

Global outlook weakens on Iran war; risks elevated

In this Issue

Overview

- The global economy entered 2026 on a solid footing. Ahead of the escalation of conflict involving Iran, the S&P Global composite PMI was at its highest level since mid-2024. A rebound from the Q4 impacted government shutdown and fiscal stimulus was expected to support US growth, domestic demand has been solid in the Euro-zone and Japan with further fiscal support to come, while China activity indicators strengthened over January/February. Financial conditions were also broadly supportive.
- The conflict in the Middle East represents a negative but highly uncertain shock to the global outlook. Its significance lies in the region's central role in global energy supply. Our baseline assumes oil prices remain elevated in the near term but ease as disruptions partially unwind, with Brent settling around USD\$80 per barrel in coming weeks. On this basis, global growth is expected to be around 3.2% in 2026 and 3.1% in 2027, modestly lower than previously forecast. Risks are skewed to the downside should energy prices remain higher for longer. If oil prices were to track at around \$US100/barrel for the rest of this year, before easing in 2027, then quarterly yoy growth could dip towards 2.5% yoy.
- Net energy importers — particularly Japan, India and parts of Europe — face the largest growth headwinds, while energy exporters such as the US and Canada are better positioned, though still exposed as higher energy prices will still drag on many parts of their economies and via confidence, financial market and external demand channels.
- Uncertainty around US trade policy remains elevated. While the recent SCOTUS ruling has temporarily lowered average tariff rates, it does not materially alter the medium-term outlook. Any small gain from the lower tariffs will likely be offset by the increased uncertainty faced by business. Trade flows may also swing around in coming months as exporters seek to get ahead of attempts by the US to rebuild its tariff structure.
- For central banks, higher energy prices lift near-term inflation but weigh on growth, reinforcing a cautious approach and implying fewer, more conditional rate cuts if not the possibility of rate hikes. We have pushed back our expectations for the timing of Federal Reserve and Bank of England rate cuts. For the Fed, we now expect the next rate cut will be in Q4, and again in Q1 2027 (previously Q2 and Q3 2026). Core PCE inflation has been uncomfortably high in recent months, and the Fed will need to see evidence inflation is on a sustainable path back to target. It will also need to be assured that inflation expectations remain anchored even as energy prices rise, which will take time to assess.

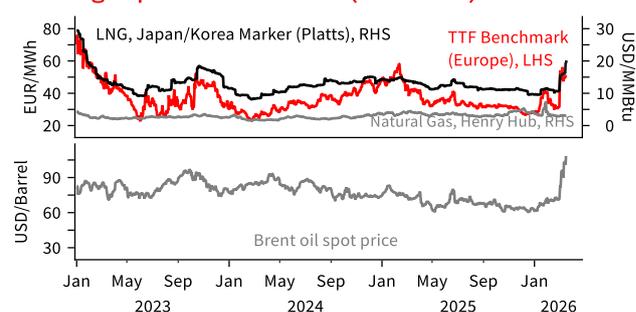
Overview	1
The conflict in Iran	2
United States	4
China	5
Euro-zone	6
United Kingdom	6
Canada	7
Japan	8
India	8
Central Bank Monitor	10
Economic Forecast Detail - Advanced Economies	11
FX Forecasts	11

Key Economic Forecasts

(Change since previous Forward View in brackets)

	2024	2025		2026		2027	
US	2.8	2.1	(-0.1)	2.3	(-0.3)	1.9	(-0.1)
Euro-zone	0.9	1.5		1.2	(-0.2)	1.3	(-0.2)
Japan	-0.2	1.2	(0.1)	0.7		0.6	(-0.1)
UK	1.1	1.3		0.8		1.0	(-0.1)
Canada	2.0	1.7		1.0	(-0.1)	1.7	
China	5.0	5.0		4.6		4.2	
India	7.2	7.5	(-0.2)	6.5		6.5	
Latin America	2.4	2.3	(0.1)	1.8		2.0	
Other East Asia	4.0	4.2	(-0.1)	4.2	(-0.2)	3.4	(-0.2)
NZ	-0.3	0.3		2.4	(-0.1)	2.3	
Global	3.3	3.5		3.2	(-0.2)	3.1	(-0.1)
Major trading partners	3.5	3.8	(0.1)	3.6	(0.3)	3.2	(0.1)

Oil and gas price benchmarks (2019 = 100)



Source: National Australia Bank, Intercontinental Exchange (ICE), CME Group, Energy Information Administration (EIA), Macrobond

The conflict in Iran

A negative but very uncertain shock

The conflict between US/Israel and Iran is a negative for global economic growth. By how much is highly uncertain and will depend on how the conflict evolves from here. While Iran is only a small part of the global economy (0.8%), the region’s importance to global energy supply—and the Strait of Hormuz as a critical shipping chokepoint—means even limited disruption can have outsized global effects.

Around a quarter of the world’s seaborne oil trade passes through the Strait of Hormuz, with few viable alternatives, and roughly a fifth of global LNG trade is also exposed. This area is a significant source of urea and sulphur, both key ingredients in fertiliser production. Sulphur is also utilised in making sulfuric acid, an essential industrial chemical. All these products have experienced substantial price hikes.

Since the war began, despite swinging wildly, Brent crude has averaged around US\$92/barrel (based on closing prices) – up from US\$64 in Q4 2025. Gas markets, particularly in Europe and Asia, have also seen large moves (see chart on page 1).

At a high level, potential **exposure to this war is jointly determined by energy independence and intensity**. The heatmap below maps economies across these dimensions using a range of metrics. It indicates that net energy importers (Japan, EU, UK and India) on average are more exposed to the Iran war than their net energy exporter counterparts (US, Canada and Australia). Asian economies such as Japan face the greatest downside given high energy intensity and dependence on imported energy, while Europe is less exposed due to its lower energy intensity. However, these metrics aren’t perfect: US’ performance is undersold given its strong domestic gas production (and with US gas prices little impacted so far) while Australia’s is oversold given almost all oil products are sourced from the middle east indirectly via Asian refiners (with practically no domestic refining capacity).

Energy security heatmap (ordinal rankings)

Metric name	JPN	EU	UK	IND	CH	US	CAN	AUS
Electricity production from oil and gas (% of total)	7	5	6	2	1	8	3	4
Energy intensity of GDP	4	3	2	5	7	6	8	1
Most recent energy weight in CPI	6	7	2	3	N/A	5	4	1
Net energy imports (% of energy use)	8	7	6	5	4	3	2	1
Effective days of oil reserves	4	5	6	8	3	1	1	7
Middle east crude oil imports in 2024 (% of total)	8	4	4	6	7	2	3	1
Middle east refined oil imports in 2024 (% of total)	7	4	4	8	6	3	1	2

Source: National Australia Bank, World Bank, BP, IEA, Energy Institute, Macrobond
 Note: China does not publish an energy CPI weight. Middle east oil import figures do not delineate between EU/UK nor AU/NZ.
 For all metrics except effective days of oil reserves, a lower number implies a higher rank.

