

WP-Update

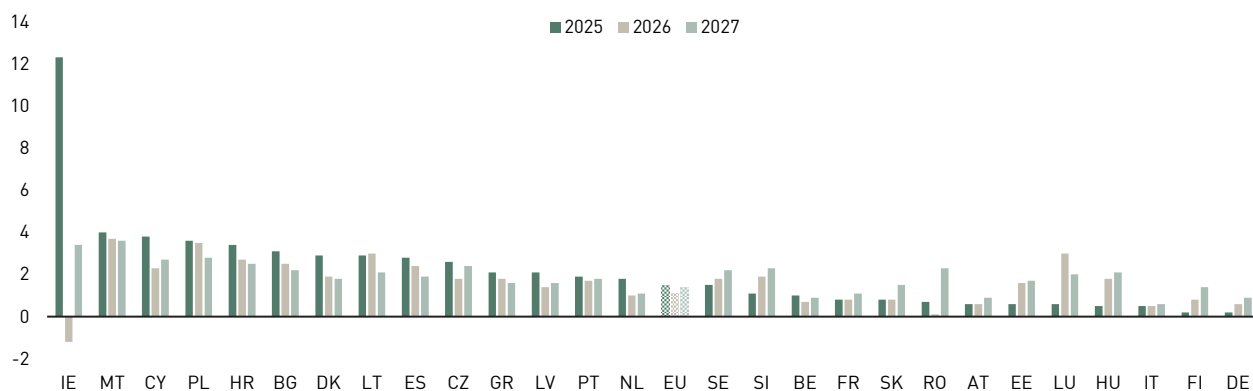
EU economic growth is decelerating

EU Economic Outlook 1/2026

The European Union is operating in an increasingly **challenging economic environment**. Rising uncertainty and geopolitical risks are weighing on economic activity and exacerbating existing **structural weaknesses**. While the previous year was largely shaped by the U.S. tariff policy, the economic outlook in 2026 is being driven primarily by the impacts of the conflict in the Middle East and the associated **energy and price shocks**. These developments are dampening growth, intensifying inflationary pressures, further eroding Europe's competitive position and widening fiscal imbalances. Against this backdrop, following moderate growth in 2025, **economic momentum is expected to weaken further** over the course of the current year.

The EU's average GDP growth rate masks significant disparities across Member States

Real GDP growth, annual change (%)



Source: European Commission, Economic Forecast Spring 2026.

After GDP growth of 1.5% in 2025, the European Commission's latest forecast projects **EU growth of just 1.1%** for the current year (euro area: 0.9%), a downward revision of 0.3 percentage points compared with the [autumn 2025 forecast](#). The subdued outlook is primarily driven by the conflict in the Middle East and the associated energy price shock, with effects expected to remain visible through 2027 (1.4%). However, the average EU growth figure masks **substantial disparities across Member States**. Significant imbalances were particularly evident in 2025:

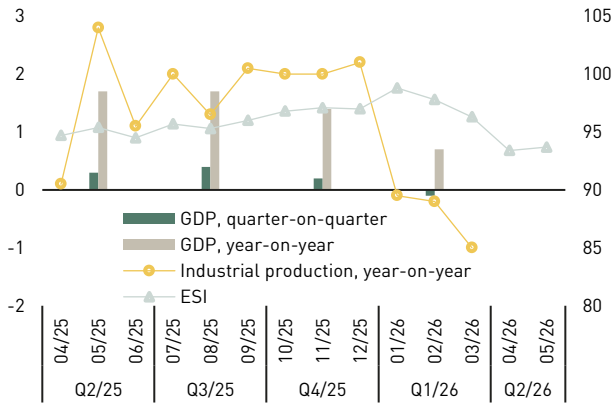
- Three of the EU's four largest economies recorded below-average growth last year. **Germany** recorded the weakest performance at 0.2%, while **France** (0.8%) and **Italy** (0.5%) likewise registered weak growth. Factors such as weak competitiveness, subdued external demand and low private consumption weighed on economic activity. By contrast, **Spain** (2.8%) recorded significantly stronger GDP growth, driven by a booming tourism sector, a resilient labour market and rising investment.
- Several Eastern European countries, including **Bulgaria, Croatia** and **Poland**, recorded GDP growth rates above 3%, driven by robust domestic demand and investment supported by EU funding. **Cyprus** (3.8%) and **Malta** (4.0%) also posted strong growth, underpinned by dynamic services sectors, especially in tourism, IT and financial services.
- **Ireland** stands out in particular, recording GDP growth of 12.3% in 2025. This was largely driven by frontloaded pharmaceutical exports to the U.S., as well as a resilient domestic economy with rising investment and robust private consumption. For the current year, however, Ireland is projected to be the only Member State to register negative GDP growth (-1.2%), primarily due to base effects stemming from the export frontloading in the previous year. In addition, the high concentration on a limited number of sectors dominated by multinational corporations increases the economy's vulnerability to external and sector-specific shocks.

