EUROPEAN DEPARTMENT

EUR Regional Economic Outlook Update

OCTOBER 25, 2022

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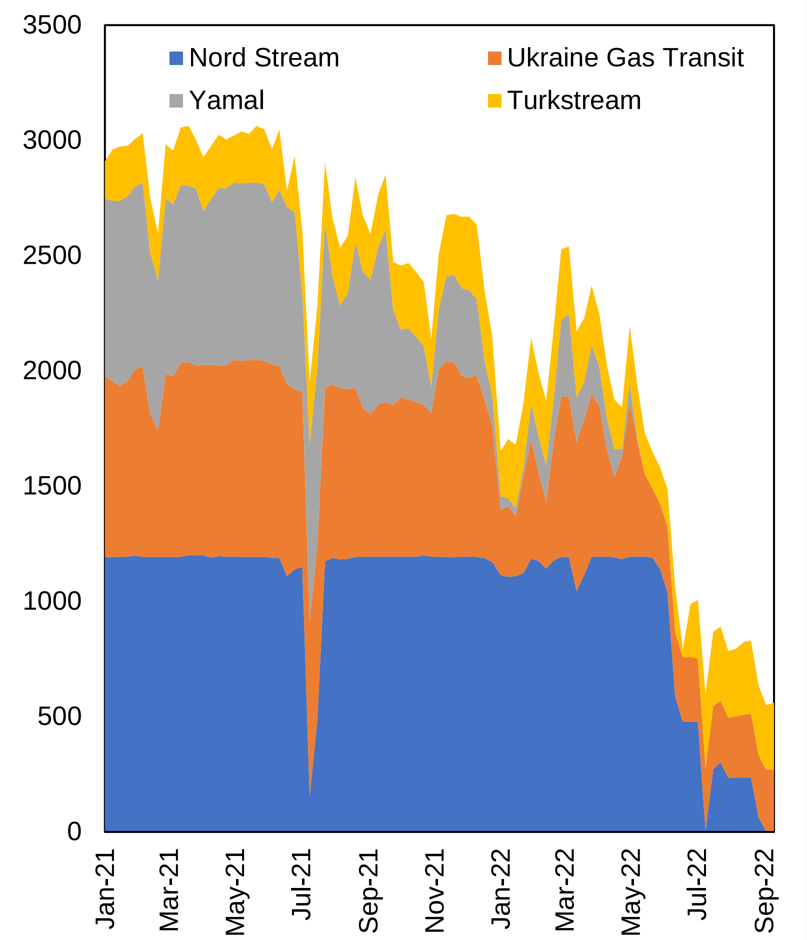
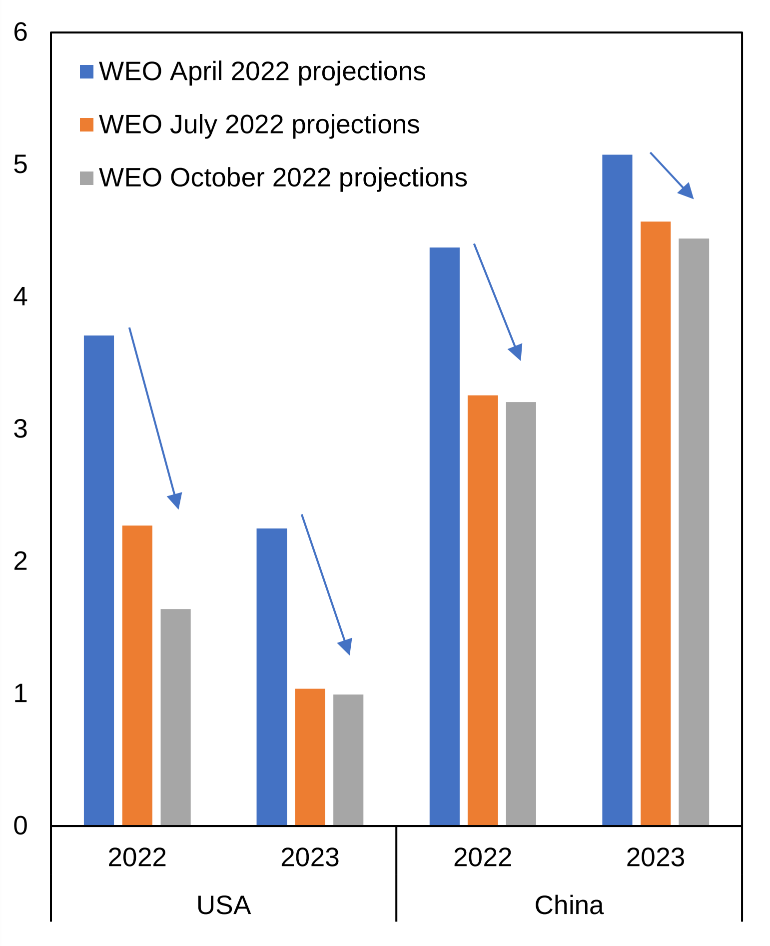
European Department

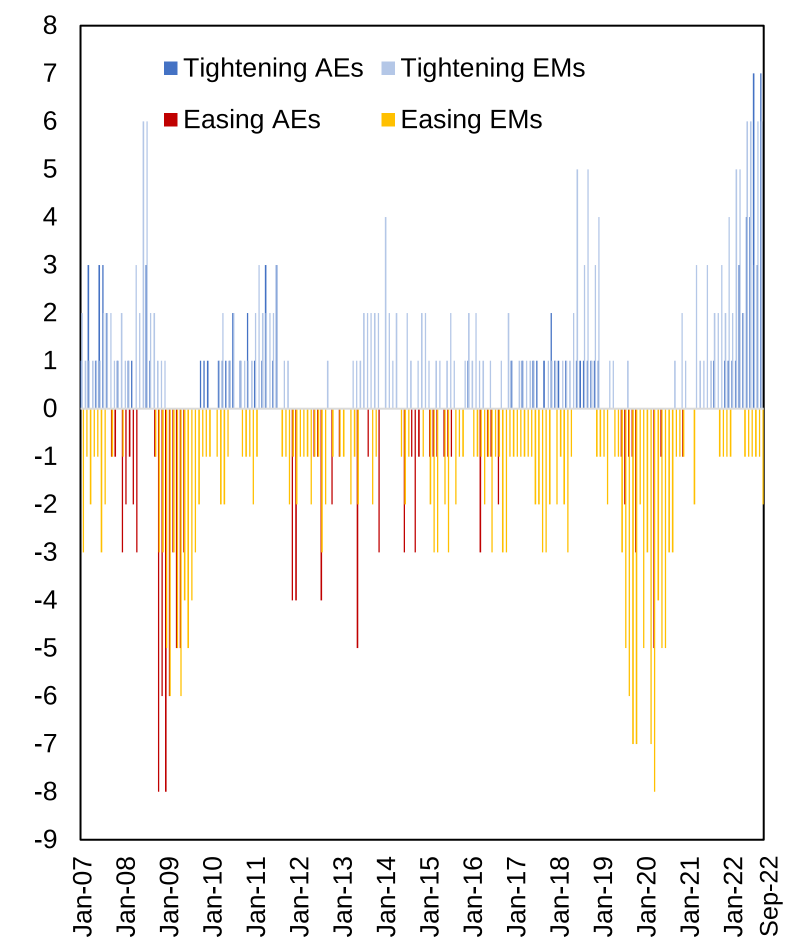
European Union: Russian Natural Gas Imports
(By Route, million cubic meters/week)



Projected GDP Growth: US and China
(Percent)

