European Commission

ISSN 2443-8014 (online)

European Economic Forecast

Winter 2022

INSTITUTIONAL PAPER 169 | FEBRUARY 2022

EUROPEAN ECONOMY

Economic and Financial Affairs

European Economy Institutional Papers are important reports analysing the economic situation and economic developments prepared by the European Commission's Directorate-General for Economic and Financial Affairs, which serve to underpin economic policy-making by the European Commission, the Council of the European Union and the European Parliament.

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Luxembourg: Publications Office of the European Union, 2022

PDF ISBN 978-92-76-43938-7 ISSN 2443-8014 doi:10.2765/333044 KC-BC-22-0006-EN-N

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Cover photography: © iStock.com/kwasny221

European Commission
Directorate-General for Economic and Financial Affairs

European Economic Forecast

Winter 2022 (Interim)

EUROPEAN ECONOMY

Institutional Paper 169

CONTENTS

LIST OF TABLES

LIST OF GRAPHS

LIST OF BOXES

GROWTH EXPECTED TO REGAIN TRACTION AFTER WINTER SLOWDOWN

The EU economy entered the new year on a weaker note than previously projected. Having regained the pre-pandemic output level in summer last year, a moderate slowdown was already expected in the Autumn Forecast. However, since then headwinds to growth have intensified. After a soft patch, the economic expansion is set to regain pace in the second quarter of this year and remain robust over the forecast horizon. Following a strong recovery by 5.3% in 2021, the EU economy is now forecast to grow by 4.0% in 2022, as in the euro area, and by 2.8% in 2023 (2.7% in the euro area).

The resurgence of the pandemic last autumn and the exponential spread of the new Omicron variant have led to renewed strains on healthcare systems and an unprecedented surge of absences from work in many EU countries. Governments across the EU have reinstated restrictions– though generally of a milder or more targeted nature than in previous waves. Persistent logistic and supply bottlenecks, including shortages of semiconductors and some metal commodities, keep weighing on production, as do the elevated prices of energy. Stronger than expected inflationary pressures weigh on households' purchasing power.

This forecast assumes that the impact on the economy caused by the current wave of infections will be short-lived and that most of the supply bottlenecks will fade in the course of the year. Finally, inflationary pressures are expected to moderate towards the end of the year. Looking beyond this short-term turbulence, a continuously improving labour market, large accumulated savings, still favourable financing conditions, and the full deployment of the Recovery and Resilience Facility (RRF) are all set to support a prolonged and robust expansionary phase.

Compared to the Autumn Forecast, inflation projections have been revised up, as energy prices are now set to remain high for longer and price pressures are broadening to several categories of goods and services. Inflation in the euro area is projected to peak in the first quarter of 2022 and remain above 3% until the third quarter of the year. As the pressures from supply constraints and energy prices fade, inflation is expected to decline markedly in the final quarter of the year and settle at below 2% next year. Overall, inflation in the euro area is forecast to increase from 2.6% in 2021 (2.9% in the EU) to 3.5% (3.9% EU) in 2022, before declining to 1.7% (1.9% EU) in 2023.

The balance of risks to the growth outlook is broadly even. The current wave of infections could have a longer lasting economic impact than assumed, bringing fresh disruptions to critical supply chains. On the upside, household consumption could grow more strongly, as observed following previous waves, while investments fostered by the RRF could generate a stronger impulse to activity. The inflation projections are subject to upside risks if cost pressures are passed on from producer to consumer prices to a larger extent, increasing the likelihood of strong second-round effects. Risks to the growth and inflation outlook are aggravated by geopolitical tensions in Eastern Europe.

Table 1:
Overview - the Winter 2022 interim forecast

	Real GDP growth						Inflation					
	Winter 2022 interim forecast			*Autumn 2021 forecast*			Winter 2022 interim forecast			*Autumn 2021 forecast*		
	2021	2022	2023	*2021*	*2022*	*2023*	2021	2022	2023	*2021*	*2022*	*2023*
Euro area	5.3	4.0	2.7	*5.0*	*4.3*	*2.4*	2.6	3.5	1.7	*2.4*	*2.2*	*1.4*
EU	5.3	4.0	2.8	*5.0*	*4.3*	*2.5*	2.9	3.9	1.9	*2.6*	*2.5*	*1.6*

1. EURO AREA AND EU OUTLOOK

1.1. SETTING THE SCENE

The EU economy entered the new year on a weaker footing than previously expected, but the economic expansion is set to regain pace in the second quarter of this year and remain robust over the forecast horizon. As the EU economy closed the gap with its pre-pandemic output levels in summer 2021, a moderate slowdown towards year end was already expected in the Autumn Forecast. Yet, headwinds to growth have intensified since the fall, impacting negatively on the short-term outlook.

The surge in COVID-19 infections as from late October proved that high vaccination rates alone are not sufficient to contain the spread of the virus. In November, several Member States thus re-introduced or tightened containment measures, though the restrictions tended to be milder than in previous waves as they were mainly focused on persons with no proof of vaccination or recovery. The subsequent emergence and rapid spread of the Omicron variant was a stark reminder that risks stemming from virus mutations are all but hypothetical.

The new wave of the pandemic is exerting pressure in many EU countries through a combination of renewed stress on health care systems and staff shortages due to sickness, quarantine and care duties. At the current juncture, the uncertainty over the future evolution of the pandemic has taken a new dimension. Reassured by the lower severity of the new strain, in terms intensive care unit (ICU) admissions, some Member States are starting to relax the restrictions; others are keeping them in place or even tightening them further. The high uncertainty surrounding the evolution of the pandemic warrants once again the formulation of assumptions on the economic impact of the pandemic for the purposes of this forecast. The following section looks in detail into recent developments of the pandemic and spells out technical assumptions for the near term evolution of its course.

Developments of energy prices have been broadly in line with the expectations formulated in the Autumn 2021 Forecast. Future contracts, however, now signal that prices of gas – and consequently electricity – are not set to substantially abate until 2023. Futures for oil prices have inched higher. Consequently, energy prices are now assumed to remain high for longer, especially in Europe. Amidst record low gas storage levels, fluctuations in demand and supply and concerns about the geopolitical tensions in the EU's eastern neighbourhood are putting upward pressure on gas prices and are heightening volatility. The direct impact of the surge in energy prices on consumer inflation is already materialising. Heterogeneity in the structure of retail markets, nevertheless, implies that higher wholesale prices are passed on to consumers with different time lags and intensity. Some Member States are reducing pressure on consumers by e.g. capping price adjustments in regulated markets or by directly supporting low income households. Box 1.2 discusses the transmission of wholesale energy prices to retail prices in the EU and analyses some of the factors behind cross-country heterogeneity of retail price dynamics.

Supply conditions have deteriorated further this winter. Shortages of raw materials and equipment continue to constrain industrial production. What is more, labour shortages are also becoming more pervasive. This is a significant change for the EU, where demand and not supply has generally been the main factor limiting production. This forecast continues to assume a progressive normalisation of supply conditions over the course of the year, but several indicators now suggest that constraints are more binding and lasting longer than expected back in autumn. Labour and material/equipment shortages are discussed in detail in Box 1.1.

Developments in energy markets and supply constraints are putting pressure on prices. Inflationary pressures are nevertheless expected to fade over the forecast horizon given that, to a large extent, they are linked to the post-pandemic adjustment and energy and non-energy commodity volatility.

Financial conditions remain favourable by historical standards, but have tightened somewhat since autumn. Despite the continuing accommodative stance of the ECB, yields have inched higher, while equity markets turned lower in January amidst increased volatility. The euro has weakened against major currencies while inflation expectations are closer to price stability targets.

Finally, the EU external environment appears less supportive in the short run. Most of the developments discussed above are indeed also affecting the global outlook. Large swathes of the emerging world are still struggling with low vaccination coverage and hence are even more exposed to pandemic developments. Whereas high energy and non-energy commodity prices are lifting the growth prospects of commodity exporters, a tightening monetary cycle in response to high global inflation puts a number of emerging market economies that still have not fully recovered their pre-pandemic output levels in a vulnerable position.

These headwinds weigh primarily on the supply side of the economy. As a consequence, the temporary drag on activity is set to go hand-in-hand with renewed inflationary pressures.

Looking beyond the current turbulence, however, the fundamentals underpinning the expansionary phase continue to be strong. A continuously improving labour market, high household savings, still favourable financing conditions, and the full deployment of the Recovery and Resilience Facility stimulus are all set to sustain a prolonged and robust expansionary phase. Economic growth can thus be expected to regain momentum as the wave of infections abates, supply conditions normalise and inflationary pressures moderate. The prospects for household consumption – which in the third quarter still remained below pre-pandemic levels – are very favourable. Managers' upbeat plans assessment of investment in 2021 and plans for 2022 are analysed in the Box 1.3.

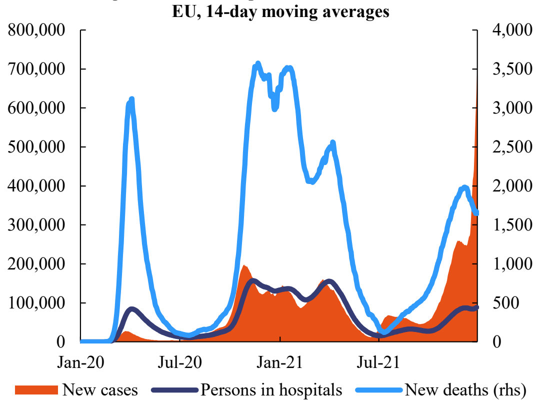
The Winter Interim Forecast provides an update of the Autumn Forecast, published on 11 November 2021 and reassesses the economic growth and inflation outlook for the EU and its Member States in light of these recent developments.

1.2. EVOLUTION OF THE PANDEMIC AND INTERVENTIONS TO STEM IT

The Omicron variant is spreading at unprecedented speed…

The Omicron variant is now the dominant variant in the US and Europe. It is spreading rapidly, with daily new cases still chasing one record high after another in many countries. By end-January, the 14-day incidence ([1]) of cases had increased in almost all Member States, reaching levels of more than 6,000 in Denmark, France, Portugal and Slovenia. Despite marked decreases in the countries first affected by Omicron, the average incidence for the EU as a whole continued to rise, surpassing 3,500 cases at the end of January. In the rest of the world, the situation is more heterogeneous. New cases appear to have peaked in the UK, the US, Canada and Argentina for instance, while in other countries the uptick in cases is more recent (e.g. Japan, Brazil, Russia, India) or has not (yet) materialised (e.g. Indonesia, China). However, the link between cases, hospitalisations and deaths has weakened ([2]) and boosters seem to provide adequate protection against severe symptoms (see Graph 1.1).

Graph 1.1: **Cases, hospitalisations and deaths in the EU, 14-day moving averages**



Source: Our World in Data, WHO.

The European Centre for Disease Prevention and Control assesses the overall level of risk to public health and the society posed by the ongoing spread of Omicron as high to very high, especially in countries with low vaccination rates. ([3]) Despite the lower severity of the new Omicron variant, the exponential growth of infections puts strain on the healthcare systems and is leading to high absenteeism, including among healthcare and other essential workers.

([1]) The 14-day incidence shows the number of new infections within the past 14 days per 100,000 inhabitants.

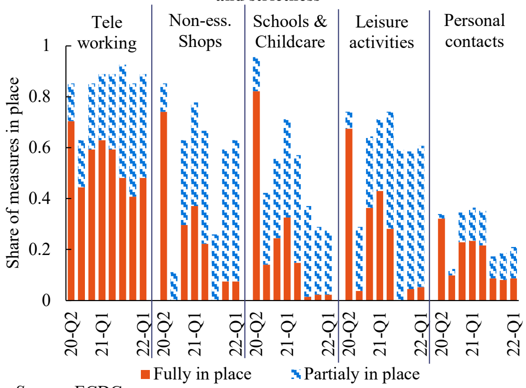
([2]) However, prior immunity from natural infection, vaccination including booster doses, and improved treatment options contribute to less severe outcomes, making it challenging to estimate the inherent risk of severe infection for Omicron.

([3]) See 'European Centre for Disease Prevention and Control. Assessment of the further spread and potential impact of the SARS-CoV-2 Omicron variant of concern in the EU/EEA, 19th update - 27 January 2022. ECDC: Stockholm; 2022.'

…resulting in renewed strains on health care systems and the economy…

The rapid increase of infections is taking a toll on economic growth, though much less so than in earlier episodes of the pandemic. Since November, the average stringency of containment measures has increased again in the EU according to the Oxford Stringency Index. However, also thanks to the high shares of vaccinations, Member States moved towards measures of a more partial nature, such as limiting access to restaurants to fully vaccinated or tested persons, as opposed to shutting down restaurants altogether (see Graph 1.2). Still, the unprecedented amount of worker absenteeism, due to sickness, isolation, precautionary quarantines or care duties, is set to hit supply, thus forcing the economy to run in low gear. (4)

Graph 1.2: **Containment measures in the EU, by nature and strictness**



Source: ECDC.
Note: A measure was counted when lasting for at least 4 weeks.

…that are assumed to be short-lived.

At the current juncture, the uncertainty over the future evolution of the pandemic has taken a new dimension. Reassured by the apparently lower severity of the new strain, in terms ICU admissions, some Member States are starting to relax the restrictions; others are keeping them in place or even tightening them further.

This forecast is therefore based on the technical assumption of short-lived economic effects of the current pandemic wave, mainly in the first quarter, and no major disruptions thereafter.

(4) For example, the US Census Bureau has reported that in the first two weeks of the year, almost 9 million workers were absent in relation to a COVID-19 infection, the highest since the survey began in 2020 and almost three times as high as in the first two weeks of December 2021.

1.3. THE GLOBAL ECONOMY: RECENT DEVELOPMENTS AND OUTLOOK

Global economic activity picked up in the third quarter …

Global economic output surpassed pre-pandemic levels in early 2021, but this largely reflected the strong performance of China, the rapid recovery in the US and in a handful of smaller economies. A significant number of both advanced and emerging economies were still below their pre-pandemic output levels in Q3-2021.

Overall, global growth (excluding EU) accelerated to 1.5% quarter-on-quarter in 2021-Q3, after a flat 2021-Q2. Growth in advanced economies (excl. EU) moderated, however, to 0.5% quarter-on-quarter (compared to 1.5% in 2021-Q2) as the Delta variant and supply side disruptions continued to affect activity. Emerging market economies (EMEs) on aggregate did well in 2021-Q3 (2.2% quarter-on-quarter) after a dip in 2021-Q2 (-1%) but this largely reflected extreme outturns for India, which saw a steep drop in output in Q2 and a very strong rebound in Q3.

After reaching pre-pandemic levels by the end of 2020 and continuing to grow in the first half of 2021, global trade in goods fell in Q3 (-1.0% quarter-on-quarter), before picking up in October and November. Global goods trade in November 2021 was 7.5% above the pre-pandemic level (December 2019). International trade in services trade remains, however, well below pre-pandemic levels.

…while inflation increased…

Inflation has been increasing sharply since the start of 2021, particularly in advanced economies. Some countries also show signs of tight labour markets, with high vacancy levels and accelerating nominal wage rises (e.g. US, Canada, UK). Inflation has also picked up in emerging markets, but the increase is less pronounced. In China, the producer price index increased sharply throughout 2021, on the back of rising prices of energy and metals, but pass-through to consumer prices is low and inflation remains contained (1.2% year-on-year in December). In other emerging market economies rising food and energy prices (e.g. Russia, Mexico, Brazil, India) have contributed to higher inflation. In some, these developments have been

Table 1.1:
International environment

(Annual percentage change)				Winter 2022 interim forecast			Autumn 2021 forecast		
	2018	2019	2020	2021	2022	2023	2021	2022	2023
				Real GDP growth					
World (excl.EU)	3.8	2.9	-2.9	**5.7**	**4.2**	**3.8**	*5.8*	*4.5*	*3.7*
				Trade volumes					
World (excl.EU) exports of goods and services	3.9	0.0	-8.0	**9.4**	**4.8**	**4.6**	*8.9*	*5.6*	*4.1*
World (excl.EU) imports of goods and services	4.3	-0.8	-8.9	**9.3**	**5.5**	**4.6**	*9.3*	*6.1*	*4.5*

accompanied by depreciating currencies (notably Turkey).

…driven by rising energy and non-energy commodity prices.

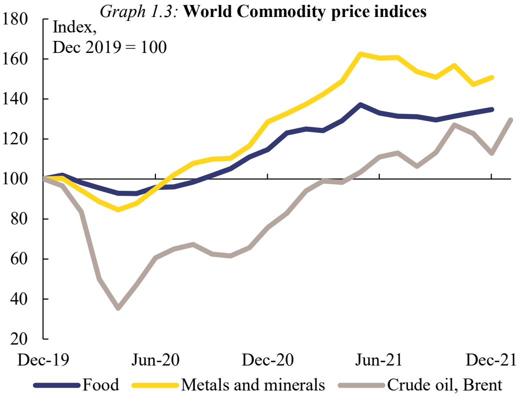
The broad-based increase in commodity prices in recent months took oil prices to pre-pandemic levels, while base metal and food prices reached multiple-year highs. Oil prices reached USD 71 per barrel in 2021 (around 60% higher than in 2020, and around 22% above the 2015-19 average) amid declining storage levels, continued production cuts by OPEC+ and a substantial projected increase in oil demand in the second half of 2021. Oil prices are expected to rise to USD 82 per barrel in 2022. The slight decline in the course of the year is based on the expectation that the increase in global oil production will outpace demand in 2022.

Globally, gas prices have recently come down from record levels, but remain elevated. In the European market, gas and electricity continue to trade at record high levels, and are now expected to moderate significantly only in 2023 (see Box 1.2).

Metal prices soared in 2021 on the back of booming global demand for goods and an accelerating energy transition (see Graph 1.3). On the supply side, pandemic-related closures and labour strikes in South America resulted in supply disruptions. Prices are expected to moderate slightly in 2022 as demand rotates back towards services, the property sector in China slows down, and past investment comes on stream and lifts production.

Prices for agricultural commodities are nearing the 2011 price peak, reflecting high Chinese demand for feed grains, rising input costs due to higher energy prices, transport bottlenecks and increased demand for biofuels. The UN's Food and Agriculture Organization reported that its global food price index (FFPI) reached a 10-year high in 2021, increasing by 28% over 2020, though there were signs of some moderation in December. Looking ahead, food prices are expected to remain elevated given cost pressures and solid demand.

Graph 1.3: **World Commodity price indices**

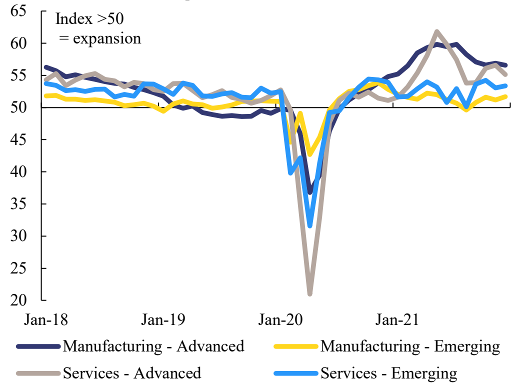


Source: World Bank.
Note: Oil estimates for January 2022 by DG ECFIN.

The global growth outlook for 2022 has softened amid a projected decrease in trade intensity…

Purchasing Managers Indices (PMI) remain well in expansionary territory, but are somewhat stronger in the advanced economies, especially for manufacturing (see Graph 1.4). The spread of the Omicron variant is, however, expected to lead to more moderate global growth in 2022 than previously projected (e.g. US, UK), while the property-related slowdown in China has been more abrupt, and the recovery in Latin America - slower (e.g. Brazil). The faster-than-anticipated pace of monetary policy tightening in the US is also likely to contribute to a softer global outlook. Real global GDP (excluding the EU) is now expected to grow by 4.2% in 2022 (-0.3 pps. versus the Autumn Forecast) and 3.8% in 2023 (+0.1 pps.), still with wide variations both within and between regions.

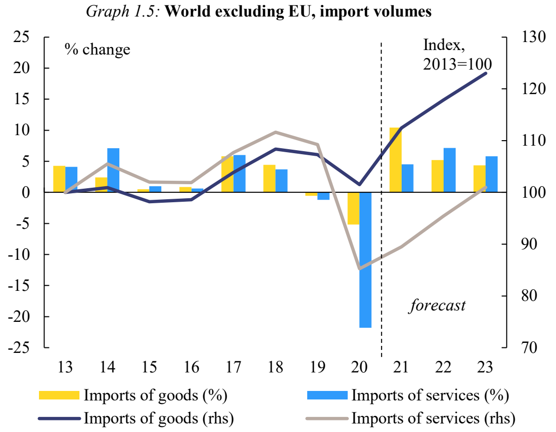
Graph 1.4: **Global PMIs**



Source: IHS Markit

Overall, global imports of goods and services (excluding EU) are forecast to grow by 5.5% in 2022 and 4.6% in 2023, a change of -0.6 and +0.1 pps., respectively, relative to the Autumn Forecast (see Graph 1.5). This reflects the now projected softer global growth (notably in US and China) and a slightly slower recovery in service trade than previously expected, due to the re-surgence of the pandemic.

Graph 1.5: **World excluding EU, import volumes**



Global supply-side disruptions have recently eased in some areas, but bottlenecks remain and continue to pose risks to the global outlook. The global PMI suppliers' delivery times index in December indicated the smallest deterioration since March 2021, while indices of shipping costs declined slightly from their peaks in September and October. However, according to research by Susquehanna Financial Group chip delivery times lengthened again in December to the longest since the firm began tracking the data in 2017.

