Monthly — May 15, 2026

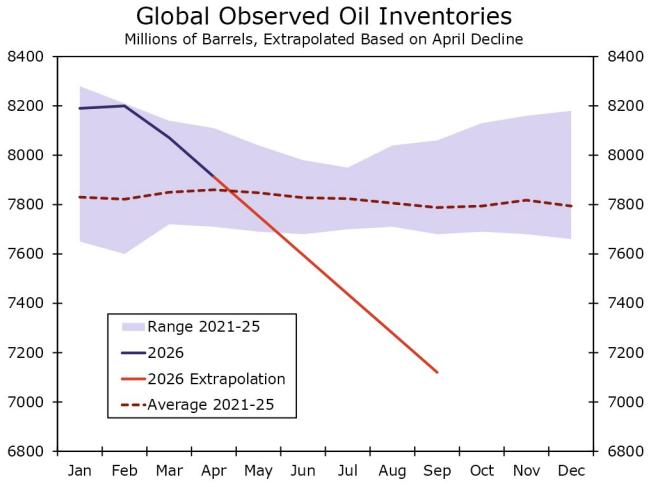
International Economic Outlook: May 2026

Policy Caught Between Inflation and Growth

Summary

- **Geopolitics and energy risk remain unresolved.** The US–Iran ceasefire is fragile, diplomacy is stalled and shipping through Hormuz is still down more than 90%, keeping uncertainty elevated and preserving upside risks to energy prices.
- **This is a historic physical supply shock.** The effective closure of Hormuz has removed 12.8 mbpd of oil supply, driven a rapid global inventory drawdown, and exposed how thin true buffer stocks really are, with refined product inventories now near critically low days-of-supply levels outside the Middle East.
- **Oil prices are behaving as history would suggest.** Past shocks of similar scale show oil price increases not only persist but often intensify over time, with gains on average nearly doubling over a 12-month horizon.
- **Inflation pressures are broadening from energy outward.** CPI upside has been led by energy so far, but supply bottlenecks now span metals, fertilizers and industrial inputs, raising the risk of spillovers into food, core goods and services via second-round effects that may be stronger than in prior cycles.
- **We see higher inflation and lower growth than consensus.** Despite some upward revisions, markets still underestimate inflation upside given the scale of the shock and limited fiscal buffers, while growth risks are most acute for energy importers such as Europe, Japan, China and parts of EM Asia.
- **Policy risks are skewed toward tighter for longer.** Major central banks are increasingly constrained by inflation persistence, with the Eurozone, UK and Japan facing stagflationary tradeoffs, Canada biased toward renewed hiking, Australia for a cycle extension and EMs turning cautious as inflation expectations need re-anchoring.

Figure 1



Source: International Energy Agency, S&P Global and Wells Fargo Economics

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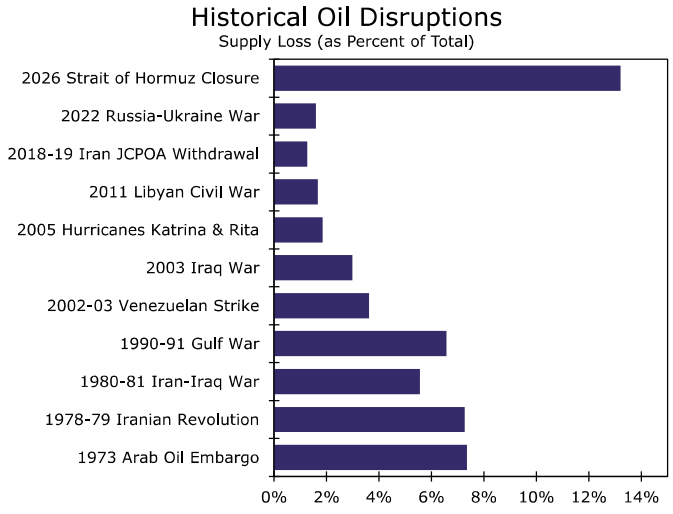
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Key Themes