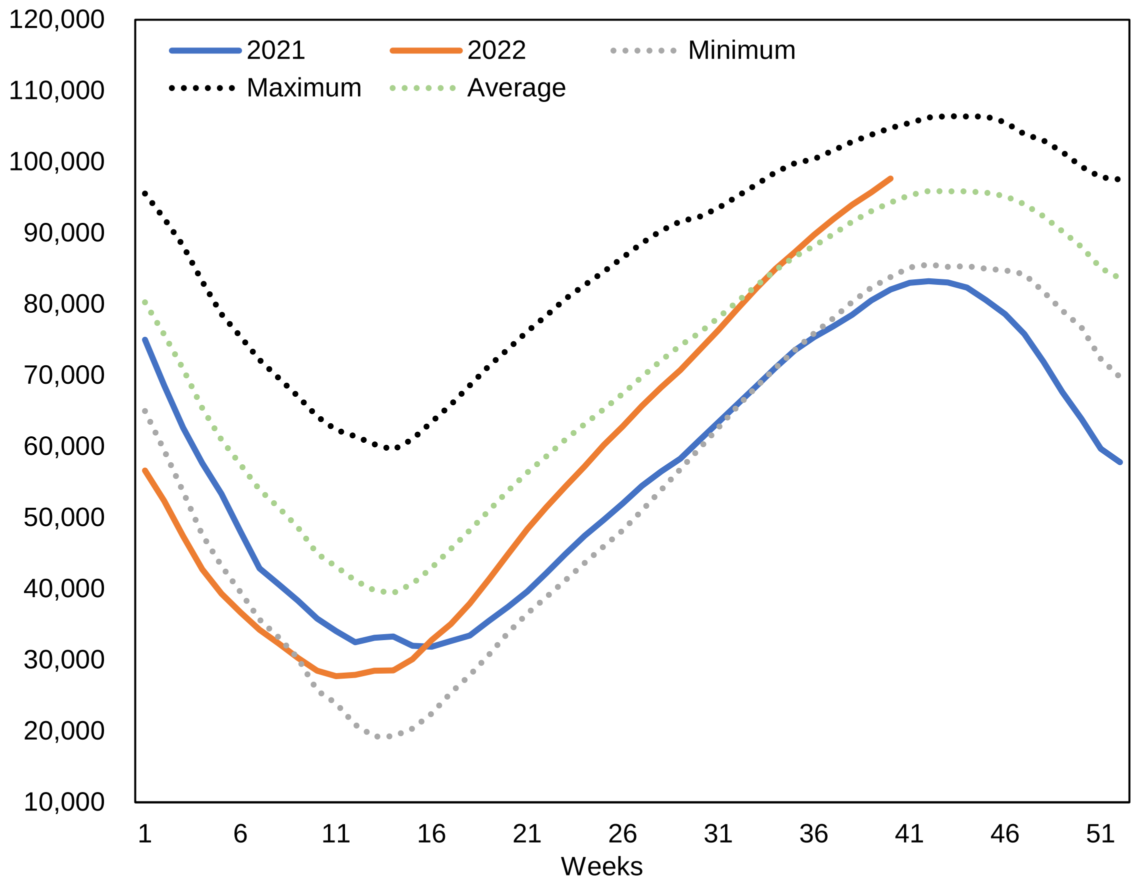


G20: Monetary Policy
(Number of changes in policy rates)

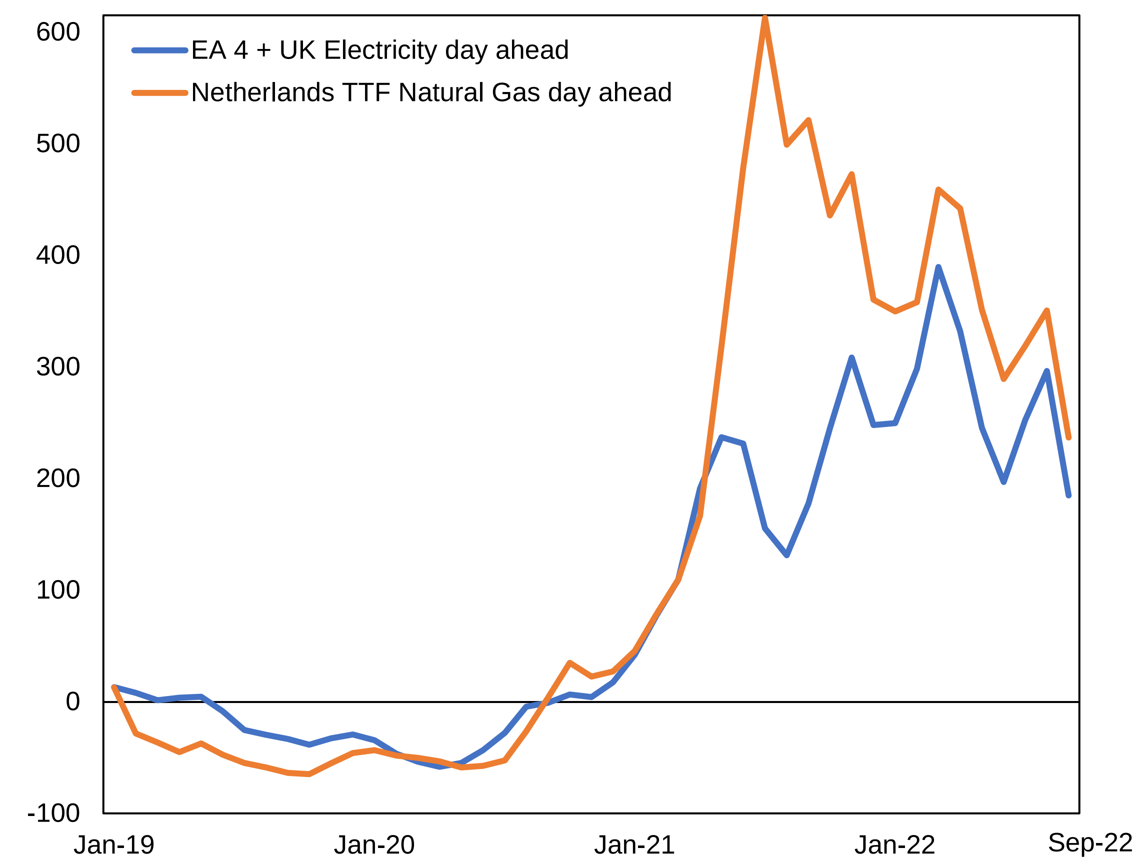


Source: Bloomberg Finance L.P.; Bruegel; IMF, *World Economic Outlook*; Haver Analytics and IMF Staff calculations
Notes: In the right panel, for years prior to Jan. 2008, May 2010, Jan. 2016, and Feb. 2016, MEX, TUR, JPN, and ARG are not included, respectively.

European Union: Natural Gas Storage
(Million cubic meters/day)



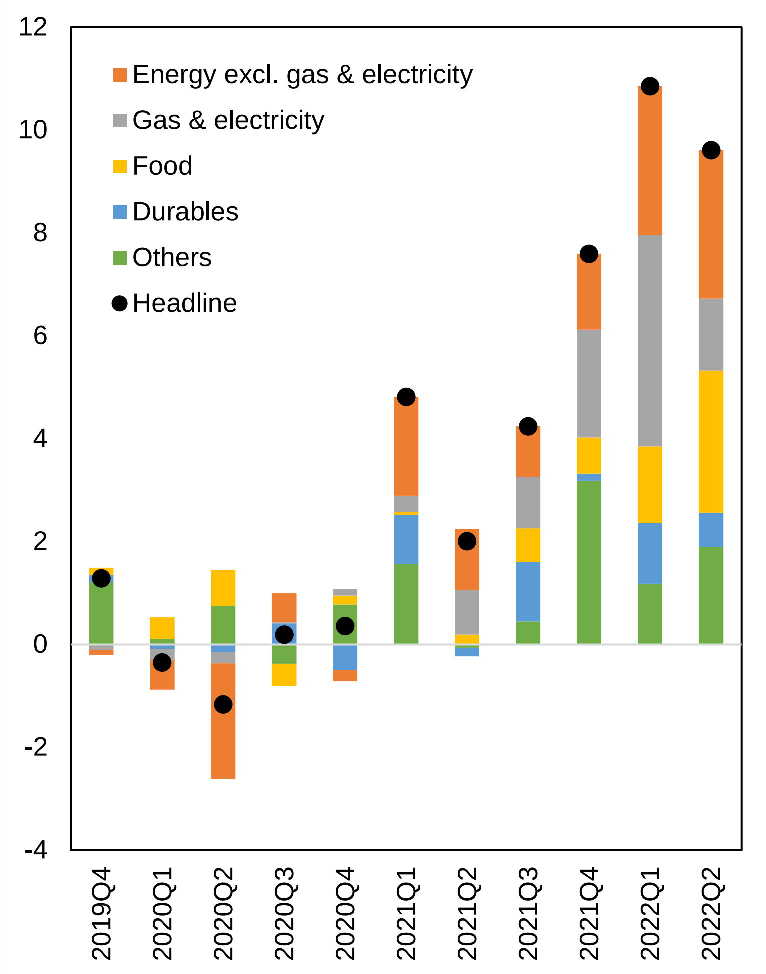
Europe: Electricity and Natural Gas Prices
(Select countries; annual change over 3-month moving averages, percent)



