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DIW Weekly Report

A policy bulletin from the German Institute for Economic Research

11 2026

Economy. Policy. Science.



# DIW Economic Outlook Spring 2026

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## LEGAL AND EDITORIAL DETAILS

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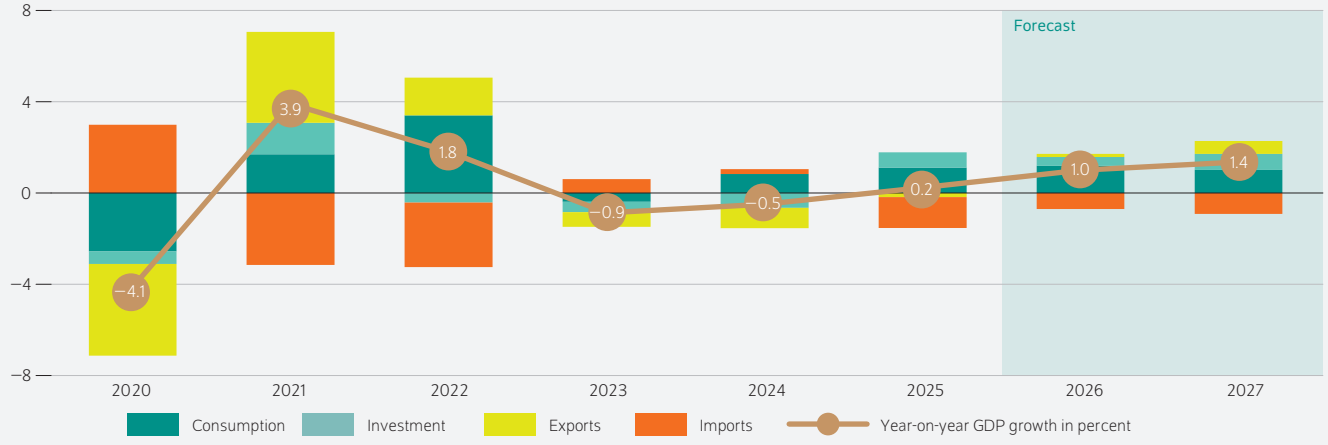
AT A GLANCE

# German economy on the upswing—global economy continues to grow moderately

**By DIW economic researchers**

- German economy on recovery path after three years of subdued activity – pressures from Iran war and erratic U.S. trade policy only slightly slow growth
- The recovery continues to be driven by the domestic economy, while export-oriented industry is only gradually gaining momentum due to structural weaknesses and global uncertainty
- Public investment is gradually picking up, initially in defense and later also in infrastructure – the labor market remains robust
- DIW Berlin forecasts German economic growth of 1.0 percent this year and 1.4 percent next year – slightly below previous winter expectations
- The global economy is expected to continue expanding moderately, with growth of 3.3 percent in both 2026 and 2027

**German economy on a recovery path—Iran war and trade conflicts dampen growth only slightly**
Individual components' contribution to overall GDP growth in percentage points




Source: DIW Economic Forecast Spring 2026.

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## FROM THE AUTHORS

*"Oil and gas prices are likely to remain at a higher level in the coming months because of the Iran war, but will then gradually fall again. Inflation is expected to be about 0.4 percentage points higher, and economic growth is likely to be dampened by 0.1 to 0.2 percentage points. Overall, however, the recovery will not be halted by the Iran war."*
*— Geraldine Dany-Knedlik —*

## MEDIA

**Audio Interview** with Geraldine Dany-Knedlik (in German)
**www.diw.de/mediathek**

# German economy on the upswing—global economy continues to grow moderately

**By Geraldine Dany-Knedlik, Guido Baldi, Nina Maria Brehl, Angelina Hackmann, Konstantin A. Kholodilin, Laura Pagenhardt, Jan-Christopher Scherer, Teresa Schildmann, Hannah Magdalena Seidl, Ruben Staffa, Kristin Trautmann, and Jana Wittich**

**EXECUTIVE SUMMARY**

After three years of subdued economic activity, the German economy is on the road to recovery. While the Iran war and erratic U.S. trade policy are weighing on growth, their impact is only moderate. Although the U.S. Supreme Court has ruled that U.S. tariffs are unlawful, this does not change the tariff rates imposed on German exports, as the agreement with the European Union is assumed to remain in effect. The recent rise in energy prices resulting from the escalation in the Middle East is also significantly lower than during the energy price crisis of 2022/23. Germany is less dependent today on fossil fuels from the Gulf region than it was then on gas and oil from Russia. Assuming that the sharpest price surge has already occurred and that oil and gas prices will now rise only moderately, they are expected to increase inflation by 0.4 percentage points this year and dampen growth by 0.1 to 0.2 percentage points. Overall, this will slow down the recovery of the German economy but not halt it: The upturn continues to be driven by the domestic economy, while the export-oriented sector will only slowly regain momentum in the face of structural weaknesses and global uncertainty.

The German economy grew by 0.2 percent in 2025, supported primarily by strong private and public consumption. By year-end, activity had picked up noticeably, and the upswing is continuing into early 2026, albeit at a more moderate pace. Growth is expected to remain positive, underpinned primarily by ongoing expansionary fiscal measures: Public consumption remains strong, and government investment is gradually picking up – initially in defense, later in infrastructure. Private consumption continues to benefit from the resilient labor market, while foreign trade remains weak due to declining competitiveness, the burden of U.S. tariffs, and global uncertainty. Higher energy prices are temporarily slowing growth slightly.

The DIW Berlin projects growth of 1.0 percent for 2026 and 1.4 percent for 2027. The inflation rate is expected to be 2.4 percent in 2026 and 2.3 percent in 2027; further interest rate hikes by the European Central Bank are not foreseeable. The swift deployment of public funds remains crucial. The risks cut both ways: Faster project implementation could boost growth, while delays and capacity bottlenecks would slow it down. In terms of foreign trade, U.S. tariffs and geopolitical tensions remain key sources of uncertainty, while a de-escalation in the Middle East could bring relief in the form of falling energy prices.

The global economy is expected to continue expanding moderately over the forecast period, growing by around 3.3 percent this year and next. While slightly expansionary fiscal policies in many countries are supporting demand, protectionist U.S. trade policies and the Iran war are dampening growth momentum, particularly starting in the second quarter of 2026. Regions with a high dependence on energy imports are particularly affected.


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# German economy: Energy price hikes due to the Iran war only slightly dampen recovery

After a long wait, the German economy has finally embarked on a path to recovery: Following three years of subdued economic activity, signs of a more dynamic recovery are mounting. The effects of the Iran war and recent trade policy developments are likely to slow the upswing only slightly overall.[1]

The ruling by the U.S. Supreme Court that U.S. tariffs are unlawful is expected to have only limited effects on German exports. While trade policy uncertainty has risen again as a result of the ruling, it is assumed that previously reached agreements—such as the trade agreement with the European Union (EU) —will remain in place and that the tariff burden on German exports will remain virtually unchanged. The war in the Middle East that broke out at the end of February caused oil and natural gas prices to rise and created turmoil in the financial markets. However, the price increases have so far been smaller than during the energy price crisis following the war in Ukraine. Furthermore, dependence on fossil fuels from the Middle East is noticeably lower today than the previous dependence on Russian gas and oil.

The recovery of the German economy is driven primarily by strong domestic demand. The government's expansionary spending policy is providing support, although it has so far done little to stimulate corporate investment. Private consumption remains a reliable pillar: households have significantly increased their spending, thereby stabilizing the domestic economy. The export-oriented German industry, on the other hand, is recovering only gradually and is slowing the pace of overall economic expansion. At the same time, the external economic environment remains marked by considerable uncertainty, which is dampening the export recovery.

## 2025: Tentative start to an upturn

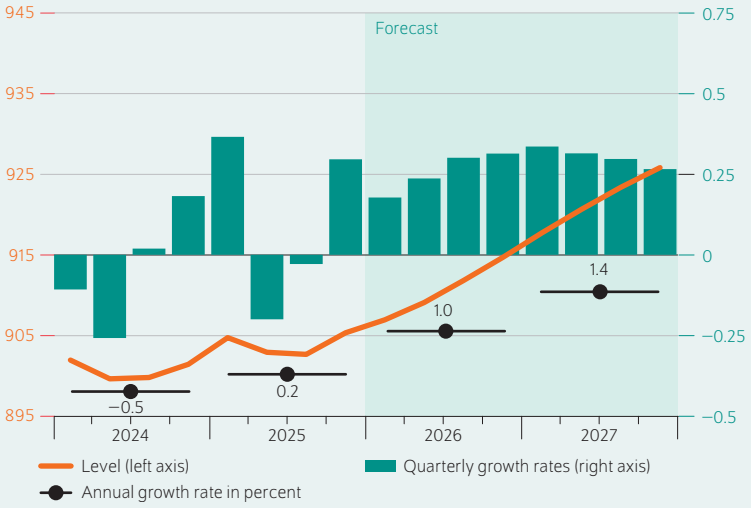
The data available so far show that the German economy has begun a modest recovery in 2025 and—as expected in the DIW Economic Outlook in Winter—has grown by 0.2 percent (Figure 1). Economic output has thus stabilized following the recessionary years of 2023 and 2024. The main driver was private consumption, which rose sharply thanks to robust gains in purchasing power and a relatively stable labor market. Public consumption also continued to expand noticeably.

By contrast, investment activity was significantly weaker, particularly in the private sector. The Special Fund for Infrastructure and Climate Neutrality (SVIK) had not yet provided any significant impetus by 2025. Foreign trade was also disappointing; however, the impact of U.S. tariff policies was less severe than initially feared.[2] Structural problems such as declining competitiveness and the shortage of skilled workers continue to weigh heavily, meaning that industry has not yet fully regained its footing in 2025.

Figure 1

**Growth of real GDP in Germany**

In billions of euros (left axis) and quarter-on-quarter in percent (right axis)




Note: Forecast from the first quarter of 2026 onward; adjusted for price, seasonal and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2026.

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The German economy is experiencing an upswing.

## Fourth quarter 2025: Expansion heralds a dynamic recovery

Following a slowdown in economic activity in the middle of the year, gross domestic product rose significantly by 0.3 percent in the fourth quarter of 2025. Growth was driven primarily by the domestic economy, particularly by consumption. Government spending rose sharply again, mainly due to higher social benefits in the areas of health and long-term care as well as increased employee compensation. However, private consumer spending also increased noticeably (Table 1).[3]

1 The cut-off date for this forecast is February 20, 2026; for commodity prices, it is March 3, 2026.

2 Since the United States accounts for less than one-tenth of Germany's goods exports, strong growth in exports to other European countries was able to offset the heavy losses—particularly in motor vehicles and automotive parts. In addition, exports of pharmaceuticals to the United States continued to rise steadily, as these products are difficult to substitute (at least in the short term) due to their high degree of specialization and patent protection.

