European Economic Outlook



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November 2026

Executive summary

- The eurozone economy has remained resilient to the energy price shock, geopolitical uncertainty, and trade disruption. A key factor affecting the outlook is developments in the Middle East and their impact on wholesale energy prices. Broadly in line with futures curves, we have assumed energy prices will gradually ease next year while remaining above pre-Iran conflict levels.
- Overall, we expect eurozone growth to be close to trend next year, at 1.2%, following 1.0% growth this year. But the composition of growth is changing.
- We see consumption growth slowing over the coming quarters, partly due to a squeeze on real incomes from higher inflation, and partly because of increased job insecurity leading to a rise in precautionary saving.
- Meanwhile, investment growth is likely to pick up, driven by AI (which has proven to be interest-rate insensitive), as well as defence and infrastructure spending in Germany.
- The risks to growth are skewed to the downside. Part of the economy's recent resilience reflects a reduction in existing buffers, including fiscal support to cushion the impact of the energy shock, drawdowns of natural gas inventories and a fall in the household savings rate, albeit to levels that remain high by historical standards. Long-term government bond yields have risen sharply. This rise has been synchronised across advanced economies, but those with weaker fiscal positions (e.g. France) have seen larger increases. Against this backdrop, the upcoming general election in France next year is coming into sharper focus.
- Potential upside risks to growth come from AI and the possibility of a quicker pace of integration within the eurozone. Completing the Savings and Investments Union would help to redirect the eurozone's savings surplus to productive uses within the bloc although progress is likely to be slow.
- Eurozone inflation is set to peak at just over 4% in the fourth quarter of 2026 but then should fall quite quickly towards the 2% target by the end of 2027 and into early 2028, assuming wholesale energy prices gradually decline. The likelihood of meaningful second-round effects from higher energy prices appears low given the gradual loosening of the labour market, rising job insecurity and slower consumption growth.
- The ECB has already raised interest rates twice this year, taking the deposit rate to 2.5%, the upper end of the neutral range. We expect further tightening, with two additional rate rises in December and March.

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Contents

The changing drivers of growth 2
Labour market softening, but only gradually 3
Public finances are coming under increasing pressure 4
Inflation outlook driven by energy prices 6
Monetary policy set to be tightened in the near term 7
EU–China trade: Trade barriers buy time for industrial renewal 9

The changing drivers of growth

European economic growth has remained resilient despite heightened geopolitical uncertainty and elevated energy prices following the conflict in Iran. Eurozone growth in the first half of the year was supported by robust domestic demand.

In the near-term, momentum is expected to fade as high energy prices weigh on consumption. We expect growth to pick up again in late 2027, supported by strong investment and a recovery in consumption as energy prices ease.

Robust consumption growth in the first half of the year was in part supported by a decline in savings rates, particularly in Nordic countries as well as Belgium and Italy (see chart 1), while fiscal support measures helped cushion lower-income households from rising cost-of-living pressures.

Some of this growth was driven by one-off spending, particularly on new cars, with new electric vehicle registrations surging in the second quarter. Consumers appear to have brought forward purchases ahead of anticipated price increases and to combat rising petrol and diesel prices; if so, this will weigh on demand in the near term.

The rundown of savings buffers is unlikely to provide the same support going forward. Greater fears of unemployment (see chart 2) will likely increase precautionary savings. For this reason, and because higher inflation will erode the purchasing power of household incomes, we expect consumer spending growth to moderate.

This softer outlook is consistent with recent retail sales data, suggesting consumer spending has lost momentum heading into the third quarter. While consumer confidence has partially recovered from its fall when the conflict in Iran began, it is well below its historical average. The easing in food price inflation, a highly visible component of household spending, has probably helped to support sentiment despite energy cost pressures, but this may not last long amid the further rise in wholesale energy prices, drought conditions in Europe and the possible impact of El Niño (see the inflation section below). Looking ahead, we expect consumer spending to recover towards the end of 2027 and into 2028 as inflation subsides and consumer purchasing power strengthens.

Investment is likely to play an increasingly important role in supporting the European economy. NGEU (NextGenerationEU) funds are expected to have some positive effect, although the expiry of this program is likely to see momentum fade in countries such as Spain. However, this is likely to be offset by stronger investment elsewhere in Europe.

In particular, significant public investment in infrastructure and defence in Germany is likely to support investment growth over the medium term while generating positive spillovers to private-sector activity. At the same time, AI-related investment in data centres and digital infrastructure, software and IT services across Europe is likely to become an increasingly important driver of growth.