The economic sentiment in the EU presents a mixed picture

In the first quarter of 2026, EU GDP contracted by **0.1%** (euro area: -0.2%) quarter-on-quarter, while still recording year-on-year growth of 0.7%. Industrial production also posted **negative growth** compared with the previous year. Overall economic sentiment across the EU likewise reflects the subdued economic environment.

Middle East conflict is dampening economic sentiment

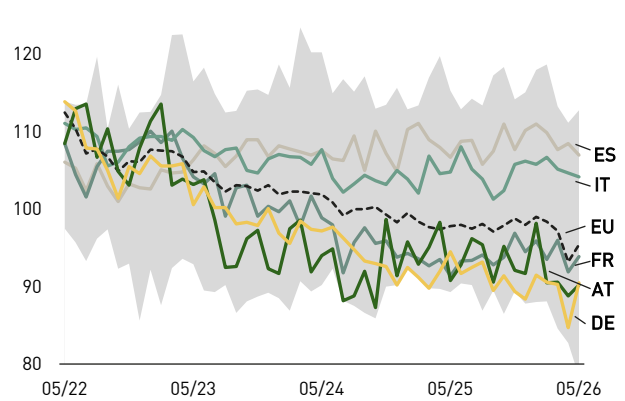
Economic Sentiment Indicator (ESI, right), growth rates of production indicators (%), left



Source: Eurostat | Seasonally and calendar adjusted. Industrial production for March 2026 is based on estimates.

Employment expectations are diverging

Employment Expectations Indicator (EEI)

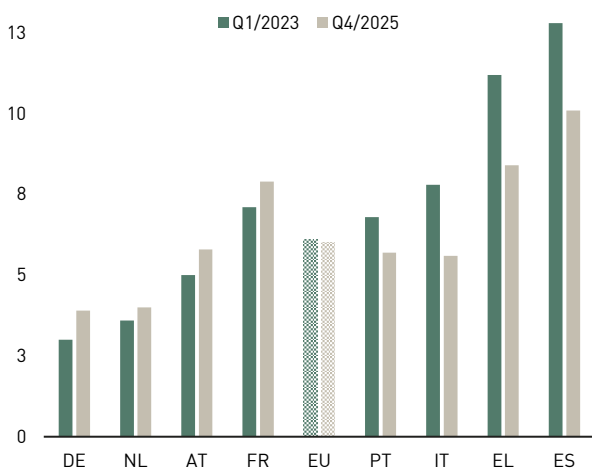


Source: Eurostat | Employment expectations for the next three months, seasonally adjusted.

- EU industrial production** increased by 0.8% in March 2026 compared with February, but remained **1.0% below the level recorded a year earlier**. The euro area saw a steeper year-on-year decline of 2.1% (+0.2% month-on-month). Headwinds included the unwinding of front-loading effects from the first quarter of 2025 – particularly in Ireland – as well as higher energy prices. In the first three months of 2026, Irish industrial output averaged 15.5% below the same period a year earlier. Weak industrial output in major economies such as Germany is adding further drag on the EU aggregate.
- The Economic Sentiment Indicator (ESI) and the Employment Expectations Indicator (EEI) both fell for the third consecutive month in April 2026, following a brief uptick in January.** In May, economic sentiment in the EU moved broadly sideways (+0.3 points), while employment expectations recovered somewhat (+2.1 points). Nevertheless, both indicators remain well **below their long-term averages**. Notably, employment expectations have shown increasingly divergent trends across EU Member States since 2023.

