

Eurozone: An improving outlook

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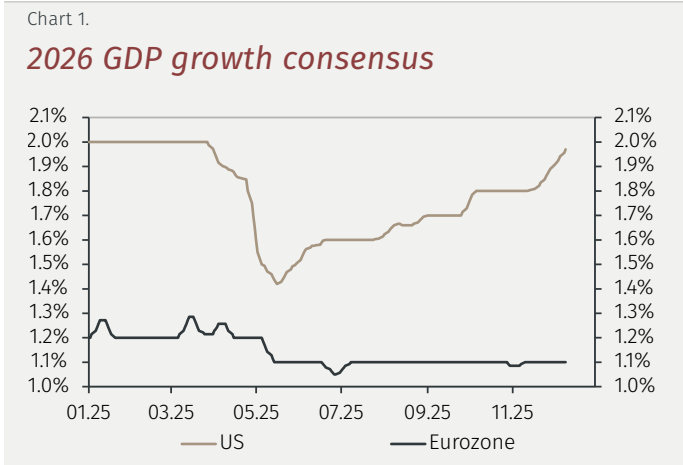
GianLuigi Mandruzzato,
Senior Economist & Strategist

The eurozone economy is set to remain weak in 2026, according to market consensus. However, the latest data has been better than expected. In this edition of InFocus, Senior Economist and Strategist GianLuigi Mandruzzato looks at the eurozone outlook and considers the implications for financial assets.

Key Statements

- Growth forecasts for the eurozone remain subdued but the economy has already started to see a rebound, primarily driven by domestic demand.
- Government spending should continue to be supportive, and such investment could catalyse higher private-sector investment plus strengthen labour markets.
- In the absence of further shocks, the ECB's interest rates are likely to remain at the current levels throughout 2026.

Recent updates from the International Monetary Fund, the OECD, and market analysts point to subdued GDP growth in the eurozone for 2026 (see Chart 1). This would confirm the conventional view that the eurozone is a structural underperformer compared to, for example, the US whose GDP is expected to grow at a much higher rate next year.

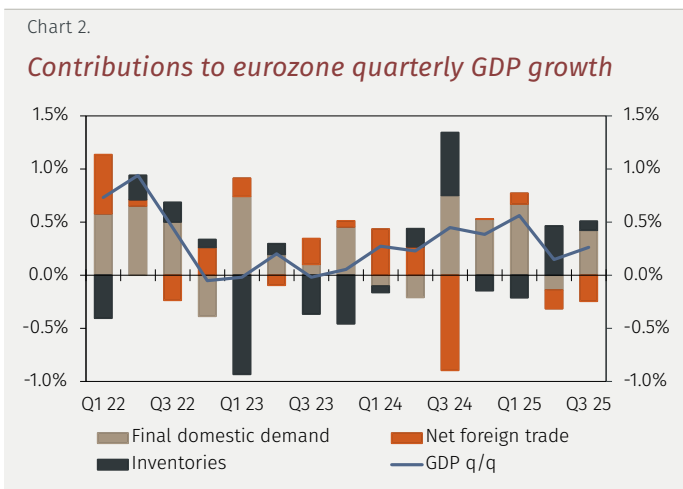


Source: Bloomberg. Data as of 9 December 2025.

Eurozone growth has gained momentum

However, growth is already set to surpass expectations in 2025. Last June, the European Central Bank (ECB) forecast sub-1% growth this year, but the latest data suggest an expansion of at least 1.4%, exceeding estimates of potential growth.¹ Activity strengthened in the second half of the year, with the composite purchasing managers' index reaching 52.8 in November, the highest in two-and-a-half years, signalling further upside.²

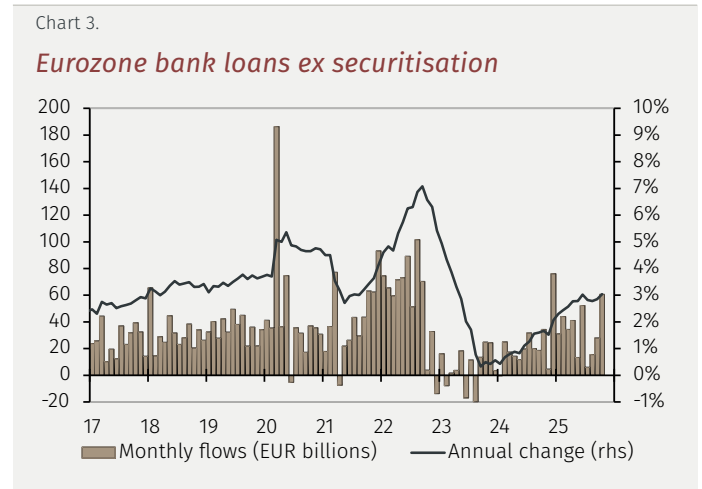
The rebound is being driven primarily by domestic demand (see Chart 2), reducing the region's reliance on global trade and suggesting that the fiscal stimuli announced earlier in 2025 are beginning to filter through.³ Germany is a case in point: industrial output has risen strongly after the summer following a long stagnation.