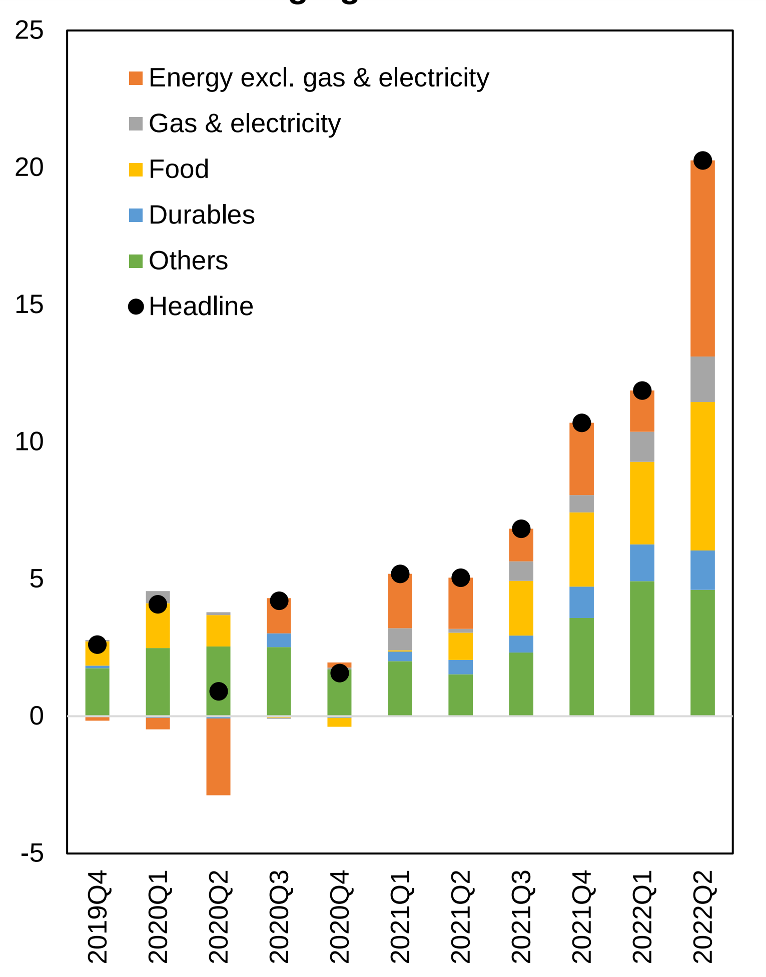
Source: Bloomberg Finance L.P.; Bruegel; Haver Analytics; IMF staff calculations.
Notes: In the left panel, average, minimum and maximum values are calculated from the period 2015 – 2020. In the right panel, latest data point is September 27, 2022; EA 4 include DEU, ESP, FRA, ITA.

Europe: Factors contributing to Inflation
(Annualized SA QoQ change, in percent)

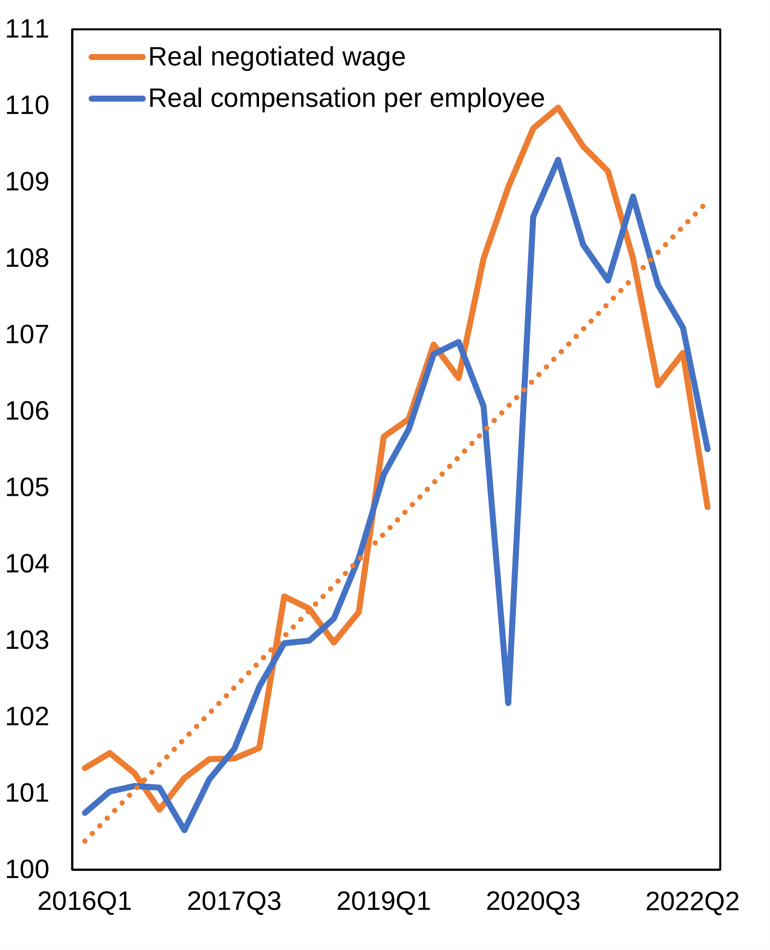
Euro Area



Emerging Economies

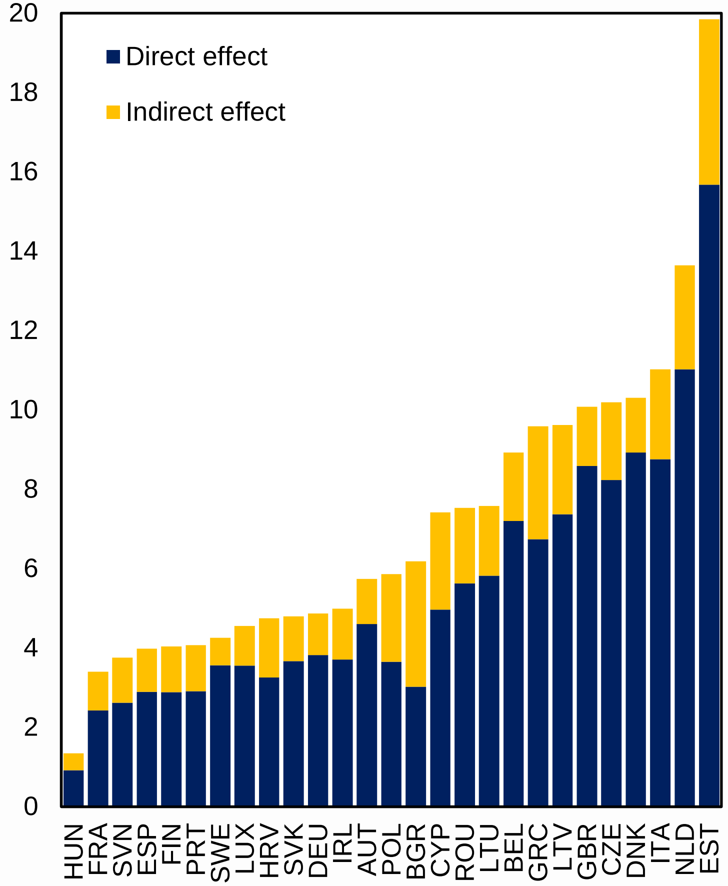


Euro Area: Negotiated Wages and Compensation Per Employee
(index 2015=100, in real terms)

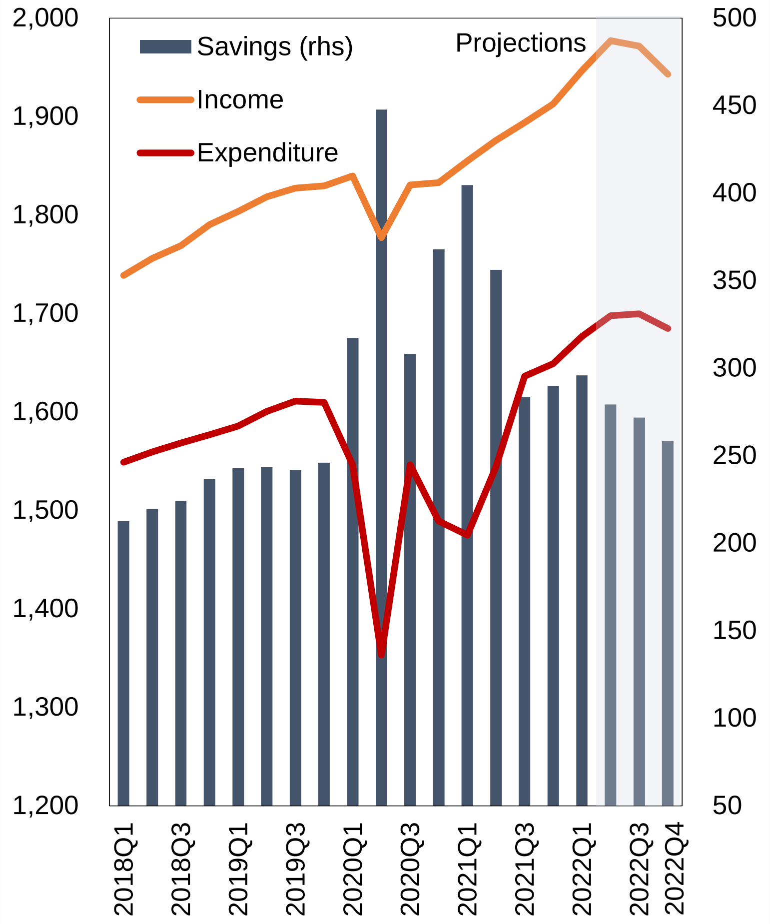


Sources: European Commission; Statistical Office of European Communities; Haver Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.
Notes: In the middle panel, Emerging Economies includes BGR, HRV, HUN, MKD, POL, ROU, and SRB. In the right panel, BLR, RUS, TUR, UKR are excluded for Emerging Economies.

