KPMG

European Economic Outlook

KPMG. Make the Difference.

May 2026

- Europe faces another energy shock, but the impact is likely to be different to 2022: limited direct gas exposure caps shortage risks, while the impact on a broader basket of commodities and the more globalised nature of the impact means potentially more pervasive supply chain disruption than in 2022.
- Economic growth momentum is also weaker, but a recession across most European economies remains unlikely.
- Consumer spending is expected to remain the foundation of growth, despite households facing a real income hit, as the labour market resilience could cushion the blow in much of Europe.
- In the event of a relatively quick reopening of the Strait of Hormuz later this summer, the weaker economic environment compared to 2022 could ensure fewer second round effects on inflation and therefore more muted response by European central banks this year.
- However, a more prolonged crisis lasting until the end of this year could see more elevated inflationary pressures, while downside risks to the summer tourism season, stemming from potential jet fuel supply constraints in some regions, could trigger a recession in the more exposed European economies should they materialise.
- Government finances are relatively constrained across most of the continent, and measures to support domestic economies have so far been very targeted and time limited in nature, in a shift away from broad-based support measures of previous eras as fiscal sustainability remains front of mind for Brussels.

Table 1: KPMG Eurozone economic forecasts

	2025	2026	2027
GDP	1.4	0.9	1.2
Consumption growth	1.5	0.9	1.3
Investment growth	3.0	1.7	2.5
Unemployment rate	6.3	6.3	6.2
Inflation	2.1	3.1	2.3
Key deposit rate	2.0	2.5	2.25

Source: KPMG projections using Oxford Economics' Global Economic Model.

GDP, consumer spending and investment are all measured in real terms. Average % change on previous calendar year except for unemployment rate, which is average annual rate, while key deposit rate represents level at the end of calendar year. Investment represents Gross Fixed Capital Formation. Inflation is measured as HICP.

Authors

Yael Selfin
Chief Economist, EMEA
T: +44 (0)7766 362 369
E: yael.selfin@kpmg.co.uk

Hamish McHugh-Smith
Economist, EMEA
E: hamish.mchughsmith@kpmg.co.uk

Dennis Tatarkov
Senior Economist, EMEA
T: +44 (0)7468 711 320
E: dennis.tatarkov@kpmg.co.uk

Moustafa Ali
Economist, EMEA
T: +44 (0)7935 352 083
E: moustafa.ali@kpmg.co.uk

Contents

Implications of war in Iran 2
Inflation on the rise 3
Consumer demand to weaken 4
Interest rates and financial conditions 5
Government spending 6

© 2026 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Europe once again faces an externally driven energy shock following the disruption to the Strait of Hormuz. Market volatility remains high while traffic through the Strait of Hormuz remains at a standstill and a fragile ceasefire agreement means risks of further escalation remain elevated.

The macroeconomic effects are already feeding through and are likely to shape inflation dynamics, financial conditions and growth in the months ahead. With downside risks to the outlook still elevated, the ultimate economic impact will depend on both the duration and severity of the disruption.

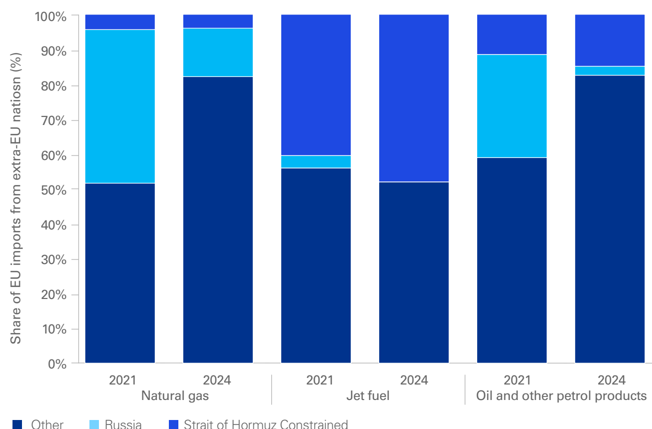
In this context, economic growth across Europe is anticipated to slow, yet an outright recession remains less likely at this stage. Domestic demand is expected to remain the foundation of growth; nevertheless, we foresee consumer expenditure softening as elevated inflation weighs on real incomes. Meanwhile, subdued external demand and tighter financial conditions are likely to constrain business activity.

