Outlook for 2027: upturn continues, inflation remains elevated

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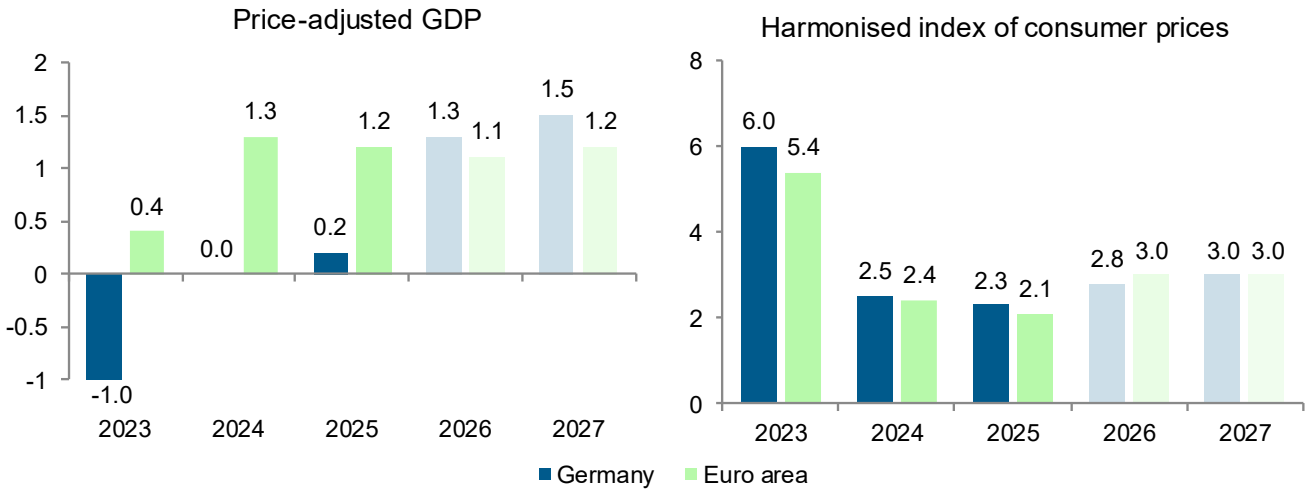
- German GDP rose by 0.1% in the third quarter compared with the previous quarter, adjusted for prices, seasonal effects and calendar effects. Persistently high energy prices and low water levels on the Rhine slightly slowed economic momentum; growth still stood at +0.3% in the second quarter.
- In view of the resilient summer quarter and positive sentiment indicators for Q4, we have raised our forecast for price-adjusted growth in 2026 by 0.2 percentage points to +1.3%. We continue to expect growth of +1.5% in 2027. In particular, the boost from further increases in defence spending and well-filled order books in some industrial sectors give us reason to hope for sustained strong growth momentum. Acute economic risks include a possible end to the global boom in the expansion of AI infrastructure and renewed escalation in energy markets.
- The euro area grew robustly despite higher energy prices. We have therefore raised our GDP forecast for 2026 by 0.3 percentage points to 1.1%. Although we continue to expect headwinds from losses in purchasing power in 2027, rising foreign demand is likely to support the economy – accordingly, we have left our growth forecast for 2027 unchanged at 1.2%.
- The ongoing conflicts in the Gulf region have clouded the outlook for energy price developments. Oil and gas futures now signal high prices for longer in 2027. In Germany, healthcare reform and rising tobacco taxes are providing an additional inflationary impulse. We have therefore raised our inflation forecasts for 2027 significantly, by 0.7 percentage points for Germany and 0.6 percentage points for the euro area, to 3% in both cases.

Economic growth and Inflation

Per cent year-over-year change



Source: Destatis, Eurostat; from 2026 KfW Research forecast (as at 25 November 2026).

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.