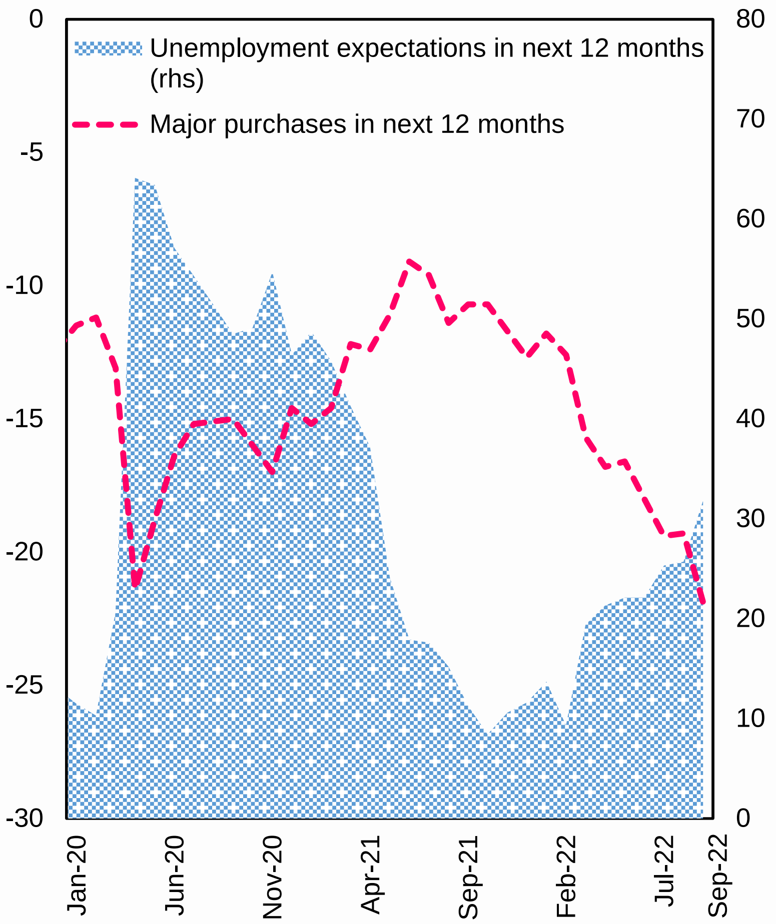
Households' Burden of Higher Energy Prices
(Average; in percent of household consumption)



Euro Area: Household Savings and Expenditure
(Euro billion)

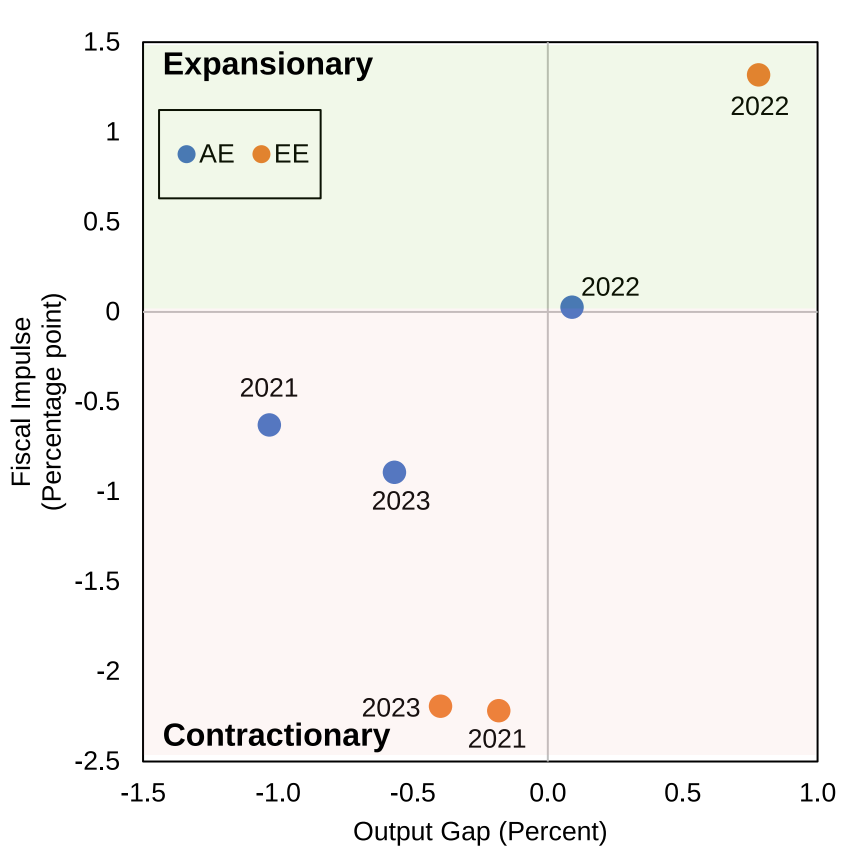


Survey on Consumption and Unemployment
(Percentage balance)

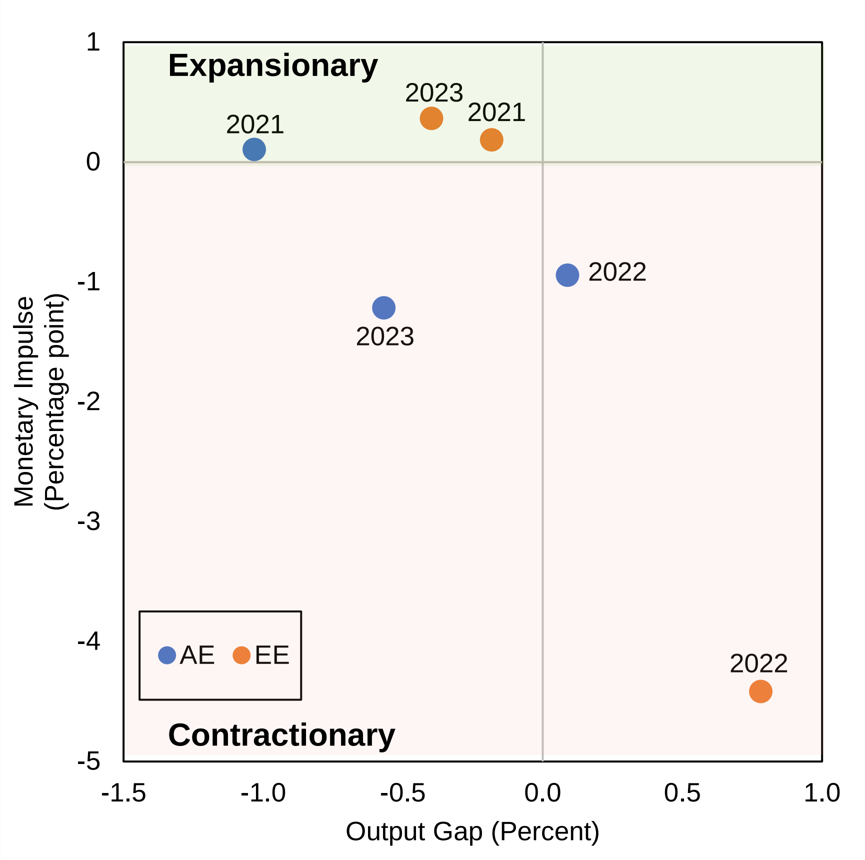


Sources: Bloomberg Finance L.P.; Eurostat; Haver Analytics; and IMF staff calculations.
Notes: In the left panel, the direct effect is the increase in household cost of living due to increases in energy prices themselves, and the indirect effect is the increase in the cost of living due to the increase in prices of other goods.

