The Year Ahead

2027

From resilience to growth



Santander

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Editor's note

"What stands in the way becomes the way." The idea, drawn from Meditations by the Stoic philosopher and Roman emperor Marcus Aurelius, is that the ways in which we respond to obstacles — whether in life or in the economy — can themselves open up new paths. Today's global economy is the outcome of the major shocks that have "stood in the way" in recent years: from the COVID-19 pandemic and Russia's invasion of Ukraine to renewed tensions in the Middle East, the latest tariff war and the disruptive emergence of artificial intelligence (AI) in our lives.

These events have reshaped the global economy, accelerating the transition from an era of deepening globalisation to a more fragmented system increasingly shaped by economic security and strategic autonomy. They have led countries to recognise the fragility of global value chains, reconsider their international alliances and agreements, and reassess their trade, industrial and technological policies.

Geoeconomics has taken centre stage in economic analysis as never before. The shift in the global economic paradigm can be summarised as follows: a transition from a world organised around efficiency as the overriding objective (globalisation) to one in which efficiency is increasingly subordinated to resilience and security in the broadest sense — economic, military, technological and beyond.

Over the coming decades the global economy will be shaped by the interaction of four megatrends: the new geopolitical order (including geoeconomic fragmentation); demographic change (population ageing, migration, etc.); the energy transition; and the diffusion of new technologies, led by AI. What will emerge from the interplay of all these forces, each evolving at a different pace and with varying intensity? Technology can change in a matter of months; politics moves over years; demographics unfold across generations; and electricity grids can take a decade or more to build.

Currently, two of these megatrends dominate the near-term outlook: geopolitics and AI. Geopolitics accounts for much of the uncertainty facing the global economy. Over the past year the value of global trade affected by new restrictive measures more than tripled, reaching nearly 2.5 trillion euros, the highest level in more than 15 years.

Meanwhile, AI is increasingly seen as a key engine of economic growth, particularly in certain sectors and countries. Although this megatrend is not without potential risks, estimates of its future impact on productivity range widely from gains of just 0.7% over a decade to more than 10%. Whatever the precise figure, the impact is likely to be substantial. The combined effects of geopolitics and AI are reshaping the global

economy, favouring net energy exporters and countries with strong participation in the AI value chain.

The other two megatrends, by contrast, are "quieter": they are unfolding more gradually, but no less inexorably. Demographic change, for example, will have far-reaching consequences for the world ahead. By the mid-2030s, the number of people in the world aged 80 or over is projected to reach around 265 million, outnumbering infants for the first time.

All these forces will reinforce one another: ageing will accelerate the demand for automation, AI will increase energy and infrastructure needs, and geopolitical fragmentation will influence where both technology and energy investment take place.

Another consequence of the interaction of these four megatrends, as we explain in this report, is that the global economy is likely to be increasingly shaped by supply-side forces (instead of the usual demand-side). This will require a rethink of many of the traditional models and theoretical frameworks, and places a premium on analytical approaches that capture sectoral constraints, production networks, strategic dependencies and the interaction between economic and security policies.

Looking back over recent years, a paradox emerges: the global economy has proved more resistant than expected. Yet each shock has left it with weaker trend growth and less room to respond to the next. Trend growth is now around half a percentage point lower than during the first two decades of this century. The world also has fewer buffers: less room for fiscal expansion due to elevated — and in many cases record — debt levels, while persistent inflation risks constrain the scope for monetary easing. The recent global rise in long-term bond yields partially reflects these constraints. In fact, one year ago, in this very report, we warned that a combination of forces, including fiscal pressures, rising investment needs, AI and demographic trends, would eventually lead to an upward repricing of the equilibrium interest rate (the so-called "neutral" or "natural" interest rate).

The global economy faces an uncomfortable underlying trade-off — one that must be acknowledged if it is to be addressed: resilience is not free. It is being "purchased" at the cost of lower growth and somewhat greater inflationary pressure. In a sense, the world seems to have learned how to overcome crises, but it has yet to work out how to turn that resilience into a foundation for a new cycle of stronger growth. Hence the title of the 2027 edition of "The Year Ahead", Santander Research's flagship annual economic publication: "From Resilience to Growth". We are convinced that this is the defining challenge for the coming years.

Meeting the global challenges ahead — population ageing, the energy transition, adaptation to new technologies, among others — will require a reset of the global growth model. One of the greatest risks facing the world today is that lower growth becomes entrenched. Without stronger growth, putting debt on sustainable trajectories, restoring fiscal balance and achieving lasting reductions in poverty and

income inequality will all become far more difficult. Weak growth also erodes institutional trust and the international willingness to cooperate.

Resilience and growth are arguably the two central concepts in today's global economy. They are deeply interconnected, but balancing them entails the trade-offs described above. Accelerating growth will require: making full and efficient use of the new technologies already available, starting with AI (some recent studies suggest that AI could help the global economy recover, over the medium term, the roughly half percentage point of growth it has lost); undertaking a large-scale reskilling of the workforce; and strengthening cooperation on two fronts — renewing international dialogue and deepening collaboration between the public and private sectors.

Above all, however, faster growth requires more investment. And investment, if it is to be sustained over time, requires financing. Financing is precisely the common denominator shared by the four megatrends that will shape the world ahead. It will be needed, inter alia, to support pension systems under mounting pressure; to meet growing investment needs associated with the energy transition, defence and other strategic priorities; and to develop and deploy new technologies, such as those related to AI.

All of this will require a historic reallocation of capital. This does not simply mean more funding, but financing with longer horizons, greater capacity to bear risk, effective risk-sharing mechanisms, and deeper and more integrated markets.

Around 60% of the slowdown in global economic growth relative to the first two decades of this century is due to Europe's lower contribution. This is nearly three times the region's share of global gross domestic product (GDP), which stands at around 20%. Reviving global growth will therefore demand a stronger growth performance in Europe. This, in turn, will require a regulatory framework that, while safeguarding financial stability, supports the financing of growth by enabling savings to flow more efficiently towards productive investment, innovation and job creation.

How much financing will the world need? Under the assumptions set out in this report, we estimate the gap between what is already being financed and what will be needed in the next five years to be around 30 trillion euros. To put that figure into perspective, it is more than half of global pension fund assets or more than twice the total deposits held by households and firms in the Eurozone.

Today's world is full of risks and uncertainty. Yet it is also full of transformations and opportunity. The task is not to eliminate risk, which is impossible, but to build more resilient and inclusive economies capable of seizing the opportunities ahead and translating them into faster growth.

Risks and opportunities are precisely the two themes that best capture the spirit of this report. Here we present our outlook for the global economy, with a particular focus on the regions in which Santander has a strong presence — the United States, Europe and our core markets in Latin America — and topics of global relevance.

In today's landscape, the main challenge for any research area is to separate the signals from the noise. "The Year Ahead 2027" seeks to identify the most relevant signals and share conclusions that contribute to the public debate around the forces shaping our collective future.

In times of profound structural change, we must stand ready to reassess our views as new evidence emerges. In this context, intellectual humility and an open mind are the most valuable analytical tools at our disposal. Rather than offering definitive answers, this report aspires to frame the right questions, grounded in reliable data and sound evidence.

Welcome to "The Year Ahead 2027". We hope you find it both useful and thought-provoking.



Juan Cerruti
Global Chief Economist
Madrid, November 2026

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Executive summary

Global growth outlook

Global growth is projected to average 3.3% per year over the next three years, compared with 3.7% during the first two decades of this century. Around 60% of this slowdown can be attributed to Europe's lower contribution to global growth.

A resilient world, but with fewer buffers

The global economy is showing itself to be resilient, but growth is insufficient to meet rising investment needs from ageing, artificial intelligence (AI) and the energy transition. Geopolitical fragmentation and widening fiscal imbalances add to the challenge, leaving the world with fewer buffers to absorb future shocks.

Sticky inflation and hawkish central banks

Inflation should ease gradually from 2027, but geopolitical tensions, energy prices and growing resource demand will keep risks tilted to the upside. Central banks are therefore likely to remain less accommodative, while higher debt and financing needs will keep long-term rates elevated.

Resilient labour markets

Labour markets are an important source of resilience, with unemployment rates still historically low across many major economies. So far, the impact of AI on aggregate labour-market indicators has been limited, although its longer-term effects are still uncertain.

The market paradox: surging equities and rising bond yields

Sticky inflation and higher debt coexist with strong optimism over AI, creating an unusual combination of high equity valuations, tighter monetary policy and elevated long-term yields. A key question for 2027 is whether AI-driven productivity gains will validate market expectations or whether valuations will adjust to a structurally higher cost of capital.

Financing the 'reset' of global growth

Resetting global growth requires a structural reboot: more investment, greater international coordination, new technologies and smart regulation that mobilises savings towards productive uses. We estimate a 30 trillion euro global financing gap between 2026 and 2030, equivalent to half of the world's pension savings. The challenge will be not only to mobilise financing, but to channel it effectively into productive investment.

By region: what to expect

Growth will remain resilient in 2027, but will be increasingly uneven across regions. The combined effects of geopolitics and AI are reshaping the global economy, favouring net energy exporters and countries with strong participation in the AI value chain.

- United States: investment and AI will reinforce the US lead in developed-world growth, with economic expansion holding solid through to 2027 and above 2%. Inflation will continue to be the key risk.
- Euro area: investment will drive an acceleration in growth from 1.0% in 2026 to 1.4% in 2027, although fiscal capacity will be uneven and inflation risks will persist.
- Spain: growth will again be well above the euro-area average, moderating from 2.6% to 2.2%, supported by domestic demand and non-tourism services exports.
- United Kingdom: growth will slow from 1.3% to 0.9% in 2027, as renewed inflation pressures weigh on consumption and fiscal constraints limit room for manoeuvre.
- China: the growth model will shift towards productivity, innovation and technology, as traditional drivers weaken and property remains a structural drag.
- Latin America: growth will stay resilient at around 2%, while inflation will continue to ease and solid external positions to provide support.
- Brazil: high real rates will push growth down to 1.3% in 2027, with fiscal policy remaining the key source of uncertainty.
- Mexico: growth will stay resilient at 1.7% in 2027, following on from 1.8% in 2026, while persistent fiscal challenges will continue to be the main vulnerability.

Special topics

Beyond the 2027 outlook, our Special Topics explore the structural forces reshaping the global economy and their potential effects and spillovers:

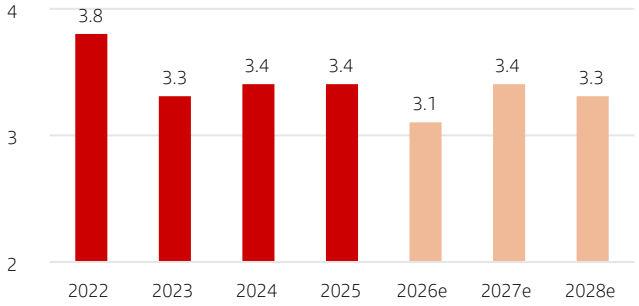
- How much financing does the world need?
- Rethinking the macroeconomic framework in a supply-driven world.
- The macroeconomics of artificial intelligence.
- European Banking Union: from firewall to engine of growth.
- Defence spending in the EU: between opportunity and fiscal dilemma.
- The European car industry: from regulatory compliance to industrial competitiveness.
- Latin America's role in the new geopolitical landscape.

The Year Ahead at a glance

Growth will hold up, but be subdued

The global economy will remain resilient in 2027, but growth will stay below historical rates at a time of rising structural investment needs.

World economic growth
(% y/y)



Global GDP growth in 2027

+3.4%

Resilience alone will not be enough to meet global challenges

Ageing, geopolitical fragmentation and widening fiscal imbalances are weighing on growth potential and leaving less room to absorb future shocks.

Insufficient growth to meet mounting global challenges

Investment and financing are key to resetting growth

Technology, investment and smarter regulation will be critical to mobilise savings.

30 trillion euro global financing gap between 2026 and 2030

Easing inflation, resilient labour markets

Disinflation should resume in 2027, though supply-side risks could slow convergence.

Labour markets will be solid, supporting activity.

The last mile of disinflation remains challenging

Equities at records, yields at multi-year highs

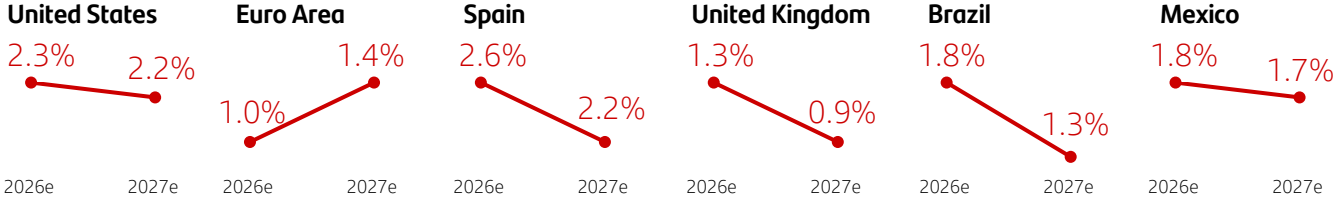
Strong expectations around AI are supporting equity valuations.

However, concerns about fiscal sustainability, competition for funding from the AI sector and sticky inflation have driven rates higher, particularly at the long end.

AI valuations remain an issue to watch

Resilience remains, but growth paths will diverge across countries

Differences in investment momentum, fiscal space and exposure to global shocks will increasingly shape regional performance.



Global overview



A resilient world, but with fewer buffers

From resilience to growth

What is the greatest challenge facing the global economy in the coming years? Initial answers might point to geopolitical tensions, a shift in market expectations regarding artificial intelligence (AI), or persistently high inflation, among other possibilities.

Over the next three years, the world economy will grow by an average of 3.3% per year

In our view, all of these are plausible answers. But there is an even greater challenge, one so evident that it may seem obvious: low growth. Or, more precisely, the risk that low global growth becomes chronic.

Over the next three years, the world economy is projected to grow by an average of 3.3% per year, according to our estimates and those of most global institutions. This is well below the 3.7% average recorded during the first two decades of this century. Without stronger global growth, it is hard to envisage convergence in the high debt-to-gross domestic product (GDP) ratios of many countries. Nor does it seem plausible to expect improvements in income distribution or in the willingness to cooperate internationally. Growth is not a sufficient condition for solving all the problems facing the world, but it is a necessary one. It is unrealistic to expect consensual solutions in a context where each country's constraints allow only for domestic focus.

In recent years, the global economy has taught us two clear lessons. The first is that it is more resilient than we thought: it has navigated a global pandemic, numerous armed conflicts and tariff tensions, among other events, better than expected. However, this resilience has not come "for free": the global economy has paid for it through slower growth and smaller buffers with which to confront future shocks.

The resilience of the global economy has not come "for free": it has come at the cost of lower growth and fewer buffers to absorb future shocks

The fiscal and monetary policy room available to countries and regions around the world to respond to unforeseen shocks is significantly smaller today than it was six years ago, before the pandemic. Since then, global shocks have followed one another in succession in a way rarely seen in world economic history. Meanwhile, global public debt has risen from 82% to 96% of GDP, and from 97% to 105% across the Organisation for Economic Co-operation and Development (OECD) countries. The recent rise in long-term bond yields globally is a sign of concern about these fewer buffers and increasing constraints going forward.

All these shocks — the pandemic, the war in Ukraine, the tariff war and tensions in the Strait of Hormuz — also share an important common feature: their impacts arrived primarily on the aggregate supply side, rather than the demand side. The same is true for the four megatrends that will define the coming decades: the new geopolitics, demographic change, the energy transition and new technologies led by AI.

Only through greater investment will the world be able to successfully address the global challenges that lie ahead

For a world that for decades has moved to the rhythm of demand, this is no minor change. The data confirm this: one year after each of the aforementioned episodes, GDP slowed by an average of 1.7 percentage points and inflation accelerated by 0.8 points. That is the classic pattern of a negative stagflationary supply shock and, with it, comes the uncomfortable reality that neither fiscal nor monetary policy alone can fully address these challenges. As we discuss in one of the special topics in this report, the lasting response does not lie in managing demand, but in expanding the productive frontier by focusing on productivity, investment, technology and reskilling the labour force.

It is worth adding a nuance regarding timing, because these megatrends do not progress at the same pace. Technology can change in months, geopolitics moves in years, demographics in generations and an electricity grid (to prop up the energy transition) can take a decade to build. Many of the tensions we observe today — between regulatory ambition and implementation capacity, between market expectations and productivity outcomes — stem precisely from this mismatch in speeds.

Higher levels of investment are a necessary condition for accelerating global growth: only through investment can sustainable growth be achieved over time. In this report, we estimate that successfully addressing the world's major challenges will require gross financing of close to 50 trillion euros between 2026 and 2030 — around 10 trillion euros per year — and that the financing gap currently amounts to around 30 trillion euros over that five-year period. That is equivalent to half of all pension savings worldwide, twice the total deposits in the euro area or, alternatively, almost two years of euro-area GDP.

We estimate that the financing gap for the coming years currently stands at around 30 trillion euros. That is equivalent to half of all pension savings worldwide

But it is not only about obtaining financing; funds must also be channelled efficiently towards investment. The world has the savings, technology and institutional capacity required; what it lacks are an alignment of incentives, risk reduction and prioritisation. Regulation will play a key role in this. For years following the global financial crisis, financial regulation focused almost exclusively on preserving financial stability. This is undoubtedly a key asset that must be protected and strengthened. But, for all the reasons set out above, stimulating growth should be designated as one too.

One figure illustrates the urgency: of the half-percentage-point slowdown in global growth experienced during the current decade, around 60% is explained by a weaker growth contribution from Europe. Given that the continent accounts for around 20% of global GDP, its contribution to the slowdown is three times its economic weight. Europe is precisely the region where complex regulatory bureaucracy and a lack of coordination have had the greatest negative impact on the ability to compete globally.

Against this backdrop, inflation rose again in 2026 as a result of the interaction between geopolitical tensions, energy bottlenecks and growing demand for resources from rapidly expanding sectors such as AI. This has forced central banks in the United States and the euro area, among others, to resume their monetary tightening cycles,

the scale and depth of which remain difficult to anticipate given the high degree of uncertainty surrounding the factors driving them. We expect inflation in most regions of the world to begin gradually easing from 2027, converging to central banks' target levels from 2028 onwards. However, this will be heavily dependent on the evolution of hard-to-anticipate dynamics, such as global geopolitics.

The mix of sticky inflation, higher debt and AI optimism has created a paradox: equity markets at record peaks alongside central banks tightening cycles and long-term bond yields at multi-year highs

The combination of more persistent inflation than expected, higher debt levels and, on the other side, renewed optimism about AI's capacity to transform the global economy has created a paradox: equity markets are at record peaks as central banks tighten monetary policy, while long-term bond yields are reaching multi-year highs in many countries. In fact, one year ago, in this very report, we warned that a combination of forces, including fiscal pressures, rising investment needs, AI and demographic trends, would eventually lead to an upward repricing of the equilibrium interest rate (the so-called "neutral" or "natural" interest rate).

Regarding this "anomaly", the relevant question is which of these two signals will converge towards the other: will the productivity gains derived from AI validate current valuations, allowing long-term rates to decline? Or will equity markets ultimately adjust to a structurally higher cost of capital? Available estimates of AI's impact on productivity — ranging from a cumulative 0.7% over ten years to 10-15% — are so disparate that they alone explain much of this tension.

Meanwhile, labour markets remain solid in most of the regions in which Santander has a presence. Unemployment rates are at historically low levels in countries such as the United States, Mexico, Brazil and the United Kingdom, as well as in the euro area. The potential impact of AI on this market is still barely perceptible from the perspective of macroeconomic aggregates, although some sectors or industries could be somewhat affected in the coming years.

Labour markets remain solid in most of the regions in which Santander operates

In summary, the world of 2027 will foreseeably be one that grows significantly less than in the first two decades of this century and needs to invest heavily; one that lives with inflation above target levels and with central banks that are less accommodating than expected a year ago; and one in which differences between regions will increasingly be determined by their ability to turn available savings into productive investment, particularly in sectors linked to disruptive technologies such as AI.

By region: what to expect in 2027

The regional outlooks we anticipate for 2027 are not homogeneous. The combined effects of geopolitics and AI are reshaping the global economy, favouring net energy exporters and countries with strong participation in the AI value chain.

The United States will maintain solid growth supported by investment and productivity, while the euro area will seek to turn its resilience into a lasting investment cycle, and the United Kingdom will continue to grapple with inflationary pressures and fiscal constraints.

Meanwhile, China will move towards a more mature phase, with slower growth and an agenda focused on productivity and technology; and Latin America will face a year of consolidation, with a Brazil needing to achieve fiscal convergence alongside a Mexico whose level of activity will maintain a good pace.

The common denominator is that, in almost every region, the difference between mediocre and stronger growth will depend on the ability to mobilise investment and send credible signals of fiscal discipline.

United States

The US economy will remain the main engine of developed-world growth in 2027

The US economy will remain the main engine of developed-world growth in 2027, supported by robust business investment, resilient consumption and productivity gains. Investment will be the cornerstone of growth, with AI and data centres boosting high-tech capital expenditure. But US growth goes beyond AI: companies have accepted uncertainty as the new normal and are moving ahead with projects supported by available credit and solid profits. Productivity has already increased, reflecting investment in automation and more efficient operating models.

Inflation will be the main focus in 2027, with a more hawkish Fed and high long-term rates helping core inflation converge to 2%. Risks remain: tariffs, energy and geopolitics could reignite price pressures, while questions persist over the pace of the AI investment boom and the medium-term fiscal outlook.

Euro area

2027 could mark a transition towards an economy in which investment, rather than simply resilience to shocks, becomes a more important driver of growth. We expect the euro-area economy to accelerate to 1.4%, supported by a gradual recovery in investment. Growth will nevertheless continue to be uneven, with Germany making gains while other economies face severe fiscal constraints.

The key challenge for the euro area is to turn resilience into investment-led growth

Inflation will probably moderate in 2027 but could stay above the European Central Bank (ECB)'s 2% target for much of the year. Persistently high energy prices present an upside risk, as they could increase business costs and ultimately feed through into broader goods and services inflation.

Spain

Spain continues to be one of Europe's most dynamic economies, with GDP growth of 2.6% in 2026 supported by consumption, a resilient labour market, tourism and services exports. Growth will moderate to 2.2% in 2027, while unemployment will fall below 10%. Strong tourism, non-tourism services exports, immigration and healthy private-sector balance sheets underpin this outlook. However, the inflation forecast will be subject to upside risks if higher energy prices pass through to core inflation. In such a scenario, inflation may not converge to the ECB's target until late 2028.

United Kingdom

UK growth in 2026 has been moderately better than expected. The outlook for 2027, however, points to some slowdown — to 0.9% — with more expensive energy and food

once again weighing on consumption. The resolution (or otherwise) of the conflict in the Middle East will be decisive, particularly through its impact on inflation.

The unemployment rate stood at close to 5% in mid-2026 and appears to be stabilising somewhat, while inflation will end 2026 close to 4%. Fiscal constraints will remain the main source of vulnerability, with the tax burden at record highs and a need for further measures on the public spending side.

China

China is shifting from capital-led growth to a model increasingly driven by productivity and innovation

China is entering a more mature phase of development, with future growth increasingly dependent on productivity, innovation and better capital allocation — priorities also reflected in the technology and AI focus of the 15th Five-Year Plan.

The main imbalance continues to be weak domestic demand compared with strong industrial supply, which keeps disinflationary pressures elevated. Meanwhile, property remains the largest structural drag. Macroeconomic policy will retain a supportive bias, led by fiscal policy. External demand is still a key growth engine, supported by export momentum in electric vehicles (EVs), batteries and solar, although rising protectionism and dependence on imported crude oil are still major risks.

Latin America

Latin America enters 2027 having navigated external shocks and challenging financial conditions better than expected

Latin America enters 2027 having navigated external shocks and challenging financial conditions better than expected, with resilient markets and contained inflationary pressures for the Latin America-7[1]. Growth should hold steady at around 1.9% in the aggregate, while inflation will continue to decline and move closer to central banks' tolerance ranges, although the El Niño phenomenon could temporarily delay the process.

The external position remains solid, with robust trade balances and foreign direct investment (FDI)-financed current-account deficits. The key challenge will be to translate this stability into stronger investment, while modest potential growth and fiscal consolidation constrain policy space.

Brazil

2027 should be a year of macroeconomic rebalancing for Brazil

Brazil will start 2027 feeling the cumulative effects of a prolonged period of restrictive monetary policy. Growth will slow as high real interest rates weigh on consumption, investment and credit-sensitive sectors, while the labour market should cool only gradually, avoiding a sharp deterioration in household income. Inflation will continue to fall to around 4%, although services will keep convergence gradual.

Fiscal policy continues to be the biggest challenge. Sending concrete signals of fiscal convergence could improve confidence and partly offset the monetary drag. We expect monetary policy to retain a restrictive approach in 2027, albeit less so. In short, 2027 should be a year of macroeconomic rebalancing for Brazil.

[1] Latin America-7 includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

Mexico

The Mexican economy will go into 2027 having shown surprising resilience, supported by consumption, recovering investment and technology exports. Growth should maintain a good pace as these trends continue, alongside a more stable global environment and less adverse fiscal and monetary headwinds. The labour market is strong, with unemployment close to record lows. Inflation should stay at around 4%, with little change expected in monetary policy. Fiscal adjustment is still a challenge, however, as debt has continued to rise despite a narrowing deficit, although Mexico retains investment-grade status.

Commodities

Energy markets could gradually ease as geopolitical tensions normalise and global oil and LNG supply becomes more abundant

In an environment shaped by the interaction between geopolitics, supply constraints, climate change, the energy transition and the increasing fragmentation of international trade, everything points to 2027 being a particularly challenging year for commodity markets.

Energy developments will continue to be heavily influenced by the Middle East. The trajectory of prices will depend, to a large extent, on the duration of the conflict, the restoration of trade routes, the degree of damage to infrastructure and the speed at which disrupted supply recovers. A trend towards normalisation would favour a correction in oil and natural gas risk premia, although the process could be gradual if the need to rebuild inventories keeps physical demand elevated.

Beyond the immediate impact of the conflict, the oil market faces a more structural shift in its equilibrium. On the supply side, a more fragmented OrganIzation of the Petroleum Exporting Countries+ (OPEC+) with weaker internal discipline could see its ability to manage production in a coordinated manner reduced, as countries outside the organisation continue to increase supply. On the demand side, growth in oil consumption continues to slow, reflecting greater energy efficiency, the progressive electrification of transport and the transformation of China's growth model. Consequently, once the geopolitical shock has been absorbed, the combination of potentially more flexible supply and moderate demand could favour a more amply supplied oil market, although it would still be exposed to episodes of high volatility in the event of new supply disruptions. The expected greater availability of crude oil could, however, coexist with tensions in certain refined products, reflecting a refining capacity that is more rigid and unevenly distributed geographically.

Agricultural markets remain particularly vulnerable to climate shocks, trade restrictions and geopolitical disruptions

In the natural gas market, the expansion of US production and global liquefied natural gas (LNG) capacity should progressively strengthen supply availability. Europe, however, will continue to be exposed to international competition for cargoes and the need to maintain adequate storage levels. On the demand side, electrification and the sharp rise in electricity consumption associated with data centres, AI and new digital infrastructure reinforce the role of gas as a flexible source of generation. Overall, beyond current geopolitical tensions, the increase in global LNG capacity points to a

market with more abundant supply, although it will still be vulnerable to supply disruptions.

In agriculture, the main risk stems from simultaneous exposure to climate, geopolitical and trade shocks. Greater variability in climate patterns reduce visibility over harvests. A potentially very intense El Niño episode, which could extend into the first months of 2027, will alter temperature and rainfall conditions in some of the main producing regions. At the same time, the reconfiguration of export routes as a result of the war in Ukraine, trade restrictions, and the food-security strategies of major consumers such as China and India are changing traditional trade patterns. The connection between energy, fertilisers and agricultural costs keeps open a transmission channel from energy markets to agricultural commodity prices. The result is a market that is well supplied, but vulnerable to climate, geopolitical and logistical disruptions.

Electrification, digitalisation and defence spending will sustain structural demand for copper and other critical minerals

Industrial metals exhibit a structurally more favourable dynamic on the demand side. Electrification, electricity grids, data centres and defence spending will continue to increase demand for copper, aluminium and other strategic minerals. However, the balance could vary across markets, given that structurally strong demand does not necessarily imply scarcity when supply can respond rapidly. Copper is where this tension is most evident. The combination of growing demand, long mining development lead times and difficulties in expanding production capacity increases the risk of a tighter market. By contrast, nickel and, in the short term, lithium show how a rapid expansion of production capacity can generate surpluses even with strong demand growth.

Security of supply is becoming strategic: where resources are produced, processed and transported increasingly matters

Security of supply for critical minerals will become an increasingly important dimension. The major economies are incorporating access to these resources into their industrial and economic security policies, while producing countries are seeking to capture a greater share of the value they generate. The result is increasing interaction between geopolitics, trade and investment, with supply chains that are potentially more diversified and resilient, but less efficient and more costly.

In summary, 2027 could present a mixed outlook across commodities. A potential normalisation of disruptions in the Middle East, the structural slowdown in oil demand growth and the increase in global LNG capacity would favour easing in energy markets. Agriculture will remain exposed to climate and trade disruptions, while industrial metals will account for the structural pressures associated with electrification, digitalisation and defence spending. The common denominator is that security of supply has become a strategic variable. In an environment of geopolitical fragmentation, what matters is no longer only how much of a resource exists or is produced globally, but also where it is produced, who processes it and how it reaches consumption centres.

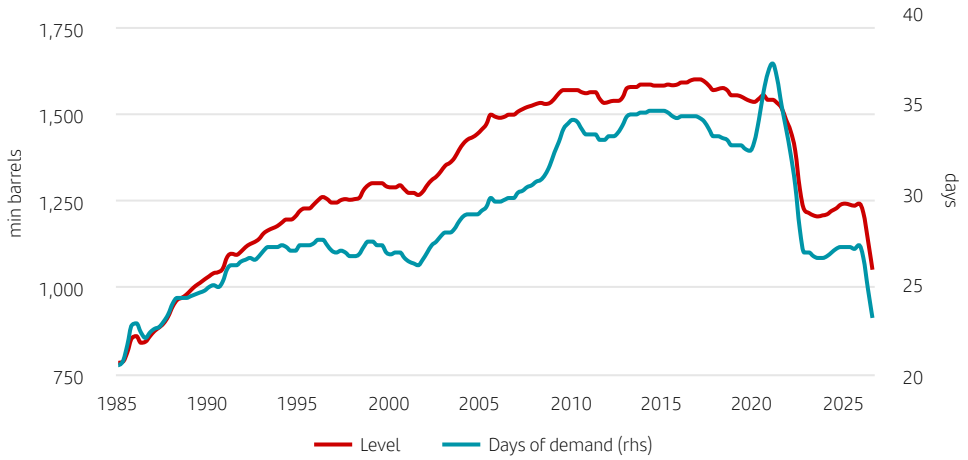
Juan Cerruti
María Victoria Nuñez Cortés

Commodity price forecasts

S&P GSCI index components	2026	2027	2028
S&P GSCI			
Agriculture	421	439	440
Energy	326	261	234
Base metals	607	615	621
Precious metals	5,501	5,774	6,075
All commodities	744	658	620
Selected commodities			
Soybeans (USD/bushel)	13	13	13
Brent oil (USD/bbl)	93	77	73
Copper (USD/MT)	14,697	14,944	15,130

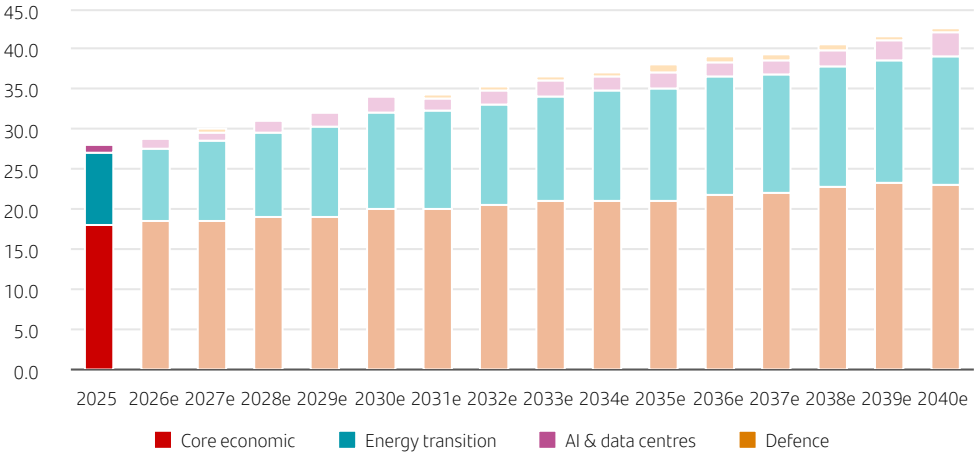
End of period.
Sources: Refinitiv, S&P GSCI and Santander Research.

OECD strategic petroleum reserves



Source: IEA.

Global copper demand by sector (2025–2040)
(mn metric tons)

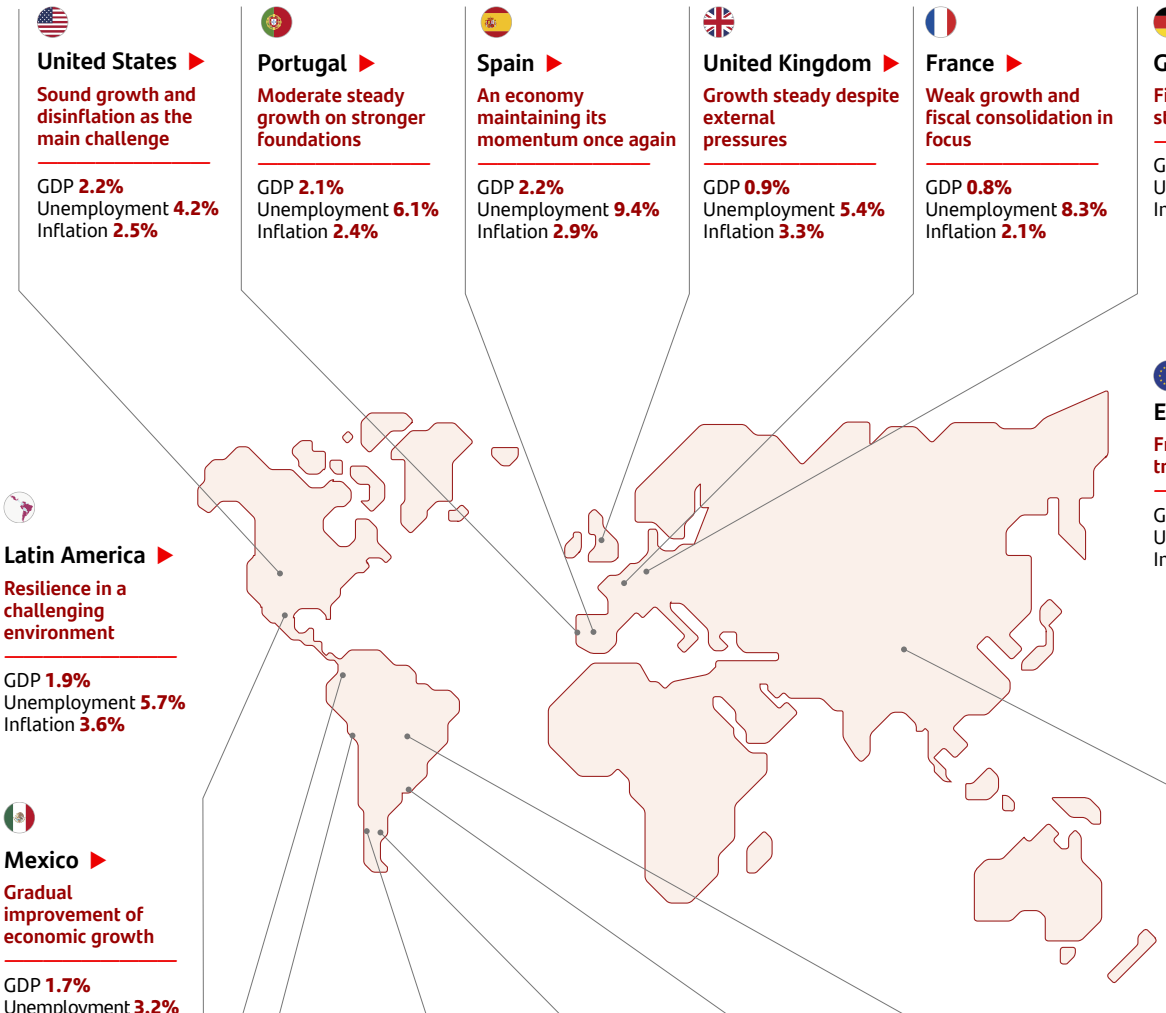


Source: S&P Global.



Regions and countries

Regional and country focus in 2027



United States
Sound growth and disinflation as the main challenge
GDP **2.2%**
Unemployment **4.2%**
Inflation **2.5%**

Portugal
Moderate steady growth on stronger foundations
GDP **2.1%**
Unemployment **6.1%**
Inflation **2.4%**

Spain
An economy maintaining its momentum once again
GDP **2.2%**
Unemployment **9.4%**
Inflation **2.9%**

United Kingdom
Growth steady despite external pressures
GDP **0.9%**
Unemployment **5.4%**
Inflation **3.3%**

France
Weak growth and fiscal consolidation in focus
GDP **0.8%**
Unemployment **8.3%**
Inflation **2.1%**

Germany
Fiscal stimulus and structural challenges
GDP **1.2%**
Unemployment **6.3%**
Inflation **2.6%**

Euro Area
From resilience to transformation
GDP **1.4%**
Unemployment **6.3%**
Inflation **2.6%**

Latin America
Resilience in a challenging environment
GDP **1.9%**
Unemployment **5.7%**
Inflation **3.6%**

Mexico
Gradual improvement of economic growth
GDP **1.7%**
Unemployment **3.2%**
Inflation **3.9%**

China
The next growth chapter
GDP **4.5%**

Colombia
Towards a more balanced growth model
GDP **2.0%**
Unemployment **10.1%**
Inflation **5.1%**

Peru
Strong underlying economy and investment beyond recovery
GDP **3.2%**
Unemployment **5.0%**
Inflation **3.0%**

Chile
Turning the corner as investment takes the lead
GDP **3.5%**
Unemployment **8.5%**
Inflation **3.5%**

Argentina
A more robust macroeconomy for the next stage
GDP **2.7%**
Unemployment **7.1%**
Inflation **23.0%**

Uruguay
Moderate recovery amid investment constraints
GDP **1.5%**
Unemployment **8.1%**
Inflation **4.8%**

Brazil
A year of macroeconomic rebalancing
GDP **1.3%**
Unemployment **6.0%**
Inflation **4.4%**

United States

Sound growth and disinflation as the main challenge

The US economy is expected to maintain solid growth throughout 2027, supported by robust business investment, resilient consumption and strong productivity gains. A more restrictive Fed policy, relatively high long-term interest rates and a balanced labour market will help moderate underlying inflation in 2027.

