DIW Weekly Report

A policy bulletin from the German Institute for Economic Research

24 2026

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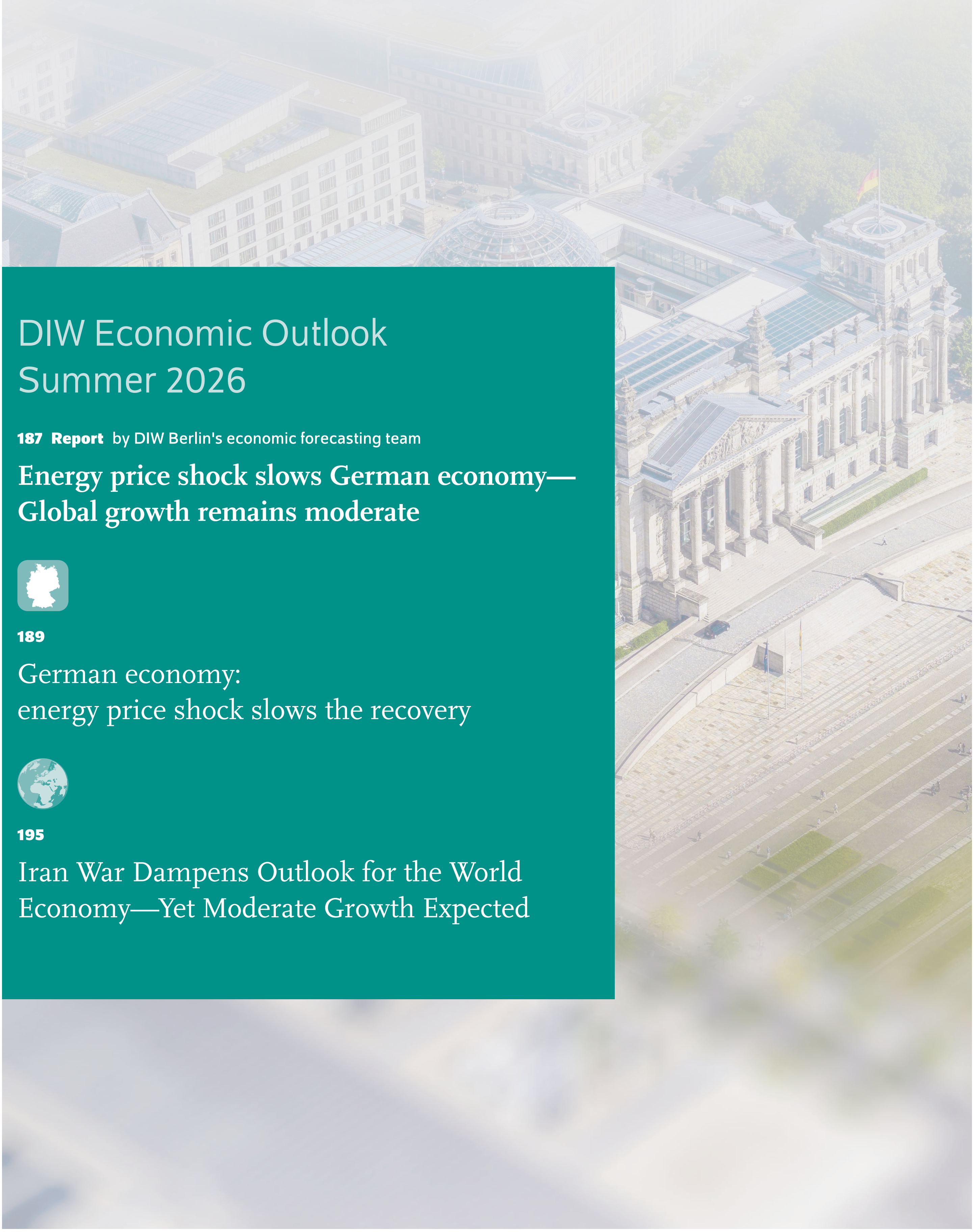

DIW Economic Outlook Summer 2026

LEGAL AND EDITORIAL DETAILS

DIW BERLIN

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Volume 16 June 18, 2026

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ISSN 2568-7697

DIW Weekly Report 24 2025

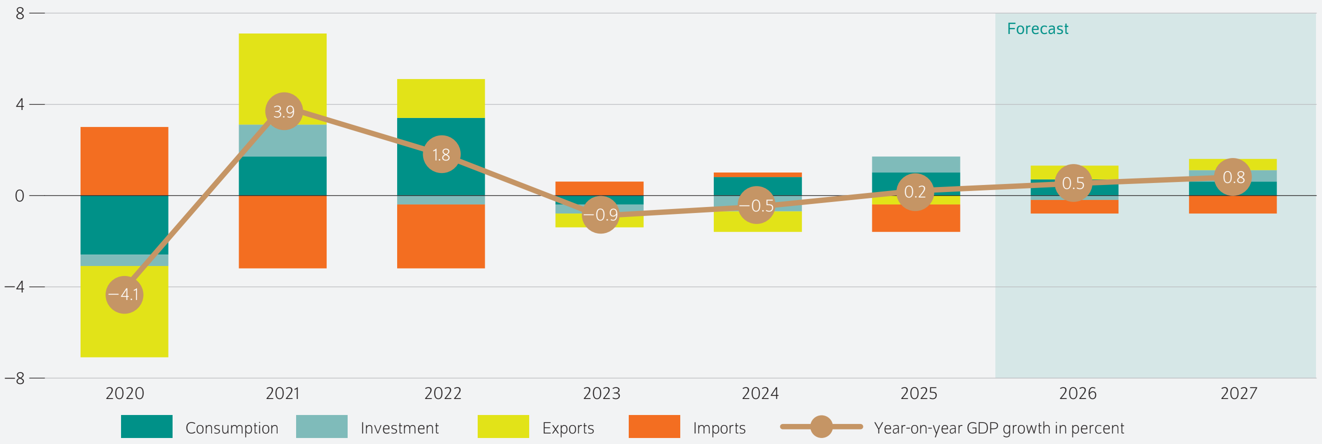
AT A GLANCE

Energy price shock slows German economy—Global growth remains moderate

By DIW Berlin's economic forecasting team

- Energy price shock triggered by the Iran War stalls the nascent recovery of the German economy—technical recession expected around mid-year
- Deep downturn comparable to 2022/23 remains unlikely—shock is smaller, energy supply remains secure, and expansionary fiscal policy provides support elsewhere in the economy
- Higher oil and gas prices push inflation to 2.9 percent this year and 3.0 percent next year—unemployment rate rises temporarily to 6.4 percent
- DIW Berlin expects the German economy to grow by 0.5 percent in 2026 and 0.8 percent in 2027—forecast revised down by around 0.5 percentage points in each year compared with the spring outlook
- Global economic output continues to expand at a moderate pace despite the energy price shock, by 3.1 percent this year and 3.3 percent next year—US economy continues to grow

Recovery of the German economy weaker than expected in the spring forecast
Contributions to GDP growth by expenditure component in percentage points



Source: DIW Economic Forecast Summer 2026.