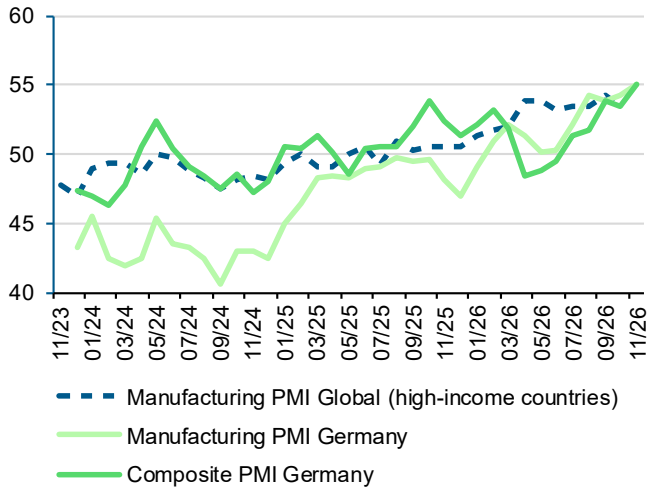
Germany: Growth drivers likely to persist in 2027

Despite very high energy prices and historically low water levels on the Rhine, the German economy grew slightly in the third quarter: gross domestic product expanded by 0.1% compared with the previous quarter, adjusted for prices, seasonal effects and calendar effects, following growth of 0.3% in the second quarter and 0.4% in the first quarter. We have therefore raised our forecast for growth in price-adjusted gross domestic product in 2026, which is now almost over, to 1.3%.[1] In August, we had expected stagnation in Q3 and growth of 1.1% for the year as a whole.

Government consumption in particular supported the economy in the summer, growing by 0.3%. Private consumption, by contrast, was affected by losses in purchasing power due to high fuel prices and possibly also by the heatwaves: it grew only marginally (+0.1%), while retail sales actually slumped (-3.0% Q/Q). Following strong growth in the previous quarters, exports also suffered a setback (-1.0%), and gross fixed capital formation declined significantly (-1.2%). The latter was mainly due to a sharp drop in private investment in equipment, while public investment expanded significantly. Low water levels on the Rhine contributed to a significant decline in average industrial production over the quarter. Overall, the economic data reported by Destatis therefore also shows some weak points in the third quarter. However, if we broaden the view to include activity indicators from business surveys, the positive growth momentum is confirmed. Above all, the fairly reliable Composite PMI increased in Q3, while the assessment of the current situation in the ifo business survey also rose significantly.

Activity indicators from the Purchasing Managers' Survey

Purchasing Manager Index (PMI), balance points



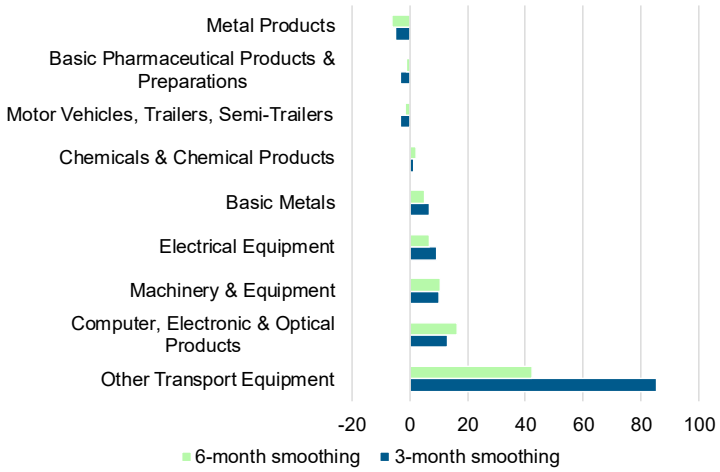
Note: The Composite PMI is a current-conditions indicator for current growth in economic activity in the industrial and services sectors. The Manufacturing PMI includes an indicator for growth in industrial production as well as other forward-looking indicators for industry. The indicators are constructed such that values above 50 indicate expansion and values below 50 indicate recession.

Source: S&P Global, Macrobond, KfW Research.

For the coming year, we continue to expect price-adjusted GDP growth of 1.5%.[2] Forward-looking sentiment indicators such as the ifo business expectations, production expectations and the Manufacturing PMI have risen significantly in recent months. Above all, however, the uptrend in manufacturing order intake that began at the end of 2025 has continued. Defence-related industrial sectors such as other transport equipment manufacturing once again have well-filled order books, driven by rapidly rising defence spending in Germany and some partner countries. In addition, some businesses in areas such as computers, electronics and optics or electrical equipment are benefiting as suppliers from the global expansion of AI infrastructure. Despite all the persistent structural problems – such as high labour and bureaucracy costs and intense competitive pressure from China – it is encouraging that parts of German manufacturing industry are apparently once again managing to produce sought-after components for global investment needs. Order intake in civil engineering has also risen significantly, pointing to an acceleration in construction output in the coming quarters, while domestic orders in mechanical engineering have also achieved a positive turnaround – giving reason for hope regarding the development of business investment.