Elena Nieto Vega

The US economy continues to show resilience. Despite higher interest rates, geopolitical uncertainty, tariffs and elevated energy prices, private domestic demand has expanded strongly. Growth is expected to stay solid through 2026 and 2027. Business investment will continue to be a key pillar of expansion, largely driven by the artificial intelligence (AI) buildout, with data centres and related technological upgrades supporting high-tech capital expenditure. Yet investment is extending beyond AI, with buoyant activity across several sectors. Businesses are increasingly accepting uncertainty as part of the new normal. Healthy credit flows and strong corporate earnings are supporting momentum.

Productivity growth has strengthened, largely reflecting pre-AI investment in automation, leaner operating models and efficiency gains. The productivity benefits from AI are likely to materialise gradually as adoption broadens, providing an additional tailwind to productivity and potential growth. Consumption, meanwhile, remains resilient. Despite lower real incomes, low unemployment, limited layoffs and wealth gains among asset-owning households continue to support spending. Looking ahead, moderating inflation and a stable labour market should support real household incomes and help sustain private consumption growth.

Labour market conditions remain stable. The labour market has settled into a "low-hire, low-fire" environment, with firms cautious about adding headcount while layoffs are still limited, as healthy demand and earnings reduce the need for aggressive restructuring. Crucially, lower hiring has coincided with slower labour supply growth, reflecting a sharp drop in immigration and an ageing population. Labour demand is therefore broadly keeping pace with workforce growth, resulting in a relatively stable equilibrium that we expect to persist through 2026 and 2027.

Inflation is now the main macroeconomic concern. Headline and core PCE inflation have remained above the Fed's 2% target for more than five years. Adverse supply shocks explain part of the recent acceleration. However, this does not necessarily imply that its effects will prove transitory. Prices ultimately reflect the interaction between

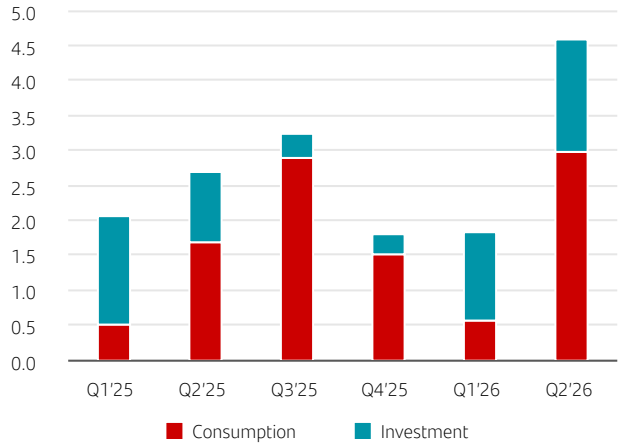
United States

supply and demand: a resilient economy can facilitate the propagation of supply shocks, while strong AI-related investment is generating price pressures in some goods categories. The longer inflation remains above target, the greater the risk that firms' price-setting behaviour and inflation expectations adjust accordingly.

Against this backdrop, the Fed has turned more hawkish. After raising rates in September, policymakers signalled that insufficient disinflation could warrant further tightening. Underlying inflation is easing, but not as quickly as desired. We therefore expect additional tightening in 2026. Long-term rates are likely to stay relatively high, reflecting solid growth, robust corporate and Treasury issuance, and little prospect of fiscal consolidation. This should complement the Fed's restrictive stance, limiting the need for further policy-rate increases in 2027. With a non-overheating labour market and continued productivity gains, underlying inflation should moderate towards the 2% target in 2027.

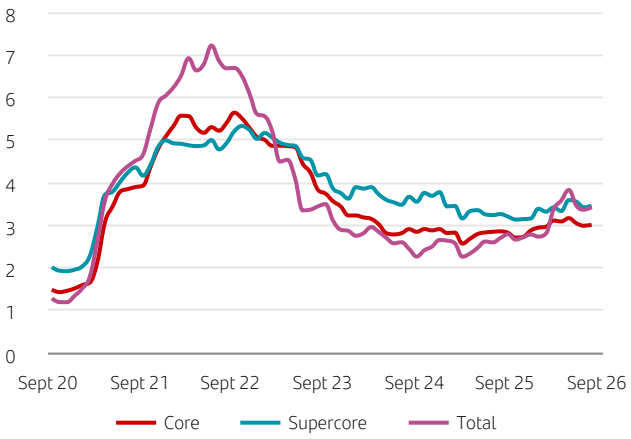
However, considerable uncertainty persists. Tariffs, energy prices and geopolitical disruptions could generate renewed price pressures, prolonging the period of above-target inflation. At the same time, questions linger over the scale, duration and eventual returns of the AI investment boom.

US: Real final sales to private domestic purchasers
(%, q/q annualised)



Sources: LSEG, BEA and Santander Research.

US: PCE inflation has remained above the 2% target
(%, y/y)



Source: LSEG.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	2.3	2.2	2.0
Unemployment rate	4.2	4.2	4.2
CPI inflation	3.5	2.5	2.1

Source: Santander Research. Annual average.



United States In focus

Artificial intelligence buildout and its impact on the economy



Artificial intelligence (AI) is fast emerging as a new general-purpose technology that could significantly boost productivity and profoundly transform production processes and service provision. As in previous technological transitions, this breakthrough has triggered an investment boom in the United States, already raising economic activity. It is creating opportunities but also potential challenges.

The AI transition in the US: where do we stand?

The sequence typically associated with general-purpose technologies is as follows. First, technological capabilities improve and the cost of specific applications declines. That is followed by broad-based adoption and investment by firms. Finally, measurable aggregate productivity gains and labour market effects emerge. Current evidence suggests that the AI transition is still in the buildout phase, with capabilities advancing rapidly, investment booming and adoption increasing, albeit unevenly. There is not yet compelling evidence of substantial aggregate productivity gains or broad labour market effects[1].

AI is driving a wave of physical capital formation in the US that is unusual in both scale and composition. Training and deploying modern AI systems requires large quantities of specialised hardware, electricity and purpose-built facilities. The associated investment encompasses not only buildings, but also substations, transmission upgrades, cooling systems and substantial volumes of specialised IT equipment. Hyperscalers[2] are set to invest more than 700 billion US dollars in capital expenditure in 2026 alone. This buildout resembles previous infrastructure booms (such as those associated with the railways, electrification and telecommunications) more closely than a conventional increase in technology-sector capital expenditure[3].

In the current phase of the AI transition, infrastructure investment is being mainly led by AI-producing firms. As adoption becomes more widespread, investment is likely to increasingly shift towards AI-using firms across the broader economy.

[1] Soto, Paul E., Mason Thieu, and Jeffrey S. Allen (2026), 'The AI Buildout and the Economy: Publicly Available Data to Assess AI's Impact', FEDS Notes, Washington: Board of Governors of the Federal Reserve System, July 17, 2026.
[2] Including Microsoft, Amazon, Alphabet, Meta and Oracle.
[3] BIS (June 2026), 'Annual Economic report'; and Stijn Van Nieuwerburgh (2026), 'Financing the AI Buildout'.



United States

In focus

Impact on economic growth so far

Quantifying the precise contribution of the AI investment boom to recent gross domestic product (GDP) growth is challenging. Both the capital expenditure of major technology firms and the national accounts investment categories most closely associated with AI spending (including computers and peripheral equipment and software) may also contain substantial non-AI expenditure. Moreover, the equipment supporting the buildout has a high, but difficult-to-estimate, import content, which does not contribute to GDP. Available estimates suggest that AI-related investment may have added between 0.5 and 1.0 percentage points, on average, to annualised quarterly US GDP growth since 2025[4]. This would correspond to roughly one-quarter to one-half of total growth over this period.

Beyond the direct contribution of investment, AI may also have supported economic activity through other channels. AI-related optimism has boosted equity valuations, potentially supporting household consumption through wealth effects. However, the concentration of capital flows towards AI-related firms may be crowding out investment elsewhere, while the surge in bond issuance by Big Tech firms may be exerting upward pressure on US long-term yields.

Opposing forces affecting inflation

The effects of AI on inflation are less straightforward, as the technology is likely to affect both aggregate supply and demand. On the supply side, AI could generate significant productivity gains, enabling firms to increase output at a lower cost. On the demand side, stronger AI-related investment may be raising the prices of key inputs, including semiconductors, other high-technology equipment and software. In addition, optimism about AI may boost investment and consumption before the expected productivity gains fully materialise.

The timing and relative strength of these effects are therefore critical to assessing the inflation outlook. If investment and consumption strengthen before supply-side benefits emerge, AI could increase inflationary pressures. Conversely, if productivity gains reduce production costs earlier, the technology may have a disinflationary impact. During the transition, however, firms must invest in organisational change, data infrastructure and systems integration, which may temporarily raise production costs even as the technological frontier continues to expand.

Reshaping the financial system

Artificial intelligence could make the financial system more productive, innovative and efficient by automating routine tasks, enhancing analytics, modernising legacy systems, strengthening cybersecurity and accelerating financial processes. It could also broaden access to credit and help financial institutions to allocate capital more

[4] Soto, Paul E., Mason Thieu, and Jeffrey S. Allen (2026), 'The AI Buildout and the Economy: Publicly Available Data to Assess AI's Impact', FEDS Notes, Washington: Board of Governors of the Federal Reserve System, July 17, 2026; and Rubinton, Hannah and Bontu Ankit Patro (January 2026), 'Tracking AI's Contribution to GDP Growth', Federal Reserve Bank of St. Louis.

effectively. These efficiency gains may support additional lending, investment and economic growth.

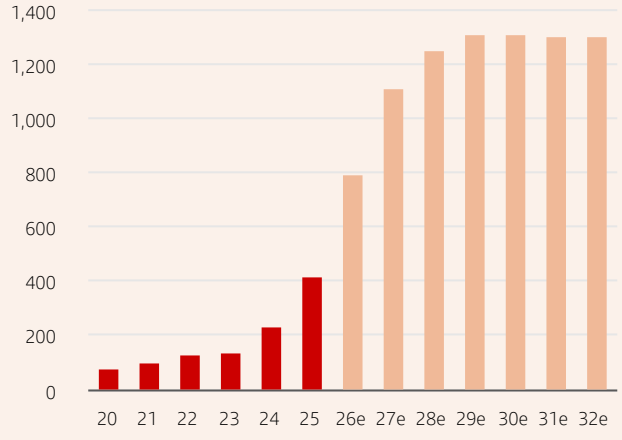
At the same time, innovation may entail a range of new challenges, including vulnerabilities associated with AI-driven algorithmic trading, sectoral disruption and the growing use of debt markets to finance AI infrastructure[5]. Until recently, the hyperscalers investing in AI infrastructure financed capital expenditure largely through retained earnings. However, rising funding requirements are prompting a shift towards debt markets.

Although many of the largest investors are also highly creditworthy borrowers, the increasing use of leverage to finance investment in an emerging technology carries risks, particularly if expected returns fail to materialise or prove lower than anticipated.

Looking ahead

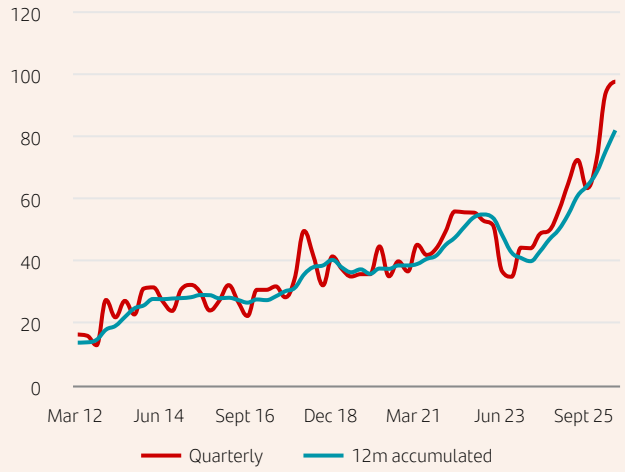
AI has the potential to reshape the global economy by boosting productivity and innovation and expanding productive capacity. At the same time, the uncertainty and adjustment costs associated with the transition call for flexible policies and close monitoring of business impacts and macroeconomic and financial challenges. A broad range of financing channels will ultimately be required to meet the funding needs associated with the AI buildout in the coming years.

Hyperscaler Capex
(USD bn)



Source: Bloomberg Intelligence.

Capex share of operating cash flow for hyperscalers*
(%)



* Includes Amazon, Google, Meta, Microsoft and Oracle.
Sources: LSEG and Santander Research.

[5] Lisa Cook (May 2026), 'The Opportunities and Risks AI Presents for the Economy and Financial System', Remarks at Stanford Institute for Economic Policy Research.

Euro Area

From resilience to transformation

Europe has proved resilient in the face of a new energy shock, but increasing its growth potential will require a sustained investment cycle that delivers a lasting improvement in productivity and competitiveness. In 2027, investment could accelerate thanks to fiscal support, but this push needs to be complemented by stronger private investment.

Concepción Sanz Gómez

The euro area exhibited an unexpected degree of resilience in 2026. We expect gross domestic product (GDP) to grow by 1.0% in 2026, showing a notable capacity to adapt to higher energy costs and uncertainty arising from the Middle East conflict.

This resilience reflects several factors. First, the economy is less dependent on gas and has lower energy consumption than at the beginning of the 2022 crisis. Second, households have drawn on part of their savings to cushion the impact on disposable income and sustain consumption. Finally, domestic demand is benefiting from higher defence spending, the expansionary German fiscal stance and the global increase in technology investment, including artificial intelligence (AI)-related investment.

Inflation has risen, but the impact on underlying inflation remains limited. Wage growth has moderated and, so far, there are no clear signs of second-round effects.

We expect stronger growth in 2027, but the challenges are also greater. We expect euro-area GDP to grow by 1.4% in 2027. The main boost is expected to come from a gradual recovery in investment, supported by defence spending, German infrastructure plans and investment in digitalisation and AI. The labour market will continue to provide stability for households. We expect employment to grow and the unemployment rate to stay at historically low levels.

However, growth could continue to be uneven across countries and sectors. Germany is playing an increasingly important role, supported by higher defence and infrastructure spending, while other economies face tighter fiscal constraints. At the same time, stronger Chinese competition is putting further pressure on the euro area's external competitiveness. In addition, part of the new spending on defence and technology will translate into imports, limiting its direct impact on European GDP.

Inflation will remain a key risk in 2027. We expect inflation to moderate, but probably stay above the European Central Bank (ECB)'s 2% target for most of the year, with risks tilted to the upside. The main concern is that persistently high energy prices raise business costs and progressively feed through to wages and broader goods and services prices. Against this backdrop, we expect the ECB tightening cycle to extend into 2027.

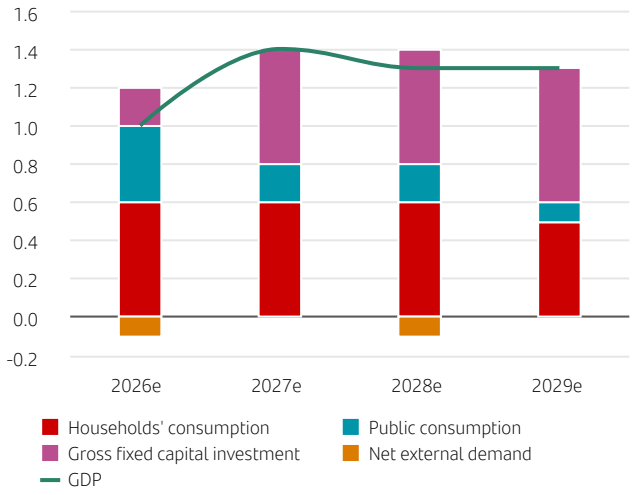
Euro Area

Fiscal policy support could become more uneven. In 2026, fiscal policy has been having a mildly expansionary effect, driven by public investment, defence spending and measures aimed at cushioning the energy shock. We expect the budget deficit to increase to 3.5% of GDP, from 3% in 2025. In 2027, the fiscal stance will be mildly restrictive for the euro area (we expect the budget deficit to be 3.6% of GDP), although with significant differences across countries. Germany will maintain an expansionary stance. Elsewhere, the end of NextGenerationEU (NGEU) funds and the need to consolidate public finances will have a contractionary effect.

Against this backdrop of uneven fiscal capacity, mobilising private investment will be crucial to support the public investment push, as it is private capital contributions, together with an uptick in firms' productive capacity and adoption of new technologies, that will determine the effect public investment has on potential growth.

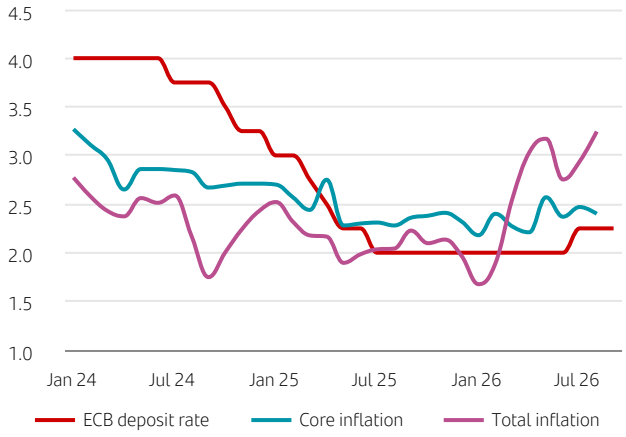
Ultimately, 2027 could mark the beginning of a transition towards an economy in which investment plays a greater role in supporting growth, alongside its capacity to absorb shocks. How this develops will determine whether resilience can translate into durable economic expansion.

Euro area: Fixed investment to make an increasing contribution to GDP growth
(%)



Source: Santander Research.

Euro area: Inflation will remain a key risk in 2027
(%)



Source: ECB.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.0	1.4	1.3
Unemployment rate	6.4	6.3	6.3
CPI inflation	3.1	2.6	1.9

Source: Santander Research. Annual average.

Eurobonds: the debate shifts from desirability to institutional design

The case for eurobonds is changing. A debate that was initially about preventing financial fragmentation and sovereign debt crises is increasingly becoming a discussion about how Europe can finance its strategic priorities, deepen capital markets and strengthen the euro's international role.

Why Europe needs a common safe asset

1. Europe faces substantial investment needs in defence, the energy transition, digital infrastructure and technological innovation. These investments are difficult to finance exclusively through national budgets or private markets because their benefits extend beyond national borders and often display the characteristics of European public goods. Given the scale of the investment required and the fiscal constraints facing many member states, around 80% of the necessary investment would need to come from private capital[1]. A common European safe asset could provide an appropriate tool for delivering the financing capacity needed to support these investments.

2. The international role of the euro remains constrained by the relatively limited supply of euro-denominated safe assets[2]. The contrast with the United States is striking: US Treasury securities exceed 30 trillion US dollars in outstanding volume. German Bunds, the closest equivalent to a European safe asset, represent less than one-tenth of that amount, while European Union (EU)-issued bonds are much smaller in scale still.

3. A common European safe asset would strengthen the euro area's financial architecture and improve the functioning of its system in several ways. A larger supply of high-quality collateral would deepen repo markets, derivatives and other financial markets, improving risk management and financial intermediation. It could also bolster financial stability by reducing banks' dependence on domestic sovereign debt to satisfy liquidity requirements, thereby weakening the sovereign-bank nexus. Moreover, it would provide a common benchmark yield curve, which could reduce the fragmentation that still characterises European capital markets and improve the transmission of monetary policy by narrowing differences in financing conditions across countries[3].

[1] European Parliament (2026), 'Financing competitiveness in the EU: One year on from the Draghi Report' (PE 783.090), Directorate-General for Internal Policies of the Union.
[2] Villeroy de Galhau, F. (2025), 'The international role of the euro and the development of European safe assets', speech, Banque de France, 2 October.
[3] Lane, P. R. (2026), 'Expanding the supply of euro safe assets', keynote speech at the European Systemic Risk Board workshop 'A European Safe Asset and Financial Stability', European Central Bank, Frankfurt am Main, 22 April.

4. A deeper market for euro-denominated safe assets could promote innovation and competitiveness by supporting the development of stablecoins and other digital financial instruments, much as US Treasuries underpin dollar-based markets. More importantly, it would complement the objectives of the Savings and Investment Union by making it easier to channel European savings towards productive investment.

Obstacles

Traditionally, the main obstacle to eurobonds has been the risk of moral hazard. Countries with stronger fiscal positions have worried that common borrowing could weaken incentives for fiscal discipline and ultimately create implicit transfers towards more indebted member states.

That concern has eased somewhat as the fiscal position of peripheral economies has improved. Moreover, there is growing recognition that Europe would benefit from an adequate supply of euro-denominated safe assets. As a result, the debate is gradually moving towards how to design an appropriate institutional framework for a European safe asset.

Here, views still diverge. Some policymakers argue that common debt should be accompanied by stronger governance arrangements at the European level and, potentially, by greater EU revenue-raising capacity. Others favour faster solutions based on converting part of the existing stock of national debt into a common instrument.

Fiscal credibility remains central to the discussion. Recent analyses argue that the principal obstacle no longer lies in the design of the fiscal rules themselves but in their effective enforcement[4]. Overcoming this resistance would require consistent application of the fiscal rules by member states.

Debate also continues regarding the allocation of common expenditure. A stronger political case can be made when borrowing is clearly linked to genuine European public goods — such as defence, energy security, research, innovation and cross-border infrastructure — where the benefits are shared across countries[5].

Conclusion

A common European safe asset could strengthen the EU's financial architecture by reducing financing costs, fostering financial integration, enhancing financial stability and reinforcing Europe's strategic autonomy. The main controversy is no longer whether Europe needs such an asset. It is about what institutional design would make one compatible with fiscal discipline and the effective provision of European public goods, making a European safe asset economically efficient, financially credible and politically acceptable. Finally, its implementation may also require the right timing, both from a fiscal and a market perspective.

[4] Arnal, J. (2026), 'Why Eurobonds will never fly without credible fiscal enforcement', EUobserver, 26 May.
[5] Rehn, O. (2026), 'A European safe asset: From crisis pragmatism to strategic necessity', welcome address at the European Systemic Risk Board workshop 'A European Safe Asset and Financial Stability', European Systemic Risk Board, Frankfurt am Main, 22 April.



France

Weak growth and fiscal consolidation in focus

The French economy is expected to stay on a very modest growth path over the next two years, constrained by weak domestic demand, a challenging international environment and the need to make progress on fiscal consolidation.

Economic activity will remain subdued, with gross domestic product (GDP) growth of 0.4% in 2026 and 0.8% in 2027. Household consumption was affected in 2026 by the rebound in inflation, the resulting loss of purchasing power and heightened uncertainty. However, easing energy price pressures should support a recovery in real disposable income from next year onwards. A recovery in confidence will also be important in 2027, as will the extent to which the expected increase in household income translates into consumption rather than additional savings. The household saving rate is still relatively high by historical standards, at around 18% of disposable income.

Business investment is also weak, weighed down by restrictive financial conditions and persistent political and fiscal uncertainty, which continues to undermine business confidence.

By contrast, we expect the external sector to continue being one of the main sources of support for economic activity, with exports maintaining the positive momentum observed in 2026. France retains a competitive position in high-value-added industries such as aerospace, defence, electronics and electrical equipment, which is still one of the economy's key strengths.

The labour market is also likely to remain weak. Total employment has been broadly stagnant since late 2024, with declining salaried employment not offset by growth in self-employment. As economic activity gradually recovers, we expect employment conditions to improve, although probably not before the second half of 2027. Even then, the improvement is unlikely to be strong enough to generate a significant drop in unemployment. We expect the unemployment rate to stay at 8.3% in 2026 and 2027.

Inflation has increased as a result of higher international energy prices. Our scenario envisages average inflation of 2.1% in 2027. This would put it below the euro-area average, reflecting weak domestic demand and intense competitive pressures, which make it difficult for companies to fully pass higher costs through to final consumer prices.

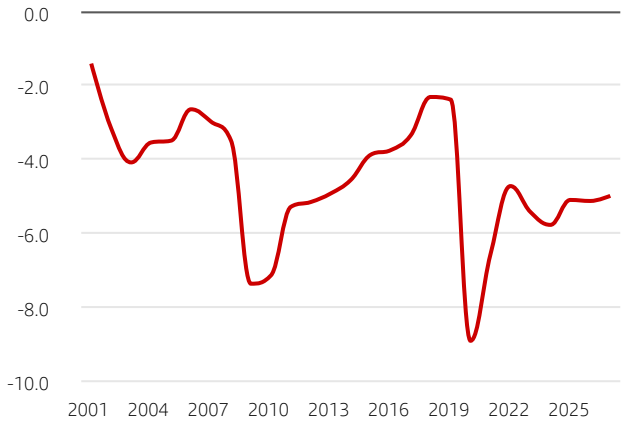
France

France's main structural challenge is still its public finances. The fiscal deficit continues to exceed 5% of GDP, while public debt stands above 115% of GDP. Approval of fiscal consolidation plans has proved difficult in an environment of domestic political instability. Fragmentation in the National Assembly is making it harder to reach agreements on budgets and structural reforms, while the proximity of the 2027 presidential election reduces incentives to adopt potentially unpopular measures.

This lack of clarity regarding the fiscal strategy is also putting upward pressure on government bond yields and tightening sovereign financing conditions. These pressures could ultimately spill over into financing conditions for both businesses and households, further delaying the economic recovery.

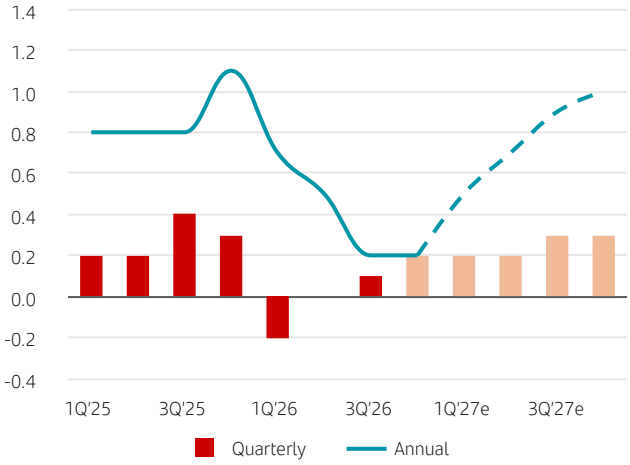
Overall, France's economy is stagnating rather than falling into recession, while the country retains important strengths in high-value-added industrial sectors. Weak domestic demand, fiscal consolidation that has yet to begin in earnest, low confidence and higher interest rates are delaying the recovery. The key challenge will be to combine a credible fiscal consolidation strategy with greater political stability. Next year's presidential election will be a test of this.

France: The public deficit is a challenge
(% GDP)



Source: Fiscal Monitor IMF.

France: GDP will improve in 2027
(%)



Source: Fiscal Monitor IMF.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	0.4	0.8	1.1
Unemployment rate	8.3	8.3	8.1
CPI inflation	2.3	2.1	1.4

Source: Santander Research. Annual average.

Germany

Fiscal stimulus and structural challenges

After several years of stagnation, the German economy has begun to recover, supported by fiscal policy. We expect gross domestic product (GDP) to grow by just over 1% in 2026 and 2027, with a temporary inflation rebound driven by higher energy prices and a labour market that will take time to reflect the improvement in activity. Improving industrial competitiveness and addressing demographic pressures remain key structural challenges.

The economy is emerging from several years of virtually no growth, although the recovery is still uneven. Fiscal stimulus, a modest uptick in domestic demand and an external sector that continues to lose weight as competitiveness declines will shape the way the economy rallies. Fiscal policy is expected to be the main support for activity in the coming years.

We expect GDP to grow by 1.1% in 2026 and 1.2% in 2027. Private consumption should gradually gain traction, supported by moderating inflation and rising nominal wages, which should improve real disposable income and reduce precautionary saving. Investment will also make a growing contribution, particularly through higher public spending on defence and infrastructure. Its impact will depend on the government's ability to execute projects and whether fiscal stimulus encourages stronger private investment. The external sector is likely to be less dynamic than in previous cycles because of trade tensions and declining competitiveness in some industries.

The labour market is expected to remain weak, with unemployment averaging 6.4% in 2026 and 6.3% in 2027. A significant share of employment growth in recent years has been concentrated in public-sector-related activities, while industry and other private-sector activities have lost jobs. We expect this pattern to reverse only gradually. A clearer recovery in private employment will be needed to confirm a broad-based improvement.

Inflation should gradually move towards 2% following the temporary rebound caused by higher energy prices, assuming no new geopolitical shocks. We expect average inflation of 2.8% in 2026 and 2.6% in 2027, with some normalisation in energy prices and limited second-round effects.

Despite the cyclical recovery, **Germany faces a structural transformation of its growth model.** For decades, growth relied on technologically competitive industry, cheap energy and strong external demand, particularly from China. These conditions have changed. Energy costs are higher, productivity and business investment have advanced

Germany

slowly, and delays in physical and digital infrastructure are hampering firms' adaptation. China has also shifted from being a major market for German exports to becoming a direct competitor, notably in the automotive sector.

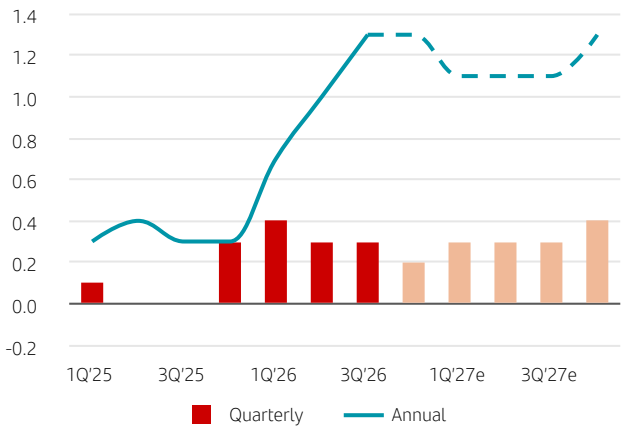
Demographic pressures add to the competitiveness challenge, with an ageing population and growing shortages of skilled workers. Raising labour-force participation, attracting skilled workers and improving productivity will be essential to lift potential growth.

The structural reform package presented in July, covering fiscal and labour-market reforms, investment incentives, bureaucracy reduction and pensions, could raise potential growth by up to 0.3 percentage points if implemented.

The international environment is still a key source of uncertainty. Prolonged geopolitical tensions could keep energy prices and inflation elevated, delaying interest-rate cuts. Higher public financing needs could put upward pressure on long-term rates.

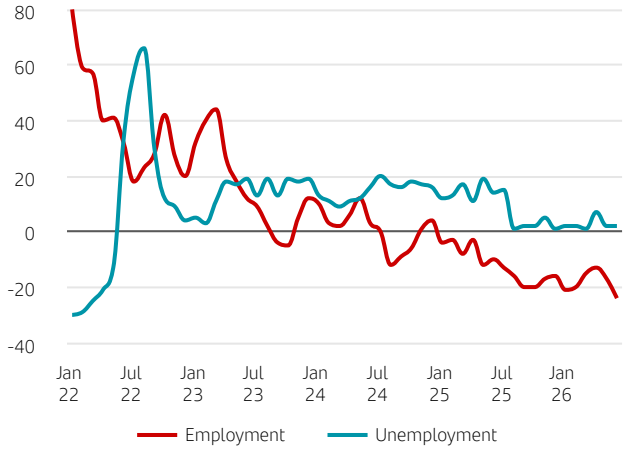
In conclusion, Germany is leaving behind its period of stagnation with a gradual recovery expected in 2026–27, driven mainly by fiscal policy. The key challenge will be to translate this stimulus into stronger private investment, technological capabilities and productivity, thereby raising potential growth.

Germany: GDP is leaving stagnation behind
(%)



Source: Fiscal Monitor IMF.

Germany: Employment and unemployment
(monthly change, 3 month moving average, thousands)



Source: Refinitiv.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.1	1.2	1.4
Unemployment rate	6.4	6.3	6.1
CPI inflation	2.8	2.6	1.9

Source: Santander Research. Annual average.



Portugal

Moderate steady growth on stronger foundations

Portugal enters 2027 with the economy still expanding, but in a more demanding environment than during the post-pandemic reopening. The baseline scenario is moderate, steady growth supported by stronger structural fundamentals: activity remaining near potential, inflation gradually declining, the labour market normalising without any sharp deteriorations, and financial conditions staying orderly, though less supportive than during the low-rate period.



Bruno Fernandes
Rui Constantino

2027 is expected not to mark a new acceleration phase, but rather **a period of controlled normalisation from a stronger potential-growth base.** Gross domestic product (GDP) is projected to grow by around 2%, after a 2026 performance constrained by the temporary energy shock, weaker confidence and softer external demand. Comparing Portugal's potential-growth trajectory before and after the sovereign-debt adjustment period, we find that between 2013 and 2019, the average pace of potential growth was around 1.5 times higher than in 2000-08. This suggests that the economy entered the current cycle with sounder fundamentals, such as lower indebtedness and greater financial autonomy, higher productivity and greater energy autonomy. Growth of around 2% in 2027 would not be a temporary rebound, but evidence of a more resilient underlying trajectory.

Domestic demand is still the main growth driver, supported by employment, wage increases and household savings, although higher prices and financing costs should keep consumption selective. Within this moderate growth path, the composition of demand matters more than GDP expansion alone. Buoyancy will depend increasingly on the quality, timing and execution of investment in, inter alia, digitalisation, renewable energy, logistics, data infrastructure and artificial intelligence (AI)-related technologies, as well as the spillover effects from Recovery and Resilience Plan projects. Tourism and services should continue to support exports, while exports of goods remain exposed to subdued European industrial activity and high input costs. The central issue is whether moderate growth can translate into a more productive and resilient expansion.

Inflation is expected to decline again in 2027, but the last mile is yet to be completed. After a temporary increase in 2026, mainly linked to energy prices, average inflation is projected to ease to around 2.4%. Headline inflation should benefit from the fading of the energy shock, while services prices, wage dynamics and residual pass-through from earlier cost increases may prove more persistent.

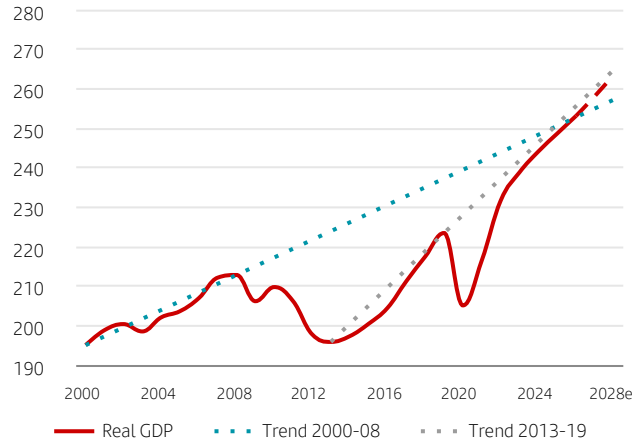
Portugal

The labour market should remain strong, although less tight than in recent years. The unemployment rate is projected to rise only marginally, to around 6.1% in 2027, after staying close to 6% in 2025-26. This points to labour-market normalisation rather than deterioration. Employment growth should slow as activity stabilises, and firms may become more selective in hiring. However, demographic constraints, labour shortages and demand for digital, energy and services-related skills should continue to support employment. Wage growth is expected to moderate, while still sustaining household income and contributing to persistent services inflation.

Portugal's public debt ratio is projected to decline to around 80% of GDP in 2027, providing a stabilising factor that will help to preserve investor confidence and contain sovereign spreads. This perceived stabilisation will also strengthen fiscal credibility by reducing refinancing risk and creating a larger buffer against adverse scenarios.

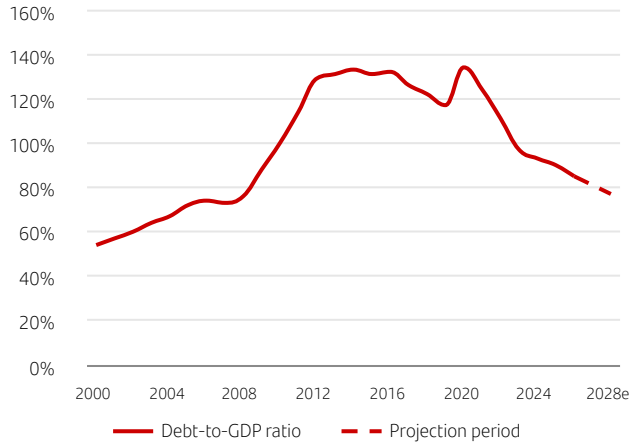
Overall, the 2027 outlook points to controlled normalisation rather than cyclical stress. The main challenge is not short-term stabilisation, but turning a stronger growth base into higher productivity, better investment quality and greater macroeconomic resilience.

Portugal: Real GDP and long-term growth trends
(Historical data and projections, 2000–2028)



Sources: INE and Santander Research.

Portugal: Debt-to-GDP ratio on a downward path
(Historical data and projections, 2000–2028)



Sources: INE and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	2.2	2.1	2.1
Unemployment rate	5.8	6.1	6.4
CPI inflation	2.7	2.4	2.2

Source: Santander Research. Annual average.



Portugal In focus

Tourism: the hen that lays the golden eggs learns to look after the nest



Portuguese tourism has already proved that it can recover and grow. Its next challenge is harder: to turn scale into value, demand into better experiences, and short-term success into a more resilient model for territories, companies and communities.

An economic fable to explain the sector's maturity

The fable of the golden-egg-laying hen warns against extracting value without preserving its source. In Portuguese tourism, the 'golden eggs' are jobs, revenues and value added. The question is how to protect the 'hen' that produces them: the companies, services, territories and reputation on which the sector depends.

The logic has changed. Before the pandemic, growth came mainly from scale; today it depends less on increasing volumes and more on preserving the 'nest': the conditions that allow the sector to remain attractive, productive and trusted.

Tourism consumption expenditure has risen strongly over the past decade and is now well above pre-pandemic levels. Beyond this recovery, tourism has become a powerful vehicle for converting external demand into domestic revenue. The next phase is therefore about generating more value from each visit.

Where tourism first creates and then spreads value

Accommodation, food services and transport are still the sector's main monetisation channels, but sources of value are evolving. Accommodation combines location, brand and service; food services combine gastronomy and culture; and transport provides access to new markets.

Tourism activates diversified chains, from construction to technology, culture and urban services. Both characteristic tourism products and related or indirect products have expanded significantly, showing that the sector works as a wider demand platform. It can spread value, investment and employment, but also pressure housing, mobility and infrastructure. Sustaining tourism therefore means steering these effects towards productive gains while minimising congestion.

From visitor spending to domestic value added

Tourism spending matters because it is not only an external source of demand; it is also a channel through which income is created within the Portuguese economy. When visitors spend on accommodation, food, transport, culture or leisure, part of the money becomes national production through wages, margins, purchases from suppliers and investment. The recovery in tourism consumption has been accompanied by a stronger contribution to

gross value added (GVA). The next challenge is to improve that value added with higher productivity, better wages and stronger links to the rest of the economy.

Portugal now attracts a broader mix of visitors, with non-core European markets growing faster than traditional sources of demand. Rather than replacing historical markets, they add new sources of growth: different calendars and motivations help reduce seasonality and strengthen resilience.

