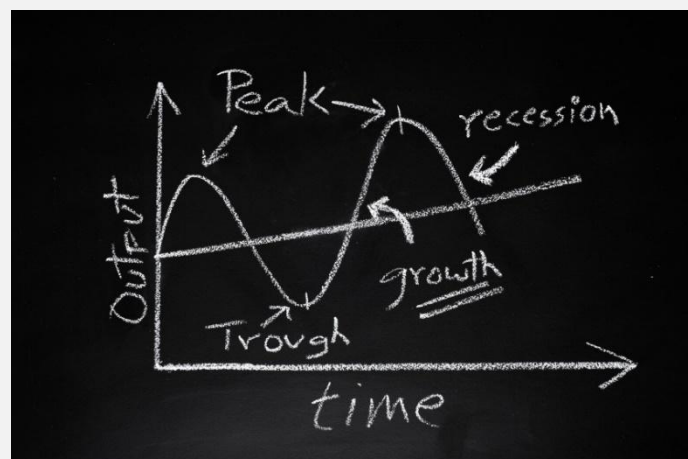


Creditreform Rating

Europe's Adjustment Phase – Fiscal Impulse Meets Structural Limits

Creditreform Economic Briefs
06 March 2026



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This analysis takes into account information available until 25 February 2026. Subsequent geopolitical developments in the Middle East occurred after this cut-off date and are briefly discussed in the introductory section. The publication is protected by copyright. Any commercial use is prohibited without prior written permission from Creditreform Rating AG. Excerpts may only be used with the express consent of Creditreform Rating. Publication of the report without the consent of Creditreform Rating is prohibited. Creditreform Rating assumes no liability, express or implied, as to the accuracy, completeness, or timeliness of any assessment, opinion, or information in any form or manner whatsoever. The analyses underlying this publication and their results do not constitute a recommendation for investment.

KEY TAKE-AWAYS

1.

The euro area entered 2026 in a position of cautious stability. Growth regained momentum in the second half of 2025, supported by domestic demand and services activity, though performance remains uneven across member states. Spain continues to outperform, while Germany and France are stabilizing after a prolonged period of weakness. The recovery is expected to strengthen moderately in 2026, driven by improving real incomes and EU-funded public investment.

2.

Inflation across the euro area has fallen decisively and is now below target in several countries. While services inflation remains sticky, the broader risk profile has shifted from overheating toward potential undershooting. The ECB has completed its easing cycle and entered a pause, with policy now broadly neutral and the deposit rate likely to remain at current levels through most of 2026. Financing conditions are gradually improving but remain cautious, reflecting subdued credit demand and prudent lending behavior.

3.

Labor markets remain resilient across much of the euro area, even as hiring momentum cools. At the same time, sovereign bond markets have entered a new phase of differentiation. Investors increasingly price fiscal credibility on a country-specific basis, leading to narrowing spreads in parts of the former periphery while core issuers face greater scrutiny. Institutional credibility and the region's strong external position continue to anchor market confidence.

4.

Germany is showing early signs of cyclical stabilization, but structural constraints continue to cap the strength of the recovery. We project GDP growth of 1.1% in 2026 and 1.5% in 2027, implying a gradual normalization rather than a dynamic upswing. Fiscal expansion and rising real wages provide short-term support, while industrial momentum has begun to stabilize. However, demographic pressures, weak productivity growth, and competitiveness challenges — particularly in manufacturing — cap the medium-term growth outlook. The reform agenda signals intent, but implementation will be decisive. 2026 will test the credibility and effectiveness of reform execution.

5.

The UK faces a delicate balancing act between easing inflation and subdued growth. Domestic demand remains fragile and labor-market dynamics are adjusting to higher statutory costs. Monetary

policy has pivoted toward supporting growth, and fiscal headroom offers a buffer. The medium-term outlook hinges on productivity gains and the resilience of the services-led growth model.

6.

The US economy enters 2026 with cooling momentum. Tariff-related uncertainty, softer consumption dynamics, and fiscal imbalances are weighing on growth, even as inflation remains above target. The Federal Reserve has paused rates and is likely to ease later in the year, conditional on further labor-market softening. The balance of risks is modestly tilted to the downside, particularly if trade tensions intensify.

Editorial Note: Geopolitical Update on the Escalation in the Middle East

Recent geopolitical developments occurred after the cutoff date for this publication. The military escalation between Israel, the United States, and Iran has introduced a new layer of uncertainty to the macroeconomic outlook. While the situation remains fluid and the duration of the conflict is unclear, financial markets have already reacted with higher energy prices and rising risk premia.

From a macroeconomic perspective, energy markets are likely to be the most immediate transmission channel. A sustained disruption in oil and gas flows from the Persian Gulf, particularly through the Strait of Hormuz - a critical bottleneck for global energy trade - could cause energy prices to rise, temporarily reversing some of the recent progress in disinflation. For advanced economies, this would create a familiar policy dilemma. Higher energy prices could increase headline inflation, even with moderate growth, which would complicate the outlook for monetary policy in the United States and the euro area.

At the same time, rising geopolitical uncertainty could weigh on economic activity by dampening investment and confidence. However, Europe's energy supply has become more diversified, and the current situation appears to be primarily price-driven rather than a disruption of physical supply. The key variable for monetary policy will be inflation expectations. As long as longer-term expectations remain well-anchored, central banks may be able to overlook temporary, energy-driven price pressures.

Currently, however, the macroeconomic implications depend critically on whether the conflict remains limited or evolves into a more prolonged regional confrontation. Therefore, the projections in this report remain unchanged, but the situation will require close monitoring in the coming weeks.

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1. World

The U.S. economy is entering 2026 with diminishing momentum. After a period of resilience in mid-2025, growth has slowed as temporary tariff-related spending effects fade and underlying demand softens. While overall activity remains positive, the composition of growth has become more fragile and uneven.

United States: Cooling Momentum Under Trade and Fiscal Pressures

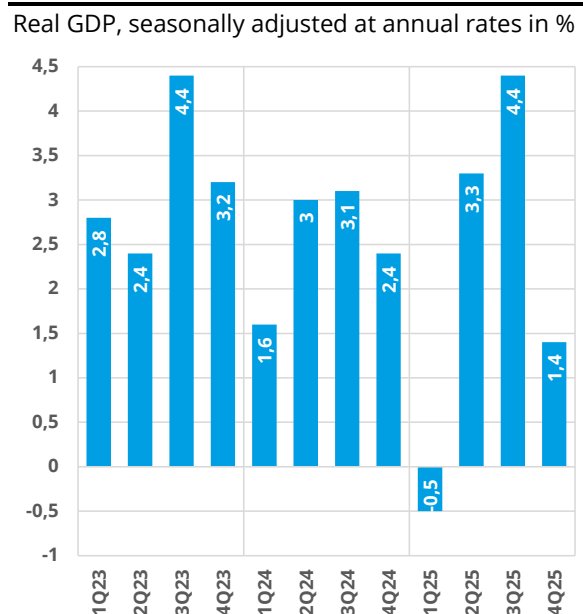
Real GDP growth decelerated to 1.4% in the fourth quarter, following stronger expansion in the third quarter (see Figure 1). Earlier strength had been supported by firms and households front-loading purchases ahead of anticipated tariff increases. As these effects unwind, inventory accumulation and durable goods demand have moderated, revealing weaker underlying final demand. Retail sales stagnated in December, and core retail sales (excluding autos and gasoline) declined slightly, pointing to a loss of consumer momentum.

The slowdown reflects several interacting forces. Elevated borrowing costs continue to weigh on interest-sensitive sectors, while real income gains have moderated as inflation, though easing, remains above pre-pandemic norms. Spending has therefore become increasingly bifurcated: high-income households continue to benefit from asset price gains and accumulated savings, whereas lower- and middle-income households face tighter financial conditions. This divergence has reinforced a more pronounced “K-shaped” pattern in consumption dynamics.

Trade policy developments add another layer of uncertainty. Following the Supreme Court’s par-

tial invalidation of earlier measures, the administration introduced a revised global import tariff, currently set at around 15% on a broad range of goods. This shifting legal and policy framework is raising input costs and complicating corporate pricing and investment decisions. While the full macroeconomic impact will depend on duration and scope, renewed tariff volatility increases the risk of goods-price inflation re-accelerating and may dampen business confidence in the near term.

