Spring 2022 Economic Forecast: Russian invasion tests EU economic resilience

Brussels, 16 May 2022

The outlook for the EU economy before the outbreak of the war was for a prolonged and robust expansion. But Russia’s invasion of Ukraine has posed new challenges, just as the Union had recovered from the economic impacts of the pandemic. By exerting further upward pressures on commodity prices, causing renewed supply disruptions and increasing uncertainty, the war is exacerbating pre-existing headwinds to growth, which were previously expected to subside. This has led the European Commission to revise the EU’s growth outlook downwards, and the forecast for inflation upwards.

Slowdown in growth as war exacerbates pre-existing headwinds

EU GDP is projected to remain in positive territory over the forecast horizon, thanks to the combined effect of post-lockdown re-openings and the strong policy action taken to support growth during the pandemic. Namely, the post-pandemic re-opening of contact-intensive services, a strong and still improving labour market, lower accumulation of savings and fiscal measures to offset rising energy prices are set to support private consumption. Investment is set to benefit from the full deployment of the Recovery and Resilience Facility and the implementation of the accompanying reform agenda.

Real GDP growth in both the EU and the euro area is now expected at 2.7% in 2022 and 2.3% in 2023, down from 4.0% and 2.8% (2.7% in the euro area), respectively, in the Winter 2022 interim Forecast. The downgrade for 2022 must be read against the background of the growth momentum gathered by the economy in spring and summer last year, which adds around 2 percentage points to the annual growth rate for this year. Output growth within the year has been reduced from 2.1% to 0.8%.

The main hit to the global and EU economies comes through energy commodity prices. Although they had already increased substantially before the war, from the low levels recorded during the pandemic, uncertainty about supply chains has pressured prices upwards, while increasing their volatility. This is true for food and other basic goods and services, with households’ purchasing power declining.

War-induced logistics and supply chain disruptions, as well as rising input costs for a broad array of raw materials, add to the disturbances in global trade caused by the drastic COVID-19 containment measures still applied in parts of China, weighing on production.

Energy prices drive inflation to record highs

Inflation has been picking up momentum since early 2021. From 4.6% year-on-year in the last quarter of 2021 it went up to 6.1% in the first quarter of 2022. Headline inflation in the euro area surged to 7.5% in April, the highest rate in the history of the monetary union.

Inflation in the euro area is projected at 6.1% in 2022, before falling to 2.7% in 2023. For 2022 as a whole, this represents a considerable upward revision compared to the Winter 2022 interim Forecast (3.5%). Inflation is expected to peak at 6.9% in the second quarter of this year and decline gradually thereafter. For the EU, inflation is expected to increase from 2.9% in 2021 to 6.8% in 2022, and fall back to 3.2% in 2023. Average core inflation is projected above 3% in 2022 and 2023 in both the EU and the euro area.

Strong and still improving labour market

The labour market is entering the new crisis on a strong footing. In 2021, more than 5.2 million jobs were created in the EU economy, which attracted nearly 3.5 million more people into the labour market. In addition, the number of unemployed decreased by nearly 1.8 million people. Unemployment rates at the end of 2021 fell below previous record lows.

Labour market conditions are expected to improve further. Employment in the EU is projected to grow by 1.2% this year, though this annual growth rate is spurred by the strong momentum in the
second half of last year. People fleeing the war in Ukraine to the EU are expected to enter labour markets only gradually, with tangible effects only becoming visible from next year.

Unemployment rates are forecast to decline further, to 6.7% this year and 6.5% in 2023 in the EU and to 7.3% and 7.0% in 2022 and 2023 respectively in the euro area.

**Government deficits continue declining but war-related costs rising**

Despite the costs of measures to mitigate the impact of high energy prices and to support people fleeing Ukraine, the aggregate government deficit in the EU is set to decline further in 2022 and 2023 as temporary COVID-19 support measures continue to be withdrawn. From 4.7% of GDP in 2021, the deficit in the EU is forecast to fall to 3.6% of GDP in 2022 and 2.5% in 2023 (3.7% and 2.5% in the euro area).

After decreasing in 2021 to around 90% (97% in the euro area) from the historic peak of almost 92% of GDP in 2020 (almost 100% in the euro area), the aggregate debt-to-GDP ratio of the EU is forecast to decline to around 87% in 2022 and 85% in 2023 (95% and 93% in the euro area, respectively), remaining above the pre-COVID-19 level.

**Uncertainty and risks depend on the evolution of the war**

Risks to the forecast for economic activity and inflation are heavily dependent on the evolution of the war, and especially on its impact on energy markets.

Given the high uncertainty, the baseline forecast is accompanied by a model-based scenario analysis that simulates the impact of higher energy commodity prices, as well as of an outright cut in gas supply from Russia. In this latter, more severe scenario, GDP growth rates would be around 2.5 and 1 percentage points below the forecast baseline in 2022 and 2023, respectively, while inflation would increase by 3 percentage points in 2022 and by more than 1 in 2023, above the baseline projection.

On top of such potential disruptions in energy supply, worse than expected problems in supply chains and further increases in non-energy commodity prices, especially food, could lead to additional downward pressures on growth, and upward pressures on prices. Greater than expected second round effects in the face of an imported inflationary shock could compound stagflationary forces. Strong inflationary pressures also come with increased risks to financing conditions. Finally, COVID-19 remains a risk factor.

Beyond these immediate risks, Russia’s invasion of Ukraine is leading to an economic decoupling of the EU from Russia, with consequences that are difficult to fully apprehend at this stage.

**Members of the College said:**

Valdis Dombrovskis, Executive Vice-President for an Economy that Works for People said: "There is no doubt that the EU economy is going through a challenging period due to Russia's war against Ukraine, and we have downgraded our forecast accordingly. The overwhelming negative factor is the surge in energy prices, driving inflation to record highs and putting a strain on European businesses and households. While growth will continue this year and next, it will be much more subdued than previously expected. Uncertainty and risks to the outlook will remain high as long as Russia's aggression continues. But there are some positives that allow us to weather this crisis. Our economic fundamentals are solid: before this war started, the EU economy had embarked on a path of strong recovery and growth. More jobs are being created in the EU economy, attracting more people into the labour market and keeping unemployment low. And as Member States put their recovery and resilience plans into full effect, this will provide a much-needed boost to our economic strength."

Paolo Gentiloni, Commissioner for Economy said: "Russia's invasion of Ukraine is causing untold suffering and destruction, but is also weighing on Europe's economic recovery. The war has led to a surge in energy prices and further disrupted supply chains, so that inflation is now set to remain higher for longer. Last year's strong economic rebound will have a lingering positive effect on growth rates this year. A strong labour market, post-pandemic reopening and NextGenerationEU should provide further support to our economies and help to drive public debt and deficits lower. This forecast is however subject to high uncertainty and risks that are closely linked to the development of Russia's war. Other scenarios are possible under which growth may be lower and inflation higher than we are projecting today."

**Background**

This forecast is based on a set of technical assumptions concerning exchange rates, interest rates and commodity prices with a cut-off date of 29 April. For all other incoming data, including assumptions about government policies, this forecast takes into consideration information up until, and including, 29 April. Unless new policies are announced and specified in adequate detail, the projections assume no policy changes.
The European Commission publishes two comprehensive forecasts (spring and autumn) and two interim forecasts (winter and summer) each year. The interim forecasts cover annual and quarterly GDP and inflation for the current and following year for all Member States, as well as EU and euro area aggregates.

The European Commission's Summer 2022 Economic Forecast will update GDP and inflation projections and is expected to be presented in July 2022.

For More Information

Full document: Spring 2022 Economic Forecast

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