Will weigh primarily on demand

Higher energy costs will feed into higher prices for businesses and households, weighing on consumption and investment. The timing and magnitude of pass through will vary by country depending on whether energy is purchased under long term contracts or not, the extent of government gas/petrol subsidies and price controls.

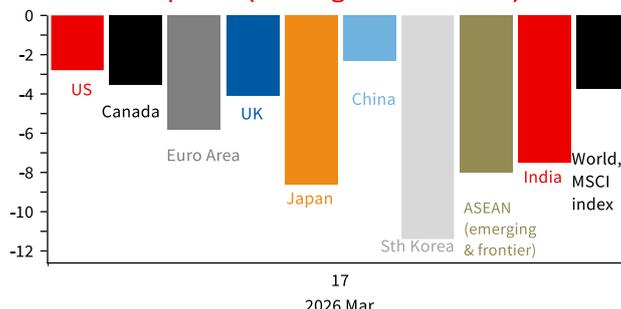
For energy producing countries there could be some offset through higher profits for energy companies or government revenue, and potentially greater investment. However, the latter could be limited in an environment where there is potential for the energy price rises to be only temporary. More broadly the elevated uncertainty about the outlook could also weigh on investment.

There is also **the potential for shortages in downstream products**. Countries which struggle to source gas/oil may see interruptions in domestic energy production. For example, [reports](#) suggest that Taiwan has stores of natural gas sufficient for only eleven days. While the government is already taking steps to ensure electricity generation is not disrupted, if it was, this could impact semi-conductor production (and the global investment in AI).

Two other broad channels which could amplify the impact of the conflict are sentiment and financial markets. It is too early to assess the impact of the conflict on sentiment, although advanced economy measures of consumer sentiment did fall when Russia invaded Ukraine and energy prices rose.

There has been some tightening in financial conditions. Equity prices have declined, though the impact has been uneven. The impact in China and North American markets has been muted, while other parts of Asia such as South Korea have seen larger falls. However, it is still up over the last six months, as are most major stock markets.

Share market prices (% change since 28 Feb.)



Source: National Australia Bank, S&P Global, Toronto Stock Exchange, FTSE Russell, Nikkei Inc., Shanghai Stock Exchange, KRX Korea Exchange, MSCI, Bombay Stock Exchange (BSE), Macrobond

Bond yields have also risen on fears of higher inflation, the potential for adverse impacts on Government budgets and an associated **lift in market expectations for central bank rates** (relative to their pre-conflict levels).

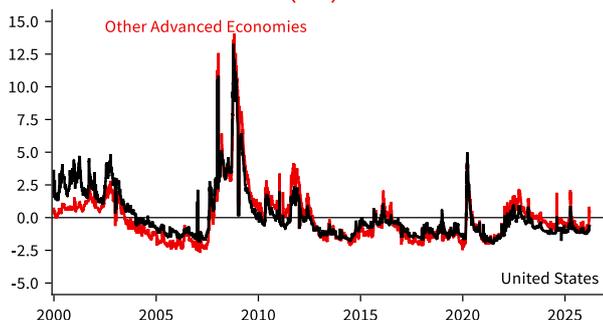
An energy shock will push inflation higher but is a negative for growth and labour markets, so **creates a tension between the two mandates many central banks navigate**. The textbook approach is for central banks to ‘look through’ supply side driven increases in the price level, but this assumes there are no ongoing inflationary impacts and, relatedly, well-anchored inflation expectations.

Due to recent experience, central banks may be more sensitive in this regard, particularly where inflation has been persistently above target (US, Canada, UK) but how they assess the impact on labour markets will be important. For many countries, market pricing for central policy rates now sees a higher level of rates (either few cuts – e.g. the Fed, or rate hikes as for the BoC, ECB and even the BoE) than was the case before the war.

The response by central banks, if the shock to economies is seen as large enough to materially raise the risk of a recession could be different. Such a scenario could ultimately be deflationary. In this case, they could move to cut rates depending on their assessment of the 2nd round inflationary impacts and the need to anchor inflation expectations.

Broader measures of financial stress have also increased since the war began. This can be seen in the OFR financial stress index for advanced economies (ex US) although the US stress indicator has not significantly changed. While for the former it is a material move, the index remains below other major risk-off events (e.g. ‘Liberation Day’ tariffs, Ukraine - Russia war), at the time of writing.

Financial Stress Index - Global (OFR)



Source: National Australia Bank, The Office of Financial Research (OFR), Macrobond

Producing a global outlook downgrade

In a [note last week](#), we outlined several possible oil price scenarios. **One scenario – which underpins our baseline forecasts** sees Brent settle at \$US80/barrel in 2-3 weeks’ time, as a de-escalation of the conflict allows shipping to resume in the Strait of Hormuz but at lower volumes than previously. In the next few weeks however, it is likely to trade materially higher.

Alternative, but seen as less probable, scenarios were for a full de-escalation in coming weeks (\$US60-70/barrel) and at the other extreme Brent sustains at >\$120/barrel as the war escalates, with no progress on shipping for over a month.

International Energy Agency members have [agreed to release 400m barrels of oil](#) from their reserves (from total emergency stockpiles of 1.2b). However, oil prices subsequently moved higher, reflecting this is a finite measure and not a permanent fix to the situation. In addition, news that merchant vessels were attacked, touching \$100US/barrel, illustrates that the key for oil prices to ease from here depends on a de-escalation of the war and a resumption of shipping activity.

Research suggests that a supply driven oil shock detracts 0.1-0.2% from GDP for a 10% rise in the oil price (with a bias towards the higher end of that range), but higher for emerging market (EM) economies. The greater exposure of EM economies reflects that many have lower emergency oil reserves and, in a risk-off environment, concerns over capital outflows, coupled with less well-anchored inflation expectations, can force tighter policy settings relative to advanced economies. They also have less ability to compete for scarce energy sources.

A new baseline where in a couple of weeks oil settles at around \$USD 80/barrel is around a 25% price increase from our previous forecast assumption. Mechanically, this would

suggest a reduction in our global forecasts of around 0.25 to 0.5% of GDP, or more, over time.

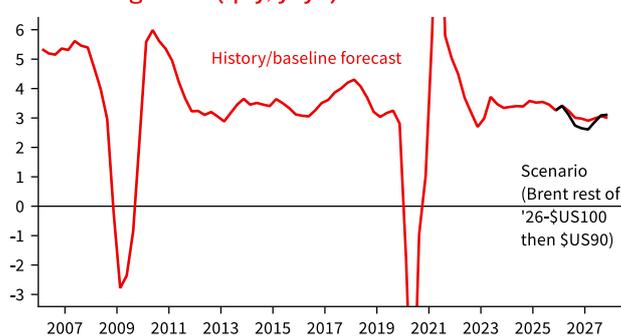
However, the impact will depend on a range of factors, including how sentiment and financial market conditions evolve. Financial market stress to date has been relatively contained, particularly the closer oil prices have been to our baseline assumption. Governments are starting to respond; in Asia a mix of fuel rationing, price caps and subsidies are being put in place. At a global level subsidies/caps do not offer relief (they will push oil prices higher), but policies that reduce demand may be more effective.