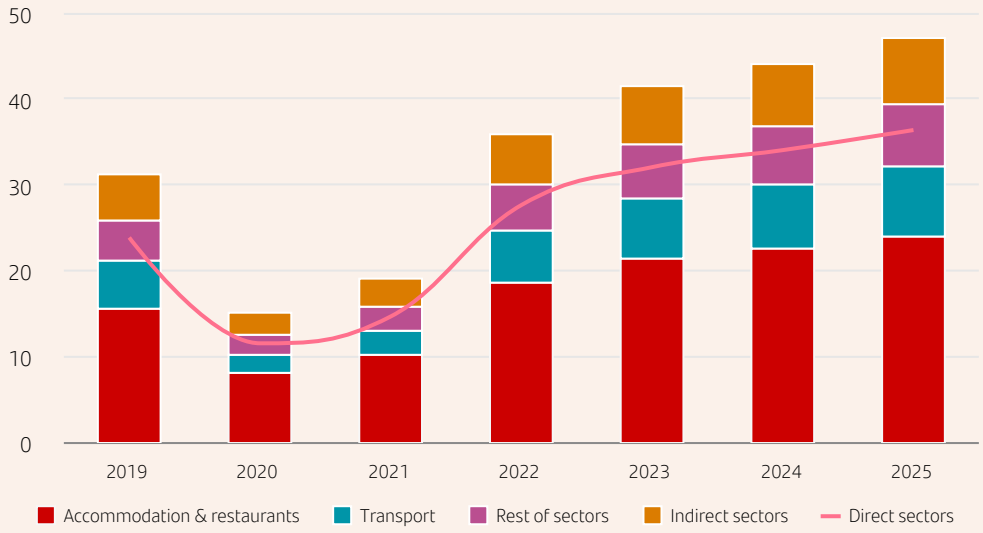
Revenue per overnight stay has risen materially, showing that tourism is not only attracting demand but also generating more value from each night. Being labour-intensive, the sector can still raise productivity through training and technology, from digital check-in to stock management. Tourism supports a particularly large share of employment in Portugal compared with the European average, making sectorial jobs and skills central to growth.

The next test: sustaining value creation

Having moved from scale to value, tourism now faces the challenge of sustainability. Its maturity agenda covers five fronts: product (from gastronomy to wine tourism), territory (spreading benefits across regions and seasons), human capital (upskilling teams), productive investment (technology and data) and governance of indirect effects (protecting housing, mobility and sustainability).

In conclusion, Portugal's tourism sector has built significant scale. There is an opportunity now for the country to make scale work harder: generating more value, supporting better jobs, easing pressure on territories and protecting the reputation that made the country attractive. In an unstable world, Portugal's safety, openness and Atlantic position are strategic assets. The task is to build a tourism model that remains competitive because it is also sustainable.

Portugal: Tourism spending trends
(€bn)



Sources: INE and Santander Research.

Spain

An economy maintaining its momentum once again

After expanding more strongly than expected in 2026 despite the Middle East energy shock, growth will moderate to 2.2% in 2027 but remain clearly above that of the euro area. Inflation will continue moving towards the European Central Bank (ECB)'s target and employment will keep climbing, while the main challenges of raising productivity and improving housing affordability will persist.

Sandra Esteve Gualda

Solid domestic demand supports above-euro-area growth. The Spanish economy will enter 2027 having once again surprised on the upside during 2026. Despite the deterioration in the international environment caused by the conflict in the Middle East, the temporary increase in energy prices and heightened geopolitical uncertainty, economic activity has shown remarkable resilience. Gross domestic product (GDP) growth continues to perform stronger than expected, allowing the 2026 forecast to be revised upwards to 2.6%, supported primarily by robust private consumption, strong employment growth and the solid performance of services exports.

In 2027, we expect growth to moderate to 2.2%, but it will stay clearly above that of the euro area, maintaining the growth differential: since 2023, Spain has been growing at three times the rate of the euro area.

As before, domestic demand will be the main driver of economic activity. Private consumption will continue to grow faster than GDP, supported by improving real disposable income and a labour market that will continue to generate employment. Investment will moderate from the strong growth recorded in 2025 and 2026, with investment in construction performing better than investment in capital goods, driven by the persistent imbalance between housing supply and demand, while investment in intangible assets will continue to grow above the average, consolidating the structural shift towards higher-value-added activities. A key upside risk is the implementation of European funds, which concluded in 2026 and whose effects could become more evident in 2027.

At the same time, in the external sector, services exports will continue to grow faster than goods exports. However, imports will also hold strong, in line with domestic demand, meaning that the external sector's contribution to GDP will be close to zero. Tourism will grow broadly in line with GDP, as Spain will continue to benefit from its position as a safe, higher-value-added destination, with tourism expenditure growing faster than visitor numbers. Meanwhile, non-tourism services exports will continue to consolidate their position as one of the main structural drivers of growth.

Spain

Despite the positive outlook for the Spanish economy, there will still be uncertainties, the main one being the international environment. Developments in energy prices, persistent geopolitical tensions and still relatively restrictive financial conditions could constrain growth in private investment.

Employment remains strong, but productivity is the key challenge. The labour market will retain its position as one of the main pillars of the Spanish economy. In 2027, the pace of job creation will moderate to around 2%, in line with the normalisation of economic growth, but that will be enough to keep reducing the unemployment rate, despite the continued increase in the labour force.

The challenge from 2027 onwards will be to improve productivity. The Spanish economy continues to grow primarily thanks to the incorporation of more workers and higher total hours worked across the economy, yet productivity gains are still limited, constraining medium-term growth potential.

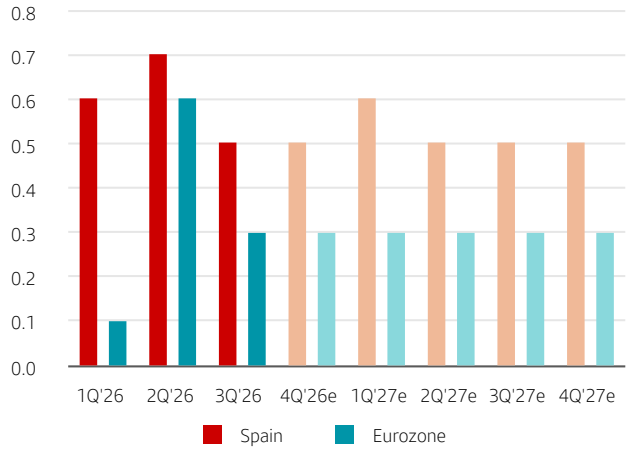
Easing energy pressures support further disinflation. We expect inflation to moderate gradually in 2027, but it will stay above the ECB's target until 2028. Although the energy component is expected to cease exerting the pressure observed during 2026, core inflation will continue to show some persistence owing to developments in services, where moderation typically occurs with a greater lag. The main risk will be the emergence of second-round effects, which have not materialised so far.

The housing market will continue to be shaped by two opposing forces. On the one hand, worsening affordability — driven by rising interest rates and house prices outpacing wages — will weigh on effective demand. On the other, persistent supply constraints will widen the housing shortfall in 2027, as household formation continues to significantly outpace housing completions. House price growth is expected to continue moderating from its Q1 2026 peak, but still stand well above inflation.

In conclusion, in 2027 Spain will continue to grow faster than the euro area, supported by solid domestic demand, dynamic services exports and a labour market that will continue to generate employment. The challenge will no longer be merely to maintain growth above the European rate, but to improve its quality. Increasing productivity and accelerating investment will be key to consolidating sustainable growth in an international environment that is likely to remain characterised by high uncertainty.

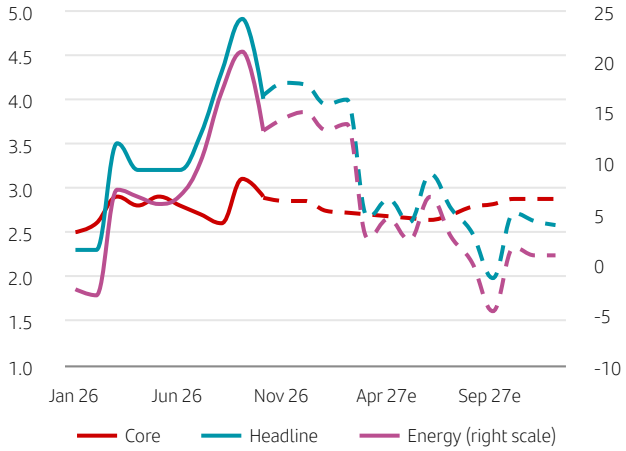
Spain

Spain: GDP growth in Spain vs the euro area
(%, q/q)



Sources: Refinitiv and Santander Research.

Spain: Inflation is expected to moderate in 2027
(%, y/y)



Sources: INE and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	2.6	2.2	1.8
Unemployment rate	9.9	9.4	9.2
CPI inflation	3.6	2.9	2.1

Source: Santander Research. Annual average.

The 'silent engine' of the Spanish economy

Not all of Spain's services exports are related to tourism. There is another, less well-known export engine that may represent a significant structural change in the Spanish economy: non-tourism services exports. What is included in this category and how has it evolved?

The growth in non-tourism services exports — i.e. services provided to foreign clients other than tourism, such as business services, financial activities and transport services — has doubled from an average of 6.8% in 2014–2019 to 14.5% in 2025. In contrast, tourism exports have increased only from 5.5% to 6.9% over the same period. Non-tourism services account for 60% of total services exports, and their share of gross domestic product (GDP) is increasing (to almost 8% in 2025). The European Union (EU) is still the main destination for Spanish exports, while the United States is the leading non-EU market, particularly for technology-intensive services.

What types of services does Spain export and where?

Non-tourism services are concentrated in three broad segments that together account for 75% of Spain's non-tourism services exports: business services — the main structural driver and closely linked to corporate internationalisation; information and communications technology (ICT)-related services; and transport services, which are more dependent on the trade cycle. Since the pandemic, business and ICT-related services have grown fastest (by more than 15% on average), increasing the weight of high value-added, productive and knowledge-intensive activities in Spain's export mix and strengthening its long-term growth potential[1].

What is driving the stronger growth in non-tourism services exports?

Following the global financial crisis[2], wage moderation made it possible to reduce relative labour costs versus the euro area, supporting the internationalisation of many services companies and the growth of their exports. However, the current competitive advantage no longer rests on lower costs, but on structural factors.

At the global level[3], there has been a strong increase in demand for services, driven by digitalisation and remote working, which have reduced barriers to international trade in services. Spain has continued to internationalise its companies and has increased investment in intangible assets (the area of investment that has grown the most in Spain since the pandemic), boosting provision of higher value-added services. In addition, Spain has competitive advantages for the development of digital services, such as fibre-optic coverage in 95% of households[4] (versus 69% across Europe) and more than 30 submarine cables connecting it with Europe, Africa and the Americas[5].

[1] ICT-related services: services related to information and communication technologies, including telecommunications, computer and digital services, software development, data processing and other IT-related activities.
[2] Banco de España (2023), 'Recent Developments in Spain's Non-Tourism Services Exports', Economic Bulletin, 2023/Q3, Article 05, July.
[3] Banco de España (2026), 'Annual Report 2025', Box 1.5: Investment in Intangible Assets and the Expansion of Spain's Non-Tourism Services Exports.
[4] European Commission (2024), 'Digital Decade Country Report – Spain' (formerly DESI).
[5] TeleGeography, 'Submarine Cable Map' (consultation 2025/2026).

Spain In focus

Benefits for Spain's growth model

One of the most beneficial aspects of Spanish growth becoming more dependent on non-tourism services exports is that, unlike tourism, their performance is much less reliant on the economic cycle, so they act as a stabiliser, as happened during the pandemic. While tourism suffered a drop of more than 70% in 2020, non-tourism services recorded more moderate declines of around 10%, and some segments, especially digital ones, even continued to grow thanks to the possibility of providing many of these services remotely.

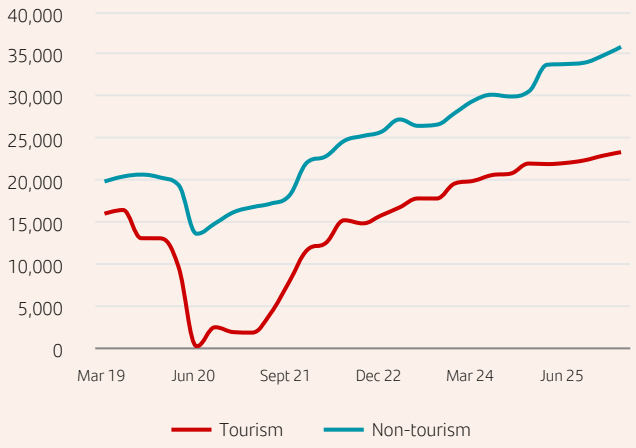
In addition, non-tourism services exports have become the second pillar of Spain's external balance behind tourism. In 2025, according to balance of payments data, both generated a trade surplus of 3.8% of GDP, offsetting the deterioration in the goods balance (-3%) and reducing dependence on tourism alone.

Another important benefit is the type of employment these activities generate. Business and ICT services tend to be knowledge-intensive and reliant on highly skilled workers, supporting demand for professionals in areas such as engineering, technology, consultancy and research and development (R&D). Their expansion therefore also contributes to a gradual shift towards higher-productivity and higher value-added employment.

Conclusion

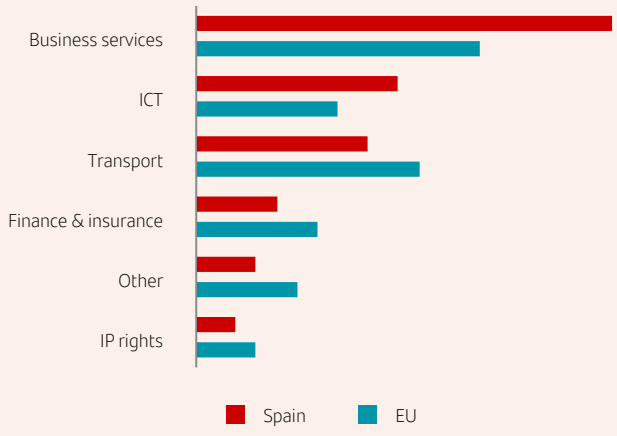
Overall, non-tourism services exports may represent a significant structural change in the Spanish economy. Their expansion has diversified the export base, strengthened the external balance and consolidated high-value-added, knowledge-intensive activities that are less exposed to the economic cycle and have considerable growth potential.

Spain: Services exports
(EUR mn)



Source: Spanish National Statistics Institute (INE).

Spain: Composition of non-tourism services exports
(% of total, 2024)



Source: Eurostat.

United Kingdom

Growth steady despite external pressures

Growth in the UK economy was better than expected in 2026 despite headwinds from geopolitical events. However, the labour market has loosened, and inflation, having fallen in the early part of the year, has risen again as higher energy costs feed through. Looking forward, fiscal constraints are likely to remain, given the level of government debt, while monetary policy will be constrained by higher inflation, raising the possibility of rate increases.

Frances Haque
Giles Andrews

Economic growth was positive for the first half of 2026, growing by 0.6% in Q1 and 0.4% in Q2 despite the headwinds from the Middle East conflict, with households supporting growth by using savings, as seen in chart one. However, the outlook is for weaker growth, with higher energy and food prices squeezing household consumption again. The resolution of the conflict in the Middle East will have a large impact on this outlook — particularly inflation — with the possibility of second-round effects increasing the longer the conflict continues. That is not to mention its impact on interest rates, growth, etc.

The labour market continued to loosen in 2026 and appears to be having some effect on reducing private sector wage growth, which at the end of Q2 was 2.8% — a level that the Bank of England would consider in line with its inflation target. Unemployment fluctuated and the ongoing issues with the Office for National Statistics (ONS) Labour Force Survey continue, but the unemployment rate and other data such as vacancies, His Majesty's Revenue & Customs (HMRC) payroll data and the results of other surveys suggest that the labour market could be stabilising in H2 2026. The unemployment rate at the end of Q2 was 4.9%. However, risks around increasing costs for businesses either through higher taxation, higher energy prices or other higher input prices could mean further consolidation of the workforce. The use of artificial intelligence (AI) may also have an impact on areas of the labour market looking forward.

Inflation had been falling in the first half of 2026, but with household energy bills rising in July, inflation returned to 2.9% at the start of Q3. Headline inflation is set to increase over the rest of the year, peaking at 4%. It is also considered likely that the energy price cap will increase again in October and January, meaning that inflation will be higher in 2027 than previously thought. At present, growth in output producer price inflation is lower than input producer price inflation, as shown in chart two. This suggests that firms are not passing on all cost rises at present. However, this may change if costs to businesses continue to rise.

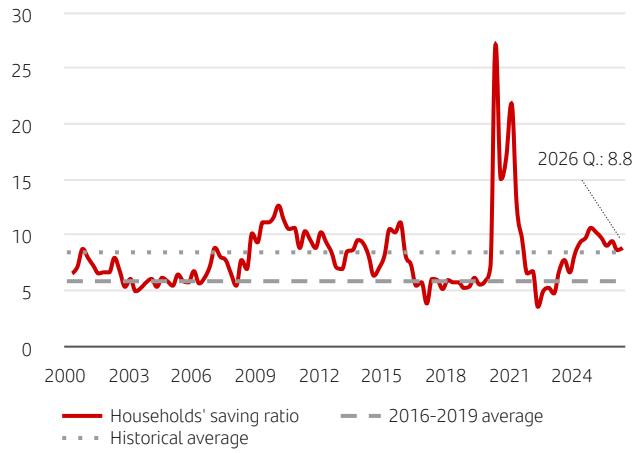
United Kingdom

Inflation is forecast to rise over the rest of 2026 and into 2027. It is now expected that the Monetary Policy Committee (MPC) will raise Bank Rate further. However, this is heavily dependent on the cessation of the conflict in the Middle East. Inflation expectations, which can be key to second-round effects, have increased recently given the continuation of the conflict. However, with a weaker labour market than in 2023, the probability of strong second-round effects is lower. That said, rising inflation into 2027 could alter the outlook.

The fiscal constraints facing the UK are similar to those of other countries, although UK government bond yields seem to be more volatile, bringing up borrowing costs and continuing to pose problems for the government. The constraints for the government remain the same, but with taxes at an all-time high and many of the largest tax-raising measures ruled out, large increases in taxes will be challenging. With extra borrowing difficult, cuts in spending would also be needed to help the country move towards a more sustainable fiscal position.

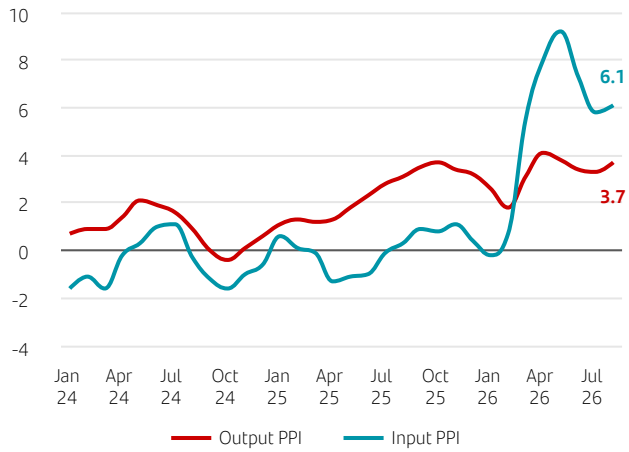
Key risks to the outlook include: an energy shock from the ongoing Iran conflict; a potential fiscal crisis due to the level of government debt; lower real disposable income; and higher business costs. However, on the positive side, AI could drive productivity and growth.

UK: Households' saving ratio
(%)



Source: Macrobond.

UK: Producer price inflation
(%, y/y)



Source: Macrobond.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.3	0.9	1.4
Unemployment rate	5.4	5.4	5.2
CPI inflation	3.1	3.3	2.1

Source: Santander Research. Annual average.



United Kingdom In focus

Are there signs of a productivity revival in the UK?



UK productivity appears to be improving after years of weak growth, but the signal is uncertain because it depends on the employment data used. The key question is whether this reflects a genuine structural gain in efficiency or a temporary labour market effect. The answer will be crucial for judging the UK's medium-term growth outlook.

UK productivity growth has slowed markedly since the financial crisis

Productivity is a measure of how efficiently inputs are converted into outputs and is one of the most important factors in determining living standards and prosperity in the long run. Before the 2008 financial crisis, UK productivity typically grew by around 2% per year. However, the country has experienced a significant slowdown in productivity growth, to around 0.6% between 2010 and 2019 and 0.4% between 2020 and 2024.

Labour productivity is the most common way to measure productivity, with output per hour worked the preferred metric in the UK because it accounts for changes in working hours. Data published by the Office for National Statistics (ONS) suggest output per hour worked fell by 1.2% q/q in Q2 2026, with output per worker estimated to have increased by 0.2% q/q in Q2 2026.

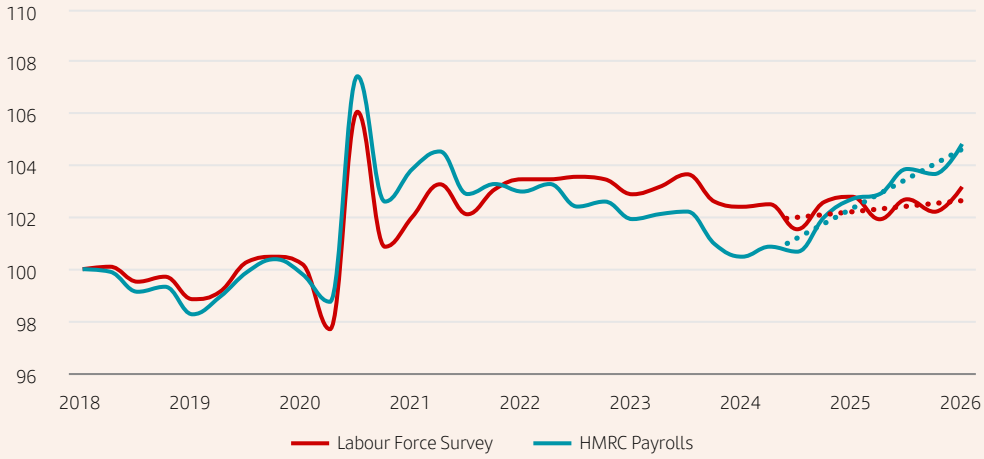
Measurement issues cloud the UK's recent productivity performance

However, the accuracy of productivity data depends on which measure of employment is used, with different sources showing that productivity has either soared or broadly flatlined since 2024.

For years, the ONS' sole measure of labour productivity was calculated by dividing UK gross value added (GVA) by the number of hours worked in the economy, based on figures from the Labour Force Survey (LFS). However, the LFS has suffered from a spate of major challenges since the pandemic, which has made the sample less representative of the UK population and increased volatility and statistical uncertainty in the series. The problems with the LFS have led policymakers and economists to place more weight on alternative data sources for the labour market, such as payroll numbers from HMRC and the ONS' workforce jobs (WFJ) data. When looking at measures of employment across different sources, it is clear that the LFS has diverged from the other two. The LFS has been far more optimistic on the level of employment in the economy in recent years. Since the end of 2019, the LFS suggests employment has risen by 6.4% compared to 4.5-5% for WFJ and payroll data. As the chart below shows, using the weaker alternative sources of employment data to calculate output per hour

implies the UK has experienced a sharper rise in productivity than the official data suggests.

UK: Output per hour (Q1'18=100)



Sources: ONS and Santander Research.

Given the above, we would place more weight on these alternative sources (as they align with other surveys, such as the Purchasing Manager's Index (PMI) employment balance) and employment measures in the Bank of England's Decision Maker Panel (DMP) survey, which suggest a gradual loosening of the labour market.

More in hope than expectation

An improvement in productivity growth would of course be welcome, and it looks as if this could be greater than the ONS data suggest. If sustained, it would partly offset some of the expected strain on the public finances. However, it is also important to understand why productivity may have improved. It may be due to the increasing use of artificial intelligence (AI)[1], seeing as the UK is relatively well placed to benefit from new technology given the strength of our services sector. However, it could also have been driven by the large minimum wage increases and higher employer National Insurance contributions, pushing low-paid and younger workers out of jobs, and thereby increasing output of the remaining workers temporarily.

Conclusion

Productivity has risen, but why is less clear. Both points of view set out above have merits, but for current productivity levels to be sustained and benefit the UK's medium-term growth prospects, improvements need to be focused on those sectors best placed to take advantage of new technologies.

[1] Van Reenen, J. (2026), 'Productivity, innovation and the future of growth', keynote speech, Royal Economic Society Annual Conference, 20 August.

Latin America

Resilience in a challenging environment

Latin America enters 2027 after a year marked by external shocks, political uncertainty and demanding financial conditions, which most economies navigated better than expected. Imbalances remain contained, but the challenge now is to consolidate the stability achieved and translate it into a sustained recovery in investment and growth.

Marisol de Francisco Bartolomé

Latin America's economic performance in 2026 has been shaped by a complex global environment. Trade and geopolitical tensions were compounded by conflicts in the Middle East and higher energy prices. While the impact has been uneven (benefiting oil producers but worsening the terms of trade for net importers), it has broadly generated inflationary and fiscal pressures.

At the start of 2026, expectations were for weak growth, with doubts lingering about the region's ability to make further progress on disinflation without a pronounced deterioration in activity. The outcome, however, has been more favourable than expected in most countries, with a few exceptions. Growth has stayed close to 2% and labour markets have shown notable resilience, while weakness in some economies reflects temporary factors, including climate-related and sector-specific shocks. Inflation has continued to moderate, with limited pass-through from higher energy prices to underlying components. This has allowed monetary policy normalisation to proceed, albeit at different speeds.

At the same time, rising sovereign bond yields in advanced economies and uncertainty surrounding the US economy and monetary policy have influenced financial conditions, capital flows and investment decisions. Despite this, Latin American markets have performed well, with the main currencies appreciating against the dollar, risk premia remaining contained and equity markets reaching record highs in some cases.

The political calendar has also been busy. Several countries have held presidential elections in 2026 or are preparing to do so. Traditionally, such periods have been associated with greater financial volatility and weaker investor sentiment. This year, however, the impact has been limited and has not significantly disrupted either the financial markets or the region's broader macroeconomic performance.

The external position is holding solid. Exports have stayed dynamic, supported by the diversification of trading partners and the region's productive structure, which combines manufacturing with agriculture, mining and energy. Trade balances are still strong, while current account deficits are moderate and comfortably financed by foreign direct investment. Portfolio inflows have also recovered, supported by a more favourable perception of Latin America among international investors. Together with

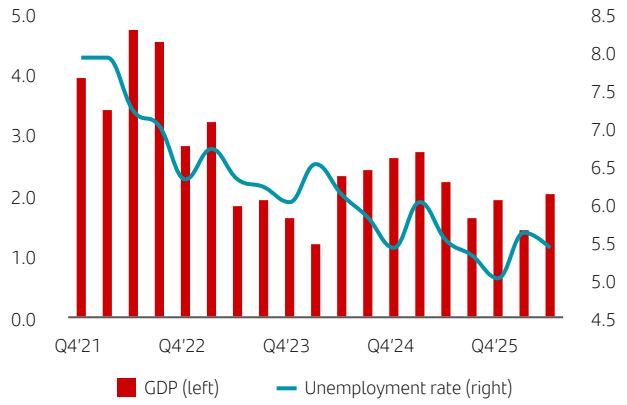
Latin America

high foreign-exchange reserves, these factors strengthen the region's ability to absorb potential external shocks.

Looking ahead to 2027, growth is expected to remain moderate, with significant differences across countries. Inflation should continue to decline and move closer to central banks' tolerance ranges, although in most economies it will stay above target. El Niño could temporarily delay this process in some countries, without altering the broader disinflationary trend. This backdrop should allow further monetary policy normalisation where rates are still restrictive, while in other cases supporting a relatively stable policy stance despite higher global interest rates.

Labour markets should continue to support domestic demand, although they are likely to lose some momentum. At the same time, further progress on fiscal discipline will remain important, while a recovery in investment will be essential to sustain activity beyond the short term. The scope to respond to growing economic and social demands will be constrained by both modest potential growth and the need for further fiscal consolidation. Even so, Latin America enters 2027 with stronger fundamentals and an opportunity to turn the resilience demonstrated in recent years into a new phase of growth and investment.

Latin America-7[1]: GDP growth & unemployment
(%, y/y; and %)



Sources: INE's and Central Banks.

Latin America-7: Trade balances
(12-month cumulative balance, USD bn)



Source: Refinitiv.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	1.9	2.2
Unemployment rate	5.4	5.7	5.9
CPI inflation*	4.2	3.6	3.1

Latin America - 7: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay.
Source: Santander Research. Annual average.
* Without Argentina.

[1] Latin America-7 includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay.



Argentina

A more robust macroeconomy for the next stage

Argentina will enter 2027 with stronger macrofinancial fundamentals than in previous presidential cycles. Fiscal discipline is the main anchor of stability, while slowing inflation and reserve accumulation have strengthened resilience. Energy, mining and agriculture continue to support the medium-term outlook for growth and foreign-currency generation. Although electoral and global risks remain, the economy enters the year with stronger buffers.

Cristian Cancela
Mariela Díaz Romero
Agustín Fabbricatore

Argentina is heading into the 2027 presidential election from a more favourable starting point than in previous electoral episodes. Fiscal consolidation, lower inflation, an improved external position and stronger public finances have helped correct imbalances that historically amplified political and financial uncertainty. As a result, the economic debate is shifting from stabilisation towards the sustainability of growth. The challenge will now be to turn greater macroeconomic stability into a platform for higher investment, productivity and private-sector expansion, securing better conditions for medium-term growth.

The main difference compared with previous cycles is still the fiscal position. Maintaining a primary surplus has become the principal source of policy credibility, reducing reliance on monetary financing and strengthening perceptions of public-sector solvency. At the same time, reserve accumulation and improvements in the Central Bank's balance sheet have increased the capacity to manage potential episodes of portfolio dollarisation. These advances do not eliminate election-year risks, but they provide a stronger position from which to absorb potential volatility.

Another relevant factor is the public sector's financing strategy. The 2026-2027 financing programme appears consistent with expected resource and financing needs. This is particularly important considering that Argentina will be operating with sovereign rating upgrades to levels equivalent to B-. The combination of multilateral financing, access to the domestic market, precautionary liquidity accumulation and more orderly management of maturities helps reduce refinancing risks and strengthens the public sector's ability to navigate the electoral process.

Consolidating growth will also require the benefits of the new macroeconomic framework to extend to less dynamic but more employment-intensive, domestically oriented sectors. The challenge will be to ensure that macroeconomic stability and the recovery of investment translate into stronger formal employment, real incomes and activity across the economy. This normalisation could also support further financial

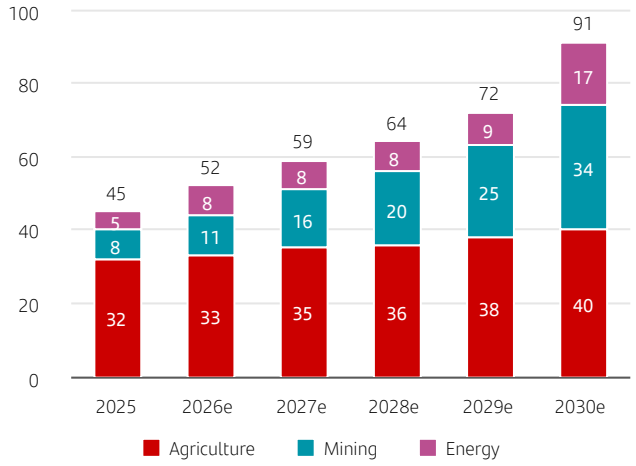
Argentina

deepening, as low credit and financial intermediation leave substantial room to expand financing to households and businesses.

The medium-term outlook continues to improve. Expansion in energy, rising mining investment and a strong agricultural export complex are creating a more diversified and resilient export base. While imports are likely to rise in 2027 alongside stronger activity and investment, the external position appears stronger than in previous episodes. The current account should remain manageable, supported by energy, mining and agribusiness exports and higher productive investment. A gradual widening of the deficit would therefore not necessarily signal an imbalance, but could instead reflect higher investment and future foreign-currency generation.

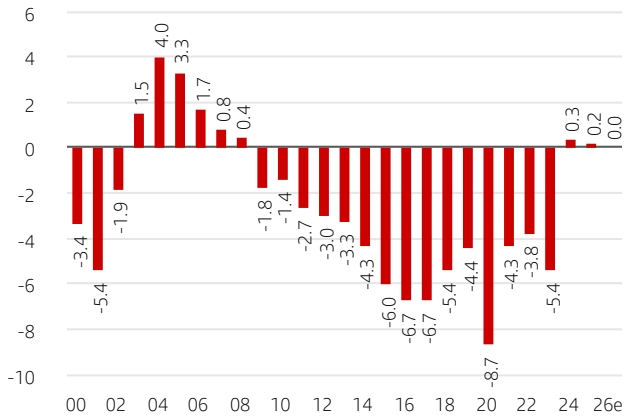
Naturally, the scenario is not without risks. The proximity of the presidential election could generate episodes of financial volatility, and reserve accumulation will keep being closely monitored by markets. Preserving fiscal discipline, maintaining external competitiveness and sustaining the momentum of institutional reforms will also be essential for consolidating confidence. On balance, however, Argentina appears set to enter 2027 with stronger fundamentals than in previous presidential years.

Argentina: Expected trade balance for natural resources
(USD bn)



Sources: BCRA based on Ministry of Economy and INDEC.

Argentina: Fiscal balance
(% of GDP)



Sources: IMF and Ministry of Economy.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	2.7	3.9
Unemployment rate	7.2	7.1	7.0
CPI inflation	30.1	23.0	12.7

Source: Santander Research. Annual average.



Argentina In focus

RIGI as a catalyst for investment and productive transformation in Argentina



The Incentive Regime for Large Investments (RIGI) is presented as one of Argentina's main opportunities to accelerate investment and the development of strategic sectors with export capacity. In a context marked by low levels of domestic savings and external constraints, the regime seeks to offer a more stable and competitive framework for large-scale projects.

What is RIGI?

The Incentive Regime for Large Investments (RIGI) constitutes one of the pillars of Argentina's economic strategy to increase investment and expand productive capacity, an especially relevant objective for an economy that has historically exhibited low levels of capital formation. According to the International Monetary Fund (IMF), investment in Argentina has averaged 16% of gross domestic product (GDP) over recent decades, significantly below the 22% average recorded by countries such as Chile, Colombia, Mexico and Peru.

In this context, RIGI was designed to create more competitive conditions for the development of large-scale projects, particularly in sectors with high export potential and substantial capital requirements. The regime combines regulatory stability for up to 30 years with tax, customs and foreign-exchange incentives aimed at reducing uncertainty and improving the expected returns on investments with long maturity horizons. The scheme is aimed at projects in oil and gas, mining, energy, infrastructure, steelmaking, technology, tourism and the forestry industry, among other sectors considered strategic for the country's economic development.

The importance of the regime must also be analysed in light of the structural savings constraints of the Argentine economy. Historically, the low level of domestic savings has restricted the capacity to finance large-scale investment projects exclusively with national resources. As a result, the development of capital-intensive sectors, such as energy and mining, requires access to external sources of financing. Therefore, the capacity to attract foreign savings constitutes a fundamental condition for sustaining a more dynamic growth process and a significant expansion of investment.

The comparative experience

Argentina has lagged behind in attracting foreign direct investment (FDI). According to World Bank data, net FDI inflows represented just 0.5% of GDP in Argentina during 2025, compared with 4.1% in Chile, 3.1% in Peru and 2.5% in Colombia. These differences reflect the considerable scope that exists to increase the participation of

international capital in financing productive projects. From this perspective, RIGI could bring Argentina closer to investment and capital-attraction standards observed in other economies in the region.

Results in investment decisions

The initial response from the private sector has been significant. As of July 2026, official data indicated that 18 projects had been approved, representing a committed investment of 35.7 billion US dollars and an estimated 56,717 direct and indirect jobs. The sectoral composition is concentrated in activities linked to natural resources and energy: nine projects are in mining, five are in oil and gas, two are in energy, one is in steelmaking and one is in infrastructure. Mining accounts for more than half of the projects already approved, reflecting investors' interest in the development of copper, lithium and other strategic minerals linked to the global energy transition.

In addition, the portfolio currently under evaluation comprises 24 projects worth 112 billion US dollars and an estimated 141,547 direct and indirect jobs. This estimate rises even higher when company announcements are taken into account. Within this group, sectors with a stronger export profile again predominate, with 12 projects linked to oil and gas and 10 to mining. The remaining two projects are in energy and technology, respectively. This distribution suggests that a substantial share of the investment that could materialise over the coming years will be associated with the development of Vaca Muerta and the expansion of mining production aimed at international markets.

Of the 42 projects submitted in total, 19 are in mining and 17 are in oil and gas, while energy accounts for three initiatives, infrastructure one, steelmaking one and technology one. Overall, RIGI is channelling investment mainly towards sectors with natural comparative advantages and a high capacity to generate foreign currency, concentrating more than four-fifths of the projects in energy, hydrocarbons and mining.

Beyond the specific incentives provided by the regime, the economic significance of RIGI lies in its potential to accelerate a transformation of Argentina's productive structure. For decades, the country's growth was constrained by external restrictions and insufficient foreign-currency generation. The current project portfolio reveals an orientation towards sectors capable of structurally expanding export supply, taking advantage of resources in which Argentina has competitive advantages on a global scale.

The development of Vaca Muerta, copper and lithium projects, the expansion of energy infrastructure and the growth of activities associated with the energy transition could significantly increase the weight of capital-, technology- and productivity-intensive sectors within the national economic structure. In this regard, RIGI is not only a tool for promoting investment, but also a mechanism for accelerating a process of productive change aimed at consolidating new sources of growth and foreign-currency generation.

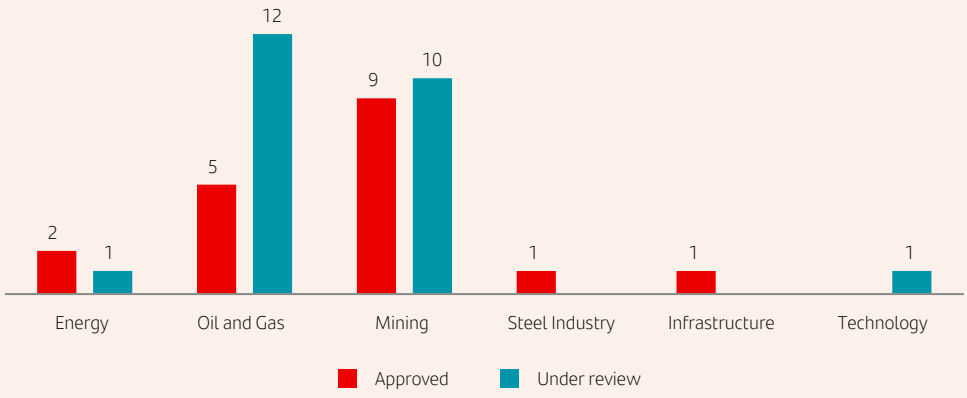
The potential impact of the regime also has an important regional dimension. Unlike other investment processes historically concentrated in the major urban centres, the

projects currently approved or under evaluation are distributed across various of the country's provinces, including Buenos Aires, Catamarca, Jujuy, La Pampa, Mendoza, Neuquén, Río Negro, Salta, San Juan and Santa Fe. This territorial distribution means that a significant share of the benefits associated with the investments, including employment, supplier procurement, infrastructure development and greater economic activity, could extend to regions with very diverse productive profiles. The location of mining projects in the Northwest and Cuyo regions, together with energy investments linked to Vaca Muerta and the infrastructure associated with export corridors, has the potential to drive regional development processes, strengthen local value chains and generate multiplier effects across broad segments of the economy.