Figure 1: US GDP growth levelled off in Q4 as underlying demand softens



Sources: US BEA, Creditreform Rating

While quarterly momentum has softened, full-year growth in 2026 is still expected to remain above potential. The IMF expects U.S. real GDP growth to reach 2.4% in 2026. Although fiscal stimulus will provide partial support, tariff-related price pressures and cautious consumption will constrain expansion. Overall, we believe the balance of risks has shifted slightly toward the downside as the economy has entered 2026 on a softer footing.

Manufacturing: Stabilizing, but Not Rebounding

Business surveys confirm the cooling trend. The manufacturing PMI fell from 52.4 in January to 51.2 in February, indicating slower factory output growth and weaker demand. While this moderation partly reflects post-holiday adjustments, the broader picture points to a loss of momentum in industrial activity. Trade policy uncertainty remains high, and capital expenditure plans are cautious. Though growth has slowed, the services sector has remained comparatively stable. Input cost pressures and slower demand are limiting expansion. Overall, business activity indicates modest growth rather than recession, but confidence remains fragile.

Consumer Confidence and Household Strain

Meanwhile, consumer sentiment has deteriorated significantly. The Conference Board's Consumer Confidence Index fell to 84.5 in January, the lowest level in over 11 years. Although households are somewhat less concerned about future inflation, they are increasingly worried about income stability and debt burdens. Total household debt has risen to approximately \$18.8 trillion. Student loan delinquencies are climbing, approaching 10%. Higher interest rates have increased the cost of credit card and mortgage servicing, reducing disposable income. While the wealth effect from strong equity markets has cushioned higher-income groups, most households are becoming more cautious with their spending. The flat retail performance in December reflects this caution. Consumers are prioritizing essentials over discretionary purchases, a shift consistent with slowing economic momentum.

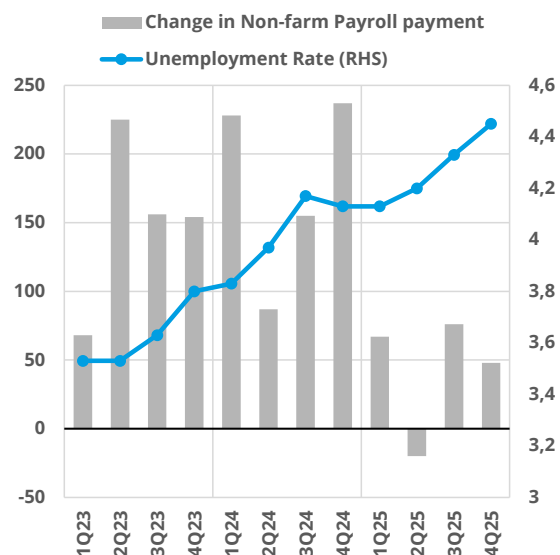
Labor Market: From Tightness to Gradual Cooling

The labor market has transitioned from exceptionally tight conditions to a softer equilibrium. Unemployment stood at 4.3% in January, which

is low by historical standards, albeit higher than in 2024 (see Figure 2). Nonfarm payrolls increased by only 50,000 in December, which is well below earlier monthly averages. Job openings have fallen to 6.54 million, a five-year low. Although hiring has slowed, layoffs remain limited, creating what could be described as a "low-hire, low-fire" environment. Employers appear reluctant to lay off workers aggressively, yet they are also hesitant to expand their payrolls. The risk for 2026 lies in further deterioration. If hiring continues to slow and business confidence weakens, unemployment could rise further. While this does not imply a recession, it reflects cooling labor demand and reduced income growth.

Figure 2: Job growth slowed in 2025, while unemployment edges higher

Unemployment rate in %, US employees non-farm payroll m-o-m net change in absolute terms



Sources: US BLS, Creditreform Rating

Fiscal Policy and the Budget Outlook

Fiscal policy remains expansionary. Enacted in mid-2025, the One Big Beautiful Bill Act extended tax cuts from 2017 and increased defense and border spending. While these measures provided short-term stimulus, they

also widened fiscal imbalances. The White House expects average tax refunds to increase by \$1,000 or more due to the implementation of the Working Families Tax Cuts Act. This fiscal stance may sustain aggregate demand. However, it also increases borrowing requirements at a time when interest rates remain relatively high. Rising debt-servicing costs will put additional pressure on the federal budget in the medium term.

Government Shutdown and Its Economic Impact

The government shutdown in October 2025 further complicated the outlook. Government consumption fell, and spending among affected workers weakened as well. Beyond the direct loss of income, the shutdown disrupted public services and delayed the release of important economic data. This created a temporary "visibility gap" for policymakers and investors. Although funding was restored in early 2026, uncertainty surrounding future budget negotiations persists. Repeated fiscal standoffs continue to risk undermining confidence in U.S. governance and may contribute to higher term premia in bond markets.

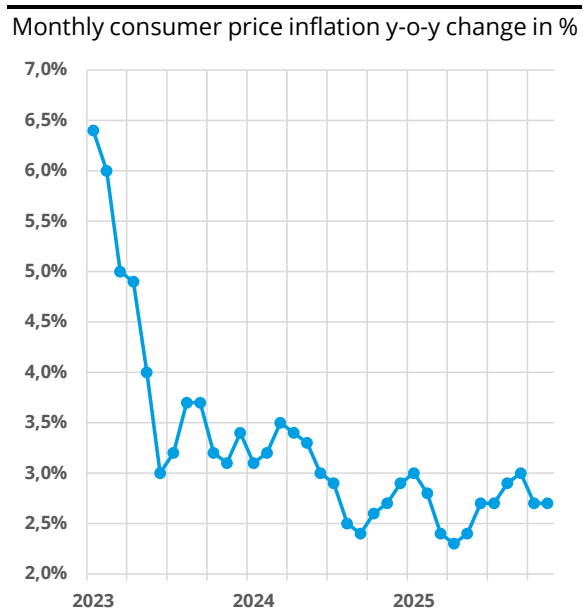
Monetary Policy: Pause Amid Persistent Inflation

Monetary policy is entering a transitional phase. As of January, the Federal Reserve maintained its policy rate at 3.50%-3.75%. Markets anticipate a prolonged pause, with the possibility of rate cuts later in the year if labor market conditions worsen. Notably, Kevin Warsh was appointed as the incoming Fed Chair and will assume office in May. His leadership could signal a shift in tone. Although Warsh has historically been viewed as an inflation hawk, his recent statements suggest a greater openness to easing if growth weakens materially. We believe the most likely scenario is two 25-basis-point rate cuts in 2026, which would bring the Fed funds rate to 3.0%-3.25% by

the end of the year. Recent Federal Reserve communications underscore a high degree of data dependency, suggesting that any easing will remain conditional on further labor market softening and sustained progress in core inflation. Policymakers appear reluctant to signal a pre-committed path, reflecting lingering inflation concerns and fiscal uncertainty.

Although inflation moderated in 2025, it remained above the Federal Reserve's target of 2%. The headline CPI was 2.7% in December (see Figure 3). Core inflation measures, which exclude volatile components, have remained high, reflecting broad-based price pressures. Of particular concern are producer prices. The Producer Price Index rose by 0.5% in December, marking the strongest monthly increase in five months. This suggests that firms are increasingly passing on higher import costs linked to tariffs to consumers. Although goods inflation had been easing, the shifting tariff regime and the potential for retaliatory measures are putting pressure on supply chains and raising input costs once again.

Figure 3: Inflation remains sticky above the Federal Reserve's 2% target



Sources: US BLS, Creditreform Rating

According to the Federal Reserve Board, the projected core Personal Consumption Expenditures (PCE) inflation rate is 2.5% in 2026, a downward revision from the September 2025 projection of 2.6%. While this is an improvement from earlier peaks, persistent inflation limits the scope for rapid monetary easing. The risk is not a renewed surge in inflation but rather a prolonged period of above-target price growth.

