

October 2025

Highlights

- Ample supply and easing tensions in the Middle East are putting downward pressure on energy prices. Oil prices declined by 3% last month to 66 USD per barrel. The decline is largely supply-driven as OPEC+ has again increased its production quota and non-OPEC+ supply remains at elevated levels. The geopolitical risk premium has also diminished, thanks to the Gaza ceasefire agreement. Natural gas prices remained broadly unchanged at 31 EUR per MWh. High US LNG supply is putting downward pressure on gas prices, but this is compensated by the relatively high gas demand as EU countries are still refilling gas reserves.
- Euro area inflation accelerated from 2.0% to 2.2% year-on-year in September. The increase was, as expected, primarily due to less negative energy inflation, as base effects start kicking in. Food inflation moderated slightly. Core inflation remained unchanged at 2.3% as core goods inflation remained unchanged and services inflation increased slightly. In the coming months, lower oil prices, along with lower wage pressures, might weigh on inflation figures. We maintain our 2.1% and 1.8% forecasts for 2025 and 2026, respectively.
- In the US, in line with CPI inflation, PCE inflation accelerated again in August from 2.6% to 2.7% year-on-year. Here as well, the increase was primarily caused by less negative energy inflation, though higher food inflation also played a role. Core PCE remained unchanged as core goods and core services inflation stabilized. As the September CPI release is delayed by the US shutdown and the August PCE report was in line with expectations, we keep our inflation forecast unchanged at 2.8% in 2025 and 2.6% in 2026.
- The euro area economy is on a very gradual path to recovery. Producer confidence indicators have gradually improved, though they remain at low levels. The labour market also remains surprisingly resilient as the unemployment rate remains low. However, the German economy is not yet out of the doldrums, as industrial production remains sluggish. The French government crisis is also weighing on French and European confidence indicators. We maintain our 1.2% and 0.9% growth outlooks for this year and next year, respectively.
- The US economy is continuing to show surprising resilience in the face of high tariffs and increased migration restrictions. Q2 GDP saw major upward revisions and high consumer spending and strong investment is likely to keep growth elevated in Q3. That said, challenges are mounting as the savings rate looks too low, the government is in shutdown and the labour market is weakening steadily. Furthermore, a large part of H1 investment growth is caused by an AI-driven boom, which might

contribute less in coming quarters. We thus adjust our 2025 growth forecast from 1.8% to 1.9%, while maintaining our 1.5% 2026 forecast.

- The economic outlook for China is little changed compared to last month as the economy continues to muddle through. Though the 5% GDP growth target for 2025 remains in reach, risks are tilted to the downside, with growth expected to slow to 4.4% in 2026.
- Central banks are on different trajectories. The Fed restarted its rate cutting cycle in September given labour market concerns. We expect another four rate cuts, with the policy rate ending at 3.125% in March. Meanwhile, the ECB is likely to maintain its deposit rate at 2% for the foreseeable future as inflation is close to target in the euro area. The bond markets have been challenged by political instability in France. French spreads are likely to remain elevated as political uncertainty is likely to remain present going forward. The French turmoil also put pressure on the euro. We expect this downward pressure to be temporary as the euro remains fundamentally undervalued versus the US dollar.

Global Economy

Donald Trump's trade war shifted into slower gear last month. Though Trump announced increased tariffs on non-generic pharmaceuticals, kitchen cabinets, bathroom vanities, furniture and trucks, their implementation has been mostly delayed. Furthermore, even if they would be fully implemented, they would only increase the US effective tariff rate minimally (from 17.4% to 17.9%). However, the most recent 100%-tariff threat on Chinese imports poses new risks to global trade. For now, however; we consider this tariff threat more a strategic move ahead of eventual US-Chinese (re)negotiations than a genuine re-escalation of the trade war.

The trade war's detrimental effects are slowly becoming visible. In the US, the labour market is weakening, prompting the Fed to resume its rate cutting cycle (despite accelerating PCE inflation). In the euro area, the trade war is slowing the on-going (very gradual) recovery. The government crisis in France is another cause for concern there. China's economy is also sluggish, as the private sector remains cautious and is in deleveraging mode. Its 5% economic growth target is still in reach for this year, however.

Energy prices under further pressure

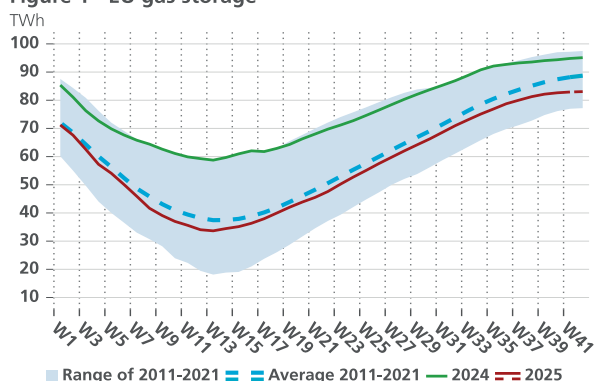
Oil prices continued their descent as Brent oil prices declined by 3% last month to 66 USD per barrel. Oil prices

are now 11% lower than a year ago. The descent in oil prices is mostly supply-driven. Earlier this month, OPEC+ announced another 137k barrels per day production. Since April, OPEC+ raised its production quota by 2.67 million barrels per day. Furthermore, non-OPEC+ supply remains at elevated levels, leaving the market oversupplied in aggregate.

Lower geopolitical tensions in the Middle East have also contributed to lower oil prices. On 29 September, Donald Trump and Benjamin Netanyahu set out a 20-point plan for peace in Gaza. On 8 October, Israel and Hamas signed off on the first phase of the plan, which consists of a ceasefire, the release of remaining Israeli hostages, a prisoner exchange, a partial withdrawal of the Israeli military and a surge in humanitarian aid. This could set the stage for a more durable end to the war in Gaza (Phase 2 of the plan), though many obstacles remain. Nonetheless, this ceasefire agreement is an important first step and significantly lowers the risk of a wider conflict in the Middle East.

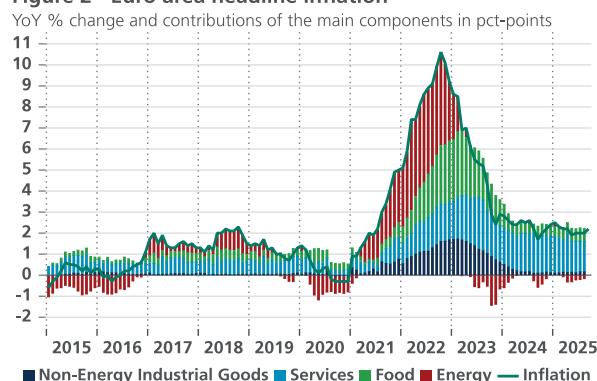
Lower tensions in the Middle East also relieves pressure on natural gas prices. European natural gas prices remained broadly unchanged last month, finishing at 31 EUR per MWh. The market remains well supplied as American LNG is imported at record levels. Gas reserves remain somewhat below historical averages, however (see figure 1).

Figure 1 - EU gas storage



Source: KBC Economics based on Gas Infrastructure Europe (GIE)

Figure 2 - Euro area headline inflation



Source: KBC Economics based on Eurostat

Disinflation in the euro area (almost) over

In the euro area, after three months of being on the 2% target, inflation rose slightly again in September to 2.2%. This was due to less negative energy price inflation (-0.4% compared to -2.0% the previous month). Food price inflation fell slightly to 3.0%, while core inflation (inflation excluding energy and food prices) stood at 2.3% for the fifth month in a row.

