HIGHER INFLATION, TIGHTER FINANCIAL CONDITIONS

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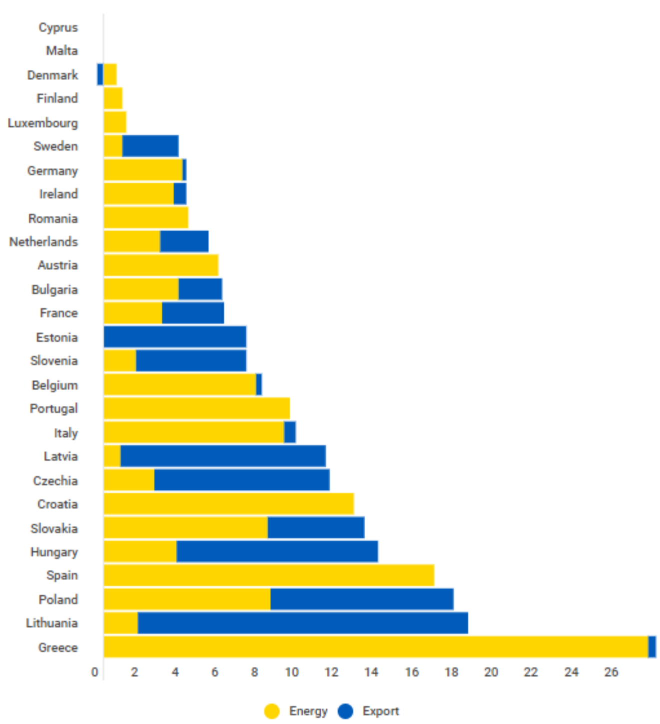
The war in Ukraine risks upending Europe's economic recovery. Higher energy prices and trade disruptions could destabilize EU firms already weakened by the pandemic. At the same time, the European Investment Bank's (EIB's) economic models show that rising inflation could push more Europeans under the poverty line. Real economic growth in the European Union is now expected to fall below 3% in 2022, down from the 4% estimated by the European Commission before the war. A recession could happen, and further trade disruptions or increased economic sanctions would increase the risk for the European economy.

1. Stretching already strained firms

Increase in the share of firms reporting losses (in percentage points)



Source: EIB estimates
Notes: Energy refers to the amount of losses caused by higher energy prices, and exports refers to the losses resulting from the suspension of exports to Ukraine, Russia and Belarus.

The COVID-19 crisis weakened EU firms, particularly small ones. Those firms were slowly weaning themselves off government support when the Ukraine war hit. Now these firms are contending with higher energy prices, reduced trade and potentially higher funding costs as banks try to avoid risk.

The European Investment Bank Economics Department analysed the war's impact on the profitability of EU firms. A model with several assumptions:

Firms' energy bills doubled for at least one year
Firms absorbed those higher costs by reducing their profit, instead of increasing prices for their own products
Exports to Ukraine, Russia and Belarus are completely suspended.

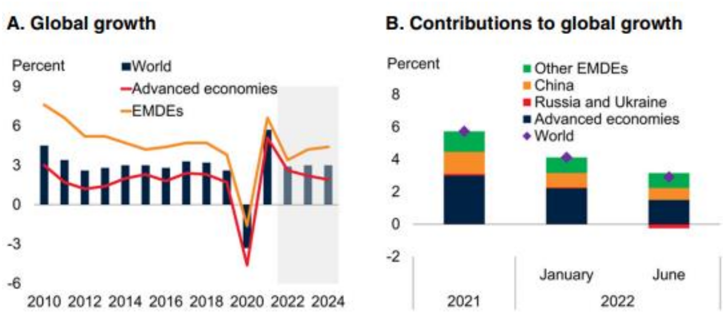
Under the model, the share of EU firms losing money rises from the normal average of 8% to 15% in the year after the start of the invasion. The share of firms that risk defaulting on their debt also surges from 10% to 17% in the same period. Firms in sectors like transport, chemicals and pharmaceuticals, and food and agriculture suffer the most. Firms located in countries close to Ukraine, such as Poland, Latvia and Lithuania, are also hard hit, as are firms in Greece, Croatia and Spain.[1]

[1] Ukraine conflict threatens Europe's recovery and mass poverty (eib.org)

2. Global Economic Prospects – World Bank

Compounding the damage from the COVID-19 pandemic, the Russian invasion of Ukraine has magnified the slowdown in the global economy, which is entering what could become a protracted period of feeble growth and elevated inflation, according to the World Bank's latest Global Economic Prospects report. This raises the risk of stagflation, with potentially harmful consequences for middle- and low-income economies alike.