Industrial order intake by sector

3- and 6-month averages compared with the previous year, changes in per cent, latest figure: September 2026



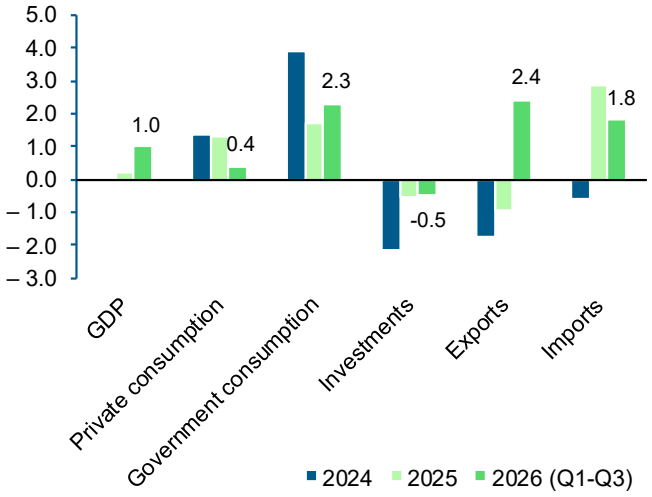
Source: Destatis, KfW Research.

According to the capital plans of the large AI companies ("hyperscalers"), investment in data centres will be increased significantly again in 2027, meaning that the resulting boost to German exports is likely to grow. The current correction in the equity markets does highlight the risks surrounding the expansion of AI infrastructure. For the time being, however, we assume that this correction will not significantly slow the expansion. The growth impulse from German fiscal policy is likely to be similarly strong in 2027 (+0.6 percentage points) as in the current year: substantial further increases in German defence spending in particular are still planned for 2027.[3] In the case of public investment expenditure, we also expect an increasing disbursement rate and positive lagged effects from the expenditure already incurred in 2026, meaning that despite an unchanged level in the budget plans, it is likely to boost growth again. The still very high energy prices will continue to have a dampening effect next year, however. In line with futures markets, we expect wholesale gas and oil prices to decline gradually over the course of 2027. Nevertheless, inflation is likely to increase somewhat further next year (see the section on inflation). Finally, the interest-rate level has risen significantly, partly in response to the monetary policy reaction to increased inflationary pressure and partly because of greater competition in the bond market due to the financing needs for AI investment. The increase of slightly more than half a percentage point in the

Bund yield since the beginning of the year is gradually also feeding through into higher interest rates on corporate bonds, bank loans and, in particular, residential mortgages.

Development of GDP expenditure components

Price-adjusted change compared with the previous year, in per cent



Source: Destatis, KfW Research.

Export growth is likely to slow slightly next year following its astonishing comeback in 2026. In view of the uptrend in foreign orders, a significant rise in export expectations and the likely continuation of the boost from global AI investment, we nevertheless see net exports as a key driver of growth in 2027 as well. We also expect a significant boost once again from government consumption, driven in particular by the expansion of the Bundeswehr. In addition to infrastructure investment, military procurement expenditure is also likely to ensure strong growth in public investment. In the case of business investment, the negative effect of worsening financing conditions is being offset by the positive effect of increasing capacity utilisation. Ultimately, we expect business investment to rise moderately in 2027. Housing investment will be particularly affected by higher interest rates, as already indicated by a setback in some leading indicators. Nevertheless, the steep downward trend that has continued since 2022 is likely to come to an end next year. Factors supporting at least modest growth include regulatory simplification and increased funding for social housing. Private consumption, meanwhile, will continue to be dampened by inflation-related losses in purchasing power. We nevertheless expect wage growth in 2027 to allow for a slight increase in real incomes – partly because the minimum wage will rise by 5% – and therefore anticipate at least modest growth in private consumption. A substantial improvement in employment expectations is also having a positive effect in this regard. Increasing capacity utilisation is likely to bring the gradual rise in unemployment to an end next year.

