



NatWest

Euro Area Economy & Markets Outlook

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Tomorrow begins today

Information Classification - Restricted

“Never waste a good crisis” ... what about polycrises then?!?

- 2019: secular stagnation, ageing, low productivity
- 2022: Post-Covid implications, return of inflation, supply chains' rewiring
- 2026: *all of the above* plus energy insecurity (again), defence, monetary fragmentation

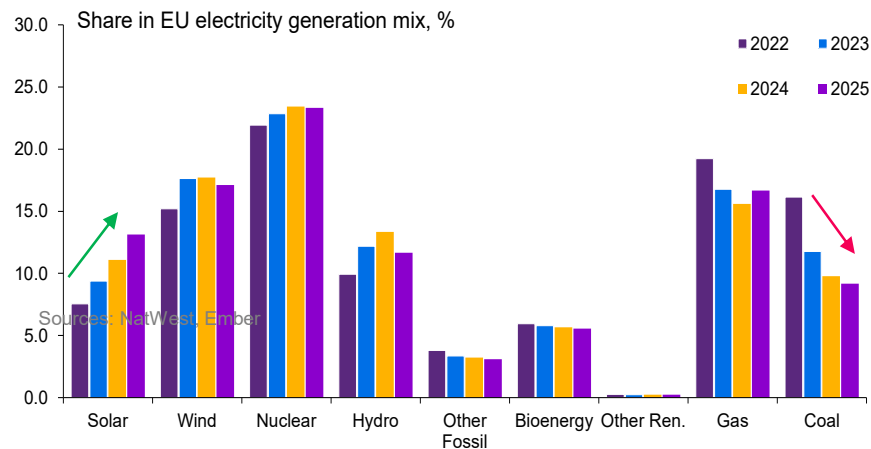
→ A structural turning point with enormous challenges... but also big opportunities for the EU... Europe at its most complex conjuncture since the Euro's creation as:

- Structural and cyclical shocks colliding
- Policy errors now have non-linear costs
- The next few years will shape:
 - growth potential
 - strategic autonomy
 - political integration

Energy Shock

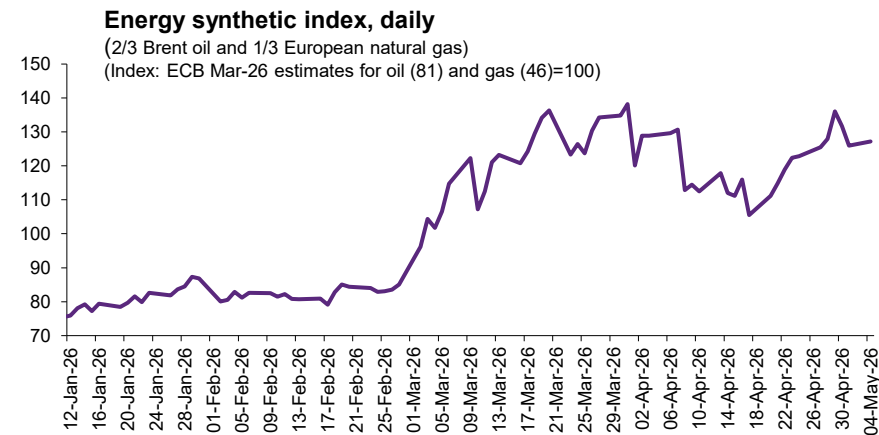
- From strategic vulnerability to promising investment case
- Energy is key: fundamental production input + inflation vol + security variable + decarbonisation targets
- Hormuz/Iran risk highlights Europe as fragile and price-taker, once again
- Adverse scenarios reshape monetary, fiscal & political space
- Massive investment is a short-term pain in terms of consumer spending constraints but.....
- The paradox
- Energy vulnerability ↔ strongest long-term investment/ potential growth narrative (Draghi report: 300bn+/y, additional)
- Renewables + efficiency + REPowerEU = energy (EU) sovereignty logic

EU energy mix – getting there... still too slowly: renewables accounted for 47.5% of EU electricity