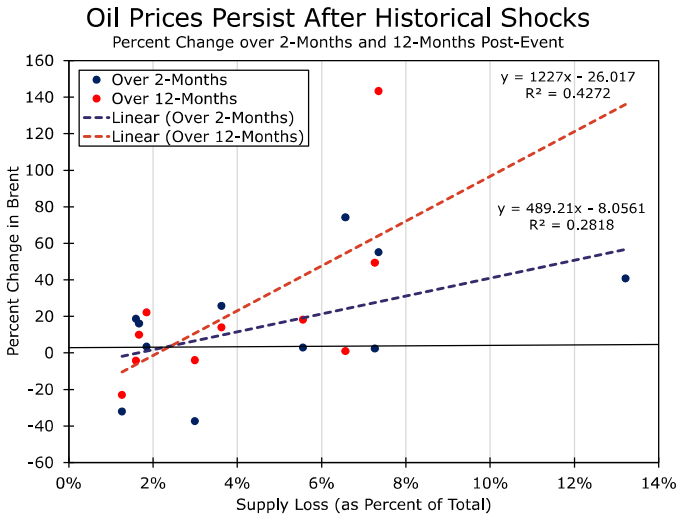
- **The US-Iran ceasefire continues to muddle along**, marked by sporadic hostilities and little meaningful progress toward a broader peace deal. Washington and Tehran remain far apart on core issues and political pressure does not yet appear to be approaching levels that would force a compromise. More importantly for markets, shipping through the Strait of Hormuz remains severely disrupted, with transit volumes still more than 90% below pre-war levels. Recent US efforts to enforce naval control and freedom of navigation have instead reduced traffic and heightened risks for commercial shipping, as reflected in the surge in attacks. Against this backdrop, uncertainty around the future operating environment for the Hormuz and the wider region remains elevated. We therefore see persistent upside risks to energy prices over both the near and medium term.
- **The implications of the US-Iran war are still being digested from a macro and policy perspective.** The closure of the Strait of Hormuz has resulted in the largest disruption in modern history with 12.8 mbpd of supply lost, per International Energy Agency (IEA) estimates (Fig 2). Crude oil demand has fallen but less significantly leading to substantial reduction in global observed inventories. Data from IEA and S&P Global suggest that oil inventories are down roughly 250–300 million barrels from pre-war levels. Although global observed inventories are about 8 billion barrels, these have been declining rapidly, given the muted demand-side response thus far (Fig 1). We note that true buffer stock is only about 10% of total with the remainder needed for logistical and strategic needs. Inventories of refined products have fallen sharply with global levels consistent with roughly 45 days of supply for gasoline, diesel and jet fuel. Moreover, inventory levels sharply vary across regions and countries with a glut in the Middle East given supply bottlenecks and sharper declines elsewhere. As such, physical supply constraints are likely to become an issue for key economies particularly in Asia and Europe into June.
- **The oil price response has largely been in line with past historical supply shocks.** Figure 3 maps out the relationship between change in oil prices over 2 months after a supply shock since the 1970s with the size of the supply loss (as a percent of total). Significantly, the oil price response tends to persist with the move almost doubling on average over 12 months. In the current episode, this persistence is likely reinforced by an already tight supply-demand balance and a near-term outlook that points to further deterioration.