3 Revised data from the Federal Statistical Office show that private consumption expanded significantly more strongly over the course of 2025 than initially reported.

Table 1

**Quarterly data on the development of use and value-added components of real GDP in Germany**
In percent (quarter-on-quarter, seasonally and calendar adjusted)

| | 2025 | | | | 2026 | | | | 2027 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | I | II | III | IV | I | II | III | IV |
| Private consumption | 0.8 | 0.4 | 0.0 | 0.5 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| Government consumption expenditure | −0.8 | 0.3 | 0.6 | 1.1 | 0.7 | 0.4 | 0.4 | 0.5 | 0.6 | 0.4 | 0.5 | 0.4 |
| Gross fixed capital formation | 0.5 | −0.9 | 0.3 | 1.0 | −0.8 | 0.7 | 0.8 | 0.9 | 0.9 | 0.8 | 0.7 | 0.7 |
| Construction | 0.5 | −1.0 | −0.7 | 1.6 | −0.8 | 0.7 | 0.8 | 0.9 | 0.8 | 0.7 | 0.6 | 0.7 |
| Equipment | 0.3 | −2.1 | 1.7 | 0.1 | −2.1 | 0.6 | 0.8 | 1.0 | 1.0 | 0.9 | 0.7 | 0.6 |
| Other fixed assets | 0.6 | 1.2 | 0.9 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 0.9 |
| Inventory changes[1] | −0.5 | 0.2 | 0.5 | −0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic demand | −0.1 | 0.2 | 0.8 | 0.4 | 0.1 | 0.3 | 0.4 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 |
| Net exports | 0.4 | −0.4 | −0.8 | −0.1 | 0.1 | −0.1 | −0.1 | −0.1 | −0.1 | −0.1 | −0.1 | −0.1 |
| Exports | 2.5 | 0.2 | −0.9 | −0.6 | 0.3 | 0.1 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 |
| Imports | 1.5 | 1.4 | 1.0 | −0.3 | 0.1 | 0.4 | 0.5 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 |
| **GDP** | 0.4 | −0.2 | 0.0 | 0.3 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| **Gross value added** | 0.6 | −0.1 | 0.0 | 0.4 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Manufacturing | 1.6 | −0.3 | −0.9 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Construction | 1.4 | −2.2 | −0.8 | 1.7 | −0.8 | 0.7 | 0.8 | 0.8 | 0.8 | 0.7 | 0.6 | 0.7 |
| Trade, hospitality, transport | 1.4 | −0.4 | 0.4 | 0.0 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Business services | −0.3 | 0.4 | 0.0 | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| Public services, education, health | 0.1 | 0.5 | 0.3 | 0.8 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 |

1 Contribution to growth in percentage points.

Note: Forecast from the first quarter of 2026 onward.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Spring 2026.

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The labor market remained resilient and likely had a stabilizing effect: although employment fell slightly, overall unemployment remained flat. Cyclical unemployment no longer rose as rapidly as in previous quarters, which likely alleviated households' concerns about job losses. At the same time, disposable income increased again and at a faster rate than inflation, which had fallen to around two percent. As a result, real purchasing power rose. Spending on services, particularly in the hospitality sector as well as on insurance and housing, increased especially sharply. The seasonally adjusted savings rate fell back to its pre-pandemic average of 10.3 percent after a temporary increase.

Investment activity also supported domestic demand in the fourth quarter, as gross fixed capital formation increased overall. Construction investment contributed most significantly, expanding markedly across all sectors. In addition to growth in non-residential construction—particularly in the civil engineering segment, where infrastructure projects for digital and rail networks as well as the energy transition likely played an increasingly significant role—there were also initial signs of a turnaround in residential construction. More stable prices and interest rates over the course of the year led to greater predictability and, consequently, to higher order intake and more building permits, which were likely implemented in greater numbers toward the end of the year. The particularly strong growth rates were also likely supported by the mild temperatures at the start of winter. Meanwhile, investment in equipment rose only slightly. A slump in private investment was offset by a massive increase in public procurement. A one-time effects, such as a large-scale delivery of defense equipment financed through the Bundeswehr Special Fund, likely played a role here.

In contrast, foreign trade performed poorly in the final quarter of 2025. Despite a temporary easing of the transatlantic trade dispute, export and import prices rose significantly and trade volumes declined. Exports and imports saw particularly sharp drops in the services sector. In goods trade, exports to the U.S. and China declined, while demand from Europe proved to be a stabilizing factor. Goods imports increased slightly, primarily from China and the eurozone. Since imports declined less sharply than exports, this resulted in a slightly negative trade balance overall.

The pattern in the expenditure components was also reflected on the production side. While gross value added in the manufacturing sector stagnated, confirming the ongoing weakness in industry, the construction sector grew significantly. Services also expanded, particularly in the public sector (such as education and health) and consumer-related service, especially the hospitality sector. Overall, gross value added rose by 0.4 percent in the fourth quarter.

## U.S. trade policy and the Iran conflict—what can we expect?

The Supreme Court's ruling on the legal basis of the tariffs imposed by U.S. President Trump under the International Emergency Economic Powers Act (IEEPA) has once again heightened uncertainty regarding the future direction of U.S. trade policy . Despite the verdict that these measures are unlawful, the tariff environment for German exports is not expected to improve significantly (Box 1).

At the end of February, pressures from the war in Iran were added to the mix. The attacks and the rapid escalation led to blockades of sea lanes in the Gulf region, such as the Strait of Hormuz, which is central to the transport of oil and gas. Some countries curtailed their energy production. As a result, energy prices on global markets rose significantly.

This forecast assumes that energy prices will remain elevated in the short term and gradually decline, while remaining well below the levels seen during the 2022/23 Energy Price Crisis. Although consumers will likely have to pay slightly more for energy than previously expected, the impact on overall inflation is projected to remain moderate. The inflation rate therefore likely remains close to the European Central Bank's (ECB) stability target of two percent in the medium term, meaning no further interest rate hikes are expected (Box 2). Since energy prices only began to rise in early March, most of the effects will likely become apparent starting in the second quarter.

## First quarter of 2026: Upturn continues

Short-term indicators, all of which were recorded before the outbreak of the Iran war, paint a cautiously optimistic picture. For instance, the ifo Business Climate Index has recently risen. In particular, companies' assessment of current conditions has improved, and business expectations were also more optimistic. This increase was not limited to specific sectors but was evident across the board—companies in manufacturing, construction, and the service sectors were all more confident. Only in the retail sector did the index decline slightly. The Purchasing Managers' Index reflected the overall positive trend: In the manufacturing sector, the index climbed above the 50-point expansion threshold for the first time since June 2022. In the services sector, where the index has been in expansion territory for some time, it also continued to rise.

As a result, the German economy is expected to expand moderately by 0.2 percent at the start of the year. As in previous quarters, much of the growth is expected to originate in the service sectors, while the manufacturing sector is likely to gain momentum only slowly. Given the freezing temperatures in much of Germany in January and February, construction output is likely to have been hampered in the first quarter and—despite growth in the finishing sector at the start of the year—to have contributed negatively to economic output.

Box 1

### Assumptions on tariffs

This forecast is based on specific assumptions regarding the future design of U.S. trade policy. Following the ruling of the Supreme Court of the United States, this policy is once again subject to considerable uncertainty. According to the ruling, the import tariffs most recently imposed under the International Emergency Economic Powers Act (IEEPA) of 1977 were unlawful.

The judgment undoubtedly represents a political and legal limitation of the president's previous tariff strategy, which relied heavily on short-term announcements and a broad interpretation of executive powers. In this sense, the decision can be seen as an institutional strengthening of the separation of powers. However, DIW Berlin does not expect this to fundamentally change the protectionist orientation of U.S. trade policy. The political incentive to use trade instruments to pursue industrial and security policy objectives remains in place. Tariffs are therefore likely to continue to serve as a central instrument – though probably more strongly embedded in formalized investigation and review procedures as well as clearer legal foundations.

Nevertheless, trade policy uncertainty remains high, as alternative legal bases are available for new measures. Specifically, this forecast assumes that bilateral trade agreements will persist and that a general baseline tariff rate of ten percent on German export goods will apply throughout the entire forecast horizon. Product-specific tariffs were not affected by the ruling and will also remain in place.

These assumptions are subject to considerable uncertainty. For example, the currently applicable ten-percent baseline tariff rate requires parliamentary approval after 150 days, which cannot be taken for granted. It is also unclear whether the level of the baseline tariff rate will rise to 15 percent, as announced by U.S. President Trump. Such a general tariff rate would primarily affect countries that have complied with demands from the U.S. government, such as the EU, Japan, or the United Kingdom. At the same time, U.S. trade representatives have generally indicated that bilateral agreements will remain in force, which supports the assumption of relatively stable framework conditions. In addition, with the midterm elections in the United States scheduled for the fall, political considerations may also play a role in avoiding sharp price increases for U.S. consumers. Should the universal tariff rate nevertheless be increased to 15 percent, this would represent a noticeable deterioration in trade policy conditions – at least for the following 150 days, until the required parliamentary confirmation or a possible correction takes place.

Box 2

## Assumptions and framework conditions

The forecast is based on assumptions regarding the path of policy interest rates, exchange rates, and commodity prices (Table). These assumptions are derived from past developments, prices on futures markets, and closing values as of the forecast cut-off date of 20 February 2026. For commodity prices, a separate cut-off date of 3 March 2026 applies.

Inflation in the euro area currently stands at 1.7 percent, slightly below the European Central Bank's (ECB) target of two percent and thus broadly in line with its expectations. Accordingly, the ECB recently left its policy rates unchanged. This forecast assumes that interest rates will remain constant throughout the entire forecast horizon. With the deposit facility rate – currently the key policy rate – at two percent, monetary policy is therefore expected to remain neutral.

In line with the policy rates, money market rates have also settled at their current level and are expected to remain at just under two percent. This normalization has also been reflected in declining refinancing costs for firms and borrowing costs for households. For the purpose of this forecast, it is assumed that lending rates will no longer decline following the end of monetary policy easing. It is also assumed that long-term capital market interest rates will remain largely unchanged over the forecast horizon, standing at 2.9 percent for Germany and 3.2 percent for the euro area. Compared with the winter forecast, capital market interest rates have therefore remained unchanged.

At the beginning of the year, the euro appreciated significantly against the US dollar and briefly exceeded the threshold of 1.20 US dollars per euro. However, among other factors, more robust U.S. economic data subsequently supported the dollar somewhat. As a result, the exchange rate stabilized and is currently fluctuating around 1.18 US dollars per euro. The forecast assumes that the euro exchange rate will remain at this level – slightly higher than assumed in the winter forecast.