...with some easing expected on the inflation front.

Inflation in the US and other advanced economies is expected to decline over 2022 as demand shifts back towards services, lowering pressure on goods prices, supply bottlenecks progressively ease, and prices of energy commodities moderate. Persistence in inflation is a risk in economies (e.g. US, UK, Canada) where labour market tightness may generate pressure for higher wage claims (to offset rising prices) and induce second-round effects. Inflation in emerging market economies can be expected to remain elevated in 2022, though moderating gradually due to the fading impact of higher commodity prices and tighter monetary policy.

1.4. FINANCIAL MARKETS

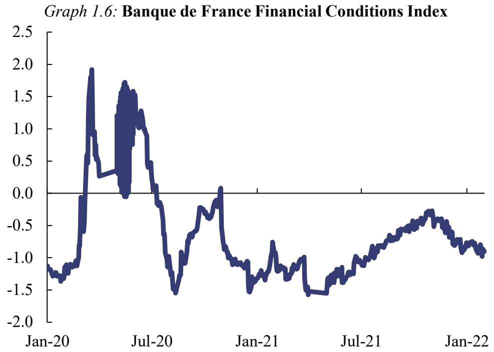
Global financial conditions have been tightening since the cut-off date of the Autumn Forecast...

While monetary policy in advanced economies remains highly accommodative, the sharp rise in inflation rates in 2021 is prompting a change in policy stance. On 26 January, the Fed confirmed its decision to reduce net asset purchases and signalled that policy rates may rise sooner than previously projected. As a consequence, both short-term and long-term rates have moved visibly higher, while US equity markets have turned more volatile. In emerging market economies, several central banks already started to raise policy rates in early 2021. Capital inflows into EMEs (outside China) have moderated recently over fears of their delayed recovery, while the USD appreciated steadily over the second half of 2021. A less accommodative monetary policy across advanced economies and rising geopolitical tensions are expected to put further pressure on financing conditions in EMEs. After significant turmoil in the real estate sector, China's central bank has recently taken a more accommodative policy stance to support the stabilisation of the economy.

...while in the EU, financial conditions remain supportive...

In the EU, financial conditions continue to be very favourable by historical standards though risk sentiment has somewhat weakened amid uncertainties about the economic impact of the new wave of the pandemic. The Banque de France composite financial indicator for the euro area(5) indicates a slight tightening of financial conditions during the second half of 2021, mainly due to inflation surprises and higher uncertainty. However, recent movements suggest that financial conditions loosened again (see Graph 1.6). All in all, the index remains well below the long-term average, indicating supportive financial conditions.

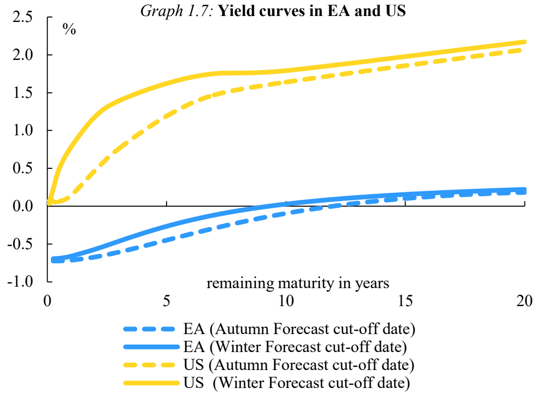
Graph 1.6: **Banque de France Financial Conditions Index**



Source: Banque de France
Note: Upward movements signal a tightening of financial conditions.

At its meeting in December 2021, the ECB Governing Council judged that monetary policy in the euro area should remain accommodative. At its February meeting, which took place shortly after the cut-off date of this forecast, the ECB confirmed its December monetary policy decisions but acknowledged that now risks to the near-term inflation outlook were tilted to the upside. The repricing in the market suggests market operators now expect the ECB to bring forward a change in the monetary policy stance before the end of the year. Some central banks from non euro-area EU Member States already tightened their monetary policy stance. These developments contributed to a broad-based increase in sovereign yields across the EU. The 10-year German bund yield climbed above the zero threshold on 19 January, for the first time since January 2019, while bond spreads to the German Bund for some EU member states widened, both within and outside of the euro area. As in the US, the euro area yield curve has shifted upwards (see Graph 1.7). Still, real sovereign benchmark yields remain deeply in negative territory, and well below pre-pandemic levels.

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



Sources: ECB for Euro area, US Department of Treasury for US.

Although corporate earnings came in strongly in late 2021, developments of the pandemic, inflation and global supply chain bottlenecks raise concerns. Higher costs and difficulties to pass them on to consumers risk weighing on corporate margins going forward. In this context, corporate bond yield spreads to the German Bund have also widened slightly since Autumn, but remain tight overall. Equity markets turned more volatile over the past months, and share prices declined in January 2022. Still, European stock indices were basically unchanged compared to November, while the banking segment outperformed, helped by higher long-end yields.

...and bank lending continues to be dynamic.

In the euro area, bank loans to the private sector increased further in December, driven by the non-financial corporate sector. The annual growth rate of adjusted loans (i.e. adjusted for loan sales, securitisation and notional cash pooling) to households stood at 4.1% in December (4.2% in November), and that of adjusted loans to non-financial corporations accelerated to 4.2% (from 2.9%). The latest January 2021 ECB bank lending survey points to a marginal tightening of credit standards for loans to enterprises, while net demand increased considerably in the fourth quarter of 2021. Loan demand was mainly driven by firms' financing needs for working capital, but also for fixed investment, which picked up significantly. For housing loans, credit standards remained unchanged while banks reported increasing demand. In the first quarter of 2022, euro area banks expect credit standards for loans to firms to remain broadly unchanged but to tighten for mortgage loans amid continued increase in demand from both household and corporate customers.

(5) See A new Banque de France Financial Conditions Index for the euro area | Banque de France (banque-france.fr)

The euro depreciated against most major currencies.

Since the end of October, the euro has depreciated against most currencies of the euro area's main trade partners, except the Turkish lira and the Russian rouble. In particular, it recorded important depreciations (i.e. of over 2%) against major currencies such as the US dollar, the Chinese renminbi and the Swiss franc. The euro also weakened against the British pound and against the currencies of some EU Member States (e.g. the Czech koruna and, to a lesser extent, the Hungarian forint and the Polish zloty). This broad-based depreciation mainly reflects divergence in monetary conditions and inflation developments between the euro area and the other economies. In nominal effective terms, however, the euro has remained broadly stable, as its strong appreciation against the Turkish lira and, to a lesser extent, the Russian rouble broadly offset the weakness against other currencies.

Looking ahead, financing conditions are expected to remain supportive in the euro area.

The ECB confirmed in December that it would discontinue its pandemic emergency purchase programme (PEPP) after March 2022, and recalibrate its asset purchase programme (APP) in order to engineer a gradual reduction in its total net asset purchases over the course of 2022. The pace of asset purchases is therefore set to slow down over the coming quarters. Financing conditions are nevertheless set to remain supportive, due to the favourable conditions on the ECB's liquidity-provision operations, the large stock of bonds on the Eurosystem's balance sheet and the forward guidance on policy rates.

While financing conditions continue to be supportive, several vulnerabilities of the macro-financial environment remain, such as high prices of financial assets despite weaknesses in parts of the corporate sector, high indebtedness and rising residential real estate prices in several Member States.

1.5. RECENT ECONOMIC DEVELOPMENTS IN THE EU

1.5.1. Economic activity developments

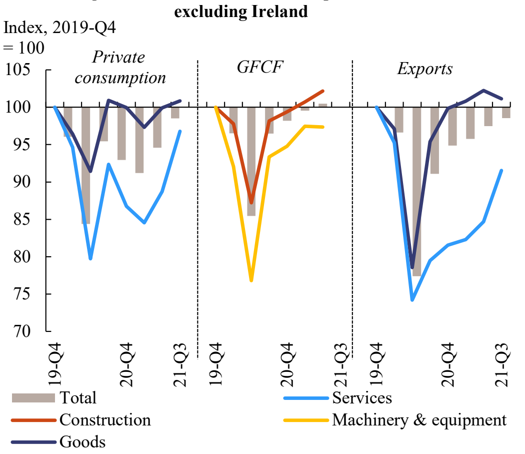
Strong growth in the third quarter lifted EU output above its pre-pandemic level…

The robust rebound in economic activity that started in spring last year continued unabated through early autumn. According to quarterly national account data released after the publication of the Autumn 2021 Forecast, in the third quarter of 2021 EU *real GDP* increased by 2.2% (2.3% in the euro area) from the previous quarter. Revisions to historical quarterly data also lifted growth rates in the first half of last year slightly above previous estimates. As a result, the EU closed its gap with the GDP level that was recorded just before the pandemic (fourth quarter of 2019).

The third quarter rebound was mainly driven by household spending. *Private consumption* increased by 4.2% (quarter on quarter), supported by growing labour incomes and a further decrease in the household saving rate, which fell from 17.9% in the second quarter to 14.6% in the third. Spending on consumer services picked up sharply, as containment measures eased and vaccine protection reassured consumers about engaging in economic activities involving close social contacts. As a result, private consumption in the EU moved closer to its pre-pandemic level (see Graph 1.8), but with substantial cross-country heterogeneity. *Public consumption* grew moderately in the third quarter (0.3% quarter-on-quarter). *Investment*, in contrast, dropped by 0.6% (quarter-on-quarter). Considering the EU without Ireland (which continues to display very volatile investment dynamics), investment had closed the gap to its pre-pandemic level in the second quarter of 2021, and the decline in the third quarter left it just above that level. ([6]) The drop reflected in particular negative contributions from transport equipment and construction.

([6]) Compared to the fourth quarter of 2019, investment in the EU in the third quarter of 2021 was 8.2% lower and 0.2% higher, respectively, with and without Ireland. The quarter-on-quarter decline in the third quarter was mostly accounted for by the EU without Ireland.

Graph 1.8: **GDP demand-side components, EU excluding Ireland**



...but the economic expansion slowed in the fourth quarter...

In the fourth quarter, mounting headwinds coupled with the fading tailwind of the re-opening impetus, dented the growth momentum. As expected in the autumn, disruptions of global value chains and international logistics, coupled with strong demand, created supply bottlenecks and pushed commodity and energy prices up. In addition, the deterioration of the epidemiological situation led to the tightening of containment measures but also behavioural changes of consumers.

The loss of growth momentum was confirmed by preliminary flash estimates of economic activity in the fourth quarter. GDP growth in the EU is estimated to have slowed to 0.4% compared to the third quarter, well below what was expected in the Autumn Forecast (0.8%). Germany, Latvia and Austria recorded an outright contraction. The other seven reporting Member States, with the exception of Lithuania, saw GDP growth slowing down, but not below the rates expected in autumn. Among the largest euro area countries, output expanded by 2.0% in Spain, 0.7% in France and 0.6% Italy. The contraction in Germany amounted to -0.7%.

The economic impact of the deteriorating epidemiological situation was much less pronounced than in previous surges of the pandemic, in particular when set against the sharp contraction observed in the fourth quarter of 2020 when the second wave hit Europe. Despite a markedly higher incidence of infections, containment measures were relatively less stringent and/or more targeted than those enacted one year before. Moreover, households and businesses appear to have adapted to living with the pandemic.

...as also suggested by indicators of activity in industry, construction and retail sectors.

Industrial production, construction output and retail trade volumes all increased in November, although they broadly confirmed the slowing growth.

Industrial production was up by 2.5% (month-on-month) in November 2021, mostly offsetting the declines in the three preceding months. After the growth momentum, as measured by 3-month-on-3-month rates, had followed a downward trend for more than a year, the latest uptick mainly benefitted from exceptionally strong growth in industrial production in Ireland. Throughout last year, developments in the EU were largely driven by the car sector. The car production declined by more than 40% in the first nine months of 2021 when it was scaled back mostly due to the shortage of semiconductor components. Despite a rebound in October and November, the car production in the EU was in November still about one third lower than before the pandemic. The low level of car production is also reflected in the number of new passenger car registrations across the EU, which fell further in 2021 and was about 25% lower than in 2019.

Production in the construction sector increased by 0.2% in the EU (month-on-month), a marked slowdown from the rates achieved in September (1.2%) and October (0.7%).

The *volume of retail trade* increased by 0.9% in the EU (month-on-month), following an increase by 0.4% in October. Retail trade volumes were 7.9% higher than in November 2020 and 6.8% higher than in November 2019.

1.5.2. Labour market developments

Labour markets tightened further, although the recovery remained incomplete...

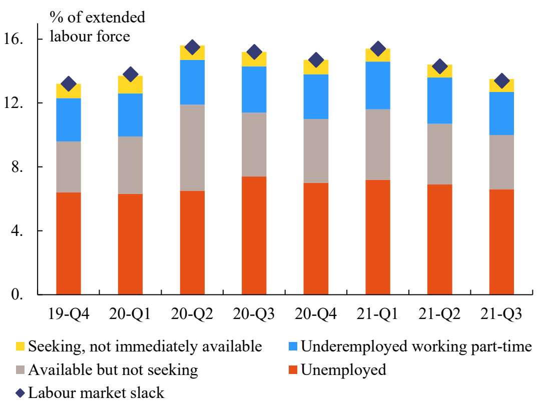
Labour markets continued to perform very well in the third quarter of 2021. Headcount employment in the EU and the euro area increased by 0.9%, adding around 1.8 million jobs in the EU. Employment in contact-intensive sectors, accounting for two thirds of the total increase, narrowed its gap with the pre-pandemic level to just below 2%. By contrast, facing headwinds from supply bottlenecks, employment in the manufacturing sector stagnated, extending its track of lacklustre growth. Since the trough in the third quarter of 2020, employment in the sector increased by less than 1%, remaining 2.6% shy of its pre-pandemic level. By contrast, employment in the construction sector, which was broadly stable (-0.1%) in the third quarter, stood 3.2% above the level seen before the pandemic.

Employment increased across all educational, age and gender groups. Still, the recovery in employment levels of the low skilled continued to lag behind in the third quarter of last year.

Total hours worked increased by 1.7% in the EU in the third quarter of 2021. An increase in average hours per worker, accounting for nearly half of the total increase, reflects a further reduction in the use of job retention schemes. Contact-intensive sectors significantly outperformed the manufacturing and construction sectors. Still, total hours worked did not recover all the losses inflicted by the pandemic and remained 1% lower than in the last quarter of 2019, dragged down by contact-intensive sectors and, to a lesser extent, manufacturing.

A tightening labour market pulled nearly one million people out of inactivity in the third quarter of 2021 in the EU. Labour market slack – calculated as the sum of all unmet employment needs – decreased to 13.4% of the extended labour force, 0.2 pps. above its pre-pandemic level (see Graph 1.9). The unemployed, those available to work but not seeking, and involuntary part-time workers contributed to the reduction of labour market slack. According to the latest data, the EU labour force surpassed its pre-pandemic level by 0.3% in the third quarter.

Graph 1.9: **Labour market slack, EU**



In the last quarter of 2021, the unemployment rate continued to fall while employment likely increased further. The unemployment rate slid below the pre-pandemic rates to record-low readings of 6.4% in the EU and 7.0% in the euro area in December. A majority of Member States saw unemployment rates decreasing at the end of last year. Among the five largest economies, the unemployment rate decreased in December to 3.2% in Germany, 3.8% in the Netherlands, 7.4% in France, 9% in Italy and 13% in Spain, which remained the highest rate in the EU.

In addition, managers reported higher employment during the fourth quarter of 2021 and January this year in all euro area countries surveyed by IHS Markit. Employment growth was reported to have slowed in the services and construction sectors at the beginning of the year, likely due to the aggravating pandemic situation. In manufacturing, employment growth slightly increased compared to previous months.

... leading to pronounced labour shortages.

Despite its strong performance, employment growth did not keep pace with surging labour demand. According to the Commission's business surveys, labour was becoming an increasingly important factor limiting production throughout last year, with managers in the industry, services and construction sectors increasingly reporting labour shortages between October 2021 and January 2022. Reported labour shortages reached all-time highs in all three surveyed sectors, but have become particularly biting in some service activities (see Box 1.1).

Up until the third quarter of 2021, increasing job vacancy rates underscored the imbalance between the pace of job creation and the job-filling rate. Still, there is not yet evidence that the efficiency of labour market matching has deteriorated. ([7]) Until the third quarter of 2021, job vacancy rate increases went hand in hand with a reduction in unemployment rates in the EU.

The Commission's Employment Expectations Indicator signals that labour demand likely reached its peak in the last quarter of 2021, with December and January aggregate readings slightly easing from the November maxima. However, employment expectations in industry reached a new all-time high in January, while employment growth in services may accelerate again once the current pandemic wave abates.

([7]) European Commission (2021), "European Economic Forecasts, Autumn 2021", *Institutional paper* No. 160

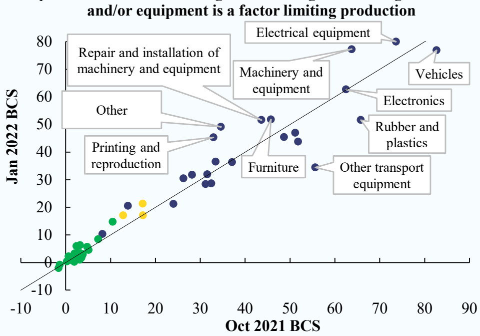
Box 1.1: **Production bottlenecks through the lens of the Commission's business surveys**

According to the Commission's business surveys, supply-side bottlenecks in the European economy aggravated further in January. Shortages of material and equipment were particularly severe in manufacturing while services were mainly affected by shortage of labour. The construction sector appears to suffer from shortages in both labour and supply and equipment.

The share of managers reporting material and/or equipment shortages rose to 51% in January 2022 (from 49.5% in October) in manufacturing and to 28.6% (from 20.8%) in construction. In services, where the question concerns space and/or equipment, constraints remained a marginal issue in managers' view (3.5% vs. 3.2%).

In manufacturing, the increase was driven by the aggravation among producers of machinery and equipment and electrical equipment, which were already severely affected in the autumn by e.g. the shortage of microchips and some metals. The automotive sector, which has been grappling with the shortage of microprocessors for several months, saw a slight easing of the problem in January but remained the most severely affected manufacturing sector in the EU. Likewise, rubber and plastics, and other transport equipment, reported some improvements, but continue to rank high among the most affected sectors (see Graph 1). Other sectors reporting increased shortages of material and equipment include repair and installation of machinery and equipment, and printing.

Graph 1: **Percent of EU managers indicating that shortage of material and/or equipment is a factor limiting production**

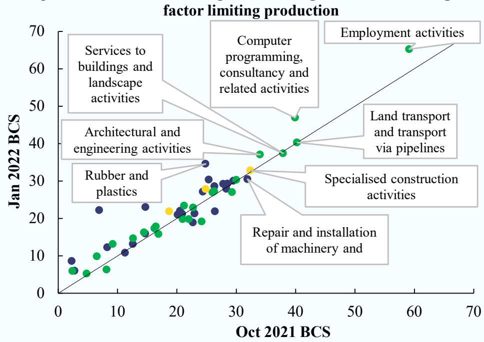


Note: blue dots - 24 manufacturing sectors, green dots- 37 services sectors, yellow dots - 3 construction sectors

Labour was reported to be the most pressing production bottleneck in the construction sector, where 31.4% of managers identify labour shortages as a factor limiting production, followed by services, at 26.3%, and manufacturing, at 25.9%.

The sector most hit by the imbalance between labour demand and supply was the employment activities, which include employment placement agencies. In this case, labour shortages likely also reflect difficulties to satisfy the labour demand of their clients. Surveys suggest that labour shortages risk impeding further progress in the digital transformation and aggravating supply chain bottlenecks. With a 7 pps. increase from October to 47% in January, computer programming, consultancy and related activities was another subsector facing insufficient labour supply. The land transport and transport via pipelines sector, a critical link in supply chains, also continued to be among the most affected. Finally, architectural and engineering activities and services to buildings and landscape activities also remained among the most affected (see Graph 2).

Graph 2: **Percent of EU managers indicating that labour shortage is a factor limiting production**



Note: blue dots - 24 manufacturing sectors, green dots- 37 services sectors, yellow dots - 3 construction sectors

According to the January survey, shortages in manufacturing were particularly widespread in Germany (material), Ireland (both material and labour) and Malta (labour). The services' sector was affected by big labour shortages in Malta, Ireland and the Netherlands, with no countries so far reporting significant space and equipment shortages, on average. Finally, construction emerges as particularly affected in Ireland (both material and labour), Luxembourg and Finland (labour), and, to a lesser extent, France and Germany (both material and labour) (see Graph 3).