Conclusion

RIGI emerges as a relevant tool for addressing some of the main structural challenges of the Argentine economy: low levels of investment, the scarcity of domestic savings, limited foreign-currency generation and the need to expand productive capacity. The scale of the portfolio currently submitted reflects a significant opportunity to channel external savings towards strategic sectors, strengthen the country's export profile and promote more balanced development at the regional level. Although the potential of the regime depends not only on the regulatory framework, but also on the effective implementation of the projects, it is encouraging that a significant number of the initiatives are already advancing through the initial stages of structuring and financing. In fact, some projects are beginning to show associated flows that are already being reflected in the foreign-exchange market.

Argentina: Total projects submitted (RIGI)



Source: Ministry of Economy.

Brazil

A year of macroeconomic rebalancing

Brazil enters 2027 with its economy feeling the effects of a prolonged period of restrictive monetary policy, while the transition to a new political cycle should keep fiscal management and financial conditions at the centre of the outlook. Our baseline is one of slower growth, gradual disinflation and limited room for monetary easing.

Marco Antonio Caruso

We expect gross domestic product (GDP) growth of 1.3% in 2027, after a moderate performance in 2026. The main driver will be the delayed transmission of high real interest rates to consumption, investment and other interest-sensitive sectors. The economy is therefore predicted to receive less support from domestic demand, while exports are likely to remain constrained by a less benign global environment and softer commodity prices. The key uncertainty is fiscal policy. A credible adjustment strategy could improve confidence and partially offset the drag from tight monetary conditions, while a weaker fiscal signal would keep risk premia elevated and limit investment.

The labour market should cool only gradually. Employment has stayed unusually resilient; unemployment is still low by historical standards and wage income continues to support consumption. However, the combination of weaker activity, slower credit creation and more cautious hiring should reduce labour demand during 2027. We expect some increase in unemployment over the year, but not a sharp one, as structural changes in labour supply and a lower estimated natural unemployment rate suggest that the market can hold relatively tight even with modest GDP growth. Wage gains should moderate rather than collapse, helping the disinflation process without generating a major negative shock to household income.

Inflation should continue to decline, but convergence to target is likely to remain slow. We forecast inflation to be around 4% by the end of 2027. The improvement should come from weaker demand, lower inflation inertia and more favourable behaviour from goods and food prices as the lagged effects of restrictive monetary policy start to become more evident. Services inflation, nevertheless, should continue to be the main source of persistence, reflecting the still-tight labour market and elevated wage growth. Inflation expectations will also be an important constraint, particularly because the fiscal outlook continues to influence both the exchange rate and medium-term expectations. Even with headline inflation dropping, the composition of inflation is likely to justify continued caution from the Central Bank of Brazil (BCB).

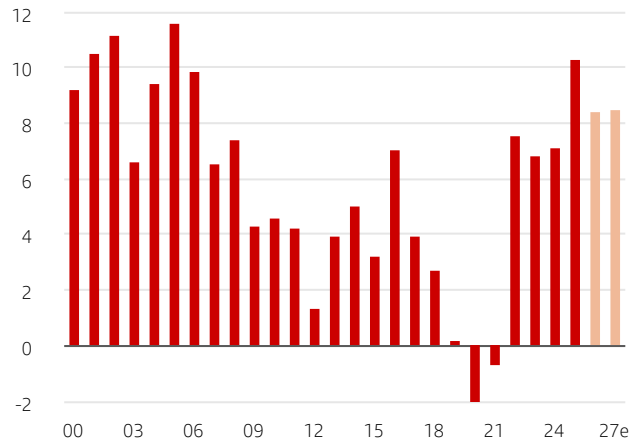
We expect monetary policy to remain restrictive throughout 2027. As the easing cycle progresses, the BCB is likely to retain a cautious approach, assessing both the cumulative impact of previous policy decisions and the fiscal direction of the new government. After the initial phase of the easing cycle, we expect the BCB to enter a

Brazil

prolonged pause, allowing time to determine where the exchange rate and inflation expectations settle and how these developments will feed through to the inflation outlook. With inflation still above target and expectations likely to remain sensitive to fiscal and policy signals, the bar for an immediate continuation of the easing cycle should remain relatively high. As the year progresses, however, the cumulative effects of restrictive monetary policy should become increasingly visible in activity and the labour market, reducing underlying inflationary pressures. This should eventually allow the BCB to resume rate cuts in the latter part of the year, bringing the Selic towards 12.5% by end-2027 while keeping monetary policy in restrictive territory.

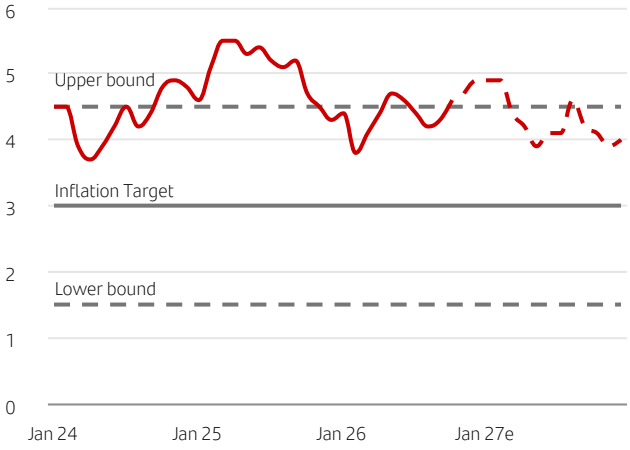
Financial conditions should stay tight even as the easing cycle progresses. Domestic interest rates are likely to stay sensitive to fiscal developments, global yields and the credibility of the incoming economic policy framework. Credit conditions should soften slowly, with banks maintaining a selective stance and highly leveraged households facing limited room for renewed borrowing. The exchange rate should also continue to act as an important transmission channel, supported by Brazil's high carry, but will remain vulnerable to shifts in global risk appetite and domestic risk. Overall, 2027 should be a year of adjustment rather than acceleration, with a prolonged monetary policy pause in the first half eventually giving way to renewed easing as weaker activity and lower inflation create room for additional rate cuts.

Brazil: Persistently high real rates
(%, y/y)



Sources: BCB, IBGE and Santander Research.

Brazil: Consumer inflation above the 3% target
(%, y/y)



Sources: IBGE and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	1.3	1.5
Unemployment rate	5.5	6.0	6.5
CPI inflation	4.5	4.4	3.9

Source: Santander Research. Annual average.



Brazil In focus

The narrowing path to a soft landing in Brazil



Macroeconomic stabilisation is never free. Bringing inflation back to target requires some moderation in demand, just as supporting growth often involves tolerating temporarily higher inflation. What changes across countries and over time is not the existence of this trade-off, but its drivers. Our baseline is one of continued disinflation without a recession. However, stabilisation should rely less on monetary policy and more on fiscal convergence.

The current monetary cycle in Brazil may prove a challenging one, as the central concern revolves not only around whether inflation can return to target, but also how much economic adjustment will be required. The answer depends on the broader macroeconomic policy mix.

For much of the inflation-targeting era, Brazil operated under relatively favourable conditions. Inflation expectations remained anchored, fiscal policy broadly supported stabilisation, and financial markets interpreted gradual interest-rate adjustments as evidence of confidence. In that environment, the Central Bank could smooth business cycles while preserving credibility. Monetary policy was largely an exercise in calibration. That environment has changed.

Uncertain macroeconomic policy mix

The key issue is no longer whether Brazil will eventually stabilise public debt, but whether fiscal adjustment will come before markets demand it. In other words, will adjustment occur proactively before financial conditions force it, or only reactively? As long as this is uncertain, inflation expectations will embed part of the risk, forcing monetary policy to compensate for an adjustment yet to occur.

Since the pandemic, Brazil has combined persistent fiscal expansion, above-target inflation expectations, higher sovereign risk premia and a structurally higher neutral real interest rate. Taken together, these factors reflect some uncertainty surrounding the future macroeconomic policy mix.

None of them prevent inflation from converging to target. Collectively, however, they have raised the cost of disinflation. Brazil's stabilisation frontier has deteriorated: bringing inflation back to target now requires a stronger policy response, a larger slowdown in activity, or a combination of both.

This does not mean monetary policy has become less effective. Rather, the economy now requires tighter financial conditions to deliver the same reduction in inflation. In other words, the sacrifice ratio appears to have increased.

This also changes how monetary policy responds to shocks. Central banks should generally look through temporary supply shocks, tightening only when they threaten inflation expectations. But such an approach depends on credibility. When expectations remain above target for a prolonged period, the room to accommodate temporary shocks narrows. Markets become more sensitive to any perceived weakening of the commitment to price stability, increasing the likelihood that temporary shocks become embedded in wages and longer-term expectations.

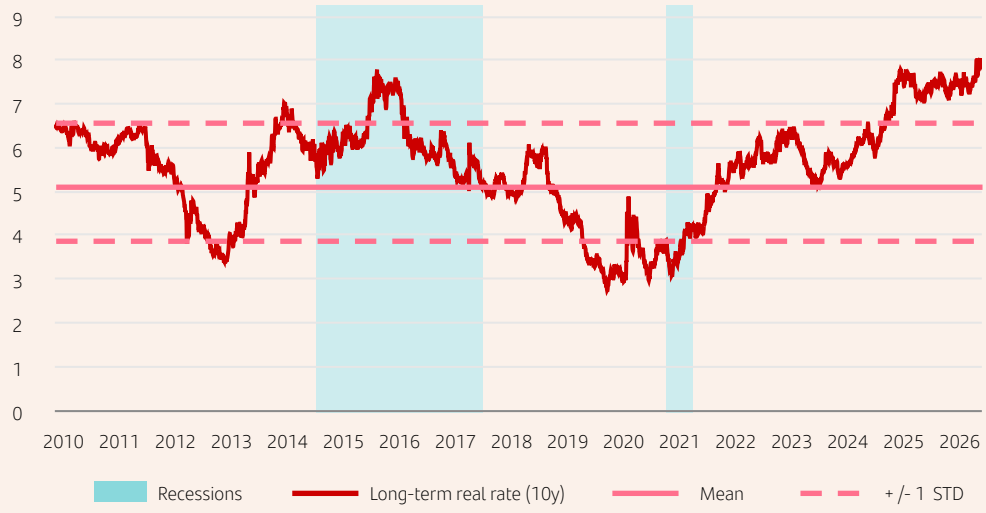
As a result, monetary policy loses flexibility. Gradualism becomes harder to distinguish from complacency, while a balanced approach becomes more difficult because credibility becomes part of the stabilisation process. Monetary policy is no longer calibrating only the business cycle; it is also preserving confidence in the broader macroeconomic regime.

The outlook for 2027 therefore deserves particular attention. As activity moderates, investors naturally expect monetary easing to accelerate. Our assessment is more cautious. Slower growth alone may not create the same room for policy normalisation if inflation expectations remain above target and the equilibrium real interest rate has shifted upwards. Monetary policy may need to keep to a restrictive approach.

Conclusion

Our baseline is one of continued disinflation without a recession. Yet risks have become increasingly asymmetric. As stabilisation relies more heavily on monetary policy, the economy becomes more vulnerable to nonlinear adjustments. Proactive fiscal consolidation would help lower risk premia, re-anchor inflation expectations and restore the Central Bank's room for policy calibration. Otherwise, monetary policy will continue to bear a larger share of the stabilisation effort.

Long-term real rates in Brazil: From mean reversion to a new high
(%)



Sources: Bloomberg and Santander Research.

Chile

Turning the corner as investment takes the lead

Chile is set to close 2026 below start-of-year expectations. The combination of weaker results in natural resource sectors and the fuel price shock, which hit disposable income and household expectations, explains much of the underperformance. For 2027 and 2028, the outlook improves: investment should lead the recovery, inflation will converge relatively quickly, and the labour market could begin to rally.

Andrés Sansone
Lorena Palomeque

What happened in 2026 and why it disappointed. The year began with high expectations for gross domestic product (GDP) growth, with consensus estimates rising above 2.5% during the first part of the year. Yet, as 2026 progressed, activity weakened significantly, and our latest forecast suggests the economy will end the year with virtually no growth.

Three factors largely explain this weaker performance. First, a decline in natural resource sectors, particularly a sharp drop in mining output. Agriculture, fishing and the food-related industry also faced significant disruptions during the year, whether due to sector-specific challenges or adverse weather conditions. Second, the oil shock, which passed through rapidly to domestic fuel prices, and the resulting fall in disposable income. This was compounded by a deterioration in expectations, with consumers and firms revising theirs downwards. Finally, public investment fell sharply during the first half of the year as part of fiscal consolidation.

In 2027, GDP is predicted to grow above 3%, with investment being the main driver. On the one hand, the pipeline of large-scale projects continues to grow strongly. On the other, the Reconstruction Law, which prescribes a reduction in corporate taxes, provides an additional boost that is set to add around 0.5 percentage points to annual growth in 2027 and 2028. Gross fixed capital formation is forecast to grow by more than 5% next year. Consumption, by contrast, looks likely to recover more gradually because its fundamentals remain weak: employment is falling, real wages have been eroded by inflation and confidence is still in pessimistic territory.

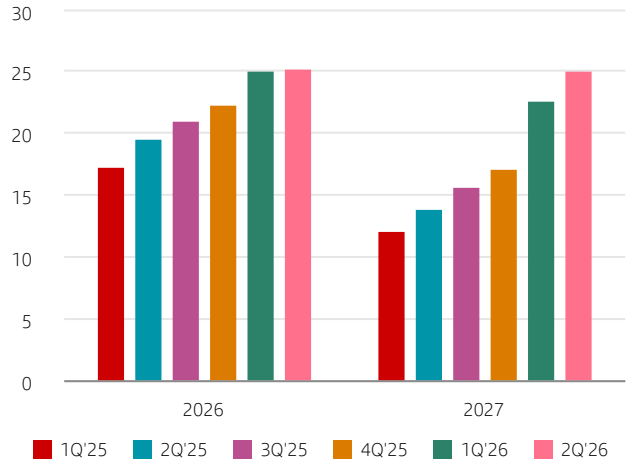
The labour market has shown a marked deterioration. Job destruction has been observed over the past year, particularly in formal salaried employment, and the unemployment rate stood above 9% for much of 2026. This high rate reflects both cyclical deterioration and a larger structural component that is associated with higher labour costs and demographic changes. Cyclical deterioration should start to ease during 2027 as the economy recovers.

Chile

The rise in inflation is explained by the oil shock. At the start of the year, inflation stood below the 3% target, but the fuel price shock pushed it above 4%. No significant second-round effects have been observed, partly contained by the weakness of domestic demand. We expect to close the year at around 5% and to see a rapid convergence towards 3% during 2027, as the energy shock normalises and drops out of the comparison base. Core inflation looks set to remain close to 3% throughout the forecast horizon.

We expect the Central Bank to keep the monetary policy rate at 4.5% for an extended period. Although domestic demand has weakened, inflation is still elevated, with latent risks; next year, we estimate that inflation convergence will occur alongside the rebound in activity. This asymmetry leaves little room for cuts.

Chile: Capex outlook strengthens on large-scale projects
(bn of US $)



Note: bars show quarterly investment projections for each year.
Sources: Chilean Corporation of Capital Goods and Santander Research.

Chile: Unemployment reaches highest rate since Covid era
(%)



Sources: Chile's National Institute of Statistics and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	0.0	3.5	2.8
Unemployment rate	8.9	8.5	8.1
CPI inflation	3.9	3.5	3.0

Source: Santander Research. Annual average.

Reforms and growth

Average growth over the past 15 years has been below that recorded in previous decades. Part of this weaker momentum reflects global factors, such as the stagnation of international trade, and sector-specific factors such as lower copper grades, but there are domestic factors at play too: a higher regulatory burden, longer approval times for investment projects and lower expected returns on capital in an environment of limited innovation.

Reforms to unlock investment

Against this backdrop, the recently approved Law for National Reconstruction and Economic and Social Development represents a constructive move to support investment. Although it contains measures of different kinds, its most important components from a macroeconomic perspective are those that affect supply: lower burdens on investment and shorter processing times.

The main provisions are:

• **Reduction of the corporate income tax** from 27% to 23%, phased in gradually through 2029, which will increase the post-tax return on investment projects, improve incentives to invest and strengthen the country's competitiveness as a destination for capital.

• **Simplification and acceleration of environmental and sectoral permitting procedures**, limiting the timeframes for resolving environmental appeals, restricting subsequent administrative reviews and streamlining certain permits. Shorter approval times will reduce the financial cost of projects, lower regulatory uncertainty and increase the likelihood that new investments will materialise.

The bill also includes other measures that may be relevant for the investment climate, although their impact on gross domestic product (GDP) is more uncertain. These include the gradual reintegration of the tax system and the establishment of a tax invariability regime for large investment projects. The latter applies to initiatives starting at 50 million US dollars, with stability periods of between 10 and 20 years depending on the amount committed and in exchange for a permanent 1.5% surcharge on the First Category Tax for companies that opt into this regime. These measures seek to provide greater tax certainty and reduce uncertainty for long-term projects.

Estimated impacts

Together, these measures are relevant for capital-intensive sectors in which Chile has comparative advantages, but also long and costly approval processes.



Chile

In focus

Our estimates suggest that the effects on the level of activity will be significant. In our central path, the level of GDP would be 5.5% higher in 2035 and 6.3% higher in 2040 than in a no-reform scenario. The latter figure contrasts somewhat with the government's estimate of 8.6%, a level that would stand above the 90th percentile in our estimates. Nevertheless, the effects remain positive even under more adverse assumptions regarding the scale and speed of implementation.

Fiscal considerations

Stronger economic growth broadens the tax base and strengthens fiscal revenues over time, although its effects materialise with a lag. In addition, empirical evidence suggests that the revenue loss from a tax-rate cut is not fully offset by greater economic dynamism, thereby weakening the fiscal balance. Consequently, as the law has been approved, an increase in the fiscal deficit should be expected over the coming years.

The starting point is demanding. Chile ended 2025 with an estimated fiscal deficit of 2.8% of GDP, and we project the country will close 2026 with a deficit of 2.4% of GDP. In this context, the reform's transition period is relevant: in our central-path scenario, the fiscal balance associated with the bill would remain in deficit until approximately 2035, with an additional deficit of between 0.2% and 0.5% of GDP for much of the 2026–2033 period. This could eventually translate into higher debt and higher long-term interest rates.

From challenge to opportunity

The reform may help unlock investment, but persistent growth requires a broader agenda. Chile has significant opportunities in mining, energy, infrastructure, agro-industry, tourism and digital services. However, taking advantage of them does not depend solely on reducing permitting requirements or improving tax incentives. It also demands expansion of the labour base, a strengthening of human capital and an acceleration of the adoption and development of new technologies.

One first margin is labour participation, especially among women. Improving access to quality care services and advancing policies that facilitate the reconciliation of work and family life would increase the available labour force, reduce income gaps and raise potential growth. In an economy facing less favourable demographic headwinds, bringing more people into the labour market constitutes one of the main available sources of growth to offset the slower expansion of the working-age population.

A second point is skills development. The economy of the future will require workers with stronger digital capabilities, adaptability and knowledge of new technologies, including artificial intelligence. Improving education, technical training and reskilling is essential if new investments are to translate into higher wages, productivity and labour mobility.



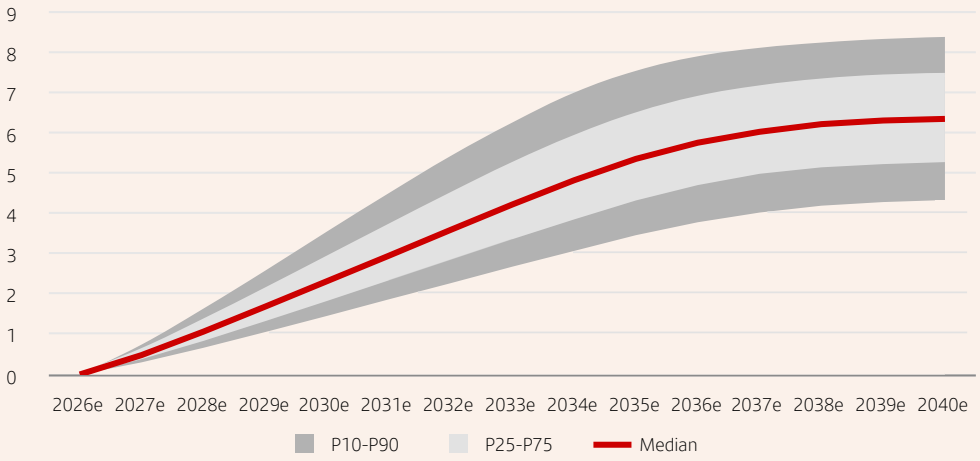
Chile

Finally, Chile needs to strengthen its innovation ecosystem. Innovation should not be understood only as frontier research, but also as the ability to incorporate technology, improve processes and raise productivity in traditional sectors. This requires greater technological adoption by firms, stronger links between universities and the productive sector, financing for scalable ventures and an institutional framework that facilitates the diffusion of new solutions.

Conclusion

In summary, an agenda that reduces barriers to investment can significantly raise the economy's potential growth. However, to fully seize the opportunities facing it, Chile's reforms will need to be complemented by policies that increase labour participation, strengthen human capital and accelerate innovation. In this sense, only a comprehensive strategy will make it possible to sustain higher growth rates, improve household incomes and strengthen public finances over the long term.

Chile: Simulation of the cumulative increase in the level of GDP
(difference relative to the no-reform scenario, %)



Note: Simulations of the reform's impact on the level of GDP: median, 25th to 75th percentile and 10th to 90th percentile.
Source: Santander Research.

Colombia

Towards a more balanced growth model

2027 is set to be a year of adjustment for Colombia, marked by the gradual correction of macroeconomic imbalances accumulated over recent years. Our central scenario envisages moderate growth, persistent inflation and the beginning of a prolonged fiscal consolidation process, with interest rates remaining elevated.

Sergio Cruz

We expect the economy to grow by 2.0% in 2027, slightly below 2026, but with a healthier composition as investment gains importance relative to consumption. Restrictive monetary policy will weigh on private consumption, while fiscal consolidation will reduce the contribution from public consumption. Fixed investment should recover, although elevated interest rates will moderate the pace, resulting in a more balanced growth mix.

The labour market is forecast to begin to deteriorate gradually in 2027, mainly reflecting weaker economic activity, particularly as private and public consumption moderate. Employment has shown notable resilience in recent years despite higher labour costs and softer economic growth. The shift towards a greater contribution from investment could support formal job creation; however, informality is likely to maintain a significant share of the labour market. We expect a moderate increase in the unemployment rate, while further measures that raise labour costs could constrain formal job creation and make a more significant reduction in informality more difficult.

By 2027, we expect the rate-hiking cycle that began in 2026 in response to strong consumption and higher labour costs to have concluded. We therefore anticipate a period of policy-rate stability through much of the year as inflation begins to moderate, although the disinflation process is likely to remain gradual and subject to upside risks. We expect the beginning of a gradual easing cycle towards the end of 2027, bringing the policy rate to around 11% by year-end. Nevertheless, persistent inflation will require cautious policy normalisation, keeping interest rates elevated for much of 2027.

The fiscal consolidation process initiated in 2026 should continue in 2027, with the incoming government starting from a weaker fiscal position and a revised fiscal framework. We expect the adjustment to combine greater expenditure discipline with new revenue measures aimed at strengthening the primary balance and helping stabilise the debt trajectory. However, the magnitude and pace of consolidation will depend largely on the implementation of the proposed measures. In this regard, the

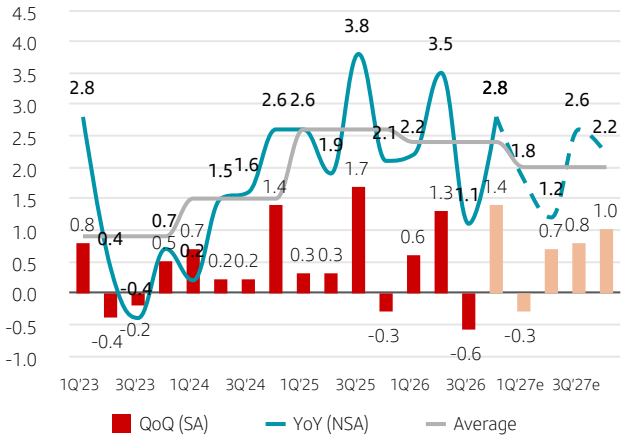
Colombia

main risk for 2027 will be execution, as a significant part of the adjustment will require congressional approval.

Financial conditions should improve gradually in 2027 as the easing cycle progresses, although they are likely to remain restrictive. Lower rates and recovering activity should help limit further deterioration in loan quality, although households and corporates will continue to face elevated financing costs, and banks are likely to maintain relatively selective underwriting standards. Domestic interest rates will still be sensitive to fiscal developments, global financial conditions and the credibility of the new economic policy framework.

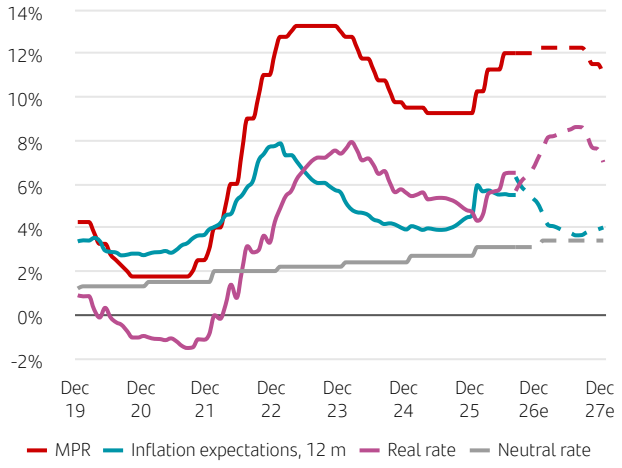
Overall, 2027 should be a year of adjustment rather than acceleration. We expect gradual disinflation and the beginning of a rate-cutting cycle towards year-end, alongside a progressive recovery in investment and a shift towards a more balanced growth composition. However, growth will remain moderate, financial conditions relatively restrictive, and fiscal consolidation will continue to be a key determinant of the evolution of the economy and financial markets.

Colombia: GDP growth will remain moderate
(%)



Sources: DANE, BanRep and Santander Research.

Colombia: Financial conditions will stay relatively restrictive
(%)



Sources: DANE, BanRep and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	2.4	2.0	3.1
Unemployment rate	9.3	10.1	9.5
CPI inflation	7.0	5.1	4.0

Source: Santander Research. Annual average.



Mexico

Gradual improvement of economic growth

Economic growth strengthened in 2026 and is expected to gain further momentum in 2027. Although the economy has shown notable resilience in a challenging environment, Mexico continues to face medium-term challenges arising from lower potential growth and structural pressures on public finances.

Rodrigo Barros
Alonso Cervera

Despite quarter-to-quarter volatility, economic activity in Mexico improved in 2026. Average gross domestic product (GDP) growth is projected at 1.8%, up from 0.7% in 2025 and above our 1.0% forecast in the previous edition of The Year Ahead. This acceleration was underpinned by resilient consumption, a partial recovery in investment during the second half of the year and modest spillovers from strong exports of technology-related goods.

For 2027 we expect these trends to continue. Together with a more stable global environment and diminishing headwinds from fiscal and monetary policy, they should result in a similar pace of growth. We project average GDP growth of 1.7%. While this is below the 2.0% forecast we made last year, it suggests that the economy will gradually move towards that figure, albeit more slowly than anticipated. Evidence suggests that potential growth has declined relative to the decade before the pandemic. Nevertheless, the economy has shown considerable resilience despite a challenging global environment and persistent uncertainty across North America.

Unemployment has remained near historical lows against a backdrop of reduced labour force participation, as well as a rising share of informal employment. Formal job creation should pick up gradually throughout 2027, in line with economic activity, while unemployment should move closer to its long-run average.

Annual headline inflation ranged from 3.1% to 4.6% in 2026, driven by agricultural supply shocks. Core inflation declined from 4.5% at the beginning of the year to levels slightly below Banco de México's upper tolerance threshold of 4.0%, as currency appreciation and moderating wage pressures offset the effects of new taxes. We expect headline inflation to reach 3.9% by year-end 2026, converging to 4.0% by the end of 2027. On monetary policy, we believe that the policy rate has reached its terminal level in this cycle and will therefore remain at 6.5%.

The medium-term adjustment of public finances continued, albeit more slowly than announced. The fiscal deficit has narrowed by slightly more than 1.5% of GDP over the last two years despite weaker economic activity, while the public debt-to-GDP ratio

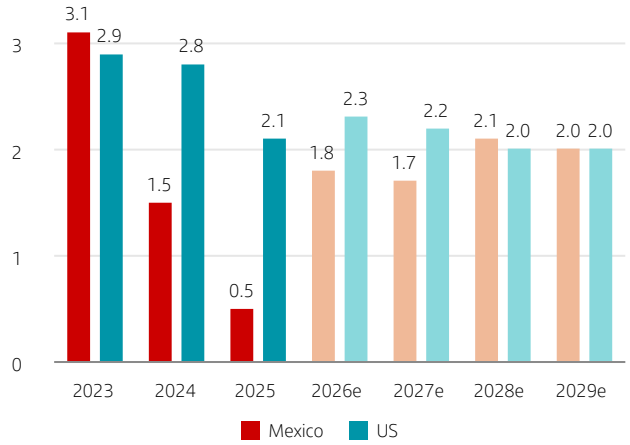
Mexico

continued to rise. Several major rating agencies have downgraded or revised their outlook for Mexico's sovereign debt, although Mexico has retained investment grade status, supported by a public debt of 54% of GDP and a debt structure heavily tilted towards peso-denominated, fixed-rate instruments.

In 2027, the fiscal deficit is set to decline by 0.2% of GDP to 3.9%, while public debt will rise by an additional 1.0% of GDP to 55.0%. We expect further gradual fiscal adjustments over the coming years, supported by measures to enhance revenues, which should be sufficient to fend off short-term market concerns. However, structural challenges will persist, given reduced flexibility in public expenditure and the narrowness of the revenue base.

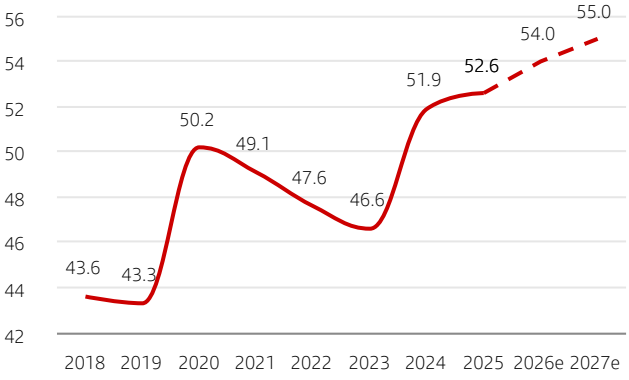
External imbalances have diminished from already low levels, driven by surging technology-related exports, weak imports of capital goods and stronger remittance inflows. We project the current account deficit at less than 0.5% of GDP in 2026, widening modestly to below 1.0% in 2027. As the deficit amounts to less than one-third of expected net foreign direct investment inflows in both years, Mexico will be relatively insulated from capital market volatility, and the peso's expected depreciation should be gradual and orderly.

Mexico: Growth will continue to strengthen
(%, y/y)



Sources: INEGI, BEA and Santander Research.

Mexico: Public debt will continue to increase through 2027
(% of GDP)



Source: SHCP (Historical Balance of the Public Sector Borrowing Requirements).

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	1.7	2.1
Unemployment rate	2.8	3.2	3.4
CPI inflation	3.8	3.9	4.0

Source: Santander Research. Annual average.

Mexico's export resilience amid trade uncertainty

Mexico's trade engine remains strong, and preferential access to the US market continues to support export growth and external stability. However, shifts in US trade policy have diminished gains for domestic activity.

An export-oriented manufacturing base and the USMCA agreement

International trade has been a cornerstone of Mexico's development strategy ever since the North American Free Trade Agreement (NAFTA) was signed in 1993. In the following years, NAFTA was complemented by a network of 13 free trade agreements spanning 52 countries that account for roughly 60% of global gross domestic product (GDP).

The strategy to open up the Mexican economy to trade fostered the development of a large and sophisticated export-oriented manufacturing base: Mexican goods exports in 2025 were worth 665 billion US dollars, or 36% of Mexican GDP, with manufacturing goods accounting for more than 90%. Mexican exports are heavily focused on the US, which is the destination of around 80%.

Given the heavy reliance of Mexican exports on the US market, the renegotiation of NAFTA during the first Trump administration was a critical moment. The resulting agreement, the US-Mexico-Canada Agreement (USMCA), entered into force in 2020 and introduced several changes, particularly regarding the automotive sector. Regional content for vehicle exports increased from 62.5% to 75.0%, new wage requirements were introduced for vehicle production, and a 16-year sunset provision was established, with periodic six-year joint reviews to determine whether the agreement should be extended. Failure to reach an agreement in the joint reviews triggers annual reviews until an agreement is reached or the original 16-year term expires.

Although the overhaul of the regional trade framework increased uncertainty, thereby contributing to a decline in private investment in Mexico during that period, the USMCA also helped preserve Mexico's preferential access to the US market at a time of profound changes in global trade patterns. In the years that followed, Mexico overtook China as the top exporter to the US. Between 2020, when the USMCA entered into force, and 2025, the value of Mexican exports to the US increased by 38% in US dollar terms, while total automotive exports grew by 26%.

Changes under the second Trump administration

The shift in US trade policy that began with the second Trump administration, which raised the average effective tariff on US imports to its highest level in nearly a century,



Mexico

In focus

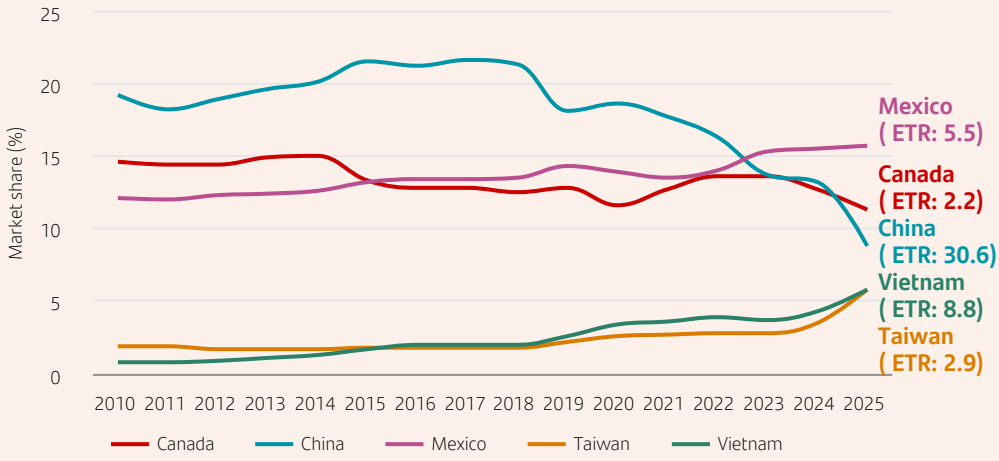
has posed a new challenge for the Mexican economy. While it has once again contributed to a material weakening of private investment, it has also enabled Mexico to consolidate its position as the top exporter to the US.

Mexican exports have benefited from a comparatively favourable tariff treatment, as most USMCA-compliant trade continues to enter the US duty-free. However, elevated sector-specific tariffs, combined with limited exemptions for USMCA-compliant goods, have weighed heavily on the automotive sector. This, together with higher trade barriers on Chinese exports and the booming demand for technology-related goods by US firms, has led to strong growth of Mexican exports and a marked shift in their composition. Auto exports have contracted, while computer and electronics exports have surged. This compositional shift has been unfavourable for economic growth, as the domestic spillovers generated by auto exports are significantly larger than those of the computer and electronics sector, reflecting the former's more extensive domestic supply chains and the latter's lower labour intensity.

The US government's decision not to renew the USMCA under its current terms for an additional 16 years, despite proposals by the Mexican and Canadian governments to do so, means that the agreement will be subject to annual reviews. Therefore, the environment surrounding the trade relationship in the coming two years will closely resemble the current one, with low average tariffs, full exemptions for the bulk of USMCA-compliant trade, some elevated sector-specific tariffs, including on vehicles and auto-parts, and limited clarity regarding the medium-term outlook. In that setting, Mexican exports should continue to expand at a solid pace, although their contribution to growth will be lower than in the past.

In short, Mexico's preferential access to the US market should continue to underpin external stability, but persistent policy uncertainty and less domestically integrated export growth will likely keep the broader growth impulse contained.

Composition of US imports by country of origin
(% of Total US Imports)



Source: US International Trade Commission. ETR: average Effective Tariff Rate for 2025.

Peru

Strong underlying economy and investment beyond recovery

Peru enters 2027 from a position of relative strength, with El Niño representing a temporary disruption rather than a change in the underlying trajectory. Strong external accounts, private investment and improving confidence should support resilience through the first-half shock. Greater political predictability and an investment-oriented policy agenda should reinforce private-sector momentum, contributing to a more favourable medium-term growth outlook.

Yasser Rodrigo

Peru closes 2026 with solid underlying momentum. Gross domestic product (GDP) is expected to grow 3.4%, alongside stronger domestic demand growth of 5.6% and a 10.5% expansion in private investment. Headline growth, however, understates the economy's underlying strength: Peru's Ministry of Economy and Finance (MEF) estimates that in the first half of 2026, the actual growth of 3.0% would have been around 4.0% absent the climate shock. Business expectations reinforce this picture, with investment and hiring intentions near their strongest levels in years.

Domestic and external conditions should boost investment in 2027. Following Keiko Fujimori's election in June 2026, the new administration has prioritised private investment, employment, infrastructure, formalisation and state efficiency. Early business indicators are supportive, with 16 of the Central Reserve Bank of Peru (BCRP)'s 18 indicators in optimistic territory in July, and investment and hiring expectations remaining strong. At the same time, record terms of trade — supported by high copper and gold prices — and a trade surplus projected at around 37 billion US dollars in 2027 should reinforce external resilience and support the sol. Together, greater policy predictability and strong external fundamentals are expected to strengthen the environment for domestic and foreign investment, particularly in mining, infrastructure and energy.

Fiscal fundamentals are also still relatively contained, although consolidation will hinge on execution. Under the MEF's baseline, the fiscal deficit narrows from 1.8% of GDP in 2026 to 1.4% in 2027, with public debt around 29% of GDP; however, previously approved expenditure measures could lift the deficit to 2.7%. Meanwhile, household fundamentals continue to improve, with formal employment up 4.2% in the first half of 2026 and average formal wages rising 4.8%.

