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Stagflation threat

Atradius Economic Outlook

Atradius Economic Research

John Lorié, chief economist
john.lorie@atradius.com
+31 (0)20 553 3079

Dana Bodnar, economist
dana.bodnar@atradius.com
+31 (0)20 553 2169

Theo Smid, senior economist
theo.smid@atradius.com
+31 (0)20 553 3165

Ellen Patrickson, intern

Executive summary

Headwinds to the global recovery from the pandemic are mounting, in the form of ongoing supply bottlenecks, geopolitical turmoil in Eastern Europe, and rampant inflation. Inflation was already rising in 2021 as consumer demand picked up, but has been exacerbated by Covid lockdowns in China and war in Ukraine. Global commodity prices are rising rapidly and central banks are struggling to maintain control over the situation amid growing concerns of another *stagflation* episode, one characterised by low growth and high inflation.

Key points

- Despite global GDP growth recovering to 5.9% in 2021, we expect it to decrease to 3.1% in 2022, as inflation squeezes consumer spending and supply-chain issues limit trade. By 2023 we expect growth to slow further to 3.0%
- We expect global CPI inflation to soar to 7.6% in 2022, dropping to 3.8% in 2023. Inflation initially started rising due to a surge in demand as Covid restrictions eased, while supply bottlenecks kept supply down. The war in Ukraine has since exacerbated inflation, as global commodities, notably fuel and wheat, experience shortages and further price hikes. Central banks are aggressively raising interest rates to combat inflation and to normalise monetary policy following the pandemic
- Although global trade was growing healthily at the start of 2022, Russia's invasion of Ukraine and the subsequent sanctions thoroughly disrupted this growth. China's severe zero-Covid policy and lockdowns have also stalled global trade. Overall, we expect that as Covid becomes increasingly endemic, supply-chain disruptions will ease, boosting global trade
- GDP growth in advanced economies is expected to slow to 2.7% in 2022 and 2.1% in 2023. Consumers are feeling the pressure of surging inflation, generally driven by high energy prices in Europe and supply-demand imbalances in the US. Continued global supply issues drag on export growth in advanced economies, along with general fiscal consolidation
- GDP growth in emerging market economies (EMEs) is forecast to be nearly halved in 2022 to 3.5%, down from 6.9% in 2021. EMEs are also feeling the pressure of supply-chain bottlenecks and inflation, but due to lower vaccination rates, are also at greater risk of new Covid outbreaks. We expect the Middle East and Emerging Asia to maintain the highest growth in 2022
- The continuation and escalation of the war in Ukraine is the key risk to our outlook, potentially leading to 1.7% lower GDP growth by the end of 2022. All regions would be impacted by shortages, higher commodity prices, and political instability, with Europe and especially Eastern Europe the most impacted

1. The global macroeconomic environment

Pandemic lurking as war dominates inflation rise

In April this year, in answer to widespread calls, we came up with a view on how the Russian invasion of Ukraine would affect global economic developments. It was very early days, but it was clear the event would cause a dent in global growth. The impact would be far beyond the size of the economies of both countries, which together account for only about 2% of global GDP. After all, Russia in particular is a prominent producer of key commodities, such as oil and gas, wheat, fertilizer as well as nickel and platinum. Sanctions on Russia, combined with fear for supply disruptions, caused prices of these commodities to soar.

These price rises came at a bad time. Consumer inflation was already on the rise after an unexpectedly strong recovery from the pandemic, coinciding with value chain tensions that were only slowly fading out. A further impetus to inflation from - especially – energy, and to a lesser extent, commodity and food prices from the war was exactly what the global economy had not been waiting for. The simple reason is that inflation hits the purchasing power of the consumer. The very consumer who was expected to push growth with spending, in particular in the services sector after its reopening following the pandemic. A loss of purchasing power dampens demand and GDP growth. As a result, our 2022 global GDP forecast took a hit of 0.7% points; for 2023 0.4% GDP was shaved off.

The assumptions that underlie the April forecast, while reasonable at the time, may need to be revisited. First, the war was not expected to be protracted. That is to say: not lasting well into 2023. A second assumption was that sanctions may be intensified, but not to the extent that the energy exports from Russia will be severely disrupted.

Only three months on, these assumptions look a lot less convincing. After an initial attempt to conquer the whole of Ukraine, the Russian ambitions appear to have been scaled back to the Southern and Eastern parts of the country. In these places, current fighting is intense and Russian progress seems grounded. It suggests a protracted, though more limited war than perhaps envisaged. Sanctions have been scaled up, with the EU most recently following the US (and the UK) with a package covering a ban on Russian oil imports. Russia is answering this by gradually turning off the gas to the EU. Having cut supplies to Finland, Bulgaria, Denmark and the Netherlands, in mid-June Russia announced that supplies to Germany were to be reduced by 60%, while Italy also reported reductions. It would be premature to completely abandon our key assumptions. But is also clear the situation has not yet improved, to say the least.

As the potential fall-out from the war dominates the economic outlook, it has become increasingly evident that the pandemic can still wreak havoc. Most importantly, the second largest economy in the world, China, maintains a zero tolerance policy on Covid-19, with full-scale lockdowns for numbers of cases that dwarf those of earlier phases of the pandemic. Shanghai underwent a two-month lockdown following a wave of new cases of the Omicron variant that peaked at about 1500 (seven days average) in a 25 million population this spring. As the city is the busiest port in terms of maritime traffic, value chain disruption easing has suffered a setback and with that the expected fall back inflation from that source. The lower demand from China due to the lockdowns does help reduce inflation in commodity markets, though. Second, although admittedly somewhat less of a threat, the number of cases in, for example, the US, the UK, Germany and France is on the rise again. True, the levels are still relatively low and due to group immunity (vaccination and/or having been infected), the impact is likely much lower than before. But virologists warn that the pandemic is not over and new variants may develop. Moreover, the high level of absenteeism from sickness, including Covid-19, does not help to resolve the scarcity of labour supply affecting a large number of countries.

Meanwhile central banks across the globe, facing increasing inflation, have been forced to accelerate monetary tightening. The most recent Fed hike of 0.75% point came in reaction to another unexpectedly high inflation figure in May - 8.6% - a 40 year high. A week earlier, the ECB announced it would start hiking rates in July while ending its bond purchase program, far earlier than previously expected. Both central banks are walking a tightrope, bringing down inflation while trying to avoid a recession. In other words, carefully navigating away from stagflation – an environment of little or no economic growth combined with high unemployment and rising prices.

Growth slides further

Can stagflation be avoided? Disruptions from the war in Ukraine and the Chinese zero Covid policy have resulted in further upward pressure on inflation and a more pronounced reduction of consumer purchasing power. These factors, as well as the acceleration of monetary tightening are inevitably dampening economic growth in 2022 and 2023.

Figure 1.1 Consumer confidence plummets

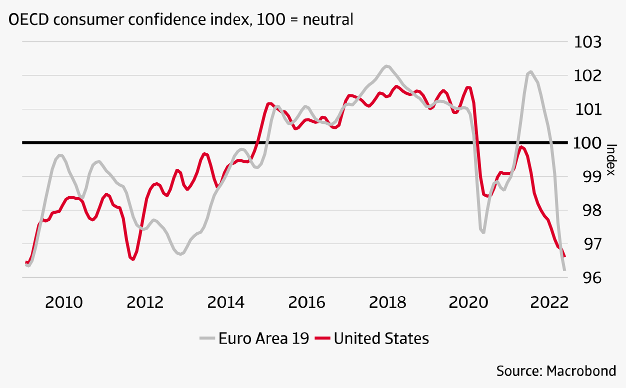
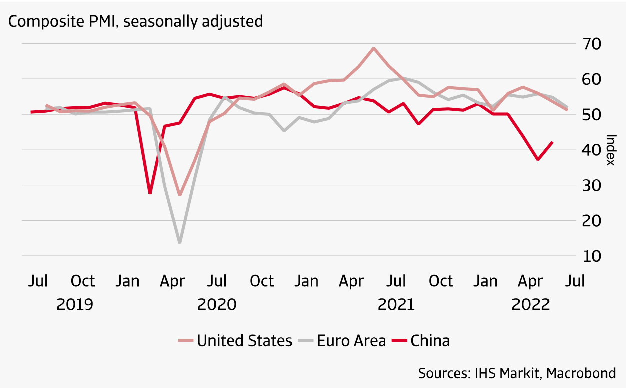


Figure 1.2 PMIs still suggest growth



Sentiment indicators provide a mixed picture. Consumer confidence has plummeted in both the US and the eurozone and is now clearly in negative territory (below 100), suggesting contraction.[1] This is most likely based on the squeeze on real household incomes coming from the acceleration in inflation as well as greater uncertainty. It is not only the level of inflation that plays a role, the unexpected element in inflation is important as well. For example, wage rate setting in collective bargaining is too low and provides only limited compensation for higher prices.[2] On the other hand, business sentiment indicators in the US and the eurozone have slid somewhat following the war, but remain in positive territory (above 50), suggesting growth. This picture can be seen for both manufacturing and services. The Chinese indicator is recovering, for services, and is even more pronounced for manufacturing, but remains in negative territory. What to make of these different signals? We are inclined to consider business sentiment to be more reliable for GDP growth.[3] The consumer is less so. For example, the fall in consumer confidence in the US has coincided with strong growth in retail sales. As a result, we can expect US growth to continue, though at a slower pace than previously expected.

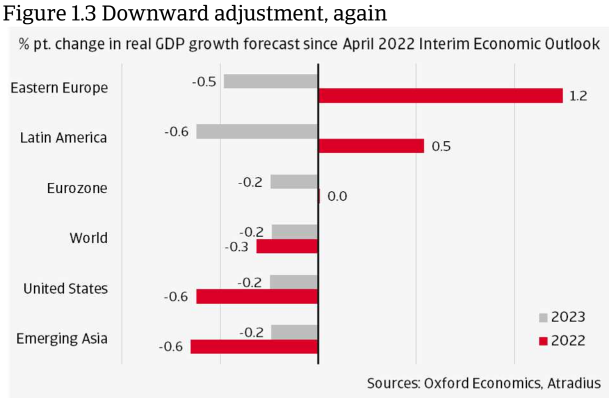
That is precisely what our forecast revisions point to. The global economic forecast is taking another hit of 0.3 percentage points in 2022 and 0.2 ppt in 2023 versus our April 2022 forecast.[4] The impact is slightly softened by the significant upward revisions of the forecast for Eastern Europe (plus 1.2 ppt for 2022, minus 0.5 ppt for 2023), reflecting less contraction in Russia and more growth in Turkey. The other positive news, at least for 2022, comes from Latin America, upwardly revised in view of incoming data. The negative impact on the eurozone forecast is limited. For the US and Emerging Asia, dominated by China, though matters look different, with hits of 0.6 percentage point and more than 0.2 ppt respectively. The US economy shrank in Q1 but is expected avoid recession, despite Fed tightening. Chinese lockdowns weigh in heavily, restraining consumption growth.

Table 1.1 Real GDP growth (%) – global regions

	2020	2021	2022f	2023f
Eurozone	-6.5	5.3	2.9	2.5
United States	-3.4	5.7	2.6	1.8
Emerging Asia	-0.1	7.2	4.4	5.1
Latin America	-6.7	6.8	2.3	1.2
Eastern Europe	-2.0	6.5	-0.7	1.1
World	**-3.4**	**5.9**	**3.1**	**3.0**

Sources: Oxford Economics, Atradius

Figure 1.3 Downward adjustment, again



We anticipate slowing GDP growth rather than stagnation, except for Eastern Europe. The global GDP growth figure of about 3% remains decent, and growth in the US as well as the eurozone remains relatively robust at around 2%-2.5%. Despite the somewhat lower 2022 growth Emerging Asia rebounds in 2023, confirming its leadership in global growth: 5.1% in 2023. This picture shows that the global economy will stay away from a stagflationary scenario.

Baseline assumptions revisited

Our forecast is subject to ten assumptions - revisited and where necessary updated from our previous Outlook. First, a

[1] The decline in the US set in a lot earlier than in Europe, which is related to the phasing out of generous Covid-19 stimulus in the US. OECD Economic Outlook, June 2022, p.23.

[2] OECD Economic Outlook, June 2022, p23.

[3] See Why global soft landing is still a safer bet than a recession, Oxford Economics, June 15 2022

[4] It brings the cumulative hit to 1 ppt for 2022 and 0.6 ppt for 2023.

lengthy military conflict in Ukraine is avoided, that is to say: not lasting well into 2023. The main economic spill-overs from the conflict run via higher commodity prices, particularly for oil and gas, food, especially wheat, and some supplies of key inputs from Russia and Ukraine.

Second, the pandemic has become endemic. Future pandemic waves, clearly not to be excluded, will be far less economically disruptive as far fewer restrictions are imposed to curb infections. Temporary lockdowns may not be avoided, but the impact on growth is smaller and shorter.

Third, the war in Ukraine combined with China's zero tolerance policy towards Covid-19 have worsened supply chain tensions. That will delay, but not end, the easing process. Over the course of this year signs of easing of these tensions will be reinforced.

Fourth, we see consumer led growth, despite the dent in purchasing power that the war and ongoing supply chain disruptions have been causing. This is because during the pandemic, real incomes have been largely maintained, owing to large government support. But spending was significantly curtailed, as services such as hospitality, events and travel were in short supply due to the health care restrictions. That meant a savings glut, which comes in handy now that the consumer may feel as though fetters are being released. Indeed, we expect the consumer to spend significantly more than can be justified on the basis of current real income, meaning spending partly from excess savings. In this context the initial spending from excess savings of 5% (globally) is probably a gross underestimation.

Fifth, fiscal support has been or will be phased out during 2022 as the pandemic becomes endemic. Still, a return to pre-pandemic fiscal restraint is not on the cards either. The US and the EU have initiated large programs to structurally change the economy, which includes spending on digitisation and energy transition, as well as in the case of the US, infrastructure improvements.[5] The result is somewhat wider government deficits than envisaged before the pandemic. This somewhat looser approach is less visible in the emerging economies, where governments may be facing market pressures based on fiscal policy control issues.

