

# The European economy: current situation and economic outlook

**Bucharest, 5 May 2022**

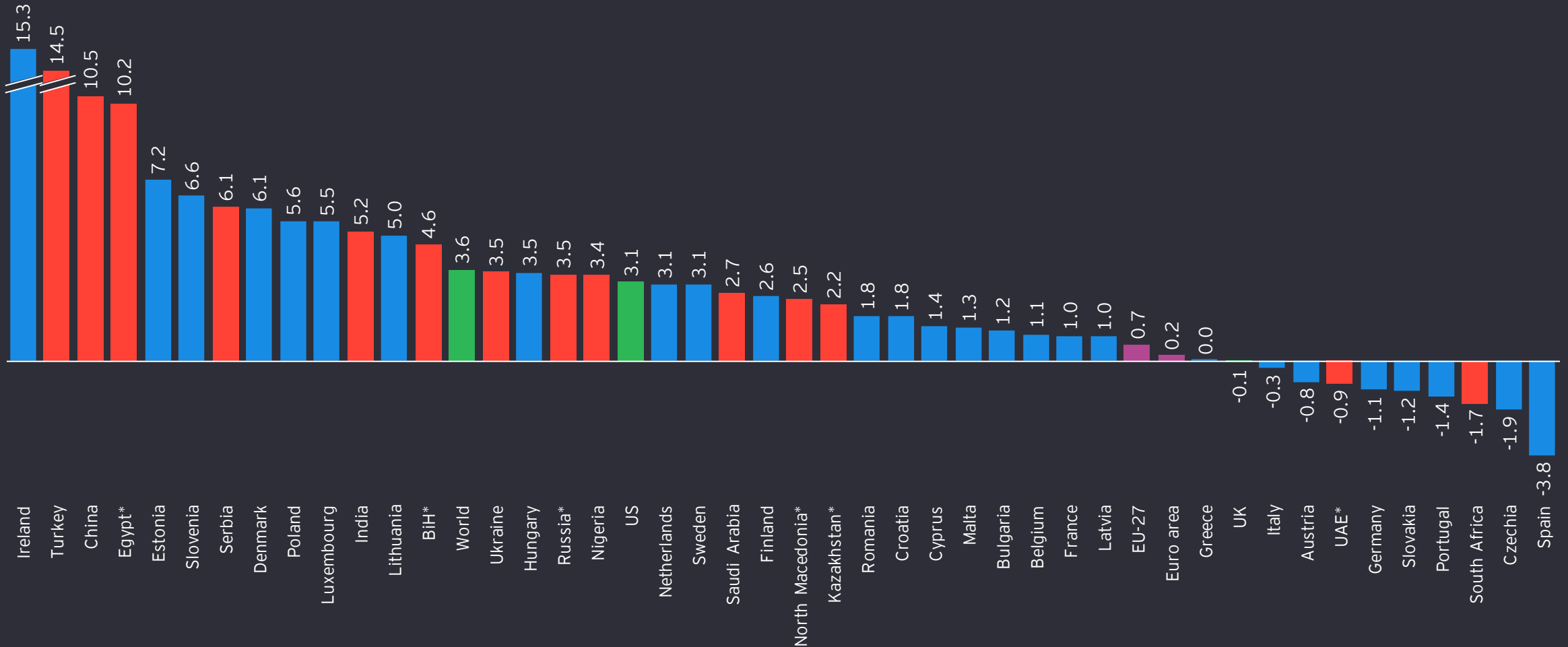


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# By the end of 2021, most economies in Europe and the world exceeded pre-pandemic levels of their economic activity

