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European Economic Forecast

Summer 2022

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EUROPEAN ECONOMY

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European Economic Forecast

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Institutional Paper 183

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RUSSIA'S WAR WORSENS THE OUTLOOK

As the reality of a protracted Russian invasion of Ukraine sinks in, the assessment of its economic consequences for the global economy is turning grimmer. The shocks unleashed by the war are hitting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. The rapid increase in energy and food commodity prices is feeding global inflationary pressures, eroding the purchasing power of households and triggering a faster monetary policy response than previously assumed. Furthermore, the deceleration of growth in the US is adding to the negative economic impact of China's strict zero-COVID policy.

Whereas prices of some commodities are retreating from recent peaks, the EU economy remains vulnerable to developments in energy markets due to its high reliance on Russian fossil fuels. With gas prices nearing all-time highs energy inflation is on the rise. Food inflation is also surging, but pressures are broadening further as higher energy costs are passed-through to services and other goods. Lower income households are especially hit by the protracted rise in prices. Whereas businesses still eye an expansion of economic activity, they are less optimistic about the future, which will weigh on investment. Households are just as negative about the future as they were at the onset of the pandemic, which is set to drag on the recovery of private consumption.

Overall, real GDP is forecast to grow by 2.7% in 2022 and 1.5% in 2023 in the EU and by 2.6% in 2022 and 1.4% in 2023 the euro area. The projected annual growth rate for this year is propped up by the momentum gathered with the recovery of last year and a stronger first quarter than previously estimated. Both bring acquired growth at the first quarter of this year to a solid 2.7% for the EU and 2.4% for the euro area. Economic activity is expected to have weakened in the second quarter, but should regain some traction during summer, thanks to a promising tourism season. In 2023, economic growth is expected to gather some momentum, on the back of a resilient labour market, moderating inflation, support from the Recovery and Resilience Facility and a still large amount of excess savings. However, on an annual basis there is a downward revision of almost one percentage point compared to the Spring Forecast.

Inflation in the euro area is projected to peak at a new record high of 8.4% in the third quarter of 2022. As the pressures from energy prices and supply constraints fade, inflation is expected to decline steadily thereafter and to fall below 3% by the end of 2023. The annual rates of 7.6% in 2022 (8.3% in the EU) and 4.0% in 2023 (4.6% in the EU) imply upward revisions by more than one percentage point from the Spring Forecast.

Risks to the forecast for economic activity and inflation are heavily dependent on the evolution of the war. Further increases of gas prices could strengthen the stagflationary forces currently at play. Second round effects could amplify these forces and lead to a sharper tightening of financial conditions that would not only weigh on growth, but also on financial stability. At the same time, recent downward tendencies of oil and other commodities' prices could intensify, bringing about a faster deceleration in inflation. Moreover, private consumption could prove more resilient to increasing prices if households were to use more of their savings. Finally, COVID-19 remains a risk factor.

Table 1:
Overview - the Summer 2022 interim Forecast

	Real GDP growth						Inflation					
	Summer 2022 interim Forecast			*Spring 2022 Forecast*			Summer 2022 interim Forecast			*Spring 2022 Forecast*		
	2021	2022	2023	*2021*	*2022*	*2023*	2021	2022	2023	*2021*	*2022*	*2023*
Euro area	5.3	2.6	1.4	5.4	2.7	2.3	2.6	7.6	4.0	2.6	6.1	2.7
EU	5.4	2.7	1.5	5.4	2.7	2.3	2.9	8.3	4.6	2.9	6.8	3.2

1. EURO AREA AND EU OUTLOOK

1.1. SETTING THE SCENE

In just two months since the Spring 2022 Forecast was released, many of the negative risks surrounding it have materialised. The Spring Forecast identified as downside risks “shocks reverberating from an unpredictable evolution of energy markets”, “tighter financial conditions than those underpinning the forecast”, a “much sharper deceleration [in the US]” and pandemic-related lockdowns “[…] resulting in lower-than-expected economic activity in China”. These risks have largely materialised.

The escalation of tensions between Russia and the EU, as a result of the Russian invasion of Ukraine, put additional upward pressures on gas prices. The Brent crude oil price hit 117 USD on 13 June, but retrenched thereafter amidst growing evidence of slowing global demand. Disruptions in Russian gas supply and concerns over further cuts pushed up again the European benchmark gas price. By end June, it was trading at above 140 EUR MW/h – more than six times the price one year earlier. Compared to the Spring Forecast, the oil futures curve that underpins this forecast points to slightly higher prices over the forecast horizon, especially in the near term. Gas and electricity futures point to more substantial upward pressures – particularly leading up to next winter.

Intensifying and broadening inflationary pressures are prompting faster normalisation of monetary policy in the euro area. Inflation continued to rise in May and in June, pushed up by strong increases in energy and food prices. The ECB pledged to increase interest rates for the first time since 2011 in July, by a quarter percentage point, and is leaving the door open for a bigger move in September, unless there is a rapid improvement in the inflation outlook. The euro area yield curve underpinning the forecast shifted up. Compared to the cut-off date for the Spring Forecast, the euro area 10 year bond rate, calculated as an average over the period between 17 and 30 June was up by some 60 pps. The weakening growth outlook has led to some softening in long-term interest rates over the past two weeks – but rates remain well above their level back in spring. Monetary conditions have tightened earlier and more significantly in a number of non-euro area Member States than in the euro area, especially in Central and Eastern Europe.

The US economy is set to decelerate markedly. US headline inflation climbed again in May to a 40-year high, as food, energy, services and housing charges picked up pace. The Federal Reserve is adjusting to high inflation readings with fast normalisation of monetary policy, which has led to a sharp tightening of financial conditions. Inflation expectations have adjusted downwards swiftly, but so have expectations for future growth. Most forecasters expect that the US economy will decelerate markedly, but still manage a soft landing. Yet, the risks of a (mild) recession have increased.

The damage from the strict lockdowns implemented in China appears larger than previously expected. COVID-19-related restrictions have been gradually eased since the cut-off date of the Spring Forecast in some Chinese regions. Yet by mid-June, some eight cities with 74 million citizens were still in full or partial lockdown. At the same time, the magnitude of the economic damage stemming from the spring lockdowns is becoming evident, prompting significant downgrades in this year’s growth forecast. The authorities remain firmly committed to the zero-COVID policy and adjustments are unlikely at least until the party congress in the autumn.

Finally, consumer confidence plummeted and the household saving rate reversed course in the first quarter. Consumer confidence plummeted in March and continued to drop throughout June to levels close to the historical dip of April 2020, at the beginning of the COVID-19 pandemic. The uptick in the euro area household saving rate recorded in the first quarter likely reflected this lower confidence as well as pandemic-related measures which restricted consumption opportunities in the beginning of the quarter.

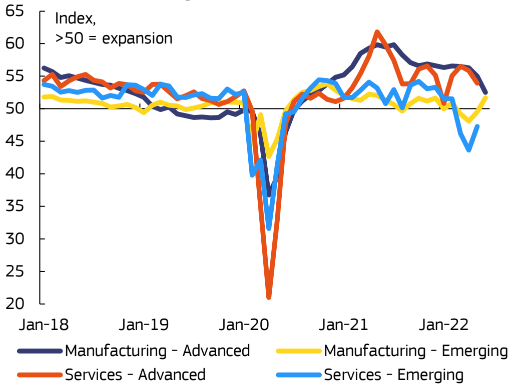
These developments set the EU economy on a path of lower growth and higher inflation compared to the Spring Forecast. The EU economy posted a positive growth surprise in the first quarter of 2022 – with real GDP growth at 0.7%, up from 0.3% in the Spring Forecast. However, the shocks outlined above push the EU economy away from the Spring Forecast baseline projections. The model-based adverse scenario accompanying the Spring Forecast envisaged that a 25% increase in energy commodity prices, coupled with lower global demand, lower consumer confidence and higher cost of funding for firms would slow growth by a cumulative 1.5 pps. and lift inflation up by more than 1 ppt. by 2023. ([1]) The magnitude of shocks materialised since spring is more benign, and so is the revision to the growth outlook. At the same time, the larger magnitude of upward revisions to the inflation projections suggests that the breadth of underlying inflationary pressures is stronger than expected.

1.2. THE GLOBAL ECONOMY: RECENT DEVELOPMENTS AND OUTLOOK

Global economic activity slowed down in the first quarter of 2022, amid headwinds. Under the impact of the pandemic, rising prices and tightening financial conditions, global output decelerated to 0.7% q-o-q in the first quarter of 2022, after a strong 1.7% q-o-q in the previous quarter. Real GDP growth in advanced economies (ex. EU) flattened in the first quarter of 2022. Notably, activity contracted in the US, Japan and parts of Asia. Growth in China was held back by lockdowns, which mainly affected consumption, but, with ample fiscal and monetary support, China still managed a decent rate of expansion. Growth declined in EMEs amidst rising input costs and tightening financing conditions.

The global growth momentum weakened further in the second quarter. While remaining in expansionary territory in the second quarter, Global PMIs declined. The slowing growth momentum was driven by an important slowdown in China.

Graph 1.1: **Global PMIs**

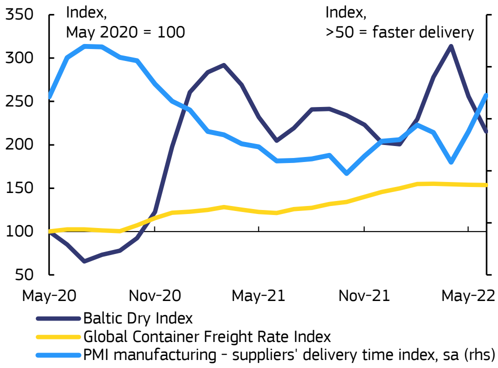


Source: S&P Global

Logistic and supply chain disruptions continue to hamper global activity, though signs of easing are emerging. Persistent lockdowns in some of the key manufacturing and transport hubs in China led to congestion in Chinese ports, adding stress on global value chains. Shipping congestion has also been on the rise in several North European ports, but eased on the US West Coast. At the same time, global shipping costs such as the Baltic Dry Index have retreated from the highs reached in 2021 (e.g. shipping rates for bulk cargo and container freight have fallen 59% and 36% from their 2021 peaks, respectively), on the back of a slowdown in demand and the re-pivoting of household consumption towards services. The J.P. Morgan Global Manufacturing PMIs' global delivery times also pointed to a modest improvement in transport bottlenecks, but remain elevated. Both the New York Fed's Global Supply Chain Pressure Index (GSCPI) and the S&P Global PMI Commodity Price and Supply Indicators show that global supply disruptions have resumed their declining trend. Also pointing to declining supply pressures, the PMI's orders-to-inventories ratio declined strongly in the EU and, to a lesser extent, in Japan, and moderated in emerging markets, albeit remaining relatively high in the United States.

([1]) For further details, see Special Issue in European Commission (2022), European Economic Forecast Spring 2022, Institutional Paper 173, May 2022.

Graph 1.2: **Global freight indices and PMI's suppliers' delivery times**

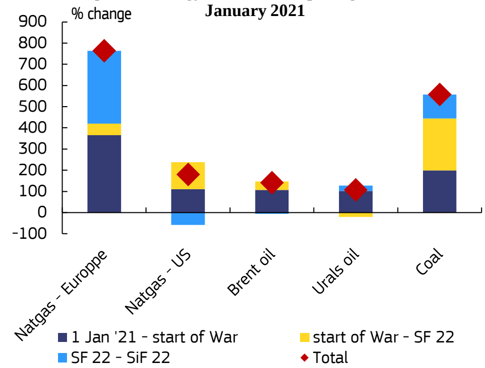


Sources: Baltic Exchange and Freightos, S&P Global

Geopolitical tensions continued to impart major shocks to energy prices. Global oil prices have increased slightly since spring and remain elevated due to low storage levels, limited additional production capacity or limited commitments among several producers to increase production further. Brent crude oil prices averaged around 113 USD/bbl in 2022-Q2, up from 100 in 2022-Q1, while the Urals crude oil has kept selling at a discount of around 35% throughout the second quarter. The average benchmark for European gas prices stood at 101 EUR/MWh in 2022-Q2, which is more than four times the price in the same period last year. Moreover, prices accelerated sharply in the last weeks of June, on the back of rising concerns about deliveries (see Graph 1.3). In late May, the announcement of a 40% reduction of gas supply capacity of the Nord Stream 1 pipeline to Germany and a 15% cut in Gazprom supplies to Italy added to the cut in LNG imports following an explosion at the LNG terminal in Freeport (US), which exports roughly 70% of its supply to the EU and the UK. Decoupling of the US and European benchmark gas prices continued, with quotations at the US Henry Hub trending down in June on reports of a larger than expected storage level.

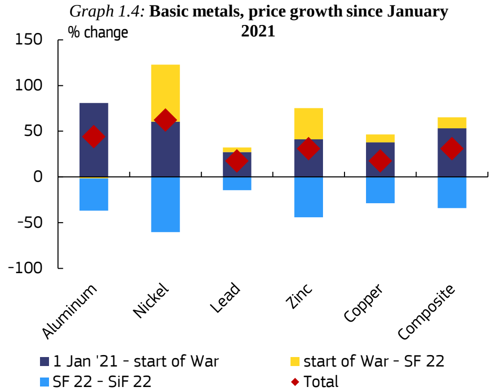
Metal and food prices have retreated in recent weeks. The prices of important metals used for construction and electrification like copper, steel and aluminium fell strongly since the Spring Forecast, reflecting the slowdown in global demand (see Graph 1.4). Food prices also moderated in recent weeks, but are still up by 30% compared to the same period in 2021, with cereal prices (e.g. wheat) affected the most by the war in Ukraine (see Graph 1.5). For the EU, these declines are partially offset by the depreciation of the euro and other EU currencies vis-à-vis the dollar.

Graph 1.3: **Energy commodities, price growth since January 2021**



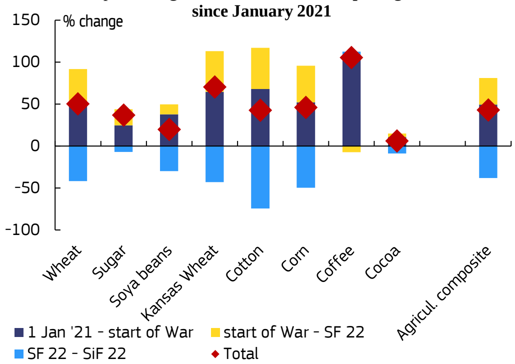
Source: Own calculation based on data from Commodity Research Bureau, ICE, NYMEX, investing.com, ECB (exchange rates)

Graph 1.4: **Basic metals, price growth since January 2021**



Source: Own calculation based on data from Standard & Poor's/Goldman Sachs, ECB (exchange rates)

Graph 1.5: **Agricultural commodities, price growth since January 2021**



Source: Own calculation based on data from Standard & Poor's/Goldman Sachs, ECB (exchange rates)

Global inflationary pressures keep mounting. Global inflation reached 6.4% in

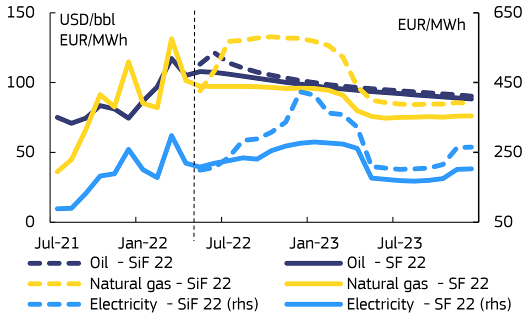
April, as reported by the US Dallas Federal Reserve, reflecting surging commodity prices, persistent supply disruptions and tight labour markets in some advanced economies. Notably, inflation reached a 40-year high of 8.6% in the US in May, as price pressures initially concentrated in the durable goods sector spread to services. Likewise, US non-energy goods inflation remained elevated, though moderating demand has started to reduce this pressure. Inflation in many EMEs remains notably high, especially in Russia and Brazil. It is increasing in many parts of Asia, with the notable exception of China, where growth in consumer prices remains contained and decoupled from rising producer prices.

Going forward, based on futures the prices of oil and agricultural commodities are expected to moderate. Markets expect oil price pressures to abate in 2023 on the back of additional supply from non-OPEC countries as well as weaker global outlook. Overall, oil prices are assumed to average 108 USD/bbl in 2022 and 96 USD/bbl in 2023, marginally higher in both years than expected in spring, but substantially higher than in 2021 (71 USD/bbl). The global supply of cereals is expected to decline in 2022 amid lower exports from Ukraine and rising input prices (e.g. fertilisers, energy). The increase in cereal prices also affects the price of meat production, as it increases feed costs. The futures curve for wheat shifted down compared to spring, but remains relatively flat, suggesting that markets expect wheat prices to remain at elevated levels in 2023. A fall in the exports of cereals from Ukraine and high input prices are expected to keep food prices high in 2022. All in all, the futures curves for major staple agriculture commodities like corn, soya beans, rice and cocoa have declined somewhat compared to spring and remain on a downward trajectory as from the second half of this year.

In the near term gas and electricity prices are set to keep rising in Europe. Russia's disruption of gas supplies to Europe led to an upward revision in the assumed European TTF gas prices. While gas storage levels in Europe have increased to almost 60%, almost double the rate in winter, uncertainty about flows from Russia mainly, but also hiccups in US LNG supply and maintenance of nuclear power plants in France, are keeping gas prices in Europe at elevated levels. Futures imply gas prices that are on average 18% and 20% higher in 2022 and 2023 compared to the Spring Forecast, while average electricity futures in Europe show increases of 13% and 28%, respectively (see Graph 1.6).

The outlook for the US and China is weaker than in spring. In the US, tightening monetary policy and a drag on consumption from persistently high inflation are behind a tangible downward revision to growth in 2022 and 2023. However, a resilient labour market, strong corporate investment and still elevated excess household savings should support growth. Growth has also been revised lower for China as there are clear indications that the property sector, a mainstay of growth during the past years, is facing challenges, if not an outright decline.

Graph 1.6: **Energy commodity price assumptions**



Note: The assumptions are based on 10-day moving averages of future prices. For wholesale electricity price assumtions, a weighted average of data from DE, FR, IT, ES, NL, BE and AT is used.
Source: ICE Futures Europe.

Global activity and EU external demand have been revised down compared to the Spring Forecast. Despite a general reopening of most economies, the outlook is hampered by the impact of the war on commodity markets, declining sentiment and an accelerated tightening of global financing conditions. Overall, real global GDP (excluding the EU) is now expected to grow by 3.0% in 2022 and 3.3% in 2023 (see Table 1.1). This is respectively 0.3 pps. and 0.4 pps. less than in spring. With global momentum weakening, global import volumes (ex EU) are expected to grow by 4.1% in 2022 (-0.8 pps. compared to the Spring Forecast) and 3.6% in 2023 (-0.7 pps. compared to the Spring Forecast), reflecting in particular downward revisions in projected trade volumes for China and US in both 2022 and 2023.

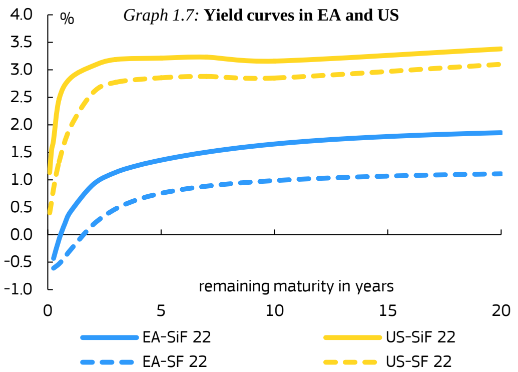
Table 1.1:
International environment

(Annual percentage change)	2018	2019	2020	Summer 2022 interim forecast 2021	2022	2023	Spring 2022 forecast 2021	2022	2023
				Real GDP growth					
World (excl.EU)	3.7	3.0	-2.8	**5.9**	**3.0**	**3.3**	*5.9*	*3.3*	*3.7*
				Trade volumes					
World (excl.EU) exports of goods and services	3.9	0.1	-7.2	**10.0**	**3.4**	**3.6**	*10.3*	*3.8*	*4.5*
World (excl.EU) imports of goods and services	4.3	-0.6	-8.5	**10.9**	**4.1**	**3.6**	*10.9*	*4.9*	*4.3*

Global inflation is expected to remain high until the summer, and gradually moderate towards the end of the year and into 2023. Part of the decline in 2023 is due to negative base effects, reflecting declining commodity futures. The slowdown in global demand will also alleviate current supply pressures and input costs. At the same time, drivers of inflation are expected to differ across countries. In advanced economies, tight labour markets are set to push wage growth higher and thus keep inflation elevated and above central banks' policy targets. The assumed policy tightening is however expected to hit growth and inflation expectations and thus put brakes on further increases in inflation. In a number of EMEs, the exposure to high commodity prices compounded by a currency depreciation versus the dollar exacerbates inflationary pressures.

Capital inflows into EMEs have moderated since the beginning of the year reflecting the risk-off environment and fears of a delayed recovery in EMEs, while the US Dollar appreciated strongly during the spring and early summer. This will add to the stress several EMEs face from the high food price inflation combined with, in some cases, debt distress.

Graph 1.7: **Yield curves in EA and US**



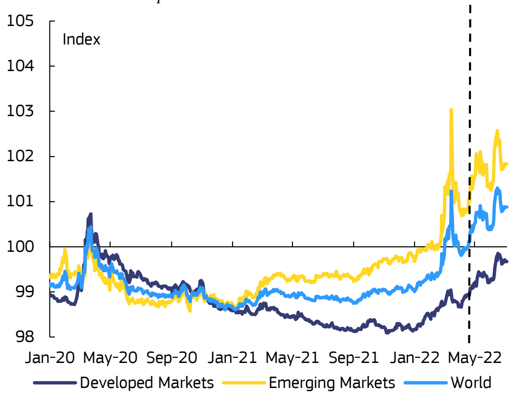
Note: Average par yield rates, average yields in the reference period of the forecast assumptions (17-30 June for SiF22 and 14-27 April for SF22).
Sources: ECB for Euro area, US Department of Treasury for US.

