

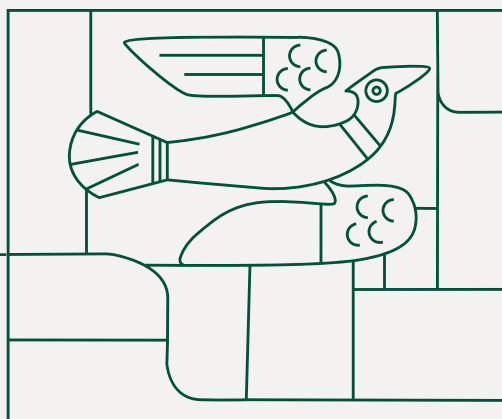


BULGARIAN
NATIONAL BANK
EUROSYSTEM

Topical Research and Highlights

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

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

As of the cut-off date of the forecast on 27 May, the military conflict in the Middle East is a source of significant uncertainty for the baseline of the macroeconomic forecast. The baseline is therefore complemented by three alternative macroeconomic scenarios: a milder scenario, an adverse scenario and a severe scenario. They have been developed using the BNB's main simulation model, and their design and underlying assumptions follow those set out in the alternative scenarios of the ECB staff macroeconomic projections for the euro area published on 11 June 2026.¹ These three scenarios differ in terms of the size of the energy price shock and the strength of its transmission to non-energy goods and services prices. The scenarios do not assess the likelihood of their materialisation and do not take into account the effects of potential monetary and fiscal policy measures beyond those set out in the baseline. They are purely illustrative and aim to present changes in the key macroeconomic indicators under various assumptions about international commodity price dynamics. These scenarios take into account the specificities of the Bulgarian economy and cover the main channels through which the Middle East conflict impacts it.

It should be noted that the preliminary agreement signed on 17 June between the United States and Iran to end the war reduces uncertainty in the forecast baseline, with oil prices as of 18 June staying at levels below the baseline.

Description of the Alternative Adverse Scenarios

The three alternative scenarios differ mainly in terms of the size and duration of the international energy price shock, the strength of its transmission to non-energy goods and services prices and the degree of uncertainty in international financial markets. In particular, the scenarios reflect the impact of the military conflict on the Bulgarian economy in case of divergent developments in international prices of oil, natural gas, electricity,² food, the exchange rate of the euro against the US dollar, external demand for Bulgarian goods and services and non-energy prices in the euro area (see Chart 1).

The path of international oil and gas prices in the alternative scenarios is based on the distribution of expected prices of these commodities, derived from option prices as of 28 May. A technical assumption is made that from the third quarter of 2026 oil and gas prices follow the 25th percentile of market-based distributions in the milder scenario, the 75th percentile in the adverse scenario and the 95th percentile in the severe scenario. These percentiles provide the market participants' assessment of the risks stemming from energy commodity prices and implicitly reflect market expectations about the evolution of the war in the Middle East. The different degree of non-linearity between energy prices and inflation is also reflected in designing the scenarios. In periods of high inflation, the propagation of the energy shock to final consumer prices may be significantly stronger than historically observed. With tight labour market conditions and larger price shocks, it is typical to observe a non-linear relationship between energy prices and inflation, which standard linear models cannot describe. This non-linearity is reflected³ to a different degree in the adverse and severe scenarios.

¹ For further details, see [ECB staff macroeconomic projections, June 2026](#).