The impact on GDP for a given move in energy prices could become greater as prices move higher (i.e. the relationship is non-linear). Were prices to climb to a very high level – e.g. to \$120/barrel – which raises recession concerns then risk aversion and financial market stress could become major headwinds, and any incipient weakening in activity self-reinforcing. The downstream risks of manufacturing disruptions and broader supply chain disruption also rise in this scenario.

Accordingly, we have made only modest changes to our forecasts for now, which also incorporate adjustments relating to the regular data flow but global growth, based on our baseline scenario, is now expected to be 3.2% in 2026 and 3.1% in 2027 (previously 3.4% and 3.2% respectively).

Clearly though there is considerable uncertainty around any point forecast at this time, and risks are tilted to the downside for growth relative to our baseline assumption. **The chart below illustrates how an extended period of oil prices at around \$US100/barrel might impact global growth.** For this scenario we assume Brent trades at \$US100/barrel for the rest of the year before moving down to around \$US90/barrel in early 2027. Year average growth in this scenario is down a further -0.2 ppts to 3.0% in 2026. However, in quarterly yoy terms, there is a more pronounced dip in growth to a bit above 2.5%. If this scenario (and estimated impact) was realised it would be the slowest period of growth since the GFC (excluding the COVID shutdowns).

World GDP growth (qtl, yoy%)



Source: National Australia Bank, Macrobond. COVID extremes removed from y-axis

Even in this scenario recession risks are not particularly high. **Recession risks across some of the major economies would start to become materially elevated if oil prices were to sustain at a level north of \$US120/barrel** (with a commensurate increase in gas prices).

United States

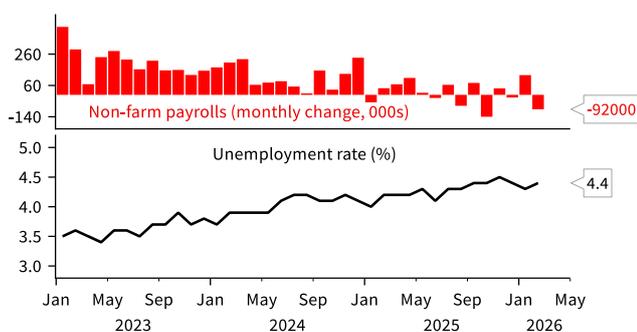
Activity data, covering the period ahead of the war with Iran, overall, still point to an economy exhibiting solid growth. While the US is a net energy exporter, growth is still likely to be negatively impacted by a lift in oil and other product prices caused by the war, but the stimulus from the OBBBA budget bill will provide an offset.

Trade policy also remains a source of uncertainty. In February the US Supreme Court ruled tariffs instituted under the International Emergency Economic Powers Act (IEEPA) to be invalid. In response, the administration has used Section 122 of the Trade Act of 1974 to put in place a flat 10% tariff globally. For now, this leaves tariffs at a lower level than they were before the supreme court decision, but in fiscal terms, the impact is not large. Refunds of around 0.5% of GDP will need to be paid, but as this will be a windfall to importers it is likely to have a low pass through to activity.

As Section 122 tariffs have a 150 day limit the administration moves to re-establish its earlier tariff framework using other legal instruments. Two separate Section 301 investigations were started this month - one targeting manufacturing over production and excess capacity, and a second focused on goods produced with forced labour. For the former, the countries covered represent around 75% of US imports.

US Q4 GDP was revised down to 0.7% qoq (annualised), from 1.4%. This partly reflected a weaker net export contribution, but household consumption, private investment and government demand were all marked down. Growth over 2025 is now estimated to be around trend at 2.0% but down from 2024 (2.4%). **We expect GDP to bounce back in Q1,** to 2.8% qoq annualised in Q1, assisted by a re-opening of the Federal government and the OBBBA tax cuts.

US labour market indicators



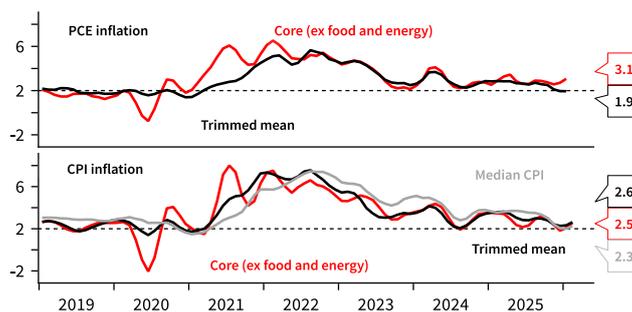
Source: National Australia Bank, U.S. Bureau of Labor Statistics (BLS), Macrobond

Indicators generally point to a stabilising labour market. Employment growth has cooled but not collapsed: a weak February payrolls print (-92k) followed stronger January outcomes, leaving only modest gains overall. However, this is largely being matched by weaker labour supply. As a result, the unemployment rate has risen only marginally to 4.4% (+0.1 ppts). Forward indicators have been mixed implying no significant change in momentum: a decline in job openings as per the JOLTs survey has been countered by stability in the Indeed indicator and jobless claims.

We have lowered our 2026 growth forecast to 2.3% from 2.6%. This reflects the downward revision to Q4 GDP as well as allowing for a modest negative impact from the rise in

energy prices. We still expect the unemployment rate to be broadly stable from here, but the risk that it weakens further has increased.

Core inflation measures (3mth/3mth annualised %)



Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Federal Reserve Bank of Dallas, U.S. Bureau of Labor Statistics (BLS), Federal Reserve Bank of Cleveland, Macrobond

Inflation outcomes have, overall, been disappointing and the rise in energy prices will add to inflationary pressures.

While core CPI was contained in February at 0.2% mom, the details point to a 0.4% mom rise in February core PCE inflation, following a 0.4% rise in January and 0.3% in December. Core services ex housing inflation remains high while goods prices are still feeling tariff and USD impacts. Overall, quarterly core PCE inflation is on track for its highest outcome in two years. The only consolation is that trimmed mean inflation (to January), an alternative underlying inflation measure, has softened. Reflecting the early data for the year, and movements in energy costs, we have revised up our headline and core PCE inflation forecasts for Q4 2026 to 2.9% and 2.8% yoy (from 2.3 and 2.5%) respectively.

The Fed made no change to the federal funds rate target range at its March meeting. Median fed projections for GDP were revised up out to 2028 (likely a productivity story), the end 2026 unemployment rate was seen as unchanged (4.4%) but still above its longer-term level, while core PCE inflation was edged up in both 2026 (2.5 to 2.7%yoy) and 2027 (2.1. to 2.2%). The median fed funds rate projection was unchanged with one 25bp cut seen in each of 2026 and 2027.