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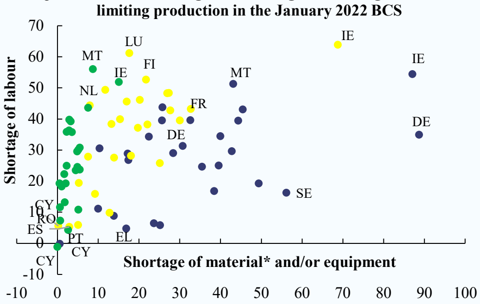
Box (continued)

Graph 3: **Percent of managers indicating that shortages are a factor limiting production in the January 2022 BCS**

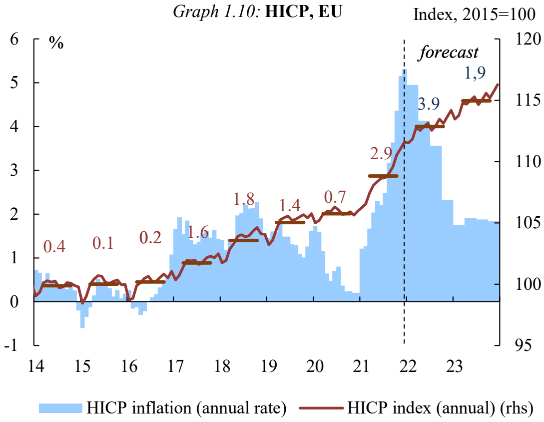


Note: blue dots - 24 manufacturing sectors, green dots- 37 services* sectors, yellow dots - 3 construction sectors

* shortage of space and/or equipment in services

The tightening labour market has not put noticeable pressure on wages so far. The indicator of negotiated wages ([8]) in the euro area increased by 1.3% in the third quarter of 2021, compared to the same quarter of 2020, the slowest growth rate since the pandemic broke out. At 2.7% year-on-year in the EU, compensation per hour worked -a measure of labour cost that is usually less distorted by job retention schemes than compensation per employee- increased at a pace somewhat above the post-2009 average of 2.4%. Taking into account steeply rising consumer prices, compensation per hour worked decreased somewhat in real terms in the third quarter.

Graph 1.10: **HICP, EU**



Note: Figures next to horizontal bars are annual inflation rates.

1.5.3. Inflation developments

After decreasing on average by 0.3% in the last quarter of 2020, euro area prices started increasing again last year, gathering strong momentum in the last quarter of 2021. In December, HICP inflation in the euro area reached 5%, the highest reading on record. It averaged 4.6% in the fourth quarter, almost one percentage point higher than expected in autumn, and 2.6% in 2021 as a whole. In the EU, the inflation rate was 4.9% in the final quarter of 2021 and 2.9% for the year. Dispersion among the non-euro area Member States widened in the fourth quarter, with inflation ranging from 3.5% in Denmark to 7.3% in Poland. Dispersion was however exceptionally wide also in the euro area, mainly on account of the differential impact of energy inflation across EU countries.

Energy inflation was indeed the main driver of headline inflation in the euro area and beyond, though the December reading (25.9% in the euro area) came in a notch lower than in November, amidst fading base effects (see Box 1.2). Food inflation is also driving headline inflation up, with December registering a major increase in unprocessed food inflation (4.7%), on account of both a strong base effect from last year and solid month-on-month growth (1.5%). Averaged over the fourth quarter, unprocessed food inflation rose to 2.6% in the euro area. Higher input costs, in particular for fertilisers, are fuelling pressures on food prices.

([8]) European Central Bank, Statistical Data Warehouse

Box 1.2: An update on energy price developments: pass-through from wholesale to retail

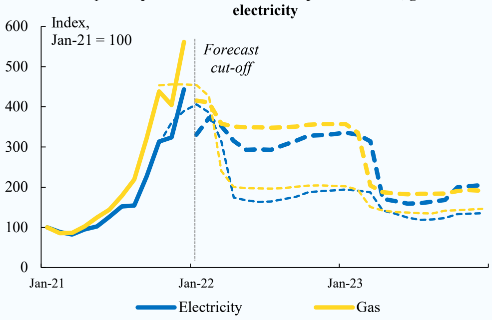
Increasing wholesale energy prices are the main driver of the recent pick-up in consumer and producer price inflation throughout the EU. The pace and extent to which these pressures are passed on to household consumer prices remain highly differentiated across EU Member States. Understanding the transmission of the hikes in energy commodity prices, both in terms of amplitude and timing, is crucial for the outlook for households' real disposable income and, consequently, for their consumption and saving decisions. This Box reviews recent energy price developments as well as the factors driving the price pressure transmission and gauges the speed and extent of this pass-through.

Energy prices are fluctuating at a high level but futures signal the peak is close

After strong increases during the summer and fall, the Dutch TTF Gas – which acts as the European benchmark for wholesale gas prices – increased again, doubling during December to a level of 180 €/MWh, but has since retreated. This increase was accompanied by heightened volatility. As gas storage levels continued to decline, (1) prices reacted sharply to swings in supply or demand, as well as to market sentiment. Wholesale electricity prices have continued to broadly move in lockstep with gas prices. Average EU wholesale electricity prices jumped significantly to about 250 €/MWh in the early days of December, and have since remained at elevated levels. The surge in carbon permit prices in the EU Emissions Trading System added pressure on electricity prices, though this is estimated to have played a more limited role. (2) Oil prices fell temporarily with the emergence of the Omicron variant, as concerns on renewed obstacles to the global recovery increased, but they have since recovered and hit a seven-year peak of around 90$/barrel at the end of January.

Compared to the Autumn Forecast, there has been a significant upward shift in gas and electricity futures from the first quarter of 2022 onwards. Futures' prices for Brent oil also increased, but to a much lesser extent. Future contracts still point to a retreat from high levels after this winter, though prices are set to remain higher than expected in autumn throughout 2022, before abating more substantially in the spring of 2023 (see Graph 1).

Graph 1: **Spot and future wholesale prices of brent, gas and electricity**



Source: ICE
Note: Thick dotted lines refer to updated assumptions; thin dotted lines to those of the Autumn 2021 Forecast.

Consumer energy prices have yet to fully adjust

Energy inflation in the EU increased from about 14% in July to 26% in December, partly due to base effects stemming from the low energy prices the year before. Energy components account for around 10% of the HICP basket in the EU. Of this share, the largest part comes from fuels (45%) followed by electricity (30%) and gas (20%). Overall, the rise in energy prices directly explains around half of the increase in inflation since the summer.

Developments in HICP energy continued to vary within the EU. Cumulated over the 24 months from January 2020 to December 2021, consumer-level price changes ranged from -12.9% (CZ) to 130.2% (EE) for electricity and from -11.4% (CZ) to 118.2% (EE) for gas (see Graph 2).

Even in the absence of further increases in energy commodities prices, the past increases are yet to be fully reflected in retail energy prices. The extent to which this will happen depends on a broad variety of factors that ultimately shape consumer price developments in individual Member States.

First, differences in the dynamics of wholesale gas prices faced by individual Member States rose sharply in the course of 2021. As a result of lags in

(1) European gas storage was down to 47.6 % of capacity on 15 January (54 billion cubic meters, or BCMs) compared to 62.5 % a year earlier.

(2) According to recent estimates between December 2020 and June 2021, wholesale electricity market prices almost doubled in Spain, with around 20% of the increase due to the rise in CO_2 prices in the European ETS. Pacce, M., Sánchez, I., and Suárez-Varelam M. (2021), 'Recent Developments in Spanish Retail Electricity Prices: the role played by CO_2 emission and higher gas prices'.

(Continued on the next page)

Box (continued)

adjustments of pipeline import contracts - to the TTF benchmark - among different gas providers, the range of wholesale gas prices across the EU rose to a multi-year high in September 2021. ([3])

Second, the structure of retail energy prices differs significantly across Member States. For example, the share of energy and supply costs (including the price of the raw material) in the consumer gas price varied in 2020 between some 21% (DK) to 73% (CZ), while that of taxes ranges from 9% (EE) to 62% (SE). Additionally, network costs differ markedly across the EU, both in terms of levels and shares in the final price. Adjustments in all these price components will lead to changes at the consumer level. Nevertheless, these vast differences in price structures appear to shed little light on the heterogeneity in actual energy price developments in 2020 and 2021.

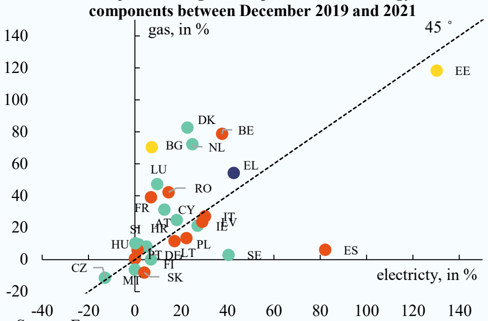
Third, regulatory frameworks and government interventions differ significantly across countries. Roughly half of Member States actively intervene in retail markets for electricity and gas ([4]). Regulators may impede or constrain upward adjustments, with the ensuing cost either directly absorbed by the government (or state-owned energy companies), or shared between the government and energy companies. However, the link between the extent of regulation and the size of retail price adjustment over the past two years is not obvious, with regulated markets present in both high (EE, ES, BE) and low (SK, HU, PT) tails of the price change distribution (see Graph 2).

Fourth, many Member States, including those that do not normally regulate energy prices, introduced in 2021 and early 2022 extraordinary measures to shield consumers from soaring energy prices. Some of these (e.g. temporary cuts in energy taxes or network fees) have had a direct impact on retail prices of gas and electricity.

Finally, it should be recalled, that even within Member States, multiple contracting practices may coexist, with some households opting for longer term contracts that lock in retail price for several years.

To shed light on the speed and intensity of the transmission mechanism, a simple pass-through model is estimated, relating commodity price changes to consumer price changes, allowing for transmission delays up to one year. ([5]) Estimates show that, on average, almost 40% of the change in Brent oil prices is passed onto liquid fuel consumer prices within 12 months (see Graph 3). The transmission is relatively swift, with 80% of the price increase occurring within one month. While the high degree and speed of the transmission is a characteristic that generally holds across countries, the estimated range may be explained by differences in the total tax shares between Member States.

Graph 2: **Change in the price of HICP energy components between December 2019 and 2021**



Source: Eurostat

Note: Colour of the dots corresponds to the extent of price intervention: red - in both markets; yellow - only in gas markets; blue - only in electricty markets; green - no intervention.

The picture looks different in the case of natural gas. Generally, the effect is found to be both smaller and to feed through at a much slower pace. On average, about 13% of the increase in natural gas prices is passed on to consumer gas prices 12 months later, with only about 20% of this effect occurring within the first month. This feature implies that the rise in wholesale gas prices observed until the end of 2021 is set to exert significant upward pressure on retail gas prices throughout this year. Furthermore, cross-country heterogeneity is strong, which can be explained by the differences in national market structures noted above.

The transmission mechanism to electricity prices is more challenging to estimate. In the past, markets

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([3]) European Commission (2021). 'Quarterly report on European gas markets Q3 2021'. Issue 3, section 2.3.3.

([4]) ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2020 - Energy Retail Markets and Consumer Protection Volume, November 2021.

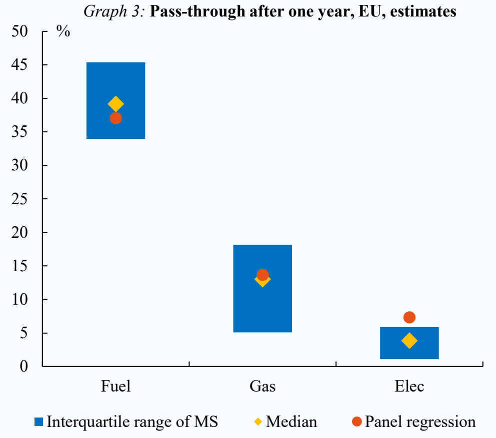
([5]) The estimated model is an autoregressive distributed lag model: $dlog(P)_t = \beta_0 + \beta_1 dlog(P)_{t-1} + \sum_{j=0}^{12} \delta_j \, dlog(X)_{t-j}$ where P is the HICP energy component index and X the respective commodity price. The model is estimated for each EU Member State.

(Continued on the next page)

Box (continued)

were more segmented and differences in the energy production mix played a major role in determining price-setting mechanisms. This makes the choice of a driver of movements in electricity prices more challenging. In the EU, wholesale electricity prices have recently been more correlated with gas prices. For this reason estimates are performed using the European gas benchmark. [6] On average, only about 4% of a change in wholesale gas prices is passed on to consumers' electricity prices within 12 months, which is a markedly lower share than for the other two commodities. About 25% of this effect happens within the first month. For a majority of Member States, however, no significant transmission is found.

Graph 3: **Pass-through after one year, EU, estimates**



These results are subject to important caveats in the current context. First, they assume that all countries face the same energy commodities price increases, which is not necessarily the case for natural gas due to differing supply and contract conditions. Second, changes in the functioning of markets, e.g. as a result of regulatory changes, may imply that past relationships no longer hold.

To crosscheck the robustness of the findings, alternative modelling strategies were employed. A panel regression accounting for country-fixed effects broadly corroborated the previous findings on the average magnitude and time lags of transmission. A principal component analysis shed further light on the differences between the three markets. The first factor explains about 70% of the total variation in consumer fuel prices across Member States, which suggests that there is a strong common determinant of monthly changes in consumer prices for fuel. The same cannot be said for gas and even less so for electricity, where the first factor only explains 20% and 10% of the variation, respectively. [7] This confirms the role of other important country-specific drivers.

Conclusion

Going forward, energy prices will remain a key driver of inflation dynamics in 2022. Despite the expected stabilisation of spot wholesale prices as from the second quarter, consumer gas price inflation is likely to peak on average only mid-year, as past increases will keep feeding through until then. While decelerating, prices of futures suggest that gas inflation is likely to still be positive up to mid-2023. Thereafter, a sharp downward correction could be in the cards. For electricity prices, inflation largely follows the same path. However, both swings to the upside and to the downside are set to be less pronounced.

By contrast, given the swift transmission of Brent oil prices to prices at the pump, fuel inflation (measured as year-on-year change) should gradually decline and fade over the next 12 months, assuming that the broad stabilisation implied by futures materialises.

This analysis concerns the direct impact of rising energy commodity prices on the corresponding consumer prices. Indirect effects are also affecting inflation developments, and they are likely to linger around for longer. [8] As energy is a major input in the production of virtually all goods and services included in the HICP basket, to widely varying degrees, the extent of firms' profit margin compression may force them to pass the increase in production costs on to consumers. [9]

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(6) In the EU, wholesale electricity prices are based on the marginal pricing model, with gas power plants being often the marginal producer.

(7) Assuming that the first component captures the effect of changes in commodity prices, a regression of wholesale gas prices on the first factor is performed. It points to a pass-through of about 12%. For electricity, the same exercise yields an estimate of 2%.

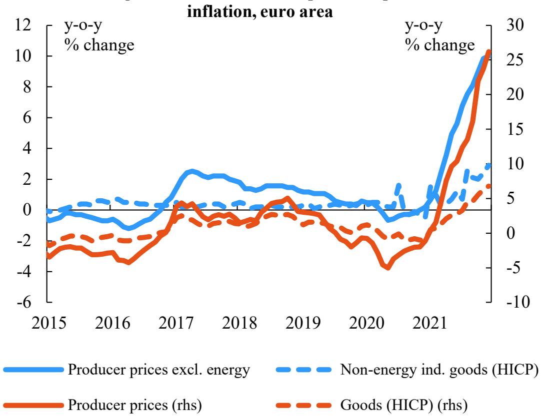
(8) Alonso, I., Kataryniuk, I., & Martínez-Martín, J. (2021). 'The impact of supply and demand shocks on recent economic developments and prices'. *Quarterly Report on the Spanish Economy*, 2021(4).

(9) See also Special Issue 2 "Energy prices" in European Commission (2021). 'Autumn 2021 Economic Forecast: From recovery to expansion, amid headwinds'. *Institutional Paper* 160, November 2021.

HICP annual inflation excluding energy and unprocessed food – i.e. core inflation - increased further to 2.7% in December in the euro area, up from 2.6% in November, signalling that price pressures are building up also across less volatile components. Processed food (2.8%) and non-energy industrial goods (2.4%) led the increase. Services inflation moderated to 2.4% on a year-on-year basis, but it increased by 0.6% on a monthly basis. On a month-on-month basis, all five broad inflation categories increased in December, overall delivering a month-on-month increase of 0.4% in the headline index – a rate above the historical norm in December – which added to the 0.8% and 0.9% increase recorded respectively in October and in November. Dynamics for the whole of the EU were similar, though as customary a bit more pronounced.

Energy prices and supply bottlenecks are acting powerfully on industrial producer price inflation, which topped 23.7% y-o-y in both the EU and euro area in November, up from approximately 22% in October. While the bulk of the increase was due to energy, the index excluding the energy sector rose by a high 10% in the EU. Sustained growth of non-energy producer prices suggests a broadening of inflation pressures, as already reflected to some extent in the rise of non-energy goods inflation over 2021.

Graph 1.11: **Consumer and producer price inflation, euro area**



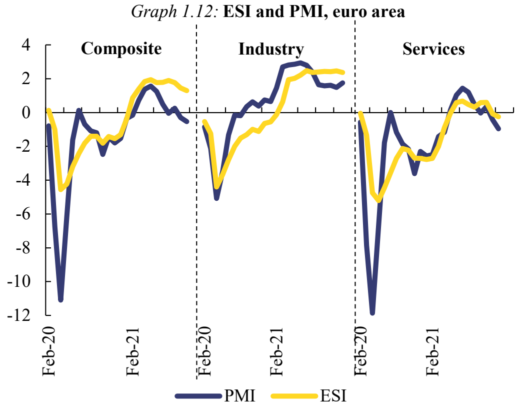
1.6. THE OUTLOOK

1.6.1. Economic growth outlook

Survey indicators point to weak growth momentum in the near term...

Recent economic indicators suggest that the softening of growth registered in the fourth quarter of last year is set to continue throughout the first quarter of 2022. In January, the Economic Sentiment Indicator (ESI) eased further (-1.4 points to 111.6) but remained well above its long-term average (see Graph 1.12). The decrease was driven by a decline in services, construction and, to a lesser extent, industry and among consumers, while confidence rebounded in retail trade. The decline in industry confidence was mainly due to a reported increase of the stocks of finished products, which at the current juncture of record low stocks would point to some normalisation of inventories, rather than to a weakening demand. The slight increase in the Economic Uncertainty Indicator over the past three months mirrors the development pattern of the ESI.

Graph 1.12: **ESI and PMI, euro area**



Source: IHS Markit, Europeam Commission.
Note: Standardised data based on 2000-'07 sample.

The flash Purchasing Managers Indices (PMI) also pointed to a slowing growth momentum. In January 2022, the euro area composite flash PMI declined by 0.9 pts. to 52.4, falling to its lowest level since February last year, when the stringency of containment measures was much higher. The decline in the services sector PMI, which fell to its lowest reading since April 2021, was only partially offset by higher readings in the manufacturing sector.

...and highlight the persistence of supply side constraints.

The Commission business surveys show that in January 2022 supply side constraints and labour shortages had grown in importance in the EU economy across all the surveyed sectors compared to October 2021 (see Box 1.1). The PMI for the euro area confirmed the persistence of bottlenecks in the fourth quarter of 2021 and in January, even if the data has recently pointed to some tentative easing. The January PMI suppliers' delivery times signalled that the number of supply delays has continued to fall from the peak in early 2021.

The outlook is for moderate economic growth in early 2022 ...

All in all, the latest economic indicators mostly signal positive, but weak growth momentum in the first quarter of 2022, under the impact of adverse pandemic developments as well as supply-side bottlenecks. The bottlenecks in the transport and metals sectors are nevertheless expected to ease gradually over 2022, while the shortages of semiconductors are set to take until 2023 to resolve. In addition, energy price developments are set to continue acting as a drag. These factors are behind a downward revision to the growth forecast for the first quarter, with real GDP growth at 0.4% in the EU and 0.3% in the euro area (down from 0.8% in the Autumn Forecast).

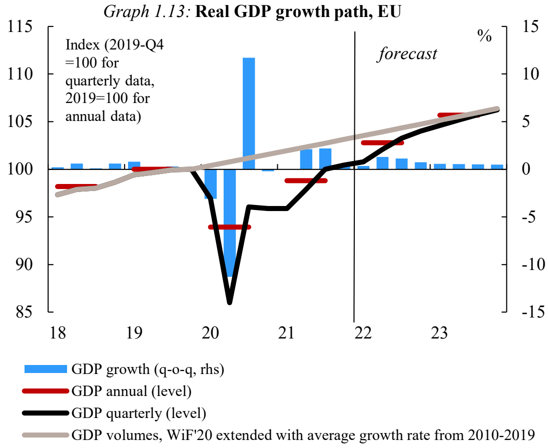
The near-term outlook for *private consumption* is clouded. Lingering uncertainty about the evolution of the pandemic and its economic fallout weighs on consumer sentiment. In January, at -10.0, the Commission's Consumer Confidence Indicator remained above its readings during previous waves (e.g. -22.0 in April 2020 and -16.6 in January 2021) and its long-term average, but it had fallen for a fourth consecutive month. In early 2022, with high infection rates, the stringency of containment measures is expected to linger at high levels, while consumers may again decide to voluntarily limit contact-intensive activities due to health concerns. Household incomes are set to be supported by growth in employment and wages, but elevated inflation is expected to weigh on purchasing power. Policy measures taken in several Member States to partly offset rising energy prices are set to provide some relief for households. However, the compensation is set to be partial, as inflation keeps broadening beyond energy items. In addition, persisting supply bottlenecks and lean inventories reported in the retail sector may postpone households' spending opportunities, especially for some durable goods.

With supply side disruptions remaining an important constraint to economic activity, the near-term outlook for *investment* also remains subdued. As regards equipment investment, orders for capital goods were exceptionally strong last year, but supply chain problems (e.g. missing semiconductors) appear to have lengthened the period between orders of goods and their production and delivery. Bottlenecks have also been weighing on residential investment.

