ECOPERSPECTIVES

3rd Quarter 2026
September 2026

ADVANCED ECONOMIES



"HISTORY TENDS TO REPEAT ITSELF IN ADVANCED ECONOMIES. ONCE AGAIN, GROWTH ULTIMATELY FELL SHORT OF EXPECTATIONS BY ONLY A SMALL MARGIN IN THE FIRST HALF OF 2026, DESPITE THE CONFLICT IN IRAN. AS EARLY AS 2025, THE IMPACT OF TARIFFS WAS LESS SEVERE THAN FEARED. THIS IS A SIGN THAT STRUCTURAL FACTORS (NOTABLY AI, DEFENCE AND ELECTRIFICATION) ARE UNDERPINNING GROWTH IN THESE COUNTRIES"

ECONOMIC RESEARCH

BNP PARIBAS

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EDITORIAL

RESILIENCE TO SHOCK AFTER SHOCK

History tends to repeat itself in advanced economies. Once again, growth ultimately fell short of expectations by only a small margin in the first half of 2026, despite the conflict in Iran. As early as 2025, the impact of tariffs was less severe than feared. This is a sign that structural factors (notably AI, defence and electrification) are underpinning growth in these countries and are expected to continue to do so in 2027. However, there are significant risks to the economic outlook, primarily of a geopolitical nature, with a significant upside risk to inflation and interest rates. The other instance of history repeating itself concerns a period that those under 20 cannot have experienced: the period leading up to the 2008 crisis, echoes of which can be seen in terms of growth, inflation, the direction of monetary policy, and long-term interest rates.

Advanced economies are experiencing trends similar to those they faced nearly 20 years ago:

- **Growth remains resilient in 2025-26 despite shocks**, as it did in 2006-07, in the major advanced economies.

- **Inflation is above central banks' targets**: as in 2006-07, this calls for a tightening of monetary policy.

- **In Europe and the United States, long-term interest rates have returned to their 2006-07 levels (1996 in Japan)**: a challenging environment for public finances in a context where public debt ratios are significantly higher than those seen 20 years ago.

THE GLOBAL ECONOMY IN THE MIDST OF A GROWTH CYCLE

We are already well into 2026, and the picture so far is clear: global growth is proving resilient. Following a US tariff shock last year, growth is once again proving, for the time being, to be significantly less affected by the conflict in Iran than had been anticipated when it first broke out. Initially, however, there were fears that this new shock would hit growth even harder. As with the tariff hike in 2025, the impact was measurable, particularly in terms of consumer confidence. But in both 2025 and 2026, growth has also shown a degree of resilience.

The figures for the second quarter bear this out, despite the sharp rise in oil prices, the recessionary impact of which is not yet apparent. According to our forecasts, growth was expected to reach or exceed 1% in 2026 in the four major advanced economies (the Eurozone, Japan, the United Kingdom and the United States, where it exceeds 2%) for the second consecutive year. This had not happened (excluding the post-COVID catch-up period) since 2006-07. Growth figures are more moderate (particularly for demographic reasons), but the private sector is not (at present) showing the same excesses (at that time, the credit boom had preceded the worst crisis since the 1930s); although debt levels have recently risen in the US tech sector.

The driving force behind the current growth cycle is clear: artificial intelligence (AI). It is fuelling global trade and business investment in most countries. This is clearly the case in the United States, where business investment is growing strongly as investment plans in the US tech sector are implemented.

However, the world's major economies are currently engaged in a broader push to expand their capital goods investment. Alongside the ongoing development of services—particularly digital services—we have seen a rebound in industrial production in most countries since early 2025. The leading sectors are primarily technology equipment, machinery, aeronautics, defence and their essential inputs (energy and metals). This trend is evident everywhere, including in Europe, and is becoming entrenched over the long term, with an improvement in business climate indicators, particularly new export orders. Growth is therefore expected to strengthen further in 2027, particularly in the Eurozone, where German investment plans are set to gather momentum and whose spillover effects will have a greater impact on the economy.

Growth is more resilient to shocks than initially anticipated

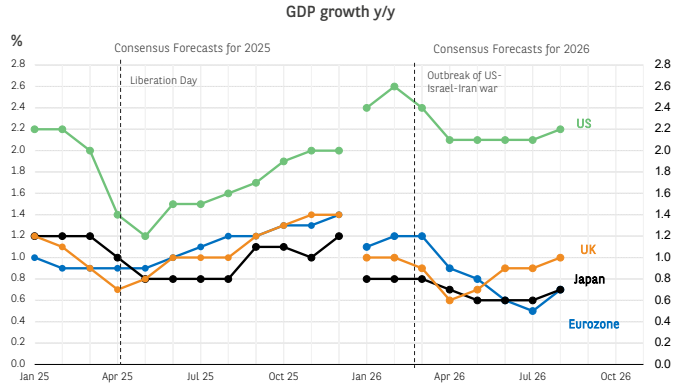


CHART 1 SOURCE: CONSENSUS FORECASTS, BNP PARIBAS

Growth is expected to pick up in 2027

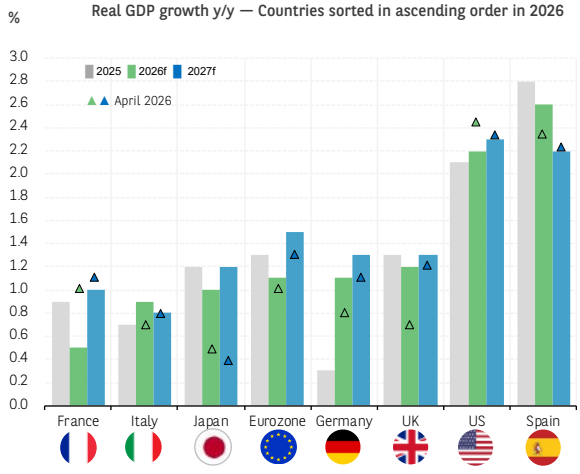


CHART 2 SOURCE: LSEG, BNP PARIBAS

However, not all sectors are experiencing the same momentum. This is particularly true for the sectors that depend on household consumption, which has shown mixed trends. Our observation that consumer spending is more buoyant in the United States than in Europe was confirmed in 2026, and the outlook does not point to a change in this ranking.

While European and US households are experiencing more or less the same energy price shock, inflation remains higher in the United States. But this has not prevented consumer spending from keeping pace, primarily because it is driven by the wealthiest households, who are less sensitive to inflation than to the wealth effect. Furthermore, while the savings rate remains high in the Eurozone, US households have been drawing down their savings. This is also true of British households, which explains why the UK has seen slightly stronger growth since the beginning of the year. In Japan, government spending has partially offset energy inflation (while other countries are doing so to a much lesser extent than in 2022), which has supported consumption growth.

However, these buffers—reduced savings or fiscal support—have their limits when shocks persist. The two major current conflicts (Iran and Ukraine) are far from being resolved, and their impact is continuing. This persistent geopolitical risk and its implications for inflation represent a significant headwind to the growth outlook for 2027.

HIGHER INFLATION CALLS FOR MONETARY TIGHTENING

Inflation is exceeding the target set by three of the four central banks examined in this publication, which is another similarity (albeit with different underlying causes) with the 2006-07 period. Japan is the exception, as government support measures for households are temporarily holding back inflation.

Apart from the Bank of Japan, which is engaged in a long-term normalisation process, no central bank was expected to raise its key rates in 2026. But they are now being prompted to do so for reasons that vary from one region to another. The first is the conflict in Iran and the resulting rise in oil prices, which triggered a rebound in energy inflation from the second quarter onwards. However, since the conflict was not resolved by the memorandum of understanding signed in June, and given that the subsequent drop in oil prices proved short-lived, inflation is expected to rise again. The rise in gas prices is expected to exacerbate the impact, particularly in Europe, where inventories are being replenished ahead of winter. Electricity prices are expected to follow suit in most countries, but at a more moderate pace than in 2022. Indeed, gas is now used less to generate electricity than it was at that time (thanks to the expansion of renewable energy), and to an even lesser extent in France.

There is a significant risk that energy inflation will spread further to other components of inflation in the future, and inflation expectations could eventually reflect this. This is why the European Central Bank has already raised its key interest rate twice (in June and September) and, according to our scenario, will likely do so again in December. For the same reason, we expect the Bank of England to raise its policy rate in November. Although the cap on energy prices was maintained for a long time, it has now been raised. As a result, inflation is expected to rise between now and the end of the year. The aim will then be to prevent second-round effects.

Inflation can also be a sign of (too much) economic strength. In the United States, it has exceeded the 2% target since 2021. The main argument in favour of a new cycle of rate hikes (following the one in 2022-2023) lies in the current resilience of growth and the improving labour market. The Federal Reserve (Fed) must balance two equally important objectives: maximum employment and price stability. However, unlike in the 4th quarter of 2025, when the decline in job creation justified monetary easing (by 75 basis points), the current sharp rebound in job creation completely reverses that analysis. According to our forecasts, the unemployment rate is expected to decrease in the coming months, which pushes back the prospect of a decline in core inflation. This situation persists due to both supply constraints

Inflation is expected to remain above the central banks' target in the coming months

Consumer Price Inflation (y/y) — Countries sorted in descending order in 2026

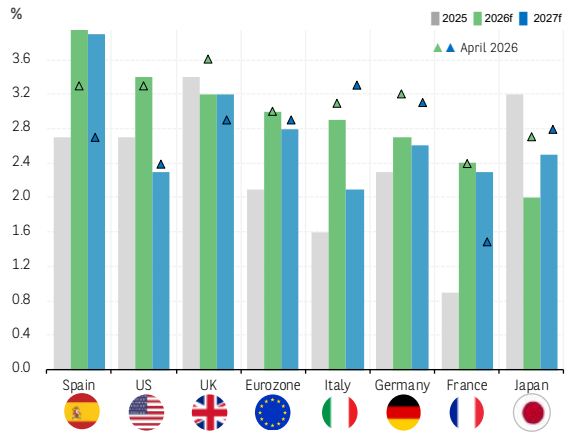


CHART 3

SOURCE: LSEG, BNP PARIBAS

(over which a central bank has no control) and excess demand (which the Fed can, however, mitigate). Consequently, the Fed raised its key rate in September and is expected to implement two further rate hikes between now and January 2027.

In Japan, finally, while headline inflation has been brought down by government support measures, core inflation remains significant. Wage pressures are mounting against a backdrop of labour shortages. The Bank of Japan is therefore being forced to accelerate the pace of its monetary normalisation.

In all these regions, inflation is currently expected to peak in Q4 2026 or Q1 2027. It is against this backdrop of temporary inflation that rate hikes could also come to an end by that time (excluding Japan). However, this assumes that once the energy shock—the course of which remains uncertain—subsides, inflation will fall. The effects of El Niño, which are still difficult to gauge at present, could take over. Inflation would then remain above the central banks' target for a longer period. Under this scenario, rate hikes would go further than is currently envisaged.

THE RISE IN LONG-TERM INTEREST RATES: A FACTOR THAT WILL WEIGH ON PUBLIC FINANCES

Monetary policies have also to offset the inflationary effects of fiscal policy, particularly in the United States (where the budget deficit is high and shows no signs of shrinking) and in Japan (where the new government is pursuing pro-growth policies). In Europe, fiscal policy is playing a much smaller role than it did in 2022. While the stimulus measures implemented at that time did help reduce the inflation rate in the short term (by nearly 2.5 pp in France, for example), by keeping demand at a high level, they delayed disinflation and increased the scale of the monetary tightening required.

The outbreak of the conflict in Iran acted as a catalyst: it triggered a rise in long-term rates (which had been trending downwards at the start of the year) to levels close to those of 2006-07. This rise is widespread, but its causes vary. Inflation expectations appear to play a more significant role in the Eurozone, whereas the rise in real interest rates seems to be the main factor in the United States and Japan.

Higher inflation and more resilient real growth than feared point in the same direction: stronger than expected nominal growth that is likely to be sustained. However, in the long term, high nominal growth tends to drive up nominal interest rates (as it is a positive sign of more profitable investment projects), in contrast to the problem of secular stagnation raised in the 2010s (which combined low nominal growth with low nominal interest rates).

The other issue is the high level of fiscal deficits (too high for a period of growth), with various situations. In several countries, the public debt-to-GDP ratio continues to rise. In the United States, deficit reduction does not appear to be a priority, to the extent that it is expected to remain above 6% of GDP at the very least until the end of Donald Trump's term of office (with little hope that the mid-term elections will significantly alter this trend). In the United Kingdom and France, fiscal consolidation has begun, but it is being hampered by the simultaneous increase in certain areas of expenditure (debt servicing, defence and healthcare, due in particular to an ageing population), which is slowing the pace of consolidation. In Germany, the implementation of investment plans is leading to a widening of the deficit. While this does not pose a sustainability problem, it does result in an increase in annual debt issuance. In Japan, the budget deficit is kept in check by interest payments that remain low, as the rise in interest rates is recent and the average maturity of the debt is high (10 years). However, expansionary fiscal policy could pose further problems in terms of debt dynamics if it were to continue through the end of the decade. In Italy and Spain, fiscal consolidation has been sufficient to stabilise the public debt-to-GDP ratio (and even to reduce it in Spain), but the high level of Italy's debt service it vulnerable to a rise in interest rates.

In all these countries, the fiscal arithmetic is simpler today than it will be in 2030. Indeed, in most cases, only half of the debt was issued after 2022 (that is, after the end of the zero-interest-rate period). The debt service has so far only partially risen, except in the United States, where most of the increase has already occurred due to a shorter average debt maturity (6 years). This means that, for all countries combined, the rate of GDP growth remains higher than the average interest rate paid on public debt (or the effective interest rate).

By 2030, the effective rate will have risen and caught up with GDP growth. As a result, in most cases, the debt service will have returned to the level as a share of GDP seen in the early 2000s. In order to stabilise public debt-to-GDP ratios, primary balances will need to have improved. This will even require the generation of primary surpluses, particularly in Italy (which is already achieving this), France and the United Kingdom. This is a crucial shift that governments will need to introduce as early as the 2027 budget; otherwise, they risk postponing the stabilisation of their public debt-to-GDP ratio once again.