The escalation of the Iran war has led to sharp price increases in energy markets. On 2 and 3 March 2026, crude oil prices rose on average by twelve percent compared with the previous week, while wholesale gas prices increased on average by 59 percent, at times even surging by up to 90 percent.[1] The reason was the closure of the Strait of Hormuz[2] as a response by Iran to attacks by the United States and Israel. In addition, Qatar, and in some cases Saudi Arabia, suspended gas production following attacks on energy infrastructure, which led to a further rise in gas prices.

This forecast assumes that energy prices will decline again over the forecast horizon. Based on futures prices, it is assumed that the price of crude oil will gradually fall again in the coming months, averaging around 75 US dollars per barrel in the current year and about 68 US dollars per barrel in the following year. Compared with the winter forecast, this implies an oil price 18 percent higher for the current year and seven percent higher for the coming year.

Wholesale gas prices are expected to average 46 euros per megawatt hour this year before declining to around 32 euros per megawatt hour in 2027. Compared with the winter forecast, the gas price assumptions have therefore been revised upward by 48 percent for this year and 14 percent for next year. It is assumed that oil and gas prices will remain at a higher level in the second quarter before gradually declining from the middle of the year onward.

This forecast is also based on trade policy assumptions (Box 1).

**1** See Figure 4 in this report for further details.

**2** The Strait of Hormuz is of great importance for global crude oil and natural gas supply. Around 20 percent of global demand for both crude oil and gas is transported through this maritime passage.

Overall, the increase in gross domestic product is thus expected to be somewhat weaker than in the previous quarter. The reason for this is a slowdown in domestic economic components, which had recorded exceptionally strong growth in the final quarter of 2025. Private consumer spending will likely rise only moderately and not at the same pace as at the end of the year: Retail sales declined noticeably at the start of the year, and retailers' assessment of the economic situation has also deteriorated somewhat. Furthermore, consumer goods manufacturers are reporting only a slight improvement. New car registrations plummeted in January and are significantly below the level of the final quarter in the first two months of the year. At the same time, indicators of consumer sentiment remain weak and offer little sign of rising consumer confidence. The increase in the minimum wage effective January 1, 2026, is likely to provide support and also help keep income inequality at a low level (Box 3). Furthermore, the labor market is unlikely to deteriorate further: labor demand—measured by job openings—has risen slightly in recent months. Unemployment is not expected to rise further.

Two special factors are driving the projected decline in investment in the current quarter (Figure 2): First, freezing temperatures at the start of the year slowed construction activity—nearly 30 percent of construction companies, ten percentage points more than the long-term monthly average, reported weather-related disruptions in February. Civil engineering was hit particularly hard, with capacity utilization plummeting from just over 70 percent to below 60 percent.

Table

**Forecast assumptions**

| | | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|
| ECB deposit facility[1] (year-end) | Percent | 3.0 | 2.0 | 2.0 | 2.0 |
| ECB key interest rate (year-end) | Percent | 3.15 | 2.15 | 2.15 | 2.15 |
| Money market interest rate | Three-month EURIBOR in percent | 3.6 | 2.2 | 2.0 | 2.1 |
| Capital market interest | Yield on euro-area government bonds with a remaining term of ten years | 3.0 | 3.1 | 3.2 | 3.2 |
| Capital market interest | Yield on German government bonds with a remaining term of ten years | 2.4 | 2.7 | 2.9 | 2.9 |
| Exchange rate | USD/EUR | 1.08 | 1.15 | 1.18 | 1.18 |
| Crude oil price | USD per barrel | 79.7 | 68.0 | 74.9 | 67.9 |
| Gas price | EUR per megawatt hour | 34.4 | 36.3 | 45.9 | 31.9 |

1 The ECB is currently steering the economy via the deposit facility, not the main refinancing rate.

Note: Annual averages; year-end ECB deposit facility values.

Sources: European Central Bank; European Money Markets Institute (EMMI); Eurex Exchange; Deutsche Bundesbank; Federal Reserve; Energy Information Administration (EIA); Intercontinental Exchange (ICE); CME Group; DIW Berlin Economic Forecast Spring 2026.

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Although strong growth in the less weather-sensitive finishing sector led to an increase in construction output in January, construction investment is still expected to decline overall in the first quarter. Second, equipment investment is also likely to show a decline, due to a countervailing effect in the public sector: the extraordinary increase in the final quarter appears to have been only temporary and is not expected to be repeated for the time being. Despite expected growth in private equipment investment due to rising order intake, this results in a negative rate for the first quarter.

In foreign trade, however, a slight improvement is emerging compared to the previous quarter. The ifo Export Expectations improved noticeably in February and are back in positive territory for the first time since the fall of 2025. Although incoming orders in the manufacturing sector from abroad have recently declined—following two increases at the end of 2025—a slight upward trend is emerging in the less volatile three-month comparison. At the same time, the erratic trade policy of the U.S. government and declining global market shares of formerly important export goods "Made in Germany" continue to weigh on foreign trade. The automotive industry, in particular, remains under pressure, partly due to weakening sales in China. Overall, exports in the first quarter thus show only moderate growth. Imports are also expected to expand—supported by imports of military goods and the exchange rate favorable to importers—albeit at a somewhat weaker pace than exports.

## 2026 and 2027: War with Iran and U.S. trade policy will not halt the upswing

Assuming no further sharp increases in energy prices, the German economy is expected to grow robustly this year and next, further consolidating the upswing. The main driver remains the highly expansionary fiscal policy, which is providing significant support to the domestic economy. Public consumption and—increasingly—public investment are providing particular momentum, with defense spending likely to take effect more quickly than infrastructure projects. Private consumption is also expected to continue rising thanks to a stable labor market and modest gains in purchasing power.

Foreign trade, on the other hand, is expected to develop only modestly. Structural problems such as declining competitiveness are weighing on the manufacturing sector, while trade barriers and global uncertainties are providing additional headwinds.

The consequences of the Iran war are also exerting a slight drag. Higher energy prices are expected to push inflation up by 0.4 percentage points more than previously assumed this year and to slow growth slightly—by about 0.1 to 0.2 percentage points.

## Sluggish outflows from special funds are only gradually boost investment

For the years 2026 and 2027, additional government spending of 39.9 billion and 37.3 billion euros, respectively, is assumed (Box 4).[4] A large portion is attributable to the fiscal package: approximately 17 and 14 billion euros for the Special Fund for Infrastructure and Climate Neutrality (SVIK), excluding the increase in the Climate and Transformation Fund (KTF), as well as around 17 and 14 billion euros, respectively, for additional defense spending. Against this backdrop, the general government deficit is expected to widen from 2.7 percent of GDP in 2025 to 3.4 percent in 2026 and 3.6 percent in 2027. Adjusted for the cyclical component and interest

4 As in previous forecasts, lower outflows of funds are assumed than those provided for in the federal budgets; see most recently Geraldine Dany-Knedlik et al. (2025): The German Economy in the Starting Blocks—The Global Economy Holds Its Own. DIW Weekly Report No. 50, 805–839 (available online; accessed on March 9, 2026. This also applies to all other online sources cited in this report, unless otherwise noted).

Box 3

## Nowcast of labor income inequality

DIW Berlin has developed a model that can forecast labor income inequality up to the present time (so-called nowcast). The model combines annually available microeconomic data from the Socio-Economic Panel (SOEP) with a large number of higher-frequency macroeconomic and labor market indicators, as well as the current results of the DIW Economic Outlook, within a macro-econometric framework. This makes it possible to project the average labor incomes of different income groups. Based on the model results, and under certain distributional assumptions, a labor income distribution for the total population can then be constructed.

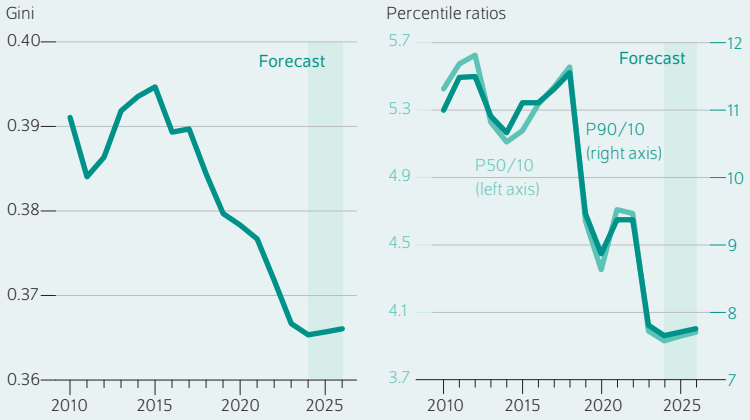
The SOEP data are currently available up to 2023 (wave v40). The model is therefore used to estimate the development of inequality for 2024, 2025, and 2026. The estimates for 2024 and 2025 rely exclusively on macroeconomic data from official statistics, whereas the nowcast for the current year also incorporates the DIW Berlin business cycle forecast.

After labor income inequality declined significantly up to 2023, it changes only slightly in the following years. The Gini coefficient fell by about 0.05 points to 0.367 in 2023 and is expected to have remained roughly at that level since then (Figure). A decline in inequality is typical in recession years, as higher earners often experience stronger income losses than lower-income groups during such phases.[1] The development also suggests that fiscal policy measures introduced during the energy crisis and thereafter were able to stabilize lower incomes.

In the current year, inequality is expected to rise only slightly – partly due to stable income growth among low-wage earners following the increase in the minimum wage. This is also reflected in the income ratios between top and bottom earners (P90/10) as well as between the middle and the lower end of the distribution (P50/10).

Figure

**Nowcast of labor income inequality: Gini index and selected percentile ratios**
Index points (left side), percentile ratios (right side)




Sources: Socio-Economic Panel (SOEP); Federal Statistical Office; DIW Berlin Economic Outlook Spring 2026.

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Labor income inequality declined in 2023 and has been stable since.

1 See e.g. Geraldine Dany-Knedlik and Alexander Kriwoluzky (2021): Income Inequality in Germany Temporarily Sinks During Crises. DIW Weekly Report No. 46, 349–355 (available online).

payments, this results in a structural primary deficit relative to potential gross domestic product of 1.7 percent in the current year and 2.2 percent in 2027, starting from 0.7 percent in 2025 (Figure 3).

The expansionary fiscal policy is likely to have a direct impact on economic growth, primarily through rising government spending and, to a lesser extent, through capital transfers to private-sector companies. Thus, the measures outlined in the SVIK are expected to lead to a robust expansion of public construction investment, particularly in civil engineering projects such as roads and railways. At the same time, rising defense spending will support strong growth in that government investment in equipment, purchases of intermediate goods, and employment in the defense sector—and thus government consumption. Demographic aging will also drive further increases in employment in other public service sectors—such as health and long-term care—as well as in social benefits in kind, providing an additional boost to public consumption spending.