...followed by a return to stronger expansion...

As anticipated in autumn, logistic and supply bottlenecks, including shortages in some metals, are set to keep weighing on production, while energy prices are now projected to exert a more protracted drag. However, the current soft patch caused by these factors is expected to prove short-lived. The easing of pandemic-induced brakes on the economy is projected to push the economy closer to the previously projected path of expansion, starting already from the second quarter (see Graph 1.13).

Graph 1.13: **Real GDP growth path, EU**



Private consumption is expected to remain the key driver of economic growth. Beyond the near term, as the pandemic-related uncertainty dissipates, consumer sentiment should improve again. Abating inflation, an improving labour market, rising wages and the record high savings accumulated over the past two years are set to propel household consumption. Two aspects call for caution in the private consumption outlook. First, during the pandemic, households cut spending on services more than on goods, which limits the potential for deferred demand effects.

Second, the distribution of household savings - mainly among wealthier households and the elderly - implies that the savings were accrued by consumers with a relatively low marginal propensity to consume, which limits pent-up demand.

The high levels of sentiment and still very accommodative financing conditions provide supportive factors for investment. Last autumn, industry managers had assessed their production capacity as insufficient to satisfy current order books and expected demand. Consequently, expectations of managers in industry and services about investment for 2022 have recently hit record highs (see Box 1.3). This heralds a strong rebound in equipment investment once supply side issues ease. Investment is also set to benefit from the large boost provided by the implementation of the Recovery and Resilience Plans. On the downside, with the end of temporary public support measures, a moderate increase in corporate defaults is likely, especially in countries where the crisis has increased private sector debt.

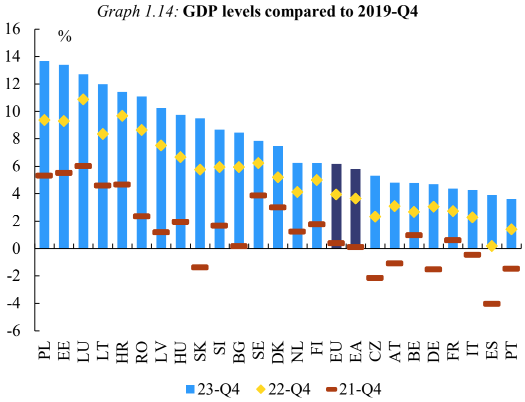
...with sustained growth in the EU in the remainder of 2022 and in 2023.

Most of the output lost during the first quarter as compared to the autumn forecast should be made up over the course of 2022, when the level of activity should gradually converge towards the path expected in the Autumn Forecast. However, the output forgone in the last quarter of last year and the first quarter of 2022 will translate into a lower annual growth rate for 2022 as a whole. At 4.0%, the projected GDP growth rate for 2022 in both the EU and the euro area is lower than for 2021 (5.3% in both the EU and the euro area), but still well above the long-term average.

In 2023, growth is expected to moderate further to 2.8% (2.7% in the euro area), in a movement towards ‘normalcy’. This growth rate is however somewhat higher than forecast in autumn last year, reflecting stronger growth rates in the second half of 2022. While the economy still benefits from solid fundamentals and support by the RRF, the end of the measures taken to support the economy during the pandemic will remove an important tailwind.

Output is projected to surpass pre-pandemic levels in all Member States by the end of 2022. However, there are marked differences in terms of growth forecasts due to differences in the spread of the virus, types of containment measures taken, vaccination rates, policy responses, and economic structures of Member States (see Graph 1.141.12)

Graph 1.14: **GDP levels compared to 2019-Q4**



Note: Quarterly GDP forecasts are not reported for IE, CY, EL and MT.

1.6.2. Inflation outlook

After reaching a record rate of 4.6% in the fourth quarter of last year, inflation in the euro area is projected to peak at 4.8% in the first quarter of 2022 and remain above 3% until the third quarter. Inflation is then expected to decline to 2.1% in the final quarter of the year, before moving below 2% throughout 2023. Overall, inflation in the euro area is forecast at 3.5% in 2022 and 1.7% in 2023. For the EU, inflation is expected at 3.9% in 2022 and 1.9% in 2023.

The high inflation projected in 2022 is partly driven by the rapid increases in the price index in the latter part of 2021, which left the level of prices entering the new year significantly above the level recorded 12 months before. Even if prices were to stabilise at that level throughout the year, the year-on-year inflation readings would not fall below 2% until the third quarter of 2022.

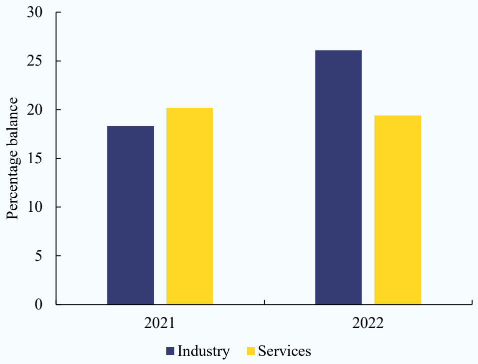
Further price developments *within* the year are set to add to inflation in 2022. Past increases in wholesale prices are set to continue to make their way to retail prices. The impetus from energy should nevertheless diminish throughout the year, reflecting the moderation in oil, gas and electricity prices implicit in future contracts. By the fourth quarter, the contribution of energy to headline inflation is expected to be marginal. Nonetheless, higher production costs due to supply side bottlenecks and higher energy costs are set to broaden inflationary pressures. In 2023, the effect of the sharp acceleration of prices registered in 2021 will fade out, while normalisation of supply-

Box 1.3: Business managers are upbeat about investment this year

While interim forecasts focus on aggregate GDP and do not project its demand components, the European Commission business surveys can provide useful indications on, inter alia, business investment plans in the first forecast year.

Twice a year – in spring and autumn – the Commission's survey for the manufacturing sector includes specific questions on investment. Since October/November 2021, similar questions have been included also in the services sector. In autumn, business managers are asked about investment realised/planned in the current year as well as plans for the following year. The survey also enquires about the purpose of investment (replacement, extension of production capacity, process streamlining, other) and the factors driving it (demand, profitability, technical factors, others). ([1])

Graph 1: **October/November 2021 investment survey results - EU**



In autumn 2021, the share of industry managers who assessed their investment to have increased in 2021 over the previous year was significantly higher than the share who reported it decreased, with the difference clearly exceeding its long-term average. This sharp increase is aligned with available National Account data on Gross Fixed Capital Formation (GFCF), which indicate for the EU without Ireland a 7.9% rebound during the first three quarters of 2021 compared with the same period of 2020. More broadly, over the period 2008 to 2021, the survey results correlate well with the GFCF data. In 2022, on balance, managers were expecting further expansion of their investment. A high positive balance in 2022 points to an increase in investment beyond what was projected in the Commission's autumn forecast. In services, managers estimated investment to have increased in 2021 compared to 2020, but the balance for 2022 was broadly even, suggesting stabilisation of investment on aggregate.

Upbeat investment plans for 2022 could be explained by the relatively high share of managers in industry who assessed their production capacity as insufficient to satisfy current order books and the expected change in demand in the coming months. The historically negative correlation between production capacity and investment is thereby confirmed for 2022. It must be noted, however, that at the time of the survey, risks related to a resurgence of the pandemic still appeared rather low, which may also explain the upbeat investment plans.

The increase in investment in 2021 and 2022 is broad-based across industrial groupings. In particular, the motor vehicle sector shows a strong rebound in the balance of managers' answers for 2022. This suggests a particularly strong investment growth in this sector this year, after an extremely negative final assessment of investment goods' producers in 2020 and only a mild recovery in 2021. An explanation could be the ongoing sweeping transformation of the sector from combustion engines to electric vehicles, which requires huge investment that was probably suspended in 2020/2021 due to the pandemic and the supply bottlenecks of raw materials (e.g. metal) and semi-conductors.

Also in the services sector the increase in investment in 2021 and 2022 is broad-based among sub-sectors. For 2022, the balance remains positive but decreases markedly among managers in 'real estate activities' and 'repair of computers and personal and household goods' branches.

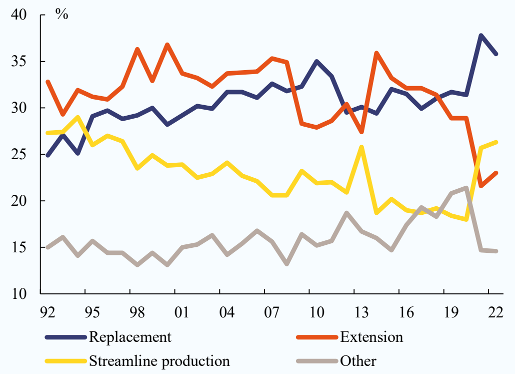
Graph 2 shows that investment in 2021 and 2022 mainly serves the purpose to streamline processes or replace worn-out plants or equipment.

([1]) For a full review of the results, see Technical paper 053, European Business Cycle indicators, 4th Quarter 2021 "Focus on investment activity and business sentiment across subsectors after COVID".

(Continued on the next page)

Box (continued)

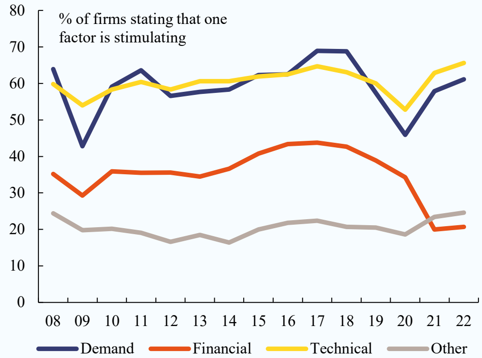
Graph 2: **EU – Industry survey - Structure of investment**



These trends suggest ongoing technological changes in equipment, including towards new green and digital technologies. Companies may also seize the opportunity – and are indeed often encouraged through specific policies - to replace outdated equipment with more efficient technologies.

Turning to the drivers of investment, the autumn Investment Survey points to the rebound in demand and technical factors as stimulating their investments in 2021 and 2022. This seems plausible in the light of the return of demand after COVID, as well as new investment needs related to the green and digital transition. These trends hold for both industry (See graph 3) and services. In particular for services, demand is considered to stimulate investment by more than 50% and 70% of managers in 2021 and 2022, respectively.

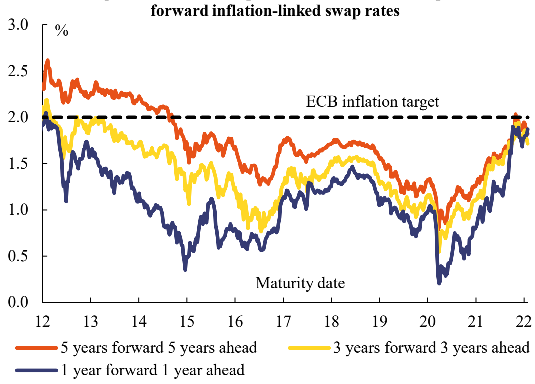
Graph 3: **EU – Industry survey – factors stimulating investment**



chain bottlenecks and energy prices is expected to lower inflation below 2% in 2023. This forecast sees a limited impact of higher prices on wages, as some residual labour market slack and continuous uncertainty related to the pandemic weaken claims for stronger wage growth. In addition, production bottlenecks and rising input costs weigh on companies' profit margins, further limiting room for wage hikes.

Market-implied inflation expectations remained at broadly similar levels to those around the cut-off date of the Autumn Forecast, with the widely followed 5-year forward 5-year ahead indicator standing at 1.9 at the end of January (see Graph 1.15). Meanwhile, selling price expectations reached record high levels in November, eased in December, to rise again in January across all surveyed business sectors (i.e. industry, services, retail trade and construction).

Graph 1.15: **Inflation expectations derived from implied forward inflation-linked swap rates**



Source: Bloomberg

1.7. RISKS TO THE OUTLOOK

Uncertainty in the economy increased in the winter months, according to the Commission's surveys, highlighting that risks surrounding the outlook remain high. However, the materialisation of some adverse risks since the Autumn Forecast leaves the balance of risks to the growth outlook broadly even. By contrast, the balance of risks to the inflation forecast remains skewed to the upside.

This assessment does not take into account the risk stemming from an intensification of geo-political tensions, which is an adverse tail risk that could fundamentally skew the distribution of potential outcomes to the downside for output and to the upside for inflation, mainly through energy commodity prices.

The pandemic continues to deal the cards…

The assumption that the current wave of infections will peak in the first quarter, with limited impact on the economy may prove too benign. In particular, staff shortages could disrupt production, logistics and transports to a larger-than-expected extent, resulting in lower economic activity and additional inflationary pressures.

Moreover, the recent strong surge in infections is a reminder that the course of the pandemic is unpredictable and the health risks stemming from it are real and present. As the current wave of the Omicron strain moves eastwards towards Member States with lower vaccination rates, severe pressure on the healthcare systems could still require the tightening of containment measures that curtail economic activity. Outside the EU, this risk is even greater, as vaccination rates in many regions remain low.

In the medium term, the possible gradual endemisation of the virus, which would reduce uncertainty, should be weighed against the risk of the emergence of new variants of concern.

… amid persistent headwinds from the supply side and energy prices…

Global supply frictions may intensify and/or persist for longer than assumed if efforts to contain the spread of the virus further dent the functioning of critical supply chain infrastructure and lengthen delivery times. Such risks are amplified by China's zero-COVID-19 policy.

At the same time, weaker demand growth in the near-term, both in the EU and abroad, may help to resolve supply bottlenecks somewhat earlier than assumed.

Commodity prices may play out more favourably than assumed. Lower demand and more reliable supply, due to e.g. favourable weather conditions ensuring a steady flow of renewables, may alleviate some cost pressures. As a result, household income would strengthen.

Risks stemming from the global economic outlook appear skewed to the downside …

The recent acceleration of global inflation could entail a faster-than-anticipated tightening of monetary policy, with repercussions on global financing conditions and demand. Moreover, the unwinding debt crisis in China's real estate sector may have negative spill-overs to the rest of the world if uncontained.

… while domestic demand could surprise on the upside

Household demand could accelerate stronger than expected, as already experienced in the period ensuing the reopening of economies in 2020 and last year. Furthermore, investments fostered by the RRF could generate a stronger impulse to activity through e.g. stronger cross-sector and cross-country spillovers. Ongoing structural shifts, accelerated by the pandemic, favouring the digital transformation, could also spur productivity advances leading to faster and more resilient growth.

Risks to inflation remain mainly on the upside over the forecast horizon.

Developments in commodity prices may play out more favourably than assumed also for inflation. At the same time, inflation may turn out higher than expected if cost pressures resulting from supply bottlenecks and energy commodity prices are passed on from producer to consumer prices to a larger extent than projected. In addition, higher than expected second-round effects from potentially above-productivity wage increases may keep inflation higher over a longer period. If inflation were to prove more persistent, central banks might be forced to bring forward their tightening cycle, triggering a change in financing costs and constraining demand.

2. PROSPECTS BY MEMBER STATES

EURO AREA

2.1. BELGIUM

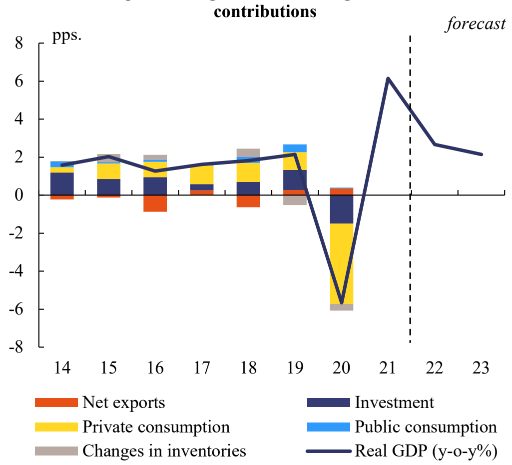
Real GDP bounced back strongly in 2021 after a severe decline of 5.7% in 2020 caused by the COVID-19 outbreak. The gradual easing of restrictions throughout the year allowed real GDP to surpass its pre-crisis level already in the third quarter, with a strong increase of private consumption. However, activity is expected to have slowed down at the end of the year driven by the new wave of infections and renewed restrictions, as well as by supply side constraints and high input prices. GDP is estimated to have grown by 0.5% in the last quarter of 2021, leading to an annual growth rate of 6.1% for 2021.

At the beginning of 2022, restrictions on activity and supply side constraints are still affecting the economy but are expected to gradually ease. Real GDP is forecast to be roughly flat in the first quarter before recovering strongly in the following quarters. As from the second quarter of 2022, the economy is expected to return to a solid expansionary path, with sustained increase in private consumption. While private consumption surpassed its pre-crisis level already in the third quarter of 2021, it is set to expand further after restrictions are lifted on the remaining contact-intensive activities.

Investment is projected to grow strongly over the forecast horizon, supported by low interest rates, the Recovery and Resilience Facility, easing supply side constraints, robust private consumption and the energy transition. Net exports are expected to contribute negatively to growth in 2022, as tourism abroad resumes further. After a strong recovery in 2021, real GDP growth is forecast to be more moderate in 2022, but still above historic averages, reaching 2.7%. In line with consumption developments, GDP growth is then set to gradually return to its long-term trend in 2023, with annual growth rate forecast at 2.2%.

On the back of increasing energy prices and strong economic recovery, headline HICP inflation reached 3.2% in 2021. After exceptionally high electricity and gas prices in the fourth quarter of 2021 and the first quarter of 2022, energy prices are expected to gradually decline over the forecast horizon, though remaining at a high level. The Belgian Government recently announced measures to help assuage electricity prices. Annual HICP is projected to reach 4.3% in 2022 before declining strongly in 2023 to 1.3%.

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

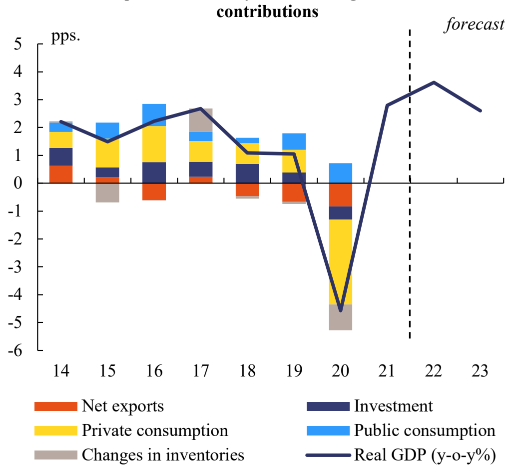


2.2. GERMANY

After contracting by 4.6% in 2020, the German economy rebounded by 2.8% in 2021. In the second and third quarters of the year, the economy benefited from the easing of the pandemic-related restrictions and a rise in private consumption, growing by 2.2% and 1.7%, respectively. Exports and investment were a drag on growth in the third quarter, as supply bottlenecks held back production activity, notably in the automotive sector, and depressed business sentiment. In the fourth quarter, GDP declined by 0.7%. Investment dropped further, while the recovery in private consumption was halted by the new infection wave and elevated consumer price inflation, including soaring energy prices.

Employment remained below its pre-crisis peak throughout 2021. However, the labour market has been improving steadily since the second quarter of last year, supported by the extension of regulations on short-time work and by recovering labour demand. Wages increased by 3.2% after stagnating the previous year. The net saving rate of households eased to 15.0%, from 16.1% in the previous year, but remained significantly above its pre-crisis level of 10.8% due to the re-emergence of factors restraining consumption.

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



With infection rates still rising, private consumption is expected to remain subdued in early 2022, particularly for services. In addition, exports are set to continue suffering from supply chain disruptions. Activity is also likely to be slowed down by sickness-related absenteeism. As a result, the economy is expected to stagnate in the first quarter of this year.

The expansion of the economy is set to resume in the second quarter, favoured by assumed subsiding infection rates and supply bottlenecks. Moreover, record-high manufacturing order books, in particular in the investment goods industries, suggest that exports and domestic sales of equipment and vehicles are likely to grow again especially as sentiment in industry has improved at the turn of the year. Accumulated savings should spur a resumption in the recovery in consumer spending, even if rising consumer prices somewhat dent purchasing power.

Overall, real GDP is forecast to expand by 3.6% in 2022, implying a return to its pre-crisis level in the course of the year. In 2023, GDP is expected to continue growing by 2.6% as restraints on pent-up consumer and investment demand dissipate.

HICP inflation soared to 6.0% in November and 5.3% in December, raising the annual rate in 2021 to 3.2%, from just 0.4% a year before. This was mainly driven by the reinstatement of regular VAT rates, increased carbon taxes and rising commodity prices, reinforced by strong pent-up demand. Lingering supply bottlenecks, higher energy prices and waning labour market slack are expected to lead to even higher inflation in 2022. A series of minimum wage increases, in particular 6.4% in July and 14.8% in October 2022 are expected to give a boost to wage growth in consumer services and overall in both 2022 and 2023. In 2023, inflation is expected to moderate. Still, robust aggregate demand, and the tight labour market are expected to keep it above 2% in 2023.