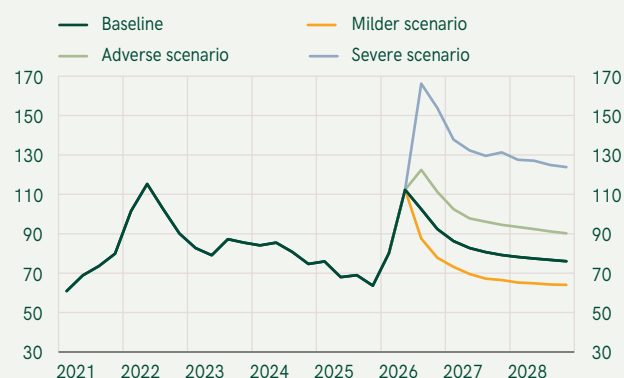
² The assumptions about the trajectory of energy prices in individual scenarios are provided to the BNB by the ECB, except those for electricity for non-household consumers. Reflecting the large importance of the electricity price for non-household consumers for producer price dynamics in the Bulgarian market, it is included in the scenarios for the Bulgarian economy based on its historical relationship with international natural gas prices.

³ In the BNB's main simulation model, these non-linearities are captured by calibrating the coefficients in the equations used to model services inflation and food inflation in order to reflect expected stronger indirect and second-round effects of the shocks in the two negative scenarios. These calibrations are based on the estimated amount of relevant coefficients over the high-inflation period in 2022–2023 in Bulgaria and cover the first year of the simulation.

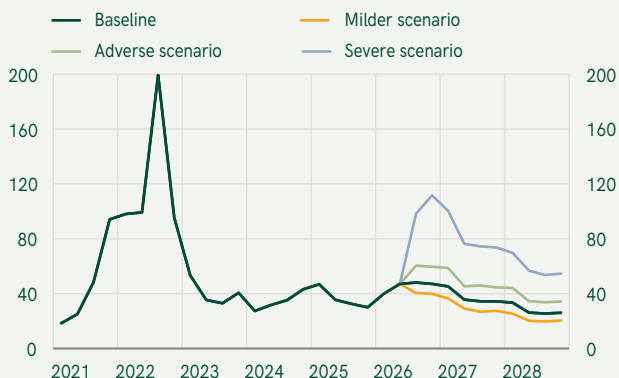
CHART 1

(a) International Oil Price

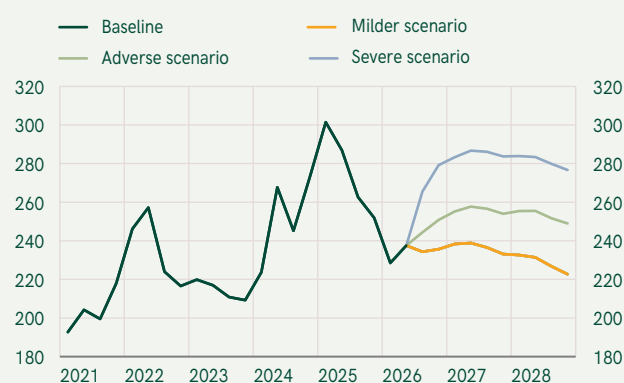
(USD/barrel)

**(b) International Natural Gas Price**

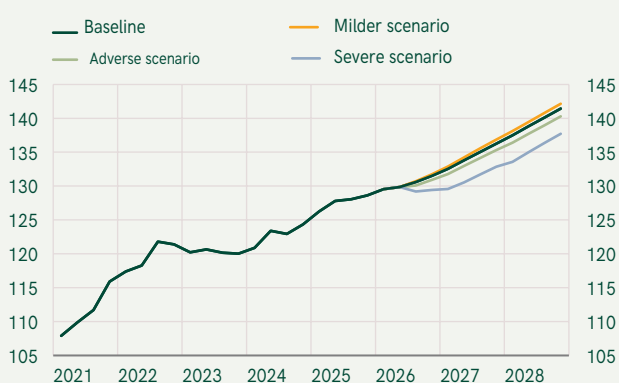
(EUR/MWh)

**(c) International Food Prices**

(USD)

**(d) External Demand for Bulgarian Goods and Services**

(index 2020 = 100)



Source: ECB, BNB calculations.