Viewed over a longer period, the period of disinflation or cooling inflation appears to be over. Since mid-2024, inflation has fluctuated between 1.8% and 2.5% (see figure 2). Since June 2024, it has averaged 2.2%, which is exactly the most recent figure.

However, with 2.2% headline and 2.3% core inflation, the inflation rate is still slightly above the European Central Bank's (ECB) medium-term target. A look back at the contribution of the main components to inflation shows that the contribution of services in particular is still significantly higher than in the three years immediately preceding the pandemic and the subsequent energy price shock. The contribution of non-energy goods and food is also slightly higher than it was then, but to a lesser extent. Given their lower weight in the consumer price index, this is less important, especially since inflation in 2017-2019 remained stubbornly below the ECB's target: 1.5% on average and even only 1.0% for core inflation. Slightly higher inflation than at that time therefore seems desirable, at least from the perspective of the ECB's target. However, the current pace of services inflation – which has by far the largest weight (45.6%) in the consumer price index – is not compatible with that target.

Yet, especially for services, disinflation is probably not over yet. Wage agreements point to a further slowdown in wage growth, which is a key driver of services inflation. Together with stronger labour productivity growth, this should ease labour cost pressures on inflation and on corporate profit margins.

We therefore expect core inflation to cool further to around 2% by the second half of 2026. Depending on energy price developments, whose volatility, as in the past (see figure 2), tends to disrupt inflation trends, headline inflation may thereby temporarily undershoot the 2% target in the course of 2026. We maintain our forecast for average inflation at 2.1% for 2025 and 1.8% for 2026.

US PCE inflation accelerates in August

As, for now, the US government remains in shutdown, the release of the September CPI report has been postponed. The last major inflation-related release was the August PCE data. In line with the August CPI release, PCE inflation accelerated from 2.6% to 2.7%. On a monthly basis, PCE inflation increased by 0.3%. The increase is mostly due to an acceleration in non-core components as both food and energy saw large month-on-month price increases.

Core PCE inflation remained unchanged at 2.9%. Core goods inflation remained unchanged at 1.1%, thus showing limited evidence of tariff passthrough. Core services inflation also stabilised. We might see some softening in this category in the months ahead, given declining wage pressures (see figure 3). Given that PCE inflation was in line with expectations, we keep our inflation forecasts

unchanged at 2.8% this year and 2.6% next year.

Waiting for clear signs of growth recovery in the euro area

The composite index of purchasing managers' confidence (PMI) in the euro area improved further in September to 51.2. It has been above 50 since January 2025. This is the threshold that differentiates between economic growth and contraction. However, it is not very far above that threshold. Moreover, the improvement in September was only noticeable in the service sectors. In manufacturing, the indicator fell just below the threshold again (49.8), and in construction it weakened to 46, well below the threshold. The European Commission's surveys on business confidence also paint a mixed picture: from a slight weakening of confidence in the service sectors to, at best, a stabilisation at a low level in industry and construction. Consumer confidence has also remained largely stagnant in recent months, at a level that can only be associated with sluggishness.

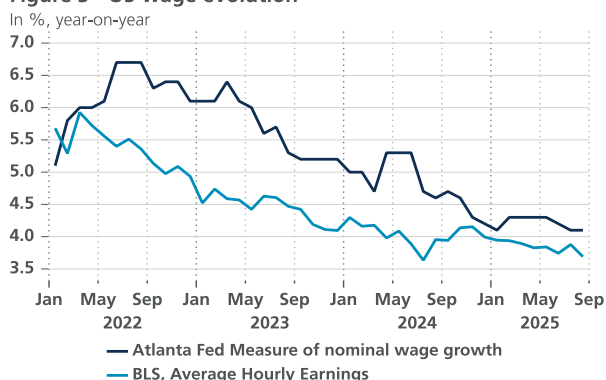
We are thus still waiting for clear signs of a (strong) economic recovery. Against this backdrop, the significant deterioration in sentiment among both businesses and consumers in France is noteworthy. The political malaise risks taking a toll on the country's economy. Meanwhile, German industrial indicators remain disappointing as production continues to trend downward. In energy-intensive sectors, it recently fell to more than 20% below the 2018 average, while the recovery in car production in the first half of 2025 currently appears to be stalling (see figure 4). It is also discouraging that, after the improvement in the first half of the year, German business

expectations for the next six months are once again gloomy, not only in the manufacturing industry, but in virtually all sectors with the exception of construction.

A number of reasons still point to a gradual strengthening of economic growth in the euro area, however. At 6.3% in August, the unemployment rate was only 0.1 percentage points above its historic low. The resilience of the labour market is also visible in the growth in both the number of jobs and hours worked in Q2. Together with additional, limited, real wage increases, this boosts disposable household income and creates potential for consumption growth. The consumption boost could receive additional impetus from a decline in the household savings rate, which is currently still particularly high in most euro area countries. Such a decline could help offset the expected negative impact on disposable household income of the consolidation of public finances in many countries this year. On that matter, recent ECB estimates suggest that fiscal policy in the euro area will be slightly expansionary for the euro area as a whole in 2026, thanks to NextGenerationEU transfers, especially in southern countries, and strong investment impulses from the German budget. Together with the easing of monetary policy since June 2024, budgetary policy is thus accommodating the efforts to tackle structural economic problems. It also offers some counterweight to the headwinds that are likely to continue to blow from the external environment due to geopolitical tensions and trade barriers.

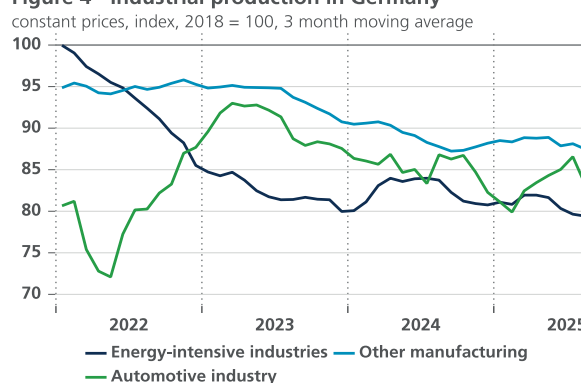
Despite the uncertainty, we therefore maintain our expectation of a gradual strengthening of economic growth in the euro area as from the last quarter of 2025

Figure 3 - US wage evolution



Source: KBC Economics based on Atlanta Fed, BLS

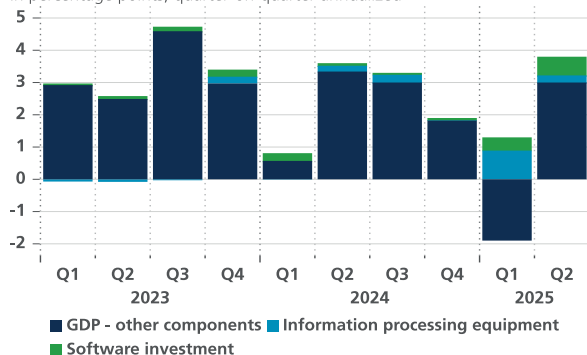
Figure 4 - Industrial production in Germany



Source: KBC Economics based on DESTATIS

Figure 5 - US GDP contributions

In percentage points, quarter-on-quarter annualized



Source: KBC Economics based on BEA

and especially in the course of 2026. The expected average real GDP growth rate in 2026 will nevertheless be lower than in 2025 (0.9% vs. 1.2%). The latter figure mainly reflects the strong growth at the beginning of 2025 and masks the slowdown we have seen since then.