Article completed on 17 September 2026

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UNITED STATES

A SHOCK-RESISTANT EXPANSION

US growth remains resilient despite successive shocks. According to our forecasts, it is expected to reach 2.2% in 2026 and 2.3% in 2027. Its main driver is still investment in artificial intelligence (AI), which has remained entirely unaffected by the energy crisis. The labour market has seen a marked improvement in job creation and a fall in the unemployment rate. Core inflation remains stubbornly high and above the Federal Reserve (Fed)'s target. Against this backdrop, the Fed has begun a hiking cycle in September, which, according to our scenario, would bring the Fed Funds target to 4.50% (upper limit) by Q1 2027. At the same time, long-term rates are under upward pressure.

THE ENERGY SHOCK IS NOT HOLDING BACK GROWTH

Driven by AI-related investment, US growth is holding up despite rising energy inflation. We forecast GDP growth at 2.2% in 2026 and 2.3% in 2027 on an annual average basis. The AI-related investment cycle[1] (+14.8% y/y in H1 2026) is expected to continue, accompanied by potential productivity gains. However, other private-investment segments (including residential property) remain sluggish. In addition, the rising cost of capital could accentuate its '**K-shaped**' profile. Household consumption is expected, on the whole, to benefit from the rebound in job creation and to remain above 2% y/y through to the end of 2027. In H1 2026, it held up against resurging inflation due to an average year-on-year increase of 11.5% in tax refunds and a savings rate standing at its lowest level since 2022 (2.8% in Q2).

RECORD CAPITAL-RAISING DRIVEN BY AI

This year, AI-related investments are driving massive capital-raising by companies through loans, bond issues or share placements. This trend is set to continue given the seemingly colossal scale of the funding requirements, even as risk premia in the bond market begin to widen. According to their statements, the five tech giants could invest nearly USD 900 bn this year and over USD 1,000 bn next year—more than double the figure for 2025. Spurred on by regulatory easing, the major US banks have announced that they will mobilise significant resources to support projects considered strategic for the United States (AI, defence, energy and infrastructure). While funding for the AI boom appears unaffected by rising long-term interest rates, these latter are likely to continue to weigh on household demand for mortgages. Since the start of the conflict in the Middle East, 30-year mortgage rates have risen by 78 bp (to 6.76% at the start of September). Conversely, consumer lending remained buoyant in H1 2026 and is supporting household spending.

TWO-SPEED GROWTH IN INDUSTRY

Industrial production rebounded slightly in 2025 (+1.1%), driven by AI and aerospace. We forecast an acceleration to +1.5% in 2026 and +2% in 2027. Investment in AI is bolstering the electronics sector, while the (civil and military) aerospace sector is rebounding as order backlogs are cleared and defence requirements rise. Conversely, sectors exposed to rising tariffs (in particular, the steel, aluminium and automotive sectors) are still on the back burner, contrary to the objective of these measures. This positive momentum in industrial production, while concentrated, is expected to continue, bolstered by the recovery in business sentiment. The ISM Manufacturing Index has been in expansionary territory since early 2026, despite ongoing pressures on prices and supply chains.

Growth and inflation

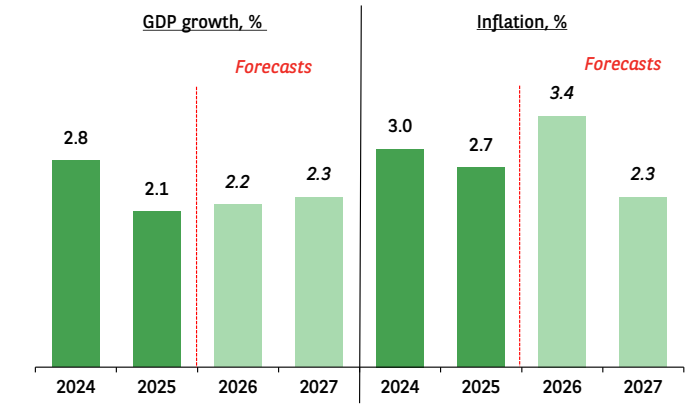


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Industrial production is being driven by the AI cycle and the aerospace sector

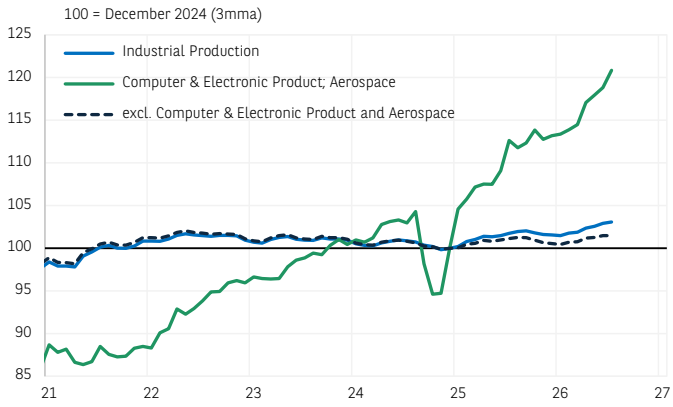


CHART 2 SOURCE: FEDERAL RESERVE, BNP PARIBAS

1 This includes: energy and communications; data centres (facilities); IT equipment and peripherals; communication equipment (equipment); software; and research and development (intellectual-property products).

LABOUR MARKET: A LOW UNEMPLOYMENT RATE ON A DOWNWARD TREND

Job creation (non-farm payrolls) has rebounded, averaging +80,000 per month since the start of the year, compared with +10,000 in 2025. This growth is no longer limited to the healthcare sector. Excluding healthcare, job creation is up by an average of +38,000 in 2026, compared with -47,000 in 2025. Manufacturing and construction, two sectors driven by AI, are contributing to this rebound. At the same time, the labour force has not grown since January 2025 due to the decline in the foreign-born workforce (down 4.2% cumulatively over the period). Excluding the impact of COVID-19, the labour force participation rate is at its lowest level since the 1970s, standing at around 61.5%. The rebound in labour demand and persistent pressure on the labour supply have brought the unemployment rate down to 4.1% in August 2026 (a 0.3 pp fall since the start of the year). The jobless rate is expected to fall to 3.9% at the end of 2027 (4.2% corresponds to full employment, according to the CBO) thanks to a job creation rate of around 40,000–60,000 per month.

INFLATION: STRUCTURALLY ABOVE TARGET

The rise in oil prices has triggered a rebound in CPI inflation. The contribution from the energy component (+1.2 pp) largely accounts for the rise in inflation since February. A slowdown was seen (from +4.2% to +3.4% y/y) between the May peak and August. This is expected to continue due to base effects on energy prices. We anticipate the trough to be +1.8% y/y in Q2 2027 before a stabilisation at around +2.3% y/y later in the year.

Meanwhile, core inflation is expected to remain above the Fed's 2% target, and above +2.5% y/y in 2027. This highlights the structural nature of inflation, beyond short-term fluctuations linked to energy. Non-housing services are expected to show significant inertia, with inflation hovering at around +3% y/y by the end of 2027. The potential for disinflation also appears limited for housing-related services, as the rise in rents shows no signs of abating. Finally, inflation on non-energy goods is slowing as the effects of tariffs fade. However, the AI cycle is exerting upward pressure through the general rise in the cost of electronic goods.

FED: GREEN LIGHT FOR RATE HIKES

The FOMC has embarked on a cycle of rate increases. The Fed Funds target was raised to 4.0% (+25 bp) at the September meeting, and we anticipate two further rises that would bring the policy rate to 4.5% in January 2027. These three rises (made possible by reassuring developments in employment and economic activity) are intended to reverse the three cuts in 2025 adopted to counter the 'downside risks' to the labour market at that time. As a result, the committee can recalibrate its policy towards 'price stability' and, through its interest rate decisions, reflect the priority given to this objective in its communications. The risks point towards further monetary tightening: in our baseline scenario, core inflation would remain sticky and the fall in unemployment would give the FOMC room for manoeuvre to raise rates further.

PUBLIC FINANCES: UNDERLYING DETERIORATION AND PRESSURE ON LONG-TERM RATES

According to our estimates, the federal deficit is set to widen by 0.7 pp to -6.6% of GDP in 2026 (by 0.4 pp to -3.1% for the primary deficit), weighed down by falling tariff revenue (refunds of tariffs already collected and lower-than-expected receipts). In 2027, the end of this one-off effect is expected to lead to a marginal improvement to -6.3% (to -2.8% for the primary deficit). The growing burden of interest payments (3.5% of GDP in 2026 and 3.6% in 2027, following 3.2% in 2025) and the conflict in Iran (affecting the military budget) are weighing on the budget balance and federal-debt dynamics. Federal debt is still on an upward trend, with no particular change in direction, exceeding 100% of GDP (101.9%, up 3.3 pp, in 2026, and 103.5% in 2027). It is expected to reach 110% by the end of the decade against a backdrop of budget deficits of close to 6% of GDP, assuming fiscal policy remains unchanged.

Furthermore, the mid-term elections (which see the entire House of Representatives and one-third of the Senate up for re-election) could result in a divided Congress or in both chambers changing hands to the Democratic Party. Should the former occur, this would increase the risk of a legislative deadlock, while the presidential veto would limit the Democrats' ability to influence fiscal policy in the latter scenario.

Against this backdrop, pressure on the bond market is likely to continue in the coming months. Treasury issuance is rising, fuelled by increasing spending requirements (in areas such as AI, defence and supply chains). At the same time, **shifts in investor demographics** are increasing demand volatility, and issuances by companies in the artificial intelligence sector are intensifying competition for capital. We anticipate a 10-year yield of 4.95% in Q1 2027, before a slight easing brought about by Fed rate rises, which would lend credibility to the price-stability objective. However, according to our forecast, 10-year yield is expected to remain close to a 20-year high, at 4.80% in Q4 2027.

THE US RELIES ON IMPORTS FOR ITS GROWTH

The US trade deficit has recently started to rise again. According to our forecasts, it is expected to account for the same proportion of GDP in 2026 as it did in 2024 (4.4%). This trend is driven by imports of AI-related capital goods, which are set to rise from 1.2% to 2.1% of GDP between 2022 and 2026. Investment in AI is, in fact, import-intensive (*Chart 2*), which dampens its positive impact on growth and highlights the US's dependence on foreign supplies in a cycle that it is nevertheless spearheading.

The additional tariffs have failed to reverse the trend in the trade deficit. Furthermore, the IEEPA tariffs struck down by the Supreme Court were replaced, in July 2026, by 'Section 301' tariffs (forced labour) ranging from 10% to 12.5%. These tariffs target 60 countries and have been introduced on top of existing sector-specific tariffs (steel, aluminium and automotive). Following these adjustments, the statutory rate (measured against the 2024 import structure) remained slightly above 10%. The main risks relate to potential new sector-specific tariffs and the renegotiation of the USMCA.

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EUROZONE

GROWTH ON TRACK DESPITE THE TURBULENCE

Growth was stronger than expected in Q2 and is set to strengthen further in the coming quarters. According to our forecasts, it will reach 1.5% in 2027 after 1.1% in 2026. This growth is expected to be driven by investment and its knock-on effect on exports. On an annual average basis, inflation is expected to stand at 3% in 2026 and 2.8% in 2027, peaking at the end of 2026. The ECB is expected to continue its monetary tightening. At this stage, a single further rate rise, aimed at keeping inflation expectations anchored, is expected in December. The impact of rising interest rates (key policy rates and market rates) on public finances and private sector borrowing conditions will be worth monitoring.

GROWTH: BEYOND THE SHOCKS, A RESILIENT MOMENTUM

Growth in the Eurozone remained robust in the first half of 2026, at 0.25% q/q in Q1 and 0.33% q/q in Q2, excluding Ireland (where economic activity is volatile). It was driven by Germany, where signs of a recovery are becoming clearer (*see* ***Germany***). Our baseline scenario forecasts growth of 1.1% in 2026, followed by 1.5% in 2027 on an annual average basis. This growth is expected to be driven by the strengthening of trends already underway in public and private investment (particularly in defence and AI) and in exports (trade in services and intra-zone trade in goods). Household consumption is likely to be resilient too. According to our forecasts, job creation would continue to underpin household incomes, thereby cushioning the impact of inflation.

A NEW LEASE OF LIFE FOR INDUSTRY

The Eurozone is undergoing one of the most profound industrial transformations in its history. This is giving rise to divergences between key sectors but, above all, to new drivers of growth whose effects are becoming increasingly apparent (***see our analysis***). Indeed, the signs of an economic recovery are growing stronger. Business sentiment indicators show a marked improvement in the economic outlook across most sectors (*Chart 2*), driven primarily by electronics (AI, digitalisation), the automotive sector and aerospace. European industry is thus benefiting from strong demand for capital goods; a structural trend that will continue to be fuelled by ongoing investment cycles in AI, defence and electrification. The introduction of minimum European content quotas in the draft law on the industrial accelerator, together with the Commission's intention to tighten the criteria for access to European public procurement markets, will provide additional support for European industry in the longer term.

FOREIGN TRADE: A REPOSITIONING THAT IS PAYING OFF

Following a decline in 2026, linked to rising energy import costs, the trade surplus is expected to rise to around 3.0% of GDP in 2027 (of which 2% of GDP for goods and 1% for services). Growth in European exports has slowed compared with its pre-Covid trend and is being hampered by the decline in Chinese and US markets. However, Eurozone exports in volume rose significantly in Q2 (+3.4% q/q).

More importantly, since Liberation Day (April 2025), Eurozone countries have found significant sources of growth amongst other European partners, which has enabled them to cushion the decline in exports to certain third markets. This is evident in exports to the rest of the EU, EFTA countries (Switzerland in particular) and, to a lesser extent, the United Kingdom, Ukraine and the Balkans (*Chart 3*). The momentum of intra-European trade therefore remains very strong. It is expected to strengthen further with the anticipated investments in defence, AI and electrification.