Europe: Fiscal Policy Changes
(change in primary fiscal deficit excluding grants)



Europe: Monetary Policy Changes
(change in nominal short-term interest rates)



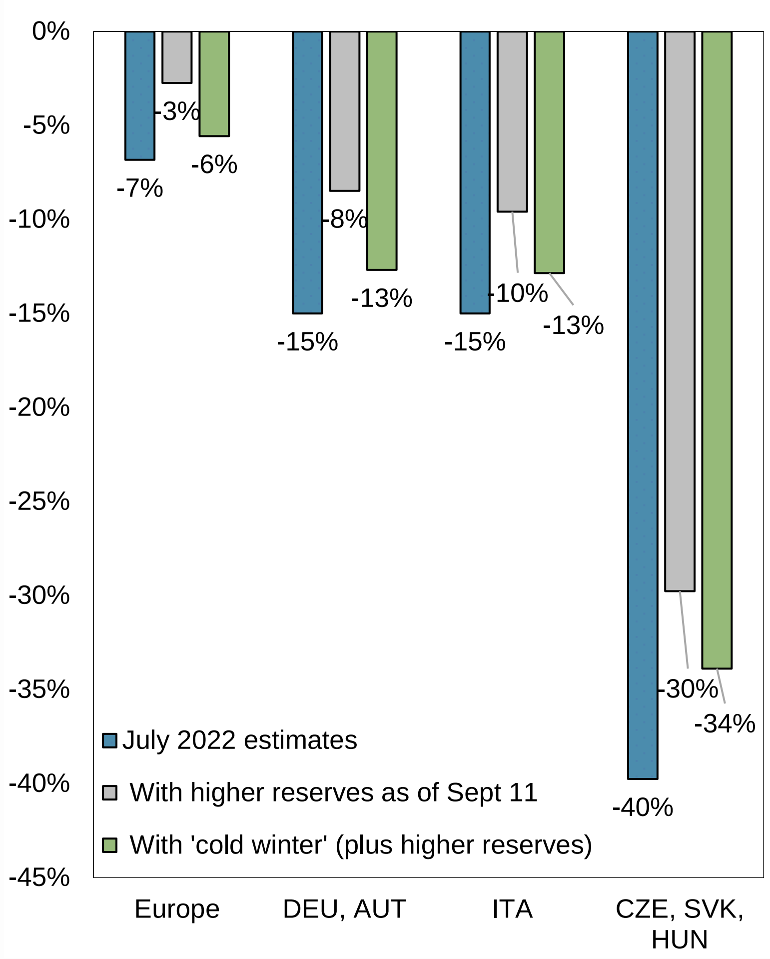
Sources: IMF, *World Economic Outlook* and IMF staff calculations.
Notes: In both panels, the changes in Fiscal and Monetary policies have been inversed to show positive values as expansionary and negative values as contractionary. In the left panel, fiscal impulse is the change in the cyclically adjusted primary deficit excluding grants; AE excludes NOR and EE includes BIH, BGR, HRV, HUN, POL, and ROU. In the right panel, monetary impulse is the change in the either the deposit rates or treasury-bill rates; EE includes BIH, HRV, HUN, MDA, POL.

Year	Real GDP Growth					CPI Inflation (average of the year)				
	2021	2022		2023		2021	2022		2023	
WEO vintages	WEO Current	WEO Current	Diff. since Jul. 2022	WEO Current	Diff. since Jul. 2022	WEO Current	WEO Current	Diff. since Jul. 2022	WEO Current	Diff. since Jul. 2022
Europe	6.0	2.6	0.7	0.6	-0.5	4.8	15.1	0.8	10.6	1.8
Advanced Europe	5.6	3.2	0.4	0.6	-0.7	2.5	8.3	1.0	6.2	2.1
Euro area	5.2	3.1	0.5	0.5	-0.7	2.6	8.3	1.0	5.7	1.8
Emerging Europe	6.8	1.2	1.3	0.5	-0.1	9.7	30.6	0.3	20.7	1.2
Emerging Europe excl. Belarus, Russia, Türkiye, and Ukraine	6.4	4.3	0.3	1.7	-1.1	4.7	13.3	1.6	11.8	3.0

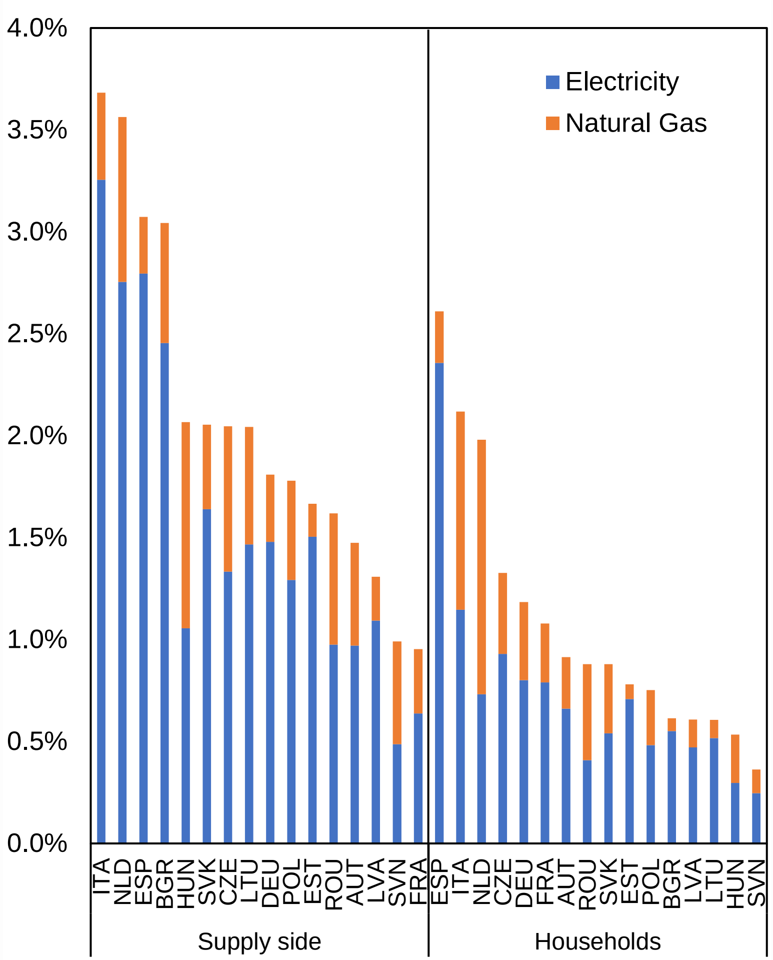
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Notes: Projections are updated as of September 26, 2022.


Upside risks
Lower inflation persistence allows for a faster soft landing
More resilient than expected Household Consumption
Fast unwinding of supply disruptions
War escalates and (or) other geopolitical tensions increase
Full and persistent interruption of Russian gas supplies to Europe
Larger-than-expected trade, financial, and commodity prices' disruptions
The cost-of-living crisis leads to increased social tensions
De-anchored inflation leads to sharper-monetary policy tightening
Outbreaks of lethal and highly contagious COVID-19 variants
Abrupt global slowdown or recession in China and (or) the US
Downside risks

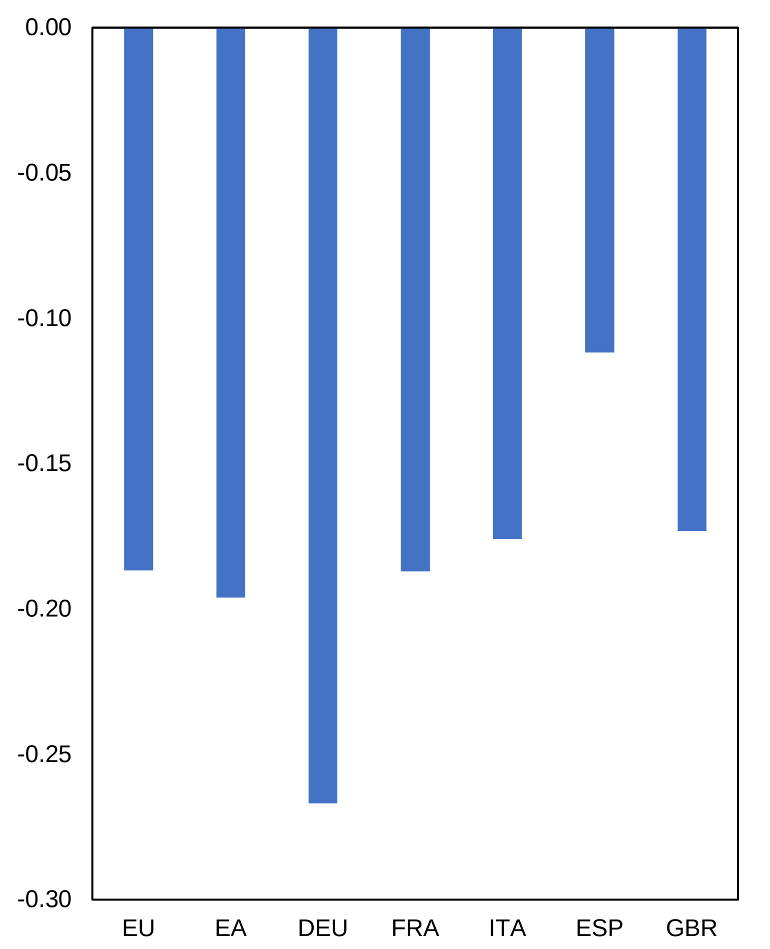
Europe: Demand Compression in a Full Russian Gas Shutoff
(percent of annual consumption)



