pressures. Since the peace agreement between the US and Iran was closed mid-June, shipping traffic through the Strait of Hormuz has picked up moderately. This has led to a decline in energy prices, particularly oil. At the same time, the recent military escalation on July 8 shows that the truce may very well collapse and lead to a resurgence in oil prices. The evolution of the conflict with Iran is therefore still the main downside risk to the economic outlook. If the conflict persists longer than expected, it would once again lead to higher inflationary pressures and lower economic growth. In our baseline scenario, we forecast GDP growth of 0.4% in the eurozone in 2026, followed by 1.5% in 2027. Compared to our December Outlook, the GDP forecast has been revised down by 0.5 and 0.1 percentage points for 2026 and 2027, respectively.

Eurozone GDP contracted by 0.2% quarter-on-quarter in Q1 2026 due to a significant reduction in Irish GDP. Excluding Ireland, the eurozone economy expanded by 0.3%. Spain continued to enjoy strong growth momentum, with GDP expanding by 0.6%. Growth was more modest in Germany (0.3%) and Italy (0.2%), while stagnant in the Netherlands (0.1%) and France (0.0%).

Survey indicators declined sharply in the months after the conflict with Iran started. The eurozone composite Purchasing Managers Index (PMI) and European Commission's Economic Sentiment Indicator fell sharply in March-May, signalling a contraction in economic activity. However, they partially rebounded after the peace agreement between the US and Iran was signed in mid-June. This regional aggregate of sentiment masks a stark geographic divergence among the bloc's largest economies. Germany and France remain stuck in contraction territory, confronted with escalating input costs and domestic policy headwinds. In contrast, Italy and Spain display more resilience, hovering near or above neutral levels. They have a lower vulnerability to the global trade slowdown, enjoy a post-pandemic tourism boom and are the largest beneficiaries of EU fiscal support.

### Inflation rises on energy price shock

Eurozone headline inflation has accelerated in 2026, driven by the energy supply shock linked to the conflict in the Middle East. Over time, the energy price shock is likely to spill over into food and core inflation. Headline inflation moved up from 1.7% at the start of the year to 3.2% in May, then declined to 2.8% in June on lower energy prices. We expect an average headline inflation in 2026 of 2.8%.

While inflation has moved up compared to pre-conflict, we don't expect a repetition of the 2022 inflation shock. The eurozone economy is at a more mature phase in the business cycle now than in 2022, and inflationary pressures appear more contained. Moreover, current labour market conditions are less tight, and inflation was on a declining path before the closure of the Strait of Hormuz.

Due to the energy shock created by the conflict in the Middle East, inflation rose across all major eurozone economies in the earlier months of 2026. In June, there was a partial reversal of inflation as the preliminary peace agreement between the US and Iran triggered lower energy prices. In France, inflation increased by 2.4 ppts to 2.8% in May, before retracting to 2.0% in June. Despite its extensive nuclear power capacity, the country experienced a sharp rise in energy prices, particularly in natural gas. Italy saw a similar development, with inflation rising by 2.2 ppts to 3.2% in May, reflecting its high sensitivity to imported energy costs. In June, inflation in Italy showed a mild decline, bringing inflation to 3.1%. Inflation in Spain was already relatively elevated at the start of the year and increased by a further 1.2 ppts to 3.6% in June. By contrast, Germany recorded a more moderate increase of 0.3 ppts to 2.4%. In response to the war in Iran, the German government introduced a vehicle fuel tax adjustment in February to help contain price pressures. The inflation outlook for all major economies was revised up for 2026, compared to the pre-conflict situation. With the exception of France, inflation is expected to remain above the ECB's 2% target in all major eurozone countries.

## ECB raises interest rates amid rising inflation

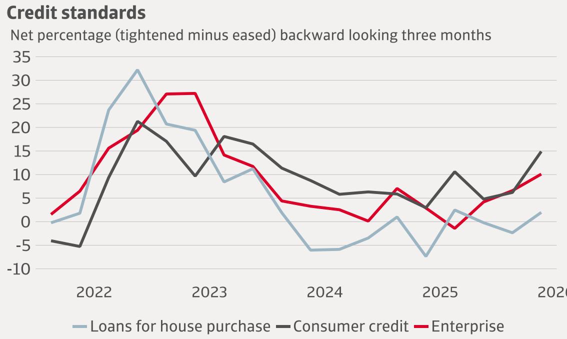
At its June meeting, the ECB raised interest rates by 25 basis points, as widely expected. The central bank argued that inflation driven by the war in Iran, and the broadening of price pressures, made the move necessary. The hike can be seen as a recalibration of policy, adjusting the ECB's stance to an outlook in which inflation risks have worsened considerably. With the energy price shock fading in June, we expect the ECB to hold policy rates in July. Furthermore, due to the improving inflation outlook we currently don't expect further rate hikes in the rest of 2026 either.

Despite recent tightening, eurozone real interest rates remained negative in June across all major economies except France. Spain recorded a real rate of -1.4%, Italy -0.8%, and the Netherlands and Germany -0.2%. France was the only major economy with a real rate above 0%, as inflation declined substantially in June. Crucially, these predominantly negative real rates do not indicate an accommodative monetary stance. Rather, they reflect temporary supply-side pressures, particularly from energy prices, while the ECB's increases in nominal interest rates continue to tighten financial conditions. Over time, this policy stance should restrain credit growth and help contain inflation, provided long-term inflation expectations remain well anchored.

The ECB's Q1 2026 bank lending survey showed that eurozone banks further tightened credit standards for loans to businesses. Perceived risks to the economic outlook and a lower risk tolerance of banks were the main drivers, with banks pointing to geopolitical tensions and energy market developments.

Among the four largest eurozone economies, banks in Spain, France and Germany reported tighter credit standards for firms, while banks in Italy indicated no change. Banks also reported a tightening of credit standards on consumer credit, alongside a moderate tightening in mortgage lending. For 2026 Q2, banks expect a further and more pronounced tightening of credit standards across all loan categories, further reflecting geopolitical tensions, energy developments, and higher funding costs.

**Figure 2.1 Credit standards continued to tighten**




Source: ECB, Macrobond

Bank lending activity showed some recovery for both corporates and households. In May 2026, lending to households rose by 3.1% year-on-year, while lending to non-financial corporations rose by 4.0%.

## Trade outlook weakens after strong 2025

Trade is likely to be a drag on eurozone growth this year. We expect a 0.2% export decline in 2026, followed by a 1.5% expansion in 2027. Global demand is under pressure due to the rise in energy prices. Furthermore, exporters are expected to lose market share in goods, reflecting structurally weaker manufacturing competitiveness and a limited presence in fast-growing, trade-intensive AI-related sectors. Services-oriented economies continue to outperform peers that are more manufacturing-focused. Strong international tourism and cross-border commercial services are a boon for Spain and France, while Germany's manufacturing-oriented economy faces structurally higher input costs, keeping its manufacturing sector under intense pressure.

### Investment growth moderates

Investment growth exceeded expectations in 2025. This was driven largely by intellectual property products, mainly but not exclusively in Ireland, and, to a lesser extent, by construction and equipment investment. Following this positive surprise, investment growth is expected to cool somewhat in 2026 and 2027. Lower export growth and subdued production expectations are set to reduce investment needs. Higher financing costs and weaker profits constrain firms' investment capacity, while elevated uncertainty leads many to postpone or scale back investment plans. Unlike in the US, where tech investment has driven a capital expenditure boom, we do not expect AI to be a significant growth driver this year or next. Overall, investment is set to expand by 1.2% in 2026 and 2.1% in 2027.

### Hiring slows despite low unemployment

Employment in the eurozone grew by 0.7% in 2025, which corresponds to 1.2 million jobs. Job creation was mainly driven by services. Overall, employment growth in 2025 was primarily supported by rising activity rates, while the contribution of population growth continued to moderate. Unemployment has remained broadly stable, with only minor monthly fluctuations over the past 1.5 years. The latest unemployment figure is 6.2% (May 2026).

Despite low unemployment, labour demand moderated in the second half of 2025. Hiring intentions among eurozone employers deteriorated in February-April, reflecting downward revisions to employment plans across all sectors (figure 2.2). We expect a cooling of employment growth in 2026 and 2027. The adjustment on the labour market has so far occurred mostly through reduced recruitment rather than job cuts. However, if the economic shock from the Iran war persists, adjustment is likely to shift increasingly towards rising unemployment. In our baseline scenario, we expect unemployment to remain low at 6.3% in 2026.

**Figure 2.2 Hiring intentions and employment growth cool**


Source: Eurostat, DG ECFIN, Macrobond

Consumer confidence weakened further in March and April 2026, driven by rising energy prices. Wage growth continued to moderate in the second half of 2025 and early 2026. Despite the recent rise in inflation, forward-looking indicators suggest wage growth will remain subdued in 2026. The Indeed wage tracker, based on online job postings, points to year-on-year wage growth of around 2%. As higher energy prices reduce real incomes, private consumption is forecast to grow by only 0.8% in 2026, before recovering to 1.4% in 2027.