Figure 2



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 3

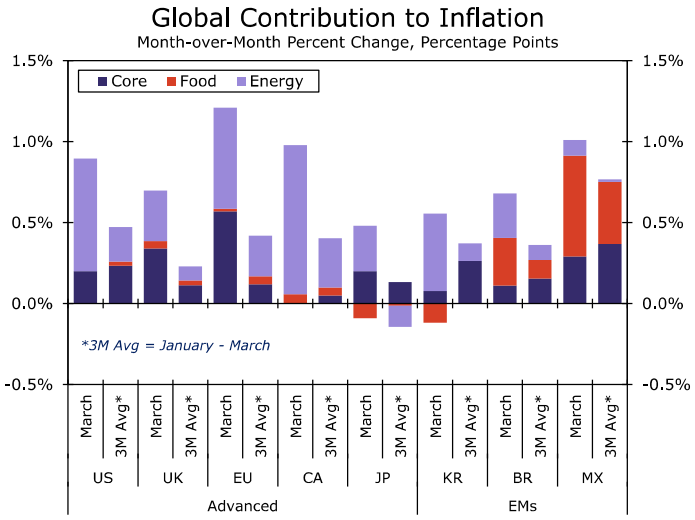


Source: Bloomberg Finance L.P. and Wells Fargo Economics

- **The move higher in inflation has been felt globally but largely driven by energy components thus far.** The full set of March readings indicate that the energy components (transportation, fuels, etc.) were largely responsible for the acceleration in monthly CPI (Fig 4). We expect April readings to show a similar dynamic along with some signs of broadening to other categories. As we noted in our April Monthly, the supply bottleneck affects a broader range of commodities

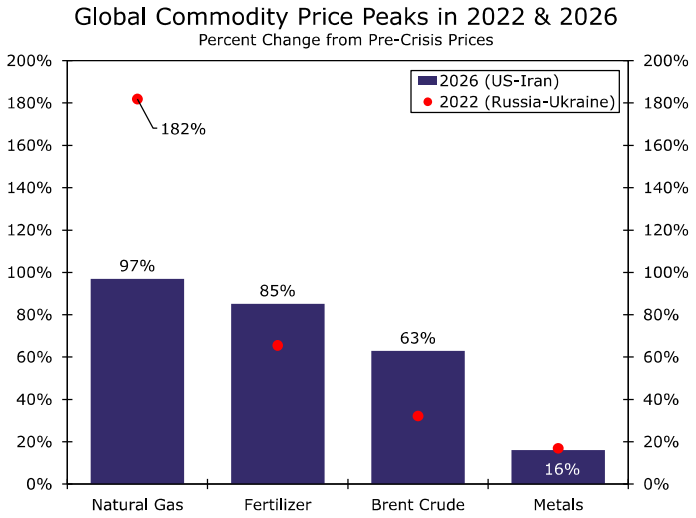
such as natural gas, aluminum, urea, sulfur and helium, with varying lead times in terms of their economic impacts. Prices for these commodities have surged recently with additional gains the longer that disruptions persist (Fig 5). Inflationary effects are likely to broaden over time affecting food and core goods categories via direct and indirect effects and services prices via broader pass-through. Moreover, indirect and second-round effects are likely to be higher than in the past given the 2022–23 inflation surge experience following Russia's invasion of Ukraine.