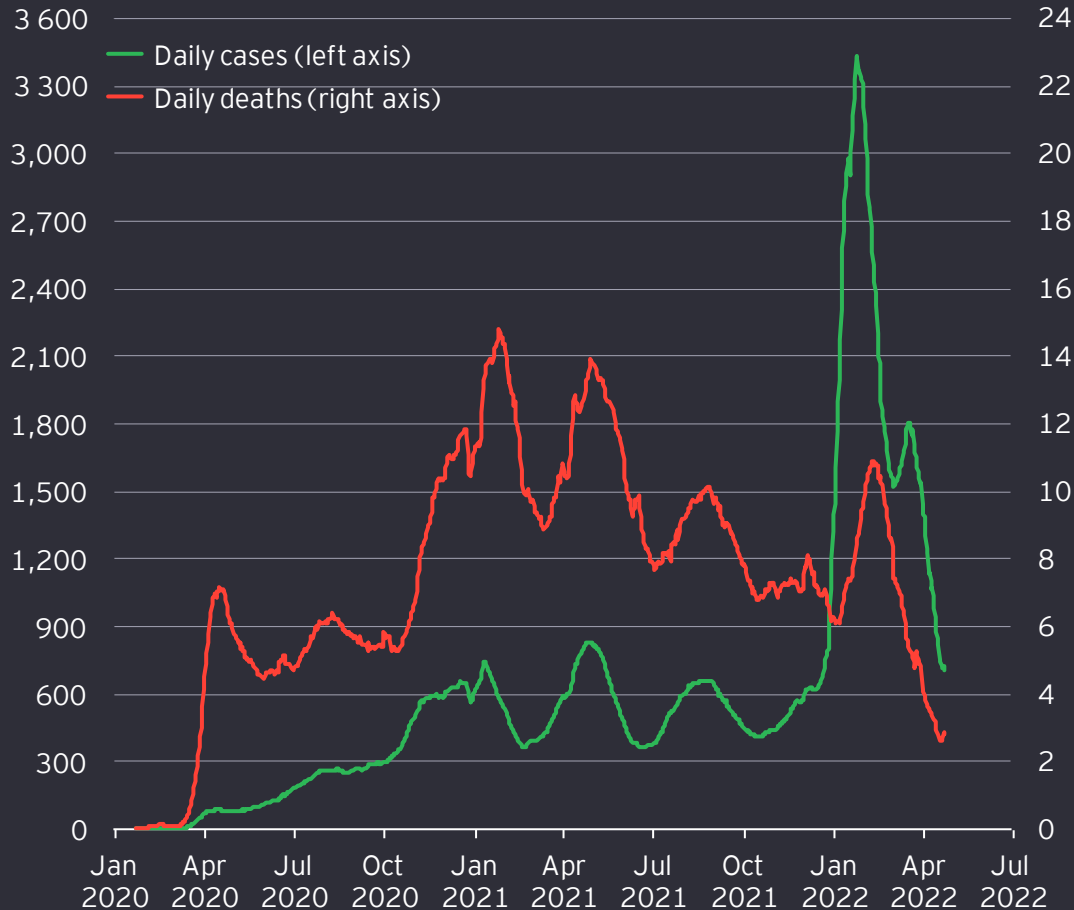
GDP change: Q4 2021 vs. Q4 2019 (In percentage)



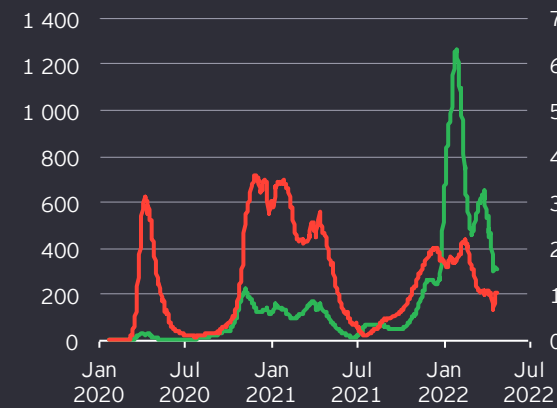
The pandemic seems to be finally receding in most countries, supporting activity in services, though uptick in cases in China and ensuing lockdowns are again intensifying supply bottlenecks

### Confirmed COVID-19 cases and deaths (seven-day moving average)

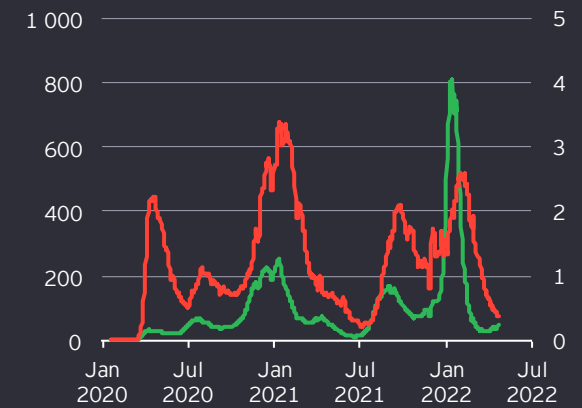
a. World (In thousands)