Unlike 2022, which was a more localised shock to Europe, the disruption to the Strait of Hormuz is a more global shock, with broader supply chain implications for Europe, particularly in regard to dependencies on Asian production centres due to their high reliance on oil and gas from the Middle East.

The disruption to the Strait of Hormuz has other materially different implications for Europe than the 2022 energy price shock triggered by the loss of Nord Stream gas flows. Europe's direct exposure to Hormuz-linked gas imports is notably smaller than its former reliance on Russian pipeline supplies (see Chart 1), limiting the risk of physical shortages, although supply exposure remains elevated in some economies, notably **Italy**, owing to their reliance on Qatari gas. Instead, transmission to Europe is occurring primarily through higher global energy prices, reflecting increased competition for LNG cargoes.

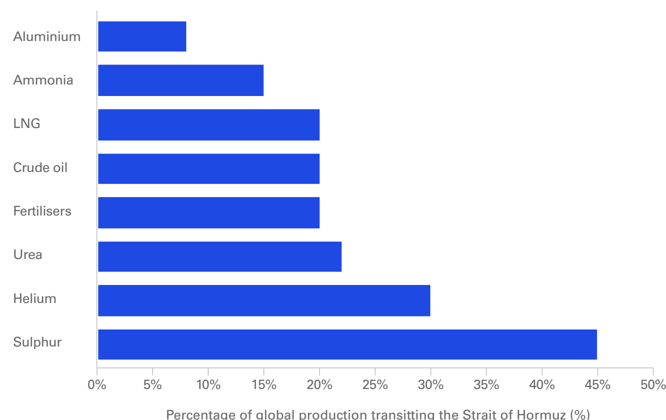
Disruption to the Strait of Hormuz affects a much broader set of commodities than just energy (see Chart 2), making the impact on a range of products more prominent. Many of these inputs are produced as by-products of oil and gas processing in the Middle East, limiting the scope for short-term substitution. Prices for several of these commodities have already risen sharply, reflecting constrained availability.

Chart 1: The current energy price shock is materially different from the one in 2022 for Europe



Source: Eurostat. Strait of Hormuz constrained is defined as imports from Saudi Arabia, UAE, Iraq, Iran, Kuwait, Qatar and Bharain.

Chart 2: A broad range of commodities are impacted by the disruption to the Strait of Hormuz



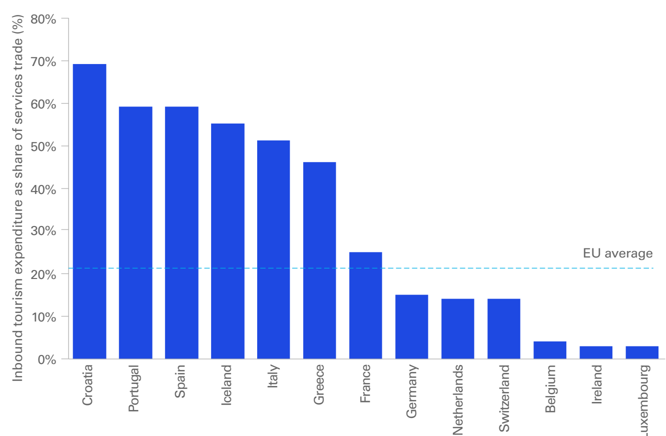
Source: IEA, 2025.

The effects are likely to be felt unevenly across sectors. Potential constraints in jet fuel supply pose a downside risk to the summer tourism season, with the possibility for more widespread flight reductions and cancellations to disrupt travel. This risk is especially acute for tourism-dependent economies such as **Croatia** and **Portugal**, where the sector plays a significant role in supporting economic activity (see Chart 3). Any sustained disruption, whether that be through reduced travel or weaker bookings as people choose to holiday closer to home, would weigh on services export revenues, and could undermine a key source of resilience in recent years, and potentially trigger a recession in the more exposed European economies.

Industrial sectors face parallel pressures: tighter aluminium supply is increasing costs for the automotive sector. Constrained helium availability, a critical input to semiconductor manufacturing, poses risks for advanced manufacturing hubs in **Germany** and the **Netherlands** and could complicate plans to boost defence production.

The scale of these effects will depend on the duration of the disruption. More prolonged restrictions on transit through the strait, for example lasting for the remainder of this year, would intensify supply chain disruptions as inventories are depleted and alternative supply chains remain limited, weighing on global production and reinforcing upward pressure on prices.