Figure 4



Source: Haver, Bloomberg Finance L.P. and Wells Fargo Economics

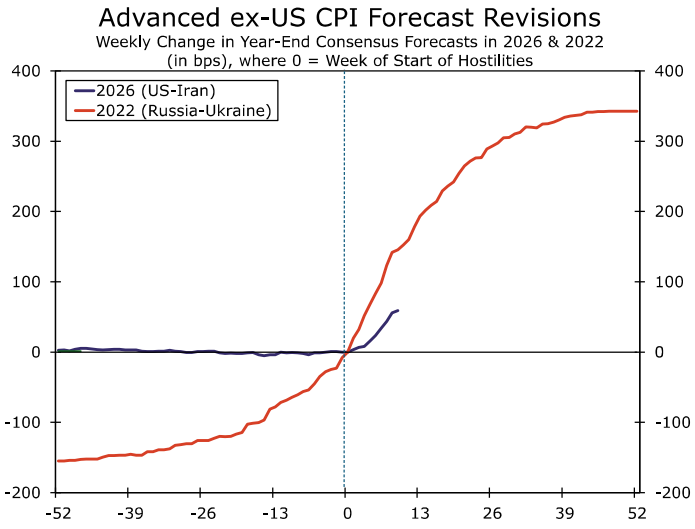
Figure 5



Source: Bloomberg Finance L.P. and Wells Fargo Economics

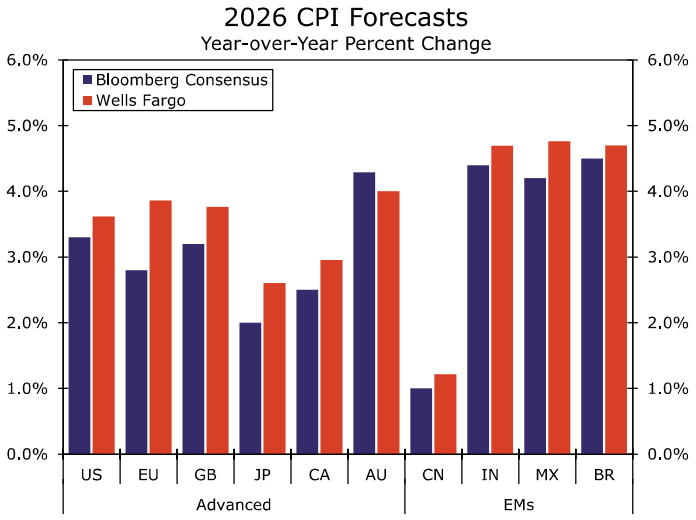
- **Our forecast for 2026 global inflation at 4.5%, sits higher than consensus (at 4%), whereas our forecast for 2026 global GDP growth at 2.6% is well below (at 3%).** Consensus Inflation forecasts have adjusted higher in recent weeks, but this has been less significant than the 2022 episode, particularly after accounting for the larger supply shock (Fig 6). Although more benign starting conditions contain the inflation response, the larger size and breadth of the supply shock and lower fiscal buffers to offset imply greater inflation upside, in our view. We expect higher year-end inflation than the consensus for most of the major economies (Fig 7).

Figure 6



Source: Bloomberg Finance L.P. and Wells Fargo Economics

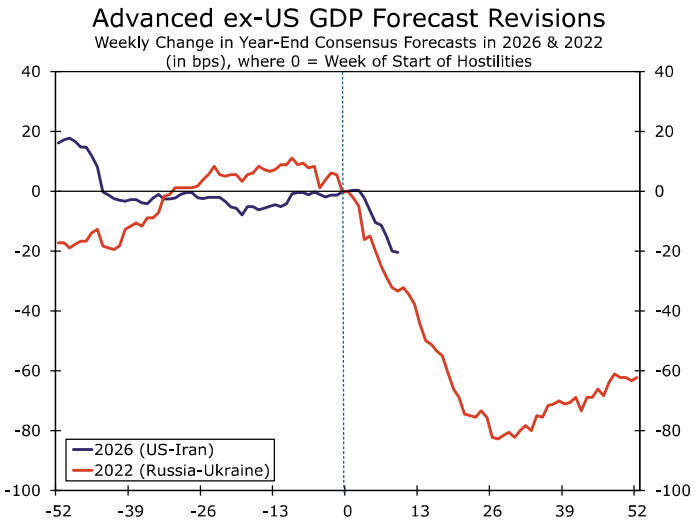
Figure 7



Source: Bloomberg Finance L.P. and Wells Fargo Economics

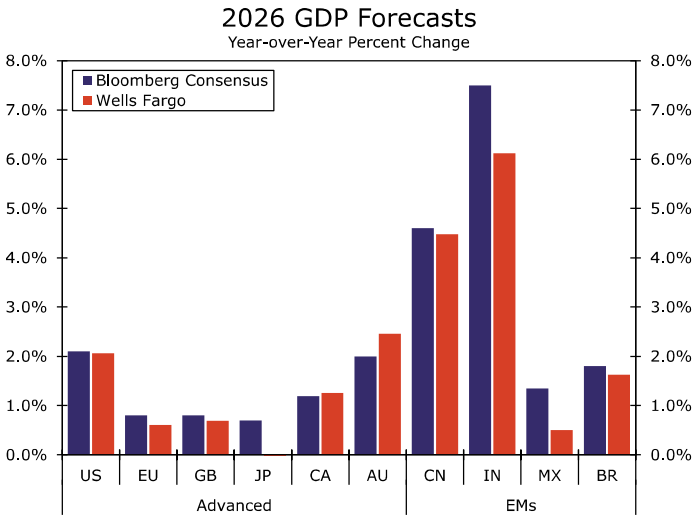
- In contrast, consensus growth forecasts have been worked down more aggressively in aggregate (Fig 8) but even here we are more pessimistic with lower growth forecasts for energy importer economies. In particular, we are more bearish than consensus in terms of our forecast for Japan, Eurozone and UK growth among Advanced economies, and China and India growth among EMs, whereas we are more constructive on net energy exporters such as Australia and Canada (Fig 9).