The main features of the alternative scenarios are:

- Milder scenario:** Energy prices are assumed to remain 15–20 per cent below the baseline levels. As a result, in the third quarter of 2026 the oil price is assumed to drop to USD 88 per barrel and the gas price to EUR 41 *per* MWh. This dynamics is in line with part of market expectations that the conflict would be resolved in a relatively short period of time and by the end of 2026 prices would gradually return to their pre-conflict levels. This scenario includes additional assumptions about stronger external demand for Bulgarian goods and services *vis-à-vis* the baseline and an appreciation of the euro against the US dollar. In the milder scenario, international food prices remain unchanged compared to their baseline level.
- Adverse scenario:** A stronger and more prolonged increase in energy prices is assumed compared with the baseline along with higher uncertainty and more significant indirect and second-round effects on inflation. In this scenario, oil and natural gas prices would peak in the third quarter of 2026 (USD 122 *per* barrel and EUR 60 *per* MWh, respectively), remaining around 20–30 per cent above the baseline levels throughout the whole forecast horizon. As regards food prices, an increase is also projected compared to the baseline. This scenario includes also assumptions about weaker external demand for Bulgarian goods and services and a depreciation of the euro against the dollar. In addition, the adverse scenario assumes also emergence of non-linear indirect and second-round effects on inflation.

- **Severe scenario:** This scenario implies that international oil prices would be around 60 per cent higher than the baseline and natural gas prices around 100 per cent higher, reaching USD 166 *per* barrel and EUR 98 *per* MWh in the third quarter of 2026. Compared with the adverse scenario, the energy price and other variables shock is both stronger and highly persistent, with deviations from the baseline still being of a similar magnitude up to the end of the projection horizon. This scenario is consistent with market participants' expectations of a prolonged conflict coupled with significant damage to oil and gas production and transmission infrastructure. Assumptions in this scenario include also a higher degree of uncertainty in the economic environment and a stronger increase in non-energy prices than in the adverse scenario. At the same time, the severe scenario assumes lower external demand, a stronger depreciation of the euro against the dollar and stronger indirect and second-round effects on inflation compared to the adverse scenario.

The Transmission Mechanism to the Bulgarian Economy

Scenarios for Bulgaria take into account the main channels through which external shocks are transmitted to a small open economy. External demand channel, reflecting the impact of the military conflict on economic activity in our trading partners and hence exports of Bulgarian goods and services plays a key role for Bulgaria's economic activity.

Oil, natural gas and electricity 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 sub-components of the Harmonised Index of Consumer Prices (HICP), particularly food and services prices, *via* rising production costs of corporations. Second-round effects from higher oil, gas and electricity prices on inflation are visible through indexation of wages and a subsequent increase in unit labour costs. Accordingly, the extent to which price increases from the initial shock affect real economic activity in Bulgaria depends on the degree to which increases in firms' and households' income may offset their higher costs.

Dynamics of international food commodity prices has a direct impact on food prices in Bulgaria. In addition, a higher degree of pass-through of energy prices to consumer food prices is included, which is consistent with the historical elasticity observed in the 2022–2023 period and is higher than the average estimated historical elasticity. At the same time, services prices imply a higher degree of labour cost pass-through, also in line with the estimated dependence over the 2022–2023 high inflation period. These assumptions reflect an expectation of a potential intensification of non-linear second-round effects in a scenario of a strong and prolonged energy price shock.

Simulations take into account assumptions about price increases in industrial goods in the euro area under an adverse and a severe scenario and their price declines under a milder scenario. These assumptions have an impact on dynamics of these goods prices in Bulgaria.