Sixth, we still see current inflation levels starting to come down in the course of the rest of 2022. As energy, commodity and food markets calm down later this year and in 2023, prices will gradually decline from crisis levels. This will already be a source of disinflation, as will the easing of supply side disruptions and lower demand as a result of loss of purchasing power and monetary tightening. Inflation will consequently come down significantly, but a return to pre-pandemic levels is not envisaged over the forecast horizon. We will further elaborate on this in a separate section on inflation below.

Seventh, despite the lowering of growth due to the Ukraine war we see broad-based monetary-policy tightening as inevitable during 2022. Current inflation levels are simply too high. But as we see inflation as largely transitional, we expect to see less pressure on central banks to further tighten as we move into 2023.

Eighth, as tightening will imply higher interest rates, financial markets can be expected to express volatility (especially around central bank announcements) and a somewhat declining tendency in the equity markets. We do not expect large scale lasting volatility and/or a fall in equity markets, however.

Ninth, under the Biden presidency, the tone of foreign policy has much changed and, especially in security matters, reconciliation with partners such as the EU and within NATO has been sought and collaboration reinstated. The same tone is used in trade policy, and even the rhetoric with China has been toned down. But the Trump era tariffs between the US and China are still in place and, given the Democrats' inclination towards protection of local production, that is not expected to change over the forecast horizon. This implies frozen US - China trade tensions.

Tenth and last, the pandemic has damaged potential supply, which is partly the cause of current high inflation levels. These are (partly) simply an expression of supply facing too much demand. Some 'scarring' of ability of workers and machines has occurred as a result of the pandemic, especially to the extent production factors have been locked in so-called 'zombie' firms. But we estimate the extent of this (partially temporary) factor limited, and thus likewise the impact on productivity.

War hits global trade

Global merchandise trade rebounded strongly in 2021 from the 2020 slump, despite the negative impact of recurring Covid-19 waves during the year. It showed a healthy growth of 9.8%, surpassing the pre-pandemic trade level by October 2021. Services trade grew as well and has also regained its pre-pandemic level. In early 2022 global trade was still expanding. International travel was gradually recovering too, bar the Asia Pacific region where the impact of lockdowns and other restrictions held sway. However, the disruptions related to the war in Ukraine have curbed this trend. Global merchandise trade lost momentum, though still only marginally, by contracting in Q1 compared to Q42021, and the trend in global export orders away from negative territory was reverted. The Russian invasion has also prompted a significant downward revision of the forecast for merchandise trade, shaving off 1%-2% points for 2022, down to 4%. For 2023, 4% trade growth is forecast. This makes the trade forecast revision for 2022 higher than the cumulative global GDP forecast revision of 1% since the war broke out. It implies an accelerated reversion of global trade to normal, which is an approximate one-on-one relationship between global (merchandise) trade growth and global GDP growth.

[5] NextGenerationEU spending total euro 750 billion; and the USD 1.2 trillion US infrastructure plan.

Figure 1.4 Global trade losing momentum

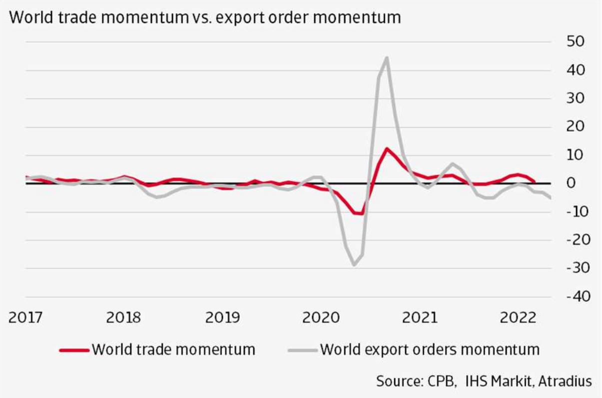
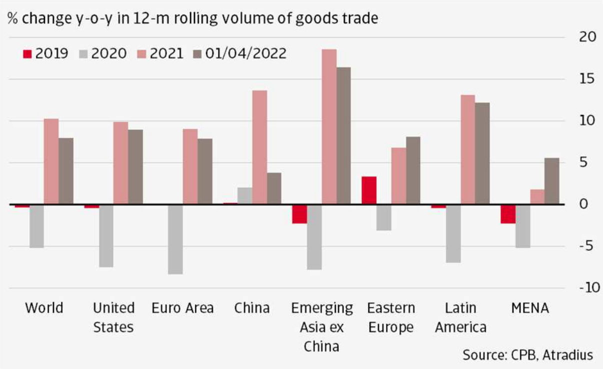


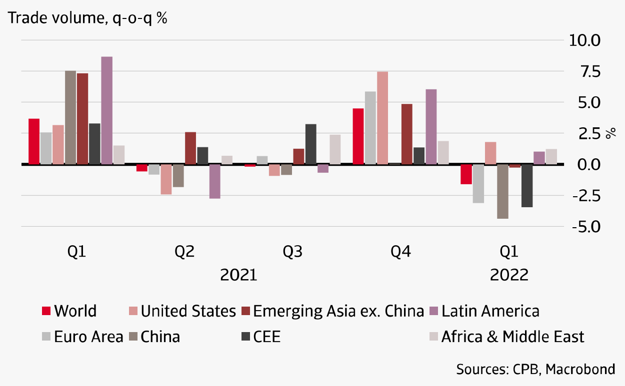
Figure 1.5 Trade growth until war outbreak



Looking more closely at the developments in 2021 we see steady merchandise growth in sectors such as iron and steel, chemical and integrated circuits and weaker growth in ones such as clothing and machinery. That partly still reflected a recovery from the 2020 slump, but in pharmaceuticals, computers and circuits, pre-pandemic levels were surpassed. That most likely reflects higher demand for Covid-19 vaccines and a preference for (and imposition of) remote working. The automotive sector showed strong growth but remained below its 2019 level. Value chain disruptions have played a clear role in this. Global trade in commercial services veered back, boosted by transport services which grew robustly, even compared to the pre-pandemic level. International travel, which almost halved in 2020, showed weak recovery as pandemic restrictions were only partially eased during the course of the year. Other services, including financial and business services, recovered from the 2020 pandemic hit during the year.[6]

Regionally, for y-o-y merchandise growth (figure 1.5), we observe that eurozone trade growth is very close to, but on average still below, the global growth level. US trade growth matches the global average almost perfectly. The US import side, in particular, was boosted by the massive government support. Chinese trade growth momentum is under pressure since Q2 of 2021 (figure 1.6), for which a large part can be attributed to lockdowns. These have reduced demand, especially consumer demand, eating into imports. Chinese exports are restricted by disruptions in production and transport. Nevertheless, Chinese trade growth during 2021 of almost 13.6% as compared to 2020 was above the global average (9.8%) Meanwhile, the rest of emerging Asia continued to grow (far) above the global average in 2021, reaching 18.6% trade growth. Apart from in the US, imports grew strongly in Latin America as well, showing up in a trade growth figure close that of China for the full year (13.1%).

Figure 1.6 Momentum decline not in all regions



With respect to trade growth momentum, we observe a decline in q-o-q trade growth in Q1 2022 as opposed to Q4 2021. This is visible in all regions except the US, Latin America as well as Africa and the Middle East (figure 1.6). This development is reflected in the forecast for 2022 and 2023: for all regions except the Middle East these have been revised downwards. To find the reasons behind this, we consider two factors: the impact of the war in Ukraine and the Chinese zero tolerance policy towards Covid-19.

Let us start with the war. Firstly, Russia and Ukraine have a relatively small share in global trade, about 2%. Still, sanctions imposed on Russian firms and individuals by the US and the EU, including the blocking of Russian banks from the SWIFT settlement system, will have an impact, particularly in the EU. There is also an informal corporate boycott, with an exodus of firms from Russia, including oil majors, since the war started. Especially in commercial services trade with the EU, the impact of the war will be strongly felt. Russia bought 42% of its USD 74 billion services imports from the EU, and 31% of its USD 55 billion service exports went to the EU. Other important trading partners for Russia are the US and China. Services such as travel and tourism will be negatively affected as well, as will operational leasing for aircraft (traded particularly with Ireland) and intellectual property services mainly delivered from the US, the EU and the UK. Though not insignificant, the impact of the war via this channel will be rather muted. That is not the case with the second transmission channel, via the prices of commodities. Russia and Ukraine are major

[6] This section uses WTO information based on value (USD) terms. We are aware of the USD fluctuations that may dilute the picture somewhat, but not materially.

exporters of a number of key global commodities. Between them, they account for a quarter of world wheat exports, 13% of fertiliser exports, 8% of cereal exports and 6% of exports of fats and oils. Russia accounts for 12% to 13% of nickel and platinum exports and – most importantly - over 10% of world oil and gas exports. The war has triggered steep price rises in these commodities (to be detailed below), which eat into real incomes and raise production costs in advanced as well as emerging economies. The higher the price rise, the larger the impact. This impact simply hits global trade via a lower GDP.[7] The third impact of the war runs via the aggravation of the international supply chain bottlenecks, meaning rising trade costs. Supplier delivery times rose in many countries earlier during the spring and shortages of intermediate goods have also increased (figure 1.7). This was not expected as the end of the pandemic was to normalise demand, that is to say: rebalancing from goods to services, thus relieving supply chain pressures and the cost of transport. But the war has resulted in diversion of freight routes to already over-stretched channels, providing another impulse to trade cost. Parts of the Black Sea and Sea of Arsov are not passable and maritime companies have closed routes to avoid Russian airspace and ports. Container loads in Russian ports have also declined by 50% versus a year ago and have stopped altogether in Odessa. Existing crew shortages are exacerbated, with 15% of freight crews being Russian or Ukrainian.

Figure 1.7 Scarcity of equipment up

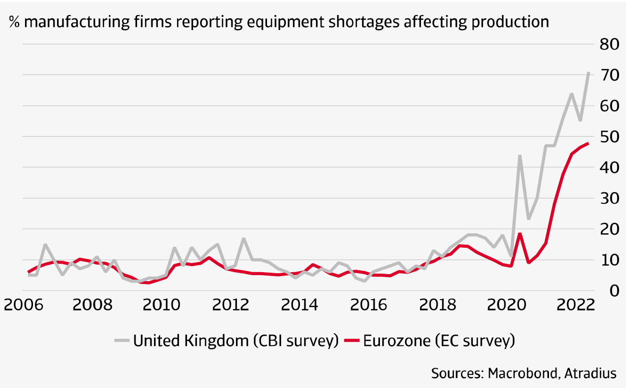


Figure 1.8 Transport costs show first signs of easing

To these factors a fourth needs to be added. The G7 and the EU have agreed to ban or phase out Russian oil, with similar measures taken for coal and gas. Moreover, sanctions will be imposed on the insurance of Russian merchant ships (or ships transporting sanctioned goods). This will clearly aggravate the impact discussed above. Moreover, Russia has started to react to the sanctions by slowly reducing the gas flow to the EU.[8] As described in more detail below, trade will be diverted, such as LNG coming from the US instead of gas from Russia, and Russian oil will flow to China, but the net effect on global trade is unclear.[9] In any case, trade costs will rise as the new pattern based on the ban is unlikely to be more efficient. That rise in trade costs, in turn, is a drag on global trade flow.

The significant disruption to global trade is compounded by the value chain disruptions which are still under pressure from the zero-Covid strategy in China. Though air and ocean ports are being kept operational, lockdowns in Shanghai and other large cities have created labour shortages that affect truck companies, reduce ground handling staff and will ultimately be reflected in slow operations in ports. Air traffic has been hit significantly as well. Overall, the picture is one of hampering the easing of value chain disruption. This process is now delayed, but not halted, by the double whammy of the Ukraine war and Chinese zero tolerance policy.[10]

Very high oil and gas prices only moderately softer

The invasion in Ukraine has led to an accelerated rise in energy prices that was already perceptible during the second half of 2021. Sanctions imposed on Russian oil exports as well as the announcement to reduce Russian imports in the EU by two-thirds by year end 2022 have triggered not so much further price rises but rather very high price volatility

[7] Oxford Economics has calculated that in the case of a doubling of energy and other commodity prices versus the baseline ones (which indicate some softening), global trade growth will plummet to 0.7% in 2023.

[8] The EU has announced that by the end of 2022 its dependence on Russian gas should be reduced by 2/3 anyway. This constitutes a policy intention rather than formal sanctions.

[9] Initial data from Oxford Economics point at a diversion of Russian oil exports from the EU to China and India with a net zero effect on total exports. Reportedly, Russian oil is being sold significantly below the market price.

[10] See further on value chain disruptions https://atradius.nl/rapport/economic-research-pandemic-and-security-shocks-shake-global-value-chains.html

of already very high prices. We expect this to continue as long as the underlying worries about energy provisioning last. Meanwhile oil and gas demand is likely to face some downward pressure with the economic slowdown and the higher prices. This implies oil and gas prices are likely to soften somewhat over the forecast horizon from the current levels of USD 110 to 120 per barrel for Brent and USD 133 per megawatt hour Dutch TTF Natural Gas (the European benchmark). Given the unstable (geopolitical) environment, volatility is set to remain high, though.

Oil. Despite the higher price and the lower GDP growth, demand for oil is expected to increase in 2022, by 1.8mb/d on the back of an expected economic recovery in China in H2. It will further increase by 2.2 mb/d in 2023. This year the OECD will lead the expansion; in 2023 non-OECD countries are set to account for nearly 80% of the demand growth. Supply growth will be predominantly provided by non OPEC+ countries, especially in 2022. In 2023 OPEC+ (which includes Russia) volumes threaten to fall as a result of Russian export volumes being reduced due to sanctions, potentially wiping off 2.5 mb/d (30% of total production) according to the IEA. This implies that other OPEC+ members will have to step in to keep up OPEC+ production. What is more, rebuilding of inventories has started after two years of decline. In April OECD industry stocks rose by 42.5 mb. But this is a fraction of the 290 mb increase needed to revert to the 2017-2021 average (about 3000 mb) and for industry stocks only. The United States and other IEA countries have agreed to release a total of USD 180 mb, which helps, although is not sufficient.[11] Further building of inventories needs to happen in order to reduce price volatility from the current - even for the oil market - exceptionally high level.

