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European Economic Forecast

Winter 2023

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European Commission
Directorate-General for Economic and Financial Affairs

European Economic Forecast

Winter 2023

EUROPEAN ECONOMY Institutional Paper 194

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EU ECONOMY SET TO AVOID RECESSION, BUT HEADWINDS PERSIST

This Winter interim Forecast lifts the outlook for growth and slightly lowers the inflation projections. Growth for 2022 is now estimated at 3.5% in both the EU and the euro area. GDP is projected to expand by 0.8% in 2023 and 1.6% in 2024 (0.9% and 1.5% in the euro area). Headline inflation in the EU is forecast to fall from 9.2% in 2022 to 6.4% in 2023 and 2.8% in 2024. In the euro area, it is projected to decelerate from 8.4% in 2022 to 5.6% in 2023 and to 2.5% in 2024.

Since autumn, the EU economy has seen a number of positive developments. The European gas benchmark price has fallen below its pre-war level, helped by a sharp fall in gas consumption and continued diversification of supply sources. Despite the energy shock and ensuing record high inflation, the slowdown in the third quarter turned out milder than previously estimated and in the fourth quarter, the EU economy managed a broad stagnation, instead of the 0.5% contraction expected in autumn. Labour markets have also continued to perform strongly, with the unemployment rate in the EU remaining at its all-time low of 6.1% in December. Three months of falling inflation rates confirm that, as projected in autumn, the peak is now behind us. Finally, economic sentiment has continued improving, suggesting that economic activity will avoid a contraction also in the first quarter of 2023. The EU economy is thus set to narrowly escape the recession that was pencilled in back in autumn.

Yet the EU economy is still beset with challenges. Core inflation increased further in January. Consumers and businesses continue to face high energy costs, and with more than 90% of the core items in the HICP basket registering above-average price increases, inflationary pressures are still broadening. Monetary tightening is therefore set to continue, exerting a drag on investment. Weakness in consumption is set to persist in the near term as inflation keeps outpacing nominal wage growth. Finally, the external environment is expected to continue providing little support.

All in all, recent developments do not warrant a substantial upward revision to the growth profile that was projected in autumn for 2023 and 2024. Still, with higher momentum from last year carrying over to 2023 and slightly better growth projected in the current quarter, by the end of the forecast horizon the volume of output is set to be almost 1 percent above that projected in autumn. Inflation is projected to end 2024 a notch above target, as in autumn.

While uncertainty surrounding the forecast remains high, risks to growth are broadly balanced. Domestic demand could turn out higher than projected if the recent declines in wholesale gas prices pass through to consumer prices more strongly. Yet, a potential reversal of that fall cannot be ruled out in the context of Russia's war against Ukraine and other geopolitical tensions. External demand could also turn out to be more robust following China's re-opening, which could, however, fuel global inflation. Risks to inflation remain largely linked to developments in energy markets in the short run, but upside risks dominate in outer quarters, as a still tight labour market could result in stronger than anticipated wage pressure.

Table 1:
Overview - the Winter 2023 interim Forecast

	Real GDP growth						Inflation					
	Winter 2023 interim Forecast			*Autumn 2022 Forecast*			Winter 2023 interim Forecast			*Autumn 2022 Forecast*		
	2022	2023	2024	*2022*	*2023*	*2024*	2022	2023	2024	*2022*	*2023*	*2024*
Euro area	3.5	0.9	1.5	*3.2*	*0.3*	*1.5*	8.4	5.6	2.5	*8.5*	*6.1*	2.6
EU	3.5	0.8	1.6	*3.3*	*0.3*	*1.6*	9.2	6.4	2.8	*9.3*	*7.0*	3.0

1. EURO AREA AND EU OUTLOOK

1.1. SETTING THE SCENE

Almost one year after Russia launched its war of aggression against Ukraine, the EU economy is on a better footing than expected in autumn. The Autumn Forecast projected a shallow contraction of the EU economy in the fourth quarter of 2022 and the first quarter of this year. Headwinds unleashed by the war and in particular the energy crisis were then expected to continue dampening demand in the first half of 2023. As inflation was forecast to progressively loosen its grip on the economy, growth was projected to resume in spring and gradually pick up pace in 2024. While the expected slowdown in economic activity has occurred, and inflation remains very high, data revisions and favourable economic developments since the release of the Autumn Forecast motivate a reassessment of the economic outlook. In particular, the combination of new upside and old downside factors indicate that the EU economy should avoid the previously projected economic recession and raise the question of whether it can look forward to better growth prospects over the forecast horizon. For inflation, the question is whether the recent decline in energy prices will continue, despite the assumed continued geopolitical tensions, and pressures on core inflation will abate.

An only mild slowdown in economic activity in the second half of last year points to resilience of the EU economy, against exceptionally adverse shocks. Following robust expansion in the first half of last year, real GDP growth in the third quarter decelerated as expected. The deceleration was however milder than projected. Real GDP grew by 0.3% q-o-q in both the EU and the euro area, which is 0.1 pps. higher than the preliminary flash estimate that had been incorporated into the Autumn Forecast. The drag from falling real wages was more than offset by still growing employment, large fiscal support and a further decrease in the household saving rate, allowing household consumption to expand further. Investment also increased marginally, while net exports detracted from growth. In the fourth quarter, Eurostat's preliminary flash GDP estimate suggests that the EU economy narrowly escaped the contraction that was anticipated in autumn. The milder than expected slowdown in growth momentum in the second half of last year translates into a better starting position for this year. For the current quarter, the PMI for January entered expansionary territory for the first time in six months, and the Commission Economic Sentiment Indicator improved further, but remained below its long-term average, especially for consumers.

Inflation appears to have peaked and favourable developments in energy markets foreshadow further forceful declines. Three consecutive months of moderating inflation suggest that the peak in inflation is now behind us. Moderation was mainly driven by the energy component, while core inflation was still trending up. Favourable developments in energy markets herald continued decline. The European gas benchmark price has fallen well below pre-war level, helped by lower consumption and continued diversification of supply sources. With hindsight, the resilience of households and corporations, including energy intensive industries, has been impressive: EU gas consumption in November was a whopping 25% below the five-year seasonal average for that month. As a result, at the cut-off date of this forecast, gas inventories were only marginally below their level at the beginning of the heating season, and above seasonal average, implying lower refilling needs going forward. Futures on the TTF were trading substantially lower than in autumn, though still more than three times higher than 2019 prices. Oil prices have also been falling, appeasing concerns over potential adverse effects of the ban on seaborne crude flows from Russia and the oil price cap put in place in December. The picture for prices of non-energy commodities is more mixed. Prices of a broad array of agricultural commodities have come down from previous highs, while those of industrial metals moved up again after a long downward adjustment, possibly reflecting expectation of resuming construction activity in China.

Developments in China and the US point to a moderately improved outlook compared to just a few weeks ago. The Autumn Forecast expected the global outlook for growth and trade to be subdued and of little support to the EU economy. The sharp rise in infections in the wake of China's turnaround in its "zero COVID-19" policy might have contributed to the observed weakness of demand in the fourth quarter. Yet, expectations of a rebound in mobility within and outside China, after several years of strict containment policies, warrant a reassessment of the growth outlook. Supply chain disruptions, which had already eased substantially, are set to further abate in the absence of intermittent localised lockdowns. The US economy performed better than expected in the second half of last year. It remains to be seen to what extent recent developments translate into a more supportive external environment than in autumn.

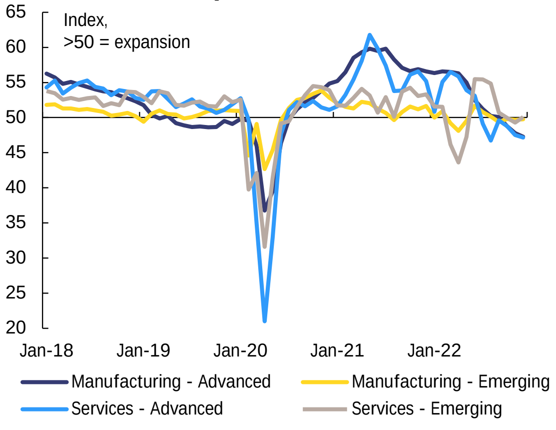
Headwinds holding back the EU economy remain strong. While the easing of energy inflation is good news for households, real wages are set to continue falling in the short term and recoup part of the lost purchasing power only in later quarters, as wage growth outpaces declining inflation. With a still strong labour market and rising core inflation, markets now expect policy rates to peak by mid-year at a slightly higher level than expected in autumn. The impact of previous rises is already visible in slowing credit flows, and more is to come. While uncertainty has somewhat decreased, it remains elevated in historical perspective. These developments are inevitably set to weigh on investment and consumption alike. While the external environment appears marginally better than a few months ago, a stronger euro will weigh on exports. Last, but not least, geopolitical tensions caused by Russia's aggression against Ukraine have not eased and the working assumption underpinning this forecast is again that they will not be resolved within the forecast horizon. It is also assumed that the overall number and geographical distribution of people fleeing the war in Ukraine will not change materially over the forecast horizon.

1.2. THE GLOBAL ECONOMY: RECENT DEVELOPMENTS AND OUTLOOK

After largely stagnating in the first half of 2022, global economic activity picked up in the third quarter, but signs of renewed weakness emerged at the end of the year. Global growth is estimated to have picked up to 1.3% q-o-q in the third quarter of 2022, after showing little advance over the first half of the year. The improvement was mainly driven by the US and particularly China, though some other emerging economies also saw a modest uptick. In the US, GDP grew by 0.8% q-o-q in 2022-Q3, after a small contraction (-0.1%) in the previous quarter. In China it grew by 3.9% q-o-q, rebounding from the 2.9% q-o-q contraction in 2022-Q2, when many areas, including Shanghai, saw lockdowns to control COVID-19 outbreaks. Among other emerging market economies (EMEs), India, South Africa, and Argentina also saw some improvement in the third quarter of 2022. Data for the final quarter of the year is only available for a small number of economies. In the US, the pace of growth was largely unchanged, at 0.7% q-o-q, whereas the Chinese economy flat-lined.

Survey indicators (PMIs) remain consistent with falling momentum heading into 2023. Global PMIs for manufacturing and services edged down steadily in 2022 from their peak in February, before the Russian invasion of Ukraine, and moved into contractionary territory over the summer. The global manufacturing PMI fell from 52.2 in June to 48.6 in December, while over the same period the services PMI fell from 53.9 to 48.1 (see Graph 1.1). In December, the PMIs for emerging economies were a little higher for emerging economies in both manufacturing and services (at 49.8 and 50.1 respectively) than for advanced economies (47.3 and 47.2). January global PMIs, released after the cut-off date of the forecast, confirm the loss in momentum, but do not suggest a sharp global slowdown. The global manufacturing PMI remained in contractionary territory but picked up a little to 49.1, while the global services PMI recovered to 50.1.

Graph 1.1: **Global PMIs**



Source: S&P Global.

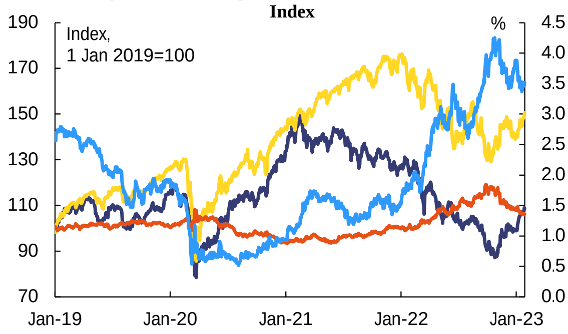
The advanced economies are expected to see a marked slowdown in 2023. The steady growth pace recorded by the US economy in the last quarter of 2022 came with a clear slowdown in fixed investment, offset by a large inventory component and a stronger contribution from net trade. Annual growth for the US economy in 2022 is estimated at 2.1%. Recent high frequency indicators point to contraction in manufacturing, slower growth in services, and a sharp slowdown in housing starts, sales and prices. Growth in 2023 is nevertheless projected to be slightly higher than in autumn, at 1% (+0.3 pps), due to the stronger carry-over from 2022. In 2024, growth is projected to reach 1.6% (-0.1 pps). A tight labour market, with the unemployment rate hovering around historically low levels, and still high services inflation raised the Fed's concerns over persistence of inflation. The Federal Open Market Committee members expect further target rate increases to just above 5% in mid-2023, following the steep increase from 0.25% in March 2022 to 4.5% in December. Market expectations are however not fully in line, as they are pricing in rate cuts already as from mid-2023, and the yield curve is heavily inverted. Prospects for most other advanced economies (e.g. UK, Canada, Switzerland, South Korea) are also for a slowdown in 2023 before a modest pick-up in 2024. On aggregate, growth in advanced economies (outside the EU) is expected to fall from an estimated 2.5% in 2022 to 1.3% in 2023, and then recover to 1.7% in 2024. The projected slowdown this year is less severe than estimated in autumn when only a 0.9% growth was expected.

The change in COVID-**19 policy improves China's growth prospects, despite short**-term disruptions. Stagnation in the fourth quarter of 2022 came on the back of downbeat consumer sentiment and surges in infections. The relaxation of containment measures as from December led to a sharp increase in new infections and reported deaths, but mobility and transport indicators point to a gradual normalisation towards the end of December and in January. The surge in infections may still weigh on activity in the first quarter of 2023, but the availability of wider opportunities to spend is expected to boost private consumption thereafter. Construction activity is also expected to recover gradually from the current very low levels, as stalled projects are resumed. Nevertheless, China's economy remains burdened by high corporate and local government debt, and by declining demographics, while disruption in the real estate sector will continue to weigh on growth over the forecast horizon. Consumer price inflation fell below 2% in 2022-Q4, from around 2.5% in the previous quarter. Overall, after an estimated annual growth of 3.0% in 2022, the forecast for Chinese growth in 2023 has been revised upwards to around 5%, +0.5 pps compared to the Autumn Forecast, and is unchanged for 2024 at 4.7%.

Other emerging markets remain under pressure from high energy and food prices and are facing slowing demand from advanced economies. Growth in emerging markets other than China is projected to slow a little in 2023, before picking up modestly in 2024. Outside of China, growth in emerging Asia is likely to edge down in 2023 and see little improvement in 2024. In Latin America, the largest economies (Argentina, Brazil, Mexico) are all projected to slow sharply in 2023 and see limited recovery in 2024. Sub-Saharan Africa is expected to grow in 2023 and 2024 at around 3.5%, a similar pace to 2022, though per capita income growth is likely to be small, given the rapidly growing population. Russia's economy is also projected to contract further in 2023, with depressed consumption and weak exports, reflecting the EU ban on crude oil and refined oil products and the G-7 price caps. A limited recovery is expected in 2024, with labour supply adversely affected both by army mobilisation and emigration, and with continued challenges in the supply of critical goods and components. In 2022, inflation outside the EU reached levels not seen for decades, but the peak appears to have passed. Inflationary pressures remain in the major advanced economies with tight labour markets and high core inflation (e.g. US, UK, Canada, and South Korea). Recent readings, however, suggest that headline inflation has peaked. In emerging economies, it has also started to fall, though core inflation remains elevated. Headline and core inflation in both advanced and emerging economies are expected to ease further in 2023 on the back of declining global commodity prices, easing logistical constraints and the slowdown in global goods demand.

Global financial conditions tightened steeply in 2022, but eased a little towards the end of the year. Many emerging markets started to tighten their monetary policy in early or mid-2021, with advanced economies following suit from early 2022 as inflation picked up. The US dollar appreciated sharply in 2022 against almost all currencies, while portfolio capital flows to most emerging economies dried up as markets shifted to a “risk-off” stance and were strongly negative for China. Global financial conditions remain tight, but have eased since November, with US ten-year yields dropping back by around 50 bps. and the USD depreciating by almost 10% (see Graph 1.2). Sovereign yields in emerging markets have also edged down since November, and EME bond issuance, which fell off sharply in 2022, picked up strongly in January 2023. Equity markets in both advanced economies and emerging economies have also moved up in recent months.

Graph 1.2: **Global equity, US 10-year bond, US Dollar Index**

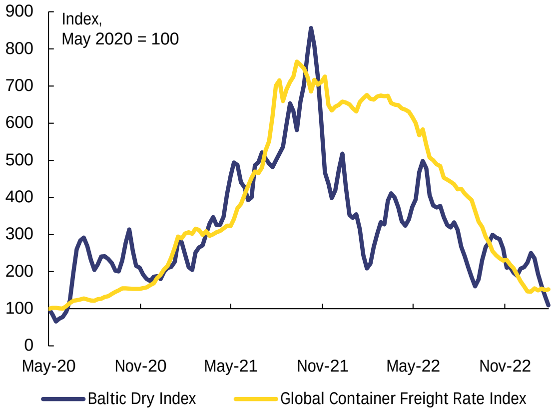


Source: MSCI, U.S. Department of theTreasury

Slowing global growth, and the rotation of demand from goods to services (e.g. in the US) are reflected in slower global trade. World merchandise trade volumes decreased by 2.5% in November 2022 compared to October. Both imports and exports fell globally, particularly in the euro area and advanced Asia. World trade momentum (3 month-on-3 month growth) also dropped from 1.3% in September to -0.8% in November. Adverse structural forces are set to continue weighing on global trade growth over the forecast horizon and beyond (Box 1.1).

Supply chain pressures have eased. The Federal Reserve’s Global Supply Chain Pressure Index is back to around November 2020 ([1]) levels, while global delivery times have fallen since mid-2022 and port congestion in the US and Europe continues to decrease or stabilise at low levels. Global shipping rates have also continued to fall, but remain higher than pre-pandemic averages (see Graph 1.3). Container and bulk cargo rates are currently 60% and 102% higher than in mid-March 2020 ([2]), respectively. While port congestion in China increased moderately in December following the surge in infections, it is expected to subside amidst an improving health situation and weak global demand.

Graph 1.3: Global freight indices



Source: Baltic Exchange, Freightos.

In sum, the outlook for global growth and demand for EU exports appears broadly unchanged from the Autumn Forecast. Global growth (excluding the EU) is now expected to be around 3.1% in 2022 (as in autumn), 3.0% in 2023 (+0.1 pps.) and 3.3% in 2024 (-0.1 pps.). The slight improvements mainly reflect the upgraded projections for China and the US. Trade growth has been revised slightly downwards: global import volume growth excluding the EU is expected to slow down to 2.4% in 2023, recovering to 3.6% in 2024. A similar trend is projected for trade elasticity, which is forecast to drop to 0.8 in 2023, and then rise to 1.1 in 2024.

EU's efforts to wean itself off Russian gas are paying off and the economy appears better prepared to meet its short-term energy needs. High and fast increasing prices until summer, public campaigns to restrain consumption and a mild start of the winter season contributed to a sharp fall in gas consumption. From May to November 2022, consumption of natural gas in the EU was consistently below the

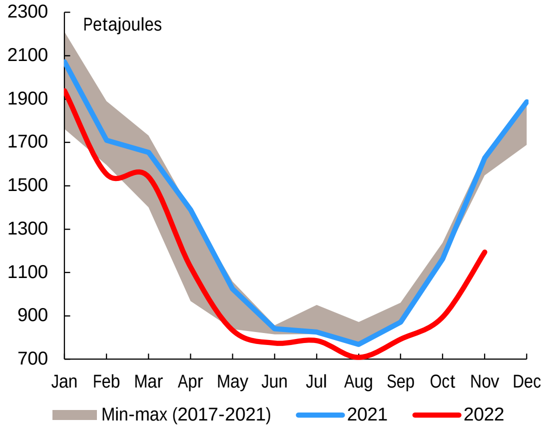
([1]) The current wave of supply chain pressures in shipping started in November 2020, peaking in December 2021.
([2]) Mid-March 2020 marks the trough of the series, before the sharp pandemic-related rise.

Table 1.1:
International environment

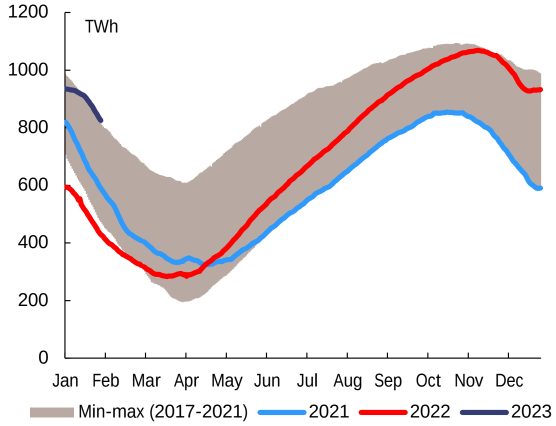
(Annual percentage change)	2019	2020	2021	Winter 2023 interim Forecast 2022	2023	2024	*Autumn 2022 Forecast* *2022*	*2023*	*2024*
				Real GDP growth					
World (excl.EU)	2.9	-2.7	6.1	**3.1**	**3.0**	**3.3**	*3.1*	*2.9*	*3.4*
				Trade volumes					
World (excl.EU) exports of goods and services	0.2	-7.0	9.9	**4.2**	**2.9**	**3.6**	*4.3*	*2.9*	*3.7*
World (excl.EU) imports of goods and services	-0.6	-8.4	11.0	**4.4**	**2.4**	**3.6**	*4.8*	*2.5*	*3.7*

minima recorded in the period 2017-2021 (see Graph 1.4), with consumption in October and November falling 25% below the 2017-2021 average, therefore overachieving the reduction target set by Council Regulation (EU) 2022/1369 of 5 August 2022. Lower demand for gas, combined with the accelerated deployment of new LNG terminals (e.g. in Germany) and ongoing diversification of suppliers left gas inventories at the end of January around 74% full, only marginally below their level at the beginning of the heating season, and well above seasonal average over the past seven years (see Graph 1.5). This implies lower demand for refilling going forward.

Graph 1.4: **Natural gas consumption in the EU**



Graph 1.5: **Gas storage in the EU**

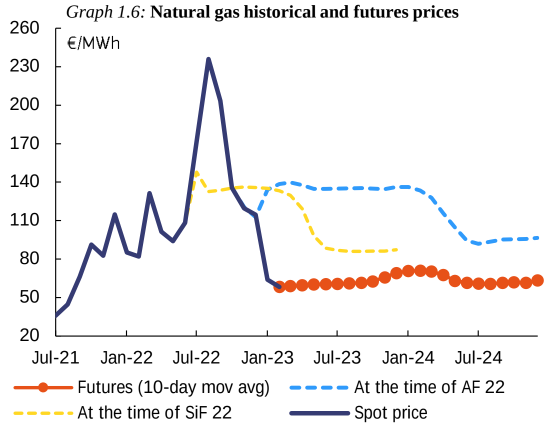


Source: Gas Infrastructure Europe (GIE).