US economy overperforms in Q2 and Q3

The US economy is showing surprising resilience in the face of higher US protectionism. Q2 GDP was revised upwards from 0.75% quarter-on-quarter in the initial release to 0.95% in the latest release. This increase was mostly the result of a big upwards revision of the personal consumptions expenditures (PCE) contributions (from 0.25% to 0.42%). For Q3, consumption is likely to make an even stronger contribution. Real PCE increased by 0.4% month-on-month in July and August.

The strong Q2 and Q3 figures seem to indicate that the protectionist US policies are only having a limited impact on US growth. Yet a closer look at the data suggests that the high growth figures are partially driven by a strong AI boom. Indeed, if we exclude AI-related components (i.e. information processing equipment and software investment) H1 GDP growth would drop from 1.6% to 0.55% in annualised terms (see figure 5).

These elevated AI-related contributions might wane somewhat in the coming quarters. Furthermore, consumption could also weaken in Q4. Indeed, as real PCE growth outpaced real disposable income growth, the savings rate dropped from 5.7% in May to 4.6% in September, a level that seems hard to sustain. Consumer confidence also declined again in September. The

ongoing shutdown and announced layoffs might also temporarily lower consumption by federal employees, though the effect on GDP has historically been quite muted. Consumption aside, there has been significant deterioration in business confidence indicators last month, especially in the services industry.

The most concerning aspect of the economy is the deterioration in the labour market. Though the official employment report has not been published because of the shutdown, the ADP report (a private report) pointed to weakness in the job market. According to this report, private payrolls declined by 32k in September on top of a (downwardly revised) 3k decline in August. Though this labour market weakness hasn't had much effect on GDP growth yet, that could change in the coming quarters. All in all, we slightly upgrade growth this year from 1.8% to 1.9%, while maintaining our 1.5% growth forecast for next year.

China's economy muddles through

The economic outlook for China is little changed compared to last month given a lack of decisive data that move the needle one way or the other. The economy continues to muddle through, with a good chance of GDP growth reaching the government's 5% target for 2025, though risks remain to the downside. In August, momentum in industrial production and retail trade stabilised somewhat at 0.37% month-over-month and 0.17% month-over-month, respectively. However, in year-over-year terms, both series dipped lower in August (5.2% and 3.4%). Other hard data also point to sluggish growth. Credit growth (total social financing) remains overwhelmingly supported by government bond issuance while fixed asset investment, which fell to 0.5% year-to-date year-over-year in August, is kept positive only by state-owned enterprises, together suggesting that the private sector is still cautious and deleveraging.

One brighter signal for the Chinese economy of late has been an improvement in business sentiment, particularly the S&P PMIs for manufacturing and services (51.2 and 52.9, respectively in September, where anything above 50 represents expansion). Meanwhile, external trade holds up well despite the higher tariffs imposed by the US, with total exports growing 8.3% year-over-year in September. Though exports to the US have declined markedly (-27% year-over-year), the decline has been offset by a substantial increase in exports to other regions.

Trade tensions remain an important risk, however, with significant uncertainty surrounding an expected meeting between President Xi and President Trump later this month. China's more stringent export controls recently imposed on rare earth minerals, and a threat by Trump to increase tariffs on Chinese exports to 100%, are, at least in part, strategies to gain leverage for negotiations ahead of the meeting, but they do raise the risk of the US-China trade conflict once again spiraling into an avalanche of tit-for-tat measures.

Chinese leaders will also meet internally to prepare the next five-year plan for China, though details on the country's long-term strategy will likely not be released until March 2026. For now, we maintain our forecast of 5.0% real GDP growth in 2025 and 4.4% growth in 2026. Inflation remains bogged down by deflationary impulses and is expected to average 0.0% in 2025 and 1.0% in 2026.

Fed resumes rate cuts

As expected, the Fed resumed its easing path in September, cutting its policy rate by 25 basis points to 4.125%. That is still a moderately restrictive level. This 'risk management' rate cut was prompted by increasing downside risks to the labour market in light of recently weaker monthly net job creation and the (moderate) rise in the unemployment rate to 4.3% in August. This development takes place against the backdrop of an inflation rate that is still about one percentage point above the 2% target, but probably only temporarily so.

We continue to assume that the Fed has started a cycle of interest rate cuts of 25 basis points each at each of the next four policy meetings. Hence the policy rate will settle at 3.125% in March 2026; a level which the Fed considered neutral in its most recent September 'dot plot'. The fact that policy rates are unlikely to fall below neutral is consistent with our expectation that the US business cycle and labour market will have a very 'soft landing'.

The ECB's deposit rate has already bottomed out

Unlike the Fed, the ECB policy rate is already "in a good place", according to ECB president Lagarde. While underlying core inflation is still slightly above the 2% inflation target at 2.3%, it will continue to converge towards the inflation target in the coming quarters barring additional economic shocks. We therefore expect the deposit rate at 2% to have reached its bottom in this

interest rate cycle and to remain unchanged at that level for quite some time.

Due to the divergence of interest rate policy between the Fed and the ECB, the interest rate differential will move in favour of the euro against the dollar. Consequently, we expect a gradual further appreciation of the euro. Moreover, this expectation is supported in the longer term by our assessment that the dollar is still fundamentally overvalued at its current exchange rate.

Bond yields in an upward trend

Against the backdrop of the soft expected landing of the US economy, we no longer assume that US 10-year yields will see another drop in the short term. Moreover, the expected Fed rate cuts have been fully priced in by the bond markets by now. For US 10-year bond yields, this scenario implies a gradual and moderate rise to around 4.20% by the end of 2025 and to 4.50% by the end of 2026. German 10-year yields will also continue their gradual upward trend, mainly driven by the further decompression of the term premium. By the end of 2025, German 10-year rates are likely to be around 2.75%, rising slightly further to 2.80% during 2026.

France in focus of European bond markets

A notable development in European bond markets has been the rise in France's 10-year government bond spread against Germany. That spread rose to the spread level of Italy and was even briefly above it. This was due to the country's entrenched political impasse resulting in the resignation of the new prime minister Lecornu in early October as he failed to form a new government and pass a 2026 budget through parliament. The underlying cause of this political paralysis is a deadlock in parliament where none of the three major political blocs have a workable majority. That structural problem will not disappear in the near future. Possible new parliamentary elections will not necessarily provide a solution but could rather create additional political uncertainty. Moreover, we are gradually approaching the presidential elections in spring 2027, with a highly uncertain outcome.

As a result of this environment of persistently high political risk, we expect the current French 10-year spread of around 85 basis points to remain at that relatively high level until after the presidential election. An intervention by the ECB via an activation of its Transmission Protection

Instrument (TPI) is not in the cards. Indeed, according to ECB president Lagarde, European bond markets remain sufficiently liquid, function properly and the transmission mechanism of ECB monetary policy is not compromised. In other words, the conditions for a TPI activation have not been met at this stage.