1.3. FINANCIAL MARKETS

Central banks around the world have accelerated on their monetary policy tightening path. Monetary policy in advanced economies is being tightened faster than previously expected in response to rising inflation, including core inflation. In the US, the Fed accelerated the pace of monetary tightening with a 75bps. rate hike in June. Markets have lifted their expectations of short-term US rates for this year and next. Other central banks in advanced economies have followed suit, with the notable exception of the Bank of Japan, which left its key short-term interest rate unchanged at -0.1% while continuing unlimited bond buying. Meanwhile, central banks in Emerging Market Economies (EMEs) continued the tightening cycle they mostly started already in 2021. The tightening cycle in the US is likely to contribute to further tightening of global financing conditions, notably in some EME and low-income countries.

Global financing conditions have tightened further since the Spring Forecast. Advanced economies have experienced further equity market losses and rising bond yields, both sovereign and corporate. In the US, equity markets underwent a sharp correction while the 10-year government bond yield increased from around 2.95% beginning of May to almost 3.5% mid-June, before falling back slightly below 3% as the economy appeared to slow down and fears of a US recession increased. Meanwhile EMEs sovereign spreads widened further, as tighter financial conditions, slowing global growth and a pick-up in market volatility continued to weigh on EMEs assets (see Graph 1.8).

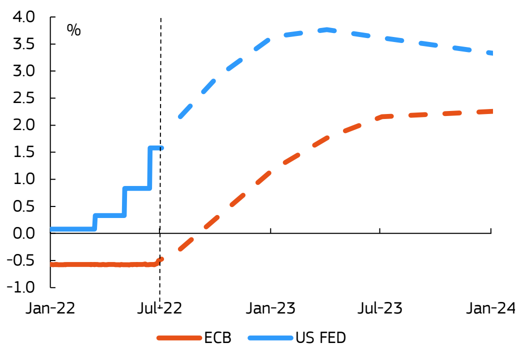
Graph 1.8: **Global financial conditions**



Source: Goldman Sachs Research.

The ECB is accelerating its move towards normalisation of monetary policy. With medium and long term inflation expectations rising above target, the ECB moved onto a more forceful normalisation of monetary conditions. At its latest meeting on 9 June, the ECB Governing Council announced the end of net asset purchases as of 1 July and pledged to increase interest rates by 25bps. in July, and possibly by more than 25bps. in September if there are no signs of abating inflation. Beyond that, the ECB anticipates a gradual but sustained path of further increases in interest rates. In the period between 17 and 30 June – the reference window used for this forecast – markets expected the euro-area short-term rates to increase by 190bps. between July and the end of 2022 and to increase further by around 90bps. by the end of 2023 (see Graph 1.9). Since then though, markets have shifted their expectations towards more modest increases in short-term rates, reflecting a grimmer economic outlook that would require a less forceful tightening by central banks.

Graph 1.9: **Policy rates, past and expected**



Note: values are those of the reference period for this forecast, the average between 17 to 30 June

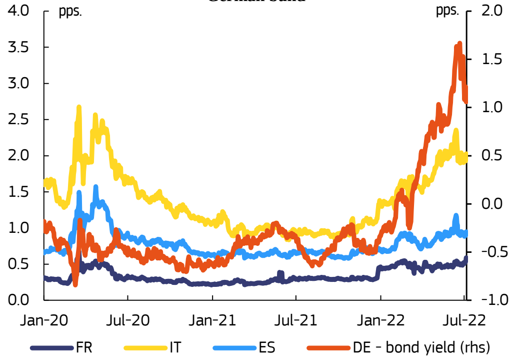
The euro has kept sliding in nominal effective terms, largely reflecting the strength of the US dollar. Since the end of April, the euro depreciated moderately in nominal effective terms (-0.7%) but slid more significantly against the US dollar (-2.2%) amid a faster monetary policy normalisation in the US than in the euro area and the preserved safe-haven role of the US dollar. In a context of high exchange rate volatility, the euro also depreciated strongly against the Russian ruble (-30% since the Spring Forecast cut-off date), reflecting Russia's positive trade balance and financial controls that prevented Russians from buying foreign currency. At the same time, the euro appreciated against a broad panel of currencies such as the Japanese yen, the British pound and a couple of EU non euro area currencies such as the Swedish krona and the Hungarian forint ([2]).

Bond yields increased across the board amidst growing spreads both within the EU and within the euro area. In the period between 17 and 30 June, the 10-year German bund yield averaged 1.57%, up from 1.0% early May but lower than the almost 1.8% reached mid-June. Since end June, it has further retreated with expectations about inflation returning towards target (see Graph 1.20). Spreads of EU Member States with high public debt have increased since the ECB signalled a more forceful normalisation of monetary conditions and the end of additional purchases under the Asset Purchase Programme. At an ad-hoc meeting on 15 June, the ECB Governing Council decided to use the flexibility in the Pandemic Emergency Purchase Programme reinvestments in response to increasing financial fragmentation risks that would contribute to an uneven transmission of monetary policy normalisation across the euro area. Furthermore, the ECB Governing Council announced it will accelerate the completion of the design of a new anti-fragmentation instrument. Since this announcement, euro area sovereign spreads have partially reverted the increases recorded since spring (see Graph 1.10). In Central and Eastern EU, sovereign spreads have widened further since spring as

([2]) Exchange rate developments are based on a comparison between the average exchange rates over the 10-day period ending on 27 April for the Spring Forecast and the average exchange rates over the 10-day period ending on 30 June 2022.

monetary conditions continued to tighten in response to additional inflationary pressures. While higher nominal rates will increase interest expenditure, the impact on the sovereign budgets will kick in with a delay thanks to the large share of debt locked in at long maturities and record-low rates.

Graph 1.10: **Sovereign bond yields and spreads to German bund**



Source: IHS Markit

Funding costs for the private sector are also rising. Equity markets declined and corporate bond spreads continued widening, both in the investment grade and in the high-yield segments, leading to rising market-based funding costs for EU enterprises. Bank lending rates have increased for companies and households amidst broader tightening of banks' credit standards while loan demand remains robust. ECB data show that the annual growth rate of adjusted loans to households stood at 4.6% in May, compared with 4.2% in December 2021, while the annual growth rate of adjusted loans to enterprises rose to 5.8% in May, from 4.3% in December 2021. (3) While corporate insolvencies and nonperforming loans could possibly rise, banks are relatively well capitalised to withstand losses.

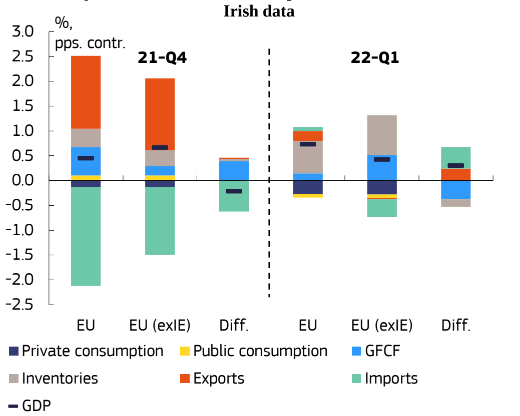
1.4. RECENT ECONOMIC DEVELOPMENTS IN THE EU

1.4.1. Economic activity developments

GDP growth in the EU in 2022-Q1 came in stronger than previously estimated. EU real GDP increased by 0.7% in the first quarter of this year (q-o-q), following +0.5% in 2021-Q4. This is higher (by 0.3 pps.) than the preliminary flash estimate incorporated in the Spring Forecast. The main contribution to growth came from the build-up of inventories, which added 0.7 pps. to growth in the first quarter.

Disregarding volatile growth developments in Ireland, GDP in the rest of the EU decelerated from 0.7% in 2021-Q4 to 0.4% in 2022-Q1. The growth dynamics around the turn of the year are heavily affected by activities of multinational enterprises in Ireland (see Box 1.1 and the country section). This has left its mark on GDP developments in the EU, affecting particularly the contributions of exports, imports and investment (see Graph 1.11).

Graph 1.11: **Recent GDP developments and the effect of Irish data**



Investment weathered well the intensifying headwinds in the first quarter, highlighting resilience of the corporate sector. (4) Investment growth in the EU (excl. Ireland) accelerated to 2.4% (q-o-q) in the first quarter, after 0.9% in the preceding quarter, and contributed 0.5 pps. to GDP growth. (5) The surge was broad-based across components, with construction investment growth accelerating to 6.0% (from 1.9%) and

(3) Figures are adjusted for loan sales, securitisation and notional cash pooling

(4) To obtain a better picture of the underlying investment dynamics, this paragraph describes developments for the EU excluding Ireland.

(5) Investment growth was also very volatile around the turn of the year in both Malta (-15.0% in 22-Q1 after -1.8%) and Cyprus (+54.4% in 22-Q1 after -28.6%). However, given their much lower share in total investment, these movements affect the overall aggregate to a lesser extent than the Irish data.

Box 1.1: **Irish GDP developments and multinational enterprises' activities**

The upward revision of the EU GDP growth rate in the first quarter of 2022 - to 0.7% q-o-q from 0.3% based on Eurostat's preliminary flash estimate - was almost entirely driven by real GDP of Ireland, which increased by a sizeable 10.8%. Irish growth in 2022-Q1 was driven by net exports (+72.6% q-o-q), which more than offset a contraction in investment (-39.4% q-o-q). The opposite pattern drove the 6.2% q-o-q GDP contraction in 2021-Q4.

Large volatility in Irish GDP (and some of its demand components) is not new, but it has increased substantially over the past decade as the weight of foreign-owned multinational enterprises (MNEs) progressively rose. ([1]) Ireland is not the only EU Member State hosting foreign-owned MNEs, yet their weight is so large in Ireland that it affects "standard" national accounts aggregates for both the Irish economy and the EU economy at large.

What drives volatility is not the large presence of MNEs per se, but rather some of the transactions they conduct, such as large-scale relocation of sales proceeds and assets across countries. These follow primarily from transfers of intellectual property assets between Irish and non-Irish subsidiaries of MNEs and contract manufacturing agreements (see below). ([2]) On top of this, Ireland is a major hub for MNEs operating in the aircraft leasing industry – with as much as 50% of the world's leased commercial aircraft managed from Ireland. ([3])

From a national accounts perspective, a number of these activities are broadly neutral in terms of their impact on aggregate GDP, though they affect its demand components. Other activities affect both GDP and its components.

For example, in the case of transfers of intellectual property assets across subsidiaries of a same MNE, normally the acquisition of the asset is recorded on the date of the transfer, implying a simultaneous increase in imports and gross fixed capital formation. As the magnitude of the two is broadly similar and time of recording always coincides, they cancel each other out with no effect on GDP in the quarter in which they are recorded. ([4]) The same applies in the case of acquisition of aircrafts by an Irish leasing company, with the acquisition being booked as imports of goods. ([5])

Contract manufacturing is a form of outsourcing, whereby an Irish hiring company enters an agreement with a foreign-based company to manufacture most or all parts of its products. In national accounts, the acquisition of material inputs and payment of royalties towards the patents required to make the final goods are registered as imports, even if production inputs never enter the territory. If (as is often the case) the final goods are sold to customers outside Ireland, these are booked as export of goods, even though the goods might never enter the Irish territory. ([6]) Time lags between acquisition of inputs and sales can lead to important fluctuations in GDP, with imports possibly being registered in one quarter and exports in subsequent quarters.

More recently, Ireland has also seen a surge in domestic value added in pharmaceuticals, thanks to the development of cutting-edge immunology drugs produced in Ireland. Moreover, sizeable investment in computer hardware production, e.g. the semiconductors plant at Leixlip, and significant expansion of

([1]) According to the Irish Central Statistical Office, foreign owned MNEs represented more than 85% of value added in the industries of Chemicals and chemical products, Software and communications sectors, Reproduction of recorded media, Basic pharmaceutical products and pharmaceutical preparations, Computer, electronic and optical products, Electrical equipment, Medical and dental instruments and supplies.
([2]) The impact of multinationals' transfers on Irish GDP | Banque de France (banque-france.fr)
([3]) According to the Central Bank of Ireland, the impact of the aircraft leasing sector on GDP can be approximated by the share of Operational Leasing revenues from BOP statistics in GDP. This ratio was about 4% in 2021.
([4]) The intellectual property investment has however a net positive effect on future GDP developments, since (all things equal) it generally leads to lower imports/higher exports of royalty payments. A similar reasoning applies to the acquisition of aircrafts (see below).
([5]) Moving to a Transfer of Economic Ownership Basis for Trade in Aircraft - CSO - Central Statistics Office
([6]) Contract Manufacturing - CSO - Central Statistics Office

(Continued on the next page)

Box (continued)

several computer services companies located in Ireland boosted value added in the ICT sector. ([7]) Even if these sectors are dominated by MNEs, the related surge in investment, exports and imports largely reflects activity taking place in Ireland and – contrary to the transactions discussed above – cannot be seen as a "statistical distortion". The value of individual transactions and potential time lags in recording, nevertheless, are such that they also contribute to large fluctuations in GDP and components. (For a discussion of how these operations affected Irish GDP and demand components in 2021-Q4 and 2022-Q1 see the country section on Ireland).

The Irish Central Statistics Office (CSO) regularly publishes a number of alternative metrics, such as Modified Domestic Demand and Modified Gross National Income (or GNI*), that net GDP out of the MNEs-related activities. Modified Domestic Demand includes government consumption, household consumption and investment, excluding investment in imported intellectual property and aircraft for leasing. The aggregate is available on a quarterly basis. These statistical adjustments to Irish national accounts for domestic purposes, while useful to understand the dynamics of the (non-MNE) Irish economy, cannot be included in the EU or euro area GDP aggregates, as they are not based on internationally comparable definitions.

([7]) Contract Manufacturing - CSO - Central Statistics Office

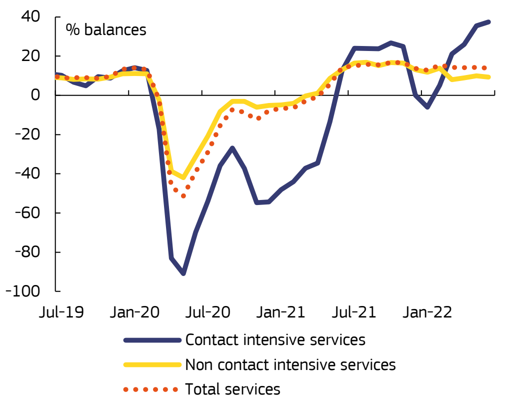
machinery and equipment investment growing strongly for the second quarter in a row (by 2.9% after 2.6%).

By contrast, real household consumption contracted for a second quarter in a row. Real private consumption in the EU decreased by 0.5% in the first quarter, following a drop of 0.3% in the last quarter of 2021. Faced with high inflation, consumers reduced the volume of their consumption, but still disbursed more than in the previous quarter. The wedge between nominal and real consumption was particularly large for non-durable consumer goods, which contracted by around 1% in real terms, while increasing in nominal terms by 4%. Retail trade data confirms that in response to rising fuel and food prices, households cut their consumption also on other categories of goods, including clothes. Real consumption of durable goods decreased too, likely also under the impact of long delivery times and high uncertainty. This is especially true for car parts and repairs as well as for information and communication equipment, where the volume of retail sales contracted by between 1% and 2% q-o-q in the first quarter. Households on lower incomes are impacted the most by the high energy bills and food prices, as a larger share of their spending is on these basic items (see Box 1.2). Persisting pandemic-related restrictions also explain part of the weak consumption, as that of services increased only modestly.

The household saving rate edged up again in the first quarter, while household investment increased further. According to preliminary 2022-Q1 sector accounts, the household saving rate increased to 15% (from 14.1% in the previous quarter). Households allocated a lower share of the increase in nominal disposable income to consumption. This halted the continuous decline in the household saving rate observed since the second quarter of 2021. At the same time, the investment rates for households increased further, reaching the highest value since the first quarter of 2009.

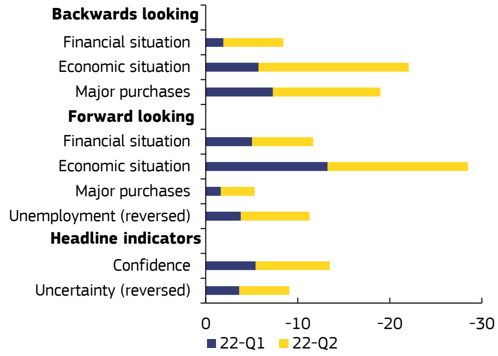
Business survey indicators lost momentum over the second quarter but remained at relatively high levels. According to the European Commission's business surveys, confidence in industry has declined significantly from its record high pre-war levels but remains well above its long-term average. The decrease is mainly due to a significant drop of production expectations, signalling some fading of momentum. At the same time, the assessment of order books managed to stay close to historical highs. Also managers' assessment of past production trends remained broadly stable over the second quarter. On the upside, the S&P Global manufacturing PMI supply delivery indicator shows that supply side bottlenecks are attenuating in the euro area. For the services sector, the European Commission's survey points to a stable assessment of the past business situation and an improvement of the assessment of past demand in the course of the second quarter, when the sector benefitted from the reopening momentum in contact intensive services (see Graph 1.12). However, in industry, the outlook on expected demand worsened, foreshadowing a slowdown of activity in the near future.

Graph 1.12: **Confidence in service subsectors in the EU**



In contrast, consumer confidence has plummeted. Compared to the first quarter, confidence among households declined from a quarterly average of -14.6 to -22.6 in the second quarter. The June reading of -24.0 brought the index close to the historic low observed at the onset of the COVID-19 crisis. The quarterly decline is due to a more pessimistic assessment of households' past and future financial situation (which hit a record low in June) as well as of the general economic situation (see Graph 1.13). In addition, a strong rise in perceived inflation went hand in hand with a significant downward revision of consumers' intentions to make major purchases amidst record high levels of consumer uncertainty. Mirroring consumers' worsened outlook, also the European Commission's retail trade confidence indicator fell markedly over the second quarter. Retail trade data confirm a shift in consumer sentiment: the sales volume decreased (-1.3% m-o-m) in April and, based on data available from some Member States, should deliver only a small rebound in May.

Graph 1.13: **Change in consumers' assessment of past and present developments in the EU since 2021-Q4**



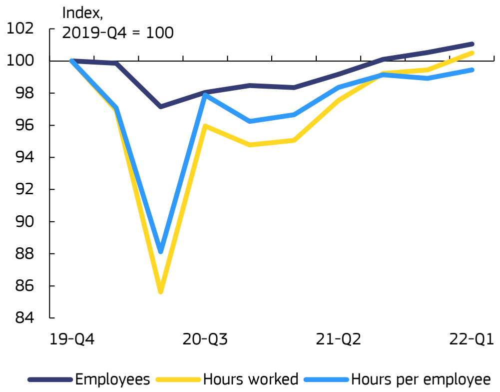
Note: The graph presents absolute changes in quarterly averages.

1.4.2. Labour market developments

Labour markets entered the year on a strong footing. According to national accounts data, the number of employed persons in the EU increased by 0.5% in the first quarter of this year, exceeding its pre-pandemic level by about 2.2 million persons. The relaxation of containment measures throughout the quarter allowed many workers to exit job retention schemes. The number of people covered by such schemes in the euro area is estimated to have decreased from 1.6% of the labour force in December 2021 to 1.1% in March this year. [6] Coupled with headcount employment gains, total hours worked increased by 1.1% compared to the last quarter of 2021. With this strong performance, hours worked in the EU surpassed (by 0.5%) the pre-pandemic level for the first time since the pandemic broke out (see Graph 1.14). Still, hours worked per employee remained below the pre-pandemic level. In May, the unemployment rate in the EU remained at the series' low of 6.1% recorded in April, following an extended period of notable reductions.

[6] ECB (2022), Economic Bulletin, Issue 4 June 2022

Graph 1.14: **Employment, EU**



Employment gains were broad-based across sectors and countries. The contact-intensive sectors were a major contributor to total headcount employment growth, followed by the construction sector. Other sectors recorded lower, but largely positive rates of change. Labour markets in most Member States performed strongly, with only Croatia and Italy registering virtually no change in headcount employment compared to the previous quarter. Italy, along with five other Member States – Czechia, Latvia, Slovakia, Bulgaria and Romania (7) – saw their headcount employment still short of pre-pandemic levels.

Strong demand for labour further tightened labour markets. The vacancy rate continued to increase in the EU in the first quarter, reaching a new multi-year high. A continuous decline in labour market slack (8) up until the first quarter of 2022 underscores labour market tightness. In addition, the assessment of labour as a factor limiting production hit an all-time high in the service and industry sectors in April and remained close to an all-time high in construction in June, according to the Commission's surveys.

Labour markets are expected to remain resilient, but employment growth is set to soften. Decreasing slack in the labour market, coupled with strengthening headwinds, are set to slow down the dynamics in labour markets in the near term. The composite PMI Employment Index for the euro area decreased strongly in June from a multi-month high in May, though still signalling unabating employment growth in the second quarter. In addition, the Commission's business surveys underscore the slowing momentum as the Employment Expectations Indicator for the EU has been retreating somewhat since March, although remaining considerably above its long-term average until June. Demand for labour is envisaged to soften in industry, construction and retail, while in services it is likely to remain strong in the near term.

Tight labour markets are setting the stage for faster, albeit still moderate, wage growth, partly mitigating losses in real disposable income. The ECB Indicator of negotiated wage rates in the euro area increased by 2.8% in the first quarter of 2022, the highest reading since the first quarter of 2009. However, the pick-up was largely driven by German data on the back of high special payments and corona bonuses. (9) At the same time, compensation of employees per employee grew at an above-historical average rate for three consecutive quarters (10), posting a 0.9% q-o-q (1.1% in the EU) rise in the first quarter of 2022, largely driven by the increase in hours worked. Hourly wages thus increased by a more modest 0.3% (0.6% in the EU). In real terms, wage growth remained negative. Wages are likely to continue rising at a swift pace, partially mitigating losses in real incomes. At the current juncture, a persistent feedback loop between wages and inflation is unlikely to develop. The limited practice of wage indexation to past inflation and anchored longer-term inflation expectations, together with government interventions aiming at mitigating the impact of high energy prices, should prevent excessive wage growth. In addition, the objective of job security pursued by unions amid elevated

(7) A break in Romania's employment series in 2021-Q1 makes the comparison less reliable. However, Labour Force Survey data confirm that employment in Romania in 2022-Q1 did not reach its pre-pandemic level.