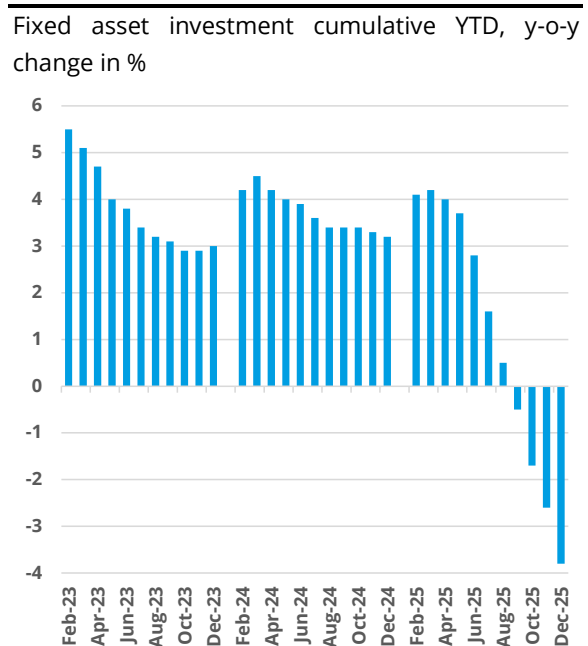
We think the principal risks are threefold. First, further trade escalation could accelerate inflation and reduce exports. Second, persistent fiscal deficits could push long-term yields higher, thereby tightening financial conditions. Third, perceived political interference in monetary policy could weaken investor confidence and increase U.S. dollar volatility. The next two years will be defined by striking a balance between supporting growth and preserving stability. If policy coordination remains credible and inflation gradually returns to target, the economy can achieve moderate expansion in 2027. However, missteps in trade, fiscal discipline, or monetary independence could tip the scales toward prolonged stagnation.

China's Two-Speed Resilience in 2026

China enters 2026 with a two-speed economy, where strong external performance masks persistent domestic weakness. Record export re-routing and an exceptionally large trade surplus continue to prop up growth, but underlying domestic demand remains subdued. Although consumer prices have edged out of deflation, producer prices remain firmly negative, reflecting ongoing industrial overcapacity and weak domestic momentum. Against this backdrop, policymakers are steering the economy toward a more innovation-driven growth model. They are doing so with the support of targeted monetary easing, which aims to lower financing costs and strengthen high-tech and strategic sectors.

The fourth quarter of 2025 saw the slowest growth rate for the Chinese economy since 2023, with annual GDP expanding by only 4.5%. China managed to maintain full-year growth of around 5%, largely due to a record trade surplus, as domestic demand continued to lag. Retail sales and fixed-asset investment weakened, and momentum in retail sales and industrial output slowed notably in the fourth quarter compared with the third. Industrial output fell to an annual low of 4.8% in November, and retail sales decelerated sharply, reaching only 0.9% y-o-y growth in December 2025. Despite this subdued finish, the Chinese government expects to maintain a pragmatic growth target of 4.5%-5% for 2026. Concurrently, the IMF has lowered its 2026 growth forecast to 4.5%.

Figure 4: Fixed-asset investment turns negative in Q4 2025



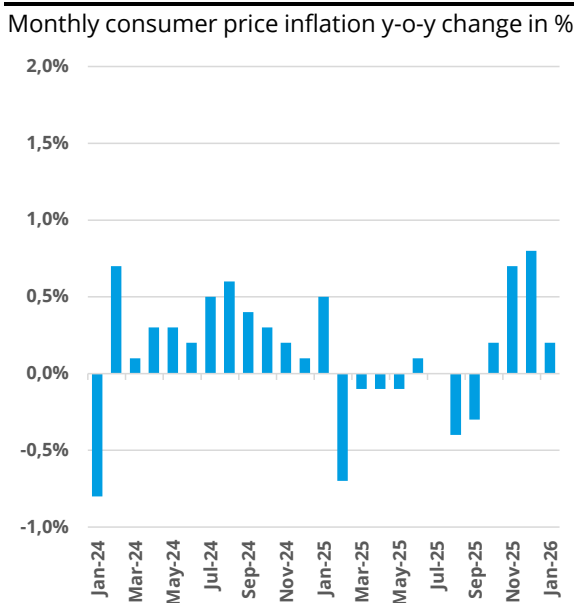
Sources: National Bureau of Statistics of China, Creditreform Rating

Fixed investment significantly hindered China's growth trajectory in Q4 2025 (see Figure 4). After a 1.7% y-o-y decline in October, the contraction worsened to 3.8% by December. The ongoing real estate downturn was the main culprit, with

property investment plummeting by 17.2%. Local governments also scaled back infrastructure spending. We assume that fixed-asset investment will continue to negatively impact domestic demand this year.

Price dynamics revealed additional imbalances within the economy (see Figure 5). China technically exited its deflationary streak in December, when the consumer price index (CPI) rose 0.8% y-o-y, though this increase was largely driven by cost-push factors. Core inflation reached 1.2%, which is below the government’s 2% target. Meanwhile, producer prices remained deeply negative. December marked the 38th consecutive month of producer price index (PPI) deflation, with the index at -1.9% y-o-y. This persistent weakness underscores the ongoing problem of industrial overcapacity.

Figure 5: China exits CPI deflation, but producer prices remain negative



Sources: National Bureau of Statistics of China, Creditreform Rating

Although domestic demand remained stagnant, China’s export performance improved in late 2025. Direct exports to the U.S. fell by 30% in December, yet total exports increased 6.6% y-o-y to

a record \$357.8 billion. This growth was driven by the strategic rerouting of trade toward low- and middle-income countries, particularly ASEAN economies. These shifts helped China achieve a record annual trade surplus of \$1.2 trillion, cushioning the economy and supporting the Chinese government’s growth objectives despite intensified U.S. tariff pressures.

As China enters 2026, the People’s Bank of China (PBoC) is maintaining a "moderately loose" monetary policy aimed at reducing financing costs and channeling capital toward high-tech and innovation-driven sectors. Following its annual work conference, the PBoC emphasized the importance of bolstering domestic demand and promoting "new quality productive forces," including artificial intelligence, green technologies, and strategic emerging industries. These priorities aim to offset weak consumption and mitigate the prolonged impact of the property sector as China transitions to a more resilient, innovation-driven growth model. Currently, the central bank is focusing on ensuring ample liquidity and maintaining price stability. While the one-year benchmark Loan Prime Rate (LPR) remained at 3.0% in January, marking its eighth consecutive month of stability, the PBoC recently cut sector-specific relending and rediscount rates by 25bps.

These monetary and structural measures together signal a decisive shift away from China’s historical reliance on infrastructure investment and low-value manufacturing. The government aims to cultivate a more resilient economic model that can withstand future shocks by allocating resources to advanced industries and bolstering domestic demand.

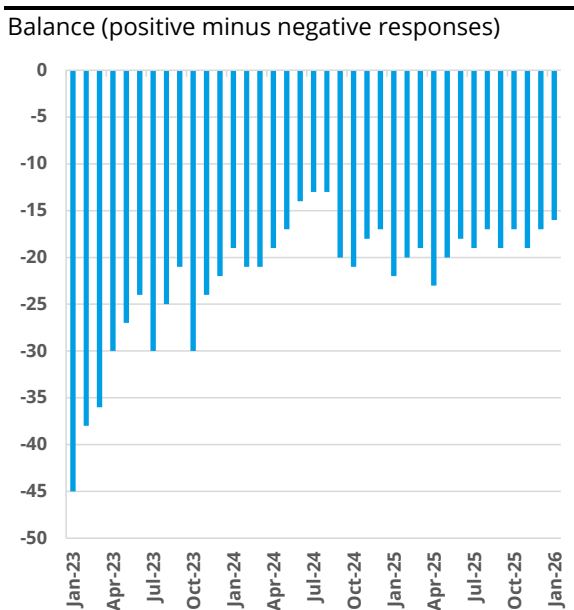
United Kingdom: Monetary Easing Signals Pivot as Stagnant Growth and Labor Fragility Mount

The UK ended 2025 with stagflationary trends, which are characterized by weak growth and soft

domestic demand. Inflation remains high, and labor market conditions are tightening due to rising statutory costs. As inflation gradually retreats, the Bank of England (BoE) has begun shifting toward monetary easing. However, the recovery remains constrained by weak investment, subdued households, and lingering uncertainty. Although the Autumn Budget provides some short-term fiscal support, the overall environment remains muted.