Growth and inflation

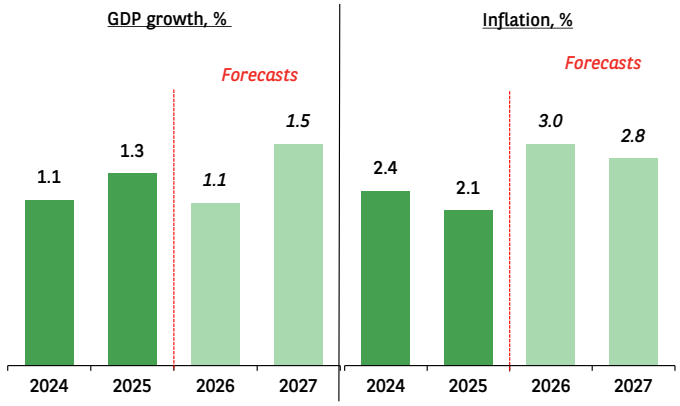


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

A broader recovery in industrial activity is on the horizon

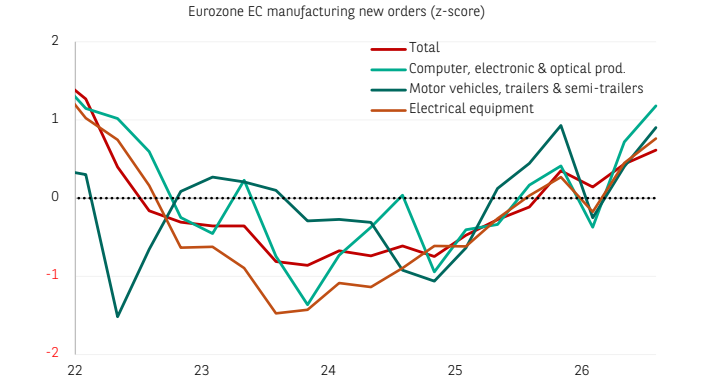


CHART 2 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

FINANCING: FINANCIAL CONDITIONS ARE EXPECTED TO REMAIN TIGHT

Financial conditions in the Eurozone remained tight in Q2 2026, according to indices calculated by the ECB (including the BIG [Broad Intermediation Gauge]). They are expected to tighten more significantly in the second half of the year: i/ the rise in long-term bond yields, which has accelerated since the outbreak of the conflict in Iran, is expected to continue; and ii/ the ECB will continue its monetary tightening (+25 bps

Exports to Europe help offset weaknesses in other markets

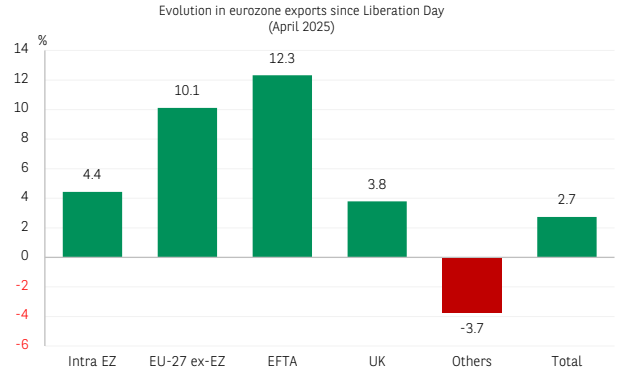


CHART 3

SOURCE: EUROSTAT, BNP PARIBAS

in Q3, then in Q4). For the time being, the debt burden is still weighing only moderately on public finances due to the long average maturity of countries' debt (8.2 years on average in the Eurozone in July), but this burden will increase by 2030.

On the corporate front, the rise in interest rates has remained contained (+2 bps since January 2026, reaching 3.9% in July), which has contributed to the strong growth in new investment loans (cumulated over one year, +9.1% y/y in July compared with 15.3% y/y in September 2025). By contrast, cumulative net debt securities issues over one year remained stable in July, whilst cumulative net issues of listed shares over one year halved month on month.

Rising interest rates will continue to hamper new variable-rate home loans to households (around 65% of new lending) more significantly than fixed-rate loans, for which rates stood in July at 3.69% (+4 bps m/m) and 3.36% (+2 bps m/m) respectively. New home loans, which are stable in 2026 on a cumulative over one year basis, are therefore unlikely to see any improvement. A fall in real-estate transactions could weigh on new consumer credit through a reduction in expenditure on home furnishings and renovations, whereas consumer credit has been fairly buoyant so far (year-to-date, +5.2% y/y in July compared with +1.4% y/y in January).

LABOUR MARKET: RESILIENCE YET TO BE CONFIRMED

Employment in the Eurozone rose again by an average of 0.1% q/q in the first half of 2026, driven by Spain and Portugal. Given the growth outlook in these two countries, this momentum is likely to continue, whilst business sentiment surveys in Germany suggest that employment is beginning to stabilise. Nevertheless, employment levels are plateauing (France, the Netherlands) or even falling in other countries (Austria, Finland), which is likely to slow the decline in the Eurozone unemployment rate, meaning it is expected to remain close to current levels in 2027. Furthermore, second-round effects of the rise in inflation on wages cannot be ruled out: the ECB's wage tracker suggests wage growth of close to 3% by summer 2027 (2.9% y/y in June 2027, compared with 2.6% in September).

INFLATION: A PEAK EXPECTED IN LATE 2026

Changes in wage dynamics will be a key factor in the inflation outlook for 2027, whilst energy price rises are picking up again, driven by the conflict in the Middle East. This rise is even sharper than in the spring for gas (linked to restocking ahead of winter) and is likely to feed through to electricity prices in several countries. We therefore anticipate inflation peaking at 3.7% y/y in Q4 2026, before easing as the energy component falls. On an annual average, headline inflation is expected to stand at 3% in 2026 and then at 2.8% in 2027.

At this stage, the pass-through of rising energy prices to other components of the consumer price index, particularly services, remains limited. The alternative core indicators monitored by the ECB, including the PCCI (Persistent and Common Component of Inflation, 2.1% in July), remain close to the 2% target. Core inflation, however, is expected to peak two months later than headline inflation (3% in March 2027).

Inflationary risks are nevertheless tilted to the upside. These are linked to food prices, which are expected to be affected by the energy shock and weather conditions (summer drought, El Niño); they could also stem from a delayed impact of energy price rises on underlying inflation. The rise in prices of energy-dependent inputs (notably chemicals and plastics) and those linked to the AI sector is expected to be sustained. Growth, which we expect to remain robust over the coming quarters, will also fuel underlying inflationary pressures.

MONETARY POLICY: TIGHTENING WITHOUT SLOWING (GROWTH)

Following two 25-basis-point rises (in June and September), we expect a third in December, which would bring the deposit facility rate to 2.75%. It would then be in slightly restrictive territory (we estimate the upper bound of the neutral rate to be 2.5%). This rise would be aimed primarily at anchoring inflation expectations and, consequently, at curbing the pass-through effects of inflation. Monetary tightening would therefore remain limited. Indeed, the overshoot of the inflation target would be temporary, and the operational framework adopted by the ECB in June 2025 allows it to tolerate this, provided it remains brief. However, it cannot be ruled out that the ECB might take further action if the decline in inflation proves slower than expected.

PUBLIC FINANCES ARE CONTINGENT ON RISING INTEREST RATES

The fiscal impulse in the Eurozone is expected to be clearly positive in 2026 due to the rise in defence and infrastructure spending in Germany. This will contribute to a widening of the country's primary deficit (from +0.9 pp of GDP to 2.8%, according to our forecasts). The improvement in public finances is expected to stall in both France and Italy, at least in 2026, due to the impact of inflation on the debt burden *via* index-linked bonds. This trend is expected to reverse in 2027 with less expansionary fiscal policies. Nevertheless, the increase in the debt service burden would fuel a further rise in the public deficit, which would thus reach around 3.3% and 3.5% of GDP in 2026 and 2027 respectively (compared with 2.9% in 2025). Against this backdrop, the Eurozone's public debt-to-GDP ratio is projected to exceed 90% of GDP in 2026 and reach 93% of GDP in 2027, according to our forecasts.

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GERMANY

AN EXPORT-DRIVEN RECOVERY

Growth, which began in the fourth quarter of 2025, gained momentum in the first half of 2026. This momentum should continue, with expected growth of 1.1% in 2026 and 1.3% in 2027. In the short term, the main driver will still be exports, particularly to Europe, which will contribute to restructuring industry. The impact of investment plans is expected to strengthen in 2027, while domestic demand is likely to remain constrained by inflation (2.7% in 2026 and 2.6 % in 2027), which will weigh on purchasing power. Fiscal stimulus and structural reforms are expected to continue to support growth. However, the rise in the deficit and debt levels means that the increase in long-term interest rates observed so far is mostly structural.

A RETURN TO GROWTH DRIVEN BY EXTERNAL TRADE

The first half of 2026 confirms the rebound in growth (0.4% and then 0.3% q/q in Q1 and Q2). This growth is driven by foreign trade (contributions from net exports of +0.8 pp and +0.2 pp, respectively, with +0.9 pp on average coming from exports and -0.4 pp from imports), following two years of contracting exports, particularly those to Europe (*see below*). The increase in public expenditure (***see our analysis***) reflects the implementation of investment plans, with the multiplier effect on growth of these plans expected to increase.

In the second half of the year, growth is expected to remain robust, pushing the annual average to 1.1% in 2026 (following 0.3% in 2025). Exports are set to remain the main driver, thanks to continued strong European demand, which is compensating for domestic demand that remains sluggish. Growth of private consumption will, in fact, remain subdued by energy inflation. Business investment is expected to be driven by dynamic sectors (defence, technology equipment and aerospace), which would limit the impact of rising interest rates.

In 2027, growth (1.3%) would be based more heavily on domestic demand, with greater spillover effects from investment plans and a likely recovery in household consumption (following a peak in inflation in Q1 2027). At the same time, external demand is expected to remain strong, but its contribution to growth would be lower than in 2026. This is because the stronger growth in domestic demand would stimulate imports to a greater extent.

INDUSTRY IS BENEFITING FROM AI INVESTMENT AND INTRA-EUROPEAN MOMENTUM

The business climate in industry improved significantly at the start of the second half of the year (the manufacturing PMI has risen by 4 points since May, reaching a four-year high in August). New export orders have even reached their highest level since early 2022. These positive signs put into perspective the risks associated with the summer's climate events (heatwaves and the historic drought on the Rhine), which disrupted industrial activity and river transport.

Since early 2025, output in some sectors has rebounded, particularly in the electronics sector (+6.4 %). Manufacturers of electrical equipment, as well as IT and electronics firms, are benefiting in particular from the wave of investment in data centres and defence. If this momentum continues, it could offset some of the losses recorded in the automotive and chemicals sectors, which have both seen the sharpest falls in output since late 2017 (-12.8% and -19.4%, respectively).

The sustained increase in military spending on medical technologies and robotics across Europe is driving a restructuring of the intermediate-goods sector. Companies exposed to struggling sectors are gradually turning towards these new markets. However, this reorientation is not fully offsetting the loss of historical markets.

Growth and inflation

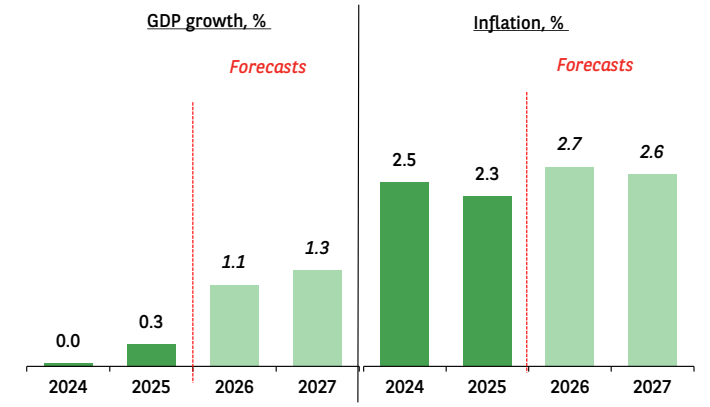


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The rebound in German industry is also being fuelled by European demand. While exports to China (-12.7% YTD in July) and the United States (-1.5%) have certainly continued to fall, exports to a number of European Union countries have risen sharply, particularly in Southern and Central Europe. This shift is benefiting machinery and transport equipment (47.6% of goods exports, up 20.5% since January 2025) in particular. We expect this momentum to continue in 2027, creating a virtuous cycle that reinforces European growth.

A STAGNANT LABOUR MARKET

The situation in the German labour market has stabilised over the past several quarters, but it is not yet showing signs of improvement. The unemployment rate is shifting relatively little (4% in November; +0.2 pp y/y) and remains below the Eurozone average (6.4%). Falling employment in the manufacturing sector (-0.6% since Q4 2019) is offset by an increase in the services sector (+0.9%). Nevertheless, the latest business climate surveys suggest that the situation may stabilise. The gradual retraining of the workforce in struggling sectors is helping to meet some of the needs arising from new investment.

Generally speaking, in the longer term, pension reform should support the labour supply. As a matter of fact, it will help to increase the number of workers gradually, notably through the phasing out of early retirement at 63 and the indexing of the retirement age to life expectancy from 2032 onwards.

Although the unemployment rate is set to remain low, wage growth would remain limited, particularly in 2026, as negotiated wages will offset inflation to a lesser extent than they will in 2027. The planned increases in the minimum wage (+8% in 2026 and +5% in 2027, to EUR 14.6 per hour), significant as they are, will have little knock-on effect on the rest of the wage scale.

PURCHASING POWER CONTINUES TO BE SQUEEZED BY HIGH INFLATION

Wage purchasing power is expected to fall further in 2026, having already lost 4 pp since 2022, before stabilising in 2027. The reduction in income tax (by EUR 10 billion, or 0.2% of GDP), which will come into force next January, is also expected to support the disposable income of low- and middle-income households.

Inflation has been rising again since the start of the summer and is expected to remain above 2% throughout our forecast horizon. It has accelerated since June (+0.5 pp to +2.9% y/yin August) driven by a further rise in energy prices (+6.7 pp to +9.4% y/y), while core inflation remains stable at +2.6%. From spring 2027 onwards, the expected easing in energy prices (particularly gas prices) should bring down inflation. However, this decline will be limited by the inflationary effects of the wider roll-out of investment plans, as well as by the expected rise in food prices.

This inflation, which has been structurally higher since the onset of the 2022 energy shock, will weigh on household consumption. Furthermore, German households' propensity to save remains high by international standards (with a net balance 15 points higher on average over the last ten years, according to the European Commission), which is also weighing on their consumption.

FISCAL STIMULUS CONTINUES

After recording a public deficit of -3% of GDP in 2025, we anticipate a further deterioration in the public balance to -4% in 2026, then -4.2% in 2027. The primary deficit is projected to reach -2.8% of GDP in 2026 (after -1.9% in 2025) before narrowing slightly to -2.7% in 2027. At the same time, the interest burden is expected to rise gradually from 1.1% of GDP in 2025 to 1.5% in 2027. This combination will result in a rapid rise in the debt-to-GDP ratio, from 62.6% of GDP in 2025 to 66.1% in 2026 and then 69.7% in 2027, before approaching 85% by the end of the decade.

The yield on the 10-year Bund rose above 3.5% on 14 September, its highest level since 2007. In addition to the increase in issues linked to extra-budgetary funds, inflationary pressures are also contributing to this rise. A gradual easing of inflation next year would make a moderate easing of sovereign yields possible in 2027. However, yields would remain high, at 3.2% in Q4 2027, suggesting that the bulk of the rise is structural.