Sources: NatWest, Ember

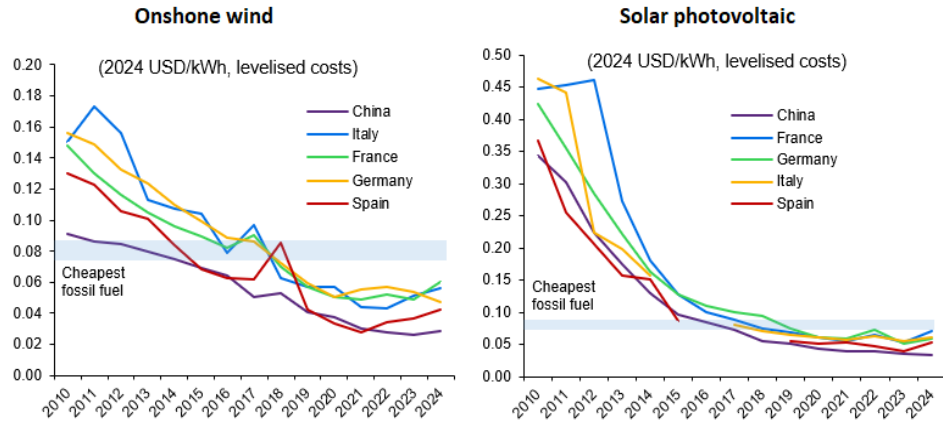
Energy prices about 27% higher than the ECB's Mar-26 baseline