Figure 1.9 Oil price high and volatile

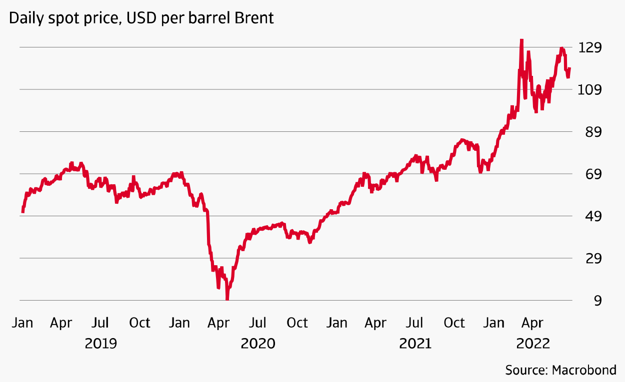
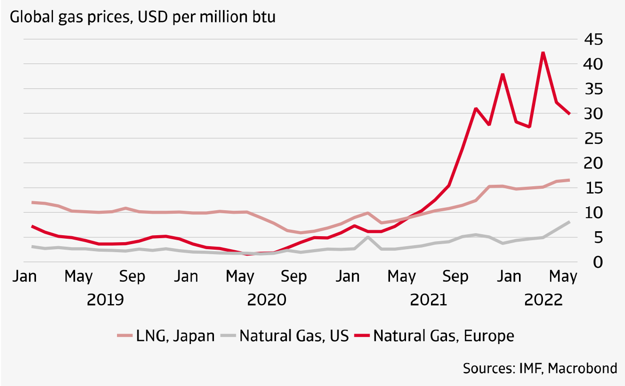


Figure 1.10 The European gas price problem



This is badly needed, because the uncertainties the Russian invasion has created are considerable. First, if the EU ban on Russian oil is implemented, the size of the Russian exports reduction could be much larger – the EU currently imports 3.4mb/d from Russia. Therefore, export diversion needs to be much greater as well. India and China have already increased their purchases of Russian oil, but there is a limit to what these countries can and are willing to absorb. Moreover, there are infrastructural constraints. For example 9% of Russian oil exports is delivered via pipelines to Europe and would be difficult to re-direct. Oil tankers are in short supply and the ban on insurance will provide another hiccup. Meanwhile, European refineries are designed to process Russian oil and need time to adjust to other variants of crude. Second, as a buffer for potential supply shortfall, and thus reducing price volatility, rebuilding of inventories has just started and the current levels are by no means sufficient. The process, moreover, seems to be rather slow. The rather large share of the inventory being provided by a release of strategic reserves does not solve the underlying imbalance in the market. This part of the stock is temporary, as strategic stocks need to be refilled some day. Third, spare production is an alternative source, although this will take some months to become available. It is held by OPEC+ countries such as Saudi Arabia (2mb/d), the UAE (1.1 mb/d) and Iraq (0.6 mb/d). These have so far been reluctant to raise production faster than agreed. Even worse, these agreements are not even being met. Iran (1mb/d) and even Venezuela, both subject to US sanctions, should be considered a long shot. The same holds for an increase of US oil production beyond the current 1.4mb/d growth in 2022. This is due to scarcity of production means, such as skilled labour, physical inputs (e.g. sands) as well as financial constraints. Fourth, oil consumption is rather price inelastic, so higher prices at current levels are unlikely to reduce demand for oil significantly. Moreover, government packages that include tax cuts and fuel subsidies are precisely reinforcing, rather than weakening, price inelasticity on the demand side.

Gas. The global demand for gas is set to decline slightly in 2022 as a result of higher prices and market disruptions

[11] These include the UK, Germany, France and Italy. For a list see https://www.iea.org/about/membership

caused by the war. This compares with the expectation of a small increase prior to the war. In 2021 the market grew by 4.5%. Prices have risen in all three markets as the recovery turned out stronger than expected, but the focus of price pressure and uncertainty is on Europe, where prices have risen far more as a result of the large EU reliance on Russian gas.

The EU intention to divert sharply and quickly from Russian gas - and the Russian apparent willingness to accelerate this process by lowering gas supplies -[12] leads to market disruptions and creates high uncertainty. The EU will have to source LNG from other countries and expand its own LNG processing capacity, step up the use of renewable energy and seek to lower demand by efficiency measures as well as behavioural change, namely lowering heating (or raising cooling) temperatures.

Some reaction of demand to higher prices is already happening, as energy intensive activities, such as fertiliser plants and aluminium and zinc refineries have been reduced. Coal fired electricity is being revamped, replacing gas. This seems far from sufficient, however. Inventories to buffer a supply shortfall have risen from their recent lows, but the level in April at 32 bcm was only one third of the storage capacity. Russia delivers 155 bcm of total European gas consumption of 400bcm, so if those Russian deliveries fall away abruptly, strong measures, including rationing for industry and households may possibly be needed. At the current juncture such a situation, though not our baseline, can certainly not be discarded. Some restraint from the Russians in this regard can be expected because diverting gas exports away from the European market is constrained by infrastructural issues. Indeed, seventy percent of Russian exports is by pipeline to Europe. Diversion of these flows would require, apart from finding the clients, major investment in LNG processing facilities as well. This should keep Russia away from drastic steps. But potential supply side substitution for Russian gas for the EU on the other hand is currently rather limited too. Increasing imports from Algeria and the US will take time to come on stream and will come at the expense of other countries. The dark scenario is then: if Russian gas almost completely disappears from the market, demand substitution and reduction will only be very limited in the short term. This will further drive up gas prices in the Asian and US markets as well. As long as this threat exists, let alone its materialisation, we cannot expect gas price volatility to calm down.

Coal. Russian exports of the most polluting fossil fuel are also hit by a ban from the US, EU and Japan. Unlike for the US, exports were material to the EU - accounting for one third of the Russian total - and 10% went to Japan. As in the oil and gas markets, this will cause significant disruption and rising prices. The EU will seek substitute imports from Australia, Colombia, Indonesia, South Africa and the US. China and India will buy more from Russia. But it is a change away from more efficient trade flows, raising trade costs due to larger distances and limited availability of sea and air transport.

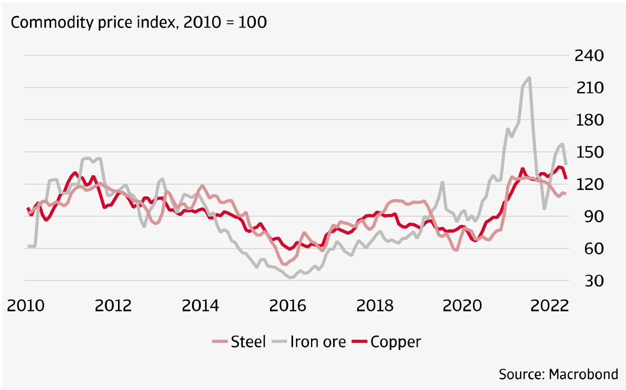
Commodity price rises calm down after shock

The relevance of the Russian invasion is not limited to energy prices. Commodity prices, including those of food, have risen as well, further feeding inflationary pressures.

Metals. Prices of basic metals such as iron ore, steel and copper had already risen during the second half of 2021 in reaction to the stronger-than-expected economic recovery. Since the Russian invasion, prices of metals have risen further, especially those metals in which Russia has a significant market share, such as nickel, platinum, palladium, aluminium and iron ore (where Ukrainian supply also plays a role). The rise of metal prices has softened considerably in late Q2 in the wake of the slowdown of global economic activity that has reduced demand for metals, particularly from China due to housing market cooling and lockdowns . Over the forecast horizon, we see metals prices 10-15% higher than in 2021, with some light downward trend in 2023. This implies a calming down after the early 2022 shock.

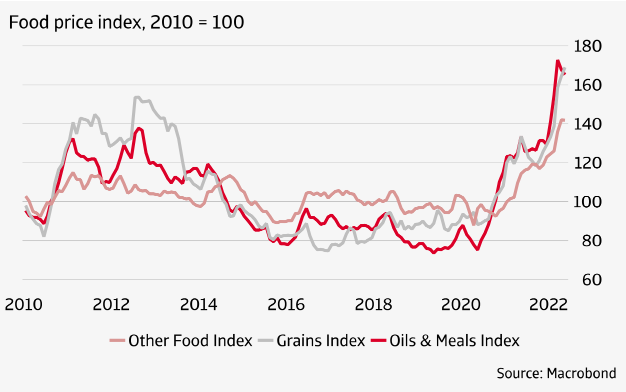
When the war broke out, nickel prices rose by 45%, whereas platinum and palladium price rises remained in the 15-20% range. The nickel price rise was inflated by a halt in trading on the London Metal Exchange during mid-March. The price of aluminium rose, not so much as a result of a strong direct effect of the Russian market share, but rather the energy intensive nature of aluminium production.

Figure 1.11 Commodity prices calmer after the shock



[12] For example, 'maintenance' is a plausible reason for Gazprom to halt delivery and at the same time not use other channels to live up to contractual agreements. See FT 24-6-2022 Russia nearer gas rationing as Moscow 'weaponizes' gas exports.

Figure 1.12 Food prices have almost doubled



The iron ore price rose in reaction to the invasion but later softened. Here the role of Chinese economic development is important. Iron ore is used as a raw material for steel and that in turn is a critical commodity in construction. The global steel market is facing significant overcapacity, especially in China, where measures are being taken to reduce capacity. These should provide longer term support to the steel price. In the short term, demand for steel and iron ore depends on the construction sector in China and, more generally, economic developments. These have softened recently, and therefore the prices, after the Russian invasion boost. For copper there is an underlying upward trend, at least in demand, as copper plays a role in the energy transition, such as electrification of transport and renewables such as wind turbines and batteries. Neither Russia, nor Ukraine plays a significant role in this market where prices are very sensitive to the business cycle.

Food. Food prices were already on the rise before the war, reflecting poor crop outcomes and more expensive energy. The war added to this. No wonder, since Russia and Ukraine produce 15% of global wheat, for example. Wheat prices therefore saw a very steep increase, more than 30% higher compared to December 2021. Edible oil prices rose due to disruptions in Ukraine's sunflower seed oil exports, as well as production shortfalls in South America. Fertilizer prices rose sharply as well, which is caused by the direct disruptive effect of the war (e.g. hampered exports), as well as the indirect effect of higher energy prices (also as a result of the war); gas and coal are key inputs in fertiliser production. The impact of the war on food prices will only gradually dissipate as increased production in other countries such as Argentina, Brazil and the United States comes on stream. The upshot is that prices in 2022 will be significantly higher, with relief coming only in 2023. This implies food prices will eventually calm down after the shock of the invasion as well.

Inflation decline delayed

Continued supply chain constraints, higher trade costs and price rises of commodities and energy already visible before the war and given further impetus since, have pushed up global inflation to levels unseen for at least a decade. In the United States, headline inflation rose to 8.6% y-o-y in May (figure 1.13), in the eurozone to 8.1% (figure 1.14), whereas China kept inflation at 2.1%. That latter figure is not representative for the emerging economies though; inflation there was higher than the global average (of 8%). We still see inflation declining over the forecast horizon, though not as fast as we envisaged in earlier outlooks.

Figure 1.13 Energy dominates eurozone inflation

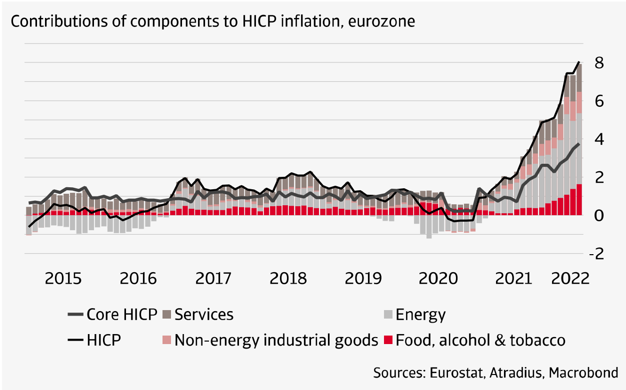
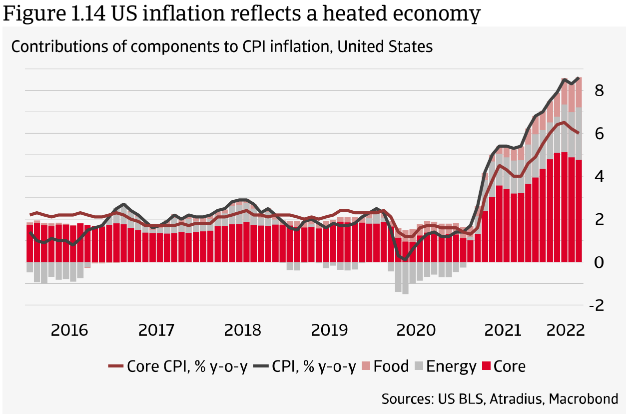


Figure 1.14 US inflation reflects a heated economy

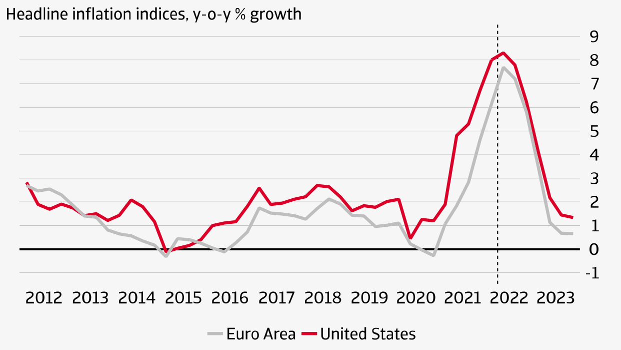


Inflation pressures have not only intensified, but also broadened. Not only headline inflation rose. Core inflation, which excludes food and energy, has increased as well, reaching 4% in the eurozone and 6% in the US in May. In the first half of the year, the housing, transport and furnishing sectors contributed by about two-thirds to inflation in the advanced economies and two-fifths in the emerging economies. In the United States, the eurozone and the United Kingdom the prices of at least half the items in the inflation basket rose by more than 4% y-o-y.