Forecasts for 2028 are currently subject to immense uncertainty. In any case, the baby-boomer generation's retirement in the coming years will increase downward pressure on labour supply and growth potential. As capacity utilisation in the German economy is expected to normalise next year, this is likely to become a limiting factor. In addition, the fiscal policy impulse from the increase in investment and defence spending will peter out in 2028.[4] Without significant reforms or a strongly positive productivity effect from the use of artificial intelligence, weaker growth in Germany should therefore be expected again after the current economic upswing.

Euro area: stable outlook despite high energy prices

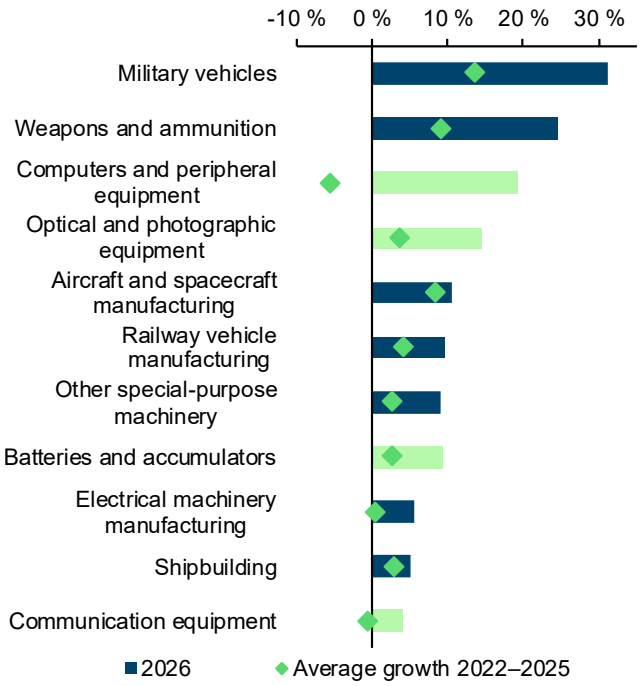
Following the second quarter, price-adjusted GDP in the euro area also surprised on the upside in the third quarter, increasing by 0.4% compared with the previous quarter – after the figure for the second quarter had subsequently been revised upwards to 0.6%. Although Ireland's typically volatile economic data once again played a role, the euro area also recorded remarkably stable growth of 0.2% in the third quarter without this special effect, following 0.3% in both the first and second quarters. In view of the higher energy prices and the heatwave, we had expected weaker growth.

The expenditure components presented a mixed picture in the first half of the year. While government consumption and exports drove growth, investment lost momentum in view of tighter financing conditions, and private consumption weakened as a result of higher price pressures. In the third quarter, however, the dampening effect on consumption from the renewed increase in energy prices and inflation rates was less pronounced than feared: real retail sales have so far barely declined. The first signs of a slowdown are nevertheless emerging in the output of energy-intensive industries. Output in the manufacturing sector as a whole also fell in the third quarter, declining by 0.9% compared with the previous quarter, with the significant drop in Irish industrial production making a major contribution. Industrial production is nevertheless being supported by defence and high-tech goods (see chart).

Sentiment indicators also remain robust at the beginning of the fourth quarter. Despite a slight decline compared with the previous month, the Purchasing Managers' Index (Composite PMI) and the Economic Sentiment Indicator for the euro area in October remained in a range consistent with modest growth. Leading indicators for industrial order books and export orders are also pointing clearly upwards. Despite the persistently high energy prices and stronger price pressures, we expect the solid growth trajectory to continue in the final quarter (excluding Ireland). Mainly due to the stronger-than-expected figures for the second and third quarters, we have raised our GDP forecast for the euro area for 2026 by 0.3 percentage points compared with our August forecast. We now estimate annual growth at 1.1% this year.

Euro area: top growth performers in industrial production by sector

Since the beginning of the year compared with the previous year, light green = AI-related sectors



Source: Eurostat.

For 2027, we continue to expect growth of 1.2%, unchanged from our August forecast. The growth drivers have shifted somewhat, however. In mathematical terms, growth is primarily supported by the statistical carry-over of 0.5 percentage points with which the euro area enters the new year, thanks to unexpectedly strong growth in 2026. Growth momentum in 2027, by contrast, is likely to be slightly weaker than previously assumed. This is mainly because energy prices are expected to remain high for longer than assumed in our previous forecast, resulting in higher inflation (see the section on inflation). In particular, the delayed pass-through of energy costs to the prices of industrial goods and food is likely to mean that real disposable incomes will rise only marginally at best. This will dampen consumption. A decline in the saving rate could cushion this effect; in the large euro area countries, with the exception of Spain, it remains significantly above its pre-pandemic average. In addition, employment expectations point to further employment growth despite the shrinking working-age population.