Apart from the specific French situation, we confirm our general view on the evolution of intra-EMU interest rate spreads. This implies a further moderate spread decline due to the expected economic recovery in Europe, the further rise of the German benchmark yield and, as the ultimate safety net, the ECB's TPI. This convergence scenario was recently explicitly confirmed in the upgrade of the Portuguese sovereign credit rating by Fitch (to A) and S&P (to A+), as a result of the favourable business cycle outlook and the policy efforts made with respect to public finances.

Belgium

Upwardly trending sentiment

Sentiment of both consumers and businesses continued to rise in September. Consumer confidence is now well above its long-term average. Looking at the indicator since the start of the year, the remarkable improvement mainly results from consumers' more optimistic unemployment expectations. Likely, many responses in the consumer survey have been affected by the policy decision to limit the unemployment benefit duration. Respondents clearly believe (particularly so in Wallonia) that unemployment will decline as a result of the reform measure (see figure BE1). Producer confidence, which is still below its long-term average, grew in all sectors in September and most markedly in construction. In particular, confidence in construction of residential buildings showed a remarkable upswing that month (see figure BE2). Several other forward-looking indicators also recently point to a slow brightening of housing investment. E.g., the number of building permits issued (a key indicator of upcoming residential projects) seems to be bottoming out.

Given the continuing positive trend in sentiment indicators, we slightly upgraded qoq growth of the Belgian economy in Q3 2025, from 0.0% to 0.1%, and in Q4 2025, from 0.1% to 0.2%. Belgian growth for the whole year is now seen at 1.0% for 2025 and 0.9% in 2026, up from 0.9% and 0.8% respectively. Uncertainty, albeit reduced given the US-EU trade deal, remains elevated in today's volatile international environment. At the national level,

still unknown is what the growth impact of the budget consolidation and structural reforms will be within our forecast horizon (e.g., the share of people impacted by the discontinuation of unemployment benefits that will find a job). As a result, our updated growth outlook for the Belgian economy continues to be relatively cautious and moderate.

Belgian inflation (based on the HICP) came in at 2.7% in September, up from 2.6% in August. The slight increase was caused by core inflation (excluding energy and food), which was up from 2.1% to 2.5%. Both non-energy goods inflation and services inflation drove core inflation higher. Energy inflation and food inflation were down, from 3.4% to 2.1% and from 3.5% to 3.2% respectively. As euro area inflation was slightly up as well, the positive inflation differential between Belgium and the euro area stayed unchanged at 0.6 percentage points. We kept our outlook for annual Belgian HICP inflation unchanged at 3.0% and 1.8% in 2025 and 2026 respectively. In 2027, inflation will likely rebound slightly above the 2% level due to the introduction of the EU's new Emissions Trading System (ETS2) pushing up energy inflation.

Q2 house price data

In early October, Eurostat published harmonised house price figures for the second quarter of 2025. Prices rose by 1.6% qoq in the total EU. The quarterly price rise was the strongest (more than 4%) in Portugal, Luxembourg, Croatia and Spain. Two countries witnessed a slight price decline. Belgium was one of these two (the other being France), with the quarterly price decline limited to 0.1% (see also the KBC Economic Brief of 16 October 2025

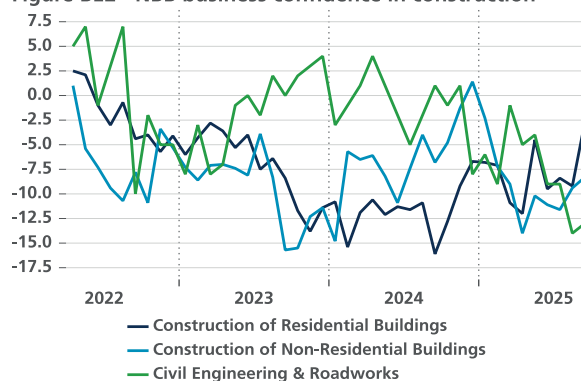
Figure BE1 - Unemployment outlook +12M

NBB consumer confidence indicator, standardised



Source: KBC Economics based on NBB

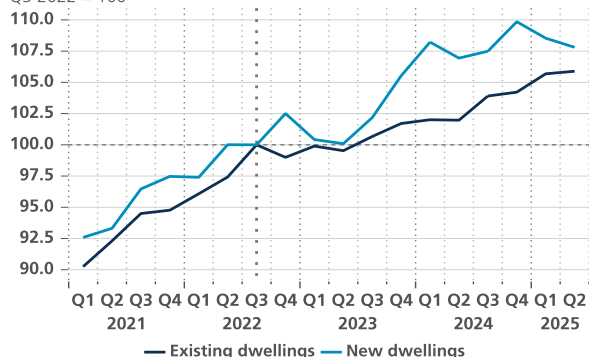
Figure BE2 - NBB business confidence in construction



Source: KBC Economics based on NBB

Figure BE3 - Harmonised house price index Belgium

Q3 2022 = 100



Source: KBC Economics based on Eurostat

[“European housing market continues to steam ahead in second quarter 2025”](#) . The correction only concerned new construction (−0.7%). Prices of existing dwellings continued to rise, this time by just 0.2%. The minuscule decline in prices for dwellings as a whole followed three previous quarters of decent price rises. Typically, quarterly changes in house prices are quite volatile. The second-quarter figure in fact brought some tempering to the robust pace of new construction price rises since spring 2023 (see figure BE3). The Q2 data do not change our view on Belgian real estate substantially. For existing and new dwellings taken together, we now see annual house price growth running at 2.6% in 2025 and 3.1% in 2026, changed from 3.0% in both 2025 and 2026 previously.

Central and Eastern Europe

In recent months, the Central and Eastern European (CEE) region continued to experience intensified policy and political divergence. Czechia achieved significant disinflation but simultaneously pivoted politically towards Euroscepticism following the October election. Slovakia adopted an aggressive, contractionary fiscal consolidation package designed to curb its soaring deficit. Hungary continued to maintain a restrictive monetary stance to counteract structural fiscal drag. In stark institutional contrast, Bulgaria cemented its trajectory toward Euro adoption in January 2026, providing a robust anchor for long-term credibility despite grappling with strong domestic inflationary pressure.

Czech Republic

Disinflation continues in the Czech Republic. CPI inflation eased to 2.3% year-over-year in September, down from 2.5% in August, falling slightly below market forecasts. This easing was mainly attributed to softer price increases in food and goods. However, service price inflation remained sticky at 4.7%. Despite the successful path of inflation toward the 2% target, the Czech National Bank (CNB) maintained its two-week repo rate at 3.50% in September, signalling a patient, stability-oriented approach designed to allow the full transmission of previous tightening to affect persistent inflationary factors, such as dynamic wage growth, inflation in services or rapidly rising housing costs. Our average inflation forecast for Czechia remains at 2.4% for this year and 2.2% for the next.

The defining recent development in the country, however, was the October 3–4 parliamentary election, which resulted in a decisive victory for Andrej Babiš's populist ANO movement (see the Box). This outcome, largely driven by voter dissatisfaction over the cost-of-living crisis, generates policy uncertainty. The leader of the future government coalition, who campaigned on reversing austerity, now holds a mandate for fiscal expansion. If the new administration implements populist spending and tax reduction policies envisaged in ANO's election program, the resulting surge in domestic demand and shifting inflation expectations could quickly erode the hard-won disinflationary gains. The CNB, committed to price stability, would then face pressure to consider tightening rates, creating a direct and potentially costly

conflict between monetary and fiscal policy. For the time being, though, we keep our prediction of the key CNB interest rate stable until the end of 2027, as well as our expected real GDP growth rates for the next two years.