In his press conference, Powell indicated that a large part of the above target inflation (0.50-0.75ppts) was due to tariffs and their impact should start to fade from mid-year. He noted that ‘looking through’ the oil price shock depends on inflation expectations not moving. As with January, the committee discussed whether the next move in rates could be up, but Powell indicated that this was not the baseline view of the ‘vast majority’ of participants.

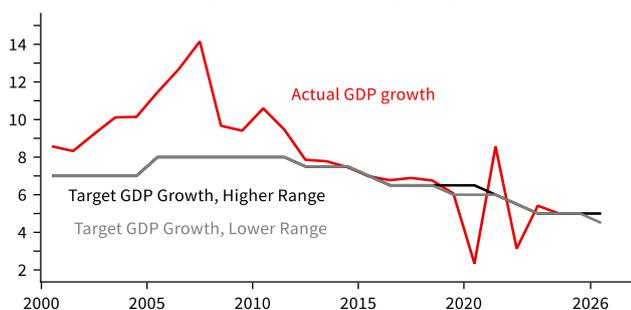
We had been expecting the Fed to cut rates in June and September, but we now expect these cuts to be delayed, with the first move in Q4 2026 and then again in Q1 2027.

We still see rate cuts as the next likely move as most Fed members see the policy rate as restrictive. Core inflation should ease over time given moderate wage, and robust productivity, growth and the unemployment rate is above the Fed’s view of its longer-term level. Upside risks around this view are that recent high inflation prints are flagging that inflation is going to be stickier than we expect, or rising energy prices feed more into core inflation than we anticipate or shifts inflation expectations higher. Earlier rate cuts could arrive if the labour market cools further on war impacts, given Fed sensitivity to labour market weakness.

China

At this month's **14th National People's Conference a 2026 growth target of 4.5%- 5.0% was set**, compared to 5% for 2025. The Government is focussed on building more advanced industry capacity with a focus on emerging 'pillar' industries, including integrated circuits, aviation and aerospace, biomedicine, new types of energy storage and robotics. Some of these pillars are expected to support more traditional sectors (e.g. through modernisation).

China, Growth targets (year average % growth)



Source: National Australia Bank, China National Bureau of Statistics (NBS), China National Development & Reform Commission (NDRC), Macrobond

Fiscal support is not projected to be significantly different from last year. The fiscal deficit is projected to be 4% of GDP – unchanged from last year – and while estimates of broader measures of the budget suggest some stimulus, it is smaller than last year. A total of 250 billion yuan in ultra-long special treasury bonds will be earmarked for consumer goods trade-in programs (noting this program ran last year), with another **100 billion yuan for a package** of 'coordinated fiscal and financial policies to support private investment and consumer spending'. There is also an increase in the policy bank funding support to 800b yuan (from 500b last year) which is aimed at bolstering investment.

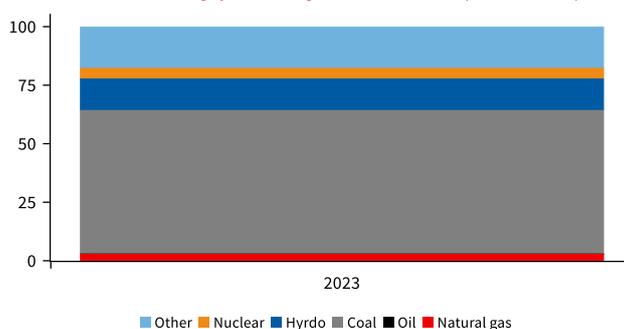
While expanding domestic demand is still considered a 'top priority', this focus on industrial development means any major changes in household consumption are unlikely, particularly given the soft labour market and ongoing property market downturn.

This means that **exports, and industrial production, will need to remain a growth driver.** This was given support by the January/February trade data (noting they are combined to reduce Lunar New Year distortions) with exports rising 21.8% yoy, from 6.6% yoy in December. Imports also rose strongly (19.8% yoy up from 19.8% yoy) so the net trade boost will be smaller. Export growth has been broad based outside of the US, with large increases to other Asian economies (ex Japan), the EU, Latin America and Africa.

This raises the risk of protectionism in these markets, but to-date action has been limited. The replacement of US IEEPA tariffs with s122 tariffs of 10% means that **tariffs barriers have been temporarily lowered for Chinese exporters.** With the US administration indicating its intention to rebuild its tariff structure this may be short lived – this week the USTR launched a s301 investigation that includes China, but a temporary boost in exports looks possible in the meantime.

Developments in the middle-east, and the rise in energy prices, are a downside risk to the Chinese economy – export driven growth will be hard to sustain if global downside risks are realised, **although at this point the change to our baseline forecast is modest.** China's economy is relatively energy intensive, and it is also a net energy importer sourcing a large proportion of oil from Gulf countries. Mitigating these factors, it has a large strategic oil reserve, its imports of energy are diversified and its electricity generation does not rely heavily on gas or oil. Its refiners have been told to halt exports – essentially a risk transfer to other countries.

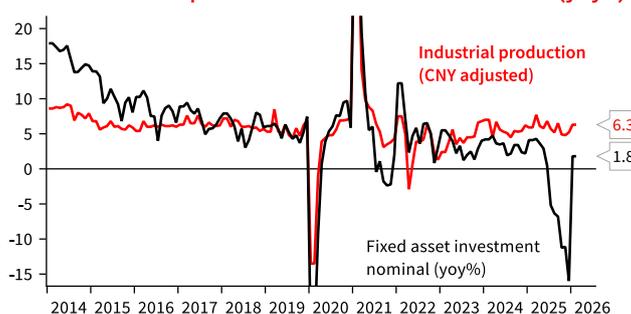
China - electricity prodn by fuel source (% of total)



Source: National Australia Bank, World Bank, Macrobond

Partial activity data for January-February saw a notable strengthening. Industrial production grew by 6.3% yoy (up from 5.2%) while there was a sharp upwards correction in fixed asset investment growth, which was 1.8% yoy compared to -16% in December. The reflected stronger outcomes across the three main categories – manufacturing, infrastructure and real estate, although the latter is still seeing negative growth. Retail sales growth also improved, but remains soft, growing 2.8% yoy, up from 0.9%, but this partly reflects price impacts (as CPI inflation also increased).

China industrial prodn. & fixed asset investment (yoy%)



Source: National Australia Bank, China National Bureau of Statistics (NBS), Macrobond, Account in-house. Scale truncated for COVID extremes

We have left our forecasts for Chinese GDP unchanged – we expect growth of 4.6% in 2026 and 4.2% in 2027. While the Iran-US/Israel war is a risk, our baseline view has not changed enough to represent a material drag on exports, and the turnaround in activity data for January/February suggests a stronger starting point than we had been expecting. Exports continue to grow strongly and will likely underpin growth. However, with fiscal support more limited than in 2025, and with domestic demand growth likely to remain relatively weak, in part due to the ongoing housing market downturn, we remain comfortable with a forecast a little below the mid-point of the Government's growth target.