FROM THE AUTHORS

"The German economy was only just starting to work its way out of a three-year slump when the Iran War drove up energy prices. This is noticeably slowing the recovery—but this is not a repeat of 2022: the shock is smaller, energy supply remains secure, and expansionary fiscal policy is providing support."
— Geraldine Dany-Knedlik —

MEDIA

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

Energy price shock slows the German economy—Global economy remains on a moderate growth path

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

The German economy is failing to gain momentum after three weak years. At the turn of the year, a modest recovery appeared to be taking hold, driven primarily by domestic demand and private consumption. However, in addition to the structural problems already present, the German economy must now also contend with the consequences of the Iran War. The energy price shock has halted the recovery before it could gain traction. Rising oil and gas prices have since been driving up consumer prices, eroding household purchasing power, and fueling the already widespread uncertainty. Nevertheless, a deep downturn comparable to the energy price crisis of 2022/23 does not appear to be on the horizon.

At the start of the year, Germany's economic output still grew by 0.3 percent, supported by the public sector and foreign trade, while the rest of the domestic economy remained weak. As the year progresses, the impact of the energy price shock is becoming clearly apparent: economic output is likely to contract slightly in the second quarter (by 0.2 percent) and decline marginally again in the third quarter, before stabilizing toward year-end. Private consumption is softening, and investment appetite remains subdued. Once again, the public sector remains the sole source of support. Even beyond the current year, the expansionary fiscal policy stance remains the decisive driver. Rising defense spending and the gradual deployment of funds from the special fund for infrastructure and climate neutrality will account for the bulk of growth—though they are no miracle cure, as the impact of these investments is unfolding only gradually. After growth of 0.5 percent this year, DIW Berlin expects the economy to expand by 0.8 percent next year—both around half a percentage point lower than forecast in the spring outlook. Consumer price inflation, at 2.9 and 3.0 percent respectively, exceeds the European Central Bank's stability target, and the unemployment rate is rising to 6.4 percent this year. An updated scenario analysis by DIW Berlin highlights the scale of these risks. In a downside scenario derived from market expectations, growth this year would be around 1.5 percentage points lower—equivalent to the German economy contracting by just under half a percent in 2026. Inflation would reach a level similar to that seen during the energy price crisis of 2023.

The global economy continues to grow at a moderate pace despite the energy price shock. While the Iran War is weighing on the global outlook, world trade expanded strongly at the start of the year and is only slowing modestly. The United States is bucking this trend, growing by 2.2 percent this year, driven by investment and energy exports; the euro area, by contrast, is growing only weakly at 0.3 percent. For global economic output overall, DIW Berlin projects growth of 3.1 percent this year and 3.3 percent next year.

 DOI: https://doi.org/10.18723/diw_dwr:2026-24-1

German economy: energy price shock slows the recovery

High energy prices are holding back a stronger recovery in the German economy. Toward the end of last year, a modest recovery had begun to take shape, driven primarily by domestic demand and robust private consumption. However, the energy price shock resulting from the Iran War has stalled this recovery before it could gain traction. Rising oil and gas prices are pushing up consumer prices, eroding household purchasing power, raising business costs, and fueling already elevated uncertainty. At the same time, the structural weaknesses of the German economy—the declining competitiveness of industry, high production costs, and demographic change—remain unresolved. Even amid the current energy crisis, these challenges remain as relevant as before.

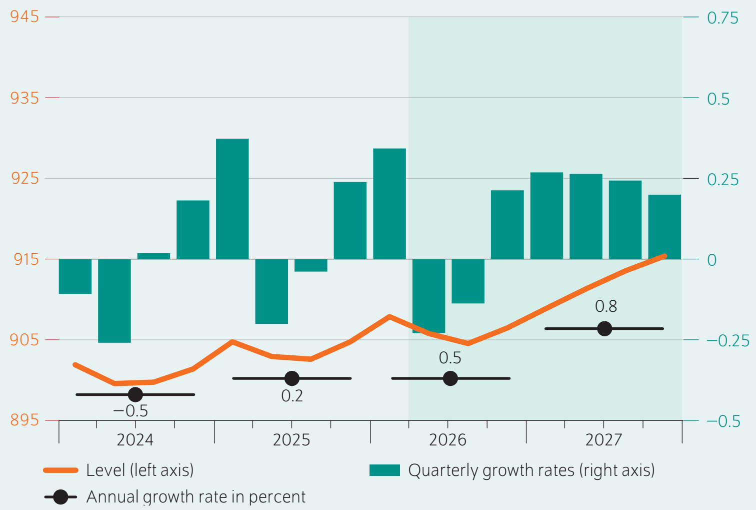
The consequences of the Iran War are likely to noticeably weigh on German economic growth this year and next; nevertheless, the real economic impact is expected to be smaller than following the energy crisis of 2022/23 triggered by Russia's invasion of Ukraine. The shock is both smaller in magnitude and different in nature: this time it is primarily an oil price shock rather than a gas price shock. Moreover, there is currently no shortage of oil or gas—a supply-volume shock has not materialized. Energy supply has been diversified since the last crisis, and domestic security of supply is not at risk. The macroeconomic backdrop is also different: unlike in 2022, when the shock hit an economy operating above potential with high employment and low unemployment, the German economy is currently in a phase of underutilization. With demand weak, businesses have only limited scope to pass on higher energy costs, and potential second-round effects via wages are likely to remain subdued. The energy price shock therefore feeds through primarily via the direct impact of higher energy costs on purchasing power, while effects on core inflation excluding energy and food remain contained. Moreover, monetary policy is assumed to react more quickly to the inflationary impulse than it did in 2022, helping to contain second-round effects.

German gross domestic product increased by 0.3 percent in the first quarter compared with the previous quarter (Figure 1). Growth was driven by the public sector and foreign trade, while domestic private-sector activity remained subdued. Public consumption expanded strongly once again (by 1.1 percent), whereas private consumption stagnated—at the same time, the seasonally adjusted savings rate edged down slightly to 10.1 percent. Gross fixed capital formation fell sharply by 1.5 percent: construction investment in particular declined noticeably (by 2.5 percent) due to low temperatures at the start of the year. Equipment investment also decreased (by 1.2 percent), reflecting a correction after unusually strong investment growth in the previous quarter, particularly in the public sector.

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 Summer 2026.

The recovery of the German economy has been put on hold, but not called off.

Foreign trade, by contrast, provided a significant boost to growth. Exports rose unexpectedly strongly (by 3.3 percent) after three weak quarters. Services exports grew strongly—particularly in the field of information technology—and goods exports to the United States stabilized. Imports, however, increased only marginally (by 0.1 percent). As a result, net exports contributed 1.3 percentage points to GDP growth (Table 1).

On the output side, the picture was mixed. Gross value added in the production sector increased overall (by 0.5 percent), driven by manufacturing (up 0.7 percent), while construction contracted again (down 0.6 percent). Service sectors were largely stagnant: trade, transport, and hospitality as well as information and communication recorded only modest gains (up 0.1 percent each). Public services stagnated, and both business services and other services declined slightly. Overall, gross value added rose by only 0.1 percent in the first quarter.