Tighter financing conditions will also weigh on GDP. The overall weak performance of private investment, which was already evident in the first half of 2026, is therefore likely to continue to a large extent. Non-residential construction investment, which has so far benefited from NGEU funding, is also likely to decline significantly as the programme expires at the end of 2026. In view of high mortgage interest rates, housing construction is also expected to remain subdued. The fact that investment nevertheless increases moderately is likely to be mainly due to the AI boom. Technological adaptation by businesses could generate additional investment in intellectual property and equipment, albeit to a lesser extent than in the US. Public investment in Germany is also set to expand dynamically. However, as the NGEU funding that is being withdrawn will only be partly replaced by other EU programmes and national funds, the fiscal impulse in the euro area is likely to be neutral overall in 2027.

GDP growth is being supported by strong foreign demand. The significant increase in exports in 2026 is likely to moderate slightly but will continue to drive growth. The global AI boom remains the main driver, although the euro area is benefiting less from it than other regions of the world.[5] However, euro area businesses supply some of the equipment used in data centres, such as power and cooling technology, as well as essential equipment for semiconductor manufacturing. Overall, the contribution from net exports is expected to be positive again, also because import growth is likely to be somewhat weaker.

Among the four largest economies, Germany and Spain are expected to grow above the EU average. Although growth momentum in Spain is likely to weaken somewhat, growth will remain above average. Italy is particularly affected by the energy price shock, as the country is heavily dependent on gas. Investment will also lose significant momentum as government support comes to an end. France is expected to bring up the rear. Increased political and economic policy uncertainty is likely to prompt households and businesses to postpone major consumption and investment projects. Even after the presidential election in spring 2027, no sustained growth impulse is expected, as fiscal policy space is limited in view of the high level of debt.

Annual GDP growth in euro area countries, including forecasts

Percentage change compared with the previous year, price-adjusted, as at 25 November 2026

	DE	FR	IT	ES	EA
2024	0.0	1.5	1.1	3.7	1.3
2025	0.2	0.8	0.6	2.6	1.2
2026	1.3	0.3	0.8	2.6	1.1
2027	1.5	0.4	0.6	2.0	1.2

Source: Destatis, Eurostat, from 2026 onwards KfW Research forecast

Acute economic risks for Germany and the euro area: energy, AI, public finances and trade policy

The German and European economies have so far proved surprisingly resilient to the effects of the war in Iran. However, they are not completely immune to high energy prices. This means that developments in the Gulf remain the most acute economic risk, and the outlook also depends on the weather: given the very low levels of gas storage, an unusually cold winter would drive up gas prices considerably further and could potentially lead to production restrictions in energy-intensive industries. A slowdown in global AI investment – possibly indicated by the current volatility on the NASDAQ – could also have a negative impact on the economic outlook for Europe. Germany in particular is more vulnerable as a result of its newly established growth driver. A sharp downturn in the currently very highly valued equity markets would also be likely to dampen the global economy in general. In addition, trade disputes could flare up again, for example if the EU's talks on the trade imbalance with China fail and escalate into a cycle of trade policy retaliation. Another key downside risk for the euro area would be a further escalation in the government bond market, particularly in France. In view of costly election promises, France's presidential election in spring

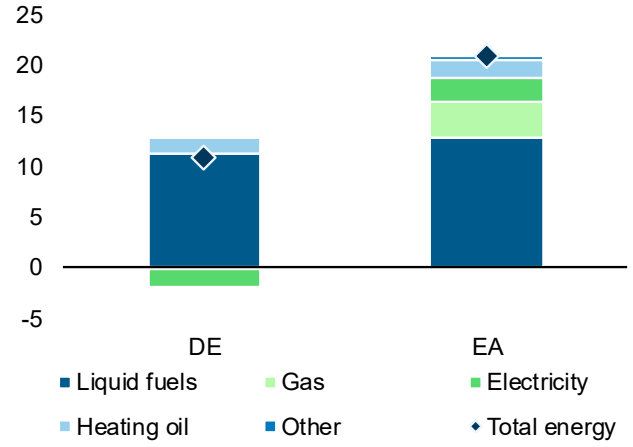
2027 and any subsequent parliamentary elections are unlikely to produce a clear commitment to reducing the budget deficit. Yields on French government bonds could therefore continue to rise and feed through into private-sector financing conditions. Less likely, but nevertheless conceivable, is that a crisis-driven increase in risk premia could spread to Italy.