Euro-zone

The Euro-zone has been experiencing **robust domestic demand supported by a healthy labour market and strong household balance sheets. These factors will help the Euro zone as it enters a difficult period of higher prices and headwinds to economic growth from the war in the Middle East. We expect the ECB to sound hawkish, but ultimately hold off hiking rates, unless the rise in energy prices is more prolonged.**

Final Q4 GDP data revised down Euro-zone growth to 0.2% qoq from the initial 0.3% rise and to 1.2% yoy. The outturns were a tenth below our forecast with the main reason for the underperformance being Ireland, which fell 3.8%. Against the disruptions and uncertainty stemming from 2025 trade tariffs, this was a positive outcome.

Domestic demand expanded by a strong 0.4% qoq, ex-stocks. While inventories and net trade were both negative, each shaving 0.1ppts off growth and investment growth at 0.6% was half its Q3 strength, private consumption picked in the final quarter to 0.4%, double the Q3 pace. **The backdrop here remains supportive with (to now) higher real incomes, stable wages and a healthy labour market.**

While the pace of employment has slowed and unemployment in Germany remains a focus, there is strength in labour markets such as Spain and other South European economies. Overall, unemployment remains historically low. Downward pressure on real incomes is likely as inflation rises in line with energy costs, but household balance sheets remain in good health, and the savings rate is elevated, which may soften the impact on consumption.

Recent data remains mixed. Retail sales volumes declined in December (-0.5% m/m) and January (-0.1% m/m), while industrial production also continued to post negative outturns at -0.6% m/m in December and -1.5% in January. The S&P Global composite PMI eased in December and January but accelerated again in February to 51.9 maintaining a fitful recovery back towards almost 53 highs last November. However, economic sentiment in the European Commission's indicator pulled back from near three-year highs in February.

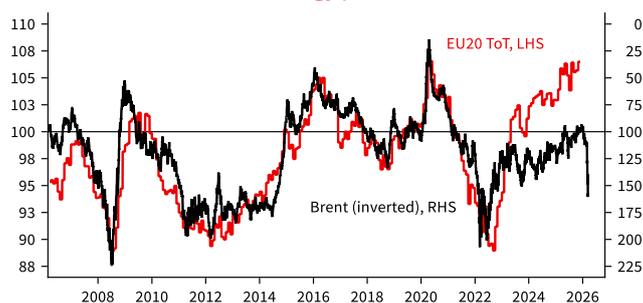
Reported progress on Mario Draghi's recommended reforms continues but remains painfully slow. Looking across a range of initiatives and reform areas such as competitiveness, the regulatory environment, Single Market integration, the Savings and Investment Union, AI adoption, R&D, relative energy prices, critical minerals, the productivity gap to others, there is a grudging acceptance that the pace is too slow. The proposed two-speed Europe 'E6' initiative that involves Germany, France, Italy, Spain, the Netherlands and Poland and is aimed at allowing a 'coalition of the willing' to advance specific projects will need to demonstrate tangible results.

The combination of stronger household balance sheets, a higher level of savings and still healthy wage growth puts the EZ in a reasonable position to weather the incoming challenges from the war in the Middle East. While the euro has pulled back from 1.20, it retains strength that will help

with higher prices. Resilience in Europe's southern economies and increased fiscal spending in Germany in particular will all help out with an expected negative impact in growth. We have lowered our 2026 forecast to 1.2%, but much depends on the duration of the crisis.

This is not 2022 where the EZ's terms of trade suffered hugely. The EU has significantly altered its energy consumption behaviours with renewables accounting for a greater proportion of energy usage. That said with monetary policy at the lower end of neutral, the ECB will want to ensure its messaging conveys vigilance and a willingness to act if needed. We expect hawkish messaging that might surprise some, but for now, it will be just talk.

EU20 terms of trade and energy prices



Source: National Australia Bank, Eurostat, Energy Information Administration (EIA), Macrobond
Note: Monthly price indices are unavailable for Europe, so unit values are used to approximate ToT. All values are indexes and rebased where 2019 = 100.

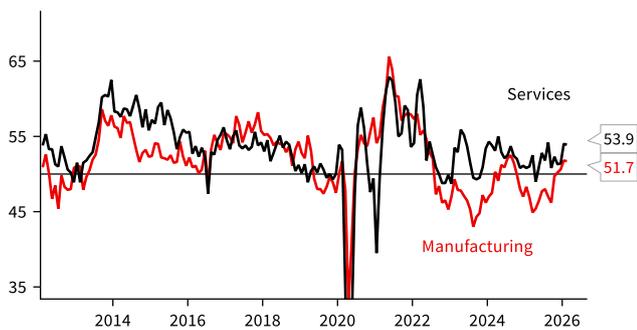
While latest inflation data for February has been revised up to 1.9% yoy at the headline level, thoughts will be of this moving further above 2% over the coming months. Markets are starting to price a hike as early as June and even April might turn live. Our previous forecast was of unchanged rates in 2026, but where the risks were skewed to a cut on a combination of EUR strength and China exports into Europe putting downwards pressure on prices. **We think rate hikes can be avoided if the crisis de-escalates relatively soon or growth is materially impacted.** However, expect the ECB to sound like it wants to take policy back towards 2.5% in the coming months.

United Kingdom

Against expectations that UK economic growth would improve in the early part of 2026 following a lacklustre 2025, **monthly GDP data for January underwhelmed.** There are reasons to suspect some of the January weakness will rebound, however prolonged poor weather is likely to have acted against certain sectors and now **the war in the Middle East with its attendant higher energy prices, threatens to usher in fresh headwinds.**

We have previously noted the UK economy would improve in early 2026 on its lacklustre 2025 performance as the factors driving that weakness – worries over tax rises in the lead up to last November's Budget and the plunge in manufacturing following the Jaguar Land Rover cyber hit – faded. Households and businesses also had reasons to be more cheerful with inflation expected to drop markedly to around 2% this spring, aiding further interest rate cuts.

UK PMIs



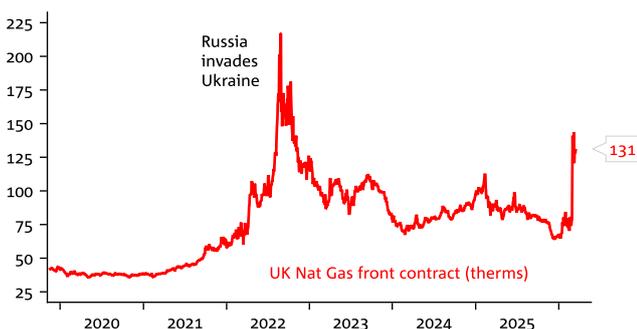
Source: National Australia Bank, Account in-house, Macrobond

The PMI for January and February had foreshadowed an improvement, with the important services PMI accelerating from 51.4 in December to around 54. Meanwhile manufacturing activity has rebounded from 50.6 in December to 51.7 and 51.8 for the first two months of 2026. It was a surprise therefore that **monthly GDP growth for January was zero**, with 3m/3m growth of only 0.2%.