Sentiment worsens—Economy contracts in mid-year

Since the outbreak of the Iran War, sentiment in Germany has deteriorated markedly (Figure 2). The ifo Business Climate Index fell in April to its lowest level since May 2020,

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	1.1	0.1	−0.3	0.6	0.0	−0.3	−0.1	0.0	0.1	0.1	0.1	0.1
Government consumption expenditure	−0.7	0.2	0.7	1.5	1.1	−0.4	0.3	0.5	0.6	0.6	0.7	0.5
Gross fixed capital formation	0.5	−0.9	0.1	1.3	−1.5	1.0	0.6	0.7	0.6	0.5	0.5	0.4
Construction	0.5	−0.9	−0.7	0.8	−2.5	1.8	0.6	0.9	0.4	0.2	0.1	0.0
Equipment	0.4	−2.2	1.2	2.5	−1.2	−0.3	0.3	0.4	0.6	0.7	0.7	0.8
Other fixed assets	0.6	1.2	0.9	1.0	0.6	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Inventory changes[1]	−1.0	0.7	0.2	0.3	−0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic demand	−0.5	0.6	0.3	1.2	−0.9	−0.1	0.1	0.3	0.3	0.3	0.3	0.3
Net exports	0.8	−0.8	−0.3	−1.0	1.3	−0.2	−0.2	−0.1	0.0	−0.1	−0.1	−0.1
Exports	3.4	−1.2	−1.1	−1.5	3.3	−0.3	−0.3	0.2	0.4	0.4	0.4	0.4
Imports	1.5	0.8	−0.4	1.0	0.1	0.1	0.3	0.5	0.5	0.5	0.5	0.5
GDP	0.4	−0.2	0.0	0.2	0.3	−0.2	−0.1	0.2	0.3	0.3	0.2	0.2
Gross value added	0.6	−0.1	0.0	0.3	0.1	−0.2	−0.1	0.2	0.3	0.3	0.2	0.2
Manufacturing	1.7	−0.2	−1.0	0.3	0.7	−0.6	−0.4	0.0	0.1	0.2	0.2	0.1
Construction	1.3	−2.1	−0.8	−0.6	−0.6	0.5	0.3	0.8	0.4	0.2	0.1	0.0
Trade, hospitality, transport	1.1	−0.3	0.2	0.0	0.1	−0.5	−0.3	0.1	0.2	0.2	0.2	0.2
Business services	−0.1	0.3	0.1	−0.1	−0.1	−0.5	−0.4	0.1	0.2	0.2	0.2	0.2
Public services, education, health	0.2	0.4	0.4	1.0	0.0	0.2	0.2	0.4	0.4	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.

with expectations in particular worsening. The Purchasing Managers' Index slipped back below the expansion threshold of 50 points, driven primarily by a very weak reading in the services sector. This deterioration in sentiment is already being reflected in activity data: the production index in the manufacturing sector declined in the first quarter (by 0.6 percent), with industrial output and capital goods production in particular falling more sharply. Revenues in manufacturing stagnated, while retail sales declined. Consumer sentiment weakened further: the GfK Consumer Climate Index fell noticeably in the wake of the war and has recently stabilized at a low level, while the HDE Consumer Barometer also remained subdued following repeated declines. Investment sentiment remains subdued as well: according to a DIHK survey, corporate investment intentions have fallen again. In the labor market, the ifo Employment Barometer points to a further—albeit moderate—decline in employment. New manufacturing orders, which had increased at the start of the year, likely benefiting from front-loading ahead of potential supply disruptions related to the Iran War, fell sharply in April.

Against this backdrop, the German economy is expected to contract slightly by 0.2 percent in the second quarter. Private consumption is likely to weaken in response to rapidly rising prices and heightened uncertainty. Equipment investment is also likely to decline modestly again, as persistent regulatory burdens, tariff uncertainty, and high energy costs—the latter further amplified by the Iran War—are dampening corporate investment appetite. Only the public sector is providing support. Following the exceptionally strong start to the year, no further positive contribution from foreign trade is expected; exports may temporarily soften somewhat after the front-loading effects of the first half of the year. A recovery also appears unlikely as the year progresses. Economic output is expected to decline marginally again in the third quarter before stabilizing toward year-end.

Energy price shock slows recovery while structural weaknesses persist

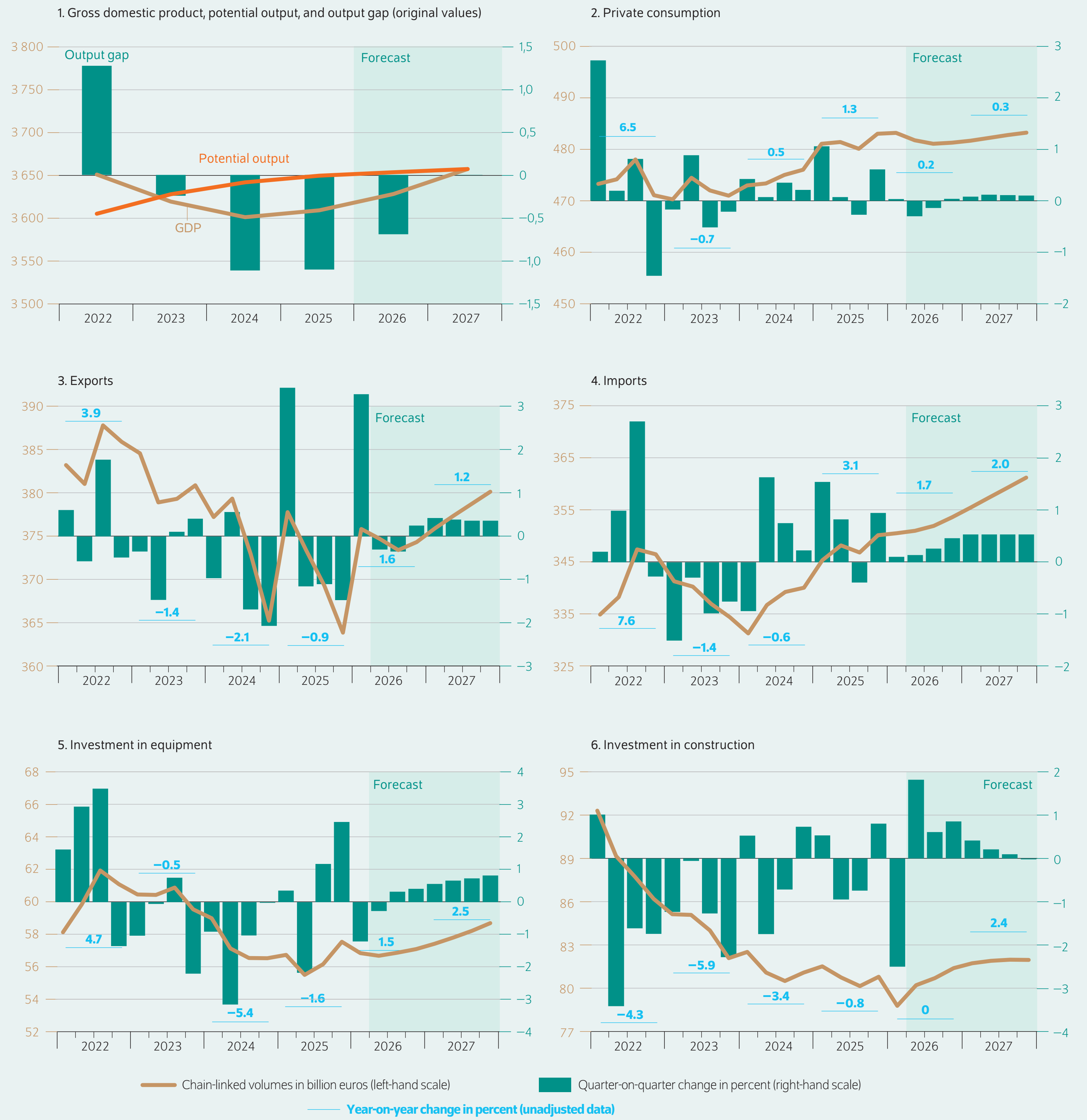
The German economy remains in a phase of structural transformation. The declining competitiveness of industry, high production costs by international standards, and demographic change continue to weigh persistently on economic activity. The shifts are substantial: compared to the peak of industrial employment in mid-2019, there are now around 660,000 fewer jobs in this sector. At the same time, more than 1.2 million positions were added in the public sector, healthcare, and social services over the same period—a development that partly reflects the demographically driven expansion of personal services.

