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From Tariffs... to Tolls

The conflict in the Middle East and the blockade of the Strait of Hormuz have reignited tensions over energy prices and fears of a new inflationary shock, clouding the growth outlook for the eurozone and Luxembourg. Uncertainties regarding the duration and consequences of the conflict remain high.

Global outlook clouded by geopolitical context

The easing of global uncertainty observed in early 2026 to a moderate but still high level was derailed by the outbreak of war in Iran on February 28, 2026. The resulting energy shock has reignited the spectre of an inflationary crisis, foreshadowing a response from central banks that will vary in strength depending on the magnitude of the inflationary shock. In the eurozone, economic activity resulted in a 1.4% rise in GDP in 2025, masking mixed performances among its various members. For 2026, forecasts remain clouded by developments in the war in Iran, the consequences of which remain difficult to assess at this stage.

A recovery set to strengthen in Luxembourg in 2026... provided the Strait of Hormuz reopens soon

Luxembourg's GDP grew by 0.6% in 2025, well below its historical average and the eurozone's result for the fourth consecutive year. The results remain unbalanced: only financial activities and the non-market sector are supporting economic activity, while investment continues to decline. In the baseline scenario of this Note de conjoncture, which assumes a short conflict and a reopening of the Strait of Hormuz in June, Luxembourg's GDP is projected to grow by 1.2% in 2026 and 1.9% in 2027. In the current context, the balance of risks is clearly tilted to the downside. If the war in Iran and the blockade of the Strait of Hormuz were to last three more months, GDP could decline by about 1% in 2026, before rebounding by 1.8% in 2027.

Energy prices are driving inflation up again

The conflict in the Middle East is reigniting pressure on energy prices and leading to an upward revision of inflation forecasts. In the baseline scenario, which assumes a short-lived conflict, inflation in Luxembourg would stand at 2.5% in 2026 and 1.7% in 2027. This trajectory incorporates a sharp rebound in energy inflation in 2026, followed by a decline in 2027 as prices normalize, while second-round effects—particularly via food prices—would continue to strengthen. Following the index bracket in June 2026, another one is expected in the 2nd quarter of 2027. A prolonged conflict (adverse scenario) could push inflation to around 4% in 2026 and 2.4% in 2027 and trigger an additional index bracket as early as the 3rd quarter of 2026.

Compensation per employee accelerated over the first three quarters of 2025, driven notably by the May wage indexation, before slowing in the 4th quarter, bringing annual growth to 4.4%. A slowdown, whose extent varies across scenarios, is expected in 2026.

Job creation is expected to pick up, but not enough to lead to a significant drop in unemployment

While employment growth continues to slow in the eurozone, momentum has, however, strengthened significantly in Luxembourg since last summer. Despite this, the unemployment rate in the Grand Duchy has continued to rise and, at the start of 2026, exceeded that of the eurozone—a historic first. This increase is mainly due to a more sustained growth in the labour force, driven by increased labour market participation. Furthermore, it is primarily cross-border employment that is gaining momentum, which does not contribute to reducing unemployment among residents.

The rebound in cross-border employment reflects the recovery in employment in the non-financial market sector, which has been significantly hampered in recent years by the crisis in construction. While growth in total employment has relied primarily on non-market activities since 2024 (accounting for three-quarters of the increase in 2025), the market sector is projected to be the main driver of job creation over the forecast horizon: in the baseline scenario, its rebound would drive employment growth to +1.7% this year and +1.9% in 2027 (after +1.2% in 2025). At the same time, the unemployment rate would decline slightly to an average of 6.2% in 2027 (compared to 6.3% in March 2026). A prolonged war in Iran, however, would stifle the economic recovery: in this scenario, employment growth would slow again this year (+0.7%), leading to a rise in unemployment to around 6.7% in 2027.

A public deficit still close to 2% of GDP in 2026 and 2027

In 2025, public finances deteriorated significantly due to a sharp slowdown in tax revenue (+2.5%, compared to nearly +10% annually in 2023 and 2024) and a sharp rise in public spending (+8.8%). Corporate and household taxes declined, while VAT revenues were held back by a slowdown in consumption and inflation. At the same time, public spending rose sharply, particularly through capital transfers linked to special funds, as well as increases in social benefits and the total payroll. This trend led to a reversal in the public balance: after a surplus of 0.9% of GDP in 2024, Luxembourg recorded a deficit of 2% of GDP in 2025, much larger than expected. For 2026 and 2027, the public deficit is expected to remain at around 2% of GDP. It could worsen and approach 3% of GDP in the scenario of a prolonged conflict in the Middle East.

An energy crisis unlike the previous one

Following the 2022 energy crisis linked to the war in Ukraine, tensions in the Middle East and disruptions to maritime traffic in the Strait of Hormuz are reigniting risks to global oil and gas supplies. Europe, however, appears less affected than in 2022, as it has reduced its gas consumption, diversified its supplies, and expanded its renewable electricity generation capacity.

In Luxembourg, the conflict has so far only affected the prices of petroleum products. Gas and electricity prices are not expected to be significantly impacted if the conflict is resolved before the summer. In this baseline scenario, STATEC forecasts a 2% decrease in greenhouse gas emissions this year and a further 5% decline in 2027. Such a trend would allow Luxembourg to align almost perfectly with the reduction trajectory set out in the Climate Act for 2027.

Thematic studies in this Note

1. Assessment of Luxembourg's CO_2 tax since 2021
2. Employment and wages in occupations facing shortages
3. Sluggish investment in Luxembourg
4. Tool for robust forecasting

Main macroeconomic developments in Luxembourg

		Short war[1]		Long war[2]	
	2025	*2026*	*2027*	*2026*	*2027*
		Growth rate in % unless otherwise specified			
Real GDP	0.6	1.2	1.9	-1.1	1.8
Total domestic employment	1.2	1.7	1.9	0.7	1.1
Unemployment rate (% of labour force)	6.0	6.3	6.2	6.6	6.7
National consumer price index (NICP)	2.3	2.5	1.7	4.0	2.4
Compensation per employee	4.4	3.1	2.8	3.4	3.5
Government budget balance (% of GDP)	-2.0	-1.8	-2.1	-2.9	-3.0
Greenhouse gas emissions	-7.7	-2.4	-5.3	-4.1	-5.4

Source: STATEC (2026-2027: forecasts)

[1] Baseline scenario of the Note de conjoncture 1-26, which assumes a relatively short conflict in the Middle East and a reopening of the Strait of Hormuz in May.

[2] The prolongation of the conflict in the Middle East and the blockade of the Strait of Hormuz until the fall leads to a critical drop in oil supplies and a sharp rise in global inflation, weighing on financial markets and undermining economic activity.

For further information

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