Looking at some of the drivers of the weakness in January GDP data **there is the prospect of a rebound in February data**. Improved mining and oil production could also help, though the latter will likely require better weather. The extremely wet first two months of the year will have weighed on construction and hospitality activity. In line with that, services sector growth also under-achieved at 0% m/m.

The flat m/m services reading came despite strong retail sales growth in the month of 2%. That probably suggests a weaker payback in February and from then on, the UK will be in the grips of the impact of the Middle East war. While UK households have a relatively high savings rate, which could be used to absorb price increases, elevated uncertainty might mitigate against this.

UK gas prices



Source: National Australia Bank, Macrobond

UK households are shielded to some extent from the immediate impact of higher utility energy costs via the government's price caps, which will actually lower energy prices in April until July. Those who rely on heating oil – a relatively small percentage of the total and which is not covered by price caps have been offered around £50 in a £50m government assistance package. That compares to the £60b that was the size of government's mainly gas and electricity energy bailout of 2022.

With higher defence spending hanging over it and little fiscal headroom, the UK simply does not have the capacity to offer

2022-style energy bailouts. Tax increases in the last two budgets leave the UK in a tight spot without spending cuts or reforms elsewhere – something the government has been unable to facilitate so far.

Of course, the pass-through of higher petrol, diesel and other refined products will push up prices more quickly. Markets have removed the 60bps of rate cuts priced by end 2026 and now price 10-13bps of hikes by September. **It is the UK that has undergone the largest such swing in 2026 rate expectations**, as well as seeing the largest rise in 10-year and longer-term rate rises, that markets are factoring in as a result of anticipated increased fiscal spending. UK 10-year yields have risen 47bps since late February.

Driving this inflation scepticism and bond underperformance is a combination of some political risk and the UK's post-Covid high and stubborn inflation experience, that leaves some members of the BoE MPC fearing inflation scarring and a susceptibility to second-round effects. Base effects and government initiatives will bring **UK headline inflation down in April's release to around 2.5% but will likely now head back above 3% in H2 through to well into 2027**.

With still weak economic growth (our forecast is now 0.8% for 2026) and a labour market that continues to loosen, we do not currently see the BoE raising rates. **Our April and September rate cut calls have been pushed out to one in Q4 and one in early 2027**. While we expect the BoE to sound like it will take some convincing to ease again, the risks are skewed to rate cuts forecasts being brought nearer again, especially should the Middle East crisis ease sufficiently, or economic growth and the labour market weaken further.

Canada

Growth in Canada remained volatile through 2025, shaped by difficult US trade negotiations and very weak population growth. Inflation, however, looks contained alongside modest labour-market improvement.

Canada Domestic Final Demand (% tty)



Source: National Australia Bank, Statistics Canada, Macrobond

Q4 GDP contracted 0.6% q/q annualised. While a sharp inventory drawdown exaggerated the weakness, domestic final demand still shows a clear loss of momentum throughout the year. Looking forward, early Q1 signals are mixed with PMIs and the housing pipeline showing some stabilisation, but the advanced monthly GDP estimate for January was flat, suggesting this theme of volatility will persist into 2026. Conversely, under the hood, **the labour**

market looks softer than the headline suggests. Although the unemployment rate is down about half a point since Q3, this is mainly on weaker labour supply growth which is hiding a persistent deceleration in employment growth.

Given this, we expect **GDP growth of 1.0% (a 0.1ppt downgrade owing to a weaker Q4 outcome) for 2026 and 1.7% for 2027**, owing to the ongoing effects of trade disruptions and very low population growth. USMCA negotiations remain a key downside risk to this outlook, where a poor outcome here could further weigh on trade-exposed industries and exacerbate the already subdued growth trajectory.

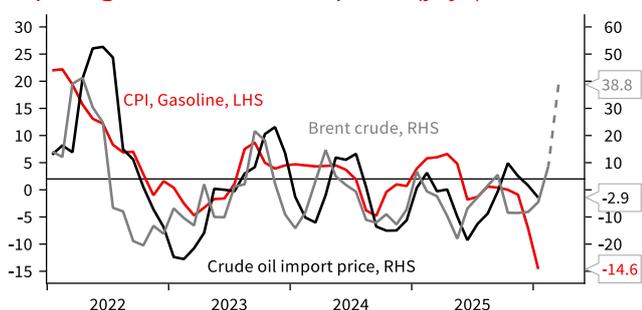
By contrast, the outlook for inflation looked to be relatively benign ahead of the recent spike in energy prices. Headline inflation was 1.8% in February (core 2.3%), and recent trends had pointed toward gradual convergence to the 2% target, consistent with the BoC’s outlook for end-2026.

For now, the BoC sees US trade policy as the dominant growth concern, while Iran is treated mainly as an inflation shock whose policy relevance depends on persistence. Therefore, it is currently willing to look through the Iran war’s immediate impact given its assessment of the economy being in excess supply but is firm on not allowing its effects to broaden to more persistent inflation. Because of this, **we expect the BoC to remain on hold for 2026.**

Japan

As a net importer of energy, the Iran war represents a terms of trade shock which will weigh on the economy. Sourcing supplies, is also a concern with most of its imports of oil sourced from the middle-east, and transiting through the strait of Hormuz, However, Japan has the third largest strategic oil reserve (after the US and China) and has already announced a release of 80mb/d. Its gas reserves are smaller and one-third of Japan electricity production was fuelled by gas in 2023, but are far less dependent on the gulf countries (Australia is the major supplier).

Japan - gasoline & crude oil prices (yoy%)



Source: National Australia Bank, Japanese Statistics Bureau, Ministry of Internal Affairs & Communications, Petroleum Association of Japan (PAJ), Intercontinental Exchange (ICE), Macrobond

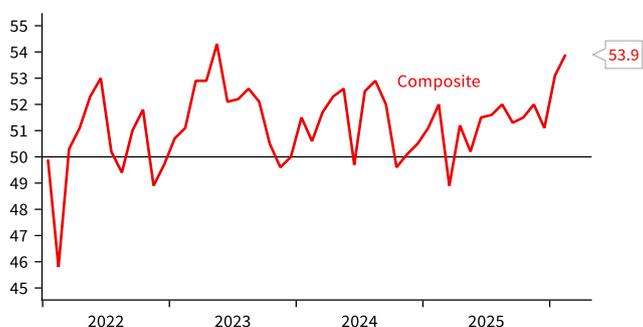
Since 2022, the government has used subsidies to effectively cap petrol prices. Petrol price subsidies were increased towards the end of 2025, reducing retail petrol prices and lowering headline CPI. The Government has announced that it will subsidise oil wholesalers to keep retail prices around 170Yen/litre – which is almost 10% higher than their February level and would return prices to the level seen before the end-

2025 subsidy increases. As a result, the fall in CPI inflation to 1.5% in January, – from around 3% in late 2025, is likely to be partially reversed.