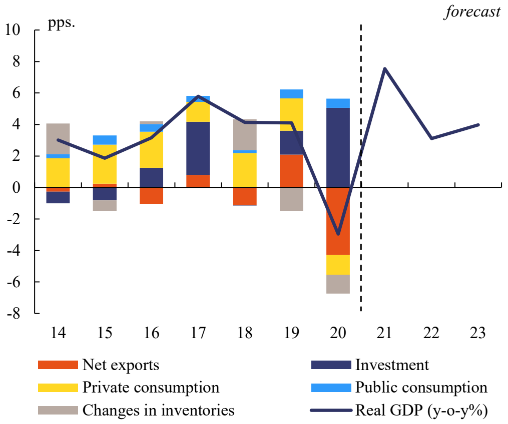
2.3. ESTONIA

Real GDP is forecast to have rebounded by 7.5% in 2021, after a mild contraction in 2020. Private consumption benefitted from the relatively fast employment recovery, the COVID-19-related government support and the early withdrawal of second-pillar pension savings. Public spending on wages and intermediate consumption also contributed positively. Investment rose significantly, mainly driven by a single large foreign direct investment in intangibles, which correspondingly increased the import of services. As a result, external demand acted as a drag on GDP growth.

Output growth slowed down in the third quarter of 2021 and is expected to bottom out in the first quarter of 2022. Lingering uncertainty on the evolution of the pandemic, protracted shortages in the supply of some durable goods, and elevated energy prices are set to weigh on consumption and investment decisions in the first half of 2022, starting to ease later in the year. GDP growth is thus expected to accelerate somewhat in the second part of the year and reach 3.1% in 2022 as a whole, driven mainly by private consumption and net exports. Investment is set to wind down after two years of double digit increases, but to still provide a positive contribution. Real GDP is forecast to rise by 4.0% in 2023, mostly thanks to domestic demand.

Consumer price inflation reached a decade-long peak in 2021 at 4.5%, with a very sharp acceleration in the last quarter of the year due to the flare-up of energy prices. HICP inflation is forecast to remain high in the first half of 2022, despite some government measures to cap gas and electricity retail prices, before subsiding gradually to around 2% by the end of 2023. Thanks to Estonia’s flexible price-setting system, the higher energy prices quickly passed through to the rest of the economy, but are expected to go into reverse as soon as oil and gas prices start receding. However, wage rises that were secured in recent months and wage contract renewals coming due in 2022 are bound to reflect the price increases, with persistent effects on core inflation throughout the forecast horizon.

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



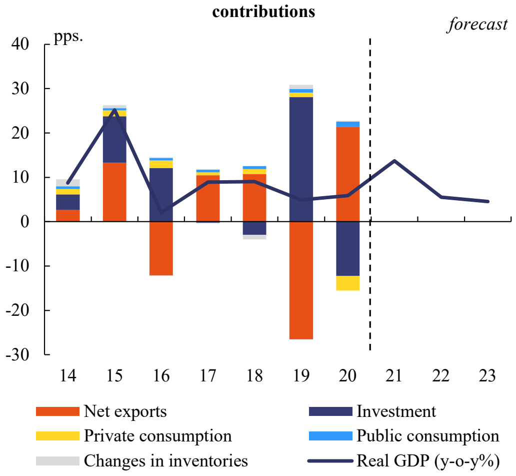
2.4. IRELAND

Real GDP in Ireland grew by 0.9% quarter-on-quarter in the third quarter of 2021 — a modest rate when compared with the extremely strong growth in the first half of the year. While public and private consumption expanded modestly, a fall in investment and shrinking net exports weighed on growth. Growth in the fourth quarter of 2021 is estimated to have been positive, supported by strong exports, especially in the information and communication sector, though restrictions re-introduced due to the Omicron variant negatively affected end-year retail sales and business confidence. Production by multinationals was very volatile in October and November, adding uncertainty regarding the final quarter. Annual real GDP growth in 2021 is hence estimated to be somewhat weaker than in the European Commission Autumn Forecast, at 13.7%.

COVID-related restrictions were still in place in the first weeks of 2022, which might slightly dampen growth in the first quarter. Nevertheless, economic growth for the year as a whole is projected at 5.5%, supported by a rapidly recovering labour market, a gradual reduction of large household savings through consumption and a relatively benign financial situation in the corporate sector. Growth in 2023 is forecast at 4.5%.

The unemployment rate has continued declining, as employment bounced back in sectors previously affected by restrictions. The gap between the official and COVID-adjusted unemployment rate has been consistently narrowing, with a slight divergence in December when restrictions were reintroduced. The official unemployment rate stood at 5.1% by the end of 2021, and the COVID-adjusted rate was up at 7.5%.

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



HICP inflation accelerated in the final months of 2021, particularly driven by steeply rising energy prices, though core inflation also rose substantially. In the fourth quarter of 2021 prices rose for all major components except unprocessed food, leading to inflation of 5.4% year-on-year, a rate not seen for more than a decade. The high inflation is set to continue in early 2022, while some changes in taxation, such as minimum alcohol pricing that came into effect on 1st January, will add to price pressures. Inflation is projected at 4.6% in 2022 and 2.5% in 2023.

Ireland's economic outlook remains subject to uncertainty surrounding trade developments related to the implementation of the Protocol on Ireland/Northern Ireland, upcoming changes in international taxation, and rising inflation. The performance of multinational corporations could swing growth in either direction.

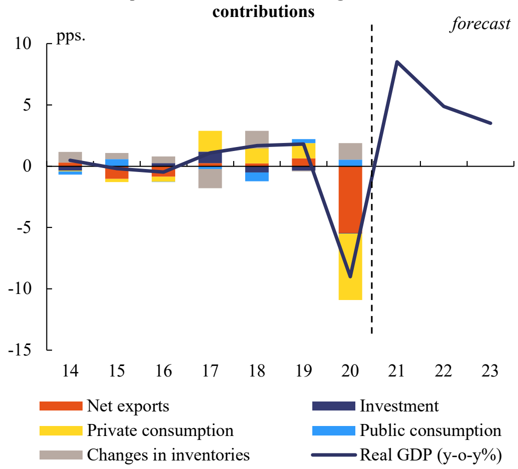
2.5. GREECE

Real GDP in Greece grew by 2.7% (quarter-on-quarter) in 2021-Q3, reflecting strong export performance and a significant contribution from private consumption. The notable recovery in tourist inflows over the summer helped the economy to reclaim a significant part of the previous losses due to the negative impact of the COVID-19 pandemic, while the industrial sector has rebounded strongly. The recent emergence of the Omicron variant and the related tightening of containment measures are expected to have weighed on growth in the last quarter of 2021, but its impact is projected to largely fade out during the first quarter of 2022. Overall, real GDP is expected to have grown 8.5% in 2021.

Growth in 2022 is forecast to be driven by investment, supported by the impetus from the Recovery and Resilience Plan. As consumer spending returns to its pre-pandemic levels, private consumption is also expected to support growth. In addition, the external environment is forecast to remain supportive. Tourism in particular is expected to continue recovering its previous losses, until it fully returns to its pre-pandemic levels by the end of the forecast horizon. Overall, real GDP is projected to grow by 4.9% in 2022 and ease to 3.5% in 2023.

Driven primarily by energy prices, consumer price inflation increased in the last quarter of 2021. Electricity and fuel prices are set to peak during the first quarter of 2022 and ease later in the year. High energy costs are expected to subsequently pass-through to the remaining components of the consumption basket. Headline inflation is forecast at 3.1% in 2022 and 1.1% in 2023. Wage pressures have so far remained limited due to the still large slack in the labour market. The authorities announced an increase in the minimum wage in mid-2022, the size of which will be determined later in the year and therefore is not factored into this forecast.

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



The risks to the forecast remain elevated. Notwithstanding the quick recovery so far, the evolution of the pandemic represents a source of uncertainty in particular for tourist arrivals. In addition, the projection assumes only a limited negative impact on production from the notable pick-up in input costs. On the upside, the accumulated stock of savings during the pandemic could facilitate a bolder increase in private consumption. The strong performance of goods exports since 2020, could be indicative of structural improvements in the external sector, which could be a source of additional upside risks.

2.6. SPAIN

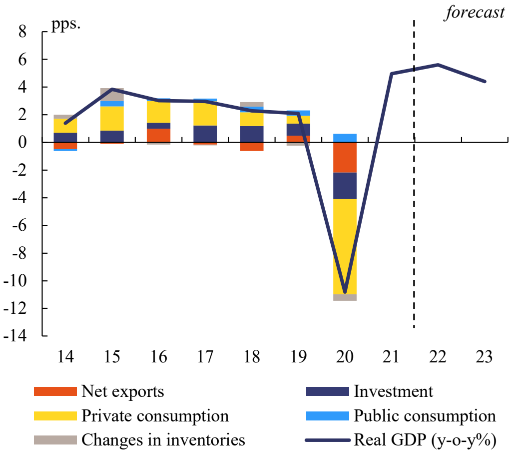
After the subdued expansion observed in the first half of 2021 due to the containment measures still in force, the recovery in economic activity gained traction in the second half of the year. GDP grew by 2.6% (quarter-on-quarter) in Q3 and 2.0% in Q4. Investment and net exports were the main drivers of the growth momentum during this period, while rising consumer prices, surging infections and uncertainty restrained private consumption. Overall, GDP increased by 5.0% in 2021.

The rapid increase of COVID-19 infections in the last weeks of December had a moderate immediate impact on the economy, as administrative restrictions remained relatively soft. As in the previous waves of the pandemic, contact-intensive services bore the brunt. The first quarter of 2022, however, is likely to see more sizeable adverse effects of the resurgence of infections, when the increasing number of sick leaves is set to act as a drag on labour supply. As a result, quarterly GDP growth is expected to slow down to 0.6%.

Economic growth is set to regain momentum as from the second quarter of 2022, with quarterly growth rates above 1% until the beginning of 2023. Afterwards, GDP growth is projected to moderate as the output gap closes and turns positive. Private consumption and investment are expected to be the main drivers of economic growth over the forecast horizon. The savings accumulated during the pandemic and recent pension increases will support consumption, while the implementation of the Recovery and Resilience Plan investment. The gradual normalisation of international tourism is set to enable a positive contribution from net exports to GDP growth. Overall, real GDP is expected to expand by 5.6% in 2022 and 4.4% in 2023. The gap with Spain's pre-pandemic GDP level is now projected to be closed by 2022-Q4.

HICP inflation peaked in the last quarter of 2021, when prices rose by 5.8% year-on-year on the back of skyrocketing energy prices and strong base effects. Headline inflation is expected to remain high in the first half of 2022, primarily driven by energy prices. In addition, producers are expected to pass on to consumers part of the increase in non-wage costs. Following it, HICP inflation is projected to start easing in the second half of 2022 and decelerate further in 2023, thanks to the stabilisation of energy prices and reversed base effects. Overall, annual HICP inflation is forecast to increase from 3.0% in 2021 to 3.6% in 2022, and then abate to 1.1% in 2023.

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



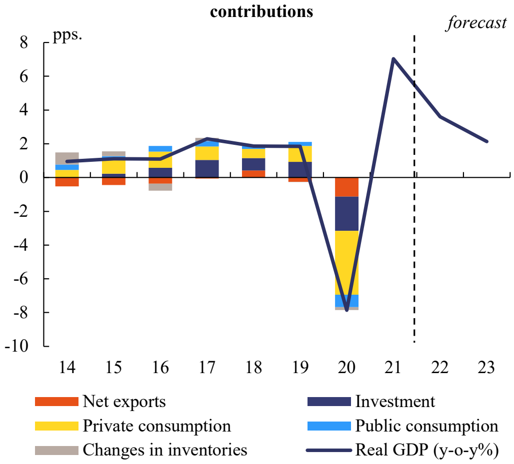
2.7. FRANCE

After rebounding strongly in the third quarter (+3.1%), GDP growth slowed down in the fourth quarter of 2021 (+0.7%) in a context of important supply bottlenecks and rising energy prices, leaving real GDP growth for 2021 as a whole at 7%. The slight tightening of restrictions and the labour absenteeism resulting from the rise in infections are set to impact activity, in particular services, during the beginning of 2022. However, the high vaccination rate should prevent further restrictions, allowing GDP growth to remain slightly positive in the first quarter of 2022 (+0.1%), and to increase as of the second quarter (+0.6%) as the COVID-19 wave gradually subsides. In the second half of the year, activity is expected to accelerate thanks to improving international trade, the recovery of tourism and the deceleration in inflation, before gradually returning to potential growth in 2023. Overall, annual GDP is forecast to increase by 3.6% in 2022 and 2.1% in 2023.

After rebounding in the second half of 2021 to reach its pre-crisis level, private consumption is expected to quasi-stagnate in the first quarter of 2022. It is, however, set to accelerate sharply as from 2022-Q2 thanks to the lifting of the last restrictions and the dynamism of the employment, bringing the saving rate gradually back to its pre-crisis level. Despite being held back by supply disruptions (affecting both construction and equipment) since mid-2021, investment is expected to remain robust over the forecast horizon as it continues to be supported by the RRF and favourable financing conditions. Net exports are forecast to contribute positively to growth throughout 2022 and 2023, supported by the rebound of tourism and the gradual recovery of transport equipment (both aircraft and ships).

HICP sharply accelerated in the last quarter of 2021 (+3.3%), mainly driven by energy prices. In the coming quarters, the increase in regulated electricity prices to households – although capped to +4% as of February, will further feed inflation even in case of decelerating wholesale energy prices. In addition, the delayed transmission of energy prices to firms along the whole value chain and the still important supply shortages are expected to push consumer prices further up. Inflation is forecast to decelerate below 2% only in the fourth quarter of 2022, mainly driven by important base effects coming from energy prices. In 2023, inflation in industrial goods is set to decrease thanks to the easing of supply disruptions. In turn, prices of services are expected to accelerate as a consequence of wage increases supported by past inflation and labour shortages. Overall, HICP is forecast to increase by 2.8% in 2022 and 1.7% in 2023.

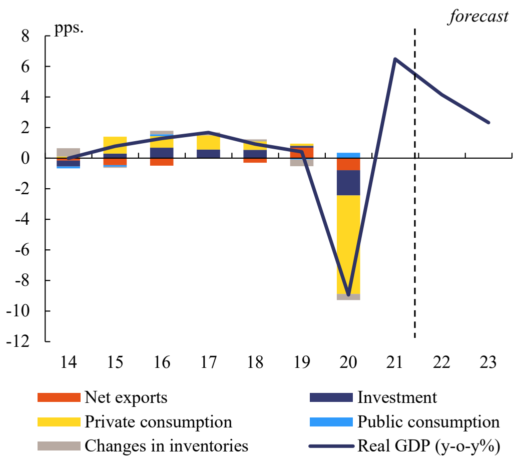
Graph 2.7: **France - Real GDP growth and contributions**



2.8. ITALY

The Italian economy grew by 6.5% in 2021 and had recovered most of the pandemic-incurred output losses by year-end. However, the short-term outlook is clouded by protracted supply disruptions and sharply rising energy prices. Eroding purchasing power and softening consumer confidence are expected to dent real GDP growth in the near term, especially consumer services. While COVID infections surged in the first weeks of 2022, high vaccination rates are likely to prevent a significant tightening of containment measures and real output from contracting in the early months of this year. Assuming that the current wave is steep but short-lived, economic activity is projected to regain momentum in the second quarter of 2022 and continue on its expansion path in the second half of the year.

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



Consumer spending, helped by improving labour market conditions and waning uncertainty related to the pandemic, is projected to support growth, with the household savings rate gradually returning to pre-crisis levels. Following the sharp rebound in 2021, growth of investment spending is set to moderate over 2022 and 2023 but still to expand solidly, driven by measures laid out in Italy's Recovery and Resilience Plan. The external environment is expected to remain supportive, extending the strong performance of goods exports of the previous year. Services are set to increasingly contribute to export growth, driven by the gradual recovery of receipts from international tourism. Overall, real GDP growth is expected to average 4.1% in 2022 and 2.3% in 2023.

Driven by energy prices, HICP inflation increased significantly in the second half of 2021 and averaged 1.9% over the whole year. Energy prices are expected to peak in the first quarter of 2022 and are set to remain at elevated levels throughout the year, with higher energy costs likely to further push up food prices. Wage pressure is set to increase only gradually, as most labour contracts in the manufacturing sector have recently been renewed and labour market slack continues to persist. Inflation is set to rise to 3.8% this year, before falling back to 1.6% in 2023.

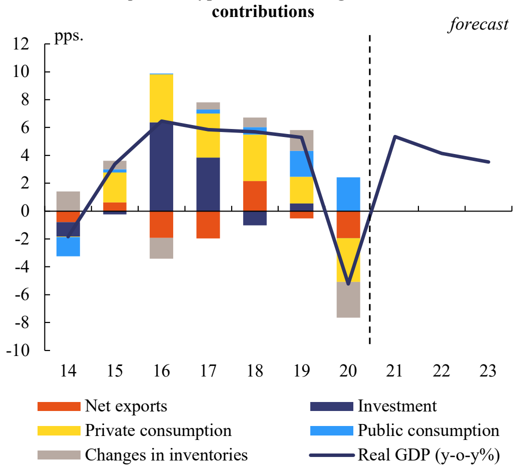
2.9. CYPRUS

After the sharp contraction in 2020, real GDP rebounded in 2021. The third quarter of 2021 came out slightly lower than expected in the autumn forecast, by 1.5% quarter-on-quarter. Real GDP increased by 5.3% in the first three quarters of 2021 compared to the same period last year. Growth was driven mainly by domestic demand, underpinned by fiscal stimulus, as well as exports of services including tourism. In the period January-October 2021, receipts from tourism continued to regain lost ground and reached 53% of the 2019-level for the same period. Despite the high rise of infections at the end of 2021 and beginning of 2022, economic sentiment among consumers and businesses remained high. On an annual basis, real GDP growth is expected to increase by 5.3% in 2021.

The recent surge of infections and the erosion of consumers' purchasing power due to high inflation is expected to somewhat dampen growth in the first quarter of 2022. The expansion of the economy is expected to resume in the second quarter, supported by the high vaccination rate for the adult population and the expected containment of COVID-related restrictions. Furthermore, the prospects for the tourism season are positive, based on the planned international flights data. In 2022, real GDP is forecast to grow by 4.1%. This will be mainly on the back of domestic demand, in particular investment boosted by the Recovery and Resilience Plan, and a small positive contribution from net exports. In 2023, growth is projected to ease to 3.5%.

High energy prices are driving inflation up. HICP inflation increased to 4.6% in the last quarter of 2021 pushing the inflation for the whole of the year to 2.3% in 2021 compared to -1.1% in 2020. It is set to further increase to 2.6% in 2022, before moderating to 1.2% in 2023.

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



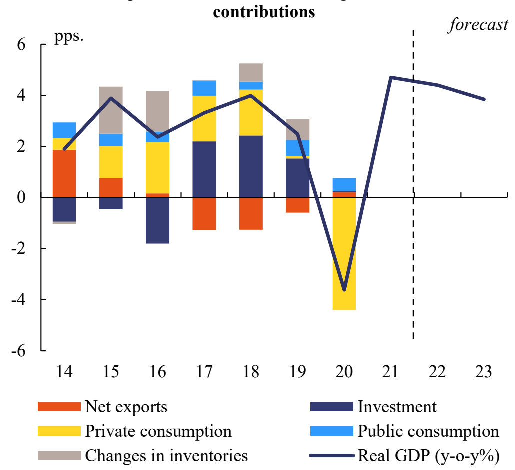
2.10. LATVIA

Real GDP is estimated to have grown by 4.7% in 2021 driven by a strong recovery of both domestic and foreign demand as restrictions eased in spring. However, the recovery slowed significantly towards the end of the year as new restrictions were put in place in response to the resurgence of COVID-19 infections.

In 2022, GDP growth is expected to reach 4.5%. With COVID-19 restrictions still in place, only moderate growth is expected at the start of the year. Growth should resume on a solid path in the second quarter as the health situation improves. Strong labour market performance and the un-winding of excess savings are expected to sup-port private consumption growth, although surging inflation is set to dent consumer purchasing power. Investments are forecast to receive a strong boost from increased inflows of EU funds. While growth in goods exports is expected to continue benefitting from the EU recovery, it is set to slow down compared to 2021. As GDP approaches its pre-pandemic path, growth is projected to converge close to its medium-term potential. In 2023, GDP growth is forecast at 3.8%, driven by still strong private consumption. Investments will continue to benefit from increasing EU-fund inflows, but the phasing out of some of the nationally-financed investments put in place to contribute to the recovery, are set to slow the growth down. Export growth is also expected to moderate as the demand boost from the EU recovery wanes.

Consumer price inflation is set to accelerate considerably on the back of rapidly rising energy prices. After reaching 3.3% in 2021, HICP inflation is expected to increase considerably to 5.9% in 2022 driven by a double-digit growth in energy prices. In the second half of 2022 energy price inflation is expected to moderate, but the knock-on effects on other prices is set to keep inflation at elevated levels throughout the forecast horizon. In 2023, however, HICP inflation is forecast to decline to 0.9% due to the expected decline in energy prices.