Higher oil and gas prices are driving up inflation and eroding real disposable incomes, which are expected to increase by only 0.1 percent this year and will not pick up meaningfully again until 2027 (by 0.6 percent). Private consumption is therefore recovering only gradually and is expected

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 Summer 2026.

Box

Assumptions and framework conditions

This forecast is based on assumptions regarding the path of key interest rates, exchange rates, and commodity prices (Table). These assumptions draw on developments to date, futures market prices, and closing values as of the forecast cut-off date of 22 May 2026.

The energy price shock stemming from the Iran War has been feeding through to euro area consumer prices since March: whereas inflation was still running just below the ECB's 2 percent stability target at the start of the year, it climbed to 3.2 percent in May. This forecast assumes that the central bank will respond to the price shock with two interest rate increases of 25 basis points each, bringing the deposit rate to 2.5 percent by the third quarter.

In line with the expected policy rate increases, money market rates have also risen and are projected to remain at just below 3 percent through the end of the forecast period. The rate increases are also expected to feed through into refinancing costs for households and businesses. It is further assumed that capital market rates will remain broadly unchanged over the forecast horizon, at 3.1 percent for Germany and 3.5 percent for the euro area—somewhat higher than in the spring forecast.

The Iran War has led to a depreciation of the euro against the dollar. The exchange rate is assumed to remain unchanged at its level on the forecast cut-off date of USD 1.16 per euro. The Iran War has triggered a price shock in crude oil and gas markets. Based on futures prices, crude oil (Brent) is assumed to remain at its elevated level in the third quarter before declining over the remainder of the forecast horizon, though staying above pre-war levels. This implies an average price of around 94 US dollars per barrel in the current year and around 81 US dollars per barrel next year—roughly 25 percent higher than assumed in the spring forecast for the current year and 19 percent higher for the coming year. Wholesale gas prices (TTF) have also risen sharply as a result of the Iran War, at times reaching roughly twice their pre-war level. This forecast assumes that prices will remain elevated through the first quarter of 2027 before gradually declining. Gas prices are accordingly assumed to average 46 euros per megawatt-hour this year and around 38 euros per megawatt-hour in 2027—unchanged from the spring forecast for the current year, but 18 percent higher for the coming year. The forecast also incorporates assumptions regarding trade policy.[1]

1 See the section on the global economy in this Weekly Report for further details.

Table 2

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

	Contributions to growth[1]		
	2025	2026	2027
Consumption expenditures	1.0	0.7	0.6
Private households	0.7	0.1	0.1
Government	0.3	0.6	0.5
Gross fixed capital formation	0.0	0.2	0.6
Construction	−0.1	0.0	0.2
Equipment	−0.1	0.1	0.2
Other fixed assets	0.2	0.1	0.2
Inventory changes	0.8	−0.4	−0.1
Domestic demand	1.8	0.5	1.1
Net exports	−1.5	0.0	−0.3
Exports	−0.4	0.6	0.5
Imports	−1.2	−0.6	−0.8
Gross domestic product[2]	**0.2**	**0.5**	**0.8**

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 Summer 2026.

to remain subdued. The export-oriented industrial sector is also recovering only slowly, given the structural burdens and persistent external economic uncertainty.

The decisive stabilizing factor throughout the forecast period remains the expansionary fiscal policy stance—in a monetary policy environment assumed to respond to the price shock with two interest rate increases of 25 basis points each (Box). Rising defense spending and the gradual deployment of funds from the special fund for infrastructure and climate neutrality are providing stimulus to public consumption and public investment, accounting for the bulk of growth in both forecast years (Table 2). However, the impact of the special fund is materializing only slowly, as planning and disbursement are lagging behind initial expectations. These expansionary effects are cushioning the cyclical setback, but cannot fully offset it—particularly since, through higher construction and investment demand, they are simultaneously exerting upward pressure on prices.

All in all, real GDP in Germany is expected to grow by 0.5 percent this year and by 0.8 percent next year. This represents a significant downward revision to DIW Berlin's growth forecast compared with the spring forecast, of around half a percentage point in each year. The revision is driven primarily by the adverse effects of the energy price shock: persistently higher oil and gas prices are pushing up inflation and weighing on private consumption through a loss of purchasing power, while heightened uncertainty is further delaying an already modest investment recovery. Consumer price

Table

Forecast assumptions

		2024	2025	2026	2027
ECB deposit facility[1] (year-end)	Percent	3.0	2.0	2.5	2.5
ECB key interest rate (year-end)	Percent	3.15	2.15	2.90	2.90
Money market interest rate	Three-month EURIBOR in percent	3.6	2.2	2.6	2.8
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	3.0	3.1	3.4	3.5
Capital market interest	Yield on German government bonds with a remaining term of ten years	2.4	2.7	3.0	3.1
Exchange rate	USD/EUR	1.08	1.15	1.16	1.16
Crude oil price	USD per barrel	79.7	68.0	93.5	80.9
Gas price	EUR per megawatt hour	34.4	36.3	46.4	37.8

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 Summer 2026.

inflation is projected at 2.9 percent this year and 3.0 percent next year—well above the European Central Bank's stability target—representing an upward shift relative to the spring forecast that is largely attributable to higher energy price assumptions. The unemployment rate is expected to rise to 6.4 percent in 2026 and stand at 6.2 percent in 2027 (Table 3). The fiscal expansion comes at a cost: the general government deficit is widening to 3.9 percent this year and 4.3 percent next year, with the debt-to-GDP ratio rising to around 67 percent by 2027.

Table 3

Key economic indicators for the German economy

	2025	2026	2027
GDP[1]	0.2	0.5	0.8
Employment[2] (1,000 persons)	45,977	45,838	45,923
Unemployed (1,000 persons)	2,948	2,992	2,896
Unemployment rate[3] (BA concept, in percent)	6.3	6.4	6.2
Consumer prices[4]	2.2	2.9	3.0
Unit labor costs[4,5]	4.5	2.4	2.8
Government budget balance[6]			
in billions of euros	−123.6	−179.0	−203.2
in percent of nominal GDP	−2.8	−3.9	−4.3
Current account balance			
in billions of euros	202.7	192.2	181.3
in percent of nominal GDP	4.5	4.2	3.8

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 Summer 2026.

