

## Highlights

- The war in Iran is driving up global commodity prices. As of Monday 18 May, oil and natural gas prices reached 110 USD per barrel and 50 EUR per MWh respectively. Our base case still assumes a near-term resolution to the conflict, in line with futures markets. However, the conflict is lasting longer than we initially anticipated. Furthermore, a longer lasting conflict could cause increasing strains in energy markets, resulting in much higher commodity prices than in our base case scenario. This is currently the most important risk to our scenario.
- Euro area inflation accelerated again last month, increasing from 2.6% to 3.0%. The inflation increase was again caused by another jump in energy prices. Food inflation remained unchanged. In contrast, core inflation decreased from 2.3% to 2.2%. This decrease was the result of another drop in services inflation. Core goods inflation increased again. Rapidly rising import prices and producer prices point to further inflation ahead. We upgrade both our 2026 and 2027 forecasts by 0.1 percentage point to 2.8% and 2.0% respectively.
- US inflation increased from 3.3% to 3.8%. Another big jump in energy prices was the prime culprit. Food prices also rose sharply. Core inflation accelerated as well (from 2.6% to 2.7%), driven by a big (one-off) increase in shelter prices. Core goods prices were unchanged and there was a modest increase in core services prices (ex. shelter). Given the increased shelter prices and high energy prices, we upgrade both our 2026 and 2027 forecasts by 0.3 percentage points to 3.6% and 2.7% respectively.
- Euro area GDP grew by 0.1% last quarter (0.2% excluding Ireland). There was wide disparity among member states. Spain continued to perform very well and the German and Italian economy also grew strongly. Meanwhile, the French economy stagnated. Confidence indicators point to further weakness ahead as the energy crisis is set to weigh on growth (especially in services and construction). We maintain our growth forecast of 0.7% for this year, while slightly downgrading our 2027 forecast to 1.2%.
- US GDP grew by 0.5% last quarter. Non-residential investment made the strongest contribution, thanks to solid contribution of software and information processing equipment. Government spending, inventories and consumption also made positive contributions, while net exports and residential investment made negative contributions. The labour market is resilient, however, as 115k jobs were added in April. We maintain our growth forecast of 2.0% for 2026 and 1.9% for 2027.
- The outlook for the Chinese economy remains largely unchanged compared to last month with

annual GDP growth expected at 4.7% in 2026 and 4.1% in 2027. Recent business sentiment data support the view that the economy is somewhat insulated from the Middle East conflict in the short term. However, risks remain to the downside, and a longer closure of the Strait of Hormuz could lead to more acute supply disruptions that weigh on China's manufacturing sector going forward.

- As expected, both the Fed and the ECB kept rates unchanged in April. We still expect both central banks to largely look through the current energy shock. We expect the ECB to keep rates unchanged in 2026 and 2027. This forecast is largely contingent on the assumption that a reopening of the Strait of Hormuz would be agreed to in the near term. We also expect the Fed to keep rates unchanged this year. We expect the Fed to cut rates twice in 2027, bringing the Fed funds rate to a neutral level.

## Global Economy

### Iran war pushes up global commodity prices

The war in Iran continues to cause enormous volatility in energy markets. Though a ceasefire is in place and remains largely intact, passage through the Strait of Hormuz remains minimal. Both Iran and US have both made proposals for a temporary peace deal, but no agreement has been made at the time of writing. We still expect Iran and the US to reach an agreement to reopen the Strait of Hormuz in the near term. A gradual normalisation of flows is also priced in by futures markets, with oil prices expected to drop from 110 USD per barrel (as of Monday 18 May) to 93 USD by end-2026 and 80 USD by end-2027. Our base case still assumes that an agreement will be found in the near term. However, uncertainty around the conflict's duration is high and a longer-lasting conflict with more permanent scarring effects on energy markets is a major risk to our scenario.

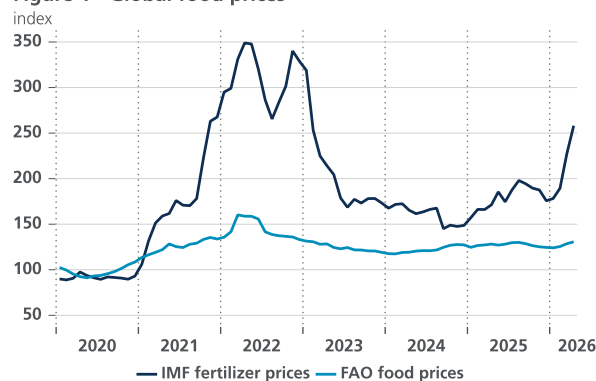
The war has already lasted longer than we initially anticipated and strains are starting to show in energy markets. The International Energy Agency (IEA) reports that global supply declined by 12.8 million barrels per day because of the war. Output from affected Gulf countries is 14.4 million barrels per day lower than before the war. Other countries such as the United States, Venezuela and Kazakhstan provided some compensation. Demand is also affected. The IEA (whose base scenario is similar to ours) forecasts to contract by 420k barrels per day year-on-year in 2026. This is 1.3 million barrels per day lower than its pre-war forecast. Lower LPG, naphta and jet fuel consumption account for most of the decline. Inventory build-offs are for now closing the gap between supply and demand. Global observed oil inventories declined

by more than 240 million barrels in March and April combined. If the war were to drag on, inventories will run low and increased demand destruction will be needed to balance supply and demand (likely through higher prices).

Gas prices are also under pressure due to the conflict and the cut-off of LNG supplies from Qatar. As of Monday 18 May, gas prices reached 50 EUR per MWh, increasing 77% year-to-date. As prices are elevated, European governments are filling up reserves at a slower pace than usual. Filled at 36.7%, EU gas reserves are filled well below historical averages.

Food prices are also pushed upward by the war. Food prices increased by 2.1% last month and are now up by 5% year-to-date. The conflict in the Middle East plays a big role here. According to the IMF, global fertilizer prices are up 47% year-to-date (see figure 1). Cereal prices increased 0.8% last month partly as a result of higher energy and fertilizer prices driving up costs. Vegetable oil prices also rose sharply again, driven by increased

Figure 1 - Global food prices



Source: KBC Economics based on IMF, FAO

biofuel demand. Meat prices also rose due to high global demand. In contrast, sugar and dairy prices declined last month, thanks to ample supply.

### Inflation in the euro area rises

According to Eurostat’s preliminary estimate, inflation in the euro area rose by 0.4 percentage points to 3.0% in April. This was mainly due to energy price inflation more than doubling from 5.1% in March to 10.8% in April. This figure was even higher than expected. Food price inflation remained unchanged at 2.4%, whilst core inflation fell from 2.3% in March to 2.2% in April. The latter was due to a further cooling of services inflation to 3.0%, the lowest level since March 2022. By contrast, the rate of price increases for non-energy goods accelerated from 0.5% to 0.8%, the highest level since April 2024.

The sharp rise in energy price inflation is the unequivocal and (more pronounced than) expected direct consequence of the sharp increase in energy prices on the international market. The assessment of the dynamics of core inflation is, for the time being, less clear-cut, but nonetheless important with a view to identifying the indirect effects of the rise in energy prices. The acceleration is strongest for non-energy goods, as is also evident from the percentage comparison of the three-month moving average of the index with that of three months earlier (see figure 2). However, the acceleration had already begun in February, when there was no sign yet of the surge in energy prices. A fresh surge in April, on the other hand, could well be the result of indirect energy price effects. More information in the near future will clarify whether this is noise or a signal of fundamentally rising core inflation. The sharp rise in expected selling

prices in business surveys suggests that the latter may be the case.