From a geopolitical perspective, in the worst-case scenario, should the populist ANO movement align with the Eurosceptic, nationalist governments of Slovakia and Hungary, the Czech election results could lead to deeper political cooperation of three members of the since long time fading Visegrad 4 bloc. Such concentration of anti-Brussels sentiment would pose an additional threat to EU decision-making processes on critical issues, including migration, budget allocations, and continued support for Ukraine, and it would inevitably increase political risk premiums for the three countries involved.

Hungary

The National Bank of Hungary (MNB) held its base rate steady at 6.50% on September 23, maintaining a tight monetary stance. In fact, the current MNB rate is the highest key interest rate in the EU alongside Romania. The continued rigidity is necessitated by persistently high inflation, which stood at 4.3% year-on-year in August, exceeding the MNB's tolerance band, while household inflation expectations remain elevated. We forecast Hungarian average inflation to reach 4.5% this year and 4.0% in 2026. Confronted with stubborn inflationary pressures, the central bank cannot rush with the relaxation of its monetary policy: we predict its key interest rate will stay at 6.50% by the end of this year, sliding down to 6.00% by the end of Q3 2026 and will not drop below 5.25% by December 2027.

The MNB's restrictive monetary policy stance is primarily required to counteract significant fiscal and regulatory distortions imposed by the government, including price caps, interest caps, margin controls, and windfall taxes. The detrimental combination of loose, distortive fiscal policy and tight monetary conditions complicates a sustainable, investment-led recovery. Furthermore, the persistent conflict with the EU over rule of law continues to block the disbursement of billions in EU RRF and cohesion funds, denying the economy convergence capital that could accelerate medium-term growth.

Slovakia

Slovakia responded to its deteriorating fiscal position

Czechia's New Political Reality

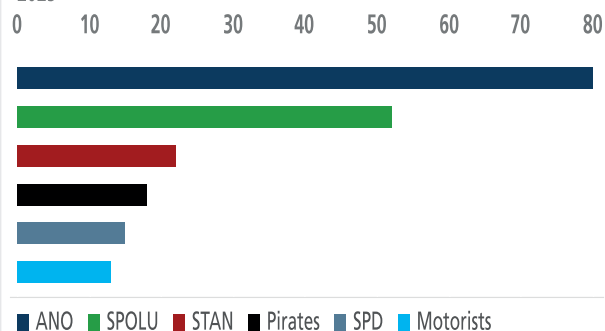
In the 2025 Czech parliamentary elections, the populist ANO party, led by former Prime Minister Andrej Babiš, won with 34.5% of the vote and secured 80 seats in the 200-member Chamber of Deputies (see figure CEE1). The governing Spolu coalition, headed by Prime Minister Petr Fiala, came second with 23.4% and 52 seats. Other parties entering parliament include STAN (11.2%, 22 seats), the Pirates (9.0%, 18 seats), SPD (7.8%, 15 seats), and the Motorists (6.8%, 13 seats). The far-left Stačilo coalition failed to cross the 5% threshold and did not enter parliament. Since ANO did not secure a majority on its own, it is exploring a coalition with SPD and the Motorists, which would give them 108 seats. SPD's Eurosceptic and NATO-critical stance may complicate talks. President Petr Pavel has stated he will not appoint ministers who threaten Czechia's NATO membership or national security.

While the Czech koruna strengthened ahead of the elections, supported by the central bank's conservative monetary stance, Czech government bonds came under pressure. Investors feared a shift toward looser fiscal policy, and the ten-year bond yield rose above 4.5% for the first time since autumn 2023 (see figure CEE2). ANO's programme includes costly social measures such as reinstating child benefits, increasing parental allowances and reversing pension reforms. Although it promises balanced budgets, it relies on more efficient tax collection and economic growth rather than tax hikes. Given the relatively small size of the grey economy, expected revenue gains are likely to be modest.

Looser fiscal policy may support short-term growth but also fuel inflation. The Czech National Bank may respond depending on the scale of budget expansion. A higher tolerance for debt financing poses an upside risk to inflation and supports the case for maintaining elevated interest rates. ANO has also signalled the need to revise the 2026 budget. Until approved by parliament, there is a risk of operating under a provisional budget regime, which would limit monthly spending to one-twelfth of the previous year's budget.

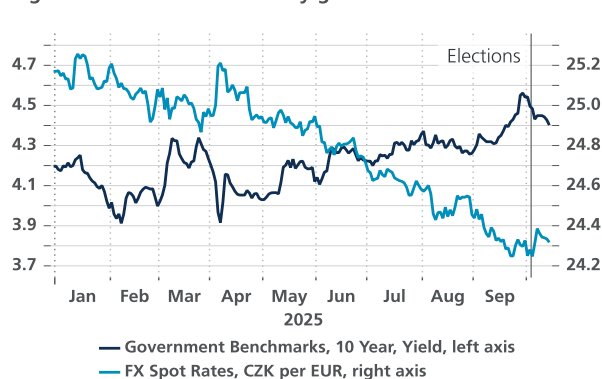
The new government is unlikely to take steps toward euro adoption. While 2034 is the earliest theoretical date, low public support suggests it may be later. Financial markets have responded calmly to the election outcome. The result was broadly anticipated, and the Czech Republic remains firmly anchored in EU and NATO structures. Despite expansive promises, Czech politics have a history of post-election pragmatism. ANO's likely partner, the Motorists, who especially oppose the Green Deal but also favour fiscal conservatism and a balanced budget by 2029, may help temper some of the more ambitious spending plans. The fact that Stačilo failed to enter parliament removes the most expansionary fiscal program from the negotiating table, which may further reassure investors.

Figure CEE1 - Czech Republic Parliamentary Elections: seats 2025



Source: KBC Economics based on Czech Statistical Office

Figure CEE2 - EURCZK and 10y government bond rate



Source: KBC Economics based on Macrobond

(with public debt projected to hit a record 62% of GDP) by accelerating fiscal adjustment. On September 24, 2025, the National Council approved the Third Package of Fiscal Consolidation. The law, which awaits the president's signature, aims to raise €2.7 billion in 2026 to reduce the public deficit to 4% of GDP. The measures are heavily revenue-focused and include severe tax increases set to take effect from January 2026. Key elements comprise raising the progressive Personal Income Tax (PIT) with a new top bracket of 30–35% for high earners, introducing a minimum corporate income tax of €11,520 for large companies, and increasing the Value Added Tax (VAT) from 19% to 23% on selected goods (such as high-sugar/salt products).

In our view, the government's plan of rapidly balancing revenues with expenditures is overambitious. We expect this year's government budget deficit to close marginally below last year's 5.3% of GDP and to slide down to 5.0% in 2026 before rising again to 5.2% the year after.

Moreover, the aggressive, front-loaded consolidation package carries a risk of producing a stagflationary shock. The simultaneous increase in taxes and VAT will sharply reduce household disposable income, suppressing consumption and domestic demand. This tightening coincides with already weak economic sentiment, which declined to 95.6 in September, reflecting worsening conditions, particularly in the industrial sector. Additionally, the imposition of tax increases, particularly the VAT hike, acts as a cost-push factor, leading us to see both this year's and the 2026 average HICP inflation at 4.2%. The policy thus risks combining growth suppression (we forecast annual real GDP growth of only 0.6% in 2025 and 0.8% in 2026) with tax-driven secondary inflation.