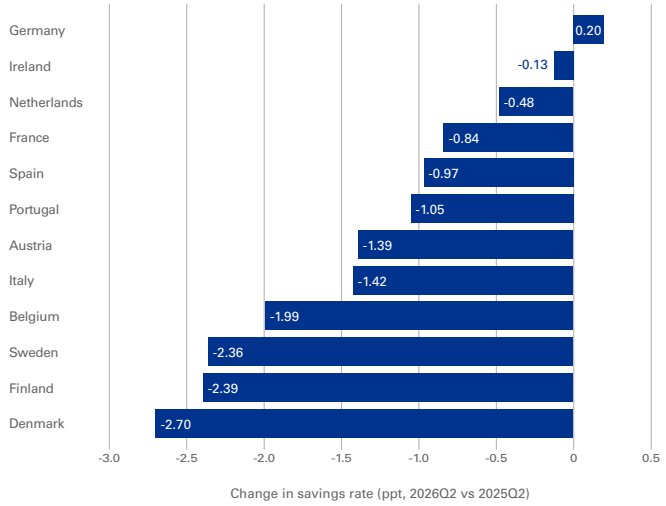
Table 1: KPMG eurozone economic forecasts

	2025	2026	2027
GDP growth	1.3	1.0	1.2
Consumption growth	1.5	1.1	0.9
Investment growth	3.0	0.8	1.8
Unemployment	6.3	6.4	6.4
Inflation	2.1	3.1	3.1
Key deposit rate	2.0	2.75	3.00

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

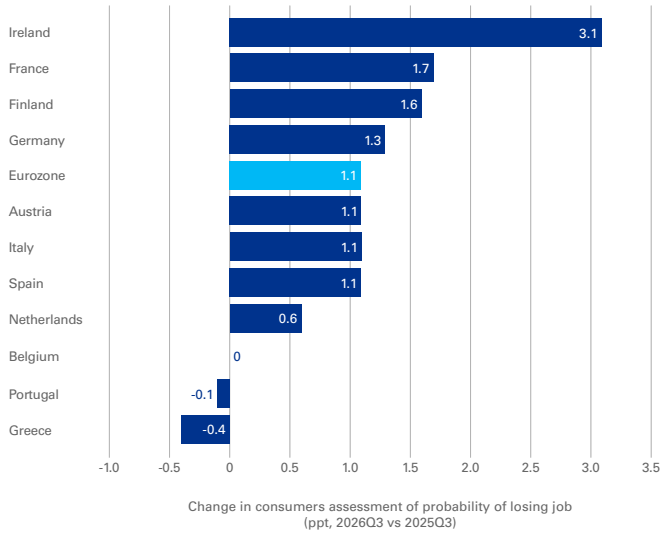
Eurozone measured by EA21. GDP, consumer spending and investment are all measured in real terms using seasonally and calendar day adjusted data. Average % change on previous calendar year except for unemployment rate, which is average annual rate, while key deposit rate represents level at the end of calendar year. Investment represents Gross Fixed Capital Formation. Inflation is measured as HICP.

Chart 1: Sharp reductions in savings rates supported consumption in the first half of the year



Source: Eurostat, KPMG.

Chart 2: Job insecurity may weigh on consumption growth



Source: ECB Consumer expectations survey, KPMG.

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Business investment was weak in the second quarter of the year, as increased uncertainty reduced firms' willingness to invest. However, the outlook is showing signs of gradual improvement. Survey indicators point to improving investment momentum, alongside stronger production expectations in capital goods sectors. Nevertheless, suppressed profit margins owing to elevated costs and tightening financial conditions are likely to weigh on non-AI-related private-sector investment in the near term.

In contrast, AI-related investment, which has so far proved relatively insensitive to higher interest rates in the US, could provide significant support, with 49% of firms in the eurozone planning to Invest in AI technology and tools over the next year.