European TTF wholesale gas prices are now well below their pre-war level, but risks of renewed upward pressures in the months ahead and supply shortages in the winter of 2023/2024 remain. At end-January, the price of the TTF gas benchmark fell to 55 EUR/MWh (the peak in August was above 340 EUR/MWh). The price of the Henry Hub natural gas in the US remains significantly below the TTF benchmark. It also declined, to an equivalent of around 8 EUR/MWh at the end of January, less than half the price recorded in autumn. According to futures contracts, TTF gas prices are set to remain within a narrow range of 55-70 EUR/MWh over the forecast horizon, on average 57% and 42% below the Autumn Forecast assumptions for 2023 and 2024, respectively (see Graph 1.6). Yet, gas prices are still more than three times higher than 2019 prices. Moreover, in a context of high volatility amid continued geopolitical tensions, a flare-up in prices like the one experienced in 2022 cannot be ruled out, especially now that LNG imports have become the main source of natural gas for the EU. A more vigorous rebound of China's demand than expected following its re-opening may boost global LNG demand, making refilling conditions in the summer costlier again. Risks of gas shortages in the winter of 2023-2024 cannot yet be dispelled.

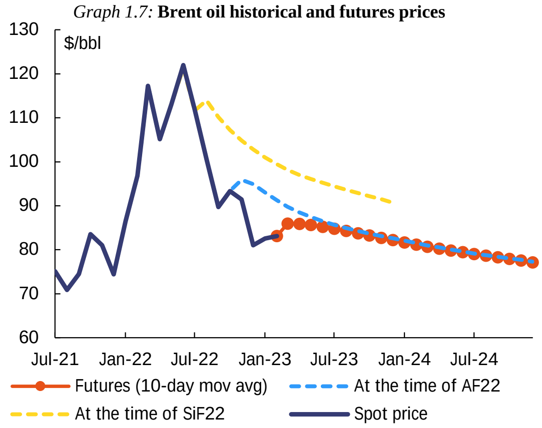
Following a further steep decline at the end of last year, Brent crude oil prices have stabilised since December and futures suggest marginally declining prices until end 2024. By end-January, Brent oil was trading around 85 USD/bbl. – some 15 USD below the 2022 average price. At the cut-off date of this forecast, the trajectory of futures oil prices is broadly the same as in the Autumn Forecast (see Graph 1.7). It shows oil prices moderating marginally over the forecast horizon, reaching around 80 USD by the end of 2024.

Graph 1.6: **Natural gas historical and futures prices**



Source: ICE.

Graph 1.7: **Brent oil historical and futures prices**

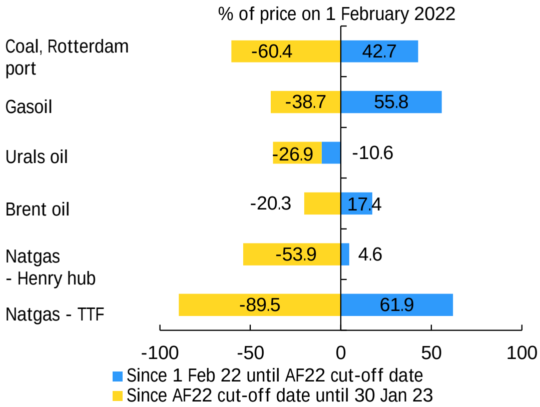


Source: ICE, Commodity Research Bureau.

The EU's ban on seaborne imports of crude oil from Russia and the oil price cap have not resulted in additional tightness on the international crude market, but pressures could emerge for refined products. As of 5 December, the EU banned the import of seaborne crude oil from Russia. The G7, the EU and Australia also imposed a price cap on Russian crude oil at 60 USD/bbl. Although Russia has seemingly succeeded in diverting most of its crude oil exports to buyers such as China, India and Türkiye, it has had to accept large discounts. The Urals price fell from USD 65-70/bbl. at the end of November to around USD 60/bbl. at the end of January, which represents a 25 USD/bbl. discount compared to Brent. Moreover, Russian export volumes hit a minimum in December. On 5 February, the EU extended the ban on seaborne imports to refined oil products, such as diesel and jet fuels. Many analysts have voiced concerns about a looming diesel supply crunch during winter. Yet, a surge in imports at the end of last year and high storage levels should have allowed to avert such risk in the short term, and grant importers additional time to re-route their sources.

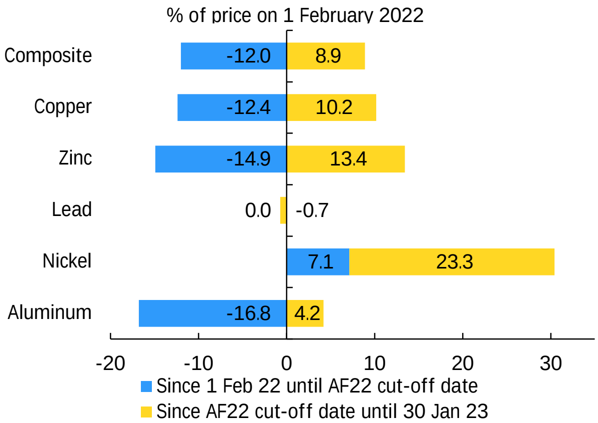
Agricultural commodity prices continued declining, but the price of industrial metals has recently rebounded. The S&P GSCI general commodity index has increased since December, but in late January it stood below its reading at the end of October, thanks to lower energy and agricultural indices (see Graph 1.9). In December, the FAO Food Price Index dropped (-2.9% month-on-month) for the ninth consecutive month and stood 1.0% below its value a year ago. The latest fall was driven by a steep drop in the international prices of vegetable oils, together with some declines in cereal and meat prices. By contrast, the price of steel, copper, aluminium and zinc ticked up in November, likely reflecting anticipation of resuming activity in China, especially in construction. Risks of higher agricultural prices remain, should exports from Ukraine get impeded again.

Graph 1.8: **Energy commodity price changes since 1 February 2022**



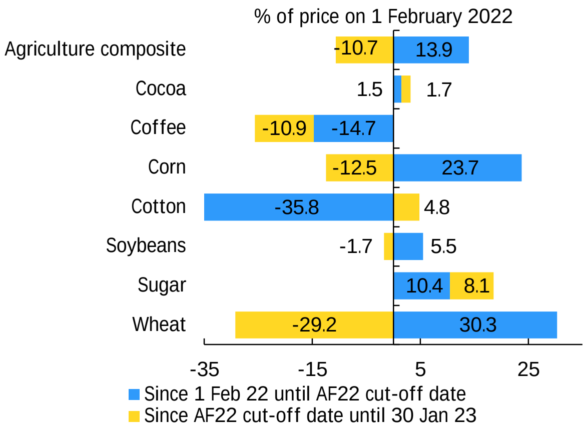
Source: Own calculation based on data from Commodity Research Bureau, ICE, NYMEX, Neste, ECB (exchange rates).

Graph 1.9a: **Metal price changes since 1 February 2022**



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

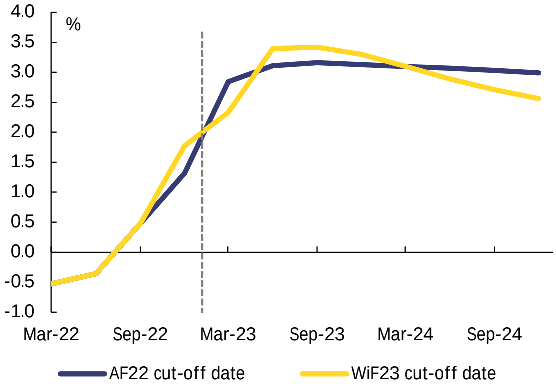
Graph 1.9b: **Agricultural commodity price changes since 1 February 2022**



1.3. FINANCIAL MARKETS

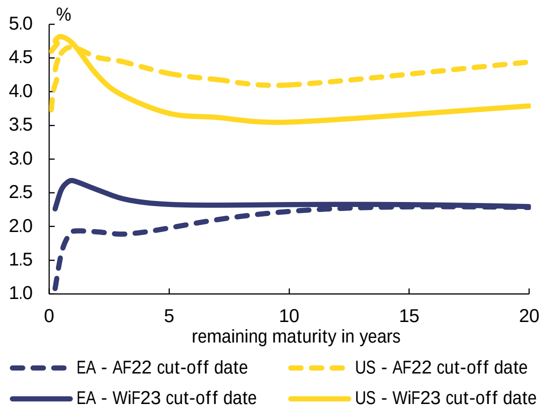
With respect to autumn, markets have lifted their expectations about near term euro area interest rates. On 15 December, the ECB Governing Council raised its policy rates further by 50 bps.. Then, on 2 February, just after the cut-off date for this forecast, the ECB announced another hike of 50 bps., which was broadly in line with markets' expectations ahead of the meeting. Accordingly, the interest rate on the main refinancing operations, marginal lending facility and the deposit facility were increased to 3.00%, 3.25% and 2.50% respectively, as from 8 February 2023. Since the beginning of the normalisation process, policy rates have increased by 300 bps. Furthermore, at its February meeting, the ECB Governing Council signalled that it intended to raise policy rates further by 50 bps. in March. Markets now expect euro area short-term rates to peak at 3.4% in the third quarter, compared with 3.0% on the Autumn Forecast cut-off date (see Graph 1.10). As part of the ongoing normalisation of monetary policy, the ECB also intends to start reducing its APP securities portfolio holdings in March 2023, by reinvesting only part of the principal payments from maturing securities. The decline in securities holdings will amount to EUR 15 bn per month on average until the end of the second quarter of 2023, and the subsequent pace of decline will be determined over time.

Graph 1.10: **Short-term euro interest rate expectations**



Source: IHS Markit, Refinitiv, Bloomberg.
Note: 3 months Euribor, expectations based on future contracts.

Graph 1.11: **Yield curves in the US and the euro area**

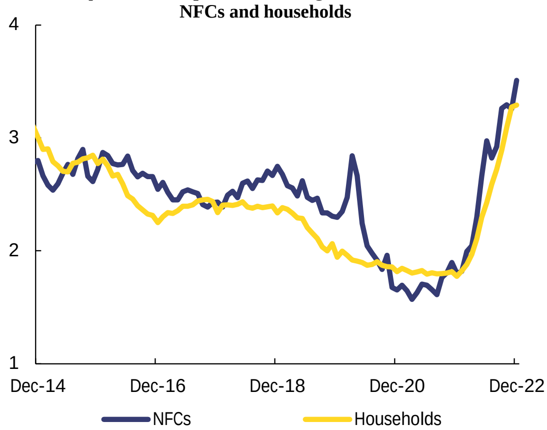


Source: ECB, US Department of Treasury.

The euro area long-term bond yields (10-year maturity) have remained at the levels of the Autumn Forecast cut-off date. Consequently, the euro area yield curve inverted, with some 40 bps. differential between the 2-year and 10-year German bond yields. In the US, the inversion of the yield curve has become more pronounced, due to a decline in long-term yields rather than an increase at the short end of the curve (see Graph 1.11). These market trends suggest investors expect the tightening cycles to be close to their peaks. For most EU countries, spreads are at the levels of the Autumn Forecast cut-off date, and for Italy, Greece, and the EU non-euro area countries spreads declined.

Financing costs continued to rise sharply for euro area households and corporations in late 2022. Progressive tightening of monetary policy kept driving financing costs for euro area households and non-financial corporates (NFCs) in the fourth quarter. The composite index of financing costs (CFCI) continued its strong increase in the fourth quarter, reaching in December 2022 the highest levels since late 2011 (corporates) and mid-2014 (households) (see Graph 1.12).

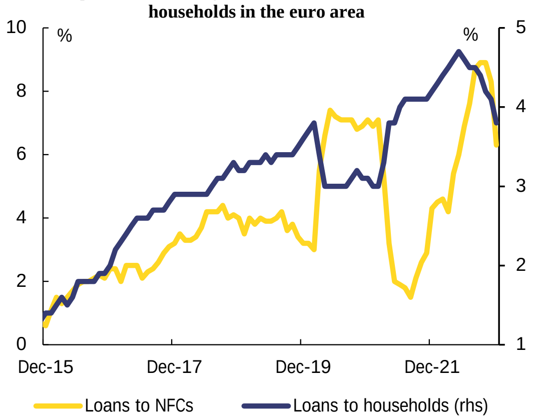
Graph 1.12: **Composite Financing Cost Indicator for NFCs and households**



Source: ECB, Bloomberg, Datastream, DG ECFIN calculations.

Annual growth in bank lending to the private sector remained positive, but decelerated further in December. In the euro area, growth of adjusted loans to households moderated for the fourth consecutive month to 3.8% y-o-y in December (from 4.1% and 4.2% in November and October, respectively), while that to NFCs decelerated to 6.3% in December (from 8.3% and 8.9% in November and October, respectively) (see Graph 1.13). Dynamics of mortgages to households slowed to 4.4% y-o-y, down from 4.6% in November, while the annual growth of credit for consumption picked up slightly (from 3% to 3.1%). While still robust, nominal credit growth to the private sector was the weakest since May 2021 and is markedly lower in real terms given the high levels of inflation.

Graph 1.13: **Annual growth in credit to NFCs and to households in the euro area**



Source: ECB.

Credit demand fell and bank lending standards tightened strongly in the fourth quarter and are expected to tighten further in the current quarter. According to the January 2023 ECB's Bank Lending Survey, lending standards continued to tighten strongly in the fourth quarter of 2022 vis-à-vis both firms and households. Enterprises saw the largest net tightening in credit standards since the euro area sovereign debt crisis in 2011. This shift was driven by e.g. higher risk perceptions related to the economic outlook and industry or firm-specific situation, declining risk tolerance, as well as higher cost of funds. For households, standards tightened strongly as well, for both housing and consumer loans. Banks also reported a strong net fall in credit demand from both firms and households, with the drop in the former exceeding banks' prior-quarter expectation. Key drivers for this decline were rising interest rates, as well as lower fixed investment (corporations), weaker consumer confidence and deteriorating housing market prospects (households). Going forward, in the first quarter of 2023 banks expect further tightening in credit standards and a continued decline in demand for credit.

The increase in interest rates and tighter credit standards continued to weigh on house prices in the third quarter. In the third quarter of 2022 growth in EU house prices decelerated, for the second consecutive quarter, to 7.4% on an annual basis. This is 3 percentage points down from the peak in 2022-Q1, and lower than 8.4% on average in 2021, but still above the 4.8% registered on average in the prior five years (2015-2020). In 2022-Q3 more than half of Member States reported double-digit annual house price growth, with Hungary's and Estonia's growth rates exceeding 20%. The main factor behind the slowdown in house price inflation is the increase of mortgage rates that started in 2022 (particularly in countries where mortgage rates were very low and floating, and where typical loan maturities are longer). Transactions in the housing market and new mortgage credit have already seen a significant decline in many Member States as of mid-2022. However, while the increase in mortgage interest rates is expected to continue in 2023, a generalised fast correction of house prices to pre-pandemic levels is unlikely, as housing supply remains constrained in most EU countries.

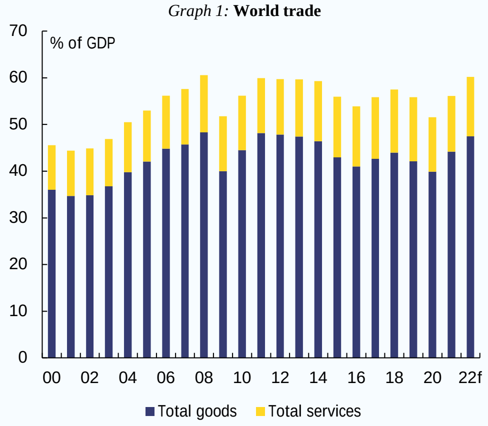
In contrast with the tighter credit outlook, conditions for market financing have loosened somewhat thanks to a pick-up in valuations, particularly since the start of the year. Following a declining trend until October 2022, EU equity markets continued their recovery in recent months, reflecting better than previously expected economic data, including retrenchment of gas prices below pre-war levels. Similarly, corporate bond spreads declined from their October peaks, in particular in the lower-credit-quality and high-yield segments. Corporate default rates remained below pre-pandemic levels. Overall, banks overperformed significantly on strong fundamentals and robust profitability in 2022.

The euro has appreciated vis-à-vis the US dollar since the Autumn Forecast, amid a narrowing interest rate differential with the US. The decline in the US treasury yields led to a weakening of the dollar against a broad set of currencies. The EUR/USD exchange rate reached 1.09 on 1 February, and current assumptions see the EUR-USD exchange rate, some 8% stronger than assumed in the Autumn Forecast.

Box 1.1: Global trade fragmentation risks

Global trade has lost dynamism in the last decade and its growth is not expected to regain traction. While global trade as a share of GDP increased rapidly before the Global Financial Crisis (GFC), from around 41% in 1996 to more than 60% in 2008, it has stalled since then (Graph 1; see also Wozniak and Galar, 2018). Taking into account the more complex and, sometimes, more hostile global environment for trade relations, as well as changing economic drivers, going forward world trade growth is set to be in line or slightly below global output (WTO, 2022; BCG, 2022). In light of these trends, this box reviews the slowdown in global trade and its underlying factors, while suggesting elements that are likely to influence its future performance.

Graph 1: **World trade**



EU goods trade and, particularly, services trade have expanded above global trends since the GFC. Partly as a result of the integration into the world trade system of EU Member States joining after 2004, the EU goods trade share of GDP increased by 10 pps. between 2000 and 2021, from 57% to 67% ([1]). The EU's trade share in services increased faster than trade in goods, from 14% of GDP in 2000 to 26% of GDP in 2021. Similarly, the EU's participation in global value chains increased rapidly until 2008 but remained relatively stable afterwards. Foreign value added in EU gross exports, also known as 'backward participation' in value chains, rose from 12.7% in 2000 to 17.3% in 2012, declining moderately to 15.8% in 2018. The EU domestic value added in partner countries' exports ('forward participation') increased from 14.9% in 2000 to 16.5% in 2008, gradually falling back to 14.9% by 2018 ([2]).

Several economic and policy factors explain the slowdown of global trade during the last decade. First, the benefits from trade-facilitating levers seem to have been largely exhausted. The world's weighted average tariff applied on traded manufactured goods fell from 13.6% in 1986 to 7.5% in 2008 and to a low of 3.9% in 2019. Second, the marginal benefits of technological progress in transportation and communication, which facilitated the geographical dispersion of productive processes, are reaching diminishing returns (Antràs, 2021 ([3])). Third, further offshoring is being restrained by a stabilisation of the share of manufacturing in high-income nations and by a decline in the share of intermediate goods in imports for emerging countries, as the latter are increasingly relying on their own industrial base to provide inputs (Baldwin, 2022 ([4])). Fourth, in some key emerging economies, notably China, an increasing share of services in the economy and a reduced integration in global value chains contribute to the decline in trade openness, ultimately reinforcing the moderation in global trade. Compared to goods trade, services trade retained its dynamism (except for tourism during the COVID shock) as digital technology improvements boosted trade in intermediate services (Baldwin, 2022) ([5]).

Geopolitical tensions and the COVID-19 pandemic have further weighed on cross-border trade and global value chains. Rising antagonism between the US and China in particular have resulted in trade restriction measures and the adoption of industrial policies in technology-intensive sectors (semiconductors, "green technologies", etc.). Shortages in health-related products at the onset of the COVID-19 pandemic raised calls in favour of nearshoring or even nationalising some supply chain segments. The war in Ukraine has further

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([1]) This increase was driven by both intra and extra-EU trade, as the share of intra-EU trade in goods has remained fairly constant, at around 60% of the total (for goods) for the past two decades.
([2]) Trade integration data is produced with significant time lag, with the latest data points typically being 2018 and 2019.
([3]) Antràs, P. (2021). "De-Globalisation? Global Value Chains in the Post-COVID-19 Age". National Bureau of Economic Research Working Paper No. 28115. November.
([4]) Baldwin, R. (2022). "The peak globalisation myth". VoxEU column available at https://cepr.org/voxeu/columns/peak-globalisation-myth-part-1
([5]) This was particularly the case in high-income countries and regions, such as the EU, which generally have few barriers to this sort of exports.

(Continued on the next page)

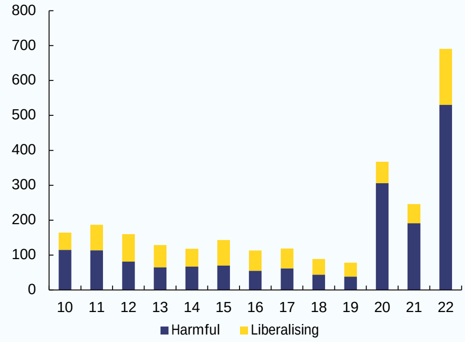
Box (continued)

raised geopolitical tensions, bringing to the fore risks that trade could increasingly be driven by geopolitical rather than economic considerations. Overall, efforts to boost the reliability of sourcing, improve responsiveness to demand or prioritise national security concerns are likely to relocate and shorten some supply chains (IMF, 2022 ([6]); Capital Economics, 2022 ([7])).

Trade relations have been influenced by challenges to the rules-based order. Examples are the United States abandoning the Trans-Pacific Partnership in 2017 or the disabling of the World Trade Organisation's dispute settlement system. In this context, the ability of multilateral institutions to facilitate global trade flows has been waning (Dadush 2022 ([8])).

Recent developments in trade policy signal a continued difficult environment for cross-border trade and global value chains going forward. Although tariffs have remained at low levels overall, the number of non-tariff trade restrictions has risen significantly since 2020, first in the context of the pandemic and later as a result of Russia's war against Ukraine and the ensuing food and energy crisis. Consequently, the annual average of harmful trade restriction measures, which was 71 between 2010-2019, rose sharply to 530 by 2022 (Graph 2). The number of import restriction measures affected 9.3% of world imports in 2021 (WTO, 2022), increasing further in 2022 due to EU sanctions following Russia's invasion of Ukraine.

Graph 2: **Trade policy interventions**



Source: www.globaltradealert.org

Several causal factors, including the abovementioned geopolitical tensions, the pandemic or the need to address climate change pledges, are leading policy to value chain rearrangements. Several countries are introducing subsidies to foster reshoring in strategic sectors and reduce dependence on foreign technologies and inputs. A prominent example is the semiconductor industry, with the US, the EU, Japan and China having implemented measures and subsidies to build domestic manufacturing capacity. Subsidies are expected to increase considerably ([9]) and tend to be increasingly linked to local production requirements. The US Inflation Reduction Act is a recent example. Several subsidies are subject to local production and sourcing requirements, distorting the level playing field and likely leading to reshoring some supply chains in the green technology sector. While other economies are considering introducing similar subsidy schemes also with local production criteria, the recently adopted European Green Deal Industrial Plan underscores the importance of an open rules-based trade regime for making trade work for the green transition.

Businesses are likely to adapt their strategies in response to these challenges. A survey conducted by the US-China Business Council in June 2022 found that 87% of respondents (US multinationals in China) declared that US-China tensions are having an impact on their operations and investment decisions, with 26% shifting away from industry segments in China, 29% developing separate US and China-specific value chains and 24% disinvesting in China. A similar survey conducted by the EU Chamber of Commerce in China in April 2022 noted that geopolitical tensions were negatively impacting European investments in China, with 7% of surveyed firms considering disinvesting in China as a result of the war in Ukraine, and 33% declaring that geopolitical tensions were decreasing China's attractiveness as an investment location.

Policy pressure to relocate supply chains may not immediately result in a significant change in standard aggregate trade indicators. Rearranging value chains will take time to materialise due to sizeable costs and technological challenges (IMF, 2022). Nevertheless, policy efforts are likely to alter trade patterns. In Asia, for instance, recent years have seen a notable shift in China's export shares, with shares to the US declining and those to ASEAN countries increasing, and with India emerging as a potential new engine for global value

([6]) IMF (2022). "Global Trade and Value Chains During the Pandemic". Occasional paper. World Economic Outlook. April.
([7]) Capital Economics (2022). "Global Economic Fracturing". October.
([8]) Dadush, U. (2022). "Deglobalisation and Protectionism". Working Paper 18/2022, Bruegel.
([9]) For instance, US subsidies in the next decade could double compared to the previous decade. For details, see The Economist (2023). "The destructive new logic that threatens globalisation". 14 January.

(Continued on the next page)

Box (continued)

chain development (Banga, 2022 ([10])). Hence, policy changes appear to have rather diverted than destroyed trade so far. These new trade patterns are an initial confirmation of the reconfiguration of supply chains in Asia, in response to the deteriorating trade and geopolitical relationship between the US and China. Similar reconfigurations are expected to take place in other regions. Central and Eastern Europe could increase their participation within European value chains, while certain Latin American countries, notably Mexico, could do same in US value chains (AMRO, 2021 ([11])).

Changing trade patterns would not necessarily negatively impact aggregate trade indicators but could deliver significant economic costs. Increasing barriers to international trade, FDI and technology exchange could make resource allocation less efficient, with harmful effects for productivity growth. Rising trade restrictions and/or higher trade policy uncertainty would lead to increased global economic fragmentation. The IMF ([12]) shows that a relatively intense fragmentation of the global economy would lead to permanent global output losses, which could range from 0.2% up to 7% of GDP, depending on the severity of fragmentation. Scenarios that combine trade fragmentation with technological decoupling could lead to output losses between 8% and 12% of GDP in some countries.

Overall, multiple factors cloud the prospects for global trade, posing a downside risk to economic growth. Some of the structural factors inhibiting trade growth over the last decade, such as the reduced scope for major technological breakthroughs in transportation and information technologies, are likely to remain broadly unchanged. In addition, recent exogenous shocks and trade policy developments, both at country and multilateral level, suggest that headwinds against the expansion of global trade are intensifying. In this context, the growth-enhancing effects from trade openness that many EU Member States have registered in the past may become less relevant. All things considered, and in light of the research identifying a causal link between trade and productivity and potential output growth ([13]), the fragmentation in global trade constitutes a downside risk for the global economy, entailing significant potential economic costs (IMF, 2023).

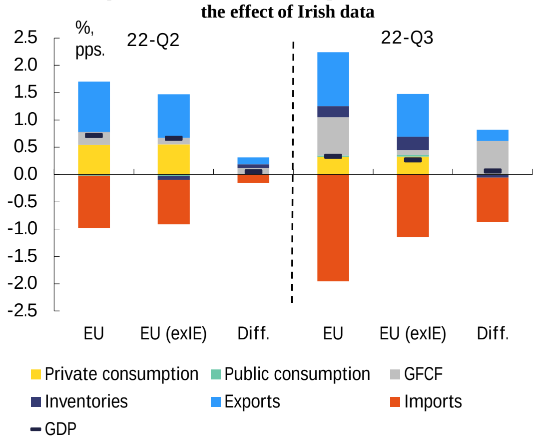
([10]) Banga, K. (2022). Opportunities, risks and realities of India's participation in global value chains. Institute of Development Studies. 23 November.
([11]) AMRO (2021). "Global Value Chains in the Post-Pandemic New Normal". Regional Economic Outlook 2021.
([12]) IMF (2023). "Geoeconomic Fragmentation and the Future of Multilateralism". Staff Discussion Notes. No. 2023/001.
([13]) For further details see Singh, T. (2010). "Does International Trade Cause Economic Growth? A Survey". The World Economy. Volume 33, Issue 11. November 2010.

1.4. RECENT ECONOMIC DEVELOPMENTS IN THE EU

1.4.1. Economic activity developments

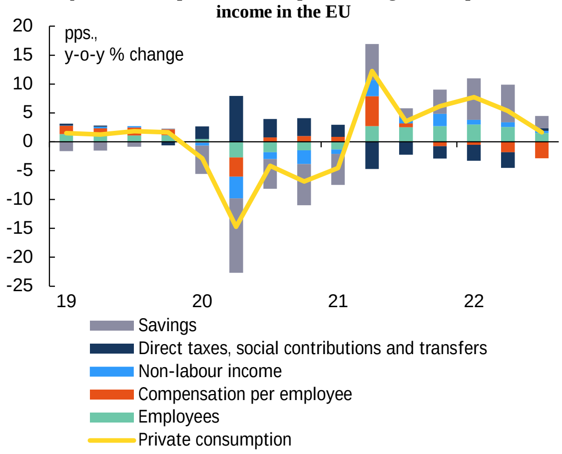
The slowdown in EU economic activity in the third quarter of 2022 was milder than previously estimated. Following an expansion of 1.5% in the EU (1.3% in the euro area) in the first half of 2022, in the third quarter real GDP decelerated to 0.3% q-o-q in both the EU and the euro area. This was a notch higher than the 0.2% incorporated in the Autumn Forecast based on Eurostat's preliminary flash estimate. Growth was driven by private consumption and investment. Real private consumption increased by 0.6% q-o-q, which represents a deceleration from the second quarter (1.0%), but still contributed 0.3 pps. to growth. Investment grew by 3.2% q-o-q in the EU (see Graph 1.14). This strong reading was driven by a boost of investment in Ireland, as a result of the relocation of intellectual property rights by multinationals, largely offset by an increase in imports. Excluding Ireland, investment in the EU still grew by 0.4%, following 0.6% in the second quarter. Public consumption grew only marginally in the third quarter (0.1% q-o-q). Despite lower imports of energy, net exports detracted 0.9 pps. from GDP growth, again reflecting strong import growth in Ireland.

Graph 1.14: **Recent GDP developments in the EU and the effect of Irish data**



Resilience of private consumption was supported by employment gains, a further decrease in the saving rate and fiscal support. These factors more than offset the decrease in purchasing power stemming from high consumer prices and the contraction of real compensation of employees (see Graph 1.15). The household savings rate in the EU in the third quarter of 2022 was down to 12.4%, back to the rate recorded just before the pandemic and slightly below the long-term average (12.8%). Consumer spending on services continued to increase, although at a slower pace compared to the previous quarter. Spending on goods in contrast retreated somewhat, dragged down by non-durable goods. Durable goods consumption grew markedly for the first time after three consecutive quarters, probably owing to easing supply disruptions in the automotive sector. This evidence is corroborated by the strong rebound in passenger car registrations in the third quarter, after having contracted for four quarters in a row.

Graph 1.15: **Real private consumption, savings and disposable income in the EU**



In the fourth quarter, the EU economy narrowly avoided an outright contraction. According to Eurostat's preliminary flash estimate (3) for the fourth quarter, GDP in the EU stagnated on a quarter-on-quarter basis, instead of turning negative as projected in the Autumn Forecast (-0.5%). However, excluding Ireland, which is estimated to have grown at the high rate of 3.5%, the EU economy is estimated to have contracted marginally. Information on the demand composition of growth in the fourth quarter is only available from national sources for a few countries, including Spain, France, Germany and Italy. It points to contraction of domestic demand, and in particular private consumption, consistently with the steady decline in the volume of retail trade recorded up to November in the EU. Net trade added to growth, but mainly due to a fall in imports.

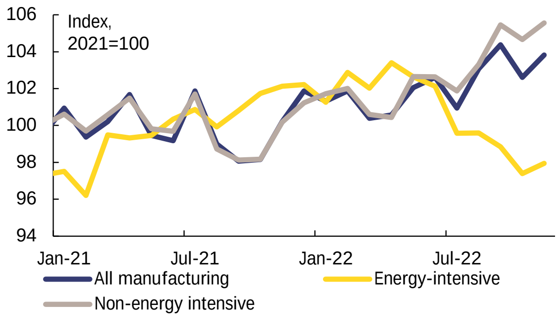
(3) Published on 31 January 2023 based on the data of 18 Member States, covering 94% of EU GDP and 96% of euro area GDP. The t+45 flash estimate will be published on 14 February 2023.

Still, some Member States saw real GDP decline in the fourth quarter and even experienced a technical recession. Six out of twelve Member States for which the preliminary flash estimate is available recorded an outright contraction in economic activity. These include Germany (-0.2%) and Italy (-0.1%), though the contraction was milder than projected in autumn (+0.7 pps. and +0.2 pps. respectively). In Estonia, Czechia and Hungary, the real GDP decline in 2022-Q4 followed a contraction in the previous quarter, which implies that these countries have entered technical recession. The other six reporting Member States saw continued economic growth, instead of the fall in output projected in autumn. Among the large Member States, output expanded by 0.2% in Spain and by 0.1% in France (+0.3 pps. and +0.2 pps. compared to the Autumn Forecast, respectively).

In 2022 as a whole, real GDP is estimated to have expanded by 3.5% both in the EU and in the EA. Thanks to the better-than-expected growth turn-out in the second half of last year, these estimates are higher than the Autumn Forecast projections by 0.2 pps. and 0.3 pps., respectively.

On the supply side, industrial production softened and construction activity recovered in the last quarter of last year. Taking the average of the first two months of the fourth quarter of 2022, industrial production in the EU fell by 0.6% compared to the previous quarter. Between June and November, manufacturing output has trended moderately up, despite the negative drag from the production of energy-intensive goods, under the impact of high energy prices (see Graph 1.16). Production in the construction sector in the EU expanded on average in October and November (+0.7%) compared to the previous quarter, following a contraction in both the second and third quarters.

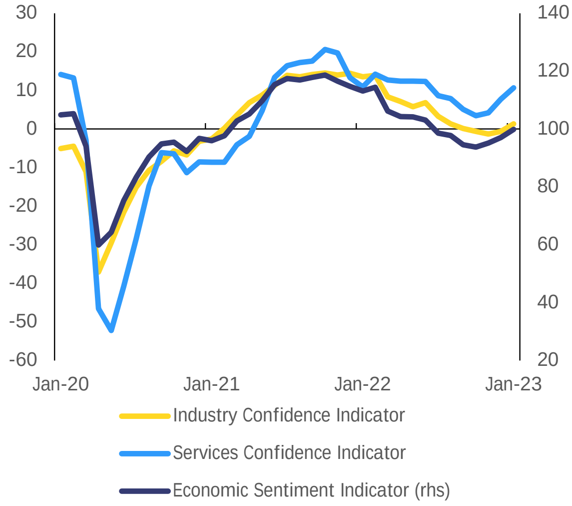
Graph 1.16: **Volume of manufacturing output in the EU**



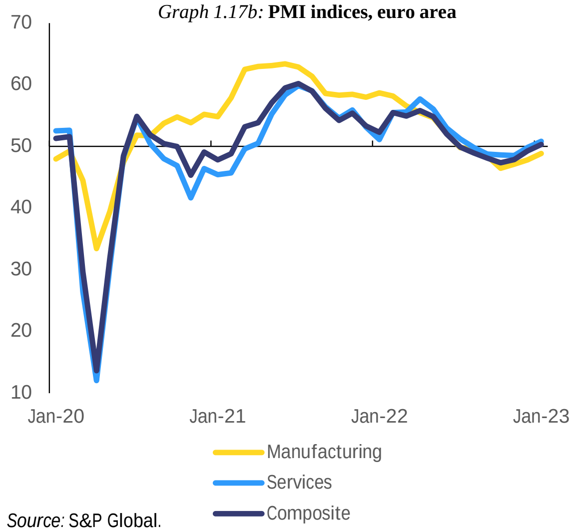
Note: Energy intensive sectors defined as having energy intensity above the average in manufacturing. Energy intensity equal to energy content embodied in gross value added, in TJ / million EUR, as calculated by the JRC with the FIGARO database for 2020. For exact definition see European Economic Forecast, Spring 2022, Box I.2.2.

Survey indicators at the start of the year point to improved economic sentiment. In January, the European Commission Economic Sentiment Indicator (ESI) moved up further (see Graph 1.17a), though it remained a notch below its long-term average. The increase was driven by a broad-based improvement in industry, services, retail and among consumers. Confidence in the construction sector, in contrast, worsened notably. The flash Purchasing Managers' Indices (PMI) also pointed to improved economic performance at the start of the year (see Graph 1.17b). In January, the euro area composite flash PMI increased for a third consecutive month (to 50.2 from 49.3 in December), moving to expansionary territory – i.e. above the 50 threshold - for the first time since June 2022. The improvement was broad-based in both the manufacturing and services sectors, in line with the Commission business surveys. The services sector index moved into expansionary territory for the first time since July, while the manufacturing index remained below the no-change mark, suggesting only a modest contraction. Some further encouraging signals came from the slowing contraction of new orders in both sectors. Similarly, the European Commission survey pointed to stability of order books at a level above the long-term average. Overall, survey data so far is consistent with a marginal expansion of economic activity in the first quarter of 2023.

Graph 1.17a: **EC Business and Consumer Survey, euro area**



Graph 1.17b: **PMI indices, euro area**

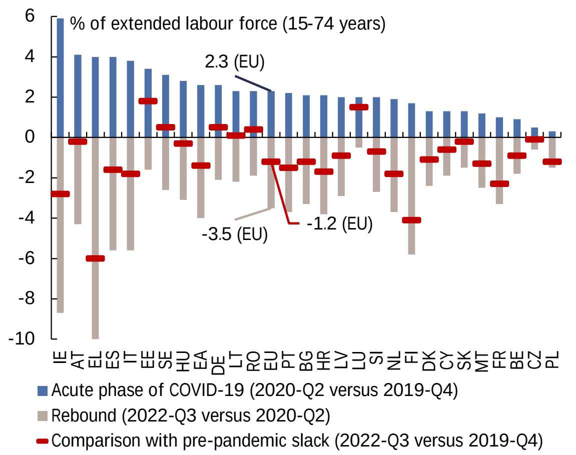


Source: S&P Global.

Supply bottlenecks eased, but insufficient demand is increasingly limiting production. While remaining at a relatively high level, the percentage of industry managers quoting shortage of material and/or equipment, or shortage of labour force as factors limiting production decreased in January compared to October (by 2.5 pps. to 37.2%, and by 2.3 pps. to 26.4%, respectively). This easing of supply bottlenecks was corroborated also by the PMI for the euro area, according to which the suppliers' delivery times index in the manufacturing sector has come back to pre-pandemic level. By contrast, softening demand is an increasing concern. The share of managers in the Commission survey indicating insufficient demand as a hurdle to their production increased somewhat (by 2.4 pps. to 27.6%).

1.4.2. Labour market developments

Graph 1.18: **Change in labour market slack**



The EU labour market remained tight in the third quarter of 2022. According to National Accounts, employment continued to grow, though at a slower pace. In the EU, it was 0.2% higher than in the second quarter, when it expanded by 0.3%. According to the labour force survey for the third quarter, in the EU the employment rate of people aged 20-64 stood at the all-time high of 74.7% (series started in 2009), while in this age group 5.9% of the labour force was unemployed. At 202.4 million, the number of employed people aged 15-74 was in the third quarter only marginally lower than the all-time peak in the second quarter. Labour market slack, which comprises all people who have an unmet need for employment, including the unemployed, stood at 12.2% of the extended labour force aged 15-74, which was in almost all Member States markedly lower than before the pandemic (see Graph 1.18). The job vacancy rate declined only marginally to 2.9% (from 3.0% in the second quarter), thus remaining at historically high levels.

Latest data point to continued strong performance of the labour market. In December 2022, the unemployment rate was at 6.1% in the EU (unchanged since April) and 6.6% in the euro area (unchanged since October). These were the lowest readings in the history of the series (since 2000 in the EU, since 1998 in the euro area). In January, the Employment Expectations Indicator increased in the EU to the highest reading since June last year. The increase reflected improved employment plans in manufacturing, services and retail services, which were only partly offset by deteriorated employment plans in construction. Unemployment expectations of consumers declined for a third consecutive month, falling to the lowest level since June last year. Finally, results from the European Commission business survey point only to a marginal abatement in labour shortages, signalling a continuous tightness in the EU labour market at the beginning of the year.

The outlook is for the labour market to remain tight in 2023 and 2024. The slowing down of economic activity estimated at the end of last year and projected in early 2023 is set to weigh on the pace of employment growth. At the same time, difficulties in recruiting – as highlighted by the reported labour shortages and job vacancy rates - can be expected to motivate firms to hoard labour in the face of a temporary slowdown. Later in 2023, with economic activity slightly picking up as of spring, an increase in the number of hours worked should be followed by increased headcounts. Accordingly, back in autumn, Commission forecast projected only a temporary and marginal rise in unemployment rates in 2023.

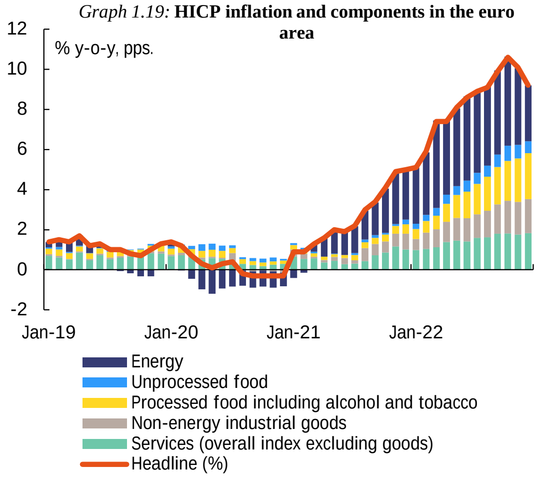
Nominal wage growth continued at rates below inflation rates, resulting in further purchasing power losses of employees. In the first three quarters of 2022, nominal compensation per employee in the EU was 4.8% higher than in the first three quarters of 2021 (4.4% in the euro area). The ECB indicator of negotiated wages in the euro area, which is not sensitive to the number of hours worked, increased in the third quarter of 2022 at an annual rate of 2.9% (2.5% in the second quarter). This was the second highest reading since 2009 (with the highest reading in the first quarter of 2022 when one-off payments distorted the reading). In the third quarter of 2022, hourly labour costs rose by 3.4% in the EU and by 2.9% in the euro area, compared with the third quarter of 2021. The breakdown by economic activity shows the strongest increase in services (3.9%), followed by construction (3.1%) and industry (1.9%).

Nominal wage growth is expected to come in stronger than in the years before the pandemic. Continued tightness of labour markets, higher minimum wages in several Member States, and increased efforts to compensate for inflation are likely to exert upward pressure in wage negotiations, especially considering the fading recession risks. Moreover, current wages of many employees still reflect wage settlements agreed upon before inflation accelerated last year, which suggests a lagged and staggered impact of past inflation on future wages. As projected in autumn, a full recovery of the lost purchasing power still appears unlikely over the forecast horizon, but real wages should start rebounding in the second half of the year.

1.4.3. Inflation developments

Inflation in the last quarter of 2022 was slightly weaker than expected. In annual terms, the Harmonised Index of Consumer Prices (HICP) inflation in the euro area decreased to 10.1% in November and 9.2% in December, after peaking at an all-time high of 10.6% in October (see Graph 1.19). Inflation also eased in the EU, falling from 11.5% in October to 10.4% in December. At 10%, euro area inflation in the final quarter of last year turned out 0.2 pps. below the rate projected in autumn.

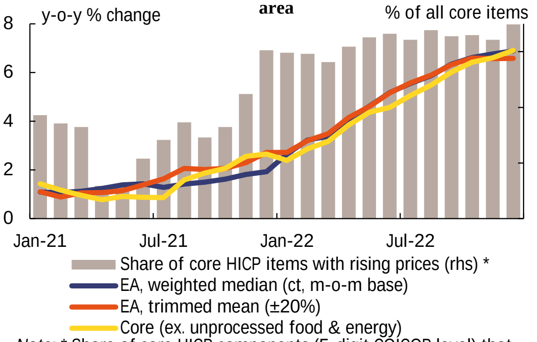
Graph 1.19: **HICP inflation and components in the euro area**



The inflation surprise is the result of lower-than-expected energy inflation. By the end of 2022, energy inflation in the euro area decreased markedly from its peak of over 44% in March 2022. It thus lost its place as the largest contributor to euro area headline inflation after 20 months, taken over by food inflation. Among key energy items, inflation of fuels for transport has been declining since July, promptly following the decrease in crude oil prices. Meanwhile, gas and electricity inflation continued to increase until October, before starting to decline in November, mainly under the impact of policy measures and base effects. (4) As the pass-through from wholesale gas and electricity prices to consumer prices is typically slower than for fuels, the impact of the recent steep fall in wholesale prices for gas and electricity inflation is yet to be seen in retail prices. (5) Still, some Member States saw their gas inflation rates closely trailing dynamics in wholesale gas prices with a short lag, also contributing to the fall in euro area inflation. Namely, gas inflation rates in Estonia, Greece, the Netherlands, and two non-euro area Member States, Bulgaria and Denmark, fell markedly in November and December compared to October. (6) Finally, core inflation (headline inflation excluding energy and unprocessed food) continued to increase to 6.9% in December, implying a slightly higher outcome for the fourth quarter than projected in autumn (6.6% compared to 6.4%).

In December, price pressures remained broad-based. The share of core items registering monthly inflation rates above their typical monthly patterns increased to their last year's highest (see Graph 1.20). This suggests that pressures on core inflation will likely remain elevated in the near term, as past cost shocks continue to spread to the consumption basket. Alternative measures of underlying inflation hint at gradual stabilisation. Namely, weighted median inflation (7) and the measure of inflation that excludes 20% of the most extreme (both high and low) price changes (trimmed mean) levelled off in the last months of 2022 (see Graph 1.20).

Graph 1.20: **Broadening price pressures in the euro area**



Note: * Share of core HICP components (5-digit COICOP level) that registered average positive monthly growth in the last three months above their long-term average in the given period.

Headline inflation continued to fall at the beginning of this year. The January flash estimate shows inflation in the euro area extending its fall for a third consecutive month, down to 8.5%. The signals from this estimate are blurred by missing data for Germany, the impact of support measures and the adjustment of regulated prices in some Member States. However, the trends observed in the last months of 2022 appear to have persisted. Energy inflation eased further to 17.2%, while core inflation increased slightly further to 7%. Among core inflation components, processed food inflation climbed to 14.9% and non-energy industrial goods inflation accelerated to 6.9%. Finally, services inflation, which has oscillated around 4.3% since September, posted a 4.2% rate in January. According to an estimate released after the cut-off date of the forecast, Germany posted an inflation rate of 9.2% in January, which appears higher than the rate implicitly assumed in Eurostat's flash estimate for the euro area. Detailed data for the main components of the HICP are not yet available.

Inflation rates remained highly heterogeneous across countries. Among the euro area countries for which the flash estimate for January is available, inflation ranged between 5.8% in Spain and Cyprus and 21.6% in Latvia. While inflation decreased in a majority of Member States, it increased in five countries. Still, inflation came in below last year's highs in all reporting Member States, albeit only slightly in some. For the Member States outside the euro area, for which the January flash estimate is not available, only Sweden and Hungary saw their inflation rates increasing to new highs in December.

(4) For some estimates of the impact of policy measures on inflation, see Insee (2022), Insee Analyses n° 75, September 2022 for France, Banca d'Italia (2023), Economic Bulletin No. 1 – 2023 for Italy, Banco de España (2022), Macroeconomic projections for Spain 2022-2025 for Spain and Bundesbank (2022), Monatsbericht Dezember 2022, December 2022 for the impact of measures on the inflation outlook for Germany.

(5) For more details, see Box I.2 in "European Economic Forecast, Winter 2022", European Economy Institutional Paper 169, February 2022.

(6) With the extreme changes in wholesale gas prices in 2022, the methodology of recording consumer prices also plays a significant role. For example, Statistics Netherlands announced the introduction of a new methodology, based on which annual gas inflation in August 2022 was in the range of 34%-96.5% compared to 170.1% based on the current methodology. See https://www.cbs.nl/en-gb/background/2022/44/towards-a-new-method-of-calculating-energy-prices.

(7) Weighted median inflation is the inflation of the median basket component, or the 50th percentile (by cumulated weight) of the sorted distribution of inflation rates of individual HICP items in a given month.

1.5. THE OUTLOOK

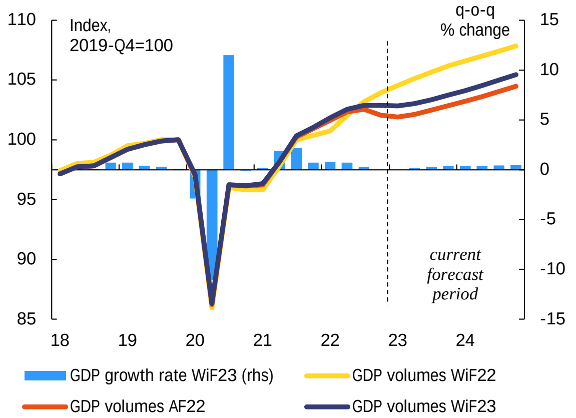
1.5.1. Economic activity outlook

Opposite forces are at play in the first half of 2023. Powerful headwinds are still dragging domestic demand. Namely, while inflation is moderating, it remains high, and consumers and businesses continue to face high energy costs. The cumulative impact of past monetary tightening is starting to weigh on lending activity. With core inflation still trending up, monetary policy tightening is set to be more forceful than previously assumed, especially affecting sectors that are more sensitive to interest rates, like construction. Though uncertainty has come down in recent readings, it is still high and weighs on investment of firms and households alike. Moreover, wage developments are still expected to remain below inflation in the short term, constraining real consumption. On the positive side, improved economic sentiment in January (see Section 1.4.1.) suggests that the EU economy is on a better footing starting the year. Falling wholesale gas prices are set to benefit consumption, as they progressively pass through to consumer prices.

Annual GDP growth for 2023 is projected at 0.8% in the EU (and 0.9% in the euro area). On balance, the EU economy is projected to keep stagnating in the first quarter of this year, instead of contracting as forecast in autumn. Growth is expected to pick up mildly in spring as inflation gradually loosens its grip on the economy. The gap between wages and price growth is projected to narrow, leading to a slowdown in the pace of contraction in real disposable income, though this is set to be partly offset by the progressive withdrawal of fiscal support measures. As RRF spending moves up to cruise speed, it should push up investment despite the adverse effects of tighter financing conditions. The upward revision of respectively 0.5 and 0.6 pps. compared to autumn is largely driven by the much stronger position from 2022 and to a minor extent by a slightly more favourable outlook for within year growth.

For 2024 as a whole, growth is expected at 1.6% in the EU (1.5% in the euro area), unchanged compared to the Autumn Forecast. The reduction in inflation is set to support a rebound in private consumption. Increased domestic and external demand in a context of further adjustment to supply shock is expected to support a more robust uptake in investment and exports. Importantly, by the end of the forecast horizon (2024-Q4), the volume of output is now set to be almost 1.0% above the Autumn Forecast. At the same time, it is expected to remain 2.4% below the output level projected before Russia's war of aggression against Ukraine [8] (see Graph 1.21).

Graph 1.21: **Real GDP growth path in the EU**



Heterogeneity across Member States remains elevated. The previous forecasts already reported a strong degree of heterogeneity in growth performances across Member States. Over the autumn, different exposure and public and private sector response to the energy crisis resulted in high heterogeneity. This forecast continues to project considerable differences in growth rates across Member States over the forecast horizon. Since the beginning of the war, the difference between the highest and lowest growth rate has widened again and is set to amount to almost 10 pps. at the end of the forecast horizon.

1.5.2. Inflation outlook

Upstream inflationary pressures are gradually subsiding. Receding producer price inflation points to moderating inflationary pressures ahead. In December, industrial producer prices in the EU and the euro area increased slightly from November, mainly driven by energy, but annual inflation fell to 24.6% in the euro area

(8) This is computed on the extrapolation of growth outlook from the WiF22 based on the extension of GDP volumes with the average growth rate from 2010-2019.

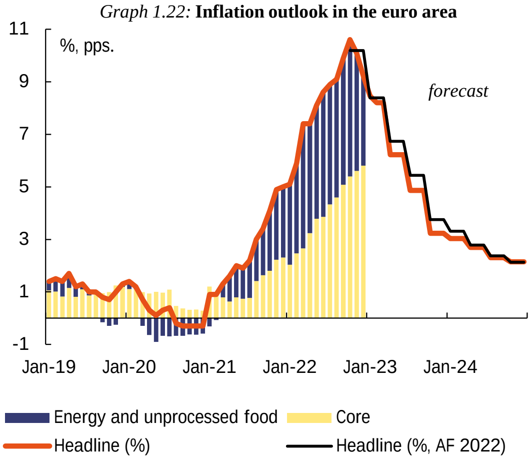
and to 25.2% in the EU from the August highs of over 43% in both areas. According to January PMI data, easing input cost inflation was felt particularly in manufacturing but also in services. Mounting evidence of subsiding pipeline price pressures signals that core inflation is likely close to its peak. This expectation is corroborated by evidence from the Commission's business surveys. Managers' selling price expectations have declined from their April 2022 peak in the sectors producing non-energy consumer goods. They have not yet receded in the services sector (see Box 1.2 for further details).

The recent substantial fall in energy commodity prices, together with a stronger euro and tighter financing conditions are set to drive inflation lower. In particular, energy inflation is set to continue easing. The continued decline in oil prices is set to drive inflation of transport fuel negative in the first half of 2023. In addition, the impact of lower wholesale gas prices is set to progressively kick in. This impact is, however, expected to be muted by several factors. First, in many Member States, the pass-through of prior wholesale price surges is still far from complete. This is due to transmission lags at various levels – including adjustment by national regulators, or staggered renewal of long-term contracts, both at wholesale and retail level. The net effect of the "backlog" of upward retail price adjustments and the current downward pressure from the wholesale prices is very difficult to gauge. Second, the withdrawal of policy support measures to relieve households and firms of the burden of high energy prices is set to partly offset the declines in retail energy prices. Based on known policy plans, most euro area Member States are currently expected to start gradually unwinding these policies in spring this year.

Food and goods inflation is also set to slow, while services inflation is expected to remain elevated. The observed gradual stabilisation in farm-gate food prices together with lower wholesale energy prices are likely to ease food inflation. Especially non-energy industrial goods inflation is set to benefit from a stronger euro and the ongoing normalisation of supply bottlenecks. (9) By contrast, services inflation is expected to ease only gradually, sustained by wage growth. In an environment of subdued economic growth and tightening monetary policy, core inflation is also expected to decelerate over the forecast horizon.

Strong base effects will detract from year-on-year headline inflation rates. The strong price increases in 2022 continue to affect annual inflation rates, but their impact will fade during 2023. The contribution of base effects to the easing of inflation will be sizeable in each quarter of this year, with the strongest impact in the second.

Graph 1.22: **Inflation outlook in the euro area**



Inflation in the euro area is expected to ease substantially over the forecast horizon. Headline inflation in the euro area is forecast to fall from 8.4% in 2022 to 5.6% in 2023 and to 2.5% in 2024. For the EU, it is projected to decelerate from 9.2% in 2022 to 6.4% in 2023 and to 2.8% in 2024. Starting from 10% in the euro area in the last quarter of 2022, headline inflation is projected to close this year at 3.2% (see Graph 1.22). All major components are expected to contribute to the slowdown, with the fall in core inflation set to be more sluggish than the fall in energy inflation. In 2024, headline inflation is expected to continue easing, stabilising close to the inflation target towards the end of the forecast horizon. Somewhat stronger economic activity, compared to the forecast in autumn, is set to keep core inflation slightly more persistent. Still, developments in energy prices are set to dominate the headline inflation profile, easing direct and indirect pressures across the consumption basket. Compared to the Autumn Forecast, the projected inflation rates for the euro area and the EU are lower in both forecast years. In 2023, headline inflation is now expected to be lower by 0.5 pps. and 0.6 pps. in the euro area and the EU, respectively. The revision is minor for both the euro area and the EU in 2024.

(9) For recent evidence on the impact of the appreciation/depreciation of the euro on consumer inflation, see Box I.2.3 in "European Economic Forecast, Autumn 2022", European Economy Institutional Paper 187, November 2022.

This outlook is largely consistent with market-based inflation expectations. Short-term market-based inflation expectations have stabilised in recent weeks, with no surprising news in inflation-relevant economic data releases. Until late January, short-term market-based expectations went down significantly from last year's peak, implying expected inflation of around 2.4% at the end of 2024. Market-based indicators for medium-term and longer-term inflation expectations have remained broadly stable around the ECB inflation target of 2% since early January. The 5y-5y inflation-linked swap, a common measure of longer-term inflation expectations, moved in a narrow band around 2.3% in January. While this is slightly above the ECB's medium-term objective for inflation, it does not indicate any de-anchoring of inflation expectations given that financial market indicators also include risk premia. 5-year ahead inflation expectations of professional forecasters remained stable, with the 6 to 10 year-ahead expectations even edging down to 2.0% (-0.1 pps.) at the beginning of 2023.

1.6. RISKS TO THE OUTLOOK

The balance of risks to the growth outlook appears broadly balanced. Almost one year since Russia launched its war of aggression against Ukraine, uncertainty among businesses and consumers remains high, but has receded in recent months, according to the Commission's Economic Uncertainty Indicator. Some of the previously identified downside risks are losing strength, while others are gaining prominence. New upside risks are emerging.

The threat of gas shortages appears less serious than a few months ago, but can still not be dismissed. Alternative sources of gas supply have been put in place, gas storage levels have been boosted, energy-use efficiency increased, while the price of gas has come down strongly. Nonetheless, amid continued geopolitical tensions, energy spot and futures prices may rise again, and China's re-opening may add to global LNG demand. Refilling of gas shortages ahead of the winter of 2023-2024 may therefore pose more challenges than expected in this forecast.

The adjustment to the high interest rate environment could prove challenging. In a context of rising core inflation, tight labour markets and subdued activity, the exact calibration of the additional tightening needed to stem inflation will be a difficult balancing act. As the ECB and other EU central banks are expected to continue increasing their key interest rates and reducing further the size of their balance sheets, heavily indebted firms and households may be subject to heightened stress, which could spill-over to the banking sector. Tensions may also arise among some non-bank financial institutions. Given the sharp increase in house prices over the past two years, residential property markets in some Member States may experience sharper than expected corrections in prices that would weigh on demand and households' balance sheets.

Yet, upside risks to growth are also emerging. Domestic demand could turn out stronger than projected if the recent declines in wholesale gas prices pass through to consumer prices more strongly and consumption proves more resilient. Moreover, the combination of a resilient labour market and sustained wage growth could still largely offset the erosion of purchasing power after the progressive withdrawal of fiscal support measures. Finally, the re-opening of China could boost external demand more than expected, while the likelihood of renewed supply disruptions caused by localised lockdowns has been diminishing.

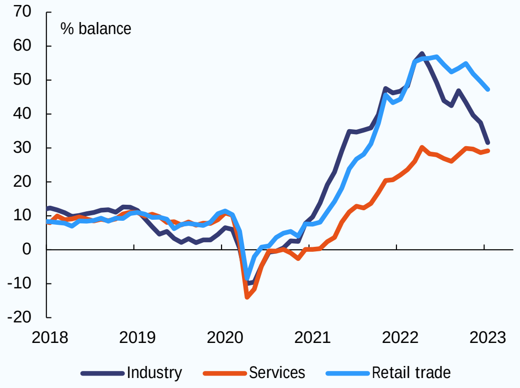
Risks to inflation remain largely linked to developments in energy markets. Some of the above-mentioned upside risks to growth are mirrored by downside risks to inflation, and vice-versa. Namely, a stronger pass-through of the recent fall in energy and food commodity prices and swifter resolution of supply chain disruptions could lead to a faster decrease in inflation. Yet, potential reversals of the recent downward trend in energy prices and China's reopening may again push up energy inflation. Especially in 2024, upside risks to inflation prevail, as price pressures may turn out broader and more protracted than expected in the baseline if wage growth were to settle at above-average rates for a sustained period.

Box 1.2: Selling price expectations and core inflation – **insights from the Commission's business surveys**

A key question shaping this forecast concerns the future dynamics of core inflation. Namely, to what extent will recent declines in energy and food commodity prices pass through to retail prices, at what speed, and will countervailing forces – mainly from wages – result in more entrenched inflationary pressures? Information on managers' pricing intentions for their firms' output can help answer these questions.

This Box analyses the results of the European Commission's monthly business surveys until January 2023 regarding managers' selling price expectations ([1]). As the surveys do not cover energy utilities ([2]) nor agriculture, they appear particularly well-suited to provide leading indications for core inflation and some of its sub-components.

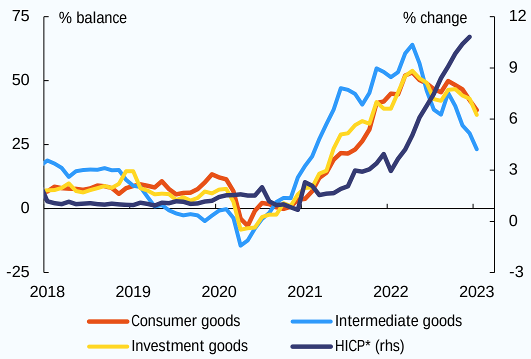
Graph 1: **Selling price expectations, EU**



Graph 1 provides an overview of developments in selling price expectations in industry, services, and retail trade over the past five years. Expectations in the construction sector are not shown, as the output of building activities mainly relates to investment goods, with no direct correspondence to any core inflation item. Selling price expectations in industry and retail trade peaked in April 2022 and, while remaining at a high level, have since been declining. In the services sector, selling price expectations also peaked in April 2022 but have since remained broadly stable. On balance, expectations remain well above average in all three sectors – meaning that an unusually high share of managers keep reporting their intention to charge higher prices for their output in the near future. ([3]) Overall, this suggests that core inflation could be about to peak, but is set to remain very high, with continued pressures especially on services.

Not all goods and services produced by the surveyed firms are destined to final consumption items. The remainder of this analysis therefore focuses on product groupings and sub-sectors that are geared towards consumers, and tries to map the relationship between their firms' pricing intentions with the corresponding HICP sub-components up until December 2022, the latest month for which detailed inflation data are available.

Graph 2: **Main Industrial Groupings and 'Non-energy industrial goods and Processed food' HICP, EU**



Note: * see footnote ([4])

Disaggregated sectoral developments

Within industry, the available breakdown of activities by Main Industrial Groupings (MIG) allows to single out consumer goods. Graph 2 shows that the observed dynamics of selling price expectations for the manufacturing sector as a whole are broad-based across the three Groupings. They all peaked in April 2022 and moved down thereafter. However, the magnitude of the swings differs somewhat, with intermediate goods (such

([1]) The question on selling price expectations asked in all business sectors (i.e. industry, services, retail trade and construction) reads "How do you expect your selling prices to change over the next 3 months? They will increase, remain unchanged or decrease".

([2]) The only exceptions are sector 19 'Manufacture of coke and refined petroleum products', which in any case is not included in any of the three Main Industrial Groupings (MIGs) analysed in this Box and sector 47.3 'Retail sale of automotive fuel', which is included in the retail trade sector.

([3]) Percentage balances are the difference between positive and negative answer options, expressed as a percentage of total answers.

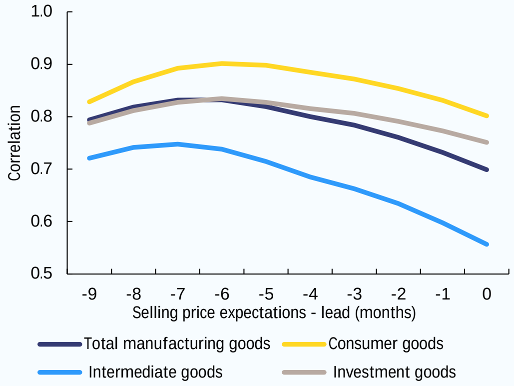
(Continued on the next page)

Box (continued)

as chemicals, basic metals, and electrical equipment, affected by supply side bottlenecks) displaying the steepest increase in 2021 and the fastest decline after reaching the peak. Manufacturers' pricing intentions for consumer goods, typically comprising the HICP components of non-energy industrial goods and processed foods, appear to lead relatively well developments in inflation for these components. ([4]) Managers' selling price expectations for these goods thus appear to provide reliable forward indications for core HICP developments in the coming months.

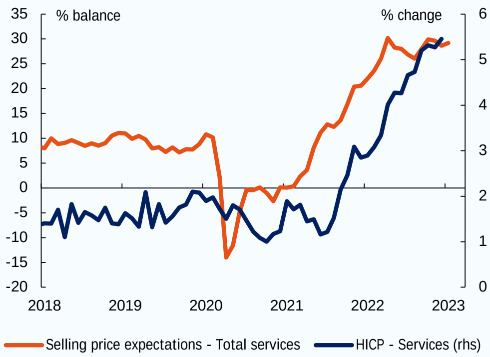
The above intuition is supported by the simple correlation analysis shown in Graph 3. The correlation between selling price expectations in the manufacture of consumer goods and HICP inflation for the aggregate of 'non-energy industrial goods and processed food' is relatively high (0.72 over the period January 2001 - December 2022), peaking at a lag of six months. This suggests that inflation for the core goods of the consumption basket, which was still increasing in December 2022, should start to moderate in the second half of this year.

Graph 3: **Selling price expectations versus 'non-energy industrial goods and processed food' HICP inflation**



For the service sector, which comprises services for both consumers and corporations, survey data does not offer a breakdown by sub-sector or type of activity that can be directly mapped to selected core inflation components. Graph 4 shows that selling price expectations for services as a whole nevertheless co-move quite well with service inflation ([5]). Correlation is lower than for industrial consumer goods but still high, with BCS selling price expectations leading by some months (correlation is highest, at almost 0.7, when selling price expectations are five months ahead). Stabilisation of BCS selling price expectations after the peak suggests that services inflation, while not increasing further, is not set to abate soon either. This could be related to managers' expectations of higher wages, given the greater role played by labour costs in this labour-intensive sector.

Graph 4: **Selling price expectations and HICP in services, EU**



This general picture is the result of different dynamics within the sector. Focusing on specific services activities, clearly geared towards final consumers, the picture is mixed. In food services (like restaurants, cafés), for instance, selling price expectations have remained broadly stable since April 2022, while HICP inflation for the corresponding activities has continued to increase until December (see Graph 5a). This suggests that HICP inflation in this sub-sector may stabilise in the coming months. At the same time, inflation for accommodation services has moderated visibly since July 2022, whereas selling price expectations have remained broadly stable since September 2022, with an uptick in January (see Graph 5b). This suggests that the decline in inflation in these services may come to an end and remain stable or even revert in the coming months. ([6])

([4]) 'Non-energy industrial goods and Processed food' HICP is calculated as the weighted average of the two aggregates 'Non-energy industrial goods' and 'Processed food including alcohol and tobacco' as published by Eurostat

([5]) HICP for services is defined as the year-on-year percentage change in the EU HICP special aggregate 'Services (overall index excluding goods)' as published by Eurostat.

([6]) The correlation between selling price expectations in food and beverage service activities and the corresponding HICP series is highest (0.9) when BCS data are six months ahead. In accommodation, correlation with its corresponding HICP series is highest (0.7) when BCS data are three months ahead.

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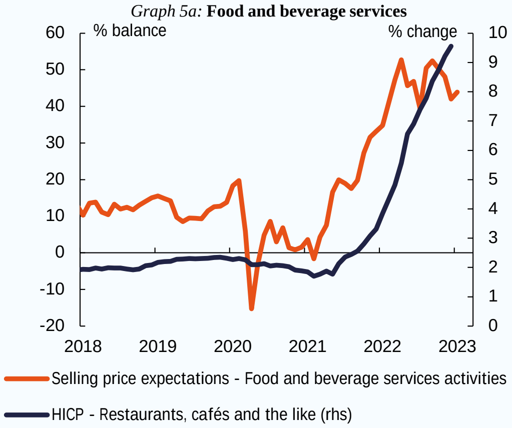
Box (continued)

Selling price expectations and HICP for selected services, EU

Graph 5a: **Food and beverage services**

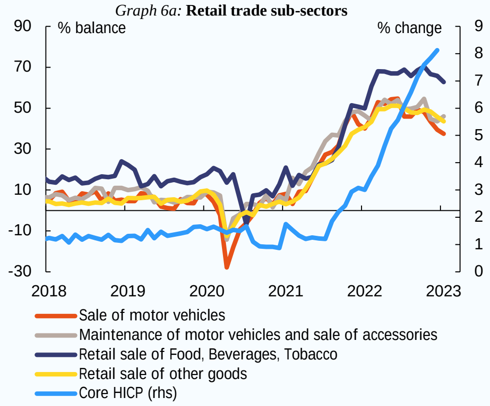


Graph 5b: **Accommodation services**

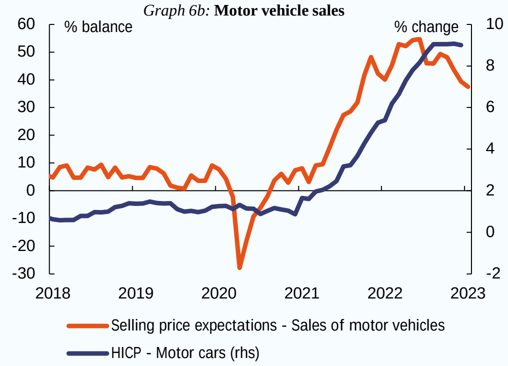
Finally, Graph 6a shows that BCS selling price expectations are declining across all the retail trade sub-sectors, largely anticipating HICP core inflation dynamics (for all sub-components excluding retail of fuel). (7) Zooming into specific sub-sectors (see Graph 6b), the HICP for motor vehicles has remained stable since August, while managers' selling price expectations have been decreasing since July 2022, signalling abating inflationary pressures in the coming months.

Selling price expectations and HICP for selected retail trades, EU

Graph 6a: **Retail trade sub-sectors**



Graph 6b: **Motor vehicle sales**



(7) The correlation between retail sub-sectors and core inflation is around 0.8 and highest when BCS data are six months ahead. For motor vehicle sales, correlation with its corresponding HICP is highest when BCS data are two months ahead.

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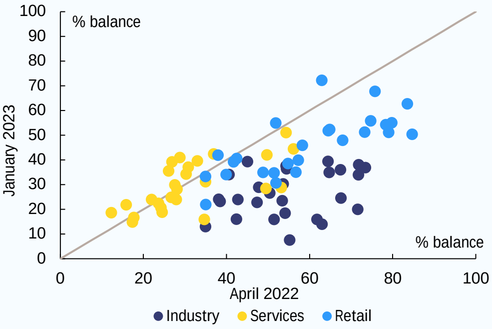
Box (continued)

Developments across EU Member States

The decrease in selling price expectations since April 2022 is widespread across countries (Graph 7). In industry and retail trade, all countries (except for AT, NL and FR in retail trade) have recorded a decrease in selling price expectations. By contrast, in services, stability of selling price expectations on aggregate in the EU masks some heterogeneity across countries. Expectations have decreased markedly in five Member States (i.e. CZ, EE, IE, HU and PL), have kept increasing in nine, notably in NL, BE and CY, and remained broadly stable elsewhere.

Graph 7: **EU Member States selling price expectations – April 2022 versus January 2023**



Note: Dots below the 45°-line depict a decrease in selling price expectations.

Overall, survey results show an easing in selling price expectations in the sectors producing goods and offering services destined to consumers. This suggests that, in the coming months, pressure on consumer prices should ease also for the corresponding core items of the consumption basket. However, inflation moderation may not materialise soon in the service sector, as selling price expectations, after having peaked, have remained broadly stable.

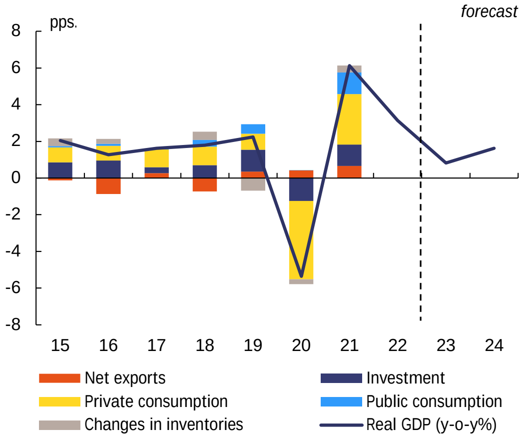
2. PROSPECTS BY MEMBER STATES

EURO AREA

2.1. BELGIUM

Output is estimated to have expanded by 3.1% in 2022. The easing of COVID-19 related restrictions allowed for economic activity to expand dynamically in the first half of the year, especially on the back of private consumption. In the second half, growth slowed down due to high inflation. After recording a rate of 0.2% in the third quarter, real GDP increased by 0.1% in the fourth quarter.

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



In 2023, the automatic indexation of wages and social benefits will continue to contribute to the recovery of the purchasing power of households, especially as headline inflation is projected to substantially slow down. In line with improving confidence indicators, private consumption is expected to expand moving forward.

Uncertainty, tighter financing conditions, cost pressures from input prices and wages are projected to continue weighing on investment. At the same time, economic actors' response to the increased needs for the energy transition and the financial contribution under the Recovery and Resilience Facility (RRF) are forecast to support gross fixed capital formation. Muted global trade prospects are forecast to weigh on imports and exports in 2023. After a positive contribution in 2022, net exports are expected to slightly drag on growth in 2023 and 2024.

After recording a rate of 0.2% in the first quarter of 2023, quarterly growth rates are projected to gradually increase to around 0.5% at the end of the forecast horizon. All in all, real GDP is forecast to increase by 0.8% in 2023 and 1.6% in 2024.

HICP inflation reached 10.3% in 2022, mainly driven by energy, but also elevated food inflation and rising core inflation. Headline inflation is forecast to fall to 4.3% in 2023 as the expected decline in wholesale gas and electricity prices is set to be transmitted quickly to retail prices. Core inflation is forecast to remain elevated in the first half of 2023 before slowly receding as pressures ease. In 2024, headline inflation is projected to decline further to 2.7%.

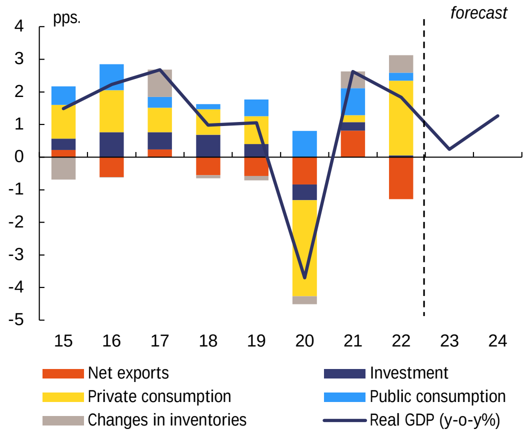
2.2. GERMANY

Germany's real GDP increased by 1.8% in 2022. Despite high inflation, growth was supported by the boost in demand that followed the post-pandemic reopening of the economy, and in particular services. However, by the third quarter of 2022, investment and private consumption had not yet reached their pre-pandemic levels and decreased in the fourth quarter with real GDP contracting by 0.2%.

Despite a recent improvement in confidence, the economy is expected to suffer another mild decline in early 2023 as energy prices for households are still increasing and government support for January and February will only be disbursed in March. Meanwhile export growth is set to slow down dragged by weak foreign demand.

The easing of energy price inflation, the gradual adjustment of supply chains and overall solid corporate finances and full order books should set the stage for a resumption of investment growth in 2023. However, the pressure on corporate margins from sharp increases in producer prices has been depressing the outlook for equipment investment, and higher building and borrowing costs are expected to weigh on construction. As supply bottlenecks ease and foreign demand improves, exporters should then be able to unwind production backlogs and benefit from recovering global demand

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



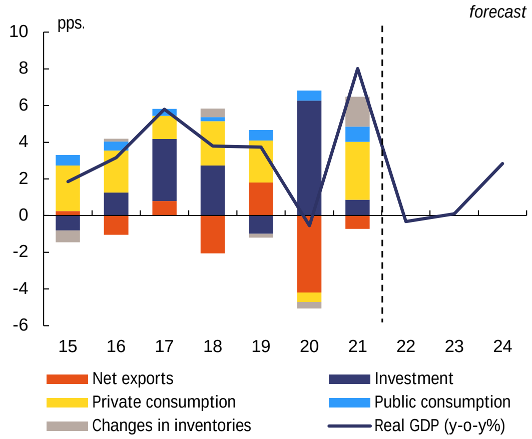
Altogether, real GDP is expected to increase slightly by 0.2% in 2023. This represents an upward revision from the -0.6% projected in the Autumn Forecast, mainly driven by abating energy prices and by the policy support to households and firms which have shored up the growth outlook. In 2024, growth is expected to rebound to 1.3%.

HICP inflation peaked at 11.6% in October 2022 driven by the surge in energy prices and rising input costs. It eased somewhat since, in December notably due to the government intervention on the retail gas market that had a deflationary effect on total month-on-month inflation. For the year 2022, inflation was reported at 8.7%. In 2023, the pass-through of elevated wholesale energy price growth is expected to be mitigated by the caps on gas and electricity prices, although these remain at historically high levels. However, still rising producer costs are set to keep HICP inflation high, at a projected 6.3% in 2023. The labour market remains tight, but wage growth has so far continued to trail inflation. The impact of ongoing and outstanding rounds of wage negotiations is also expected to remain contained. In 2024, inflation is projected to ease to 2.4% on the back of a decrease in energy costs.

2.3. ESTONIA

GDP is estimated to have contracted by 0.3% in 2022. Latest available quarterly data from 2022-Q3 indicates a sharp decline by 1.8% q-o-q. The Estonian economy was hit early on by the rapid rise in energy prices and suffered from a strong pass-through to other inflation components. Private consumption therefore slowed markedly during 2022. Industrial production turned strongly negative in the last months of 2022, reflecting lower demand for key industry sectors (wood and metal industry). The labour market nevertheless remained strong in late 2022 and early 2023, with only a slight uptick in the unemployment rate.

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



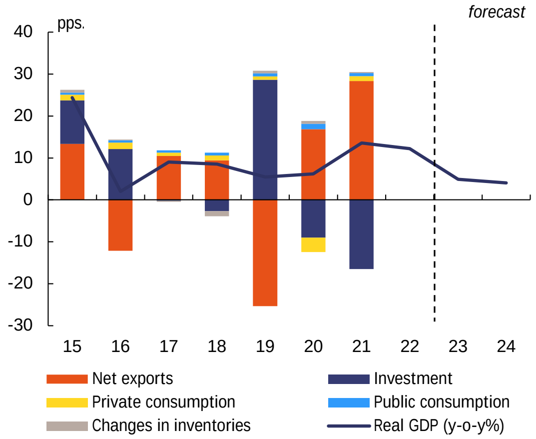
The rise in interest rates is set to heavily affect consumption and construction activity, given the prevalence of flexible interest rates in Estonian loan contracts. GDP, however, is forecast to return to growth in 2023 as the current headwinds, notably inflation, weak external demand and low confidence, are expected to gradually subside and fiscal policy turns expansionary. For 2023 as a whole, GDP growth is projected to reach only slightly positive rates, given the negative carry-over from the previous year. Next year is set for a more robust expansion, projected at 2.8%, driven by a revitalisation of export demand and private consumption, and a resilient labour market.

Consumer price inflation peaked in August 2022 and has since slowly decelerated, recording 19.4% on average in 2022. The deceleration is expected to continue in 2023, driven by declining commodity and energy prices. In addition, inflation indexation clauses are typically not used in Estonia for wage setting or price-setting contracts, which should support a relatively rapid deceleration in inflation. Overall, inflation is forecast to reach 6.2% in 2023 and 2.2% in 2024.

2.4. IRELAND

Real GDP in Ireland grew by 2.3% q-o-q in the third quarter of 2022, much stronger than anticipated. Investment increased by 92% q-o-q, driven by multinational corporations' investment in intellectual property (matched by a corresponding negative impact of imports on GDP). Exports of both goods and services kept on expanding robustly and private consumption grew despite downbeat consumer sentiment. The flash estimate indicates that real GDP expanded rapidly in the fourth quarter of 2022, by 3.5% q-o-q, leading to an estimated annual growth of 12.2% in 2022.

Graph 2.4: Ireland - Real GDP growth and contributions



Going forward, sentiment indicators point to an improving outlook, partly driven by falling inflation towards the end of the year. The Irish labour market continues to perform very well, with the unemployment rate at 4.3% in December. Despite news on some "big tech" companies reducing their staff worldwide in autumn, with yet no visible negative impact in Ireland where the multinational sector has increased employment in 2022 by 9%. Employment expectations in December were also improving.

A strong labour market together with very high household savings underpin further private consumption growth. Foreign investment in the first half of 2023 is set to be strong, as signalled by Ireland's Industrial Development Authority, while a slightly brighter global outlook is set to support exports. Real GDP growth for 2023 is revised upwards to 4.9% compared to the autumn, and it is thereafter expected to expand by 4.1% in 2024.

HICP inflation peaked in October 2022 and has been easing since. Energy remains the main driver for inflation, although it has started moderating. By contrast, growth in food prices reached double digits in the final quarter of 2022. Inflationary pressures in non-energy industrial goods and services, while elevated compared to the previous years, have moderated in recent months. Inflation reached 8.1% in 2022 overall. It is set to remain high at the beginning of this year and to gradually subside thereafter, to 4.4% in 2023 as a whole and 2.1% in 2024.

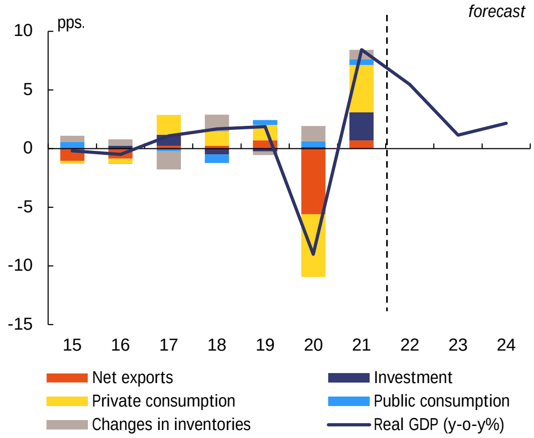
Ireland's economic outlook remains subject to uncertainty due to trade developments related to the implementation of the Protocol on Ireland/Northern Ireland. Furthermore, the performance of multinational corporations could swing growth in either direction.

2.5. GREECE

Greece's economy recorded solid growth in the first half of 2022, but rising inflation took its toll on growth in the second half of the year. However, the RRF provided notable support to the economy and government measures cushioned the impact of energy prices on businesses' input costs and households' real disposable incomes. Overall, real GDP growth is expected to have reached 5.5% in 2022.

Falling inflation is expected to gradually ease the burden on households' real income and benefit private consumption. The timely and effective implementation of the Recovery and Resilience Plan (RRP) is projected to remain the main driver of investment growth, partly offsetting weakening corporate investment due to the tightening of financing conditions. With the external environment slowly improving as of the second half of 2023, exports are set to pick up pace in 2024. Receipts from international tourism are forecast to increase in 2023 and 2024. Overall, real GDP is forecast to grow by 1.2% in 2023 and to pick up to 2.2% in 2024.

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



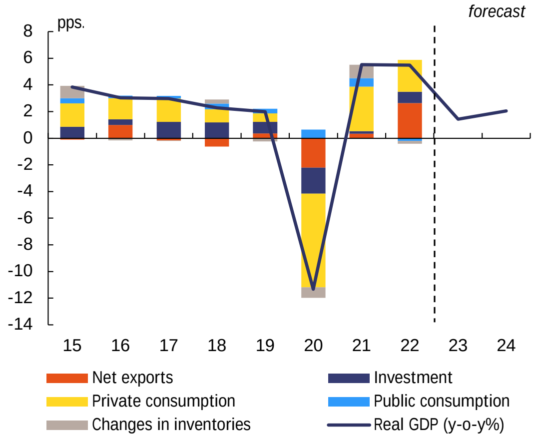
Energy price inflation eased following its September 2022 peak and HICP inflation is set to further moderate over the forecast horizon, on the back of falling energy prices and associated negative base effects. However, food price inflation is expected to prove more persistent, given the lagged pass-through of high energy costs on food production. After averaging 9.3% in 2022, headline inflation is forecast at 4.5% in 2023 and 2.4% in 2024. The announced increase in the minimum wage, set to come into effect in April 2023, has not been factored into this forecast as the Greek authorities have yet to define its scope.

Greece's growth outlook is subject to downside risks related to the potential impact of geopolitical tensions on international tourism. As regards risks to the inflation outlook, upside risks are related to the forementioned increase in the minimum wage.

2.6. SPAIN

Spain weathered relatively well the negative shocks unleashed by Russia's war of aggression against Ukraine in 2022. The resilience of the economy was underpinned by the strong rebound in tourism over the summer season and dynamism of private consumption, also supported by positive labour market developments. Compared to the Autumn Forecast, growth for 2022 is estimated to be 1.0 pp. higher, at 5.5%. The more robust outturn stems from the stronger-than-anticipated first half of the year, particularly 2022-Q2, as well as the less pronounced slowdown in the last quarter. Furthermore, despite the loss in real purchasing power, the deceleration of inflation as from fall 2022 contributed to stronger consumer and business confidence, in turn sustaining consumption and investment towards the end of the year. Still, by the fourth quarter of 2022, GDP remained below its pre-pandemic level in 2019-Q4.

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

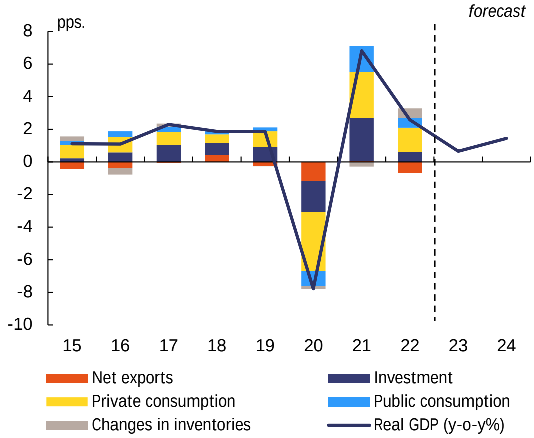


Economic activity is expected to gradually pick up in the first half of 2023 and to gain further momentum in the second half of the year. Overall, GDP growth is set to reach 1.4% in 2023, partly reflecting a higher-than-projected carry-over from 2022. As inflation moderates, stronger private consumption and a further normalisation of tourism are expected to sustain activity throughout the year. In addition, the implementation of the RRP is set to boost investment growth, notably in construction and equipment. In 2024, real GDP growth is projected to increase to 2.0%. Factors potentially weighing negatively on output going forward are the impact of the prolonged tightening of financial conditions on households and firms' financial positions, and the weakening of labour market dynamics.

Annual HICP inflation averaged 8.3% in 2022. It is forecast to moderate to 4.4% in 2023 and further to 2.3% in 2024. Energy prices declined markedly as from the third quarter of last year, but the pass-through of high energy prices to other items in the inflation basket has accelerated considerably. This is set to lift core inflation to elevated levels in 2023, particularly in the first half of the year amid lingering pressure especially from food and services prices, and in 2024. Inflationary headwinds this year are expected to be partially eased by the measures implemented by the government to mitigate the impact of high energy prices. These include the extension of some actions adopted in Autumn 2022 (e.g. VAT cuts to electricity and gas) and a new package unveiled last December, envisaging an additional discount voucher on electricity bills for vulnerable households and a further VAT reduction on a large number of food products. Second-round effects on wages were very limited in 2022. A faster-than-assumed adjustment would feed into higher core inflation over the forecast horizon.

2.7. FRANCE

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



GDP is estimated to have grown by 2.6% in 2022 on the back of a substantial carry-over effect from 2021. The economy slowed down in the second half of 2022 in a context of significant supply bottlenecks and increasing energy and commodity prices. The first estimate for the fourth quarter of 2022 came in at 0.1%, after 0.2% in the third quarter. Private consumption was flat amid a significant decline in consumers' confidence, while rising imports weighted on growth despite a muted domestic demand. Economic activity is expected to remain subdued over the first half of 2023, with a stable first quarter. Investment, in particular, is set to fall on the back of higher production costs, tighter financial conditions and heightened uncertainty. However, the projected deceleration of inflation is expected to allow for a gradual recovery in the second half of the year, with private consumption gaining momentum and investment growth rebounding as domestic demand and international trade bounce back. For the whole of 2023, GDP is forecast to expand only moderately in annual terms, by 0.6%.

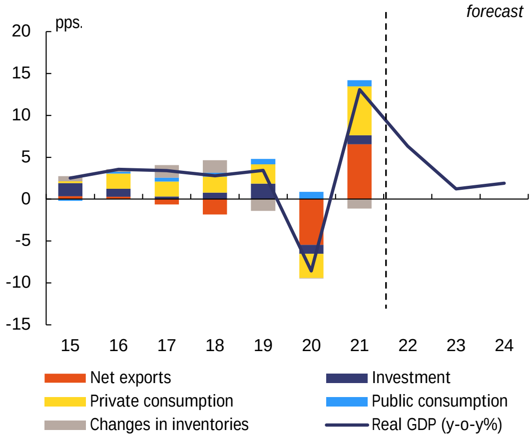
The French economy is projected to keep gaining traction until the end of 2024 as energy and food inflation moderate, and core inflation progressively declines. This gradual acceleration is expected to be driven by domestic demand, with a mostly preserved household purchasing power over the forecast horizon resulting from government measures, dynamic wages, and a very favourable labour market. Net exports' contribution to growth is set to remain moderately negative despite a strong growth of exports of goods and services. For the whole of 2024, GDP is forecast to expand by 1.4%.

HICP inflation has been continuously accelerating since the last quarter of 2021. It averaged 5.9% over the whole year 2022 and reached 7.0% in the fourth quarter of 2022, mainly driven by energy and commodity prices. At the start of this year, the increase in regulated electricity and gas prices, although capped to 15%, the end of the fuel rebate, the delayed transmission of energy prices along the whole value chain and the still significant supply shortages are set to feed into consumer prices. In 2023, inflation is expected to peak in the first quarter before progressively slowing down as wholesale prices of energy and commodities decelerate. Inflation is forecast to decrease only gradually through the end of the forecast horizon, as wage increases are set to feed into core inflation while the effect of lower energy prices on non-energy industrial goods comes with a delay. Overall, HICP inflation is projected to increase by 5.2% in 2023 and 2.5% in 2024.

2.8. CROATIA

Croatia's GDP contracted in the third quarter of 2022 (-0.4% quarter-on-quarter) due to declining investment and government consumption in a context of tighter financing conditions, supply chain disruptions and rising inflation. In the fourth quarter, mixed signals point to a broad stagnation although a technical recession cannot be ruled out, as industrial production and retail trade weakened but consumer and firms' confidence started to recover, especially in industry and services. Overall, the strong first half of the year is expected to allow Croatia to reach 6.3% real GDP growth in 2022, with domestic demand being the main driver of growth, but the external sector also contributing positively.

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



In 2023, real GDP is forecast to grow by 1.2% supported also by the accession of Croatia to the euro and Schengen areas, which is expected to further reduce costs and frictions to trade and travel and support inbound investments. At the same time, geopolitical tensions and a weaker global environment are set to weigh on external demand. Real incomes are expected to start recovering in the second half of the year, benefiting from lower energy and food inflation and a still resilient labour market, supporting a mild increase in household consumption.

Quarterly growth in 2023 is set to gain momentum as the year advances, inflation decelerates and consumer confidence recovers. Household consumption is expected to remain the most important contributor to growth as a tight labour market triggers higher wage growth in key sectors, such as hospitality. Investment is set to expand moderately, driven partly by the impulse of EU funds, while public consumption is also expected to add to growth. Weaker external demand for goods and services, coupled with higher growth in imports, is projected to contribute negatively to growth in both 2023 and 2024. In 2024, wage developments and the reduction of inflation towards target are expected to further support internal demand, while stronger activity in the country's main trading partners is set to boost export growth. Dynamic public and private investments are expected to sustain imports over the forecast horizon. Overall, GDP growth in 2024 is projected to reach 1.9%.

HICP inflation averaged 10.7% in 2022, above the euro area average (8.4%) but still below most EU central and eastern European countries. Stronger inflation in services, processed food and non-energy industrial goods are the main factors behind this relatively higher inflation rate. In 2023, base effects and a steeper decline in energy and food prices than previously expected are set to lower inflation to 6.5%, narrowing the gap to the euro area average (5.6%). In 2024, the negative contribution of energy prices, as well as the moderation of food and services prices, is forecast to bring inflation down to 1.6%.

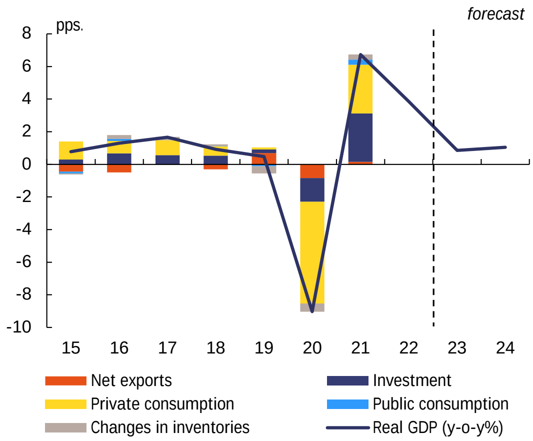
2.9. ITALY

Italy's economic output is estimated to have grown by 3.9% in 2022, driven by domestic demand, in particular housing investment. The sharp increase in energy prices in the second half of the year, however, led to a marked slowdown in private consumption and in firms' investment, in the context of rising financing costs.

After the small contraction recorded in the last quarter of 2022, economic activity is expected to pick up only gradually this year, as household consumption continues to be held back by the loss of purchasing power, also due to the expiry of tax rebates on transport fuels (at the end of 2022) and of other measures supporting households' incomes (at the end of March 2023). In the second half of the year, consumer spending is forecast to resume growing, in parallel with accelerating investments, also thanks to the public investment projects included in Italy's RRP. On average, GDP is set to grow by 0.8% in real terms in 2023.

Net exports are expected to subtract from GDP growth in both 2022 and 2023. In 2024, they are anticipated to become mildly supportive as exports of goods and services are set to benefit from a better outlook for international trade and still recovering tourist flows. Together with moderately expanding domestic demand, real GDP growth is forecast to reach 1.0% in 2024.

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

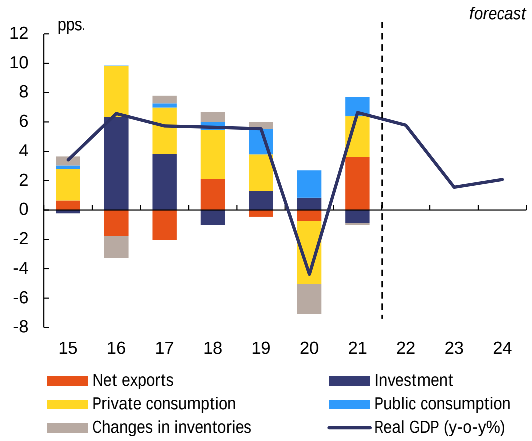


HICP inflation picked up substantially in 2022, fuelled by the sharp increase in energy prices. It is estimated to have peaked in the fourth quarter, averaging 8.7% over the whole year. Although international energy commodity prices have mostly fallen back to their 2021 levels, their increase has spread to producer and retail prices of food, industrial goods and eventually services. The higher inflation in the second half of 2022 carries over into 2023, but base effects are projected to help bring the annual rate down to 6.1%. Still subdued wage dynamics, given the slow process of collective contract renewal and the very partial indexation mechanism, as well as an expected stabilisation of commodity prices underpin the 2.6% inflation rate forecast in 2024. Core inflation is set to rise in 2023 before falling back gradually through 2024.

2.10. CYPRUS

Real GDP continued its solid growth momentum, increasing by 6.1% in the first three quarters of 2022 compared to the same period in the previous year. Despite rising inflation, private consumption remained robust, supported by increased employment and wages, and underpinned by targeted government measures to compensate for high energy prices. Tourism also played a role as arrivals regained lost ground during the pandemic and reached 80% of the 2019-levels. In addition, exports of business services increased significantly. On an annual basis, real GDP growth is estimated to have increased by 5.8% in 2022.

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



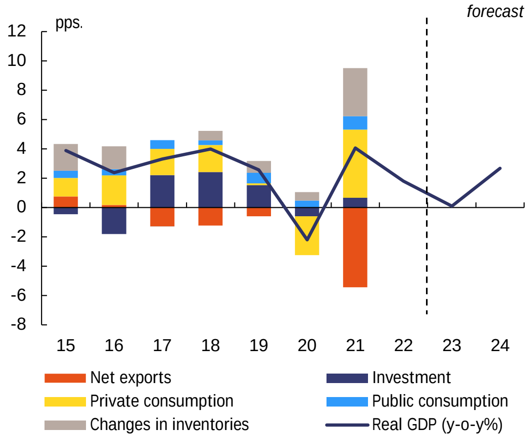
Economic sentiment among consumers and businesses slightly improved in January 2023. The improved economic outlook among Cyprus's trading partners is set to further support tourism, which is expected to almost reach the 2019-level. The 50% wage indexation, implemented in January 2023, is expected to somewhat support purchasing power. However, increasing interest rates are set to negatively affect corporate investments and residential construction. Elevated prices and tightening monetary policy are expected to weigh on real GDP growth, which is forecast to slow down to 1.6% in 2023, before accelerating to 2.1% in 2024.

HICP inflation reached 8.1% in 2022 fuelled by high energy prices and supply bottlenecks. HICP inflation is projected to decrease over the forecast horizon, as falling gas and oil prices ease energy inflation and supply disruptions attenuate further. By contrast, wage indexation is expected to exert some upward pressure on core inflation. Overall, HICP inflation is set to moderate to 4% in 2023 and to 2.5% in 2024.

2.11. LATVIA

Real GDP is estimated to have grown by 1.8% in 2022, driven primarily by strong growth in private consumption, which was still regaining the ground lost during the acute phase of the pandemic. However, the inflation surge in the second half of the year, which weighed on household disposable income, combined with an investment slowdown, resulted in negative economic growth in the third quarter. As these factors persist throughout the winter, growth is expected to remain lacklustre at the start of 2023. Thereafter, with inflation moderating, domestic consumption is set to pick up. Additionally, EU funded investments, including those financed by the RRF, are projected to pick up, providing a further boost to economic growth in the second half of 2023. However, given the decline in activity in second half of 2022 and, hence, the negative carry-over, yearly growth in 2023 is expected to be almost flat.

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



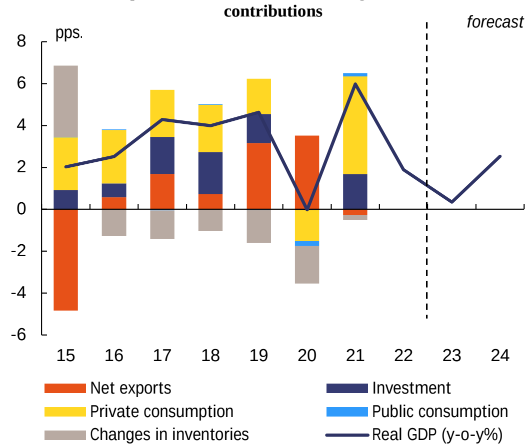
In 2024, growth is forecast to pick up to 2.7%. A marked slowdown in inflation is set to foster private consumption. A further increase in EU-funded investments and a decline in prices of construction materials are expected to boost investment, even though higher interest rates are set to dampen this effect. Export growth is projected to pick up as the inflation slowdown elsewhere in the EU boosts foreign demand.

Consumer price inflation increased rapidly throughout the year and averaged at 17.2% in 2022. It appears to have peaked in the third quarter of 2022. Energy prices are set to continue slightly declining during 2023, after having peaked in 2022-Q3. In 2023, headline inflation is forecast to remain elevated at 7.9% as the energy price shock works its way through the other inflation components. In 2024, inflation is expected to slow down to 1.5% as energy prices decline somewhat and growth of other prices slows down, except for services inflation, which is set to accelerate as wages partially catch up with the price increase of the past years.

2.12. LITHUANIA

Following the Russian invasion of Ukraine, economic growth in Lithuania slowed down in 2022 to 1.9%. Quarterly growth was subdued throughout the year and turned negative in the fourth quarter (at -1.7%). Economic activity was dampened by falling exports to some eastern European countries and contracting private consumption, as high inflation was not compensated by the rise of labour income.

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



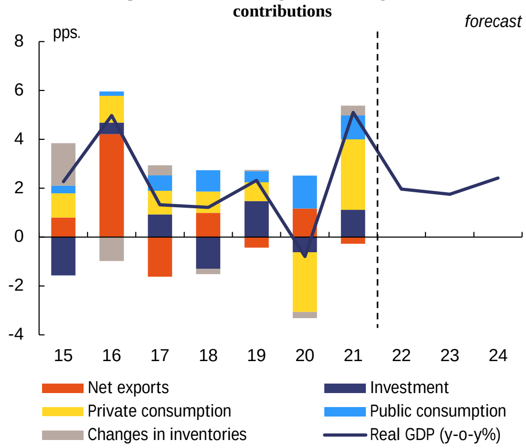
In the near term, economic activity is set to continue to be impacted by economic and geopolitical uncertainty, the deteriorating financial situation of companies and weakening purchasing power of households. Only moderate quarterly growth is forecast for the entire 2023. Overall, growth is expected to reach 0.3% in 2023, down from the 0.5% growth forecast in autumn. In 2024, growth is projected at 2.5%, driven by stronger private consumption expenditure. Additionally, increased EU funds absorption, notably of the RRF, is set to support aggregate investment in both 2023 and 2024.

Following its peak in September 2022, headline HICP inflation has started declining on the back of plunging global oil prices and domestic efforts to curb the energy price increase for consumers, including the VAT rate cut on heat energy. Non-energy price inflation, by contrast, is still relatively high, possibly reflecting the lagging effects of costs that surged in the previous months. Nevertheless, following 18.9% inflation in 2022, the rate of price growth is projected to decrease to 8.7% in 2023 and 2.1% in 2024. Weaker activity both in the domestic economy and in major trading partners, easing shortages of various production inputs, and a gradual decline in global energy prices are expected to contribute to the declining dynamics of inflation.

2.13. LUXEMBOURG

After a subdued first half of the year, with a slowdown of investment and export of goods, real GDP accelerated in 2022-Q3 (1.1% q-o-q) on the back of resilient private consumption and a robust financial sector. Overall, annual growth for 2022 is revised up to 2%.

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



Higher growth projected in 2022 and a stronger increase in domestic demand (compared with the Autumn Forecast) are set to lift the GDP outlook for 2023. In particular, private consumption is expected to rise, supported by government measures to mitigate the impact of high energy prices and by sequential indexations of wages sustaining household purchasing power. Investment is set to be supported by decreasing commodity prices and improving confidence, as reflected in business sentiment indicators. Nevertheless, the tightening of financial conditions is expected to weigh on investment, particularly in the construction sector. Residential real estate construction is projected to decline due to rising interest rates that negatively affect the borrowing capacity of households and demand for mortgages. Overall, real GDP is forecast to slow down to 1.7% in 2023, before returning to 2.4% in 2024, more in line with potential growth and mainly driven by the better investment outlook.

After having peaked in 2022-Q2, headline inflation gradually decelerated in the last two quarters, driven by the slowdown in energy and services price growth, while prices of food and non-energy industrial goods continued to accelerate. For the year as a whole, HICP inflation reached 8.2%, with major contributions from energy and food prices. The projected further decrease in wholesale energy prices in combination with a package of government measures (the so-called *Solidaritéitspak*) to support households and businesses in mitigating the impact of elevated energy costs are expected to ease inflationary pressures in 2023. Overall, HICP inflation is set to decrease significantly to 3.1% in 2023 and further to 2.7% in 2024. By contrast, core inflation is forecast to increase due to rising food, non-energy industrial goods and services prices, and further driven by wage indexations. Following the wage indexation of February, two additional ones (also of 2.5% each) are anticipated to take place this year, in April (postponed from July 2022), and in the fourth quarter. In 2024, core inflation is expected to decrease, mainly reflecting a slowdown in food and services prices, while only one wage indexation is projected in the third quarter.

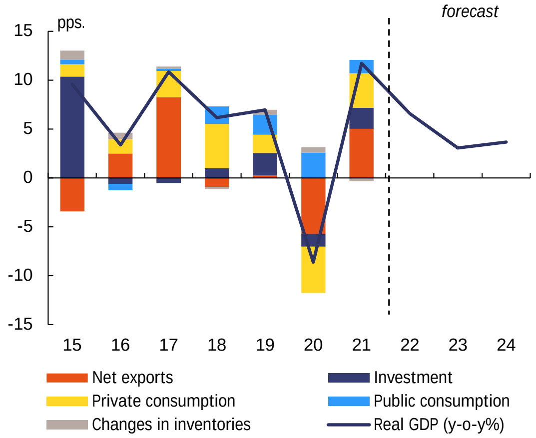
2.14. MALTA

In 2022, real GDP growth is estimated to have reached 6.6%, which is higher than projected in autumn. The economy showed strong growth in both private and public consumption, which were partially offset by a decrease in gross fixed capital formation. In addition to strong performance by the services sectors in general, the export of tourism services in 2022 rebounded quickly, both in terms of total number of visitors and tourism expenditures, contributing to overall positive economic results. In 2023, real GDP is forecast to grow at a slower pace, by 3.1%, following a wider economic slowdown in Malta's main trading partners. In 2024, real

GDP growth is expected to reach 3.7%, supported by net exports and growth in domestic demand. The strong impulse to growth from the recovery in tourism is however set to moderate in 2024, as tourist flows approach pre-pandemic levels.

HICP inflation in 2022 reached 6.1%, despite energy prices being kept at 2020 level by government intervention. The Maltese authorities announced that they will continue limiting energy inflation in 2023 and 2024. Nonetheless, inflation in 2023 is set to remain elevated at 4.3%, due to continuing pressures in food, transport, and imported goods prices. In 2024, inflation is expected to subside to 2.4% as imported price pressures are also set to moderate.

Graph 2.14: **Malta - Real GDP growth and contributions**

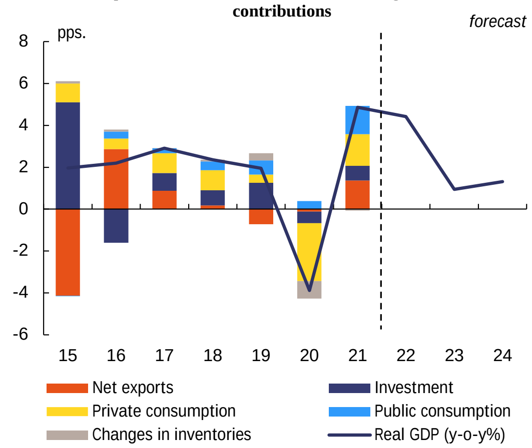


2.15. THE NETHERLANDS

The Dutch economy grew strongly in the first half of 2022, but is expected to have slowed down markedly in the second half. High inflation rates have reduced households' purchasing power, while tightening financial conditions, labour shortages, increased input prices and uncertainty are weighing on business investment. This resulted in a small contraction in economic activity in the third quarter of 2022 and is expected to have led to stagnation in the fourth quarter. Annual growth in 2022 is estimated at 4.4%.

Private consumption growth is set to remain subdued in 2023, with increasing wage growth and support measures from the government only partially offsetting the loss in purchasing power caused by increased prices. Business investment is expected to remain weak as financial tightening continues while labour shortages persist. Overall, growth in 2023 is forecast at 0.9%. Growth is projected to pick up to 1.3% in 2024 on the back of easing inflation and a partial recovery in households' purchasing power. Decreasing input prices for raw materials are also expected to lead to a pick-up in investment growth.

Graph 2.15: **The Netherlands - Real GDP growth and contributions**



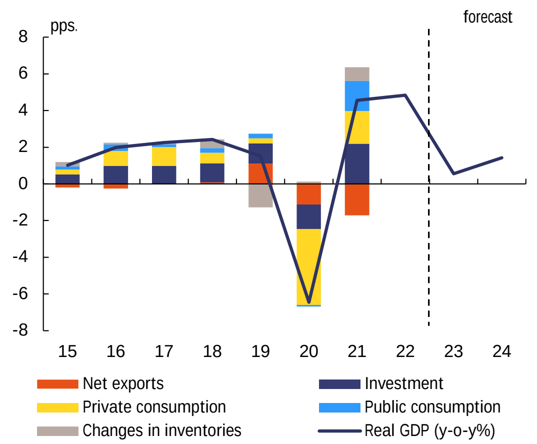
HICP inflation in 2022 surged on the back of increasing energy prices and peaked in September at 17.1% y-o-y. Since then, energy price inflation has come down and headline inflation decreased to 11% y-o-y in December. For 2023, the authorities have put in place a price cap for gas and electricity to protect consumers from further energy price spikes. Core inflation is forecast to come down slightly but remain elevated throughout 2023, also supported by increasing wage growth. Overall, the decrease in energy prices and the introduction of the price cap are expected to bring headline inflation down to 4.5% in 2023, from 11.6% in 2022. Inflation is forecast to slow down to 2.7% in 2024 as energy prices ease further and core inflation slowly continues to decelerate.

2.16. AUSTRIA

After a strong rebound at the beginning of 2022, following the acute phase of the COVID-19 pandemic, growth slowed down since mid-2022 (0.2% q-o-q growth in 2022-Q3) on the back of a reduction in industrial output. This decline in industrial production is expected to have continued, leading to a technical recession with GDP growth estimated at -0.7% in 2022-Q4 and forecast at -0.2% in 2023-Q1. Currently, economic sentiment indicators as well as the Purchasing Managers' Index remain substantially below their long-term averages.

On an annual basis, solid GDP growth of 4.8% is estimated for 2022, essentially due to the unwinding of the COVID-19 crisis. Looking ahead, growth is set to benefit from increasing real disposable incomes as energy prices moderate and wages increase. However, labour shortages are currently at a very high level and, combined with falling industrial production and generally low economic sentiment, they are expected to restrain the growth momentum. Therefore, the Austrian economy is forecast to grow by 0.5% in 2023 and 1.4% in 2024.

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

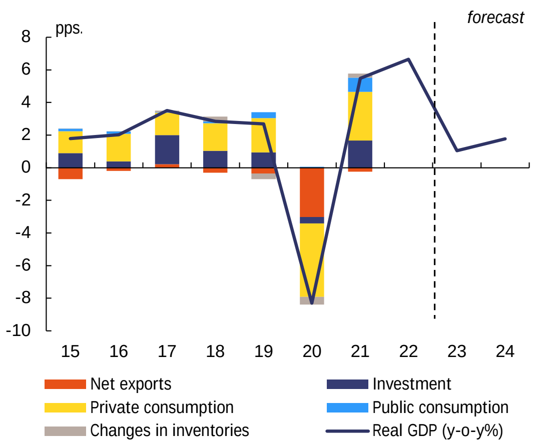


Inflation is expected to stay elevated over the forecast horizon. In 2022, consumer prices were pushed upwards by high energy inflation. Moreover, wage agreements in recent months have resulted in wages settling slightly above the inflation rate, leading to additional pressure on prices. With energy inflation expected to moderate throughout 2023, consumer price inflation is forecast to settle at 6.6% (from 8.6% in 2022). In 2024, core price developments are set to moderate, with inflation projected at 3.6%.

2.17. PORTUGAL

Portugal's economy continued growing in the final quarter of 2022, despite challenging global conditions. According to the flash estimate, GDP increased by 0.2% (q-o-q) in 2022-Q4, after growing by 0.1% and 0.4% in the previous two quarters. On an annual basis, growth in 2022 is estimated at 6.7%, up from 5.5% in 2021. Private consumption and net exports contributed significantly to the expansion, benefiting from a strong rebound in tourism after the lifting of COVID-19 restrictions. On the production side, industrial production and construction remained relatively weak, particularly in the last quarter of the year, due to unfavourable external conditions and volatile commodity prices.

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



In 2023 as whole, growth is forecast to slow down to 1.0%. Despite the recent downturn in wholesale energy prices and improving economic sentiment, the growth outlook for the first quarter of the year remains weak as consumers and businesses are still facing uncertainties about energy costs in the winter months. Growth is projected to improve somewhat in the second quarter of 2023 and to further pick up thereafter, reaching a full-year rate of 1.8% in 2024 against the backdrop of assumed stronger external demand and more favourable commodity prices.

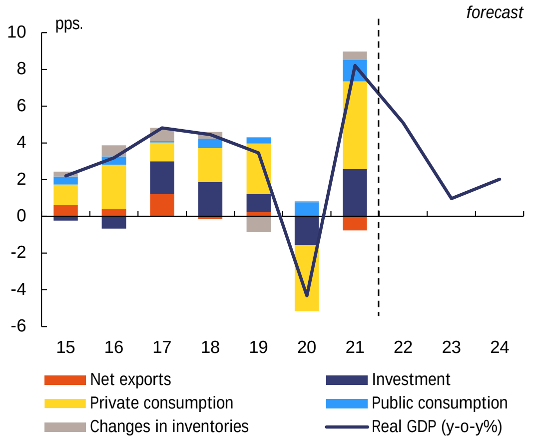
Headline inflation rose from 9.5% (y-o-y) in 2022-Q3 to 10.2% in 2022-Q4 as the observed acceleration in prices of food and industrial goods outweighed the slowdown in prices of energy and services. The flash estimate for January 2023 confirmed the expectations that the peak in inflation was reached in 2022-Q4, as the headline inflation rate slowed to 8.6% (y-o-y) during the month, reflecting a substantial downturn in the energy price index.

Inflation is projected to slow further over the forecast period in line with the downward correction in wholesale energy prices and the assumed developments in commodity markets. The heavy rainfalls in the Iberian Peninsula over the past months are also expected to support the disinflationary path both on the energy and food markets, partly reversing the negative effects from the severe drought that affected the country until September 2022. The increased level of water reservoirs already appears to contribute to the significant decrease in the wholesale electricity prices on the Iberian market. However, rising wage pressures are expected to keep services prices and core inflation relatively high. Overall, inflation is projected to slow from 8.1% in 2022 to 5.4% in 2023 and 2.6% in 2024.

2.18. SLOVENIA

Slovenia's GDP is projected to have expanded by 5.1% in 2022, mainly supported by the strong carry-over from 2021. Over the first three quarters of 2022, private consumption continued to increase and investments proved robust. Imports increased significantly faster than exports, leading to a negative contribution from net exports. In the third quarter, the economy contracted quite strongly. Slowly improving economic sentiment over the last months suggests that this trend could be partly reversed in the final quarter of the year. Employment has remained strong and the industrial production indicator also improved.

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



Continuing global economic uncertainty and the tightening of financial conditions are expected to limit growth in the beginning of 2023. However, as employment remains high and wage growth is set to be robust, growth is projected to improve as from the second half of 2023. While private consumption is expected to grow only modestly after its rapid increase in 2022, investment is forecast to continue growing, partly sustained by RRF-supported public investments. Public consumption is set to grow faster than in 2022 fuelled by increases in public wages. Exports growth is projected to accelerate in 2023, but net exports are set to remain negative due to strong imports. Overall, GDP is forecast to grow by 1.0% in 2023 and 2.0% in 2024.

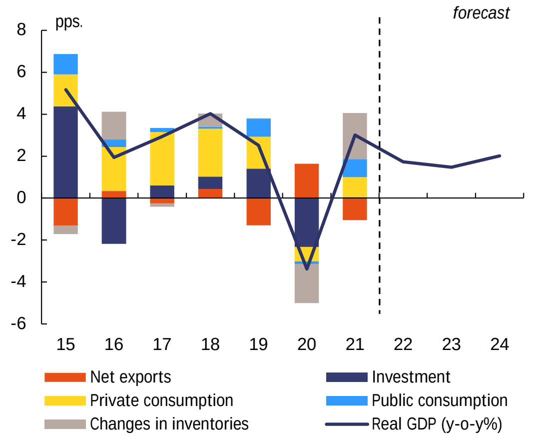
Inflation in the final quarter of 2022 was slightly lower than in the third quarter. However, energy inflation was the only component that decreased, with the prices of industrial goods, food and services increasing faster than before. Overall, inflation averaged 9.3% in 2022. With global energy prices easing and growth remaining weak, headline inflation is projected to decrease to 6.1% in 2023. In 2024, inflation is forecast to fall further to 3.5% on the back of assumed economic growth and moderation of energy prices. Core inflation is expected to remain elevated on account of more generalised price and wage growth.

2.19. SLOVAKIA

The Slovak economy is projected to grow faster than previously expected thanks to government measures to reduce the impact of rising energy prices on households and businesses, and an improved economic outlook in Slovakia's major export destinations. After an estimated growth of 1.7% in 2022, real GDP is forecast to increase by 1.5% in 2023 and by 2.0% in 2024. Although the weakening of global demand is still expected to weigh on economic activity, subsidised energy prices should support both households and energy-intensive exporters in 2023.

Newly announced government measures are projected to help avoid a crunch in consumer spending in 2023 by reducing the impact of higher energy prices. However, a real wage decrease is set to keep a lid on private consumption growth. Exports are expected to pick up in 2023 and 2024, as supply bottlenecks ease, energy prices are subsidised and the economic situation in major export destinations, like Germany, improves. EU funds are assumed to significantly contribute to investment growth in 2023, even to a larger extent than in 2022, although tighter financing conditions are expected to mute growth somewhat.

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



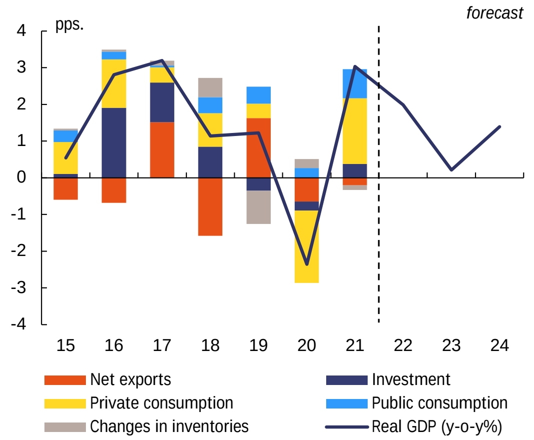
Inflation soared to over 12% in 2022 due to high energy prices and the pass-through to core components, particularly food. Consumer food prices are expected to continue to grow swiftly and to remain the main driver of inflation in 2023, just like in the last quarter of 2022. High energy prices are expected to keep inflationary pressures broad-based, and a tight labour market is set to contribute to more persistent growth of prices in the service sector. The government measures are expected to be at least partially phased out in 2024, increasing energy inflation. Therefore, inflation is forecast at 9.7% in 2023 and at 5.3% in 2024.

2.20. FINLAND

Finland's economic growth in 2022 was interrupted in the third quarter with a small decline in real GDP. Against the backdrop of Russia's war of aggression against Ukraine, high inflation and rising interest rates dented consumption after a very strong performance in the second quarter of 2022. Exports of goods remained relatively robust despite the decline in trade with Russia, but export growth was outpaced by imports, thus contributing negatively to GDP growth. Investment and government consumption continued to support growth and unemployment declined further in the fourth quarter of 2022. Overall, real GDP growth in 2022 is estimated at around 2%.

Real GDP growth is forecast to decelerate to 0.2% in 2023 and then pick up to 1.4% in 2024. In 2023, private consumption and investment are forecast to stay subdued, while exports are expected to remain resilient. Gradually recovering domestic demand is projected to support the economy towards the end of the forecast horizon.

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



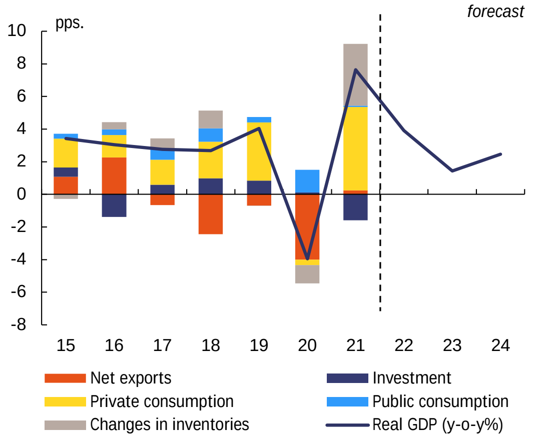
Annual HICP inflation reached 7.2% in 2022 and peaked in the last quarter. Declining energy prices are set to put downward pressure on headline inflation going forward. However, core inflation will remain relatively high due to generalised price increases across different categories of goods and services, as well as to wage pressures in the economy. Overall, HICP inflation is projected to stand at around 4% in 2023 and fall back to approximately 2% in 2024.

NON-EURO AREA

2.21. BULGARIA

Despite high inflation, economic activity continued to expand in 2022, supported by robust growth in exports and by wage and social transfer increases that compensated for increasing consumer prices. Still, private consumption growth decelerated in the first half of the year as inflation gathered pace. However, consumer demand is assumed to have firmed up in the second half of 2022 due to continued growth in disposable income, combined with some moderation in month-on-month inflation dynamics. The downward trend in fixed capital investment that started in 2021 persisted in 2022. Growing prices of investment goods, both in construction and equipment, have likely supressed new investment. Overall, real GDP is estimated to have increased by 3.9% in 2022.

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



Real GDP is expected to increase by 1.4% in 2023 and by 2.5% in 2024. The path of the economy is expected to largely depend on the interplay between wage and price developments. The short-term indicators and inflation figures suggest that inflation is set to decrease only gradually over the forecast horizon, as services price inflation is set to persist. In the context of a tight labour market, wages are expected to continue to grow strongly and to sustain household consumption. Rapid export growth in 2022 was underpinned by the possibility to satisfy supply shortages of food, metal and other materials products, caused inter alia by the Russia war of aggression against Ukraine. Export growth is forecast to slow down considerably in 2023 given that the factors for further gains in export market share were largely exhausted in 2022. In 2024, exports are expected to grow in line with external demand. Increased EU funds absorption, notably of the RRF, is set to support aggregate investment in both 2023 and 2024. Potential delays in RRP implementation constitute a downside risk to investment growth.

Average HICP inflation reached 13% y-o-y in 2022, with a strong contribution from energy and food price inflation. The dynamics in services' prices was driven by transport and restaurant services that rely on energy and/or food as direct inputs. Towards the end of the year, inflation also spread to other services, in line with increasing unit labour costs. Overall, HICP inflation is set to decline from 13% in 2022 to 7.8% in 2023 on account of lower energy prices. In 2024, headline inflation is set to decelerate further to 4%, as food price dynamics abate. Services price inflation is set to persist over the forecast horizon.

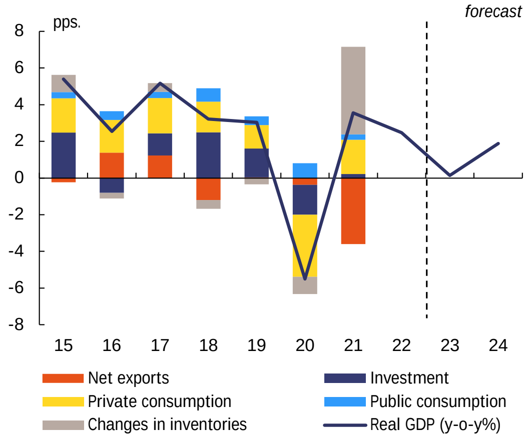
2.22. CZECHIA

Real GDP increased by 2.5% in 2022, according to the preliminary GDP release. The Czech economy benefited from strong investment activity, while private consumption slowed down from the previous year. In the fourth quarter of 2022, economic activity declined by 0.3% q-o-q. Economic growth in Czechia is forecast to stagnate in the first quarter of 2023 and to resume growth from the second quarter onwards, reaching its pre-pandemic level in 2023-Q4. Overall, GDP growth is forecast at 0.1% in 2023 and 1.9% in 2024.

Investment growth is expected to be the main driver of economic activity also in 2023 despite its significant decline compared to the previous year. While a deterioration in firms' financial situation and tight financial conditions are weighing on private investment, investment activity is set to benefit from EU funds, including the RRF.

While supported by fiscal measures, household consumption is expected to stagnate in 2023 on the back of a decline in real disposable income, a tight financial situation of households, and low consumer sentiment. Household consumption is, however, set to be the main growth contributor again in 2024. Similarly, net exports are expected to have a neutral impact on the economic performance in 2023 and to add to growth in 2024, supported by the assumed easing of supply bottlenecks and an improving economic situation in Czechia's main trade partners.

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

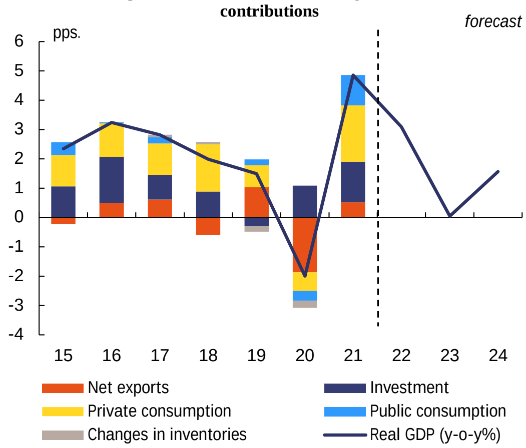


Inflationary pressures declined towards the end of 2022 on the back of government measures to mitigate the impact of high energy prices. Annual HICP inflation reached 14.8% in 2022. Cost pressures are set to continue to ease during 2023, supported by government-imposed caps on energy prices and related indirect effects. Moreover, a decline in real disposable income and tight monetary policy are expected to prevail in 2023 amid stagnating economic growth. HICP Inflation is forecast to decline to 9.3% in 2023 and to decelerate to 3.5% in 2024.

2.23. DENMARK

Denmark's economic performance in 2022 was marked by strong net exports, some positive stock building and rather subdued domestic demand. Investment was depressed by rising interest rates, while private consumption suffered from markedly falling real wages due to high inflationary pressures. Annual real GDP is estimated to have expanded by 3.1%, largely due to a positive carry-over from 2021.

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



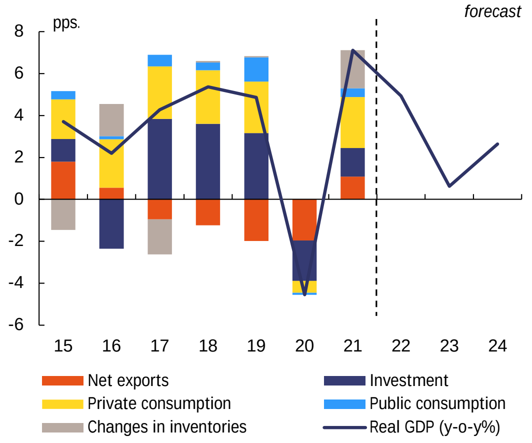
Domestic demand is expected to remain sluggish in late 2022 and the first half of 2023, as rising interest rates and subdued international demand prospects weigh on investment. Meanwhile, high inflation is set to lead to continued fall in real wages, which is expected to hold back private consumption. Net exports, however, continue to provide a sizeable impetus to growth. Overall, real GDP is forecast to grow by 0.1% in 2023.

Financially sound households and positive, albeit cooling, labour market developments reflected in high employment are expected to attenuate the falling domestic demand going into 2024. Domestic demand is set to recover in late 2023 and 2024, helped by slightly stronger private demand. With slowing international growth, domestic demand could re-emerge as a growth driver. Overall, for the whole of 2024, real GDP is projected to grow moderately, at 1.6%.

After accelerating throughout much of 2022, HICP inflation appears to have peaked and declined markedly in the final months of the year. Overall, HICP inflation reached 8.5% in 2022. In 2023, inflation is projected to fall on the back of base effects and lower energy prices. Previous price increases for food, raw materials and other imported goods will only be partly reversed, while base effects are set to level off inflationary pressures from these components in 2023 and further in 2024. Core inflation is expected to decline more slowly, owing to expected wage increases following collective wage bargaining in spring 2023. On the back of receding inflationary pressures, HICP inflation is forecast to decrease to 4.4% in 2023 and further to 2.5% in 2024.

2.24. HUNGARY

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



Hungary's economy contracted by 0.4% q-o-q in the third quarter of 2022 as the impact of earlier fiscal stimulus faded and severe droughts hit agricultural production. Consumption and investment slowed down, inventories declined, while easing supply chain disruptions led to a pick-up in export growth. In 2022-Q4, a further decline in economic activity is expected as rising energy prices further weighed on domestic demand.

Economic growth is set to remain subdued in 2023 as the economy gradually adjusts to higher energy prices. Private consumption is projected to shrink at the turn of 2022/23 as high inflation squeezes households' purchasing power. Investment is also expected to fall, driven by weaker demand, rising borrowing costs and fiscal consolidation efforts. Indicators of housing transactions and lending point to a downturn in the housing market, which is expected to limit construction activity further. While export growth is forecast to slow down in line with external demand, imports are set to do so even more, as domestic energy demand adjusts to higher prices. The external balance is thus expected to improve, also supported by the assumed moderation of energy commodity prices compared to 2022 levels. Economic growth is set to pick up gradually over the forecast horizon as inflation recedes and external demand improves. Real GDP growth is forecast to decrease from 4.9% in 2022 to 0.6% in 2023, before recovering to 2.6% in 2024.

HICP inflation increased to 25% in December 2022. Core inflation also continued to rise, reflecting broad-based price pressures from rising production costs, currency depreciation and indirect tax hikes in several sectors in 2022. The pass-through of higher costs and taxes is set to continue in 2023, and HICP inflation is projected to rise from an annual average of 15.3% in 2022 to 16.4% in 2023. The increase of administrative residential energy prices in August 2022 and the phase-out of the motor fuel price cap in December 2022 are set to add nearly 4 pps. to annual average inflation in 2023. Once the price level adjusts to higher costs, inflation is expected to subside to 4.0% in 2024, supported by the assumed moderation of commodity prices and the continuing weakness of consumer demand.

Hungary's economic outlook remains sensitive to global investor sentiment. The country is also particularly exposed to energy price changes and potential supply disruptions due to its large dependence on energy imports and its limited scope for import diversification in the short term. Inflationary risks are tilted to the upside as inflation expectations might become entrenched at a high level.

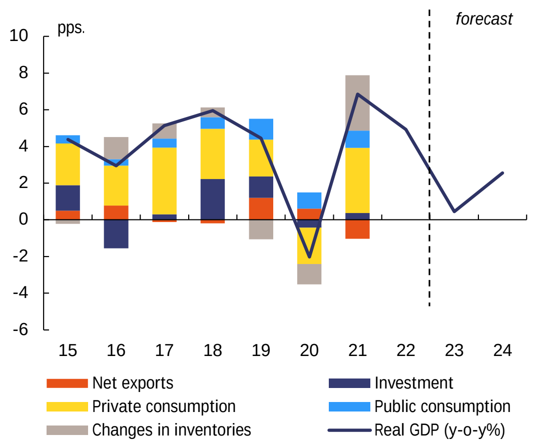
2.25. POLAND

Despite significant headwinds, the Polish economy continued on a strong growth path in 2022, supported by an expansionary fiscal stance, a favourable situation in the labour market and the large inflow of displaced persons from Ukraine. Data on the real economy suggests that economic growth in the fourth quarter weakened visibly, partly due to elevated inflation and tighter financing conditions. Nevertheless, a strong revision of historical data led to a significantly higher starting GDP level for 2022, lifting the real GDP growth projection in 2022 to 4.9% - i.e. 0.9 pps. higher than in the Autumn Forecast.

Elevated inflation and low consumer and business confidence are expected to keep weighing on economic growth in the coming quarters. In particular, declining real incomes amid an already low savings rate will likely put downward pressure on private consumption, which is projected to decrease slightly in 2023. Private investment, especially in construction, is expected to continue being affected by higher interest rates and elevated uncertainty. Still, a significant inflow of foreign direct investment and an expected rise in public spending (particularly on defence) are set to more than outweigh these factors, leaving total investment growth well into positive territory over the forecast horizon. Regarding foreign trade, the easing of supply bottlenecks will likely support export growth. Coupled with a weak import outlook, net exports are projected to contribute positively to growth in 2023 and, to a lesser extent, 2024. All in all, after decelerating to 0.4% in 2023, GDP growth is expected to bounce back to 2.5% in 2024 as inflation eases and global economic growth gathers pace.

HICP inflation has consistently surprised on the upside throughout 2022 due to increased prices of commodities, rising production costs and demand pressures, which allowed businesses to pass costs down to consumers. Going forward, despite the measures introduced by the government to limit the increase in gas and electricity prices, energy price inflation is expected to remain elevated due to the phasing-out of tax breaks on energy products in January 2023. While core inflation will likely be fuelled by strong wage growth and an expansionary fiscal stance, falling wholesale energy prices and some easing in the labour market are expected to gradually dampen inflationary pressures, especially towards the end of the forecast horizon. Consequently, after peaking in the first quarter of 2023 at almost 17.0%, HICP inflation is projected to decelerate to 4.2% in the final quarter of 2024, leaving yearly HICP inflation at 11.7% in 2023 and 4.4% in 2024.

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



2.26. ROMANIA

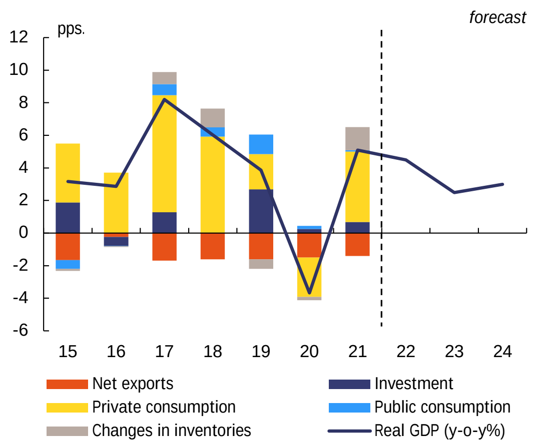
In the first three quarters of 2022, Romania's annual real GDP grew by 4.3%, due to strong gross fixed capital formation and private consumption, which was supported by a strong labour market and wage growth, in combination with government support measures to mitigate the impact of high energy prices.

Based on short-term indicators, Romania's economy is expected to have been resilient in the fourth quarter, on the back of favourable developments in the services sector and economic sentiment, and despite the further fall of production in manufacturing.

For 2023, the negative impact of still high inflation, tight financing conditions and the slowdown of the other EU economies are all set to lower real GDP growth in Romania to 2.5%.

The implementation of the RRP should contribute to strong investment, which is expected to be the main growth driver. Other EU funds are set to support investment as well. Private consumption, although negatively affected by high inflation, is projected to grow due to increases in the minimum wage, pensions, and public sector wages, as well as to the extension of the energy price cap until 2025. Net exports are expected to remain negative on the back of a strong currency and low demand in export markets.

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



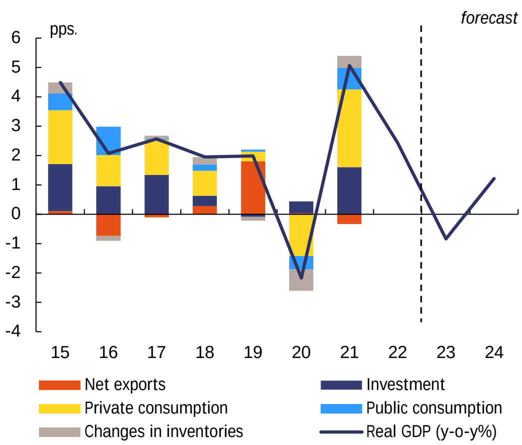
A rebound of 3% in economic growth is projected for 2024 on the back of receding inflationary pressures, lower interest rates, and improved external outlook.

The annual HICP inflation slowed down in December on the back of lower energy and food commodity prices, bringing the 12-month average in 2022 to 12%. HICP inflation is expected to ease further over the forecast horizon, but only modestly as inflationary pressures remain very high in core components such as services, non-energy industrial goods and processed food. Average annual HICP inflation is projected at 9.7% for 2023 before slowing down to 5.5% in 2024 due to the extension of the energy price cap, lower commodity prices and base effects kicking-in.

2.27. SWEDEN

In 2022, the Swedish economy is estimated to have grown by 2.4%, largely propelled by a powerful carry-over from 2021. In the course of last year, private consumption was constrained by high inflation, which eroded real disposable incomes, and the growing burden of mortgage loans, as monetary policy tightened. Gross fixed capital formation held up relatively well due to strong corporate balance sheets. Net trade subtracted from growth in the context of the large terms-of-trade shock with import growth, propelled also by investment, surpassed export growth. GDP decreased in the fourth quarter with records on both the production and the use side indicating a 0.6% quarter-on-quarter decline of the economy.

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



The economy is expected to keep contracting in the first half of 2023, before picking up later in the year. Households are set to further adjust their consumption expenditure in response to the loss of real disposable income, high uncertainty and increasing unemployment. Moderate consumption growth is expected from 2023-Q3 onwards as the inflation shock dissipates, real disposable income starts recovering and the housing market reaches its trough.

Construction activity is expected to contract strongly in 2023 due to higher construction costs, depressed demand from higher interest rates and falling real disposable income. At the beginning of 2023, corporates are expected to reduce investment against rising short-term interest rates and uncertainty. However, order books are still well-filled and corporates still have good margins. This should help to support corporate investment later in 2023. Sizable nominal wage growth, a still solid labour market performance and a bottoming out of the housing market are set to support growth going into 2024. Overall, real GDP is forecast to shrink by 0.8 % in 2023 and to increase by 1.2 % in 2024.

Annual HICP inflation increased to 8.1% in 2022. Electricity prices rose strongly until the end of 2022, when they started to fall across the EU and in Sweden. Electricity and other energy prices are projected to decline strongly in 2023 in line with current energy futures. Domestic wage and price pressures are expected to remain contained over the forecast period. Core inflation, however, is set to increase in 2023 as higher costs are still being passed on to consumers. Menu costs and more price-aware consumers, as well as downward pressure on demand, are expected to limit further price increases. Overall, HICP inflation is forecast to average 6.3% in 2023 and decrease to 1.8 % in 2024.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2004-2024) 01.02.2023

	5-year averages							Winter 2023 interim Forecast			Autumn 2022 Forecast		
	2004 - 08	2009 - 13	2014 - 18	2018	2019	2020	2021	2022	2023	2024	2022	2023	2024
Belgium	2.5	0.7	1.7	1.8	2.2	-5.4	6.1	3.1	0.8	1.6	2.8	0.2	1.5
Germany	1.9	0.6	1.9	1.0	1.1	-3.7	2.6	1.8	0.2	1.3	1.6	-0.6	1.4
Estonia	5.6	-0.4	3.5	3.8	3.7	-0.6	8.0	-0.3	0.1	2.8	-0.1	0.7	2.1
Ireland	3.6	-0.3	10.3	8.5	5.4	6.2	13.6	12.2	4.9	4.1	7.9	3.2	3.1
Greece	2.8	-5.9	0.5	1.7	1.9	-9.0	8.4	5.5	1.2	2.2	6.0	1.0	2.0
Spain	3.1	-1.8	2.7	2.3	2.0	-11.3	5.5	5.5	1.4	2.0	4.5	1.0	2.0
France	1.9	0.4	1.5	1.9	1.8	-7.8	6.8	2.6	0.6	1.4	2.6	0.4	1.5
Croatia	4.1	-2.3	2.4	2.8	3.4	-8.6	13.1	6.3	1.2	1.9	6.0	1.0	1.7
Italy	0.9	-1.6	0.9	0.9	0.5	-9.0	6.7	3.9	0.8	1.0	3.8	0.3	1.1
Cyprus	4.7	-1.9	3.9	5.6	5.5	-4.4	6.6	5.8	1.6	2.1	5.6	1.0	1.9
Latvia	7.4	-1.7	3.1	4.0	2.6	-2.2	4.1	1.8	0.1	2.7	1.9	-0.3	2.6
Lithuania	7.1	-0.3	3.3	4.0	4.6	0.0	6.0	1.9	0.3	2.5	2.5	0.5	2.4
Luxembourg	4.1	1.2	2.5	1.2	2.3	-0.8	5.1	2.0	1.7	2.4	1.5	1.0	2.4
Malta	2.9	2.9	7.5	6.2	7.0	-8.6	11.7	6.6	3.1	3.7	5.7	2.8	3.7
Netherlands	2.7	-0.4	2.2	2.4	2.0	-3.9	4.9	4.4	0.9	1.3	4.6	0.6	1.3
Austria	2.7	0.3	1.7	2.4	1.5	-6.5	4.6	4.8	0.5	1.4	4.6	0.3	1.1
Portugal	1.4	-1.6	2.2	2.8	2.7	-8.3	5.5	6.7	1.0	1.8	6.6	0.7	1.7
Slovenia	4.9	-1.9	3.5	4.5	3.5	-4.3	8.2	5.1	1.0	2.0	6.2	0.8	1.7
Slovakia	7.3	1.1	3.3	4.0	2.5	-3.4	3.0	1.7	1.5	2.0	1.9	0.5	1.9
Finland	3.4	-1.0	1.5	1.1	1.2	-2.4	3.0	2.0	0.2	1.4	2.3	0.2	1.4
Euro area (20)	2.1	-0.4	1.9	1.8	1.6	-6.1	5.3	3.5	0.9	1.5	3.2	0.3	1.5
Bulgaria	6.6	0.1	2.6	2.7	4.0	-4.0	7.6	3.9	1.4	2.5	3.1	1.1	2.4
Czechia	5.3	-0.3	3.7	3.2	3.0	-5.5	3.6	2.5	0.1	1.9	2.5	0.1	1.8
Denmark	1.9	-0.1	2.4	2.0	1.5	-2.0	4.9	3.1	0.1	1.6	3.0	0.0	1.3
Hungary	2.9	-0.7	3.9	5.4	4.9	-4.5	7.1	4.9	0.6	2.6	5.5	0.1	2.6
Poland	5.2	2.6	4.4	5.9	4.5	-2.0	6.8	4.9	0.4	2.5	4.0	0.7	2.6
Romania	7.9	-0.6	4.9	6.0	3.9	-3.7	5.1	4.5	2.5	3.0	5.8	1.8	2.2
Sweden	3.0	1.0	2.7	2.0	2.0	-2.2	5.1	2.4	-0.8	1.2	2.9	-0.6	0.8
EU	2.3	-0.2	2.1	2.1	1.8	-5.7	5.4	3.5	0.8	1.6	3.3	0.3	1.6

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 01.02.2023

	2022/1	2022/2	2022/3	2022/4	2023/1	2023/2	2023/3	2023/4	2024/1	2024/2	2024/3	2024/4
Belgium	0.6	0.5	0.2	0.1	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.5
Germany	0.8	0.1	0.5	-0.2	-0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.4
Estonia	0.0	-1.3	-1.8	-0.5	0.2	1.0	1.2	0.9	0.5	0.5	0.5	0.5
Ireland	7.0	2.2	2.3	3.5	:	:	:	:	:	:	:	:
Greece	2.2	0.6	-0.5	:	:	:	:	:	:	:	:	:
Spain	0.0	2.2	0.2	0.2	0.1	0.3	0.5	0.6	0.5	0.6	0.5	0.5
France	-0.2	0.5	0.2	0.1	0.0	0.2	0.3	0.5	0.3	0.4	0.4	0.5
Croatia	2.8	1.5	-0.4	0.0	0.0	0.5	0.7	1.0	0.2	0.3	0.3	0.4
Italy	0.1	1.1	0.5	-0.1	0.0	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Cyprus	1.7	0.3	1.3	:	:	:	:	:	:	:	:	:
Latvia	1.8	0.0	-1.7	0.3	0.0	0.7	0.5	0.6	0.5	0.6	0.7	0.7
Lithuania	0.6	0.3	0.4	-1.7	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.7
Luxembourg	0.7	-0.5	1.1	0.8	0.4	0.4	0.4	0.5	0.6	0.7	0.7	0.7
Malta	1.1	0.9	1.3	:	:	:	:	:	:	:	:	:
Netherlands	0.3	2.4	-0.2	0.0	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.4
Austria	1.2	1.9	0.2	-0.7	-0.2	0.4	0.3	0.4	0.3	0.3	0.3	0.3
Portugal	2.4	0.1	0.4	0.2	0.0	0.3	0.4	0.4	0.4	0.4	0.5	0.5
Slovenia	-0.1	0.2	-1.4	0.9	0.2	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Slovakia	0.3	0.4	0.4	0.3	0.2	0.4	0.5	0.5	0.4	0.5	0.6	0.7
Finland	0.0	1.0	-0.2	0.1	-0.2	0.0	0.1	0.3	0.3	0.4	0.5	0.5
Euro area (20)	0.6	0.9	0.3	0.1	0.0	0.2	0.3	0.4	0.3	0.4	0.4	0.4
Bulgaria	0.4	0.8	0.6	0.7	0.2	0.2	0.2	0.3	0.8	0.8	0.9	0.9
Czechia	0.6	0.3	-0.2	-0.3	0.0	0.2	0.3	0.4	0.5	0.5	0.6	0.6
Denmark	-0.5	0.8	0.3	-0.3	-0.2	0.0	0.2	0.4	0.4	0.4	0.5	0.5
Hungary	1.6	0.8	-0.4	-0.3	0.2	0.4	0.5	0.6	0.8	0.8	0.8	0.8
Poland	4.3	-2.3	1.0	:	:	:	:	:	:	:	:	:
Romania	1.5	1.2	1.2	1.0	0.2	0.3	0.5	0.5	1.0	0.9	0.8	1.0
Sweden	-0.4	0.3	0.2	-0.6	-0.6	-0.2	0.2	0.4	0.3	0.3	0.5	0.5
EU	0.8	0.7	0.3	0.0	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.4

Table 3: Harmonised index of consumer prices, (percentage change on preceding year, 2004-2024) 01.02.2023

	5-year averages							Winter 2023 interim Forecast			Autumn 2022 Forecast		
	2004 - 08	2009 - 13	2014 - 18	2018	2019	2020	2021	2022	2023	2024	2022	2023	2024
Belgium	2.6	1.9	1.5	2.3	1.2	0.4	3.2	10.3	4.3	2.7	10.4	6.2	3.3
Germany	2.1	1.5	1.1	1.9	1.4	0.4	3.2	8.7	6.3	2.4	8.8	7.5	2.9
Estonia	5.8	3.1	1.7	3.4	2.3	-0.6	4.5	19.4	6.2	2.2	19.3	6.6	2.6
Ireland	2.6	0.1	0.2	0.7	0.9	-0.5	2.4	8.1	4.4	2.1	8.3	6.0	2.8
Greece	3.4	1.9	-0.1	0.8	0.5	-1.3	0.6	9.3	4.5	2.4	10.0	6.0	2.4
Spain	3.4	1.8	0.5	1.7	0.8	-0.3	3.0	8.3	4.4	2.3	8.5	4.8	2.3
France	2.2	1.5	0.9	2.1	1.3	0.5	2.1	5.9	5.2	2.5	5.8	4.4	2.2
Croatia	3.4	2.2	0.4	1.6	0.8	0.0	2.7	10.7	6.5	1.6	10.1	6.5	2.3
Italy	2.4	2.0	0.6	1.2	0.6	-0.1	1.9	8.7	6.1	2.6	8.7	6.6	2.3
Cyprus	2.5	1.9	-0.3	0.8	0.5	-1.1	2.3	8.1	4.0	2.5	8.0	4.2	2.5
Latvia	8.9	1.7	1.3	2.6	2.7	0.1	3.2	17.2	7.9	1.5	16.9	8.3	1.3
Lithuania	4.8	2.8	1.3	2.5	2.2	1.1	4.6	18.9	8.7	2.1	18.9	9.1	2.1
Luxembourg	3.3	2.2	1.0	2.0	1.6	0.0	3.5	8.2	3.1	2.7	8.4	3.8	3.1
Malta	2.6	2.1	1.2	1.7	1.5	0.8	0.7	6.1	4.3	2.4	6.1	4.0	2.4
Netherlands	1.7	2.0	0.7	1.6	2.7	1.1	2.8	11.6	4.5	2.7	11.6	4.2	3.9
Austria	2.2	2.1	1.5	2.1	1.5	1.4	2.8	8.6	6.6	3.6	8.7	6.7	3.3
Portugal	2.6	1.4	0.7	1.2	0.3	-0.1	0.9	8.1	5.4	2.6	8.0	5.8	2.3
Slovenia	3.6	1.9	0.6	1.9	1.7	-0.3	2.0	9.3	6.1	3.5	9.2	6.5	3.5
Slovakia	4.1	2.2	0.6	2.5	2.8	2.0	2.8	12.1	9.7	5.3	11.8	13.9	3.6
Finland	1.5	2.4	0.7	1.2	1.1	0.4	2.1	7.2	4.2	2.0	7.2	4.3	1.9
Euro area (20)	2.4	1.7	0.8	1.8	1.2	0.3	2.6	8.4	5.6	2.5	8.5	6.1	2.6
Bulgaria	7.8	2.3	0.0	2.6	2.5	1.2	2.8	13.0	7.8	4.0	12.8	7.4	3.2
Czechia	3.1	1.8	1.1	2.0	2.6	3.3	3.3	14.8	9.3	3.5	15.6	9.5	3.5
Denmark	2.0	1.8	0.5	0.7	0.7	0.3	1.9	8.5	4.4	2.5	7.9	3.7	2.0
Hungary	5.6	4.0	1.2	2.9	3.4	3.4	5.2	15.3	16.4	4.0	14.8	15.7	3.9
Poland	2.8	3.0	0.4	1.2	2.1	3.7	5.2	13.2	11.7	4.4	13.3	13.8	4.9
Romania	8.1	4.8	1.0	4.1	3.9	2.3	4.1	12.0	9.7	5.5	11.8	10.2	6.8
Sweden	1.7	1.3	1.2	2.0	1.7	0.7	2.7	8.1	6.3	1.8	8.1	6.6	1.8
EU	2.6	1.9	0.8	1.8	1.4	0.7	2.9	9.2	6.4	2.8	9.3	7.0	3.0

Table 4: Harmonised index of consumer prices, (percentage change on preceding year) 01.02.2023

	2022/1	2022/2	2022/3	2022/4	2023/1	2023/2	2023/3	2023/4	2024/1	2024/2	2024/3	2024/4
Belgium	9.1	9.9	11.0	11.2	7.2	5.4	3.5	1.3	3.1	2.9	2.5	2.2
Germany	6.1	8.3	9.4	10.8	9.3	7.0	5.6	3.7	2.9	2.7	2.1	1.9
Estonia	12.5	20.4	24.1	20.4	15.4	6.8	1.7	2.3	2.8	2.3	2.0	1.9
Ireland	5.9	8.4	9.1	8.8	7.7	4.6	3.5	2.0	2.0	2.3	2.3	2.0
Greece	6.6	10.4	11.5	8.6	7.4	3.9	3.4	3.4	2.6	2.3	2.3	2.2
Spain	7.9	8.9	10.0	6.5	5.0	4.0	4.3	4.1	3.0	2.5	1.8	1.8
France	4.2	5.9	6.5	7.0	7.4	5.5	4.5	3.6	2.9	2.6	2.4	2.2
Croatia	6.4	10.8	12.6	12.8	11.4	8.3	4.3	2.6	1.8	1.5	1.6	1.4
Italy	6.0	7.4	8.9	12.5	8.9	7.5	5.9	2.3	3.0	2.6	2.5	2.4
Cyprus	5.7	8.8	9.7	8.1	4.7	3.8	3.6	3.7	3.0	2.6	2.1	2.1
Latvia	9.2	16.4	21.6	21.4	18.7	9.5	3.6	1.3	1.3	1.4	1.6	1.6
Lithuania	13.9	18.5	21.5	21.2	15.9	10.8	6.2	3.0	2.3	2.3	1.9	1.9
Luxembourg	6.8	9.5	8.9	7.5	4.4	2.9	2.5	2.5	2.8	2.7	2.7	2.5
Malta	4.3	5.8	7.1	7.3	5.7	4.9	3.7	3.0	2.5	2.4	2.3	2.3
Netherlands	8.9	10.4	14.1	13.0	8.0	6.1	2.6	1.8	3.6	3.1	2.3	1.9
Austria	5.5	7.9	9.9	11.1	10.0	7.4	5.4	4.1	3.8	3.7	3.6	3.2
Portugal	4.4	8.2	9.5	10.2	8.4	5.7	4.5	3.2	3.2	2.6	2.4	2.2
Slovenia	6.3	9.0	11.3	10.6	8.6	6.5	5.0	4.3	4.2	3.6	3.2	3.0
Slovakia	8.5	11.8	13.3	14.9	13.0	11.0	8.2	6.9	6.3	5.4	5.3	4.4
Finland	4.8	7.0	8.1	8.7	6.3	4.4	3.6	2.7	2.8	1.8	1.3	2.1
Euro area (20)	6.1	8.1	9.3	10.0	8.2	6.2	4.9	3.2	3.0	2.7	2.3	2.1
Bulgaria	8.9	13.4	15.2	14.5	11.7	7.5	6.4	5.7	4.8	4.2	3.6	3.4
Czechia	10.2	15.0	17.4	16.5	12.9	9.6	7.5	7.4	5.3	3.7	2.6	2.6
Denmark	5.4	8.2	10.2	10.2	7.4	4.7	3.1	2.8	3.5	3.2	2.0	1.5
Hungary	8.3	11.0	18.0	23.3	25.1	21.5	13.6	7.4	4.0	3.9	4.0	3.9
Poland	9.0	12.8	14.9	15.9	17.0	12.8	10.2	7.5	4.7	4.4	4.3	4.2
Romania	8.2	12.4	13.3	14.1	13.1	10.0	8.7	7.2	6.6	5.9	5.2	4.5
Sweden	4.9	7.7	9.4	10.2	8.6	6.8	5.4	4.3	1.8	1.8	1.8	1.9
EU	6.5	8.8	10.3	11.0	8.9	6.8	5.3	3.6	3.2	2.9	2.5	2.3

Box .1: Some technical elements behind the forecast

The Winter 2023 interim Forecast provides an update of the Autumn 2022 Forecast of 11 November 2022, focusing on GDP and inflation developments in all EU Member States.

The cut-off date for taking new information into account in this forecast was 1 February 2023.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounts (ESA 2010). Due to differences in revision schedules of annual and quarterly national accounts, annual and quarterly figures may not be fully consistent for some Member States. 2023 and 2024 are forecast years. 2022 GDP data are also forecast, except for AT, BE, CZ, DE, FR, IT, ES, LV, LT, PL, PT and SE where preliminary or flash estimates exist. In the case of Poland, the difference between the last GDP quarterly publication (adjusted for calendar effects) from 30 November and the unadjusted GDP preliminary annual release for 2022 from 30 January, does not allow for the production of a reliable quarterly forecast at the current juncture.

HICP inflation

This forecast takes into account preliminary HICP item weights for AT, BE, CY, FI, FR, HR, IE IT, ES, LV, LT, LU, PT and SK that were published by Eurostat on 1 February.

Working-day adjustment

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

The working-day effect in the EU and the euro area is estimated to be limited in 2022, 2023 and 2024, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1 pps.).

Technical assumptions

To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 16 and 27 January) were used for exchange and interest rates, and for commodity prices.

Nominal exchange rates are kept constant over the forecast horizon at the level recorded during the reference period (see Table 1). Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest

Table 1:
Technical assumptions

		Winter 2023 interim Forecast		*Autumn 2022 Forecast*	
	2022	**2023**	**2024**	**2023**	**2024**
3-month EURIBOR (percentage per annum)	0.3	**3.1**	**2.8**	*3.1*	*3.0*
10-year government bond yields (percentage per annum) (a)	1.1	**2.1**	**2.1**	*2.3*	*2.4*
USD/EUR exchange rate	1.04	**1.08**	**1.09**	*0.98*	*0.98*
GBP/EUR exchange rate	0.85	**0.88**	**0.88**	*0.87*	*0.87*
RMB/EUR exchange rate	7.03	**7.35**	**7.35**	*7.11*	*7.11*
JPY/EUR exchange rate	136.98	**140.48**	**140.49**	*146.45*	*146.45*
EUR nominal effective exchange rate (annual percentage change) (b)	-4.0	**3.3**	**0.0**	-0.5	0.0
Natural gas (EUR/Mwh) (c)	131.9	**63.2**	**63.6**	*146.5*	*110.3*
Electricity (EUR/Mwh) (d)	260.7	**157.7**	**169.2**	396.1	248.8
Oil price (USD per barrel)	100.7	**84.8**	**79.9**	85.0	78.0

(a) 10-year government bond yields for the euro area equal the German government bond yields.
(b) 42 industrial countries EU TR CH NR UK US CA JP AU MX NZ KO CN HK RU BR. (c) ICE Dutch TTF. (d) GDP - weighted average of electricity prices in DE, FR, IT, ES, NL, BE, AT.

(Continued on the next page)

Box (continued)

rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. Assumptions for Brent oil, natural gas and electricity prices are based on futures markets.

Trade policies

For trade policy, this forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the Autumn 2022 Forecast, there are no significant changes.

Geographical zones

Euro area: EA20 (BE, DE, EE, IE, EL, ES, FR, HR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK and FI).

European Union: EU (EA20, BG, CZ, DK, HU, PL, RO and SE).

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