### Fiscal spending rises on energy support measures

The primary budget balance is expected to remain roughly on par in 2026-2027 compared to 2025. This means the fiscal position remains largely unchanged, after accounting for interest expenses. Public finances remain stretched by the legacy of measures adopted in response to the pandemic and the 2021-2022 energy crisis. In addition, the expenditure-to-GDP ratio is set to rise this year and next year, partly due to measures to address the 2026 energy crisis as well as commitments to raise defence spending. In total, European governments have so far committed around EUR 14.5 billion in fiscal measures to cushion the impact of the Iran war on energy bills, albeit with large differences among member states.

The government debt ratio in the eurozone is projected to increase slightly in the coming years. This upward pressure on public debt is driven by larger budget deficits, higher interest rates and lower GDP growth. Four eurozone member states are projected to have a debt ratio that exceeds 100% of GDP by end-2027. These are Belgium, Greece, France, and Italy.

## 2.3 US: growth running on fewer cylinders

The US economy continues to expand at a respectable pace, with 2.2% growth forecast in 2026 and 2.6% in 2027, although the Iran war is weighing modestly on growth through higher energy prices and weaker external demand. The economy has proven remarkably resilient to higher interest rates, geopolitical tensions and shifts in trade policy. But that resilience increasingly depends on a relatively narrow set of factors: strong investment in AI, continued fiscal support and the advantages of domestic energy production.

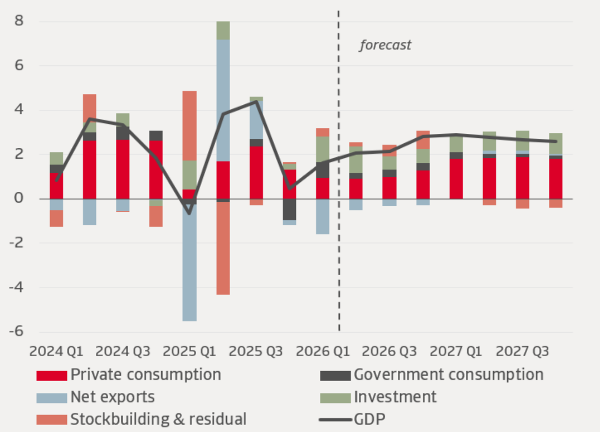
This represents the evolution of the "two-speed economy" that characterised much of the past year, presented in our December 2025 Economic Outlook. While technology-related sectors continue to outperform, broader economic momentum has become more uneven. Growth is expected to continue, but this increasing dependence on narrow growth drivers leaves less margin for policy mistakes or external shocks than the headline growth figures suggest – just as these kinds of risks are broadening.

## The economy keeps moving forward

US GDP growth got off to a weak start in 2026, but the outlook is steady – among the strongest across advanced economies. Real GDP growth did start the year with weak momentum, expanding at an annualised 1.6% in Q1 (second estimate), after just 0.5% in Q4 2025. The weak start was due to adverse winter weather conditions, carry-on effects of the government shutdown at the end of last year and the start of the drag from higher energy prices linked to the Middle East conflict. Private domestic demand though has remained strong. Final sales to private domestic purchasers rose 2.4% in Q1, consistent with a steady labour market and sustained domestic demand, not an abrupt downturn.

**Figure 2.3 Private consumption to stay growth driver**

**US annualised GDP growth**




Source: Oxford Economics, Atradius

The composition of growth is increasingly risky. While headline private consumption is leading GDP, consumption patterns have become increasingly bifurcated, with headline consumption being increasingly carried by those least exposed to the current shock mix. The AI boom is also fuelling investment - the other component of domestic demand. Additionally, the trade component is distorted by tariffs and uncertainty.

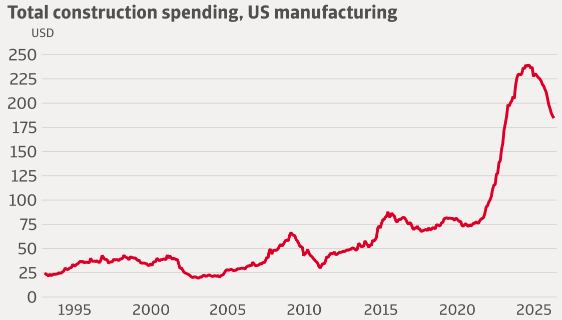
## AI becomes the lead cylinder

The clearest engine of growth has become AI-related investment. While GDP growth already slowed in 2025, AI-related investments contributed almost one-third of the 2.2% growth[23]. Spending on data centres, semiconductor manufacturing, cloud infrastructure and electricity networks has become a major driver of business investment. Large technology firms continue to commit substantial resources to expanding AI capabilities, generating demand across construction, manufacturing and specialised business services.

This investment wave has helped sustain overall economic growth despite tighter financial conditions. Manufacturing construction spending remains close to record levels following a series of investments in semiconductor production, advanced manufacturing and digital infrastructure (figure 2.4). The technology sector has also contributed disproportionately to corporate earnings growth and financial market performance, supporting business confidence and household wealth. It has become one of the few areas where corporate America is still prepared to spend, despite uncertainty surrounding tariffs, inflation and interest rates.

**Figure 2.4 Construction spending still historically high**

**Total construction spending, US manufacturing**




Source: US Census Bureau, Macrobond

The potential long-term impact of AI adoption on productivity in the US could help offset structural challenges facing the US economy, including demographic ageing, labour shortages and rising public debt. Stronger productivity growth could also allow more robust economic growth without generating excessive inflationary pressure. But these effects are far from certain and are long-term in nature.

At the same time, the growing importance of AI introduces concentration risk. A substantial share of investment growth, earnings growth and equity performance is increasingly tied to a relatively small group of firms. While current AI-related spending levels appear supported by strong demand and healthy corporate balance sheets, the expectations are exceptionally high, laying the foundation for disappointment.

Moreover, this engine cannot be assumed to develop automatically into a more broad-based economic expansion. For now, AI is lifting GDP primarily through fixed investment rather than through widespread productivity gains or stronger median household incomes. The spillovers to the rest of the economy remain limited and uncertain. This means a narrow set of sectors can keep headline growth afloat while other

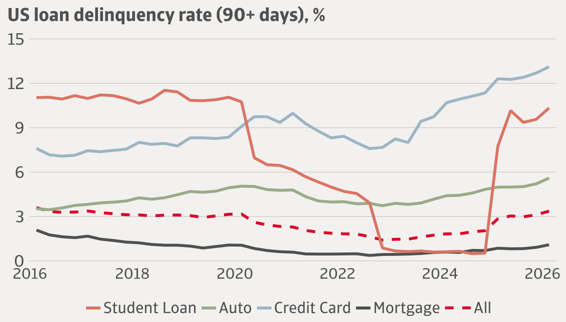
[23] AI-investeringen voorkomen vertraging Amerikaanse economie - ESB

parts of the economy cool. It also raises the vulnerability of the broader economy to any reassessment of AI-related earnings expectations, supply constraints in energy or chips, or tighter financial conditions.

## Resilient consumers help keep engine running

Consumers are still supporting activity, but not in a uniform way. Real household spending has continued to grow, but more slowly than before. Real final sales to private domestic purchasers rose 2.4% in Q1, indicating that private demand remained a core pillar of the expansion. But the personal savings rate fell to 2.6%, down from 4.6% on average through 2025, suggesting households are using more of their income to maintain spending as prices rise. At the same time, consumer loan delinquency rates are rising across the board, especially on credit card loans (figure 2.5). This divergence can be attributed to contrasting signs in the labour market.

**Figure 2.5 Household finances deteriorating**



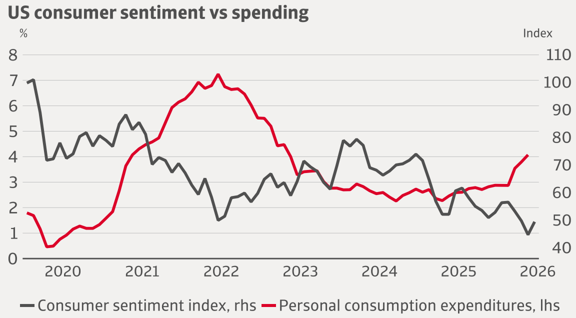

Source: Macrobond, New York Fed

The relatively balanced labour market is supporting consumption. Job growth accelerated in the lead-up to the summer with nonfarm payrolls increasing nearly 188,000 per month in Q2. This is also supported by private sector data from ADP showing hiring increasing by rates not seen since January 2025. Broader indicators like job openings relative to labour supply are steady, suggesting no meaningful worker shortages. Unemployment has dipped to 4.2% in June after three consecutive months at 4.3%. Nominal wage growth has moderated to about 3.5% year-on-year, consistent with stable conditions. In contrast to recent inflationary periods, this equilibrium exerts less upward pressure on prices while still supporting household income and consumption.