Economic growth remained subdued at just 0.1% in the fourth quarter of 2025. Preliminary estimates suggest that UK GDP increased by 1.3% in 2025, following 1.1% growth in 2024, and is projected to expand by around 1.3% in 2026. While this implies sub-trend growth rather than outright stagnation, the composition of expansion remains fragile, with domestic demand constrained by cost pressures and weak investment dynamics. Consumer confidence has also softened, with the GfK Index dropping to -19 in November before rebounding modestly to -16 in January 2026 (see Figure 6).

Figure 6: Consumer confidence has recovered only modestly



Sources: GfK group, Creditreform Rating

Despite the soft economic backdrop, short-term cyclical pressures are becoming increasingly visible in the UK labor market. The UK labor market faced significant challenges in the fourth quarter, with unemployment rising to a four-year high of 5.1%. This reflects firms' difficulty in absorbing the combined impact of the April 2025 minimum wage increase and higher National Insurance contributions. Total pay growth slowed from 4.8% in October to 4.2% in December (see Figure 7). The fourth quarter was marked by a pronounced margin squeeze. Weak consumer confidence limited firms' ability to raise prices, leaving them unable to offset rising statutory labor costs. Unable to achieve immediate productivity gains, companies turned to aggressive cost-cutting and workforce reductions.

Figure 7: Unemployment reached a four-year high as pay growth slowed

Unemployment rate (% , seasonally adj.), pay growth (y-o-y % , 3-month average, seasonally adj.)



Sources: Office for National Statistics, Creditreform Rating

The dynamics of the labor market in the near term are further compounded by deeper structural strains. The surge in policy-driven profit warnings illustrates the current strain on the UK's private sector. In 2025, a record 42% of UK-listed firms issued warnings due to policy and

geopolitical uncertainty. Fifty-five warnings were recorded in the fourth quarter alone. A spike in order cancellations accounted for 33% of the warnings. Weak consumer confidence and rising costs each accounted for 11%.

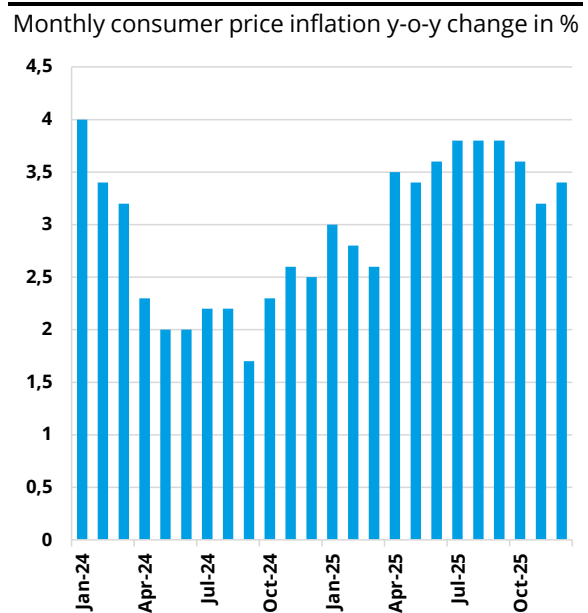
Despite domestic fragility, the external sector provided some cyclical relief in Q4, though momentum softened toward the end of the year. Exports fell by 1.0% m-o-m to a three-month low of £76.96 billion in December, reversing the earlier pickup seen in November. The initial increase was driven by a 2.8% surge in EU goods shipments, particularly medicinal and pharmaceutical exports. However, total exports of goods fell by £1.0 billion (3.2%) in December, reflecting a sharp pullback in medicinal and pharmaceutical exports.

Against the backdrop of subdued activity and persistent cost pressures, the policy environment has begun to evolve. In December 2025, the BoE finally shifted its monetary policy, reducing the bank rate to 3.75%. This level was maintained through February 2026. This recalibrated policy priorities, shifting the focus from aggressively fighting inflation to preserving growth. However, progress toward the 2% inflation target remains gradual. Inflation eased to 3.0% in January 2026, down from 3.4% in December, extending its steady downward trend (see [Figure 8](#)). This decline was driven by softening costs in transportation, food, housing, and recreation, as core inflation fell to 3.1%, the lowest rate since September 2021. UK food prices eased to 3.6% in January from 4.5%, while service inflation fell to 4.4%. Consequently, expectations for BoE rate cuts are rising.

Fiscal policy is now working alongside monetary easing to support the recovery. This includes the energy bill reform package, which is expected to save households around £150 annually. This fiscal support allows the Bank of England (BoE) to continue easing despite core inflation remaining

significantly above the 2% target until January, when it was at 3.1%. The Treasury expanded fiscal headroom to £21.7 billion (approx. 0.8% of GDP), a move that will likely stabilize bond markets. Ten-year gilt yields are projected to decline to 4% by the end of the year. The budget introduced a 40% first-year capital allowance for the private sector, effective January 2026, to offset margin pressures.

Figure 8: Headline inflation declines in the UK, but remains above target



Sources: Office for National Statistics, Creditreform Rating

2. Euro area

Despite external shocks and political risks, the euro area ended 2025 on a firmer footing. It showed resilience as growth regained momentum in the second half of the year, driven by capital formation, services activity and domestic demand. Inflation fell below the target level, leading the ECB to conclude its easing cycle and adopt a neutral stance. Labor markets remained resilient, consumer confidence improved toward

the end of the year, and the external position remained strong with a robust current account surplus.

Growth Regains Footing, but Momentum Remains Uneven

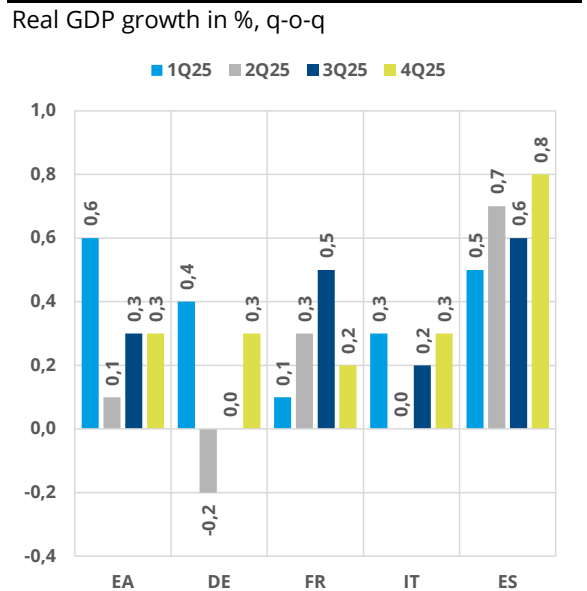
Despite continued structural and political risks, the outlook for the euro area economy improved by the end of 2025 compared to our initial expectations at the beginning of last year. After a subdued first half of the year, growth stabilized in the second half, with GDP expanding by 0.3% q-o-q in the third and fourth quarters, respectively.

This steady performance highlights the region's underlying resilience despite experiencing external shocks. Capital formation was the primary driver of GDP growth, with the trade balance providing an additional contribution. This resilience was largely driven by services activity and domestic demand, while manufacturing remained a drag. Composite PMI readings remained in expansionary territory throughout 2025, though momentum dipped to 51.3 in January 2026. However, the economy regained its footing in February, with the preliminary Composite PMI rising to a three-month high of 51.9. Although momentum briefly reached a four-month low in January, February's rebound extended the euro area's growth streak to 13 consecutive months. This sustained expansion suggests a gradual stabilization rather than a broad-based cyclical upswing.

However, growth dynamics remained uneven across countries (see Figure 9). Spain continued to outperform (0.8% q-o-q), bolstered by robust tourism and consumption. France experienced modest output expansion of 0.2%, though it was constrained by political uncertainty and fiscal stress. Germany, the bloc's largest economy, finally broke a two-year cycle of contraction by posting 0.3% q-o-q growth in the last quarter.

Likewise, Italy's economy expanded by 0.3%, its strongest growth since the first quarter.