Considering US and eurozone inflation we see notable differences (i) in headline inflation, with the US having the higher level; (ii) in core inflation, with the US having the higher level as well, even in proportion to the headline; and, therefore, (iii) in much smaller contributions of energy and food to headline inflation growth in the US. This can be explained by three factors. First, in the US strong pandemic government support was given to households, pushing consumption above pre-pandemic levels. In the eurozone the focus was on job preservation and maintaining pre-pandemic income. Thus, the pandemic shift towards demand for goods rather than services was stronger in the US as was the impetus given to inflation. Second, whereas the US is a major oil and gas producer and has (close to) energy self-sufficiency, the eurozone is an energy importer. For example, gas price rises are a phenomenon seen in all three markets (US, Europe and Asia) but the gas price rises in Europe are far higher. Russia's ability to play geopolitical gas games that we see unfolding at the moment is largely limited to the European market. Third, wage rises have been far more pronounced in the United States as compared to the eurozone. This largely reflects differences in unemployment: 7% in the eurozone and almost half that percentage in the US. No wonder the wage pressure in the US is larger and inflation broader (figure 1.16). The difference in the strength of inflation drivers determines to a large extent the difference in monetary policy stance.

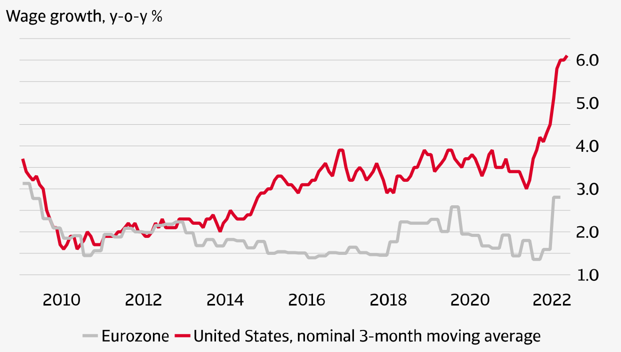
While headline as well as core inflation is higher, and pressures have broadened, we maintain our view that inflation will ease over the forecast period albeit not significantly, because the fall back to more normal levels will now take more time. Moreover, the situation is admittedly also fraught with a lot more uncertainty.

Figure 1.15 Current inflation levels not lasting



Sources: Oxford Economics, Macrobond

Figure 1.16 Wage growth up, divergence between US and eurozone



Sources: Federal Reserve, ECB

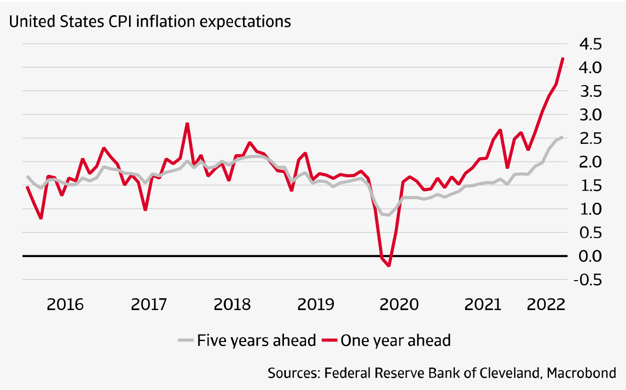
Starting with the fundamental forces that will drive down inflation in the upcoming period, these have remained unchanged. First, the fundamental forces that have kept inflation to such low levels during the last decades have not disappeared, perhaps only weakened. These forces are: (i) globalisation, and resulting (downward) price pressures as the number of suppliers is larger (and thus more competition); (ii) digitisation so that prices are more transparent and comparison between alternative products and services is easier; (iii) weak wage growth due to low labour participation, low union membership and foreign labour supply, also due to migration; (iv) aging, which results in lower aggregate spending.[13] Arguably, globalisation is under some pressure from the pandemic and geopolitical tensions. But we do not see a strong de-globalisation force. Neither do we see significant changes in the other factors. Second, the cause of inflation prior to the Russian invasion is economic activity that rose more quickly than expected. That revival coincided with a slow demand uptick of services, putting additional pressure on goods markets and pushing up inflation. The international value chain was simply overstretched, leading to delays and rising costs. But services demand will bounce back and that will take some pressure off the value chain. That process, of which we are already seeing the beginning (see above) is now delayed, but the underlying force has not changed. Third, higher commodity and energy prices are another driver of inflation. These prices have risen in H2 2022 and recently due to the shock of the Russian invasion. But another shock is not on the cards (by nature unpredictable anyway). This implies that as the prices of energy and commodities stabilise or even decline, that source of inflation is taken away as well. Fourth, the crucial element for the future development of inflation is avoiding new shocks. Such a shock would occur, for example, if the burden of inflation were borne by firms because employees wage demands are so high that the impact of inflation is fully compensated. But that is not what we are seeing. Wages in the US are rising quickly but remain below current inflation levels; in the Eurozone the level of wage rise is even half that of the US and remains lower than inflation as well. Apparently, firms and households take the view that, although actual inflation is high, it will be redressed[14]. This is what current (survey based) inflation expectations, especially the most relevant 5-year ahead expectations, suggest as well (figures 1.17 and 1.18). This reflects the credibility of central bank policy to effectively tighten monetary policy when needed. Such monetary tightening indeed reduces demand, as financing for firms and households becomes more expensive and savings more attractive.

[13] This is not completely undisputed. Goodhart and Pradhan (2020) argue that if healthcare services are included, aggregate demand due to aging, and thus aging, becomes an inflationary force. That sounds plausible, but their empirics fail to take account of the impact of lower government spending (as a result of healthcare being largely publicly funded). See Charles Goodhart and Manoj Pradhan (2020), The Great Demographic Reversal: Aging Societies, Waning Inequality, and an Inflation Revival, MacMillan.

[14] The BIS in its Annual Economic Report (June 26 2022) warns that inflation is at a tipping point, urging central banks to take action to address the problem

Figure 1.17 Inflation expectations: ECB maintains credibility

Figure 1.18 Inflation expectations: Fed capabilities trusted



While these underlying forces have hardly changed, the war has put further pressure on (some) value chains, and boosted energy and commodity prices. That shock now needs to be absorbed before the decline of inflation can start, and the latter is therefore delayed. Moreover, and here is the snag: energy and commodity price rises are gradually spreading to the rest of the economy as can be seen from the rise in core inflation. The point is that the longer the easing of the underlying inflationary forces is postponed, the more the other components of inflation come under pressure. Indeed, a short period of high oil prices which is expected to ebb will not lead to additional wage demands and more generally: adjustment of inflation expectations. But if it endures and other products in the economy become more expensive as well, this will no longer be the case. Therefore, the feeding of energy and commodity price rises into other inflation components as well as the length of the current period of high energy and commodity prices are the uncertain elements related to our view. For the moment though, we still do not see a compelling reason to change our view on inflation other than as described above.

Accelerated monetary policy tightening

Our view earlier this year was that inflation would be temporary and rather short lived before a reversal to levels close to the central bank mandates of 2% was to set in. Whereas this view has not fundamentally changed, the adjustment process will take longer and is surrounded by much more uncertainty. Moreover, (long-term) inflation expectations have risen to levels even slightly above target, a sign for central banks that the credibility of monetary policy is being eroded. This has triggered an acceleration of the monetary tightening process which had so far been restrained in order to avoid unnecessarily depressing post pandemic GDP growth. The Fed in particular has stepped up the pace, while the ECB has taken more muted steps (figures 1.19 and 1.20). This pace is expected to slow when inflation will gradually revert to lower levels over the forecast period.

The Fed had already announced it would accelerate its tapering of the asset purchasing program of USD 120 billion per month in December 2021, expecting it to end in early Spring. Moreover, three 2022 interest rate hikes were announced and another three for 2023. Meanwhile, after a set of consecutive high monthly inflation data coming in, we have already seen three hikes, with the most recent one 0.75% point, with further hikes expected this year, potentially ending the year at 4%. Fed balance sheet shrinking by way of only partially reinvesting expiring assets held has started as well. The ECB had taken a backseat prior to the war and then waited before stepping in. But mid-June it took a major step announcing its intention to end its asset purchase program, raise the policy rate by an expected 0.25% in July and further raise the rate in September based on developments of (future) inflation. Further details are in the Advanced Economies chapter (chapter 2).

Figure 1.19 Balance sheets show end of bond purchases

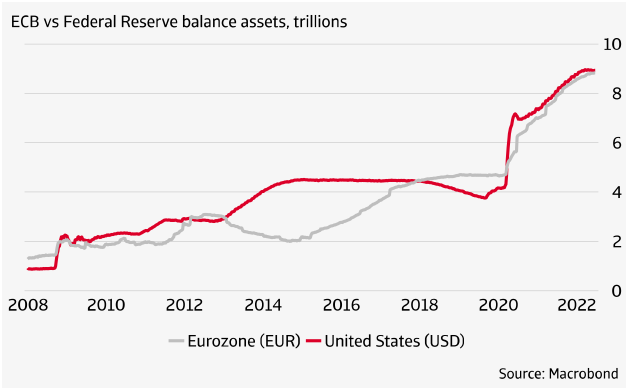
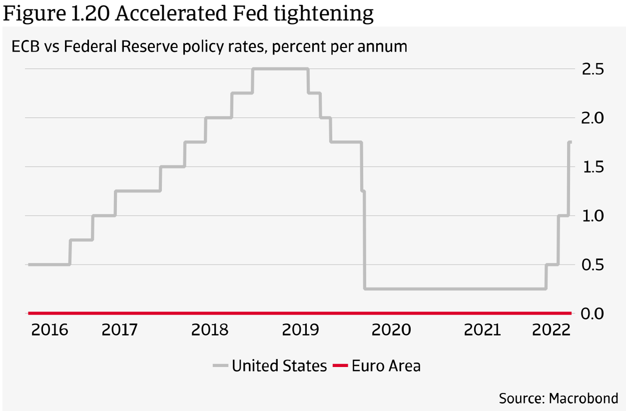


Figure 1.20 Accelerated Fed tightening



How should we assess these steps, which head in the same direction, but are markedly different in terms of pace, while headline inflation is similar and GDP growth not significantly different? The first point to make here is that central banks had so far been conducting a very loose monetary policy in reaction to the pandemic. That was justified and even necessary, but as the pandemic moved towards the endemic stage, it had to end. In other words, monetary policy normalisation had to happen anyway, even without these inflation levels. Otherwise, the central banks would lack the means to support the economy in the next economic downturn. Then, as to the difference of pace between the Fed and the ECB, two factors are to be taken into account. First, as we have seen in the inflation section, the composition of inflation in the US and EU is very different. US core inflation is much higher, suggesting a little overheating of the US economy and reflecting the much more tense labour market situation already mentioned above. This suggests more aggressive tightening in the US which is what we are observing. Second, whereas the Fed has good reason to be more aggressive with normalisation, the ECB has good reason to be more cautious. This is due to the heterogeneity of the eurozone, where countries such as Greece, Italy, Spain and even France have high public debt levels. These are bearable when rates are low and financing is ample, but become less so with higher interest rates. Indeed, since the June ECB announcement we have seen spreads between the German benchmark bond and those of these countries widen significantly. The ECB has to take into account this threat of another eurozone crisis when setting monetary policy (see chapter 2 for further details),[15] The Fed is subject to no such constraint.

Figure 1.21 Yields are going up

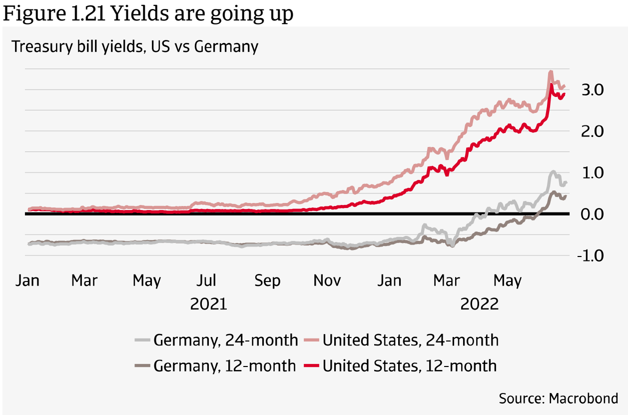


Figure 1.22 Equity prices take a hit

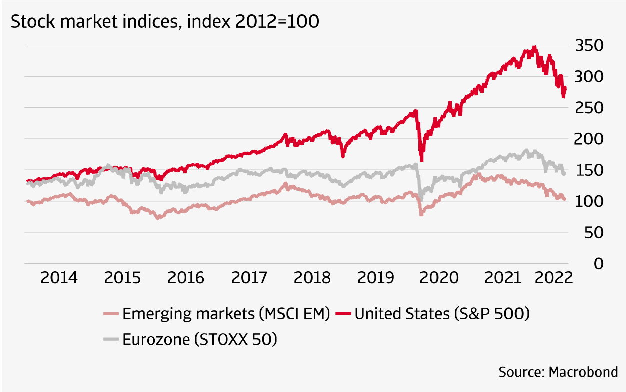
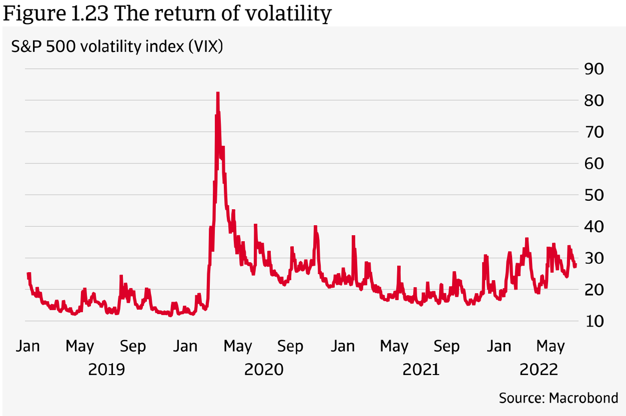


Figure 1.23 The return of volatility



Monetary policy tightening has several implications. Market interest rates can be expected to go up, even in anticipation of what the central bank will ultimately do. In fact, what we observe from the short-term and long-term government bond yields is a gradual increase since the beginning of the year (figure 1.21). At the same time, as financial markets realise that the end of cheap money is near, stock prices come under pressure. Under a gradual monetary tightening policy that would be a gradual process. Stock price pressures from less favourable monetary conditions could then be alleviated by GDP growth expectations. But we have seen a very strong equity market reaction when it became clear that the Fed would accelerate in view of incoming inflation data. By the time of writing, the three major global indices had lost around 20% of their value since the beginning of the year. Tightening not only means more expensive money, but also lower economic growth. There is also a lot of uncertainty about future developments, as expressed by the level of the VIX volatility index (figure 1.23). Government bond yields also shot up because of the somewhat unanticipated element in tightening. Clearly, in addition to the impact of inflation on purchasing power of households, higher interest rates will put another brake on demand. Good for inflation containment, but restraining GDP growth. The other implication is closely related to the Fed tightening and has a global character. During previous periods of monetary

[15] The Eurozone crisis covers a period from 2009 on when Greece, Spain, Ireland, Portugal and Cyprus were given emergency aid by the EU to avoid government debt default.

tightening,[16] capital flows reversed away from emerging economies towards the US and especially Asian currencies came under pressure, whereas the USD strengthened. This is indeed what we are currently observing.[17] But the scent of crisis that was perceptible during other periods is largely absent now. This comes from emerging economies being in a much better position than in previous bouts of volatility. Most of the larger emerging economies have indeed earlier started the tightening that we now see in the US and eurozone. Moreover, the financing needs from a number of large emerging economies such as South Africa and Brazil are not as high as before. That, together with policy improvements, makes them less vulnerable (see Emerging Economies in chapter 2). Nevertheless, tightening by the Fed is an imported drag on GDP growth for the emerging economies as financing conditions for firms and investors deteriorate.