For the time being, we have not made any further adjustments to our outlook for the future monthly trend in inflation. After all, we had already factored in a limited increase in indirect price effects. The slight increase (compared with last month’s forecast) in the expected average inflation for 2026 (2.8% instead of 2.7%) and 2027 (2.0% instead of 1.9%) is solely due to the higher-than-expected inflation figure for April. The outlook continues to assume that the indirect effects of the energy price surge will remain limited overall, that second-round effects via wage adjustments will be virtually non-existent, and that energy price inflation will exert a clear downward effect on inflation in 2027. However, higher inflation over a longer period remains the main risk, particularly if the blockade of the Strait of Hormuz were to last longer than expected.

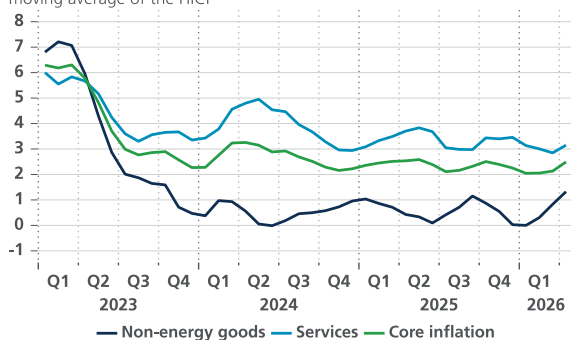
### US inflation rises again

US inflation made another major jump in April, from 3.3% to 3.8%. The prime culprit was again the energy component. Energy prices rose by 3.8% month-on-month due to large increases in gasoline, fuel oil and electricity prices. Food prices also made an important jump of 0.5% month-on-month. This increase was mainly in the food-at-home component.

The high inflation was not only driven by non-core components, however. Core inflation also accelerated from 2.6% to 2.7%. On a monthly basis, core inflation rose by 0.4%. The prime driver of core inflation was shelter, whose prices rose by 0.6% last month. This is likely a one-off, as the price increase was mostly caused by a technicality. Looking ahead, we expect continued softness in this important category, as suggested by market rent prices (see figure 3).

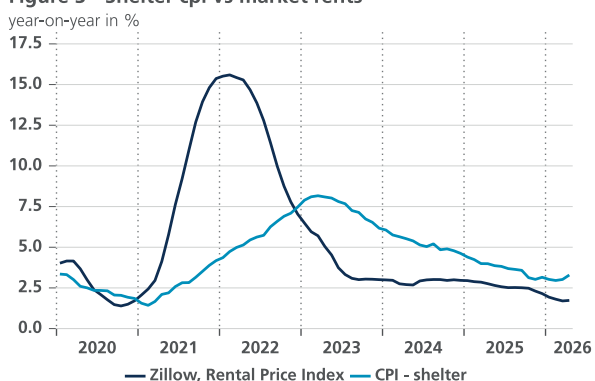
In contrast to shelter, other categories were softer. Core goods prices were unchanged. Categories such as household furnishings, vehicles and medicinal drugs saw prices decline. In contrast, apparel prices continued to increase rapidly as did information technology commodities. Services (ex. shelter) increased by 0.3% month-on-month. Part of this increase was driven by another big increase in airline fares. Many other services components saw modest price increases. This is likely a result of weakening wage pressures, which in combination with high productivity increases keep unit labour costs in

**Figure 2 - Core inflation in the euro area**  
annualised percentage change over previous 3 months of the 3 months moving average of the HICP



Source: KBC Economics based on ECB

**Figure 3 - Shelter cpi vs market rents**



Source: KBC Economics based on Zillow, BLS

check. Unit labour cost increased by only 1.2% year-on-year in Q1.

Given elevated energy prices and the upside surprise in shelter inflation, we upgrade both our 2026 and 2027 forecasts by 0.3 percentage points to 3.6% and 2.7% respectively.

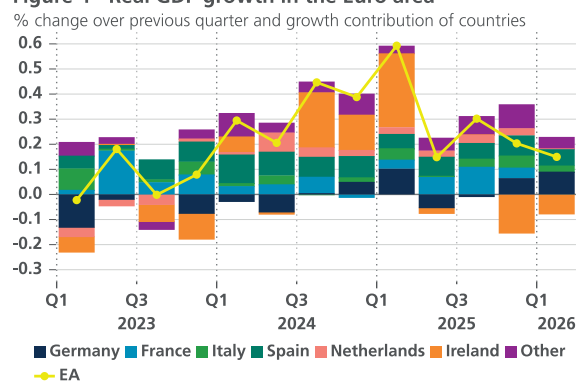
### Euro area growth remains resilient

According to Eurostat's flash estimate, real GDP growth in the euro area stood at 0.1% quarter-on-quarter. This figure was in line with our expectations, although it was largely driven by the new sharp contraction in the Irish economy (by 2%), which more than offset the stronger-than-expected growth in several core countries. Growth in the German, Italian and Spanish economies was indeed significantly higher than expected, at 0.3%, 0.2% and 0.6% respectively. France and the Netherlands, on the other hand, disappointed with (almost) zero growth.

In France, all components of final demand fell short. The exceptionally sharp decline in exports was linked to delays in aircraft deliveries, which were accompanied by a substantial build-up of inventories. In the Netherlands, too, exports of goods and services fell quite sharply (by 0.6%) and private consumption remained broadly flat. Gross fixed capital formation and government consumption showed a slightly more dynamic trend.

Despite the slight slowdown in growth, Spain remains the growth champion among the larger euro area countries, with private consumption and investment in fixed assets driving growth. For the second quarter in a row – and in contrast to a long series of previous

**Figure 4 - Real GDP growth in the Euro area**



Source: KBC Economics based on Eurostat

quarters – the German economy is playing its part (see figure 4). Figures on the components of expenditure are not yet available, but according to comments by Destatis, the German statistical office, both private consumption and government consumption were higher than in the previous quarter, as were exports. In Italy, the better-than-expected growth is mainly attributable to net exports, according to comments by Istat, the Italian statistical office.

Meanwhile, the war in the Middle East is eroding confidence among both consumers and businesses. Particularly striking is the sharp decline in consumer confidence, which had not yet returned to its long-term average since the previous energy crisis. It is now at a level comparable to the lows seen during various previous crises (see figure 5). As regards business confidence, it is notable that the deterioration is currently more pronounced in the domestically oriented service sectors and construction than in the internationally oriented

**Figure 5 - Consumer confidence in the euro area**



Source: KBC Economics based on DG ECFIN

manufacturing industry. Nevertheless, some concern regarding supply is also becoming apparent in industry.