Chart 3: Potential disruption to the summer tourism season could weigh heavily on some European economies

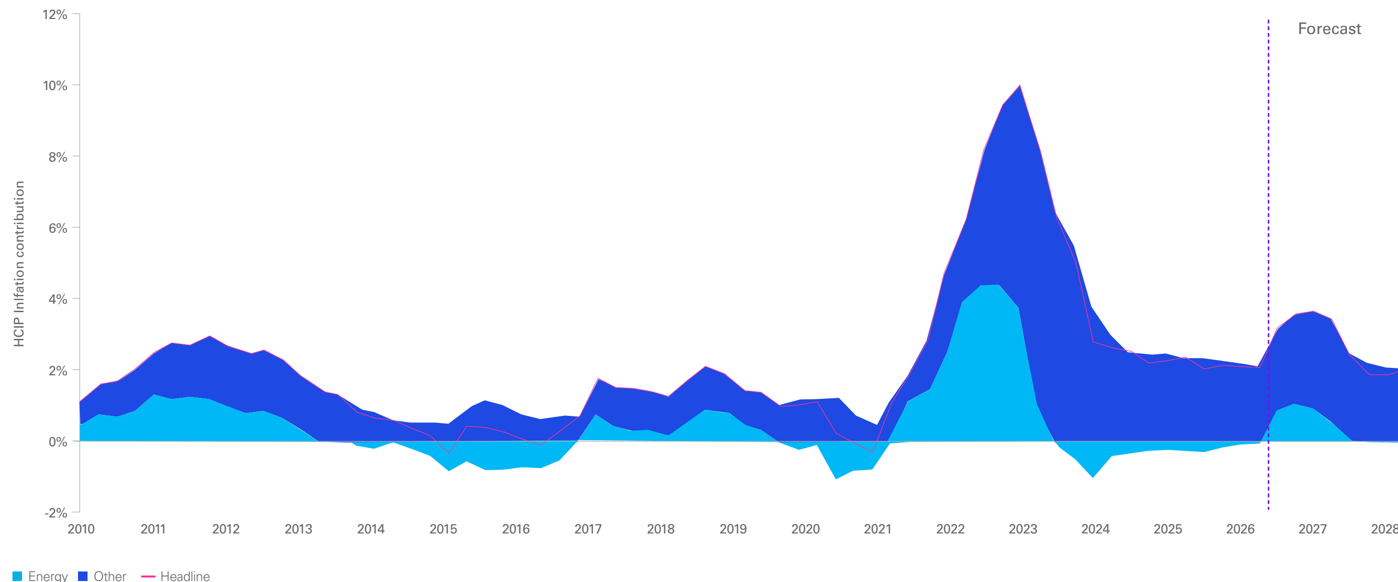


Source: Eurostat 2022 TSA data. KPMG calculation for Greece based on Bank of Greece estimates using 2025 data.

© 2026 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Inflation on the rise again

Chart 4: Increases in Eurozone inflation will be driven by the energy component



Source: Eurostat, KPMG forecasts.

Eurozone inflation could average 3.1% in 2026 as rising energy prices drive renewed inflationary pressure across Europe. Increased energy prices are feeding into higher transportation costs, with fuel prices having increased by 55%[1] since the conflict began, providing a key near-term driver of headline inflation.

Our forecast reflects the continued pass-through of elevated oil and gas prices into broader price pressures over the coming months (see Chart 4). While energy is expected to remain the primary driver of near-term inflation dynamics, indirect effects are likely to extend the impact of the shock beyond direct energy components, sustaining upward pressure across the wider price basket.

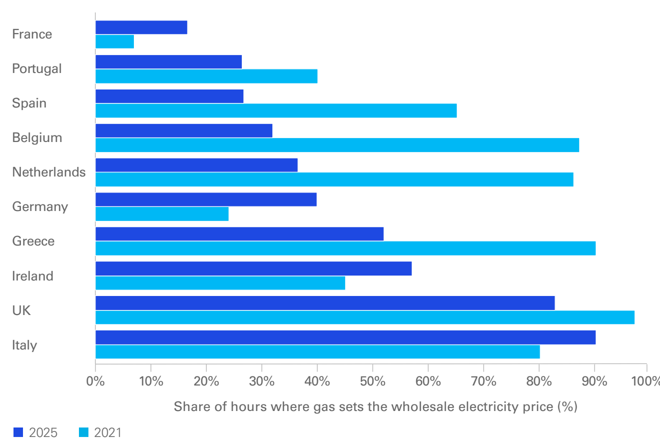
The inflationary impact is expected to diverge across countries, partially reflecting differences in energy mix and the degree to which higher energy costs are transmitted into consumer prices.