Government support withdrawn

Financial support by governments in combination with the fall in GDP during the pandemic resulted in a very sizable global debt surge of 23% of GDP, the largest since World War II. More than half of the surge occurred on public balance sheets, which now account for more than 100% of global GDP. Now that we have moved to the endemic stage and government support is withdrawn, deficits are falling globally. But as reported before, they are expected to remain above the pre-pandemic levels, reflecting the larger role governments see for themselves in the economy. The relatively good news comes from debt, which is expected to decrease globally as a percentage of GDP. Average advanced economies' debt-to-GDP is expected to move downwards to 113% (from 120% in 2020). For the emerging economies this figure is lower at 70%, but implies an increase (65% in 2020).

The underlying factors at play here are spending, GDP growth and, indeed, inflation. We will discuss these first before providing some detail on the most important countries. As to spending, it is obvious that withdrawal of pandemic support has a negative impact on government spending. It is room for fiscal manoeuvre that some countries can use. For example, by providing energy subsidies to soften the impact of the energy or food price rises. This is a very disputable[18] and costly measure, but one still often applied by governments. Alternatively, given the higher geopolitical threats, defence spending will have to increase. But this additional spending is by no means going to compensate for the withdrawal of pandemic support. That means spending is declining. GDP growth on the other hand will boost tax revenues, providing another impetus to lower deficits. Inflation, especially when higher than expected, helps as well, because spending is usually fixed in nominal terms, whereas taxes are related to nominal GDP.[19] Inflation also works positively on debt-to-GDP ratios, with the denominator - nominal GDP - growing as the debt amount is fixed in nominal terms. That effect had a positive impact on global debt- to-GDP for about 2 ppt in 2021 versus 2020: 1.8 ppt for advanced economies and 4.1 ppt for emerging economies. These are short-term effects due to the surprise element in inflation. In the longer term, pressure will build for governments to adjust their spending to inflation. Moreover, inflation will lead to interest rate hikes and increases in borrowing costs. But as long as, and to the extent that loans do not have to be refinanced, these costs will not rise. In short, in public finance there is also some silver lining related to (unexpected) inflation.

Figure 1.24 Debt will slowly decline

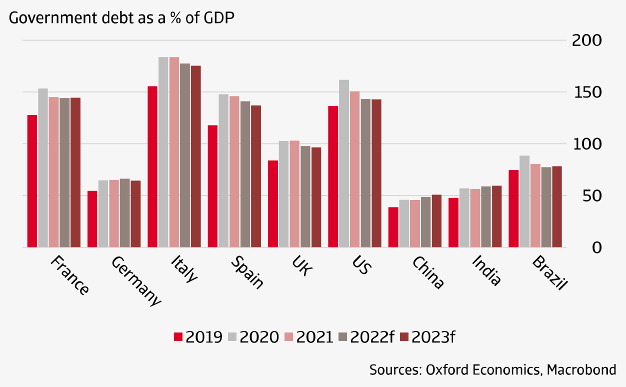
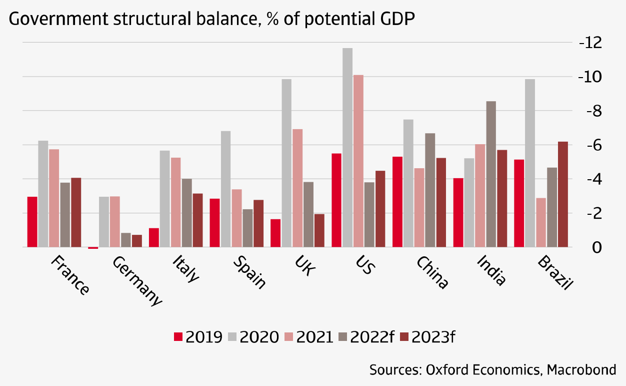


Figure 1.25 Government support remains



The above elements play a role in our view in fiscal developments in various major economies. After softening in 2021, in the advanced economies deficits will further decline in 2022 as pandemic support is withdrawn and tax revenues increase.[20] In 2023 we see some rebound in deficits in major countries as various policies to support the structural

[16] Such as during the so-called Taper tantrum of 2013, when the mere announcement of US policy tightening created an atmosphere of crisis, especially in the Asian markets.

[17] See e.g. The Global Interest Rate Shock and EM Outflows, IIF, June 16 2022.

[18] The problem with this approach is that the behavioural adjustment to higher prices, i.e., lower consumption, is softened. A much better policy is a direct handout to consumers, possibly those most affected by the price increase.

[19] This is confirmed by evidence as referred to in Fiscal Monitor: Fiscal Policy from Pandemic to War, IMF April 2022.

[20] Our measure concerns the structural deficit, which corrects the expenditure for financing costs and relates it to potential GPD rather than GDP itself. This latter essentially means GDP is corrected for the business cycle.

transformation of various economies kick in. In the US there is an infrastructure bill totalling 2% of GDP for projects related to transportation, energy transition and digitisation. Some EU countries have started implementing Recovery and Resilience Plans, partly funded by an EU budget, also focussing on energy transition and digitisation. The amount involved is 0.5% of EU GDP. The UK has a programme called Plan for Growth, focussing on infrastructure, skills and innovation. In the case of the UK this coincides with some fiscal consolidation. Debt-to-GDP levels, meanwhile, are projected to gradually decline over the forecast period after the pandemic jump in 2020.

For the emerging economies the overall picture in 2021 was one of declining deficits as pandemic support measures were withdrawn. This decline is expected to persist. Few countries saw widening of fiscal deficits. There is heterogeneity though, with countries that had the highest increases in 2020 showing the largest decreases in 2021. Brazil is a case in point, with most of the pandemic related support expiring by 2020 year end. The deficit will increase again over the forecast horizon, however. For China, 2021 was a year of fiscal tightening as most pandemic support expired, investment was delayed due to the pandemic and tax revenue grew with GDP. Less buoyant GDP growth is weighing on revenues over the forecast horizon, pushing the deficit up again. The India deficit is to peak in 2022 as the government is taking measures to shield the economy from commodity price rises. The debt-to-GDP ratio in emerging economies is to stabilise, after the jump in 2020, at around 60% of GDP, which picture more or less holds for Brazil, India and China.

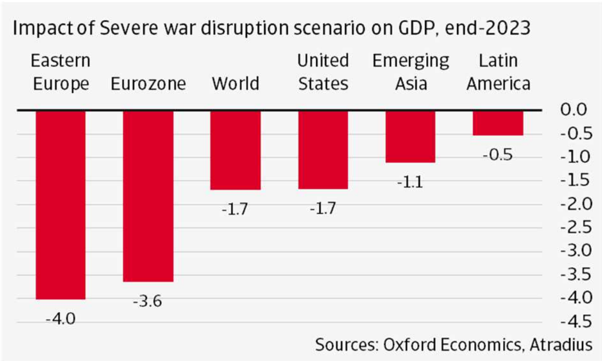
Stagflation threat

What we sketched in this outlook is a picture of higher inflation and lower growth, with central banks and to a lesser extent governments withdrawing their pandemic support. Moreover, compared to our April Interim Outlook, and certainly compared to the January Outlook the risks have increased. These risks are predominantly of a geopolitical nature and may materialise if the Ukraine war intensifies or Russia cuts off gas to Europe. Our baseline is still that this will not occur and therefore shows relatively decent growth, but at the same time we have moved closer to the alternative scenario described in the January Outlook, that of stagflation. This scenario of little or no GDP growth accompanied by high inflation is a scenario in which the advanced economies enter a recession.

In this scenario, the global economy essentially experiences another major shock. It will be the third within 3 years, after the pandemic and the Russian invasion. The war will be more protracted and energy market disruption more severe than in our baseline forecast. With the Russian energy supplies to Europe severely curtailed, oil and gas prices soar, even from their current levels. There is no longer any doubt about the persistency of elevated inflation. Against this backdrop, inflation expectations rise further and confidence takes another hit. As financial market sentiment deteriorates further, equity prices fall sharply again; European equities fall more than 20% below baseline within six months. Negative wealth effects from the loss of equities hit the consumer, especially in the US. Central banks can do nothing other than accelerate tightening. That will weigh on activity, with global growth slowing to 1.3% in 2023, 1.7 ppt below baseline. Economic scarring is significant, with weaker productivity and higher structural unemployment weighing on Europe especially over the medium term. In Europe the hit to potential GDP is more than 2 ppt.

Russian supply of gas and oil to Europe comes to an end during H2 2022. Russian oil production then begins to recover slowly and converge with baseline amid diversification of exports to other partners. But the process is hampered by sanctions. That effectively produces a repeat of what happened after the Russian invasion. Inflation expectations rise further globally, by 1 ppt in Europe and 0.75 ppt elsewhere. The shock begins to dissipate later in the scenario, against a backdrop of tighter monetary policy and falls in energy prices and core inflation. In the US, the Federal Reserve raises policy rates more quickly than in the baseline. In the eurozone, the ECB proceeds with the baseline near-term tightening, despite weakening activity, as it seeks to counter higher inflation and inflation expectations; policy is tighter than baseline by the end of the forecast period.

Figure 1.26 Stagflation GDP forecasts (versus baseline)



2. Developments in major economies

Advanced economies

Prior to the outbreak of the war in Ukraine, the outlook for 2022 and 2023 looked slightly better. Growth and inflation were set to return to normal levels as the Covid-19 pandemic and supply contraints waned. However, the invasion of Ukraine, along with shutdowns in major cities and ports in China, has generated a new set of adverse shocks. Inflation is surging past multi-decade highs, squeezing real incomes and dimming the outlook for consumer spending. Inflation in Europe is mostly driven by high energy prices, caused by shocks to the energy markets from the war in Ukraine. In the US, it is rooted in more general supply-demand imbalances as demand after the pandemic far outstrips supply. Given that the US economy is operating at near or above full capacity, there is a clear need to raise interest rates. While fiscal support in advanced markets will weaken this year compared to 2021, it should remain supportive of growth in most countries. Overall, growth in advanced economies is expected to slow to 2.7% in 2022 and 2.1% in 2023.

Table 2.1 Real GDP growth (%) – advanced markets

	2020	2021	2022f	2023f
Eurozone	-6.5	5.3	2.9	2.5
United States	-3.4	5.7	2.6	1.8
United Kingdom	-9.3	7.4	3.6	1.3
Japan	-4.6	1.7	2.0	2.4
Advanced economies	**-4.5**	**5.2**	**2.7**	**2.1**

Sources: Oxford Economics, Atradius

Eurozone economy slows

The eurozone struggles with a strong divergence between a weak industrial sector plagued by supply bottlenecks, higher input costs and weakening sentiment on the one hand, and a solid services sector, which is experiencing a post-Covid rebound. We expect 2.9% GDP growth in 2022 and 2.5% in 2023.

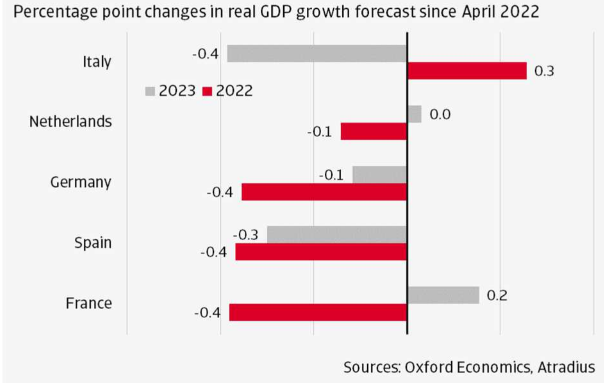
Table 2.2 Real GDP growth (%) – eurozone

	2020	2021	2022f	2023f
Austria	-6.8	4.6	4.3	1.7
Belgium	-5.7	6.2	2.3	1.1
France	-7.9	6.8	2.6	2.2
Germany	-4.9	2.9	1.7	3.1
Greece	-8.7	8.0	5.3	2.5
Ireland	5.9	13.4	5.2	2.0
Italy	-9.1	6.6	3.2	1.9
Netherlands	-3.8	5.0	3.1	1.7
Portugal	-8.4	4.9	6.9	1.9
Spain	-10.8	5.1	4.5	3.6
Eurozone	**-6.5**	**5.3**	**2.9**	**2.5**

Sources: Oxford Economics, Atradius

Among major economies, 2022 GDP growth since our previous Economic Outlook in April has been downwardly revised by -0.4 ppt in France, Spain and Germany, -0.1 ppt in the Netherlands, but +0.3 ppt in Italy (figure 2.1). Downward revisions have been mainly due to high inflation and falling confidence. Only Italy's growth was revised upwards due to better than expected GDP data over the first quarter.