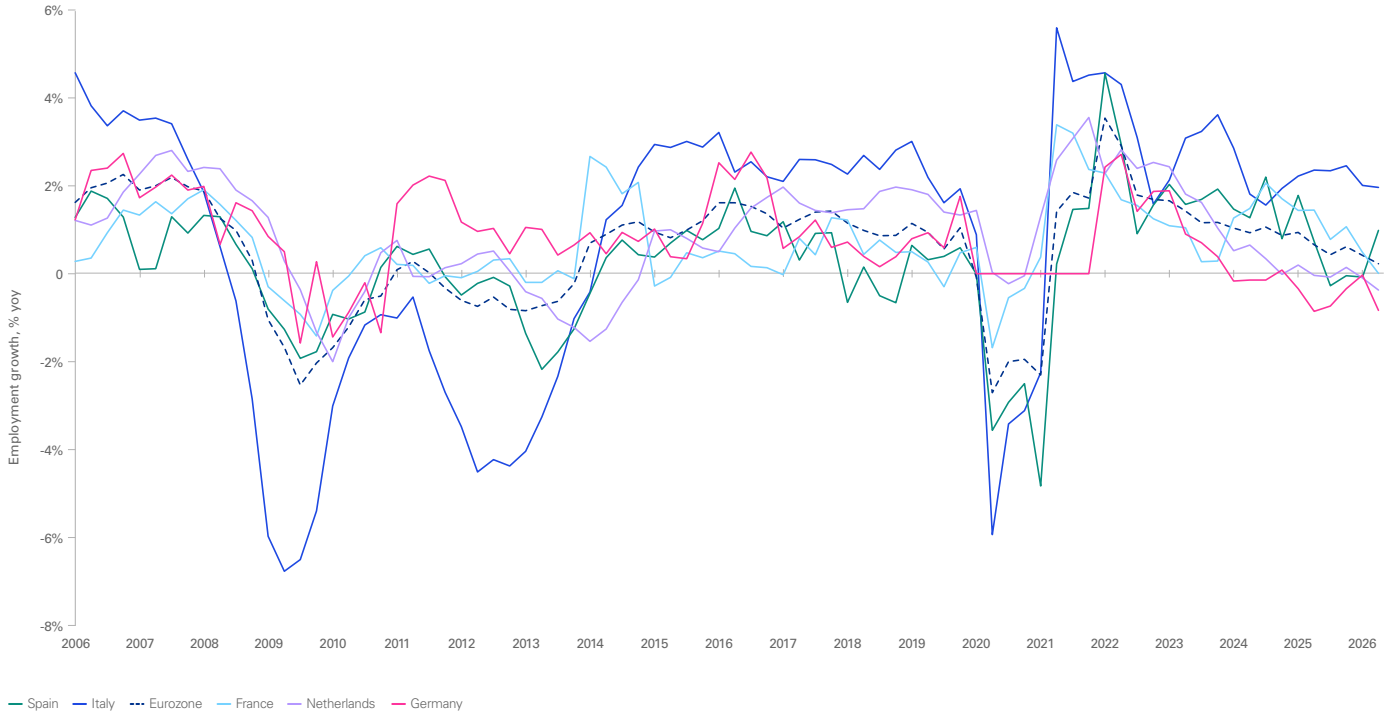
Labour market softening, but only gradually

Labour market conditions remain broadly resilient across much of Europe. However, employment growth has slowed (see chart 3) and unemployment rates have edged up in several member states, although they remain close to historic lows. This points to a gradual softening in labour market conditions.

Regional divergences are also apparent. Labour market weakness is concentrated in parts of Northern Europe, with countries such as Finland and Sweden experiencing relatively high and rising unemployment over the past year. By contrast, Southern European labour markets continue to outperform expectations, with countries such as Spain, Greece and Portugal still experiencing strong employment growth.

Looking ahead, we do not expect significant increases in the unemployment rate. Employment expectations have recovered somewhat since the start of the conflict in Iran, particularly in Germany, but remain below their long-run level, suggesting a gradual weakening rather than a sharp deterioration in labour demand. Nevertheless, workers remain cautious, with rising fears of unemployment likely to be partly driven by uncertainty over the impact of AI on jobs.

Chart 3: Employment growth has declined in recent quarters



Source: Eurostat; KPMG

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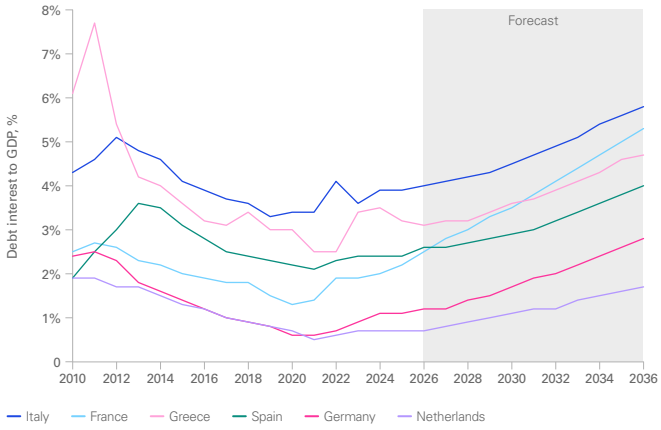
Public finances are coming under increasing pressure

Governments are facing growing demands to increase spending on defence, infrastructure and ageing populations, while subdued productivity growth and rising debt-servicing costs (see chart 4) are limiting fiscal space.

As a result, debt-servicing costs are increasingly competing with other spending priorities such as defence. Recent increases in sovereign bond yields (see chart 5) are exacerbating this challenge, with countries facing higher debt burdens and weaker fiscal dynamics experiencing more pronounced rises in borrowing costs, notably France.

This is placing greater pressure on governments to make difficult choices over consolidation and spending priorities to ensure fiscal sustainability. Balancing fiscal discipline against growing demands from areas such as ageing populations is likely to become an increasingly important constraint on growth in parts of Europe.

