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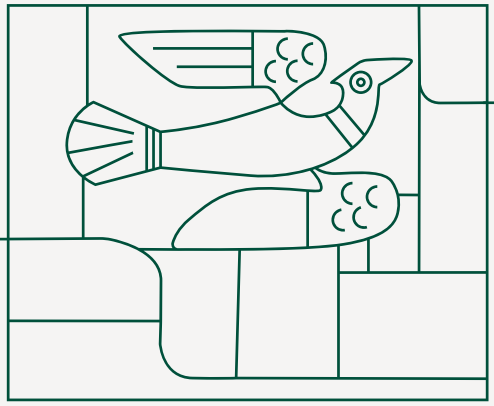


Alternative Scenarios for the Economic Implications of the War in the Middle East

Given the high degree of uncertainty surrounding the development of the military conflict in the Middle East and its impact on international oil and natural gas prices, as well as on global economic activity, the baseline macroeconomic forecast is complemented by two alternative scenarios: an adverse and a severe. They have been developed through simulations with the BNB's macroeconomic forecast model and applying the assumptions used in the euro area macroeconomic projections published by the ECB on 19 March 2026.[1] These scenarios illustrate possible macroeconomic effects in the event of a stronger and more prolonged shock on supply and prices of energy products. They do not include an assessment of the likelihood of their materialisation and do not take into account the effects of potential monetary and fiscal policy measures.

Description of the Adverse and Severe Scenarios

The adverse and severe scenarios have been prepared by the BNB based on the assumptions developed by the ECB, which differ in three key factors: (1) the size of the initial shock in supply and prices of energy commodities in international markets; (2) persistence of disruptions in the supply chains of these commodities; and (3) the degree of uncertainty in international financial markets.

- Adverse Scenario: It is assumed that in the second quarter of 2026, around 40 per cent of the usual flows of oil and liquefied natural gas passing through the Strait of Hormuz will be temporarily hampered, mainly due to the blockade of transport routes. It is also assumed that there will be no significant damage to the energy infrastructure in the region. This would result in a significant but short-lived increase in energy commodity prices and a moderate increase in the uncertainty in international financial markets. Disruptions in the supplies of these commodities would persist until the third quarter of 2026, followed by a relatively rapid recovery in trade flows.
- Severe Scenario: This scenario assumes a more intense and prolonged shock to the energy commodity supply, including a suspension of around 60 per cent of the flows in the Strait of Hormuz. In addition to logistical difficulties, there is also a risk of direct damages to the energy infrastructure of energy-exporting countries in the Middle East as a result of military operations, which would significantly prolong the time required to restore the supplies of these commodities. Volumes would only begin to return to normal in the first quarter of 2027, and the process would be gradual. Accordingly, the uncertainty in international financial markets would be more intense and prolonged, further amplifying the negative economic effects.

Transmission Mechanism to the Bulgarian Economy

The scenarios for Bulgaria take into account the main channels through which external shocks are transmitted to a small open economy. First, the external demand channel plays a key role, reflecting the impact of the economic activity slowdown in Bulgaria's trading partners on exports of Bulgarian goods and services. Second, the pass-through channel to final consumer prices, where higher euro area non-energy commodity prices affect corresponding prices in Bulgaria, is included.

Oil and natural gas prices have a direct effect on consumer prices of energy products in Bulgaria. At the same time, they also have an indirect impact on the other main groups of the Harmonised Index of Consumer Prices, particularly on food and services prices, *via* rising production costs of

[1] For further details, see *ECB staff macroeconomic projections, March 2026*.

corporations. Second-round effects from higher oil and natural gas prices on inflation could arise from wage indexation and an associated rise in unit labour costs.

As regards food prices, the simulation assumes a degree of pass-through of energy prices to food prices, corresponding to the rate observed in 2022–2023, which is higher than the average estimated historical elasticity. This assumption reflects an expectation that additional second-round effects may intensify in the context of severe energy shocks.

Simulation Results

Simulation results show that if the adverse and severe scenarios for Bulgaria materialise, higher inflation and lower economic activity growth compared to the baseline projections can be observed, with the effects being stronger and more prolonged under the severe scenario.

According to the adverse scenario, inflation would increase in 2026, mainly driven by energy prices, with price pressures thereafter gradually transmitted to food and, to a more limited extent, to core inflation. Over the whole projection period, inflation would be higher than in the baseline projections by 0.7 percentage points in 2026, by 1.4 percentage points in 2027 and by 0.6 percentage points in 2028. The maximum effect would emerge in 2027, reflecting both estimated delayed pass-through of higher euro area non-energy goods prices to Bulgaria and delayed indirect effects on the other HICP components. The impact on economic activity would be relatively short-lived, with real GDP growth being lower by 0.3 percentage points in 2026 compared to the baseline forecast, followed by a gradual recovery as the shock in external demand subsides. As a result, economic activity growth in 2027 and 2028 would be 0.2 percentage points higher than the baseline, mainly due to the lower 2026 base. The level of real GDP in the adverse scenario reverts to its baseline projections values in 2028.