At the same time, the government is continuing to implement its programme of structural reforms, including measures to support business investment, health-insurance reform, pension reform and an overhaul of the tax system. A number of measures have come into force, particularly accelerated depreciation for business investment until 2027, which will be followed by a reduction in corporation tax from 2028. Administrative simplification is also set to lead to an overhaul of the tax system from January 2027[1]. The health-insurance reform has been passed, while the pension reform is still under discussion, with expectations that it will be adopted by the end of the year.

Industry is restructuring and benefting from investment in AI and defence

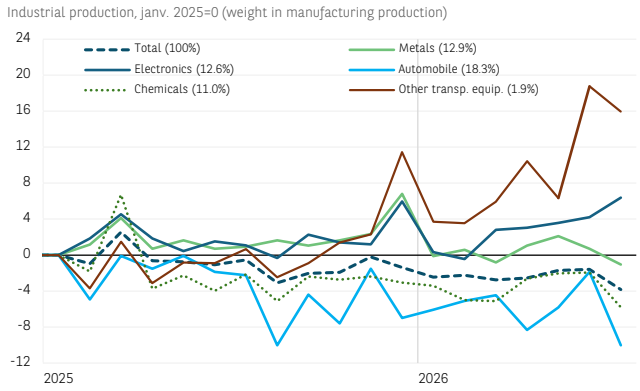


CHART 2

SOURCE: DESTATIS, MACROBOND, BNP PARIBAS

The intra-European reorientation of German exports is underway

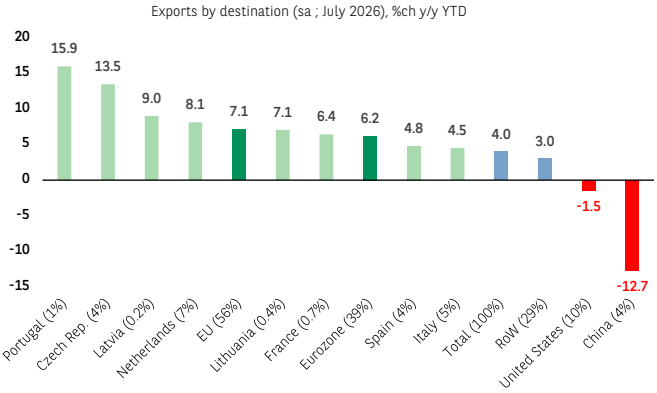


CHART 3

SOURCE: BUNDESBANK, MACROBOND, BNP PARIBAS

Article completed on 14 September 2026

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1 The main measure will be a reduction of EUR 10 billion per year in income tax for individuals on low incomes, funded in part by an increase in taxes on high earners. The bill will be submitted to Parliament in the autumn, before being implemented from 2027.

FRANCE

GROWTH IS BENDING, BUT NOT BREAKING

French economic growth will underperform in 2026, partly due to a number of exceptional setbacks. In 2027, it is expected to rebound to 1% (compared with 0.5% in 2026), supported by rising external demand (particularly from Europe). So far, businesses and households appear to be weathering the rise in inflation relatively well, although it is expected to continue (we are forecasting 2.3% inflation in 2027, following 2.4% in 2026). Fiscal consolidation remains challenging, complicated by the weak growth seen in 2026, and is expected to be implemented gradually. As a result, public debt is expected to rise, with a moderate upside risk due to the rise in sovereign-bond yields.

GROWTH: HEADING TOWARDS A RECOVERY?

France narrowly avoided a recession in H1 2026 due to exceptional factors: a decline in public investment (which is typical in the run-up to municipal elections), a drop in agricultural production, and energy inflation.

The slowdown in public spending (investment and consumption) is significant. Its contribution to growth has been declining since 2025 (0.3 pp, down from 0.6 pp in 2024), a trend that is expected to continue in 2026 and 2027 (0.2 pp). The decrease is particularly pronounced for public investment (+5.2% in 2024, +2.7% in 2025 and forecast of -1.6% in 2026), for which the outlook remains negative.

Business investment is expected to recover after a decline in H1. Order books are filling up again, particularly for exports (*see below*), and investment intentions are rebounding, according to the INSEE. After being affected during the early months of the conflict in Iran, in August 2026, the business climate returned to a level close to its pre-dissolution level (as it had already done between December 2025 and February 2026). Unlike in 2022, the energy-price shock has, for the time being, had little impact on electricity prices. As a result, profit margins remained stable in Q2 2026, standing at 31.5% (they had fallen by 1 pp during the same period in 2022).

Households have also weathered the inflationary shock better than had been feared, with consumption rebounding in Q2. Consumption growth is expected to remain fairly stable between 2025 and 2027 (+0.5% annually), thanks in particular to the favourable momentum in electric-car sales. Conversely, household investment (which declined in H1) is expected to continue to decline, adversely affected by the moderate rise in interest rates.

MANUFACTURING OUTPUT LIMITED BY SUPPLY-SIDE CONSTRAINTS

Manufacturing output has rebounded since mid-2025, driven by the aeronautics sector (where output rose 15.5% over the following 12 months). This rebound has been more moderate in other sectors, but is significant in electrical (+2.5%) and electronic (+4.2%) capital goods, as well as in several inputs (metals: +1.8%).

This rebound is driven by exports, particularly exports to Europe. It is fuelled by investment plans in defence (***see our analysis***), infrastructure in Germany and demand linked to electrification (AI, energy and electric vehicles).

However, this rebound in industrial output has lost momentum in recent months (-1.2% in July, 3m/3m), despite improving order books. Supply-side constraints increased in H1, while, at the same time, business investment contracted (back down to its Q2 2024 level in Q2 2026).

Growth and inflation

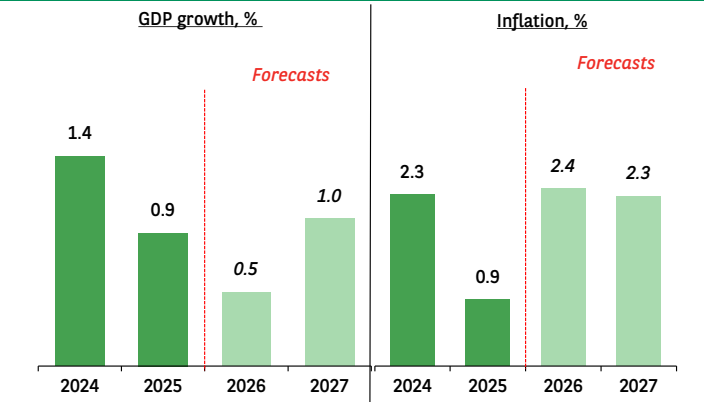


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The business climate has absorbed the rise in inflation well

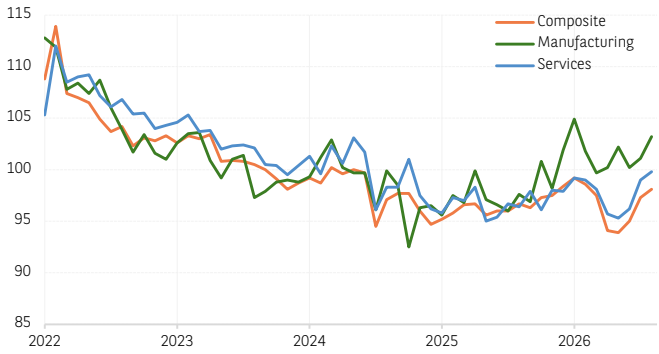


CHART 2 SOURCE: INSEE, BNP PARIBAS

DEMAND FOR FINANCING FROM BUSINESSES REMAINS STRONG, WHILE OUTSTANDING LOANS TO HOUSEHOLDS ARE STABLE

In June, investment loans to companies (+4.5% y/y) were driven by housing loans (+5.1% y/y), while loans for equipment were less buoyant (+4.1% y/y). Market-based financing was also robust year on year (+4.8%) but declined month on month. With a new phase of rising interest rates appearing to have begun, growth in financing to NFCs could

slow. Political uncertainty is also likely to weigh on the outlook, but investment is expected to continue to be bolstered by spending on technology, the energy transition and defence.

Household investment could be held back by the rising cost of new housing loans, which is expected to increase more significantly in the second half of 2026, following an initial rise observed in June–July from 3.1% to 3.17%. It should be noted that the average interest rate remained stable at 3.1% until May, despite the rise in short- and long-term market rates. Indeed, the increase in these rates stems from the rise in the sovereign-bond yield, which has no direct influence on the cost of bank funding (within certain limits). Our scenario of continued rate rises suggests that the rate on new housing loans is likely to increase. New lending was at a low level in July (EUR 11 bn, compared with around EUR 12.5 bn between March 2025 and March 2026). Outstanding amounts would continue to rise only slightly (less than 0.3% y/y in June 2026) due to persistently high repayment flows, linked to the high volume of new lending during the period of low interest rates. The deterioration in households' property purchasing capacity would weigh on transaction volumes and, ultimately, on house prices.

THE DETERIORATION IN THE LABOUR MARKET REMAINS MODERATE

The rising unemployment rate over the past two years (+0.9 pp to 8.3% in Q2 2026) reflects the gradual deterioration of the labor market. This is due to sluggish growth in private-sector payroll employment (101,000 net job losses over the period), which was not offset by the creation of 20,000 public-sector jobs. This slowdown stems primarily from the construction sector (nearly 50,000 net job losses). Despite a rebound in order books, the manufacturing sector lost jobs (-26,000), as sectors with strong order books struggled to recruit. At the same time, self-employment (204,000 net new jobs over the past two years) continued to drive total employment (103,000 net new jobs). The coming months are expected to follow the same trends. The unemployment rate is projected to reach 8.5% by the end of 2026 and peak at 8.7% in mid-2027.

A MODERATE INCREASE IN INFLATION

France entered the conflict in Iran with low harmonised inflation: 1.1% y/y in February 2026, 0.8 pp below the Eurozone average—a gap that has persisted since then. While French inflation reached 2.7% in August, its core component remains below 2%, whereas it is above in the Eurozone.

Nevertheless, household purchasing power is expected to contract by 0.5% in 2026, before stabilising in 2027. Wage growth has not accelerated so far (excluding the minimum wage, which rose +2.4% in June) and fell below inflation in Q2 2026 for the first time in two years. In addition, unlike in 2022, government aid has done little to offset this inflation, due to a milder shock and more limited fiscal leeway than at that time.

According to our forecasts, inflation is expected to peak between late 2026 and early 2027, at 3.4% y/y, before easing as energy inflation moderates. It is expected to remain below the Eurozone average, particularly if electricity production and prices continue to be only slightly dependent on natural gas (as has been the case so far in 2026, unlike in 2022).

TIME IS PLAYING AGAINST FRANCE'S PUBLIC FINANCE

France still enjoys an effective interest rate (the average rate paid on the total public debt) of just over 2%. With an average maturity of nearly 8.5 years, a portion of the debt continues to carry a rate close to zero. As a result, the debt burden is projected to account for "only" 2.5% of GDP in 2026 (2.1% in 2025). However, with 10-year market rates currently above 4%, an increase in the debt servicing is only a matter of time (we project it to reach 4% of GDP in 2030).

The rise in interest payments will put pressure on the public deficit

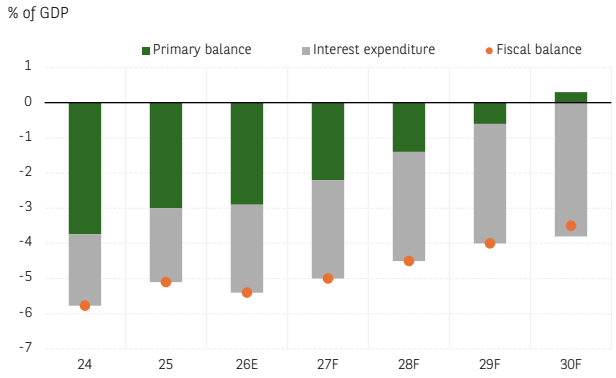


CHART 3 SOURCE: MACROBOND, BNP PARIBAS FORECASTS

This increase, combined with additional defence spending, will total nearly 0.5 pp per year between now and the end of the decade, which will complicate efforts to reduce the fiscal deficit. After a decline in 2025 (from 5.8% to 5.1% of GDP), 2026 is expected, according to our forecasts, to see a moderate deterioration in the fiscal deficit (to 5.4% of GDP), due to the additional increase in the debt servicing linked to inflation (because of inflation-indexed bonds) and lower-than-expected growth.

In its draft budget for 2027, the government plans to reduce the deficit to 5% of GDP, with the adjustement spread more evenly than in previous years (for the first time, retirees would be asked to contribute EUR 6 billion). However, with no majority in the National Assembly, fiscal consolidation is expected to remain moderate. The public debt-to-GDP ratio should reach 121% of GDP in 2027 (after 115.7% in 2025 and a forecasted 119% in 2026).

The next government formed following the 2027 elections could amend this budget. The impact on the public deficit would, however, be moderated by the implementation date for these measures (not before July). Beyond that, most presidential candidates are promising a return to a deficit of 3% of GDP by 2032 (which we had projected for 2030). Under this scenario, the public debt-to-GDP ratio would then reach nearly 124%.

With the current rise in long-term rates, there is a risk that debt service will increase further, just like the public debt ratio. Standing at 4.5% on 14 September, the 10-year yield is 50 bp higher than in our end-Q3 scenario. If this 50-bp increase was to be permanent, the additional debt servicing would be 0.05 pp in 2027 and 0.25 pp in 2030, for a total of 4.25% of GDP. The public debt-to-GDP ratio would rise by 0.8 pp (and by 1 pp in 2032). In order to avoid this increase in the deficit and debt, additional efforts would be required on the primary balance (equivalent to the additional debt service – for example, 0.25 pp in 2030).

Article completed on 17 September 2026

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ITALY

EUROPEAN FUNDS BOLSTER GROWTH, WHILE MANUFACTURING AND DEBT CONSTRAINTS PERSIST

Italian GDP grew 0.2% q/q in Q2 2026, bolstered by household consumption and investment financed by European funds, while the manufacturing sector is not benefitting from the same improvement seen elsewhere in Europe (due to lower exposure to the tech sector). As a result, we expect growth to remain quite stable in 2026 and 2027 (0.9% and 0.8%, respectively), despite an improving momentum in the Eurozone. Inflation acceleration is mainly driven by energy prices, which are weighing on the recovery of purchasing power. Disinflation should be observed in 2027, with inflation standing at 2.1%, after 2.9% in 2026. The fiscal deficit narrowed to 3.1% of GDP in 2025 on the back of a stronger primary surplus, but the rising debt burden points to increasingly tight fiscal margins.