Labour market dynamics are increasingly diverging between Northern and Southern Europe

Unemployment rate (%)



Source: Eurostat | Seasonally adjusted.

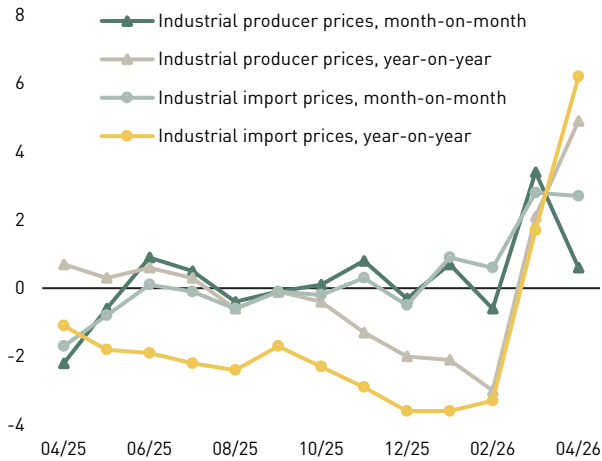
The **EU unemployment rate** held steady at 6.0% in April 2026, broadly stable since early 2025 (euro area: 6.3%). However, the aggregate figure masks **significant cross-country disparities**. While unemployment rates in Southern Europe remain comparatively high, they have declined noticeably in recent years, whereas countries with traditionally strong labour markets have recorded increases in their unemployment rates. Private sector employment growth has been stronger in Southern Member States, while job creation in Northern Europe has remained more subdued – weighed down by higher wage pressures and weaker cyclical conditions. Northern labour markets are also more industrially oriented, leaving them more exposed to structural weakness in manufacturing, while Southern economies have benefited more strongly from the (tourism) services sector.

Inflation is facing upward pressure

The Middle East conflict is fuelling inflation, particularly through **rising energy prices**, which in turn are also pushing up industrial prices. However, differences in energy dependency, energy mix and policy measures are resulting in **diverging inflation dynamics** across Member States. In response to mounting inflationary pressures, the European Central Bank raised its **key interest rate** for the first time since September 2023 by 0.25 basis points to 2.25%.

Industrial prices have recorded a significant increase

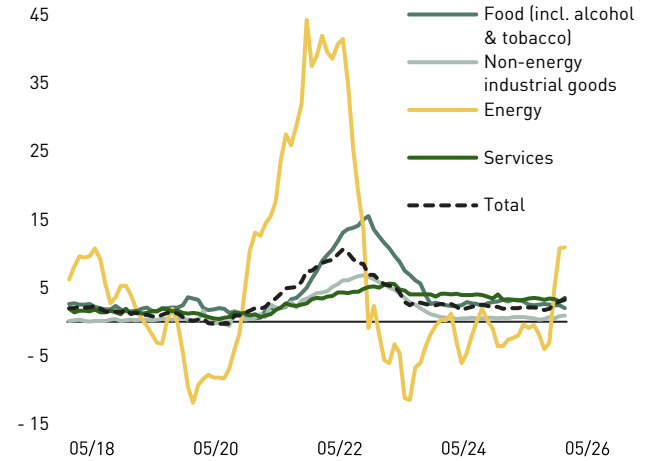
Rates of change for prices (%), euro area



Source: Eurostat.