The severe scenario shows more intense and prolonged inflationary pressures. The initial shock in the prices of energy products would be larger and more persistent, leading to a more pronounced pass-through to food prices and subsequently to an acceleration in core inflation over the projection horizon. The acceleration in core inflation reflects both indirect effects of higher prices of energy products and food and additional second-round effects. As a result, headline inflation would be higher than in the baseline by 1.2 percentage points in 2026, by 3.4 percentage points in 2027 and by 2.3 percentage points in 2028, reflecting stronger indirect and second-round effects. Concurrently, economic activity would slow down significantly for a longer period, with real GDP growth being lower by 0.6 percentage points in 2026 and by 0.3 percentage points in 2027 compared to the baseline forecast. In 2028, GDP growth would be higher than in the baseline projections, due to the lower base in the previous two years. Real GDP would remain below the baseline level throughout the entire forecast horizon.

TABLE 1

Simulation Results of the Effects of the War in the Middle East on the Bulgarian Economy under the Adverse and Severe Scenarios

Effects on GDP and Average Annual Inflation in Bulgaria
(percentage points deviation from baseline)

	Change in Real GDP			Average Annual Inflation (HIPC)		
	2026	2027	2028	2026	2027	2028
Adverse Scenario	-0.3	0.2	0.2	0.7	1.4	0.6
Severe Scenario	-0.6	-0.3	0.4	1.2	3.4	2.3

Source: BNB.

TABLE 2

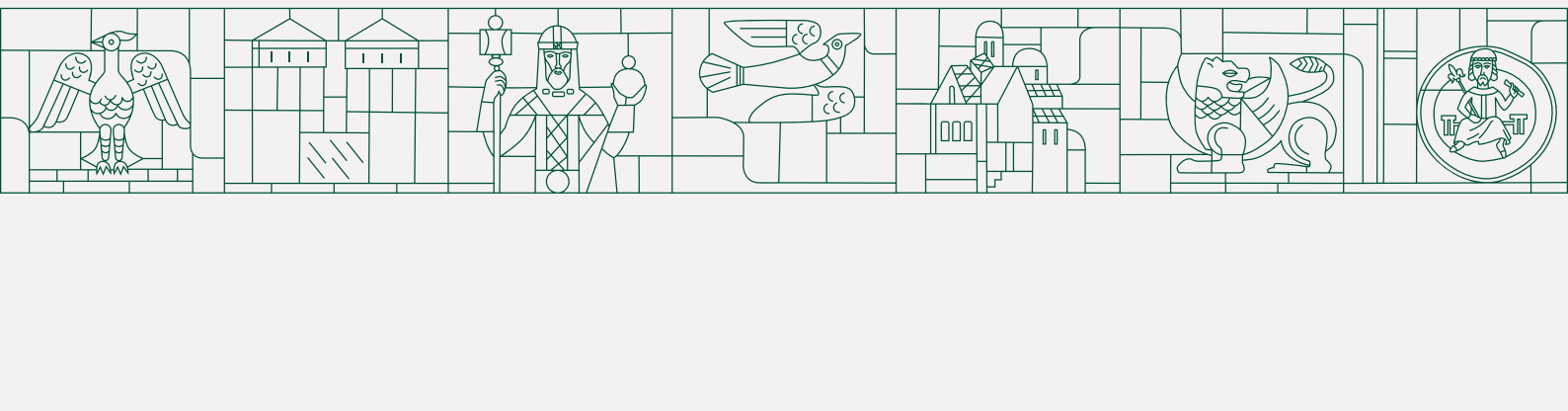
Simulation Results of the Effects of the War in the Middle East on the Bulgarian Economy under the Adverse and Severe Scenarios

Effects of Average Annual Inflation in Bulgaria by Component
(percentage points deviation from baseline)

	Adverse Scenario			Severe Scenario		
	2026	2027	2028	2026	2027	2028
Headline Inflation as Measured by HICP	**0.7**	**1.4**	**0.6**	**1.2**	**3.4**	**2.3**
Food Inflation	1.2	3.1	1.7	1.8	5.5	3.7
Inflation in Energy Products	2.7	-0.4	-1.9	4.6	5.1	-0.7
Core Inflation	0.1	1.0	0.6	0.3	2.1	2.2

Source: BNB.

Constraints Related to Scenario Preparation

It should be noted that the simulations are illustrative and aim to present the main economic mechanisms through which the war in the Middle East would affect the Bulgarian economy. Therefore, by their construction, they do not cover all factors that could significantly affect consumer price developments and economic activity. First, simulations do not assume a shut-down of crude oil physical deliveries to Bulgaria. Moreover, there is no additional monetary and fiscal policy response beyond that already projected in the baseline, nor any effects on inflation and economic activity of a potential deterioration in household and corporate perceptions. In fact, the significant inflation increase, especially under the severe scenario, would likely trigger monetary policy tightening in the euro area, as well as implementation of various fiscal measures to support vulnerable households and firms. While monetary policy tightening would be a precondition for lower inflation than presented in the alternative scenarios, the impact of fiscal policy measures on inflation and economic activity would not be straightforward and would depend on the orientation, scope and impact of the measures on aggregate demand.

In addition, some additional transmission channels are not explicitly included in the analysis. One of them is the impact on electricity prices given the high integration of the Bulgarian market with those of Romania and Greece, where natural gas plays a significant role in electricity production. Another channel relates to the international market of fertilisers, given the role of natural gas as the main raw material for their production and the fact that a significant part of the global trade in fertilisers passes through the Strait of Hormuz. This creates prerequisites for an increase in international prices of the main agricultural products.