The main challenge in 2027 will be El Niño, which the BCRP estimates could subtract around 1.1 percentage points from annual growth. This should produce a two-speed year, with activity weakening in the first half of 2027 before rebounding strongly in the

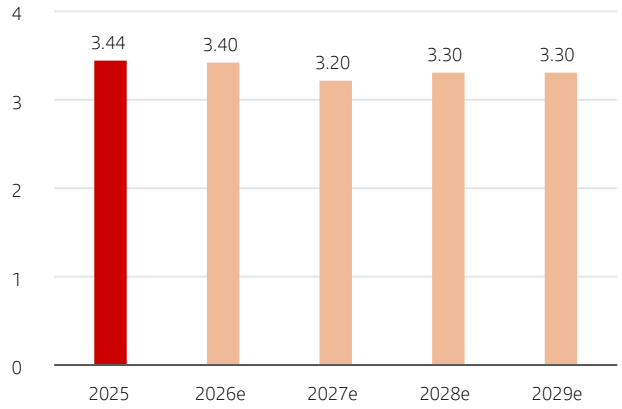
Peru

second half, leaving full-year growth at 3.2%. Inflation should remain temporarily elevated before normalising towards 2.8% by year-end. El Niño interrupts Peru's acceleration rather than changing its medium-term trajectory. Strong private-sector momentum provides a buffer, with private investment expanding 15.5% in the first half of 2026, supporting activity and the prospect of a rapid recovery once the climate shock fades.

The investment cycle extends beyond the immediate recovery. MEF projections point to sustained private investment growth through 2030, supported by a broad pipeline across mining and critical minerals, infrastructure and concessions, energy and other sectors. If execution follows this pipeline, 2027 could mark the beginning of a multi-year capital expenditure cycle rather than simply a post-El Niño rebound.

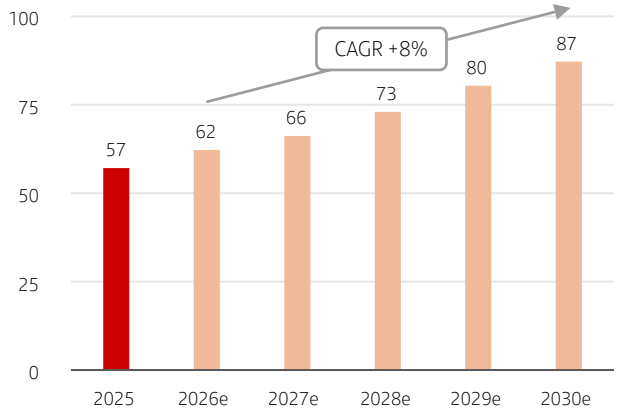
Our take on artificial intelligence (AI): a new source of growth, but one that could initially widen Peru's productivity gap. AI offers a medium-term productivity upside, but adoption will likely be uneven. With informality around 70% and only 10% of CEOs integrating AI into core processes, initial gains could concentrate among larger, formal firms, widening productivity gaps. Over time, broader adoption, stronger human capital and improved digital infrastructure could allow AI to support productivity convergence.

Peru: Resilience through the shock
(GDP growth, %, y/y)



Source: Business Advisory Services (SAE – Apoyo Consultoría).

Peru: Private investment remains the growth engine
(USD bn)



Source: Peru's Ministry of Economy and Finance (MEF).

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	3.4	3.2	3.3
Unemployment rate	5.7	5.0	5.0
CPI inflation	4.0	3.0	2.5

Source: Santander Research. Annual average.



Uruguay

Moderate recovery amid investment constraints

Uruguay's economy should regain some momentum in 2027, although growth will remain moderate. We forecast gross domestic product (GDP) growth of 1.5%, up from 1.0% in 2026. Private consumption should continue to support activity, while recovering exports and softer import growth improve the external contribution. Inflation should ease to 4.6% by year-end. However, weak investment and persistent competitiveness challenges will limit a stronger acceleration.

Cristina Conti

Economic activity should recover gradually after a weak and uneven 2026. Indicators point to a loss of momentum after a strong start, particularly in tradable sectors. Drought conditions weighed on agriculture, freight transport and grain-related activities, while manufacturing also weakened. By contrast, private consumption remained resilient, supported by rising real wages, broadly stable employment and credit growth. The 2027 improvement therefore represents a recovery rather than a significant change in Uruguay's underlying growth pace.

Private consumption will continue to be supportive, although its contribution is likely to moderate. We expect consumption to expand by around 1.5% in 2027, after an estimated 2.1% in 2026. Real wages should continue to rise, though more slowly than in recent years, while unemployment is projected to edge up from 7.9% to 8.1%. Credit should continue to support domestic demand, with total lending expected to grow by around 6% in US-dollar terms, and local-currency credit expanding more strongly.

Investment will be one of the main constraints on stronger growth. Beyond a few large-scale projects, capital formation has been relatively low for much of the past decade. The issue appears to be less about sovereign risk — which has fallen significantly — and more about expected returns that are insufficient to trigger a sustained cycle of private investment. High international financing costs, domestic challenges related to energy costs, competitiveness and labour relations will also maintain relevance. With fiscal constraints limiting public investment, stronger medium-term growth will depend largely on measures that improve expected private-sector returns.

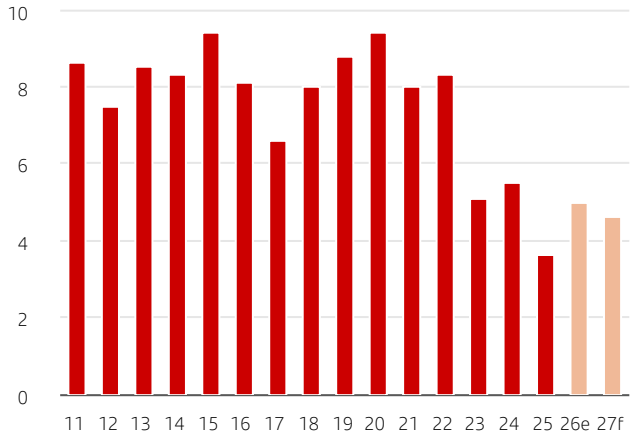
The external sector should contribute more favourably in 2027. After falling around 0.7% in 2026, exports are projected to rise 1.8%, reaching nearly 24 billion US dollars, while import growth will slow below 1%. The current account deficit should narrow from 2.1% of GDP in 2026 to 1.7% in 2027. Weather remains a key risk given potential impacts on agriculture, energy and tourism.

Uruguay

Inflation should resume a downward trend. After rising to around 5.0% at year-end 2026, partly due to higher international oil prices, we expect inflation to ease to 4.6% by year-end 2027, close to the Central Bank's 4.5% target. Our scenario assumes an orderly depreciation of the peso, from 41 Uruguayan pesos per US dollar at year-end 2026 to around 43 Uruguayan pesos in 2027, while nominal wages will rise by approximately 5.0–5.5%, allowing for a further, though more modest, increase in real wages. With inflation expectations anchored, monetary policy will increasingly depend on the cyclical position of the economy and the Uruguayan Central Bank's estimate of the neutral interest rate. We expect the policy rate to remain at 5.75% at year-end 2027.

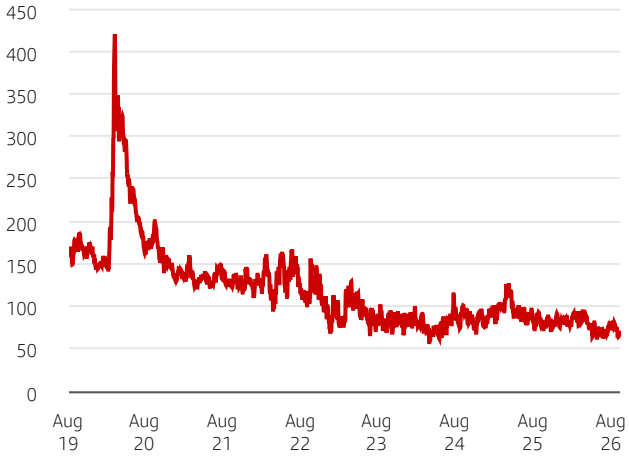
Overall, 2027 should be a year of moderate recovery rather than strong growth. Improving external conditions, continued consumption growth and inflation closer to target should support macroeconomic stability. However, slower real wage gains, limited employment creation and, above all, subdued investment will continue to constrain the pace of expansion. Downside risks are concentrated in adverse weather conditions and a weaker-than-expected recovery in tradable sectors, while improvements in the business environment and investment conditions could support stronger growth.

Uruguay: Inflation is expected to stay close to target
(%, y/y)



Sources: National Institute of Statistics of Uruguay and Santander Research.

Uruguay: Country risk premium remains at low levels
(bps)



Note: Credit risk spread represents the average excess yield demanded by the market on Uruguay's US dollar-denominated sovereign debt over US Treasuries.
Source: BEVSA.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.0	1.5	2.0
Unemployment rate	7.9	8.1	8.2
CPI inflation	4.1	4.8	4.3

Source: Santander Research. Annual average.



China

The next growth chapter

China is entering a more mature phase of economic development, with traditional growth drivers losing strength. Capital accumulation, demographics, property investment and technological catch-up contribute less than in previous decades. Growth is therefore likely to slow further, while future convergence should increasingly rely on productivity, innovation, efficiency gains and better capital allocation.



Benjamín Alonso Castaño

As China moves closer to the global technological frontier, growth is naturally slowing, while population ageing and a shrinking working-age population add further structural pressure. However, this does not imply stagnation. Artificial intelligence (AI), digital applications and continued participation in regional and global trade networks could help sustain growth in a more fragmented global environment.

The 15th Five-Year Plan reflects this strategic shift. Although it does not set an explicit gross domestic product (GDP) growth target for 2026-2030, the objective of doubling 2020 GDP per capita by 2035 is broadly consistent with real GDP growth averaging around 4% over the coming decade. The plan focuses on technology, security and people's livelihoods, combining support for research and development (R&D) and strategic industries with measures to strengthen supply chains and support consumption through better childcare, elderly care and public services. AI is a particularly important cross-cutting priority, with the "AI Plus" initiative aimed at accelerating its adoption across the economy.

China's main macroeconomic imbalance remains the gap between weak domestic demand and strong industrial supply. Household consumption has not yet become a self-sustaining growth engine. It is constrained by the property downturn, subdued confidence, labour-market uncertainty and high precautionary savings.

At the same time, China's supply side is holding strong, with industrial capacity expanding, particularly in new-economy sectors. However, insufficient domestic absorption is driving disinflationary pressures, excess capacity and weak pricing power. Inflation is therefore likely to be subdued in 2027, despite efforts to curb excessive competition, while durable rebalancing will require deeper reforms to income formation, social protections and the consumption environment.

Real estate is still the largest structural drag on domestic demand, weighing on household wealth, confidence, private investment and local-government finances. Despite policy efforts to stabilise the sector and signs of stabilisation in selected cities, the nationwide adjustment runs deep. A durable nationwide recovery has yet to emerge, while the sector's role as a major engine of growth has been structurally diminished. The old property-led growth model is unlikely to return.

China

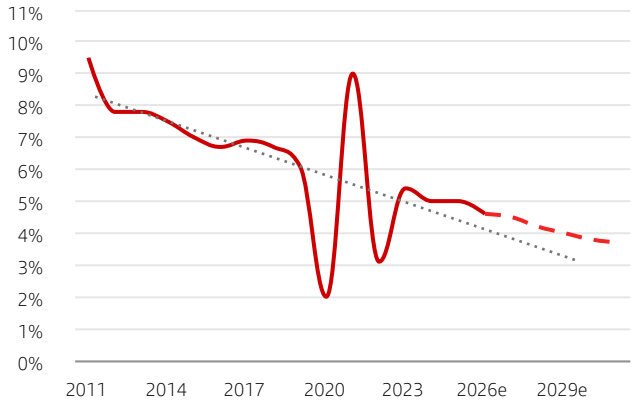
Labour-market conditions are likely to remain uneven, particularly among younger workers, weighing on confidence and precautionary saving. Macroeconomic policy is likely to be supportive, led by fiscal policy, while subdued inflation gives the People's Bank of China (PBoC) room to maintain accommodative conditions, although bank margins and currency stability may favour a gradual approach.

External demand continues to provide key near-term support. Export momentum is increasingly visible in higher-value-added sectors such as electric vehicles (EVs), batteries and solar products. Chinese firms are also diversifying towards Europe, Southeast Asia, Latin America, Africa and other emerging markets. The main risk is a stronger protectionist response abroad, including anti-subsidy investigations, safeguards and tighter scrutiny of transshipment.

Renminbi (RMB) internationalisation is advancing through practical use in trade, funding, investment and liquidity management, supported by Cross-Border Interbank Payment System (CIPS) activity and Panda and Dim Sum bond issuance[1].

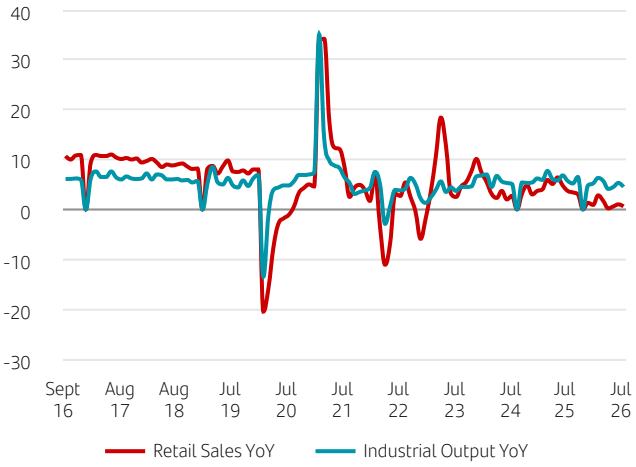
Finally, Middle East tensions add uncertainty through energy, trade and financial channels. China's diversified suppliers, strategic inventories and renewables provide some resilience, but its reliance on imported oil leaves it exposed to prolonged disruptions in the Strait of Hormuz and persistently higher energy prices.

China: Annual GDP growth is slowing



Sources: Datastream (Oxford Economics) and Santander Research.

China: Supply-demand imbalance



Source: Datastream (NBS China).

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	4.6	4.5	4.2

Source: Santander Research. Annual average.

[1] CIPS: China's cross-border RMB clearing and settlement system. Panda and Dim Sum Bonds: Onshore and offshore RMB-denominated bonds that support the international use of the renminbi.

China In focus

China's trade reorientation: barriers, changing capacity and strategic dependencies

US tariffs do not create China's trade reorientation; they accelerate and redirect it. China is not simply exporting more or importing less; it is trading differently: pushing outwards in technology-intensive sectors, diversifying geographically and concentrating imports in strategic bottlenecks.

Trade reorientation

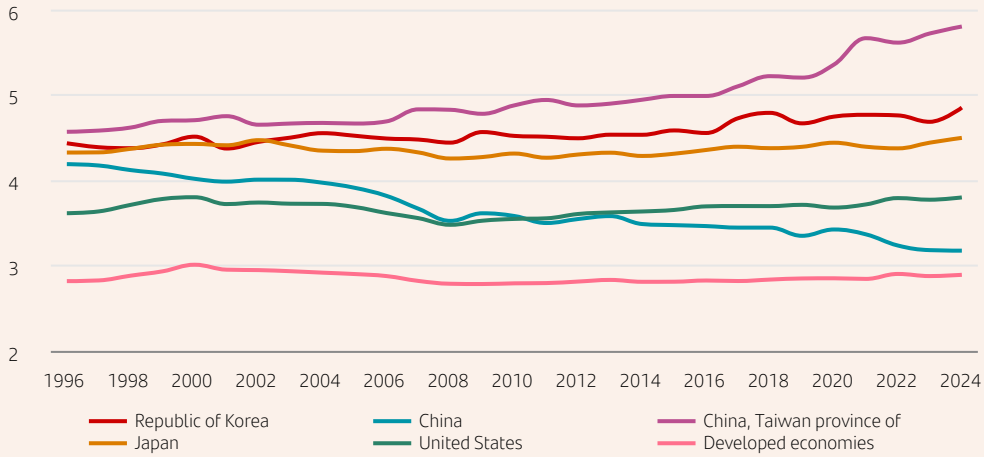
China's trade reorientation will remain a key theme for 2027. It is tempting to frame it mainly as a consequence of US tariffs, but that would be too narrow. Tariffs matter, especially because they restrict access to one of the world's largest high-income consumer markets. Yet the deeper story is structural: China is changing what it exports, where it sells, and what it still needs to import. Three forces are driving this shift: the changing composition of Chinese production, the proliferation of trade barriers and Beijing's pursuit of strategic autonomy.

The first driver is the transformation of China's export base. China is no longer competing mainly in labour-intensive consumer goods. Its export strength is increasingly visible in electric vehicles (EVs), batteries, solar panels, electrical machinery, electronics, capital goods and selected chemicals. This reflects domestic priorities such as electrification, automation, energy security and industrial upgrading, as well as a policy effort to move up the value chain. As a result, China's capacity is also changing in nature. It is no longer only associated with mature sectors such as steel or textiles; it is increasingly present in industries that advanced economies consider strategic.

This does not mean that China's exports are narrowly concentrated. Quite the opposite. The Theil export concentration index[1] suggests that China's export base remains relatively diversified compared with several other Asian manufacturing economies. That matters. The issue is not that China depends on a few export products or markets. Rather, it is that a broad and diversified export base is becoming more competitive in sectors where many economies seek to preserve or build industrial capabilities. The tension is therefore not aggregate concentration, but the changing composition of competition.

[1] UNCTAD's Theil export concentration index measures whether a country's exports are spread across many products and destination markets or concentrated in only a few. Higher values indicate greater concentration; lower values indicate greater diversification. UNCTAD defines developed economies broadly as Northern America and Europe, plus Israel, Japan, the Republic of Korea, Australia and New Zealand.

Theil export concentration index*



(*) Geographical labels follow the underlying statistical sources.

Source: UNCTADstat, Merchandise: Theil concentration indices of exports and imports, annual; UNCTAD classification of developed economies.

Exports redirection

The second driver is rising trade barriers. The US has raised tariffs on Chinese goods in sectors such as EVs, batteries, semiconductors and clean technologies, while the European Union (EU) has introduced countervailing duties on Chinese EVs. Other economies are also reviewing trade measures in sectors such as the automotive industry, steel and clean technologies.

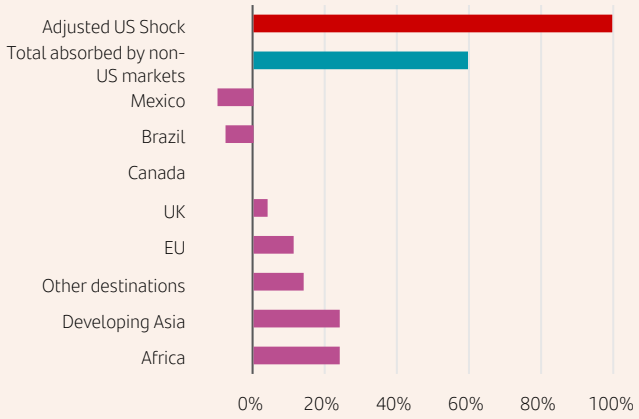
These barriers do not eliminate Chinese capacity; they change its geography. When one market becomes less accessible, Chinese firms have stronger incentives to redirect exports, cut prices, invest abroad or use third countries as production platforms.

To illustrate this shift, we calculate an apparent absorption measure adjusted for preexisting trends[2]. Chinese sales to the US fell by 104.2 billion US dollars in 2025. Relative to their previous trend, the adjusted US shock was 122.3 billion US dollars. Exports to the rest of the world rose 72.8 billion US dollars above trend, equivalent to around 60% of the adjusted US decline. The compensation was therefore significant, but incomplete. Africa and developing Asia each absorbed around one-quarter of the adjusted US shock, while the EU accounted for just above 10%. China's reorientation is therefore not mainly a story of lost US exports being redirected to Europe. It is broader, with emerging markets playing a central role.

[2] Apparent absorption adjusted for trend compares the above-trend increase in China's exports to each destination in 2025 with the above-trend fall in exports to the US. Formally, $A_i=[\Delta X_{i,2025} - \Delta X_{i,2021\text{-}2024}]/[-(\Delta X_{US,2025} - \Delta X_{US,2021\text{-}2024})]$, where $\Delta X_{i,t} = X_{i,t} - X_{i,t-1}$. The indicator is descriptive and should not be interpreted as a causal estimate of tariff diversion.

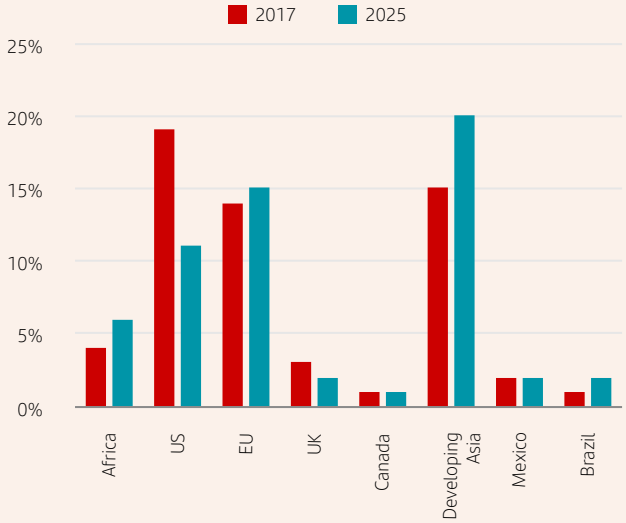
China In focus

China: Apparent absorption of US shock
(% of adjusted US export shock)



Sources: Datastream (IMF Direction of Trade Statistics) and Santander Research calculations.
Note: Apparent absorption: export growth vs. the 2021–24 trend, as a % of the adjusted fall in exports to the US. Negative values indicate below-trend exports.

China: Export reorientation extended beyond the US
(share %)



Sources: Datastream (IMF Direction of Trade Statistics) and Santander Research.

Strategic autonomy

The third driver is strategic autonomy. China's objective is not autarky, but selective self-reliance: reducing vulnerabilities in technology, energy, food and critical materials while preserving access to foreign demand and essential inputs. This is visible in aggregate import intensity. China's real goods imports declined from around 14% of real gross domestic product (GDP) in 2015 to 11% in 2025, suggesting that the economy has become less import-intensive in volume terms. But lower import intensity should not automatically be read as evidence of self-sufficiency.

The more revealing shift is compositional. Using United Nations (UN) Comtrade data, we construct a narrow basket of strategic imports: semiconductors and semiconductor manufacturing equipment, energy products, selected food staples and selected critical industrial materials[3]. This basket increased from 31.6% of China's total goods imports in 2015 to 44.0% in 2024. China is therefore not becoming autarkic. Rather, it is importing more selectively: the imports it still needs may be increasingly concentrated in hard-to-substitute strategic inputs.

[3] The strategic import basket is constructed from UN Comtrade data for China's goods imports from the world, using HS product codes. The basket includes technology goods, HS 8542 and 8486; energy products, HS 2709, 2711 and 2701; selected food staples, HS 1201, 1001 and 1005; and critical industrial materials, HS 2601, 2606, 7403 and 7601. It is expressed as a share of China's total goods imports. The measure captures the concentration of China's import needs in selected strategic inputs; it is not a comprehensive measure of import dependence or self-sufficiency.

Special topics



How much financing does the world need?

Artificial intelligence (AI) and new technologies, population ageing, energy transition and national security: all these megatrends will require increasing financing over the next years. Our preliminary estimates for 2026–2030 suggest that the world needs to invest around 50 trillion euros over 2026–2030 and, given the financing sources currently available and their expected growth rate, the financing gap would be around 30 trillion euros. This is the equivalent of more than half of global pension fund assets or more than two times the total deposits held by households and firms in the Eurozone.

Tomás Riestra Giner de los Ríos
Juan Cerruti

50 trillion euros – Gross investment needs in 2026–2030

30 trillion euros– financing gap to be mobilised

More than half of global pension fund assets

Over the next five years, the global economy will simultaneously have to finance the energy and climate transition, digitalisation and artificial intelligence, the effects of population ageing and, very likely, a more costly response to global geofragmentation. Estimates of investment needs and increased expenditure derived from the main global reports on these four issues[1] point to a requirement of around 50 trillion euros accumulated over 2026–2030, that is, around 10 trillion euros per year. To cover this, the financing gap or additional financing mobilisation required would stand at around 30 trillion euros over five years. That is the equivalent of almost two years of the Eurozone's gross domestic product (GDP), more than half of global pension fund assets or more than two times the total deposits held by households and firms in the Eurozone. The main message is simple: it is not enough to find more money; existing savings need to be channelled more effectively, risks reduced and projects made more financeable.

The million-dollar question

We often focus on the substance, when in reality the form requires equal or greater attention. Almost everyone could name four or five global challenges facing humanity over the coming decades. How many could name a source or form of financing? Should the way in which an adequate response to these challenges is delivered not attract the same attention as the challenges themselves? After all, the solution requires action rather than the accumulation of diagnoses.

50 trillion euros. That is the central figure. Or, more precisely, the order of magnitude estimated to be necessary to address four overlapping transformations: the climate transition, digitalisation and AI, ageing and strategic security.

[1] Climate Policy Initiative, 'Global Landscape of Climate Finance 2026' and 'Assessing Top-down Climate Finance Needs: Methodology, 2025'; International Energy Agency, 'World Energy Investment 2026', 'Energy and AI' and 'Global Critical Minerals Outlook 2025'; United Nations, 'Financing for Sustainable Development Report 2026'; McKinsey & Company (2025), 'The cost of compute: A 7 trillion dollars race to scale data centres'; OECD, 'Global Outlook on Financing for Sustainable Development 2025', 'Ageing populations, their fiscal implications and policy responses', No. 1844, 'Pensions at a Glance 2025' and 'Health at a Glance 2025'; SIPRI, 'Trends in World Military Expenditure, 2025'.

The figure of 50 trillion euros should not be read as a single public-sector bill. It includes profitable private investment, public expenditure, concessional financing, debt, equity and the reallocation of existing resources. The effective gap to be mobilised is smaller, but still enormous: around 30 trillion euros over five years. The real challenge is how to mobilise that capital and where to allocate it.

Almost everyone could name four or five global challenges facing humanity over the coming decades. How many could name a source or form of financing?

The energy transition requires grids, renewables, storage, electrification and adaptation. Artificial intelligence requires data centres, chips, energy, connectivity, data and talent. Ageing pushes up healthcare expenditure, long-term care and pressure on pensions and budgets. And more fragmented geopolitics adds the need for greater spending to bolster defence, cybersecurity, critical mineral markets and redundancies in supply chains.

Estimated global financing needs and financing gap by area, 2026–2030

Area	Gross financing need (2026–2030)	Financing gap / additional mobilisation
Energy transition	€ 35 tn	€ 22-26 tn
Digitalisation and AI	€ 10 tn	€ 2.5-4 tn
Population ageing	€ 3.2 tn	€ 1.3-3.0 tn
Geofragmentation and defence	€ 4.7 tn	€ 2.5-4 tn
Adjustment for overlaps	€ -1.7 tn	€ -1/-2 tn
Net total	**€ 50 tn**	**€ 30 tn**

Methodological note: the figures in this article are an estimate constructed on the basis of the main studies published by multilateral agencies, public authorities, multilateral banks and leading consultancies, including the Organisation for Economic Co-operation and Development (OECD), the United Nations (UN), the International Monetary Fund (IMF), the United Nations Environment Programme (UNEP), the International Energy Agency (IEA), the European Central Bank (ECB), the European Commission, the World Bank, the Stockholm International Peace Research Institute (SIPRI), Climate Policy Initiative (CPI) and McKinsey. To standardise the figures, amounts originally published in dollars have been converted into euros using a rounded exchange rate of USD 1 = EUR 0.86, consistent with exchange rates at the end of August 2026. Given that these are order-of-magnitude estimates, the conversion is not intended to provide exchange-rate precision.

1. Energy transition: the largest bill and the greatest opportunity

Energy transition accounts for the largest financing need. Climate Policy Initiative's (CPI) new Global Landscape of Climate Finance 2026 confirms that flows continue to grow, but too slowly: global climate finance exceeded around 1.7 trillion euros, and the preliminary estimate for 2025 is around 1.8 trillion euros. Against this, CPI estimates that mitigation alone requires an average of 6.7 trillion euros per year between 2025 and 2030. For 2026–2030, this implies around 33.5 trillion euros for mitigation alone.

Adaptation must also be added. The United Nations Environment Programme (UNEP)[2] estimates that developing countries will need between 267 billion euros and 314 billion euros per year by 2035, while CPI identifies only around 55 billion euros in adaptation flows in 2024. Combining mitigation and adaptation, our estimate for the amount of climate financing needed for 2026-2030 rises to around 35 trillion euros in investment needs, with a gap of 22–26 trillion euros. With regard to the broader transition financing landscape, the International Energy Agency (IEA) notes that global energy investment will reach around 2.9 trillion euros in 2026, of which around 1.9 trillion euros will go to clean energy and related infrastructure. Ultimately, financing

[2] UNEP, 'Adaptation Gap Report 2025: Running on empty'.

the climate is not about financing a separate agenda, but rather the basic infrastructure of the twenty-first-century economy.

2. Digitalisation and AI: the new critical infrastructure

AI is not just software: it requires energy, chips and data centres

Artificial intelligence is often presented as software, but in reality it rests on highly capital-intensive physical infrastructure: data centres, chips, electricity grids, fibre, cooling and storage. McKinsey estimates that data centres will require around 5.8 trillion euros in global investment by 2030, of which approximately 4.5 trillion euros will correspond to AI workloads. Adding models, applications, connectivity, data and digital capabilities, our central estimate for digitalisation and AI financing requirements stands at around 10 trillion euros in 2026–2030, with a gap of around 2.5–4 trillion euros.

The IEA adds that electricity consumption by data centres could more than double to around 945 TWh by 2030. The risk is that the gap between countries will widen if investment is concentrated in only a few technology hubs. The response should not be to duplicate everything, but to invest strategically, ensure interoperability and combine national capabilities with partnerships.

3. Ageing: a silent pressure on budgets

Ageing does not usually appear as a large one-off investment; instead, it represents a persistent fiscal pressure. The Organisation for Economic Co-operation and Development (OECD) notes that population ageing leads to increasing expenditure on pensions, healthcare and long-term care, and affects potential growth and public revenues. Our estimate does not add up all existing expenditure; it is based solely on the incremental pressure associated with demographic change: around 3.2 trillion euros accumulated over 2026–2030, with an additional gap of between 1.3 trillion euros and 3.0 trillion euros.

The key is to invest earlier in preventive healthcare, more efficient care, assistive technology and senior employment. Delaying reforms merely shifts the bill into the future

The key is to invest earlier in preventive healthcare, more efficient care, assistive technology and senior employment. Delaying reforms merely shifts the bill into the future.

4. Geofragmentation, defence and strategic autonomy

Globalisation has not disappeared, but it is becoming more defensive. The Stockholm International Peace Research Institute (SIPRI) estimates that global military expenditure reached around 2.5 trillion euros in 2025, a historic high equivalent to 2.5% of global GDP. If the new geopolitical environment pushes the effort towards 3.0%–3.5% of GDP, approximately 0.5–1.0 trillion euros in additional expenditure per year would be required. Our estimate for global military investment needs does not add the baseline military expenditure for each year; it accounts only for the incremental effort in rearmament, modernisation and strategic resilience, which, together with strategic autonomy, places the financing requirements for this area at around 4.7 trillion euros for 2026–2030.

Added to this are non-military investment needs in semiconductors, critical minerals, batteries, cybersecurity, critical infrastructure, strategic reserves and redundancies in supply chains.

The IEA warns that concentration in critical minerals markets and their refining chains creates significant vulnerabilities. However, diversifying supply comes at a cost: mining and refining projects outside the dominant producers have capital costs of around 50% higher on average. The priority should be selective resilience: investing in the bottlenecks that protect productive and defence capacity, without falling into indiscriminate duplication.

Europe is overdiagnosed but underexecuted. There is growing consensus on how to restore competitiveness and move towards greater strategic autonomy. But the pace needs to accelerate

The situation is compounded by the fact that fragmentation has a potentially enormous macroeconomic cost. The International Monetary Fund (IMF) has calculated permanent losses of 2.3% of global GDP in a scenario of trade blocs, while the World Economic Forum (WEF) estimates output losses of up to 4.9 trillion euros in one year in a scenario of severe financial fragmentation.

5. Europe in focus: financing needs and the financing gap

Europe is overdiagnosed but underexecuted. There is growing consensus on how to restore competitiveness and move towards greater strategic autonomy. But the pace needs to accelerate.

The continent has important advantages, including savings, institutions and financial coordination experience, among others. However, it also has a twofold central problem to overcome: how to mobilise resources and how to convert savings into investment rapidly and across borders. The OECD's Global Outlook on Financing for Sustainable Development 2025 stresses that the main bottlenecks lie in the channelling, coordination and execution of financing.

The European gap is particularly visible in innovation and venture capital.

The European Central Bank (ECB) estimates that around 1.2 trillion euros[3] per year in additional investment is needed in Europe between 2025 and 2031 to jointly finance the green, digital and defence transitions, a figure obtained by updating the European Commission's needs for climate and digitalisation and adding the greater defence effort following the North Atlantic Treaty Organization (NATO) summit in June 2025. The ECB itself presents this as an upward revision from the 800 billion euros estimated by Mario Draghi one year earlier.

In addition, ageing will weigh heavily on public expenditure: the European Commission's 2024 Ageing Report[4] projects that the total cost of ageing in the EU will rise from 24.4% of GDP in 2022 to 25.6% by 2070. This figure can be broken down into: pensions +0.4 percentatge points (pp), healthcare +0.4 pp, long-term care +0.8 pp and education −0.5 pp.

[3] ECB (2025), 'Time to be strategic: how public money could power Europe's green, digital and defence transitions'.
[4] European Commission, '2024 Ageing Report: Economic and budgetary projections for the EU Member State'.

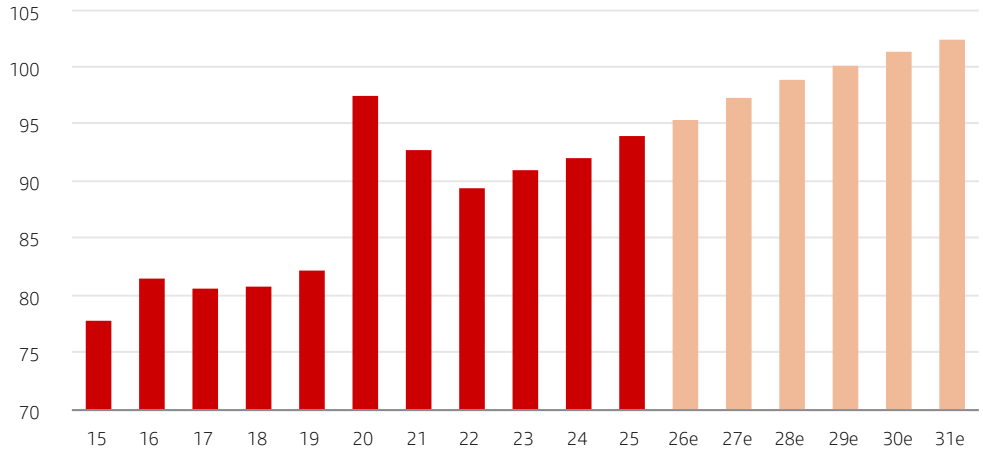
6. Fiscal constraints and public-private collaboration

The scale of the needs exceeds the capacity of public budgets to respond on their own. In a context of high debt, higher financing costs and greater simultaneous pressure from pensions, healthcare, defence and the energy transition, the public sector will have to prioritise, sequence and use its balance sheet selectively. Financing these transitions will require public-private collaboration, with private capital acting as a multiplier of public capital through guarantees, blended finance and risk-sharing mechanisms to mobilise private savings towards projects of general interest.

Banks must play a key role. Not only by lending money, but also by structuring projects, distributing risks, mobilising deposits and supporting companies

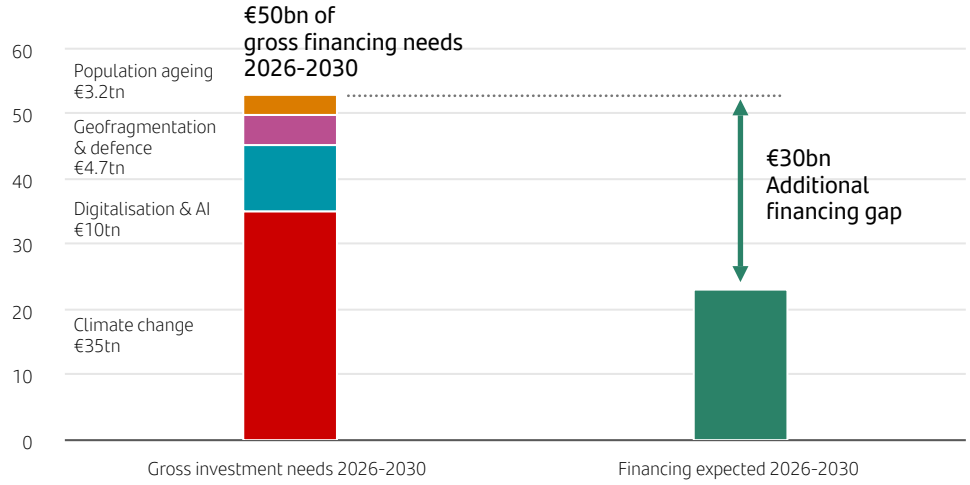
Banks must play a key role. Not only by lending, but also by structuring projects, distributing risks, mobilising deposits, supporting companies and combining private financing with public guarantees and support from multilateral banks. In an environment of simultaneous transitions, this intermediation function is as important as the volume of credit. Of course, growth in global capital markets is also essential. As is the healthy development of non-bank financial players.

Global public debt
(% of GDP)



Source: IMF.

Global investment needs are raising
Estimated gross financing need, 2026-2030



Source: Banco Santander. Methodological note: see table above.

Conclusions

The next decade will be defined not by one single transition, but by the concurrence of several. The energy transition, AI, population ageing and strategic security will compete for resources, but they can also reinforce one another if managed well. The central figure of around 50 trillion euros in gross needs and around 30 trillion euros in the effective financing gap over five years, with a range of 28–33 trillion euros, is not an exact prediction, but an indication of scale and a call to move from diagnosis to execution.

The world has the savings, technology and institutional capacity to finance these transformations. What is lacking is the alignment of incentives, the reduction of risks and prioritisation. The real challenge will not only be how much to invest, but the ability to invest in time, invest better and prevent a lack of financing from turning inevitable transitions into postponed challenges.

Rethinking the macroeconomic framework in a supply-driven world

All the global shocks the world has experienced over the past six years have one common feature and it is the same denominator shared by the four megatrends that will shape the global economy in the future: they are all issues related to the aggregate supply side of the economy. For a world that, in previous decades, essentially moved to the rhythm of the demand side, this has important implications. The way these shocks have been dealt with so far raises doubts about the sustainability of some economic policies over the medium term. What other measures or strategies should be considered? We outline them here.

Juan Cerruti
María Victoria Núñez Cortés

What do the Covid pandemic, the war in Ukraine, trade tensions over tariffs and the conflict in the Middle East have in common? The same thing as several global megatrends, such as geofragmentation, demographic change, climate change and new technologies led by artificial intelligence (AI). They are all shocks or trends that initially emerge on the aggregate supply side of the economy.

For a world that has historically been affected mainly by aggregate demand, this has profound implications for how global phenomena are thought about and understood. The debate is not only theoretical; it could also have consequences for the global economy and for economic and industrial policies in the years ahead.

For economists or economic analysts who grew up studying textbooks whose models were largely developed under the opposite premise — that aggregate demand is the main source of economic disruptions, essentially inspired by the Keynesian school — this entails a radical shift in the way we will think about and understand the world ahead. Over recent years, the global economy seems to have moved from a demand-driven regime to a supply-driven one.

