

## ECONOMIC OUTLOOK 2026-2027: ADVANCED ECONOMIES FACE THE RISK OF STAGFLATION

Before the outbreak of war in the Middle East in late February, our 2026 forecasts for the major advanced economies pointed to higher growth and lower inflation. However, this new conflict in the Persian Gulf is a game-changer. The resulting energy shock is of a stagflationary nature: growth forecasts are being revised downward and inflation forecasts upward, with variations observed across different countries. Most of the supportive factors that were present in 2025 are expected to remain in place in 2026, providing some buffer against the shock. Under the central scenario of the conflict losing intensity by the end of the second quarter, growth forecasts for 2026 are lowered by 0.4 percentage points (an average of the revisions for the countries considered here) while inflation forecasts are revised up by 1.1 percentage points. Fiscal support is expected to remain limited and targeted, with little room for manoeuvre. Monetary support, however, is not currently on the agenda. For the time being, central banks are more concerned about inflationary risks than the negative impact on growth. They appear ready to raise their policy rates, although a definitive decision has yet to be reached. This is our scenario for the ECB and the Bank of England (BoE). For the Bank of Japan (BoJ), such a hike would align with the ongoing process of monetary tightening. The Fed, for its part, would stick to the *status quo*.

At the start of the year, we expected 2026 to be as turbulent as 2025 (judging by geopolitical upheaval and tensions in the early days) as well as characterised by stronger growth, this latter being driven by the reinforcement of the supportive factors at work in 2025 (lower uncertainty, favourable financial conditions, low oil prices, resilient global trade, the AI boom, European revival, good labour market performance, lower inflation, less restrictive monetary policy, and broadly neutral fiscal policy). The challenge was to capitalise on the momentum and, as in 2025, overcome obstacles despite the risks: upward pressure on long-term interest rates, the full impact of the U.S. tariff shock, escalating trade tensions, AI-driven stock market correction, threats to the Fed's independence, and geopolitical tensions<sup>1</sup>.

### FROM ONE SHOCK TO ANOTHER

A few months later, geopolitical risk resurfaced. The Israeli-American offensive in Iran on 28 February, along with the spread of the conflict throughout the region, propelled the geopolitical risk indicator to an historic high, comparable to that reached when the Russian offensive in Ukraine began (see Chart 1). The resilience of the global economy is being severely tested by the new energy shock triggered by this latest war. This shock affects all countries, albeit to varying degrees, depending on their level of exposure and their capacity to absorb the impact. This is a negative shock for the global economy, in which there are only losers, even if net hydrocarbon-exporting countries will be less impacted than net importers. Of the seven advanced economies reviewed in this issue of EcoPerspectives, the United States is the least vulnerable, while Italy, Germany, the United Kingdom and Japan are more exposed; France and Spain fall somewhere in between.

Deprived of a number of its supporting factors (oil prices, uncertainty, inflation and monetary conditions, all previously favourable), to what extent will growth withstand the shock thanks to the cushioning effect of the remaining factors still in play? To what extent should we also be concerned about the apparent disconnect between, on the one hand, the stock markets' rather benign outlook and the geopolitical de-escalation they seem to be factoring in, and, on the other hand, a more difficult, complex and uncertain reality on the ground, characterised by substantial concerns (disruptions in fuel and derivative supplies, a prolonged and delayed return to normalcy)? Is there excessive optimism on one side and excessive pessimism on the other? At this stage, it is not easy to decide.

### The war in the Middle East is driving geopolitical risk to a peak close to that seen at the outbreak of the war in Ukraine

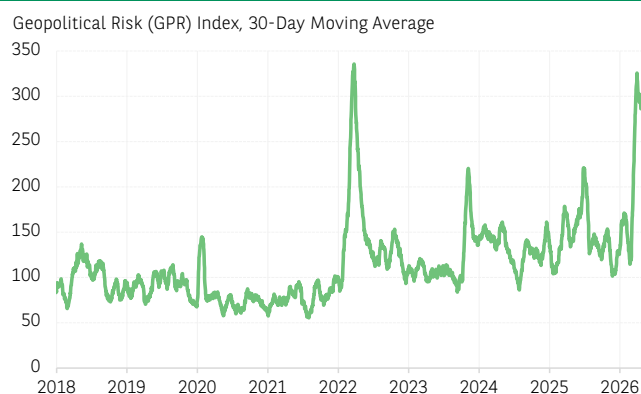


CHART 1

SOURCE: MATTEO IACOVIELLO, BNP PARIBAS

In summary, our new baseline scenario strikes a balance: it acknowledges a definite shock mitigated by several structural supportive forces at play. However, a scenario involving a severe economic crisis cannot be ruled out: the longer the shock lasts, the greater the risk of cascading and non-linear negative effects will become, especially as the likelihood of reaching the limits of fiscal and monetary policies also increases.