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



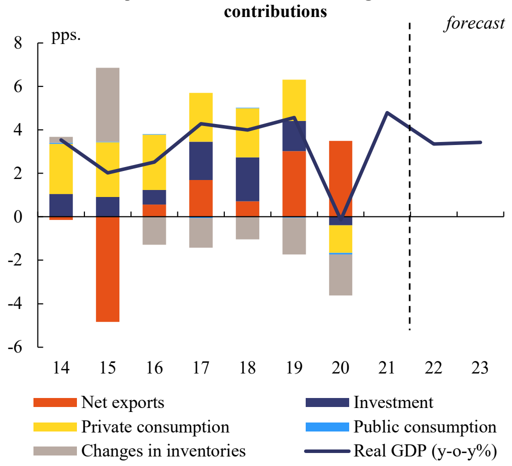
2.11. LITHUANIA

Following a mild contraction in 2020, Lithuania's GDP rebounded by 4.8% in 2021, almost returning to the pre-pandemic growth path. This was primarily led by the tradable sector, as manufacturing companies benefitted from stronger foreign demand and newly developed high-value added products in the area of pharmaceutics. Accumulated savings and continued growth of households' disposable income fuelled a pickup of domestic demand. The recovery of economic activity and high capacity utilisation contributed to the intensification of investment in machinery and other equipment, transport equipment, and information and communication technology. Heightened activity in the real estate market was accompanied by growth of investment in dwellings.

Economic activity is forecast to decelerate this year, growing by 3.4%. GDP growth is also forecast at 3.4% in 2023. Although household disposable income will continue increasing at an elevated pace, in part owing to heightened growth of wages as labour shortages persist, private consumption is forecast to be adversely affected by higher inflation. Investment is forecast to be negatively affected by slower growth of domestic and foreign demand, as well as by persistent uncertainty amid the ongoing pandemic, while investment will be supported by the expected increase in the inflows of the EU funds. In addition to a projected weakening of economic momentum in the main trading partners, exports are likely to be negatively impacted by geopolitical tensions.

Consumer price inflation surged in Lithuania towards the end of 2021, mostly driven by a spike in energy prices. HICP inflation is expected to further pick up to 6.7% in 2022 due to carry-over effects and continued strong growth in energy prices, despite the measures taken by the Lithuanian government to distribute the growth in administered energy prices over the next few years. At the same time, services prices are expected to increase at the fastest pace in more than a decade because of their close link to rising wages and rebounding domestic demand. Other consumer prices are forecast to increase mainly buoyed by global factors such as shortages of intermediate and final consumption goods. In 2023, as energy prices normalise and goods' shortages ease, inflation is projected to moderate to 2.2%.

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



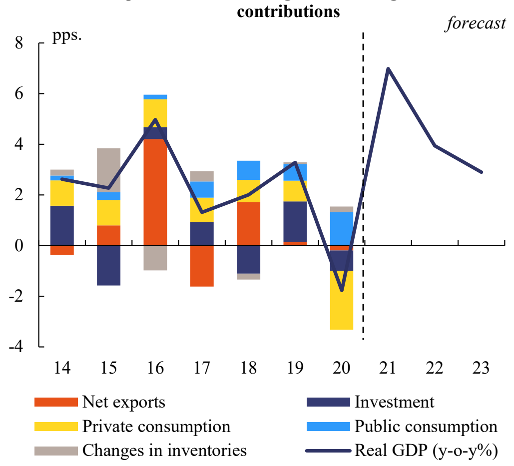
2.12. LUXEMBOURG

GDP is estimated to have strongly rebounded by around 7% in 2021, following a relatively limited decline of 1.8% in 2020. This strong growth is mainly driven by private consumption, which grew above its pre-crisis level in the third quarter of 2021. Investment increased in the first two quarters, before decreasing in the third quarter of the year. Almost all the sectors are expected to positively contribute to GDP growth in 2021, with information and communication services registering the most favourable dynamic. Despite the high vaccination rate, growth in the fourth quarter is set to have been negatively affected by a worsening of the epidemiological situation, leading to the (re-)introduction of additional sanitary measures. These restrictions are expected to mainly affect hotels and restaurants, as well as cultural activities. Nevertheless, even if slowed down, quarterly GDP growth is projected to have remained positive.

On an annual basis, GDP is forecast to continue expanding in 2022 and 2023, although at a slower pace than in 2021, with yearly growth rates of 3.9% and 2.9%, respectively. Private consumption is estimated to further increase, supported by a decrease in the high saving rates, which are expected to reach their pre-crisis level in 2023. Nevertheless, the increased uncertainty about geopolitical tensions, energy prices and the duration of the health crisis could negatively impact equity markets, having in turn a potential adverse impact on the financial sector in the country.

Following a zero inflation rate in 2020, inflation increased significantly in 2021, reaching 3.5%. Inflation is forecast to rise to 3.8% and 1.5% in 2022 and 2023, respectively, underpinned by high energy prices - which are estimated to peak in the first quarter of 2022 - as well as increased prices for non-energy goods and services.

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



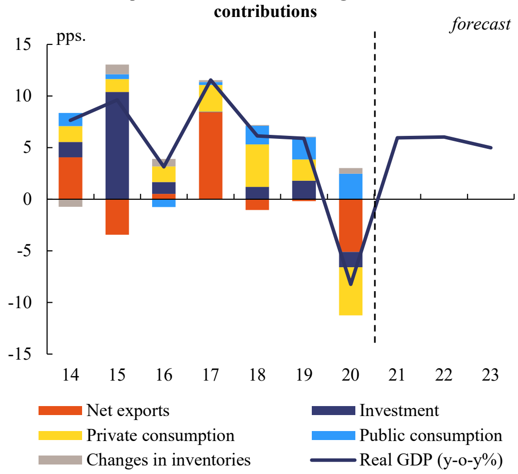
2.13. MALTA

After a considerable decline (-8.2%) in 2020, real GDP growth is estimated to have rebounded strongly to 5.9% in 2021. Growth is driven by the strong performance in the first three quarters of the year, when the improvement of the public health situation in Malta allowed for a significant relaxation of restriction measures. Improved business and consumer sentiment, as well as a recovery in tourism supported the economy. Growth is estimated to have been negative in the last quarter of 2021 and to remain muted in the first quarter of 2022, affected by the surge in infections in late 2021, the tightening of restrictions, low tourist numbers, continued disruptions in global value chains and negative effects of price increases in shipping and transport.

In the course of 2022, growth is expected to pick up again as domestic demand recovers, supported also by the implementation of the Recovery and Resilience Plan. Real GDP is forecast to grow by 6.0% in 2022 and 5.0% in 2023. Malta is expected to reach pre-pandemic levels of economic activity around mid-2022.

A limited downside risk remains related to possible consequences of the June 2021 decision of the Financial Action Task Force (an inter-governmental body against money laundering) to add Malta to the list of jurisdictions under increased monitoring.

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



Relative to the EU average, inflation in Malta increased only moderately in 2021. The authorities have also expressed a commitment to continue to limit energy prices growth in 2022. Nonetheless, the increase in food, transport and imported goods prices and a gradual recovery in the tourism and hospitality sectors are set to drive up price pressures in 2022. After increasing to 2.1% in 2022, inflation is expected to be at 1.9% in 2023.

2.14. THE NETHERLANDS

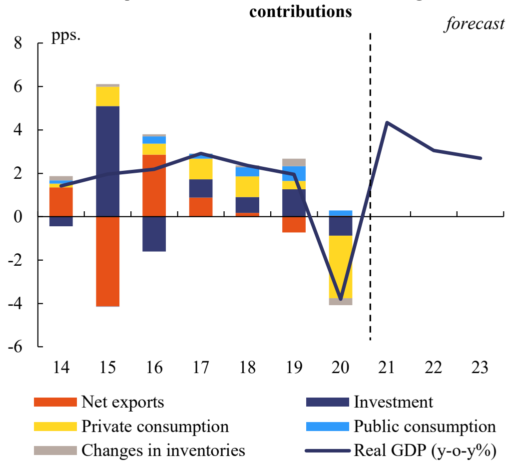
The Dutch economy recovered swiftly in 2021, as the health situation improved and restrictions were gradually lifted. Private consumption recovered especially quickly as the vaccination campaign progressed in the first half of 2021, allowing the economy to open up again. Net trade also contributed substantially, with imports only recovering partially while exports performed strongly. After a rebound in late 2020 and early 2021, investment contracted in the second and third quarters of 2021 due to supply side constraints. Investment activity was in particular affected by shortages and longer delivery times of raw materials and intermediate inputs as well as increasing labour shortages. The economy reached pre-pandemic levels in the third quarter, but economic expansion was brought to a halt by a new wave of the pandemic and related restrictions on economic activity. Reflecting the strong recovery overall, annual GDP growth in 2021 is forecast at 4.3%.

Growth is expected to remain robust in 2022, despite strict COVID-related restrictions weighing on economic activity in the first quarter. Private consumption is set to show a small dip in the first quarter due to the restrictions. Thereafter, however, a quick rebound is forecast and private consumption is expected to remain the main growth driver in 2022. Labour shortages are set to continue to weigh on investment activity of businesses while other supply side constraints are expected to ease in the course of 2022. Overall, GDP growth is forecast at 3.0% in 2022. In 2023, it is projected to remain strong with consumption and government spending driving the growth of 2.7%.

Consumer price inflation increased substantially in the final quarter of 2021 due to surging energy prices, with inflation over the whole year coming in at 2.8%. For 2022, inflation is forecast to increase further to 4.0% with energy prices expected to remain relatively high throughout the year and second-round effects driving up prices of industrial goods and food products. Inflation is projected to moderate to 1.4% in 2023 when energy prices are expected to show a more marked decrease.

Despite a tight labour market and rising inflation, wage growth does not show a clear upward trend yet, reflecting the uncertainty caused by the pandemic and indicating that wages react to economic developments with a delay. Wage growth is however expected to pick up in the course of 2022 and 2023 as the tight labour market and strong recovery start to affect wage developments.

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



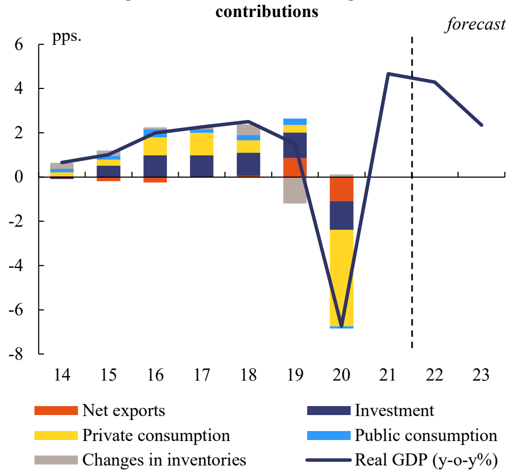
2.15. AUSTRIA

After its deepest recession since the Second World War, Austria's economy has recovered and reached its pre-crisis level of GDP in the third quarter of 2021. However, with the resurgence of COVID-19 infections and the reinforcement of containment measures, GDP declined by 2.2% q-o-q in the fourth quarter of 2021, resulting in annual GDP growth of 4.7%. In 2022, with the easing of measures and the albeit slow return of the winter skiing season, real GDP growth is projected to recover by 1.0% in the first quarter and to expand by 1.9% and 0.8% in the second and third quarter, respectively, before moderating to 0.5% in the fourth quarter. On an annual basis, real GDP is expected to expand by 4.3% in 2022, which is slightly lower than projected in the Autumn Forecast, primarily due to a lower carry-over from the previous year. In 2023, real GDP growth is set to moderate to 2.3%.

The expansion is set to be mostly driven by private consumption that benefits from pent-up demand, the ongoing recovery of the services and tourism sector, and continued increases in private investment. Further support should come from the eco-social tax reform and the implementation of the Austrian RRP. Sentiment indicators in January support this outlook. While the labour market has already fully recovered in 2021, the expansion is set to be increasingly restrained by labour shortages, both for high-skilled professions and low-skilled workers in the services and tourism industry.

As in other EU Member States, rising oil, gas, and electricity prices are having a noticeable impact on inflation. Further increases stem from the gradual introduction of carbon pricing, introduced by the eco-social tax reform. Overall, energy inflation is expected to remain high this winter but should moderate over the course of 2022. After reaching 2.8% in 2021, headline inflation is expected to peak at 3.3% in 2022, before gradually easing to 2.2% in 2023.

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



2.16. PORTUGAL

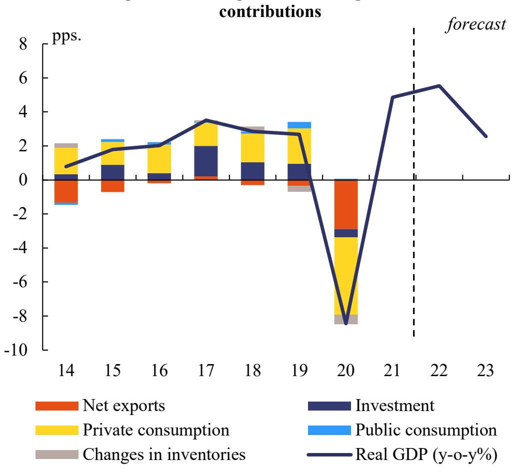
Economic recovery continued in the final quarter of 2021 with GDP growth of 1.6% (quarter-on-quarter), but at a slower rate than in the third quarter, as the boost from pent-up demand gradually waned. Portugal's economy grew by 4.9% in 2021, recovering slightly more than half of the output level lost in 2020, when GDP dropped by 8.4% due to the outbreak of the COVID-19 pandemic. Across demand components, investment and exports of goods rebounded to above pre-pandemic levels in 2021. Private consumption recovered at a somewhat slower pace as contact-intensive services faced continuous restrictions for most of the year. Exports of services picked up substantially in the second half of the year, but remained well below their pre-pandemic level as the country's large foreign tourism sector was still constrained by international travel conditions.

The resurgence of COVID-19 infections in early 2022, as well as a renewed drop in international travels, is expected to slow economic growth in Portugal to 0.5% in the first quarter of 2022. However, assuming improvement in the pandemic conditions, growth is projected to pick up again in the second quarter, when the economy is set to reach its pre-pandemic level.

In full-year terms, growth is forecast at 5.5% in 2022 and 2.6% in 2023. Domestic demand is set to contribute substantially to growth in both years, helped by the implementation of the Recovery and Resilience Plan. The external sector is projected to have a positive net contribution to growth in 2022, reflecting the recovery in tourism, followed by a broadly neutral impact in 2023. The balance of risks remains somewhat on the downside as foreign tourism would suffer a setback should the pandemic cause further disruptions over the forecast horizon.

Inflation increased from -0.1% in 2020 to 0.9% in 2021 amid significant volatility in energy prices. Consumer energy prices rose by 13.2% (year-on-year) in the last quarter of 2021, mainly driven by crude oil prices, while changes to the regulated components of electricity shielded households from the steep increase in wholesale prices. However, the energy component of producer prices rose at a much higher rate, triggering pass-through effects to a broad range of goods and services in the consumer basket. Overall, headline HICP inflation reached 2.4% (year-on-year) in the last quarter of 2021 compared to a core inflation rate of 1.6% for the same period. Although energy price inflation is expected to decline over the forecast horizon, base effects and a further recovery in service prices are set to push up inflation to 2.3% in 2022 before moderating to 1.3% in 2023.

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



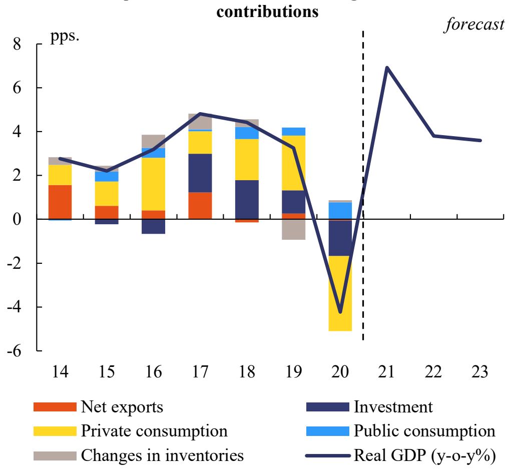
2.17. SLOVENIA

Slovenia's GDP is projected to have expanded by 6.9% in 2021. Growth in the first three quarters was strong across all components, especially investment. Imports increased more than exports, leading to a negative contribution from net exports. Growth in the third quarter was somewhat lower than in the first two quarters and is expected to be even lower in the final quarter. GDP exceeded its end-2019 level in the third quarter. Economic sentiment remained elevated throughout the year, employment recovered and the unemployment rate decreased, providing a good base for growth in 2022.

The rapidly increasing prices and supply bottlenecks are expected to limit growth in the beginning of 2022. Still, the high employment level and robust wage growth are expected to support strong consumption growth over the forecast horizon. In addition, investment growth is forecast to remain high, also sustained by public investments supported by the RRF. Strong demand in export markets is expected to remain supportive of export growth but, as in 2021, net exports are expected to be negative due to the strong imports. Overall, GDP is forecast to grow by 3.8% in 2022 and 3.6% in 2023.

Inflation in the final quarter of 2021 was particularly high, mainly driven by energy prices, but also by prices of non-energy goods and services. Overall, inflation averaged 2.0% in 2021 and is expected to remain high at the beginning of this year but to gradually ebb in the second half of the year, averaging 3.7% in 2022. In 2023, taking into account the projected recovery and assumed decrease in energy prices, inflation is expected to reach 2.1%.

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



2.18. SLOVAKIA

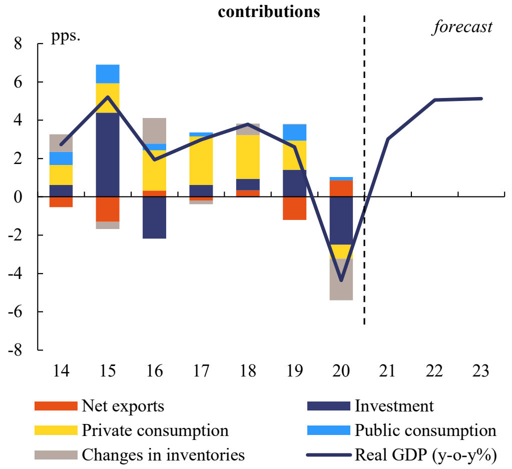
The recovery of the Slovak economy slowed down in the second half of 2021, as global supply bottlenecks proved to be more disruptive than expected, and the pandemic situation deteriorated. After a marked deceleration in the third quarter, annual GDP growth is expected to have been 3% for 2021. The outlook for economic activity remains weak in the first quarter of this year. The recovery is expected to regain momentum thereafter, with the economy forecast to surpass its pre-pandemic output level in the second quarter, bringing projected annual GDP growth to 5.0% in 2022, and 5.1% in 2023.

Private consumption bounced back sharply in mid-2021 on the back of easing COVID-19 containment measures. However, the resurgence of infections since autumn, combined with a low vaccination rate, is expected to have hurt domestic spending towards the end of 2021, and to continue weighing on domestic demand throughout the first quarter of 2022. The scope of the omicron wave is likely to have temporary adverse effects on labour supply via rising sick leaves and quarantine obligations. Pandemic-related uncertainty and ongoing supply chain disruptions are assumed to delay the recovery of private investments, while consumption is likely to be weakened also by slower real income growth due to higher inflation. After this temporary disruption, domestic demand is forecast to resume its robust expansion over the rest of the forecast horizon, as spending by households and corporations catches up to its pre-crisis path. Accelerating public investments funded via Next Generation EU are set to provide additional growth stimulus.

Slovakia's industry-heavy export sector has been hit by severe supply-chain disruptions. Global semiconductor shortages are assumed to persist throughout 2022, gradually fading by the end of the year. This is expected to constrain Slovakia's automotive industry, resulting in markedly lower export levels. Due to a large share of imported intermediate inputs, weaker exports should also go along with lower import growth, before trade volumes catch up to their previously predicted paths from 2023 onwards. As the robust recovery in domestic demand fuels imports further, the contribution of net exports to GDP growth is expected to be slightly negative over the forecast horizon.

Inflationary pressures have intensified recently, driven by adverse supply side developments and labour shortages, as well as by fast-rising commodity and input prices. A sharp increase in regulated energy prices and faster food price growth is expected to raise inflation further at the beginning of 2022, before price growth decelerates during the rest of the year, bringing average annual inflation to 6.4% in 2022. Well-anchored inflation expectations should prevent temporary price pressures from becoming entrenched, and allow inflation to slow to 2.4% in 2023.

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



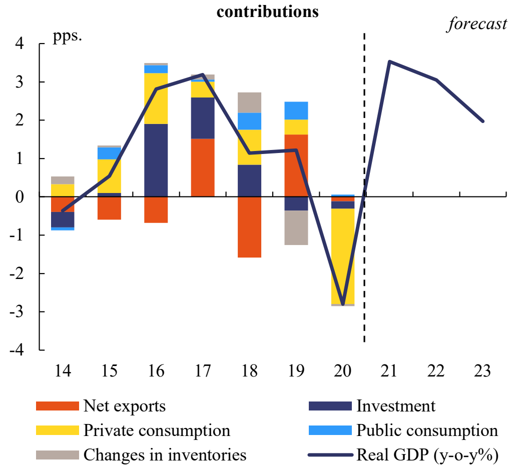
2.19. FINLAND

Despite a slowdown in the fourth quarter due to the resurgence in COVID-19 infections, real GDP is estimated to have increased by 3.5% in 2021, marking a stronger recovery from the crisis than previously expected. Growth was driven by domestic demand on the back of robust private consumption and investment growth. Exports rebounded more strongly than imports, also providing a positive contribution to GDP growth. Employment was recovering and the unemployment rate is estimated to have decreased slightly. Public expenditure continued to provide significant support to the economy through crisis-related measures.

Favourable prospects for domestic and external demand are set to continue, holding up private consumption and investment in 2022, while supporting also exports. Despite dampening economic sentiment in the first quarter of 2022 due to the rise in COVID-19 infections, GDP growth is forecast to reach 3% in 2022 on the back of carryover effects and strong demand. In 2023, growth is expected to slow down to 2% as it approaches the estimated potential output.