Recent crises have shifted the global economy from a demand-driven environment to one shaped by supply-side shocks, including pandemics, geopolitical conflicts, trade tensions and technological change

An "uncomfortable" environment

Strictly speaking, an environment dominated by supply shocks is somewhat "uncomfortable" for everyone. For economists, because, as noted, it requires moving beyond traditional models and developing a better understanding of certain patterns usually associated with other disciplines, such as engineering, that are more closely linked to global value chains, production processes and technological change. And for policymakers, because such an environment is often associated with phenomena such as stagflation — economic slowdown alongside accelerating inflation — a particularly challenging situation for both governments and central banks. In most cases, the "definitive solution" lies beyond what can be done in the

short term (even beyond the time horizon of political cycles) using the usual economic policy tools, apart from trying to mitigate temporary effects and "buy time" while the source of the disruption, such as a military or trade conflict, slowly dissipates.

Negative supply shocks create stagflation, combining weaker growth and higher inflation, while making traditional fiscal and monetary policies less effective

The history of the contemporary global economy, strongly influenced by Keynesianism since the middle of the last century, has documented and identified demand disturbances as traditional or typical drivers of inflation — for example, through empirical tools such as the Phillips curve, which links the level of inflation to unemployment.

Something called "stagflation"

It was not until just over half a century ago, in the mid-1970s, that the so-called "oil price crisis" pushed the debate on aggregate supply disturbances and the term "stagflation" to the fore. If the initial shock affects aggregate supply, the situation becomes rather more complicated. A negative supply shock produces a stagflationary effect: price increases alongside economic slowdown or recession. This is the worst possible scenario or, at the very least, the one no government would want to face. But no fiscal or monetary policy alone can solve both problems simultaneously — accelerating inflation and slowing economic activity — at least not without worsening the other problem in the meantime. The solution to a negative supply shock requires some recovery in supply itself. For example, we have seen this with the easing of bottlenecks and global trade chains after the pandemic and the invasion of Ukraine, which paved the way for the subsequent fall in global inflation.

As mentioned above, the main negative supply shocks in recent years have been the Covid pandemic (2020), the war in Ukraine (2022), the trade tariff war (2025) and, more recently, tensions in the Strait of Hormuz (2026). But there are other medium- and long-term trends that will bring about positive, probably more gradual supply shocks, such as the spread of new technologies led by AI. Over the medium and long term, these trends are projected to bring faster growth alongside slowing inflation. Demographic changes — population ageing, migration and so on — are also essentially supply-side movements, as might be the disruptions climate change could create. It is worth clarifying here that when we speak of supply shocks, we are not ignoring the fact that demand also moves during this process; rather, the initial impact, the trigger, comes from the aggregate supply side of the economy.

Policy responses have cushioned economic activity but left the world with higher public debt and larger central bank balance sheets, reducing room to tackle future shocks

Empirical data support

Do the empirical data support the view that the pandemic, the war in Ukraine and the recent trade tensions have been supply shocks? The answer is yes, with some qualifications. On average, one year after each of these events global gross domestic product (GDP) slowed down by 1.7 percentage points (pp), while inflation accelerated by 0.8 pp. All these events behaved as expected: activity slowed and inflation picked up pace. The only exception is the Covid pandemic, when prices

were still falling a year later. By two years later, however, prices had accelerated, driven by the bottlenecks generated and the incipient recovery, and inflation had already jumped by 2.4 pp to 5.6%[1].

As noted, the latest major global shocks have been supply shocks. Indeed, even demand-side imbalances seem somewhat old-fashioned these days. With the improvement in the calibration and management of monetary and fiscal policy in recent decades through independent central banks and sophisticated monitoring models, not to mention stricter budgetary controls, the possibility of persistent demand imbalances — the gap between actual and potential output, or the output gap, widening systematically over time — seems lower than in previous decades. In this context, the initial sources of imbalances have shifted to supply, where, as we shall see, traditional fiscal and monetary policies operate in a more uncertain way.

In a macroeconomic environment dominated by supply-side shocks, inflation spikes tend to occur more frequently. At the same time, monetary policy becomes less effective in containing them

So how has the world dealt with negative supply shocks so far? In general, through expansionary demand-side fiscal policies, which sought to minimise the short-term contractionary impact on activity. Evidence of this is that, compared with 2020 — before the pandemic, wars, trade tensions and so on — the level of global public debt was 82% and for OECD economies it was 97%. Now it is 96% and 105%, respectively[2].

Meanwhile, with regard to monetary policy, the situation has fluctuated. There were very marked expansionary cycles at the start of the pandemic, aimed at providing markets with abundant liquidity, followed by periods of monetary tightening when the pandemic recovery and bottlenecks overlapped with Russia's invasion of Ukraine, which pushed up energy and food prices. The fact is that in a macroeconomic environment dominated by supply-side shocks, inflation spikes tend to occur more frequently. At the same time, monetary policy becomes less effective in containing them, while its transmission mechanisms become more complex and indirect.

Lack of coordination

The way the world has dealt with supply-side shocks has been quite contradictory: fiscal and monetary policy have often moved in opposite directions

The result has been that, from a global perspective, fiscal and monetary policy have often moved in opposite directions or with only modest coordination, the equivalent of the right hand doing the opposite of the left. The final outcome of this monetary and fiscal policy mix has been a more indebted world, with much more swollen central bank balance sheets and monetary policies that have had to swing between cycles of rate cuts and hikes. Some effects of this policy mix appear likely to endure over time, such as the recent rise in long-term interest rates, partly explained by greater doubts over the long-term fiscal sustainability of many economies.

What are the implications of a world that, in the future, is more frequently affected by positive supply-side disruptions, such as AI, or by other negative disruptions, such as geopolitical conflicts, pandemics or transition and physical risks related to climate change? Any answer would be incomplete and partial. But here are some key preliminary conclusions. An initial one is that the "traditional" solution of applying

[1] International Monetary Fund (IMF). World Economic Outlook Database, various editions.
[2] International Monetary Fund (IMF). Fiscal Monitor, various editions.

expansionary or contractionary monetary and/or fiscal policies does not resolve the situation by itself. It is necessary to work on policies that influence aggregate supply as well as aggregate demand. Aggregate supply means focusing on productivity, improving technology, increasing training and labour-force reskilling, applying targeted stimulus policies by sector, implementing strategic industrial policies and promoting a coordinated energy transition, among other things. In sum: to expand the productive frontier of the economy.

Future growth will depend on expanding aggregate supply through productivity gains, innovation, investment, skills development and targeted industrial policies

A 2017 article by economists Dirk Jan van de Ven and Roger Fouquet[3] describes the impact of supply shocks arising from energy prices in the United Kingdom. Their findings suggest that the impact of supply disruptions increased with growing dependence on coal and declined with the partial transition to oil. However, the shift from exporting coal to importing oil increased the negative impact of demand disruptions. Broadly speaking, the findings indicate the economy did not become significantly more resilient to supply disruptions as they developed. The transition to less dependent and less volatile — and cleaner — forms of energy is likely to help mitigate these impacts, although greater international interdependence could hold back this effect. Other economists, such as Carolina Pagliacci (2018), argue that supply shocks may be more frequent than we think, but that we do not detect them[4, 5].

A study by European Central Bank (ECB) economists Massimo Ferrari Minesso, Marie-Sophie Lappe and Denise Rößler presents a slightly different view of the role of energy. It notes that the correlation between geopolitical events and the price of oil is not as clear as previously believed. Increased geopolitical tension does not always lead to a systematic rise in energy prices. In fact, they argue that, after a time, oil prices tend to remain below their previous levels[6].

The global economy has proved remarkably resilient, but lower growth and weaker policy buffers highlight the need for long-term structural reforms

But it is not all bad news in this world of "supply tensions". The emergence of AI could have a material positive effect on global productivity in the coming years. But to what extent? It is difficult to know with certainty. Estimations of the potential impact on productivity — a key channel through which AI will impact the economy — range from a low of a 0.7% increase over 10 years (Acemoglu[7]), to a higher 6.8% (Aghion and Bruel[8]), or a significantly more optimistic, but still plausible, 10-15% by other public and private institutions.

Two main lessons

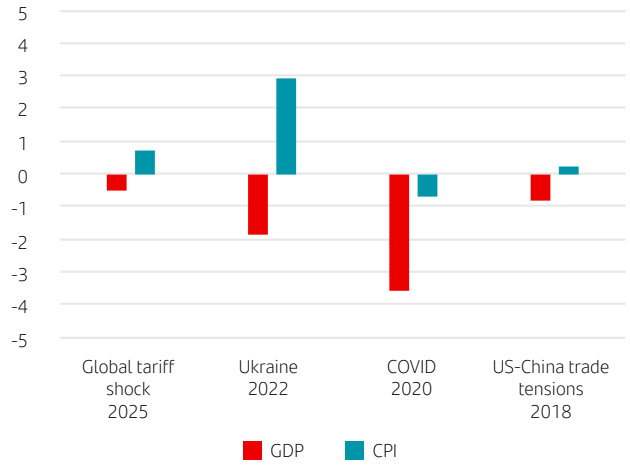
In recent years we have learnt some central lessons about the global economy, together with a general conclusion on how to proceed going forward. The two lessons are: 1) the global economy is more resilient than we initially believed. All the post-pandemic recoveries bear this out. 2) Even so, global growth has been affected: annual growth is half a percentage point lower than it was in the first two decades of this century. These two main lessons lead us to conclude that, although the global

[3] van de Ven, D. J., & Fouquet, R. (2017). Historical energy price shocks and their changing effects on the economy. Energy Economics, 62, 204-216.
[4] Pagliacci, C. (2019), 'Are we ignoring supply shocks? A proposal for monitoring cyclical fluctuations', Empirical Economics, 56, 445–467.
[5] van de Ven, D. J., & Fouquet, R. (2017), 'Historical energy price shocks and their changing effects on the economy', Energy Economics, 62, 204–216.
[6] Ferrari Minesso, M., Lappe, M.-S., & Rößler, D. (2023), 'Geopolitical risk and oil prices'. ECB Economic Bulletin, Issue 8/2023, Box 2. European Central Bank.
[7] Acemoglu, D. (2024), 'The Simple Macroeconomics of AI', NBER Working Paper No. 32487, National Bureau of Economic Research.
[8] Aghion, P., & Bunel, S. (2024), 'AI and Growth: Where Do We Stand?', Federal Reserve Bank of San Francisco.

economy has been resilient, it has emerged from all these shocks with fewer buffers than in the past: with less fiscal policy room for manoeuvre, high levels of debt and swollen central bank balance sheets.

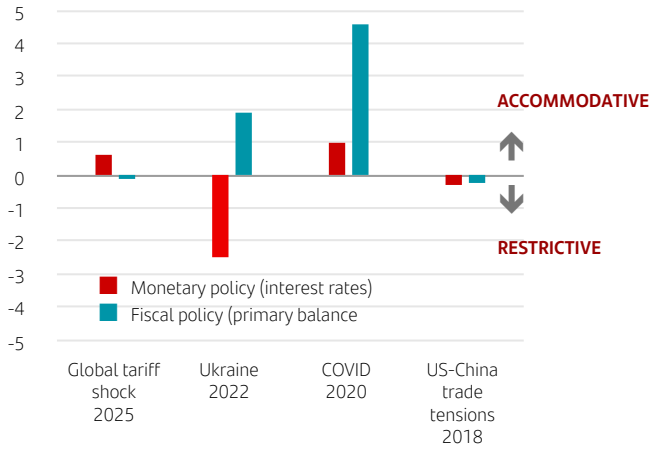
This raises doubts about the capacity to deal with new unexpected shocks in the future. Short-term palliative policies on the aggregate demand side, both fiscal and monetary, may be necessary at a given moment. But in order not to overuse them, it is necessary to work in parallel on long-term policies to strengthen aggregate supply across multiple areas, including international coordination, labour training, productivity gains, technological innovation and investment. The challenge looking ahead will be to design economic policies that make it possible to better reconcile economic growth with medium-term sustainability.

Impact on GDP & CPI after 1 year
(Economic and geopolitical shocks 2000-2025)
pp



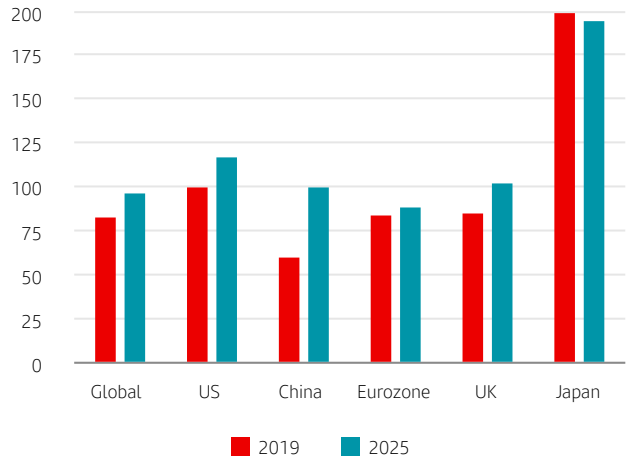
Sources: Refinitiv and Santander Research.

Impact on monetary & fiscal policy after 1 year
(Economic and geopolitical shocks 2000-2025)
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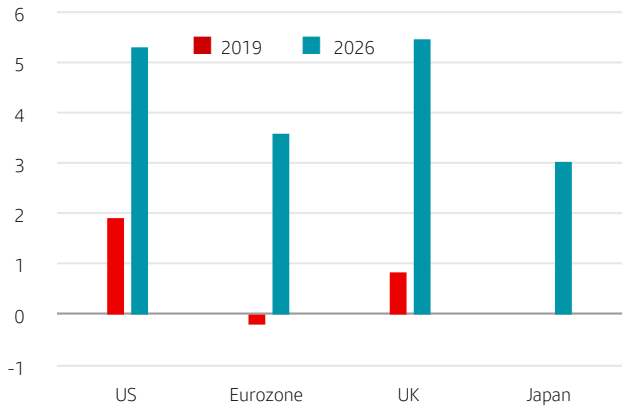
Sources: Refinitiv and Santander Research.

Government debt by country
(% GDP)



Source: BIS.

10y government debt yields
(%)



Source: Refinitiv.



The macroeconomics of artificial intelligence

Artificial intelligence (AI)'s trajectory to becoming the next *General-Purpose Technology* (GPT) remains steady and rapid, capturing all the attention. It has a dominant role not only in the narratives but also in the dynamics of financial markets, and is already making a visible economic impact on investment in the US. Its impact is not yet so evident on employment and aggregate productivity, and there are huge uncertainties about the magnitude and timing of its potential medium-term macroeconomic impact and differences among countries.



David Martín Heredero

When a technology becomes a GPT — such as in the case of engines, electricity, computers and the internet — it eventually reaches a widespread and versatile use, with ripple effects that enhance other technologies, affect jobs and sectors and, ultimately, bolster productivity and economic growth.

This article explores the early signs of this transition and what we may expect for the future from a macroeconomic point of view, analysing: the advance of AI technology capabilities; evidence of current macroeconomic outcomes; expectations for future macroeconomic outcomes, and factors driving the different levels of performance across countries.

The advance of AI capabilities

There is a certain dissonance about advancement in AI. On the one hand, it is advancing at an extraordinary pace. On the other, AI's applicability and impact on everyday domains seem to be developing more slowly. How are both these things possible?

The gap between AI capabilities and real-world deployment remains significant: benchmark progress is extraordinary, but reliability, consistency and safety still limit economic impact

Measuring what AI can do has proven difficult. The progression of AI capabilities is addressed by AI benchmarking. The latest benchmarks evaluate AI according to its ability to complete real tasks. One example is METR's[1] framework for measuring AI agents' capacity to perform long-duration software engineering and machine learning tasks. Results show that AI task-completion horizons have increased exponentially over recent years, doubling approximately every seven months.

However, benchmark performance does not necessarily translate into effective deployment in real-world environments. Many practical applications require not only high capability but also reliability, consistency and safety. Kapoor and Narayanan[2] argue that this gap between capability and reliability (consistency of performance,

[1] METR (2025), 'Measuring AI ability to complete long tasks'.
[2] Kapoor, S., & Narayanan, A. (2025), 'Towards a science of AI agent reliability'.

robustness under changing conditions, etc.) helps explain why the economic effects of AI have so far been gradual.

Current macroeconomic outcomes

AI adoption is accelerating, especially among large firms and knowledge-intensive sectors, but its diffusion remains uneven across companies, industries and countries

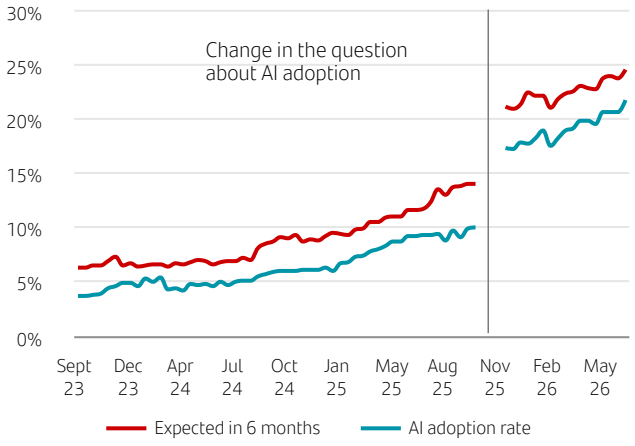
Identifying the current macroeconomic outcomes of AI requires an exploration of its adoption, investment and financing, labour-market performance and aggregate productivity.

AI adoption

AI adoption continues to accelerate, particularly among large firms and knowledge-intensive industries, although use remains far from universal.

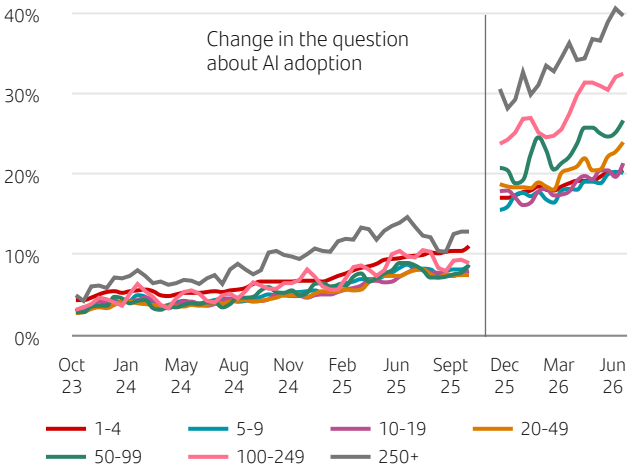
This is borne out in the United States, where Census Bureau[3] data indicate that around 22% of firms use AI, of which 40% are large companies operating in information-intensive sectors, most commonly sales and marketing, IT, strategy, finance and accounting.

AI adoption rate among companies



Sources: Census Bureau and BTOS.

AI adoption rate by number of employees

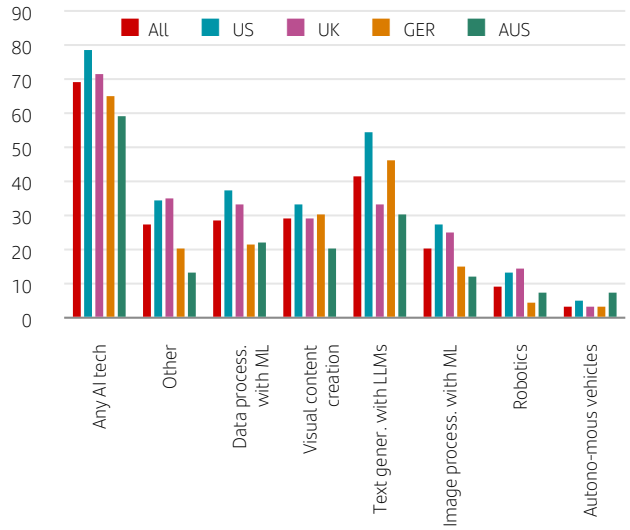


Sources: Census Bureau and BTOS.

International evidence, however, points to significant differences in AI adoption across countries. Surveys of business executives around the world[4] (data not comparable with those above) indicate adoption rates of around 78% in the United States, followed by 71% in the United Kingdom, 65% in Germany and 59% in Australia. Brookings[5] research similarly finds higher AI usage among American workers than their European counterparts. These differences are explained partly by worker characteristics and industrial composition, but also by management quality and firms' organisational capabilities.

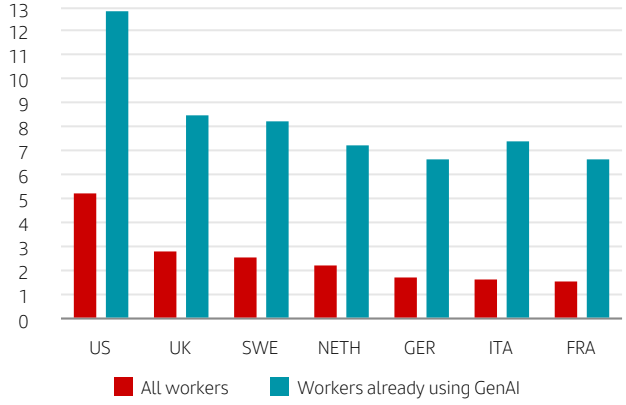
[3] U.S. Census Bureau (2025), 'Business Trends and Outlook Survey (BTOS)', U.S. Department of Commerce.
[4] Yatzov, A., et al. (2025), 'Firms predict an AI productivity boom is coming', Centre for Economic Policy Research (CEPR).
[5] Bick, A., Blandin, A., Deming, D. J., & Summers, L. H. (2025), 'Generative AI at work', Brookings Institution.

Which of the following AI technologies does your business currently use?
(% of business)



Source: Yatzov et al.

Share of work hours using Generative AI in 2026



Source: Brookings.

Investment and finance

AI investment has become a strong driver of current economic activity, particularly in the United States. Progress in AI depends not only on advances in algorithms but also on massive investment in physical infrastructure, including data centres, semiconductors, networking equipment, cooling systems, electricity generation and transmission.

The largest technology companies are expected to invest more than one trillion US dollars in AI-related capital expenditure during 2025–2026. This investment contributes directly to gross domestic product (GDP) growth, although some of its effects leak abroad through capital goods imports. AI-related investment may have added 0.5-1.0 percentage points, on average, to annualised quarterly US GDP growth since 2025.

Financial markets have also been heavily influenced by AI optimism. AI-related expectations have supported equity valuations, increased market concentration and generated positive wealth effects. Financing is gradually shifting from internal corporate cash flows towards a broader combination of public debt, private credit, leasing arrangements and project-finance structures. While this expands funding capacity, it also redistributes financial risks from equity markets to credit markets and financial intermediaries.

Labour market

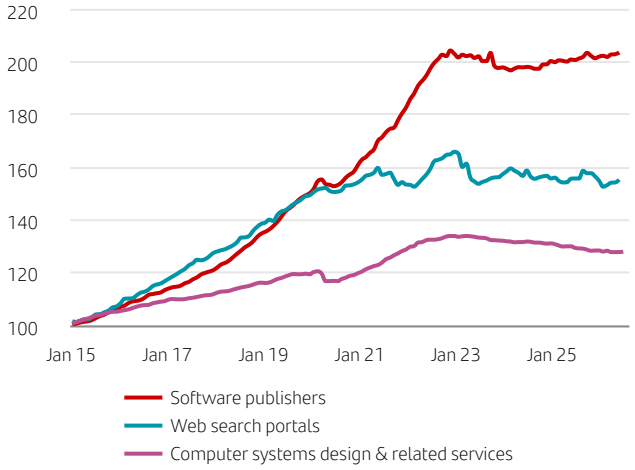
At the aggregate level, labour markets still show limited evidence of significant AI-related disruption, as unemployment remains moderate by historical standards.

Labour-market effects remain limited at the aggregate level, but early impacts are visible in specific occupations, especially coding and other AI-exposed knowledge-based jobs

Nevertheless, impacts are emerging in specific occupations. The clearest evidence[6] concerns software developers and programmers, whose employment growth has slowed markedly since the introduction of ChatGPT. Some studies[7] also suggest that AI primarily affects younger or less experienced workers through reduced hiring rather than increased layoffs.

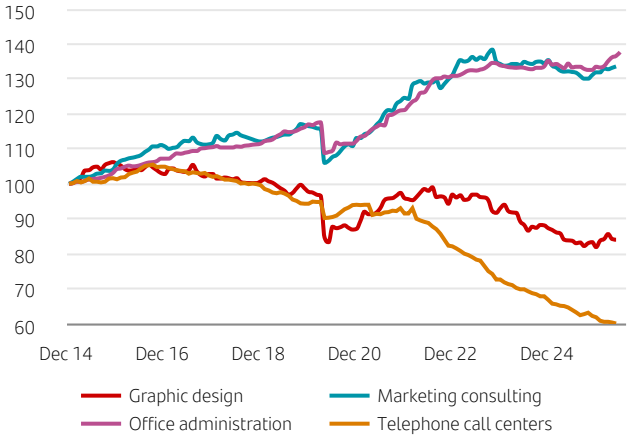
But this does not tell us about the net effects on the labour market. Further evidence[8] indicates that AI may substitute for junior workers while complementing more experienced employees, who benefit from higher productivity and wage growth. In addition, firms making substantial AI investments often continue expanding employment[9], suggesting that productivity gains may stimulate growth rather than simply replace the workforce.

Payroll data in some AI-exposed tech service sectors
(Dec 2014=100)



Source: LSEG.

Payroll data in some AI-exposed non-tech service sectors
(Dec 2014=100)



Source: LSEG.

Micro-level studies show productivity gains from AI tools, but translating task-level improvements into aggregate output remains constrained

Productivity

The emerging empirical record suggests that some groups of workers and some occupations may already be experiencing measurable productivity gains from AI, but the aggregate macroeconomic signs remain difficult to isolate from typical fluctuations in a dynamic economy.

There are many examples of micro-level research finding productivity gains from AI tools[10]. Similarly, a recent study[11] uses the Anthropic Economic Index (which samples Claude AI conversations, mapping them to occupational tasks) to estimate labour cost savings by combining observed reductions in task completion times with country-

[6] Gittleman, M. (2025), 'AI and coder employment: Compiling the evidence'.
[7] Lichtinger, J., & Hosseini Maasoum, S. (2025), 'Artificial intelligence and hiring outcomes', SSRN Working Paper.
[8] Federal Reserve Bank of Dallas (2025), 'AI is simultaneously aiding and replacing workers, wage data suggest'.
[9] PwC (2025), 'A new look at AI's impact on jobs'.
[10] Brynjolfsson, E., Li, D., & Raymond, L. (2025), 'Productivity effects of generative AI in the workplace'; Cui, R., et al. (2026), 'Productivity gains from artificial intelligence: Evidence from field applications'.
[11] Anthropic (2025), 'Aggregate gains from AI and their distribution: Global evidence from usage data'.

specific wage levels. Based on assumptions regarding AI diffusion, the research says that these gains could represent labour cost savings equivalent to approximately 3.4% of GDP across the countries analysed.

But are these micro gains translating into aggregate productivity growth? A Fed[12] analysis shows that while the sectors with higher AI exposure appear to have higher labour productivity growth, productivity trends across sectors have been relatively consistent over time, suggesting micro-level productivity gains are not adding up in aggregate. Why?

One explanation is that most empirical studies measure improvements at the task level rather than at the level of firms or entire production processes. Productivity gains achieved in individual tasks are often diluted by organisational bottlenecks, coordination costs and other constraints that limit their translation into final output. Research[13] on software development illustrates this effect. While AI dramatically increases the amount of code produced, much of this is filtered through subsequent stages of review, integration and deployment, translating into much smaller improvements in actual software releases and even lower increases in final demand or product usage.

Expectations for future macroeconomic outcomes

Future productivity effects could be substantial, yet estimates vary widely and current projections may understate the role of agentic AI, physical AI or more advanced systems

As we have seen above, businesses and economies are undergoing a process of technological reorganisation, with measurable effects concentrated in some sectors and occupations, rather than being visible across the macroeconomy.

But the absence of a large aggregate effect as of 2026 does not invalidate future productivity impacts, given the shallow adoption thus far and the fact that historically, productivity gains from GPTs lag investment by years. And even if we can be confident that if AI becomes a GPT it will have a significant macroeconomic effect, there is a large degree of uncertainty about the size, nature and the timing of its impacts. Estimations of the potential impact on productivity — the key area in which AI will impact the economy — range from lows of a 0.7% increase over 10 years (Acemoglu[14]) to 6.8% (Aghion and Bruel[15]) and a significantly more optimistic, but still plausible, 10-15% for other public and private institutions.

Importantly, nearly all existing estimates focus on the expected effects of current AI, including machine learning and generative AI, but generally do not take into consideration the potential contributions of agentic AI, physical AI or AGI (recursive self-improving systems, etc.), which could fundamentally alter future productivity dynamics.

[12] Board of Governors of the Federal Reserve System (2025), 'The AI buildout and the economy: Publicly available data to assess AI's impact'.
[13] Dell'Acqua, F., et al. (2025), 'Writing code vs. shipping code: Productivity effects across generations of AI coding tools', NBER Working Paper.
[14] Acemoglu, D. (2024), 'The simple macroeconomics of AI', NBER Working Paper No. 32487.
[15] Aghion, P., & Bunel, S. (2024), 'AI and growth: Where do we stand?', Federal Reserve Bank of San Francisco.

The competition for global AI leadership

Another source of uncertainty is the difference in the impacts that AI will have across countries.

If AI becomes the next GPT, it will not be only transformative, but will underpin the mutually reinforcing pillars through which power is built. The leading countries in AI will gain advantages in other technologies simultaneously, and their leadership will translate into geopolitical influence and agency over the direction and impacts of AI for the rest of the world, as countries that lead technological revolutions typically capture a large share of both their short- and long-term economic benefits.

AI leadership is becoming a strategic race: countries that dominate talent, research, infrastructure and models may capture both economic gains and geopolitical influence

The state of the competition for global AI leadership

The competition for global AI dominance is akin to a multi-tournament championship, with different races, each representing a different pillar of the AI ecosystem, and no clear finish line, but an ongoing contest for advantage[16]. To analyse the current state of play, a combination of performance indicators measuring different aspects such as talent availability, research intensity and technological and innovation capabilities is needed.

Available information shows that the United States is currently the leading force in AI, followed by China. But both countries have distinct advantages. The US has the strongest private sector, talent and technology. But China's research, scaling capacity and rapid progress mean that it could catch up. Other regions like South Korea, Europe and the Middle East are increasingly becoming serious AI players with significant AI intensity (for example, boasting a large number of relevant AI companies in relation to the size of the economy), but are still far behind the leaders, as scale and size play a key role in power.

The US currently leads in frontier models, private investment and data centres, while China is closing gaps through research scale, patents, energy capacity and open-source models

AI human capital. Innovation starts with people.

- The US leads in attracting top talent. According to the MarcoPolo Global AI Talent Tracker[17], 38% of elite AI researchers were educated in China (24% in the US, 10% in India, 5% in South Korea), but 59% of the world's top AI researchers work in US organisations, with higher salaries, more flexible environments, and talent inflows from China and India.

AI research. The main source of new AI knowledge.

- China now leads in research output, producing 23.2% of global AI publications[18] and 22.6% of citations in 2023. However, the US still dominates the most influential work, accounting for 64 of the top 100 cited papers in 2021, 59 in 2022, and 50 in 2023, although China is narrowing the gap. China also dominates AI patenting, receiving 70% of AI patent grants in 2023 versus 14% for the US.

[16] Anthropic (2025), '2028 AI leadership'.
[17] Stanford Institute for Human-Centered Artificial Intelligence (2026), 'AI Index Report 2026', chapter 'Research and development'.
[18] Stanford Institute for Human-Centered Artificial Intelligence (2026), 'AI Index Report 2026', chapter 'Technical performance'.

AI technology and innovation. Leadership depends on model performance, investment, infrastructure and computing power.

Model performance

- The US is still the leading developer of frontier AI models[19], producing 40 notable models in 2024, compared with 15 for China and 3 for Europe (all in France). Yet Chinese models are approaching parity. China also promotes adoption through an open-source strategy.

Model costs

- Cost has become a major competitive factor[20]. Companies increasingly adopt Chinese AI models to reduce expenses, while some European firms have pivoted away from US providers following US trade measures and export controls.

Finance and investment

- Private AI investment[21] continues to be heavily concentrated in the US, which attracted 285.9 billion US dollars in 2025 — 23 times China's 12.4 billion US dollars and 48 times the UK's total. However, official figures likely underestimate China's spending, as government funds invested an estimated 184 billion US dollars in AI firms between 2000 and 2023. The US also led in new AI companies (1,953 in 2025 versus 172 in the UK and 161 in China) and captured nearly three-quarters of global private equity and venture capital investment.

Infrastructure and computing power

- AI development relies on data centres, energy and advanced chips. The US hosts about half of the world's data centres (5,427), compared with 529 in Germany, 523 in the UK and 449 in China. China invested nearly 900 billion US dollars in energy[22] in 2024, versus 600 billion US dollars in the US and over 400 billion US dollars in Europe, while also leading in energy production and nuclear expansion. The US seems to maintain its leadership in advanced chip design[23] and model development through export controls, although Chinese labs have continued advancing despite these restrictions[24]. China also benefits from a vast domestic data ecosystem.

Business landscape

- The AI corporate landscape[25] mirrors the technological state of affairs. Among the 1,246 AI companies valued above 500 million US dollars, 696 are based in the US and 244 in China, followed by the UK with 40. Israel (42) and Taiwan (20) also have notable AI ecosystems. AI firm density is positively associated with economic size, research and development (R&D) expenditure and venture capital inflows.

[19] Financial Times (2025), 'Companies turn to Chinese AI models to cut costs'.
[20] Stanford Institute for Human-Centered Artificial Intelligence (2026), 'AI Index Report 2026', chapter 'Economy'.
[21] International Energy Agency (2025), 'World energy investment 2025'.
[22] Mackintosh, M. (2024), 'The chip design landscape today', JSTOR Daily.
[23] Anthropic (2025), '2028 AI leadership'.
[24] Crunchbase (2025), 'The geography of AI firms'.
[25] International Monetary Fund (2025), 'AI Preparedness Index (AIPI)'.

Expectations for future cross-country macroeconomic outcomes

Although technological leadership will influence future economic outcomes, AI is expected to generate benefits well beyond the borders of the countries that develop frontier technologies (as the presence of AI companies around the world suggests). The magnitude of these gains relies fundamentally on the productivity gains that in turn will depend primarily on each country's ability to adopt and integrate AI effectively throughout its economy. Following Acemoglu's framework, differences in impact across countries are expected to be determined by AI adoption rates, occupational and sectoral exposure to AI and labour-cost savings.

AI preparedness and adoption

AI's benefits will extend beyond technological leaders, but countries' gains will depend on preparedness, adoption capacity, sectoral exposure and labour-cost incentives

The International Monetary Fund (IMF)'s AI Preparedness Index[26] provides a useful framework for assessing countries' ability to benefit from AI adoption. The index evaluates four broad dimensions: digital infrastructure; innovation and economic integration; human capital and labour-market policies; regulation and ethical frameworks.

Advanced economies generally perform better across all four dimensions of the index, particularly in digital infrastructure and regulatory readiness, making them better positioned to adopt AI rapidly. These differences are consistent with current adoption patterns (see section 2) and suggest that existing gaps may persist unless substantial investments are made.

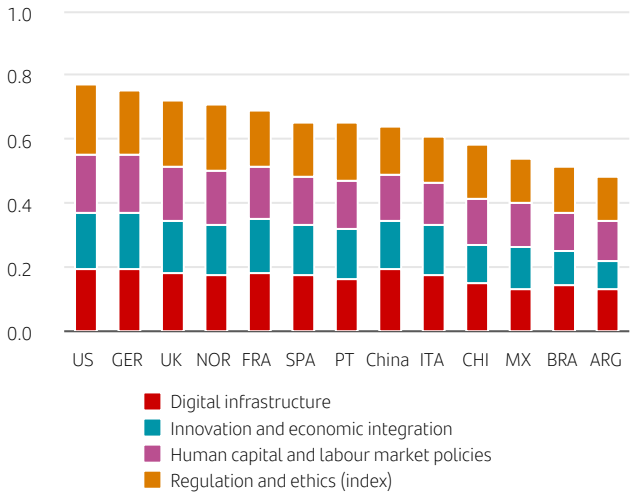
Sectoral exposure and wages

The economic impact of AI will also depend on the sectoral composition of activity. Research[27] consistently shows that AI exposure is concentrated in high-skill, knowledge-intensive activities. Consequently, countries with a larger share of these sectors — and a greater proportion of highly skilled workers — are expected to capture larger productivity gains while also potentially facing greater labour-market adjustments.

Labour costs represent another important driver of AI adoption. Evidence[28] suggests that firms operating in high-wage countries have stronger incentives to automate tasks or enhance worker productivity using AI. This partly explains why adoption rates tend to be higher in the United States than in Europe, where average wages are generally lower.

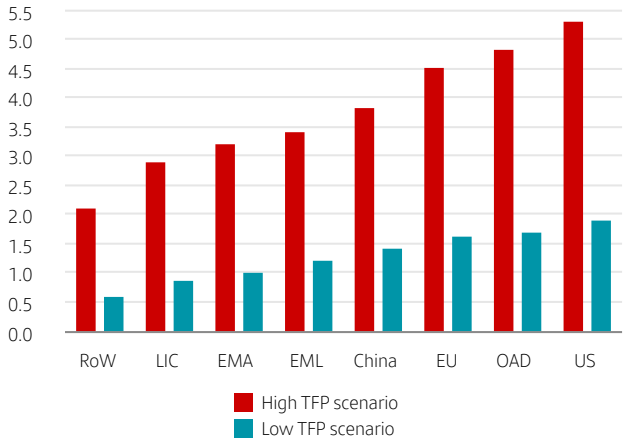
[26] Organisation for Economic Co-operation and Development (2025), 'Gen-AI: Artificial intelligence and the future of work. A sectoral taxonomy of AI intensity'.
[27] McKinsey Global Institute (2025), 'AI and productivity in Europe'.
[28] International Monetary Fund (2025), 'The global impact of AI: Mind the gap', Working Paper No. WP/25/76.

AI preparedness index



Source: IMF.

GDP impact after 10Y
(%)



Sources: IMF - RoW = rest of the world; LIC = low-income countries; EMA = emerging Asia; EML = emerging Latin America; Middle East; OAD = other advanced economies.

Estimated macroeconomic impacts

Although considerable uncertainty remains, existing research provides useful reference scenarios. Studies combining differences in AI preparedness, sectoral exposure and technology diffusion consistently conclude that advanced economies will experience the largest long-term economic gains.

AI's macroeconomic impact remains highly uncertain: future outcomes will depend on business choices, regulation, energy, other technologies and geopolitical dynamics

IMF[29] estimations show that gains in Europe are expected to be slightly smaller than those in the US but will still be substantial. Within Europe, however, important differences are likely to emerge. Countries with stronger digital infrastructure, higher AI preparedness and more knowledge-intensive economies — such as Sweden, Switzerland or Israel — may experience impacts that are comparable to, or even exceed, those of the United States. In contrast, many emerging and low-income economies are expected to benefit less from AI because of weaker preparedness, lower adoption rates and smaller shares of AI-intensive sectors.

Some conclusions, many uncertainties

AI will impact economies through potentially large productivity gains, which research suggests will be higher in advanced and some emerging economies.