Figure 9: Euro area growth regains momentum in H2 2025



Sources: Eurostat, Creditreform Rating

We project euro area real GDP growth to be around 1.2% in 2026 and 1.5% in 2027, driven by recovering real incomes, easing financing conditions, and growing public investment on the back of EU funding programs. However, the recovery is expected to be moderate rather than dynamic, reflecting ongoing trade fragmentation and subdued productivity growth.

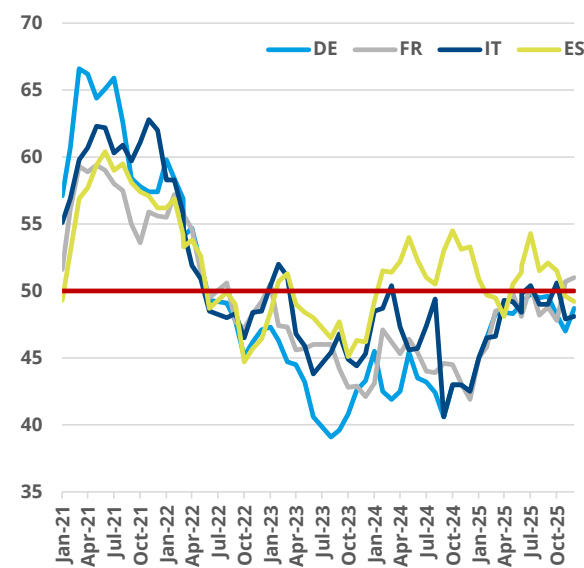
Manufacturing: Stabilization, Not a Revival

Although manufacturing conditions improved modestly in 2025, a convincing recovery has yet to be achieved (see Figure 10). The euro area manufacturing PMI slipped into contraction in December, reaching 48.8. It improved slightly, reaching 49.5 in January 2026 and inching up to 50.8 in February 2026, signaling stabilization rather than a decisive recovery. Improvements in manufacturing business conditions and production were offset by a decline in new orders. While

industrial production cooled to 1.2% y-o-y in December, it still managed to expand by 1.5% in 2025 as a whole.

Figure 10: Euro area manufacturing stabilizes but remains fragile

Manufacturing PMIs, <50: contraction, >50: expansion



Sources: S&P Global, Creditreform Rating

Foreign demand remains fragile. In response to U.S. tariffs, firms continued to adjust their supply chains, with many reporting that the full impact would not be apparent until 2026 or later. Consequently, manufacturing is expected to recover slowly next year, with growth concentrated in defense, infrastructure-related, and select capital goods sectors.

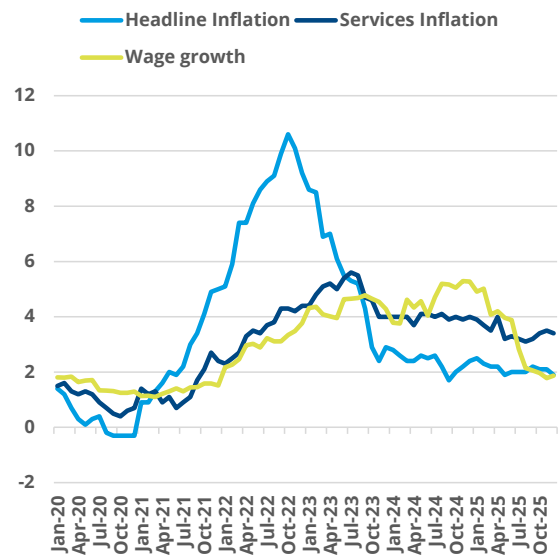
Inflation Under Control, Undershooting Risks Rising

Inflation developments in 2025 largely validated the European Central Bank’s (ECB) assessment that price pressures had eased substantially. Headline inflation slowed to 1.9% by year-end and fell further to 1.7% in January 2026. This was supported by falling energy prices, a stronger euro, and cooling goods inflation (see Figure 11). In France, inflation fell to 0.3% by January 2026, primarily driven by sharp corrections in energy

and electricity prices relative to 2024 peaks. Additionally, cooling costs for services and manufactured goods outweighed a slight acceleration in food prices.

Figure 11: Euro area headline inflation drops below target, while wage growth eases

Headline inflation (y-o-y, %), negotiated wage growth (y-o-y, %, incl. collectively agreed one-off payments)



Sources: Eurostat, Eurosystem, Creditreform Rating

Core inflation decreased more gradually. It ended the year at 2.3% and decreased further to 2.2% in January 2026. Although this was an improvement from earlier peaks, services inflation remained above 3% throughout the year due to ongoing labor cost pressures and robust demand in labor-intensive sectors.

Nevertheless, the inflation risk profile shifted significantly. By mid-2025, the ECB had acknowledged the downside risks, and its projections showed that inflation would be below the target in 2026 and would only gradually return to 2% in 2027–28. The strong real appreciation of the euro and lower import prices reinforced disinflationary forces, raising concerns that inflation expectations could drift below the target level if policy remained overly restrictive.

ECB Policy Easing Completed, Vigilance Maintained

In response, the ECB lowered interest rates by a total of 235 basis points between mid-2024 and mid-2025. This brought the deposit rate to 2.0% by June 2025. By the first quarter of 2026, monetary policy had shifted to a pause. The ECB emphasized symmetry in its inflation mandate, treating undershoots as seriously as overshoots.

The ECB has indicated that rates will likely remain at 2% for most of 2026, unless inflation undershoots by more than expected, or financial conditions unexpectedly tighten. Reductions to the balance sheet under the Asset Purchase Program (APP) and the Pandemic Emergency Purchase Program (PEPP) are gradually continuing without causing market stress.

Overall, monetary policy has become broadly neutral, supporting growth while remaining cautious enough to protect the central bank's credibility. With the deposit rate now firmly within the ECB's estimated neutral range, the hurdle for additional easing has increased. At the same time, expanding fiscal policy in parts of the euro area — particularly in Germany — may partially offset disinflationary forces, reinforcing the case for a prolonged pause rather than renewed rate cuts. In our baseline scenario, the ECB is likely to maintain the deposit rate at 2.0% throughout most of 2026, with the balance of risks tilted slightly toward a longer pause rather than renewed easing. Upside inflation surprises would likely delay easing rather than trigger renewed tightening at this stage.

The economic consequence of this stance is a slow but steady easing of financing conditions. Credit growth to households and firms has begun to recover, though it remains below historical averages due to persistent uncertainty. According to the ECB's Bank Lending Survey for the fourth quarter of 2025, euro-area banks re-

ported a modest net tightening of credit standards for loans and credit lines to firms, reflecting elevated risk perceptions and lower risk tolerance among lenders. Banks also noted subdued demand for new loans from enterprises and households, and expect credit conditions to remain broadly unchanged or slightly tighter in early 2026. While this does not point to a broad credit contraction, it suggests that financing conditions are not yet markedly supportive, consistent with cautious lending behavior in a moderate growth environment.

Labor Market Resilient Across the Euro Area

Despite weaker growth this year, the euro area labor market remained remarkably resilient. The unemployment rate stayed near historic lows, reaching approximately 6.3% in the fourth quarter of 2025. Although employment growth slowed and wage growth eased, deterioration was limited.

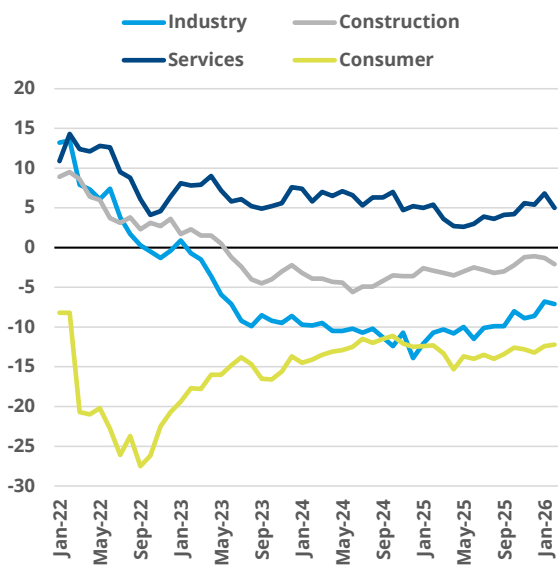
Spain and Italy both exhibited moderation in unemployment dynamics, though driven by different underlying forces. In Spain, the unemployment rate fell from 10.5% in Q3 2025 to 10.0% in Q4 2025. This decline was primarily driven by robust private-sector job creation. This improvement was reinforced by Spain's solid macroeconomic performance and the continued effects of the 2021 labor market reform. In contrast, Italy's unemployment rate remained at 5.6% due to a decline in labor force participation, as a 72,000-person rise in inactivity masked underlying weaknesses in the labor market. France moved in the opposite direction. Its unemployment rate climbed to 7.9% in Q4 2025, up from 7.7% in the previous quarter, reflecting mounting economic strain.