ECONOMIC ACTIVITY IS GROWING, THANKS TO THE NATIONAL RECOVERY AND RESILIENCE PLAN (NRRP)

GDP rose 0.2% q/q in Q2, extending a positive trend under way since Q4 2022. Real GDP is now 7.7% above its pre-pandemic level (Q4 2019), compared with 1.9% in Germany, 6.3% in France and 12.1% in Spain. As a result, the growth carry-over for 2026 reaches 0.8%, higher than estimates published in July by the Bank of Italy (+0.6%) and the IMF (+0.5%). We expect growth to keep running at the same pace as in Q1 and Q2 during the upcoming quarters, helping it to reach 0.9% in 2026 and then 0.8% in 2027 in annual average terms.

Household consumption accelerated in Q2 (+0.3% q/q), marking the tenth consecutive quarter of growth. Consumption of durable goods (+0.9% q/q) continued to benefit from government incentives, including NRRP-related incentives. Consumption growth reflects a rebound in disposable income. After the decline seen at the end of 2025, disposable income began to rise again from Q1, boosting purchasing power, while the overall savings rate remained stable at around 8% for the quarter. In Q2, growth was also bolstered by positive investment dynamics, particularly in non-residential buildings and other construction works (+7.4% q/q), benefiting from NRRP spending. By contrast, investment in machinery and equipment declined (-2.3% q/q), as did investment in transport equipment (-1.9% q/q).

The NRRP has allocated a total of EUR 194.4 bn in grants and loans to Italy, equivalent to around 9.1% of GDP. According to the UPB[1], in 2026 – the peak year for NRRP-related spending – Italy's GDP growth rate would be around 0.5 pp lower if there were no additional projects financed by the Plan. The impact of the NRRP has been particularly significant on investment, as, over the last five years, the value of tenders for public works has averaged 3.6% of GDP (more than double the previous decade's level), and around 20% has been financed or co-financed with Plan resources. Expectations for 2026 remain positive, as, according to the Invind survey conducted between February and May 2026 by the Bank of Italy on firms' expectations, 47% of firms with at least ten employees expect to receive NRRP-related public contracts in 2026 (down from 51% in the second half of 2025). Public investment was therefore lifted above 3.8% of GDP, the highest rate in 40 years.

THE MANUFACTURING SECTOR LAGS BEHIND

Industry continues to make no contribution to the growth of the country's value added, reflecting the smaller tech sector in Italy (investment in intellectual property products reached 3.4% of GDP in 2025, compared with 4.4% in Germany and 5.4% in France and 5.3% in the UK in 2025), which is partially driving the recovery seen in other Eurozone countries or in the United Kingdom. In Q2, the industrial output (excluding construction) declined by 0.5% y/y. The post-pandemic years have been a bumpy path for the sector, with the aggregate figure masking widely diverging trends across industries. In H1 2026, manufacturing output stood at 5.9% below its 2019 average level, and sectors accounting for around 70% of the overall index recorded negative variations. The negative gap was particularly significant in textiles (-37.1%), chemicals (-15.9%) and metals (-10.4%), sectors that continued to post negative annual changes in H1 2026 as well. On the other hand, car production rebounded 14.6% y/y in H1 (but was down 23.5% in 2019). Compared with 2019, output levels rose significantly in food (+6.2%), pharmaceuticals (+15.5%) and electronics (+15.1%), despite these sectors slowing in 2026, however.

Growth and inflation

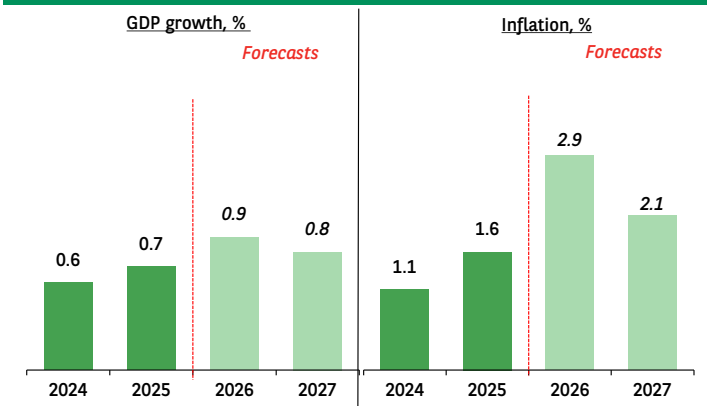


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

THE LABOUR MARKET IS TIGHT

The labour market is benefiting from an improving employment rate and a steadily falling unemployment rate (standing at 5.8% in July, -0.1 pp m/m), below the Eurozone's 6.4% and the EU's 6.1%. Between July 2021 and July 2026, the employment rate increased 4.4 pp to stand at 63.2%, mainly among the over-50s (+7.8 pp). The main weak point of the labour market is the persistently high youth-unemployment rate, which rose in July to 18.9% (+0.2 pp m/m; +1.2 pp over 5 years), a level that remains well above the Eurozone average (14.9%). This trend reflects an aging labour force, despite the employment rate among those over 50 (67.9%), which is now roughly double that of those under 35, marking a reversal of the trend observed fifteen years ago (2011). New Istat projections estimate a population decline from 58.9 million in 2025 to 55 million by 2050. Over the same period, the working-age population is expected to fall from 63.4% to 55.3% of total population,

1 UPB, Report on Fiscal Policy, June 2026.

equivalent to 7 million fewer working-age people. Mitigating this trend will require policies that encourage broader labour market participation, particularly among young people and women.

INFLATION ACCELERATES, DRIVEN BY ENERGY PRICES

The harmonised index of consumer prices (HICP) rose 3% y/y in Q2 and continued to rise over the summer, peaking at 3.2% in August (from 2.9% in July), driven mainly by energy prices (+17.1%). On the back of high energy prices, we expect inflation to reach 2.9% y/y in 2026 before easing to 2.1% in 2027, as we expect somewhat lower energy prices next year. The significant exposure to gas, more widely used in Italy compared with European peers, is an upside risk to our inflation forecasts, since gas prices are currently surprising on the upside. This increase may also favour a wider pass-through to manufacturing producer prices.

However, wage growth, is losing momentum just as inflation is reaccelerating. According to the Italian National Institute of Statistics (Istat), this is the first quarter in ten where contractual wage growth has fallen below inflation, reversing the real-wage gains built up since 2023. With no wage-price spiral, inflation should decrease more significantly in Italy in 2027 compared to the Eurozone.

A LOWER FISCAL DEFICIT, BUT LIMITED ROOM FOR MANOEUVRE

In 2025, Italy's fiscal deficit fell to 3.1% of GDP (from 3.4% in 2024), continuing the consolidation under way since the pandemic peak of 9.4% of GDP in 2020. The improvement reflects a strengthening primary balance, which posted a surplus for the second consecutive year, rising from +0.5% to +0.8% of GDP on the back of higher contribution revenues. Compared with 2019, total revenues have risen by more than 1 pp of GDP (from 47% to 48.1%), bringing the tax burden to 43.1% of GDP (+0.8 pp *vs.* 2019). The deficit-reduction path set out for 2026 government documents (2.9% in 2026) still points to Italy exiting the Excessive Deficit Procedure in 2027, albeit with very tight spending margins. We expect a fiscal deficit of 2.8% of GDP in 2026 and 2027.

Interest expenditure, which is stable at 3.9% of GDP in 2025, is expected to rise gradually to 4.5% by 2029 (4.0% in 2026 and 4.1% in 2027), due to higher yields linked to higher long rates on the markets.

Against this backdrop, the public debt-to-GDP ratio has stabilised recently and is not expected to increase in 2027 (136.8% in 2027, after 137.5% in 2026). At the same time, Italy's public debt financing model is shifting from a structure dominated by domestic institutional investors to one where foreign and private savings cover the bulk of the financing needs. The foreign-held share reached 35.9% in June (over EUR 1,100 bn), the highest level since November 2011.

Meanwhile, the energy shock continues to weigh on already limited fiscal margins. Starting in March, the government has made repeated use of the "mobile excise duty" mechanism (which, under certain conditions, allows the additional VAT revenue generated by rising fuel prices to be used to reduce excise duties) for cumulative spending of EUR 2.3 bn (0.1% of GDP). On the EU side, Minister of Economy and Finance Giancarlo Giorgetti has announced that Italy will request the full available fiscal margin of 0.6% (up to a maximum of EUR 14.4 bn over the 2026–2028 period), usable only for structural measures.

Italy's merchandise trade with EU and non EU countries

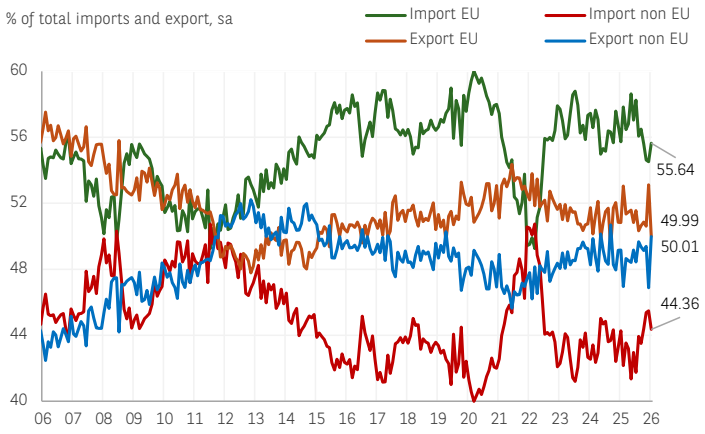


CHART 2

SOURCE: ISTAT, BNL ECONOMIC RESEARCH

ITALIAN FOREIGN TRADE IS HOLDING UP WELL

Italy's goods exports held up well, as, in H1, they rose 4.5%, continuing the growth seen in 2025. However, Italy's limited specialisation in AI-related segments has prevented the country from fully benefiting from strong demand in this area. The increase in exports was roughly similar in the EU and non-EU markets. Outside the EU, exports to the United States rose 2% (the second destination for Italy's exports, after Germany). Overall, non-EU markets accounted for 48.7% of Italy's exports (the same share as in 2025) and 44.2% of its imports (43% in 2025).

Article completed on 16 September 2026

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SPAIN

STRONG GROWTH

According to our forecasts, Spanish growth is set to remain stable at a healthy level (2.6% in 2026 and 2.2% in 2027), significantly higher than that of the euro area. Growth is being driven by consumption, investment and a labour market that is still buoyant. The industrial recovery is more pronounced than the European average due to advantages in terms of labour and energy (mix and cost). Nevertheless, in the absence of productivity gains, the labour market is approaching its structural limits, as reflected in particular by inflation that is higher than the European average. At the same time, the fiscal trajectory remains favourable, with a falling deficit and debt-to-GDP ratio, as well as a contained spread.

GROWTH: STABLE AT A HIGH LEVEL

Growth remained robust in H1 2026 (an average of +0.65% q/q), driven mainly by private consumption (contribution of +0.4pp) and investment (+0.1pp, mainly supported by investment in intellectual property [+0.7pp]). These two drivers are expected to continue over the coming months, with further improvement in the labour market and the ongoing disbursement of funds under the NGEU scheme, which will, however, come to an end in December 2026 (a quarter of the allocated amount, *i.e.* EUR 25 bn, remains to be disbursed).

According to our forecasts, Spanish growth is set to reach 2.6% in 2026 before slowing slightly to 2.2% in 2027, while remaining significantly higher than that of the euro area (1.1% and then 1.5%). After a downturn linked to the conflict in Iran, business sentiment—and in particular the services PMI—is once again showing strength (the index stabilised at around 58 over the summer, its highest level since early 2023). The manufacturing sector, on the other hand, remains more affected by geopolitical tensions, as evidenced by a manufacturing PMI that has been hovering around 50 since late 2025.

Growth and inflation

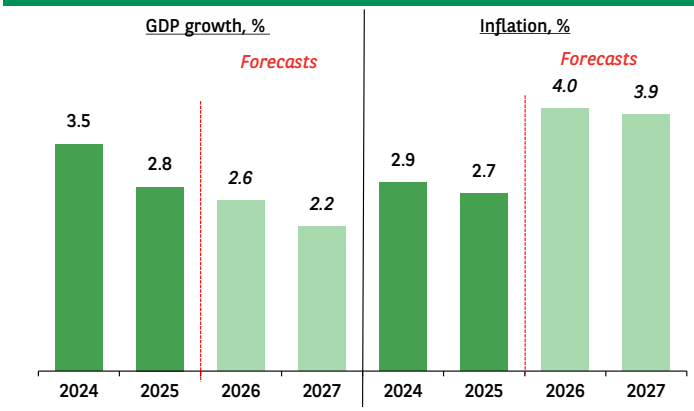


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

A MORE COMPETITIVE INDUSTRY THANKS TO A SUSTAINABLE ENERGY ADVANTAGE

Although industry accounts for a smaller share of Spain's value added than in other countries (15%, compared with 23% in Germany, 19% in Italy and 14% in France), it has been performing significantly better since the end of 2019: industrial value added has increased by 10.9% (compared with +8.3% in France, +1.6% in Italy and -2.2% in Germany). Over the period 2019-2026, the sectors that have outperformed their European counterparts the most are IT (+45% in Spain compared with an average of +10% in Germany, France and Italy) and the pharmaceutical industry (+38% compared with +17%), while chemicals (+3% compared with -16%), paper (-2% compared with -13%) and car manufacturing (-11% compared with -26%) have fared better than elsewhere (*see Chart 2*).

The strength of Spanish industry can be attributed to a more favourable energy mix. Since 2022, Spain has seen its energy production costs increase more moderately than in the euro area (by 20 pp less), which has boosted the competitiveness of its industry compared with its European competitors. This advantage stems from a reduced reliance on gas and greater use of renewable energy[1]. According to a CaixaBank study, medium-sized industrial companies are benefiting the most, with electricity prices 29% lower than the euro area average since 2023. Large industrial consumers are also paying significantly less than in Italy or Germany, but more than in France, based on Eurostat data.