Sources: NatWest, Bloomberg

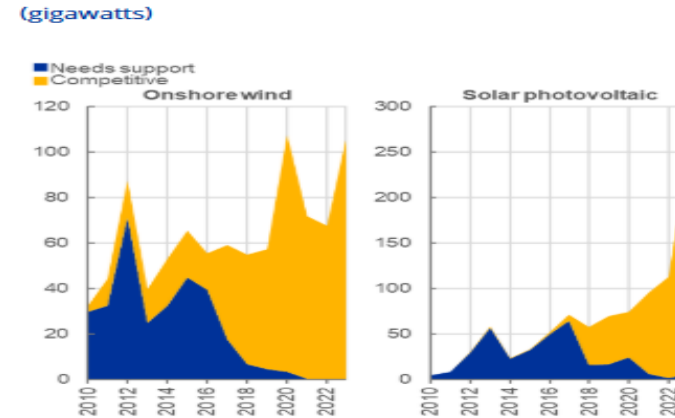
Energy Shock

Plummeting costs of renewables: game-changing



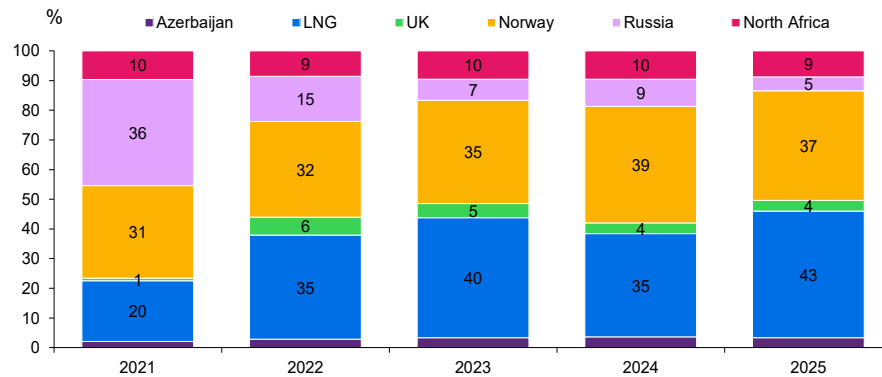
Sources: NatWest, IRENA

Worldwide additions of utility scale renewable electricity



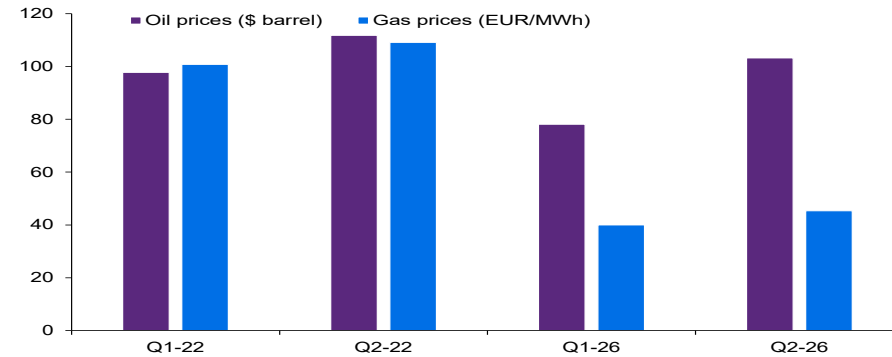
Sources: ECB

European natural gas imports (share of pipeline imports by country and share of LNG): diversification



Sources: NatWest, Eurostat, ECB

Energy prices: still below the highs of 2022

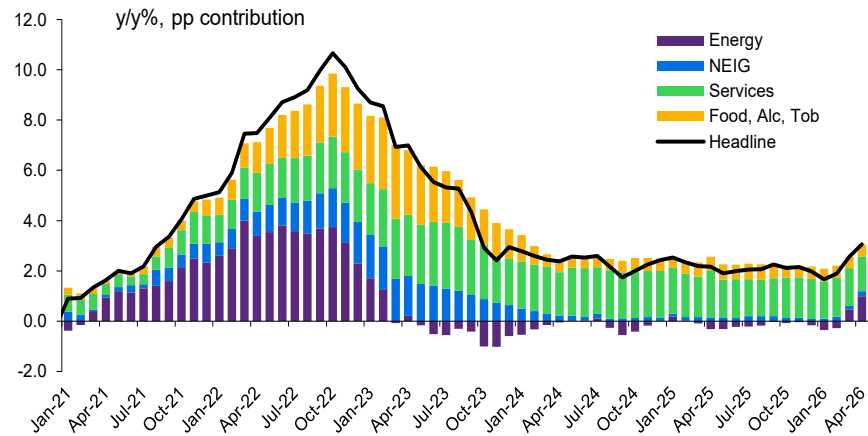


Sources: NatWest, Bloomberg; Q2-26: latest data available till early May

Inflation: Not (2022) Again...

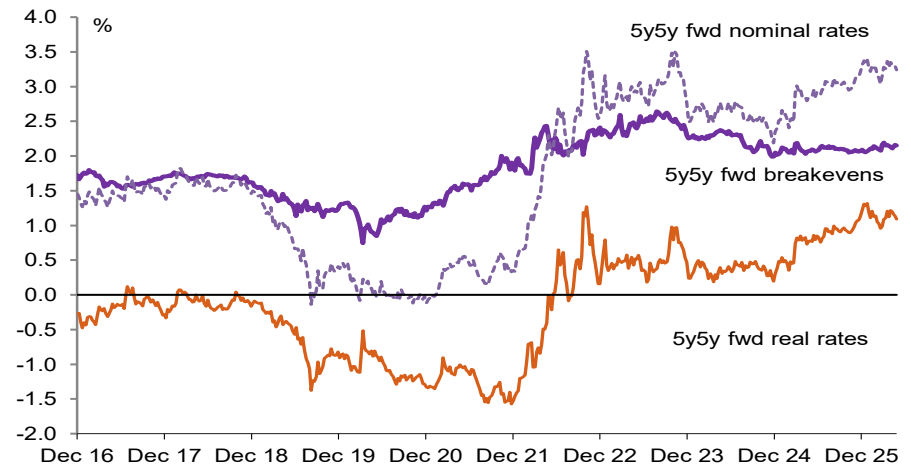
- Headline inflation back near 3%, energy-led
- Core inflation ~ stable and near target for now,
- Structural pressures from defence and investment, but more persistent than permanent

Headline inflation up....but its all energy....