Rising energy prices are adding to inflationary pressures

Annual rate of change (%), euro area

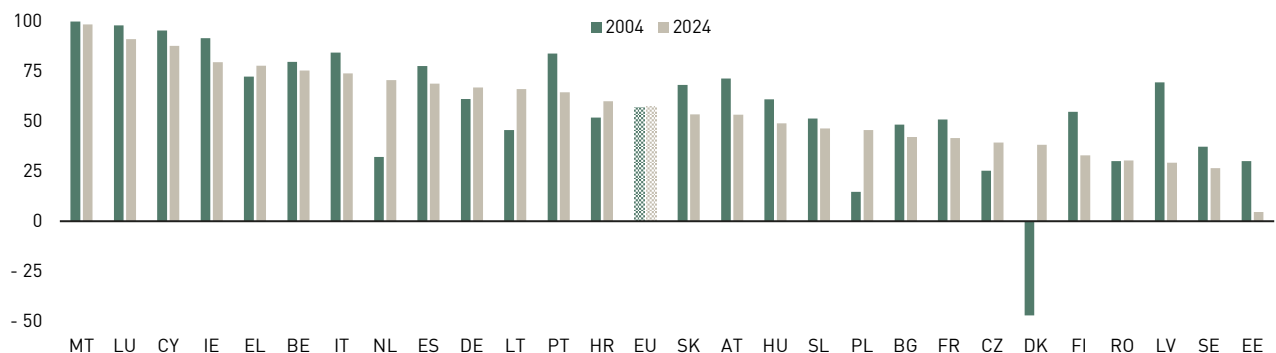


Source: Eurostat. | The May inflation rate is based on estimates.

- The Middle East conflict is driving up both **industrial producer prices** (April: +4.9% year-on-year) and **industrial import prices** (April: +6.2% year-on-year) through higher oil and gas prices, rising freight costs and more expensive intermediate goods, further weighing on Europe's already weakened price competitiveness.
- The euro area **inflation rate** is estimated at 3.2% in May, with **energy prices** rising particularly strongly (+10.9%), followed by services (+3.5%) and food (+2.0%).
- However, inflation shows **significant differences** among Member States. **Bulgaria**, which joined the euro area in early 2026, recorded the **highest overall inflation rate** in the euro area in May at **6.3%**, largely driven by the energy component (+18.2%). In addition, following the introduction of the euro, food and services prices saw somewhat above-average monthly increases compared with previous years – a pattern observed in earlier euro area enlargements as well.
- Outside the euro area, **Romania** stands out with an overall inflation rate of **9.5%** and energy inflation of 21.2% (April 2026). Beyond the impact of the Middle East conflict, energy prices had already been pushed higher in 2025 by the removal of electricity price caps. VAT increases have further contributed to higher food and services prices.

The EU continues to exhibit a high dependence on energy imports

% of net imports in gross available energy



Quelle: Eurostat. | Energy dependence refers to net energy imports (imports minus exports) as a share of total energy consumption.

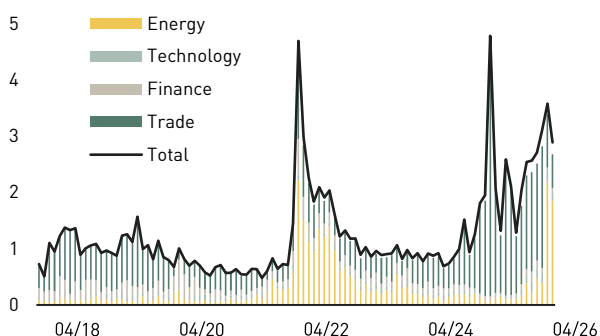
- The EU's **reliance on net energy imports of around 57%**, combined with its shift towards a more LNG-based system, leaves it exposed to global energy market shocks.
- Smaller economies such as **Malta, Lithuania and Cyprus** tend to be particularly import-dependent, though this does not necessarily translate into elevated energy prices. While **Luxembourg** recorded energy inflation **above 25%** in April and May 2026, contributing to one of the highest overall inflation rates in the EU (May 2026: 4.5%), energy inflation in Malta remained at 0% (overall inflation May 2026: 2.1%). This largely reflects a government price-fixing policy that has been in place for several years and subsidises electricity and fuel prices, thereby decoupling domestic energy prices from global market volatility. At the same time, these measures also place a significant burden on public finances.
- Measures aimed at mitigating rising energy prices are also expected to **increase public debt** in other EU Member States in 2026. Fiscal space, however, has narrowed significantly since the 2022 energy shock, reflecting additional spending pressures related to defence, demographic change and investment aimed at strengthening competitiveness.