Figure 8



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 9



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Advanced Economies

- **Eurozone:** The macro-outlook has shifted decisively toward a stagflationary configuration. Growth momentum has softened materially since the start of the year, with activity indicators now consistent with near-stall speed and services bearing the brunt of the slowdown. At the same time, the energy shock linked to the Middle East war has reintroduced persistent inflation risks, as higher oil and gas prices push up headline inflation, tighten supply conditions and raise the risk of second-round effects via services prices, wages and FX pass-through. Against this backdrop, the European Central Bank (ECB) leaned heavily on optionality at its April meeting, but it is increasingly clear that a June hike has become the central case even if geopolitical tensions do not escalate further. The ECB's consumer expectations survey showed a sharp rise in inflation expectations, to around 4% from 2.5% over both the next 12 months and the three-year horizon. With the direct effects of higher energy prices already evident in the data, policymakers will be watching closely for signs of indirect and second-round effects in upcoming releases. The June meeting will bring an updated set of forecasts, which should better capture the evolving energy shock. Our base case remains two 25 bps hikes this year, starting in June and taking the Deposit Rate to 2.50% by end-2026, with risks skewed toward additional tightening if energy prices remain elevated and inflation expectations continue to drift higher.
- **Japan:** The Bank of Japan (BoJ) delivered a hawkish hold in its April meeting, underscoring that the policy debate has shifted from whether to hike to how soon, even as the macro backdrop has become more complicated. The BoJ is increasingly concerned that the war-driven energy shock could generate stagflation-like dynamics, with broader price pass-through and second-round effects posing upside risks to underlying inflation, while growth faces mounting headwinds from a worsening terms-of-trade shock. The revised forecasts reflect this tension, with materially lower growth and persistently higher core inflation, pushing convergence to target further out. Policy risks now look incredibly two-sided, making the timing of the next rate increase less certain, but the overall direction remains clear. Even if liftoff slips into Q3, the likelihood of a more extended hiking cycle has risen, with the BoJ increasingly reactive to data and markets and the risk growing that policy falls behind the curve as inflation proves more durable than what their baseline assumes.