Sources: NatWest, Eurostat

Long-term inflation expectations still well-anchored

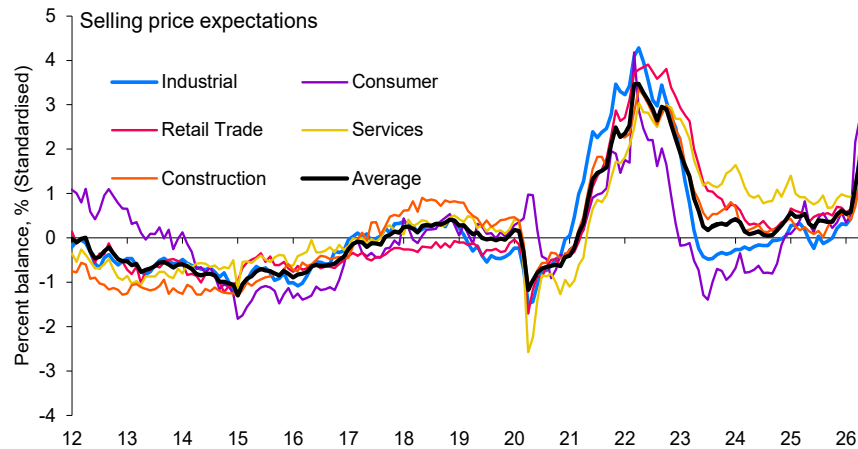


Sources: NatWest, Bloomberg

Inflation: Not (2022) Again...

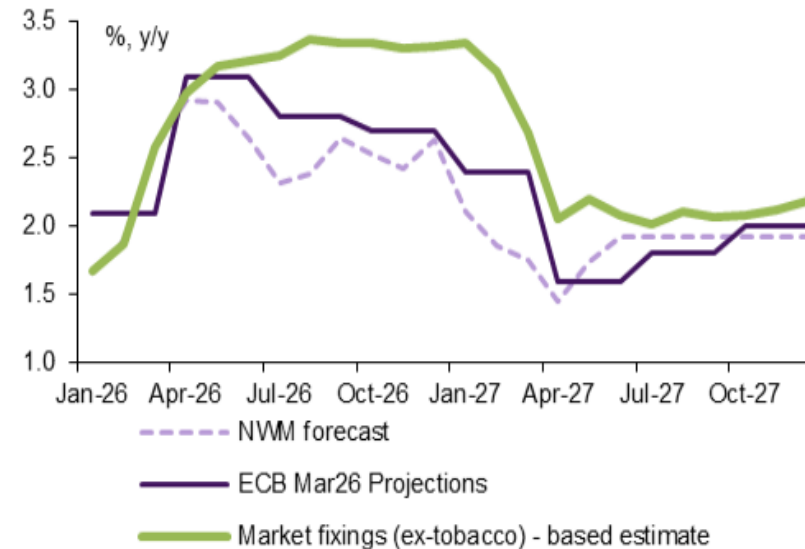
- Long-term expectations broadly anchored
- ECB credibility intact
- Hawkish rhetoric different from premature&numerous hikes... but June hike (25bp) likely if nothing changes
- Hiking aggressively into negative supply shock risks repeating past mistakes

Most surveys do point to rising price pressures in the short-term....



Sources: NatWest, European Commission

Market inflation expectations more negative than the ECB (and us), but still viewing the spike as a 'one off': ~2% in '27