Bulgaria

Bulgaria's macroeconomic data indicate the economy is operating robustly, with 2025Q2 GDP growth (+3.4% year-on-year) driven primarily by strong domestic consumption and investment. We expect the country's annual real growth rate to remain at an elevated 2.7% next year, also owing to the benefits of euro adoption on January 1, 2026.

The primary immediate challenge for Bulgarian policy makers remains inflation. The HICP inflation, accelerating since April 2025, reached 3.5% year-on-year in August. The persistent inflationary pressures are mainly attributed to domestic cost factors, driven by a tight labour market

and strong wage dynamics (total hourly labour cost rose 13.2% year-on-year in Q2 2025) which are outpacing productivity gains. While Bulgaria narrowly achieved the inflation convergence criterion in April (12-month average HICP at 2.7%, below the 2.8% reference value), maintaining price stability in the face of domestic overheating is essential to limit inflationary spikes immediately following adoption. According to our forecast, annual headline HICP inflation should be close to 3.5% both this and next year and drop by nearly one percentage point to 2.6% in 2027.

Summing up, the macroeconomic and political news recently arriving from Czechia, Hungary, Slovakia, and Bulgaria reconfirm significant policy and risk heterogeneity ruling within the CEE landscape.

In Czechia, disinflation success is jeopardized by prospective fiscal expansion, potentially leading to a renewed cycle of monetary tightening in 2026. In Slovakia, aggressive fiscal contraction creates a significant risk of demand suppression and stagflationary pressures next year. In Hungary, policy gridlock persists, with tight monetary policy offsetting distortive fiscal measures, hindering sustainable growth acceleration. In Bulgaria, institutional gains from euro adoption anchor long-term stability, provided the government successfully manages high domestic demand and wage-driven inflation pressures. While the utilisation of RRF funds is expected to provide a boost across the CEE region in the coming years, policy effectiveness and economic performance will be defined by the complex trade-offs between fiscal consolidation (Slovakia), political populism (Czechia and Hungary), and institutional commitment (Bulgaria).

Figures

Real GDP

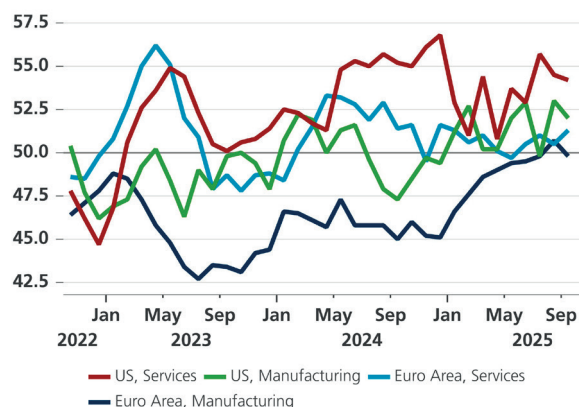
yearly change in %



Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators

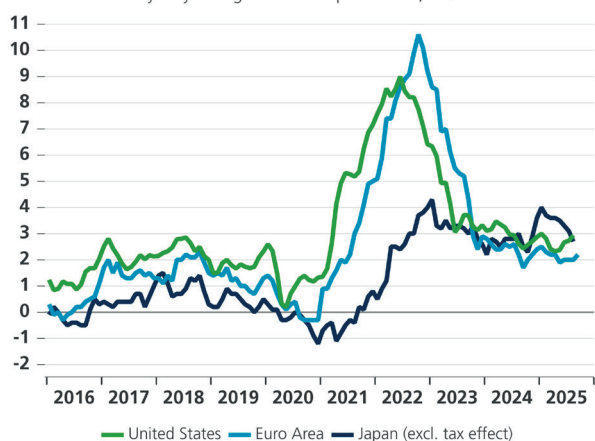
index, above 50 = expansion



Source: KBC Economics based on S&P Global

Headline inflation

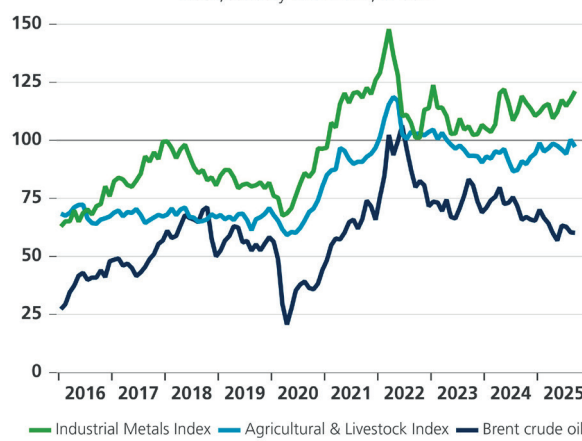
yearly change consumer price index, in %



Source: KBC Economics based on Eurostat, SBJ, BLS

Commodity prices

index, January 2013=100, in USD



Source: KBC Economics based on World Bank, S&P Global

United States interest rates

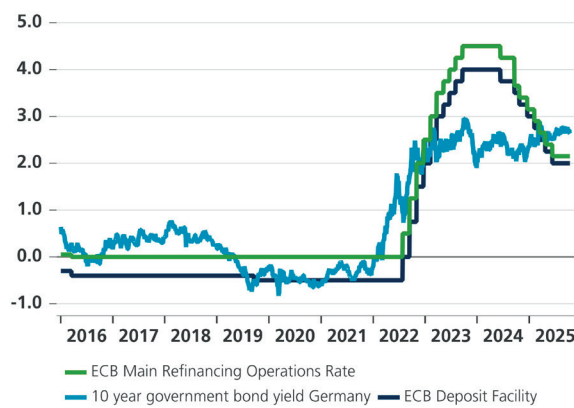
in %



Source: KBC Economics based on Fed, U.S. Treasury

Euro area interest rates

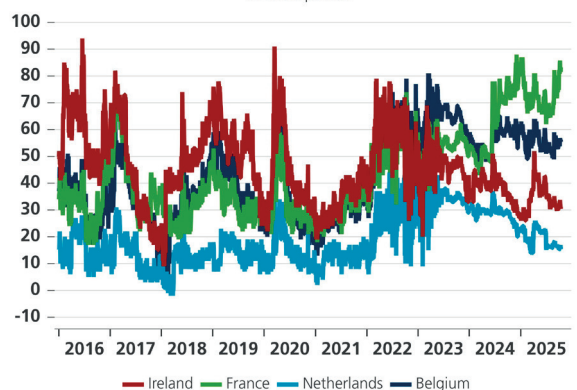
in %



Source: KBC Economics based on Macrobond, ECB

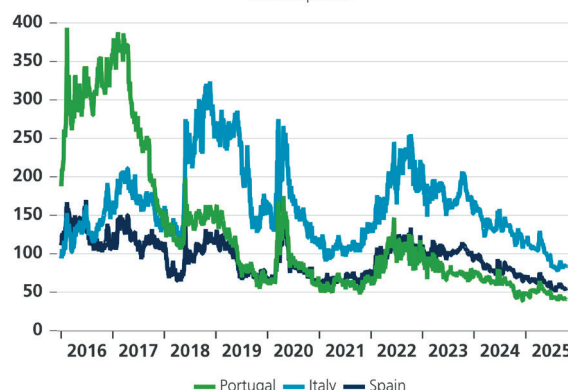
Figures

10 year government bond yield spreads to Germany
in basis points



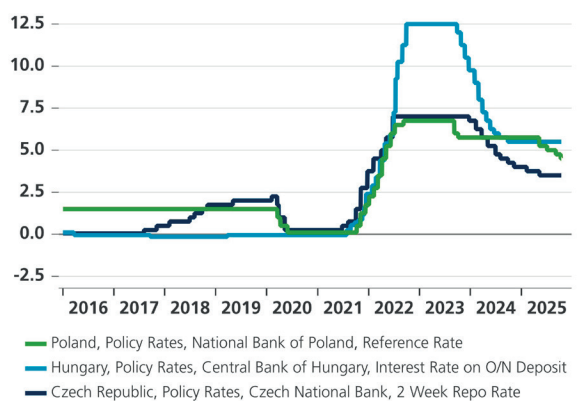
Source: KBC Economics based on Macrobond