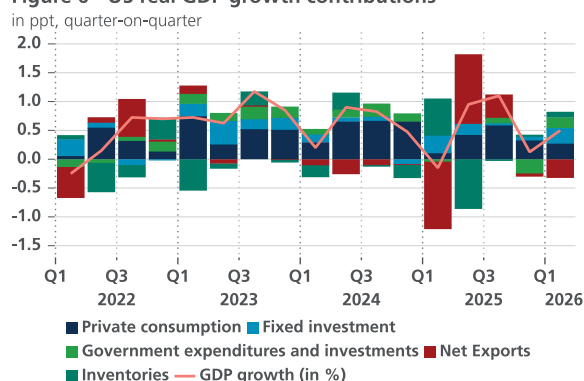
The employment outlook is deteriorating across all sectors, with the exception of construction, where it is stabilising at a relatively high level. This deterioration warrants close monitoring in order to assess the economy's resilience. For the time being, there are no major causes for concern. After all, the unemployment rate fell again in March to its historic low of 6.2%, whilst the labour hoarding indicator – the extent to which businesses whose sales prospects are deteriorating intend to at least maintain their workforce and thus 'hoard' labour – is rising once more. Apparently, the perceived tightness of the labour market for suitable staff continues to deter businesses from resorting to redundancies too quickly. This is a key factor in maintaining confidence that the economy will remain resilient enough to absorb this shock as well.

As the effective, sustainable reopening of the Strait of Hormuz – which is crucial to maintaining economic growth – is taking slightly longer than was anticipated at the start of the war in late February, we have revised our growth forecast for the third quarter downwards slightly. (In March, we had lowered our forecasts for the second quarter and, to a lesser extent, for the third quarter as well.) The expected average real GDP growth for 2026 remains at 0.7% (without the downward revision to the third-quarter growth forecast, this would have been 0.8%), whilst that for 2027 has been lowered from 1.3% to 1.2%. Should the normalisation of shipping in the Strait of Hormuz drag on into or, a fortiori, beyond the summer months, growth would likely turn out even lower. The latter risk also applies should US President Trump reignite the trade war in July – something he appeared to be announcing in recent statements, but which we do not yet factor into our current base scenario. The provisional agreement on the ratification of the US trade deal that the EU Council and the EU parliament reached on 20 May has lowered the chances of a US-EU trade war escalation.

### US economy supported by AI investments

In line with our expectations, the US economy grew by 0.5% quarter-on-quarter in Q1 (see figure 6). Non-residential investments provided the strongest contribution to growth (0.35 percentage points). The ongoing AI investment boom is the likely driver of this strong contribution. Information processing equipment and software investment made a 0.35% contribution. This implies that non-IT non-

**Figure 6 - US real GDP growth contributions**



Source: KBC Economics based on BEA

residential investments made no contribution last quarter. Another important contributor was government spending (0.2 percentage points), which bounced back following last quarter's shutdown. Inventories also contributed positively. Meanwhile net exports made a negative contribution as the trade balance widened in March. Residential investments also contributed negatively for the fifth quarter in a row. Consumption made a 0.27 percentage points contribution, the weakest contribution since Q1 2025. Only services consumption increased, while goods consumption stagnated.

The labour market is resilient, however. Following a 185k job increase in March, another solid 115k jobs were added in April. Private job growth was even larger, as government job growth continues to decline. Other details were a bit weaker, however. The unemployment rate rose from 4.26% to 4.34%, while the participation rate edged down. The number of people working part time for economic reasons edged up for the second month in a row. Job openings also decreased notably in March.

Looking ahead, risks for the US economy remain elevated. Not only does the outcome in the Iran war remain uncertain, the trade war also remains a major source of uncertainty. Furthermore, the Court of International Trade recently invalidated the 10% Section 122 tariffs. The Trump administration has appealed this decision. Furthermore, the Section 122 tariffs are set to expire by 24 July. By then, the Trump administration is likely to issue new tariffs on trade partners, using Section 301. Several investigations on trading partners are on-going. However, the outcome (in terms of tariff level) remains unclear. On the upside, AI remains a tailwind for the US economy, as Magnificent Seven companies forecasted record capex spending

in their latest earning calls. Increased AI adoption could lead to productivity gains for the US economy. In a recent Atlanta Fed Survey, 74.1% of firms reported using Generative AI technology, up from 46.4% in November last year.

All in all, we maintain our growth forecast of 2.0% for this year and 1.9% for next year. The uncertainty surrounding this forecast is elevated, however with important risks to both the downside and the upside.

### Exports keep boosting China's economy

The outlook for the Chinese economy remains largely unchanged compared to last month. As expected, the economy has shown some degree of resilience to the disruptions caused by the closure of the Strait of Hormuz. April business sentiment surveys did not deteriorate materially. The S&P manufacturing and services PMIs improved marginally while the NBS manufacturing PMI stayed above 50, signalling expansion, at 50.3. NBS manufacturing sub-indicators, such as supplier delivery time, don't point to significant supply chain disruptions impacting manufacturing yet, while new export orders continued to improve.

In another sign that exports continue to be a main driver of growth for China, export growth bounced back in year-on-year terms to 14.1% in April (from 2.5% in March). Meanwhile, solar cell exports surged in March in both volume and price terms (79.6% and 83.8% year-on-year, respectively), highlighting the strong demand for China's clean energy tech amid the negative global energy supply shock. For now, we therefore leave the GDP growth outlook for China unchanged, at 4.7% average growth in 2026 and 4.1% in 2027. However, the longer the closure of the Strait of Hormuz persists, the higher the risk that energy and other product shortages will negatively impact China's growth momentum.

Headline inflation, meanwhile, ticked up again to 1.2% year-on-year in April, led by a surge in energy prices for transportation purposes. Electricity prices for households remained more contained due to electricity regulations. Producer prices also moved further into positive territory in April to 2.8% year-on-year, pulling China out of its deflationary spiral. We have modestly increased the annual average inflation outlook for 2026 from 1.0% to 1.2% but left the 2027 figure unchanged, also at 1.2%.

### Monetary policy under the spell of geopolitics

We expect the US central bank to remain on the sidelines for the rest of 2026 and early 2027. After that pause, the Fed is likely to cut its policy rate to the neutral level of around 3% during 2027. At the June policy meeting, the Fed will publish its new 'dot plots' which will also show whether the Fed will stick to this medium-term interest rate projection under the leadership of new Fed Chairman Walsh.

For the ECB, however, the outlook is much more uncertain. Our scenario is crucially based on the assumption that the flow of trade through the Strait of Hormuz restarts soon. In the short term, the most likely scenario for this is that the declaration of principle between the US and Iran, with subsequent negotiations lasting about 30 days, gets underway quickly. The longer this is delayed, the more likely the scenario of a longer-term economic impact of the war in Iran on the global economy becomes.

That situation puts the ECB in a dilemma. After all, there are both arguments for and against a rate hike at the next policy meeting on 11 June. We assume in our baseline scenario that the ECB will stay on the sidelines until further notice, to await the additional economic data to be released before the next policy meeting. However, we do explicitly link this expectation to the assumption that the transport of oil, gas and derivatives through the Strait of Hormuz will restart in the very short term. If that turns out not to be the case, at least a limited precautionary rate hike ('risk management hike') by the ECB seems likely. The uncertainty surrounding this is extreme, since this is a geopolitical decision by just a few actors, who have not always made predictable decisions in the past.