## Robust labor market supports private consumer sentiment

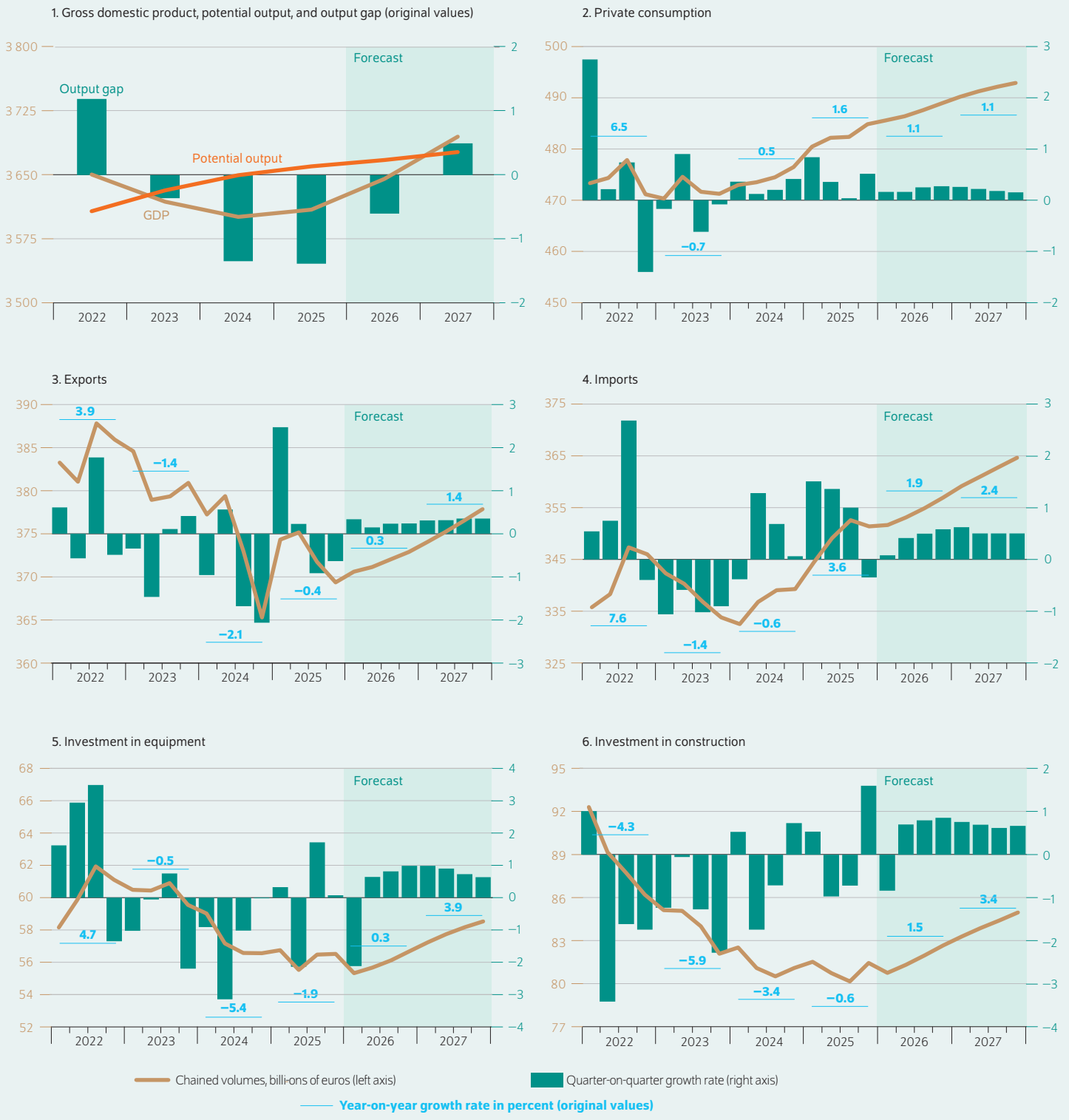
The labor market is likely to continue stabilizing as the economy recovers; wages are expected to rise again. Although wage growth under collective bargaining agreements has slowed somewhat following the expiration of the inflation adjustment bonus, and recent wage agreements have been more moderate than in previous years, real earnings are expected to rise robustly overall during the forecast period.

Despite slight additional inflationary pressure from higher energy prices and extensive government spending, further noticeable real income growth is thus expected (Table 2). Household purchasing power is thus continuing to rise, which should bolster private consumption. The savings rate is likely to remain roughly at its long-term average. In residential construction as well, rising order and permit figures point to a gradual positive momentum.

Figure 2

## GDP and important components

Seasonally, calendar, and price-adjusted development




Note: Forecast from the first quarter of 2026 onward; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2026.

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Box 4

## Assumptions on fiscal policy

Fiscal policy is expansionary over the forecast horizon (Table). This is supported by tax relief for households and firms, although this year these effects are largely offset by higher revenues on the side of the social security system. On the expenditure side, fiscal policy provides strong expansionary impulses in both years through the use of the expanded borrowing leeway for infrastructure and defense.

On the revenue side, adjustments to the income tax schedule to offset fiscal drag provide relief to private households in both years of the forecast horizon. In 2026 in particular, additional tax relief arises from the increase in the commuter allowance and the so-called "Aktivrente" scheme. By contrast, the revenue losses resulting from higher basic and child allowances – introduced to exempt the subsistence minimum from taxation – are smaller than in 2025, generating a dampening effect.

Firms benefit from tax relief measures under the Growth Opportunities Act and the Immediate Investment Program over the entire forecast horizon. These include the continuation and expansion of tax incentives for investment and research expenditures as well as additional tax relief, for example for the purchase of electric vehicles. The hospitality sector benefits from the permanent reduction of the value-added tax rate to seven percent, and this year, agricultural businesses can benefit from the reintroduction of the agricultural diesel rebate. The continuation of last year's reduction in electricity tax for firms in the manufacturing sector is somewhat smaller in 2026. Accordingly, it generates minor restrictive impulses, similar to those resulting from the expansion of weight classes subject to the truck toll introduced in 2024.

The increase in the $CO_2$ levy in the heating and transport sectors since the turn of the year generates significant additional revenues this year. It is assumed that the $CO_2$ price will reach the currently applicable legal upper limit of 65 euros, making it ten euros per ton higher than last year. The integration of emissions related to heating and transport into the European Emissions Trading System has been postponed from 1 January 2027 to the following year. The coalition has therefore agreed to keep the national $CO_2$ price in these sectors constant in 2027, meaning that no fiscal impulse from emissions trading is expected. Further restrictive measures this year are the stepwise increase in the tobacco tax, as well as a global minimum tax and a plastic levy that have been introduced, generating revenue for the first time.

The average supplementary contribution to statutory health insurance is 0.4 percentage points higher in 2026 than in 2025. It is assumed that it will increase by another 0.3 percentage points next year. A federal loan to the statutory long-term care insurance scheme prevents an increase in the contribution rate in the current year. For 2027, an increase in the contribution rate of 0.1 percentage points is assumed. Overall, fiscal policy on the revenue side is neutral this year and slightly expansionary in 2027.

The design of government expenditures shows a consistently expansionary character over the forecast horizon. Although the housing benefit reform and cuts to parental allowance for top earners generate slightly expenditure-reducing effects, and the one-off compensation of the gas storage levy implemented last year is now recorded as restrictive, additional spending arises from the "Startchancen Programme for schools" and the continuation of the "Deutschlandticket" (Germany-wide public transport ticket). For the latter, however, the price increased by five euros at the start of 2026, and a further price increase is expected in 2027. Within the pension package, the "Frühstartrente" (early-start pension) has been introduced – initially only for the 2020 birth cohort, meaning that the expansionary effect of this measure remains small.

By far the largest expansionary impulse stems from the expanded borrowing scope for infrastructure, climate neutrality, and defense. From the expanded Climate and Transformation Fund (KTF), the abolition of grid fees is funded in 2026, and in 2027 the reduction of industrial electricity prices for selected energy-intensive sectors – approved by the European Commission under investment conditions – is financed. In addition to these subsidies, other program expenditures of the KTF are expected to remain stable over the forecast horizon. Instead, spending from the Special Fund for Infrastructure and Climate Neutrality (SVIK) – excluding the top-up of the KTF – will accelerate. In particular, significant funds from the federal share will be spent on the maintenance and modernization of railways and roads. Equipment ordered under the Special Fund for the Bundeswehr will gradually be delivered over the forecast horizon. In addition, this forecast assumes additional expenditures in both years within the expanded definition of defense spending, which – together with the Bundeswehr special fund – is expected to raise the NATO spending ratio to about 2.9 percent of GDP by 2027.

On the expenditure side of the social security system, the basic pension and the Care Support and Relief Act generate small expansionary effects this year and next. The hospital reform has not yet resulted in expenditure reductions. With the expiration of the extended duration of short-time work benefits at the end of 2026 and declining additional spending on disability pensions, restrictive effects will emerge in 2027. Overall, fiscal policy measures on the expenditure side of the social security system are neutral over the forecast horizon.

This forecast does not incorporate any potential relief measures for firms or households in response to the energy price shock caused by the Iran war.

All in all, the budgetary impact of fiscal policy measures amounts to −39.9 billion euros in the current year (−0.9 percent of nominal GDP) and −37.3 billion euros in 2027 (−0.8 percent).