Europe: Ex Ante Impact of additional energy price increases
(percent of 2019 GDP)

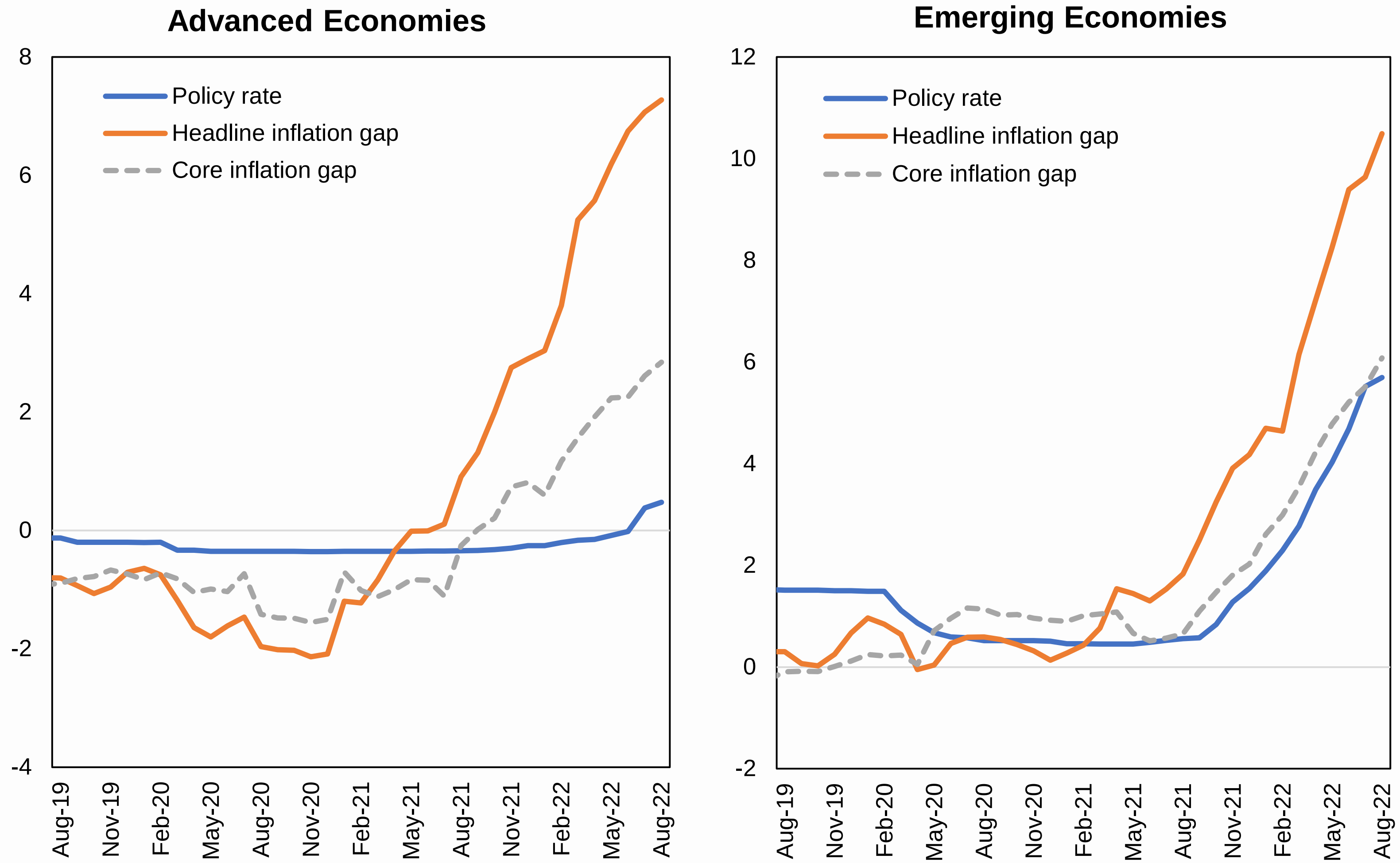


Europe: Impact of a 2-percentage point growth decline in China
(Select countries; difference in GDP level in 2023)

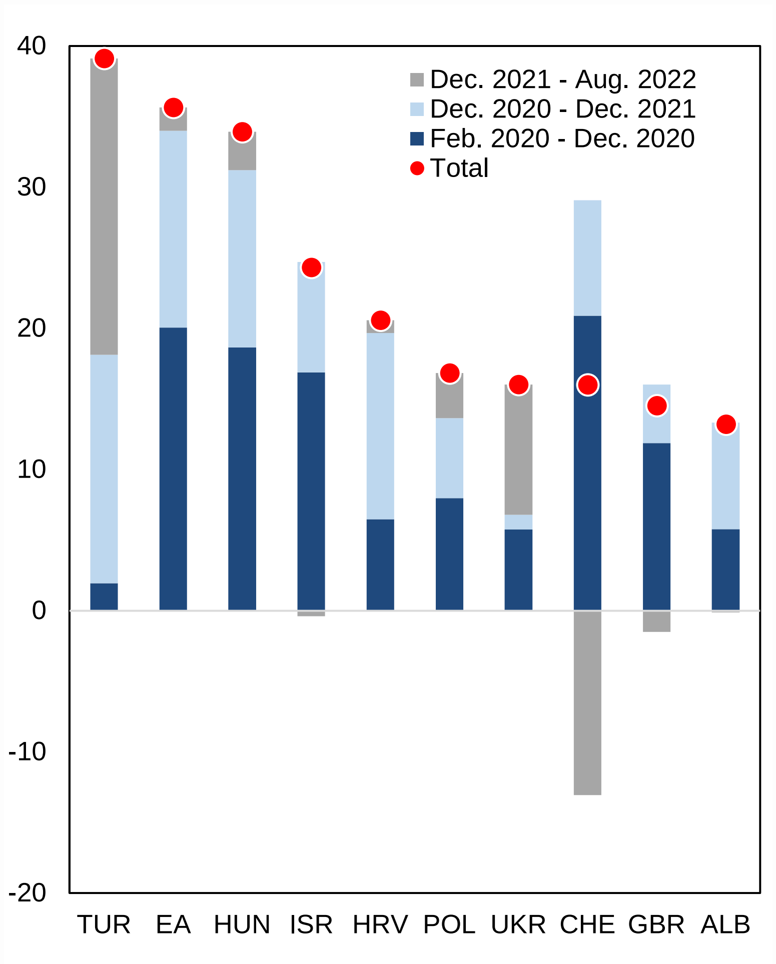


Sources: Bruegel; Eurostat; European Commission; IMF, *World Economic Outlook* and IMF staff calculations.
Notes: The left panel estimates the natural gas compression needed for to clear the market under alternative demand assumptions. The middle panel measures the ex-ante impact of a 50pp across the board increase in electricity and gas prices with respect those in 2022:Q1. The right figure shows the impact on GDP of a 2pp decline in China's growth in 2023.