(8) According to Eurostat's definition, labour market slack is the sum of unemployed persons, underemployed part-time workers, persons seeking work but not immediately available and persons available to work but not seeking, expressed as a percentage of the extended labour force, which adds up the aforementioned sum and the employed persons. The presented figure covers an age class from 15 to 74 years.

(9) In Germany, negotiated wages jumped to 4.4% y-o-y. Adjusting for one-off payments, negotiated wages increased by 1.6%. See Deutsche Bundesbank, Monthly Report, May 2022.

(10) Job retention schemes continue to distort this measure of labour cost, though the impact is fading with the diminishing use of these programmes.

uncertainty surrounding economic prospects is also set to restrain wage demands. ([11])

1.4.3. Inflation developments

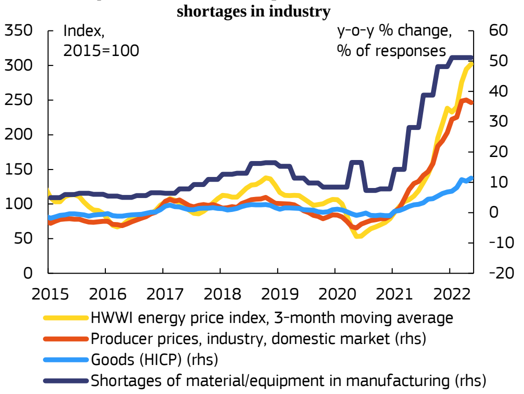
Headline inflation has hit record highs amid broadening price pressures. Inflation in the euro area grew strongly during the second quarter, from 7.4% y-o-y in March to 8.6% in June ([12]), a new all-time high. In the EU, the increase was even more pronounced, with inflation jumping a full percentage point from 7.8% in March to 8.8% in May.

Surging prices of energy remain the main inflation driver. Energy inflation in the euro area eased somewhat from its March high (44.3%) to 41.9% in June, concealing divergent trends in the three main components. Inflation of liquid fuels fell from a March high of 46.2% y-o-y to 36.3% in April, before rebounding in May on rising Brent prices. Meanwhile, gas price inflation continued its steady increase for more than two years now, hitting an all-time high of 52.9% y-o-y in May, reflecting a (partially regulated) pass-through from highly volatile wholesale (TTF) prices. In contrast, inflation of electricity prices moderated from the high of 41% y-o-y in March to 31.9% in May. Various fiscal measures (including tax cuts and price caps) introduced by Member States over the past 12 months have limited the increase in retail energy prices, in particular for electricity and gas.

Food prices continued to increase sharply. Food prices (incl. alcohol and tobacco) have accelerated markedly since the beginning of the year, hitting 7.5% y-o-y in May and 8.9% in June in the euro area, more than three times the rate in December 2021. Price increases were widespread across both unprocessed and processed food, with the June flash estimate indicating historical highs of 11.1% and 8.2% y-o-y, respectively. Food prices were driven higher by a combination of rising agricultural commodity prices and input costs in retail and catering, including wages and transport.

Prices of non-energy industrial goods and services accelerated in the second quarter. Inflation of non-energy industrial goods continued its upward trend in the second quarter (up to 4.3% y-o-y in the euro area in June), as persistent supply side bottlenecks, the depreciation of the euro and rising input costs combined with robust demand pushed prices up across various goods categories (see Graph 1.15). Consumer durables prices, traditionally detracting from EU inflation in the past decades (on the back of competitive imports from Asia) saw a particularly strong turnaround in the past 18 months, with inflation up to an all-time high of 5.6% y-o-y in May in the euro area, compared to an annual average of -0.1% on average in the period 2011-2020. Finally, prices of services accelerated from 2.7% in March to 3.5% in May, to remain broadly unchanged, at 3.4% in June (flash estimate) ([13]). Intensifying pressures across most service categories mainly reflect the post-COVID-19 surge in demand coupled with high energy prices and rising wages in a context of a tight labour market.

Graph 1.15: **Consumer and producer inflation and shortages in industry**



Sources: Hamburg Institute of International Economics (HWWI)

([11]) See Koester, G. and Grapow H. (2021): "The prevalence of private sector wage indexation in the euro area and its potential role for the impact of inflation on wages", ECB Economic Bulletin, No 7 or Izquierdo, M. and Soler, I. (2022): "An initial analysis of the impact of inflation on collective bargaining in 2022", Quarterly report on the Spanish Economy, 2022-Q1.

([12]) Figures for June refer to the flash estimate for the euro area.

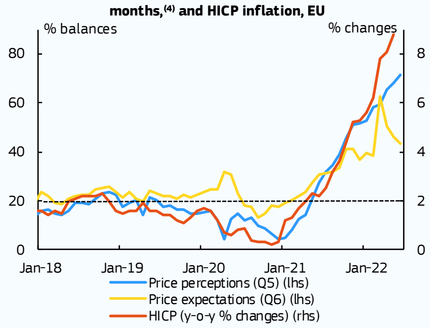
([13]) The introduction of a (massively) discounted train ticket in Germany that pushed services inflation into the negative in June (CPI, -1.2% m-o-m, seasonally adjusted) is likely to have temporarily weighed on the euro area services inflation in June.

Box 1.2: **The impact of inflation on consumers' financial situation – insights from the Commission's consumer survey**

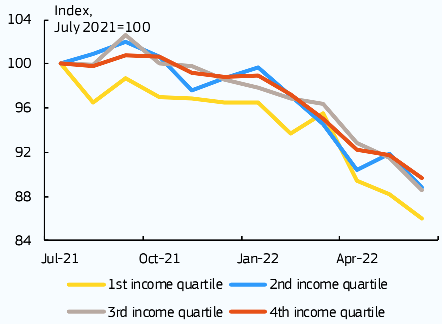
Rising inflation between January 2021 and June 2022 has increased the cost of households' per capita consumption by around €160 per month ([1]), on average. As energy bills and food prices go up, it is likely that it is households on lower incomes that suffer the most, as a larger share of their spending is on these basic items. ([2]) The analysis in this Box takes a close look at the results from the Commission's harmonised EU-wide consumer surveys ([3]) until June 2022 to explore the impact of high and rising inflation on consumers' assessment of the financial situation of their household and their consumption/saving intentions. Information on the socio-economic characteristics of the respondents in the survey allows to get insights into the distributional impact of rising inflation on consumption.

Reflecting inflation developments, an increasing share of consumers has been reporting rising prices since the beginning of 2021. In June 2022, a large and unprecedented share of consumers perceived a surge in prices over the previous 12 months (see Graph 1). ([4]) Similarly, consumers' expectations of price developments for the next 12 months started to rise already in October 2020, reaching record levels one year later. Following some stabilisation between November 2021 and February 2022, consumers' price expectations jumped to a new and unprecedented high in March 2022, in the aftermath of the outbreak of the war in Ukraine. In the same month, consumers' confidence plummeted by 9.1 percentage points compared to February. While consumer price expectations have then been dropping since April, they remain at levels unseen since February 1991. ([5])

Graph 1: **Consumers' perceptions of price developments over the past (Q5) and next (Q6) 12 months,[4] and HICP inflation, EU**



Graph 2: **Consumers' assessment of the past financial situation of their household, EU**



It is interesting to note that there is no visible difference in perceptions about price developments across income groups. Also, consumers' assessment of the financial situation of their household over the last 12 months ([6]) has been deteriorating for all income quartiles since July 2021, following several months

([1]) Based on consumption per-capita from National Accounts.
([2]) Based on the 2015 Household Budget Surveys, on average in the EU spending on food, electricity and gas accounts for 22.1% of total expenditure of the poorest quintile of EU households, compared to 15.4% for the highest-income quintile.
([3]) Methodological information on the consumer survey is available on the User Guide.
([4]) Question 5 reads "How do you think consumer prices have developed over the last 12 months? They have risen a lot/risen moderately/risen slightly/stayed about the same/fallen/don't know." Question 6 reads "By comparison with the past 12 months, how do you expect consumer prices will develop in the next 12 months? They will increase more rapidly/increase at the same rate/increase at a slower rate/stay about the same/fall/don't know." Percentage balances are the difference between positive and negative answer options, expressed as a percentage of total answers.
([5]) Consumers are also asked by how much (in % changes) they expect prices to change over the next 12 months. These "quantitative" inflation expectations – which are only published at a quarterly frequency– only slightly decreased in April, picked-up in May and increased further in June 2022. Quarterly results are available on the DG ECFIN BCS website.
([6]) Question 1 reads "How has the financial situation of your household changed over the last 12 months? It has got a lot better/got a little better/stayed the same/got a little worse/got a lot worse/don't know."

(Continued on the next page)

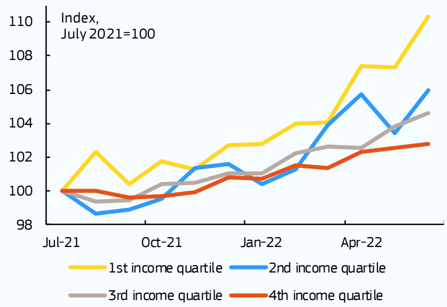
Box (continued)

of price increases. However, the deterioration has been more substantial for the lower-income group (1st quartile, see Graph 2).

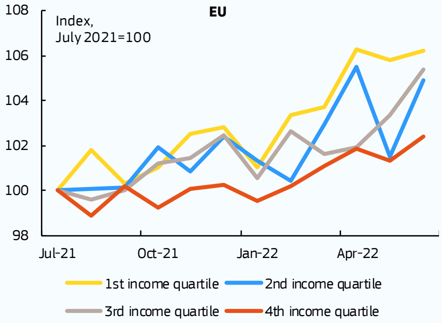
Focussing on the percentage of consumers replying that the financial situation of their household got *a lot worse* over the last 12 months (see Graph 3), the gap between high- and low-income households becomes more significant.

When asked about their household's financial situation, the share of respondents reporting to be in financial distress – that is, having to draw on their savings or running into debt ([7]) - is, as expected, higher among low-income groups. In July 2021, 21.6% of households from the 1st income quartile reported being in financial distress, against around 6% of respondents from the 4th quartile. Importantly, the gap between low-income and high-income groups has widened. Since July 2021, reported financial distress has risen sharply for the first quartile while the increase has remained contained for the fourth income quartile (see Graph 4).

Graph 3: **Share of consumers reporting that the financial situation of their household got a lot worse over the last 12 months, EU**



Graph 4: **Share of respondents reporting their household to be in financial distress, EU**

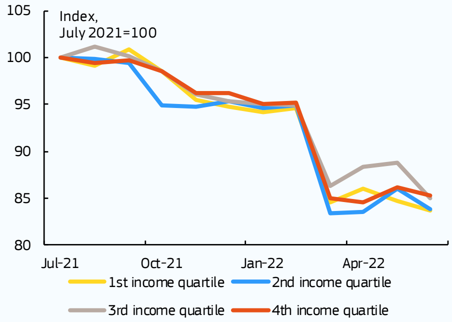


Consumers are pessimistic about the future

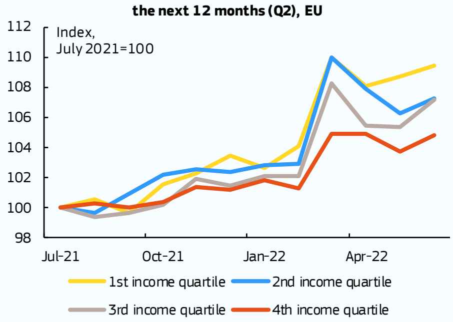
Consumers' expectations about their household's financial situation ([8]) has also deteriorated strongly over the past year, impacting all income groups (see Graph 5).

However, zooming into the different response options, the share of respondents reporting that they expect their households' situation to get a lot worse has increased more sharply amongst the poorest households (see Graph 6).

Graph 5: **Consumers' expectations of the future financial situation of their household (Q2), EU**



Graph 6: **Share of consumers expecting the financial situation of their household to get a lot worse over the next 12 months (Q2), EU**



([7]) Question 12 reads "Which of these statements best describes the current financial situation of your household? We are saving a lot/saving a little/just managing to make ends meet on our income/having to draw on our savings/running into debt/don't know."

([8]) Question 2 reads "How do you expect the financial position of your household to change over the next 12 months? It will get a lot better/get a little better/stay the same/get a little worse/get a lot worse/don't know."

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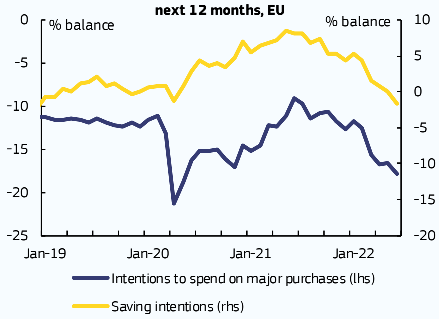
Box (continued)

Consumers' savings and consumption intentions

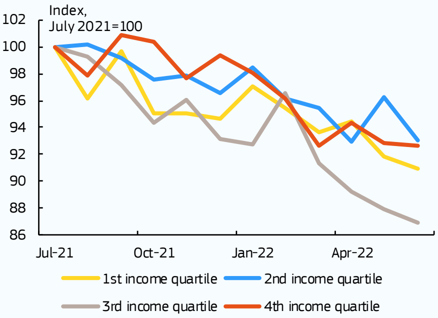
As shown in Graph 7, since January 2021, consumers' saving intentions have continued to rise but at a slower pace than during the COVID crisis, as they intended to spend part of their income on major purchases. ([9]) Since July 2021, however, consumers have been scaling down their expectations to both spend on major purchases and save money. This may indicate awareness that their real disposable income is being eroded by high inflation.

Saving intentions have been decreasing in all income categories. In July 2021, the percentage balance ([10]) was positive, at 35%, for households from the highest income quartile, and negative, at -20% for respondents from the lowest quartile. Since then, the gap between low income and higher income groups has remained broadly the same (see Graph 8), with the balance for the highest income group declining and the one for the lowest one becoming more negative.

Graph 7: **Consumers' intentions to save (Q11) and to spend money on major purchases (Q9) over the next 12 months, EU**

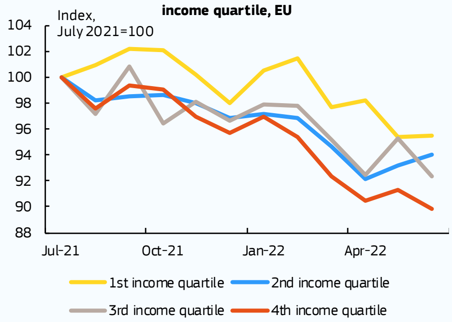


Graph 8: **Consumers' intentions to save (Q11) over the next 12 months by income quartile, EU**



The decline in expected savings goes along with a decrease in the balance of intentions to spend on major purchases. This is particularly the case among richer households (see Graph 9), whose price elasticity of demand is in principle higher.

Graph 9: **Consumers' intentions to spend money on major purchases (Q9) over the next 12 months by income quartile, EU**



Overall, according to the Commission's consumer survey, consumers' assessment of the past and expected financial situation of their household has been deteriorating for all income quartiles since July

([9]) Based on questions Q11 and Q9 of the Commission's harmonised consumer survey. Question Q11 reads "Over the next 12 months, how likely is it that you save any money? very likely/fairly likely/not likely/not at all likely/don't know.". Question Q9 reads "Compared to the past 12 months, do you expect to spend more or less money on major purchases (furniture, electrical/electronic devices, etc.) over the next 12 months? I will spend much more/ a little more/about the same/a little less/much less/don't know."

([10]) The percentage balance is the difference between the percentage of respondents saying it is likely that they will save money over the next 12 months and those saying it will be unlikely.

(Continued on the next page)

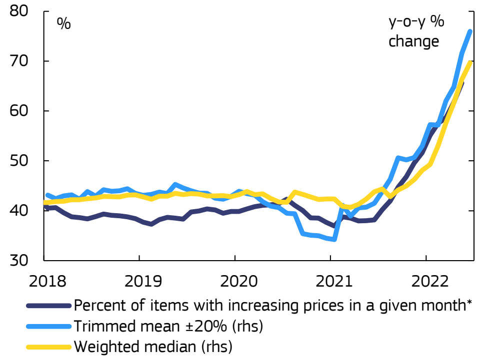
Box (continued)

2021, following several months of price increases. However, the worsening is more pronounced for the lower-income households. This confirms that it is those households who are most hit by the increasing energy bills and food prices, as a larger share of their spending is on these basic items. Moreover, more and more consumers have lowered both their intentions to save and to spend on major purchases over the next year, indicating that inflation has an important impact on aggregate spending.

External price pressures are now increasingly accompanied by domestic inflation. While imported inflation has been a key driver of headline inflation, domestic price pressures are gaining in importance. The ECB's "Low IMport Intensity" (LIMI) inflation indicator, which tracks HICP items with a relatively low import intensity (14), almost tripled between May 2021 and May 2022.

Broadening price pressures lifted core inflation to historic highs. Core inflation (excl. energy and unprocessed food) rose to an all-time high of 4.6% y-o-y in June (flash estimate) as price pressures broadened well beyond energy and food to services and other goods. This is clearly illustrated by the share of individual goods and services (15) recording positive monthly growth which is rising steadily since mid-2021, to reach an all-time high in May 2022. Likewise, all available alternative measures of core inflation (e.g. average, median, trimmed means) indicate a steady rise in underlying price pressures, well beyond usual volatility (see Graph 1.16).

Graph 1.16: **Indicator of broadening price pressures and alternative core inflation measures in the euro area**



Note: * Based on the set of 265 non-overlapping 5-digit COICOP items, seasonally adjusted

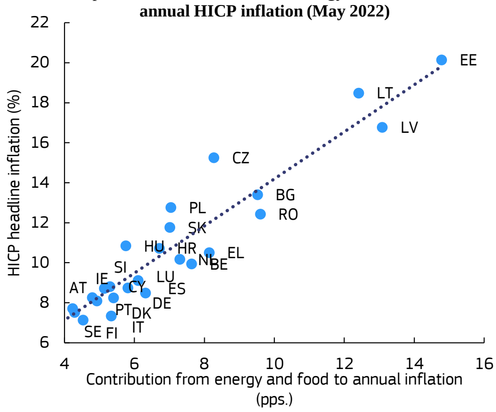
The bulk of intra-EU inflation differentials is driven by differences in energy and food inflation. Annual inflation in June ranged from 6.1% in Malta to 22.0% in Estonia, a difference of almost 16 pps., compared to 11pps. in March and 9 pps. in January. (16) While inflationary pressures at individual country level broadened steadily to core components, intra-EU divergences in headline rates in May still largely reflected differences in contributions from energy and food, due to differentials in both price growth and shares in consumption baskets (see Graph 1.17).

(14) https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202204_07~8fbdeadb34.en.html

(15) 265 non-overlapping categories at the COICOP five-digit level, seasonally adjusted

(16) Even if the coefficient of variation suggests that dispersion remained broadly stable over the same period.

Graph 1.17: **Contribution from energy and food versus annual HICP inflation (May 2022)**



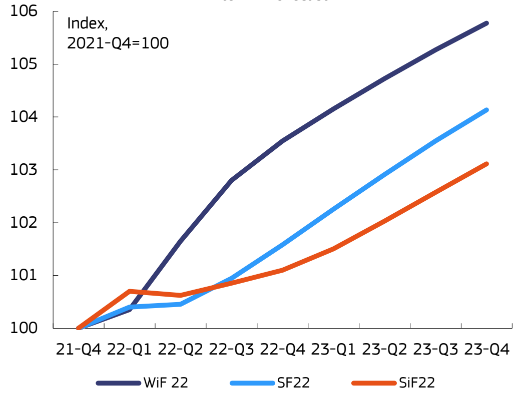
outlook for business investment. Additionally, higher costs for energy and other inputs cut into profit margins if they cannot be passed on to consumers, reducing firms' ability for self-financing and profitability of investments. The deterioration of the demand outlook is also set to weigh on companies' investment decisions and delay the realisation of investment plans. However, ongoing implementation of projects funded by the RRF is projected to continue to support investment growth both in 2022 and in 2023. From the household side, increased borrowing costs are set to drag construction investment, thus reducing the previously expected pick-up.

1.5. THE OUTLOOK

The negative shocks unleashed by the war are setting the EU economy on a path of higher inflation and lower growth. The Spring Forecast assumed that exceptional geopolitical tensions would not normalise before the end of the forecast horizon. This assumption (and its ramifications) remains valid for the current forecast (see Box 1.4). Since the publication of the Spring 2022 Forecast, however, many of the negative risks have materialised. Inflation intensified and broadened, the external environment weakened, economic sentiment worsened and financing conditions are tightening. These shocks are weighing on the EU growth outlook (see Graph 1.18). Weaker demand will ease inflationary pressures. At the same time, the recent surges in commodity prices are set to keep feeding inflation over the forecast horizon. These stagflationary forces are not projected to tip the economy into a protracted coexistence of subdued growth and high inflation, as in the 70s (see Box 1.3).

Private consumption and investment growth are set to be less buoyant than previously expected. Despite strong labour markets, high inflation is weighing on households' real disposable income, as well as on the stock of excess savings. Furthermore, as uncertainty is set to remain elevated, consumer spending on big ticket items is likely to be curtailed. All in all, private consumption is projected to continue growing throughout the forecast horizon, but less than previously expected. Tighter credit standards and increased interest rates also dampen the

Graph 1.18: **EU growth paths since the Winter 2022 interim Forecast**



Economic growth in the second quarter is expected to be broadly flat. Both the Commission's economic sentiment indicator (ESI) for the EU as well as the S&P Global composite PMI for the euro area speak for continued economic growth in the second quarter. However, especially the ESI signals a lower pace of expansion than in the first quarter. Industrial production, retail sales and construction output also point to weaker momentum at the beginning of the second quarter. GDP growth in the euro area is expected to remain flat and contract mildly in the EU at -0.1% q-o-q in 2022-Q2, down from +0.1% in the Spring 2022 Forecast.