Table

**Fiscal policy measures: burdens (–) and relief (+) by the general government budget**
In billion euros (compared to the previous year)

| | 2026 | 2027 |
|---|---|---|
| **Revenues of local authorities** | | |
| Annual Tax Act 2022 | –0.2 | –0.2 |
| Inflation Compensation Act (adjustment of income tax rates) | –0.6 | –0.5 |
| Reduction of bracket creep 2027 | 0.0 | –4.0 |
| Adjustments to the tax exemption for the minimum subsistence level | 1.3 | 0.0 |
| Increase in commuter allowance | –1.1 | –0.2 |
| Tax Law Development Act | –5.5 | –0.9 |
| Annual Tax Act 2024 | 0.3 | –0.1 |
| Active pension (pension package) | –0.7 | –0.2 |
| Second Occupational Pension Strengthening Act (pension package) | –0.1 | –0.1 |
| Changes to agricultural diesel rebate | –0.4 | 0.0 |
| Reduction in electricity tax | 0.1 | 0.3 |
| Permanent sales tax reduction in the restaurant industry | –3.5 | –0.1 |
| Revenues from fuel emissions trading (BEHG) | 3.0 | 0.0 |
| Degressive depreciation (Second and Fourth Coronavirus Tax Assistance Acts) | 3.8 | 1.5 |
| Immediate investment programme (degressive depreciation, tax breaks for electric cars, expansion of research allowance) | –3.4 | –5.2 |
| Increase in truck tolls | 0.2 | 0.0 |
| Growth Opportunities Act | –0.7 | 0.1 |
| Increase in tobacco tax | 0.8 | 0.0 |
| Financing for the Future Act | –0.1 | 0.0 |
| Global minimum taxation (Pillar 2) | 1.0 | –0.3 |
| Plastic tax | 1.4 | 0.0 |
| Other tax measures1 | –2.0 | –1.9 |

| | 2026 | 2027 |
|---|---|---|
| **Social security revenues** | | |
| Increase in average additional contribution to statutory health insurance | 5.3 | 4.0 |
| Increase in contribution rate for statutory nursing care insurance | 0.0 | 1.3 |
| **Expenditure of local authorities** | | |
| Housing benefit reform | 0.4 | 0.0 |
| Neue Grundsicherung (basic income support) | –0.1 | 0.0 |
| Deutschlandticket (Germany-wide regional rail ticket) | –0.2 | –0.2 |
| Cuts in Bürgergeld and parental allowance for top earners | 0.1 | 0.0 |
| Startchancen program for schools | –0.5 | –0.3 |
| Early retirement pension (pension package) | –0.1 | 0.0 |
| Benefits Law Adjustment Act | –0.1 | 0.0 |
| Subsidies for network charges | –6.5 | 0.0 |
| industrial electricity price | 0.0 | –1.5 |
| Abolition of gas storage levy | 2.8 | 0.6 |
| KTF special fund (excluding network charges/industrial electricity price) | –0.5 | –0.8 |
| Additional expenditure on infrastructure and climate neutrality (excluding KTF) | –17.0 | –14.2 |
| Additional expenditure on defense (including Bundeswehr special fund) | –16.7 | –14.3 |
| **Social security expenditure** | | |
| Basic pension | –0.1 | –0.1 |
| Supplementary reduced earning capacity pension | 0.0 | 0.2 |
| Hospital reform | –0.2 | –0.2 |
| Care Support and Relief Act Social security expenditure | –0.2 | –0.3 |
| Extension of the period of entitlement to short-time working allowance | 0.0 | 0.3 |
| **Total** | –39.9 | –37.3 |
| **As a percentage of GDP** | **–0.9** | **–0.8** |

Note: Without macroeconomic repercussions. Other tax measures: Annual Tax Act 2020, Act on the Modernization of Corporation Tax Law, Disabled Persons Lump Sum Act, Fourth Bureaucracy Relief Act, Credit Market Promotion Act, increase in air traffic tax.

Sources: Federal Government (budget, draft legislation, monthly reports of the Federal Ministry of Finance, tax policy data collection); DIW Berlin Economic Outlook Spring 2026.

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Meanwhile, German industry remains marked by structural upheavals and is likely to recover only slowly. Although the defense sector is benefiting from massive defense spending, it accounts for only a very small portion—about four percent, according to the latest estimates—of Germany's economic output.[5] In addition, there are companies in the so-called dual-use sector.[6] Overall, the fiscal stimulus on corporate investment will likely be moderate. Incentive programs such as the "Investment Booster" have had little impact on companies' investment plans so far and are expected to have only a slight stimulating effect on investment in equipment and commercial construction. Furthermore, rising energy prices are likely to have a dampening effect in this area.

Foreign trade is also likely to remain weak in light of structural challenges. While exports are expected to expand slightly thanks to stable demand from European trading partners, exports to third countries—primarily to the U.S. and China—are unlikely to recover significantly. Imports are projected to continue expanding robustly due to increased defense spending and the recovery in private consumption. As a result, foreign trade is projected to make a negative contribution to economic growth (Table 3).

## DIW Berlin expects growth of 1.0 percent and more

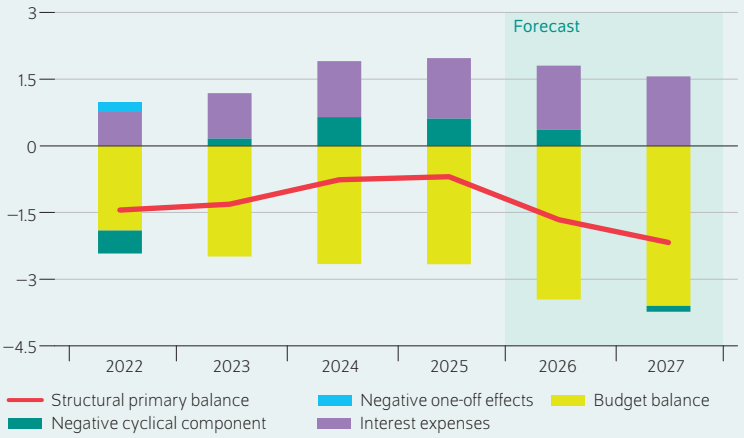
Overall, the price-adjusted gross domestic product (GDP) in Germany is expected to increase by 1.0 percent in 2026. Next year, projected growth is stronger, at 1.4 percent. For the current and coming year, DIW Berlin is thus lowering its growth forecast by 0.3 and 0.2 percentage points, respectively. The key factors behind this forecast revision are the

5 See Joint Economic Forecast Project Group (2025): Expansive Fiscal Policy Masks Weak Growth. Joint Economic Forecast 2/2025 (available online).

6 The dual-use sector refers to goods and technologies that can be used for both civilian and military purposes—such as certain machines, electronic components, software, or materials.

Figure 3

**Structural primary balance**
In percent (relative to nominal potential output)




Note: The structural primary balance is the sum of the columns. Forecast from 2026 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Forecast Spring 2026.

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The structural primary deficit will widen over the forecast period.

Table 2

**Key economic indicators for the German economy**

| | 2025 | 2026 | 2027 |
|---|---|---|---|
| GDP[1] | 0.2 | 1.0 | 1.4 |
| Employment[2] (1,000 persons) | 45,982 | 45,974 | 46,152 |
| Unemployed (1,000 persons) | 2,948 | 2,929 | 2,716 |
| Unemployment rate[3] (BA concept, in percent) | 6.3 | 6.2 | 5.8 |
| Consumer prices[4] | 2.2 | 2.4 | 2.3 |
| Unit labor costs[4,5] | 4.5 | 2.3 | 2.5 |
| Government budget balance[6] | | | |
| in billions of euros | −119.1 | −157.9 | −170.4 |
| in percent of nominal GDP | −2.7 | −3.4 | −3.6 |
| Current account balance | | | |
| in billions of euros | 197.4 | 162.0 | 145.8 |
| in percent of nominal GDP | 4.4 | 3.5 | 3.0 |

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per hour worked in Germany as a percentage of real GDP per hour worked.
6 As defined in the national accounts (Volkswirtschaftliche Gesamtrechnungen).

Note: Forecast from 2026 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2026.

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dampening effects of rising energy prices due to the Iran war and a sluggish start to private capital investment, which are likely to result in weaker economic growth this year than was anticipated last winter.

Potential GDP growth is expected to average around 0.2 percent over the forecast horizon (Table 4). Due to demographic aging, the labor force is projected to continue to decline. Against the backdrop of only a moderate economic recovery in 2025, the output gap narrowed only slightly, averaging –1.2 percent of potential GDP for the year. With the continued economic recovery over the forecast period, the gap will close by 2027; on an annual average, the economy is then expected to be slightly overutilized. Given rising public spending, moderate overcapacity is also expected beyond that point.[7]

Consumer price inflation is likely to exceed the ECB's two-percent target this year. While food price inflation has eased recently, rising energy prices are expected to be passed on to consumers to a greater extent, particularly in the second half of the year, creating additional price pressure. At the same time, service prices are likely to remain at elevated levels and contribute to the overall increase. Starting in the middle of the year, expansionary fiscal policy is expected to exert additional price pressures. Overall, the inflation rate is projected to be 2.4 percent in 2026 and 2.3 percent in 2027. DIW Berlin is thus raising its forecast by 0.3 and 0.1 percentage points, respectively, compared to the winter forecast, due to higher energy prices.

The risks to this forecast remain significant. Public spending depends crucially on the actual pace of implementation—and also on whether the funds are truly additional.[8] This forecast assumes a gradual outflow of funds. Should planning and approval procedures proceed more quickly or projects be implemented earlier, the fiscal stimulus could be stronger in the short term than assumed. Conversely, a delayed outflow of funds would postpone the economic impact and initially dampen the expansion.

The outlook for foreign trade is particularly uncertain at present. On the one hand, following the ruling by the U.S. Supreme Court, there remains uncertainty regarding U.S. tariff policy. Should a higher tariff rate be applied instead of the 10 percent base rate assumed in this forecast, this would once again dampen global trade. At the same time, a parliamentary rejection after 150 days or a judicial overturning of the current tariff regime could lead to an improvement in trade conditions and strengthen global trade flows.

**7** Compared to the winter forecast, the assumptions regarding capital stock, population, and net immigration have changed. On the one hand, current statistics on gross fixed capital formation and a new population projection have been published. On the other hand, the net migration balance for 2025 was increased from 200,000 to 216,000 people.

**8** See also in this issue of the Weekly Report: Geraldine Dany-Knedlik, Martin Gornig, Angelina Hackmann, and Teresa Schildmann (2026): Municipal Investments: Potential and Limits of the Special Fund for Infrastructure and Climate Neutrality. DIW Weekly Report No. 11, 180–189 (forthcoming).

Table 3

**Contributions to GDP growth in Germany**
In percentage points (price-adjusted)

| | Contributions to growth[1] | | |
|---|---|---|---|
| | 2025 | 2026 | 2027 |
| Consumption expenditures | 1.1 | 1.2 | 1.0 |
| Private households | 0.8 | 0.6 | 0.6 |
| Government | 0.3 | 0.6 | 0.4 |
| Gross fixed capital formation | 0.0 | 0.3 | 0.7 |
| Construction | −0.1 | 0.2 | 0.4 |
| Equipment | −0.1 | 0.0 | 0.2 |
| Other fixed assets | 0.1 | 0.2 | 0.2 |
| Inventory changes | 0.7 | 0.0 | 0.0 |
| Domestic demand | 1.8 | 1.6 | 1.7 |
| Net exports | −1.5 | −0.6 | −0.3 |
| Exports | −0.2 | 0.1 | 0.6 |
| Imports | −1.4 | −0.7 | −0.9 |
| Gross domestic product[2] | 0.2 | 1.0 | 1.4 |

1 Year-on-year change in percent; any deviation in the totals is due to the rounding of the figures.
2 Change from the previous year in percent; differences in totals due to rounding of figures.

Note: Forecast from 2026 onward.

Sources: Federal Statistical Office; calculations by the institutes; DIW Berlin Economic Outlook Spring 2026.