Consumer Confidence and Retail Sales Improved Towards the Year-end

Throughout 2025, both consumer and industrial confidence showed intermittent signs of recovery, bolstered at times by easing inflationary pressures and hopes for gradual economic normalization (see Figure 12). However, this improvement was uneven and fragile. Households continued to struggle with high living costs, and firms faced weak external demand and ongoing geopolitical uncertainty, which limited their willingness to invest or expand. Periodic setbacks, including renewed political tensions and soft global trade, repeatedly tested sentiment, leaving confidence levels vulnerable to swings despite the underlying improvement.

Figure 12: Business sentiment has continued to improve more recently

Sentiment indices for the euro area (EA-21), balances (positive minus negative responses)



Sources: Eurostat, Creditreform Rating

There were encouraging signs in retail sales in the fourth quarter. Euro area retail volumes rose 2.1% and 2.35% year over year in October and November, respectively. However, retail sales growth in the euro area slowed to an annual rate of 1.3% in December 2025. Spain continued to

outperform, and France also showed improvement toward the end of the year. Germany lagged but showed tentative improvement.

Looking ahead to 2026, falling inflation, rising real wages, and a gradual decline in household savings rates are expected to increase consumption. These factors should make private consumption a key driver of growth, partially offsetting weak exports.

External Position Reflects a Robust Current Account Surplus

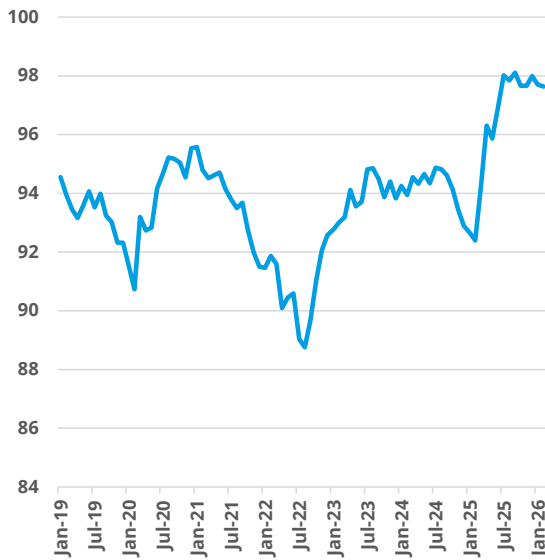
In 2025, one of the euro area’s key strengths was its substantial current account surplus, which remained positive. This surplus was supported by moderate energy import costs and robust exports of services, particularly travel, telecommunications, machinery, and chemicals. The surplus narrowed towards the end of the year due to weaker global demand rather than renewed energy stress, but still recorded a trade surplus of €12,624.5 million in December 2025. This strong external position reduced sovereign funding risks and helped stabilize the euro during periods of market volatility.

The Euro Remained Volatile, Amid Strength

The euro was volatile in 2025 due to diverging monetary cycles, geopolitical shocks, and shifting risk sentiment. Episodes of euro strength curbed inflation but hurt export competitiveness, particularly for Germany and industrial exporters. In real effective terms, the euro appreciated against a broad basket of currencies (see Figure 13), reinforcing disinflationary pressures. While this supported price stability, it also increased the risk that inflation would fall short of the ECB’s 2% target in 2026.

Figure 13: The euro appreciates in real effective terms

Real effective exchange rate of the euro vis-à-vis extended EER group of trading partners, CPI-based, 1Q99=100



Sources: Bundesbank, Creditreform Rating

Bond Markets Shift Their Focus from Core to Periphery

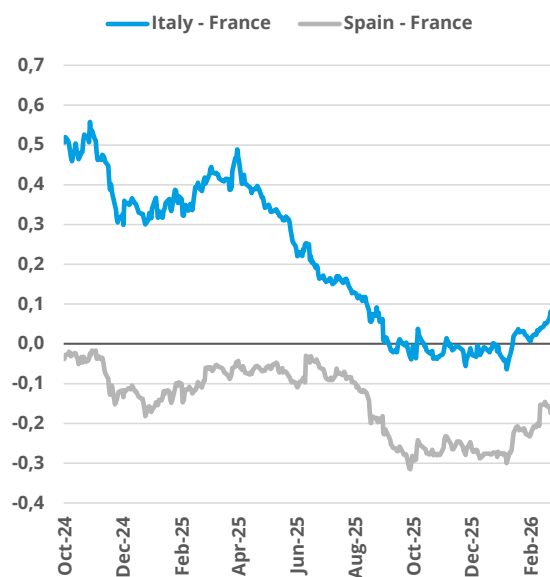
While progress on EU budget planning generally helped reassure markets, one significant narrative of 2025 was the evident repricing of sovereign risk across the euro area, as investors moved beyond the traditional core-periphery framework. Heavy sovereign issuance and increasingly divergent fiscal dynamics shaped European fixed-income markets, with country-specific fundamentals taking center stage.

Germany and France, long considered core issuers, came under pressure (see Figure 14). German 10-year Bund yields rose by around 50 bps over the year, closing near 2.9%. This marked the sharpest annual increase since the post-pandemic inflation shock. This reflected the expansion of fiscal stimulus, the record volume of net supply absorbed by private investors, and the expectation that ECB policy would remain restrictive well into 2026. French government

bond yields also increased, with 10-year yields climbing around 37 bps toward 3.6%. Political uncertainty, delayed budget approval, and persistent deficit concerns weighed them down.

Figure 14: Peripheral spreads tighten as French yields move higher

10y-government bond spreads in pp.



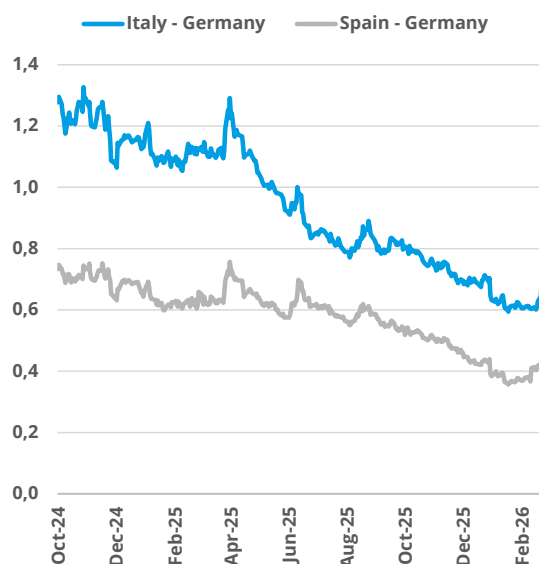
Sources: FRED, Creditreform Rating

In contrast, former "periphery" markets such as Italy and Spain outperformed. Italy's 10-year BTPs ended the year relatively unchanged, bolstered by rating upgrades, enhanced fiscal credibility, and stable inflation (see Figure 15). Spain benefited from resilient economic growth and disciplined fiscal management, which helped keep yields stable. Consequently, yield spreads moved in favor of the periphery rather than the other way around.

This shift underscored the broader realization in the market that sovereign risk was being priced based on its own merits. The ECB's Transmission Protection Instrument played a crucial role in containing fragmentation risks and preventing contagion. This allowed investors to differentiate more confidently between issuers.

Figure 15: Italy and Spain spreads narrow

10y-government bond spreads in pp.



Sources: FRED, Creditreform Rating

Outlook for 2026–27: Moderate Growth and Lower Inflation

Looking ahead, the euro area is poised to enter 2026 with cautious stability. We expect growth to accelerate modestly, driven by consumption, public investment, and gradually improving trade conditions. Inflation should fall below the target level in 2026 before slowly rising again to reach 2% in 2027–28.