The aggregate output gap remains negative in both forecast years, averaging 0.8 percent in 2026 and 0.2 percent in 2027, and is not expected to close until the medium term. Meanwhile, productive potential is barely increasing—through to 2030, potential growth amounts to just above zero percent. Demographic aging is the primary drag on potential growth, through a declining volume of labor (contributing –0.3 percentage points), while the capital stock (0.2 percentage points) and total factor productivity (0.1 percentage points) make only modest positive contributions. This leaves limited scope for a strong cyclical recovery even beyond the energy price shock.

The risks to this forecast are substantial and cut in both directions. De-escalation in the Middle East and a rapid easing of energy market tensions could bring inflation down more quickly and support purchasing power sooner than assumed. Conversely, a further escalation—such as a prolonged blockade of the Strait of Hormuz or additional disruptions to shipping through the Red Sea—would keep energy prices elevated for longer, drive inflation higher, and further delay the recovery. Moreover, even if the Strait of Hormuz were to reopen, supply chains would likely not return to normal immediately: elevated insurance risk premiums, a lengthy mine-clearing operation, and the gradual rerouting of diverted transport flows could continue to disrupt production for months. An additional upside risk to inflation lies in household inflation expectations: energy prices—and fuel prices in particular—are an especially salient price signal, and following an energy crisis only three years ago, households are reacting more quickly to a renewed rise.[1] Inflation expectations surveyed by the Deutsche Bundesbank have already risen noticeably, reaching 3.6 percent most recently. If they remain elevated or drift further from the ECB's stability target, the price surge

1 See Ulrike Malmendier and Stefan Nagel (2016): Learning from Inflation Experiences. The Quarterly Journal of Economics, 131(1), 53–87.

could become more deeply and durably embedded in core inflation than the moderate scale of the shock and the current degree of economic underutilization would suggest. On the cyclical side, downside risks exist if the funds earmarked from the special fund for infrastructure and climate neutrality flow more slowly than expected, or if they merely replace investment already provided for in the federal budget rather than representing genuine additional spending—thereby diminishing the effectiveness of the fiscal measures. Absent reforms to the social insurance system, contribution rates could also continue to rise, placing further pressure on households' net wages.

Iran War Dampens Outlook for the World Economy—Yet Moderate Growth Expected

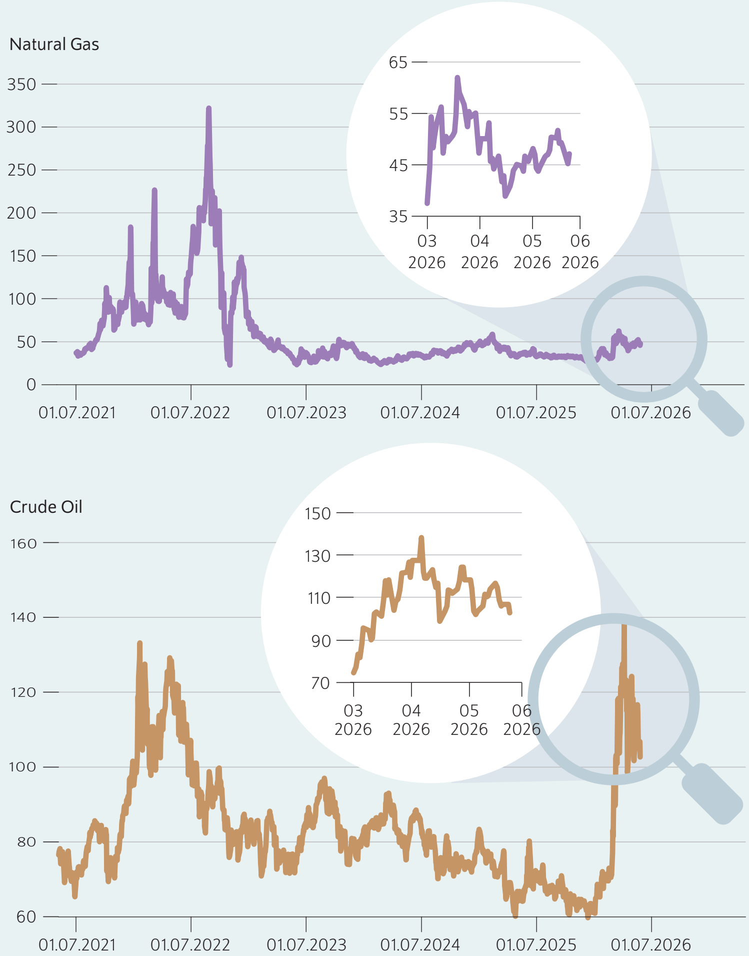
At the start of the year, the world economy still proved resilient: solid domestic activity in many places, fiscal stimulus, and persistently high investment in artificial intelligence (AI) supported economic activity in many countries. With the outbreak of the Iran War in late February, however, the picture clouded over noticeably: the extensive closure of the Strait of Hormuz—through which around one-quarter of global oil trade and 20 percent of liquefied natural gas (LNG) trade pass—has substantially disrupted oil and gas deliveries. Attacks on the region's energy infrastructure additionally damaged extraction, production, and refining capacities. According to estimates by the International Energy Agency (IEA), global oil supply is likely to have fallen by around eight million barrels per day, or 7.5 percent. Energy prices rose sharply as a result: between late February and mid-May, natural gas became around 50 percent more expensive and crude oil around 70 percent (Figure 3). The energy price shock has reignited inflation and weighs on the global economic environment.

In the first quarter, the world economy expanded somewhat more strongly than at year-end: after 0.7 percent in the final quarter of 2025, global gross domestic product (GDP) grew by 0.8 percent, as projected (Figure 4). As the conflict erupted only in the last third of the quarter, the sharp rise in energy prices initially had only a limited impact on the reported figures. Growth was driven above all by a renewed pickup in momentum in the advanced economies, whose pace of expansion accelerated from 0.1 to 0.3 percent. In the United States, growth accelerated after the weak final quarter (0.1 percent) to 0.4 percent. Decisive factors were the government spending caught up after the budget-related shutdown and AI-related investment. The latter went hand in hand with an exceptionally strong rise in imports. In Japan and South Korea, high exports of technology-intensive goods—especially AI-related semiconductors—delivered a robust quarterly gain. In South Korea, semiconductor exports rose by around 140 percent year-on-year and now account for roughly one-third of total exports. In the United Kingdom, too, economic activity picked up noticeably, with growth of 0.6 percent. The euro area, by contrast, contracted by 0.2 percent (after a 0.2 percent gain in the previous quarter). This was the first decline since the end of 2022. The main drivers were a slump in Irish economic output of 12.1 percent and export declines, for example in France.

Figure 3

Prices for Natural Gas and Crude Oil

In U.S. dollars



Notes: Latest observations: 27 May 2026 (TTF natural gas price), 27 May 2026 (Brent crude oil price).