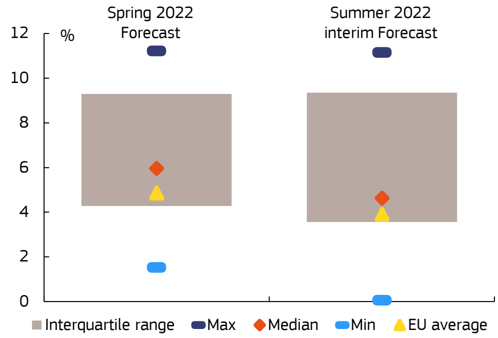
The EU is set to resume growing in the third quarter, buoyed by a promising tourism season. After the last Omicron wave, infections increased again since the beginning of June in several countries (particularly in Portugal), and in the EU in general, despite reduced testing. The number of new cases - and especially hospitalisations - remains nevertheless comparatively low and unlikely to result in economic disruptions. The first summer holiday season since 2019 without a significant pandemic effect is still set to provide a boost to economic activity, but inflationary pressures and high uncertainty are set to act as a drag. All in all, growth in the third and fourth quarters is expected at 0.2% each.

For 2022 as a whole, growth is expected at 2.7%, unchanged compared to the Spring Forecast. This unchanged growth forecast has to be seen in the light of the momentum (carry-over effect ([17])) gathered with the recovery of last year and a stronger first quarter than previously expected. Both bring acquired growth in the first quarter of this year to a solid 2.7% for the EU (and 2.4% for the euro area). Economic activity in the remainder of the year is no longer expected to add to annual growth in the EU (and is set to add a mere 0.2 pps. to growth in the euro area).

In the course of 2023, economic activity is set to gain some traction, leading to an annual forecast of 1.5%. On the back of a resilient labour market, moderating inflation, continuous support from the Recovery and Resilience Facility and a still large amount of excess savings, growth in the EU is set to gather some pace. Together with a lower than previously expected carry-over from 2022, this leads to an annual growth rate of 1.5%, a downward revision of 0.8 pps. compared to the Spring Forecast.

Heterogeneity across Member States is increasing. Already in the Spring 2022 Forecast, growth outcomes across Member States showed a strong degree of heterogeneity as Russia's invasion of Ukraine left some Member States more vulnerable to its effects than others ([18]). Heterogeneity is now amplified by differences in the monetary tightening cycle of the euro area and non-euro area Member States, Russian gas cuts in individual countries and stronger inflation differentials across the European Union than previously estimated (see Graph 1.19). Still, at the end of the forecast horizon, all Member States are set to have achieved or surpassed their pre-pandemic output levels, with Luxembourg, Poland, and Estonia leading the way (all more than 10% above 2019-Q4 levels). For the EU as a whole, these levels are expected to be exceeded by almost 4%.

Graph 1.19: **Distribution of cumulative growth since 19-Q4 across EU Member States**



Note: Based on quarterly growth rates for all Member States, except IE, EL, CY and MT.

Rapid price growth in recent months implies that annual inflation will remain elevated in 2022. The record-high inflation projected for 2022 as a whole must be read against the background of strong increases in the price level that already occurred in the first half of the year. These increases imply that even with a stable price level until the end of the year, annual inflation would reach 7.2% in the euro area. Further external and domestic price pressures in the second half of the year are set to add to this carry-over effect, pushing annual average inflation up even higher.

Past and future increases in wholesale energy and food prices should continue making their way to retail prices. Based on price projections implicit in future contracts for energy commodities and their respective pass-through to consumer prices, HICP energy inflation is expected to peak in the third quarter of 2022, before moderating in the fourth, and decreasing steadily over the course of 2023. The pace of decline will be held back by the reversal of fiscal measures counteracting the increase in energy prices introduced by most Member States by mid-2022 ([19]). Food inflation

([17]) For a detailed analysis, see Box 1.2.1: Carry-over effects and the annual growth forecast for 2022 in European Commission (2022), European Economic Forecast Spring 2022, Institutional Paper 173, May 2022.

([18]) See Box 1.2.2: Member States' vulnerability matrix in European Commission (2022), European Economic Forecast Spring 2022, Institutional Paper 173, May 2022.

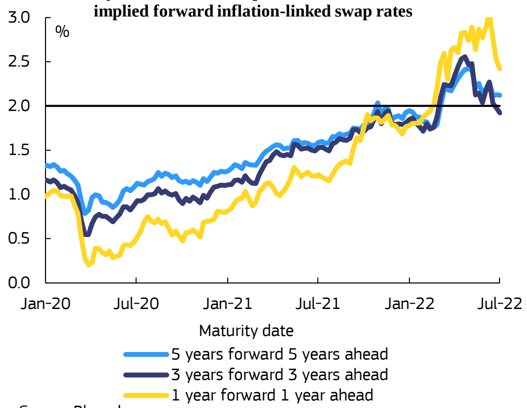
([19]) While the exact timing of their reversal is uncertain, as most of them continue to be extended in view of (both processed and unprocessed) is set remain elevated in the remainder of 2022 and in 2023, reflecting upward pressures currently at work along the entire food value chain. These include war-induced disruptions to supply, higher input and labour costs.

Core price pressures are set to be sustained in the near term and remain elevated in 2023. The lagged effects of the past depreciation of the euro, persistently high input costs and supply side disruptions (including labour shortages), together with rising wages are all set to sustain pressures on the prices of both non-energy industrial goods and services. Most of these drivers are expected to subside only gradually over the course of 2023, with the tightening of financing conditions playing an increasingly important role in cooling demand in the latter part of the forecast horizon.

Despite recent inflation surprises, medium-term inflation expectations of financial markets returned to levels consistent with the 2% price stability target. The 1-year forward 1-year ahead inflation expectations increased steadily to 3% in the second/third week of June (vs. 2.7% in the last week of April) – to fall sharply in the last week of June and early July as markets reacted to the ECB's monetary policy announcements. The 5-year forward/5-year ahead expectations are now just below 2%, while the 3-year forward/3-year ahead - a notch above (see Graph 1.20). The June flash PMI pointed to some easing of input and output price pressures, even if respective levels remained close to all-time highs from May. In the Commission surveys, selling price expectations in June rose to a new all-time high in retail trade and remained unchanged in services, slightly below the maximum reached in April. In industry and construction, price expectations eased for the second month in a row, while remaining at historically high levels. While consumers' price expectations eased for the third month running, their perceptions of price developments over the past twelve months continued soaring, reaching their highest level ever recorded by the survey.

persistently high energy prices, their withdrawal is likely to push energy price inflation up for 2023 as a whole.

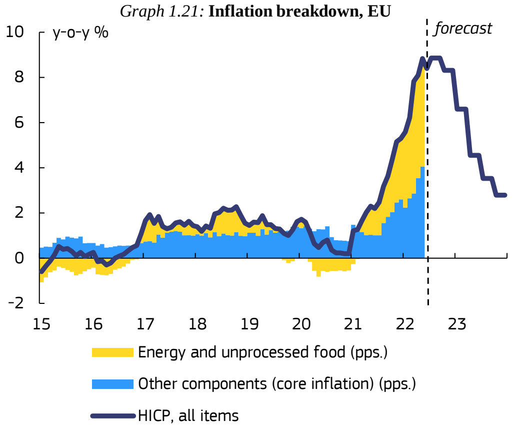
Graph 1.20: **Inflation expectations derived from implied forward inflation-linked swap rates**



Source: Bloomberg

Headline inflation is revised up sharply in both 2022 and 2023 and is now expected to peak in the third quarter. Headline inflation in the euro area is projected to increase further in the near term, in line with higher energy commodity price futures (see Graph 1.6), a weaker euro and firming core price pressures amid a stronger wage growth. Headline inflation is now expected to peak at 8.4% y-o-y in the third quarter, and remain elevated, at 7.9%, in the fourth quarter. It is then set to decline, particularly in the first half of 2023, as sharp increases in energy (and food) prices that took place in the first half of the current year gradually fall out from annual inflation, generating strong negative base effects. Consequently, headline inflation in the euro area is projected to fall to 6.2% and 4.2% in the first and second quarter of 2023, respectively, and move further down to 3.3% and 2.5% in the final quarters of the year, thus remaining above the ECB target during the entire forecast horizon (see Graph 1.20). While a more decisive tightening of financial conditions in the EU and globally, is expected to increasingly ease core and non-core price pressures, respectively, its dampening effect is not expected to offset the forces pushing inflation higher within the forecast horizon. On an annual average basis, inflation in the euro area is projected to peak at 7.6% in 2022, a historical high, before easing to 4.0% in 2023. In the EU, inflation is set reach 8.3% and 4.6% in 2022 and 2023, respectively. Compared to the Spring Forecast, this represents an upward revision of 1.5 pps. for both the EU and the euro area in 2022 and of 1.3pps and 1.4 pps. in 2023 in the euro area and the EU, respectively.

Graph 1.21: **Inflation breakdown, EU**



1.6. RISKS TO THE OUTLOOK

Particularly for the growth outlook, the balance of risks to the outlook is tilted towards adverse outcomes. Risks to the forecast for economic activity and inflation are heavily dependent on the evolution of the war. Risks affecting the global macroeconomic environment compound with the EU's specific vulnerabilities, linked to its geographical proximity to the war zone and its high reliance on Russian fossil fuels.

The global economy, and the EU in particular, remain vulnerable to shocks in commodity markets. Further reductions in gas supply to the EU would send its prices higher. In addition, the likelihood of gas rationing in the upcoming winter would increase, with significant knock-on effects on economic activity. ([20]) Also, the ongoing drought in the south of the EU might affect the production of staple agricultural commodities, exerting pressures on their prices. By contrast, a worsening economic outlook could lead to further retrenchment in the prices of oil and non-energy commodities.

Inflationary pressures could trigger faster tightening in financing conditions. As the cost shocks make their way through the consumption basket, second-round effects through wage increases may lead to more persistent inflationary pressures, forcing central banks to act more forcefully to stem a de-anchoring of inflation expectations. Tighter global financing conditions could significantly slow down global growth and destabilise vulnerable emerging market economies. In the EU, monetary policy tightening may come with increased risks to financial stability.

The COVID-19 pandemic remains a significant risk. The possibility that the resurgence of the pandemic in the EU would bring renewed disruptions to the economy cannot be excluded. More persistent or new lockdowns in China and potentially elsewhere would not only decrease global demand, but further exacerbate supply-side bottlenecks. These pose a downside risk to economic growth, but the impact on inflation prospects is ambiguous as the shock would affect both demand (anti-inflationary) and supply (inflationary).

The outlook is also subject to additional upside and downside domestic risks. In the short term, widespread disruptions to air travel and labour shortages may dampen the prospects of an otherwise promising tourism season. Over the forecast horizon, investments fostered by the RRF could generate a stronger impulse to activity through cross-sector and cross-country spillovers. By contrast, ongoing supply constraints may delay the implementation of the RRPs, with negative impact on investment. In addition, elevated uncertainty could have a stronger-than-expected negative impact on investment activity, particularly in an environment of weakening growth. Also, the fall in consumer confidence and high inflation may turn out more harmful to households' spending than expected, resulting in lower private consumption. On the other hand, domestic demand could prove more resilient to increasing prices if households were to use more of their savings for consumption or wage growth picked up more than expected.

([20]) See Special Issue in European Commission (2022), European Economic Forecast Spring 2022, Institutional Paper 173, May 2022.

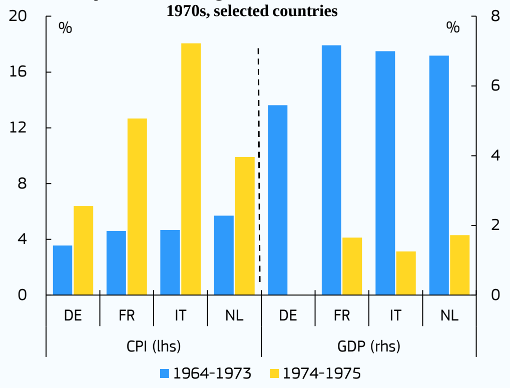
Box 1.3: **Stagflation risks in Europe: Are the 2020s different from the 1970s?**

High rates of inflation and the considerable slowdown in economic activity are awakening memories of the 1970s. This box looks at features characterising European economies in the 1970s and now, highlighting similarities, differences and new features.

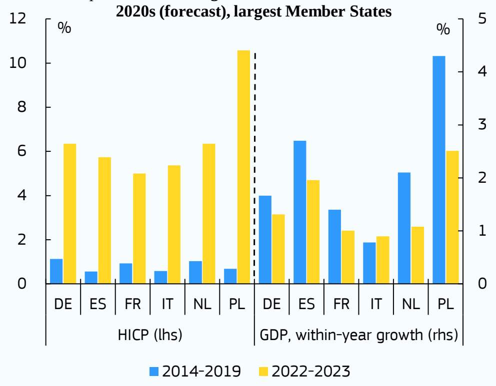
Key features of the 1970s and similarities at the current juncture

The 1970s were characterised by sharply increasing inflation and weak growth. Almost half a century ago, the Yom Kippur war of 1973 triggered a first sharp increase in the price of oil, later followed by a the second oil price shock at the end of the decade in the wake of the Iranian revolution. The first oil price shock led to a protracted period of high inflation and considerable low GDP growth (Graph 1a), a combination that went under the name of 'stagflation'. Currently, the supply side of the EU economy is impacted by a combination of similar shocks that originate from lingering pandemic-related disruptions and are exacerbated by Russia's war of aggression against Ukraine. These shocks have primarily driven up the prices for oil and gas, but have also pushed up the prices of several other raw materials and agricultural commodities. The resulting surge in inflation is going hand in hand with a projected sharp slowdown in economic activity (Graph 1b).

Graph 1a: **Economic growth and CPI inflation in the 1970s, selected countries**



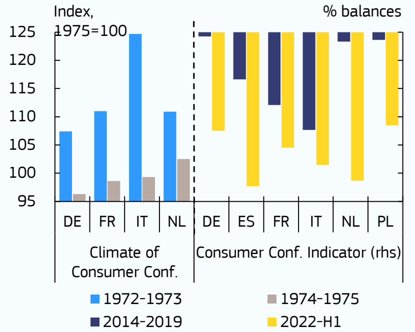
Graph 1b: **Economic growth and HICP inflation in the 2020s (forecast), largest Member States**



High inflation rates weigh on consumers' purchasing power and confidence. In the aftermath of the first oil shock, consumer climate deteriorated significantly, as has been the case with consumer confidence since spring this year in large Member States (Graph 2). This heralded weaker consumer spending and contributed to slowing economic growth, as it does now.

In the 1970s and now, European economies were not only hit by higher oil prices but also increasing prices of other commodities. In both episodes the price of natural gas also increased

Graph 2: **Consumer confidence development in the 1970s and now, largest Member States**



Sources: Data for the 1970s, European Economy, Supplement C, March 1979 (http://aei.pitt.edu/84510/1/1979.C1.pdf), data for the 2020s, European Commission, BCS database (https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/business-and-consumer-surveys_en).

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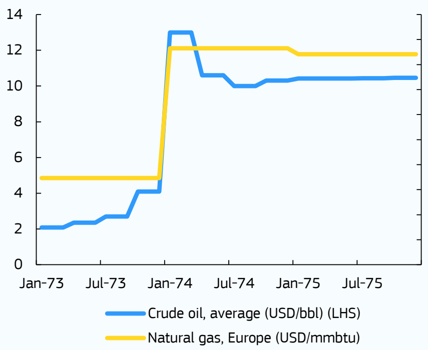
Box (continued)

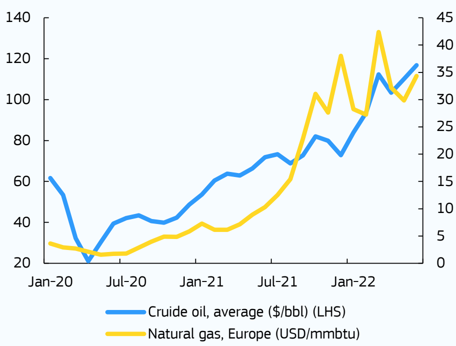
markedly. Cost of companies, made some energy-intensive capital obsolete, reduced aggregate supply and created price pressures. Since the EU economy is a net importer of oil and gas, the energy price shock in both cases triggered a terms-of-trade loss. Inflationary pressures emerged also from food prices with the Food and Agriculture Organization (FAO) food price index up by 95% between 1972 and 1974 by 95%, and by 66% between 2019 and May 2022.

Graph 3a: **Prices of oil and natural gas, 1973-1975**



Source: World Bank Commodity Price Data (The Pink Sheet).

Graph 3b: **Prices of oil and natural gas, 2020-2022**

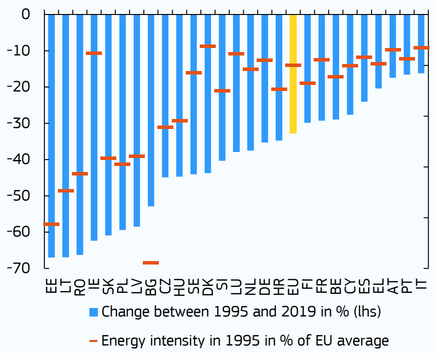


Source: World Bank Commodity Price Data (The Pink Sheet).

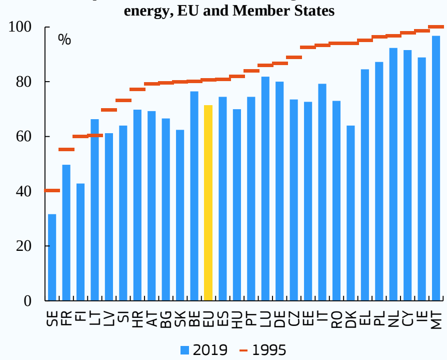
Differences between the 1970s and the current situation.

However, there are structural reasons why the 2020s can be expected not to see a rerun of the 1970s. These include the role of energy in our economies, labour market institutions, and monetary policy frameworks. ([1])

Graph 4a: **Energy intensity of real GDP, EU and Member States**



Graph 4b: **Share of fossil fuels in gross available energy, EU and Member States**



First, the EU's energy intensity of output and the share of fossil energy have declined over recent decades. A more efficient use of energy, the development of renewable energy sources, but also structural changes in the EU, including a growing share of services in gross value added, imply that increases in energy prices today are likely to cause less damage to the economy than they did five or three decades ago. As compared to the 1970s, economic activity in the EU has become much less energy-intensive (Graph 4a), and the weight of fossil fuels such as oil has declined, too (Graph 4b). ([2]) In the past 25 years, the EU energy intensity fell by a one third. The declines were much larger in

([1]) See also OECD (2022). 'Differences between the current situation and the aftermath of the 1970s oil price shocks'. *OECD Economic Outlook* 101, June, pp. 39-9; Andersson, M. et al. (2022). 'Does the private sector foresee a stagflation episode?'. *ECB Economic Bulletin* 4, p. 69-73; and for a global analysis Ha, J., Kose, M. A. and F. Ohnsorge (2022). 'Global stagflation'. *World Bank Global Economic Prospects*, June, pp. 51-77.

([2]) Rühl, C. and T. Erker (2021) 'Oil intensity: the curiously steady decline of oil in GDP'. *CGEP Report* (Center on Global Energy Policy, Columbia University), September.

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Box (continued)

Eastern and Central Europe, where the initial energy intensity had been much higher than on average in the EU. At the same time, the still high share of fossil fuels in the national energy mix is a reminder of the policy challenges ahead. ([3])

Second, structural reforms have made EU product and labour markets more resilient to shocks. In recent decades, structural reforms have made product markets in the EU more flexible and more competitive. ([4]) This has eased adjustment to shocks such as the ones currently observed. Moreover, a long period of labour market reforms in the EU left its marks. Real wage rigidity, identified as one of the factors behind the higher inflation and the weaker growth in the 1970s, appears to have become less strict, also thanks to less use of automatic wage indexation. ([5]) This provides options for better balancing the targets of preserving jobs and increasing wages, thus lowering the trade-off between output and inflation. While wages have started to increase in the context of a strong labour market recovery, there are currently no signs of a wage-price spiral in the euro area.

Finally, in the EU, all central banks are now independent and pursue price stability. For most of the 1970s, many central banks were constrained by fixed exchange-rate arrangements (e.g., Bretton Woods, the “Snake”, and the European Monetary System) and central bank independence was limited. Today, central banks in the EU are independent and price stability is their primary objective. The ECB has built up credibility from delivering on its price stability mandate since the introduction of the euro. At the current juncture, with central banks having started to embark on a normalisation and/or tightening cycle, the differences from the 1970s are clearly visible.

New features in the 2020s that matter for economic growth and inflation

Several features that characterise the current situation were not seen in the 1970s. For instance, after a long period of historically low interest rates, private and public debt is now much higher than in the 1970s, which may complicate the adjustment of the EU economy to the normalisation of monetary policy. The current strength of labour markets in the EU coupled with labour shortages could strengthen wage pressures in certain key sectors. Finally, following two years of on-and-off pandemic-related restrictions, many households have extra savings available which could help smoothing consumption and keep price pressures higher than would otherwise be the case.

Policy efforts can help to avoid a protracted period of high inflation and low growth. To bring inflation down it is indispensable to keep inflation expectations anchored as envisaged by the ECB. Coordinated policy action at the EU level and in Member States can help supporting economic growth and strengthen resilience. Policy initiatives at the EU level (e.g., SURE, InvestEU and NGEU/RRF) have become an important part of these efforts. Moreover, targeted policies to reduce the root causes of the inflation shock, notably the dependency on fossil fuels, should have a dampening impact on price pressures.

([3]) See Blanchard, O. J. and M. Riggi (2013). ‘Why are the 2000s so different from the 1970s? A structural interpretation of changes in the macroeconomic effects of oil prices’. *Journal of the European Economic Association* 11:5, 1032-52 (October).

([4]) See e.g. ECB (2015). ‘Progress with structural reforms across the euro area and their possible impacts’. ECB Economic Bulletin 2, p. 59-71; E. Canton et al. (2019). ‘Structural reforms for growth and resilience in the euro area’. *Quarterly Report on the Euro Area* 18:2, Institutional Paper 119, pp. 85-99.

([5]) See Koester, G. and H. Grapow (2021). ‘The prevalence of private sector wage indexation in the euro area and its potential role for the impact of inflation on wages’. *ECB Economic Bulletin* 7, p. 63-66 (Box 7).

Box 1.4: Key assumptions concerning the forecast

Given current context of high uncertainty, forecasts continue to rely heavily on ad-hoc assumptions. The assumptions underpinning the Summer interim Forecast remain unchanged compared to the Spring 2022 Forecast. ([1])

Russian invasion of Ukraine and geopolitical tensions.