Recent economic data has generally been positive. Q4 GDP was revised up from 0.05% qoq to 0.3% qoq. While this follows a large decline in Q3 (-0.6% qoq) and leaves GDP down in H2, this reflects a large detraction from inventories. Domestic final demand grew strongly in Q4 (0.6% qoq) assisted by solid consumption growth and a pickup in fixed investment. The Consumption Activity Index points to further solid consumption growth in Q1.

The S&P Global PMI has also strengthened in recent months. The services PMI is at its highest level in almost two years, while there has also been a major improvement in the manufacturing PMI – from below breakeven in November it is now at its highest level since 2022. Corporate profits continue to rise and with a tight labour market, this should continue to support investment. The rise in energy costs for businesses, and the impact on the global economy (and demand for exports) and sentiment may act as a brake.

Japan S&P Global PMI



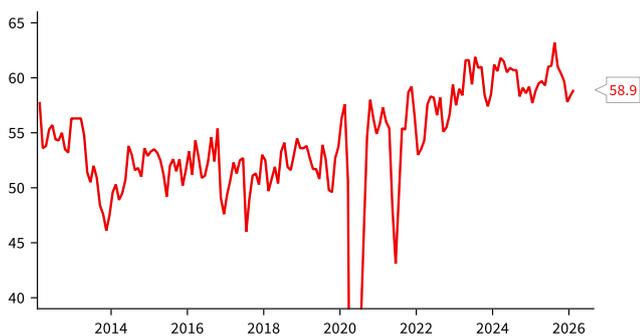
Source: National Australia Bank, Account in-house, Macrobond

Press reports of a February meeting between the PM and BoJ Governor Ueda indicated that the former had indicated reservations about additional rate hikes. In any event. The energy shock brings two sided risks (negative for growth, but upwards pressure on inflation), the BoJ is unlikely to move rates in upcoming meetings as its normal instinct is to react cautiously in the face of geo-political instability and to wait for clarity around potential impacts. **We still expect two rate rises this year – in June and December.** This is because policy was already too accommodative ahead of the Iran war - given a negative real policy rate, stimulatory fiscal policy settings, a tight labour market and the core CPI ex fresh food and energy consistently growing 2% since late 2022. With the USD/Yen close to 160 – a level that will concern the BoJ, there is a risk that they will move earlier (in April).

India

India remains one of the world’s fastest growing major economies. However, it’s exposure to the unfolding war in Iran poses some downside risks to this outlook.

India S&P Global India composite PMI



Source: National Australia Bank, Account in-house, Macrobond

Despite a slightly moderation in the pace of growth in Q4 (down to 7.8% from 8.2%) the pace of private demand growth remains solid in India. Consumption and investment both recorded annual growth in excess of 7%. There was a downside surprise in January’s print for Industrial production, but this largely reflected some payback after a strong end to last year’s growth.

Despite a strong growth outlook, domestic demand could face headwinds from India’s exposure to the Iran conflict. India imports nearly 90% of its crude oil—around half from the Middle East—with similar dependence for LNG, while trade and remittance links to the Gulf are also sizeable (around 0.5% of GDP).

Indirectly, higher LNG prices could lift nitrogen fertiliser costs, raising crop prices and, with a lag, food inflation. Added fiscal pressure would also be a concern given a significant fertiliser subsidy program (around 0.5% of GDP in 2024-25).

The initial response from markets has been negative but not out of the ordinary for a risk off event. While the US has offered India some reprieve by offering a 30-day waiver to purchase Russian oil, the impact of this event is likely to be broader than just oil the longer Iran’s disruptions wreak havoc on global trade.

India’s status as an emerging economy being highly reliant on imported energy puts the Reserve Bank of India (RBI) in a difficult position. Before, the Iran war, the RBI had a neutral stance as it balanced below target inflation and a positive growth outlook. Although easing might seem appealing as momentum softens, a rate cut would narrow rate differentials, intensify pressure on an already-weakening rupee, raise energy-import costs, and risk amplifying foreign-investor outflows. Though inflation is below target (3.2% in February compared to the 2-6% the target range), it has been rising and the RBI had been expecting it to return to 4.0% even before the Iran war. Market pricing sees the RBI on hold at its April meeting with the risk of tightening beyond that.

Central Bank Monitor

	Inflation and output gap indicators				Central bank rates		
	Core inflation*	Unemployment	GDP	Policy rate**	bias	next meetings***	year-end forecast
US Federal Reserve	3.1% 	4.4% 	2.0% 	3.75% 	easing	29 Apr 3.75 17 Jun 3.75	end 2026 3.50 end 2027 3.25
We expect 50bps of rate cuts, but now not until Q4, given recent high core PCE inflation prints and as the Fed will require time to be comfortable that the rise in oil prices does not impact inflation expectations							
European Central Bank	2.3% 	6.2% 	1.2% 	2.00% 	hold	19 Mar 2.00 30 Apr 2.00	end 2026 2.00 end 2027
On hold - ECB in a good place to look through energy driven increase in inflation as inflation had been projected to be below target. There is no longer an easing bias.							
Bank of Japan	1.3% 	2.7% 	0.5% 	0.75% 	tightening	19 Mar 0.75 28 Apr 0.75	end 2026 1.25 end 2027
Further tightening is expected by the BoJ at it moves the policy rate towards a more neutral level, but it is likely to be a gradual process							
Bank of England	3.0% 	5.2% 	1.0% 	3.75% 	easing	19 Mar 3.75 30 Apr 3.75	end 2026 3.50 end 2027
With inflation above target for an extended time, and concerns over inflation scarring and 2nd round impacts, the spike in energy prices sees expected cuts pushed out to Q4 and Q1 2027							
Bank of Canada	2.3% 	6.7% 	1.4% 	2.25% 	hold	29 Apr 2.25 10 Jun 2.25	end 2026 2.25 end 2027
A weak labour market and growth concerns from trade, will keep the BoC on hold for now even as energy prices push up headline inflation up							
Reserve Bank of New Zealand	2.6% 	5.4% 	1.3% 	2.25% 	tightening	8 Apr 2.25 27 May 2.25	end 2026 2.75 end 2027 4.00
With CPI inflation set to rise, and the economy recovering, the RBNZ will likely start raising rates later in the year							
People's Bank of China	1.8% 	 	4.5% 	1.40% 	easing	na	end 2026 1.20 end 2027
Further easing possible given need to support economy; rise in inflation post-Iran war less of an issue for PBoC as starting point was deflationary pressures							

* Core based headline ex food and energy, except Japan (also excludes alcoholic beverages), UK (also excludes alcoholic beverages & tobacco), NZ(RBNZ's factoral model), Canada (TRIM measure). US PCE measure used, CPI for all others

For federal funds rate the top of the target range is shown * For meetings spanning two days, the final day is shown

Note: number at top of each chart is latest observation (yoy change for GDP and inflation, level for unemployment rate and policy rate)