Countries such as Italy and Ireland are likely to be more susceptible to gas price driven inflation, as gas-fired electricity generation continues to set the wholesale electricity price for a significant share of hours (see Chart 5), In contrast, Spain, which has invested heavily in the deployment of renewable capacity since the 2022 energy price shock, as well as Switzerland are less reliant on gas, limiting the direct pass-through of cost pressures to consumer prices.

Beyond the direct impact of energy, broader price pressures are likely to be shaped by a combination of wage dynamics, pricing behaviour, and ongoing supply-side frictions.

Labour market tightness continues to support wage growth in parts of Europe, giving workers greater bargaining power to negotiate higher wages in response to rising living costs. This, in turn, may add to price pressures as firms face rising labour costs. At the same time, higher transportation costs are feeding into non-energy goods prices, with recent European Commission surveys pointing to a marked increase in selling price expectations over the coming year. With profit margins already under pressure in some economies such as Germany, and the experience of raising prices during the 2022 crisis still fresh, firms may increasingly seek to pass these higher costs on to customers. The extent to which they can do so will ultimately depend on the resilience of demand in the months ahead.

Chart 5: Share of hours gas-fired generation sets the price of electricity



Source: Zakeri & Staffell (2023) 2021 data. LSEG and Eurostat data, KPMG estimates for 2025, Share of hours defined as where electricity price is equal or above the short-run marginal cost of gas-fired generation.

1 Price increase is the European average price increase between 23rd February 2026 to 4th May 2026.

© 2026 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

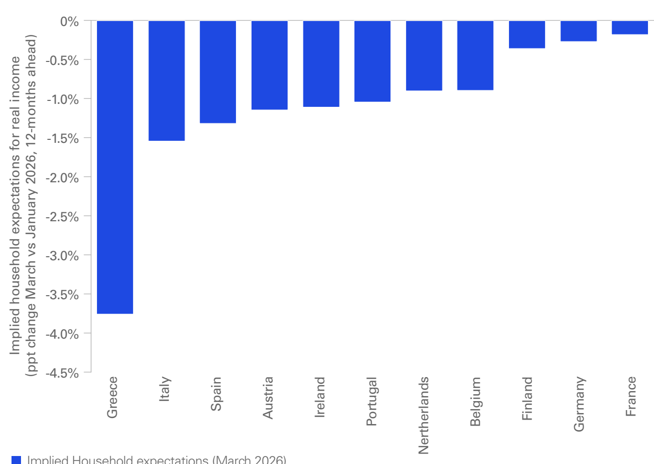
Consumer demand to weaken

We anticipate consumption growth to weaken in the coming months, as consumers face a renewed squeeze on their real incomes driven by higher inflation. Despite weaker demand, we expect consumption to remain the primary driver of economic growth within Europe supported by a relatively robust labour market.

Higher energy costs are eroding purchasing power, while consumer sentiment has deteriorated sharply, pointing to a more cautious spending outlook. The ECB's Consumer Expectations Survey indicates that households anticipate a marked decline in real income over the next 12 months (see Chart 6).

While these expectations may overstate the severity of the real income shock, weaker perceptions are nonetheless likely to weigh on behaviour, with households adjusting spending patterns and reducing discretionary expenditure, as evident by declines in consumer plans for large purchases in the latest consumer surveys.