The magnitude of the economic impact of the war is highly uncertain and depends crucially on its duration. The forecast of the global and EU economies assumes that geopolitical tensions will not normalise before the end of the forecast horizon. All sanctions against Russia stipulated until the cut-off date of the forecast ([2]), including those already implemented after Russia's annexation of Crimea in 2014 ([3]), are assumed to remain in place throughout the forecast horizon. For Ukraine, a specific working assumption is made that economic activity remains unchanged in 2023 compared to 2022.

People fleeing the war in Ukraine to the EU.

Assumptions on people fleeing Ukraine remain the following:

- The number of people fleeing the war in Ukraine to the EU is set to gradually reach 6 million by the end of 2022, and to stay stable over 2023.
- Their geographical distribution is projected using the distribution of Ukrainian immigrants in the EU in 2021; the distribution of flows of Ukrainian immigrants by country over recent years; the relative population of Member States and the actual distribution of people fleeing Ukraine across the EU as of March 23 2022.
- The employment rate of those arriving from Ukraine who are of working age increases from 8% (on average) in 2022 to 20% (on average) in 2023.

The COVID-19 pandemic.

Overall, as in the Spring 2022 Forecast, the Summer 2022 interim Forecast assumes that the pandemic will not cause any major disruptions in the EU economy over the forecast horizon, despite the recent increase in COVID-19 infections. For China, it is assumed that the current "dynamic Zero-COVID" policy is continued throughout the forecast horizon.

([1]) For the customary technical assumptions underpinning the forecast, see Box 1.4.
([2]) For the EU, these sanctions are reported by the Council. For non-EU sanctions, the Brookings Sanctions Tracker provides detailed information.
([3]) Sanctions already implemented after Russia's annexation of Crimea in 2014 have an end date (currently extended until June 2022), which is assumed to be extended at least until the end of the forecast horizon.

2. PROSPECTS BY MEMBER STATES

EURO AREA

2.1. BELGIUM

Economic growth is set to slow down in 2022 after rebounding by 6.2% in 2021. The Omicron variant wave had a limited impact on the economy in the first quarter of 2022 as the remaining restrictions on activity were quickly lifted, leading to real GDP growth of 0.5% in Q1-2022. Similarly, employment experienced strong growth at the beginning of 2022.

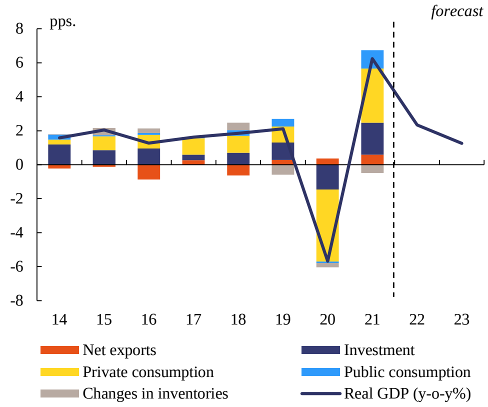
Real GDP growth is forecast to reach 2.3% in 2022, supported by a strong carry-over from 2021 and the better-than-expected figures of the first quarter. In the second quarter of 2022, the quarterly growth rate is projected to drop, as the economic situation deteriorates, before gradually increasing back to around 0.5% over the forecast horizon. In 2023, real annual GDP growth is expected to reach 1.3%.

The high level of inflation and the decrease in consumer confidence are expected to curb the expansion of household consumption. Still, automatic indexation of wages and social benefits are set to support purchasing power, especially in 2023, when inflation is projected to significantly decrease.

Uncertainty, tighter financing conditions, higher cost pressures from input prices and wages, as well as supply side constraints, are expected to weigh on investment. At the same time, the RRF and the energy transition efforts are forecast to support gross fixed capital formation. A less favourable external environment is set to weigh on imports and exports this year. Net exports are expected to contribute negatively in 2022, as tourism abroad resumes.

Headline inflation is forecast to reach an exceptionally high level of 9.4% in 2022. This is mainly due to the sharp increase in energy prices, which are transmitted quickly to retail prices. Food prices and core inflation are also pushing headline inflation up. The gradual fall in energy prices is forecast to lead to a decline in headline inflation to 2.9% in 2023.

Graph 2.1: **Belgium - Real GDP growth and contributions**



2.2. GERMANY

In the first quarter of 2022 real GDP edged up by 0.2%, thanks to a rebound in construction activity. Private consumption was weak due to pandemic-related restrictions on service activities, and exports declined due to supply bottlenecks and the onset of the Russian war of aggression against Ukraine.

Since April, the stringency of pandemic containment measures has been progressively eased, enabling the reopening of contact-intensive services. This is expected to have boosted consumer spending in the second quarter. Still, as trade disruptions were aggravated by the war, real GDP is expected to have stagnated in the second quarter.

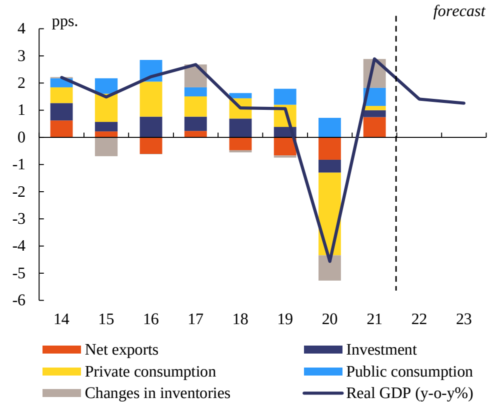
In the third quarter GDP is expected to grow by 0.2%, as soft containment measures and recourse to accumulated savings support private consumption growth, helped by a robust labour market.

However, overall growth is expected to remain subdued. Households' purchasing power is dented by soaring inflation. While manufacturers' order backlogs remain significant, their unwinding is likely to be held back by lingering supply bottlenecks and ever increasing costs. Against this background and amid high uncertainty regarding energy supplies, investment growth is likely to be restrained in the coming quarters.

On an annual basis, real GDP is expected to increase by 1.4% in 2022 and by 1.3% in 2023. For 2023, this is a significant downward revision compared to the Spring Forecast, due to the deterioration of the outlook for global trade and the loss of purchasing power, which weigh on business and consumer confidence.

Given Germany's relatively high dependence on Russian gas, a sudden stop in deliveries would constitute a significant downside risk to the outlook as it may heavily affect activity in key industry sectors.

Graph 2.2: **Germany - Real GDP growth and contributions**



HICP inflation reached 8.7% in May, a rate that is comparable to that of the high increases in consumer prices in the 1970's. Alongside surging energy prices, inflation has become more pronounced across all other consumption categories. In June, a temporary reduction of prices for local public transport helped slow inflation somewhat (to 8.2%), though the effect will be undone upon expiry of the measure later in the year. Despite a tightening labour market, wage growth and wage settlements remain moderate. Still, an increase in the minimum wage later this year is expected to temporarily push up service price inflation. In 2022, inflation is forecast to average 7.9%. The lingering pass-through of higher cost of labour, energy and other commodities and supplies are set to keep the average annual inflation rate close to 5% in 2023.

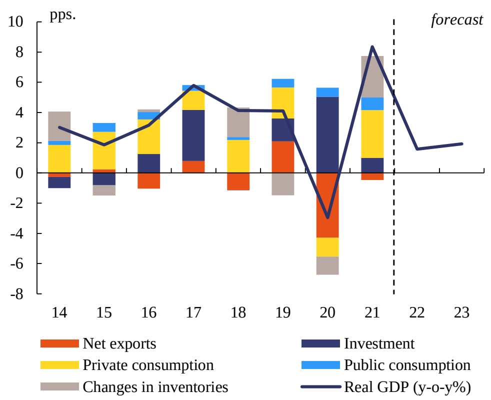
2.3. ESTONIA

Economic growth stalled in the first quarter of 2022, after reaching 8.3% in 2021. Household consumption remained buoyant, despite steep price increases; exports of services and private investment dropped sharply, while imports of both goods and services soared. As a result, GDP grew by just 0.1% q-o-q. Employment increased further in the first quarter of 2022 and is set to expand further this year, also thanks to the significant inflow of people displaced from Ukraine. Average nominal wages grew by more than 10% y-o-y in May, with notably high increases in information and communication services and accommodation and food services.

Since the beginning of the war, economic conditions worsened considerably on account of trade restrictions, continued increases in the prices of energy, industrial commodities, fertilisers and food, and elevated uncertainty. Gross fixed capital formation is projected to decrease substantially in 2022 due to a drop in corporate investment and in construction, and is set to rebound in 2023.

Output growth is expected to have turned negative in the second quarter, decrease further in the third quarter and then pick up slowly by the end of the year. Annual growth of private and public consumption is projected to slow down in 2023, while investment and net exports would support economic expansion. On an annual basis, real GDP is forecast to grow by 1.6% in 2022 and by 1.9% in 2023.

Graph 2.3: **Estonia - Real GDP growth and contributions**



Inflation is forecast to average 17.0% in 2022, the highest since 1996. Surging energy prices in the first half of the year are set to fuel sizeable increases in the prices of food, industrial materials and services. These, mainly imported inflationary drivers, are expected to subside in 2023, when inflation is forecast to decelerate to 4.7%.

2.4. IRELAND

Real GDP in Ireland grew by 10.8% q-o-q in the first quarter of 2022, a big rebound after a marked fall in the last quarter of 2021.

These dynamics were the results of different transactions by multinational enterprises (MNEs). A surge in investment in 2021-Q4 was related to the on-shoring of intellectual property which was offset by a simultaneous surge in imports of services, with no impact on GDP. Part of the surge in imports of services, however, was related to the payment of royalties for the production of drugs exported in 2022-Q1. The time lag in the production process led to the GDP contraction in 2021-Q4 and the ensuing rebound in 2022-Q1 (see Box 1.1).

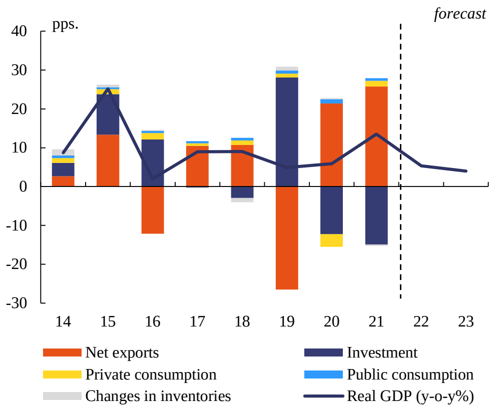
When activities of MNEs are stripped out of the accounts, the economy is seen to have contracted in the first quarter, particularly due to falling investment in non-residential construction and equipment, while private consumption contracted, owing to COVID-related restrictions and rising inflation.

Consumer sentiment took a hit after Russia invaded Ukraine, with households reassessing their future financial situation in light of the expected economic deterioration, a trend reinforced by rising inflation. Meanwhile, the labour market performed very strongly, with unemployment falling to 4.7% in May. This is expected to revive private consumption going forward.

Despite the very strong first quarter reading, real GDP growth for 2022 is revised slightly down to 5.3%, while the 2023 annual growth projection is revised down to 4.0%, reflecting the deteriorating global outlook, weakening sentiment, and persisting inflationary pressures.

The outlook for the economy is surrounded by high uncertainty also due to factors which are specific to Ireland, such as recent developments regarding the disapplication by the UK of the Protocol on Ireland / Northern Ireland under the EU-UK Withdrawal Agreement.

Graph 2.4: **Ireland - Real GDP growth and contributions**



HICP inflation kept on rising and stood at 9.6% in June 2022. Energy prices in May were 46.2% higher than in the previous year. While large parts of inflation are imported, the services inflation is more connected to domestic developments. It was above 5% over the last few months. HICP inflation is now projected to rise to 7.3% in 2022 before declining to 3.3% in 2023, when energy prices are expected to contribute negatively.

2.5. GREECE

Economic growth in Greece kept its momentum in the first quarter of 2022, with real GDP growing by 2.3% q-o-q. Solid consumer spending was supported by positive developments in the labour market, and investment notably picked up. Net exports shrank, on the back of the slowdown in Greece's main trade partners as well as persisting global supply chain disruptions.

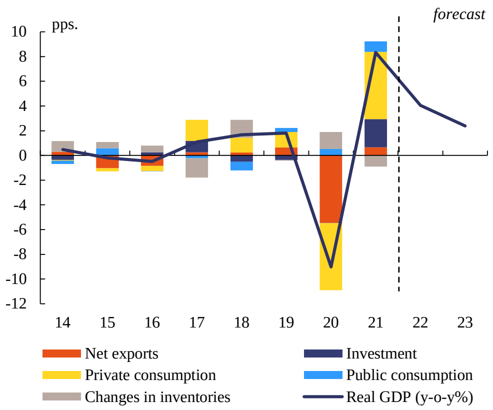
Growth in the first quarter outperformed previous estimates, but the full impact of higher inflation and the resulting squeeze of real disposable incomes is expected to materialise later in the year. In addition to the persistence of high inflation, fading dynamics in job creation, notably due to weaker output growth in sectors affected by high input costs, are expected to act as a drag on household spending in the following quarters.

Growth in 2022 is forecast to be also supported by the impetus from the deployment of the RRP. High-frequency indicators confirm the expected solid outlook for tourism in 2022, and remain in line with the projections of a full return to pre-pandemic levels by 2023. Overall, real GDP is forecast to grow by 4.0% in 2022 and to slow down to 2.4% in 2023.

Going forward, increased uncertainty is expected to further ease the demand for new jobs, and coupled with the still high inflation rate, is expected to weaken growth in 2023. In addition, weaker growth prospects of the economy, as well as tighter lending conditions, are expected to slow down private investment, despite the RRF impetus. Goods exports are set to decelerate compared to the previous forecast given the less supportive external environment.

Consumer price inflation continues to increase, driven primarily by the surge in international energy and food prices. The pass-through to the remaining components of the consumption basket is expected to keep inflation high for the entire forecast horizon. Headline inflation is projected to reach 8.9% in 2022 and 3.5% in 2023.

Graph 2.5: **Greece - Real GDP growth and contributions**



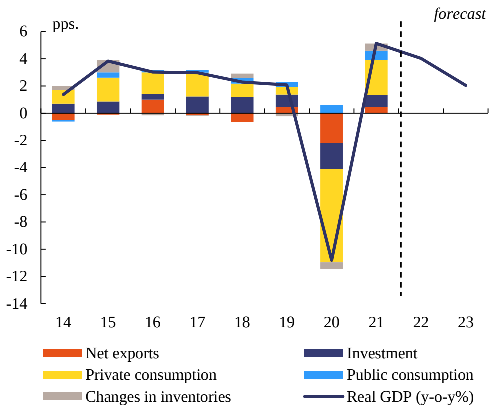
Risks to the forecast have increased. On the downside, they are linked to the tourism sector in light of the uncertain spending power of incoming tourists and increased geopolitical tensions in the region. On the upside, potentially more positive labour market dynamics could provide stronger-than-assumed support to household income and thereby to private consumption going forward.

2.6. SPAIN

Real GDP growth decelerated abruptly in 2022-Q1 (0.2% q-o-q) due to supply disruptions and the increase of inflationary pressures. Private consumption contracted significantly and is expected to remain under pressure during the forecast horizon, in a context of high inflation and weak consumer confidence. Nevertheless, quarter-on-quarter growth rates of GDP are expected to accelerate slightly in the next two quarters on the back of the return of tourism to pre-pandemic levels. Towards the end of the year, economic activity is projected to slow down again despite faster implementation of investments under the RRP, as households are expected to adjust their consumption decisions to higher prices and economic uncertainty.

Annual real GDP growth is forecast at 4.0% in 2022 and 2.1% in 2023. The gap with the pre-pandemic level of GDP is expected to be closed in the second half of 2023, when quarterly growth rates are set to regain dynamism. Compared to the Spring Forecast, changes in the outlook for 2023 are mainly explained by a more pronounced impact of inflation on households' purchasing power, particularly at the beginning of the year, in a context of limited wage increases. The impact on private consumption will be partly cushioned by the unleashing of accumulated savings, the resilience of the labour market and indexation of pensions. In 2023, investment, under the impulse of the Recovery and Resilience Plan, is expected to be the main demand driver.

Graph 2.6: **Spain - Real GDP growth and contributions**



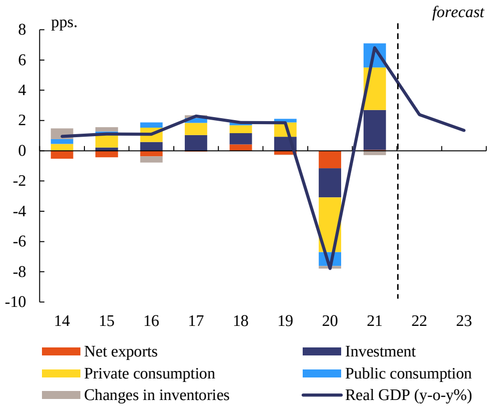
Annual HICP inflation is forecast to reach 8.1% in 2022 and 3.4% in 2023. Energy prices have been fuelling inflation pressures since 2021-Q2, and the pass-through effect to other goods (notably, food) and services (in particular, hospitality sector) has accelerated in recent months. Compared to the Spring Forecast, the persistence and intensity of this effect is the main reason behind the revision to the inflation outlook. Energy prices are expected to slowly moderate as from the second half of 2022, helped by additional government measures that entered into force in June, including the gas price cap aiming to reduce the wholesale electricity prices and a further reduction in the VAT on the electricity bill (from 10% to 5%). Core inflation is expected to remain high during 2022 and to start to ease in 2023-Q2, helped by base effects.

2.7. FRANCE

Economic output declined in the first quarter of 2022 (-0.2%) on the back of peaking COVID cases in January and the outbreak of the war at the end of February. During the subsequent quarters, GDP growth is expected to come back into positive territory thanks to the full lifting of pandemic-related restrictions. The rebound is, however, set to be limited in the second quarter (+0.2%) before slightly accelerating in the third quarter thanks to the expected improvement in tourism activity during the summer. GDP is then forecast to grow moderately over the rest of the forecast horizon, dampened by persistent supply bottlenecks and subdued internal demand in a context of declining real wages and tightening financial conditions. Overall, GDP is projected to increase by 2.4% in 2022 and 1.4% in 2023.

Both internal and external demand contribute to the deterioration of the outlook. After the sharp decline in the first quarter of 2022, private consumption is set to be further dented by the soaring inflation. The full lifting of restrictions is therefore expected to allow only a partial rebound in the second and third quarter. Private consumption is then projected to grow slowly until the end of the forecast period, leaving the saving rate above its pre-crisis level. While receiving support from the RRF, investment is expected to suffer from the gradual tightening of financial conditions and persistent supply disruptions (affecting both construction and equipment). It is set to slow down, yet to remain in positive territory. Both exports and imports are expected to be much less dynamic than previously anticipated, as a result of the deterioration of both external and internal demand. However, the rebound of tourism and the gradual recovery of transport equipment (both aircraft and ships) would allow net exports to contribute positively to growth in 2022 and 2023, although slightly less than expected in spring.

Graph 2.7: **France - Real GDP growth and contributions**



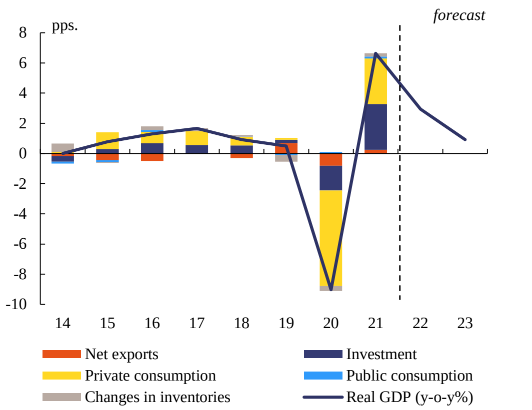
HICP accelerated sharply in the second quarter of 2022 (+5.9% y-o-y), pushed up by energy prices but also by a pickup in core inflation. Inflation is projected to keep increasing and to peak in the second half of 2022, despite the slight slowdown in energy inflation due to important base effects. The delayed pass-through of increases in the prices of energy and food commodities and – to a lesser extent – wages, as well as persistent supply disruptions are set to fuel core inflation, which is forecast to reach 5.1% in the last quarter of 2022. In 2023, headline inflation is expected to gradually decrease in the wake of energy prices. Core inflation is projected to decline more moderately, supported by higher wages and persistent supply shortages. Overall, HICP is set to increase by 5.9% in 2022 and 4.1% in 2023.

The risks to this forecast are tilted to the downside. In particular, important electricity supply constraints could materialise this winter in France because of unexpected maintenance on a significant part of its nuclear power plants. The possibility to import electricity to compensate the depressed national production is hampered by the severe constraints on gas supply.

2.8. ITALY

The Italian economy proved more resilient in early 2022 than expected in spring thanks to buoyant construction activity. In the short term, output growth is being supported by rising services activity following the lifting of almost all COVID-related restrictions and still robust production in construction. Real GDP growth in 2022 is projected at 2.9%, benefiting from a substantial carry-over effect from 2021 and an upward revision of GDP growth in Q1 2022. However, the loss in households' real purchasing power, waning business and consumer sentiment, persistent supply bottlenecks and rising funding costs overshadow the economic outlook. Thus, growth is expected to remain subdued over the forecast horizon. Output growth is estimated at only 0.9% in 2023, also given the projected weak momentum carried over from this year. The risks to the growth outlook are tilted to the downside, in particular in view of potential supply disruptions of natural gas, given Italy's still sizeable dependency on deliveries from Russia despite recent diversification efforts.

Graph 2.8: **Italy - Real GDP growth and contributions**



Consumer spending is set to slow down considerably over the forecast horizon. Households' losses in real purchasing power caused by soaring energy and food prices incurred by the energy-driven income shock are only partly compensated by government measures and accumulated savings. Investment increased at a high pace in the first quarter of 2022 and will continue to be supported by the implementation of Italy's RRP over the forecast horizon. However, deteriorating demand prospects and rising funding costs are expected to dent business investment, especially in machinery and equipment. Consistent with a weakening global outlook, goods exports are set to slow down. By contrast, services exports are likely to benefit from further normalisation of international tourism flows.