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Table 4

**Growth of real potential output**
Annual average change in percent[1]

| | 2020–2025 | 2025–2030 |
|---|---|---|
| Potential output | 0.5 | 0.2 |
| Contributions to growth | | |
| Labor input | 0.1 | −0.2 |
| Capital input | 0.3 | 0.3 |
| Total factor productivity | 0.1 | 0.2 |

1 Discrepancies in the aggregation result from rounding effects.

Sources: Federal Statistical Office; European Commission; DIW Berlin Economic Outlook Spring 2026.

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Furthermore, there are enormous geopolitical risks. The Iran war now adds to the long-standing uncertainties caused by the wars in Ukraine and the Gaza Strip. Should trade and production restrictions there persist for a longer period and lead to sharper price increases, this would dampen economic output in Germany and worldwide more significantly than projected in this forecast (Box 5). In such a scenario, central banks would likely act more cautiously due to the additional price pressure: interest rate cuts could be postponed or implemented to a lesser extent, or rates could even be raised to prevent a resurgence of inflation. This would result in tighter financing conditions and slow the economic recovery.

At the same time, a swift agreement between the conflict parties could lead to a faster decline in energy prices—in which case stronger economic growth would be expected. With easing price pressures, monetary policy would have greater leeway to implement earlier or more aggressive interest rate cuts, which would stimulate investment through lower financing costs and further support the economic recovery.

Another downside risk stems from the investment boom in AI technologies in Germany. Increased volatility in U.S. stock markets and sectoral shifts toward industries less exposed to AI point to growing vulnerability to valuation risks. A reassessment of high earnings expectations could noticeably dampen investment activity in Germany. At the same time, there are upside risks: if the use of powerful AI spreads more quickly and leads to productivity gains sooner, this could stimulate investment. A clearer regulatory framework could also strengthen investment momentum and increase growth potential.

Box 5

## Scenario analyses of energy price shocks resulting from the Iran war

Following the outbreak of war in Iran at the end of February, geopolitical risks in global energy markets have risen sharply. The Strait of Hormuz – through which around 20 million barrels of oil per day and roughly one fifth of globally traded liquefied natural gas (LNG) are transported under normal conditions – is considered a key maritime route for energy shipments. Teh current disruptions to transit have triggered significant price reactions: the Brent crude oil price temporarily exceeded 100 US dollars per barrel, while the most important reference price for natural gas in Europe (TTF) rose to around 60 euros per megawatt hour. Although this is significantly above the levels of previous years, it remains clearly below the extreme values observed during the energy price crisis following the outbreak of the war in Ukraine in 2022.

These developments are particularly relevant for Germany, as the country's energy supply remains highly dependent on imports despite diversification efforts. A substantial share of globally traded oil and LNG volumes reacts sensitively to production and supply disruptions in the Gulf states.

Against this background, DIW Berlin analyzed a scenario that illustrates the macroeconomic effects under the assumption that energy prices increase by around 50 percent for a period of two quarters. The analysis is based on a New Keynesian model with heterogeneous agents calibrated for the German economy.[1]

In this adverse scenario, the model results initially show significant effects on inflation dynamics. This year, inflation would be 1.2 percentage points higher than in the baseline scenario (3.6 percent instead of 2.4 percent), while next year it would be 0.5 percentage points lower (1.8 percent instead of 2.3 percent). For economic activity, the shock results in a reduction of about 0.5 percentage points relative to the baseline scenario in the current year. Economic growth would therefore amount to 0.5 percent instead of 1.0 percent. This decline is not fully offset over time; even at the end of the forecast horizon, real GDP remains around 0.18 percent below the level that would have been reached without the energy price shock.

A full scenario analysis will be published shortly.[2]

1 Christian Bayer et al. (2026): Redistribution within and across borders: The fiscal response to an energy shock. Journal of Political Economy Macroeconomics.

2 Christian Bayer et al. (2026): Szenarioanalyse zu Energiepreisschocks und makroökonomische Effekte des Iran-Kriegs. DIW Politikberatung kompakt (forthcoming).

# Between U.S. tariffs and the Iran war: The global economy remains resilient

At the turn of the year, the global economy continued to prove resilient despite the protectionist U.S. trade policy. In many countries, a robust domestic economy, fiscal stimulus, and persistently high investments in artificial intelligence (AI) are supporting economic activity. However, the recently begun Iran-war is weighing on the global economic environment and has already led to major disruptions in oil and gas supplies, as Iran has partially paralyzed the strategically crucial shipping route through the Strait of Hormuz. Around one fifth of global oil and liquefied natural gas trade is affected, which has caused prices to rise significantly (Figure 4).

In the fourth quarter, the global economy lost some momentum but continued to grow solidly. After expanding by 1.0 percent in the previous quarter, global gross domestic product (GDP) increased by 0.7 percent (Figure 5). The pace of expansion was dampened primarily by weaker developments in advanced economies—with the exception of the euro area. In the United States, growth slowed to 0.4 percent in the fourth quarter, after economic output had increased by a strong 1.1 percent in the third quarter. In addition to a slight moderation of the previously very strong consumption, the government shutdown at the end of the year—caused by the dispute over the budget law—also had a dampening effect. However, the resulting burdens are likely to have been only temporary and are unlikely to have significantly affected overall economic development in a lasting way.

In Japan, growth returned slightly to positive territory (0.1 percent) after economic output had declined by 0.7 percent in the previous quarter. Economic activity in the United Kingdom remained similarly subdued.

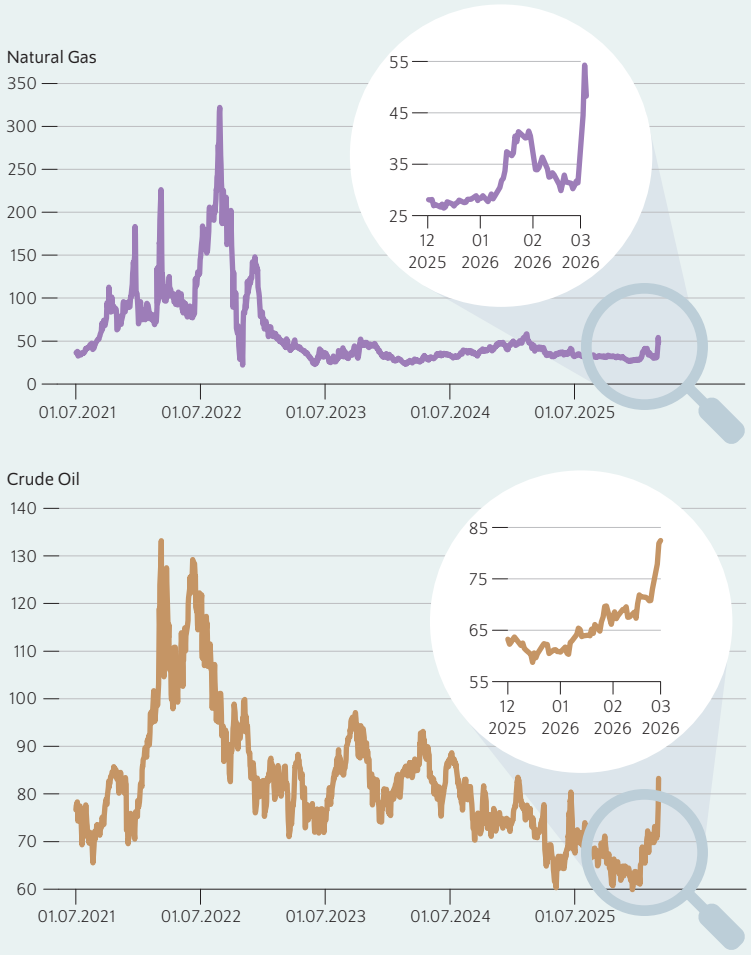
In contrast, the euro area remained fairly robust, recording quarterly growth of 0.3 percent, the same as in the third quarter. Growth was driven primarily by domestic demand: rising wages supported private consumption, and private investment increased again in most of the large member states. Spain expanded notably with quarterly growth of 0.8 percent, France lost some momentum with 0.2 percent, and Italy grew by 0.3 percent.

In emerging markets, economic momentum weakened slightly most recently. India in particular contributed to this development: growth slowed but remained strong at 1.4 percent quarter-on-quarter, driven mainly by solid domestic demand. Growth also slowed somewhat overall in the EU countries of Central and Southeastern Europe. Romania remained in a technical recession after two consecutive negative quarters, while Poland continued to grow robustly.

In China, growth slowed in year-on-year terms. Compared with the previous quarter, however, momentum accelerated slightly to 1.2 percent, up from 1.1 percent in the third quarter. Despite lower exports to the United States, exports continued to support economic activity, as China was able to diversify its export markets; exports to ASEAN and EU countries in particular increased. Domestic economic activity, however, expanded only moderately. In Brazil, growth picked up again somewhat after a weak third quarter. In Mexico, the decline in the third quarter was followed by an expansion of 0.8 percent.

Figure 4

**Prices for Natural Gas and Crude Oil**
In U.S. dollars




Notes: Latest observations: March 4, 2026 (TTF natural gas price), March 3, 2026 (Brent crude oil price).

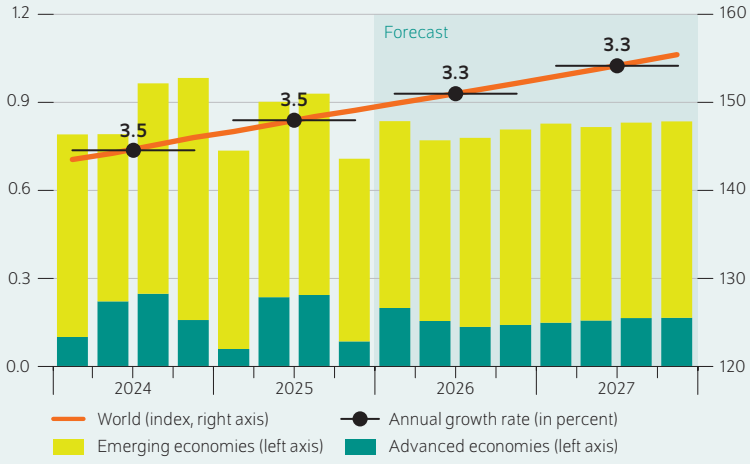
Sources: Intercontinental Exchange (ICE); Energy Information Administration (EIA).

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With the start of the Iran war, oil and gas prices rose sharply, but initially remained well below their levels during the energy price crisis.

Figure 5

**Real GDP growth**
Quarter-on-quarter percentage growth (left axis); index 2015 Q1 = 100 (right axis)




Sources: National Statistical Offices; DIW Berlin Economic Outlook Spring 2026.

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The increased U.S. trade barriers are weighing on both emerging market economies and advanced economies.

Despite the protectionist U.S. tariff policy, global trade expanded strongly in the fourth quarter, recording quarterly growth of 0.6 percent. In particular, the advanced Asian economies (excluding Japan), such as Korea and Taiwan, benefited from vibrant intra-Asian trade and persistently strong demand for technology-intensive goods, especially semiconductors. These factors are likely to have at least partially offset the burdens caused by tariffs.