Our baseline scenario posits that the conflict and associated supply disruptions will subside by the end of the second quarter. According to our forecasts, the energy shock is expected to reduce growth by 0.4 percentage points in 2026 (averaging our forecast revisions for the economies covered in this publication) and add 1.1 percentage points to inflation. The countries with the most significant revisions are Germany for the growth forecast (revised downward) and Italy and Germany for inflation (revised upward); the countries with the least significant revisions are Spain for growth and the United States for inflation (see Charts 2 and 3). Due to ongoing tailwinds, the shock is anticipated to remain generally manageable, particularly as the economic environment appears, at first glance, less inflationary than in 2022 (see our latest [Ecolnsight](#)). The spillover of rising energy prices to other components of the consumer price index will, nevertheless, be closely monitored.

<sup>1</sup> See Ecoweek editorial, [2026 Economic Outlook in Advanced Countries: Building on the Success of 2025, 12 January 2026](#).



### Growth forecasts (annual average, %, in descending order in 2026): old and new scenarios

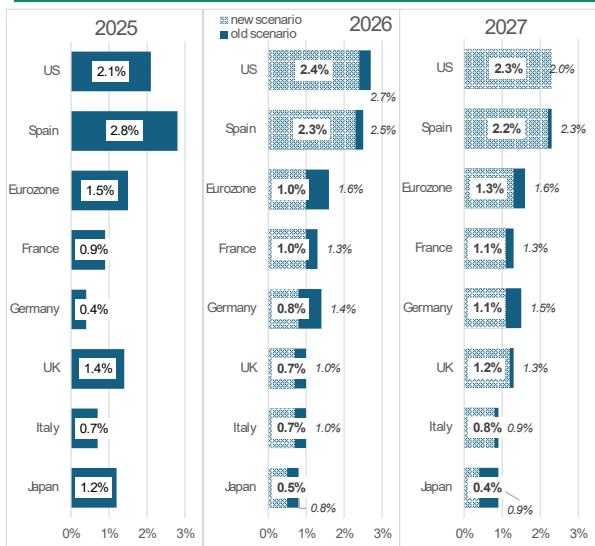


CHART 2

SOURCE: BNP PARIBAS

### Inflation forecasts (annual average, %, in descending order in 2026): old and new scenarios

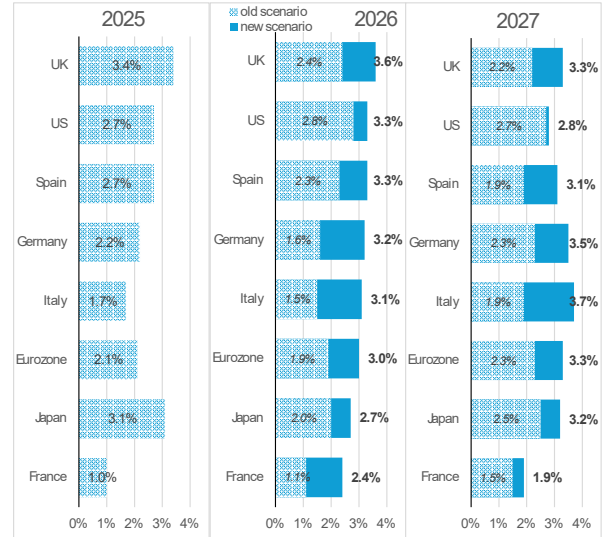


CHART 3

SOURCE: BNP PARIBAS

## SUPPORTING FACTORS SHOULD NOT BE OVERLOOKED

Household consumption appears to be the most vulnerable GDP component to this new energy shock, while investment (both private and public) could hold up better. On the one hand, the deterioration in the purchasing power of real wages (with expected inflation once again surpassing the growth in nominal wages, which is slowing) negatively affects household budgets but positively influences corporate margins. On the other hand, investment from both the corporate and public sector is likely to continue benefiting from favourable tailwinds, some of which are common to all countries (AI, defence, decarbonisation, electrification), while others are specific yet have global spillover effects (infrastructure in Germany, aerospace for France, European funds for Italy and Spain). Taken together, these factors would help offset the negative impact of uncertainty, escalating production costs and rising interest rates. The factors bolstering investment would also benefit foreign trade, which is further boosted by the ongoing reconfiguration of global trade and the resurgence of intra-European trade.

Survey data for March showed an initial, immediate but limited impact of the Gulf conflict, more pronounced in household confidence than in business confidence (illustrating households' heightened sensitivity). In terms of the business climate, the impact was more pronounced in the services sector than in manufacturing (illustrating the tailwinds in this sector)<sup>2</sup>. As a well-known adage suggests, the situation is likely to get worse before it gets better. This, in any case, is what is outlined in our baseline scenario.

The resilience of the labour market will also be tested. However, this factor will play a central role in cushioning the impact of the energy shock on household confidence and consumption. Before the outbreak of war in Iran, indicators were mixed, revealing both signs of weakness and resilience. A prime example is the unique, uncomfortable yet sustainable equilibrium that defines the U.S. labour market, characterised by a low hiring and low firing regime. Looking ahead to the coming months, we expect the unemployment rate in the major advanced economies to rise overall, but only to a limited extent.