HICP inflation reached 2.1% in 2021, driven mainly by strong energy price increases. Energy price pressures are likely to persist in the first half of 2022, combined with price pressures from steadily rising demand and expected wage increases. Inflation is projected to accelerate to 2.6% in 2022 before falling back to 1.9% in 2023.

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



NON-EURO AREA

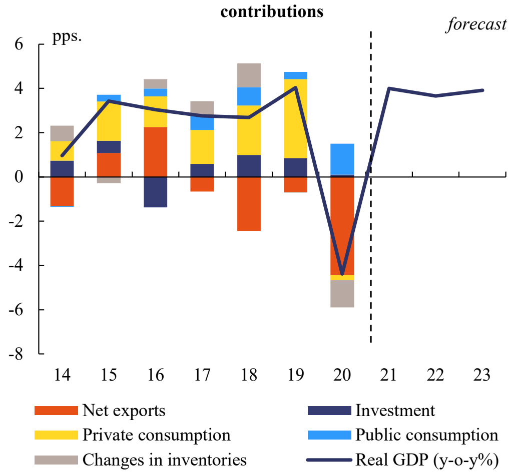
2.20. BULGARIA

After the marked decline in economic activity in 2020, the economy rebounded in 2021. Private consumption was the main growth driver on the back of favourable labour market conditions, strong consumer confidence and robust income growth, supported also by increased pensions and transfers. In contrast, investment underperformed in 2021. It was held back by persistently high uncertainty with regard to the COVID-19 pandemic situation, the introduction of containment measures and the external environment. Exports of goods and services have also contributed to the recovery. Nevertheless, foreign tourist visits remained well below pre-crisis levels. Overall, real GDP is expected to have increased by 4% in 2021.

Inflation accelerated sharply as from September 2021, driven by high fuel and gas prices and related indirect effects. To prevent further increases in electricity and heating prices for households, on 15 December the parliament imposed a moratorium on retail price changes until end-March 2022. Further measures to rein in energy price hikes for final consumers are currently being discussed. Looking forward, this year and next inflation will be largely determined by the magnitude of the indirect effects of high energy prices and the decisions of the national regulator on how to adjust retail prices to the expected evolution of wholesale prices. As a baseline scenario, the regulated electricity prices are set to increase by 15% in mid-2022 and 20% in mid-2023. These increases are consistent with the estimates by the energy regulator and with the past magnitudes and timing of price increases. These factors are set to contribute to the persistence of energy inflation leading to 6.3% and 3.9% headline inflation in 2022 and 2023, respectively.

Despite the accelerated inflation, economic growth is forecast to remain strong at 3.7% in 2022 and 3.9% in 2023. Both exports and domestic demand, also stimulated by the RRP-funded investments, are set to support the expansion. Disposable income is forecast to grow in real terms despite higher inflation. Nevertheless, higher energy and food prices are set to erode the purchasing power of low-income households in the absence of additional compensations. Energy intensive production is also expected to face challenges to remain competitive.

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



2.21. CZECHIA

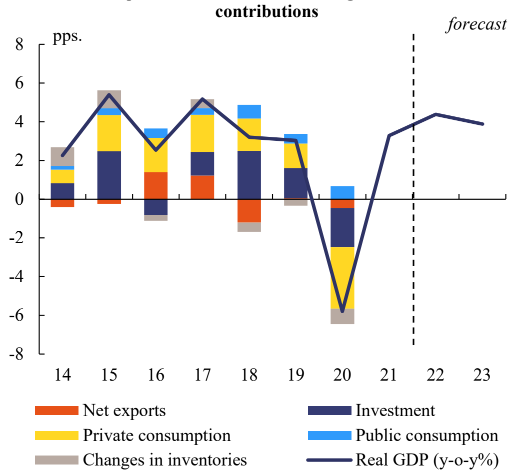
The Czech economy rebounded by 3.3% in 2021 according to a preliminary GDP release. The economy benefited from the easing of the pandemic-related restrictions and strong private consumption. In the fourth quarter of 2021, economic activity is estimated to have increased by 0.9% q-o-q. GDP growth is set to remain stable in the first half of this year and slightly accelerate in the second, surpassing its pre-pandemic level in the third quarter of the year. Overall, GDP growth is forecast at 4.4% in 2022 and 3.9% in 2023.

Private consumption is expected to remain the main driver of the economic recovery, reflecting high employment levels, pent-up demand and a declining saving rate of households. A sharp increase in the cost of living, in particular, due to high energy prices, is however likely to weigh on domestic spending. Due to increased uncertainty and ongoing disruptions in supply chains, investment is expected to remain subdued during the first half of the year. Supply-side disruptions are assumed to gradually fade in the second half of this year. Afterwards, domestic demand is forecast to resume its robust expansion over the rest of the forecast horizon, benefitting also from public investment support through Next Generation EU.

Net exports are set to hold back the performance of the economy until mid-2022 mainly due to two factors. First, global supply chain disruptions are set to hinder exports, particularly affecting the country's large export-oriented manufacturing industry. Exports are therefore expected to remain constrained until supply-side issues are resolved. Second, imports are expected to remain strong, sustained by household consumption and both private and public investment. As a result, the contribution of net exports to GDP growth is forecast to turn positive only in the second half of 2022.

Inflationary pressures intensified at the end of 2021, driven by fast-growing commodity and production input prices, adverse supply side developments, as well as a tight labour market. Overall, annual HICP inflation reached 3.3% in 2021. A sharp increase in regulated energy prices and related indirect effects, faster food price growth and prices of services are expected to raise inflation further this year. Owing to tighter monetary policy, a strong koruna and the fading of inflationary factors, the growth of consumer prices should decelerate towards the end of the year, bringing average annual inflation to 5.8% in 2022. Well-anchored inflation expectations should prevent temporary price pressures from becoming entrenched, and allow inflation to slow to 2.2% in 2023.

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

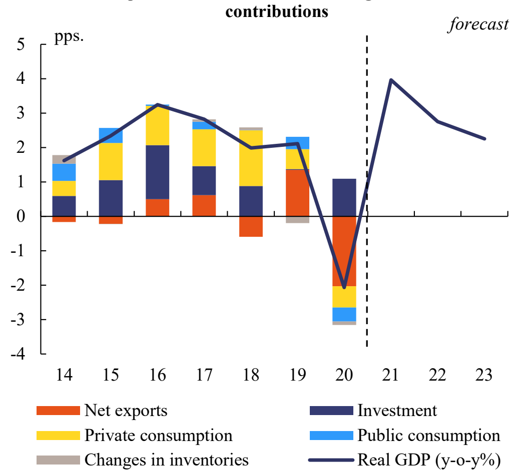


2.22. DENMARK

The successive waves of COVID-19 infections in 2021 were accompanied by varying degrees of restrictions, but these were generally light for most of the second half of the year. This led to a release of pent-up demand and buoyant economic activity from the second quarter onwards, with some deceleration expected in the last quarter of the year in view of the re-introduction of mild restrictive measures in December. As a result, following the 2.1% decline in 2020, real GDP is estimated to have expanded by 4% in 2021 mainly driven by consumption and investment.

The lifting of all COVID-related restrictions from 1 February 2022 and the gradual ease of supply side restrictions are set to help maintain Denmark's economic momentum. Growth appears broad-based with continued support from domestic demand and a pick-up in exports. The resumption of economic activity last year quickly spread to the labour market and employment increased in a robust pace. Robust private consumption dynamics this year are forecast to be underpinned by continued strong employment growth as well as the reduction in accumulated household savings. Government consumption, on the other hand, is set to decrease in 2022 following the sharp pandemic-related expansion last year. Overall, the economy is forecast to expand by 2.8% in 2022, also thanks to a positive carry-over from last year. Robust economic growth is projected to continue next year at 2.3% in 2023, albeit moderating domestic demand growth.

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



Consumer price inflation (HICP) has been on a strong upward trend since early 2021, driven mostly by energy prices, but with contributions from other factors as well. The ongoing pressure on global supply chains has been, inter alia, reflected in rising industrial goods prices. Combined with a marked increase in food prices and a hike in cigarette duties, HICP inflation accelerated from 0.4% in 2020 to 1.9% in 2021. Inflation is expected to peak in 2022 at 2.5% on the back of the sustained rise in energy prices and revived domestic demand translating into higher service prices. With energy and commodity prices expected to decline next year from the current high levels and supply chains normalising, HICP inflation is set to moderate to 2.1% in 2023. Rising labour market pressures could nevertheless fuel higher than expected wage growth, representing an upside risk to inflation.

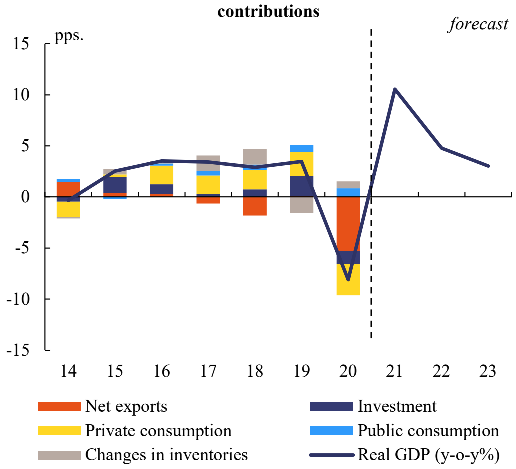
2.23. CROATIA

Economic developments in 2021 point to a full V-shaped recovery of the Croatian economy. After a drop of 8.1% in 2020, real GDP is forecast to have grown by 10.5% in 2021, bringing output above its pre-pandemic level. After strong quarterly figures in the second and third quarter, real growth in the fourth quarter is expected to have decelerated, as indicated by developments of short-term indicators of economic activity and rising prices. Looking at the components, the recovery in 2021 was supported by exports of goods and services, with tourism playing a key role as well as private consumption. Strong growth of final demand spurred imports growth, but the overall growth contribution of net exports is expected to have stayed positive.

Growth in 2022 is expected to remain dynamic, at 4.8%, supported by both domestic demand and net exports. Due to the unfavourable epidemiological situation, the economic performance is expected to be weak in the first quarter, but to pick up pace over the rest of the year. While rising inflation is set to weigh on private consumption, favourable labour market developments and relatively mild pandemic containment measures still point to its solid contribution to GDP growth. Investment activity should strengthen on the back of rising demand, expected acceleration of post-earthquake reconstruction in the Banovina region and Zagreb, favourable financing conditions and the implementation of the national RRF plan. The adopted budget indicates that government consumption should have a small positive contribution to growth this year.

On the external side, more muted demand from the main trading partners and a strong base effect suggests that export growth of goods weakens, but remain solid, while exports of services reach their pre-pandemic level, with an expected robust performance of tourism playing the most supportive role. Although the expected performance of final demand points to stronger pressures on imports, net exports is expected to retain its positive, but milder, contribution to the overall growth figure. The balance of risks is tilted slightly to the downside, most notably on account of more persistent problems with the contracting of post-earthquake reconstruction projects, which could negatively affect investment. In 2023, real GDP growth is forecasted start to gradually converge towards the potential growth rate and be around 3%.

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



After reaching 2.7% in 2021, HICP inflation is expected to accelerate to 3.5% in 2022, mostly due to higher commodity prices. Higher inflation figures in the first half of the year are expected to subside in the rest of the year. As for HICP components, the trajectory of the headline figure should be mostly shaped by energy and unprocessed food prices. Stable inflation expectations, base effects and an expected decline of commodity prices suggests lower inflation figure in 2023, below 2%.

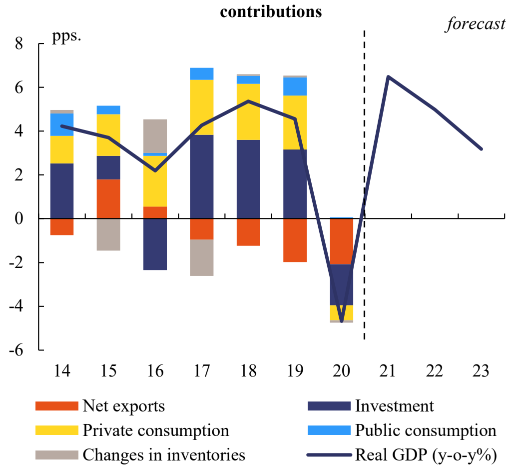
2.24. HUNGARY

Hungary's economy regained its growth momentum at the end of 2021. Supply chain disruptions in manufacturing weighed on GDP growth in the third quarter of the year (0.7% quarter-on-quarter), but industrial production has started to recover since September. Meanwhile, construction and services continued to grow as no major pandemic-related restrictions were introduced. GDP is estimated to have expanded by 6.5% in 2021.

Economic growth is forecast to slow down to 5.0% in 2022. Significant stimulus measures aim at boosting consumption in 2022, including a one-off PIT refund to families, and large administrative wage increases. However, high inflation is eroding households' purchasing power and denting consumer confidence. The expansion of investment is set to be limited by the authorities' decision to decrease the 2022 budget deficit target by 1% of GDP mainly through cutting public investments. Export growth is set to remain dynamic thanks to the assumed, gradual easing of supply chain constraints and the projected recovery of international tourism flows. GDP growth is forecast to slow further to 3.2% in 2023, after economic activity returns to its pre-pandemic trend and the temporary policy support is phased out.

Inflation remained high in recent months, with HICP growing by 7.4% year-on-year in December 2021. Consumers have been shielded from wholesale energy price increases by the unchanged regulated prices of residential energy and a temporary cap on motor fuel prices. However, core inflation has continued to rise, reflecting broad-based inflationary pressure. The government introduced temporary price controls for some essential food items as of 1 February, which are estimated to reduce inflation in 2022 by 0.1 percentage point. Inflation is forecast to rise further from 5.2% in 2021 to 5.4% in 2022 on the back of higher production costs and strong consumer demand. It is then projected to ease to 3.6% in 2023 as the impact of cost shocks fades.

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



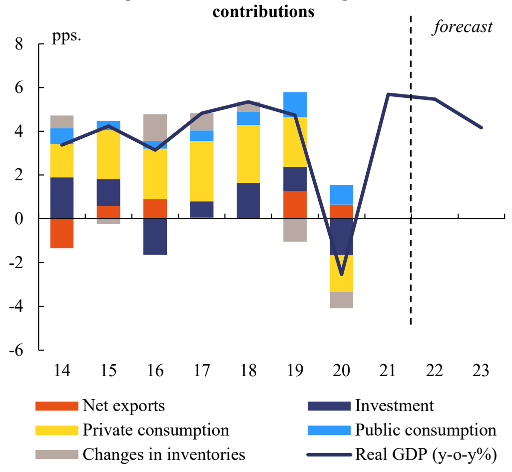
2.25. POLAND

Poland's economy surprised on the upside in the second half of 2021, confirming the economy's resilience despite recurring COVID-19 waves and disruptions in supply chains. Real GDP grew by 2.1% quarter-on-quarter in Q3, mainly driven by a gradual easing of COVID-related restrictions, which increased spending opportunities and supported private consumption growth. The flash estimate published by the statistical office suggests that economic activity maintained its strong momentum towards the year-end, with investment and inventories rising strongly amid a revival in manufacturing. As a result, real GDP growth is estimated to have reached 5.7% in 2021, putting Poland's economy back to its pre-pandemic output path.

Although the rise in new COVID-19 infections at the beginning of 2022 is expected to weigh on the short-term economic outlook, particularly for services, economic growth is projected to gather pace from the second quarter onwards. Private consumption growth will likely remain robust driven by a favourable situation on the labour market as well as policy support resulting from changes in the personal income tax, although increasing costs of living will likely erode purchasing power. Investment is projected to continue its recovery supported by a healthy financial situation of companies and firms' need to increase capacity. Poland's lower robotisation rate compared to other EU countries is also set to give firms incentives to invest in new machinery, especially in view of rising labour costs. Regarding foreign trade, even though both exports and imports are expected to show strong growth rates, imports will likely grow at a faster rate than exports, given the dynamic domestic demand. Thus, the trade balance is set to continue deteriorating in 2022, and to remain broadly unchanged in 2023. All in all, real GDP growth is projected to reach 5.5% in 2022 and decelerate to 4.2% in 2023.

HICP inflation rose noticeably in the second half of 2021 due to rising global commodity prices and supply bottlenecks, leaving the annual HICP inflation at 5.2% in 2021, the highest figure in 20 years. Going forward, even though a new package introduced by the government will reduce the taxes paid on energy and food products in the first half of the year, inflation is forecast to accelerate in the first quarter of 2022 due to a hike in regulated energy prices. Strong wage growth will likely keep putting upward pressure on core inflation throughout 2022, which is only expected to start easing in 2023 as inflationary pressures subside. HICP inflation is thus expected to accelerate to 6.8% in 2022 and to decrease to 3.8% in 2023.

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



2.26. ROMANIA

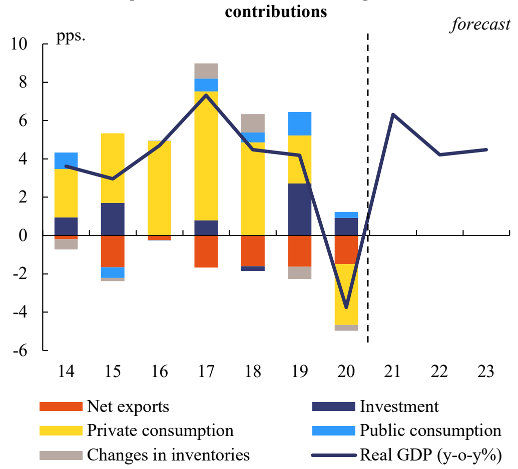
In 2021, Romania's economy is expected to have grown by 6.3%, mainly driven by strong domestic demand. Towards the end of the year, growth momentum eased due to continued supply restrictions, a new COVID-19 infection wave and a strong pickup in inflation.

Despite this loss of momentum, which is set to continue into spring 2022, latest readings of sentiment indicators point to a rather positive, albeit moderate, growth outlook, in particular in services, retail trade, construction and industry. Private consumption is expected to pick up in the second half of 2022, when restrictions are set to ease and inflation to moderate. Investment is expected to remain strong over the forecast horizon, supported by the Recovery and Resilience Facility and other EU Funds. The expected increase in interest rates however, is projected to dampen private investments. Foreign trade is forecast to benefit from easing of supply bottlenecks, but not expected to provide a growth contribution. Overall, real GDP is set to grow at 4.2% in 2022 and 4.5% in 2023.

The steep and continuous increase in energy prices pushed monthly HICP inflation to 6.7% in December, lifting average inflation to 4.1% in 2021. Prices are set to rise further in 2022 due to high energy prices, and their pass-through into the prices of other goods and services. Food prices are also expected to increase on the back of higher prices and lower supply of fertilizer. Stronger wage dynamics than currently expected are an upward risk to the inflation forecast. Average annual HICP inflation is set to rise to 5.3% in

2022. For 2023 a decrease to 2.5% is projected, as energy prices are set to moderate and base effects will kick-in.

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

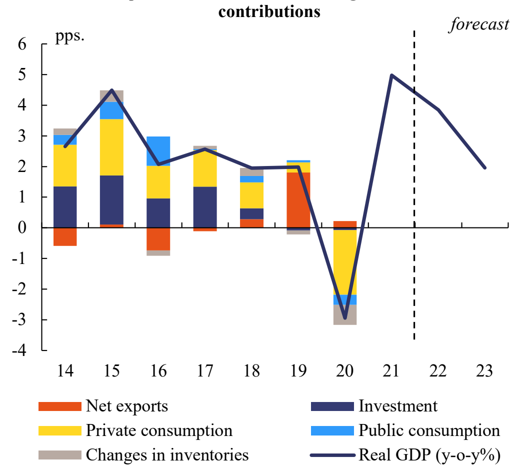


2.27. SWEDEN

In 2021, Sweden's economy expanded by 5%, boosted by strong investment growth as well as a sharp recovery in contact-related services, resulting in marked gains in private consumption. Monthly data and short-term forward-looking indicators suggest that the clear weakening in growth momentum observed towards the end of last year will continue into the first quarter of 2022 on the back of continued supply chain disruptions. The expected temporary slowdown also reflects the combined impact of the peak in inflation and omicron-related restrictions, affecting purchasing power, business and consumer confidence and orders.

Real GDP growth is forecast to pick up from the second quarter of 2022, as the pandemic's impact is assumed to recede, while production bottlenecks and price pressures are set to ease gradually. Low borrowing costs, high capacity utilisation, large-scale green transition projects (such as the production of batteries and fossil-free steel), and strong housing construction are expected to boost investment over the forecast horizon. Private consumption is set to be sustained by the use of high buffer savings, a strong labour market and fiscal support. Export growth is projected to remain brisk, reflecting the strong competitiveness of Swedish exporters. Overall, real GDP growth is set to reach 3.8% in 2022 and ease to 2% in 2023.