The main risks remain tilted to the downside. Global trade fragmentation, U.S. tariffs, and political uncertainty in major member states could negatively impact confidence and investment. Conversely, a stronger release of household savings or a sustained easing of geopolitical tensions could boost growth and accelerate the recovery.

Overall, the euro area enters 2026 in a fragile but stable equilibrium rather than in crisis. Growth has stabilized at sub-trend levels, supported by domestic demand and resilient labor markets, while manufacturing remains subdued. Inflation has fallen decisively and the balance of risks is

now tilted slightly to the downside, increasing the importance of policy calibration. Sovereign markets are increasingly differentiating along fiscal lines, but institutional credibility and a solid external position provide important anchors. The recovery is therefore progressing, albeit gradually and unevenly, and remains contingent on political stability and the ability to navigate a more fragmented global trade environment.

3. Germany

Germany is showing early signs of stabilization, but the recovery remains constrained by structural headwinds. The modest improvement toward the end of 2025 has been supported by easing inflation and domestic demand, yet the economy continues to face labor-market frictions, demographic pressures, and an uncertain external environment. Investment remains cautious and the industrial base—especially autos—continues to adjust to electrification, geopolitics, and shifting trade conditions. Against this backdrop, the outlook is best characterized as gradual progress rather than a decisive upswing.

German Labor Market Softens, Structural Pressures Persist

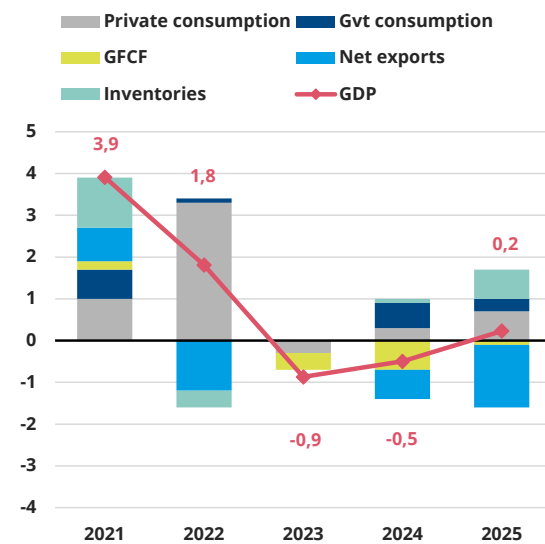
Germany's economy showed signs of stabilization in the second half of 2025. Real GDP expanded by 0.3% q-o-q in the fourth quarter, following stagnation in Q3, bringing full-year growth to 0.2% after a 0.5% contraction in 2024. The improvement was supported by easing inflation and lower borrowing costs, which strengthened household consumption and provided scope for higher government spending (see Figure 16).

Short-term indicators point to gradually improving momentum. The Germany Composite PMI

declined from 52.4 in November to 51.3 in December, before rebounding to 53.1 in February 2026. While this suggests that cyclical conditions are improving, structural challenges — including demographic pressures, investment hesitancy, and external competitiveness constraints — are likely to limit the strength of the upswing.

Figure 16: Germany avoids third recession year as investment and trade remain a drag

Real GDP growth in %, growth contributions in pp.

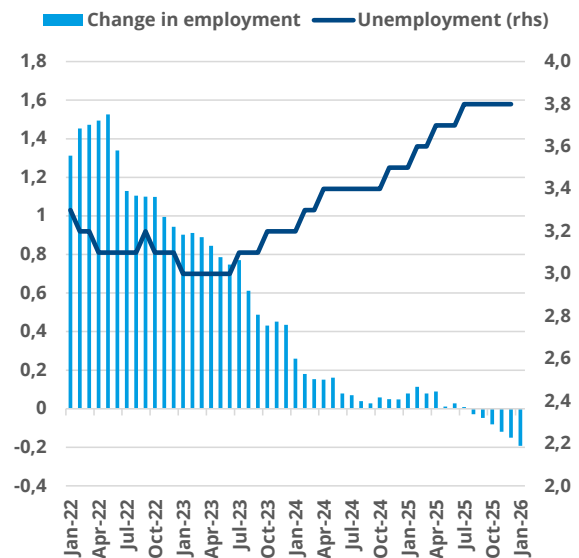


Sources: Federal Statistical Office, Creditreform Rating

The German labor market has softened moderately, though it remains tight by historical standards. The seasonally adjusted unemployment rate rose to 4.0% in January 2026 from 3.5% a year earlier (see Figure 17), marking the highest level since mid-2016. The increase reflects weaker hiring momentum amid subdued industrial activity, but does not yet signal a broad-based deterioration. Importantly, employment levels remain historically elevated and real wage growth continues to support household incomes. This suggests that the current adjustment reflects a cyclical normalization from previously tight conditions rather than a pronounced downturn in labor demand.

Figure 17: Rising unemployment rate signals labor market normalization

Unemployment rate and annual change in number of employed persons in %



Sources: Federal Statistical Office, Eurostat, Creditreform Rating

In absolute terms, unemployment reached 1.74 million at year-end, the highest level in over a decade. At the same time, labor shortages persist in several skilled occupations, highlighting the structural nature of Germany's labor supply constraints. Demographic trends are expected to reduce the labor force by roughly 40,000 workers by 2026, limiting the scope for a sharp cyclical rise in unemployment while simultaneously weighing on potential growth. Importantly, the relative stability of employment and continued real wage gains provide support to household consumption. While hiring momentum has cooled, income dynamics remain sufficiently robust to underpin private spending, preventing a sharper cyclical slowdown.

The vacancy-to-unemployment ratio remains around 28% below pre-crisis levels, indicating a normalization from previously overheated conditions rather than a collapse in labor demand. Over the longer term, demographic pressures

remain the dominant structural challenge. According to OECD projections, Germany's working-age population could shrink by around 22% by 2060, with the old-age dependency ratio rising markedly. This implies increasing fiscal and productivity pressures over the medium term.

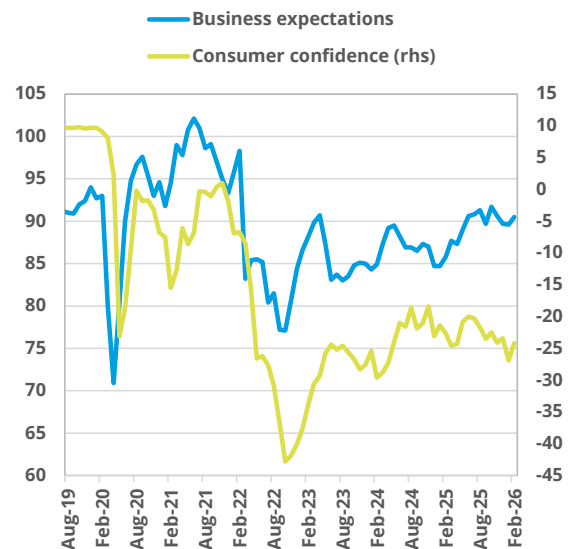
Reform Ambition Meets Implementation Reality

The government has acknowledged these structural challenges and launched an ambitious modernization agenda comprising more than 80 cross-departmental measures aimed at reducing bureaucracy by 25% across the economy. Initial projections estimate administrative savings of around €100 million, with a longer-term target of €5 billion. The package includes streamlined digital procedures, accelerated approval processes, and a planned reduction in government staffing. While the agenda signals clear reform intent, implementation remains gradual. Business confidence has improved but remains cautious (see Figure 18), reflecting persistent bureaucratic hurdles and infrastructure gaps that continue to weigh on private investment.

The structural reform package also includes corporate tax reductions starting in 2028, enhanced depreciation allowances, and expanded research and development incentives. Together with investment from special funds for infrastructure and defense, fiscal policy is expected to provide a measurable growth impulse over the coming years. According to Ifo estimates, these measures could add around 0.3 percentage points to growth in 2026 and up to 0.7 percentage points in 2027. However, the transmission into private sector investment is likely to unfold gradually, suggesting that the overall impact will depend critically on implementation efficiency and complementary structural reforms.