On the other hand, with wage growth now below the inflation rate, Americans' spending power is decreasing. Other structural indicators further point to gradually cooling momentum. Long-term unemployment has risen by over half a million over the past year and has been trending upwards since 2023. Labour force participation remains subdued at 61.5%.

Income inequality also remains central to the understanding of the US consumption outlook. Higher-income households remain better positioned to spend as they benefit more from historic equity gains and greater cash buffers. That split helps explain why aggregate consumption remains resilient even as confidence surveys deteriorate (figure 2.6). The US is increasingly an economy in which headline consumption is being carried by those least exposed to the current shock mix, underpinning the resilience of private consumption's contribution to GDP through the forecast period.

**Figure 2.6 Confidence remains weak but spending holding up**




Source: BEA, University of Michigan, Macrobond

## Fiscal policy adds horsepower

Fiscal policy remains another important support to domestic demand. The federal deficit remains historically wide with a broadly expansionary fiscal stance. Despite a period of relatively strong economic growth and low unemployment, the federal government continues to run budget deficits averaging 6% of GDP. The primary deficit, excluding interest payments, is between 3% and 4% of GDP and broadly expansionary still. Fiscal policy is set to add nearly 1ppt to GDP growth in 2026 in provisions of the One Big Beautiful Bill Act (OBBBA) like household tax cuts and business investment incentives.

This helps explain why the economy has remained resilient despite tighter monetary policy and elevated uncertainty. It also means that the US is entering a more fragile external environment with less fiscal space than in previous downturns. Debt held by the public has now reached 100% of GDP. Fiscal sustainability concerns are unlikely to materialise in the short term, but they do represent an important structural vulnerability. Net interest costs are becoming an increasingly large driver of outlays over time as debt rises. That means more borrowing is for financing debt service instead of future productive capacity. So while fiscal policy is still helping support US growth today, it's adding to medium-term vulnerabilities. Additionally, large deficits at a time of near-full employment may contribute to upward pressure on long-term interest rates, potentially complicating the Federal Reserve's efforts to curb inflation.

**Figure 2.7 Interest payments climbing as share of federal spending**

**US federal outlays, top 3 recipients, % total**


Source: Congressional Budget Office

## Trade policy creates friction

The direct tariff shock of 2025 continues to affect activity, causing a net drag on GDP growth. Imports have been distorted by front-loading and substitution, which complicates the reading of headline GDP and trade data. Higher import costs and weaker visibility over future trade rules are lowering import demand beyond the few sectors, such as AI, still willing to spend aggressively. Reduced demand and the fading out of frontloading should slow imports over the coming 1.5 years. The outlook for exports is relatively steady, with recent data showing resilience in high-value, resource-based exports like computers and energy products offset by lower external demand for US goods.

The question marks over trade policy continue to pose downside risks to the economic outlook, which have been exacerbated by supply disruptions and price increases from the Iran war. Uncertainty around future tariffs, retaliation, rising prices and supply-chain adjustment remains elevated, weighing on business sentiment. These uncertainties are highlighted in the Federal Reserve's latest Beige Book. The Philly Fed's latest manufacturing survey (June) shows some rebound in firms' assessments of current conditions after recent weakness, with new orders and shipments pointing to improving demands. Forward-looking indicators remain stronger than current activity, as firms anticipate stronger demand in technology-related sectors and easing financial conditions. The latest manufacturing PMI as presented in section 1.2 points to the same uneven picture: overall business activity improved for a third successive month in June, but the pace of growth remained weaker than at the start of the year. Firms cut staffing amid outlook concerns and higher overheads, and strong manufacturing demand was partly supported by precautionary stockbuilding as supply issues widened.

## Inflation keeps policymakers in low gear

Inflation has become more problematic again. For the US, we focus here on personal consumption expenditures (PCE) inflation because it's the Federal Reserve's preferred measure, while the global comparison in chapter 1 uses CPI inflation for global comparison. Headline PCE inflation rose to 4.1% year-on-year in June, up from 2.9% at the start of the year, while core PCE inflation edged up to 3.4%. The resurgence of inflation is driven by energy, goods prices and indirect pass-through from tariffs and shipping costs. Despite the US being a net energy exporter, prices are still set by global markets, and pass-through to US households is relatively fast because fuel prices there are more market-driven than in Europe.

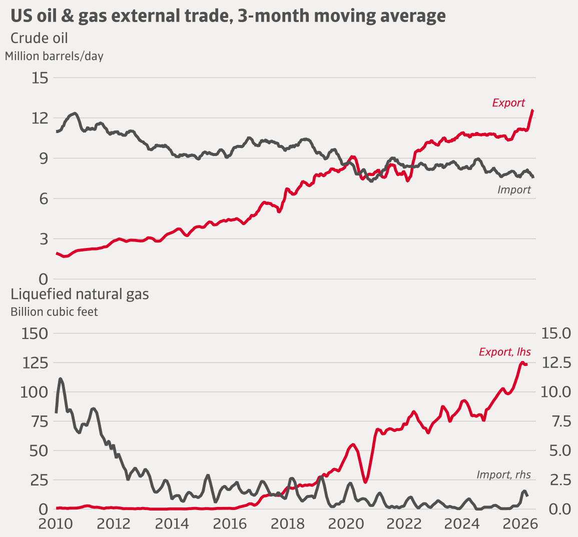
The policy dilemma for the Federal Reserve has therefore sharpened. GDP growth and the labour market are still firm enough to argue against precautionary easing, but inflation is too high to justify comfort. The Federal Reserve's March 2026 Summary of Economic Projections put PCE inflation at 2.7% in 2026 and 2.2% in 2027, with the median policy rate declining only gradually. With the ceasefire, the upside risk to that inflation forecast has eased. Since the demand-side of the economy is not nearly as tight as it was in the last inflation surge of 2022, we are more confident that this inflation spike will prove temporary. We expect the Fed to remain cautious, keeping rates higher for longer and delaying the next policy rate cut until Q3 2027 (figure 1.20).

## Energy provides resilience amid geopolitical risks

The war in the Middle East has added a new layer of downside risk to an already narrow US growth model. The immediate economic impacts are cushioned by domestic energy production and the economy's continued momentum, but the inflation and sentiment effects are meaningful. The most direct channels are higher fuel costs, more expensive transport and logistics, and a renewed rise in household and business uncertainty that persists given the fragility of the current ceasefire.

The Iran war accelerated US oil and gas exports to record levels (figure 2.8). Oil exports have exceeded 12 million barrels per day (mb/d) after plateauing at around 10 mb/d since the end of 2022. Liquefied natural gas exports grew to record levels to meet European demand. The outlook for further export growth depends on the Strait of Hormuz's reopening, but given the damage to LNG infrastructure, demand for US exports will likely persist through the forecast period.

**Figure 2.8 US oil & gas exports surging**




Source: US EIA, Macrobond

A further effect of the shock is how it interacts with the existing two-speed structure of the US economy. Higher energy prices are regressive, hitting lower-income households harder and raising costs across sectors with less pricing power. Petrol prices rose from USD 3 per gallon to above USD 4.50 as a result of the war in Iran. Prices at the pump have been easing since the mid-June ceasefire, standing at USD 3.80 at time of writing. That's still 25% higher than before the war – a meaningful cost increase as petrol accounts for 3.5% of average American household spending. At the same time, they threaten to squeeze margins for smaller firms and push back expected monetary easing. Even if energy prices continue to fall back as expected, the recent shock has again exposed the vulnerability of the US growth mix, with headline resilience increasingly dependent on a narrow set of supports.

## 2.4 UK: household squeeze keeps growth subdued

The UK economy is set for another subdued year, despite a strong start. The strong Q1 performance appears to reflect favourable timing effects, revised late-2025 data and some temporary firm-level stockpiling in the early months of the Middle East conflict, as opposed to a durable improvement in underlying demand. Instead, we expect growth to slow in the coming quarters, as the war in Iran and domestic political uncertainty weigh on demand. While the June ceasefire deal between the US and Iran has caused oil and gas prices to ease, the inflation outlook for the remainder of 2026 and early 2027 is still worse than expected before the war, putting pressure on household spending.