Chart 4: Debt interest burden for governments is expected to increase



Source: European Commission medium term fiscal plans, KPMG.

Chart 5: Concerns around fiscal sustainability have driven government borrowing costs higher



Source: LSEG, KPMG.

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Upcoming elections are likely to keep fiscal policy at the forefront of political debate across Europe. In France, the 2027 presidential election represents an additional source of uncertainty. The outcome could complicate fiscal consolidation efforts and contribute to further increases in sovereign borrowing costs, particularly as investors have become more concerned about long-term fiscal sustainability in the country.

Diverging fiscal positions and borrowing costs also risk widening economic differences between countries. Germany's relatively strong fiscal position is allowing expansionary fiscal policy to support growth with strong investment in defence and infrastructure. By contrast, France is coming under increasing market pressure to put its public finances on a credible path towards consolidation.

Italy remains committed to the consolidation efforts set out under the Excessive Deficit Procedure. However, the recent activation of the national escape clause to allow for greater energy and defence spending means Italy's latest fiscal forecasts show the deficit remaining above the 3% threshold until 2029. This may call into question expectations that Italy will leave the Excessive Deficit Procedure in spring 2027. Spain by contrast, has benefited from robust growth, helping to reduce fiscal pressures and improve budget balances.

Debate over spending priorities is also evident at the EU level, where negotiations regarding the next EU long-term budget (or Multiannual Financial Framework, MFF) are ongoing. With many member state elections coming next year, EU leaders are aiming to reach an agreement on the MFF by December, twelve months ahead of schedule. The latest negotiating proposal reduces the initially proposed budget by around 8%, bringing overall EU spending closer to levels under the existing budget. The reductions fall disproportionately on some of the new areas intended to provide greater flexibility, while protecting more traditional priorities such as agriculture and cohesion funding. Historically large recipients of EU cohesion funds such as Italy and Spain, as well as France for agriculture, could therefore benefit as this may shift resources away from newer priority areas and towards more traditional funding allocations.

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Inflation outlook driven by energy prices

Elevated energy costs continue to be the primary driver of inflation across Europe. The impact of LNG supply restrictions has been further compounded by low European gas inventories driving up demand as member states seek to replenish stock ahead of winter. Natural gas prices in Europe are expected to remain elevated over the winter before easing gradually next year while remaining above pre-Iran conflict levels (see chart 6). Europe's large LNG import capacity means outright supply shortages remain unlikely. However, if reserves remain low through the winter, energy prices could become more susceptible to weather-related spikes, particularly if cold conditions lead to sharp increases in demand (see chart 7).

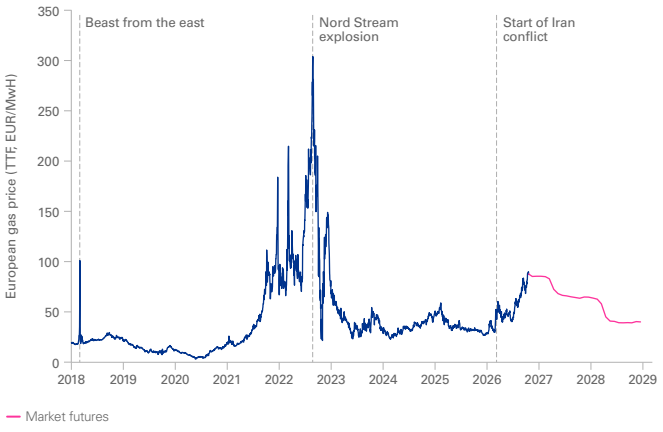
Eurozone inflation continued to rise to 4.0% in October, driven primarily by energy prices. However, across Europe the inflationary environment varies significantly. In Spain, inflation surged through the summer, reaching almost 5% in October as higher evening electricity demand contributed to a strong pass-through from gas prices to wholesale electricity prices. However, Spain's large share of renewable generation and more temperate winter climate mean this pass-through is likely to decline significantly during the winter months, providing some insulation from movements in gas prices. By contrast, inflation in Finland has remained more muted, reaching 3.4% in October, with the high share of renewables in electricity generation helping to contain energy-driven price pressures.

After likely peaking just over 4% in the final quarter of 2026, we expect eurozone inflation to moderate through 2027 as the contribution from energy prices fades and base effects lead to previous energy price rises falling out of the year-on-year comparison. However, the decline is likely to be gradual rather than rapid and is subject to substantial uncertainty, particularly surrounding developments in the Middle East.

Food price inflation has been weaker than expected in the first half of 2026, helping to keep inflation contained, but elevated energy prices, drought conditions in Europe, and the potential impact of the 'super El Niño' phenomenon reducing crop yields are all likely to place upward pressure on food prices. The UN FAO Food Price Index already shows signs of this, with raw food prices increasing by 1.5% month-on-month in September. As a result, food inflation is expected to build throughout 2027, peaking in the third quarter and keeping headline inflation elevated for longer.