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

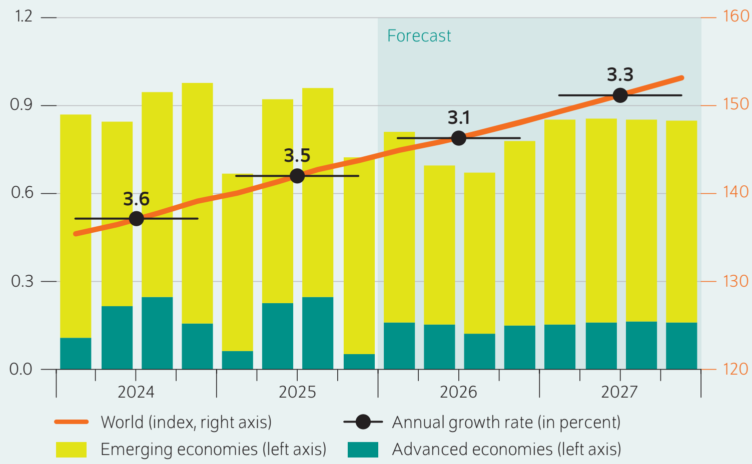
The Iran war has driven up oil prices in particular.

In the emerging economies, momentum remained robust at 1.2 percent but eased slightly compared with the previous quarter (1.3 percent). In India, growth slowed to 1.4 percent from 1.8 percent in the fourth quarter. Nonetheless, it remained robust, supported by solid domestic demand. Developments were mixed across the central and southeastern European EU member states: while Poland expanded again by 0.6 percent and Hungary, after a weak phase, also added 0.8 percent, Czechia lost considerable momentum (0.2 percent). In Romania, output stagnated. In China, growth accelerated slightly compared with the previous quarter to 1.3 percent, after 1.2 percent in the final quarter. Despite lower exports to the United States, exports supported the economy, in particular through shipments to ASEAN countries and the EU. In Brazil, momentum picked up after a weak final quarter and met expectations with a

Figure 4

Real GDP growth

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



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

The global economy is expected to grow moderately despite the energy price shock.

gain of 0.5 percent. In Mexico, by contrast, economic output contracted by 0.8 percent, after a strong rise in the previous quarter.

World trade expanded exceptionally strongly at the start of the year, with a quarterly gain of 3.4 percent (Figure 5). It was again supported by brisk trade in Asia and persistently high demand for technology-intensive goods, particularly semiconductors, which is largely driven by the ongoing AI investment boom. In addition, front-loaded shipments ahead of looming US export controls provided support. The war-related disruptions to maritime routes in the Middle East—diversions, longer transit times, and higher freight costs—only became noticeable in the last third of the quarter.

Consequences of the Iran War Cloud the Economic Outlook

For the second quarter of 2026, an attenuated expansion of the world economy is shaping up in view of the Iran War: global GDP is likely to grow by 0.7 percent, somewhat more slowly than in the first quarter (0.8 percent), with momentum likely easing somewhat in both the advanced economies and the emerging economies. The sharply higher energy prices are expected to weigh on private consumption. The present forecast is based on the expected price path for crude oil and natural gas derived from current futures markets. For the forecast horizon, the assumed oil price averages around 94 US dollars per barrel in 2026 and 81 US dollars per barrel in 2027. For natural gas, prices of 46 euros per megawatt-hour in 2026 and 38 euros per megawatt-hour in 2027 are assumed on annual average. While the price assumptions—particularly for crude oil—clearly exceed those of the spring forecast and reflect the war-induced tightening of energy supply, the fact that futures markets expect prices to decline again in the following quarters suggests that markets currently consider a lasting escalation or prolonged supply bottlenecks as rather unlikely.

Trade-policy conditions in the United States remain characterized by high uncertainty. The general tariff on US imports remains at ten percent; an announced increase to 15 percent has not yet been implemented. At the same time, the legal disputes continue: after the Supreme Court had already declared the tariffs previously based on the International Emergency Economic Powers Act (IEEPA) to be inadmissible, the US administration based the general tariff on Section 122 of the Trade Act of 1974. This legal basis permits temporary tariffs of up to 15 percent in the event of balance-of-payments difficulties. These tariffs, too, were recently declared unlawful by the US Court of International Trade. However, a fundamental departure from protectionism cannot be inferred from this—US trade policy is likely to continue to rely frequently on tariffs, although these will increasingly be embedded in formal investigation and review procedures. For trading partners, this is unlikely to mean a return to free trade and—given persistent legal uncertainties—also only limited additional planning certainty.

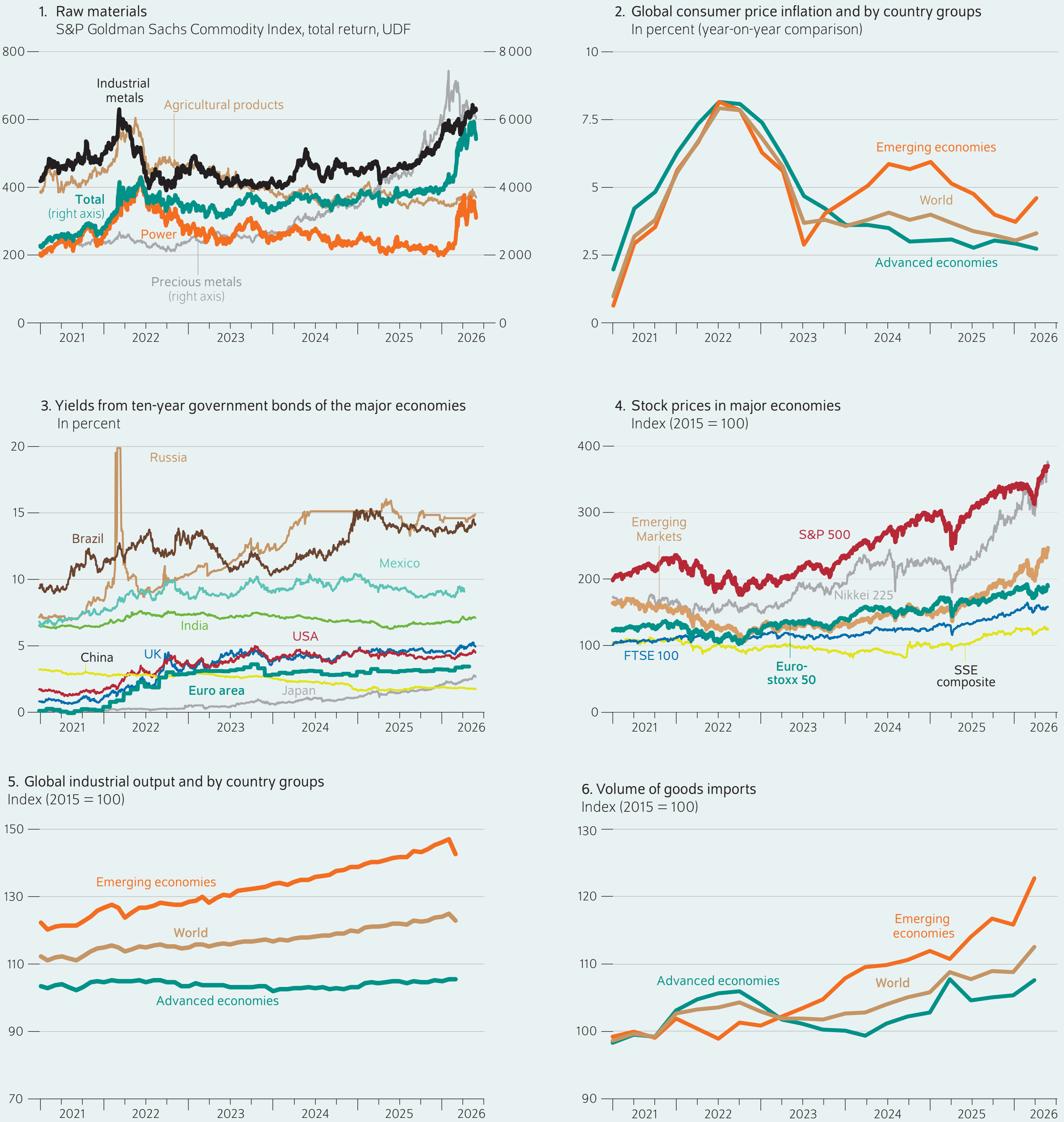
The present forecast assumes that the general baseline tariff of ten percent will remain in place over the entire forecast horizon and that bilateral trade agreements—including with the European Union—will continue. Sectoral tariffs, for example on cars, steel, and aluminum, are assumed to remain in force, and tariffs on cars and trucks are assumed to stay at 15 percent, as the originally announced increase was not implemented.