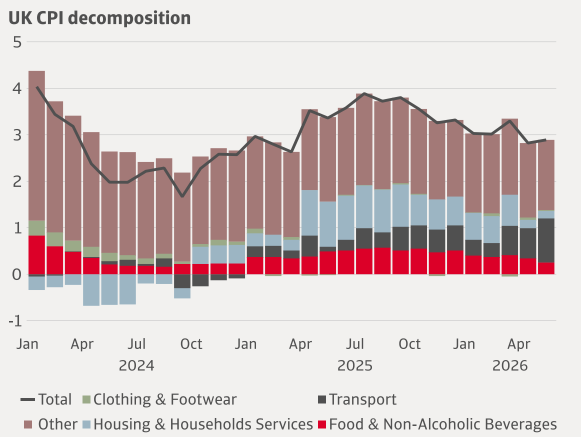
Private consumption, the largest part of the economy, is constrained by weak real income growth, elevated borrowing costs and fiscal tightening. Real household income growth is set to slow to 0.4% in 2026 and further to 0.3% in 2027. UK consumers have been increasingly cautious in recent years, with the household savings ratio rising to 9.9% as at the end of 2025. We expect this ratio to decrease this year towards the 4%-5% savings rate seen in the last inflationary episode in 2022. This should partially cushion spending but won't strengthen any demand momentum.

Total fixed investment growth is also weak, with only 0.3% growth expected this year. Low profitability, high input costs and weak confidence have been dragging on capital spending. Government consumption provides some support, but fiscal policy is tightening overall through frozen tax thresholds and spending restraint. Net trade is unlikely to offset these domestic headwinds, as tariff uncertainty, Brexit-related frictions and weak external demand weigh on importers. These drivers altogether explain the slowdown in GDP growth, rising just 0.9% this year (down 0.5ppt from the December forecast) and 0.8% in 2027 (-0.1ppt).

### Higher energy prices remain a concern

The war in Iran is the central near-term shock for the UK economy. The June ceasefire has pushed oil and gas prices lower than previously feared, but the outlook is still uncertain and prices remain elevated enough to squeeze households and firms. The May inflation figures were lower than expected but at 2.9%, inflation remains well above the Bank of England's 2% target (figure 2.9). Rising transport costs, due to higher fuel prices, were the main growth driver, whereas food and housing both offset some of the inflation pressure.

**Figure 2.9 Rising transport costs offset by lower food price rises**




Source: UK Office for National Statistics, Macrobond

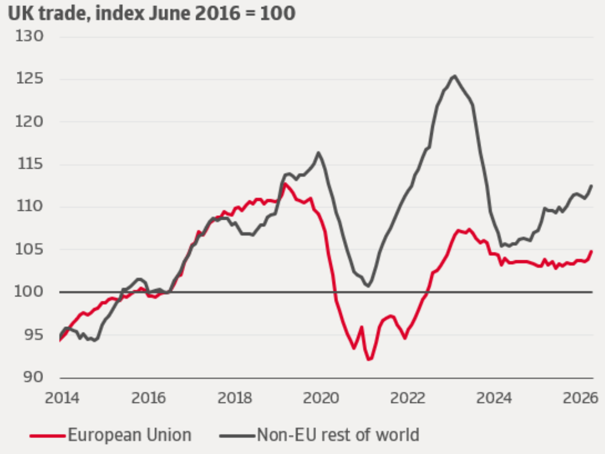
Lower-than-expected inflation reduces pressure on the Bank of England to hike rates but price risk remains on the upside,

#### In-focus: UK trade 10 years after Brexit referendum

Ten years after the Brexit referendum, UK trade has not collapsed, but has clearly lost momentum. Using ONS country-by-commodity trade data, deflated and smoothed on a 12-month basis, total UK trade has grown by only 0.9% annually since June 2016, down from 3.0% before the vote. Trade with non-EU partners has risen more strongly than trade with the EU, standing 12% above its pre-referendum level compared with 5% for UK-EU trade. This suggests some gradual reorientation, but not a wholesale shift away from Europe.

The EU still accounts for almost half of total UK trade, only 1.8 percentage points less than before the referendum. The change is more visible on the import side, where the EU share has fallen by 3.6 percentage points, while the export share has barely changed. Meanwhile, the promise of faster growth through new trade agreements has delivered only limited results so far. Most post-Brexit agreements either roll over existing EU terms or cover small shares of UK trade. Deals with Australia, New Zealand and CPTPP partners are meaningful strategically, but together account for only a modest share of current trade. The larger question is whether recent and pending agreements with the GCC and India can materially improve market access. For now, the evidence points to a slower-growing and only modestly reoriented UK trade base, with Europe still central to UK external demand and supply chains.

**Figure 2.10 UK trade with EU flatlines**




with the energy regulator Ofgem's energy price cap to rise by 13% in July as previous wholesale gas price increases feed through. This limits the scope for near-term monetary easing as well, so we expect the Bank Rate to be held steady at 3.75% well into 2027. At the same time, fiscal policy is tightening. Frozen tax thresholds and allowances are lifting the tax burden, while fragile public finances leave little room for broad-based support against higher energy bills.

### Politics adds to uncertainty

Domestic political uncertainty is another important drag on the UK economy. Prime Minister Keir Starmer announced his resignation on 22 June amid increasing pressure to step down following weak polling, heavy local-election losses earlier this year and slow policy delivery. The most likely successor is Andy Burnham, the former Manchester mayor who won a seat in Parliament in a special election in June. The Labour Party has a large parliamentary majority, so a change of government is not of concern, but a lengthy leadership process or a shift towards looser fiscal policy pose economic risks. Prolonged uncertainty or a less disciplined fiscal stance could quickly raise the risk premium on gilts, keeping borrowing costs elevated for households, firms and the government.

## 2.5 Japan: fiscal concerns drive up bond yields

We predict a 0.4% GDP growth rate in 2026 in Japan, followed by 0.5% growth in 2027. Private consumption is expect to grow only moderately, as weaker confidence and higher energy prices weigh on households, despite policy support and a return to real wage growth. Investment should be the main driver, supported by strong corporate profits and continued spending on digitalisation, automation and green technologies to address labour shortages.

Nominal export growth has accelerated since February. Exports to the US improved, led by capital goods shipments. Exports to Asia also stayed firm, as semiconductor exports continued to surge. We expect exports to gradually lose momentum towards the end of 2026. While strong tech-related demand from the US AI boom should support activity in the near term, sluggish global growth is expected to constrain broader demand for Japanese goods, particularly non-AI capital goods, amid weak global investment.

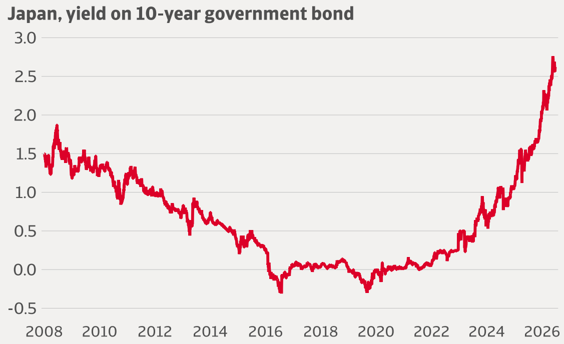
According to preliminary estimates, Japan's GDP grew by 0.3% y-o-y in Q1 of 2026, after gaining by 0.4% in Q4 of 2025. Sentiment indicators point to solid but moderating growth. The composite PMI declined in March, reflecting weaker manufacturing activity, while business sentiment reached multi-year highs, supported by strong order books and profits. Consumer confidence fell sharply from near a seven-year high in February, driven by concerns over rising fuel prices linked to the Middle East conflict.

We think fiscal policy will remain accommodative in the coming years. The government has announced an extra supplementary budget with an expenditure size of around JPY 3 trillion (USD 19 billion) to enhance energy subsidies. This will likely be accompanied by a sizeable supplementary budget later in the year. Government debt is projected to reach 201% of GDP in 2026, with a limited further increase in the coming years. In the late 2020s, the government is expected to revert to fiscal consolidation as rising borrowing costs generate market anxiety about fiscal sustainability.

The Bank of Japan (BoJ) lifted its policy rate to 1.0% at its June meeting, marking the highest level since September 1995. Inflation increased to 1.5% in May, from 1.3% in April. Energy costs are likely to push up inflation further in the coming months. Government measures, including fuel subsidies and price caps, should limit the pass-through of higher energy costs, although inflation is expected to remain above the BoJ's 2% target in both 2026 and 2027. We expect the BoJ to tighten gradually, with the policy rate rising to around 1.5% by end-2027.

Concerns over the BoJ's reduction in bond purchases, alongside US trade tariffs and elevated public debt, have pushed the 10-year government bond yield to around 2.6%, its highest level since the 2008 global financial crisis.

**Figure 2.11 Japan's bond yield reaches new highs**




Source: Macrobond

# 3. Emerging market economies

## 3.1 Resilience under pressure

The outlook for emerging market economies (EMEs) is on average stronger than that for advanced economies, but it remains weak by historical standards. We expect 3.7% growth across EMEs in 2026 and 4.2% in 2027. The war in Iran impacts EMEs through higher commodity prices, second-round effects on other inflation components, and increased risk aversion in financial markets. Of the countries presented in this report, India and South Africa are the most directly exposed to disruptions to trade flows through the Strait of Hormuz. Almost 40% of India's and 25% of South Africa's imported oil and gas come from the Gulf Countries. The gradual reopening of the strait should relieve pressure but the risk of disruptions remains a concern. In addition, EMEs continue to face headwinds from fading effects of tariff frontloading and from higher US tariffs, which are weighing on external demand. Weather-related risks are also rising, with a stronger El Niño potentially adding pressure to food prices and agricultural output in parts of Latin America, Africa and Asia.