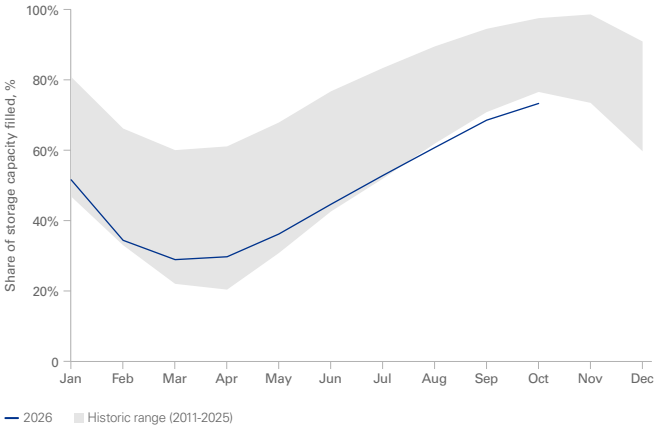
Evidence of broader domestic inflationary pressures has so far been limited. However, selling price expectations remained elevated in October, indicating firms are increasingly looking to pass on higher energy costs to consumers. That said, we do not expect a repeat of the wage-price spiral seen in 2022, as pass-through into wage growth has thus far been contained and firms' expectations are for wage growth to decline. Assuming oil and gas prices follow futures curves, we see inflation returning to the ECB's 2% target by the end of 2027 or early 2028.

Chart 6: European gas prices to remain elevated but below levels seen in 2022



Source: LSEG, KPMG.

Chart 7: European gas storage levels are at historic lows heading into winter



Source: ENTSOG, KPMG.

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Monetary policy set to be tightened in the near term

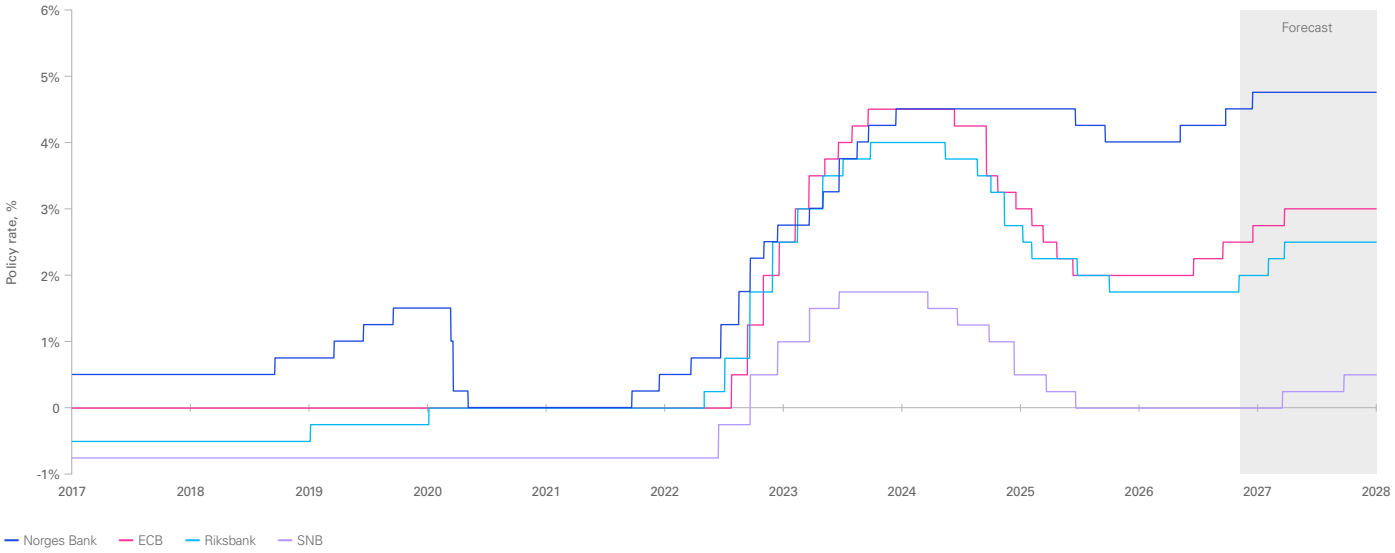
With eurozone headline inflation continuing to rise and domestic economic activity showing resilience, there remains a strong argument for further rate hikes by the European Central Bank. We expect two more rate hikes, in December and early 2027, to take the deposit rate firmly into restrictive territory at 3%. However, there has so far been limited evidence of higher energy prices feeding through to broader inflationary pressures, while the rise in bond yields across the region has itself tightened financial conditions. We therefore expect the ECB to stop raising rates once the deposit rate reaches 3%, before gradually returning policy towards a more neutral setting in 2028.