Global growth is expected to slump from 5.7 percent in 2021 to 2.9 percent in 2022— significantly lower than 4.1 percent that was anticipated in January. It is expected to hover around that pace over 2023-24, as the war in Ukraine disrupts activity, investment, and trade in the near term, pent-up demand fades, and fiscal and monetary policy accommodation is withdrawn. As a result of the damage from the pandemic and the war, the level of per capita income in developing economies this year will be nearly 5 percent below its pre-pandemic trend.



Global inflation is expected to moderate next year but it will likely remain above inflation targets in many economies. The report notes that if inflation remains elevated, a repeat of the resolution of the earlier stagflation episode could translate into a sharp global downturn along with financial crises in some emerging market and developing economies.
Growth in advanced economies is projected to sharply decelerate from 5.1 percent in 2021 to 2.6 percent in 2022—1.2 percentage point below projections in January. Growth is expected to further moderate to 2.2 percent in 2023, largely reflecting the further unwinding of the fiscal and monetary policy support provided during the pandemic.

Among emerging market and developing economies, growth is also projected to fall from 6.6 percent in 2021 to 3.4 percent in 2022—well below the annual average of 4.8 percent over 2011-2019. The negative spillovers from the war will more than offset any near-term boost to some commodity exporters from higher energy prices. Forecasts for 2022 growth have been revised down in nearly 70 percent of EMDEs, including most commodity importing countries as well as four-fifths of low-income countries.[2]

[2] Global Economic Prospects – June 2022, World Bank

3. Regional Outlooks

- East Asia and Pacific: Growth is projected to decelerate to 4.4% in 2022 before increasing to 5.2% in 2023.
- Europe and Central Asia: The regional economy is expected to shrink by 2.9% in 2022 year before growing by 1.5% in 2023.
- Latin America and the Caribbean: Growth is projected to slow to 2.5% in 2022 and 1.9% in 2023.
- Middle East and North Africa: Growth is forecast to accelerate to 5.3% in 2022 before slowing to 3.6% in 2023.
- South Asia: Growth is projected to slow to 6.8% in 2022 and 5.8% in 2023.
- Sub-Saharan Africa: Growth is forecast to moderate to 3.7% in 2022 and rise to 3.8% in 2023.

TABLE 1.1 Real GDP[1]

							Percentage point differences from January 2022 projections	
	2019	2020	2021e	2022f	2023f	2024f	2022f	2023f
World	**2.6**	**-3.3**	**5.7**	**2.9**	**3.0**	**3.0**	**-1.2**	**-0.2**
Advanced economies	**1.7**	**-4.6**	**5.1**	**2.6**	**2.2**	**1.9**	**-1.2**	**-0.1**
United States	2.3	-3.4	5.7	2.5	2.4	2.0	-1.2	-0.2
Euro area	1.6	-6.4	5.4	2.5	1.9	1.9	-1.7	-0.2
Japan	-0.2	-4.6	1.7	1.7	1.3	0.6	-1.2	0.1
Emerging market and developing economies	**3.8**	**-1.6**	**6.6**	**3.4**	**4.2**	**4.4**	**-1.2**	**-0.2**
East Asia and Pacific	5.8	1.2	7.2	4.4	5.2	5.1	-0.7	0.0
China	6.0	2.2	8.1	4.3	5.2	5.1	-0.8	-0.1
Indonesia	5.0	-2.1	3.7	5.1	5.3	5.3	-0.1	0.2
Thailand	2.2	-6.2	1.6	2.9	4.3	3.9	-1.0	0.0
Europe and Central Asia	2.7	-1.9	6.5	-2.9	1.5	3.3	-5.9	-1.4
Russian Federation	2.2	-2.7	4.7	-8.9	-2.0	2.2	-11.3	-3.8
Turkey	0.9	1.8	11.0	2.3	3.2	4.0	0.3	0.2
Poland	4.7	-2.2	5.9	3.9	3.6	3.7	-0.8	0.2
Latin America and the Caribbean	0.8	-6.4	6.7	2.5	1.9	2.4	-0.1	-0.8
Brazil	1.2	-3.9	4.6	1.5	0.8	2.0	0.1	-1.9
Mexico	-0.2	-8.2	4.8	1.7	1.9	2.0	-1.3	-0.3
Argentina	-2.0	-9.9	10.3	4.5	2.5	2.5	1.9	0.4
Middle East and North Africa	0.9	-3.7	3.4	5.3	3.6	3.2	0.9	0.2
Saudi Arabia	0.3	-4.1	3.2	7.0	3.8	3.0	2.1	1.5
Iran, Islamic Rep.[3]	-6.8	3.4	4.1	3.7	2.7	2.3	1.3	0.5
Egypt, Arab Rep.[2]	5.6	3.6	3.3	6.1	4.8	5.0	0.6	-0.7
South Asia	4.1	-4.5	7.6	6.8	5.8	6.5	-0.8	-0.2
India[3]	3.7	-6.6	8.7	7.5	7.1	6.5	-1.2	0.3
Pakistan[2]	3.1	-0.9	5.7	4.3	4.0	4.2	0.9	0.0
Bangladesh[2]	7.9	3.4	6.9	6.4	6.7	6.9	0.0	-0.2
Sub-Saharan Africa	2.6	-2.0	4.2	3.7	3.8	4.0	0.1	0.0
Nigeria	2.2	-1.8	3.6	3.4	3.2	3.2	0.9	0.4
South Africa	0.1	-6.4	4.9	2.1	1.5	1.8	0.0	0.0
Angola	-0.7	-5.2	0.7	3.1	3.3	3.2	0.0	0.5