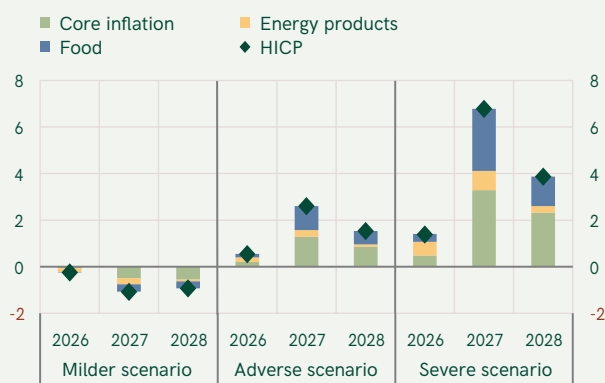
Simulation Results

Simulation results show that if the milder scenario would materialise, lower inflation and higher growth of economic activity would be observed for Bulgaria compared to the baseline. At the same time, the two negative scenarios lead to higher inflation and lower growth of economic activity compared with the baseline, with stronger and more prolonged effects in the severe scenario (see Table 1). By component of inflation, the energy shock would have the strongest effect on energy prices and core inflation. As regards economic activity, the energy shock would most strongly impact goods and services exports and private consumption (see Chart 2).

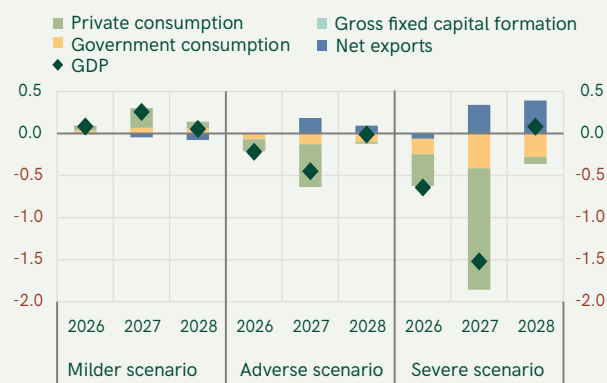
CHART 2

(a) Deviation of the HICP from the Baseline and Contributions by Component

(percentage points)

**(b) Deviation of Real GDP Growth from the Baseline and Contributions by Component**

(percentage points)

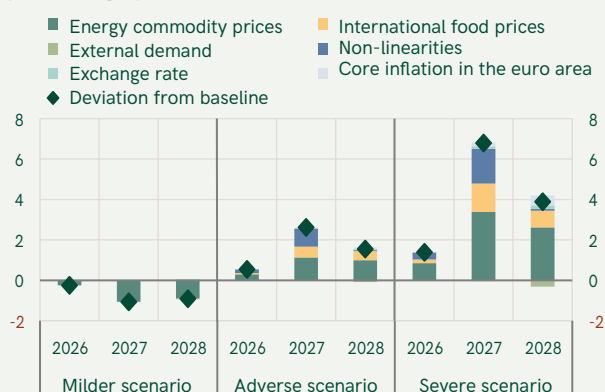


Source: BNB calculations.

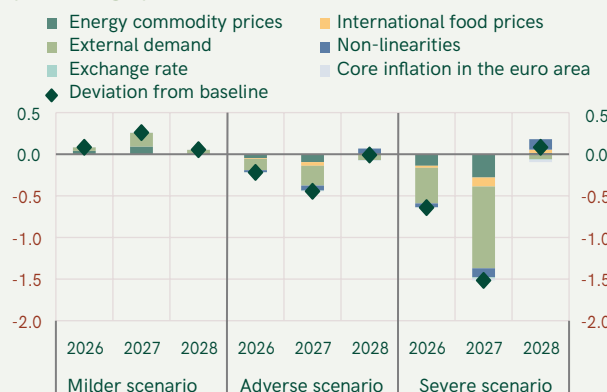
CHART 3

(a) Deviation of the HICP from the Baseline and Contributions by Shock

(percentage points)

**(b) Deviation of Real GDP Growth from the Baseline and Contributions by Shock**

(percentage points)



Source: BNB calculations.