But, as with prior technological revolutions, AI brings uncertainty. Future outcomes will depend on business decisions and the policy and regulatory environment adopted in each country. In this area we are already seeing the emergence of intercountry differences that may affect AI adoption and performance in ways we cannot yet foresee. And we mustn't forget to add to our cocktail shaker of future outlooks the impacts brought by the alignment of specific AI trends with other technologies

[29] International Monetary Fund (2025), 'The global impact of AI: Mind the gap', IMF Working Paper No. WP/25/76.

(quantum computing, robotics, biotechnology) and broader global trends (the energy transition, demographic changes, geopolitical shifts). Once we do that, we will have a delicious and complex cocktail of possibilities to enjoy.

That uncertainty need not be paralysing. Instead we can take it as a source of focus: how we address AI should be seen as a question of how we choose to manage unknowns, and which tools and principles we adopt to harness risk and maximise opportunities for the best results.

European Banking Union: from firewall to engine of growth

The European banking sector is in a stronger position than it was a decade ago, yet it remains too fragmented to play its full role in financing Europe's strategic agenda. Completing the Banking Union, alongside achieving deeper capital markets, is no longer merely a matter of financial stability: it is a key lever for mobilising savings, achieving scale, reducing financing costs and narrowing Europe's investment gap. Ultimately, it is a driver of competitiveness and growth.

Tomás Riestra Giner de los Ríos

A new context: the Commission places banking at the heart of the competitiveness agenda

The Banking Union was created in response to a crisis. Its original objective was to break the vicious circle between banks and national governments, enhance the credibility of supervision and establish common mechanisms for managing banking crises without burdening taxpayers. In this respect, progress has been considerable: common supervision, European resolution mechanisms, and stronger capital and liquidity positions have made the euro-area banking system more resilient than it was before 2012.

Completing the Banking Union is not a matter of technical reform: it represents an agenda for growth, competitiveness and strategic autonomy

However, nowadays the debate in Europe is different. The question is no longer simply whether banks are sufficiently resilient, but whether Europe has a financial architecture capable of transforming its savings into productive investment and, ultimately, fostering competitiveness and growth. The European Commission[1] is working to resolve this question under the umbrella of the Savings and Investments Union (SIU), designed to connect citizens' savings with productive investment, broaden companies' sources of finance and reduce fragmentation within the Single Financial Market.

The Commission's roadmap organises the SIU initiative around four areas: citizens' savings, investment and financing of the real economy, integration and scale, and efficient supervision within the Single Market.

Therefore, throughout this analysis, we to the Banking Union as a broad concept. Here it encompasses not only a common supervision, resolution framework and European Deposit Insurance Scheme (EDIS), but also the wider institutional, regulatory and market architecture required for banks to operate across the European Union (EU) as a genuine single market — including the cross-border mobility of capital and liquidity,

[1] European Commission (2025), 'The Savings and Investments Union: Connecting savings and productive investments', factsheet.

reduced national fragmentation, and greater consistency across prudential, crisis-management, insolvency and deposit-protection frameworks.

The policy debate has now moved from diagnosis to implementation. In July 2026, the European Commission adopted its Communication on the competitiveness of the EU banking sector and the Single Market in Banking. It identifies three connected constraints: persistent national fragmentation, an implementation of international standards that does not always reflect the specific features of the EU banking system, and undue regulatory complexity. The Commission intends to translate this diagnosis into legislative and non-legislative measures in the first quarter of 2027. Banking integration has therefore become a core component of Europe's competitiveness agenda.

The ECB estimates that the EU's strategic financing needs for the green, digital and defence transitions will average close to 1.2 trillion euros per year over the 2025–2031 period

Among the announced measures are proposals to facilitate the group-wide allocation of capital and liquidity, a new common deposit insurance proposal replacing the 2015 EDIS initiative, and targeted simplification of prudential, supervisory and resolution requirements, while preserving financial stability and appropriate safeguards for host jurisdictions.

The new macrofinancial environment reinforces the urgency. The European Central Bank (ECB)[2] estimates that the EU's strategic financing needs for the green, digital and defence transitions will average close to 1.2 trillion euros per year over the 2025–2031 period. At this scale, completing the Banking Union ceases to be an unfinished institutional project and becomes a lever for mobilising private capital, increasing financing capacity and strengthening Europe's economic autonomy.

The Banking Union has made banks stronger, but it has not yet created truly pan-European banks

Diagnosis: stronger banks, but a market that remains national

The current problem is not banks' solvency. It is one of scale, resource mobility and the ability to operate in a continental market

The European paradox is clear: there is greater resilience, but not significantly greater integration[3]. The Banking Union has improved the quality of supervision, reduced legacy risks and strengthened banks' loss-absorbing capacity. Nevertheless, lending, deposits, mergers, capital and liquidity management, and business models continue to be organised largely along national borders.

Recent microeconomic evidence is compelling. Research by the ECB and the International Monetary Fund (IMF)[4] based on AnaCredit and RIAD shows that cross-border bank lending to firms within the euro area has accounted for less than 6% of total lending to non-financial corporations since 2019. In the most relevant dimension — the bank-firm relationship — integration is even lower: cross-border relationships

[2] Bouabdallah, O., Dorrucci, E., Nerlich, C., Nickel, C. and Vlad, A. (2025), 'Time to be strategic: how public money could power Europe's green, digital and defence transitions', The ECB Blog, 25 July.
[3] Angeloni, I., Haselmann, R., Heider, F., Pelizzon, L., Schlegel, J. and Tröger, T. H. (2024), 'Can Banking Union foster market integration, and what lessons does that hold for capital markets union?', European Parliament, EGOV.
[4] Capelle, D., Fernandes, A., Kruger, J. J. and McAdam, P. (2026), 'Barriers to a European Banking Union', IMF Working Paper WP/26/123 and ECB Working Paper Series No. 3249.

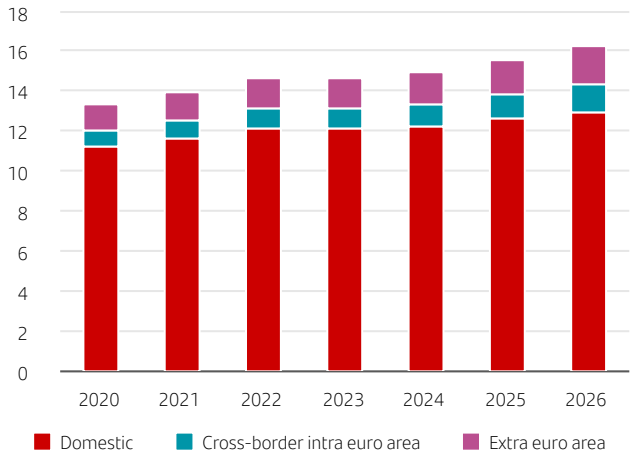
account for less than 1% of the total, although they tend to be larger than domestic ones.

As the European Commission shows, 56% of EU banks' exposures are in their home country. Cross-border exposures are almost evenly split between other EU countries (21%) and non-EU markets (22%), suggesting that expanding within the EU can be as difficult as expanding outside it[5].

Fragmentation is also evident in corporate operations. A 2025 assessment by the Association for Financial Markets in Europe (AFME) found that cross-border banking services remain marginal, subsidiary and branch activity has failed to create a de facto single banking market, deposit and lending activity has scarcely increased, and cross-border consolidation has weakened over the past two decades, with major banking groups continuing to display a strong domestic bias.

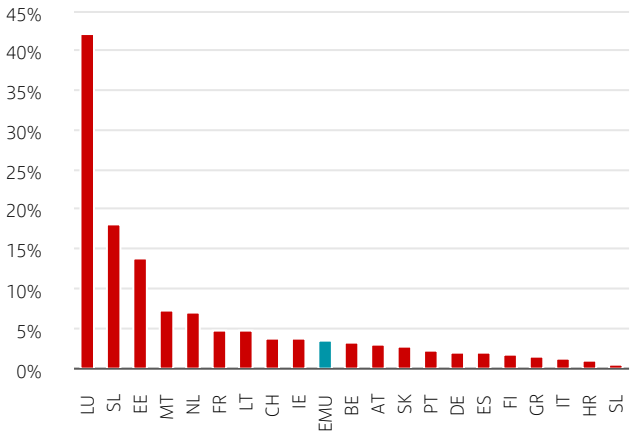
This domestic bias matters because it reduces effective competition[6] and limits the matching of firms with financiers. A European company does not necessarily gain access to the European bank best suited to its risk profile, but rather to the intermediary available within its own jurisdiction. In a single market seeking to finance innovation, infrastructure and the green transition, these invisible borders have tangible effects on competitiveness, productivity and, ultimately, economic growth.

Stock of retail bank loans in the euro area
(Trillion €)



Source: ECB.

Share of cross-border deposits in the euro area
(March 2026)



Source: ECB.

[5] European Commission (2026), Impact Assessment Report accompanying the proposal on the completion of the Banking Union, Commission Staff Working Document, SWD/2026/615 final.
[6] Buch, C. (2025), 'European banking integration: harnessing the benefits, containing the risks', speech, European Central Bank.

Invisible barriers: higher costs, less scale

Up to 475 billion euros of capital and liquidity is estimated to be constrained at subsidiary level

The barriers to banking integration do not usually take the form of explicit prohibitions. Instead, they operate as regulatory and institutional frictions: capital and liquidity requirements at subsidiary level, national discretions, differences in insolvency regimes, national deposit guarantee schemes, limits on intra-group exposures, divergent supervisory practices and the costs of entering other markets.

The most obvious obstacle is so-called "ring-fencing". Although the common prudential framework allows certain requirements to be assessed on a consolidated basis, in practice, cross-border subsidiaries continue to retain capital and liquidity within each jurisdiction. ECB Banking Supervision estimates that the transferability of around 230 billion euros of high-quality liquid assets is constrained by the application of full liquidity requirements at national level. AFME[7] separately estimates that around 250 billion euros of liquidity and 225 billion euros of capital are constrained within subsidiaries of EU banking groups. These estimates illustrate the scale of balance-sheet fragmentation, although they should not be interpreted as immediately deployable lending capacity and not all of the capital held at subsidiary level necessarily results from prudential ring-fencing. This immobilisation reduces balance-sheet efficiency, discourages cross-border expansion and limits the ability to reallocate resources to where they are most productive or most needed during periods of stress.

A common European deposit insurance scheme: aligning risk-sharing and depositor protection at European level creates the conditions for capital and liquidity to move more freely across borders

The second barrier is the absence of an EDIS. As long as deposit protection continues to rely on national schemes, host supervisors will retain incentives to preserve resources within their own borders, while depositors will continue to perceive differences in safety depending on the jurisdiction. A common European deposit insurance architecture is therefore not merely a symbolic component of the Banking Union: by aligning risk-sharing and depositor protection at European level, it could help create the conditions for capital and liquidity to move more freely across borders while addressing legitimate host-country concerns.

The third barrier is regulatory and legal heterogeneity. The ECB/IMF research[8] measures regulatory distance between countries and finds that differences in national frameworks — including insolvency, deposit insurance, corporate governance, macroprudential and microprudential regulation, resolution and supervision — are associated with greater frictions when it comes to establishing cross-border banking relationships and enabling banks' entry into other countries.

The most important finding is that the main friction arises before any loans even exist. The estimates point to an extensive-margin problem: cross-border bank-firm relationships are around 95% less likely to develop than comparable domestic relationships. The IMF[9] translates this model-implied wedge into an implicit tax of approximately 99%. Once the relationship has been established, however, differences

[7] Association for Financial Markets in Europe (2025), 'Banking Union: measuring progress and identifying implementation gaps'.
[8] Capelle, D., Fernandes, A., Kruger, J. J. and McAdam, P. (2026), 'Barriers to a European Banking Union', IMF Working Paper WP/26/123 and ECB Working Paper Series No. 3249.
[9] Brandao-Marques, L. et al. (2026), 'Deeper and More Integrated Financial Markets to Foster Growth and Resilience in Europe', IMF Staff Discussion Note SDN/2026/002.

in pricing and lending volumes are much smaller. The policy priority, therefore, is not merely to reduce the cost of existing relationships, but to make it possible for many more European bank-firm relationships to be established.

Benefits: from 3% of GDP to Europe's strategic investment challenge

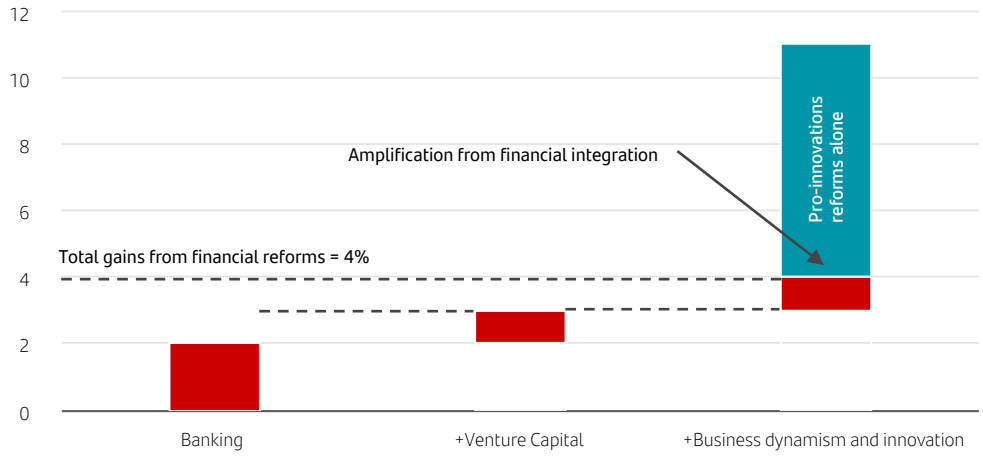
Banking Union could unlock up to €310bn annually, delivering a powerful boost to euro-area growth and competitiveness.

Quantification helps transform an institutional discussion into an economic agenda. The IMF estimates that a moderate package of financial reforms could increase EU gross domestic product (GDP) by around 3% in the long term, with approximately two-thirds of this gain stemming from deeper banking integration and the remainder from greater development of venture capital and risk financing. Moreover, these financial reforms would amplify the benefits of real structural reforms aimed at enhancing business dynamism and innovation.

Applied to the current size of the euro-area economy, the order of magnitude is highly significant. Taking the euro area's annual nominal GDP in 2025 (approximately 15.8 trillion euros) as a reference, a 3% increase in GDP would amount to around 474 billion euros extra per year. The banking component of the IMF's estimated effect — roughly two-thirds — would represent approximately 316 billion euros annually.

An alternative estimate from the ECB/IMF study, which simulates a 10% reduction in the barriers to forming cross-border banking relationships, points to a GDP gain of around 1.6%, equivalent to approximately 253 billion euros per year. In any case, the studies reach the same conclusion: advancing the Banking Union would generate tangible and substantial benefits of between 250 billion euros and 310 billion euros to support competitiveness and growth.

More integrated and deeper financial markets could raise Europe's GDP
(% change)



Source: IMF.

The comparison with Europe's strategic investment needs is striking. If Europe requires approximately 1.2 trillion euros of additional investment each year to finance its green, digital and defence transitions, the bill would exceed 6 trillion euros over five years. Total financial integration could amount to almost 40% of that cumulative figure in terms of additional annual economic capacity. The banking component alone would cover slightly more than one-quarter. Even the more conservative scenario of a 1.6% increase in GDP would cover approximately one-fifth.

A note of caution is important: this does not represent budgetary resources available from the first year, nor are we talking about a direct fiscal transfer. What we're looking at is an increase in the long-term level of GDP. However, the scale changes the debate. Completing the Banking Union would not, on its own, finance Europe's investment needs, but it would generate a macroeconomic dividend equivalent to a very substantial share of them. That is a significant difference.

Banking integration is essential to unlock growth, investment and competitiveness.

Simplifying to finance investment, innovation and employment

Policy priorities: turning the SIU into a banking agenda for growth.

The Commission's agenda offers a window of opportunity that must be translated into operational reforms. The SIU should not be viewed as a capital markets agenda separate from banking. In Europe, banks, securitisation, venture capital, equity markets, pensions and retail investment all form part of the same financing chain. They are part of a single ecosystem. Without a more integrated banking sector, the SIU risks mobilising savings without removing one of the principal bottlenecks in Europe's financial system.

Europe does not lack savings or capital; it lacks alignment between stability, growth and competitiveness.

In the short term, the priority is to align supervision with growth. This means: introducing a formal secondary objective of competitiveness and growth for supervisors alongside the primary mandate of financial stability; strengthening the accountability of the Single Supervisory Mechanism (SSM); simplifying regulation and supervision; requiring robust and independent cost-benefit analyses for new rules; and undertaking a holistic review of regulation and excess capital requirements to avoid overlaps between Pillar 1, Pillar 2, capital buffers, add-ons and margins of conservatism.

A more competitive framework should also recognise the international footprint of European banking groups. When calculating consolidated prudential requirements, the EU should allow appropriate recognition — upon request by the institution and subject to robust supervisory assessment — of equivalent local regulatory and supervisory frameworks, as well as the economic realities of the jurisdictions in which subsidiaries operate. Mechanically applying EU assumptions to third-country exposures can overstate risks, create unjustified capital burdens and penalise geographically

diversified European banks, weakening their ability to compete internationally without delivering commensurate benefits for financial stability.

In the medium term, the agenda should accelerate the SIU, simplify resolution and digitalisation, and prevent new technological frameworks from overlapping incoherently. In the field of resolution, the priority is to align the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) and Total Loss-Absorbing Capacity (TLAC) requirements for major European banks, while avoiding duplications that increase funding costs without clear prudential justification. In the digital sphere, the challenge is to reduce overlaps between the various regulatory frameworks (Artificial Intelligence, the General Data Protection Regulation (GDPR), cybersecurity and the Digital Operational Resilience Act (DORA)), ensure fair competition with large technology platforms and design the digital euro in a way that preserves financial stability without undermining banks' funding base.

The Banking Union must cease to be a defensive architecture born out of crisis and become an infrastructure for growth

In the longer term, completing the Banking Union will be essential. The Commission's intention to replace the 2015 EDIS proposal with a new common deposit insurance architecture could provide a pragmatic route forward. The new framework should align responsibilities for crisis management with the financing of deposit protection, ensure equal protection of covered deposits, address potential liquidity shortfalls in national schemes and provide credible safeguards for host jurisdictions.

This should be accompanied by greater cross-border mobility of capital and liquidity, reduced national divergences in areas such as mortgage regulation, consumer protection and anti-money laundering/countering the financing of terrorism (AML/CFT) requirements, more effective digital onboarding, and a more jurisdiction-neutral framework for banking groups with significant pan-European operations.

The proposal to establish a European deposit insurance scheme by building on existing structures[10], such as the Single Resolution Fund, points towards a pragmatic solution: less duplication, greater confidence and a safety net consistent with a genuine European banking market.

Conclusion

Europe has made substantial progress in banking resilience, but far too little in integrating its national banking systems. The Banking Union has functioned as a shield, but not yet as an engine. The result is a contradiction: an economy that needs to mobilise around 1.2 trillion euros of additional investment every year, with abundant private savings and strong banks, yet with a financial system that continues to operate behind too many internal borders and is therefore unable to channel the existing raw material into competitiveness and growth.

Banking fragmentation is not a minor issue. It reduces competition, raises financing costs, limits economies of scale, immobilises capital and liquidity, hinders the expansion of European companies and weakens the capacity to absorb shocks. Recent

[10] Banco Santander (2026), 'Santander proposal of measures to promote competitiveness in the EU/concrete proposals on competitiveness'.

evidence shows that the greatest frictions arise before credit is granted: when banks enter new markets and when cross-border banking relationships are established.

Europe has savings, strong banks and investment needs. What it lacks is integration

The Commission now has a window of opportunity. The SIU, the 2026 report on the competitiveness of the European banking sector and the 2027 mid-term review can transform what has historically been a defensive agenda into one centred on growth. To achieve this, Europe must move decisively in a clear direction: less internal fragmentation, greater intra-group mobility of resources, more European supervision and resolution, lower regulatory complexity, and an explicit link between financial stability, competitiveness and the financing of the real economy.

Only then will the Banking Union cease to be an unfinished institutional project and become one of the principal levers for financing Europe's economic future.

Defence spending in the EU: between opportunity and fiscal dilemma

The recent increase in defence spending opens a new chapter for the European economy: it can boost activity in the short term and strengthen the industrial base if managed well, but its true effect will depend on how it is financed, organised and translated into productive capacity. This article examines that balance between opportunity and fiscal dilemma.

Concepción Sanz Gómez

Europe enters a new cycle of defence spending

The war in Ukraine and geopolitical changes have led European countries to commit to a historic increase in their defence and security capabilities. In 2025, European Union (EU) countries spent 418 billion euros on defence, 80% more than before the war in Ukraine began. That spending corresponded to 2.2% of gross domestic product (GDP), compared with 1.5% recorded in 2021. All signs point to this trend continuing in 2026, when defence spending could rise to 454 billion euros, equivalent to 2.4% of GDP[1].

This trajectory will need to continue if the North Atlantic Treaty Organization (NATO) targets agreed at the June 2025 Hague Summit are to be met. Twenty-three of the EU's 27 member states belong to that organisation. The targets consist of raising military capability spending to 3.5% of GDP and dedicating an additional 1.5% to defence- and security-related investments (in, inter alia, critical infrastructure, resilience, innovation, the industrial base), to amount to a total of 5% of GDP. That figure is more than double current defence spending and is comparable to United States expenditure during the Cold War.

Europe's defence buildup will reshape fiscal priorities and economic dynamics

An increase of this magnitude implies a profound shift in fiscal priorities that will have a substantial impact on the economy, with effects that could be mixed. On the one hand, the increase will stimulate economic activity because it will produce an expansionary demand shock, especially in defence-related sectors. On the other, it could put pressure on inflation and pose serious challenges for public finances, since many countries are coming to this policy with high public debt levels and limited fiscal space.

Short-term macroeconomic impact

Empirical evidence shows that increases in defence spending usually have a positive impact on GDP in the short term, although the multiplier effect tends to be somewhat below one. In other words, for every additional euro spent on defence, economic activity rises by a slightly smaller amount[2]. Even so, there is considerable dispersion among the different estimates because the impact depends on factors that can vary

[1] European Defence Agency (2026), 'Defence Data 2025–2026', Brussels.
[2] Bokan, N., Jacquinot, P., Lalik, M., Müller, G., Priftis, R., and Rigato, R. (2025), 'Macroeconomic impacts of higher defence spending: A model-based assessment', ECB Economic Bulletin, 6/2025, European Central Bank.

widely across countries or over time, such as how the spending is financed, the type of defence goods purchased and each economy's propensity to import, its position in the cycle, or its initial fiscal situation.

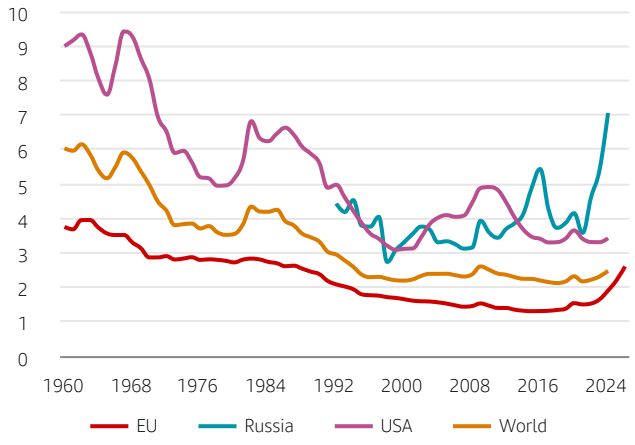
Higher defence spending supports GDP growth, while its impact on inflation appears relatively modest

For the euro area, the European Central Bank (ECB) assessed the likely impact of the defence-spending measures announced in 2025 in order to incorporate them into its economic projections for the 2025–2027 period. Its conclusion was that the impact on economic activity would be consistent with a multiplier close to one[3], in line with the empirical consensus. Specifically, for a defence-spending expansion equivalent to 0.4% of GDP over the three years of its projection horizon[4], the cumulative increase in euro-area GDP would be 0.3%.

In inflation terms, the ECB's work offers a relatively reassuring picture. Based on simulations using different economic models, it concluded that a gradual increase in spending equivalent to 1% of GDP would raise inflation by only 0.07 percentage points after two years and by approximately 0.2 points after four years. The reason these effects are so modest is that much of military spending does not enter the consumer price index basket directly, and inflationary effects appear indirectly, through stronger domestic demand, wage pressures or higher production costs.

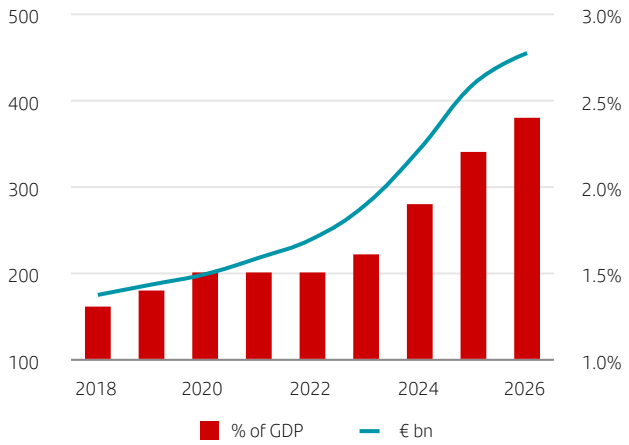
By contrast, the International Monetary Fund (IMF) has found evidence of stronger impacts on the economic growth of EU countries. In a study covering the period 1989–2023[5], it estimated that a steady increase in defence spending equal to 1% of GDP could lead to a 1.3% increase in GDP in the same year as the demand shock and nearly 2% two years later. Moreover, when spending is concentrated in investment, multipliers are higher, especially in the case of equipment purchases, the impact of which on GDP can be as much as three times greater than the amount spent.

Military spending
(% of GDP)



Sources: World Bank and European Defence Agency.

EU defence expenditure
(€bn and % of GDP)



Source: European Defence Agency.

[3] Checherita-Westphal, C., Huber, C., Rodríguez-Vives, M., and Müller, G. (2025), 'Fiscal aspects of European defence spending: Implications for euro area macroeconomic projections and associated risks', ECB Economic Bulletin, 5/2025, European Central Bank.
[4] Excluding 0.2% of GDP for support to Ukraine's defence, since the ECB assumes it has no direct macroeconomic impact on the euro area.
[5] Furceri, D., Juarros, P., Mishra, S., Anh Dinh Minh Nguyen, A. S., Pessoa, A. S., and Sollaci, A. (2026), 'Macroeconomic impacts of EU defense spending', IMF Working Paper, 26/53, Washington, DC.

The ultimate economic impact will be determined by how rearmament is financed and implemented

However, these figures should be interpreted with caution. The IMF itself notes that the rearmament process now being considered in Europe will be faster, more synchronised and larger in scale than those of the sample used for its estimates. Under current conditions, the impact on inflation could be greater given the size of the demand impulse. If that turns out to be the case, monetary policy could respond more strictly than in recent years, with interest-rate hikes that would ultimately crowd out private investment. As a result, defence-spending multipliers would be smaller than the initial estimates suggest.

Although the two studies are not fully comparable because one uses a model-simulation approach (the ECB) and the other an estimate based on a country sample over a period of time (the IMF), both conclude that defence spending can indeed boost activity in the short term, but the magnitude of that boost is decided by other factors, including the specific design of the fiscal expansion.

Long-term effects

The long-term benefits will depend on the ability to generate innovation and productivity gains

In the long run, the evidence is less conclusive. The IMF study mentioned above found that capital stock increased as a result of higher defence investment, but that the positive productivity effects disappeared once the cyclical component was removed. In other words: defence spending can help in the short term, but it does not by itself guarantee lasting productivity gains. Those gains could emerge if a significant share of spending is directed towards research and development (R&D), innovation and technologies with spillover effects on the private sector. But there is also the opposite risk: that resources are allocated inefficiently, diverting them away from the private sector or from other public goods that could have generated greater welfare[6].

Given the interest shown by the European Commission and several governments in ramping up military and security capabilities in the EU, even relatively modest multipliers suggest that EU economic growth in the coming years could be above the annual average recorded since the pandemic (which has been a meagre 1%). But that does not mean the impact will be stable, homogeneous or necessarily durable. Fiscal and industrial heterogeneity across countries can make the effects very different.

The financing challenge

Higher defence spending will test the fiscal resilience of many European economies

The first factor that determines the extent to which activity is boosted is how the spending is financed. Defence-spending expansions usually have a stronger impact on growth in the short term when financed with debt, because they raise the deficit and sustain aggregate demand. Later on, however, offsetting effects tend to appear. To finance permanent spending increases, governments consider raising taxes or cutting other spending items. The private sector may also brace for deficit-corrective measures that reduce disposable income. Investors too may become more concerned about the sustainability of public finances. All of this eventually puts upward pressure on interest rates and reduces private consumption and investment.

[6] Ilzetzki, E. (2025), 'Guns and growth: The economic consequences of defense buildups', Kiel Report No. 2, Kiel Institute for the World Economy.

A key point is that this economic boost entails risks for public finances. In many EU countries, the increase in defence spending comes in a context of already soaring public debt, interest rates higher than in the previous decade and less fiscal room to absorb new spending pressures. This means that financing defence spending with debt could, in the medium term, put pressure on the risk premium, the cost of financing and the fiscal space available for other public priorities.

In many EU countries, higher defence spending comes amid high public debt and limited fiscal space

This pattern is likely to be observed in EU countries' current rearmament cycle: first there'll be a more expansionary period and then an adjustment phase. The European Commission has given member states the option of requesting activation of the national escape clause in the fiscal rules, making it easier to temporarily raise defence spending without requiring immediate cuts to other items or tax increases. However, this solution is temporary; it expires in 2028. After that, countries will have to accommodate higher defence spending, either by restructuring other spending, improving public-spending efficiency or increasing tax revenue.

In countries with less fiscal space, the dilemma can be especially acute. So far, 18 of the EU's 27 countries have taken advantage of this flexibility[7]. Those that have not include France and Italy, two of the most indebted countries in the EU that are also among those facing the highest financing costs. These two countries, however, have requested funding through the Security Action of Europe (SAFE) instrument, which consists of long-term loans granted by the EU for joint procurement. The advantage for countries with little fiscal space is a lower financing cost than if they were to use national debt, since this instrument is backed by EU bond issuances. The fact that France and Italy have requested this funding suggests that both countries have an appetite to undertake defence projects, but financing conditions are a major constraint.

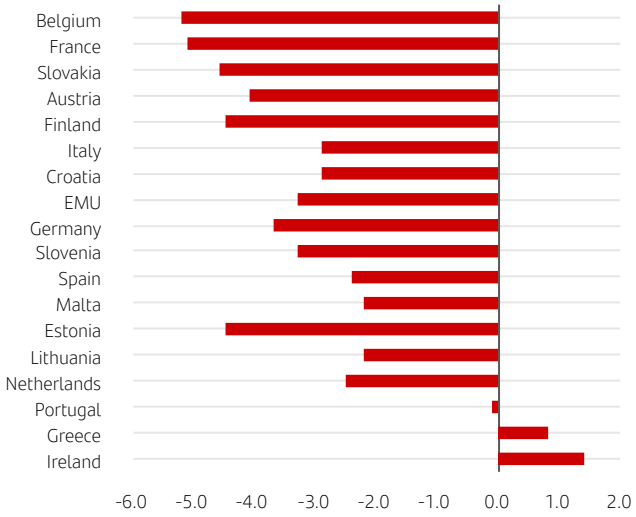
Fiscal constraints vary widely across Europe, shaping countries' ability to rearm

In short, fiscal space in Europe is not homogeneous across all countries. For that reason, having adequate financing instruments and complementing them with public-private collaboration can be essential to address the financial constraints faced by some countries. The tools made available by the Commission, such as the escape clause or SAFE loans, can be helpful, but they still count as national public debt, which may limit their use in countries with high debt.

In this context, common European financing could provide a response with greater reach. The 2028–2034 Multiannual Financial Framework could strengthen EU-level support for defence investment, with the European Commission proposing a significant expansion of funding for defence, security and space. While this would not finance member states' ordinary military expenditure, it could support common European capabilities and reduce pressure on national budgets. However, the final scale and design remain subject to negotiation.

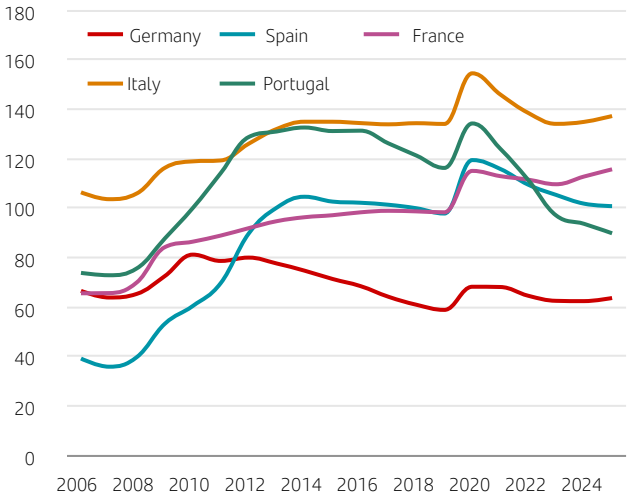
[7] Those countries are: Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovakia, Slovenia and Spain.

Public deficit in EU countries in 2025
(% of GDP)



Source: Eurostat.

Public debt in selected EU countries
(% of GDP)



Source: Eurostat.

The composition of spending also matters

The second deciding factor is the composition of spending. Not all military spending has the same economic effect. Spending directed towards investment, equipment and innovation usually has a larger and more lasting impact than spending on items such as personnel, maintenance or routine purchases[8].

This point may work in the EU's favour because the current priority is to strengthen military and technological capabilities. For that reason, the weight of investment within total spending has increased: it went from 20% in 2020 to 32% in the latest year, and could reach 36% in 2026.

The composition of defence spending matters as much as its scale

However, that rise in investment is explained mainly by the push from equipment purchases. R&D spending[9], which is the component most clearly able to foster innovation and generate more lasting effects, has grown but is still lagging. According to the European Defence Agency (EDA)[10], R&D is still concentrated in a small number of countries, and it would be desirable to strengthen links between civilian and defence innovation ecosystems so that new technologies can spread more effectively and have positive long-term effects.

Europe's industrial capacity

Third, the impact on economic activity will be greater the more it is covered by purchases within the EU. When the stimulus is partly directed towards importing goods from abroad, increases in domestic production are obviously smaller, and the external position deteriorates. Therefore, if Europe's supply capacity can respond quickly, higher

[8] International Monetary Fund (2026), 'World Economic Outlook: Global Economy in the Shadow of War', chapter 'Defense spending: Macroeconomic consequences and trade-offs', Washington, DC.
[9] Draghi, M. (September 2024), 'The future of European competitiveness', European Commission.
[10] European Defence Agency (EDA, 2026).

spending can be prevented from turning into more imports, bottlenecks and price pressures.

Fragmentation and external dependence may limit the economic dividend from rearmament

For that reason, the defence industrial base is a critical element. Today, the EU defence industry is fragmented, as it is organised around national markets. That fragmentation makes it harder to exploit economies of scale and often reinforces dependence on imports. The figure commonly used to illustrate this comes from the Draghi report, which states that nearly 80% of procurement carried out by states between June 2022 and June 2023 was from suppliers outside the EU, especially from the United States. Similarly, the European Commission has indicated that arms imports by European NATO members between 2020 and 2024 more than doubled relative to the previous five years, and the share coming from the United States rose from 52% to 64%[11].

More coordination, greater economic impact

European coordination can improve the economic impact of defence spending. Joint procurement and less fragmented public contracting appear to be essential conditions for increasing spending efficiency, promoting economies of scale and reducing leakage into imports. In that vein, the EU announced in March 2025 the European Defence Industrial Strategy (EDIS) and the European Defence Industry Programme (EDIP). Both instruments seek to boost joint procurement within the EU, expand Europe's defence industrial and technological base and improve resilience in supply chains.

Conclusion

Defence buildup can support growth, but lasting gains depend on turning spending into economic capacity

The increase in defence spending can have positive effects on short-term economic growth by acting as a demand stimulus at a time when the EU is in a weak cyclical position, operating below capacity.

However, for that effect to consolidate and translate into more lasting benefits, several additional conditions are needed: sustainable financing, sufficient European production capacity, effective coordination among member states and a rapid expansion of supply that makes it possible to absorb rising demand without generating bottlenecks. If such conditions do not materialise, the result would be much more limited, weakened by leakage into imports, higher inflationary pressure, more uncertainty around public debt and greater strain on other budgetary priorities.

[11] European Commission (May 2025), 'Spring 2025 Economic Forecast: Moderate Growth amid Global Economic Uncertainty', chapter 'The economic impact of higher defence spending'.

The European car industry: from regulatory compliance to industrial competitiveness

Europe is no longer alone on the great circuit of new mobility, but it remains one of the best-placed contenders to lead the next race for the car of the future. The electric vehicle has shifted the industry's centre of gravity: from engine to battery, from mechanics to software, from brand to scale, and from regulation to industrial policy. Europe's opportunity lies in turning a demanding climate transition into a new platform for competitiveness. The task now is to manufacture the car of the future in Europe.

Esther Cases Lozano

Europe still has its engine running

The automotive industry remains one of Europe's great industrial levers: 13 million jobs, around 7% of European Union (EU) gross domestic product (GDP), and a central role in investment, innovation and exports. But the competitive map has changed. Powerful new players with scale, technological speed and strong industrial capacity are challenging European manufacturers not only for market share, but also for part of the value added and the viability of their production model. That is why Europe's industry needs to reposition itself and move from reliance on its historic position to building a new competitive advantage in batteries, software, costs, supply chains and speed of innovation. Europe's response to the challenge has already begun to take shape. In March 2025, the Commission presented its Action Plan on the Future of the Automotive Sector; in December 2025, it followed up with an Automotive Package intended to add flexibility, simplify rules and reconcile climate neutrality with industrial competitiveness[1].

Europe's industry needs to reposition itself and move from reliance on its historic position to building a new competitive advantage in batteries, software, costs, supply chains and speed of innovation

The race has moved to a new circuit: the electric car is the new competitive arena

The electric vehicle has become the main field of industrial competition in the automotive sector; investment and rivalry are already concentrated in this arena.

The scale of the change is visible in the global market. The International Energy Agency (IEA) estimates that more than 20 million electric cars were sold in 2025, representing one in every four new cars. For 2026, it expects 23 million sales and a 28% global share; in Europe, sales could grow by 20%, with one in every three cars sold being electric[2].

[1] All online sources cited in this document were accessed on 6 August 2026. European Commission (5 March 2025), 'Boosting the European car sector' and 'Action plan on the future of the automotive sector'; and (16 December 2025) 'Automotive package'.
[2] International Energy Agency (20 May 2026), 'Global EV Outlook 2026', chapter 'Executive summary'.

China has reached this phase with an advantage in scale. The IEA reports that Chinese automakers supplied 60% of the electric cars sold worldwide in 2025, compared with about 15% each for European and North American automakers. China also accounted for more than 80% of global battery-cell production[3].