In Switzerland CPI rose by 1.5% year on year in October, continuing its gradual increase towards the middle of the 0-2% target range of the Swiss National Bank (SNB). This rise in inflation remains driven by imported petroleum products, although core inflation also edged higher in recent months, reaching 0.5% in September and stabilising in October. That said, there is little evidence of broader price pressures building, with both domestic and core inflation declining on a month-on-month basis from August. Average inflation in the third quarter was 0.7%, in line with the SNB's conditional inflation forecast. Inflation is expected to remain within the target range over the entire forecast period. As such, we expect the SNB to continue to hold rates at 0.00% in December before gradually normalising policy towards a neutral stance. However, risks to the inflation outlook remain skewed to the upside.

The Riksbank's dual mandate requires it to strike a delicate balance between returning inflation sustainably to its 2% target and supporting production and employment. That trade-off has become increasingly acute as Sweden's labour market remains weak with unemployment elevated, despite rising inflationary pressures. Headline CPIF inflation was just 1.5% in September, but this largely reflects lower energy prices and temporary fiscal support measures that are estimated to be reducing inflation by around 1.5 percentage points. With fiscal support measures expected to expire by the end of the year, inflationary pressures may rise. In its September Monetary Policy Report, the Riksbank signalled the economy is returning to capacity faster than anticipated, reducing the need for supportive monetary policy. As a result, we expect the Riksbank to place greater weight on its price stability objective and raise rates further in 2027.

Inflation remains the dominant consideration for Norges Bank. Despite policy already being firmly in restrictive territory at 4.5%, price pressures continue to show signs of persistence. Headline inflation rose to 3.4% in September, and underlying inflation also remains above target. Third-quarter domestic-price inflation, measured by CPI-ATE, came in slightly above Norges Bank expectations. Combined with forward guidance that continues to point to a policy rate above 4.5% by year-end, this suggests policymakers remain concerned about lingering domestic inflationary pressures. Given this, we expect the Norges Bank to raise rates again in December to 4.75%, though the timing of this hike remains finely balanced between December 2026 and March 2027.

Chart 8: Central bank policy rates are expected to tighten



Source: ECB, Norges bank, Riksbank and Swiss National Bank (SNB), KPMG forecasts.

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Table 2: KPMG projections for European economic growth

	2025	2026	2027
Austria	0.8	0.7	1.1
Belgium	0.9	0.6	0.8
Bulgaria	3.2	2.8	2.8
Croatia	3.6	2.1	2.4
Czech Republic	2.7	1.9	2.2
Denmark	3.5	4.0	2.0
Estonia	1.3	2.2	2.5
Finland	0.8	1.6	1.2
France	0.9	0.3	0.6
Germany	0.3	1.1	1.1
Greece	2.2	1.8	1.6
Hungary	0.6	2.0	2.0
Ireland	8.1	-3.5	3.5
Italy	0.7	0.8	0.4
Latvia	2.2	2.7	2.3
Lithuania	3.0	3.2	2.3
Luxembourg	1.4	1.3	2.2
Netherlands	1.6	1.8	1.3
Norway	1.7	1.0	1.8
Poland	3.8	3.4	2.8
Portugal	1.9	2.3	1.9
Romania	0.8	-0.6	1.9
Slovak Republic	0.9	0.8	1.2
Slovenia	1.4	3.5	1.2
Spain	2.6	2.6	2.2
Sweden	1.6	2.5	2.2
Switzerland	1.6	2.1	1.4

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

GDP is annual average % change on previous calendar year using seasonally and calendar day adjusted data. Norway measured by mainland GDP.

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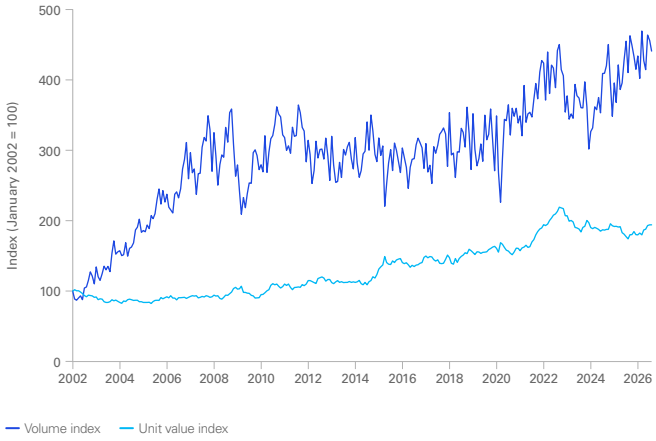
EU-China trade: Trade barriers buy time for industrial renewal

Trade relations with China have become a dominant policy issue in Brussels, as the EU's trade deficit with China reached almost EUR 365 billion in 2025 and continues to widen in 2026. The widening deficit has largely reflected rising import volumes rather than higher prices (see chart 9), highlighting the growing penetration of Chinese products across European markets.