Figure 2.1 Mostly negative growth revisions, except for Italy



Eurozone GDP growth increased to 0.6% in Q1 of 2022, noticeably higher than the initial flash estimate of 0.3%.[21] Sentiment indicators point to weaker growth in Q2 of 2022, notably due to supply chain pressures, higher food and

[21] The figure was strongly affected by volatility owing to the activities of multinational companies based in Ireland and therefore may overstate the strength of underlying domestic activity in the eurozone.

energy prices and uncertainty about the war in Ukraine. As inflation is forecast to decline in the second half of 2022, GDP may receive a boost from higher consumer spending. Sentiment indicators indeed point to a slowdown of growth in the near term. The European Sentiment Indicator declined from 113 in January 2022 to 105 in May (100 is the neutral level). The composite Purchasing Managers Index (PMI) shows a similar cooling, from 55.8 in April to 51.9 in May (50 is the neutral level). The manufacturing sub-index of the PMI is leading the decline, though services are also trending down.

We expect that services spending will rebound over the coming months as tourism and hospitality activity normalise. In the manufacturing sector, however, problems are building. New orders are starting to fall, and delivery times remain high, as lockdowns in China are affecting the transport of key production inputs. Firms are also reporting weaker demand for goods, reflecting the reorientation of spending towards services. The two-speed recovery between services and the industrial sector means that industrial economies like Germany are likely to underperform compared to more services oriented economies.

Lower external demand weighs on exports

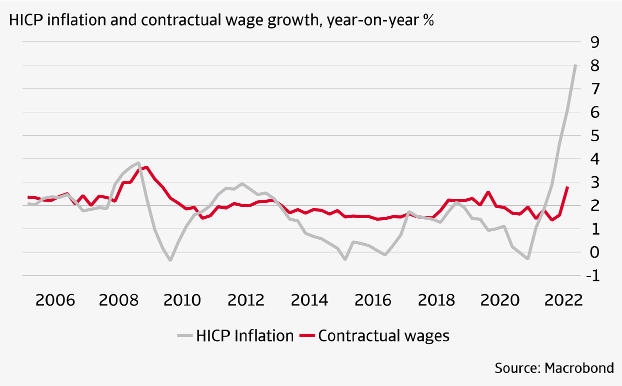
Spill-over effects from the Russia-Ukraine war lead to lower demand in Eastern Europe, which weighs on eurozone exports, especially for member states with close trade relations with the region. The global growth outlook has also deteriorated since the beginning of 2022, with higher commodity prices and disruptions to global trade caused by the Russia-Ukraine war and in the case of trade bottlenecks, also by China's zero Covid policy. Export growth therefore slows in 2022 and continues to slow next year. Trade does not contribute to eurozone growth in the next two years, as the contribution of net trade to GDP growth is forecast to be approximately zero in 2022 and 2023.

Robust labour market and easing restrictions underpin consumption

Private consumption contracted by 0.7% in the first quarter because of tighter Covid restrictions coupled with high inflation that triggered a decline in real household income. Easing pandemic restrictions, inflation that is projected to come down in H2 2022 and a robust labour market, mean that we still project reasonable consumption growth in 2022 overall (3.5% year-on-year). However, there are two risks here. First, our forecast builds on the assumption that inflation will decline in H2 2022, which is increasingly unlikely (see section on inflation). Second, consumer confidence has taken a big hit in recent months, declining from -9.5 just before the Russian invasion in Ukraine, to -23.6 in June 2022 (0 is the neutral level). The much lower confidence could make consumers reluctant to spend.

The labour market continues to hold up well. Eurozone employment expanded by approximately 3.3 million in 2021. In Q1 of 2022 alone, the number of jobs created was 1.5 million on a seasonally adjusted basis. The level of employment has already surpassed the pre-pandemic level. The unemployment rate decreased further over the past six months, but is showing signs of stabilising (it was 6.8% in the past three months). Furthermore, there remains a considerable degree of labour market slack ('underemployed'), consisting of people who are available, but not actively seeking work, and part-timers who wish to work more hours. This may also be why contractual wages are picking up, but continue to lag behind inflation (figure 2.2). We expect that high inflation will lead to a decline in real incomes in the short term, dampening consumption growth. However, we also project inflation to come down in H2 2022, reviving consumption growth again.

Figure 1.2 Wage growth remains behind inflation



Inflation still at record highs

Inflation continues to run rampant. The inflation figure of May 2022 increased to 8.1%, the highest it has been in 20 years and 3 percentage points higher than at the start of the year. Inflationary pressures are mainly coming from food and energy inflation. In May, food inflation was 7.5% year-on-year, while energy inflation was 39%. We forecast inflation to come down somewhat in H2 2022 (to an average of 6.5%). On the back of a drop in energy and food inflation, a much lower inflation rate of 1.5% is expected for 2023. However, this figure rests on the assumption that the war in Ukraine will end in 2022 (or there will be a ceasefire agreement) and that there will be no oil and gas boycotts. In a downward scenario of a protracted war and a European embargo on Russian gas, the inflation rate would be close to 5.8% in 2023.

Fiscal policy remains supportive

Fast recovery and positive revenue developments drove a significant reduction in public deficits in 2021. The overall eurozone public deficit declined from 7.2% in 2020 to 5.2% in 2021. The deficit is projected to decline further in the coming two years. The economic expansion contributes positively to the economic budget through higher revenues. These positive developments are expected to override the additional costs of measures to mitigate the impact of high energy prices and to deal with the humanitarian crisis following Russia's invasion of Ukraine. Because of fiscal stimulus measures, eurozone government debt has risen to

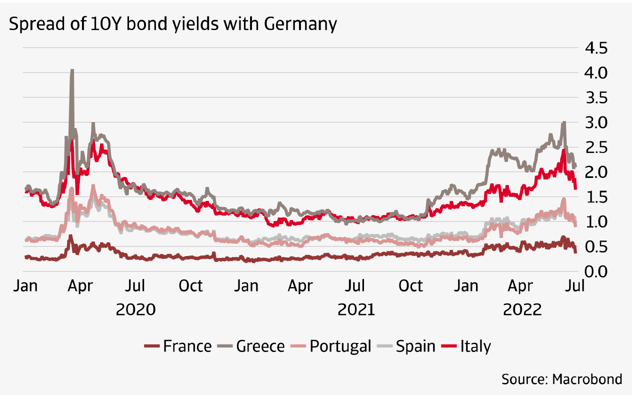
96% in 2021. We expect it to decline a little further in 2022 and 2023.

Several eurozone countries continue to struggle with high government debt ratios, including Greece (246% of GDP at the end of 2021), Italy (184%), Portugal (156%) and Spain (146%). Financing conditions have been benign in past years. However, with government bond yields edging up (see monetary policy section), there is a sustainability risk going forward.

ECB is tilting towards a more restrictive policy

As inflationary pressure shows little sign of easing, the ECB is tilting towards a more restrictive monetary policy stance. The ECB governing council has decided to end net asset purchases at the end of June. Maturing bonds remain fully invested, keeping the size of the ECB's balance sheet unchanged (figure 2.x). We expect this to continue. Still, the move marks an end to years of nonstandard policy measures. Furthermore, the governing council pre-announced two policy rate hikes – one in July and one in September. We expect two rate hikes (25 basis points each) in July and September, likely followed by another 25 basis point hike in December, lifting the ECB deposit rate to above zero for the first time in ten years. In order to contain inflation, additional rate hikes are likely needed in 2023.

Figure 2.3 Tighter ECB policy triggers fears of a new sovereign debt crisis



The more restrictive ECB policy revived fears of another sovereign debt crisis and led to a widening of bond yields between southern member states and Germany (figure 2.x). Less than a week after the governing council meeting in June, the ECB called an emergency meeting to address the surge in borrowing costs. It shows how the ECB struggles to contain both inflation and bond market fears about the eurozone's weaker economies. After the emergency meeting, the ECB announced it is accelerating plans for an "anti-fragmentation instrument" that could be used to purchase bonds of member states with weaker public finances. The exact design of such an instrument is yet unknown, but it is expected to be launched in July. In anticipation of such an instrument, yields of vulnerable Southern European countries have already started to edge down.

United States: growing recession risk in 2023

Under pressure of inflation, fiscal consolidation, and rising interest rates, US GDP growth is expected to slow to 2.6% in 2022. The tight labour market and sticky inflation are driving the Federal Reserve to step on the brakes to maintain confidence in central bank policy and prevent a de-anchoring of inflation expectations. Their policy actions to prevent stagflation are accelerating the downturn in the business cycle and increasing the risk of a recession by the end of 2023. We still anticipate a soft landing, cushioned by the tight labour market, with growth slowing further to 1.8% in 2023. But this outlook is contingent on consumer resilience, and risks are rising.

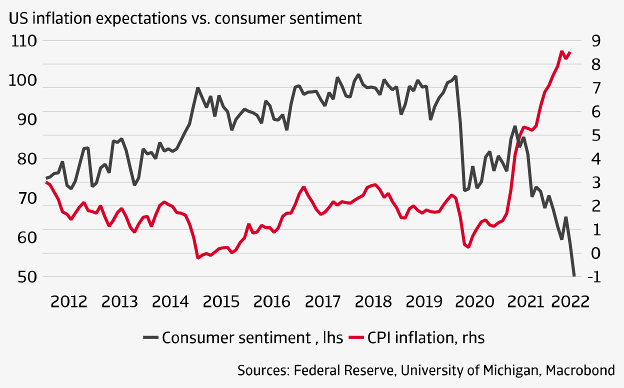
Tight labour market and excess savings support consumers

US consumers are in a strong position despite increasing headwinds. The labour market remained strong in May with employment increasing by 390,000. The supply of available workers has also increased with labour force participation reaching 62.3% in May as health risks decrease and wages continue to rise. The labour market is expected to gain about 4 million jobs total in 2022 with the unemployment rate stabilising around 3.5% in H2. With inflation eating into income gains, US consumers are increasingly forced to tap into other resources.

Household balance sheets are in relatively good shape, providing some buffer to keep up spending. Stronger household and corporate balance sheets also ensure that a recession will be less deep than for instance in the financial crisis. US households also benefit from excess savings of USD 2.5 trillion, accumulated since March 2020, providing an additional cushion. Most data point to these savings being concentrated in higher-income households though, and lower- and middle-income Americans are increasing borrowing in order to keep up spending in the face of higher costs.

Household wealth contracted in Q1 for the first time in two years, mainly due to the fall in stock prices. But we do not expect this to translate into a significant impact on consumer spending for two reasons. First, more than 90% of stocks are held by the top 10% of the population – a segment that is unlikely to change their spending habits significantly in response. Second, home values have continued to rise through H1. Home equity is a more significant indicator of wealth for a broader segment of the population. On the other hand, as housing and mortgage prices continue to rise, consumer spending, especially on big-ticket items that accompany a house purchase, is set to ease. This should relieve some pressure on prices.

Figure 2.4 Consumer sentiment continues downward plunge



But Federal Reserve policy to apply the brakes

Inflation reached another 40-year high of 8.6% in May, sending consumer confidence further down and upping the ante on the Federal Reserve. In May, headline CPI inflation reached 8.6% y-o-y, while core CPI inflation remained lower at 6.0% y-o-y, well above the Fed's 2% target rate. Pandemic-related supply-chain issues have been pushing up prices for the past several months and are exacerbated by Covid lockdowns in China and geopolitical turmoil in eastern Europe. The war in Ukraine is also causing various global shortages of cereals, fertilisers, and cooking oil, while sanctions on Russia are causing fuel prices to soar. Inflation expectations continue to rise, with the median one-year-ahead expectation reaching 6.6% in May, up from 6.3% in April, increasing the risks of de-anchoring as inflation remains above the Fed's target rate.

With inflation continuing to prove stickier than expected, the Fed has been forced to act more aggressively to rein in inflation at the expense of GDP growth. They have adapted their goal from a "soft landing" to a "softish" landing, risking a slight recession in 2024. On June 15 the Fed raised interest rates by 75 bps, the largest rise since 1994, bringing the Fed funds rate to a target range of 1.50% to 1.75%. We expect a further 75 bps hike in July and another one in September. These actions should translate to improved price stability in H2 and allow more gradual 25 bps hikes in the remaining months of the year, ending the year at 3.75% to 4.0%. Inflation is expected to remain above the 2% target for the forecast period at 7.6% in 2022 and 2.6% in 2023.

With less fiscal support to offset the pain

As most Covid-era fiscal support expires, the budget deficit is expected to shrink to USD 1.0 trillion in fiscal-year 2022, a significant drop from USD 2.8 trillion in 2021. Parts of the Build Back Better plan may pass this year but would likely total less than USD 1.0 trillion, down from the previously anticipated USD 1.8 trillion. This spending will be more than offset by tax increases, further reducing the deficit. As inflation pressures weigh on the US economy, some fiscal supports have been suggested including a 3-month gas tax holiday, but we do not anticipate significant support given voters' concerns about the role of fiscal stimulus in high inflation.

United Kingdom: inflation increasingly bites

The UK's growth is forecast to be 3.6% in 2022, followed by 1.3% in 2023, one of the worst performing advanced economies. Inflation has also accelerated to 40-year highs, but the economic toll is more dire as consumers grapple with larger squeezes in real income. The government announced a GBP 15 billion fiscal package which includes both universal and targeted support to counteract high pressure on consumers and boost growth. The package is partially funded by a windfall tax on oil and gas companies. But as trade also drags on growth, the outlook for the UK economy remains relatively bleak.

Real income under severe pressure from inflation

CPI inflation reached 9.1% in May y-o-y. Initially, the combination of high demand as Covid restrictions eased and low supply as supply chains struggled to pick back up after the pandemic caused prices to go up. This was then exacerbated by the war in Ukraine and the sanctions that followed, pushing up fuel prices. The fuel component of CPI inflation was 25.6% y-o-y in Q1 in 2022 and is expected to reach 35% in Q2. The UK energy market regulator, Ofgem, has also announced that the energy price cap is expected to rise by more than 40% in October. Simultaneously, sterling has depreciated against the USD recently due to higher geopolitical risk within Europe and the Fed's interest rate hikes, resulting in the UK's imports rising in price.