Leading indicators also point overall to a slightly weakening global economy. The global Purchasing Managers' Index lies clearly below the level seen at the beginning of the year but has recently picked up slightly. As a result of the Iran War, a two-tier picture has emerged: sentiment in manufacturing brightened markedly, while it deteriorated in services. The global manufacturing index rose to around 52.5 points and is therefore clearly above the expansion threshold of 50 points. The increase was particularly strong in the United States. Values also improved noticeably in Japan, South Korea, and China. The driving factor here is likely to be rising orders for capital goods, attributable above all to higher defense spending and persistently high AI investment. Services indices, by contrast, fell markedly with the outbreak of the Iran War: the global index dropped to around 51 points; in the euro area, the index fell sharply and now stands at 46.5 points, below the expansion threshold. High energy prices are likely to be passing through here, weighing on consumer-related services.

After the decline in the first quarter, economic activity in the euro area is expected to expand only moderately in the second quarter, by 0.2 percent, weighed down above all by

Figure 5

Global economic environment indicators



Notes: Last observations: May 27, 2026 (part 1 of figure); March 31, 2026 (part 2 of figure); May 26, 2026 (Euro Area April 30, 2026) (part 3 of figure); May 27, 2026 (part 4 of figure); March 1, 2026 (part 5 of figure); March 31, 2026 (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 World Trade Monitor.

high energy prices, which are negatively affecting household purchasing power. Exports are also unlikely to provide much support to growth. Since Donald Trump took office, the dollar has depreciated by around twelve percent against the euro. This makes imports cheaper but raises the cost of European exports. At the same time, European firms have lost their former tariff advantage on the US market since the abolition of the IEEPA tariffs: similarly low rates now apply to China and India as to European suppliers.[1]

The United States, by contrast, is decoupling from the global slowdown. Economic activity there is expected to gain further momentum in the second quarter of 2026, with an expected expansion of 0.7 percent. Expansionary impulses from the tax cuts in the *One Big Beautiful Bill Act* are likely to continue to support consumption, while higher energy prices weigh on it through purchasing-power losses. Exports are expected to benefit primarily from rising energy outflows, as the United States is replacing part of the lost supplies from the Middle East and is additionally supported by the weaker dollar. At the same time, the AI boom continues to drive investment activity. The exceptionally strong import momentum of the previous quarter is expected to normalize in the second quarter, so that net exports support growth overall.

Over the forecast horizon, an overall slightly expansionary fiscal stance is expected to support activity in many places. In the United States, the budget deficit is likely to remain high: in addition to tax cuts for businesses and households, the federal budget is also burdened by the refund of the IEEPA tariffs declared unlawful to companies. In Japan, too, the state deficit is expected to widen further, as the new government has departed from the previous austerity policy. Demand will be supported in particular by additional public investment and temporary tax relief. In the euro area, fiscal policy is overall likely to be slightly expansionary, attributable above all to Germany. In the United Kingdom, fiscal policy is also slightly expansionary thanks to measures cushioning higher energy and transport costs. These include in particular the extension of the existing fuel duty relief, support for energy-intensive companies, and measures for households such as temporary VAT cuts on certain products.

Labor markets remain robust in most advanced economies and are expected to bolster consumer demand over the forecast horizon with stable employment levels and rising wages. At the same time, signs of a gradual cooling are accumulating: employment growth is slowing, and the long-running decline in unemployment rates is coming to a halt. In addition to weaker demand and elevated uncertainty, the spread of AI—which is already dampening hiring dynamics in some areas—is likely to contribute to this.

Monetary Policy Likely to Be Slightly Restrictive Owing to High Energy Prices

In the wake of the Iran War, oil and gas prices have risen markedly and are already passing through to consumer prices. In the current quarter, inflation in the euro area has moved noticeably away from the two-percent mark and is expected to rise further in the coming months. For the current year, DIW Berlin therefore expects an annual average of 2.8 percent in the euro area and is raising its inflation forecast by 0.3 percentage points. In the coming year, the effects of the energy price increases are likely to fade gradually, so that inflation rates should ease slightly. Beyond energy, the Iran War is also expected to push food prices upward towards the end of the forecast horizon, additionally raising inflationary pressure and, alongside energy costs, weighing particularly on lower-income households. Around one-third of globally traded fertilizer, including around 35 to 40 percent of the world's shipped urea, passes through the Strait of Hormuz. At the same time, a building, strong El Niño event is expected to impair harvests this year.

Against this backdrop, monetary policy is expected to turn slightly restrictive over the forecast horizon. The deposit rate in the euro area currently stands at two percent and, after two further rate steps by the European Central Bank (ECB), is likely to be at 2.5 percent and thus in slightly restrictive territory by year-end. In the United States, the central bank Federal Reserve (Fed) is likely to wait initially despite persisting inflation risks. With a target range of 3.50 to 3.75 percent, monetary policy remains broadly in neutral territory. Without the recent sharp rise in price pressure—consumer price inflation stood at an annualized 3.8 percent in April—the Fed under its new chair Kevin Warsh, who had previously advocated lower interest rates, would likely have already initiated monetary easing. In the United Kingdom, the Bank of England is expected to end its rate-cutting cycle and respond to higher price pressure with an upward step.

Global Economy Expected to Develop Modestly in 2026 and 2027 in the Wake of the Iran War

The world economy is expected to continue expanding moderately over the forecast horizon to the end of 2027. While slightly expansionary fiscal policy in many places and the AI boom support demand, the Iran War weighs on cyclical momentum. The impacts are expected to vary regionally and will depend substantially on how strongly the respective region relies on energy imports.

The Iran War is also weighing on world trade. As the region's maritime routes are highly important for global trade, the war-related disruptions are leading to diversions, longer transit times, and higher freight rates. In addition, the energy price shock is driving up transport costs. As a result, the risk of global supply chain bottlenecks has risen again. However, these burdens are expected to be largely offset by brisk intra-Asian trade and lively trade in AI-related products. World

1 Before the abolition of the IEEPA tariffs, China and other third countries were subject to significantly higher US import tariffs than European suppliers. With the elimination of these country-specific punitive tariffs, broadly uniform rates now apply to all trading partners—the baseline tariff of ten percent based on Section 122 and the sectoral tariffs. The former relative tariff advantage of European suppliers on the US market has thus vanished.