Inflation rises significantly in the euro area – fuel discount dampens increase in Germany

Over the past three months, conditions and the outlook in the global energy markets have deteriorated considerably. Hopes in the summer of a rapid de-escalation of the conflict in the Middle East have been dashed. As a result, market prices for oil and gas have risen significantly again since mid-July. At their peak, Brent crude oil was trading at USD 118 per barrel at the end of October, while European natural gas (Dutch TTF) stood at EUR 104/MWh.[6] Since then, prices have fallen back somewhat from these peaks due to increased energy flows and declining risk premia for an escalation scenario following the US midterm elections, but they remain at high levels.

Contributions to energy inflation (HICP, October)

Energy inflation in per cent, contributions of the components in percentage points



Source: KfW Research, Eurostat.

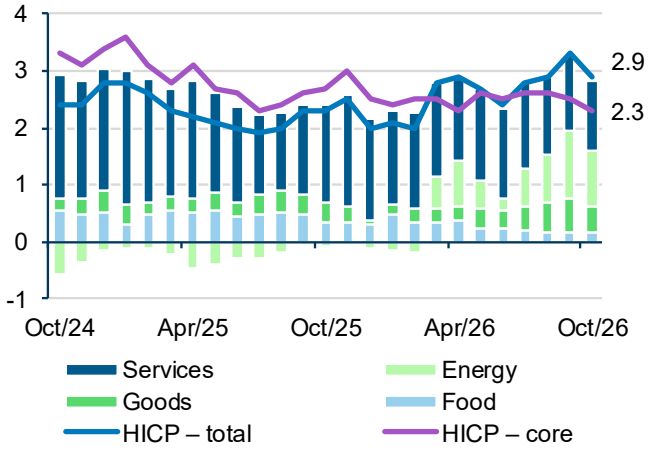
As a result, the inflation rate for energy products in the euro area doubled from July to October, reaching 21.0%, while the increase in Germany (10.9%) was considerably less pronounced. The substantial discrepancy has two main causes. First, German consumers benefited from the reintroduction of the fuel discount in October. Second – and more importantly – differences in the extent to which electricity and gas suppliers pass on costs to end customers are becoming more pronounced. In the euro area, these energy sources now account for around 30% of overall energy inflation, while they are still cheaper for German consumers than they were a year ago. In general, the pass-through of rising commodity costs is weaker for gas and electricity than for fuels. This is due to the higher share of taxes, levies and regulated prices, as well as longer-term supply contracts and pricing agreements. The delay is particularly pronounced in Germany. However, data from consumer portals such as Verivox have recently also shown a significant increase in tariffs in Germany, which will sooner or later also be reflected in the official consumer price statistics.

The divergence in energy price developments made a significant contribution to the fact that Germany's headline HICP rate was just 2.9% in October, while the rate for the euro area reached 4.0%, its highest level in three years.

Beyond energy price developments, there are still only weak signs of a broadening of price pressures. In the euro area, food and other industrial goods have recently become somewhat more expensive than in July. However, price increases of 1.5% and 1.2% respectively remain low. Services inflation continued the sideways trend that began in May 2025, with rates of just above 3% (October: 3.3%). In Germany, the inflation picture is also more subdued in the other components. Compared with July, only other industrial goods recorded a minimal acceleration to 1.6%, while inflation for food actually eased somewhat to 1.1% and that for services fell more noticeably to 2.6%. The latter is partly attributable to weakness in volatile components such as air fares and package holidays, however, meaning that a countermovement is likely in the short term.

Contributions to inflation (HICP) in Germany

Inflation in per cent, contributions of the components in percentage points



Source: KfW Research, Eurostat.