The pressure on British households is high as prices rise and as pandemic-related fiscal support from the government decreases in a fiscal contraction. Real household incomes are expected to fall by 2.2% in 2022, the largest decrease since records began in 1955. As a result, the consumer sector is forecast to enter a recession in H2 2022, weighing on growth.

In response to the high inflation the Bank of England (BoE) increased the Bank Rate by 0.25 ppts in June to 1.25%. They are expected to further increase the Bank Rate over the coming quarters so that the Bank Rate reaches 2% by the end of 2022, as the BoE adopts a more aggressive stance, prioritising dampening inflation over supporting growth. CPI inflation is forecast to peak at above 10% in October due to the large increase in the energy price cap that month. In 2022 CPI inflation is forecast to reach 8.6% before sliding gradually to 4.2% in 2023. This is still way above the BoE 2% target and inflation is not expected to return below the target until the end of 2023

Negative net exports risk worsening

Net exports continue to drag on GDP growth as the UK battles high inflation. The terms of trade have been consistently dropping since Brexit, under the pressure of trade frictions between the UK and the EU. Net exports are expected to gradually improve as we enter 2023, but newfound tensions between the UK and the EU put this recovery at risk.

The UK House of Commons voted to let the Northern Ireland protocol bill pass on June 27th. The bill proposes overriding the current Northern Ireland Protocol which is part of the UK's Brexit agreement. The new bill is considered illegal by some, including the EU which has threatened to start legal proceedings against the UK as well as a trade war if the bill were to pass through Parliament. A trade war would weigh significantly on the UK's growth in an already difficult period, as the country continues to recover from losses in trade caused by Brexit.

Japan: consumption benefits from lifting of restrictions

Japan's economy is forecast to grow by 2.0% in 2022, followed by 2.4% in 2023. As the economy is reopening, consumption growth is expected to increase, though rising inflation is posing a risk for the strength of the recovery. Export growth is under pressure from the global growth slowdown and supply chain issues.

While Covid confinement measures have been lifted, the conflict in Ukraine and lockdowns in China have affected trade and prices. Consumer price inflation reached 2.5% year-on-year in April, up significantly from 1.2% in March. Higher energy prices and a recent depreciation of the yen intensify inflationary pressures. Core inflation has remained very sluggish until recently due to the impact of a decline in mobile phone fees since March 2021 (cumulative 1.5 percentage points). However, as the impact of these price declines wears off, core inflation is strengthening. We forecast an average inflation rate of 1.9% in 2022.

We believe private consumption growth will be reasonably strong in the short term, following the lifting of confinement measures. However, rising inflation is squeezing household income and this could limit the speed of the consumption recovery. The unemployment rate has declined slightly in recent months, reaching 2.5% in April. Looking ahead, a recovery in services demand will contribute to a further increase in employment. We expect investment to improve in 2022, while the pace of the rebound could be slower than thought, as recent cooling in core machinery orders imply. That said we still expect investment to grow by a healthy 2.3% in 2022, supported by robust corporate earnings and sustained demand for digitalisation investment.

On the external side, export volumes decreased by 5% year-on-year in April after increasing 2% in March, as shipments to China fell sharply, reflecting weaker import momentum and logistics issues amid reimposed restrictions. We expect that exports will continue to be hampered by weak demand in China in the coming months. While we look for export growth to improve over H2 2022 as supply-chain disruptions ease, the pace of recovery is likely to be moderate given the slowing in global growth.

Emerging economies

After an uncertain start into 2022 due to a new wave of the pandemic, emerging market economies (EMEs) face new headwinds triggered by Russia's invasion of Ukraine. In many EMEs the risks of food shortages are high given the reliance on agricultural exports from Russia and Ukraine. The events in Ukraine come on top of other issues, such as supply chain bottlenecks and slower vaccination rates compared to advanced economies. The Covid pandemic remains a risk as more aggressive or contagious variants may emerge, leading to tighter restrictions. The zero-Covid policy in China is already creating new supply chain disruptions. Additionally, fiscal support in EMEs has been withdrawn, while central banks in many major markets have already been hiking policy rates in response to higher inflation. We expect GDP growth in EMEs as a whole to decline, from 6.9% in 2021 to 3.5% in 2022. In 2023, growth is forecast to be slightly higher as Eastern Europe emerges from recession, and Covid-related restrictions in Asia are eased.

Table 2.3 Real GDP growth (%) – emerging markets

	2020	2021	2022f	2023f
Emerging Asia	-0.1	7.2	4.4	5.1
Latin America	-6.7	6.8	2.3	1.2
Eastern Europe	-2.0	6.5	-0.7	1.1
MENA	-3.5	4.7	4.5	3.9
Sub-Saharan Africa	-2.1	4.5	3.4	3.2
Emerging Markets	**-1.6**	**7.0**	**3.6**	**4.1**

Sources: Oxford Economics, Atradius

Asia: China and India

After strong GDP growth last year at 8.1%, **China** is experiencing much slower growth this year, projected to be 4.0%. Despite nearly 90% of the population being vaccinated against Covid by domestically made vaccines, Covid restrictions continue to weigh heavily on growth under the government's zero-Covid strategy. In March, Shanghai entered a two-month lockdown, severely disrupting supply chains and domestic demand. As the government is expected to continue its tough approach to Covid, the impact of restrictions on consumption is likely to linger longer. Therefore, private consumption is expected to be slow to recover, and to grow only 1.3% this year, down from 12.6%.

China's real estate market is also experiencing a significant downturn, decreasing investment in the country, as many developers default and price expectations fall. Housing sales have slumped further since mid-March, with the central bank and commercial banks attempting to stabilise the property market by reducing the lower limit of mortgage rates and reducing the five-year loan prime rate. Both signalled the urgency of the need to stabilise the real estate market. At the same time, authorities will likely keep most of the important curbs in place – such as the three red lines related to financial ratios as well as caps on real estate lending by bank type.

In response to the growth slump in H1, the Chinese government is expected to enact many different fiscal policies to boost growth, mostly focused on infrastructure investment. VAT rebates are also expected to help keep companies afloat. Monetary policy has become more supportive with a series of interest rate and reserve requirement cuts. Further monetary easing is likely, as the government aims to support GDP growth. As Covid cases and the accompanying restrictions are expected to decrease gradually over the coming quarters, growth is forecast to rebound to 5.3% by 2023.

Despite much of the world experiencing high inflation, China's remains relatively low, with headline inflation at 2.1% y-o-y in April. Thanks to large grain and oil reserves and export restrictions, the impact of rising global commodity prices on China's inflation will be limited. However, domestic supply-side issues largely related to Covid restrictions are contributing to some inflation. Global inflation is also weighing on China's exports as international demand falls, causing exports to only grow at 2.2% in 2022, down from 18.2%.

India's GDP growth is forecast to slow to 6.9% in 2022, down from 8.1% in 2021. Under the pressure of rising inflation, with headline CPI inflation climbing to 7.8% in April, real household income growth is expected to slow considerably. The slower growth in real household incomes will weigh on spending. On the other hand, with the potential for high-contact services to rebound, overall consumption growth remains relatively robust (7.2% in 2022, down from 8.0% in 2021). India also imports about 85% of its oil requirement, so as oil prices rise globally, exacerbated by the Russia-Ukraine war, inflation in India is only worsened. Simultaneously to the imports bill rising due to inflation and supply-chain issues, global demand is also decreasing, weighing on India's exports. This caused the goods trade deficit to widen to USD 20.1 billion in April from USD 18.5 billion the previous month, pushing the current account deficit to 3% of GDP. However, as India has a significant build-up of FX reserves, this is not forecast to jeopardise India's external position.

In response to inflation, the Reserve Bank of India (RBI) is entering a phase of monetary tightening, although real rates remain quite negative. The RBI is expected to increase the rate further by 50bps in June, followed by 25bps rate hikes in August and October. The year-end repo rate is projected to reach 5.4%. To further counteract inflation, fiscal measures have been announced to lower excise duties on motor fuels, subsidise fertilizer and LPG, lower some import duties, and increase some export duties. The new measures are expected to cost around 0.7% of GDP and general government debt is nearing 90% of GDP, but the fiscal deficit is still expected to fall over the coming years under the government's fiscal consolidation plan.

Latin America: Brazil and Mexico

Brazil's upcoming general election in October heightens the uncertainty and polarization in the country, in an already complicated period. GDP growth is expected to reach 1.8% in 2022, down from 4.9% in 2021. Growth prospects are further worsened by high inflation as headline CPI inflation climbs to 11.7% y-o-y in May, a 20-year high. The Banco Central do Brasil (BCB) has aggressively been raising target rates from 2% in March of 2021 to 12.75% in June of 2022. One more hike is expected for August that will take the policy rate to 13.25%. The higher interest rate will negatively impact investment which is expected to decrease by 0.4% in 2023.

The BCB's efforts will bring inflation back within the target range of 1.75-4.75% in the course of 2023. Despite the polarization, Congress has made some progress on the reform agenda, with the privatisation of power company Eletrobras in June 2022. Still, the window of reform has now been closed given the approaching elections. And a continuation of structural reforms will be needed under the new administration to lower the government debt ratio, currently at 81% of GDP. The government needs to balance fiscal consolidation with the need to pursue social policy, which is a problem of increasing urgency as rising food and fuel prices increase the pressure on households, risking social unrest. The government has taken several mitigating measures (tax reductions on fuel and some other goods; expected costs 1% of GDP). Revenues have also increased due to higher commodity prices and inflation. Hence, the impact on the primary balance is expected to be neutral and the -0.5% GDP target for this year is within reach. During the Covid pandemic, households grew more dependent on cash transfers from the government and on debt to increase spending. But owing to the phasing out of pandemic related support measures and reduced purchasing power due to high inflation, we see consumer spending growth slowing sharply in H2 2022 and in 2023.

Down from 4.8% in 2021, **Mexico** is experiencing moderate growth in 2022, forecast to be 1.8%. Growth is supported by consumption of non-durable goods and non-automobile exports as supply-chain issues are still challenging the automobile industry, with exports expected to grow by 8.1% in 2022. Investment is lagging behind with growth of 3.2%, down from 10.1% in 2021. President Andres Manuel Lopez Obrador's business-unfriendly economic agenda points to greater involvement of the state in the economy, dissuading investors. Inflation stabilised at 7.7% year-on-year in April and is expected to settle at 6.9% year-on-year by year-end, weighing on the consumer sector. By the end of 2023, inflation is expected to ease to 4.3%. To limit inflation, the central bank of Mexico, Banxico, raised interest rates to 7.75% in June, which are expected to stand at 9.0% at end-2022. To soften the impact of high inflation, the government has introduced a range of measures including temporary price controls and a fuel tax exemption. These policies likely will have a small impact on public finances with the primary deficit expected to be -0.4% of GDP this year and projected to recover to a surplus of 0.1% by next year. The government has fiscal space for stimulus as government debt is relatively low at 52% of GDP.

Eastern Europe: Russia and Turkey

Owing to the war in Ukraine and sanctions on Russia, Eastern Europe is likely to see a 0.6% contraction of GDP in 2022, followed by 1.1% growth in 2023. We forecast that the economy of **Russia** will contract by 8.0% in 2022, followed by another 2.8% decline in 2023. Sanctions deprive Russia of much-needed industrial components. On the other hand, Russia still exports large quantities of energy, despite Western sanctions.

Directly after the war in Ukraine broke out, the rouble depreciated strongly (it lost almost 45% vis-à-vis the USD at its lowest point). Thanks to capital controls and a high surplus on the current account, however, the rouble regained all of its lost value and is now trading at levels above where it was just before the Russian invasion. Capital controls include mandatory FX sales by companies, limited FX convertibility, and a freeze on foreign investments that prevents liquidation of these investments. The current account surplus rose to USD 110.3 billion in May 2022, up 244% from May 2021, presumably due to high revenues from energy exports and import contraction. We forecast the current account surplus to be 13.8% of GDP in 2022, up from 6.9% in 2021.

There is double digit inflation in Russia (17.1% in May 2022), causing real wages to contract sharply. We may expect inflation to come down somewhat given that the rouble is strengthening. Retail sales fell by almost 10% year-on-year in April, pointing to a sharp contraction of consumption this year. The labour market is holding up quite well, with unemployment at 4.0% in April, probably reflecting inertia on the jobs market. Job losses as Western firms exit will take some time to manifest in the official statistics, as many of these firms are keeping Russian staff on their payroll. We forecast higher unemployment in the coming months, with an average unemployment rate of 7.6% in 2022, up from 4.8% last year.

Fixed investment will likely show a strong decline in 2022. Western bans on exports of technologies, electronic chips, and other components to Russia will also hamper growth in the medium and long term. The oil and gas sector, which is already cutting production, is poised to curb its investment due to the sanctions and diversification away from Russian hydrocarbons. The government is following a loose fiscal policy to help mitigate the impact of the sanctions on the economy. High hydrocarbon prices have translated into a windfall for the budget. The government is planning to channel all extra hydrocarbon revenues towards growth support. President Putin already announced a 10% hike in minimum wages and pensions, which will cost the budget an equivalent of 0.4% of GDP in 2022 and 0.7% of GDP in 2023 in additional expenditure.

In **Turkey**, a surge in domestic demand led the post-pandemic rebound in 2021, primarily driven by household spending. In 2022, growth is forecast to slow to 3.0%. This is still a 0.6% upward revision compared to the April economic outlook. However, the rise in inflation is swiftly eroding purchasing power and weighing on consumer demand. Leading indicators such as consumer confidence and the Purchasing Managers Index (PMI) signal a gradual moderation of economic momentum. While consumption remains the main growth driver, it is slowing to 5.1% on an annual basis (compared to 15.1% last year).