Inflation Gaps and Policy Rates
(Percentage points)

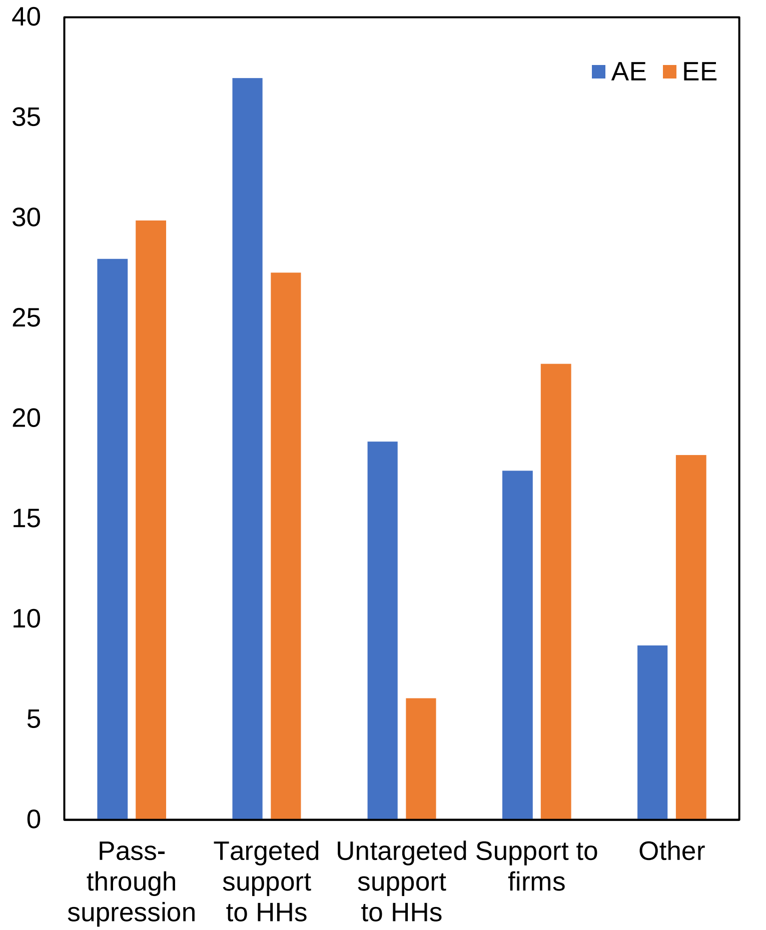


Balance Sheet Expansion by Central Banks
(Percent of 2020 GDP; select countries)

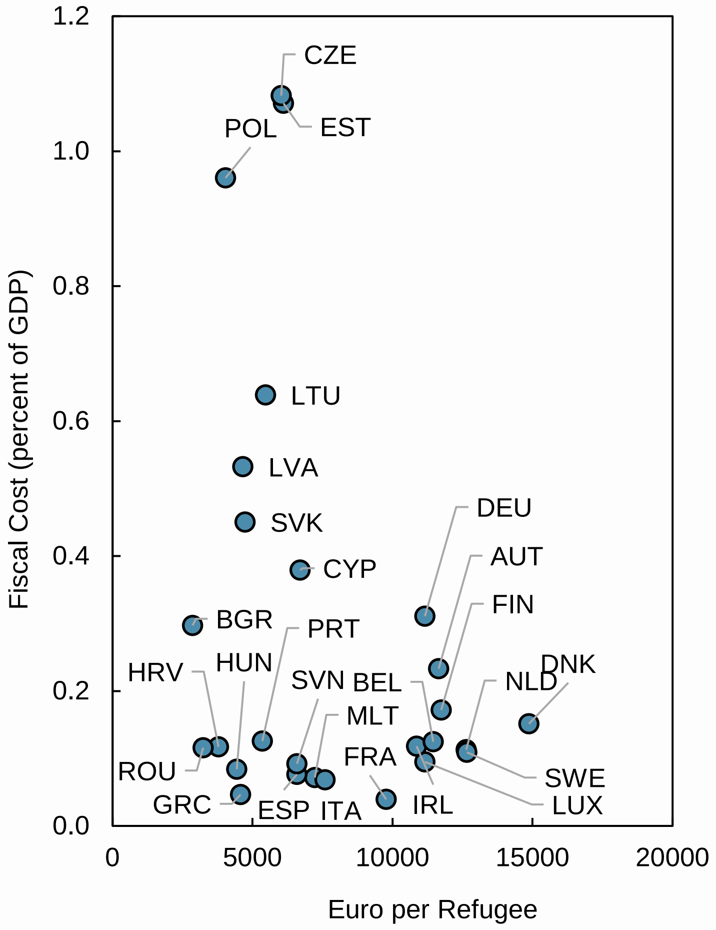


Sources: IMF, *World Economic Outlook;* Eurostat; Central Banks; Haver Analytics; and IMF staff calculations.
Notes: In the left and middle panels, policy rates and inflation gaps are aggregated by taking the PPP-GDP weighted average; inflation gap refers to the difference between the inflation target (or its midpoint) and the headline and core inflation. In the middle panel Emerging Economies exclude BLR, MDA, RUS, TUR, UKR. In the right panel, expansion is calculated as difference between Central Banks' asset value; ISR 2022 balance shows July 2022 value.

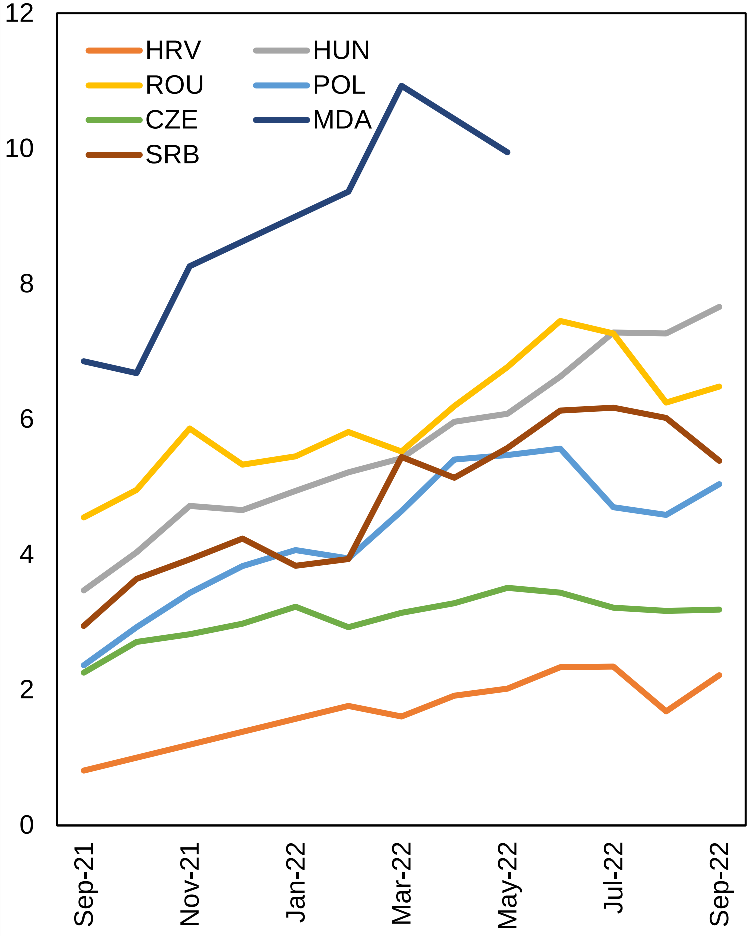
Europe: Energy Measures
(Percent of total countries in the group)



EU: Estimated Fiscal Cost of Ukrainian Refugees
(In Euros and percent of GDP)

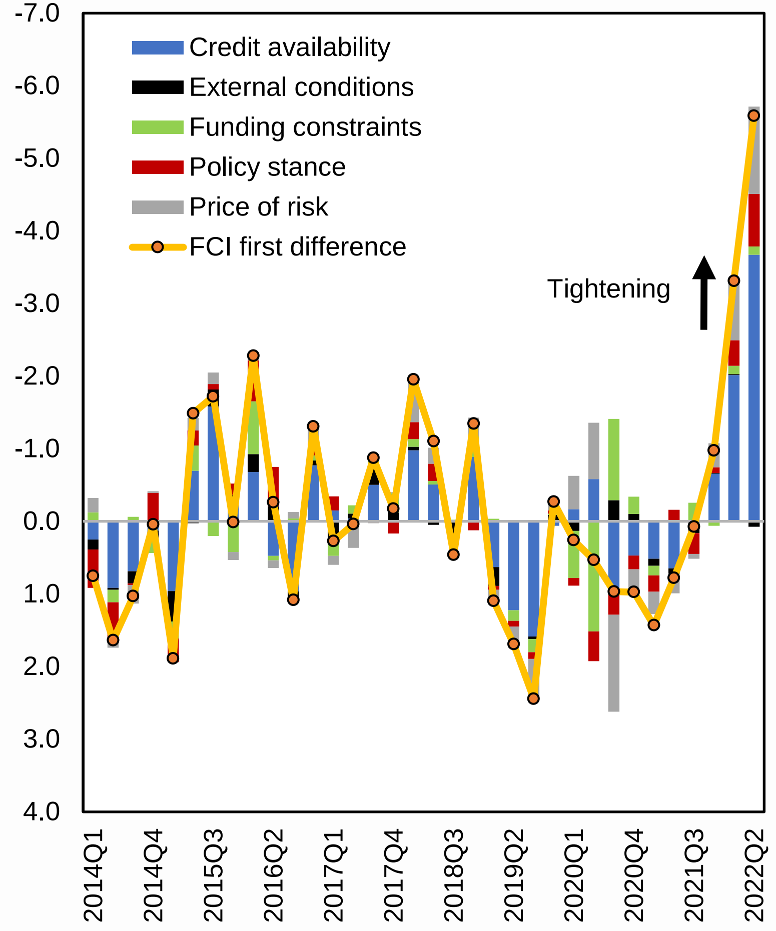


10-year Government Bond Spreads
(vs. German Bunds, percent; Select countries)