- **Canada**: The Bank of Canada (BoC) highlighted increasingly two-sided risks to its outlook, with higher energy prices posing upside inflation risks and the potential for further US trade restrictions weighing on growth. The April meeting served as a reaction function update, signaling that if energy prices remain elevated and trade tensions with the US do not materially escalate, the BoC is prepared to hike to prevent inflation pressures from becoming entrenched. Even under a baseline of no agreement, we see the July 1 USMCA deadline as less of a cliff edge, as the framework remains in force under its 10-year sunset with annual reviews. This sustains trade uncertainty rather than triggering sharply higher tariffs, limiting the case for a dovish pivot. As a result, the BoC's focus is likely to shift toward inflation risks rather than growth concerns. Growth remains soft but resilient, helping stabilize labor markets amid a negative labor supply shock from adverse net migration. Higher energy prices are likely to absorb remaining domestic slack and reintroduce risks around inflation persistence and expectations, even as the Bank avoids overreacting to what may still prove to be a relative price shock. Our baseline is for the policy rate to remain on hold through mid-year, with a 25 bps hike in July and an additional 25 bps increase in Q4, most likely in October.
- **UK:** The balance of risks around inflation has shifted to the upside and growth to the downside, as highlighted in the Bank of England's (BoE) April monetary policy decision. While the decision itself was for a hold, the Monetary Policy Committee (MPC) characterized it as an "active hold," with a focus on inflation persistence and leaning against second-round effects. Initial conditions in the UK provide some policy flexibility as monetary policy was already restrictive and at the top of the BoE's estimate of neutral, while inflation had eased, demand was soft and the labor market subdued. However, that flexibility may prove limited. Rising fertilizer prices and persistently high energy costs raise the risk of indirect effects and increase the cost of delaying action. This shock follows several years of above-target inflation, which may amplify pass-through. Survey evidence suggests firms intend to pass higher costs on to consumers as margins remain under pressure, even in a restrictive policy environment. We have therefore revised our Bank Rate forecast to include two hikes this year, one in Q3 and one in Q4, with July the most likely timing for the first move, taking the policy rate to a terminal level of 4.25% before easing next year. We recognize that uncertainty remains high and tied to developments in the Middle East, yet even with a rapid resolution, at least one hike may be required to prevent inflation pressures from becoming entrenched.
- **Australia:** Prior to the war in the Middle East, inflation was already well above target and the Reserve Bank of Australia (RBA) was expected to raise rates, with little scope to look through the shock. The post-war rise in energy prices has further lifted inflation, which is forecast to remain above the 2-3% target for some time, with material upside risks to second-round inflation and expectations. Risks to growth and employment skew to the downside, as higher energy prices are expected to slow household consumption while weaker activity weighs on labor demand. Recent surveys amplify concerns around second-round inflation effects. Input costs have risen at the fastest pace in four years and final goods price growth has accelerated, showing broader pass-through to consumers. Further, the 2026-2027 Federal Budget's mildly expansionary stance complicates the path ahead for the RBA. Greater spending restraint would have reduced aggregate demand and preserved more policy headroom. Instead, looser fiscal policy adds to the RBA's pre-existing concerns of excess demand and evolving global supply shocks. Against this backdrop, we expect one more rate hike in Q3, likely in August, taking the Cash Rate to 4.60%. Further tightening remains possible if the war persists and price pressures intensify.

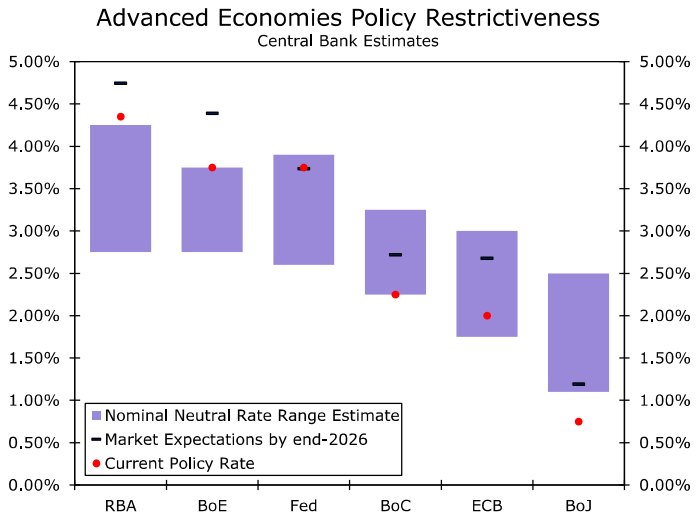
Emerging Markets

- **Brazil:** A more complex inflation backdrop implies greater caution from the Brazilian Central Bank (BCB) as it proceeds with its rate-cutting cycle. Disinflation driven by last year's aggressive tightening is now colliding with renewed external inflation pressures and lingering domestic fiscal risks. Economic activity has slowed, but resilience remains evident, with strong real wage gains and supportive fiscal policy continuing to underpin consumption. While the recent rise in inflation has been led by higher energy prices, both survey-based and market-based measures of inflation expectations have also moved higher at longer horizons, showing signs of de-anchoring. We expect inflation pressures to broaden from energy into food and other goods prices in the coming months. This backdrop is likely to increase pressure for more stimulative fiscal policy, particularly in an election year, limiting the extent of demand-side adjustment and constraining the scope for monetary easing. As a result, we expect the BCB to proceed with the rate-cutting cycle more cautiously than previously anticipated and now see fewer cuts over the remainder of 2026.