## Economic effects of the Iran war remain limited in the first quarter

For the first quarter of 2026, the global economy still appears to be expanding at a moderate pace. However, the effects of the turbulence surrounding U.S. trade policy and the outbreak of the Iran war at the end of February are unlikely to have been reflected yet.

Without these burdens, leading indicators point to robust global economic development. Global purchasing managers' indices remain above the expansion threshold of 50 points in both the services sector (53.4 points) and the manufacturing sector (51.9 points). In several advanced economies, including the United Kingdom and Japan, sentiment—particularly in manufacturing—has improved noticeably in recent months. This improvement is likely driven by rising orders in the capital goods sector, partly fueled by higher defense spending and industrial policy expenditures.

In the euro area, quarterly growth of 0.3 percent is expected. It is supported in particular by rising real wages. Exports, however, are likely to have a dampening effect, as U.S. tariffs and the strong euro reduce the price competitiveness of European goods. Since Trump took office, the dollar has depreciated by around twelve percent against the euro. While this significantly lowers the cost of imports, it makes European exports more expensive. In the United States, economic activity is expected to regain momentum in the first quarter of 2026, with projected growth of 0.7 percent. In addition to catch-up effects following the previous government shutdown, high tax refunds are likely to increase disposable incomes and stimulate private consumption.

With the beginning of the Iran war at the end of February, the outlook has changed. Energy prices rose sharply, and financial markets also reacted to developments in Iran. Stock prices declined worldwide (Figure 6). At the same time, there were significant movements in government bond markets. There is considerable concern that sharply rising energy prices could once again drive up inflation.

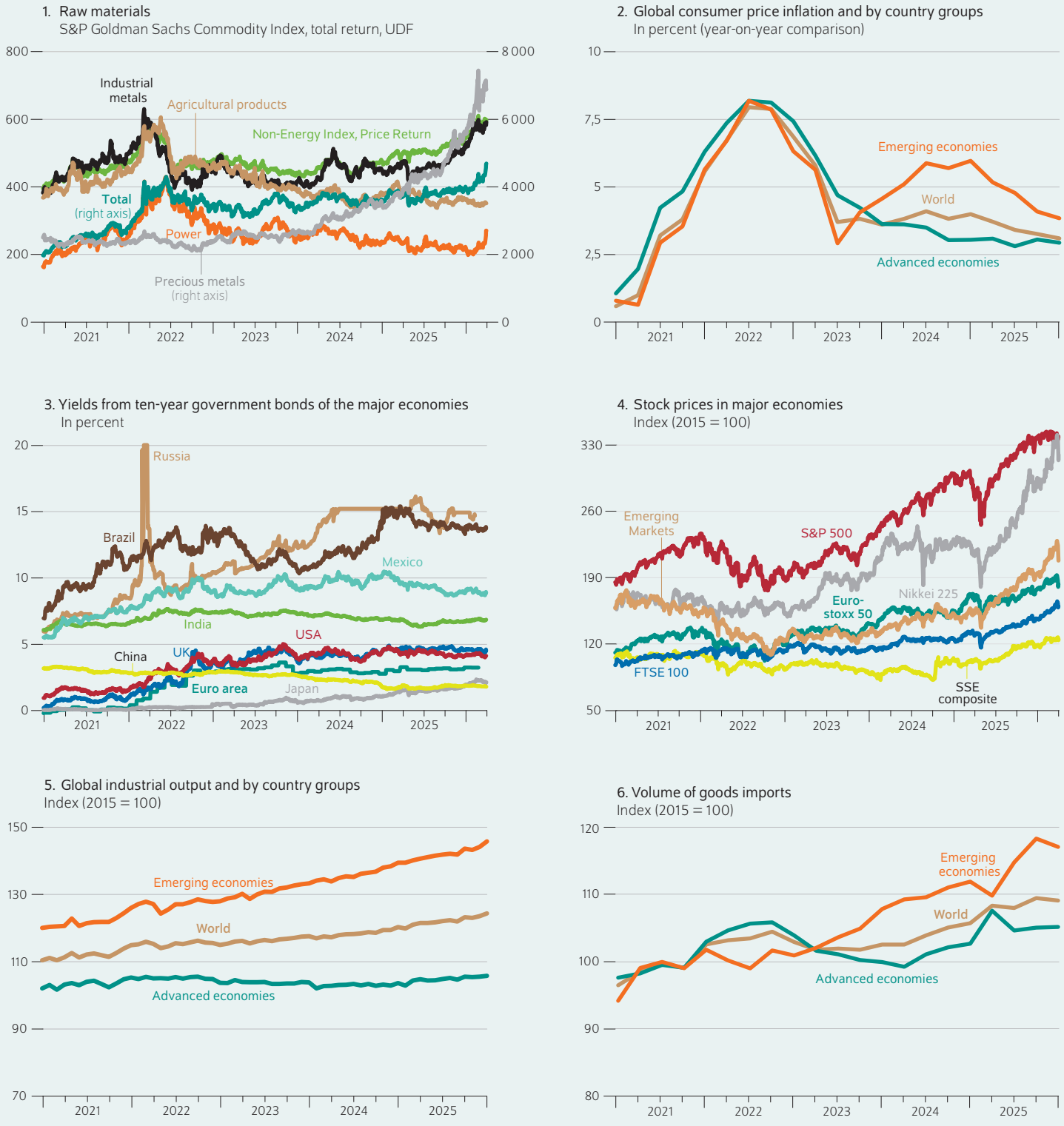
How the geopolitical situation in the region will develop further and what additional price increases or supply bottlenecks could result from it remains subject to considerable uncertainty. The present forecast is based on the expected future price developments for crude oil and natural gas as implied by current futures contracts (Box 2, as of 4 March 2026). These initially indicate further moderate price increases for the coming quarters, followed by gradual declines. For the forecast period, an oil price of around 74 US dollars per barrel in 2026 and 68 US dollars per barrel in 2027 is assumed. Before the start of the Iran war, the price stood at 71 US dollars. For natural gas, a price of 46 euros per megawatt hour is assumed for 2026 and 32 euros per megawatt hour for 2027 (January 2026: 32 US dollars). The fact that the expected price increases are assessed as moderate despite the tense geopolitical situation suggests that markets currently consider a further escalation or prolonged supply disruptions to be rather unlikely. In addition, existing excess capacity in the oil market and recently expanded supply volumes help explain the comparatively subdued price expectations.

Another source of uncertainty is future U.S. trade policy. In February, a ruling by the Supreme Court declared the country-specific tariffs imposed under the emergency regulation IEEPA (International Emergency Economic Powers Act) to be inadmissible. This increased trade policy uncertainty in the short term. At the same time, however, the ruling has significantly restricted the previous tariff practice in the United States. U.S. trade policy is therefore likely to continue relying frequently on tariffs, but in the future these will probably be more strongly embedded in formal investigation and review procedures. For trading partners, this is unlikely to mean a return to free trade, but it should allow for greater predictability.

The present forecast assumes that the general base tariff rate of ten percent will remain in place throughout the forecast horizon and that bilateral trade agreements—including those with the European Union—will continue. At the same

Figure 6

## Global economic environment indicators




Notes: Last observations: March 4, 2026 (part 1 of figure); December 31, 2025 (part 2 of figure); March 4, 2026 (euro area: January 31, 20256) (part 3 of figure); March 4, 2026 (part 4 of figure); December 1, 2025 (part 5 of figure); December 31, 2025 (part 6 of figure).

Sources: S&P Dow Jones Indices; Deutsche Börse; CBOE; EZB; PBoC; Federal Reserve; BoE; BOJ; Central Bank of Brazil; Bureau of Labor Statistics; IHS Markit; and CPB Word Trade Monitor.

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time, it is assumed that sectoral tariffs, such as those on cars, steel, and aluminum, will remain in force unchanged (Box 1).

## Fiscal policy is expected to support economic activity in many countries, while monetary policy remains neutral

Over the forecast horizon, fiscal policy is expected to provide a mildly expansionary impulse and support economic activity in many places. In the United States, the budget deficit is likely to remain high, partly due to tax relief measures from the "One Big Beautiful Bill Act." A possible repayment to companies of the IEEPA tariffs deemed unlawful would further increase the deficit. In Japan, the state deficit is also likely to rise further as the new government moves away from its previous austerity policy. In particular, public investment and temporary tax relief measures are expected to support demand. In the euro area, fiscal policy is likely to remain broadly neutral overall. While a new energy package in Italy is easing the burden on companies and households, the new budget in France signals a rather restrictive course. However, this is counteracted in France as well as in the Netherlands by the long-term expansion of military spending. In the United Kingdom, a recently higher budget surplus—resulting from one-off tax revenues—has created some short-term fiscal space. However, given the continuing weakness of economic growth, this room for maneuver is likely to be limited and only temporary.

Monetary policy is unlikely to provide significant impulses over the forecast horizon. The deposit rate in the euro area remains at two percent and is therefore still within the neutral range. Further interest rate steps are not expected for the time being. In the United States, the Federal Reserve is also likely to wait for the time being in view of persistent inflation risks. With an interest rate corridor of 3.50 to 3.75 percent, monetary policy will probably remain largely within the neutral range. In the United Kingdom, the central bank is expected to continue its interest rate cutting cycle but nevertheless remain slightly restrictive.

In the wake of the Iran war, oil and gas prices have risen significantly. While consumer prices are still close to the two-percent mark in the current quarter, higher energy prices are likely to have a stronger impact on overall inflation from the second quarter onward. For the current year, DIW Berlin therefore expects an annual average inflation rate of 2.5 percent and raises its inflation forecast for the euro area by 0.5 percentage points. In the coming year, the effects of the energy price increases are likely to gradually fade, allowing inflation rates to weaken again and average around 2.1 percent over the year.

## The global economy is expected to grow solidly in 2026 and 2027

Global economic activity is expected to continue expanding moderately over the forecast horizon through the end of 2027. While a mildly expansionary fiscal policy in many places supports demand, the protectionist U.S. trade policy and the Iran war are weighing on economic momentum, particularly from the second quarter onward. The effects are likely to vary depending on how strongly individual regions depend on energy imports.

Because the region is of considerable importance for global trade, the Iran war is also affecting world trade. An estimated ten to fifteen percent of global merchandise trade is handled via the region's sea routes.[9] The tense security situation has already led to rerouting in international maritime transport. Many shipping companies are currently avoiding the entire region, including the Red Sea, and are simultaneously facing significantly higher insurance premiums. As a result, transport times are increasing and freight costs are rising, which is putting pressure on global supply chains and is likely to weaken the momentum of world trade. In addition to geopolitical tensions, it should also be noted that the strong expansion in the previous year—with growth of 4.2 percent—was partly driven by front-loading effects in response to U.S. tariffs. Overall, world trade is expected to increase by 1.6 percent this year and by 1.7 percent in 2027, which corresponds roughly to the long-term average.