European policymakers are increasingly concerned about the underlying sectoral dynamics driving these headline figures. The deterioration in the EU's trade position has been broad-based, extending across a range of technology-intensive industries including machinery, electronics, batteries and green technologies (see chart 10), consistent with China's shift to the technological frontier among other contributing factors.

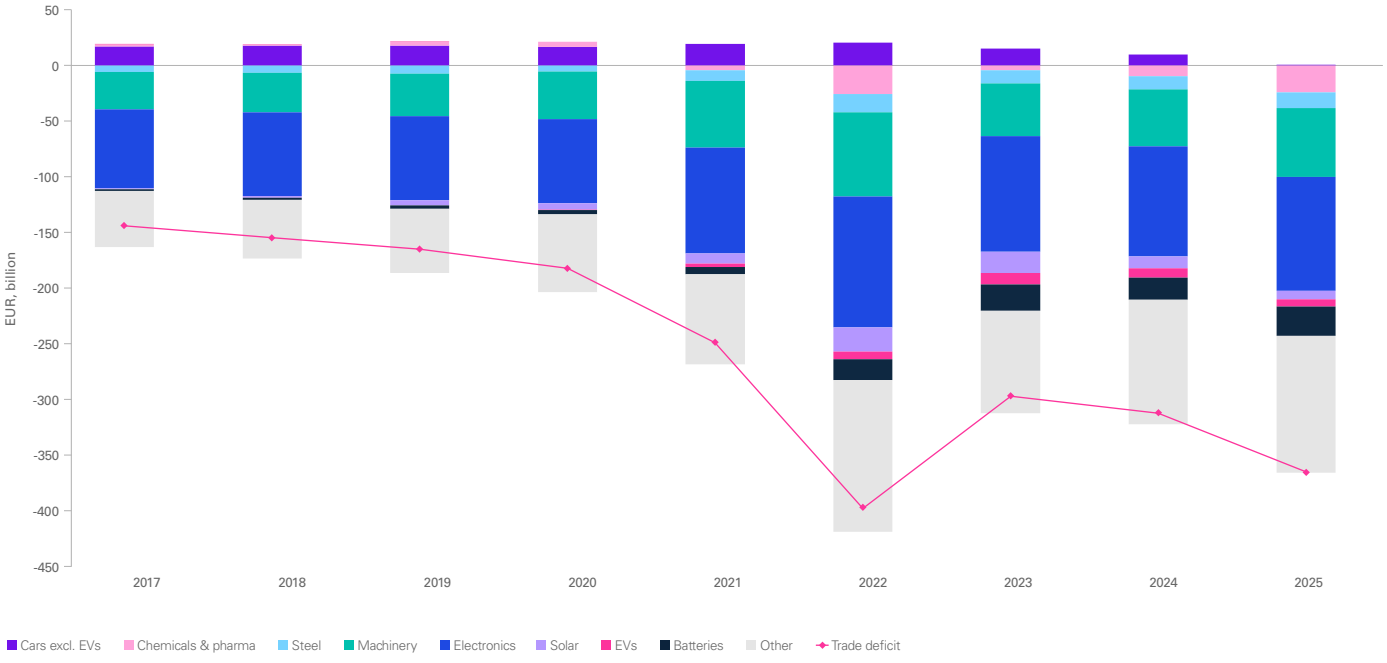
Importantly, Europe has lost ground in sectors where it has traditionally held a competitive advantage. The EU's trade surplus in internal combustion motor vehicles has almost disappeared, while the chemicals and pharmaceutical sectors have been net importers since 2021 (see chart 10). This has prompted increased concern among policymakers that the rise in imports from China reflects not only changing trade patterns, but a broader competitive pressure on Europe's industrial base.

Chart 9: Europe's deteriorating trade balance is driven primarily by an increased volume of imports



Source: Eurostat, KPMG.

Chart 10: EU trade balance with China has declined in technology intensive sectors



Source: Eurostat, KPMG.

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These trends are also evident in investment flows. Chinese investment into Europe has risen sharply since 2023, albeit remaining below the levels seen in the mid-2010s (see chart 11), with almost half of investment in 2025 directed towards the automotive sector and electric vehicle supply chain. Notably, these are the same industries where China's competitive position has strengthened most rapidly in recent years. Chinese firms are therefore expanding their presence in Europe not only through rising exports, but also through local production and investment. This suggests that Europe is becoming increasingly important both as a sales market and as a manufacturing base for Chinese companies.