Fiscal policy should also provide some support, albeit limited, by targeting aid as effectively as possible given the lack of room for manoeuvre. Most governments are constrained by very high public debt ratios and already face challenging trade-offs between resource allocation and spending savings needed to make room for "old new" expenditures (defence, decarbonisation, ageing populations). These constraints are exacerbated by the upward trend in long-term interest rates (see our latest [EcoInsight](#), for more details on the measures taken so far). However, Europe can rely on alternative strategies aimed at jointly and structurally strengthening its growth and internal market (see table).

## CENTRAL BANKS: CAUTIOUS, OBSERVANT, BUT ON HIGH ALERT

While the challenges faced by governments are not easy to tackle, those faced by central banks are even more complex. They are caught in a dilemma: should they raise their policy rates to counter inflationary risks (but further weaken growth), or should they lower them to address downside risks to economic activity (but fuel inflation)? For now, caution and patience remain the order of the day while they monitor the actual developments of the situation. Their response will depend on their own reaction function, on the timing and intensity of the risks that materialise, and potentially on the measures taken by governments (the less impactful these measures are, the less central banks will have to counter their demand-supporting effects to contain inflation).

Central banks are also on high alert and appear ready to act, currently leaning more towards tightening rather than easing. According to our forecasts, the ECB, the BoE and the Bol (for whom this would be part of its ongoing tightening cycle) are expected to raise their policy rates, while the Fed would favour the *status quo*.

Article completed on 23 April 2025

Hélène Baudchon

[helene.baudchon@bnpparibas.com](mailto:helene.baudchon@bnpparibas.com)

<sup>2</sup> See our dashboard comparing the current energy shock with that of 2022 [Eco Charts 17 April 2026 - Economic Research - BNP Paribas](#).



**BNP PARIBAS**

The bank  
for a changing  
world

## 'One Europe, One Market' Plan — European Council of 18–19 March 2026

Priority areas	Key measures	Target deadlines	Objective
<b>1. Single Market</b>	28th regime ('EU Inc.')	Agreement by end of 2026	Create a unified European legal status for innovative companies to remove barriers to cross-border growth and foster the emergence of European champions.
	Unified electronic declaration — posted workers	Agreement in June 2026	Simplify administrative procedures for employers operating in multiple Member States and facilitate labour mobility within the internal market.
	Mutual recognition of professional qualifications	EC proposal — autumn	Enable skilled workers to practice more quickly in another Member State, boosting productivity and helping meet recruitment needs across Europe.
	European Business Wallet (digital identity, 'once only')	Agreement by end of 2026	Digitalise interactions between companies and public administrations under the 'once only' principle to reduce administrative burden and speed up cross-border operations.
	Merger Regulation review	EC proposal — 2026	Relax EU merger control to remove regulatory barriers to the formation of large, globally competitive European companies
	Priority given to regulations over directives	—	Ensure uniform application of EU law across all Member States to reduce internal market fragmentation and provide a more predictable framework for businesses.
<b>2. Regulatory simplification</b>	Finalisation of the 'Omnibus' packages	Agreement by end of 2026	Ease the regulatory burden on companies, particularly SMEs, to free up their capacity to invest and innovate.
	Omnibus IA	EC proposal — July 2026	Adapt and simplify the regulatory framework for artificial intelligence to accelerate AI deployment and strengthen the competitiveness of European players.
<b>3. Energy</b>	Short-term measures — electricity prices and volatility	End of 2026	Lower energy costs for European companies and limit price volatility — essential conditions for industrial competitiveness and household purchasing power.
	Revision of the ETS (emission allowances)	EC proposal — July 2026	Revise the emissions trading system to better reconcile the decarbonisation pathway with the competitiveness of European industries exposed to international competition.
	<i>Grid package</i>	Agreement in 2026	Modernise and interconnect electricity grids to secure supply, integrate renewables, and support industrial electrification.
<b>4. Industry and innovation</b>	Mapping of critical strategic dependencies	End of 2026	Identify European vulnerabilities in critical raw materials, components and technologies to guide economic sovereignty and industrial resilience policies.
	European Preference / Industrial Accelerator Act	End of 2026	Favour European products and suppliers in public procurement and strategic sectors to support reindustrialisation and accelerate the deployment of key technologies.
	Diversification of trade and investment links	—	Reduce excessive dependencies by diversifying trade and investment partners, strengthening the resilience of European value chains.
<b>5. Investment</b>	Savings and Investment Union (proposals on securitisation, financial markets integration and supervision package)	Agreement by end of 2026	Channel European savings towards companies and innovation projects by deepening capital markets integration and facilitating equity financing.
	Digital euro	Agreement by end of 2026	Provide Europe with a public digital currency to strengthen strategic autonomy in payments and support innovation in financial services.

TABLE

SOURCE: EUROPEAN COMMISSION