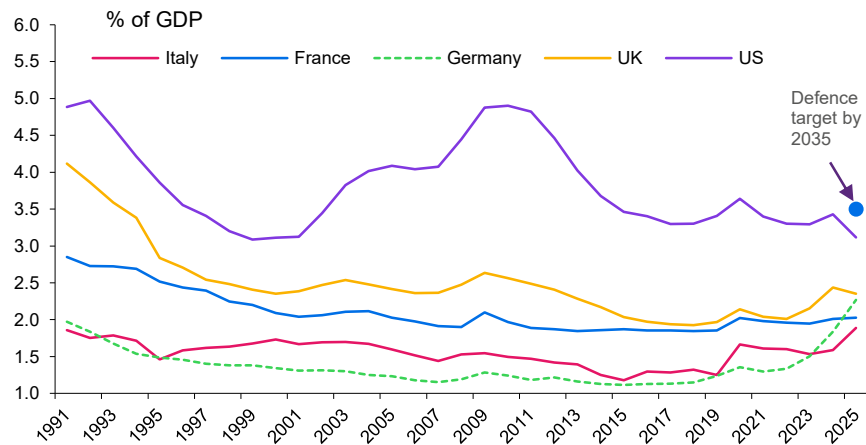


Sources: NatWest, Eurostat, ECB, Bloomberg

Defence spending – like energy: strategic on many levels

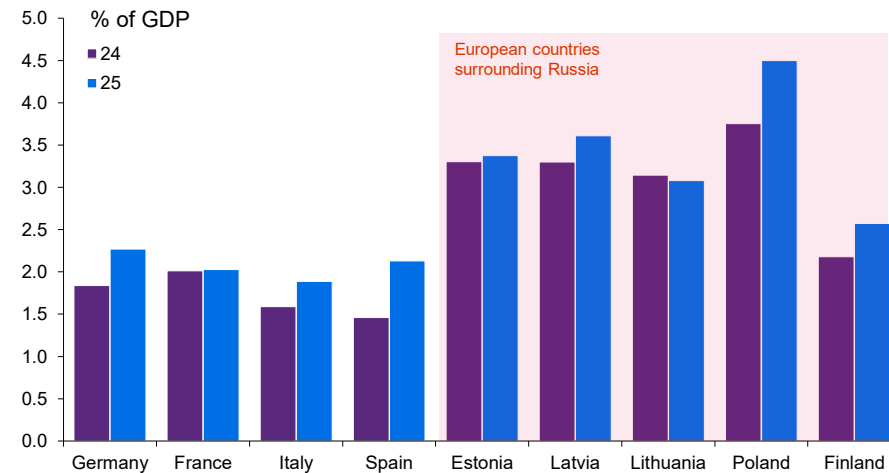
- A Structural reorientation
- Defence spending +20% y/y in 2025 (100% since 2014)... and more to come
- Shift from “peace dividend” (was it a real dividend?) to persistent reallocation
- Commitments imply near-doubling vs pre-2020 levels
- What matters most...
- Composition (prepare for new wars, invest in EU) > headline amounts
- EU procurement & R&D → higher multipliers (spillovers to civil uses)
- Defence integration = political union-building... maybe even more than the common currency

Defence spending: end of the “peace dividend”



Sources: NatWest, SIPRI

Geography matters: European defence spending highest at its eastern borders

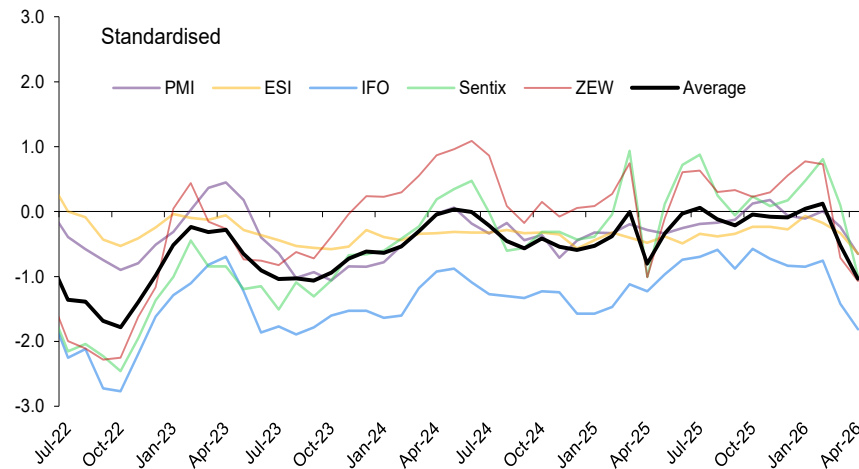


Sources: NatWest, SIPRI

Despite all these investment needs, short-term growth is faltering again...