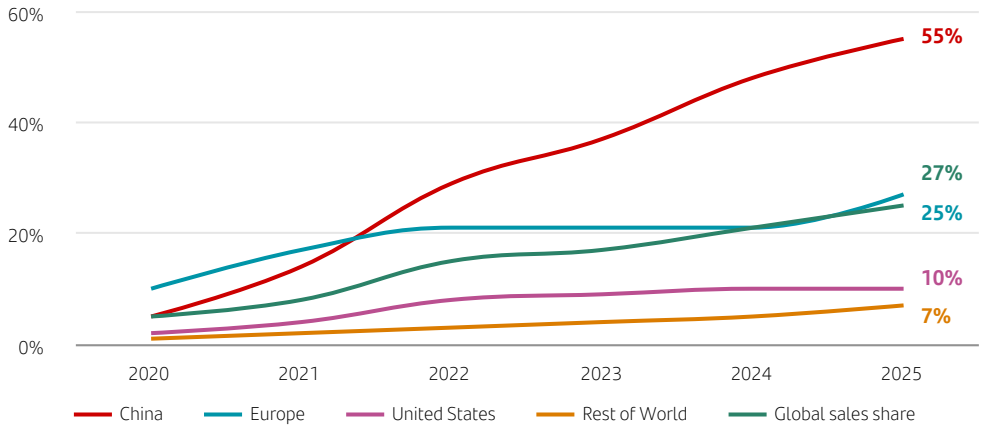
The risk is not only manufacturing fewer cars: it is becoming an assembler of technologies developed elsewhere

That position is not explained solely by public financial support: it also rests on an integrated supply chain, fast development cycles, a broad product offering and falling costs. In 2025, 70% of battery-electric cars sold in China were cheaper than the average conventional car[4].

The United States offers a different model. Its electric vehicle market is less homogeneous, but, together with China, the country leads the commercial deployment of the car's digital layer: proprietary software, data, over-the-air updates and autonomous driving. Among the leading players are Waymo and Tesla in the United States, and Baidu Apollo, Apollo Go and WeRide in China. The IEA identifies robotaxi services already operating in more than 20 cities, primarily in China and the United States. Every kilometre travelled in real-world operation generates data and learning; therefore, competition is measured not only by the number of units produced, but also by the speed at which a company converts software and operational experience into successive improvements[5].

Europe therefore faces double pressure. It must accelerate electrification so as not to lose the volume market, while also preventing the highest-value layer — batteries, operating systems, semiconductors, data and services — from slipping out of its control. The risk is not only manufacturing fewer cars: it is becoming an assembler of technologies developed elsewhere.

Electric car sales share
(% of total vehicle sales)



Source: IEA.

[3] IEA, 'Global EV Outlook 2026' (20 May 2026), chapters 'Executive summary' and 'Manufacturing and trade'.
[4] IEA, 'Global EV Outlook 2026' (20 May 2026), chapters 'Executive summary' and 'Trends in electric cars'.
[5] IEA, 'Global EV Outlook 2026' (20 May 2026), chapter 'Autonomous vehicles'.

Brussels steps on the accelerator: from regulation to industrial policy

The shift in European policy came with the Action Plan on the Future of the Automotive Sector, presented by the Commission in March 2025. Its five pillars — innovation and digitalisation, clean mobility, supply-chain resilience, skills and the social dimension, and a level playing field — reflect a change of approach: the climate transition must also serve to maintain European production and competitiveness[6].

The climate transition must also serve to maintain European production and competitiveness

The plan allocated 1 billion euros from Horizon Europe for the automotive sector between 2025 and 2027, including 350 million euros for next-generation batteries, and announced 570 million euros from the Alternative Fuels Infrastructure Facility for 2025-2026, particularly for heavy-duty vehicles. It also called for at least three large-scale cross-border testbeds with related regulatory sandboxes and automated-driving corridors[7].

The Automotive Package of December 2025 added proposed flexibility and regulatory simplification. Its most visible element would replace the current 100% reduction target for CO_2 emissions from new cars and vans from 2035 with a 90% tailpipe-emissions reduction target, with the remaining 10% compensated through either low-carbon steel made in the Union or sustainable fuels. As of August 2026, the amendment remains a Commission proposal under the ordinary legislative procedure. The package also provides for a 1.8 billion euro Battery Booster, which includes a facility of up to 1.5 billion euros in interest-free loans for European electric-vehicle battery-cell producers — a facility that was formally adopted by the Commission in June 2026. Additionally, it advances clean corporate fleets, regulatory simplification and small electric vehicles[8].

Europe wants this transition to translate into industry, investment and jobs on European soil

The approach extends to raw materials too. The Critical Raw Materials Act sets 2030 benchmarks requiring the EU to reach at least 10% of annual consumption through domestic extraction, 40% through processing and 25% through recycling while limiting dependence on any single third country to 65% for each strategic material. In March 2025, the Commission designated 47 Strategic Projects across 13 EU member states[9].

Europe wants this transition to translate into industry, investment and jobs on European soil.

And from paper to the factory floor

The strategy is already being put into practice.

In December 2025, Volkswagen, through PowerCo, commissioned the Salzgitter gigafactory in Germany and produced the first unified cells 'made in Europe'. The plant has an initial planned production capacity of up to 20 GWh a year, which is equivalent to batteries for about 250,000 electric vehicles. Salzgitter is intended as the blueprint for PowerCo's other cell factories, including the planned Valencia site near Sagunto.

[6] European Commission (5 March 2025), COM(2025) 95 final, pp. 2-3.
[7] European Commission (5 March 2025), COM(2025) 95 final, pp. 4-7 and 13-15.
[8] European Commission (16 December 2025), 'Automotive package'; Proposal COM(2025) 995 and procedure 2025/0420/COD; European Commission (9 June 2026), 'New Battery Booster set to inject 1.5 billion euros into the European battery industry'.
[9] Regulation (EU) 2024/1252, art. 1(2); European Commission (25 March 2025), 'Selected strategic projects under the Critical Raw Materials Act'.

The project symbolises the move from external dependence towards in-house battery production capacity on European soil.

The factory has become one of the symbols of the new European industry: digitally connected and built around a fresh production architecture

Another approach is to convert an existing industrial asset rather than building everything from scratch, as Renault is doing at the Douai plant, which is part of the Ampere ElectriCity industrial hub in northern France. Production of one of Renault's electric models surpassed 100,000 units in 15 months. The same modular line produces six electric models for Renault, Alpine, Nissan and Mitsubishi, while two-thirds of the wider ElectriCity supplier base is located within 300 kilometres. It is a sign of reindustrialisation and of a historic plant's adaptation to the new automotive cycle.

A third model is strategic cooperation without giving up European localisation, as employed by Stellantis through its partnership with CATL in Zaragoza, Spain. In December 2024, the companies announced an investment of up to 4.1 billion euros in a European lithium iron phosphate (LFP) battery plant, with commencement of production targeted for the end of 2026 and a potential capacity of up to 50 GWh. The joint venture began construction in November 2025. The partnership combines Stellantis's industrial scale and vehicle network with battery technology from a Chinese leader, while at the same time placing the factory, employment and part of the production learning process in Europe.

The global network for sixth-generation batteries has been reorganised by BMW, with Debrecen in Hungary becoming the first of five plants worldwide to begin series production of Gen6 high-voltage batteries. The site has also launched series production of one of BMW's electric models, combining vehicle and battery production in the same location. The factory has become one of the symbols of the new European industry: digitally connected and built around a fresh production architecture.

The connected and autonomous car: where the business model changes

The car ceases to be a finished product delivered once and instead becomes a platform that can evolve throughout its useful life

Europe's industrial process is also extending to the connected and autonomous car, which adds a second technological layer to electrification. The concepts should be kept separate: a connected car exchanges information with the outside world — the internet, applications, the manufacturer, other vehicles or infrastructure; an autonomous car, by contrast, can take over part or all of the driving task. Every autonomous car will be connected, but not every connected car is autonomous.

The software-defined vehicle shifts functions that were previously fixed in hardware towards a centralised and updatable architecture. It allows for remote improvements, predictive maintenance, intelligent battery management, fleet services, charging optimisation and new functions after sale. In economic terms, the car ceases to be a finished product delivered once and instead becomes a platform that can evolve throughout its useful life.

The Commission has placed this technological layer at the heart of its strategy. The Action Plan calls for an EU-wide open platform for software-defined vehicles, shared

hardware and software building blocks, and automotive applications of artificial intelligence. The aim is to reduce fragmentation and prevent each manufacturer from rebuilding basic, non-differentiating elements from scratch[10].

EU data rules could also become a competitive advantage

EU data rules could also become a competitive advantage. The Data Act has been in force since 12 September 2025 and gives users greater control over data generated by connected products, including cars. In the automotive sector, this paves the way for maintenance, repair, fleet management, usage-based insurance, smart charging and more transparent second-hand markets, subject to security, privacy and trade-secret safeguards[11].

The battery adds another layer of traceability. From 18 February 2027, electric-vehicle batteries placed on the EU market will require an electronic battery passport accessible through a QR code. The passport must contain information specified in the Batteries Regulation, including battery-model data, carbon-footprint information and data relevant to circularity and performance. This can reduce uncertainty about battery condition, facilitate recycling and second life, and improve the vehicle's residual value. A compliance rule thus becomes an information infrastructure for new markets[12].

European-style autonomy: caution and industrial ambition

Europe is advancing in the field of autonomous cars more cautiously than China and the United States, but it already has type approval, operational projects and use cases with an economic rationale.

Europe is advancing in autonomous cars more cautiously than China and the United States, but it already has type approval, operational projects and use cases with an economic rationale

Society of Automotive Engineers International (SAE International), whose classification system has become the global benchmark for vehicle automation, defines six levels of driving automation, from Level 0 to Level 5. At Levels 0, 1 and 2, the human driver performs or supervises the driving task. At Level 3, the automated system performs the entire dynamic driving task within a defined operational design domain, but the user must be ready to respond to a takeover request. At Level 4, the system can operate without human fallback within that domain; Level 5 would cover all conditions in which a human driver could operate[13].

Commercial deployment in Europe remains concentrated in driver-assistance systems alongside specific Level 3 approvals and limited Level 4 pilots. The Commission places connected, cooperative and automated mobility at the centre of the sector's next industrial phase, alongside software-defined vehicles and artificial intelligence[14].

Commission Implementing Regulation (EU) 2022/1426, as amended in 2026, establishes uniform procedures and technical specifications for EU type approval of automated driving systems in fully automated vehicles. It requires the operational design domain and safety concept to be defined, risks and failures to be managed, cybersecurity evidence to be provided and in-use data to be reported to type-approval

[10] European Commission, COM(2025) 95 final, 5 March 2025, pp. 3-5.
[11] European Commission, 'Data Act explained' and 'Guidance on vehicle data, accompanying the Data Act'; Regulation (EU) 2023/2854.
[12] Regulation (EU) 2023/1542, arts. 77 and 96 and Annex XIII.
[13] SAE International, SAE J3016_202104, 'Taxonomy and Definitions for Terms Related to Driving Automation Systems for On-Road Motor Vehicles'.
[14] European Commission, COM(2025) 95 final, 5 March 2025, pp. 3-7.

authorities. Common EU approval can reduce the need for each company to negotiate a separate technical framework in every member state[15].

The first profitable market may not be the universal private car

Mercedes-Benz showed that Level 3 can reach the market: DRIVE PILOT was approved in Germany for conditionally automated operation at up to 95 km/h under specified motorway conditions. The 2026 S-Class, however, was launched with MB.DRIVE ASSIST as standard and MB.DRIVE ASSIST PRO in selected markets, illustrating that a Level 3 approval does not translate into uniform deployment across every model, configuration and jurisdiction[16].

This brings us to the point that the first profitable market may not be the universal private car. The nearest use cases are services within defined environments: on-demand public transport, first- and last-mile shuttles, ports, airports, industrial campuses, automated parking and logistics corridors. In these settings, the operator controls routes, maintenance, maps or remote supervision, making economic value easier to measure.

Madrid has announced the deployment of robotaxis by Uber, WeRide and AVOMO, with public operations expected to begin later in 2026. In Hamburg, MOIA embarked on its ALIKE autonomous ridepooling passenger test with selected pre-registered users on 15 July 2026. In Munich, MOIA is testing autonomous vehicles on public roads and a dedicated test track, with complex traffic and emergency scenarios among those being evaluated[17].

The opportunity is for Europe to move from pilots to repeatable, multi-city deployments that allow it to accumulate kilometres, data and operational experience without lowering safety requirements

The European Connected and Autonomous Vehicle Alliance (ECAVA) launched in October 2025 and held its first international forum in Brussels on 23-24 June 2026. Separately, on 8 June 2026, 18 member states signed a declaration supporting large-scale cross-border testbeds, in which emphasis was placed on public transport, freight and logistics, interoperability and coordinated approval procedures. Europe now has the opportunity to move from pilots to repeatable, multi-city deployments that allow it to accumulate kilometres, data and operational experience without lowering safety requirements[18].

Competing with China without copying China

International competition is proving a spur for European industry. China continues to set the pace of the market and product offering. The IEA notes that China is the only major market in which available electric-car models outnumber conventional models, and that Chinese automakers supplied 60% of global electric-car sales in 2025. China's position reflects not only subsidies but also model variety, integrated supply chains, intense competition and falling battery costs[19].

[15] Commission Implementing Regulation (EU) 2022/1426, as amended by Commission Implementing Regulation (EU) 2026/481.
[16] Mercedes-Benz Group (2024), 'Mercedes-Benz increases top speed of its Level 3 automated driving system to 95 km/h'; Mercedes-Benz Media (29 January 2026), 'The new S-Class: Refined in every detail'.
[17] Uber (2 June 2026), 'WeRide, Uber, and AVOMO bring Robotaxis to Madrid'; MOIA (15 July 2026), 'Passenger test operation launches in Hamburg'; and MOIA, 'Testing for tomorrow, enhancing safety today'.
[18] European Commission, ECAVA and First International ECAVA Forum (8 June 2026), 'Cross-border initiative for autonomous vehicle testbeds'.
[19] IEA (20 May 2026), 'Global EV Outlook 2026': chapters 'Trends in electric cars' and 'Executive summary'.

The European model can be different. Its first component would be safety and common type approval: a vehicle authorised under rigorous rules can access a continental market. The second would be circularity, with requirements for footprint, recycling and the battery passport. The third would be data and software interoperability. The fourth would be strategic openness, allowing alliances with non-European technology providers while making market access conditional on investment, traceability and fair competition. The fifth would be the density of suppliers and plants capable of turning those rules into high-quality products.

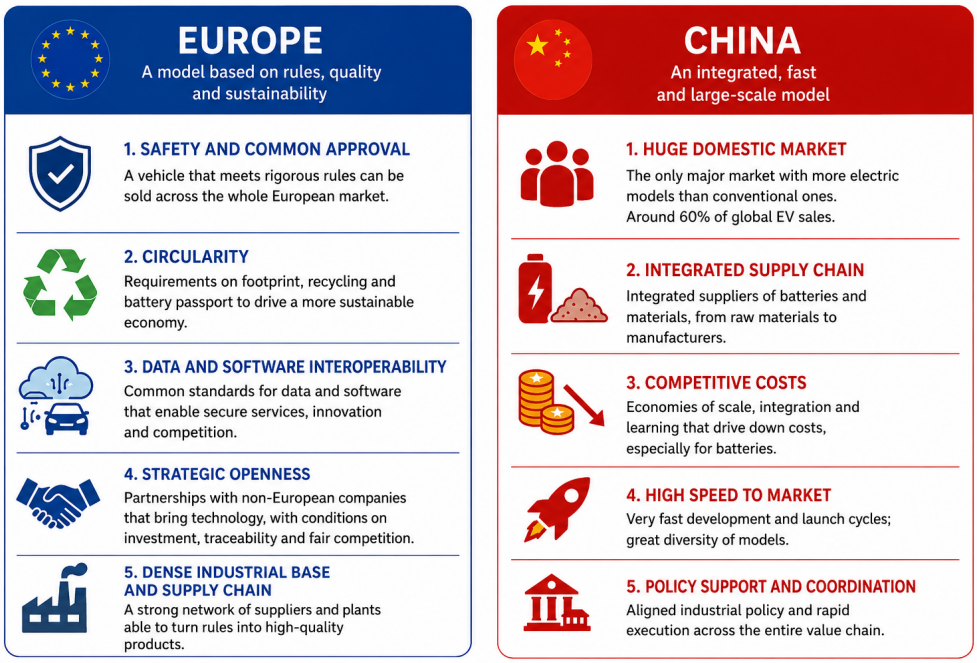
Regulation becomes competitive when it ceases to be a list of national obligations and becomes a common architecture for scaling up

This combination could work as a competitive advantage if it reduces costs and generates trust. Fragmented regulation slows things down; a single European rule can speed things up. An isolated traceability requirement raises costs; an interoperable digital passport can create value in financing, maintenance, resale and recycling. A safety standard that is too slow can delay the market; one that is clear and predictable can facilitate public procurement and social acceptance. Regulation becomes competitive when it ceases to be a list of national obligations and becomes a common architecture for scaling up.

The greatest risk is execution. The industry continues to suffer from high energy costs, weak demand in some markets, national differences in incentives and charging, difficulties in producing affordable electric vehicles, software delays and the failure of some European battery projects to meet their plans. Industrial policy cannot replace commercial discipline: it needs factories in operation, products consumers want to buy and technological platforms capable of being updated quickly.

Europe has a single market of roughly 450 million consumers, global brands, advanced engineering, specialised suppliers, common rules and an institutional capacity to set standards that often influence markets beyond its borders[20].

[20] European Commission (21 May 2025), 'Bringing down barriers to the single market to create opportunities for all'.



2027: the year of execution

The strategy already exists. The question now is whether Europe can turn scattered projects into a recognisable and scalable industrial trajectory next year. These are the objectives to be achieved in 2027:

- Affordability. The transition will not be consolidated if electric vehicles remain concentrated in the upper segments. The new generation of European compact cars, the expansion of LFP batteries and the proposal to establish a regulatory category for small cars can reduce price and weight. But demand needs stable signals: predictable taxation, available charging and corporate fleet policies that create volume without relying on intermittent subsidies.

The strategy already exists. The question now is whether Europe can turn scattered projects into a recognisable and scalable industrial trajectory next year

- Exploitation of industrial capacity. Salzgitter, Douai and Zaragoza should be understood as nodes in a network, not as exceptions. The Commission and member states will have to accelerate permits, electricity connections, access to competitive energy, recycling and raw materials projects. Industrial policy will only be credible when plants achieve volume, productivity and costs that are compatible with the market.

- Reduction of the software gap. Europe needs common components, zonal architectures, reliable over-the-air updates and talent in artificial intelligence and cybersecurity. Sharing non-differentiating layers can free up resources for what truly distinguishes each brand. Collaboration between manufacturers, suppliers and technology companies will be as important as investment in factories.

- Conversion of autonomous testbeds into markets. Public procurement and transport operators can create the first cases of scale: defined routes, high utilisation,

professional supervision and measurable benefits. If each city designs a different regime, Europe will accumulate pilots. If it shares type approval, data and operating procedures, it will be able to build an exportable platform.

Europe does not need to win every stage of the race. It does need to retain and expand a decisive share of value

- Regulatory coherence. Flexibility must not mean permanent uncertainty. Manufacturers invest over long horizons; they need to know which technologies, fuels, materials and credits will be in play in 2030 and 2035. The review of the CO_2 framework may be a more pragmatic step, but it will only help competitiveness if it is resolved quickly and maintains a clear signal towards low-carbon investment.

Europe does not need to win every stage of the race. It does need to retain and expand a decisive share of value: batteries, electronics, software, data, services and integration capacity. The first kilometres have already been covered. The competitive advantage will emerge if the continent manages to do something its industry knows well: turn a demanding standard into a reliable, manufacturable and desirable product at scale.

Conclusion

Europe's response is no longer limited to setting climate targets. It is beginning to take material shape in cells produced in Salzgitter, multi-model lines in Douai, an LFP plant under construction in Zaragoza, common rules for data and the first controlled autonomous services. The EU's opportunity lies in turning safety, traceability and the single market into an industrial platform capable of competing with China's scale and the technological speed of the United States, without copying either model but instead building a third competitive model based on industrial capacity, common rules, strategic openness and safe deployments.

Latin America's role in the new geopolitical landscape

In a fragmented world, Latin America is gaining importance in the global economic conversation. The region combines critical minerals, clean energy, agri-food capacity, biodiversity and a geographical position that places it relatively far from major geopolitical tensions. These strengths create an opportunity for the region to play a larger role in global value chains and boost its growth prospects. Yet realising this potential depends on its ability to transform those strengths into investment, productivity gains, skilled employment and greater value added.

Marisol de Francisco Bartolomé

Both the reality on the ground in Latin America and the way the world views it are changing. For decades, perceptions of the region were shaped mainly by macroeconomic volatility, political cycles and dependence on commodities. Today, Latin America is beginning to be seen as a region with the potential to play an ever more relevant geoeconomic role. This opportunity is not guaranteed and important challenges relating to informality, infrastructure, productivity and modest potential growth remain. However, there is mounting value being placed on what Latin America can contribute: its resource endowment, productive capacity and a geographical position that is increasingly propitious in a more fragmented world.

Latin America's endowment of resources strengthens its strategic role in a fragmented global economy

This shift largely reflects a transformation in the international environment itself. For years, companies and investors prioritised efficiency, low costs and market expansion. Today those factors remain important, but other priorities have come to the fore: reducing excessive dependencies, securing access to critical inputs, diversifying supply chains, advancing the energy transition and strengthening food security. The pandemic, tensions between the United States and China and increasing geopolitical fragmentation have accelerated these trends.

In this new landscape, many of Latin America's attributes acquire a different dimension. The region possesses some of the resources most in demand for the economy of the future, including critical minerals, rare earths, one of the cleanest energy matrices in the world[1] and significant agri-food capacity.

The region also arrives at this new stage with stronger macroeconomic fundamentals than in previous cycles, reinforcing its capacity to face an external environment that is both more demanding and more promising. This stronger position is the result of several structural improvements that have been implemented over recent decades.

[1] IEA, 'Latin America Energy Outlook 2023'; and 'World Energy Investment 2025: Latin America and the Caribbean'.

Many countries have bolstered the independence and credibility of their central banks, consolidating inflation targeting frameworks and increasing their ability to anchor inflation expectations. Public debt management has also become more robust, with greater reliance on local-currency financing that reduces currency mismatches and vulnerability to external shocks. Stronger external positions, supported by higher international reserves, more flexible exchange rate regimes and current account deficits that are generally moderate and comfortably financed by foreign direct investment, have enhanced the region's capacity to absorb periods of global volatility.

The assets of the economy of the future

The region enters this new phase with stronger macro fundamentals and greater resilience to external shocks than in previous cycles

Three categories of assets are becoming important in the economy of the future: critical minerals, energy and food. Copper, lithium, nickel, graphite, niobium and rare earths are essential for electrification, batteries, power grids, semiconductors, digital infrastructure and defence systems[2]. Energy and food have also become more strategic in a context in which supply security has become a concern for governments and companies. Latin America possesses all three in abundance.

Against this backdrop, the region is increasingly at the centre of competition between great powers to build more diversified and less vulnerable supply chains. With the United States, China, Europe and India all looking to secure access to essential inputs, they are more frequently turning to Latin America as an alternative partner for reducing dependencies and assuring key resources[3].

Another of the region's strengths lies in the fact that its resource base is not concentrated in a single country or sector. Latin America combines critical minerals, energy, food, manufacturing capacity and economic relationships with major markets, enabling it to respond simultaneously to the energy transition, food security concerns and the reorganisation of global supply chains. This combination broadens the region's opportunity set and enhances its ability to respond to different global demands.

Latin America's strategic resources for the economy of the future

Three strategic strengths at a glance

Strategic strength	Headline evidence	Why it matters globally
Critical minerals	~35% of global copper reserves and ~46% of lithium reserves	Key inputs for electrification, batteries, digital infrastructure and advanced industry
Energy	Close to 20% of global oil reserves, alongside a clean energy matrix	Supports energy security and the transition towards lower-carbon electricity production
Agri-food	Leading global positions in soybeans, maize, beef, coffee, sugar and fruit	Strengthens food security and provides a diversified export base

Note: Figures are rounded. Mineral data refer to 2024, oil data to 2025 and agri-food exports to 2024.

Sources: USGS, Mineral Commodity Summaries 2025 Data Release; Eni, World Energy Review 2026; Energy Institute, Statistical Review of World Energy 2026; and the trade sources used in the original table.

[2] IEA, 'Global Critical Minerals Outlook 2025'; USGS (US Geological Survey), 'Mineral Commodity Summaries 2025', Data release.
[3] White & Case (2026), article on the US and critical minerals in Latin America; Centre for Social and Economic Progress; (CSEP) (2026), article on India and critical minerals in Latin America; AP News (2026), Brazil-India Agreement on Critical Minerals and Rare Earths.

The data illustrate the scale of this opportunity. The region includes the world's largest copper producer, Chile, as well as some of the world's leading copper reserve holders, while Chile and Argentina also occupy prominent positions in lithium, a key input for batteries and energy storage. Brazil adds another dimension through its niobium, nickel and rare earth deposits, with the contrast between reserves and production providing an indication of the scope to attract investment and develop local capabilities.

This is complemented by the region's role in energy. Latin America accounts for a significant share of proven oil reserves and global production, with Brazil being the main regional producer and Venezuela still a dominant player in reserves. The agri-food dimension completes the picture. Latin America and the Caribbean are already major players in global agricultural production and agri-food exports, and have a clear comparative advantage in several basic products: Brazil and Argentina stand out for soybean, maize and animal protein production, while Brazil and Colombia maintain a very significant position in coffee farming[4].

The challenge is not only to extract resources, but to capture more value across supply chains

The shift to a larger global role is also beginning to be reflected in export patterns. In Brazil, external sales continue to be dominated by the agribusiness complex, but a growing percentage corresponds to energy, with additional potential emerging in strategic minerals. In Argentina too, agriculture remains the anchor of the export basket, but energy and mining are emerging as potential vectors of change. In Chile, mining has reasserted its position as the country's biggest export market, with copper still the main source of international sales, but a growing contribution is now coming from other minerals linked to the energy transition. Mexico has a different profile: it is still a predominantly manufacturing export economy, with the automotive sector continuing to play a central role in its export base. At the same time, the country's export basket has become increasingly diversified in recent years, with non-automotive manufacturing — particularly of electrical and electronic equipment — gaining momentum, supported by growing demand from the United States for technology-related goods linked to digitalisation, data centres and artificial intelligence.

Realising this potential will require investment, technology and a skilled workforce

The diversification of the region's export basket strengthens its capacity to generate foreign currency, reinforces its external position and may also act as a channel for attracting investment into sectors benefiting from growing long-term global demand trends.

The race for value added

The availability of minerals, energy and food provides an excellent foundation, but the real challenge for Latin America now is to transform its resources into a broader source of productive, technological and business development within the region itself. The success of this will depend on its capacity to participate in the stages in which technology, specialised services, knowledge and decision-making capacity are concentrated.

[4] World Bank (2024), 'Towards a Green, Inclusive and Competitive Agrifood System'; Eni, 'World Energy Review 2026'; Energy Institute, 'Statistical Review of World Energy 2026'.

Recent experience shows that possessing the resource does not guarantee control of the chain. International competition is moving increasingly towards downstream stages — from refining and processing to industrial transformation, intellectual property and technology services. In many cases, minerals leave Latin America as concentrates and return embedded in batteries, electric vehicles, semiconductors or industrial equipment.

Capturing more stages of the chain would allow the region to turn an advantage based on the availability of natural resources into a more sustainable source of growth. This would support long-term investment and technology transfer, raise productivity, generate more skilled employment and broaden productive linkages. That is the difference between participating in the economy of the future as a supplier of raw materials and doing so from a more strategic position, with greater capacity to influence more complex value chains.

Investment, innovation and local capabilities will determine how much value Latin America captures from its resource wealth

In the case of critical minerals, this leap will require building industrial and service capabilities around mining projects: engineering, specialised logistics, environmental certification, applied technology and skilled talent. Access to long-term financing is a basic necessity, especially in capital-intensive projects with long maturation horizons. However, the availability of investment, whether domestic or foreign, does not by itself guarantee a deeper productive transformation. As the Economic Commission for Latin America and the Caribbean (ECLAC) underlines[5], to expand the multiplier effect of mining investments, it is necessary to link capital-attraction policies with a productive development agenda that promotes innovation, the development of local suppliers and the strengthening of institutional capabilities. Only in this way can a larger share of the value associated with these resources be generated within the region itself.

Clean energy is becoming a key factor in attracting investment and higher-value activities

The same logic applies to energy. Latin America already enjoys a distinct advantage in this area thanks to its clean energy matrix, the high share of renewables and the development of new sources such as solar, wind, bioenergy and green hydrogen. However, the region has the potential to go beyond merely exporting what it has; it can instead use its energy sources as a basis to attract clean electricity-intensive industrial activities, such as low-emission mineral processing, sustainable fertiliser production, green steel undertakings, data centre operation, competitive manufacturing and new services linked to the energy transition. In a world where carbon footprints will increasingly influence investment, production and trade decisions, having clean and competitive energy can become a first-order industrial advantage.

Something similar applies to the agricultural sector too. The region is one of the world's leading producers and exporters of food, but its potential increasingly depends on its ability to consolidate a more sophisticated and resilient agri-food offer. Processed foods, biotechnology, bio-inputs, agricultural innovation and sustainability standards can expand the economic value of an already very significant productive base. Agri-food

[5] ECLAC (2025), 'ECLAC Keys to Development', No 23.

competitiveness will increasingly be determined not only by scale, but also by the capacity to produce more efficiently, sustainably and distinctively.

All three cases follow a similar pattern: Latin America's starting point is very strong, but the qualitative leap forwards will depend on its ability to broaden the spillover effects on the local economy. Investment, technology, talent and productive coordination will be key for minerals, energy and agri-food to translate into higher-value participation in the global economy.

Latin America in a more fragmented world

It will be key for the region to maintain a pragmatic strategy that enables it to diversify partners, attract investment and take advantage of the opportunities

This scenario coincides with the emergence of a more fragmented world, in which the United States, China, Europe and India offer Latin America different and, in some cases, complementary forms of economic integration. It will be key for the region to maintain a pragmatic strategy that enables it to diversify partners, attract investment and take advantage of the opportunities opened up by the global reorganisation, while avoiding replacing one set of dependencies with another.

Europe occupies a particularly relevant place in this picture. Its energy transition and industrial autonomy require more secure and diversified access to critical raw materials, energy and food. Latin America appears as a natural partner for that agenda, given its resource endowment, its historical and commercial ties with Europe and its ability to offer a relationship based on shared rules and standards.

In this context, the European Union (EU)-Mercosur agreement takes on a particular relevance. When combined with the EU's agreements with Mexico and Chile, it forms an economic integration network that covers more than 90% of the region and offers a framework of shared rules, predictability and long-term cooperation. In a more uncertain international environment, this institutional architecture can facilitate investment, reduce entry costs for companies and strengthen the economic relationship between the two regions.

Competing interest from the US, China, Europe and India broadens Latin America's trade and investment opportunities

Of course, interest in Latin America does not come from Europe alone. The United States has begun to view the region through the lens of economic and technological security, with critical minerals that are relevant both for the energy transition and for strategic infrastructure and defence applications. This US interest is beginning to translate into concrete financing and investment instruments, such as the Inter-American Development Bank (IDB) support for a lithium project in Argentina or the possible backing of the US Development Finance Corporation for the expansion of Serra Verde, in the state of Goiás, Brazil[6]. India, despite its geographical proximity to Asia, is also looking to the region as a way to diversify access to critical minerals and reduce its exposure to chains dominated by China. For Latin America, this multiplicity of partners broadens its negotiating space and can open up new opportunities for investment and the development of its own capabilities.

[6] White & Case (2026), article on 'The US and critical minerals in Latin America'.

Conditions for capturing the opportunities

These opportunities will not be granted automatically. To fully seize them, Latin America will need to make progress in areas where significant constraints remain, particularly infrastructure, human capital, productivity, legal certainty, regulatory quality and execution capacity. The region may have assets that are highly valuable in the new global environment, but turning them into sustained growth will require the reduction of internal bottlenecks that still limit investment, increase project costs and hinder the deployment of new productive activities.

Turning external interest into long-term growth will require stronger infrastructure, skills and institutions

Demographics are also an additional, albeit time-limited, source of growth potential. Latin America, like China and South Korea, is a relatively young region compared with many advanced economies, although its demographic dividend is gradually fading as fertility rates decline and the share of older populations increases. At the same time, female labour force participation is comparatively low in several countries across the region, both relative to male participation rates and to those of women in many advanced economies. This provides significant scope for higher female participation, offering an important opportunity to expand the labour force, sustain potential growth and make better use of available human capital. The implementation of policies that facilitate work-life balance, expand access to childcare services and encourage women's participation in the workforce could shore up this source of growth for the region in the years ahead[7].

It will also be important for investment arriving in the region to have a broader impact on the local economic fabric. As discussed above, attracting foreign capital can accelerate the development of new projects, but its contribution to growth will be greater if it is linked to innovation, technology transfer, talent development, supplier development and institutional strengthening. As ECLAC underlines, mining investment specifically will be more impactful if it is embedded in a productive development agenda that goes beyond extraction. In other words, the objective is for investment to help transform the region's productive structure and not merely expand the exploitation of natural resources.

Latin America has the assets. The next step is turning potential into prosperity

The more fragmented international environment adds an extra dimension to these conditions. Geopolitical rivalry can open up opportunities for countries capable of offering stability, resources and diversification, but it can also generate new sources of trade, financial and regulatory volatility. In this context, the ability to preserve flexibility and avoid excessive exposure to a single partner or market will be an important element of resilience.

Conclusion

Ultimately, the economy of the future will need many of the assets that Latin America has in abundance. But the opportunity for a greater geoeconomic role and longer-term growth prospects will depend on the region's ability to transform that initial advantage into investment, technology, skilled employment and greater productive sophistication.

[7] IMF (2026), "Critical Minerals & Energy: Powering Economic Development", keynote speech by Deputy Managing Director Nigel Clarke at the Inter-American Development Bank Annual Meetings, Paraguay, March 13.

The difference between an opportunity seized and an opportunity missed will increasingly lie less in the possession of resources and more in the control of the capabilities needed to turn them into higher-value products, services and solutions.

The region faces this scenario from a stronger position than in other periods of its recent history. Although important challenges remain in reducing informality, improving productivity and infrastructure, and raising potential growth, the region faces this scenario from a stronger position. Many countries now have more robust monetary policy frameworks, more credible central banks, better-controlled inflation, comfortable levels of international reserves, more balanced external accounts and deeper financial markets. These advances do not eliminate risks, but they improve the capacity to absorb external shocks and reinforce the perception of a more stable and predictable region.

Latin America today is poised to grasp the opportunities that lie before it. The new international context gives it greater visibility, more favourable structural demand and a more open position from which to build economic relationships with different partners. The opportunity is clear. The challenge now is to translate stronger external demand into more productive, innovative and sustainable growth.

Category	Brazil		Argentina		Chile		Mexico	
	% of total, 2025	CAGR 2015-2025	% of total, 2025	CAGR 2015-2025	% of total, 2025	CAGR 2015-2025	% of total, 2025	CAGR 2015-2025
Energy	16%	15%	13%	17%	—	—	3%	(1)%
Mining and metals	18%	6%	8%	5%	60%	8%	2%	12%
Agriculture (total), of which:	43%	7%	60%	4%	22%	5%	8%	7%
Primary agriculture	22%	8%	25%	5%	8%	6%	3%	5%
Agro-industry	20%	6%	35%	3%	14%	4%	5%	8%
Industrial manufacturing (total), of which:	23%	3%	19%	2%	17%	3%	87%	6%
Cars and other transport vehicles	7%	2%	9%	3%	—	—	28%	5%

Note: Figures are rounded. Mineral data refer to 2024, oil data to 2025 and agri-food exports to 2024.

Sources: Santander Research based on USGS, Mineral Commodity Summaries 2025 Data Release; Eni, World Energy Review 2026; Energy Institute, Statistical Review of World Energy 2026; and the trade sources used in the original table.

Summary of forecasts



Macroeconomic forecasts

Annual average, unless otherwise stated

		2026e	2027e	2028e
World	GDP growth (%)	3.1	3.4	3.3
United States	GDP growth (%)	2.3	2.2	2.0
	Unemployment rate	4.2	4.2	4.2
	CPI inflation	3.5	2.5	2.1
	Official rate*	4.25	4.25	3.50
China	GDP growth (%)	4.6	4.5	4.2
EUROPE				
Euro Area	GDP growth (%)	1.0	1.4	1.3
	Unemployment rate	6.4	6.3	6.3
	CPI inflation	3.1	2.6	1.9
	Official rate*	2.75	3.25	2.75
France	GDP growth (%)	0.4	0.8	1.1
	Unemployment rate	8.3	8.3	8.1
	CPI inflation	2.3	2.1	1.4
Germany	GDP growth (%)	1.1	1.2	1.4
	Unemployment rate	6.4	6.3	6.1
	CPI inflation	2.8	2.6	1.9
Portugal	GDP growth (%)	2.2	2.1	2.1
	Unemployment rate	5.8	6.1	6.4
	CPI inflation	2.7	2.4	2.2
Spain	GDP growth (%)	2.6	2.2	1.8
	Unemployment rate	9.9	9.4	9.2
	CPI inflation	3.6	2.9	2.1
United Kingdom	GDP growth (%)	1.3	0.9	1.4
	Unemployment rate	5.4	5.4	5.2
	CPI inflation	3.1	3.3	2.1
	Official rate*	4.00	4.25	3.25

Macroeconomic forecasts

Annual average, unless otherwise stated

		2026e	2027e	2028e
LATIN AMERICA				
Latin America - 7	GDP growth (%)	1.8	1.9	2.2
	Unemployment rate	5.4	5.7	5.9
	CPI inflation**	4.2	3.6	3.1
Argentina	GDP growth (%)	1.8	2.7	3.9
	Unemployment rate	7.2	7.1	7.0
	CPI inflation	30.1	23.0	12.7
Brazil	GDP growth (%)	1.8	1.3	1.5
	Unemployment rate	5.5	6.0	6.5
	CPI inflation	4.5	4.4	3.9
	Official rate*	13.50	12.50	10.50
Chile	GDP growth (%)	0.0	3.5	2.8
	Unemployment rate	8.9	8.5	8.1
	CPI inflation	3.9	3.5	3.0
	Official rate*	4.50	4.50	4.25
Colombia	GDP growth (%)	2.4	2.0	3.1
	Unemployment rate	9.3	10.1	9.5
	CPI inflation	7.0	5.1	4.0
	Official rate*	12.25	11.00	9.25
Mexico	GDP growth (%)	1.8	1.7	2.1
	Unemployment rate	2.8	3.2	3.4
	CPI inflation	3.8	3.9	4.0
	Official rate*	6.50	6.50	6.50
Peru	GDP growth (%)	3.4	3.2	3.3
	Unemployment rate	5.7	5.0	5.0
	CPI inflation	4.0	3.0	2.5
	Official rate*	4.75	4.25	4.25
Uruguay	GDP growth (%)	1.0	1.5	2.0
	Unemployment rate	7.9	8.1	8.2
	CPI inflation	4.1	4.8	4.3
	Official rate*	6.00	5.75	5.75

(*) End of period. (**) Without Argentina.
Latin America - 7: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay.
Source: Santander Research.

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The Year Ahead

2027

From resilience to growth

Santander