Chart 6: Consumers expectations may overstate the impact on real incomes

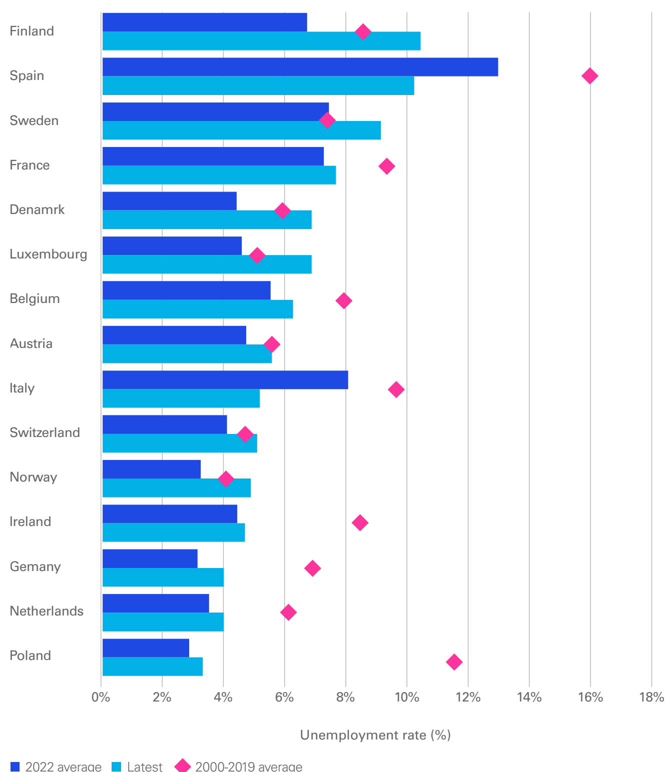


Source: ECB Consumer Expectations survey. KPMG calculations to infer the impact on real incomes.

Diverging labour market conditions across Europe could play a central role in shaping the resilience of consumer demand in the face of the current cost shock.

Unemployment remains low by historical standards across much of the region, particularly in southern economies such as Italy and Spain, pointing to a relatively tight labour market (see Chart 7). This may support wage growth and provide a buffer to household incomes, helping sustain consumer spending despite rising costs. By contrast, labour markets in parts of Northern Europe and Scandinavia, including Finland and Denmark, appear softer, with unemployment above historic averages. In these economies, weaker labour market conditions could leave households more exposed to real income pressures, constraining consumption and limiting demand.

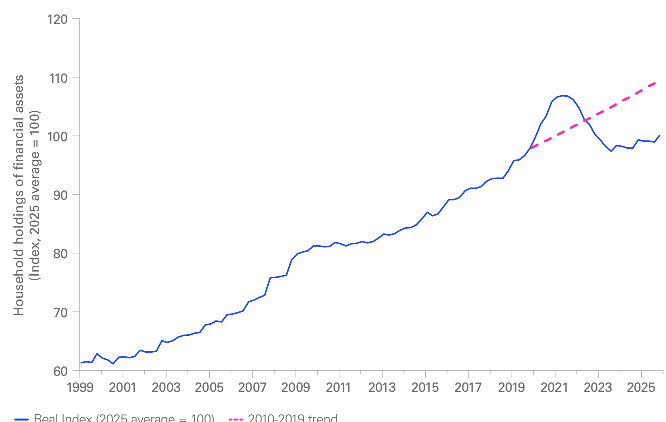
Chart 7: Divergent labour market conditions to influence consumers' behaviour and the extent of inflation pick up



Source: Eurostat.

At the same time should the conflict be more prolonged or severe, households may be less well-positioned to absorb the hit to real incomes. Despite elevated savings rates providing some cushion, the stock of financial assets held by households remains lower in real terms than in 2022 (see Chart 8). As such, households may have more limited capacity to draw down on their stock of savings to smooth consumption in the face of sharp declines in purchasing power should the conflict prove longer lasting.

Chart 8: Eurozone households real financial asset holdings are lower than in 2021



Source: ECB.

Outlook for interest rates and financial conditions

European central banks face a difficult trade-off between containing the fallout of higher energy prices whilst avoiding tightening too early, which may unnecessarily damage economic growth amid weakening domestic demand.

Before the energy shock, some European central banks were in a relatively comfortable position, with inflation close to target, while others were still gradually lowering interest rates. The energy shock has changed the calculus, shifting the focus towards keeping inflation sustainably at target over the medium term and ensuring domestic price pressures remain contained. However, financial conditions have already tightened significantly since March on the back of market expectations of rate hikes across Europe, with many households and businesses already experiencing higher borrowing costs.

In theory, central banks should potentially look through energy price shocks, since they cannot influence these prices directly. However, the 2022 shock highlighted how second-round effects, in the form of rising wages and prices of other goods and services, could make inflation more persistent, requiring central banks to step in and raise interest rates to dampen demand. Given the relatively recent memory of inflation significantly overshooting its target, central banks may wish to signal their resolve early to prevent expectations of higher inflation being embedded.