10 year government bond yield spreads to Germany
in basis points



Source: KBC Economics based on Macrobond

Monetary policy rates Central Europe
in %



Source: KBC Economics based on CNB, MNB, NBP

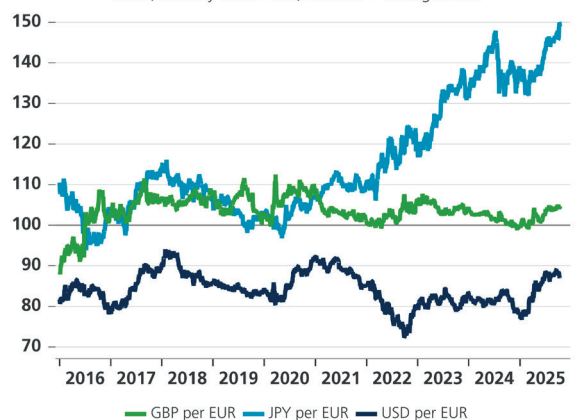
10 year government bond yield spreads to Germany
in basis points



Source: KBC Economics based on Macrobond, AKK, Eurostat

Exchange rates

index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Exchange rates

index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Outlook main economies in the world

		Real GDP growth (period average, based on quarterly figures, in %)			Inflation (period average, in %)		
		2024	2025	2026	2024	2025	2026
Euro area	Euro area	0.8	1.2	0.9	2.4	2.1	1.8
	Germany	-0.5	0.2	0.8	2.5	2.3	1.7
	France	1.1	0.6	0.9	2.3	1.1	1.6
	Italy	0.5	0.4	0.4	1.2	1.5	1.4
	Spain	3.5	2.7	2.0	2.9	2.5	1.9
	Netherlands	1.1	1.4	0.8	3.2	3.1	2.8
	Belgium	1.0	1.0	0.9	4.3	3.0	1.8
	Ireland	2.6	10.1	3.8	1.4	1.8	1.4
	Slovakia	2.1	0.6	0.8	3.2	4.2	4.2
Central and Eastern Europe	Czech Republic	1.1	2.2	1.9	2.7	2.4	2.2
	Hungary	0.6	0.5	2.4	3.7	4.5	4.0
	Bulgaria	2.7	2.9	2.7	2.6	3.5	3.4
	Poland	2.9	3.2	3.0	3.6	3.6	3.0
	Romania	0.9	1.0	1.7	5.8	7.0	6.3
Rest of Europe	United Kingdom	1.1	1.2	1.0	2.3	3.4	2.6
	Sweden	0.8	1.1	2.1	2.0	0.7	1.1
	Norway (mainland)	0.6	1.8	1.6	2.9	2.8	2.3
	Switzerland	1.4	1.2	1.3	0.9	0.2	0.6
Emerging markets	China	5.0	5.0	4.4	0.2	0.0	1.0
	India*	6.5	6.7	6.0	4.6	2.5	4.6
	South Africa	0.5	1.1	1.3	4.4	3.3	3.9
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	3.3	3.2	3.3	58.5	34.1	23.1
	Brazil	3.4	2.2	1.6	4.4	5.1	4.4
Other advanced economies	United States	2.8	1.9	1.5	3.0	2.8	2.6
	Japan	0.1	1.1	0.6	2.7	3.1	1.9
	Australia	1.0	1.7	2.2	3.2	2.6	2.7
	New Zealand	-0.4	0.3	2.3	2.9	2.7	2.1
	Canada	1.6	1.2	1.1	2.3	2.1	2.1
* fiscal year from April-March						13/10/2025	

Policy rates (end of period, in %)		13/10/2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026
Euro area	Euro area (refi rate)	2.15	2.15	2.15	2.15	2.15
	Euro area (depo rate)	2.00	2.00	2.00	2.00	2.00
Central and Eastern Europe	Czech Republic	3.50	3.50	3.50	3.50	3.50
	Hungary	6.50	6.50	6.25	6.25	6.00
	Bulgaria	-				
	Poland	4.50	4.50	4.00	4.00	4.00
	Romania	6.50	6.50	6.50	6.50	6.50
Rest of Europe	United Kingdom	4.00	4.00	3.75	3.50	3.50
	Sweden	1.75	1.75	1.75	1.75	1.75
	Norway	4.00	4.00	4.00	4.00	4.00
	Switzerland	0.00	0.00	0.00	0.00	0.00
Emerging markets	China (7-day r. repo)	1.40	1.30	1.20	1.10	1.10
	India	5.50	5.50	5.50	5.50	5.50
	South Africa	7.00	7.00	7.00	6.75	6.50
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	43.00	36.00	32.00	27.00	24.50
	Brazil	15.00	15.00	14.75	14.25	13.75
Other advanced economies	United States (mid-target range)	4.125	3.625	3.125	3.125	3.125
	Japan	0.50	0.75	0.75	0.75	0.75
	Australia	3.60	3.60	3.35	3.10	3.10
	New Zealand	2.50	2.25	2.25	2.25	2.25
	Canada	2.50	2.50	2.25	2.25	2.25

10 year government bond yields (end of period, in %)		13/10/2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026
Euro area	Germany	2.63	2.75	2.76	2.77	2.78
	France	3.47	3.60	3.61	3.62	3.63
	Italy	3.47	3.60	3.60	3.60	3.60
	Spain	3.18	3.30	3.31	3.32	3.32
	Netherlands	2.79	2.95	2.96	2.97	2.98
	Belgium	3.21	3.30	3.30	3.31	3.32
	Ireland	2.88	3.00	3.01	3.02	3.03
	Slovakia	3.43	3.55	3.56	3.57	3.58
Central and Eastern Europe	Czech Republic	4.37	4.40	4.30	4.30	4.30
	Hungary	6.85	6.85	6.80	6.60	6.50
	Bulgaria (EUR)*	3.41	3.45	3.45	3.45	3.45
	Poland	5.41	5.20	4.90	4.80	4.80
	Romania	7.35	7.50	7.50	7.50	7.50
Rest of Europe	United Kingdom	4.65	4.75	4.76	4.77	4.78
	Sweden	2.61	2.70	2.70	2.70	2.75
	Norway	4.07	4.20	4.20	4.20	4.25
	Switzerland	0.18	0.30	0.30	0.30	0.30
Emerging markets	China	1.77	1.81	1.81	1.86	1.96
	India	6.52	6.66	6.66	6.71	6.81
	South Africa	9.10	9.24	9.24	9.29	9.39
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	29.16	28.75	28.00	26.00	24.00
	Brazil	14.05	14.19	14.19	14.24	14.34
Other advanced economies	United States	4.06	4.20	4.20	4.25	4.35
	Japan	1.69	1.70	1.75	1.85	1.85
	Australia	4.29	4.45	4.45	4.50	4.60
	New Zealand	4.12	4.25	4.25	4.30	4.40
	Canada	3.17	3.30	3.30	3.35	3.45