**Table 3.1 EMEs broadly losing steam**

**Real GDP growth, % y-o-y**

| | 2025 | 2026* | 2027* |
|---|---|---|---|
| China | 5.0 | 4.8 | 4.6 |
| India | 7.5 | 6.5 | 6.7 |
| Brazil | 2.6 | 1.6 | 1.7 |
| Mexico | 0.7 | 0.9 | 2.0 |
| Russia | 1.0 | 0.4 | 1.2 |
| Türkiye | 3.6 | 2.3 | 3.4 |
| South Africa | 1.1 | 1.1 | 1.4 |

Source: Oxford Economics, Atradius (* forecast)

## 3.2 China: export resilience offsets weak domestic demand

China is relatively insulated from the energy price shock stemming from the war in Iran, reflecting its large strategic oil reserves, its leading position in clean energy manufacturing, and the continued importance of coal in primary energy demand. The reduction in US tariffs, following the Supreme Court decision to roll back emergency-based measures, provides some support to external demand. The weighted average tariff rate on Chinese goods has fallen to around 19%, from 29%.

Growth momentum strengthened at the start of the year, with real GDP expanding by 5.0% y-o-y in Q1 2026, up from 4.5% in Q4 2025. China has set an official growth target of 4.5% to 5.0% for 2026. We project growth at 4.8%, despite a weakening external environment. Growth is expected to moderate further to 4.6% in 2027, as the fiscal stimulus loses momentum and structural weaknesses in domestic demand constrain activity.

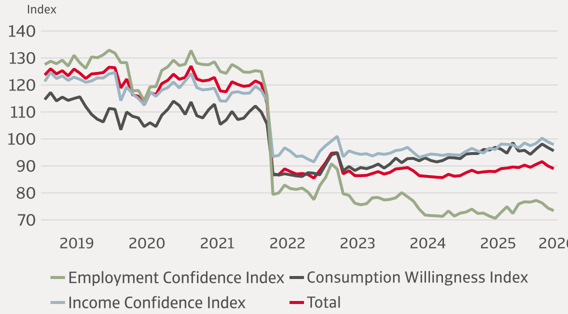
Inflation remains subdued, reflecting persistent excess capacity and weak consumer demand. However, producer prices turned positive between March and May due to the war in Iran, for the first time in more than three years. This may signal some stabilisation in industrial pricing conditions, although it is too early to conclude that deflationary pressures have fully disappeared.

China-US relations are expected to remain fraught over the coming years. We expect that China's use of both tariff and non-tariff instruments will constrain the US administration from pursuing the most severe trade actions. Exports recorded a strong 17% y-o-y growth in Q1 of 2026. China is leveraging its supply-chain resilience and increasing product competitiveness, as well as demand from AI-related capital expenditure and renewable energy investment spurred by the Iran war. Together, these forces should continue to support China's export momentum this year. Exports are likely to remain the main growth driver in 2026.

By contrast, consumption is expected to underperform in the near term. Authorities have committed to boosting household spending, but policy support has had only a limited effect on consumption to date. Structural headwinds, including weak confidence, housing market slackness, subdued income growth and limited social protection, will take time to resolve. The boost from 2025 trade-in schemes is fading. In the absence of deeper reforms, consumption is unlikely to serve as a stable engine of growth in the near term.

**Figure 3.1 Weak confidence holds back consumption growth**

**China, consumer confidence and selected sub-indicators**




Source: Macrobond

China's drive for strategic autonomy is likely to remain a regulatory risk for foreign companies operating in or dependent on China. Tighter oversight of supply chains, critical minerals and technology exports, alongside measures that may conflict with Western requirements, could increase compliance costs, supply-chain uncertainty and price volatility. These developments may also encourage firms to diversify sourcing and reduce reliance on China.

Fiscal policy should remain mildly supportive this year. Science and technology are expected to continue to benefit from strong spending growth as a policy priority. However, the government is also increasing expenditure on livelihoods, social security, healthcare and education, in line with its new slogan “investing in people”.

Monetary policy is also expected to remain cautious, as stronger than expected Q1 growth and the return of producer prices to positive territory have lessened the case for further easing. Depreciation pressures on the Renminbi limit the central bank’s policy space, as a more accommodative stance could widen rate differentials with major economies and incentivise capital outflows.

## 3.3 India: energy shock drives up inflation

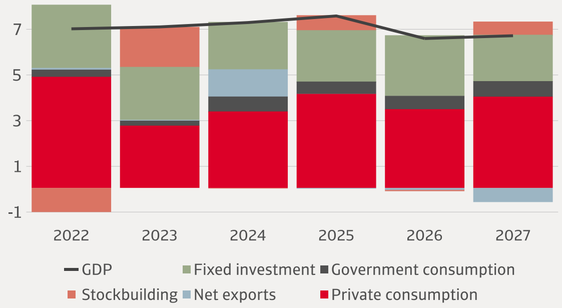
Given India’s significant exposure to the impacts of the conflict in the Middle East as a major energy importer, GDP growth is projected to slow to 6.5% in 2026. For 2027, we expect a growth increase to 6.7%, as domestic demand benefits from slowing inflation amid an improving external environment.

Disruptions in the Strait of Hormuz are expected to weigh on the outlook, given India’s reliance on imports of natural gas, fertilisers and petroleum – with almost 40% coming from the Gulf countries most impacted by disruptions in the Strait of Hormuz. The resulting increase in import costs is adding to inflationary pressures. These effects are likely to strengthen in the second half of 2026, as higher energy and fertiliser costs pass through to food prices and, more gradually, to core inflation via wider second-round effects. After relatively subdued inflation in 2025, the year-on-year CPI increased markedly in the past months, to 3.9% in May. While the authorities try to limit the pass-through of the energy price shock via various measures, including administered fuel prices, inflation is still expected to move up to an average of 5.1% in 2026.

Private consumption is expected to moderate to 6.2% growth in 2026, despite continued employment gains, reflecting the erosion of real incomes from higher inflation. As price pressures ease, consumption growth is projected to recover to 7.2% in 2027. Investment should remain a key pillar of growth. Ongoing public capital expenditure, particularly in transport, energy and digital infrastructure, is expected to continue to crowd-in private investment and support overall demand.

**Figure 3.2 GDP growth expected to slow in 2026**

**India, GDP and components**




Source: Macrobond

The Reserve Bank of India (RBI) kept its policy rate unchanged at 5.25%. The central bank prioritised macroeconomic stability and risk mitigation, driven by heightened inflationary risks from global energy prices and supply chain disruptions due to the Middle East conflict. However, we think that increasing inflation risks and depreciation of the rupee are shifting the balance towards monetary tightening. This could translate into one or two rate hikes this year. Inflation could temporarily exceed the upper bound of the target range, which is set at 4% ± 2%, reinforcing the case for a tighter stance.

Recent policy measures point to growing pressure on the government’s fiscal position. Earlier fuel tax cuts are expected to weigh on revenues, although incremental petrol and diesel price increases soften the burden on state-run refineries and mitigate the fiscal hit. The budget deficit is expected to increase to 5.1% of GDP in 2026, from 4.5% in 2025. Public debt remains elevated at around 84% of GDP. However, risks are mitigated by the structure of the debt stock, which is largely denominated in local currency and financed through long-term, fixed-rate instruments. Public debt is expected to decline only gradually over the coming years.

On foreign policy, India continues to strengthen trade and investment ties with a broad range of partners, including the EU, the US and Gulf countries, aiming to diversify export markets and deepen its integration into global supply chains. At the same time, the government is pursuing reforms to improve the business environment and attract foreign direct investment. While progress remains gradual, these efforts should provide support to investment, exports and medium-term growth over the next years.

## 3.4 Mexico: resilience strained by USMCA uncertainty

The Mexican economy started 2026 weaker than expected, contracting by 0.8% quarter on quarter, as largely seasonal and temporary factors weighed on all sectors. We still expect Mexico to avoid a technical recession, defined as two consecutive quarters of contraction, with growth strengthening in the second half of the year. Support should come from the FIFA World Cup, which Mexico is co-hosting with the US and Canada in June and July, as well as recent policy rate cuts. On the other hand, ongoing negotiations on the renewal of the United States-Mexico-Canada Agreement (USMCA) will keep business uncertainty elevated (see in-focus box). Nonetheless, we have revised down our GDP growth forecast to 0.9% in 2026 from 1.4% previously, and to 2.0% in 2027 from 2.1%.