4. 2022 Economic Reform Program of North Macedonia

The economy rebounded in 2021 and growth is expected to gradually accelerate in the mid-term. 2021 saw a solid recovery from the COVID-19-induced recession, supported by external demand and private consumption, while inflationary pressures increased during the year. The programme's baseline scenario is optimistic, with growth expected to average 5.2% between 2022 and 2024, benefiting from a global recovery from the pandemic and a planned increase in public investment to historically high levels. In a context of high uncertainty, the growth outlook for 2022 is, as elsewhere, subject to a series of downside risks due to the impact of Russia's war against Ukraine, the future course of the COVID-19 pandemic, global and domestic inflationary pressures, e.g. from strong wage growth, and potentially tightening financial conditions. Large implementation risks connected to private and public investment could also weigh on the growth outlook. War-related risks could in particular translate into further rises in energy and food prices and less favourable external trade developments due to a deteriorated growth outlook in the main EU trading partners.

Public debt, which rose sharply in 2020 due to pandemic-related financing needs, is projected to rise further in 2022, and to decline thereafter, but to stay above 60% of GDP during the programme's horizon. The declared objective is to restructure the budget, i.e. improve the composition of public finances, by significantly raising the share of capital expenditure. These plans largely depend on the unwinding of pandemic-related fiscal support, and on strong GDP growth. However, they are not sufficiently underpinned by concrete consolidation measures on the revenue or expenditure side. Hence, the envisaged consolidation path seems unrealistic, despite a likely overestimation of capital expenditure, considering that government activity in addressing shortcomings in the management of public investment is protracted.[3]

North Macedonia - Comparison of macroeconomic developments and forecasts

	2020		2021		2022		2023		2024	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	-4.5	**-6.1**	4.0	**4.1**	3.9	**4.6**	3.7	**5.2**	n.a.	**5.7**
Contributions:										
- Final domestic demand	-3.5	**-7.6**	5.0	**5.8**	4.7	**5.3**	4.1	**5.8**	n.a.	**6.2**
- Change in inventories	-2.3	**n.a.**	0.0	**n.a.**	0.0	**n.a.**	0.0	**n.a.**	n.a.	**n.a.**
- External balance of goods and services	1.3	**1.5**	-1.0	**-1.7**	-0.8	**-0.7**	-0.3	**-0.6**	n.a.	**-0.5**
Employment (% change)	-0.3	**-0.3**	1.1	**0.8**	2.6	**3.1**	2.5	**3.5**	n.a.	**3.8**
Unemployment rate (%)	16.4	**16.4**	15.7	**15.8**	15.1	**14.4**	14.6	**12.9**	n.a.	**11.4**
GDP deflator (% change)	0.9	**0.9**	1.9	**5.7**	1.4	**2.4**	1.0	**2.0**	n.a.	**2.0**
CPI inflation (%)	1.2	**1.2**	3.3	**3.2**	2.1	**2.4**	1.8	**2.0**	n.a.	**2.0**
Current account balance (% of GDP)	-3.4	**-3.4**	-3.6	**-3.8**	-2.6	**-3.8**	-2.2	**-2.4**	n.a.	**-1.6**
General government balance (% of GDP)	-8.2	**-8.3**	-6.1	**-6.4**	-4.9	**-4.3**	-4.3	**-3.4**	n.a.	**-2.9**
Government gross debt (% of GDP)	51.2	**51.9**	54.5	**51.9**	56.3	**53.3**	58.1	**53.0**	n.a.	**51.7**

Sources: Economic Reform Programme (ERP) 2022, Commission Autumn 2021 forecast (COM).

[3] 2022 Economic Reform Programmes of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina and Kosovo*: The Commission's Overview and Country Assessments (europa.eu)