Arguments for the ECB to wait for further geopolitical developments include the good medium-term anchoring of inflation expectations around the ECB's 2% inflation target. Available data on the eurozone wage agreements also point in the same direction. In addition, an economic-financial tightening in the European economy is already underway, reflected in rising long-term interest rates and weakening credit growth in the euro area. This applies to both the supply side (tighter credit conditions, mainly due to uncertainty) and the demand side (due to the uncertain economic investment climate). This means that the risks to growth in the euro area are to the downside, which is also reflected in the recent development of confidence indicators. Moreover, the ECB's current policy

rate, at 2% around the neutral level, allows the ECB to take a somewhat more wait-and-see stance compared to the energy price crisis in 2022. Finally, the so far cautious response of fiscal policy to the rise in energy prices also plays a role. If those measures are temporary, tailor-made and targeted, they do not give an additional reason for tighter monetary policy.

At the same time, we are not blind to the difficult trade-off the ECB has to make. With a possibly one-off hike in June, the ECB could signal to markets that it is taking the situation seriously. After all, despite important differences, the 2022 energy crisis is still fresh in everyone's memory. Moreover, in addition, with the new economic projections and alternative scenarios, the June policy meeting, if desired, would be an appropriate opportunity for such a precautionary interest rate hike. Finally, while there are no 'second-round effects' on inflation expectations yet, there are already indirect spillovers from higher oil and derivative prices to underlying core inflation.

Taking all these considerations into account, we consider the scenario of a wait-and-see ECB the most likely, albeit with an unseen degree of uncertainty.

### **Bond yields fluctuate around equilibrium levels**

US and German 10-year government yields recently continued to fluctuate around their estimated 'fair value' of 4.50% and 3.00%, respectively. This fluctuation was mainly driven by volatile market expectations regarding Fed and ECB policy. Since we still assume that both central banks will take a wait-and-see approach until further notice, we expect the current level of both 10-year interest rates to fall back to the level we estimate as an equilibrium level in the near future.

### **Intra-EMU government spreads remarkably stable**

Our view on intra-EMU bond yield differentials against Germany remains unchanged. Those spreads will continue to hover around current levels, with possible further slight downside potential. Country-specific, we still expect a temporary spread widening for France in early 2027 ahead of the presidential election. In the somewhat shorter term, spreads for countries such as Italy, which are heavily dependent on energy imports from the Middle East, will fluctuate along with news regarding the US-Iran negotiations.

The striking relative stability of spreads in the eurozone may be partly due to the fact that the market knows that the ECB is also closely monitoring spread developments. According to its current policy strategy, should spread developments threaten financial stability and thus the monetary transmission mechanism, the ECB can use all means, including quantitative easing if necessary, to remedy this. And for any disorderly and perceived as unwarranted market speculation, the ECB has the Transmission Protection Instrument (TPI) at its disposal. Reason enough for financial markets not to worry about European bond markets for now.

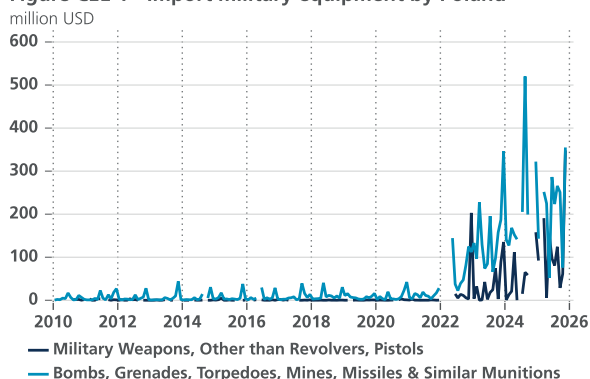
## Central and Eastern Europe

### Poland: Robust expansion amidst constitutional fragility

The Polish economy maintained a solid growth trajectory, supported by accelerated absorption of NextGenerationEU (NGEU) funds. GDP growth reached 4.0% year-on-year end of 2025 and stood at 3.7% for the full year 2025. The expansion was primarily driven by domestic demand, with strong contributions from both household and public consumption. External dynamics have become less supportive, however. Net exports weighed modestly on growth, partly reflecting the delivery of costly military equipment (see figure CEE1). Growth momentum moderated at the start of 2026, with GDP rising by 0.5% quarter-on-quarter in the first quarter, in line with our nowcast. Despite this softer sequential performance, the underlying growth outlook remains solid. For 2026, we expect real GDP growth in Poland of around 3.1%.

Inflation in Poland remains a point of concern for the National Bank of Poland (NBP). The annual CPI inflation rate rose to 3.2% in April 2026, up from 3.0% in March, marking its highest level in ten months. This increase was largely driven by higher energy and fuel prices, with prices of electricity, gas and other fuels rising by 4.7%, alongside an 8.4% increase in fuel and transport-related costs. Core inflation has moved back within the central target range, although services inflation remains persistent ("sticky"), supported by nominal wage growth of around 7% year-on-year.

**Figure CEE 1 - Import military equipment by Poland**



Source: KBC Economics based on COMTRADE

The NBP kept the reference interest rate unchanged at 3.75% in May. NBP Governor Adam Glapiński emphasised that, while global demand is weakening and the zloty remains stable, uncertainty related to geopolitical developments and fiscal expansion necessitates a cautious, data-dependent approach.

### Hungary: The historic shift toward European integration

Hungary's economy started the year positively by growing 0.8% quarter-on-quarter, or 1.7% year-on-year, in Q1 2026. The expansion was supported by strong March retail sales and improving industrial output, suggesting that the stagnation observed in 2023–2025 may be coming to an end. Annual inflation rose slightly to 2.1% in April 2026 from 1.8% in March, with food prices being less deflationary, remaining well within the central bank's target range. For now, profit caps remain in place, but will be gradually phased out in the medium term, to avoid inflation spikes. For 2026, we expect average HICP inflation of 3.3%, rising to 3.7% in 2027.

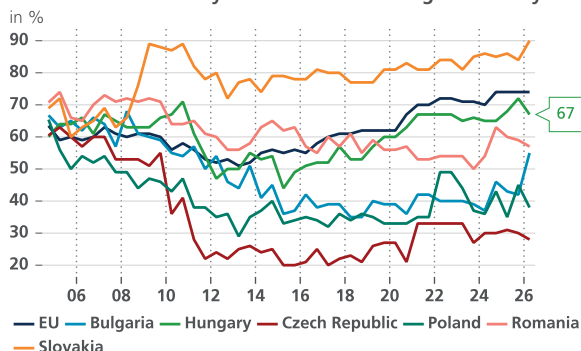
Financial markets responded with strong optimism to Péter Magyar's election victory. The forint appreciated significantly, while risk premia on Hungarian sovereign assets declined, as investors priced in the prospective unfreezing of EU funds. In April, the Magyar Nemzeti Bank (MNB) kept the base rate unchanged at 6.25%, maintaining a stability-oriented stance to anchor inflation expectations during the transition period.

Hungary's incoming administration is setting out an agenda centered on EU reintegration, structural reform and greater policy transparency. Magyar has prioritised unlocking more than EUR 17 billion in suspended EU funds, including EUR 10.4 billion relating to the Resilience and Recovery Facility (RRF). A commitment to implement the rule-of-law and judicial reforms is required for disbursement. Hungary's EUR 16 billion SAFE defence plan submitted by the defeated Orbán government is being reassessed due to corruption risks. The government has also pledged to adopt the euro by 2030, a move supported by two thirds of the population (see figure CEE2), implying a significant fiscal adjustment to meet Maastricht criteria.