At the same time, we have raised our inflation forecast to 4.2% in 2026 from 3.7%, reflecting higher tomato and chilli prices following extreme weather, as well as higher global oil and food prices linked to the conflict in Iran. We expect inflation to ease to 3.5% in 2027 as these temporary factors fade and economic weakness persists. Risks remain skewed to the downside. Geopolitical tensions, including the conflict in Iran and USMCA negotiations, could still escalate. In addition, El Niño poses a weather-related risk, bringing unusually dry summer conditions across much of Mexico and heavier-than-normal winter rainfall in northern and central regions. Forecasters estimate a nearly two-thirds probability that El Niño will intensify to a very strong level by November-December.

Mexico's direct exposure to the Iran conflict is limited. The country is a small net importer of oil and gas, with negligible dependence on Gulf supplies. Although around 75% of fertiliser demand is imported, only about 10% comes from Gulf countries. The main transmission channel is therefore indirect, particularly through higher food prices, as fuel price stabilisation mechanisms help contain the impact on domestic fuel costs. El Niño could amplify food price pressures and affect farmers producing water-intensive crops such as sugar cane and cotton. However, we expect the macroeconomic impact to remain manageable, given that agriculture accounts for less than 5% of GDP. Against this backdrop of rising price pressures, we expect Banxico to keep its policy rate at 6.5% throughout the forecast period, following the final rate cut that ended the easing cycle in May.

Despite persistent external uncertainty, Mexico's economy remains remarkably resilient. Although the peso experienced volatility against the US dollar following the outbreak of the Iran conflict, it has traded broadly around its pre-conflict level since mid-April and has appreciated by around 2.6% since the start of the year (figure 3.3). This resilience reflects strong macroeconomic fundamentals, including a credible policy framework, a robust banking sector, and solid public and external finances.

### In-focus: USMCA negotiations

The USMCA review is by far the most significant external risk for Mexico, given its deep economic integration with the US. More than 80% of Mexico's goods exports go to the US, equivalent to almost 28% of GDP, while roughly one-third of FDI originates there.

Although USMCA is a trilateral agreement, the US is conducting bilateral discussions with each partner. In contrast to negotiations with Canada, talks with Mexico have progressed relatively well, although the 1 July review deadline has passed without an agreement. Two negotiation rounds have taken place so far since the end of May with a final round scheduled for the week of 20 July. Discussions have centred on stricter rules of origin, particularly for the automotive sector, reducing reliance on external suppliers, especially China, for strategic industrial inputs, and strengthening labour enforcement and security provisions.

Our baseline scenario assumes negotiations will continue and ultimately lead to a tighter USMCA framework, including stricter origin requirements and possible limits on Chinese content. This would increase regulatory complexity and require supply chain adjustments in the coming years. Sectors such as the automotive industry, which is already struggling, and electronics, which is currently benefitting from the US' AI boom, are likely to be most affected.

As the likelihood is rising that no agreement will be reached in 2026, USMCA will be placed under annual review. Such prolonged uncertainty would continue to weigh on investment decisions. A more adverse scenario would involve a US withdrawal from USMCA and its replacement with bilateral agreements with Canada and Mexico. While this could preserve some market access, it would disrupt integrated North American supply chains and negatively affect businesses across all three member countries.

Figure 3.3 Peso appreciation shows Mexico's resilience

Mexican peso per USD (reverse axis)


Source: Macrobond

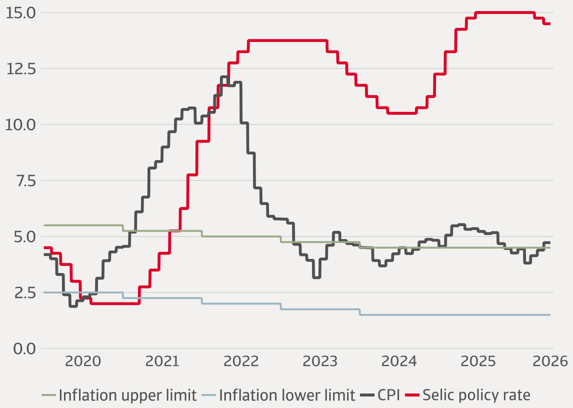
## 3.5 Brazil: high rates and geopolitical risks slow momentum

Brazil's economy is losing momentum after four years of above-trend growth. GDP expanded by 2.6% in 2025, mainly reflecting the lagged impact of sharp monetary tightening on household consumption and private investment. We expect GDP growth to ease further to 1.6% in 2026 and recover only modestly to 1.7% in 2027 as the pace of monetary easing slows amid higher-than-expected inflation due to the Iran war. This represents downward revisions for the 2026 and 2027 real GDP growth forecasts by 0.1ppt and 0.7ppt respectively.

The main domestic constraint is still tight monetary policy. The central bank raised the Selic rate to 15% in June 2025, after inflation pressures and fiscal concerns weakened confidence. Inflation had eased to within the target band by February 2026, supported by slower activity and a stronger real, but the Iran war has complicated the disinflation path. Brazil is a net energy exporter and has limited direct trade exposure to the Middle East, which gives it some protection against the shock. But it still imports refined petroleum products and fertilisers, so higher oil and gas prices can feed into fuel, transport and food costs. This pushed inflation back up since March, reaching 4.7% in May, and explains why the central bank has started slowing down its monetary easing. After a 25bp cut to 14.25% on 17 June, the BCB signalled increased caution and we now expect only one more cut by the end of the year. This also reflects expected upward price pressures linked to El Niño, which tends to cause droughts in northern and north-eastern Brazil and excessive rainfall and flooding in the south. As one of the world's largest agricultural exporters, Brazil plays a key role in global grain markets. Weather-related disruptions could therefore put upward pressure on international prices, particularly for soybeans and corn, for which Brazil is the largest and second-largest exporter, respectively, worldwide. The impact of El Niño on Brazil's economy might be significant, as agriculture contributes nearly 9% of GDP and the power sector is highly dependent on hydroelectric generation.

Figure 3.4 Monetary easing complicated by above-target inflation

Brazil target Selic rate vs inflation, %




Source: Central Bank of Brazil, Macrobond

Brazil is comparatively well placed to absorb external shocks. It is a large and relatively closed economy, with exports equal to around 18% of GDP and exports to the US only around 1.9% of GDP. This limits the macroeconomic impact of higher US tariffs, especially after broad exemptions reduced the effective tariff burden. The flexible exchange rate also remains an important shock absorber. The real appreciated strongly in 2025 and continued to strengthen in early 2026, supported by wide interest-rate differentials and improving terms of trade. We still expect mild depreciation as Brazilian interest rates fall and the differential with the US narrows.

Fiscal policy remains the main medium-term vulnerability. The current fiscal framework has not been sufficient to stabilise the debt burden, with high interest costs keeping the overall deficit above 8% of GDP. Pre-election spending is likely to widen the deficit in 2026, while government debt is projected to rise further towards 85% of GDP in 2027. Risks are mitigated by favourable debt characteristics, including mostly domestic and local-currency financing, a diverse investor base and sizeable government cash buffers. Even so, fiscal credibility will remain central to investor confidence and the pace of monetary easing.

## 3.6 Türkiye: growth slows as energy shock reignites inflation

GDP growth is expected to slow to 2.3% in 2026, before rebounding to 3.4% in 2027. For 2026, the downward adjustment compared to the pre-war situation is 0.7 ppts. Growth is dragged down primarily due to the higher oil price caused by the war in Iran, which is exerting a negative influence on domestic demand and sentiment.

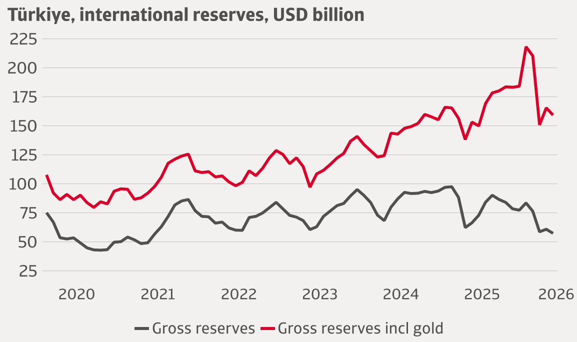
The economy slowed more than expected in Q1 of 2026, showing 2.5% y-o-y expansion (versus our 3% projection). June's PMI survey indicates that the manufacturing sector remains under pressure, following a temporary improvement in May. The broader outlook remains challenging as moderating demand continues to weigh on activity, pushing services sector sentiment to its lowest level since mid-2021.

Inflation has remained elevated in recent months. CPI inflation eased slightly to 32.1% in June, following increases in the previous two months. The decline was mainly driven by softer energy-related price pressures and slower growth in transport costs. However, households continue to face persistent inflation in housing, education and food. Assuming geopolitical tensions and related energy price pressures continue to ease, disinflation should gradually progress over the coming months. We forecast average inflation of 31.1% in 2026, falling further to 22.0% in 2027.