Unlike many of its peers across Europe, the **European Central Bank** (ECB) entered the current energy price shock with interest rates at neutral levels. This leaves the ECB under greater pressure to respond to the recent rise in headline inflation. The ECB has signalled that interest rates are likely to rise soon, with June looking the most likely timing for a first hike. Beyond that, much will depend on how long the disruption to energy supplies persists, but given the adverse inflation outlook, we think the ECB is likely to follow up with a second interest rate hike in September at the minimum.

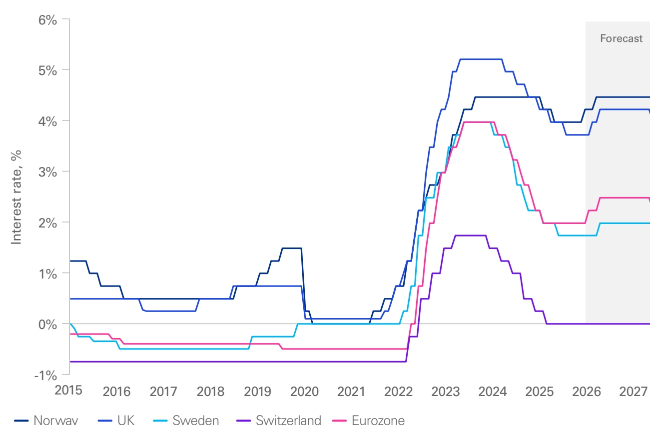
The **Bank of England** (BoE) entered the current shock with inflation still above target and interest rates in restrictive territory. The Bank has become more open to further tightening and is now not expected to cut rates any further this year and has become more open to further tightening. While the Bank has so far opted against hiking given the weaker labour market, the risk of a rebound in domestic price pressures is high. This will likely see the BoE hike in July and possibly once more by the end of the year.

More subdued inflationary pressures in Sweden including a weaker labour market put less pressure on **Riksbank** to hike. Nevertheless, the Riksbank has historically tracked the ECB closely, and with the ECB likely to raise rates more than once, it could deliver at least one hike in 2026.

The **Swiss National Bank** (SNB) left interest rates unchanged in its March meeting. The impact of the energy shock has driven headline inflation higher, but crucially for the SNB, underlying inflationary pressures remain muted and have been broadly unchanged in recent months. The SNB has signalled it remains in a comfortable position and is unlikely to hike interest rates unless there is a material worsening in the inflation outlook. The SNB has also reiterated its readiness to intervene in foreign-exchange markets to prevent excessive appreciation, signalling it views deflationary risks owing to exchange rate dynamics as a more pressing concern. The Swiss Franc's safe haven status, which often sees appreciation in the currency during times of geopolitical uncertainty, partially offsets the pass-through of increased energy prices, further dampening their effect on inflation. With imported goods representing approximately 22% of the inflation basket, a strengthening Franc exerts significant deflationary pressures.

The **Norges Bank** surprised markets by raising its key policy rate to 4.25% at its May meeting. Even before the latest energy shock, Norges Bank had been grappling with broader domestic inflationary pressures, including a healthy labour market. The Bank has signalled that further tightening may be required if inflationary pressures continue to build. We expect the Norges Bank to hike once more before the end of the year, taking rates to 4.5%.

Chart 9: Mixed response to the energy price shock is expected across European Central Banks



Source: BIS, Refinitiv Datastream, Bank of England, ECB, KPMG forecasts.