Geopolitical tensions are weighing on Europe's economic model

Geopolitical tensions have increased significantly in recent years, placing growing strain on Europe. While 2022 was primarily shaped by **Russia's aggression** against Ukraine, which had major energy and security policy implications for EU Member States, 2025 was marked in particular by **U.S. trade policy**. The **Middle East conflict**, however, has brought the issue of energy price volatility back to the top of the agenda in most EU Member States.

International trade and energy supply are increasingly affected by geopolitical and geoeconomic developments

(L)arge-language-model (G)eoeconomic and Geo(P)olitical (T)ensions (LGPT)-Index (%)*

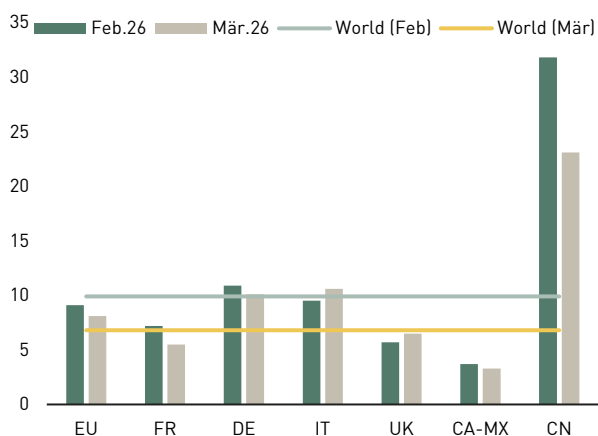


Source: Ioannou, D., Prioriello, R. & Durrani, A. | * Share of newspaper articles referring to geoeconomic tensions in France, Germany, Italy and Spain.

Geopolitical and geoeconomic tensions have reached their highest level since the introduction of the euro, with the areas of **international trade and energy** particularly affected. While tensions related to international trade dominated the policy agenda following Donald Trump's "Liberation Day" on 2 April 2025, the closure of the Strait of Hormuz at the beginning of 2026 has once again brought the energy sector into focus. At the same time, the blockade is also disrupting international trade, as the strait is a key transit route not only for energy commodities such as crude oil and LNG, but also for critical raw materials and fertilisers essential to global supply chains. This supply shock is translating into tighter global availability and higher prices for key intermediate inputs.

The EU's bilateral US tariff rate is significantly lower than that of China

Bilateral effective US tariff rate

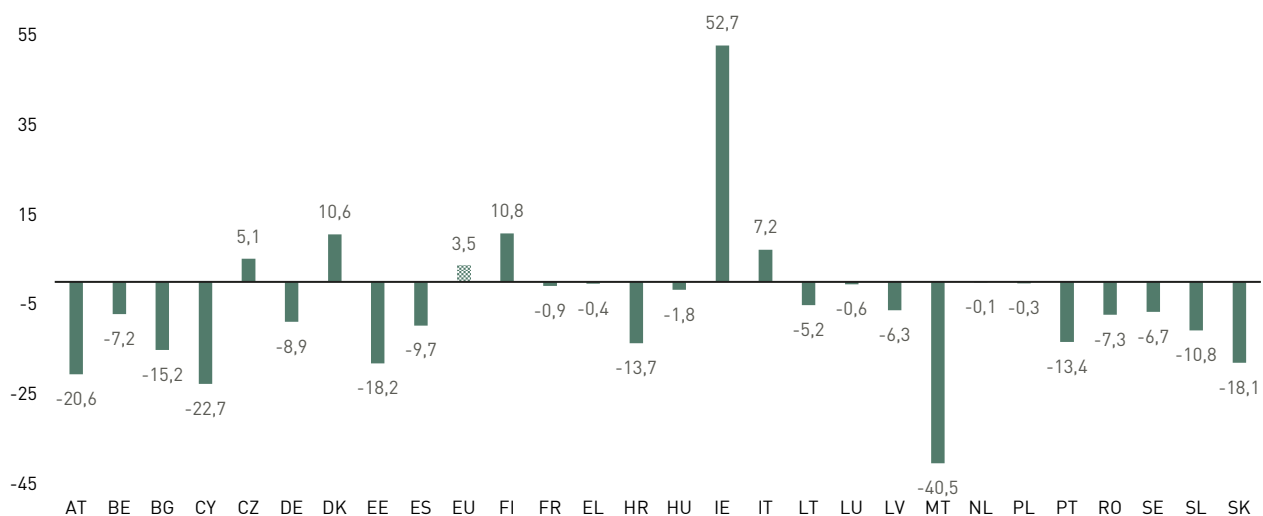


Source: IW Köln based on data from the US Census Bureau.