### Czech Republic: Fiscal pivot and stronger inflation

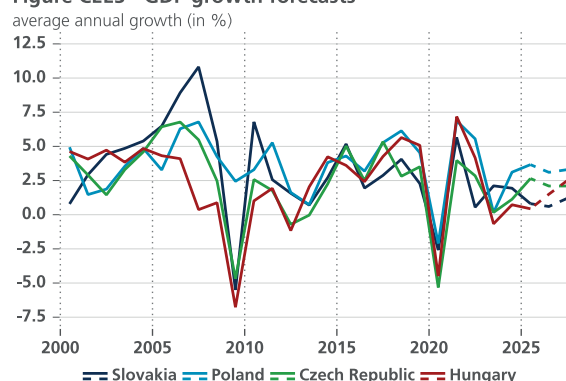
The Czech economy continues its modest recovery,

**Figure CEE2 - Eurobarometer: In Favour of a European Economic & Monetary Union With One Single Currency**



Source: KBC Economics based on DG COMM

**Figure CEE3 - GDP growth forecasts**



Source: KBC Economics

despite weak first-quarter growth of below 0.2% quarter-on-quarter. CPI inflation rose to 2.5% year on year in April 2026 from 1.9% in March. This six-month high was driven primarily by a rebound in energy prices (1.5% versus -1.7% in March) and sustained growth in services (4.8%), where labour costs remain the main driver, while food prices remained in deflation. Core inflation remains elevated at around 2.9%, reflecting persistent housing-related cost pressures and nominal wage growth of roughly 7%. Given the recent strengthening of pro-inflationary factors, we have raised our average HICP inflation forecast to 2.3% in 2026 and 3.2% in 2027. The Czech National Bank has kept its policy rate unchanged at 3.5% through May 2026, maintaining a cautious stance in response to lingering inflationary pressures.

### Slovakia: Fiscal consolidation and democratic friction

Slovakia's macroeconomic environment in 2026 is defined by a necessary but painful fiscal consolidation. The country is projected to record a low 0.6% growth in 2026 (see figure CEE3). In the first quarter of 2026, the Slovak economy expanded by only 0.17% quarter-on-quarter, equivalent to 0.9% year-on-year growth.

HICP inflation increased to 4.1% in April, although food price growth eased further to 0.98%. However, housing and utilities inflation accelerated to 9.3%, driven by the return of district heating and thermal energy prices to market levels.

The labour market faces demographic challenges, as an ageing population and persistent labour shortages limit potential growth. We nevertheless expect the

unemployment rate to rise towards 5.9% in 2026. Slovakia remains heavily reliant on its automotive sector, leaving it vulnerable to global trade uncertainties. Threats by Donald Trump to reimpose 25% tariffs on EU automobiles would disproportionately affect Slovakia (see [economic brief Imposing tariffs on European cars - Slovakia is the most vulnerable](#)).

Slovakia's political trajectory under Robert Fico has shifted markedly since mid-April 2026, with a series of contentious reforms prompting warnings from the European Parliament that EU funds could be at risk. Our growth forecast for 2027 of 1.2% depends heavily on the launch of the new Volvo plant and the efficient absorption of RRF funds before the August 2026 deadline. Fiscal policy is moving towards consolidation, with the 2026 budget targeting a deficit of 4.1% of GDP through measures such as a public sector wage freeze, higher excise duties, and a reduction in public holidays.

### Bulgaria: Eurozone integration amidst energy turmoil

In April 2026, Bulgaria's annual CPI climbed sharply to 6.8%, up from 4.1% in March. This surge, the highest since 2023, was almost entirely driven by an 18.5% rise in transport costs and a 5.3% increase in food prices, reflecting disruptions in global oil and gas supplies (see figure CEE4). We expect annual average HICP inflation of 4.1% in 2026. Despite these figures, the Bulgarian National Bank (BNB) and the ECB maintain that euro adoption itself has had a limited impact on consumer prices, with changeover-related effects concentrated primarily in the service sector. Nevertheless, the new Bulgarian government has proposed amendments to the Consumer

**Figure CEE4 - CPI Bulgaria**



Source: KBC Economics based on NSI

Protection Act which would require large retailers to justify price increases on the basis of cost developments, as part of broader monitoring efforts during the transition period.

Real GDP growth remains robust, forecast at 2.6% for 2026. Investment has accelerated, supported by the absorption of RRF funds and improved business confidence following euro adoption. However, net exports are expected to contribute negatively, as the rising energy bill deteriorates the trade balance.

Bulgaria's political landscape has undergone a decisive shift following the parliamentary elections of 19 April 2026, which delivered a landslide victory for Rumen Radev's Progressive Bulgaria party with 131 out of 240 seats, bringing an end to the prolonged period of fragmentation that had characterised governance since 2021. The new administration has moved quickly to address the external energy shock, announcing a EUR 100 million support package, including targeted monthly assistance of EUR 20 for vulnerable households alongside liquidity support for small and medium-sized enterprises.

## Box 1 – Political instability threatens necessary reforms in Romania

The Romanian four-party government coalition, composed of PSD, the centre-right PNL, the liberal USR, and the ethnic Hungarian minority party UDMR, was formed in June 2025 to contain the rise of the far-right Alliance for the Union of Romanians (AUR), led by George Simion, and to steer the country's fragile economy back towards stability. The government's mandate was straightforward but not easy: to raise taxes, cut public spending, and preserve Romania's investment-grade credit rating while unlocking EUR 11 billion in EU recovery funds.

**Figure CEE5 - Government Deficit Romania**



Source: KBC Economics based on Eurostat

Prime Minister Ilie Bolojan (PNL) succeeded in bringing the deficit down to approximately 7.9% of GDP in 2025 (see figure CEE5), but this came at a steep political price. Consequently, the PSD, the largest party in the coalition and historically the dominant force in Romanian politics, found itself co-owning deeply unpopular austerity measures and concluded that the political costs of staying outweighed the institutional costs of leaving.

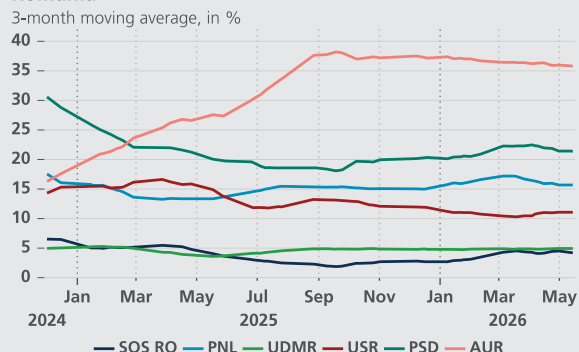
On 23 April, Deputy Prime Minister Marian Neacșu and six ministers, all from the Social Democratic Party (PSD), resigned from the Romanian government. This effectively dismembered the "grand coalition" assembled just ten months earlier. The PSD joined forces with AUR to file a no-confidence motion in Parliament. The motion passed on 5 May with 281 legislators voting in favour and only four against, a historic margin. Bolojan's remaining coalition allies, PNL, USR, and UDMR, were present in Parliament but abstained rather than voting against their own prime minister. The Romanian currency, the leu, hit a historic low against the euro.

The alliance between PSD and AUR is less paradoxical than it may appear. Both parties are, for different reasons, hostile to the pace and form of fiscal consolidation. AUR frames it as EU-imposed technocratic cruelty, while PSD

presents it as ideologically misguided liberalism. Recent opinion polls suggest that together they could command a parliamentary majority (see figure CEE6), although they have stated that they do not seek long-term collaboration.