In a milder scenario, the forecast is for lower than baseline inflation for the whole projection horizon, which is mainly due to the underlying dynamics of energy prices, in particular electricity prices for non-household consumers and international oil prices (see Chart 3 (a)). In 2026, inflation is 0.2 percentage points lower at 4.8 per cent on average for the year. By HICP component, the deviation from the baseline is driven mainly by the group of energy products (see Chart 2 (a)). In 2027 and 2028, consumer price growth is lower by 1.1 percentage points and 0.9 percentage points, respectively, compared to the baseline, coming to 2.4 per cent and 2.0 per cent, respectively. Core components of the consumer basket are the main contributors to lower inflation in the 2027–2028 period, reflecting the estimated pass-through of energy price developments with a time lag (see Chart 2 (a)). As regards economic activity, GDP growth is higher than the baseline over the whole projection horizon (see Chart 2 (b)).

In an adverse scenario, inflation increases in 2026, mainly driven by energy price dynamics, initially reflected in transport fuels and subsequently transmitted to core inflation and the food group. Inflation is higher for the whole projection horizon compared to the baseline, by 0.5 percentage points in 2026, by 2.6 percentage points in 2027 and by 1.5 percentage points in 2028. The largest deviation from the baseline is observed in 2027, reflecting both delayed indirect effects of the energy shock on the other HICP components and projected non-linear second-round effects

in consumer food and services prices. In an adverse scenario, inflation would be 5.5 per cent in 2026, before accelerating to 6.1 per cent in 2027 and slowing down to 4.5 per cent in 2028 (see Table 1). The impact on economic activity is towards lower growth compared to the forecast baseline, by 0.3 percentage points in 2026 and 0.5 percentage points in 2027, followed by a gradual recovery in external demand as the shock fades out. Lower real GDP growth in 2026 and 2027 is due to weaker growth in private consumption, fixed capital investments and exports of goods and services. Concurrently, this decline in domestic demand components and exports is reflected in lower imports of goods and services, leading to a positive deviation of net exports compared to the baseline. Real GDP growth in an adverse scenario slows down to 2.5 per cent in 2026 and 2.2 per cent in 2027, before accelerating to 2.9 per cent in 2028 (see Table 1).

Under a severe scenario, more intense and prolonged inflationary pressures are observed (see Chart 4). The initial energy price shock is larger and more persistent, resulting in a more pronounced pass-through to core and food inflation. Acceleration of inflation in 2026 and 2027 reflects both indirect effects of higher energy and food prices and stronger non-linear second-round effects than projected in the adverse scenario (see Chart 3 (a)). As a result, headline inflation is higher than in the baseline, by 1.4 percentage points in 2026 and by 6.8 percentage points in 2027, standing at 6.4 per cent and 10.3 per cent, respectively (see Table 1).

TABLE 1

Simulation Results for the Effects of the War in the Middle East on the Bulgarian Economy

	Real GDP growth (per cent)			Average annual inflation (based on HICP)		
	2026	2027	2028	2026	2027	2028
Baseline	2.8	2.7	2.9	5.0	3.5	2.9
Milder scenario	2.8	2.9	3.0	4.8	2.4	2.0
Adverse scenario	2.5	2.2	2.9	5.5	6.1	4.5
Severe scenario	2.1	1.2	3.0	6.4	10.3	6.8

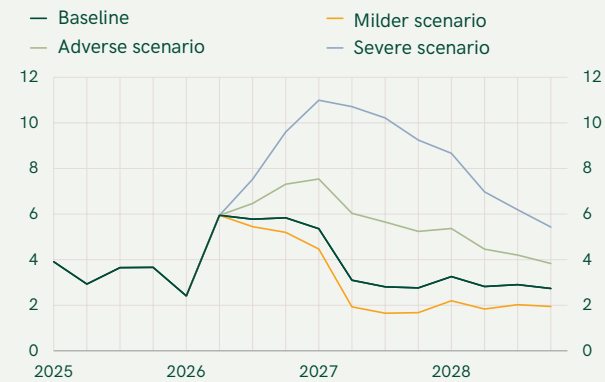
Source: BNB.