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



In December 2021 HICP inflation reached 4.5%, the highest rate on record since the index was first published in 1996, on the back of rapidly increasing energy prices – foremost electricity prices. Inflation is set to ease markedly in the course of 2022, as energy inflation fades and trade and production bottlenecks ease. Domestic wage and price pressures are expected to remain contained over the forecast period, given relatively moderate multi-annual wage agreements extending into 2023. In all, HICP inflation is expected to average 2.9% in 2022 and decrease to 1.2% in 2023. For inflation, risks are to the upside and reflect a stronger-than-expected pass-through of energy prices possibly coupled with stronger wage demands on the back of the tight Swedish labour market.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2003-2023) 01.02.2022

	5-year averages							Winter 2022 interim forecast			Autumn 2021 forecast		
	2003 - 07	2008 - 12	2013 - 17	2017	2018	2019	2020	2021	2022	2023	2021	2022	2023
Belgium	2.6	0.7	1.4	1.6	1.8	2.1	-5.7	6.1	2.7	2.2	6.0	2.6	1.9
Germany	1.6	0.7	1.8	2.7	1.1	1.1	-4.6	2.8	3.6	2.6	2.7	4.6	1.7
Estonia	8.2	-1.7	3.0	5.8	4.1	4.1	-3.0	7.5	3.1	4.0	9.0	3.7	3.5
Ireland	5.2	-1.4	8.9	8.9	9.0	4.9	5.9	13.7	5.5	4.5	14.6	5.1	4.1
Greece	4.1	-5.5	-0.3	1.1	1.7	1.8	-9.0	8.5	4.9	3.5	7.1	5.2	3.6
Spain	3.5	-1.3	1.9	3.0	2.3	2.1	-10.8	5.0	5.6	4.4	4.6	5.5	4.4
France	2.0	0.4	1.2	2.3	1.9	1.8	-7.9	7.0	3.6	2.1	6.5	3.8	2.3
Italy	1.1	-1.4	0.4	1.7	0.9	0.4	-8.9	6.5	4.1	2.3	6.2	4.3	2.3
Cyprus	4.5	0.1	1.3	5.9	5.7	5.3	-5.2	5.3	4.1	3.5	5.4	4.2	3.5
Latvia	9.9	-2.7	2.7	3.3	4.0	2.5	-3.6	4.7	4.4	3.8	4.7	5.0	4.0
Lithuania	8.7	-0.4	3.2	4.3	4.0	4.6	-0.1	4.8	3.4	3.4	5.0	3.6	3.4
Luxembourg	4.7	0.6	2.9	1.3	2.0	3.3	-1.8	7.0	3.9	2.9	5.8	3.7	2.7
Malta	3.0	2.5	7.4	11.5	6.1	5.9	-8.2	5.9	6.0	5.0	5.0	6.2	4.8
Netherlands	2.3	0.0	1.7	2.9	2.4	2.0	-3.8	4.3	3.0	2.7	4.0	3.3	1.6
Austria	2.6	0.6	1.2	2.3	2.5	1.5	-6.7	4.7	4.3	2.3	4.4	4.9	1.9
Portugal	1.1	-1.4	1.4	3.5	2.8	2.7	-8.4	4.9	5.5	2.6	4.5	5.3	2.4
Slovenia	4.8	-1.0	2.4	4.8	4.4	3.3	-4.2	6.9	3.8	3.6	6.4	4.2	3.5
Slovakia	7.3	2.0	2.7	3.0	3.8	2.6	-4.4	3.0	5.0	5.1	3.8	5.3	4.3
Finland	3.6	-0.7	1.0	3.2	1.1	1.2	-2.8	3.5	3.0	2.0	3.4	2.8	2.0
Euro area	2.2	-0.3	1.5	2.6	1.8	1.6	-6.4	5.3	4.0	2.7	5.0	4.3	2.4
Bulgaria	6.4	1.4	1.9	2.8	2.7	4.0	-4.4	4.0	3.7	3.9	3.8	4.1	3.5
Czechia	5.5	0.2	3.0	5.2	3.2	3.0	-5.8	3.3	4.4	3.9	3.0	4.4	3.2
Denmark	2.0	-0.4	2.2	2.8	2.0	2.1	-2.1	4.0	2.8	2.3	4.3	2.7	2.4
Croatia	4.8	-1.8	1.7	3.4	2.9	3.5	-8.1	10.5	4.8	3.0	8.1	5.6	3.4
Hungary	3.5	-0.8	3.2	4.3	5.4	4.6	-4.7	6.5	5.0	3.2	7.4	5.4	3.2
Poland	5.0	3.4	3.3	4.8	5.4	4.7	-2.5	5.7	5.5	4.2	4.9	5.2	4.4
Romania	6.5	0.6	4.5	7.3	4.5	4.2	-3.7	6.3	4.2	4.5	7.0	5.1	5.2
Sweden	3.5	0.7	2.6	2.6	2.0	2.0	-2.9	5.0	3.8	2.0	3.9	3.5	1.7
EU	2.4	-0.1	1.7	2.8	2.1	1.8	-5.9	5.3	4.0	2.8	5.0	4.3	2.5

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 01.02.2022

	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	1.2	1.7	2.0	0.5	0.1	0.5	0.6	0.6	0.5	0.5	0.5	0.4
Germany	-1.7	2.2	1.7	-0.7	0.4	1.9	1.8	0.5	0.4	0.4	0.4	0.4
Estonia	3.4	2.3	0.7	0.4	0.2	1.2	1.3	0.9	0.9	0.9	1.0	0.9
Ireland	10.0	5.2	0.9	:	:	:	:	:	:	:	:	:
Greece	4.2	2.1	2.7	:	:	:	:	:	:	:	:	:
Spain	-0.7	1.2	2.6	2.0	0.6	1.1	1.3	1.3	1.1	0.9	0.9	0.8
France	0.1	1.3	3.1	0.7	0.1	0.6	0.7	0.6	0.5	0.5	0.4	0.3
Italy	0.3	2.7	2.6	0.6	0.3	1.3	0.7	0.6	0.5	0.5	0.5	0.4
Cyprus	1.4	1.5	1.5	:	:	:	:	:	:	:	:	:
Latvia	0.3	2.3	0.5	-0.1	1.0	2.0	2.3	0.9	0.7	0.6	0.6	0.6
Lithuania	2.1	2.0	0.0	0.5	0.7	0.8	0.9	1.0	0.9	0.9	0.8	0.8
Luxembourg	3.7	0.0	0.9	0.6	0.8	1.5	1.4	0.8	0.7	0.3	0.3	0.3
Malta	3.3	0.6	1.5	:	:	:	:	:	:	:	:	:
Netherlands	-0.8	3.8	2.1	-0.6	-0.3	1.6	0.8	0.7	0.6	0.5	0.5	0.4
Austria	-0.4	4.2	3.8	-2.2	1.0	1.9	0.8	0.5	0.5	0.4	0.4	0.4
Portugal	-3.0	4.3	2.9	1.6	0.5	0.9	0.8	0.6	0.6	0.6	0.5	0.5
Slovenia	1.5	2.0	1.3	0.4	0.1	1.6	1.4	1.0	0.7	0.7	0.7	0.5
Slovakia	-1.4	1.9	0.4	0.0	0.8	2.5	2.4	1.3	1.1	0.8	0.8	0.8
Finland	0.3	2.0	0.8	0.2	0.2	1.6	0.9	0.4	0.3	0.3	0.3	0.3
Euro area	-0.2	2.2	2.3	0.3	0.3	1.3	1.1	0.7	0.6	0.5	0.5	0.5
Bulgaria	1.4	0.8	0.6	0.4	0.9	1.6	1.6	1.6	0.6	0.6	0.6	0.6
Czechia	-0.4	1.3	1.6	0.9	0.8	1.0	1.5	1.3	0.9	0.7	0.7	0.6
Denmark	-0.4	2.1	1.1	0.8	0.3	0.7	0.6	0.6	0.5	0.5	0.5	0.5
Croatia	7.3	0.8	2.7	1.7	0.3	1.0	1.7	1.7	0.5	0.7	0.2	0.2
Hungary	1.5	2.0	0.7	1.3	1.4	1.2	0.9	0.9	0.6	0.7	0.8	0.9
Poland	1.6	1.8	2.3	2.2	0.6	1.1	1.1	1.1	1.0	1.0	0.9	0.9
Romania	2.2	1.5	0.4	0.4	0.8	1.2	2.0	2.0	0.8	0.6	0.6	0.2
Sweden	1.3	1.1	2.1	1.4	0.3	0.7	0.7	0.7	0.4	0.4	0.4	0.4
EU	0.0	2.1	2.2	0.4	0.4	1.3	1.1	0.7	0.6	0.5	0.5	0.5

Table 3: Harmonised index of consumer prices, (percentage change on preceding year, 2003-2023) 01.02.2022

	5-year averages							Winter 2022 interim forecast			Autumn 2021 forecast		
	2003 - 07	2008 - 12	2013 - 17	2017	2018	2019	2020	2021	2022	2023	2021	2022	2023
Belgium	2.0	2.5	1.3	2.2	2.3	1.2	0.4	**3.2**	**4.3**	**1.3**	*2.7*	*2.3*	*1.6*
Germany	1.8	1.7	1.0	1.7	1.9	1.4	0.4	**3.2**	**3.7**	**2.1**	*3.1*	*2.2*	*1.7*
Estonia	3.9	4.5	1.6	3.7	3.4	2.3	-0.6	**4.5**	**6.1**	**2.1**	*4.0*	*3.9*	*2.1*
Ireland	2.8	0.6	0.2	0.3	0.7	0.9	-0.5	**2.4**	**4.6**	**2.5**	*2.3*	*3.1*	*1.5*
Greece	3.3	2.9	-0.4	1.1	0.8	0.5	-1.3	**0.6**	**3.1**	**1.1**	*0.1*	*1.0*	*0.4*
Spain	3.2	2.3	0.5	2.0	1.7	0.8	-0.3	**3.0**	**3.6**	**1.1**	*2.8*	*2.1*	*0.7*
France	2.0	1.9	0.6	1.2	2.1	1.3	0.5	**2.1**	**2.8**	**1.7**	*1.9*	*2.1*	*1.4*
Italy	2.3	2.4	0.6	1.3	1.2	0.6	-0.1	**1.9**	**3.8**	**1.6**	*1.8*	*2.1*	*1.4*
Cyprus	2.5	2.7	-0.4	0.7	0.8	0.5	-1.1	**2.3**	**2.6**	**1.2**	*1.9*	*1.7*	*1.2*
Latvia	6.5	4.6	0.8	2.9	2.6	2.7	0.1	**3.2**	**5.9**	**0.9**	*3.1*	*3.6*	*0.8*
Lithuania	2.4	4.7	1.0	3.7	2.5	2.2	1.1	**4.6**	**6.7**	**2.2**	*3.8*	*3.1*	*2.0*
Luxembourg	3.0	2.7	0.9	2.1	2.0	1.6	0.0	**3.5**	**3.8**	**1.5**	*3.2*	*2.2*	*1.8*
Malta	2.1	2.9	1.0	1.3	1.7	1.5	0.8	**0.7**	**2.1**	**1.9**	*1.1*	*1.6*	*1.5*
Netherlands	1.7	1.9	0.9	1.3	1.6	2.7	1.1	**2.8**	**4.0**	**1.4**	*2.1*	*2.2*	*1.5*
Austria	1.9	2.3	1.5	2.2	2.1	1.5	1.4	**2.8**	**3.3**	**2.2**	*2.7*	*2.5*	*2.0*
Portugal	2.7	1.9	0.6	1.6	1.2	0.3	-0.1	**0.9**	**2.3**	**1.3**	*0.8*	*1.7*	*1.2*
Slovenia	3.6	2.7	0.6	1.6	1.9	1.7	-0.3	**2.0**	**3.7**	**2.1**	*1.7*	*2.1*	*1.7*
Slovakia	4.9	2.7	0.4	1.4	2.5	2.8	2.0	**2.8**	**6.4**	**2.4**	*2.8*	*4.3*	*2.2*
Finland	1.0	2.7	0.9	0.8	1.2	1.1	0.4	**2.1**	**2.6**	**1.9**	*1.8*	*1.9*	*1.9*
Euro area	2.2	2.1	0.7	1.5	1.8	1.2	0.3	**2.6**	**3.5**	**1.7**	*2.4*	*2.2*	*1.4*
Bulgaria	5.9	4.6	-0.5	1.2	2.6	2.5	1.2	**2.8**	**6.3**	**3.9**	*2.4*	*2.9*	*1.8*
Czechia	1.8	2.7	1.0	2.4	2.0	2.6	3.3	**3.3**	**5.8**	**2.2**	*3.3*	*3.4*	*2.3*
Denmark	1.6	2.4	0.4	1.1	0.7	0.7	0.3	**1.9**	**2.5**	**2.1**	*1.7*	*1.9*	*1.6*
Croatia	2.7	2.9	0.6	1.3	1.6	0.8	0.0	**2.7**	**3.5**	**1.6**	*2.2*	*2.0*	*1.5*
Hungary	5.4	4.9	0.9	2.4	2.9	3.4	3.4	**5.2**	**5.4**	**3.6**	*5.1*	*4.8*	*3.4*
Poland	2.1	3.7	0.3	1.6	1.2	2.1	3.7	**5.2**	**6.8**	**3.8**	*5.0*	*5.2*	*2.6*
Romania	9.5	5.7	0.8	1.1	4.1	3.9	2.3	**4.1**	**5.3**	**2.5**	*4.0*	*4.0*	*2.8*
Sweden	1.5	1.9	0.9	1.9	2.0	1.7	0.7	**2.7**	**2.9**	**1.2**	*2.4*	*1.9*	*1.1*
EU	2.4	2.4	0.7	1.6	1.8	1.4	0.7	**2.9**	**3.9**	**1.9**	*2.6*	*2.5*	*1.6*

Table 4: Harmonised index of consumer prices, (percentage change on preceding year) 01.02.2022

	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	7.6	4.8	3.7	1.2	0.5	1.6	1.6	1.4
Germany	1.7	2.2	3.5	5.4	4.9	3.8	3.3	2.7	1.6	2.3	2.2	2.1
Estonia	0.6	2.8	5.4	9.1	9.0	8.2	5.3	2.4	2.0	1.9	2.1	2.2
Ireland	-0.1	1.5	3.0	5.4	5.3	5.0	4.5	3.5	3.0	2.5	2.3	2.2
Greece	-2.1	-0.6	1.3	3.7	4.6	3.6	2.7	1.7	1.3	1.1	1.1	1.0
Spain	0.5	2.3	3.4	5.8	5.5	4.3	3.3	1.4	1.2	1.1	1.1	1.1
France	1.0	1.8	2.2	3.3	3.2	3.2	2.8	1.9	1.7	1.7	1.7	1.8
Italy	0.7	1.2	2.1	3.7	5.2	4.5	3.9	1.6	1.4	1.5	1.7	1.7
Cyprus	-0.5	1.6	3.2	4.6	3.3	2.8	2.5	1.7	1.3	1.2	1.3	1.1
Latvia	-0.1	2.3	3.7	7.1	7.6	6.8	5.8	3.3	1.9	1.3	0.1	0.1
Lithuania	0.7	3.2	5.2	9.4	11.1	8.3	5.3	2.6	2.2	2.2	2.2	2.2
Luxembourg	1.0	3.6	3.6	5.7	5.7	4.6	3.7	1.3	0.8	1.5	1.5	2.1
Malta	0.1	0.1	0.5	2.1	2.2	2.2	2.0	2.0	1.9	1.8	1.8	1.8
Netherlands	1.8	1.8	2.4	5.3	6.0	4.5	3.9	1.6	1.2	1.4	1.4	1.4
Austria	1.5	2.6	3.1	3.9	5.2	3.4	2.7	2.0	2.5	2.0	2.0	2.0
Portugal	0.2	-0.1	1.2	2.4	3.0	2.6	2.1	1.6	1.4	1.3	1.3	1.2
Slovenia	-0.6	2.1	2.3	4.5	5.0	3.9	3.3	2.6	2.3	2.2	2.0	1.7
Slovakia	1.0	2.1	3.4	4.8	7.7	7.2	6.0	4.9	2.5	2.4	2.4	2.2
Finland	1.1	2.1	1.9	3.1	3.4	2.7	2.5	2.0	1.9	1.9	1.8	1.8
Euro area	1.1	1.8	2.8	4.6	4.8	3.9	3.3	2.1	1.5	1.8	1.8	1.7
Bulgaria	0.2	2.2	2.9	6.0	6.8	6.7	7.0	4.9	4.2	4.0	3.9	3.6
Czechia	2.2	2.8	3.3	5.0	6.8	6.4	5.4	4.7	2.3	2.3	2.2	2.1
Denmark	0.6	1.7	2.0	3.5	2.9	2.6	2.4	2.2	2.1	2.1	2.1	2.0
Croatia	0.7	2.2	3.1	4.6	4.6	4.5	2.7	2.4	1.4	1.4	2.0	1.8
Hungary	3.3	5.3	5.0	7.1	6.9	6.0	5.1	3.9	3.7	3.6	3.6	3.5
Poland	3.9	4.6	5.1	7.3	7.5	6.9	7.1	5.6	4.3	4.3	3.4	3.1
Romania	2.3	3.1	4.3	6.6	5.9	5.8	5.4	4.3	3.0	2.5	2.0	2.6
Sweden	1.9	2.3	2.5	3.9	3.7	3.3	2.8	1.8	1.4	1.1	1.1	1.2
EU	1.4	2.2	3.1	4.9	4.9	4.1	3.6	2.3	1.7	1.9	1.9	1.8

Box .1: Some technical elements behind the forecast

The Winter 2022 interim forecast provides an update of the Autumn 2021 forecast of 11 November 2021, 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 1 February 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. 2021 GDP data are also forecast, except for AT, BE, CZ, DE, FR, IT, ES, LV, LT, PL, PT and SE where preliminary or flash estimates exist.

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 2021, 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 14 and 27 January) 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 autumn forecast, the main change to the baseline scenario was the entering into force of the Regional Comprehensive Economic Partnership agreement on 1 January 2022.

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

	Winter 2022 interim forecast			*Autumn 2021 forecast*	
	2021	2022	2023	2022	2023
3-month EURIBOR (percentage per annum)	-0.5	**-0.4**	**0.0**	*-0.5*	*-0.3*
10-year government bond yields (percentage per annum) (a)	-0.4	**0.0**	**0.1**	*-0.1*	*0.1*
USD/EUR exchange rate	1.18	**1.13**	**1.13**	*1.16*	*1.16*
GBP/EUR exchange rate	0.86	**0.84**	**0.84**	*0.85*	*0.85*
RMB/EUR exchange rate	7.63	**7.19**	**7.18**	*7.46*	*7.46*
JPY/EUR exchange rate	129.86	**129.50**	**129.44**	*130.54*	*130.54*
EUR nominal effective exchange rate (annual percentage change) (b)	1.6	**-1.2**	**0.0**	-1.3	0.0
Oil price (USD per barrel)	70.8	**84.4**	**77.4**	78.9	72.3
Oil price (EUR per barrel)	60.0	**74.5**	**68.3**	68.1	62.5

(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.

Acknowledgements

This report was prepared in the Directorate-General for Economic and Financial Affairs under the direction of Maarten Verwey, Director General, and Reinhard Felke, Director for “Policy coordination, economic forecasts and communication”. Executive responsibilities were attached to Laura Bardone, Head of Unit “Economic situation, forecasts, business and consumer surveys”, Kristian Orsini, Deputy Head of Unit “Economic situation, forecasts, business and consumer surveys” and the forecast coordinators, Reuben Borg and Alexandru Zeana.

The report benefitted from contributions by Ronald Albers, Aurelija Anciūtė, Nicolas Bernier Abad, Paolo Battaglia, David Berthier, Adrian Bodea, Piotr Bogumił, Reuben Borg, Chris Bosma, Joël Boulanger, Lucian Briciu, Francisco de Castro Fernández, Guillaume Cousin, Milan Deskar-Škrbić, Oliver Dieckmann, Angela Droussiotou, Hugo Ferradáns Ramonde, Norbert Gaál, Sotirios Giannoulis, Susanne Hoffmann, Zuzanna Iskierka, Dirk Kamps, Szabolcs Klubuk, Daniel Kosicki, Radoslav Krastev, Anna Küffel, João Miguel Leal, Ivan Lozev, Natalie Lubenets, Ruslan Lukach, Gergő Motyovszki, Kristian Orsini, Gábor Márk Pellényi, Leonardo Pérez-Aranda, Arian Perić, Paulina Rogowska, Marie-Luise Rüd, Maja Samanovic, Sebastian Schmitz, Michael Sket, Peeter Soidla, Tsvetan Tsalinski, Milda Valentinaitė, Michael Vedsø, Ernestas Virbickas, Martina von Terzi, Milan Výškrabka, Rupert Willis, Przemysław Woźniak, Alexandru Zeana, Ingars Zustrups, Pieterjan van der Zwan and Václav Žďárek. Box 1.1 “Production bottlenecks through the lens of the Commission’s business surveys” was prepared by Milan Výškrabka and Przemysław Woźniak. Box 1.2 “Update on energy price developments; pass-through from wholesale to retail” was prepared by Susanne Hoffmann, João Miguel Leal, Milan Výškrabka and Przemysław Woźniak. Box 1.3 “Business managers are upbeat about investment this year” was prepared by Roberta Friz and Alexandru Zeana.

Statistical support for the production of the forecast was provided by Puck Boom, Paloma Cortés, Antonio Fuso, Hélène Gaston, Luisa Gonzalez Boa, Daniel Grenouilleau, Susanne Hoffmann, Ingo Kuhnert, David Zaitegui Perez and Tomasz Zdrodowski.

Support in editing was provided by Clara Gonzalez Zunzarren.

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