While easing is still likely to extend into 2027, we expect a higher terminal rate, as policy decisions become increasingly driven by the evolving inflation outlook rather than growth conditions alone.

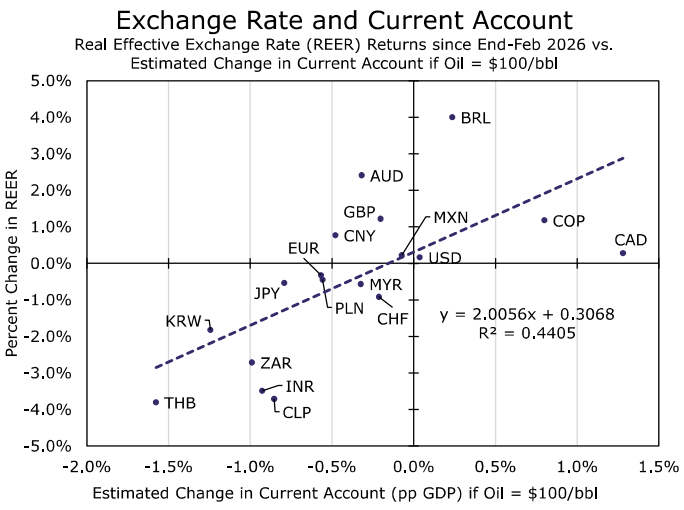
- **Mexico:** The macro backdrop for 2H26 has deteriorated, with low trend growth colliding with elevated inflation, limited fiscal space, and fragile policy credibility. Activity weakened sharply in Q1, with GDP contracting and leading indicators pointing to early-year momentum loss; any Q2 improvement is likely stabilization rather than a rebound. USMCA risks should persist, with the July 1 deadline extending trade uncertainty rather than posing a cliff edge. Inflation remains the binding constraint, with headline and core inflation at or above 4.5% year-over-year and upstream pressures likely to intensify as higher food and energy prices feed through. Upside inflation risks leave Banxico's prior dovish tilt increasingly untenable, explaining the decision to deliver a final cut in May and end the easing cycle. Markets will now focus on the December replacement of Deputy Governor Heath; a technocratic appointment would help anchor credibility, while a weaker choice risks weighing on the peso and pushing term premia higher despite weak growth.
- **China:** The economy has outperformed expectations, largely driven by stronger manufacturing production, solid external trade performance and front-loaded fiscal stimulus. However, domestic demand remains uneven, with retail sales and property investment still weak, pointing to a soft underbelly beneath headline growth. Activity is likely to moderate in the second half of 2026 as the boost from fiscal stimulus fades and the drag from higher energy prices and tighter energy supply intensifies. China remains heavily dependent on the Middle East for both oil and gas, amplifying vulnerability to external energy shocks. The truce in the US–China trade dispute also remains fragile, and China's export resilience via trade diversion risks provoking additional protectionist responses from key trading partners, particularly Europe. Inflation is now at an inflection point, with producer prices and the GDP deflator, the broadest measure of economy-wide prices, turning positive for the first time since 2022 and 2023, respectively. Against this backdrop, we expect growth to land toward the lower end of the official 4.5–5.0% target range. Firmer inflation dynamics are likely to keep policymakers on the sidelines, delaying monetary easing through Reserve Requirement Ratio cuts until later in 2026 or possibly into 2027. Policy emphasis is instead likely to remain on targeted credit support and the reorientation of fiscal policy, though room for maneuvering is increasingly constrained by a historically elevated budget deficit once special bond issuance is taken into account.