In the United States, growth this year is likely to remain largely supported by investment in the AI sector. The sharply rising energy prices resulting from the Iran war are expected to have only a limited impact on the U.S. economy, as the country has a high level of domestic energy production and is therefore less dependent on energy imports. At the same time, parts of the energy sector benefit from higher gas prices, as the United States is among the world's largest exporters of liquefied natural gas. The men's FIFA World Cup in the summer is likely to generate additional tourism revenues and temporarily stimulate private consumption, but it is unlikely to have a significant effect on overall economic growth. Over the course of the year, growth is likely to weaken somewhat, partly because the economic impulses from the tax refunds paid out at the beginning of the year will fade. Overall, the U.S. economy is expected to grow by 2.5 percent this year, with growth slowing somewhat to 2.0 percent in 2027.

In the euro area, growth of 1.1 percent is expected this year, driven primarily by private consumption and investment, including in infrastructure and defense. However, U.S. tariffs are weighing on exports. In addition, higher energy costs are likely to somewhat dampen purchasing power and private consumption. In 2027, a somewhat higher, though still moderate, expansion rate of around 1.4 percent is expected. A slight recovery in goods exports is also likely to contribute to this development.

In China, domestic economic activity is likely to remain subdued in view of the continuing weakness in the real estate

9 United Nations Conference on Trade and Development (UNCTAD) (2024): Navigating Troubled Waters: Impact on Global Trade of Disruptions to Shipping Routes in the Red Sea, Black Sea and Panama Canal. Geneva (available online).

Table 5

**Real Gross Domestic Product, Consumer Prices, and Unemployment Rate in the Global Economy**
In percent

| | GDP | | | | Consumer prices | | | | Unemployment rate in percent | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year-on-year percentage change | | | | | | | | | | | |
| | 2024 | 2025 | 2026 | 2027 | 2024 | 2025 | 2026 | 2027 | 2024 | 2025 | 2026 | 2027 |
| **Europe** | | | | | | | | | | | | |
| European Union | 1.0 | 1.6 | 1.4 | 1.8 | 2.6 | 2.5 | 2.8 | 2.4 | 6.0 | 6.0 | 5.8 | 5.6 |
| Euro area | 0.9 | 1.5 | 1.1 | 1.4 | 2.4 | 2.1 | 2.5 | 2.1 | 6.4 | 6.4 | 6.1 | 6.0 |
| ... excluding Germany* | 1.1 | 2.2 | 1.2 | 1.3 | 2.3 | 2.0 | 2.1 | 2.0 | 7.5 | 7.3 | 7.0 | 7.0 |
| France | 1.1 | 0.9 | 1.0 | 0.9 | 2.3 | 0.9 | 1.5 | 1.5 | 7.4 | 7.6 | 7.5 | 7.4 |
| Italy | 0.5 | 0.7 | 0.9 | 0.7 | 1.1 | 1.6 | 1.6 | 2.1 | 6.6 | 6.0 | 5.8 | 6.0 |
| Spain | 3.5 | 2.8 | 2.4 | 1.6 | 2.9 | 2.7 | 2.6 | 2.1 | 11.4 | 10.5 | 9.7 | 9.5 |
| Netherlands | 1.1 | 1.9 | 1.4 | 1.2 | 3.2 | 3.0 | 3.3 | 2.6 | 3.7 | 3.9 | 3.8 | 3.6 |
| United Kingdom | 1.1 | 1.3 | 0.9 | 1.5 | 2.5 | 3.4 | 2.4 | 2.0 | 4.3 | 4.7 | 5.0 | 4.7 |
| Switzerland | 1.4 | 1.3 | 1.0 | 1.5 | 1.1 | 0.2 | 0.5 | 1.0 | 4.0 | 4.3 | 4.7 | 4.5 |
| Central and Southeastern Europe | 2.0 | 2.4 | 2.3 | 2.9 | 4.0 | 4.1 | 3.7 | 3.3 | 3.7 | 3.9 | 3.9 | 3.7 |
| Turkey | 3.5 | 4.1 | 3.5 | 3.8 | 58.5 | 35.7 | 29.0 | 24.9 | 8.7 | 8.4 | 8.5 | 8.4 |
| Russia[1] | 4.3 | 0.8 | 0.9 | 1.1 | 8.5 | 8.7 | 5.9 | 5.3 | 2.5 | 2.2 | 2.3 | 2.5 |
| **The Americas** | | | | | | | | | | | | |
| USA | 2.8 | 2.2 | 2.5 | 2.0 | 3.0 | 2.7 | 2.5 | 2.1 | 4.0 | 4.3 | 4.5 | 4.7 |
| Mexico | 1.1 | 0.6 | 1.5 | 1.9 | 4.7 | 3.8 | 3.8 | 3.7 | 2.7 | 2.6 | 2.8 | 2.8 |
| Brazil | 3.0 | 2.7 | 1.7 | 2.2 | 4.4 | 5.0 | 3.9 | 3.6 | 6.9 | 6.0 | 6.0 | 6.1 |
| **Asia** | | | | | | | | | | | | |
| Japan | −0.2 | 1.1 | 0.5 | 0.6 | 2.7 | 3.2 | 2.6 | 2.2 | 2.5 | 2.5 | 2.4 | 2.3 |
| South Korea | 2.0 | 0.9 | 1.7 | 1.6 | 2.3 | 2.1 | 2.4 | 2.3 | 2.8 | 2.8 | 2.9 | 2.6 |
| China | 5.0 | 5.0 | 4.4 | 4.4 | 0.0 | −0.3 | 0.7 | 0.7 | 5.1 | 5.2 | 5.0 | 4.9 |
| India | 6.8 | 7.5 | 6.6 | 6.6 | 5.0 | 2.2 | 3.7 | 3.7 | 8.0 | 7.2 | 7.0 | 7.0 |
| **Total** | | | | | | | | | | | | |
| Advanced economies | 1.8 | 1.8 | 1.8 | 1.7 | 3.3 | 3.0 | 2.7 | 2.3 | 4.5 | 4.6 | 4.6 | 4.6 |
| Emerging economies | 5.1 | 5.1 | 4.6 | 4.8 | 5.6 | 4.4 | 4.7 | 4.6 | 6.0 | 5.7 | 5.6 | 5.5 |
| Global economy | 3.5 | 3.5 | 3.3 | 3.3 | 3.9 | 3.4 | 3.3 | 3.1 | 5.7 | 5.4 | 5.4 | 5.3 |
| **For reference:** | | | | | | | | | | | | |
| Export weighted[2] | 2.3 | 2.2 | 2.2 | 2.1 | | | | | | | | |
| GDP weighted in USD[3] | 3.0 | 2.9 | 2.8 | 2.8 | | | | | | | | |

1 The data forecast for Russia are subject to considerable uncertainty. Russia has only a small weight in the overall forecast.
2 World weighting based on shares of German exports in 2024.
3 World weighting based on gross domestic product in U.S. dollars from 2024 to 2027.

Notes: The black figures represent actual (reported) data. The values for country groups are weighted averages. For weighting real GDP and consumer prices, the respective GDP in purchasing power parities from the IMF World Economic Outlook for the years 2024 to 2027 is used. For weighting unemployment figures in the country groups, the labor force (ages 15 to 64) of each country for the year 2023 is used. The Central and Southeastern European countries include Poland, Romania, the Czech Republic, and Hungary.

Sources: National statistical offices; DIW Economic Forecast Spring 2026.

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sector. Higher energy prices are also expected to affect the Chinese economy comparatively strongly, as the country is highly dependent on energy imports. Since a large share of these imports originates from the Middle East, the closure of the Strait of Hormuz is currently placing particular strain on energy supplies. Independently of this, export momentum is also likely to weaken as positive base effects fade. In addition, the recently stronger exports to the EU and ASEAN countries could increasingly trigger trade policy countermeasures. As a result, exports are likely to contribute less to growth in the future than they have so far. Overall, the Chinese economy is expected to grow by 4.4 percent in both this year and next year. Growth would therefore remain slightly below the Chinese government's target of 4.5 to 5.0 percent.

Overall, economic growth of 1.8 percent is expected in advanced economies this year and 4.6 percent in emerging markets. The global economy is projected to grow by 3.3 percent both this year and next year (Table 5). Despite the burdens caused by the Iran war, the forecast for the current year is therefore 0.3 percentage points higher than the winter forecast. This is mainly due to unexpectedly high growth rates in the United States in the third quarter of 2025 and more robust developments in China in the fourth quarter, which raised the starting level. In addition, there are temporary special effects in the United States in the first quarter of 2026, as government spending previously postponed due to the shutdown is being made up and reflected in GDP. However, the underlying growth momentum over

the course of the year remains largely unchanged. For 2027, the forecast remains almost unchanged compared with the winter forecast.

## A possible escalation of the Iran war is the greatest risk

The outlook for the global economy remains subject to considerable risks. A major downside risk for the global economy is a possible escalation of the Iran war. If the conflict were to widen and persist, it could significantly disrupt world trade, for example through prolonged interruptions of energy exports and restrictions on shipping traffic in the Middle East. The consequences would likely include sharply rising energy prices, supply shortages, and higher inflation for goods used in private consumption and production, which would place a substantial burden on the global economy.

Another downside risk lies in the current investment boom in AI technologies. The recently increased volatility in U.S. equity markets and sectoral reallocations from technology-intensive industries toward more capital-intensive sectors with lower exposure to AI indicate growing sensitivity to valuation risks. A reassessment could noticeably dampen investment dynamics.

In the United States, it is currently difficult to foresee which further economic, trade, or geopolitical steps the government may take. Accordingly, uncertainty about the future course of policy remains high. A specific risk for the United States arises from the potential reimbursement of tariffs imposed under the IEEPA following the ruling of the Supreme Court. These repayments represent both an upside and a downside risk. The U.S. government's tariff revenues so far are estimated to amount to as much as 175 billion U.S. dollars. A repayment—plus interest—to companies could trigger a strong liquidity impulse, significantly increase corporate profits in the short term, and support investment as well as employment. This would generate a cyclical stimulus.

At the same time, a comprehensive reimbursement would further exacerbate the already strained fiscal situation of the United States in the long term. The additional fiscal burdens could intensify doubts about the sustainability of public finances and increase risk premiums in capital markets. In addition, the legal disputes over the scope and modalities of the repayments, as well as over the future use of alternative tariff instruments—such as sectoral tariffs—are likely to keep trade policy uncertainty high. As a result, a potential short-term demand impulse would be accompanied by a considerable structural risk.

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