High inflation is eroding household purchasing power. A jump in energy prices aggravated by Russia's invasion of Ukraine is driving inflation up, with the May 2022 reading at 73.5%. The authorities have called on local companies to freeze prices and are considering caps on rents to stem the inflationary surge. But we think consumer inflation still has to peak. Renewed pressure on the lira (18% depreciation vis-à-vis the USD since April) is also driving inflation upwards. Exports are slowing, but continue to make a positive contribution to growth. Recent surveys show a slowing of export orders, reflective of cooling demand from Europe.

The central bank has stuck with its loose (given inflation) monetary policy, and we do not foresee an increase in the repo rate (currently 14%). As a result, the real interest rate has become deeply negative. The central bank is intervening in the FX market to support the lira, and it has created a new protection scheme for lira deposits that compensates clients for lira depreciation (above a certain threshold). Furthermore, exporters are asked to convert 40% of their foreign currency revenues into lira. In recent months, however, this has not stopped a further slide in the lira.

Turkey's external position faces increasing challenges, with the current account in deep deficit and external financing needs rising. With the 2023 elections nearing, President Erdogan has raised the net-minimum wage and public-sector pay and pensions. Income tax on the minimum wage will also be abolished. Fiscal policy will therefore remain supportive of growth.

Sub-Saharan Africa: South Africa

South Africa's GDP growth is expected to slow to 1.5% this year, down from 4.9% in 2021. Various factors are weighing on GDP including logistical constraints and weaker external demand (Chinese lockdowns) high inflation, floods in KwaZulu-Natal, and rising government debt. Inflation is also rising in South Africa, introducing the risk of stagflation. Headline inflation was 5.9% y-o-y in April and it is expected to peak in the coming months, averaging out to 5.9% for the year. As households feel the pressure of rising prices, the consumer sector is still supported by continuation of the Covid-relief grant until March 2023 as well as a reduction in the general fuel levy. To counteract inflation, the South African Reserve Bank raised its repo rate by 50 bps in May to 4.75%, which is expected to rise to 5.75% by the end of the year.

Despite the slow growth, South Africa's trade surplus is expected to improve, especially as South African exports rise amid global commodity inflation. Similarly, fixed investment is projected to grow at 8.8% y-o-y in 2022, strengthening GDP growth.

Looking forward, South Africa's growth is only expected to reach 1.8% in 2023, while facing a variety of uncertainties. South Africa's vaccination rate remains low with just 31% of the population fully vaccinated, creating greater risks for necessitating Covid restrictions again. Infighting in the ruling party, the African National Congress, and low confidence in the President are creating further uncertainty within the country.

Table 2.4 Real GDP growth (%) – major EMEs

	2020	2021	2022f	2023f
China	2.2	8.1	4.0	5.3
India	-6.6	8.3	6.8	5.5
Brazil	-4.2	4.9	1.8	1.1
Mexico	-8.3	5.0	1.8	2.0
Russia	-2.7	4.7	-8.0	-2.8
Turkey	1.8	11.0	3.0	2.0
South Africa	-6.3	4.9	2.1	1.3

Sources: Oxford Economics, Atradius

Appendix: macroeconomic forecasts – major markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Budget balance (% of GDP)			Gross government debt (% of GDP)			Current account (% of GDP)			Export growth (% change p.a.)			Private cons. (% change p.a.)			Fixed investment (% change p.a.)			Government consumption (% change p.a.)			Retail sales (% change p.a.)			Industrial prod. (% change p.a.)		
	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023
Australia	4.8	4.0	2.9	2.8	5.8	3.3	-2.5	-0.8	-1.9	62.3	58.3	59.8	3.5	1.8	0.3	-1.8	3.0	11.2	4.9	6.1	3.3	9.6	2.7	6.1	5.1	4.3	-2.1	3.5	4.5	0.1	0.8	1.3	2.6
Austria	4.6	4.3	1.7	2.8	6.7	1.0	-6.0	-2.4	-0.5	134.7	127.9	124.4	-0.5	0.8	1.8	13.3	4.3	-0.2	3.2	3.9	5.6	4.0	2.9	2.5	6.8	0.4	-0.3	3.1	0.9	3.3	9.8	4.4	1.0
Belgium	6.2	2.3	1.1	2.4	8.0	2.0	-5.6	-6.6	-5.3	137.5	133.1	136.1	-0.4	-3.4	-2.9	9.6	1.9	3.0	6.4	3.6	0.6	7.8	0.9	3.5	4.4	1.3	1.3	5.8	-2.3	1.1	16.8	-6.2	-1.9
Brazil	4.9	1.8	1.1	8.3	10.7	6.6	-4.4	-4.5	-6.7	80.3	77.2	78.4	-1.8	-0.9	-2.1	6.3	4.5	0.4	3.9	2.1	1.3	17.3	-0.4	-0.5	2.0	2.3	0.5	1.9	1.1	1.3	4.2	0.2	3.9
Canada	4.5	3.6	1.9	3.4	6.7	2.8	-4.7	-2.2	-2.1	117.9	109.2	108.7	0.0	1.6	1.1	1.4	5.7	6.6	4.9	5.3	2.4	7.1	2.4	0.2	5.8	0.6	-1.8	8.4	2.5	2.4	4.2	4.0	3.5
China	8.1	4.0	5.3	0.9	2.2	2.4	-4.9	-7.2	-5.6	45.5	48.5	50.8	1.8	1.3	0.9	18.2	2.4	2.0	12.6	1.3	8.2	2.6	4.9	5.0	2.9	3.5	3.9	13.1	1.3	8.6	8.2	4.7	5.4
Denmark	4.7	3.8	1.9	1.9	6.7	1.1	2.3	0.6	0.0	50.3	45.2	43.5	8.7	8.7	7.0	7.8	4.7	4.2	4.2	2.0	3.2	5.6	5.2	2.7	3.7	0.4	3.1	4.0	-1.3	-0.1	8.3	6.8	0.7
Finland	3.5	1.8	1.6	2.2	5.3	2.0	-2.6	-1.4	-1.9	66.5	64.8	65.1	0.7	-1.4	-0.2	4.2	1.7	5.2	3.1	1.4	2.3	1.2	4.9	-0.4	3.2	1.4	1.5	3.5	-1.0	0.8	4.1	1.3	0.8
France	6.8	2.6	2.2	1.6	5.1	1.5	-6.5	-5.2	-5.0	144.8	144.0	144.4	-0.8	-1.9	-2.7	8.6	8.6	6.7	5.3	2.4	2.3	11.4	2.0	2.8	6.3	2.9	1.3	10.2	1.3	-2.8	5.7	1.5	4.8
Germany	2.9	1.7	3.1	3.1	6.5	1.4	-3.7	-1.8	-1.4	65.1	66.2	64.3	7.6	4.2	3.6	9.5	2.4	4.3	0.3	4.8	5.1	1.0	1.9	5.7	2.9	-0.2	0.6	0.8	-0.1	2.3	4.0	0.9	6.6
Greece	8.0	5.3	2.5	1.2	9.1	0.0	-7.9	-4.8	-1.1	246.0	224.4	217.3	-6.3	-7.9	-5.9	21.9	6.8	4.5	8.1	6.9	2.3	19.3	14.0	9.2	3.9	1.4	0.5	10.4	2.3	-1.9	9.8	3.8	1.4
Hong Kong	6.3	0.1	4.6	1.6	2.3	2.7	-0.6	-4.1	-1.7	1.5	2.6	3.4	11.2	7.3	3.8	17.0	0.6	9.3	5.4	-0.3	8.1	9.8	-3.4	11.3	4.6	3.7	-0.9	6.5	3.6	15.6	5.5	-0.4	4.5
India	8.3	6.8	5.5	5.1	7.0	5.3	-6.3	-8.7	-6.1	56.3	58.9	59.5	-1.0	-3.1	-2.8	20.8	7.8	4.8	9.3	5.4	6.0	17.6	5.3	5.1	8.2	19.3	-0.5	11.2	7.0	7.6	12.7	2.7	4.8
Ireland	13.4	5.2	2.0	2.4	5.9	1.8	-1.9	-0.5	-0.3	49.9	45.2	43.1	14.0	21.6	23.1	16.6	4.5	1.0	5.6	4.3	2.3	-37.8	-8.2	2.4	5.3	0.7	1.3	4.6	4.4	3.7	17.7	-5.2	1.0
Italy	6.6	3.2	1.9	1.9	6.2	1.3	-7.3	-5.4	-4.2	183.6	177.3	175.6	2.4	0.5	0.5	13.4	5.7	2.2	5.2	3.3	3.0	17.0	8.4	1.8	0.6	2.6	0.3	8.0	2.1	0.3	11.7	0.6	4.1
Japan	1.7	2.0	2.4	-0.2	2.1	0.5	-6.7	-7.1	-4.9	242.5	244.6	242.0	2.8	1.3	2.4	12.0	4.3	4.9	1.3	2.5	1.1	-1.4	-0.6	6.7	2.1	1.1	-0.3	2.5	1.3	1.0	5.6	1.7	4.4
Luxembourg	6.9	2.1	4.0	3.5	5.8	1.3	0.9	1.4	1.2	24.4	21.3	19.4	4.8	4.9	5.5	9.8	2.3	2.2	7.4	2.5	2.8	9.8	3.5	4.0	4.8	-2.7	-0.6	7.8	4.3	13.8	8.1	0.7	3.8
Netherlands	5.0	3.1	1.7	2.7	8.9	1.5	-2.6	-3.8	-2.5	72.6	71.3	71.2	9.5	9.4	8.9	6.6	2.0	2.6	3.5	4.0	2.5	3.5	2.5	2.8	5.5	1.2	2.5	2.5	2.4	3.1	4.7	0.1	1.6
New Zealand	5.0	1.4	3.6	3.9	6.1	1.9	-3.9	-1.8	0.0	45.6	44.1	41.8	-5.6	-6.6	-3.9	-2.5	4.5	15.9	6.6	1.2	1.9	9.7	5.6	2.7	10.4	5.8	-1.3	9.0	2.2	1.4	5.9	2.2	2.4
Norway	4.0	2.0	2.5	3.5	5.0	1.5	11.1	16.6	6.5	37.1	18.1	18.1	14.6	26.1	18.6	5.0	2.6	5.1	4.7	5.8	2.7	-0.9	3.6	4.2	3.8	0.0	3.2	1.3	-2.4	0.9	3.3	2.2	1.9
Portugal	4.9	6.9	1.9	1.3	6.9	1.8	-2.9	-2.1	-1.5	155.9	146.0	143.9	-1.1	-2.3	-2.3	13.1	14.5	4.2	4.5	5.4	0.9	6.5	7.2	3.9	4.1	1.6	0.7	4.6	5.1	1.9	3.0	1.6	3.3
Singapore	7.6	3.2	2.2	2.3	5.0	2.2	-1.6	-1.7	-0.7	145.9	133.6	132.9	18.1	19.3	17.8	6.8	2.4	8.5	4.5	8.9	5.0	19.6	2.4	3.8	4.5	-2.9	2.7	11.6	6.2	5.9	13.6	3.7	2.4
Spain	5.1	4.5	3.6	3.1	7.1	2.0	-6.9	-4.6	-4.2	146.0	140.8	136.8	0.9	0.8	1.5	14.7	12.0	2.1	4.6	2.2	5.1	4.3	7.5	5.1	3.1	1.4	1.2	3.8	1.7	4.5	7.3	2.2	2.9
South Africa	4.9	2.1	1.3	4.5	6.2	4.6	-5.2	-6.2	-5.3	68.6	69.3	72.8	3.7	2.0	0.5	10.0	7.7	-0.5	5.6	1.6	0.8	0.2	8.6	5.7	0.6	1.5	0.3	5.6	1.6	0.8	7.3	3.4	2.1
South Korea	4.0	2.5	2.4	2.5	5.1	2.1	-1.5	-1.1	-0.7	51.7	54.2	53.1	4.9	2.0	2.3	9.9	6.6	2.7	3.6	2.8	2.8	2.5	-0.2	4.6	5.6	2.9	1.6	5.9	1.3	3.0	7.3	3.7	2.4
Sweden	4.9	2.1	2.1	2.2	5.3	2.3	-0.2	-0.7	-0.4	48.3	46.3	44.7	5.5	3.9	4.4	7.6	4.9	2.3	6.1	3.4	2.1	5.9	0.9	2.9	2.6	0.5	1.9	6.1	1.3	0.5	7.3	1.7	2.3
Switzerland	3.7	2.5	1.4	0.6	2.5	0.9	-0.7	0.2	0.3	28.0	26.5	25.6	8.1	5.8	7.5	11.6	4.3	4.1	2.6	3.6	2.0	3.4	1.8	3.8	4.0	-0.5	-1.4	4.1	-1.6	1.2	10.2	5.9	3.0
Turkey	11.0	3.0	2.0	19.6	69.4	29.0	-2.3	-1.4	-1.7	38.1	31.3	28.1	-1.8	-6.6	-1.9	24.9	8.3	6.3	15.1	5.1	-1.5	6.4	-2.2	0.7	2.1	-0.4	3.8	16.4	2.9	-1.6	16.5	4.8	0.9
United Kingdom	7.4	3.6	1.3	2.6	8.6	4.2	-8.4	-4.9	-2.9	102.8	97.8	96.5	-2.6	-5.2	-3.3	-1.3	6.2	7.8	6.2	3.8	0.6	5.9	6.2	2.7	14.3	1.7	2.8	4.3	-0.3	1.4	5.1	1.6	1.6
United States	5.7	2.6	1.8	4.7	7.6	2.3	-11.8	-4.6	-5.3	150.6	143.2	142.7	-3.6	-4.6	-4.3	4.5	6.0	6.6	7.9	3.5	2.2	6.1	2.2	1.8	1.0	-0.7	0.7	12.2	-0.9	0.8	5.5	5.9	1.4
Eurozone	5.3	2.9	2.5	2.6	6.7	1.5	-5.2	-3.5	-2.8	-	-	-	2.4	0.9	0.9	10.8	4.6	3.4	3.6	3.6	3.5	4.1	3.2	3.8	3.9	1.4	1.0	5.1	1.1	0.9	7.8	0.7	4.5

Sources: Oxford Economics, Atradius

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Atradius N.V.
David Ricardostraat 1 – 1066 JS Amsterdam
Postbus 8982 – 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111

info@atradius.com
www.atradius.com