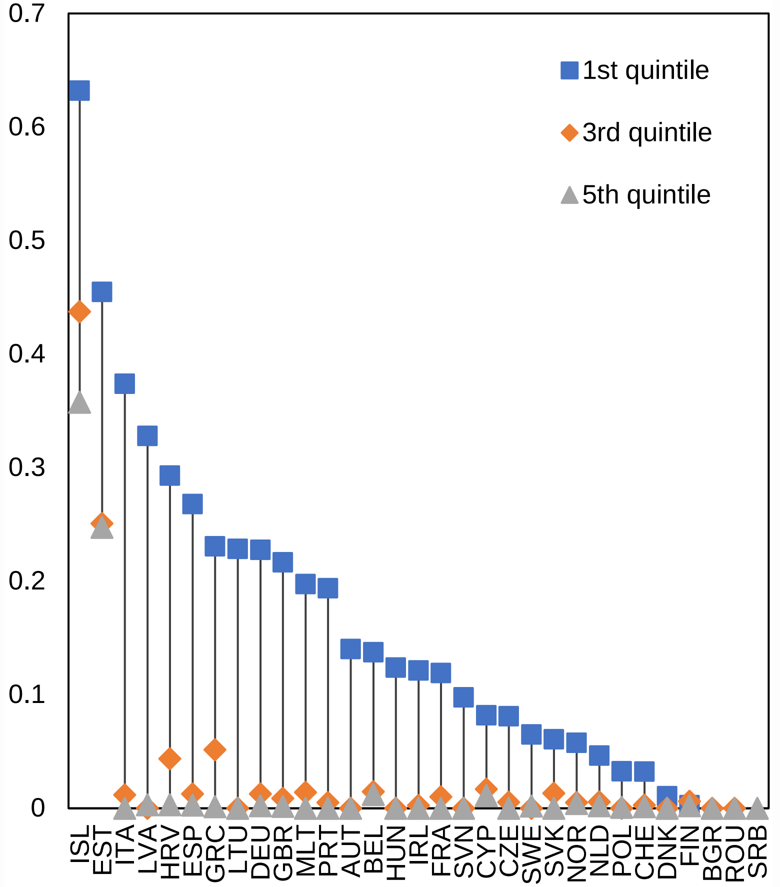


Source: Haver Analytics; Eurostat; OECD; UNHCR; and IMF staff calculations.
Note: In the left panel, EE includes SRB, BGR, TUR, MDA, HUN, POL, ROU, MKD, MNE KOS, BLR. In the middle panel, estimates are based on 2017 OECD figure of EUR 10,000 per refugee in main European destination countries updated to May 2022 prices (EUR 11,578). Cross-country values are obtained by indexing country nominal GDP per capita to value for Germany, with Luxemburg indexed to Germany, and Ireland to the UK. Estimates are preliminary. In the right panel, MDA represents 5-year government bond spread.

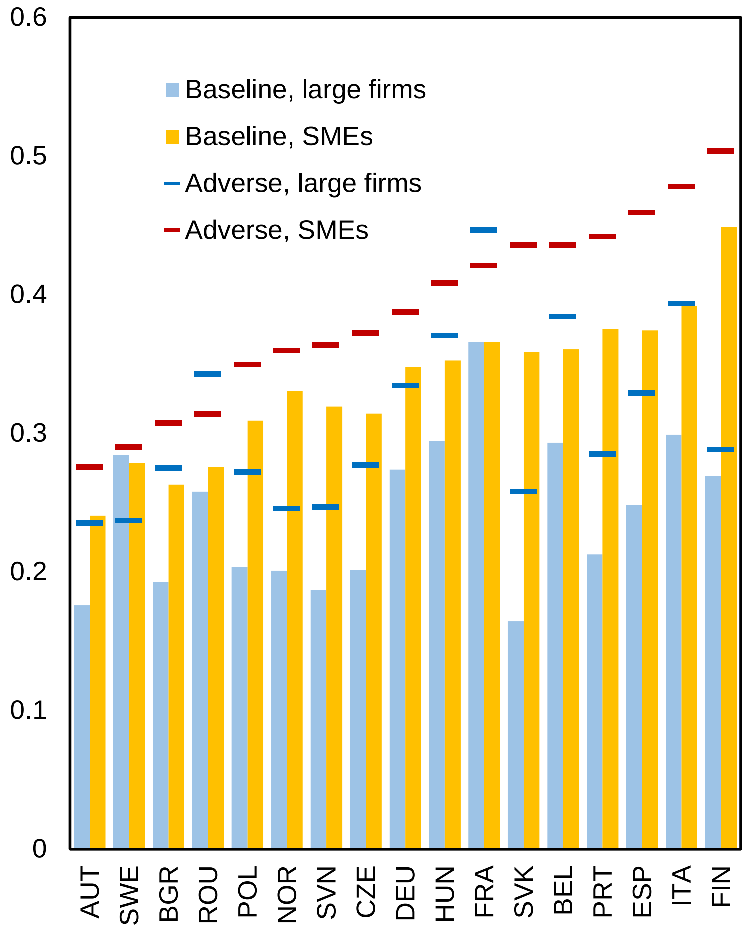
Euro Area: Change in Financial Conditions
(Contribution to the QoQ changes, percent)



Europe: Vulnerable Mortgage Owners
(DSTI>40 percent, Share of total)



Europe: NFCs with ICRs lower than one
(Share of total per country, percent)



Sources: Eurostat; EU-SILC; German Institute for Economic Research (DIW Berlin); Haver Analytics; Orbis; and IMF staff calculations.
Notes: In the middle panel, DSTI refers to the debt service to income ratio; the quintiles refer to the income distribution quintiles; EU-SILC data is used by all countries, except Germany uses German Institute for Economic Research (DIW Berlin). In the right panel, ICR refers to interest coverage ratio.

Mitigate short-term energy supply downside risks	Build gas storage and settle solidarity agreements before a full gas shut-off begins
	Allow prices to work so gas is used more efficiently
Overcome infrastructure bottlenecks while reducing GHG emissions in the medium term	Accelerate the rollout of renewables, reduce fossil fuel consumption in industry and transport
	Ramp up smart investment, including on gas connectivity
Address demographic pressures	Increase the size of the labor force by stimulating the participation rate of women and older workers
Ease labor market tensions	Further labor and product market reforms

- **Accelerating NGEU implementation can help on some of these fronts, while supporting medium-term growth**

- **Context:** Growing fallout from the war: record high energy prices pushing inflation and reducing real incomes; higher and more persistent inflation inducing central banks to act further; tightening of financial conditions starting to impact domestic demand; no offset from softening external demand.
- **Outlook:** Sharp growth slowdown though not yet a deep recession, high and volatile inflation. Very high uncertainty with predominance of downside risks to growth and upside risks to inflation. High-risk winter—complete Russian gas shutoff amid cold winter may lead to physical gas shortages.
- **Macroeconomic policy mix under the baseline: projected monetary policy normalization and fiscal consolidation are broadly appropriate**
    - ***Monetary policy.*** Policy rate increases should continue, also given the overall balance of risks. Faster pace of hikes required in *advanced economies*, and tight monetary policy stance will likely be needed in 2023 unless growth and labor market prospects weaken sufficiently below their current baseline to materially reduce medium-term inflation. Comparatively, policy stance should be tighter in most *emerging European economies* where inflation is higher, expectations not as strongly anchored, cyclical positions more robust, and wage growth higher.
    - ***Fiscal policy.*** Fiscal consolidation should proceed, although its pace may be slowed for a few months to support vulnerable households and viable firms through the energy crisis. Stronger consolidation required in countries with limited fiscal space or facing demand pressures, like many *emerging European economies*. Reform EU fiscal framework to help prevent debt distress while allowing for macro stabilization.
    - ***Financial policy.*** Macroprudential policy settings can be kept broadly unchanged. Closely monitor and stress test banks' risk exposures to vulnerable households and firms.
- ***Structural Policies*****.** Reforms to mitigate energy security risks and accelerate the green transition, ease labor market tensions, and reduce pandemic-and war-related scars (including by accelerating NGEU implementation). These will help ease supply constraints and inflationary pressures down the road.
- **Should downside risks materialize, these policy settings would need to be recalibrated**

Thank you