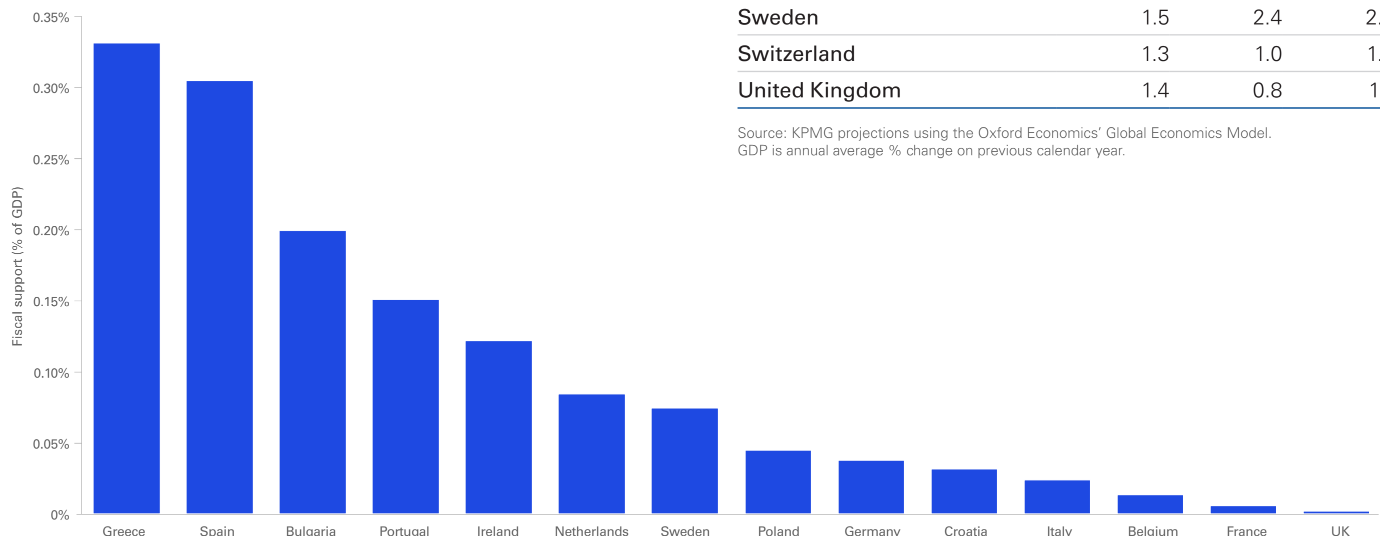
Outlook for government spending and finances

European governments face a growing challenge to support their economies both in the short and long run while ensuring longer-term fiscal sustainability amid limited fiscal space.

The **European Commission's Middle East Crisis Temporary State Aid Framework** (METSAF) grants governments the flexibility in EU fiscal rules to provide temporary relief to households and firms until the end of 2026. While many EU countries have introduced support measures since the onset of the war in Iran, these interventions are anticipated to be relatively limited, reflecting the small fiscal space available following earlier interventions to alleviate other shocks to European economies. This marks a clear departure from the broad-based support measures in 2022, with governments now focusing on balancing support for households while looking to also preserve the focus on fiscal sustainability.

As a result, the overall fiscal impact of government support measures is expected to be modest (see Chart 10). The majority of announced measures have clearly defined expiry windows, implying a relatively contained impact on fiscal balances. Some member states have called for a broader relaxation of EU fiscal rules, including activation of the General Escape Clause, but there appears to be limited appetite by the European Commission to pursue such route at this stage, reflecting concerns around excessive borrowing. Taken together, fiscal policy is therefore likely to provide only limited support to growth throughout 2026.

Chart 10: The fiscal impact of current support measures is anticipated to be small



Source: Bruegel. Current fiscal support measures include government policies implemented since the start of the Iran war to shield households and businesses from rising energy prices.

Table 2: KPMG projections for European economic growth

	2025	2026	2027
Austria	0.6	0.8	1.2
Belgium	1	0.9	1.1
Bulgaria	3.1	2.5	2.5
Croatia	3.4	2.6	2.3
Czech Republic	2.6	2.2	2.4
Denmark	2.9	2.3	1.7
Estonia	0.6	2.1	2.3
Finland	0.2	0.8	1.1
France	0.8	0.9	0.8
Germany	0.2	0.7	1.2
Greece	2.1	2.0	1.6
Hungary	0.5	1.6	2.4
Ireland	12.3	-0.1	2.8
Italy	0.5	0.6	0.6
Latvia	2.1	2.0	2.0
Lithuania	2.9	2.6	2.2
Luxembourg	0.6	1.8	1.8
Netherlands	1.8	1.3	1.0
Norway	1.8	1.2	1.2
Poland	3.6	3.5	3.0
Portugal	1.9	2.0	1.7
Romania	0.7	0.5	2.1
Slovak Republic	0.8	1.0	1.6
Slovenia	1.1	2.0	1.8
Spain	2.8	2.2	1.8
Sweden	1.5	2.4	2.3
Switzerland	1.3	1.0	1.3
United Kingdom	1.4	0.8	1.1

Source: KPMG projections using the Oxford Economics' Global Economics Model. GDP is annual average % change on previous calendar year.

© 2026 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

kpmg.com/uk/en/**macroeconomics**

© 2026 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

CREATE | CRT167338 | May 2026