Following "Liberation Day" in April 2025, the global average effective US tariff rate rose from around 2.3% in 2024 to **more than four times** that level, before falling back to just below 7% after the repeal of the IEEPA tariffs in March 2026. The EU's effective tariff rate (March 2026: **8.1%**) has since remained above the global average, though still well below the levels seen in China and other Asian economies, giving the Union a relative competitive advantage. Within the EU, **Germany and Italy** – being the largest EU trading partners of the States – face a disproportionately high exposure to the U.S. tariffs, while **France** faces a comparatively lower burden. Furthermore, the cases of Canada and Mexico underscore the **importance of trade agreements**: Their effective tariff rates are well below both the global and EU averages.

Front-loaded pharmaceutical exports to the US boosted exports in individual EU Member States

Export growth (in value terms) to the U.S., 2025 compared with 2024 (%)



Source: Eurostat.

Despite its restrictive tariff policy, the U.S. remained the EU's most important export market in 2025. The announced tariff increases initially led to strong **front-loading effects** in the first quarter, followed by a decline in exports over the remainder of the year. Overall, EU goods exports to the United States still grew by around 3.5% in value terms compared with the previous year.

- This growth was, however, largely **driven by Ireland** (EU export growth excluding Ireland: -4.2%). Irish exports to the States increased by more than 52% in 2025, with over half of total exports consisting of medical and pharmaceutical products. Other Member States, such as **Italy** and **Denmark**, also experienced positive effects from front-loaded pharmaceutical exports.
- **Austria**, by contrast, saw exports fall by more than 20% in 2025, with the decline driven largely by pharmaceutical exports to the U.S., which accounted for the bulk of the overall contraction. However, given exceptionally strong pharmaceutical export growth in the preceding two years, this decline likely reflects one-off base effects rather than U.S. tariff policy. In addition, Germany's export downturn, particularly in machinery and automotive products, indirectly weighed on Austria's export performance.
- The sharpest declines in exports to the United States in 2025 were recorded by **Malta** (-40.5%) and **Cyprus** (-22.7%). Here too, however, U.S. tariff policy is unlikely to be the main driver, as both countries had previously benefited from one-off export surges in the shipping and aviation sectors.

Overall, the increase in EU exports to the United States in 2025 was primarily driven by a small number of countries and **temporary front-loading effects in the pharmaceutical sector**. A continuation of this trend appears unlikely in the current year. In the first quarter of 2026, EU exports to the U.S. contracted by **30%** year-on-year. Looking ahead, several factors are expected to weigh on export performance: U.S. tariffs of 15% on certain pharmaceutical imports from the EU, as well as the depreciation of the U.S. dollar against the euro, which could further erode the competitiveness of European exports.

Take: Energy price shocks and shifts in trade policy are hitting structurally diverse EU Member States in different ways. From a policy perspective, reducing vulnerability to global energy price swings through **renewable energy expansion** and **deeper energy market integration** is therefore a priority. Additionally, **trade relationships must be diversified** to secure geopolitically resilient market access. Further progress on **deepening the Single Market** remains urgently needed, particularly through reducing regulatory fragmentation and greater integration of services and capital markets. Finally, a more **targeted EU industrial policy** is needed to strengthen competitiveness and reduce strategic dependencies in the face of global pressures.



Follow us and
check our latest
publications!

Media Owner/Publisher:
Austrian Federal Economic Chamber
Economic Policy Department
Wiedner Hauptstraße 63, 1045 Wien
wpf@wko.at, wko.at/wp, Tel: +43 5 90 900 | 4401

Head of Department:
MMag. Claudia Huber

Editor-in-Chief:
Thomas Eibl

Author/Contact Person:
Theresa Francke,
theresa.francke@wko.at
Tel: +43 5 90 900 | 5336
24. June 2026