Table 4

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	0.7	1.4	2.6	2.5	3.1	2.9	6.0	6.0	6.0	5.8
Euro area	0.9	1.5	0.3	0.9	2.4	2.1	2.8	2.7	6.4	6.3	6.3	6.1
… excluding Germany*	1.1	1.8	1.0	1.0	2.6	2.0	3.0	2.6	7.6	7.3	7.1	7.0
France	1.4	0.9	0.6	0.7	2.3	0.9	2.4	2.3	7.4	7.7	7.7	7.5
Italy	0.6	0.7	0.7	0.4	1.1	1.6	3.1	2.8	6.6	6.1	5.7	6.0
Spain	3.5	2.8	2.3	1.7	2.9	2.7	3.6	3.0	11.4	10.5	9.8	9.5
Netherlands	1.1	1.8	0.9	0.8	3.2	3.0	3.1	2.5	3.7	3.9	3.8	3.6
United Kingdom	1.0	1.4	1.2	1.3	2.5	3.4	3.4	2.7	4.3	4.8	5.5	5.1
Switzerland	1.4	1.3	0.9	1.5	1.1	0.2	0.7	1.0	4.0	4.3	4.7	4.5
Central and Southeastern Europe	2.1	2.5	2.1	2.8	4.0	4.1	4.1	3.1	3.7	4.0	4.1	3.8
Turkey	3.5	3.7	3.1	3.7	58.5	34.9	28.2	24.9	8.7	8.4	8.5	8.4
Russia[1]	4.9	1.1	1.0	0.6	8.5	8.7	6.9	5.3	2.5	2.2	2.3	2.5
The Americas												
USA	2.8	2.1	2.2	2.2	3.0	2.7	3.6	2.2	4.0	4.3	4.5	4.7
Mexico	1.1	0.8	0.6	1.8	4.7	3.8	4.5	3.9	2.7	2.6	2.9	2.8
Brazil	3.0	2.6	1.5	1.9	4.4	5.0	4.7	4.1	6.9	6.0	6.0	5.9
Asia												
Japan	-0.2	1.1	0.6	0.7	2.7	3.2	2.6	2.4	2.5	2.5	2.7	2.7
South Korea	2.0	1.0	2.4	1.7	2.3	2.1	2.6	2.1	2.8	2.8	2.9	2.9
China	5.0	5.0	4.4	4.4	0.0	-0.3	0.9	0.8	5.1	5.2	5.3	5.3
India	7.1	7.3	6.6	6.7	5.0	2.2	4.6	4.1	8.0	7.2	6.9	6.7
Total												
Advanced economies	1.8	1.8	1.5	1.7	3.3	3.0	3.6	2.4	4.4	4.6	4.7	4.7
Emerging economies	5.2	5.1	4.6	4.7	5.6	4.4	5.2	4.8	6.0	5.7	5.7	5.6
Global economy	3.6	3.5	3.1	3.3	3.9	3.3	4.1	3.3	5.7	5.4	5.5	5.4
For reference:												
Export weighted[2]	*2.3*	*2.2*	*1.9*	*2.1*								
GDP weighted in USD[3]	*3.0*	*2.9*	*2.6*	*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 2024 is used. The Central and Southeastern European countries include Poland, Romania, the Czech Republic, and Hungary.

Sources: National statistical offices; DIW Economic Forecast, Summer 2026.

trade momentum is thus expected to ease only slightly in 2026, to 3.9 percent. In 2027, growth of 1.9 percent is expected, roughly in line with the long-term average.

In the United States, momentum continues to be driven mainly by the ongoing AI investment boom. By contrast, residential construction is a drag, weighed down by persistently high mortgage rates and a cooling labor market. The sharp rise in energy prices in the wake of the Iran War weighs on consumer demand. At the same time, parts of the energy sector benefit from higher gas prices, as the United States is among the world's largest LNG exporters. The overall economic burden on the United States is therefore expected to remain limited. The men's FIFA World Cup in the summer is not expected to noticeably affect overall economic growth. Overall, the US economy is expected to grow by 2.2 percent in both this year and next.

In the euro area, growth of just 0.3 percent is expected this year—a downward revision of almost a full percentage point compared with the spring forecast. The increased energy costs weigh on household purchasing power on the one hand, dampening private consumption. On the other hand, they raise production costs, particularly in energy-intensive sectors, which is likely to depress willingness to invest. Public investment in infrastructure and defense provides support. In 2027, somewhat stronger expansion of around 0.9 percent is expected, driven mainly by declining energy prices.

In China, domestic activity is likely to remain subdued in view of the ongoing weakness in the real estate sector. Higher energy prices are also expected to weigh on consumption, as the country relies heavily on energy imports. However, China covers the bulk of its oil imports through discounted supplies from Russia and thus has geopolitically more favorable alternatives than other importing countries. The greatly expanded share of renewable energy also reduces dependence on fossil imports. Exports, particularly in green technologies, also lend support. The recently stronger shipments to the EU and ASEAN countries, however, could increasingly trigger trade-policy countermeasures. The Chinese economy is expected to grow by 4.4 percent in both this and next year, thus remaining slightly below the target corridor of 4.5 to 5.0 percent set by the Chinese government.

Overall, economic growth of 1.5 percent is expected in the advanced economies this year and 4.6 percent in the emerging economies. The global economy is expected to grow by 3.1 percent this year and by 3.3 percent next year (Table 4). The current forecast is thus 0.2 percentage points lower for this year than in the spring, primarily on account of the higher energy prices. The forecast for next year was left unchanged.

Further Escalation of the Iran War Remains the Greatest Risk

The outlook for the world economy remains subject to substantial risks. The main downside risk arises from a further escalation of the Iran War: a longer-lasting blockade of the Strait of Hormuz and further attacks on refining capacities would push energy prices up more sharply and persistently than assumed in the present forecast—with a correspondingly dampening effect on purchasing power and global activity. In addition, fertilizers and their precursors are transported via the Strait of Hormuz. A prolonged closure would therefore also drive food prices further up via higher production costs in agriculture. This would substantially erode purchasing power, particularly in the emerging economies, and thus weigh on private consumption. Moreover, supply bottlenecks for helium could affect global chip production: helium is an essential input for semiconductors and is a byproduct of LNG production. Qatar alone accounts for around one-third of global helium production. The AI investment boom—which in this forecast is a pillar of global activity—would also be slowed.

Energy and food inflation additionally raise the risk that households lose trust in central banks' two-percent target. As the last major inflationary surge is still recent, households and businesses respond particularly sensitively to renewed price increases. Should expectations become unanchored, central banks would be forced to tighten monetary policy more sharply than currently assumed, with correspondingly dampening effects on investment, the labor market, and private consumption.

In addition to the geopolitical risks, there are also medium-term risks from the spreading use of AI, which could weigh on the labor market. While the high investment in AI is currently substantially supporting the global economy, the increasing spread of AI-based applications could lead to substantial job displacement. Crowding out workers would slow wage and income dynamics and thereby weaken private consumption.

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JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook