Autumn Forecast 2021

UNDER EMBARGO UNTIL DELIVERED

BY COMMISSIONER GENTILONI –

CHECK AGAINST DELIVERY

From recovery to expansion, amid headwinds

- Press Speaking Points -

[slide 1]: Introduction slide [for spokesperson]

- Good morning and welcome to this press conference on the European Commission's Autumn 2021 Economic Forecast.
- I will give the floor immediately to Commissioner Gentiloni.

[slide 2]: Key messages from the Autumn 2021 Economic Forecast

Let me begin with the five key messages emerging from this forecast:

- **First, the EU economy is set to expand strongly over the forecast horizon.** We forecast the EU economy to grow by **5% this year** and to keep a solid pace of growth of **4.3% next year** before easing to **2.5% in 2023.**
- Disruptions in global logistics and shortages of several raw and intermediate inputs have been increasingly weighing on activity in the EU. Still, strong domestic demand is expected to continue fuelling the expansion in the EU.
- An improving labour market, decreasing household saving rates, favourable financing conditions and the full deployment of the Recovery and Resilience Facility are set to propel the economic expansion. Foreign demand is also expected to be supportive of growth.

- **Second, labour markets are set to recover and move into expansion.** With economic activity expected to keep growing, employment should increase above pre-pandemic levels and the unemployment rate should decrease to 6.5% in 2023.

- **Third, inflation is expected to start easing next year.** Recent increases in inflation are, to a large extent, linked to the fading forces that dragged inflation lower during the pandemic. Strong demand following the re-opening of economies, compounded by supply bottlenecks and higher energy prices, add to current inflation developments. These developments can be largely linked to the post-pandemic economic adjustments and are expected to be largely transitory.
- Inflation in the EU is expected to peak at **2.6% this year** before easing slightly to **2.5% next year** and **1.6% in 2023.**

- **Fourth, government deficits are forecast to narrow marginally this year – to 6.6% for the EU as a whole – as many Member States continue to provide high levels of support to households and firms.** As the economy expands, many governments have started to phase out the emergency support measures and revenues have started to rebound. The aggregate budget deficit should nearly halve to **3.6% next year**, and reduce further to **2.3% in 2023**.

- The aggregate debt-to-GDP ratio is projected to peak at **92% in the EU this year (100% in the euro area)** to start declining in 2022, reaching **89% of GDP in 2023 (97% in the euro area).**

- **And fifth, uncertainty remains substantial, and the risks to the outlook are tilted to the downside.** The recovery continues to be heavily dependent on the evolution of the pandemic, both within and outside the EU. Furthermore, the economic headwinds that I spoke about add to downside risks. By contrast, domestic demand may prove stronger than expected, as we witnessed in the spring.

[slide 4]: The EU economy is moving from recovery to expansion

- **The strong rebound in the second and third quarters of this year pushed the EU economy back to around its level of the last quarter of 2019.** This happened one quarter earlier than we expected last May, when I presented our Spring Forecast.

- **The EU economy is now expected to expand and converge to the steady growth path it was set to follow before the pandemic by early 2023.** This outlook is an extraordinary achievement. It is of course, subject to a number of risks, which I will elaborate on **in a few moments.**

[slide 4]: Domestic demand set to be the main growth driver

- **Domestic demand is expected to pull the EU economy through these headwinds.** The Commission's October business surveys tell us that economic sentiment increased slightly in all main sectors except construction.

- **Growth is expected to be led by consumer spending.** An improving labour market is set to strengthen household incomes, and fading uncertainty should support a further reduction in household savings.

- **Investment is set to benefit from strong demand growth, favourable financing conditions, dissipating uncertainty and an increasing contribution from the Recovery and Resilience Facility** and the need for technology upgrading of course**.** Inventory rebuilding should also be an important driver of demand.

- **Foreign demand is also expected to contribute positively to growth over the forecast horizon.** The global economy is expected to rebound strongly this year and to continue expanding in the next two years, albeit at a more moderate pace and with quite divergent paths.

[slide 5]: Labour market recovery set to continue

- **The labour market recovery is set to continue. The lifting of restrictions during the second quarter led to a marked improvement in labour market conditions.** The second quarter saw about 1.5 million new jobs and a swift rebound in hours worked, also as many workers exited job retention schemes.

- **Since then, the EU unemployment rate has declined further.** At 6.7% in September it stood just above the rate recorded at the end of 2019. Dynamic economic activity is further stimulating labour demand and pockets of labour shortages are clearly emerging, particularly in sectors where activity is surging most. **Overall:**

    - The **unemployment** rate in the EU is expected to remain at **7.1% this year** and to decrease to the pre-pandemic rate of **6.7% in 2022** and further decrease to **6.5% in 2023.**

    - **Employment** in the EU is projected to grow by **0.8% this year, 1% next year** (when the pre-pandemic level will be exceeded) and **0.6% in 2023**.

- **But of course we should not forget that the jobs rebound is not happening evenly across sectors and economies.** So the risk of worsening inequality between genders, age groups and sections of society remains real.

[slide 6]: Current account surplus to increase steadily

- **After a period of downward adjustment – an adjustment that contributed to the reduction of global imbalances – the current account surplus as a percentage of GDP** is forecast to return to the pre-pandemic level of 3% already this year. In 2023, the surplus is projected to widen to 3.2% of GDP.

- **With the expected revival of tourism, a widening surplus in the services account is set be the main contributor.** In addition, the return on EU investment abroad should recover along with the recovery in global earnings.

[slide 7]: Growth momentum now facing headwinds

- **A strong rebound of the EU economy following the re-opening in the second quarter is now facing headwinds.** The preliminary flash estimate of GDP growth in the EU confirmed an ongoing recovery in the third quarter. GDP in the EU has virtually closed the gap with its pre-pandemic output level.
- **However, the improving health situation, which allowed the economy to bounce back, is now being challenged by rising infections across the Union.** Since the beginning of October, the 14-day average incidence of infections in the EU has recorded the highest level since mid-May.
- Developments across countries as you know are highly heterogeneous with the strongest increases reported in countries with below EU-average vaccination rates. For now, hospitalisations and deaths associated with COVID-19 infections remain low compared to previous waves. But they are slowly rising, posing a risk to economic prospects.
- **As I said at the beginning, global supply chain disruptions increasingly weigh on production in the EU countries.** Manufacturing, in particular, is being held back by production input

shortages, delays in input delivery and increased strains on available production capacity.

- Our October business surveys point to unprecedented shares of managers in industry and construction identifying **shortages of material and equipment** as a factor limiting their activity. In addition, in these surveys the share of managers quoting **shortage of labour force** as a factor limiting business rose to all-time highs in industry.
- **Surging energy prices, most notably for natural gas and electricity, are also expected to dampen the growth momentum in the short term.**

[slide 8]: Inflation expected to start easing next year

- **The strong rebound of the economy has been accompanied by a pick-up in inflation, exceeding expectations**. Annual inflation in the euro area hit 4.1% in October. This swift increase reflects strong base effects, increases in energy prices and supply discruptions. Price increases have also become more broad-based, resulting in higher core inflation. Headline inflation excluding energy and unprocessed food reached 2.1% in October.

- **Looking into the near future, inflation is set to continue to score high but will progressively ease in the course of 2022**. Being to a large extent linked to the post-pandemic re-opening and ensuing economic adjustment, the current elevated price pressures are still expected to be largely transitory. This is corroborated in particular by gas and electricity market participants who expect prices to ease over the coming year after peaking this winter.

- **Overall, inflation in the EU is expected to reach 2.6% in 2021 and to moderate slightly to 2.5% in 2022 and 1.6% in 2023.**

- **In the euro area, it is expected to reach 2.4% in 2021 and to moderate to 2.2% in 2022 and 1.4% in 2023.**

[slide 9]: European growth map 2021 & 2022

- **This year, all EU Member States are set to rebound after last year's recession.** And like that recession, the rebound will be uneven across countries. Most Member States are expected to reach the pre-pandemic volume of output by year-end while a few countries will take longer.
- A few words now on the largest EU economies, as usual.
- **Germany's** GDP rebounded in the second and third quarters as the easing of containment measures spurred spending on services. However, supply bottlenecks are slowing down manufacturing and putting a lid on the rebound of exports and investment. So growth is projected at a modest **2.7% this year**, and is set to reach **4.6% in 2022** before moderating to **1.7% in 2023**.
- In **France**, economic activity is forecast to rebound by **6.5% in 2021**, reaching its pre-crisis level by the end of this year. The third quarter growth rate was particularly strong thanks to largely eased restrictions. Growth is expected to remain solid in **2022 and 2023 at 3.8% and 2.3%** respectively.

- For **Italy**, real GDP is projected to increase by **6.2% this year**. The economy rebounded strongly in the second and third quarters thanks mainly to consumer services. Growth is set to continue at a robust pace of **4.3% in 2022** thanks to easing supply shortages and RRF-supported investments and reforms. GDP is set to expand by 2.3% in 2023, a growth rate still sizeably above the long-term average.

- In **Spain**, growth is projected at **4.6% this year**, below our Summer expectations. However, Spain's GDP is expected to remain on a very strong growth path over the next two years, also thanks to the implementation of the RRF. Growth is projected at **5.5% in 2022** and at **4.4% in 2023**.

- Finally, in **Poland** the economy is expected to embark on a solid expansion after a mild recession last year. GDP growth is expected at **4.9% in 2021**, **5.2% in 2022** and **4.4% in 2023**.