Source: Eurostat, LSEG, and EFG calculations. Data as of 9 December 2025.

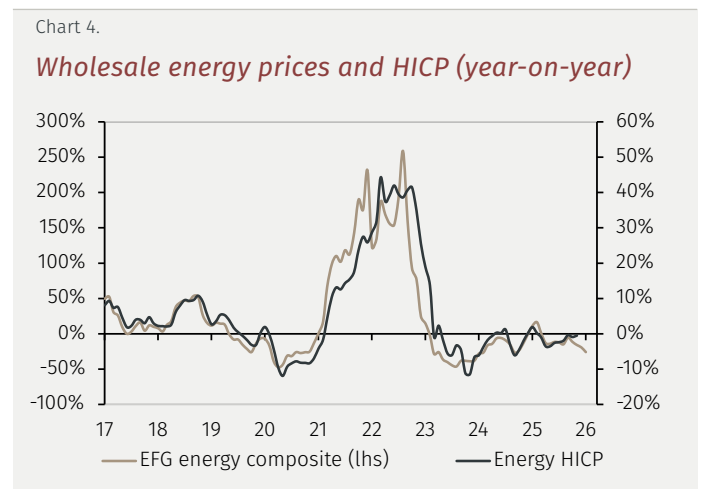
Government spending is poised to remain supportive. Berlin's commitment to spend over €1 trillion on multi-year defence and infrastructure programmes, and the energy transition may lift GDP by more than 1.5 percentage points and improve long-term potential growth, according to the German economic advisers.⁴ If deployed efficiently, such investment could catalyse higher private-sector investment and strengthen labour markets.

Financial conditions also provide grounds for cautious optimism. Credit flows to the private sector have returned to levels last seen before the ECB started raising interest rates in 2022 (see Chart 3). Growth in M3 money supply — and notably its most liquid component M1 — points to stronger consumption, although the link between money supply and overall GDP growth is less stable than in the past.



Source: ECB and LSEG. Data as of 9 December 2025.

Consumers will benefit from lower energy prices, including oil, natural gas, and electricity, which should boost household purchasing power (see Chart 4). In the eurozone, each one-percentage-point decline in energy bills translates into a 0.1% rise in households' real disposable income.



Source: Eurostat, LSEG, and EFG calculations. Data as of 9 December 2025.

¹ See European Commission [“Autumn 2025 Economic Forecast shows continued growth despite challenging environment”](#).

² See S&P Global, [November Eurozone Composite PMI](#).

³ See German Federal Ministry of Finance, [«The Special Fund for Infrastructure and Climate Neutrality»](#) and Politico, [«Germany's Merz secures breakthrough on gargantuan spending plan»](#).

⁴ See German Council of Economic Experts, [“Creating new prospects for tomorrow – not squandering opportunities”](#) and [ifo Economic Forecast Autumn 2025: Fiscal Policy May Haul the German Economy Out of the Crisis](#).

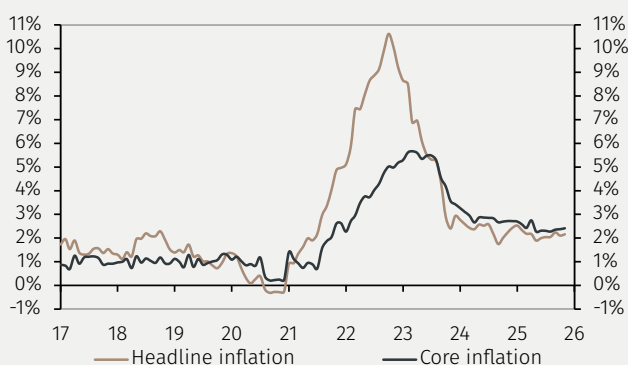
Risks to the outlook look balanced in our view. Faster-than-expected spending on defence and infrastructure could support growth and employment. A resilient global trade environment would lift demand for European exports. Conversely, geopolitical tensions, particularly surrounding Russia and Ukraine, could undermine confidence and curtail spending and investment.