Economic Forecast Detail - Advanced Economies

	2025				2026				2027			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
United States												
GDP												
qoq%	-0.2	0.9	1.1	0.2	0.7	0.5	0.4	0.5	0.5	0.5	0.4	0.4
qoq, annualised %	-0.6	3.8	4.4	0.7	2.8	1.9	1.8	1.9	2.0	1.9	1.8	1.8
yoy%	2.0	2.1	2.3	2.0	2.9	2.4	1.8	2.1	1.9	1.9	1.9	1.9
year-average				2.1				2.3				1.9
PCE deflator												
Headline - yoy%	2.6	2.4	2.7	2.8	3.0	3.3	3.2	2.9	2.4	2.1	2.0	2.0
Core												
qoq%	0.8	0.6	0.7	0.7	1.0	0.7	0.6	0.5	0.5	0.6	0.5	0.5
yoy%	2.8	2.7	2.9	2.9	3.0	3.0	2.9	2.8	2.3	2.2	2.1	2.1
Unemployment rate												
qly average %	4.1	4.2	4.3	4.5	4.4	4.4	4.5	4.4	4.4	4.4	4.3	4.3
Fed funds rate												
Top of target band (%)	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.50	3.25	3.25	3.25	3.25
Euro-zone												
GDP												
qoq%	0.6	0.1	0.3	0.2	0.4	0.3	0.3	0.3	0.3	0.4	0.3	0.3
yoy%	1.6	1.6	1.4	1.2	1.0	1.2	1.2	1.3	1.3	1.3	1.4	1.4
year-average				1.5				1.2				1.3
Policy rate (%)	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00				
United Kingdom												
GDP												
qoq%	0.7	0.1	0.2	0.3	0.4	0.2	0.2	0.2	0.2	0.3	0.4	0.3
yoy%	1.8	1.4	2.0	1.1	0.9	1.1	1.1	1.0	0.9	1.0	1.1	1.3
year-average				1.3				0.8				1.0
Policy rate (%)	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.50	3.25			
Japan												
GDP												
qoq%	0.3	0.6	-0.7	0.3	0.4	0.2	0.1	0.1	0.2	0.2	0.1	0.1
yoy%	1.6	2.0	0.7	0.5	0.7	0.3	1.1	0.9	0.6	0.6	0.6	0.7
year-average				1.2				0.7				0.6
Policy rate (%)	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25				
Canada												
GDP												
qoq%	0.5	-0.2	0.6	-0.2	0.3	0.4	0.4	0.5	0.5	0.4	0.3	0.3
yoy%	2.9	1.8	1.6	0.7	0.5	1.1	0.9	1.6	1.8	1.8	1.7	1.5
year-average				1.7				1.0				1.7
Policy rate (%)	2.75	2.75	2.50	2.25	2.25	2.25	2.25	2.25				

Source: NAB Economics and Markets Research

FX Forecasts

	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28
AUD/USD	0.70	0.72	0.73	0.73	0.72	0.71	0.71	0.70	0.70	0.70
NZD/USD	0.60	0.62	0.63	0.63	0.63	0.63	0.63	0.62	0.62	0.62
USD/JPY	154	152	150	148	146	145	143	142	140	140
EUR/USD	1.20	1.22	1.20	1.23	1.22	1.22	1.21	1.19	1.18	1.18
GBP/USD	1.37	1.38	1.38	1.38	1.36	1.35	1.34	1.34	1.33	1.33
USD/CHF	0.77	0.76	0.75	0.75	0.75	0.75	0.76	0.77	0.78	0.78
USD/CAD	1.36	1.34	1.33	1.33	1.35	1.37	1.37	1.37	1.36	1.36
USD/CNY	6.93	6.90	6.85	6.80	6.80	6.85	6.85	6.85	6.85	6.85

Australian Cross Rates										
	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28
AUD/NZD	1.17	1.16	1.16	1.15	1.15	1.13	1.13	1.13	1.13	1.13
AUD/JPY	108	109	110	108	105	103	102	99	98	98
AUD/EUR	0.58	0.59	0.61	0.59	0.59	0.58	0.59	0.59	0.59	0.59
AUD/GBP	0.51	0.52	0.53	0.53	0.53	0.53	0.53	0.52	0.53	0.53
AUD/CHF	0.54	0.55	0.55	0.55	0.54	0.53	0.54	0.54	0.55	0.55
AUD/CAD	0.95	0.96	0.97	0.97	0.97	0.97	0.97	0.96	0.95	0.95
AUD/CNY	4.85	4.97	5.00	4.96	4.90	4.86	4.86	4.80	4.80	4.80

[Global FX Strategist](#) provides details on our FX views

Economics and Markets Research Contacts

Sally Auld
Chief Economist
+61 422 224 752
sally.auld@nab.com.au

Teisha Bonner
Executive Assistant
+61 452 093 086
teisha.bonner@nab.com.au

Economics

Australian Economics
Gareth Spence
Head of Australian Economics
+61 422 081 046
gareth.spence@nab.com.au

Taylor Nugent
Senior Economist
+61 452 671 752
taylor.nugent@nab.com.au

Jessie Cameron
Economist
+61 491 380 013
jessie.cameron@nab.com.au

Michael Hayes
Economist
+61 411 186 777
michael.hayes@nab.com.au

International Economics
Tony Kelly
Head of International Economist
+61 477 746 237
antony.kelly@nab.com.au

Gavin Friend
Senior Markets Strategist
+44 207 710 1588
gavin.friend@eu.nabgroup.com

Josh Copeland
Economist
+61 484 239 255
josh.copeland@nab.com.au

Behavioural Economics
Dean Pearson
Head of Behavioural Economics
+61 457 517 342
dean.pearson@nab.com.au

Robert De Iure
Senior Economist
+61 477 723 769
robert.de.iure@nab.com.au

Economics Analytics
Brien McDonald
Senior Economist
+61 455 052 520
brien.mcdonald@nab.com.au

Thao Nguyen
Senior Data Analyst
+61 451 203 008
thao.nguyen5@nab.com.au

Markets Research

Skye Masters
Head of Markets Research
+61 467 767 604
skye.masters@nab.com.au

Barbara Leong
Research Assistant
+61 429 127 590
barbara.leong@nab.com.au

Credit Strategy
Evy Noble
Credit Strategist
+61 2 7226 7336
evy.noble@nab.com.au

FX Strategy
Ray Attrill
Head of FX Strategy
+61 2 9293 7170
ray.attrill@nab.com.au

Rodrigo Catril
Senior FX Strategist
+61 2 9293 7109
rodrigo.h.catril@nab.com.au

Rates Strategy
Kenneth Crompton
Head of Rates Strategy
+61 439 411 709
kenneth.crompton@nab.com.au

Gregorius Steven
Rates Strategist
+61 2 7209 8133
gregorius.steven@nab.com.au

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please [click here](#) to view our disclaimer and terms of use.