Spanish pharmaceutical and IT industries have significantly outperformed those of their European peers since 2019

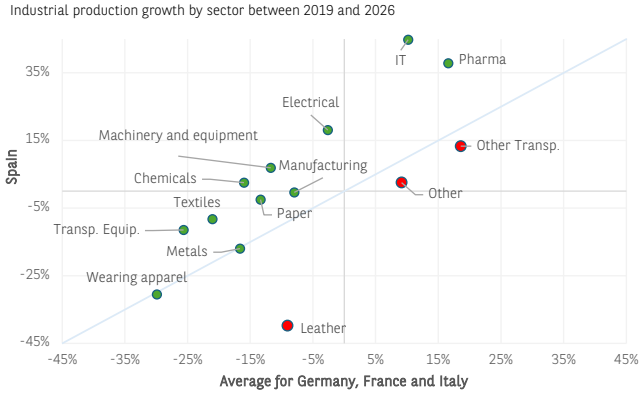


CHART 2 SOURCE: EUROSTAT, BNP PARIBAS

1 Gas accounts for around 21% of Spain's energy mix (compared with 39.8% in Italy, 27.5% in Germany and 12.1% in France), while renewable energy accounts for over 58% of electricity generation.

LABOUR MARKET: THE RECOVERY CONTINUES, BUT THE MARGINS ARE NARROWING

The labour market remains one of the main pillars of the Spanish economy. The unemployment rate has fallen below the symbolic 10% mark, reaching 9.9% in Q2 2026—its lowest level since Q1 2008—while job creation remains strong (+680,000 y/y, bringing the number of people in work to 22.4 million in August). The services sector continues to account for the bulk of this growth, with 76.7% of new jobs created. Immigration is also contributing to the increase in the available workforce: the proportion of foreign workers in the labour force stood at 18.4% in Q2 (+0.9pp y/y), while the announced regularisation of 500,000 people should facilitate recruitment in sectors facing labour shortages, such as construction and services.

There is likely still scope for a further fall in the unemployment rate, but this will require measures to tackle youth unemployment, which is significantly higher in Spain (22.9% in July) than the euro area average (14.9%).

However, as time goes by, the scope for improvement is narrowing. Job creation is expected to slow down and wage pressures are set to intensify. In the medium term, the labour market is expected to contribute less and less to Spanish growth, while fuelling inflationary pressures to a greater extent. Without a rise in productivity gains to take over[2], Spanish growth is therefore set to slow.

HIGHER INFLATION THAN ELSEWHERE IN THE EURO AREA

The energy shock is keeping Spanish inflation at a high level. Having risen from 3.4% y/y in March to 4.5% in August, it is now significantly higher than that of the euro area (3.3%). This acceleration is mainly due to the rise in energy prices (+17.3% in August compared with February), driven in particular by higher fuel and electricity prices. Core inflation also increased but to a lesser extent, rising from 3.2% in March to 3.5% in August (+0.3 pp). The rise in core inflation nevertheless remains higher than the euro area average (+0.1 pp) and, in particular, than that of Spain's close neighbours (+0.1 pp in Germany and France, -0.1 pp in Italy). The knock-on effect of the energy shock on the rest of the consumer price basket therefore warrants careful monitoring over the coming months.

Wage growth has picked up slightly, standing at +3% y/y in nominal terms since May (compared with an average of +2.9% since the beginning of the year and +3.4% in 2025), but this is not enough to offset the rise in consumer prices. Real wages therefore remain more than 2 pp below their Q4 2020 level. Real gross disposable income, buoyed by job creation, is showing a more positive trend, having risen by 16% since Q4 2020. The savings rate remains high by historical standards (11.3% of disposable income, compared with an average of 8.7% between 1999 and 2019). As a result, private consumption continues to underpin economic activity, albeit at a pace that is slowing over time.

Inflation is expected to average +4% in 2026, before slowing marginally to +3.9% in 2027 as the effects of the energy shock fade. However, this slowdown is expected to remain gradual and to keep the gains in purchasing power under pressure.

A FISCAL TRAJECTORY THAT REMAINS FAVOURABLE

Spain's fiscal trajectory remains on the right track, supported by strong nominal GDP growth and gradual fiscal consolidation, facilitated by the roll-over of the State budget since 2023. After falling to 2.4% of GDP in 2025, the public deficit is expected to fall slightly in 2026 (to 2.3%), then again in 2027 (to 2.1%), before stabilising until the end of the decade, according to our forecasts. Debt is expected to continue to fall, from 100.7% of GDP in 2025 to 99.1% in 2026 and 97.7% in 2027, and then to 95% in 2030. Nominal growth (+5.8% in 2026 and 3.9% on average until 2030), which is well above the apparent interest rate on debt (2.6% in 2026 and subject to moderate upward pressure between now and 2030), will continue to support this trend. This favourable trend is helping to keep the spread with the Bund in check, with the spread expected to stand at 48 bps by the end of 2026 (compared with 60 bps in 2025). Spain's public finances therefore have relatively considerable room for manoeuvre.

FOREIGN TRADE COULD BECOME A DRAG ON GROWTH

Spain's external accounts remain sound, but their contribution to growth is expected to gradually decline. As anticipated, the current account surplus narrowed to +2.3% of GDP on a 12-month moving average basis in Q2 (compared with +3.0% a year earlier), due to a decline in the surplus on trade in services, particularly non-tourism services. On the other hand, the surplus in tourism services remains particularly strong. This is underpinned by the sharp rise in tourist arrivals (+6.1% y/y in July and +4.5% y/y since the beginning of the year), and is benefiting in particular from the shift in international travel flows linked to tensions in the Middle East.

Meanwhile, the energy bill has risen. Indeed, the rise in oil and gas prices has further widened the trade deficit despite exports remaining high. Strong domestic demand is also expected to continue to drive imports. Foreign trade is therefore expected to make a smaller, or even negative, contribution to growth over the coming quarters.

Spain continues to attract foreign direct investment (FDI), particularly from China, in sectors linked to the energy transition. In 2025, it ranked 4th among EU recipient countries. These investment flows contribute to the development of the country's capacity to produce and export.

Article completed on 15 September 2026

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2 Spain's productivity gap persists: according to the Conference Board, the gap stands at 30% compared with Germany.

UNITED KINGDOM

GROWTH REMAINS RESILIENT IN THE FACE OF SHOCKS

UK growth remains comfortably above 1% despite successive shocks, and this favourable momentum is set to continue into 2027 (growth forecast at 1.3% after 1.2% in 2026). The development of artificial intelligence is supporting economic activity, as is industry, with the impact tending to strengthen. The anticipated acceleration in inflation towards the end of the year should trigger a rate rise by the Bank of England, tightening monetary policy and weighing on domestic demand, while the contribution from foreign trade would remain neutral. This slowdown is then expected to give way, from 2027 onwards, to a gradual recovery in economic activity as monetary conditions normalise. The main area of vulnerability lies in the sustainability of debt servicing: despite an average maturity of 13 years, sensitivity to long-term interest rates and high exposure to inflation (23% of the debt is index-linked) are likely to increase the financial burden, and could even jeopardise the timetable for stabilising public debt, which is scheduled for 2027.

GROWTH: UNEXPECTED VIGOUR

UK growth remains steady, despite a series of shocks, registering +0.6% q/q in Q1, +0.4 % q/q in Q2, and a further +0.4 % m/m in July. It already appears certain that growth will exceed 1% this year. This performance is underpinned by private consumption that has proved resilient in the face of inflation, thanks to a fall in the savings rate (9.4% of GDP in Q1 2026, down from 10.1% in 2025), and by a rebound in business investment (+1.2% q/q in Q2 compared with +0.4% in Q1), driven by machinery and equipment, non-residential construction and the rise of AI. At the same time, the positive impact of public investment on growth was offset by a fall in public consumption, whilst the contribution from foreign trade remained neutral. For the time being, the shock of the war in Iran is reflected mainly in prices (costs) rather than volumes, whilst the UK remains heavily dependent on energy imports[1]. Finally, one-off effects—early stockpiling and the 'World Cup' effect on the one hand, and the impact of the heatwave on the other—have largely cancelled each other out.

Whilst growth is expected to stall in the second half of the year (0.2% q/q), driven by rising inflation and fiscal uncertainty ahead of the October deadline, followed by a Bank of England rate rise, the medium-term outlook stays favourable. After 1.2% in 2026, growth is expected to edge up to 1.3% in 2027, as monetary conditions normalise – broadly in line with the Eurozone averages (1.1% and 1.5% respectively).

INDUSTRIAL OUTPUT IS REBOUNDING, FUELLED BY RISING DEMAND IN SERVICES

British industry continues to account for a modest share of the economy (13% of GDP in early 2026, of which 9% is excluding energy). The sector faces persistent structural constraints, amplified by Brexit related frictions, volatile energy prices and competition from China. The oil and gas sub sector is further pressured by falling North Sea production and the accelerating energy transition.

Despite these challenges, British industry can draw on its strengths in high-tech segments, which complement high value-added services (the UK invests nearly 5% of its GDP in intellectual property products, the highest level amongst the major European countries). The growth of artificial intelligence, the healthcare and pharmaceutical sectors (driven by an ageing population), defence (stimulated by European investment and support for Ukraine[2]), and the electrification of networks as part of the energy transition are all key drivers of development.

Growth and inflation

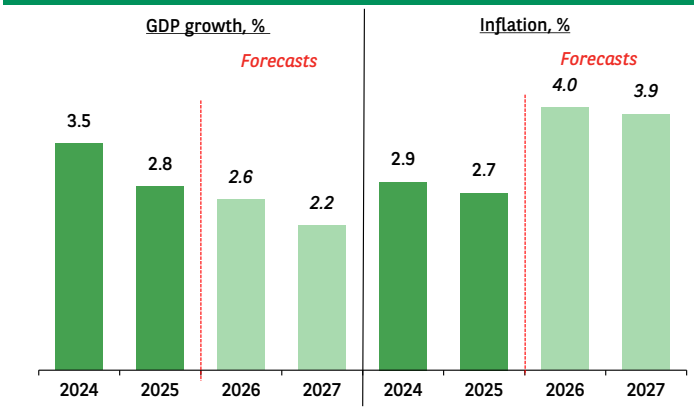


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Manufacturing output rebounds, driven by the acceleration of the AI cycle

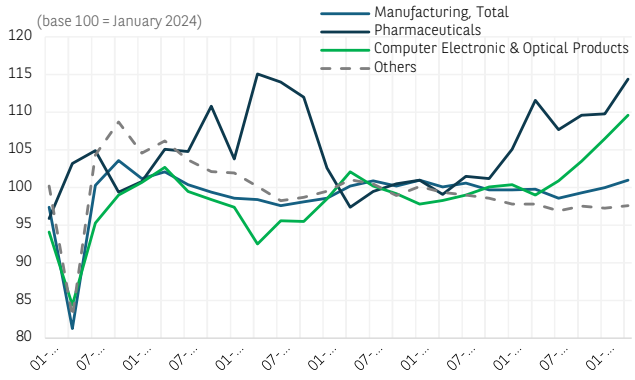


CHART 2 SOURCE: ONS, BNP PARIBAS

These trends are reflected in the industrial production index, which returned to growth as early as 2025 (*see Chart 2*).

1 Faced with declining oil production in the North Sea and the closure of several refineries, the United Kingdom now imports 43% of its primary energy consumption (DUKES 2025, 48% IEA 2024). The country therefore finds itself in a situation of increased vulnerability, exporting 90% of its crude oil only to re-import refined products – a risk exacerbated by limited storage capacity.
2 Although the UK has not secured full participation, its third-country status under the SAFE programme (€150 billion in EU defence loans) allows its suppliers to secure up to 35% of the value of European defence contracts. At the same time, thanks to the agreement signed last July, the country is expected to benefit from the EU's Ukraine Support Loan (which includes €60 billion in defence procurement) without any derogation (and therefore without needing to prove that the equipment is not available within the EU in sufficient quantities or within a reasonable timeframe).

In Q2 2026, activity expanded in eight of the thirteen sub-sectors, with a 2.6 % y/y rise in July. Whilst this momentum was underpinned by a restocking of inventories in response to geopolitical tensions in the Middle East, the latest business surveys (July–August PMIs and CBI) appear to point to a sustained recovery: new orders – especially export orders – are increasing, and recruitment has hit its highest level in more than two years.

FOREIGN TRADE: VULNERABLE TO SHOCKS

The balance of goods and services remains structurally in deficit (-2.8% of GDP in Q2 2026). Goods exports are being held back by the decline of two historic drivers: the automotive sector (-18% y/y), hampered by competition from Asia and reshoring policies (Europe/USA), and the pharmaceuticals sector (-8%), mainly affected by inventory cycles. Conversely, growth prospects are emerging for mechanical generators, up 10% y/y, driven by the aerospace sector and energy demand from data centres. Trade with the United States (which accounts for 17% of total trade) remains characterised by high tariff volatility, whilst the scope of the May 2025 Economic Prosperity Agreement is proving limited by its non-binding nature and tensions surrounding the Digital Services Tax (a 2% tax applied to the digital revenues of very large platforms, including US platforms). At the same time, while negotiations with the EU (which accounts for 46% of trade) have slowed after the change of government, the rapprochement remains a political and strategic priority.

In contrast, services exports continue to grow strongly, driven by finance, consultancy and the digital sector in markets outside Europe. Telecoms and IT are showing strong momentum (+16%), driven by cloud computing and AI. However, the services surplus only partially offsets the goods deficit.

LABOUR MARKET: A FRAGILE STABILISATION

The stabilisation of the unemployment rate at 4.9% in Q2 2026 masks a weakening in demand: job vacancies fell to 707,000 over the May–July period, reaching their lowest level since 2014 (excluding the COVID-19 period). Signs of recovery are emerging in some leading indicators (S&P/KPMG), but the underlying trend remains characterised by sluggish demand and high costs (energy, inputs and labour). To protect their margins, companies are prioritising staff retention over hiring entry-level candidates.

The unemployment rate is expected to rise slightly, peaking at 5.1% in Q4 2026. This should help ease wage pressures (growth in regular pay stood at 3.5% y/y in the three months to June 2026, compared with 4.8% a year earlier), and should limit the risk of a wage-price spiral. However, while initial forecasts for 2027 suggest wage agreements may be similar to, or even lower than, those in 2026 (BoE Agents' Summary, September), the risk of inflation expectations becoming unanchored persists and could reignite wage pressure dynamics.

INFLATION AND THE BASE RATE : RISING IN THE SHORT TERM, FALLING IN THE MEDIUM TERM

The rise in energy prices has so far had varying effects on different economic agents. Businesses felt the rise in energy input costs quickly, before a brief lull in June when market prices fell. Households were initially protected by Ofgem's energy-price cap, but the 13% cap increase in July triggered a rebound in inflation, which stood at 3.1% y/y in August. Core inflation has been stable at 2.6% for several months, but is now expected to rise again: goods inflation climbed to 2.7% in August (from 2.2% in July), while services inflation remains stable for the time being (at 3.5%).

Public debt is expected to stabilise from 2027 onward

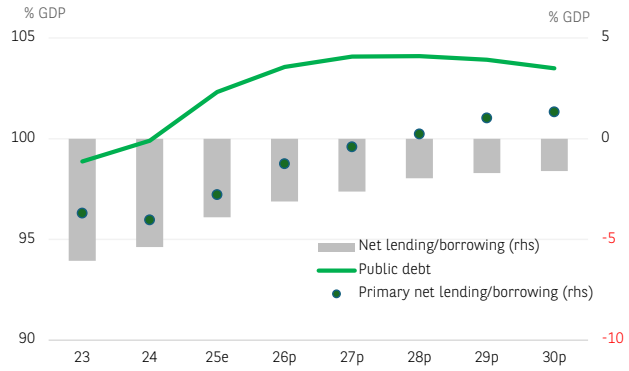


CHART 3

SOURCE: IMF, MACROBOND, BNP PARIBAS

Consequently, inflation is projected to peak at 4.1% in Q1 2027—50 bps higher than the average peak observed in the Eurozone, due to its already higher starting point. The Bank of England (BoE) is therefore expected to raise its key interest rate by 25 bps by the end of 2026, to 4%, tightening its monetary policy relative to our estimate of the neutral rate (2.25–3.25%). However, the expected moderation in wage pressures should help to ease inflationary pressures thereafter, allowing for monetary easing of 50 bps in the second half of 2027 according to our forecasts.

The exchange rate is expected to be supported by solid fundamentals, underpinned by resilient growth and the government's fiscal discipline.

THE NEW GOVERNMENT'S ROOM FOR MANOEUVRE TO CONTINUE FISCAL CONSOLIDATION IS LIMITED

Fiscal consolidation is underway: following a primary deficit of 4% of GDP in 2024 and 2.8% in 2025, the IMF forecasts a further reduction to 1.2% of GDP in 2026. Prime Minister A. Burnham has reaffirmed its commitment to fiscal rules, which will be essential for stabilising long-term interest rates, but which will limit room for manoeuvre to fund its policy priorities (decentralisation, public services, purchasing power, defence and the energy transition). The rise in UK bond yields (+120 bps on 1- and 10-year maturities as at 15 September) is one of the sharpest among advanced economies. This rise partly reflects the financial markets' increased sensitivity to macroeconomic uncertainties and monetary policy expectations. The high proportion of inflation-linked Gilts (23% in Q2 2026) also automatically increases debt service (despite an average maturity of 13 years), which is expected to rise from 2.6% of GDP in 2025 to 2.8% in 2026. The monetary easing we anticipate by the end of 2027 should ease the pressure on long-term rates, although these will remain slightly above the levels seen before the outbreak of the conflict in Iran. Furthermore, the BoE will now pursue a policy of quantitative tightening at a reduced annual pace, whilst halting the issuance of 30-year Gilts, which should flatten the yield curve at its long end. The stabilisation of public debt, expected in 2027, will require a return to a primary deficit of -0.8% of GDP, followed by a primary surplus by 2030; gross debt is therefore expected to peak at around 104.4% of GDP in 2027 (104% in 2026) before stabilising.

Article completed on 17 September 2026

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JAPAN

GROWTH UNDER PRESSURE

There is no longer any doubt that the period of stagnation and deflation is coming to an end. Growth, buoyed by the global AI cycle, is expected to exceed its potential rate (0.6%) once again in 2026 (+1%) and in 2027 (+1.2%). The end of deflation is now confirmed: notwithstanding mitigation through government intervention, inflation is expected to reach 2% in 2026, followed by 2.5% in 2027. A fundamental tension remains between expansionary fiscal policy and the acceleration of monetary tightening, with a terminal rate of 2.5% (above the neutral benchmark) in 2028. These circumstances support an ongoing rise in interest rates.

GROWTH: ABOVE POTENTIAL

Japan's GDP growth is expected to exceed its potential rate (0.6% according to the IMF), reaching 1% in 2026 followed by 1.2% in 2027, according to our forecasts. An expansionary fiscal policy has offset the impact of rising oil prices. This has resulted in a sharp rise in public spending (+1.7% q/q in Q2) and support for household purchasing power (notably through domestic energy subsidies and a cap on petrol prices). At the same time, the global artificial intelligence (AI) cycle is supporting Japan's growth through investment, and is expected to drive it increasingly through exports. Non-residential investment stagnated in H1 (-0.4% followed by -0.9% q/q) following a strong 2025 (+2.7% y/y in Q4). However, the recovery is already underway: capital goods (transport, machinery) rebounded as of Q2. Furthermore, business confidence remains at its highest level since 1991, with large companies revising their investment plans upwards for the 2026 financial year (+11.5% y/y, +8.2 pp according to the Tankan survey). On the household front, however, confidence has fallen from its highest level since 2019 (reached in February) and has only partially recovered since then (39.2, compared with 32.2 in March and 35.5 in August). However, government support for energy and wage growth (*see below*) is acting as a buffer. This prevented consumption from contracting in Q2 2026.

INDUSTRY: EXPANSION FOLLOWING RESILIENCE

Japanese industry has emerged from recession despite tariff and energy shocks. In H1 2026, manufacturing output rose by 1.6% y/y (+0.2% in 2025). This recovery is primarily driven by the AI investment cycle, with Japan benefiting from a privileged position in associated capital goods. Indeed, production growth for machinery and electronic equipment stands at 3.5% y/y (*Chart 2*). The increase in production in the automotive sector (+2.2% y/y, following +1.9% in 2025) is also noteworthy. At the same time, energy-intensive sectors (petroleum products, steel) continue to decline. Furthermore, businesses are reporting increasing capacity and labour constraints. The manufacturing PMI points to an acceleration: the three-month moving average stood at 54.8 in August, compared with 50.1 in January. This trend is being driven by both production and new orders, suggesting that the momentum is set to continue.

External demand linked to investment in AI is expected to become a driver of growth, while the United States and China remain the main destinations for Japanese exports. Foreign trade has been making a positive contribution to growth since the end of 2025 (0.5 pp in Q2 2026) *via* exports of services and a fall in imports of goods. AI is expected to make a greater contribution to this, with a 62% y/y increase in orders for machinery from abroad in H1 2026. In addition to the expected volume effect, there is also an existing price effect. The rise in imports (components) is offset by the rise in exports (finished goods). It therefore does not exacerbate the negative impact on the terms of trade (-10.2% since January 2026) caused by the rebound in energy prices.

Growth and inflation

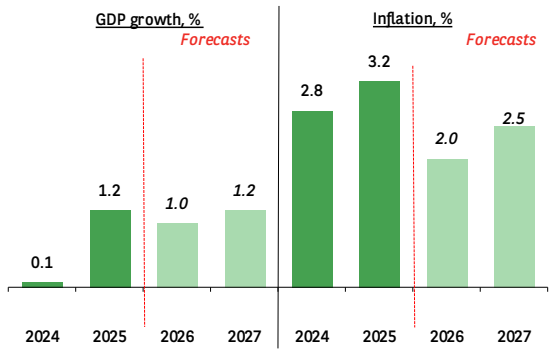


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

AI-related machinery and electronics are the main drivers underpinning the industrial recovery

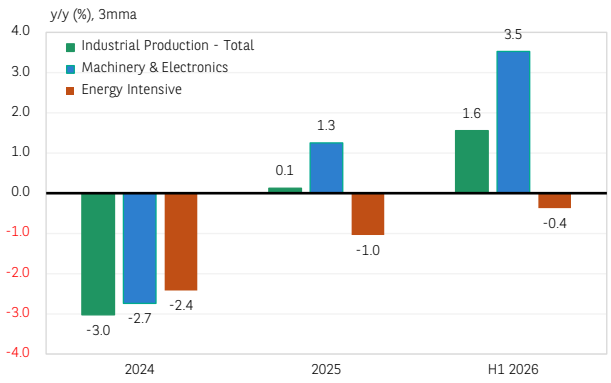


CHART 2 SOURCE: JAPANESE METI, BNP PARIBAS

LABOUR MARKET: WAGE GROWTH IS NOW FIRMLY ESTABLISHED

Nominal wage growth has exceeded 3% y/y since the start of 2026, marking a historic turnaround following decades of decline (an average of -0.3% per annum between 2000 and 2019). At the same time, real wage growth has returned to positive territory thanks to moderating inflation. However, this momentum is expected to come to an end in 2027 as inflation rebounds. The 'wages-prices' mechanism appears to be robust. On the one hand, many businesses are planning to raise

prices (+3.7% over one year according to the Q2 2026 Tankan survey). On the other hand, the recent outcomes of the annual wage negotiations known as 'Shunto' (exceeding 5% since 2023, the highest level in 35 years) reflect an increase in workers' bargaining power. This trend is underpinned by tensions in the labour market: the Tankan diffusion index ('excess employment' minus 'insufficient employment' from the businesses' perspective) remains strongly negative, and the unemployment rate reached 2.4% in July 2026 (down 0.2 pp so far in 2026).

INFLATION: MODERATION IS ONLY SUPERFICIAL

Fiscal policy has led to a recent decline in inflation, which fell to 1.5% y/y in H1 2026, down from 2.8% in H2 2025. The 'energy' component is down (-4.5% y/y) despite the rise in oil prices, due to subsidies aimed at reducing energy costs. However, core inflation (excluding unprocessed food), which excludes institutional factors, stood at +2.4% y/y in H1, compared with +1.6% for the official measure from the Statistics Bureau.

We expect inflation to rebound over the coming quarters, peaking at +3.8% y/y in Q1 2027, as the impact of fiscal support fades and wage-price dynamics take hold. Subsequently, the temporary reduction in the tax on food consumption is expected to lead to a further decline from Q2 2027 onwards. Beyond these fluctuations, inflation expectations have shown a significant and widespread rise since 2022, whether among households, businesses or the markets (*Chart 3*). This reinforces the view that the end of secular deflation is here to stay and shifts the focus to the risk of a sustained deviation above the 2% target.

ACCELERATION IN KEY INTEREST RATE RISES

The Bank of Japan (BoJ) is now focusing on stabilising core inflation around its 2% target in order to counter the risk of a sustained 'upward deviation'. It raised its key interest rate twice in 2026, in June and September, bringing it to 1.25% (its highest level since 1995). We expect two further increases (25bp each) before the end of Q1 2027. This acceleration in the 'adjustment of the degree of monetary accommodation' reflects a paradigm shift. Previously, concerns that tightening too quickly might jeopardise the exit from deflation had prevailed and led to a cautious approach (85bp of cumulative rate rises between 2024 and Q1 2026). We now expect the BoJ to adjust its monetary policy beyond the neutral rate (1.75%–2.0%), with further rate rises from December 2027 and a terminal rate of 2.5% to be reached in 2028. One of the challenges facing the BoJ will be to implement this policy without exacerbating tensions in the bond and foreign exchange markets.

According to our forecasts, the USD/JPY is expected to trend towards 163 by the end of 2026 (155 as of 16 September), and then remain at that level in 2027, as the spread between the Fed's and the BoJ's key interest rates narrows relative to historical levels. Intervention by the authorities – as illustrated by JPY 27,000 bn in transactions in H1 2026 (according to the Ministry of Finance) and the operation carried out jointly with the US Treasury in July – has not brought about a lasting change in the trend. Indeed, so far in 2026, the USD/JPY has averaged 158, its lowest level since 1986.

However, there are upside risks for the yen while the current account balance remains in significant surplus (3.6% of GDP in 2026 according to the IMF). The new interest rate regime could also increase the allocation of capital by domestic investors to Japanese assets and, as a result, boost demand for the yen.

A significant and widespread rise in inflation expectations

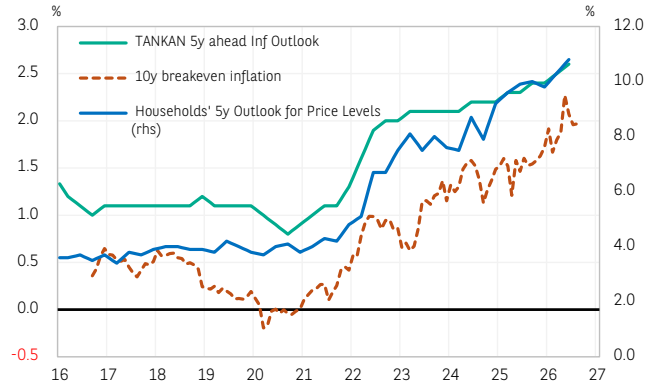


CHART 3

SOURCE: BANK OF JAPAN, MACROBOND

ACCOMMODATIVE FISCAL POLICY AND BOND MARKET TENSIONS

The Takaichi government's fiscal policy is openly expansionary. It is based on two major initiatives:

1/ a two-year reduction, from April 2027, in the tax on food consumption from 8% to 1% (fiscal cost: 0.6% of GDP), aimed at supporting household demand in the short term;

2/ a public-private investment plan totalling over JPY 370,000 bn by 2040 to boost potential growth.

The 'reflationary' nature of the government's policy is evident in its budgetary framework document (Basic Policy), in which the primary deficit takes a back seat. The focus is now on the ratio of public debt to GDP. However, this ratio can improve without any adjustment being required provided that the apparent interest rate is lower than nominal growth ($r < g$), which is currently the case.

According to our estimates, the debt-to-GDP ratio is expected to stand at precisely 203% in 2026 and 199% in 2027, despite a widening of the primary deficit (-1.5% of GDP, then -2.3%, compared with -0.9% in 2025) and the overall deficit (-2.2% of GDP, then -3.4%, compared with -1.1% in 2025).

However, this favourable window of opportunity is expected to close by the end of the decade as the average interest rate paid on public debt (or apparent rate)—which has an average maturity of around 10 years—rises. Against this backdrop of rising expenditure, combined with global pressure on yields and domestic monetary normalisation, long-term rates are expected to continue to rise. The 10-year rate, which has already returned to its 1996 level, is forecast to reach 2.9% by the end of 2026 and 3.25% by the end of 2027. Debt servicing costs are expected to reach nearly 2% of GDP in 2030 (compared with 0.2% in 2025), pushing the total budget deficit above 4% of GDP. The debt-to-GDP ratio is expected to continue to fall (to 194% in 2030), but at a slower pace, as the negative spread between interest rates and growth is set to narrow: nominal growth would no longer exceed the apparent rate by more than 1 pp, compared with 4 pp at present.

Article completed on 18 September 2026

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MAIN INDICATORS

Growth

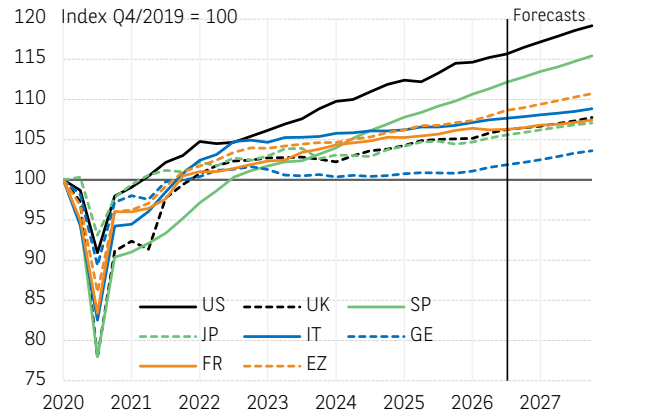


CHART 1 SOURCE: EUROSTAT, BEA, ONS, CAO, BNP PARIBAS FORECASTS

Inflation rate

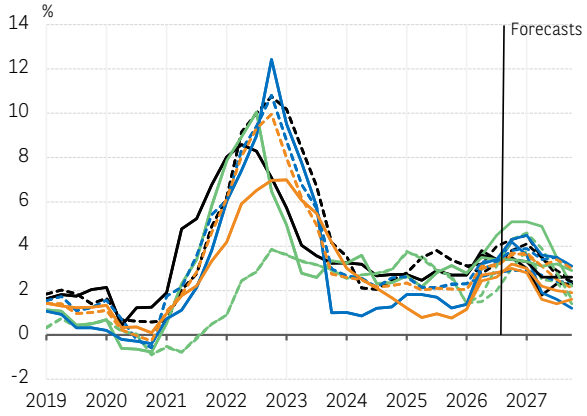


CHART 2 SOURCE: EUROSTAT, ONS, BLS, BNP PARIBAS FORECASTS

Unemployment rate

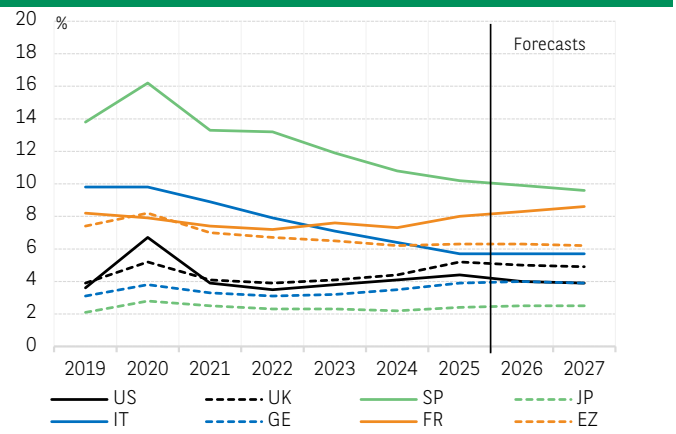


CHART 3 EUROSTAT, BLS, SBJ, DG ECFIN AMECO, OBR, BNP PARIBAS FORECASTS

Current account

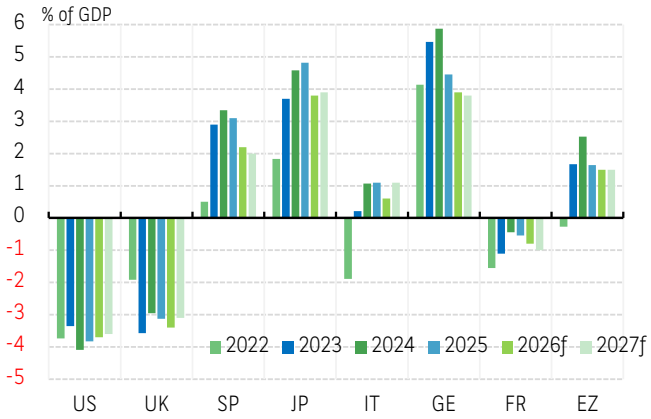


CHART 4 SOURCE: IMF, DG ECFIN AMECO, BNP PARIBAS FORECASTS

General Government balance

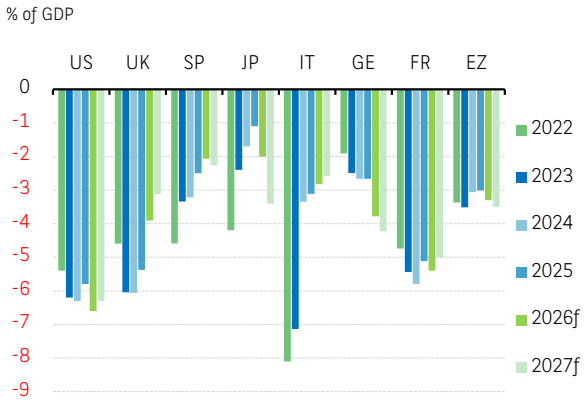


CHART 5 SOURCE: IMF, BNP PARIBAS FORECASTS

General Government debt

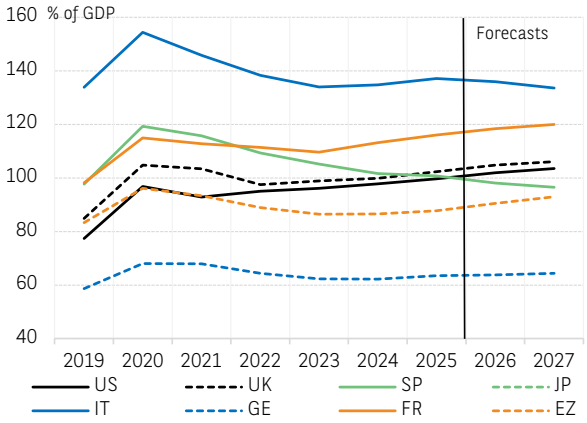


CHART 6 SOURCE: IMF, BNP PARIBAS FORECASTS

GROWTH: CONTRIBUTION BY COMPONENT OF DEMAND

		Percentage points. q/q							
		Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025	Q1 2026	Q2 2026
United States	GDP	0.8	0.5	-0.2	1.0	1.1	0.1	0.5	0.4
	Private consumption	0.7	0.7	0.1	0.4	0.6	0.3	0.1	0.6
	GFCF	0.1	-0.1	0.3	0.2	0.0	0.1	0.3	0.3
	Public consumption	0.2	0.1	-0.0	0.0	0.1	-0.3	0.2	-0.0
	Inventories	-0.0	-0.2	0.7	-0.9	-0.0	0.0	0.1	-0.2
	Net exports	-0.1	-0.0	-1.2	1.2	0.4	-0.1	-0.1	-0.3

Source: BEA

Eurozone	GDP	0.5	0.3	0.5	0.0	0.3	0.2	-0.0	0.6
	Private consumption	0.3	0.3	0.2	0.1	0.1	0.3	0.0	0.2
	GFCF	0.3	0.2	0.5	-0.3	0.2	0.2	-0.0	-0.0
	Public consumption	0.1	0.1	-0.0	0.1	0.2	0.1	0.1	0.0
	Inventories	0.5	-0.3	0.0	0.3	0.0	-0.4	0.4	-0.5
	Net exports	-0.7	0.1	-0.2	-0.2	-0.2	0.1	-0.5	0.9

Source: Eurostat

Germany	GDP	0.1	0.2	0.1	0.0	0.0	0.3	0.4	0.3
	Private consumption	0.2	0.4	0.3	-0.1	-0.1	0.5	-0.3	0.1
	GFCF	-0.1	0.1	0.1	-0.2	0.0	0.3	-0.3	-0.0
	Public consumption	0.2	0.0	-0.2	0.2	0.2	0.3	0.2	0.0
	Inventories	0.7	0.0	-0.1	0.8	0.0	-0.5	0.1	0.1
	Net exports	-0.9	-0.3	0.0	-0.7	-0.2	-0.3	0.7	0.2

Source: Eurostat

France	GDP	0.4	0.0	0.2	0.2	0.4	0.3	-0.2	0.0
	Private consumption	0.4	0.0	-0.0	0.0	0.1	0.1	-0.2	0.2
	GFCF	-0.2	0.0	0.1	0.1	0.2	0.0	-0.2	-0.1
	Public consumption	0.1	0.0	-0.0	0.1	0.1	0.1	0.1	0.1
	Inventories	0.6	-0.3	0.6	0.4	-0.5	-0.5	0.9	-0.7
	Net exports	-0.5	0.2	-0.4	-0.3	0.6	0.6	-0.9	0.6

Source: Eurostat

Italy	GDP	0.0	0.1	0.3	0.0	0.2	0.3	0.3	0.2
	Private consumption	0.1	0.3	0.1	0.2	0.2	0.1	0.3	0.2
	GFCF	-0.4	0.5	0.3	0.4	0.3	0.2	0.2	0.1
	Public consumption	0.0	0.1	-0.1	0.1	0.1	0.0	0.0	-0.0
	Inventories	0.7	-0.6	-0.2	-0.0	-0.4	0.8	-0.9	0.2
	Net exports	-0.4	-0.0	0.2	-0.6	0.1	-0.8	0.8	-0.3

Source: Eurostat

GROWTH: CONTRIBUTION BY COMPONENT OF DEMAND

		Percentage points. q/q							
		Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025	Q1 2026	Q2 2026
Spain	GDP	0.8	0.8	0.5	0.7	0.6	0.8	0.6	0.7
	Private consumption	0.7	0.5	0.3	0.4	0.5	0.5	0.4	0.4
	GFCF	-0.1	0.7	0.2	0.2	0.4	0.4	0.1	0.1
	Public consumption	0.3	0.0	0.1	0.0	0.3	0.0	0.1	0.1
	Inventories	0.2	-0.0	-0.2	0.2	0.1	-0.1	-0.1	0.0
	Net exports	-0.3	-0.4	0.1	-0.1	-0.7	-0.1	0.1	0.1

Source: Eurostat

United Kingdom	GDP	0.2	0.4	0.6	0.2	0.1	0.1	0.6	0.4
	Private consumption	0.4	0.3	0.2	0.1	0.1	0.1	0.3	0.2
	GFCF	0.2	0.0	0.5	0.0	0.2	0.0	0.1	0.2
	Public consumption	0.1	0.2	-0.1	0.2	0.1	0.0	0.3	-0.1
	Inventories	-1.6	1.2	-0.1	0.2	-0.6	0.1	0.3	0.1
	Net exports	1.2	-1.1	0.1	-0.5	0.3	-0.1	-0.4	0.0

Source: ONS

Japan	GDP	0.9	0.4	0.5	0.1	-0.4	0.3	0.5	0.4
	Private consumption	0.3	0.0	0.3	0.1	0.3	0.1	0.3	0.0
	GFCF	0.3	-0.1	0.2	0.3	-0.5	0.4	-0.1	-0.2
	Public consumption	0.0	0.0	-0.1	0.1	0.0	0.1	0.1	0.3
	Inventories	0.4	-0.3	0.7	-0.3	-0.1	-0.4	-0.1	0.3
	Net exports	-0.2	0.8	-0.7	-0.1	-0.2	0.1	0.3	0.5

Source: Cabinet Office du Japon

FORECASTS

ECONOMIC FORECASTS

	GDP Growth				Inflation			
%	2024	2025	2026 e	2027 e	2024	2025	2026 e	2027 e
United States	2.8	2.1	2.2	2.3	2.9	2.7	3.4	2.3
Japan	-0.2	1.2	1.0	1.2	2.7	3.1	2.0	2.5
United Kingdom	1.0	1.3	1.2	1.3	2.5	3.4	3.2	3.2
Euro Area	0.9	1.3	1.1	1.5	2.4	2.1	3.0	2.8
Germany	-0.5	0.3	1.1	1.3	2.5	2.3	2.7	2.6
France	1.1	0.9	0.5	1.0	2.3	0.9	2.4	2.3
Italy	0.6	0.7	0.9	0.8	1.1	1.6	2.9	2.1
Spain	3.5	2.8	2.6	2.2	2.8	2.7	4.0	3.9
China	5.0	5.0	4.6	4.5	0.2	0.0	1.0	1.2
India*	7.2	7.8	6.7	6.9	4.6	2.1	5.0	4.6
Brazil	3.4	2.3	1.9	1.3	4.4	5.0	4.5	4.6

* Fiscal year from 1st April of year n-1 to March 31st of year n

SOURCE: BNP PARIBAS (E: ESTIMATES; F: FORECASTS)

FINANCIAL FORECASTS

Interest rates, %

		2026		2027			
End of period		Q3	Q4	Q1	Q2	Q3	Q4
US	*"Fed Funds (upper limit)"*	4.00	4.25	4.50	4.50	4.50	4.50
	T-Note 10y	-	4.95	4.95	4.90	4.85	4.80
Eurozone	deposit rate	2.50	2.75	2.75	2.75	2.75	2.75
	Bund 10y	-	3.50	3.40	3.30	3.25	3.20
	OAT 10y	-	4.43	4.40	4.25	4.18	4.10
	BTP 10y	-	4.38	4.33	4.18	4.08	3.98
	BONO 10y	-	3.98	3.90	3.74	3.65	3.55
UK	Base rate	3.75	4.00	4.00	4.00	3.75	3.50
	Gilts 10y	-	4.90	4.80	4.70	4.65	4.50
Japan	BoJ Rate	1.25	1.50	1.75	1.75	1.75	2.00
	JGB 10y	-	2.90	2.95	2.95	3.15	3.25

Exchange rates, %

		2026		2027			
End of period		Q3	Q4	Q1	Q2	Q3	Q4
USD	EUR / USD	-	1.14	1.14	1.16	-	1.20
	USD / JPY	-	163	163	163	-	163
	GBP / USD	-	1.34	1.36	1.38	-	1.43
EUR	EUR / GBP	-	0.85	0.84	0.84	-	0.84
	EUR / JPY	-	186	186	189	-	198

SOURCE : BNP PARIBAS (MARKET ECONOMICS, INTEREST RATE STRATEGY,FX STRATEGY, COMMODITIES DESK STRATEGY

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