A patient ECB

Inflation in the eurozone has settled close to 2% (see Chart 5), though services prices have kept it a little above the latest ECB's projections. Lower energy prices may push it temporarily below target in early of 2026, but this is unlikely to prompt further monetary easing.⁵

Chart 5.

Eurozone headline and core inflation (year-on-year)



Source: Eurostat, LSEG, and EFG calculations. Data as of 9 December 2025.

Rather, the ECB remains alert to the possibility that above-trend growth and stabilising energy costs could reignite price pressures in the medium-term.⁶ However, with benign near-term inflation expectations, the ECB can afford to wait before changing interest rates.

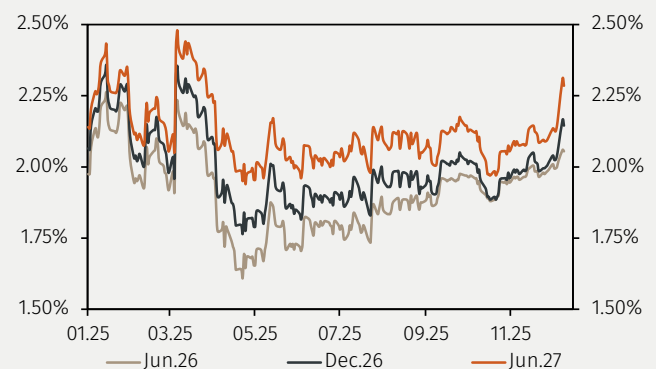
Monetary policy outlook and market implications

In the absence of further shocks, ECB's interest rates are therefore likely to remain at the current levels throughout 2026. The risks seem tilted towards a less expansionary policy – though any rate increase appears distant.

Investors seems to have adjusted expectations faster than economic forecasters. According to eurozone short-term interest rate futures prices, in April the ECB reference interest rate was all but certain to be below 2% in June 2026; such a scenario is now given only a 5% probability (see Chart 6). Rather, market expectations are shifting toward the possibility of a rate increase in the first half of 2027.

Chart 6.

Eurozone implied 3-month interest rate by date



Source: LSEG and EFG calculations. Data as of 9 December 2025.

Stronger growth should support corporate and European equity valuations, sustaining investors' appetite for European equities and perhaps leading to increased exposure to European markets. Cyclical sectors leveraged to domestic demand and those that benefit from a higher-rate environment appear best positioned. In fixed income markets, modestly higher yields would be consistent with stronger GDP growth, a tighter monetary policy, and a more expansionary fiscal policy. Such dynamics will underpin the euro exchange rate against currencies whose central banks adopt more accommodative policies.

Summary and conclusions

While consensus still sees the eurozone as a slow growing, structurally weak economy, incoming data point to a clear improvement. Growth is set to exceed expectations thanks to a rebound in domestic demand, stronger credit flows and the boost from fiscal policy. Consumers are benefiting from lower energy prices, and risks around the outlook now appear broadly balanced. Inflation is close to target, allowing the ECB to stay patient, with policy likely to remain unchanged through 2026. Markets have already shifted towards expecting a less accommodative stance, supporting equities sensitive to domestic demand and suggesting modest upward pressure on yields and the euro.

After years in the shadow of faster-growing peers, the eurozone may be entering a phase where expectations for the economy and financial assets are finally—if cautiously—being revised upwards.

⁵ See Philip Lane, ECB's Chief Economist, "[Inflation deviations and monetary policy](#)". See Isabel Schnabel, Member of the ECB's Executive Board, interview with Bloomberg.

⁶ See Isabel Schnabel, Member of the ECB's Executive Board, [interview with Bloomberg](#).

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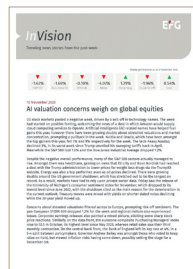
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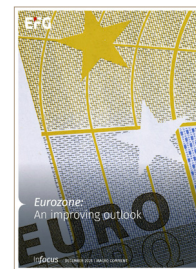
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