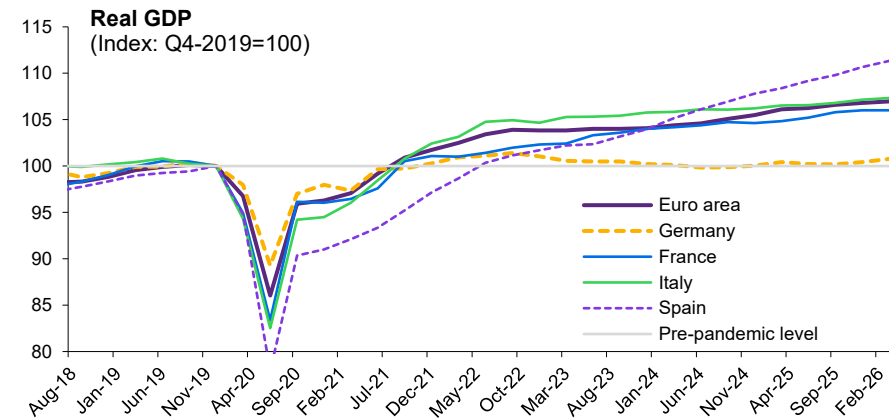
- Cyclical Fragility, Structural Urgency
- Cyclical setback from energy & geopolitical shock
- Germany: should have become the engine of growth again but... strong intent, weak execution (so far)
- Short-term growth hostage to geopolitics and uncertainty more than elsewhere...

Forward-looking surveys suggest downside risks to near-term growth amid recent shock



Sources: NatWest, S&P Global, European Commission, IFO, Sentix, ZEW

German GDP has remained close to its pre-pandemic level

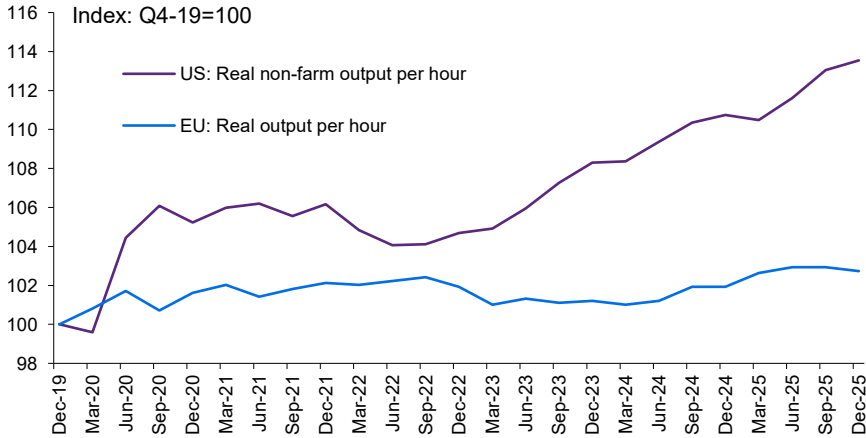


Sources: NatWest, Eurostat, Destatis, Insee, Istat, INE

Growth&productivity gap – another big ‘opportunity’

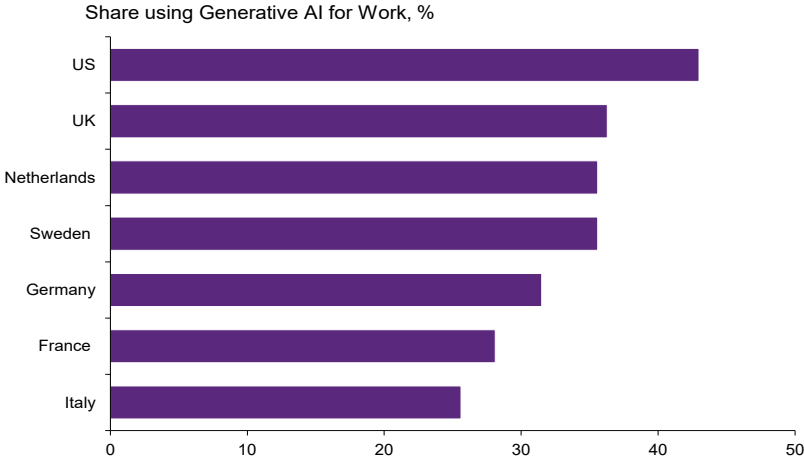
- Structural reality
- Demographics & productivity still binding
- EU-US productivity gap widening
- Accentuated by differential in AI adoption