Romania's political instability has consequences that extend beyond the domestic arena, particularly for its ability to implement EU-backed programmes. Romania has already taken key steps to secure access to approximately EUR 16.7 billion under the EU's SAFE defence financing mechanism. Parliament approved EUR 8.3 billion in defence contracts on 29 April, and on 5 May the outgoing government authorised the signing of the loan agreement with the European Commission. However, SAFE funding is disbursed in tranches conditional on the fulfilment of investment milestones, and the programme runs until 2030. With the government now operating in a caretaker capacity and several ministries politically weakened, the main risk has shifted from access to implementation. This risk is even more pronounced for Recovery and Resilience Facility funds, where disbursements are directly tied to the completion of structural reforms, raising concerns that ongoing political fragmentation could delay or jeopardise future payments. Nonetheless, the European Commission recently provided a favourable preliminary assessment of Romania's fourth payment request under the Recovery and Resilience Facility, advancing the process towards the release of EUR 2.62 billion.

**Figure CEE6 - Opinion polls parliamentary elections Romania**



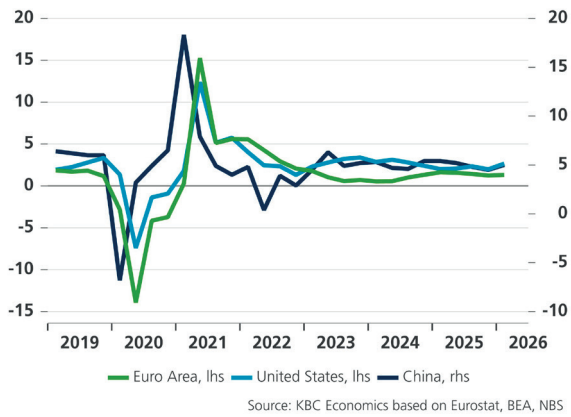
Source: KBC Economics based on Europe Elects

President Nicușor Dan, the centrist former mayor of Bucharest elected in 2025, is considering four scenarios: a minority government centred on PNL and USR, a minority government centred on PSD, a political government with a technocrat as prime minister, or a fully technocratic cabinet. Dan has explicitly rejected snap elections and has been conducting formal consultations with parliamentary parties in May, pledging a new government within a "reasonable" timeframe. The question is whether the incoming government, whatever form it takes, will have the legitimacy, the majority, and above all the political will to implement badly needed reforms. Far-right and Eurosceptic parties are on the rise, capitalising on widespread disillusionment with the ruling establishment. AUR alone commands roughly 36% in current polls.