The sharp rise in energy and food prices coupled with persistent supply bottlenecks are spurring consumer prices. HICP headline inflation is forecast to climb to 7.4% this year and to average 3.4% in 2023. While price pressures from tight markets for energy raw materials are expected to ease only next year, the severe drought in northern Italy is likely to aggravate the surge in food prices for consumers. Wage pressures are set to increase over the forecast horizon. However, the pass-through of higher consumer prices into labour costs is expected to occur only partially and with a lag, given the long duration of wage agreements currently in force and the remaining slack in the labour market. Still, core inflation is projected to pick up strongly this year and to remain close to headline inflation in 2023.

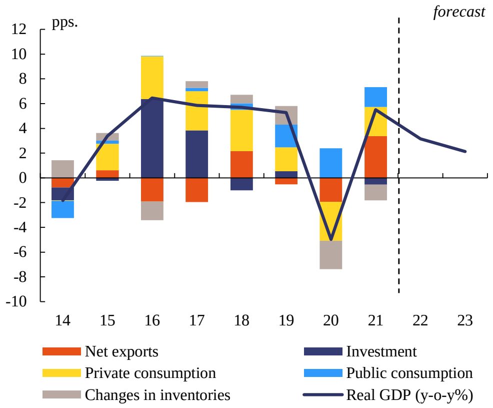
2.9. CYPRUS

The Cypriot economy surprised on the upside in the first quarter of 2022, mainly as a result of the faster-than-expected recovery of tourism and the continuing expansion of exports of other services, notably business services and IT. Arrivals of tourists and revenues increased considerably in the first months of 2022 and reached around 75% of pre-pandemic levels. The prospects for the sector remain positive for the summer season, based on data on planned international flights and surveys on reservations for tourist accommodation, despite a sizeable loss of the historically important tourism from Russia. However, weakening consumer confidence combined with soaring inflation and increasing interest rates are expected to result in a considerable slowing down of households' consumption and investments in the second half of the year.

On an annual basis, real GDP growth is forecast at 3.2% in 2022 and 2.1% in 2023. The main drivers of growth are expected to be domestic demand and, albeit to a lesser extent, net exports of services. Investment, notably in construction, is expected to suffer from the gradual tightening of financial conditions, persistent supply disruptions and exceptionally high prices for construction materials. On the positive side, the implementation of the Cypriot Recovery and Resilience Plan is expected to support investment. Private consumption is projected to be adversely affected by high inflation and the erosion in purchasing power, even though households' income is supported by measures adopted by the government to address high energy prices and the partial indexation of wages to be applied in January 2023. Significant uncertainty and downside risks to the growth outlook remain, in particular as tourism and other export-oriented services sectors are vulnerable to the adverse global impact of Russia's ongoing war of aggression against Ukraine and to the evolution of the COVID-19 pandemic.

High energy prices are driving up inflation. HICP headline inflation is forecast to average 7% this year and to decelerate to 3.3% in 2023, in line with the assumption that price pressures from tight commodity markets will ease next year. The projection for next year takes into account the impact of the partial automatic indexation of wages.

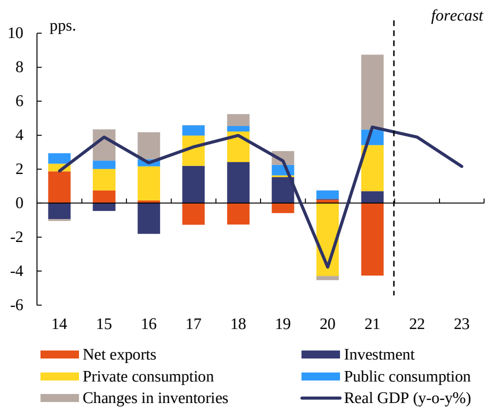
Graph 2.9: **Cyprus - Real GDP growth and contributions**



2.10. LATVIA

Economic growth picked up significantly at the start of 2022, driven by private consumption and exports. The boost to private consumption from the delayed recovery from the COVID-19 induced-slump is expected to last another quarter or two, but is set to fade by the end of the year as inflation's impact on disposable incomes begins to show. On the positive side, rising commodity prices are expected to benefit Latvian exports of wood products, compensating somewhat the negative effects stemming from the economic fallout of Russia's invasion of Ukraine. Investment growth is set to continue benefiting from high inflows of EU funds, but its real growth will be dampened by the impact of surging prices. Altogether, GDP growth is expected to reach 3.9% in 2022, which is significantly higher than expected in spring due to the very strong growth in the first quarter of 2022.

Graph 2.10: **Latvia - Real GDP growth and contributions**



Rapidly rising inflation is expected to suppress real disposable income and surging fuel import prices are expected to deteriorate the terms of trade. These factors are set to begin to weigh on growth at around the turn of the year, impacting both private consumption and investment. Slowing inflation in the second half of 2023 is expected to push growth up a little bit towards the end of the year. All in all, GDP growth is projected to slow down to 2.2% in 2023.

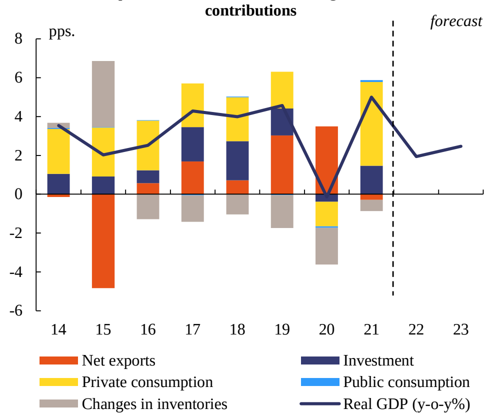
Consumer price inflation is forecast to reach 15.1% in 2022, driven by surging energy prices and their knock-on effects on other consumer price components. While the impact of the energy price surge has so far been limited by government support measures, their phasing out, together with a second round of upward revisions of regulated prices, are set to significantly increase inflation in the course of 2022. In 2023, the expected decline in energy prices is set to progressively dampen inflation, but knock-on effects on non-energy prices and wages are set to keep consumer price inflation elevated for the year as a whole.

2.11. LITHUANIA

Before the Russian invasion of Ukraine, the economy of Lithuania benefitted from higher activity in manufacturing, construction and services sectors. With the onset of the war, confidence indicators deteriorated, signalling a weakening of economic activity. Exports to Ukraine, Russia and Belarus started declining, partly offset by increased exports to other countries. Despite higher uncertainty, so far the labour market impact has been small, with employment growing gradually and nominal wages rising at an elevated pace.

The Lithuanian economy, which grew by 5.0% in 2021, is expected to expand by 1.9% in 2022, a moderate upward revision from the 1.7% forecast in spring, owing to a better than expected performance of exports in the first quarter, and by 2.5% in 2023. Economic activity is expected to be dampened by weaker exports (primarily to Ukraine, Russia and Belarus), continuing uncertainty over the geopolitical situation in Eastern Europe, lasting tensions affecting the relationship with China, and the projected fall in real household income in 2022 that has already started hampering private consumption. These factors are also set to take a toll on investment, which, in addition, will be impacted by intermediate product price inflation and delays in the delivery of needed inputs.

Graph 2.11: **Lithuania - Real GDP growth and contributions**



Inflation remains elevated and continues rising. It is projected at 17.0% in 2022, the biggest rise in prices since 1996. The sizeable upward revision from the Spring Forecast of 12.5% is mostly attributable to prices of energy and non-energy industrial goods and processed food. One third of the inflation is determined by energy prices, which are projected to increase by roughly 50% this year despite containment measures undertaken by authorities. Higher energy costs and supply disruptions are also driving up the prices of food and non-energy industrial goods. Prices of tradables, however, are increasing considerably more in Lithuania than on average in the EU, possibly indicating the role played by robust demand and surging labour costs in shaping price developments. The slowdown in economic growth, however, is anticipated to limit the rise in labour costs and reduce the price pressures induced by demand. In addition, global energy prices are expected to weaken gradually in the medium term. As a result, inflation is projected to moderate over the forecast horizon, reaching 5.1% in 2023, though staying higher than previously expected.

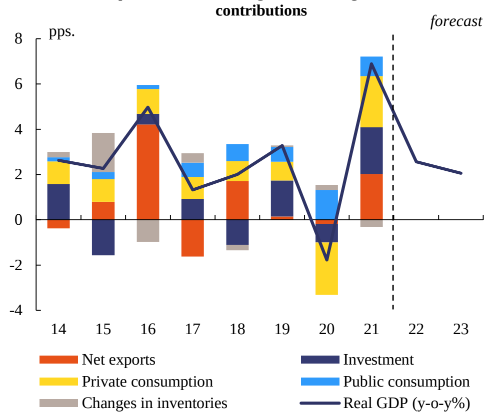
2.12. LUXEMBOURG

After registering a strong 6.9% in 2021, Luxembourg's real GDP growth is expected to slow down to 2.6% in 2022, despite a robust first quarter (1.2% quarter-on-quarter), mainly driven by private consumption and net exports. Although consumers' sentiment has weakened and high inflation is forecast to persist, private consumption is expected to remain resilient and to grow over the forecast horizon, supported by a still dynamic labour market, savings accumulated during the pandemic and fiscal support schemes to households and firms put in place in the context of high energy prices. The uncertain external environment and the tightening of financial conditions are set to weigh on investment growth. In particular, investments in equipment and construction are expected to decelerate. The contribution of the financial sector to growth is projected to decrease in 2022, mainly on the back of a deterioration in the stock market environment.

Economic expansion is projected to continue in 2023, although at a slower pace mainly due to the moderate growth of domestic demand, most notably private consumption. Overall, real GDP is expected to grow by 2.1% in 2023. Downside risks to the economic outlook are linked to the geopolitical tensions, with key risks stemming from higher financial market volatility, increasing commodity prices and uncertain global demand.

Headline inflation increased strongly in April and May (9.0% and 9.1% y-o-y respectively). All the HICP components registered an increase in the last months with energy contributing the most to the overall rise. The prices of food and non-energy industrial goods rose significantly due to soaring commodity prices and supply chain disruptions. The automatic wage indexations in October 2021 and April 2022 inflated labour costs, which notably impacted prices of services, resulting also in increased core inflation. Commodity prices, especially energy and food are expected to remain elevated this year. Consequently, the HICP is forecast to peak at 8.5% in 2022 before decreasing to 3% in 2023 due to the assumed deceleration of energy prices. While the next wage indexation has been postponed to April 2023, upside risks for inflation stem from continued increase of energy and food prices that could trigger additional wage indexations.

Graph 2.12: **Luxembourg - Real GDP growth and contributions**



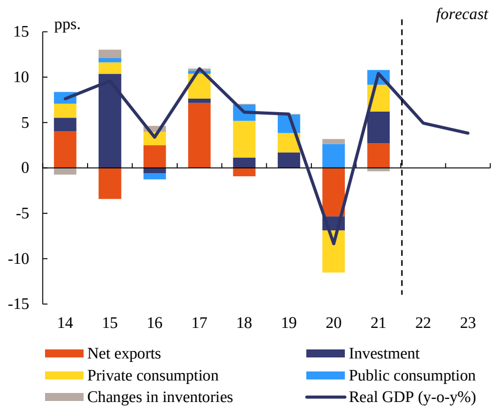
2.13. MALTA

In 2021, the Maltese economy rebounded strongly by 10.4%, thanks to improved business and consumer sentiment and growth in investment and services exports.

In 2022, real GDP growth is forecast to reach 4.9%, which is higher than projected in spring, given the expected stronger gains in the services sector, although tampered by the negative impacts of Russia's invasion of Ukraine. Growth in 2022 is expected to be driven by domestic consumption and net exports. Based on Eurocontrol's air passenger data projections, the export of tourism services is on course to a very rapid rebound in 2022 with full recovery expected by 2023, contributing to growth in both years. In 2023, real GDP is forecast to increase at a slower pace, but still by a robust 3.8%, affected by a general economic slowdown of its main trading partners, but partially compensated by continued growth of tourism and other services exports.

In June 2022, Malta was removed by the Financial Action Task Force (the international standard setting body on anti-money laundering/countering the financing of terrorism) from the list of jurisdictions under increased monitoring. This positive outcome removed the related limited downside risks flagged in previous forecast rounds.

Graph 2.13: **Malta - Real GDP growth and contributions**



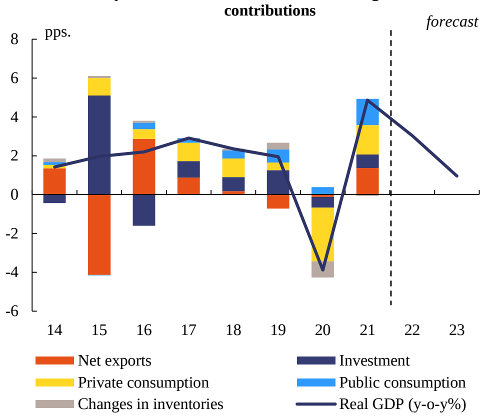
Inflation in 2021 increased only moderately by 0.7% as energy prices were kept unchanged by state interventions and hedging contracts for gas supply. While the authorities have committed to continue limiting energy price growth in 2022, the strong increase in inflation in the first two quarters of 2022 indicates that rising international energy and commodity prices are affecting Malta's prices indirectly. Inflation in 2022 is set to rise to 5.6%. The increases in food, transport and imported goods prices, and a continued recovery in the tourism and hospitality services are set to drive up price pressures also in 2023, with inflation remaining elevated at 3.3%.

2.14. THE NETHERLANDS

After strong GDP growth of 4.9% in 2021, fuelled by the gradual lifting of COVID-19 restrictions, the Dutch economy is facing new headwinds. Russia's invasion of Ukraine has resulted in further increases in commodity prices and additional supply chain disruptions. Annual growth for 2022 is revised down compared to the Commission's Spring Forecast, to 3.0%. The economy grew by 0.4% q-o-q in the first quarter, but growth in the remaining quarters is expected to be weaker, with the annual growth forecast being driven to a large extent by a substantial carry-over from 2021

(2.2%). The growth forecast for 2023 is revised down to 1.0%, with high inflation rates and geopolitical tensions continuing to hold back economic activity.

Graph 2.14: **The Netherlands - Real GDP growth and contributions**



Surging inflation rates are expected to erode households' purchasing power in 2022, negatively affecting private consumption growth especially in the second half of the year. This negative impact is, however, somewhat cushioned by a strong labour market, with a historically low unemployment rate. Investment growth is also projected to be subdued as supply chain disruptions have worsened while labour shortages and tightening financial conditions hamper business investment. The slowdown of economic growth is expected to persist in 2023 with weak private consumption growth and a negative contribution from net trade. Conversely, the government's ambitious spending plans (focused on, among others, the green transition, housing, defence and education) are expected to result in a gradual pick-up of government consumption and investment in 2023.

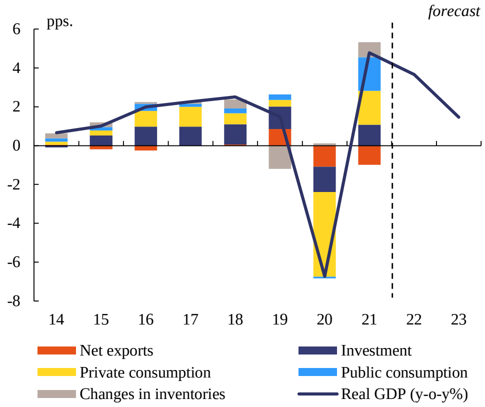
Consumer price inflation reached 11.7% y-o-y in March with only a gradual decrease since, coming in at 9.9% in May. While the surge in energy prices remains the main driver of inflation, there is a clear broadening to other price categories, with food prices standing out. Inflation rates are projected to remain elevated throughout 2022, with average inflation over the whole year coming in at 9.4%. Energy prices are expected to show a more pronounced decrease in the course of 2023, which is set to bring down the annual inflation rate to 3.3%. As a result of the tight labour market and increasing inflation, wage growth is clearly picking up from low levels, a trend which is expected to continue this year and next.

2.15. AUSTRIA

Austria's economy grew by 1.5% q-o-q in the first quarter of 2022, i.e. one percentage point slower than expected in the Spring Forecast. Since March, the economic sentiment indicator and expectations deteriorated considerably, mainly due to the headwinds from Russia's war of aggression against Ukraine and disrupted supply chains. Consequently, growth is expected also to moderate over the rest of the forecast horizon.

On an annual basis, real GDP growth is forecast to reach 3.7% in 2022 and 1.5% in 2023. Growth is supported by the ongoing normalisation of services and tourism. On the labour market, labour shortages are becoming increasingly important and have started to restrain the growth momentum. Compared to the Spring Forecast, this is a slightly clouded outlook for both years, taking into account that growth in the first quarter of 2022 stood lower than the initial flash estimate (+1.5% instead of +2.5% q-o-q) and the expected further materialisation of downside risks.

Graph 2.15: **Austria - Real GDP growth and contributions**



Energy prices increased significantly following the Russian war of aggression against Ukraine, from an already elevated level. In 2022, energy inflation is expected to remain very high throughout the year. In addition, food prices increased considerably and are set to remain high over the course of the year. A delayed pass-through of higher producer prices is projected to keep inflation elevated over the forecast horizon. Overall, HICP inflation is expected to reach 7.4% in 2022 before gradually decreasing to 4.4% in 2023.

2.16. PORTUGAL

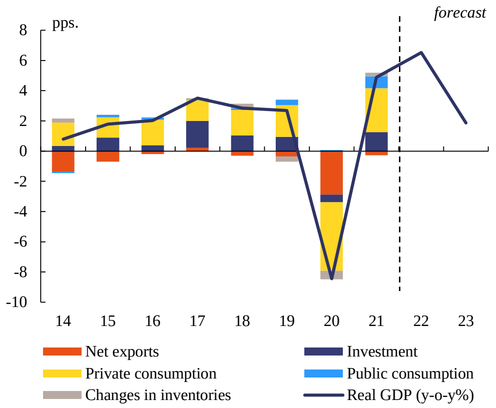
After a strong start of the year, Portugal's growth is expected to moderate in quarterly terms but to remain significant in annualised terms in 2022. Exports of services are projected to contribute most to growth, reflecting an exceptional expansion of 75% y-o-y in the first quarter of the year. This was clearly supported by the recovery of the tourism sector, with overnight stays by non-residents surging by 846% for the same period while still trailing 26% below the pre-pandemic level. Latest data suggest a continued strong performance in tourism with international flights and foreign tourist visits nearly reaching their pre-pandemic level in the second quarter of 2022. At the same time, short-term indicators suggest a slowdown in private consumption, industrial output and construction amid rising cost pressures from energy prices and global supply constraints. Weaker demand from trading partners is also projected to weigh negatively on exports of goods.

In full-year terms, growth is forecast to remain strong at 6.5% in 2022, reflecting the accumulated carry-over and the continued rebound in tourism. Growth is then projected to moderate to 1.9% in 2023 amid lower growth in private consumption and investment as well as subdued external demand. Risks to the growth outlook remain on the downside as a result of Russia's war of aggression against Ukraine and, more recently, in the context of rising concerns about staff shortages in the aviation sector, which may have negative repercussions on foreign tourist visits to Portugal.

Inflation rose substantially to 8.2% (y-o-y) in the second quarter of 2022, driven by a steep increase in the prices of energy and food products. Prices of services also increased reflecting a wide range of factors, including pent-up demand, pass-through effects from energy to transport services as well as large base effects for the prices of accommodation and air transport.

In light of the current high energy prices, inflation is projected to moderate only marginally in the second half of 2022. A more substantial moderation is expected in 2023. Overall, inflation is projected at 6.8% in 2022 and 3.6% in 2023. Core inflation is set to remain below the headline rate until the end of 2022. Wage adjustment pressures in the context of record high employment in Portugal are then expected to move core inflation slightly above the headline rate in 2023.

Graph 2.16: **Portugal - Real GDP growth and contributions**

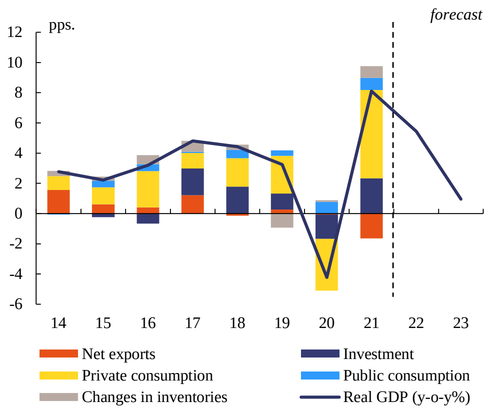


2.17. SLOVENIA

Slovenia's economy grew by 0.8% q-o-q in the first quarter of 2022, faster than expected in the Spring Forecast. Together with a vigorous growth in the last quarter of 2021, this implies a strong carry-over effect for 2022 as a whole. Based on confidence and employment indicators and early data on industrial production, growth continued also in the second quarter although with signs of softening in some sectors. Overall, the expansion in the first half of the year is expected to have been driven by private consumption and investment but exports trailed behind import growth.

The impact of Russia's war of aggression against Ukraine, increasing consumer prices and production costs, tighter financial conditions, lower expected demand in foreign markets and disruptions in supply chains are only slowly impacting incoming data, with the exception of consumer confidence, which has decreased significantly. These factors are set to gradually weigh on growth in the second half of 2022 and in 2023. On an annual basis, real GDP growth is forecast at 5.4% in 2022 and 1.0% in 2023. Private consumption has so far been supported by high employment, increases in salaries and by the use of accumulated savings from the previous periods. However, it is expected that consumption growth will slow down on the back of persistent inflation and lower real wages during the rest of the year and in 2023. Investment growth, which was still strong in the first quarter, is also forecast to decelerate in the second half of the year due to the increasing uncertainty, lower expected foreign demand, higher financing costs and prices of investment goods and construction materials. Public investment continues to be supported by the implementation of the RRP. Export growth is also expected to soften due to weak external demand.

Graph 2.17: **Slovenia - Real GDP growth and contributions**



Inflation has accelerated at the beginning of the year, driven by food and energy price increases and their pass-through to other goods and services. Inflationis projected to reach 7.6 % in 2022. Under the assumption of declining energy and food prices, inflation is expected to decrease to 4.9% in 2023.