Private consumption growth is likely to slow to 3.2% this year, from 4.0% in 2025. The energy shock and the rise in prices add to pre-existing consumer-spending headwinds with their adverse impact on real incomes. This is in parallel with the frailty of the labour market, marked by a high and rising labour underutilisation rate. Fixed investment growth is also likely to slow in 2026 due to higher uncertainty and tighter financing conditions. Net exports are likely to make a negative contribution, as external demand weakens, especially for tourism and transport services.

After the closure of the Strait of Hormuz and the rise in energy prices, there was pressure on Türkiye's foreign exchange (FX) reserves and on the lira. The central bank responded by actively providing FX to the financial system. Gross FX reserves (including gold) recovered in April, rising by USD 14 billion to USD 165 billion, but came under renewed pressure in May after a court ruling removed the leader of the main opposition party. The central bank kept the policy rate on hold in June, as widely expected. However, in past months the central bank has ceased to hold one-week repo auctions, which means it is no longer lending to the banks at its policy rate. We expect a gradual return to interest cuts towards the end of 2026.

**Figure 3.5 FX reserves show volatility**




Source: TCMB, Macrobond

We project a government budget deficit of 3.2% of GDP in 2026, roughly equal to last year and slightly below the target of 3.5%. The government has stepped in to dampen the inflationary effects of the energy price shock through a sliding scale mechanism of fuel prices, whereby the fuel tax is dynamically reduced to compensate for increases in the oil price (this mechanism offsets 75% of the pass-through from international oil prices). Despite the fiscal cost of these measures, the government deficit remains contained, and public debt is expected to remain relatively low in 2025 and 2026.

## 3.7 Russia: fiscal pressures intensify amid sustained military spending

Economic activity is expected to remain subdued. We project GDP growth of 0.4% in 2026, followed by 1.2% growth in 2027. Peace talks between Russian and Ukrainian delegations have been effectively frozen since the outbreak of conflict in the Middle East. Meanwhile, the range and intensity of Ukraine's drone attacks away from the front line have increased. The outlook remains highly dependent upon the duration of the war in the Middle East and the trajectory of government spending, with political pressure mounting to ensure growth.

The economy contracted by 0.2% y-o-y in Q1 of 2026, following growth of 1.5% in Q4 of 2025. A relatively loose fiscal stance at the start of the year is expected to support a rebound in Q2. Growth is likely to turn positive over the remainder of 2026, although momentum is expected to remain weak.

Exports declined by 6.3% in 2025, driven by lower oil and coal prices, OPEC+ production caps, and the end of gas transit to Europe via Ukraine. A recovery in 2026 is expected to be limited. On the one hand, higher global oil prices linked to the

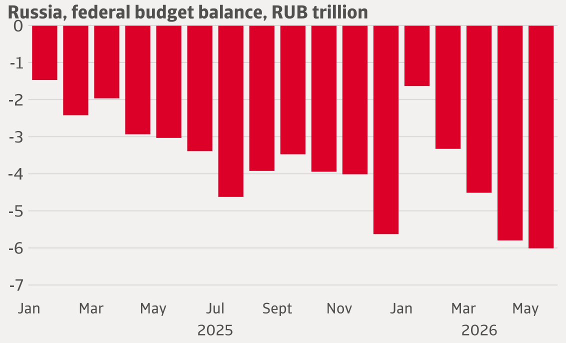
Middle East conflict and some easing of US sanctions on seaborne Russian oil provide support. On the other hand, recurring Ukrainian drone strikes on refineries are disrupting domestic processing capacity, weighing on export volumes and revenues. Overall, the external sector is unlikely to provide a strong impulse to growth.

Private consumption is likely to show positive growth in 2026, supported by a tight labour market and declining inflation, which are underpinning real wage growth. However, consumption growth is likely to soften due to the VAT increase from 20% to 22%, which erodes household purchasing power.

Investment dynamics remain weak. Private investment is expected to contract again this year, as elevated defence spending continues to crowd out non-military investment. In addition, tight monetary conditions weigh on financing conditions and business sentiment.

Inflation continued to decline, reaching 5.3% y-o-y in May, which is still above the central bank target of 4%. The central bank has been easing policy since May 2025, with the current policy rate at 14.25%. Further disinflation and improving inflation expectations are likely to allow additional rate cuts in 2026. We expect the policy rate to decline to around 11% by year-end.

**Figure 3.6 Federal budget deficit keeps rising**




Source: Russian Ministry of Finance, Macrobond

Fiscal pressures have intensified despite higher oil prices. The increase in the Urals oil price early this year has not been sufficient to offset the impact of elevated military spending. The federal budget recorded a deficit of RUB 6.0 trillion in January to May 2026, or 2.6% of GDP. This drastically exceeds the initial full-year target of RUB 3.8 trillion, or 1.6% of GDP.

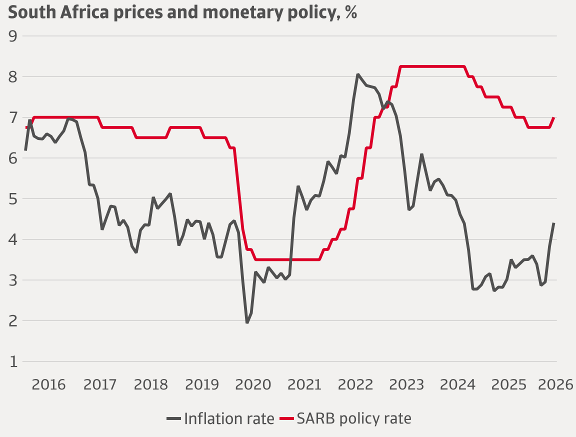
Under the fiscal rule, the authorities resumed foreign exchange interventions in May, purchasing foreign currency and gold while selling roubles. Although excess oil revenues are saved in the sovereign wealth fund, in practice these resources are likely to be redeployed to finance the widening deficit. Overall, fiscal policy remains a key support for short-term growth, but at the risk of depleting reserves in the long run.

## 3.8 South Africa: price pressures weigh on modest recovery

South Africa's economic outlook remains one of only modest recovery. GDP growth is expect to be 1.1% in 2026, the same pace as 2025, and slightly higher to 1.4% in 2027. This is only 0.1ppt lower in both years than forecast in December 2025 as the Iran war increased price risks. Private consumption is still expected to be the main growth driver, but momentum is likely to weaken to 2.1% this year, from 3.6% last year. Consumers are facing renewed pressure from high inflation, elevated administered prices and tighter monetary policy.

Inflation rose sharply to 4.5% in May, due to higher fuel prices driven by the Iran war and a recent electricity tariff hike. Headline inflation is now expected to average 4.3% this year and 3.9% next, motivating the South African Reserve Bank to begin tightening monetary policy. The SARB had been on hold at 6.75% since the end of 2025, agreeing to increase its main policy rate by 25bps to 7% at the end of May. We expect monetary policymakers to remain cautious in the remainder of 2026, with one more hike by the end of the year unless inflation eases more quickly than anticipated.

**Figure 3.7 Inflation surge forces SARB to tighten**




Source: National sources, Macrobond

The conflict in the Middle East has worsened the near-term operating environment in South Africa. Higher price pressures and interest rates have contributed to weaker business confidence, reflected in the 8-point drop to 39 in the Q2 RMB/BER business confidence index. The report shows sentiment deteriorating the most among vehicle dealers and wholesalers. It also flags risks from possible supply-chain disruptions, which could add further pressure to domestic operations and consumer purchasing power. These developments reduce the likelihood of a near-term investment recovery. After two years of contraction, we expect fixed investment to be flat in 2026.

Political stability remains an important condition for South Africa's outlook. The government of national unity (GNU) is currently functioning relatively smoothly, and recent credit rating actions point to improved perceptions of South Africa's fiscal trajectory. However, local elections later this year and the African National Congress (ANC) elective conference in 2027 could test coalition discipline. Fiscal consolidation remains the official policy direction, but weaker activity and additional social support are expected to widen the budget deficit to 4.7% of GDP in 2026. Structural constraints also remain significant. Electricity supply has improved since last year, but transport infrastructure, especially Transnet, continues to weigh on productivity and export competitiveness. As a result, growth is likely to improve only gradually unless reform momentum strengthens and private investment in network industries rises materially.