## Figures

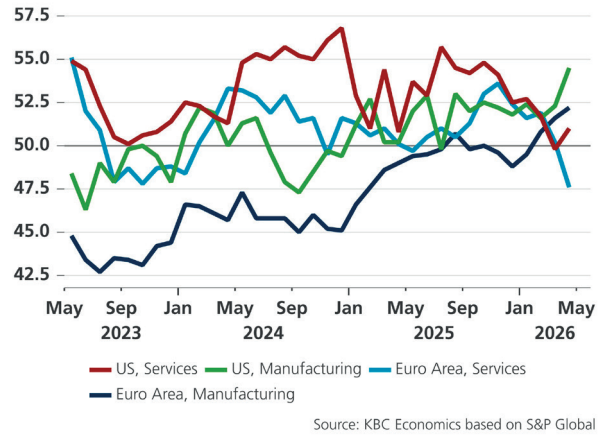
### Real GDP

yearly change in %



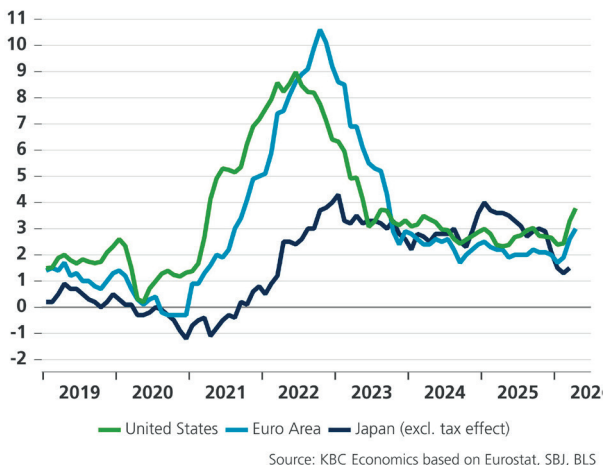
### Business confidence indicators

index, above 50 = expansion



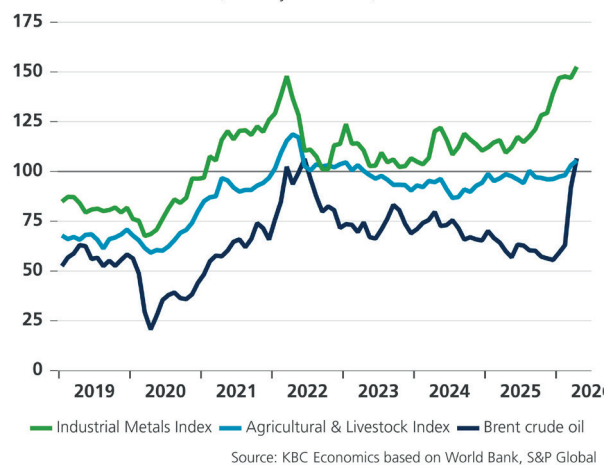
### Headline inflation

yearly change consumer price index, in %



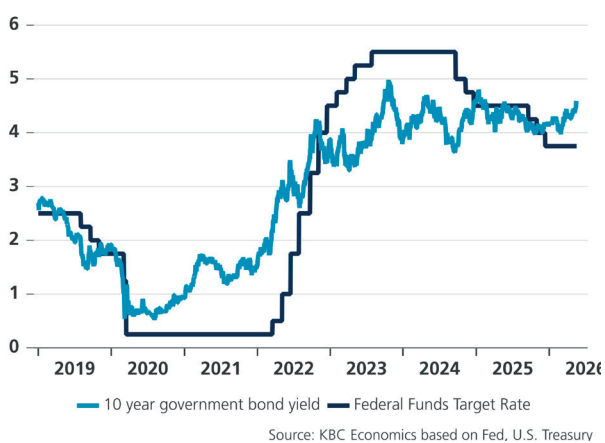
### Commodity prices

index, January 2013=100, in USD



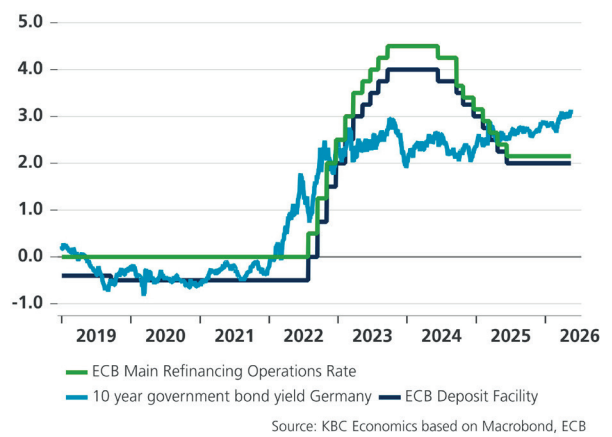
### United States interest rates

in %



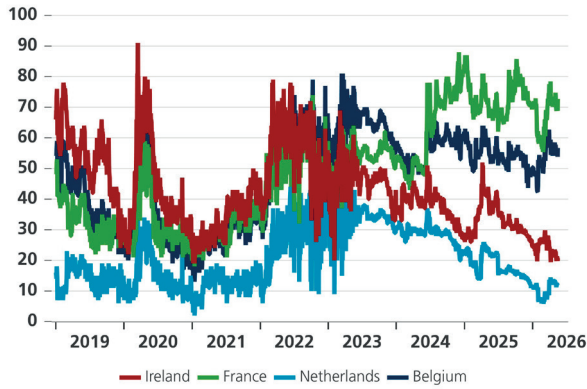
### Euro area interest rates

in %

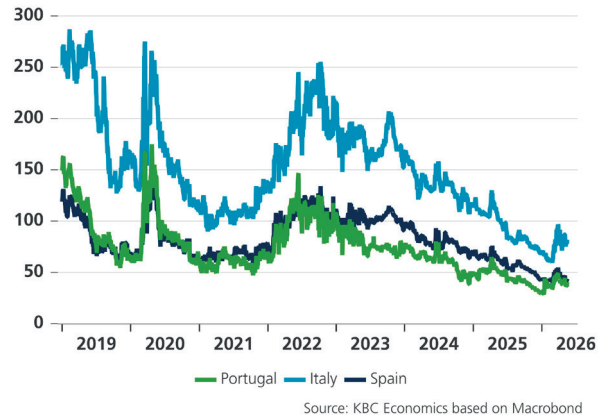


## Figures

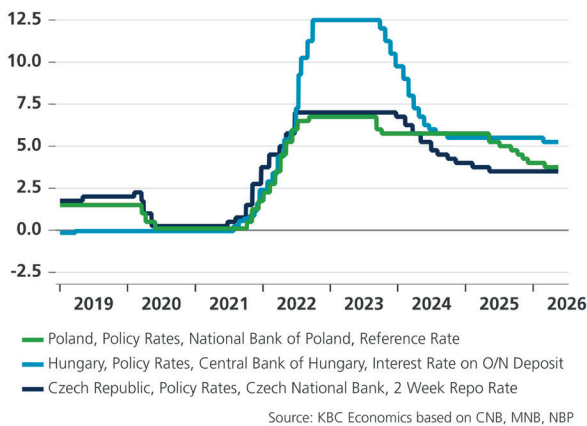
**10 year government bond yield spreads to Germany**  
in basis points



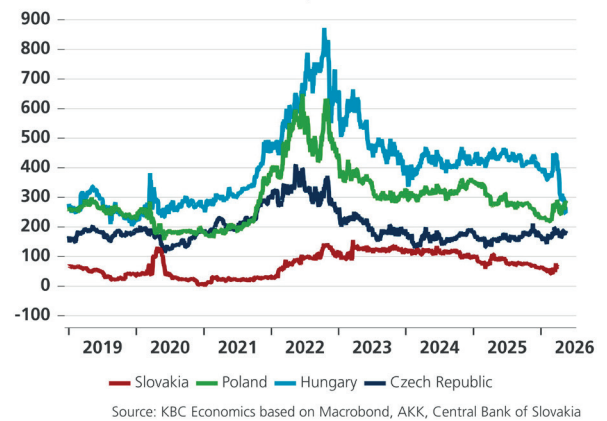
**10 year government bond yield spreads to Germany**  
in basis points



**Monetary policy rates Central Europe**  
in %

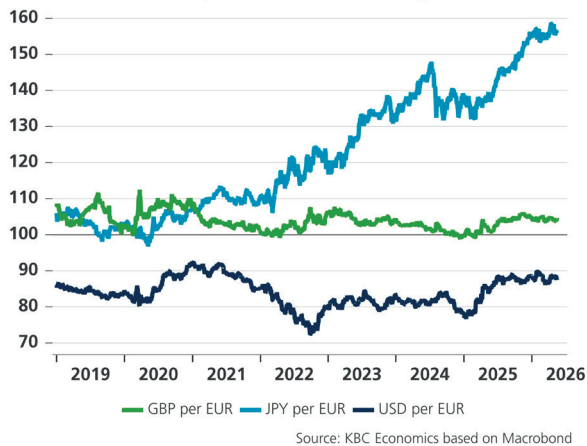


**10 year government bond yield spreads to Germany**  
in basis points



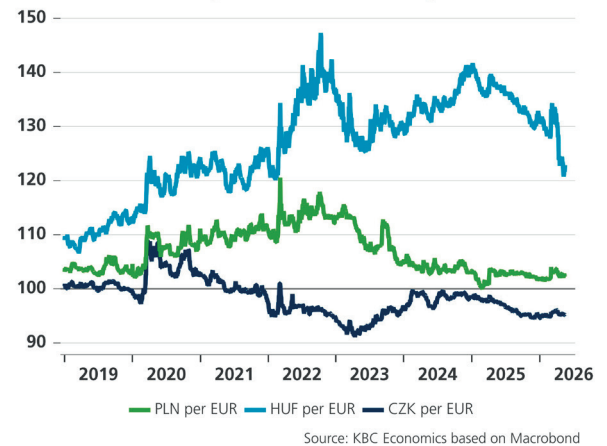
**Exchange rates**

index, January 2013=100, increase = stronger EUR



**Exchange rates**

index, January 2013=100, increase = stronger EUR



		Real GDP growth (period average, based on quarterly figures, in %)			Inflation (period average, in %)		
		2025	2026	2027	2025	2026	2027
<b>Euro area</b>	Euro area	1.5	0.7	1.2	2.1	2.8	2.0
	Germany	0.3	0.7	1.4	2.2	3.1	2.3
	France	0.9	0.7	1.1	0.9	2.2	1.5
	Italy	0.7	0.6	0.7	1.6	2.3	1.8
	Spain	2.8	2.2	1.8	2.7	3.0	2.1
	Netherlands	1.8	0.9	1.2	3.0	3.3	2.5
	Belgium	1.0	0.6	1.1	3.0	3.2	2.1
	Ireland	12.3	1.3	4.3	2.1	2.9	2.6
	Slovakia	0.8	0.6	1.2	4.2	4.3	3.5
<b>Central and Eastern Europe</b>	Czech Republic	2.6	2.1	2.1	2.3	2.3	3.2
	Hungary	0.4	1.5	2.5	4.4	3.0	3.8
	Bulgaria	3.2	2.6	2.8	3.5	4.1	3.2
	Poland	3.7	3.1	3.3	3.4	3.2	2.6
	Romania	0.7	0.5	2.3	6.8	7.5	3.7
<b>Rest of Europe</b>	United Kingdom	1.4	0.6	1.1	3.3	3.1	2.5
	Sweden	1.8	2.4	2.3	2.6	1.1	1.8
	Norway (mainland)	1.8	1.6	1.7	2.8	3.2	2.5
	Switzerland	1.3	1.0	1.4	0.1	0.6	0.7
<b>Emerging markets</b>	China	4.9	4.7	4.1	0.0	1.2	1.2
	India*	7.3	6.0	6.4	2.0	4.6	4.5
	South Africa	1.1	1.2	1.4	3.2	3.9	3.6
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	3.6	3.2	4.0	34.9	28.1	20.8
	Brazil	2.3	1.4	1.8	5.0	4.4	4.1
<b>Other advanced economies</b>	United States	2.1	2.0	1.9	2.7	3.6	2.7
	Japan	1.2	0.7	0.9	3.2	2.1	2.0
	Australia	2.0	2.2	2.0	2.8	3.8	2.7
	New Zealand	0.5	2.1	2.6	2.8	3.1	2.1
	Canada	1.7	1.1	1.9	2.2	2.7	2.0
<b>* fiscal year from April-March</b>						18/5/2026	