Productivity gap widening



Sources: NatWest, Eurostat, Bureau of Labour Statistics

The US is leading in AI adoption, large variation within Europe

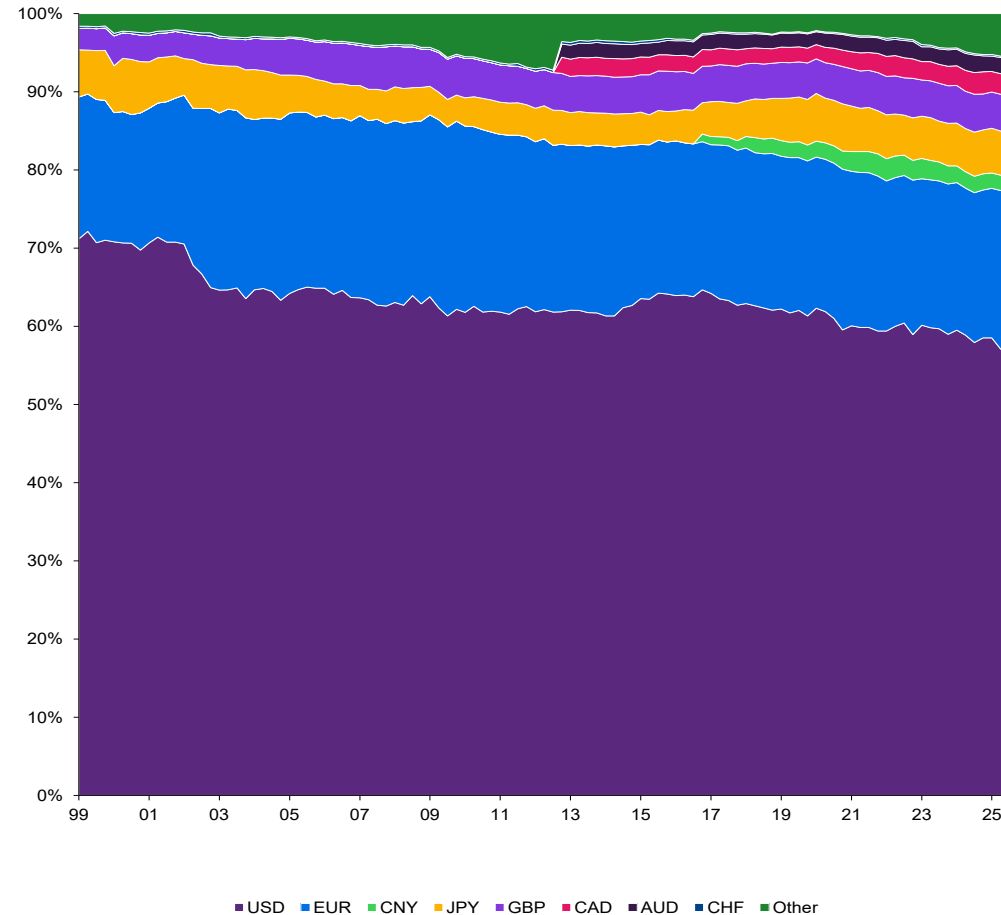


Sources: NatWest, [Bick et. al.](#)