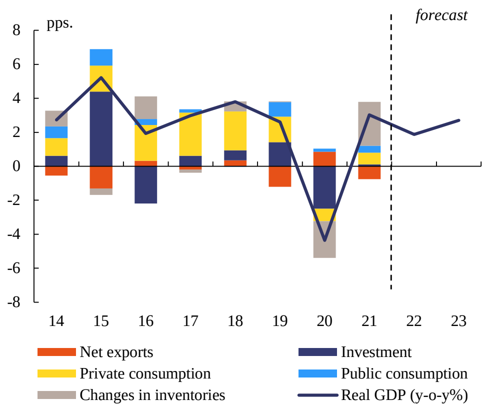
2.18. SLOVAKIA

The Slovak economy continues to recover from the pandemic-induced recession. Although weaker than expected in the spring, real GDP growth is forecast to reach 1.9% in 2022, and 2.7% in 2023. The aftereffects of the Russian military aggression against Ukraine are set to constrain economic growth over the forecast horizon. The recovery of industrial exports slowed down due to the weakening of global demand. A stronger-than-expected increase in consumption in the first quarter of 2022 was partially offset by strong reductions in investment.

Despite rising consumer prices and elevated uncertainty, private consumption grew by 3.1% in the first quarter of 2022. A newly introduced package supporting families with children, combined with other government measures, should support higher consumer spending in 2023. However, the losses in purchasing power of households are set to keep a lid on private consumption growth.

Slovakia's large export-driven industry sector remains constrained by supply chain disruptions and increasing prices of inputs. In addition, Slovakia's main export markets are expected to grow at a slower pace. Both of these effects are set to reduce the contribution from export of goods to growth. At the same time, recovering consumer demand should lead to higher imports. In 2023, gradually easing supply constraints should support export growth.

Graph 2.18: **Slovakia - Real GDP growth and contributions**



Inflation continued to exceed expectations in the second quarter of 2022, driven by higher energy and food prices. Yet another sharp increase in regulated energy prices of natural gas for households is set to drive inflation to 8.2% in 2023, following a 10.5% increase in consumer prices in 2022. Food, service and industrial good price increases are expected to persist also in 2023 but at a slower pace than in 2022. Without alleviating measures for gas prices and an agreement on price freeze for electricity, inflation in 2023 could be significantly higher.

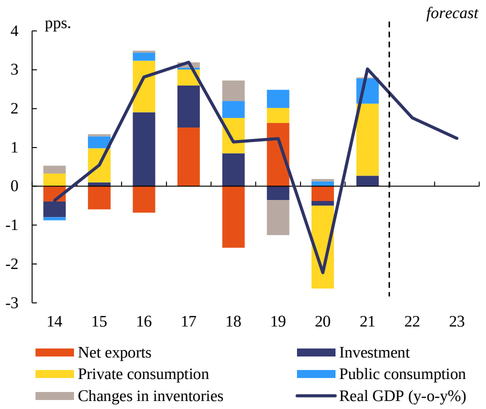
2.19. FINLAND

In the first quarter of 2022, Finland's real GDP growth slowed down but remained strong, partly due to an increase in inventories. Russia's war of aggression against Ukraine, international sanctions, surging inflation and declining consumer sentiment weighed on exports and private consumption. Imports declined at a slower pace compared to exports, bringing net exports into negative territory. At the same time, real GDP growth was supported by increases in investment, especially linked to the construction sector, and government consumption. The labour market remained strong and is set to continue performing well over the forecast horizon.

Overall, real GDP growth is forecast to reach 1.8% in 2022 and 1.2% in 2023. Continued geopolitical tensions, further increases in raw material prices and overall price levels, as well as tighter financial conditions, make the economic outlook somewhat bleaker than projected in spring. Domestic demand is forecast to remain the main growth driver, though private consumption growth is expected to slow down over the forecast horizon. On the other hand, exports are projected to gradually pick up towards the end of the forecast horizon.

HICP inflation reached 4.8% y-o-y in the first quarter of 2022 and was driven mainly by strong energy and food price increases. The latest inflation data suggest that increases in energy prices start driving other HICP components upwards. Consequently, core inflation is expected to accelerate as well. Overall, HICP inflation is projected to reach 6.4% in 2022 and fall back to 2.8% in 2023.

Graph 2.19: **Finland - Real GDP growth and contributions**



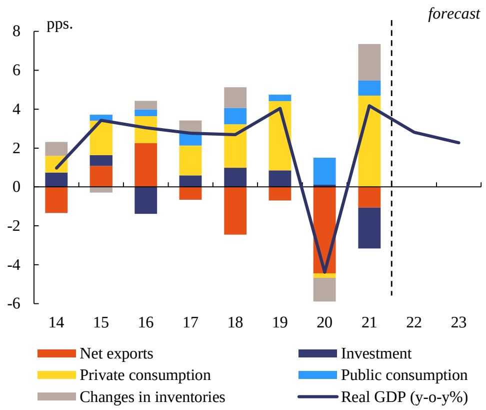
NON-EURO AREA

2.20. BULGARIA

In the first quarter of 2022 GDP grew by 0.8% quarter-on-quarter, with all demand components contributing to the expansion. Private consumption growth was supported by favourable labour market conditions and the sharp increase in wages in the private sector in the beginning of the year. Consumer confidence has deteriorated starting in March 2022, suggesting lower private consumption growth for the rest of the year. Export of goods and services are forecast to expand in 2022, due to both goods exports and tourism. The implementation of the Recovery and Resilience Plan is set to be the main factor behind the accelerated investment growth in both 2022 and 2023.

Overall, real GDP is expected to grow by 2.8% in 2022 and 2.3% in 2023. Compared to the Spring Forecast, the real GDP growth rate is 0.7 pps. higher in 2022 and 0.8 pps. lower in 2023. The upward revision in 2022 reflects mainly the strong recovery in the first quarter of this year. The weaker external environment and tighter lending conditions, combined with the weaker real wage growth, explain the downward revision for 2023. The strong wage increase in 2022 is set to lead to further price in-creases, particularly in the non-tradeable sector. In the context of less buoyant lending activity and adjusted inflation expectations, more moderate wage increases are forecast for 2023, leading to slower consumption growth.

Graph 2.20: **Bulgaria - Real GDP growth and contributions**



HICP inflation is set to accelerate to 12.5% in 2022 on the back of higher energy and food prices and indirect effects of increased energy prices for firms to overall inflation. In 2023, HICP inflation is expected to settle at 6.8%. High food and services prices are set to sustain relatively high overall inflation reflecting the assumed developments in food commodity futures and the impact of past wage increases, respectively.

2.21. CZECHIA

Real GDP is forecast to grow by 2.3% in 2022 and 2.0% in 2023, somewhat less than in 2021, when the economy expanded by 3.5%. This lower growth results from exacerbated supply chain disruptions following the Russian invasion of Ukraine and China's zero-COVID policy, as well as the elevated global inflation rate and the tightening of monetary policy.

The Czech economy started 2022 on a strong footing, with 0.9% q-o-q growth in the first quarter, fuelled by an increase in investment and a positive contribution of net exports. However, in the second quarter of 2022, the economy is forecast to contract, as the negative economic effects of the Russian invasion of Ukraine are expected to fully mature. Over the remainder of 2022, economic growth is projected to stagnate as increases in the cost of finance and reduced real income continue to drag on economic activity. In 2023, the macroeconomic situation is expected to improve but growth will remain below its historical average. Output is forecast to surpass its pre-pandemic level in the second quarter of 2023.

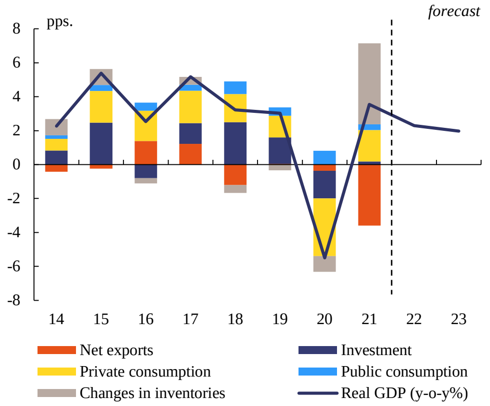
Compared to the Spring Forecast, real GDP growth is revised upward for 2022 to reflect the strong first quarter in which supply chain bottlenecks affected Czechia's industrial economy less than anticipated. Output growth for 2023 is revised downward, consistent with the deteriorated global macroeconomic outlook.

Inflation has been increasing since the start of the post-pandemic recovery. The supply chain disruptions caused by Russia's war of aggression against Ukraine add to these inflationary pressures, affecting besides the prices of energy and other production inputs, the prices of agricultural products. The Czech economy will therefore be subject to exceptionally high and broad-based inflation over 2022, and is set to experience second-round effects on for instance wages, which contribute to the height and persistence of inflation.

Inflation is expected to peak in the third quarter of 2022, when HICP growth is forecast to increase to 16% y-o-y. Inflation is foreseen to decline afterwards, when the impact of the loss of real income and the effectiveness of tightened monetary policy are expected to prevail.

Inflation as measured by HICP is forecast to average 13.9% over 2022 and 5.8% over 2023. This upward revision compared to the Spring Forecast is due to higher than expected inflation in the first half of 2022. Headline- and core inflation are forecast to converge in the first half of 2023.

Graph 2.21: **Czechia- Real GDP growth and contributions**

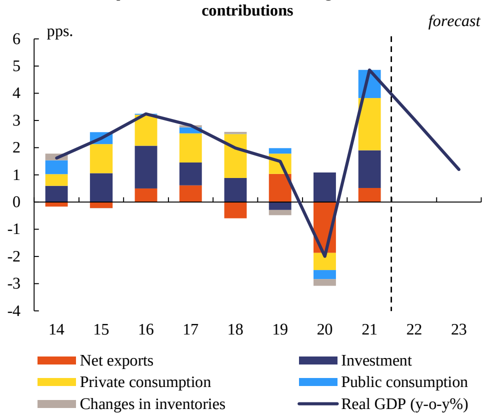


2.22. DENMARK

Denmark ended 2021 with strong growth dynamics, based on sound domestic demand, compounded by some additional growth contributions from net exports. However, in early 2022 these growth developments took a slight setback with negative quarter on quarter growth in 2022Q1. Most notably, consumption fell compared with the previous quarter in a context of ongoing COVID-19-related restrictions. The war in Ukraine further challenges the growth outlook as it adds to supply disruptions and high energy prices while contributing to tightening financial market conditions. However, most indicators suggest continued positive underlying growth dynamics. Financially sound households, positive labour market developments reflected by historically low unemployment and the number of published job vacancies and good profitability testify to strong fundamentals. Overall, real GDP is forecast to grow by 3.0% in 2022, mainly driven by domestic demand (both private consumption and investment) and with a minor positive contribution from net exports.

It is expected that the negative consequences of the war in Ukraine will continue to imply rather low growth dynamics in 2023. Despite sound underlying economic fundamentals higher interest rates, higher energy prices and a weaker external growth outlook are expected to dampen growth, and lead to a marked deceleration in 2023. For 2023, real GDP is projected to grow at 1.2%.

Graph 2.22: **Denmark - Real GDP growth and contributions**



Consumer price inflation (HICP) has been on a strong upward trend since early 2021 and has accelerated further in the first half of 2022. While higher energy and food prices lifted inflation first, core inflation is also contributing to these inflationary pressures. All other things equal, Denmark's currency peg implies inflation expectations close to those of the euro area. The war in Ukraine, uncertainty about raw materials and internationally observed supply disruptions are projected to result in a very strong surge in HICP inflation to an annual rate of 7.5% in 2022. Under the assumption of some levelling-off of energy prices, a deceleration of inflationary pressures is expected in 2023. HICP inflation is projected to reach 3.4% next year. Second round effects present an upside risk to the inflationary outlook, in particular rising labour market pressures in the context of collective wage bargaining in a tight labour market which could fuel higher than expected wage growth.

2.23. CROATIA

Croatia's GDP recorded robust growth in the first quarter of this year (2.7% q-o-q, 6.7% y-o-y), supported by both domestic demand (most notably private consumption) and net exports. Available short-term indicators for the first months of the second quarter (retail sales, industrial production, construction and trade of goods) point to still positive but somewhat weaker economic activity compared to Q1.

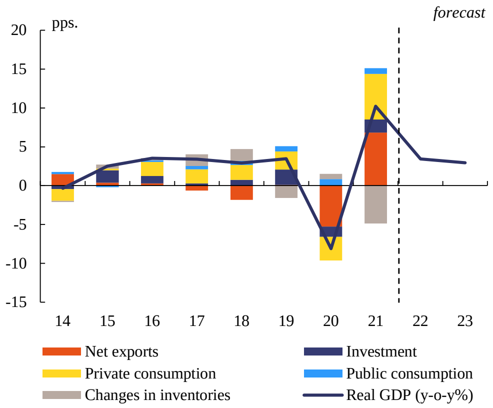
Real GDP is forecast to grow by 3.4% in 2022 and 2.9% in 2023. For 2022, growth is projected to be stronger than forecast in spring, mostly due to better than expected private consumption growth in the first quarter, which more than compensates for the deceleration towards the end of the year. The slower pace of growth at the end of 2022 is set to continue in 2023, when a somewhat weaker outlook is expected compared to the Spring Forecast, largely on account of lower growth prospects in main trading partners.

The growth profile in 2022 is set to be shaped mainly by domestic demand, to which private consumption and investments are expected to provide similar contributions. Despite rising inflation, private consumption is expected grow solidly given the accumulated savings, favourable labour market developments and a strong tourist season. Investments are expected to be backed by EU funds (both RRF and ESIF), with the public sector playing a leading role. Net exports are expected to also contribute positively, especially due to the strong tourist season, which – considering current bookings – is expected to surpass the 2019 record.

In 2023, domestic demand is set to continue to be the main driver of growth, supported by stronger private consumption in an environment of stabilising inflation and accelerating investments. On the other hand, the contribution of net exports in 2023 could turn negative due to rising pressures on imports and somewhat weaker demand than previously expected in main trading partners.

The average HICP inflation rate in the first five months of 2022 reached 7.9%, which is somewhat above the EU average of 7.3%. This is mostly due to stronger inflation in April and May, triggered by changes in administrated energy prices for households. In the remainder of the year, inflation is set to gradually decelerate given the current data on commodity futures, government measures and base effects from the last months of 2021. The inflation forecast for 2022 is revised to 8.2% (compared to 6.1% in spring), strongly affected by the higher than expected energy and processed food prices. In 2023, the inflation rate should decelerate to 3.6%, below the EA average.

Graph 2.23: **Croatia - Real GDP growth and contributions**

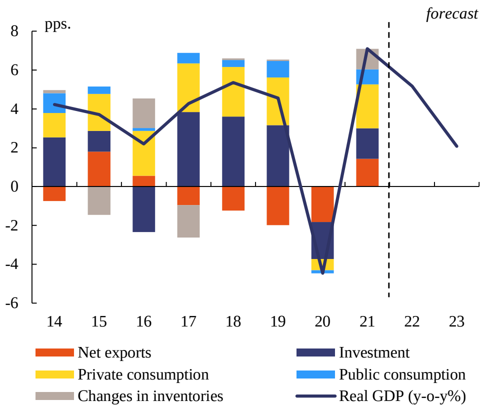


2.24. HUNGARY

Hungary's economy continued to grow rapidly in the first quarter of 2022 (2.1% q-o-q) on the back of a strong fiscal stimulus that boosted consumption and public investment. In addition to strong employment and private sector wage growth, household income was bolstered by a one-off income tax rebate and public wage and pension increases early in the year. Exports also grew briskly thanks to strong demand and a gradual easing of supply chain disruptions.

Economic growth is set to slow down markedly in the following quarters. This is already foreshadowed by lower business and consumer confidence, and the flattening level of industrial production and retail sales in April and May. The slowdown is expected to affect all demand components and be driven by rising inflation, tightening fiscal and monetary policies, as well as trade disruptions and rising uncertainty in the wake of Russia's war of aggression against Ukraine. These factors are expected to weigh on growth throughout the forecast horizon: real GDP growth is forecast to decrease from 7.1% in 2021 to 5.2% in 2022 and 2.1% in 2023.

Graph 2.24: **Hungary - Real GDP growth and contributions**



In recent months, inflation has been driven by strong domestic demand and wage growth, rising commodity prices and currency depreciation. Residential energy prices remained unchanged due to the freezing of residential utility prices and a price cap on motor fuel that was extended until 1 October. Annual average HICP inflation is set to rise from 5.2% in 2021 to 11.8% in 2022. Inflation is projected to remain high at 7.6% in 2023. Although lower consumer demand is expected to curb core inflation, the announced lifting of the motor fuel price cap towards the end of 2022 will push up next year's inflation. Furthermore, companies are expected to pass on some of the recently announced indirect tax increases to consumers.

Hungary's outlook remains particularly sensitive to the evolution of the war in Ukraine. Further uncertainties are related to global investor sentiment, and the path of monetary tightening and fiscal consolidation. The inflation profile depends on the duration of price caps, which have been extended several times already. Finally, upside risks to inflation are related to tight labour markets and rising inflation expectations.

2.25. POLAND

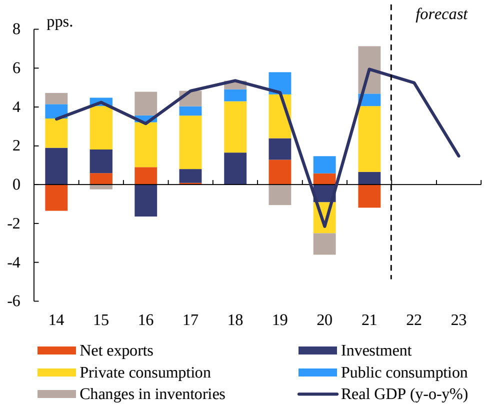
Poland's economy entered the year on a strong economic footing, with real GDP expanding by 2.5% q-o-q in the first quarter. Stock building was the main growth driver, as companies are gradually moving away from just-in-time production due to heightened uncertainty and global supply chain pressures. An outsized increase in equipment investment in the manufacturing sector lifted investment growth to 11.5% q-o-q. Meanwhile, private consumption increased only moderately despite the significant inflow of people fleeing Ukraine, which suggests that elevated inflation and declining consumer confidence are already having an adverse impact on households' spending decisions.

Going forward, economic growth is set to decelerate throughout the remainder of 2022, under the impact of Russia's war of aggression against Ukraine, monetary policy tightening, deteriorating economic sentiment and a weaker external environment. Private consumption is set to continue to be supported by the demand for necessities of displaced persons from Ukraine and ongoing fiscal expansion. Nonetheless, consumption growth will be restrained by heightened uncertainty and recent monetary policy tightening, which raises household's incentives to save and weighs on disposable income, especially given the large share of mortgages with variable interest rates in Poland. Elevated cost-pressures, higher uncertainty and tighter financing conditions are also expected to lead to firms postponing their investment projects, including in the construction sector. On the external side, the collapse in trade with Russia and Ukraine and a decrease in demand from Poland's main trading partners is set to weigh on export performance in 2022, leading to a negative contribution from net exports to growth in 2022. However, as global supply chain disruptions gradually ease and economic activity picks up, export growth should recover and lift the trade balance, especially towards the end of 2023.

Overall, GDP growth is expected to reach 5.2% in 2022, in large part driven by the exceptionally strong first quarter. Quarterly GDP growth rates are expected to remain below their historical averages at least until the second half of 2023. In 2023, despite a pick-up in growth rates, a low carryover is expected to leave the annual GDP growth at 1.5%.

Rising commodity prices, booming demand and supply side bottlenecks have all contributed to a steady and marked rise in inflation in recent months, which reached 15.6% in June. These strong price dynamics are expected to persist in the remainder of 2022, due to elevated global energy and food prices and ascending core inflation. Core inflation should remain persistently high throughout the forecast horizon as higher energy prices, labour shortages and supply bottlenecks drive price growth for services and industrial goods. Nonetheless, the weakening of growth momentum and a gradual decline in global supply chain pressures and energy prices will likely lead to a decrease in inflation towards the end of the forecast horizon. As a result, after reaching 12.2% in 2022, HICP inflation is projected to decline to 9.0% in 2023.

Graph 2.25: **Poland - Real GDP growth and contributions**



2.26. ROMANIA

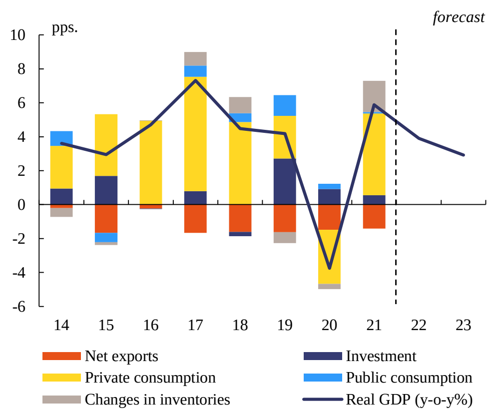
In the first quarter of 2022, Romania's economy surprised on the upside with a 5.2% real GDP growth rate. According to provisional data, this outturn is explained by a solid increase in gross fixed capital formation and private consumption, while net exports contributed negatively. This robust growth was backed by higher wages keeping pace with inflation and the phase-out of COVID restrictions.

Thanks to this very strong first quarter, GDP growth for the whole 2022 is revised upwards to 3.9%. For 2023, however, a downward revision to 2.9% is warranted, in line with the slower global and EU growth prospects. Private consumption and investments are set to be the main growth drivers for this year and the next, while net exports are projected to act as a drag on GDP and lead to a widening of the trade deficit.

Going forward, economic activity and sentiment indicators point towards a less optimistic second quarter. For the rest of the forecast horizon, both positive and negative factors intertwine. On the one hand, the high inflation is set to dent the purchasing power of households. On the other hand, the upbeat outlook in the labour market and the support measures announced by the government in April, notably for vulnerable households, should keep private consumption growing albeit more moderately. The dampening effect of high interest rates and uncertainty on private investment is forecast to be more than offset by investments supported through the sizeable RRF and other EU funds. The foreign trade outlook worsened due to the war and lockdowns in other parts of the world, implying a slowdown, which will affect more exports than imports, as seen so far.