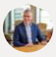
# Appendix

**Table A1 Key macroeconomic forecasts**

| | GDP growth (% change p.a.) | | | Inflation (% change p.a.) | | | Budget balance (% of GDP) | | | Gross government debt (% of GDP) | | | Current account (% of GDP) | | | Export growth (% change p.a.) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2025 | 2026 | 2027 | 2025 | 2026 | 2027 | 2025 | 2026 | 2027 | 2025 | 2026 | 2027 | 2025 | 2026 | 2027 | 2025 | 2026 | 2027 |
| Australia | 2.0 | 1.8 | 2.1 | 2.8 | 4.4 | 2.9 | -2.1 | -1.4 | -1.3 | 60 | 61 | 61 | -2.7 | -3.8 | -4.7 | 2.7 | 1.4 | 1.9 |
| Austria | 1.0 | 0.6 | 1.4 | 3.5 | 3.3 | 1.9 | -4.2 | -4.0 | -3.8 | 116 | 116 | 116 | 1.9 | 1.3 | 1.6 | 1.5 | 0.4 | 0.4 |
| Belgium | 1.0 | 0.7 | 0.9 | 2.5 | 3.4 | 2.3 | -5.2 | -4.9 | -4.3 | 115 | 116 | 118 | -1.9 | -1.3 | -2.2 | -0.3 | 1.4 | 2.4 |
| Brazil | 2.6 | 1.6 | 1.7 | 5.0 | 4.7 | 3.7 | -8.1 | -8.7 | -8.5 | 79 | 82 | 85 | -2.9 | -1.9 | -1.9 | 6.6 | 1.6 | 0.3 |
| Canada | 1.9 | 0.7 | 2.0 | 2.1 | 2.7 | 2.2 | -0.8 | -1.8 | -2.7 | 107 | 105 | 105 | -1.0 | 0.0 | -1.0 | -1.4 | 1.8 | 1.5 |
| China | 5.0 | 4.4 | 4.6 | 0.0 | 1.2 | 1.2 | -9.0 | -9.1 | -10.1 | 69 | 73 | 79 | 3.7 | 3.3 | 3.0 | 8.4 | 14.1 | 3.2 |
| Denmark | 2.9 | 3.1 | 1.0 | 1.9 | 1.1 | 1.3 | 3.0 | 2.9 | 3.0 | 35 | 33 | 30 | 12.5 | 12.9 | 11.9 | 3.0 | 4.6 | -0.3 |
| Finland | 0.2 | 1.3 | 1.0 | 0.3 | 2.0 | 1.5 | -3.4 | -3.4 | -2.8 | 88 | 91 | 93 | 1.2 | 0.7 | -0.9 | 3.4 | 0.0 | -0.8 |
| France | 0.9 | 0.4 | 0.8 | 0.9 | 1.9 | 1.8 | -5.1 | -5.1 | -5.0 | 124 | 126 | 127 | -0.3 | 0.0 | 0.4 | 2.4 | 0.1 | 1.2 |
| Germany | 0.3 | 0.4 | 1.6 | 2.2 | 2.7 | 2.3 | -2.8 | -3.2 | -3.3 | 59 | 61 | 61 | 4.5 | 4.2 | 4.0 | -0.7 | 0.2 | 0.5 |
| Greece | 2.2 | 1.9 | 1.9 | 2.5 | 4.5 | 1.7 | 1.7 | 0.6 | -0.2 | 190 | 181 | 173 | -5.7 | -8.1 | -6.3 | 1.7 | 1.7 | 1.9 |
| Hong Kong | 3.6 | 3.7 | 1.9 | 1.4 | 2.1 | 1.8 | -2.7 | -2.6 | -1.8 | 12 | 13 | 15 | 12.3 | 7.5 | 10.5 | 11.2 | 12.4 | 1.4 |
| India | 7.5 | 6.5 | 6.7 | 2.2 | 5.1 | 5.2 | -4.5 | -4.7 | -4.2 | 84 | 82 | 79 | -0.4 | -1.4 | -0.6 | 6.8 | 3.2 | 8.1 |
| Ireland | 12.4 | -10.9 | 6.7 | 2.2 | 3.3 | 1.9 | 1.7 | 0.5 | 0.5 | 26 | 28 | 25 | 8.2 | 7.1 | 6.9 | 9.7 | -6.9 | 3.6 |
| Italy | 0.7 | 0.6 | 0.6 | 1.5 | 2.7 | 1.7 | -3.1 | -2.9 | -2.8 | 149 | 151 | 152 | 1.1 | 1.1 | 1.3 | 1.4 | 1.4 | 0.9 |
| Japan | 1.1 | 0.4 | 0.5 | 3.2 | 2.5 | 2.6 | -1.8 | -3.3 | -3.5 | 205 | 202 | 201 | 4.8 | 4.6 | 3.9 | 2.5 | 0.0 | -1.8 |
| Luxembourg | 0.6 | 1.6 | 2.4 | 2.3 | 2.6 | 2.4 | -1.8 | -2.0 | -0.8 | 26 | 28 | 28 | 5.4 | 4.7 | 5.0 | 1.1 | 2.2 | 4.5 |
| Mexico | 0.7 | 1.4 | 2.1 | 3.8 | 4.2 | 3.5 | -3.9 | -3.8 | -3.2 | 56 | 57 | 57 | -0.6 | -0.6 | -0.4 | 7.3 | 0.0 | 1.3 |
| Netherlands | 1.8 | 1.2 | 1.3 | 3.2 | 3.0 | 2.4 | -1.6 | -2.2 | -1.9 | 45 | 46 | 46 | 7.8 | 9.3 | 9.5 | 2.5 | 0.6 | 1.1 |
| New Zealand | 0.5 | 1.5 | 2.8 | 2.8 | 3.6 | 1.5 | -0.9 | -1.1 | -1.0 | 51 | 52 | 50 | -3.6 | -5.7 | -4.9 | 2.8 | 2.4 | 4.1 |
| Norway | 1.2 | 1.6 | 1.3 | 3.0 | 3.3 | 2.7 | 10.4 | 8.0 | 7.8 | 48 | 47 | 50 | 14.1 | 17.8 | 11.3 | 2.8 | 4.5 | 0.4 |
| Portugal | 1.9 | 2.0 | 2.1 | 2.3 | 3.0 | 2.3 | 0.7 | -0.5 | -0.8 | 96 | 92 | 89 | 1.2 | 0.1 | 0.8 | 0.4 | 1.7 | 1.5 |
| Russia | 1.0 | 0.4 | 1.2 | 8.7 | 5.5 | 5.2 | -3.8 | -3.6 | -3.4 | 16 | 17 | 20 | 1.8 | 3.6 | 2.8 | -6.3 | 0.1 | 2.6 |
| Singapore | 5.0 | 3.4 | 2.3 | 0.9 | 2.5 | 2.9 | 0.7 | -0.1 | -2.1 | 166 | 167 | 163 | 16.7 | 19.5 | 18.7 | 10.8 | 13.3 | 0.6 |
| Spain | 2.8 | 2.5 | 2.1 | 2.7 | 3.4 | 2.1 | -2.4 | -2.3 | -2.2 | 106 | 103 | 101 | 2.9 | 2.8 | 2.8 | 3.6 | 1.1 | 2.0 |
| South Africa | 1.1 | 1.1 | 1.4 | 3.2 | 4.3 | 3.9 | -4.2 | -4.4 | -4.3 | 79 | 79 | 79 | -0.5 | -0.6 | -0.3 | -2.5 | -0.4 | 1.4 |
| South Korea | 1.1 | 2.5 | 1.9 | 2.1 | 2.8 | 1.6 | -1.8 | -1.6 | -2.3 | 50 | 46 | 49 | 6.5 | 13.4 | 9.4 | 4.3 | 6.0 | 0.5 |
| Sweden | 1.7 | 1.9 | 2.1 | 0.7 | 0.8 | 1.4 | -1.2 | -1.8 | -1.3 | 46 | 47 | 46 | 6.0 | 4.6 | 5.3 | 4.2 | 3.1 | 1.0 |
| Switzerland | 1.4 | 1.1 | 1.1 | 0.2 | 0.6 | 0.7 | 0.5 | 0.1 | 0.0 | 24 | 23 | 23 | 3.5 | 4.6 | 4.4 | 2.1 | 1.6 | 0.8 |
| Turkey | 3.6 | 2.3 | 3.4 | 34.9 | 31.1 | 22.0 | -3.2 | -3.2 | -2.6 | 22 | 24 | 24 | -2.0 | -3.2 | -2.0 | -0.3 | -4.0 | 6.9 |
| United Kingdom | 1.4 | 0.9 | 0.8 | 3.4 | 3.1 | 2.5 | -4.9 | -3.6 | -3.6 | 102 | 103 | 103 | -2.4 | -4.1 | -3.3 | 2.1 | 0.6 | 0.8 |
| United States | 2.1 | 2.2 | 2.6 | 2.7 | 3.3 | 2.1 | -7.4 | -8.4 | -7.9 | 137 | 139 | 141 | -3.6 | -3.5 | -3.5 | 1.6 | 5.4 | 1.7 |
| Eurozone | 1.5 | 0.4 | 1.5 | 2.1 | 2.8 | 2.0 | -2.9 | -3.2 | -3.1 | - | - | - | 1.7 | 1.7 | 1.8 | 2.2 | -0.2 | 1.5 |

Source: Oxford Economics, Atradius

## Atradius Economic Research

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