Dedollarisation / Euroisation

- No regime change – but a strategic window to advance role of the euro
- Dollar dominance intact, euro share stable (~20%)
- US financial weaponisation → diversification incentive
- Euro = only scalable alternative already in use
- What's missing
 - Deep safe asset market
 - Capital markets union
 - Political coherence
- Momentum
- PEPP, NGEU, SAFE = institutional infrastructure building up

Global reserve managers still hold primarily USD, although its share has fallen to just 56%

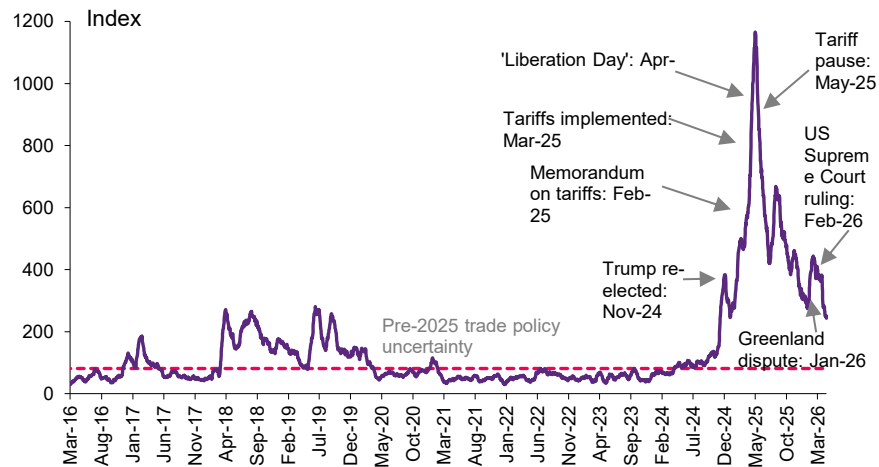


Sources: NatWest, IMF

Geopolitics spurring “more Europe”

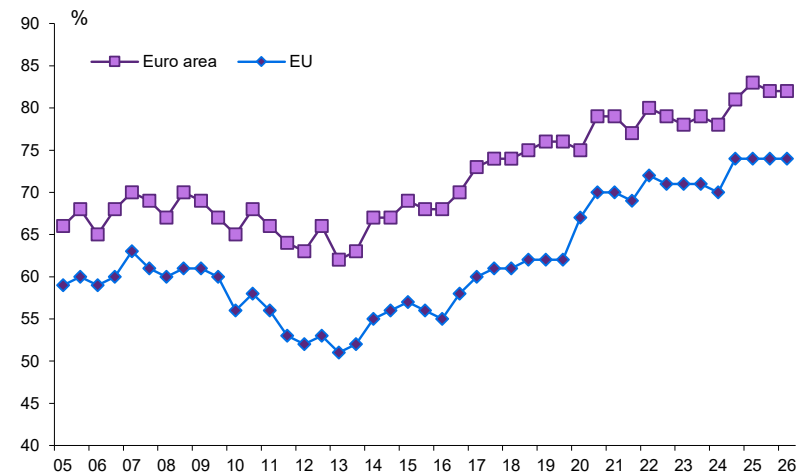
- Fragmentation as catalyst
- Higher tariffs, China as direct competitor, war on EU borders...
- Export-led model under structural pressure
- Paradox
- External hostility creates space for integration
- Defence, energy grids, tech increasingly “Europe by necessity”
- Trade diversification accelerates

Trade policy uncertainty remains elevated amidst geoeconomic fragmentation



Sources: NatWest, [Caldara et. al.](#)

Highest citizens' support ever for the euro currency amid economic uncertainty



Sources: NatWest, Eurobarometer survey

Conclusion - 2030 Litmus test: How do we know if Europe gets this right?

- 1. Energy
 - Lower dependence
 - Reduced shock sensitivity
 - Climate change better controlled
- 2. Institutions
 - Capital markets union
 - Safe euro asset
 - Further internationalisation of the euro as reserve currency
- 3. Defence
 - Joint procurement
 - EU based R&D & spillovers
 - Joint army?
- Failure on these = another lost decade