Assuming a lower degree of pass-through of energy prices and labour costs to the HICP towards historical values, inflation slows down to 6.8 per cent in 2028. Economic activity in a severe scenario decreases significantly, with real GDP growth being lower by 0.7 percentage points in 2026 and by 1.5 percentage points in 2027 compared to the forecast baseline to reach 2.1 per cent and 1.2 per cent, respectively (see Table 1). Lower growth is mainly attributable to the assumption of weaker external demand for Bulgarian goods and services. In 2028, GDP growth is higher than in the baseline, due to the lower base of the previous two years. However, the level of real GDP in the severe scenario remains lower than the baseline over the whole projection horizon.

CHART 4

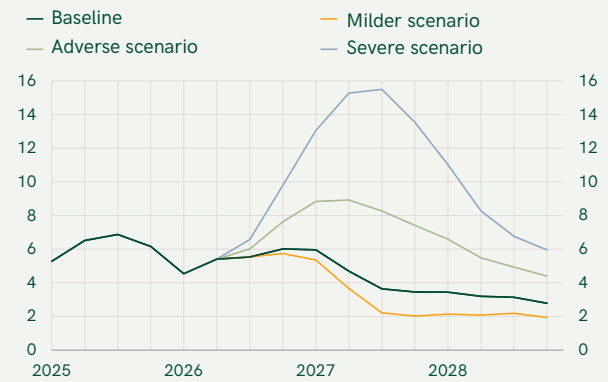
(a) Inflation (based on HICP)

(per cent)



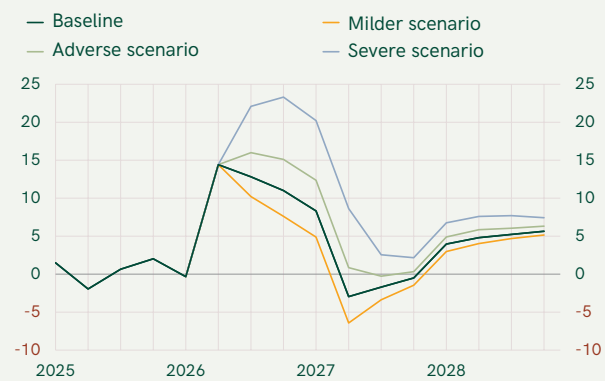
(b) Food Inflation

(per cent)



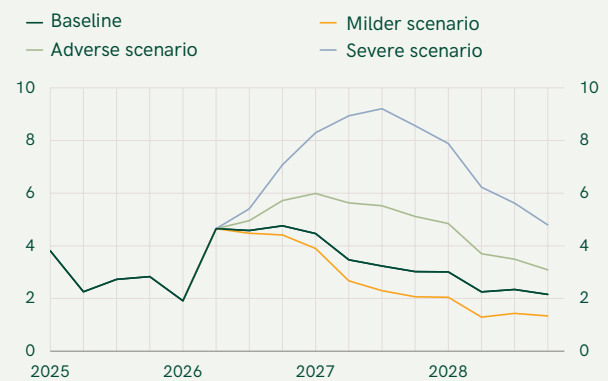
(c) Energy Inflation

(per cent)



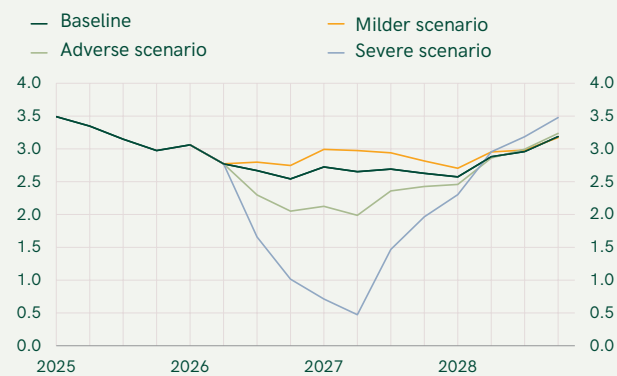
(d) Core Inflation

(per cent)



(e) Real GDP Growth

(per cent, annual growth)



Source: BNB calculations.