Figure 18: Business expectations improved but remained sluggish

Ifo Business Expectations Index (2015 = 100), GfK Consumer Climate (points)



Sources: Ifo Institute, GfK, Creditreform Rating

Demographic Reality Forces Incremental Pension Reforms

The December 2025 pension reform represents a significant step in addressing demographic pressures. Stabilizing the pension level at 48% until 2031 and introducing incentives for continued labor force participation aim to preserve purchasing power while mitigating fiscal strain. The introduction of a catch-up factor and the expansion of earnings allowances for older workers reflect efforts to balance adequacy and sustainability. Nonetheless, medium-term fiscal pressures remain substantial. The government's decision to establish a commission to propose further reforms by mid-2026 underscores that additional adjustments may be required to ensure long-term sustainability in the face of rapid population aging.

Trade Frictions and Electrification Test Germany's Automotive Model

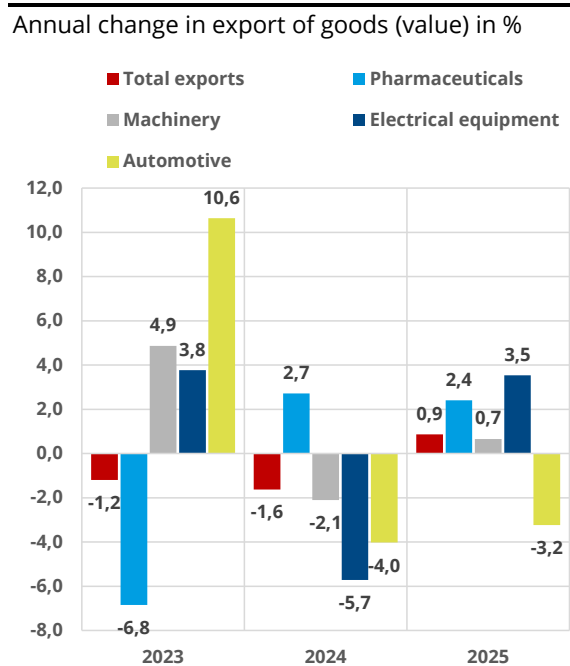
The automotive industry remains central to Germany's export model, yet it is operating in an increasingly fragmented global trade environment. According to the German Association of the Automotive Industry (VDA), new car registrations are expected to rise by around 2% to 2.9 million units in 2026—still roughly one-fifth below 2019 levels. Electric vehicles continue to provide momentum, although the transition toward electrification may prove less labor-intensive than traditional combustion-engine production. As firms adapt production networks to mitigate tariff exposure and serve end markets locally, employment dynamics in domestic manufacturing are likely to remain under pressure.

Weak global demand in 2025 weighed on German manufacturing production, particularly in export-oriented sectors. Softer external demand and subdued capacity utilization have constrained output in recent years (see Figure 19). At the same time, industrial orders showed signs of improvement toward the end of 2025, increasing by 1.8% and 1.2% month-on-month in November and December, respectively. While these gains were partly driven by large domestic defense and transportation contracts, they nonetheless indicate that cyclical momentum has begun to stabilize. Recent survey evidence and improving order inflows point to the possibility of a gradual industrial bottoming-out. However, a broad-based rebound has yet to materialize, and sustained recovery will depend on external demand conditions and competitiveness improvements.

Trade policy has become an important structural constraint. Tariffs on European automotive imports have accelerated localization trends in North America. As a result, exports of German-built cars are expected to edge lower to around 3.2 million units by 2026. Part of the recent

weakness in exports reflects cyclical softness in global demand, but it is increasingly intertwined with longer-term shifts in production geography. German producers are manufacturing closer to end markets, which may preserve global market share but reduces domestic value-added.

Figure 19: German export performance remains uneven across key manufacturing sectors



Sources: Federal Statistical Office, Creditreform Rating

Other export-oriented sectors, such as machinery and chemicals, have also faced weaker external demand, though they are less directly exposed to tariff-related trade frictions. Their primary challenges relate to competitiveness and elevated energy costs, whereas the automotive sector faces stronger pressures linked to market access and regulatory fragmentation. At the same time, global competition is intensifying. Chinese manufacturers now account for more than one-fifth of global vehicle production, reshaping pricing dynamics and technological standards. Germany remains a leading electric vehicle producer, but increasingly relies on joint ventures and local production in China to maintain its market position.

Taken together, Germany’s industrial outlook is improving cyclically, but the medium-term trajectory will depend on competitiveness and successful adaptation to a more fragmented global environment.

Tariff Headwinds and Weak Productivity Cap Germany’s Growth Outlook

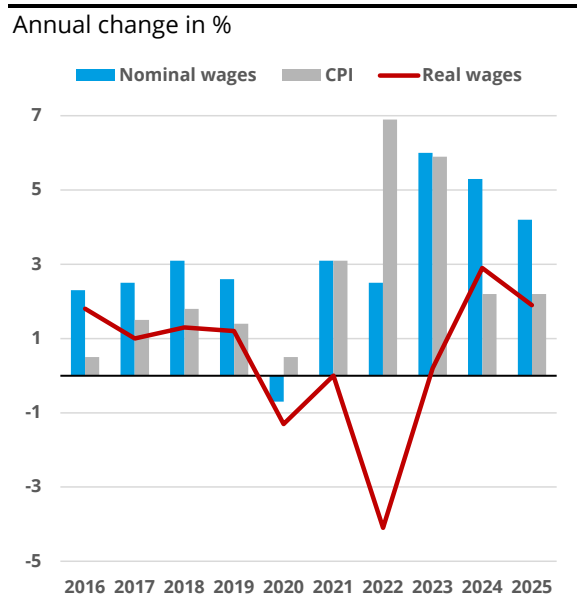
Real wage growth posted at 1.9% in 2025 and we expect it to moderate slightly in 2026 (see [Figure 20](#)). Together with a gradual decline in headline inflation, which stood at 2.1% in January and fell to 1.9% in February, this supports a recovery in purchasing power. Core inflation remains somewhat elevated at 2.5%, reflecting persistent service-sector pressures linked to nominal wage dynamics. In the absence of stronger productivity gains, rising unit labor costs continue to weigh on competitiveness relative to European peers, underscoring the importance of structural reforms.

At the same time, fiscal expansion is set to provide a meaningful cyclical impulse. The €500 billion infrastructure fund and higher defense spending are expected to support investment and industrial activity over the coming years. While implementation lags imply that the growth impulse will unfold gradually, fiscal easing should contribute to firmer domestic demand in 2026 and 2027.

Overall, we project real GDP growth of 1.1% in 2026 and 1.5% in 2027. This marks a clear acceleration from the near-stagnation of 2025 and reflects improving domestic demand conditions and stabilizing industrial momentum. Nevertheless, growth is likely to remain moderate relative

to historical averages and some G7 peers, as structural constraints — including demographic pressures, productivity challenges, and external fragmentation — continue to limit potential output.

Figure 20: Real wage growth moderates alongside nominal wage dynamics



Sources: Federal Statistical Office, Creditreform Rating

Germany is therefore not facing a crisis, but a period of gradual adjustment. The medium-term trajectory will depend on the effective implementation of structural reforms, the timely deployment of fiscal resources, and the ability of key industrial sectors to adapt to a more fragmented global trade environment. If these conditions are met, the economy can regain more durable momentum; if reform progress stalls, growth may remain constrained by underlying structural headwinds.

Figure 21: Growth forecasts for 2026 and 2027

In %, Creditreform Rating forecasts for euro area, IMF WEO forecasts for World, UK, US, and China

	2021	2022	2023	2024	2025	2026e	2027e
World	6,6	3,8	3,5	3,3	3,3	3,3	3,2
Euro area	6,4	3,6	0,4	0,9	1,5	1,2	1,5
<i>Germany</i>	3,9	1,8	-0,9	-0,5	0,2	1,1	1,5
<i>France</i>	6,9	2,7	1,4	1,2	0,9	1,0	1,1
<i>Italy</i>	8,9	4,8	0,9	0,8	0,5	0,8	1,0
<i>Spain</i>	6,7	6,4	2,5	3,5	2,8	2,2	1,8
UK	8,6	4,8	0,4	1,1	1,3	1,3	1,5
US	6,2	2,5	2,9	2,8	2,1	2,4	2,0
China	8,6	3,1	5,4	5,0	5,0	4,5	4,0

Sources: Creditreform Rating, IMF, Eurostat

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