Figure 10



Source: Individual Central Banks and Wells Fargo Economics

Figure 11



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Wells Fargo International Economic Forecast

	GDP				CPI			
	2024	2025	2026	2027	2024	2025	2026	2027
Global (PPP Weights)	3.4%	3.1%	2.6%	2.7%	5.8%	3.6%	4.5%	3.9%
Advanced Economies[1]	1.8%	2.0%	1.5%	1.7%	2.6%	2.7%	3.6%	2.5%
United States	2.8%	2.1%	2.1%	2.2%	3.0%	2.7%	3.6%	2.2%
Eurozone	0.9%	1.5%	0.6%	1.0%	2.4%	2.1%	3.9%	2.6%
United Kingdom	1.1%	1.4%	0.7%	1.1%	2.5%	3.4%	3.8%	3.0%
Japan	-0.2%	1.2%	0.0%	0.2%	2.7%	3.2%	2.6%	2.2%
Canada	2.0%	1.7%	1.3%	1.6%	2.4%	2.1%	3.0%	2.6%
Australia	1.0%	2.0%	2.5%	2.4%	3.2%	3.0%	4.0%	2.9%
Developing Economies[1]	4.5%	3.9%	3.3%	3.3%	8.0%	4.3%	5.1%	4.8%
China	5.0%	5.0%	4.5%	4.3%	0.2%	0.1%	1.2%	1.1%
India	6.7%	7.5%	6.1%	6.3%	4.6%	2.2%	4.7%	4.5%
Mexico	1.4%	0.8%	0.5%	1.6%	4.7%	3.8%	4.8%	4.6%
Brazil	3.4%	2.6%	1.6%	1.7%	4.4%	5.1%	4.7%	4.0%

Forecast as of: May 15, 2026

[1]Aggregated Using PPP Weights

Source: International Monetary Fund and Wells Fargo Economics

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

Central Bank Key Policy Rate

	2026				2027		
	Current	Q2	Q3	Q4	Q1	Q2	Q3
United States	3.75%	3.75%	3.75%	3.25%	3.25%	3.25%	3.25%
Eurozone[1]	2.00%	2.25%	2.50%	2.50%	2.50%	2.50%	2.50%
United Kingdom	3.75%	3.75%	4.00%	4.25%	4.25%	4.25%	4.00%
Japan	0.75%	0.75%	1.00%	1.25%	1.25%	1.25%	1.25%
Canada	2.25%	2.25%	2.50%	2.75%	2.75%	2.75%	2.75%
Australia	4.35%	4.35%	4.60%	4.60%	4.60%	4.60%	4.35%
China[3]	9.00%	9.00%	9.00%	8.50%	8.50%	8.00%	8.00%
India	5.25%	5.25%	5.50%	5.75%	5.75%	5.75%	5.75%
Mexico	6.50%	6.50%	6.50%	6.50%	6.50%	6.50%	6.50%
Brazil	14.50%	14.25%	14.25%	13.75%	13.25%	12.75%	12.25%

2-Year Note

	2026				2027		
	Current	Q2	Q3	Q4	Q1	Q2	Q3
United States	3.98%	3.70%	3.50%	3.40%	3.40%	3.45%	3.50%
Eurozone[2]	2.71%	2.80%	2.75%	2.65%	2.60%	2.60%	2.60%
United Kingdom	4.49%	4.60%	4.65%	4.70%	4.60%	4.55%	4.50%
Japan	1.40%	1.45%	1.50%	1.55%	1.55%	1.50%	1.50%
Canada	2.96%	3.00%	3.10%	3.20%	3.25%	3.25%	3.25%

10-Year Note

	2026				2027		
	Current	Q2	Q3	Q4	Q1	Q2	Q3
United States	4.47%	4.30%	4.20%	4.25%	4.25%	4.30%	4.30%
Eurozone[2]	3.10%	3.15%	3.15%	3.10%	3.10%	3.05%	3.00%
United Kingdom	5.07%	5.10%	5.20%	5.20%	5.10%	5.00%	4.90%
Japan	2.59%	2.65%	2.70%	2.75%	2.70%	2.60%	2.50%
Canada	3.58%	3.70%	3.80%	3.90%	4.00%	4.00%	4.00%

Forecast as of: May 15, 2026

[1] ECB Deposit Rate [2] German Government Bond Yield [3] Reserve Requirement Ratio Major Banks

Source: Bloomberg Finance L.P. and Wells Fargo Economics

FX Forecasts

For FX Forecasts, please refer to Wells Fargo Macro Strategy's Currency Cartography: Shock Therapy report (page 11).

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