*Caution: very illiquid market

Exchange rates (end of period)		13/10/2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026
USD per EUR		1.16	1.19	1.20	1.21	1.21
CZK per EUR		24.34	24.30	24.30	24.20	24.10
HUF per EUR		392.38	390.00	392.00	395.00	399.00
PLN per EUR		4.26	4.27	4.25	4.23	4.23
BGN per EUR		1.96	1.96	1.96	1.96	1.96
RON per EUR		5.09	5.09	5.10	5.11	5.12
GBP per EUR		0.87	0.88	0.89	0.90	0.90
SEK per EUR		11.01	10.95	10.90	10.85	10.85
NOK per EUR		11.68	11.60	11.55	11.50	11.50
CHF per EUR		0.93	0.93	0.93	5.00	0.93
BRL per USD		5.48	5.40	5.38	5.35	5.35
INR per USD		88.68	87.45	87.09	86.73	86.73
ZAR per USD		17.36	17.12	17.05	16.98	16.98
RUB per USD		Temporarily no forecast due to extreme uncertainty				
TRY per USD		41.80	43.54	45.75	47.74	49.75
RMB per USD		7.13	7.12	7.12	7.12	7.12
JPY per USD		152.08	147.00	145.00	142.00	140.00
USD per AUD		0.65	0.66	0.67	0.68	0.69
USD per NZD		0.57	0.57	0.57	0.58	0.60
CAD per USD		1.40	1.40	1.38	1.36	1.34

Outlook KBC markets – Central and Eastern Europe

	Czech Republic				Slovakia		
	2024	2025	2026		2024	2025	2026
Real GDP (average yearly change, based on quarterly figures, in %)	1.1	2.2	1.9		2.1	0.6	0.8
Inflation (average yearly change, harmonised CPI, in %)	2.7	2.4	2.2		3.2	4.2	4.2
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	2.8	3.2	3.1		5.3	5.4	5.7
Government budget balance (in % of GDP)	-2.2	-2.3	-2.1		-5.3	-5.2	-5.0
Gross public debt (in % of GDP)	43.3	44.0	44.8		59.3	61.5	63.5
Current account balance (in % of GDP)	1.7	0.9	0.7		-4.5	-4.0	-4.0
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	5.0	10.0	6.4		3.8	10.4	5.0

	Hungary				Bulgaria		
	2024	2025	2026		2024	2025	2026
Real GDP (average yearly change, based on quarterly figures, in %)	0.6	0.5	2.4		2.7	2.9	2.7
Inflation (average yearly change, harmonised CPI, in %)	3.7	4.5	4.0		2.6	3.5	3.4
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	4.4	4.4	4.0		3.8	3.8	3.7
Government budget balance (in % of GDP)	-4.9	-4.9	-4.8		-3.0	-3.0	-2.9
Gross public debt (in % of GDP)	73.5	73.5	73.6		24.1	26.8	29.0
Current account balance (in % of GDP)	1.7	1.3	1.0		-1.5	-3.3	-3.1
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	13.7	13.0	7.5		16.5	14.7	8.5

Outlook KBC markets - Belgium

National accounts (real yearly change, in %)	2024	2025	2026
Private consumption	2.0	2.5	1.3
Public consumption	2.6	1.4	0.9
Investment in fixed capital	1.4	0.6	2.8
Corporate investment	1.8	2.4	2.8
Public investment	9.8	1.6	5.1
Residential building investment	-4.8	-6.4	1.3
Final domestic demand (excl. changes in inventories)	2.0	1.8	1.6
Change in inventories (contribution to growth)	-0.9	-0.3	-0.0
Exports of goods and services	-3.4	-2.9	-1.6
Imports of goods and services	-3.5	-2.4	-0.7
Gross domestic product (GDP), based on quarterly figures	1.0	1.0	0.9
Household disposable income	1.8	1.3	1.2
Household savings rate (% of disposable income)	13.0	12.1	11.9

Equilibrium indicators	2024	2025	2026
Inflation (average yearly change, in %)			
Consumer prices (harmonised CPI)	4.3	3.0	1.8
Health index (national CPI)	3.3	2.6	1.7
Labour market			
Domestic employment (yearly change, in '000, year end)	17.2	32.6	30.0
Unemployment rate (in % of labour force, end of year, Eurostat definition)	6.0	5.7	5.6
Public finances (in % of GDP, on unchanged policy)			
Overall balance	-4.5	-5.8	-5.8
Public debt	104.7	108.3	111.6
Current account balance (in % of GDP)	-0.4	-1.1	-1.3
House prices (average yearly change in %, existing and new dwellings, Eurostat definition)	3.2	2.6	3.1

Contact

KBC Group Economics and Markets (GEM)

Economic Research (KBC)	Market Research (KBC)	CSOB - Prague	CSOB Slovakia	UBB Bulgaria
Hans Dewachter	Mathias Van der Jeugt	Martin Kupka	Marek Gábriš	Emil Kalchev
Group Chief Economist	Head of Market Research	Chief Economist	Analyst	Chief Economist
chiefeconomist@kbc.be	mathias.vanderjeugt@kbc.be	mkupka@csob.cz	mgabris@csob.sk	Emil.Kalchev@ubb.bg
Dieter Guffens	Peter Wuyts	Jan Cermák		
Senior Economist	FX Analyst	Senior Analyst		
dieter.guffens@kbc.be	peter.wuyts@kbc.be	jcermak@csob.cz		
			K&H Bank Hungary	
Johan Van Gompel	Mathias Janssens	Jan Bureš	Dávid Németh	
Senior Economist	Analyst	Senior Analyst	Chief Economist	
johan.vangompel@kbc.be	mathias.janssens@kbc.be	jabures@csob.cz	david2.nemeth@kh.hu	
Lieven Noppe		Petr Báca		
Senior Economist		Senior Analyst		
lieven.noppe@kbc.be		pbaca@csob.cz		
			CBC Banque	
Cora Vandamme		Irena Procházková	Bernard Keppenne	
Senior Economist		Analyst	Chief Economist CBC	
cora.vandamme@kbc.be		iprochazkova@csob.cz	bernard.keppenne@cbc.be	
Allison Mandra		Wouter Beeckman		
Senior Economist		Senior Economist		
allison.mandra@kbc.be		wbeeckman@csob.cz		
Laurent Convent		Dominik Rusinko		
Economist		Senior Economist		
laurent.convent@kbc.be		drusinko@csob.cz		
Sam Devinck				
Economist				
sam.devinck@kbc.be				

For general information:

KBC.Economic.Research@kbc.be

Visit our website www.kbceconomics.com to find more analyses and projections of the KBC economists.



Contact: Hans Dewachter, Chief Economist KBC Group NV, Havenlaan 2, B-1080 Brussels, Belgium
 Responsible editor: KBC Groep NV, Havenlaan 2 – 1080 Brussel – België – BTW BE 0403.227.515 – RPR Brussel
 E-mail: kbc.economic.research@kbc.be

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