Forecast: inflation also around 3% in 2027

The developments of the past quarter result in only minor adjustments to our inflation forecasts for the current year. Faster increases in energy prices are offset by government relief measures and weaker-than-expected price pressures in the other components. On balance, this results in an upward revision of the average annual inflation rate for the euro area by 0.1 percentage points to 3.0% and a downward revision for Germany by 0.1 percentage points to 2.8%. The inflation outlook for next year, by contrast, is changing significantly as a result of the altered prospects for the energy markets. For 2027, we no longer expect the average increase in consumer prices to ease in Germany or the euro area. We expect an inflation rate of 3.0% in both regions (previous forecast: Germany: 2.3% / euro area: 2.4%).

We regularly base our assessment of energy price developments on futures prices for oil (Brent) and European gas (TTF). Compared with our previous forecast in July, futures contracts now signal a considerably higher price level for 2027. Financial markets currently expect the resolution of the Middle East

conflict to take more time. In addition, further demand is expected as depleted inventories are replenished. The assumed decline in energy prices is therefore likely to be gradual. And while consumers are likely to benefit quickly from falling oil prices on the global market, the delayed price response for gas and electricity means that inflation rates for these energy sources are initially expected to continue rising. This applies in particular to Germany, where this process has only just begun. Some relief will come from the reduction in electricity tax by 2 cents per kWh from the beginning of 2027, recently agreed by the governing coalition. All else being equal, energy inflation in Germany is therefore likely to be 1.5 to 2 percentage points lower. Nevertheless, energy prices for German consumers are expected to rise sharply again next year, by between 5 and 6%. In the euro area, we expect somewhat higher price increases of 6 to 7%.

As described above, little evidence of indirect price effects or even second-round effects through wage demands can be seen in the other components, even eight months after the energy price shock began. However, the time lag is still within the expected range, and a significant pass-through of the increase in energy costs to other parts of the economy should still be expected, given the resilience observed and the duration and scale of the shock. Businesses' selling price expectations have also increased again since the summer, while price pressures are gradually building up along the food value chain. The agricultural commodity prices calculated by the ECB have risen again year-on-year since the summer, and a tentative turnaround in the trend has begun in producer prices for processed food. Starting from their currently very low levels, food inflation should accelerate noticeably in succession, with the increase in tobacco tax providing an additional boost in Germany.[7] The same applies to price increases for other industrial goods, which are also being driven by strong demand for information technology goods. In Germany, inflation in industrial goods is likewise being affected by a special effect resulting from government measures. Higher co-payments as part of the healthcare reform will lead to a corresponding price surge for medicines at the beginning of the year. The same applies to the healthcare services concerned. On balance, however, services inflation is likely to ease somewhat in both Germany and the euro area, owing to the continued moderate pace of wage growth.

The ECB will respond to the persistently high inflation in December by continuing its monetary policy tightening and raising its key interest rates by a further 25 basis points. This is also clearly reflected in comments made by Governing Council members in recent weeks. Financial market participants even expect further interest rate increases. This cannot be ruled out, but given the expected subdued price effects beyond energy goods, we do not expect this. The coming months will bring greater clarity on this, as we have now entered the period in which the "contagion effects" of cost shocks should materialise.

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[1] The price- and calendar-adjusted growth rate is expected to be 1.0%. Due to the large number of public holidays falling at weekends, the so-called calendar effect on growth in 2026 is relatively substantial at 0.25 percentage points.

[2] Price- and calendar-adjusted, the figure is 1.4%.

[3] See Scheuermeyer, P. (2026) KfW Research Chartbook: Der Verteidigungsboom in Deutschland – Vermessung, Chancen, Probleme. (*KfW Research Chartbook: Germany's defence boom – measuring its scale, opportunities and problems*, our title translation, in German)

[4] Investment and defence spending will remain high, but changes in expenditure are decisive for the economic impulse. At most, therefore, positive second-round effects can still be expected, while consolidation pressures are increasing in the Federal Government's core budget and at the other levels of government.

[5] Philip, L. (2026) AI adoption in Europe, speech by Philip R. Lane at the Federal Reserve Bank of San Francisco Economic Research Symposium, 30 October 2026.

[6] The prices mentioned each refer to the next futures contract to mature.

[7] For the effects of government measures on the inflation rate in Germany, see also the Bundesbank's monthly report for October 2027.