		18/5/2026	Q2 2026	Q3 2026	Q4 2026	Q1 2027	
<b>Euro area</b>	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	
<b>Central and Eastern Europe</b>	Czech Republic	3.50	3.50	3.50	3.50	3.50	
	Hungary	6.25	6.00	5.75	5.75	5.50	
	Poland	3.75	3.75	3.75	3.75	3.75	
	Romania	6.50	6.50	6.50	6.50	6.25	
<b>Rest of Europe</b>	United Kingdom	3.75	3.75	3.75	3.75	3.75	
	Sweden	1.75	1.75	2.00	2.00	2.00	
	Norway	4.25	4.25	4.25	4.50	4.50	
	Switzerland	0.00	0.00	0.00	0.00	0.00	
<b>Emerging markets</b>	China (7-day r. repo)	1.40	1.40	1.40	1.40	1.30	
	India	5.25	5.25	5.25	5.25	5.25	
	South Africa	6.75	6.75	6.75	6.75	6.75	
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	37.00	37.00	35.00	32.75	30.00	
	Brazil	14.50	14.25	13.25	12.25	11.50	
<b>Other advanced economies</b>	United States (mid-target range)	3.625	3.625	3.625	3.625	3.625	
	Japan	0.75	1.00	1.00	1.25	1.25	
	Australia	4.35	4.35	4.35	4.35	4.35	
	New Zealand	2.25	2.25	2.50	2.75	2.75	
	Canada	2.25	2.25	2.25	2.25	2.25	

10 year government bond yields (end of period, in %)		18/5/2026	Q2 2026	Q3 2026	Q4 2026	Q1 2027
<b>Euro area</b>	Germany	3.17	3.00	3.00	3.00	3.00
	France	3.96	3.65	3.65	3.65	3.70
	Italy	3.94	3.75	3.75	3.70	3.70
	Spain	3.60	3.45	3.45	3.40	3.40
	Netherlands	3.28	3.10	3.10	3.10	3.10
	Belgium	3.72	3.45	3.40	3.40	3.40
	Ireland	3.37	3.20	3.20	3.20	3.20
	Slovakia	3.79	3.70	3.70	3.65	3.65
<b>Central and Eastern Europe</b>	Czech Republic	4.99	4.80	4.70	4.60	4.40
	Hungary	5.74	6.00	5.90	5.85	5.75
	Bulgaria *	4.11	3.80	3.70	3.60	3.60
	Poland	5.97	5.60	5.50	5.40	5.00
	Romania	7.11	6.85	6.85	6.85	6.85
<b>Rest of Europe</b>	United Kingdom	5.13	5.25	5.25	5.25	5.25
	Sweden	2.85	2.65	2.65	2.65	2.65
	Norway	4.59	4.45	4.45	4.45	4.45
	Switzerland	0.57	0.35	0.35	0.35	0.35
<b>Emerging markets</b>	China	1.84	1.70	1.75	1.80	1.80
	India	7.13	6.97	6.95	6.95	6.95
	South Africa	8.89	8.69	8.74	8.79	8.79
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	32.68	30.00	28.00	26.00	25.00
	Brazil	14.46	13.99	13.90	13.80	13.80
<b>Other advanced economies</b>	United States	4.60	4.40	4.45	4.50	4.50
	Japan	2.75	2.75	2.75	2.75	2.75
	Australia	5.08	5.00	5.05	5.10	5.10
	New Zealand	4.85	4.70	4.75	4.80	4.80
	Canada	3.69	3.50	3.55	3.60	3.60

\*Caution: very illiquid market

Exchange rates (end of period)		18/5/2026	Q2 2026	Q3 2026	Q4 2026	Q1 2027
<b>USD per EUR</b>		1.16	1.18	1.18	1.19	1.20
<b>CZK per EUR</b>		24.32	24.40	24.20	24.10	23.90
<b>HUF per EUR</b>		361.37	358.00	363.00	368.00	367.00
<b>PLN per EUR</b>		4.24	4.27	4.25	4.25	4.23
<b>RON per EUR</b>		5.21	5.17	5.17	5.18	5.19
<b>GBP per EUR</b>		0.87	0.88	0.89	0.90	0.90
<b>SEK per EUR</b>		10.95	10.90	10.85	10.85	10.80
<b>NOK per EUR</b>		10.80	10.80	10.80	10.75	10.70
<b>CHF per EUR</b>		0.91	0.92	0.92	0.92	0.92
<b>BRL per USD</b>		5.03	4.87	4.87	4.85	4.83
<b>INR per USD</b>		96.35	95.35	95.35	94.95	94.56
<b>ZAR per USD</b>		16.64	16.38	16.38	16.31	16.24
<b>RUB per USD</b>		Temporarily no forecast due to extreme uncertainty				
<b>TRY per USD</b>		45.57	46.43	48.49	50.71	52.99
<b>RMB per USD</b>		6.80	6.79	6.78	6.77	6.76
<b>JPY per USD</b>		158.80	157.00	156.00	155.00	155.00
<b>USD per AUD</b>		0.72	0.72	0.73	0.74	0.75
<b>USD per NZD</b>		0.59	0.59	0.59	0.60	0.60
<b>CAD per USD</b>		1.37	1.36	1.35	1.35	1.35

## Outlook KBC markets - Belgium

National accounts (real yearly change, in %)			
	2025	2026	2027
Private consumption	1.7	0.1	0.8
Public consumption	1.6	1.7	0.5
Investment in fixed capital	0.1	1.8	1.7
Corporate investment	2.3	1.6	1.1
Public investment	1.0	9.0	5.0
Residential building investment	-8.2	-2.4	1.3
Final domestic demand (excl. changes in inventories)	1.3	0.9	1.0
Change in inventories (contribution to growth)	0.1	0.0	0.0
Exports of goods and services	-0.3	-2.0	1.0
Imports of goods and services	0.1	-1.6	0.8
Gross domestic product (GDP), based on quarterly figures	1.0	0.6	1.1
Household disposable income	1.6	0.3	0.9
Household savings rate (% of disposable income)	12.8	13.0	13.1

Equilibrium indicators			
	2025	2026	2027
Inflation (average yearly change, in %)			
Consumer prices (harmonised CPI)	3.0	3.2	2.1
Health index (national CPI)	2.6	3.2	2.5
Labour market			
Domestic employment (yearly change, in '000, year end)	16.6	10.0	25.0
Unemployment rate (in % of labour force, end of year, Eurostat definition)	6.5	6.7	6.4
Public finances (in % of GDP, on unchanged policy)			
Overall balance	-5.2	-5.6	-5.3
Public debt	107.3	110.2	112.5
Current account balance (in % of GDP)	-1.9	-2.0	-1.1
House prices (average yearly change in %, existing and new dwellings, Eurostat definition)	3.2	3.0	3.0

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