[slide 10]: Lower deficits, higher investment

- **The EU's aggregate deficit is forecast to narrow only marginally in 2021**, to **6.6% of GDP**, on the back of the still high level of support provided to households and firms. As the economy moves from recovery to expansion, the unwinding of the emergency support measures and the rebound in revenues are forecast to roughly halve the aggregate budget deficit to around **3.6 % of GDP in 2022**, and to reduce it further to **2.3% in 2023**.

- The aggregate debt-to-GDP ratio is projected to peak at **92% in the EU this year, declining and reaching 89% of GDP in 2023, when it will be 97% in the euro area**.

- **While deficits are set to narrow, the EU aggregate public investment-to-GDP ratio is projected to increase over the forecast horizon reaching 3.5% in 2023**. A large part of this increase is related to investment financed by the EU, especially the RRF. At the same time, almost all Member States are expected to spend more on public investment than they did before the pandemic. And this is one of the lessons learned also from previous crises.

[slide 11]: Impact of the Recovery and Resilience Facility

- The autumn forecast incorporates the impact of the RRF for all Member States with a more accurate estimate of its impact than in spring and summer, on the working assumption of a timely completion of milestones and targets. **Let me underline that these working assumptions do not pre-judge the outcomes of future Commission and Council decisions. So these working assumptions are there for all Member States despite the fact that for some Member States we are not yet approving the plans.**

- **Overall, total expenditure assumed to be financed by RRF grants amounts to around 215 billion euros over the period 2020-2023, or 1.5% of the EU's 2019 real GDP.** This is close to 65% of the total RRF grant allocation, the lifetime of which extends until 2026. This implies that on average, Member States count on fast absorption of their RRF allocation.

- **As suggested by the assumed absorbtion rates across countries, the RRF strongly supports convergence.** A larger share of the allocation is directed towards the more indebted southern and lower income eastern Member States and for these the economic impact is significantly higher. But even Member States which receive a low share of grants benefit from significant positive cross-border spillovers. So we have calculated the impact also for countries receving a lower amount of grants from the RRF. These account for around one-third of the impact on average.
- **Over the medium term, model simulations conducted by the Commission show that Next Generation EU could increase EU GDP by up to 1.5% during its years of active operation.** These simulations cover investments only and do not include the positive impact of structural reforms, which can substantially increase growth in the long run.

[slide 12]: Budgetary outlook 2021 & 2022

- **Improved growth prospects point to lower 2021 public deficits than expected in spring.** However, in most Member States, the deficit is projected to still exceed 3% of GDP in 2021. The only exceptions being Denmark, Luxembourg and Sweden, with very low levels of deficit.

- **By the end of the forecast horizon, under a no policy change assumption, ten countries are still forecast to have a deficit above 3% of GDP.**

- In 2021, debt-to-GDP ratios are projected to start declining in around half of Member States, and continue decreasing in almost all EU countries thereafter.

- At the end of 2023, the debt ratio is expected to remain above 100% of GDP in six Member States, up from three at the end of 2019.

[slide 13]: Risks tilted to the downside

- Again a few words on the risks to the downside. We have a very positive outlook but a quite high level of uncertainty.

- **A reintroduction of restrictions would impact economic activity, though to a much lesser degree than in the past.** So if we will have a reintroduction of restrictions, and for the moment we are seeing them in a very, very limited way, in any case this will have a lower impact than in the past. This risk is particularly relevant in Member States with relatively low vaccination rates.

- **Economic risks also relate to the potential protracted impact of the current supply constraints and bottlenecks**. Energy and commodity prices could also remain high for longer, pushing production costs further up and weighing on investment and consumption. Should such risks materialise, any premature withdrawal of policy support could worsen the economic situation.

- **And inflation may turn out higher than forecast** if supply constraints are more persistent and above-productivity wage increases are passed on to consumer prices. So these are the downside risks.

- **As always we have also upside risks to the forecast**. D**omestic demand could be more vigorous than projected.** Consumers could spend more of the large stock of savings accumulated during the lockdown periods while investments fostered by the RRF could generate a stronger impulse to activity.

- In particular, decarbonisation along with broader pandemic-induced structural shifts favouring the digital transformation, could lead to a faster reallocation of resources spurring strong efficiency gains and durable productivity advances.

- **In conclusion, the overall picture remains a positive one, confirming th large achievements that our national and European response reached.** But we must remain vigilant and act as needed to ensure these headwinds do not blow the recovery off course. Continued, albeit more targeted, support from governments and the EU will remain essential for the European economy to progress towards strong and sustainable growth.

- **Now thank you and I'm looking forward to taking your questions.**

[Slide 15: Growth Map again, as backdrop for the Q&A]