The steep and continuous increase in food and energy prices pushed annual HICP inflation to 12.4% in May, lifting the 12-month average inflation to 7.1%. Prices are set to rise further over the forecast horizon because of energy, as not all consumers are covered by the capping scheme and as numerous electricity and gas contracts will be renegotiated in the coming months. A spike in prices for this HICP component is expected in April 2023, as the capping scheme is set to expire. Food prices are also set to increase given the global price trends and shortages caused by the war. Average annual HICP inflation is projected at 11.1% in 2022 before slowing down to 7.2% in 2023, as energy prices are set to moderate and base effects to kick-in. Stronger wage dynamics than currently estimated represent an upward risk to the inflation forecast.

Graph 2.26: **Romania - Real GDP growth and contributions**

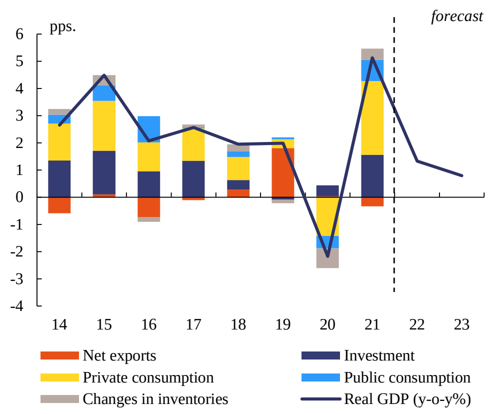


2.27. SWEDEN

In 2021, Sweden's economy recovered from the pandemic, expanding by over 5.1%. However, in the first quarter of 2022 real GDP shrunk by 0.8% and is forecast to broadly stabilise in the second quarter of 2022 before growing modestly in the second half of the year. At the beginning of the year, the surge in inflation reduced household purchasing power as Omicron variant-related restrictions also dampened economic activity while imports increased markedly.

The onset of the war in Ukraine aggravated supply bottlenecks and added to price pressures and uncertainty, thus lowering growth. Private consumption growth is expected to remain weak also in 2023 as leveraged households face the double challenge of elevated inflation and rising interest rates, notably for housing loans. This has led to a cooling in the housing market where prices started to fall in the spring. In addition, falling prices of financial assets reduce financial buffers built up during the pandemic. The non-financial business sector is set to be more resilient. Export growth and investment are expected to recover in 2023, mirroring healthy corporate balance sheets and the competitiveness of Swedish exporters. Overall, real GDP growth is set to average 1.3% in 2022 and to fall further to 0.8% in 2023.

Graph 2.27: **Sweden - Real GDP growth and contributions**



In May 2022, HICP inflation went up to 7.5%, a record high since the index was first published in 1996. Price increases were broad-based as rising energy, commodity and freight prices have fed through into consumer prices. However, wage pressures are expected to remain contained. In spite of the surge in inflation, social partners appear to be steering towards moderate central wage agreements in the upcoming collective wage negotiations, having expressed their continued support for using the central bank's inflation target as guidance. Headline inflation is set to ease in the course of 2023, partly driven by the expected moderation in commodity prices. However, domestic price pressures are set to remain high over the forecast horizon. All in all, HICP inflation is expected to average 6.6% in 2022 and decrease to 3.6% in 2023.

Risks are tilted to the downside for economic growth in view of the vulnerable household sector and global factors. Price increases could become entrenched at relatively high rates due to gradually rising inflation expectations.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2003-2023) 05.07.2022

	5-year averages							Summer 2022 Forecast		*Spring 2022 Forecast*	
	2003 - 07	2008 - 12	2013 - 17	2018	2019	2020	2021	2022	2023	*2022*	*2023*
Belgium	2.6	0.7	1.4	1.8	2.1	-5.7	6.2	**2.3**	**1.3**	*2.0*	*1.8*
Germany	1.6	0.7	1.8	1.1	1.1	-4.6	2.9	**1.4**	**1.3**	*1.6*	*2.4*
Estonia	8.2	-1.7	3.0	4.1	4.1	-3.0	8.3	**1.6**	**1.9**	*1.0*	*2.4*
Ireland	5.2	-1.4	8.9	9.0	4.9	5.9	13.5	**5.3**	**4.0**	*5.4*	*4.4*
Greece	4.1	-5.5	-0.3	1.7	1.8	-9.0	8.3	**4.0**	**2.4**	*3.5*	*3.1*
Spain	3.5	-1.3	1.9	2.3	2.1	-10.8	5.1	**4.0**	**2.1**	*4.0*	*3.4*
France	2.0	0.4	1.2	1.9	1.8	-7.8	6.8	**2.4**	**1.4**	*3.1*	*1.8*
Italy	1.1	-1.4	0.4	0.9	0.5	-9.0	6.6	**2.9**	**0.9**	*2.4*	*1.9*
Cyprus	4.5	0.1	1.3	5.7	5.3	-5.0	5.5	**3.2**	**2.1**	*2.3*	*3.5*
Latvia	9.9	-2.7	2.7	4.0	2.5	-3.8	4.5	**3.9**	**2.2**	*2.0*	*2.9*
Lithuania	8.7	-0.4	3.2	4.0	4.6	-0.1	5.0	**1.9**	**2.5**	*1.7*	*2.6*
Luxembourg	4.7	0.6	2.9	2.0	3.3	-1.8	6.9	**2.6**	**2.1**	*2.2*	*2.7*
Malta	3.0	2.5	7.4	6.2	5.9	-8.3	10.4	**4.9**	**3.8**	*4.2*	*4.0*
Netherlands	2.3	0.0	1.7	2.4	2.0	-3.9	4.9	**3.0**	**1.0**	*3.3*	*1.6*
Austria	2.6	0.6	1.2	2.5	1.5	-6.7	4.8	**3.7**	**1.5**	*3.9*	*1.9*
Portugal	1.1	-1.4	1.4	2.8	2.7	-8.4	4.9	**6.5**	**1.9**	*5.8*	*2.7*
Slovenia	4.8	-1.0	2.4	4.4	3.3	-4.2	8.1	**5.4**	**1.0**	*3.7*	*3.1*
Slovakia	7.3	2.0	2.7	3.8	2.6	-4.4	3.0	**1.9**	**2.7**	*2.3*	*3.6*
Finland	3.6	-0.7	1.0	1.1	1.2	-2.2	3.0	**1.8**	**1.2**	*1.6*	*1.7*
Euro area	2.2	-0.3	1.5	1.8	1.6	-6.4	5.3	**2.6**	**1.4**	*2.7*	*2.3*
Bulgaria	6.4	1.4	1.9	2.7	4.0	-4.4	4.2	**2.8**	**2.3**	*2.1*	*3.1*
Czechia	5.5	0.2	3.0	3.2	3.0	-5.5	3.5	**2.3**	**2.0**	*1.9*	*2.7*
Denmark	2.0	-0.4	2.2	2.0	1.5	-2.0	4.9	**3.0**	**1.2**	*2.6*	*1.8*
Croatia	4.8	-1.8	1.7	2.9	3.5	-8.1	10.2	**3.4**	**2.9**	*3.4*	*3.0*
Hungary	3.5	-0.8	3.2	5.4	4.6	-4.5	7.1	**5.2**	**2.1**	*3.6*	*2.6*
Poland	5.0	3.4	3.3	5.4	4.7	-2.2	5.9	**5.2**	**1.5**	*3.7*	*3.0*
Romania	6.5	0.6	4.5	4.5	4.2	-3.7	5.9	**3.9**	**2.9**	*2.6*	*3.6*
Sweden	3.5	0.7	2.6	2.0	2.0	-2.2	5.1	**1.3**	**0.8**	*2.3*	*1.4*
EU	2.4	-0.1	1.7	2.1	1.8	-5.9	5.4	**2.7**	**1.5**	*2.7*	*2.3*

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 05.07.2022

	2021/1	2021/2	2021/3	2021/4	2022/1	2022/2	2022/3	2022/4	2023/1	2023/2	2023/3	2023/4
Belgium	1.3	1.7	2.1	0.4	0.5	-0.1	0.0	0.2	0.4	0.5	0.5	0.5
Germany	-1.7	2.2	1.7	-0.3	0.2	0.0	0.2	0.2	0.3	0.5	0.5	0.5
Estonia	3.6	2.3	0.9	1.3	0.1	-0.3	-0.6	0.1	0.7	0.9	1.3	1.2
Ireland	9.5	5.0	1.9	-6.2	10.8	:	:	:	:	:	:	:
Greece	3.4	1.3	2.3	0.8	2.3	:	:	:	:	:	:	:
Spain	-0.5	1.1	2.6	2.2	0.2	0.4	0.5	0.2	0.4	0.7	0.7	0.7
France	0.2	1.0	3.2	0.4	-0.2	0.2	0.4	0.3	0.3	0.3	0.3	0.3
Italy	0.2	2.7	2.6	0.7	0.1	0.2	0.2	0.1	0.2	0.2	0.2	0.3
Cyprus	1.3	1.8	1.9	0.9	1.0	:	:	:	:	:	:	:
Latvia	0.0	2.4	0.5	-0.2	3.6	0.1	0.1	-0.1	0.5	0.7	1.0	1.0
Lithuania	1.7	1.2	0.7	1.3	1.2	-1.6	-0.1	1.0	0.9	0.9	0.9	0.9
Luxembourg	2.1	0.8	0.9	1.0	1.2	-0.3	0.0	0.2	0.6	0.9	0.9	0.9
Malta	4.9	0.2	3.7	2.5	1.0	:	:	:	:	:	:	:
Netherlands	0.1	3.8	1.5	0.7	0.4	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Austria	-0.5	4.3	3.4	-0.8	1.5	-0.2	0.0	0.4	0.6	0.4	0.4	0.4
Portugal	-2.9	4.4	2.7	1.7	2.6	-0.2	0.4	0.4	0.5	0.5	0.5	0.5
Slovenia	1.6	1.9	1.3	5.3	0.8	0.2	-0.7	0.0	0.4	0.4	0.4	0.4
Slovakia	-1.4	1.9	0.4	0.4	0.4	0.1	0.4	0.7	0.7	0.8	0.8	0.8
Finland	-0.1	1.5	0.9	0.8	0.5	0.0	0.1	0.2	0.3	0.3	0.3	0.3
Euro area	-0.1	2.2	2.3	0.2	0.6	0.0	0.3	0.3	0.4	0.5	0.5	0.5
Bulgaria	1.8	0.9	0.9	1.3	0.8	0.3	0.4	0.4	0.3	0.8	1.2	1.6
Czechia	-0.5	1.4	1.7	0.8	0.9	-0.6	0.0	0.3	0.6	0.8	0.9	0.9
Denmark	0.0	2.5	1.3	2.8	-0.5	0.2	0.3	0.2	0.3	0.3	0.2	0.3
Croatia	5.9	1.5	1.3	1.0	2.7	-1.3	0.0	0.1	1.2	1.1	1.0	0.8
Hungary	1.3	2.4	1.1	2.2	2.1	0.2	0.0	0.3	0.6	0.7	0.8	0.8
Poland	1.4	2.0	2.6	1.8	2.5	0.0	-0.6	0.0	0.5	0.7	0.9	0.9
Romania	1.1	3.3	-2.9	1.0	5.2	-1.9	0.0	0.4	1.0	1.2	1.6	1.2
Sweden	1.6	0.8	2.0	1.2	-0.8	0.0	0.2	0.2	0.2	0.2	0.2	0.2
EU	0.1	2.1	2.2	0.5	0.7	-0.1	0.2	0.2	0.4	0.5	0.5	0.5

Table 3: Harmonised index of consumer prices, (percentage change on preceding year, 2003-2023) 05.07.2022

	5-year averages							Summer 2022 Forecast		*Spring 2022 Forecast*	
	2003 - 07	2008 - 12	2013 - 17	2018	2019	2020	2021	2022	2023	*2022*	*2023*
Belgium	2.0	2.5	1.3	2.3	1.2	0.4	3.2	**9.4**	**2.9**	*7.8*	*1.9*
Germany	1.8	1.7	1.0	1.9	1.4	0.4	3.2	**7.9**	**4.8**	*6.5*	*3.1*
Estonia	3.9	4.5	1.6	3.4	2.3	-0.6	4.5	**17.0**	**4.7**	*11.2*	*2.5*
Ireland	2.8	0.6	0.2	0.7	0.9	-0.5	2.4	**7.3**	**3.3**	*6.1*	*3.1*
Greece	3.3	2.9	-0.4	0.8	0.5	-1.3	0.6	**8.9**	**3.5**	*6.3*	*1.9*
Spain	3.2	2.3	0.5	1.7	0.8	-0.3	3.0	**8.1**	**3.4**	*6.3*	*1.8*
France	2.0	1.9	0.6	2.1	1.3	0.5	2.1	**5.9**	**4.1**	*4.9*	*3.1*
Italy	2.3	2.4	0.6	1.2	0.6	-0.1	1.9	**7.4**	**3.4**	*5.9*	*2.3*
Cyprus	2.5	2.7	-0.4	0.8	0.5	-1.1	2.3	**7.0**	**3.3**	*5.2*	*2.7*
Latvia	6.5	4.6	0.8	2.6	2.7	0.1	3.2	**15.5**	**6.0**	*9.4*	*3.5*
Lithuania	2.4	4.7	1.0	2.5	2.2	1.1	4.6	**17.0**	**5.1**	*12.5*	*3.0*
Luxembourg	3.0	2.7	0.9	2.0	1.6	0.0	3.5	**8.5**	**3.0**	*6.8*	*2.3*
Malta	2.1	2.9	1.0	1.7	1.5	0.8	0.7	**5.6**	**3.3**	*4.5*	*2.6*
Netherlands	1.7	1.9	0.9	1.6	2.7	1.1	2.8	**9.4**	**3.3**	*7.4*	*2.7*
Austria	1.9	2.3	1.5	2.1	1.5	1.4	2.8	**7.4**	**4.4**	*6.0*	*3.0*
Portugal	2.7	1.9	0.6	1.2	0.3	-0.1	0.9	**6.8**	**3.6**	*4.4*	*1.9*
Slovenia	3.6	2.7	0.6	1.9	1.7	-0.3	2.0	**7.6**	**4.9**	*6.1*	*3.3*
Slovakia	4.9	2.7	0.4	2.5	2.8	2.0	2.8	**10.5**	**8.2**	*9.8*	*6.8*
Finland	1.0	2.7	0.9	1.2	1.1	0.4	2.1	**6.4**	**2.8**	*4.5*	*2.3*
Euro area	2.2	2.1	0.7	1.8	1.2	0.3	2.6	**7.6**	**4.0**	*6.1*	*2.7*
Bulgaria	5.9	4.6	-0.5	2.6	2.5	1.2	2.8	**12.5**	**6.8**	*11.9*	*5.0*
Czechia	1.8	2.7	1.0	2.0	2.6	3.3	3.3	**13.9**	**5.8**	*11.7*	*4.5*
Denmark	1.6	2.4	0.4	0.7	0.7	0.3	1.9	**7.5**	**3.4**	*5.1*	*2.7*
Croatia	2.7	2.9	0.6	1.6	0.8	0.0	2.7	**8.2**	**3.6**	*6.1*	*2.8*
Hungary	5.4	4.9	0.9	2.9	3.4	3.4	5.2	**11.8**	**7.6**	*9.0*	*4.1*
Poland	2.1	3.7	0.3	1.2	2.1	3.7	5.2	**12.2**	**9.0**	*11.6*	*7.3*
Romania	9.5	5.7	0.8	4.1	3.9	2.3	4.1	**11.1**	**7.2**	*8.9*	*5.1*
Sweden	1.5	1.9	0.9	2.0	1.7	0.7	2.7	**6.6**	**3.6**	*5.3*	*3.0*
EU	2.4	2.4	0.7	1.8	1.4	0.7	2.9	**8.3**	**4.6**	*6.8*	*3.2*

Table 4: Harmonised index of consumer prices, (percentage change on preceding year) 05.07.2022

	2021/1	2021/2	2021/3	2021/4	2022/1	2022/2	2022/3	2022/4	2023/1	2023/2	2023/3	2023/4
Belgium	0.8	2.4	3.3	6.4	9.1	9.9	10.9	7.9	5.9	3.1	1.8	1.1
Germany	1.7	2.2	3.5	5.4	6.1	8.0	8.2	9.2	7.5	5.3	4.1	2.4
Estonia	0.6	2.8	5.4	9.1	12.5	20.4	19.0	16.1	12.2	3.4	1.8	2.0
Ireland	-0.1	1.5	3.0	5.4	5.9	8.4	8.3	6.5	5.3	2.9	2.5	2.7
Greece	-2.1	-0.6	1.3	3.7	6.6	10.5	10.2	8.1	6.2	3.5	2.5	2.0
Spain	0.5	2.3	3.4	5.8	7.9	8.9	8.7	6.8	5.1	3.1	2.8	2.8
France	1.0	1.8	2.2	3.3	4.2	5.9	6.8	6.7	5.9	4.3	3.3	2.9
Italy	0.7	1.2	2.1	3.7	6.0	7.4	8.1	7.9	5.2	3.6	2.6	2.1
Cyprus	-0.5	1.6	3.2	4.6	5.7	8.8	7.2	5.8	4.4	3.0	3.0	3.0
Latvia	-0.1	2.3	3.7	7.1	9.2	16.3	20.1	16.3	14.7	7.7	1.9	0.5
Lithuania	0.7	3.2	5.2	9.4	13.9	18.5	19.7	16.0	11.2	4.7	2.5	2.4
Luxembourg	1.0	3.6	3.6	5.7	6.8	9.5	9.6	7.9	5.7	2.6	2.0	1.9
Malta	0.1	0.1	0.5	2.1	4.3	5.8	6.7	5.5	4.5	3.4	2.8	2.6
Netherlands	1.8	1.8	2.4	5.3	8.9	10.4	10.5	8.0	4.5	3.5	2.7	2.3
Austria	1.5	2.6	3.1	3.9	5.5	7.9	8.3	8.0	6.2	4.5	3.7	3.1
Portugal	0.2	-0.1	1.2	2.4	4.4	8.2	8.1	6.5	5.4	3.4	3.0	2.7
Slovenia	-0.6	2.1	2.3	4.5	6.3	9.0	7.8	7.4	6.1	5.4	4.2	4.0
Slovakia	1.0	2.1	3.4	4.8	8.5	11.7	11.5	10.3	10.3	7.9	7.5	7.3
Finland	1.1	2.1	1.9	3.1	4.8	7.0	7.4	6.3	4.4	2.7	2.3	1.9
Euro area	1.1	1.8	2.8	4.6	6.1	7.9	8.4	7.9	6.2	4.2	3.3	2.5
Bulgaria	0.2	2.2	2.9	6.0	8.9	13.1	14.7	13.4	11.3	6.9	5.3	4.2
Czechia	2.2	2.8	3.3	5.0	10.2	14.8	16.0	14.7	10.1	5.7	3.8	3.9
Denmark	0.6	1.7	2.0	3.5	5.4	8.1	9.0	7.6	4.1	3.4	3.1	2.9
Croatia	0.7	2.2	3.1	4.6	6.4	9.2	9.4	7.7	3.7	3.4	3.6	3.6
Hungary	3.3	5.3	5.0	7.1	8.3	10.6	12.8	15.1	12.7	8.9	6.2	3.1
Poland	3.9	4.6	5.1	7.3	9.0	12.6	14.1	12.8	13.7	9.4	7.1	6.2
Romania	2.3	3.1	4.3	6.6	8.2	12.5	12.5	11.1	8.5	8.5	6.4	5.5
Sweden	1.9	2.3	2.5	3.9	4.9	8.1	7.3	6.0	4.8	3.4	3.1	3.3
EU	1.4	2.2	3.1	4.9	6.5	8.4	8.9	8.3	6.6	4.5	3.5	2.8

Box .1: **Some technical elements behind the forecast**

The Summer 2022 interim Forecast provides an update of the Spring 2022 Forecast of 16 May 2022, focusing on GDP and inflation developments in all EU Member States.

The cut-off date for taking new information into account in this forecast was 5 July 2022.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounting (ESA 2010). Due to differences in revision schedules of annual and quarterly national accounts, annual and quarterly figures may not be fully consistent for some Member States. 2022 and 2023 are forecast years.

Working-day adjustment

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

The working-day effect in the EU and the euro area is estimated to be limited in 2022 and 2023, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1 pps.).

External assumptions

The forecast builds on the technical assumption of fixed nominal exchange rates for all currencies (see Table 1). Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. Assumptions for Brent oil prices are based on futures markets.

To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 17 and 30 June) were used for exchange and interest rates, and for oil prices.

Trade policies

Also for trade policy, this forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the Spring 2022 Forecast, the main change to the baseline scenario is the 12th Ministerial Conference of the WTO, which includes a multilateral agreement to end harmful fisheries subsidies and a waiver of certain intellectual property obligations concerning COVID-19 vaccines, among other measures.

Geographical zones

Euro area: EA19 (BE, DE, EE, IE, EL, ES, FR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK and FI).

European Union: EU (EA19, BG, CZ, DK, HR, HU, PL, RO, and SE).

Table 1:
Technical assumptions

	Summer 2022 interim Forecast			*Spring 2022 Forecast*	
	2021	2022	2023	2022	2023
3-month EURIBOR (percentage per annum)	-0.5	**0.3**	**2.2**	*-0.1*	*1.3*
10-year government bond yields (percentage per annum) (a)	-0.4	**1.2**	**1.8**	*0.8*	*1.1*
USD/EUR exchange rate	1.18	**1.06**	**1.05**	*1.09*	*1.08*
GBP/EUR exchange rate	0.86	**0.84**	**0.86**	*0.84*	*0.83*
RMB/EUR exchange rate	7.63	**7.01**	**7.04**	*7.00*	*6.97*
JPY/EUR exchange rate	129.86	**137.47**	**142.63**	*135.61*	*137.38*
EUR nominal effective exchange rate (annual percentage change) (b)	1.2	**-3.9**	**-0.4**	-2.2	-0.5
Oil price (USD per barrel)	70.7	**108.2**	**95.6**	103.6	93.5

(a) 10-year government bond yields for the euro area equal the German government bond yields.
(b) 42 industrial countries EU TR CH NR UK US CA JP AU MX NZ KO CN HK RU BR.

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- http://ec.europa.eu/economy_finance/publications/qr_euro_area/index_en.htm
(the Quarterly Reports on the Euro Area)

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