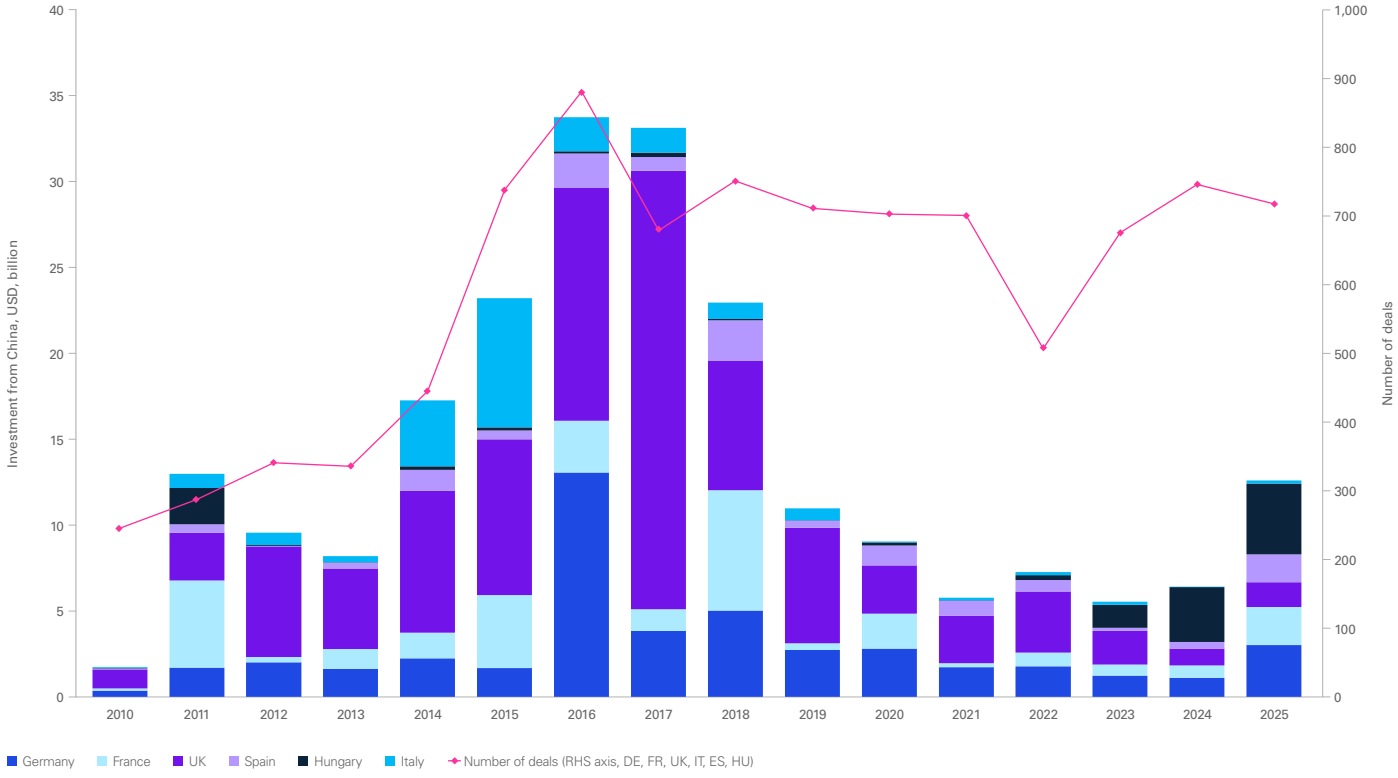
In October, France and Germany jointly advocated for stronger trade defence instruments including a proposal that would enable the EU to restrict access to the Single Market. While framed as a deterrent rather than a routinely used policy tool, the proposal highlights a growing willingness among European policymakers to adopt a more interventionist approach to trade policy.

Recent developments at the EU-China Trade Summit reinforced this trend. China has reportedly agreed to introduce voluntary limits on exports of hybrid and plug-in hybrid vehicles to the EU. While the economic impact is likely to be limited, and broader talks are still ongoing, the agreement reflects the extent to which concerns regarding Europe's industrial competitiveness are increasingly shaping relations with China.

However, the deterioration in Europe's trade position in sectors where it has traditionally held a competitive advantage points to deeper structural pressures facing the continent's industrial base. For Germany in particular, whose economic model has long relied on export-oriented manufacturing and technological leadership, the challenge increasingly lies in how to adapt in the face of this competition.

Sustaining competitiveness will require greater investment in innovation and technology to promote productivity growth. Trade defence measures may help give European firms time to adapt, but their long-term effectiveness remains contested. Critics argue that shielding firms from competition could weaken incentives to innovate and improve productivity, ultimately delaying necessary structural adjustment.

Chart 11: Chinese investment in selected European countries has surged in 2025



Source: Rhodium Group China Cross-Border Monitor.

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