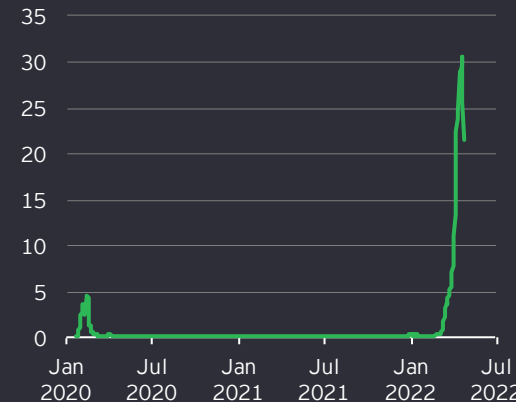
b. EU (In thousands)



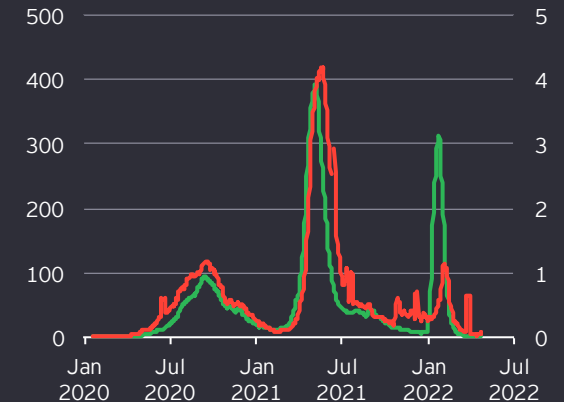
c. US (In thousands)



d. China (In thousands)



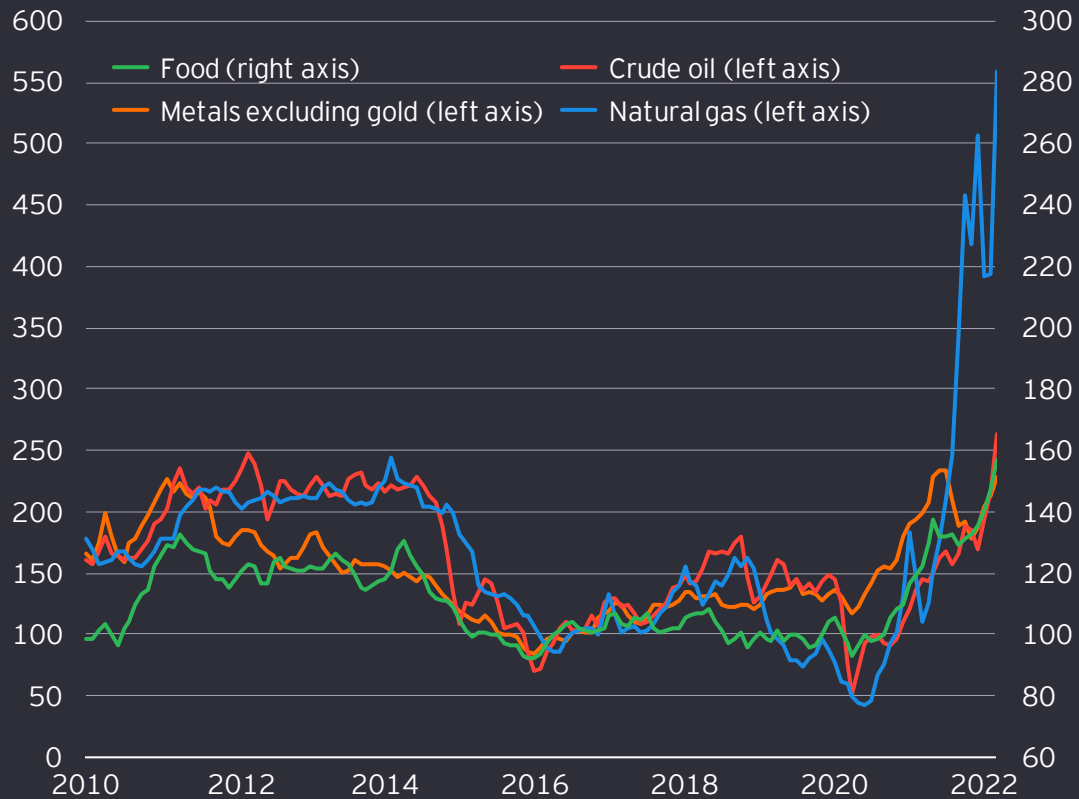
e. India (In thousands)



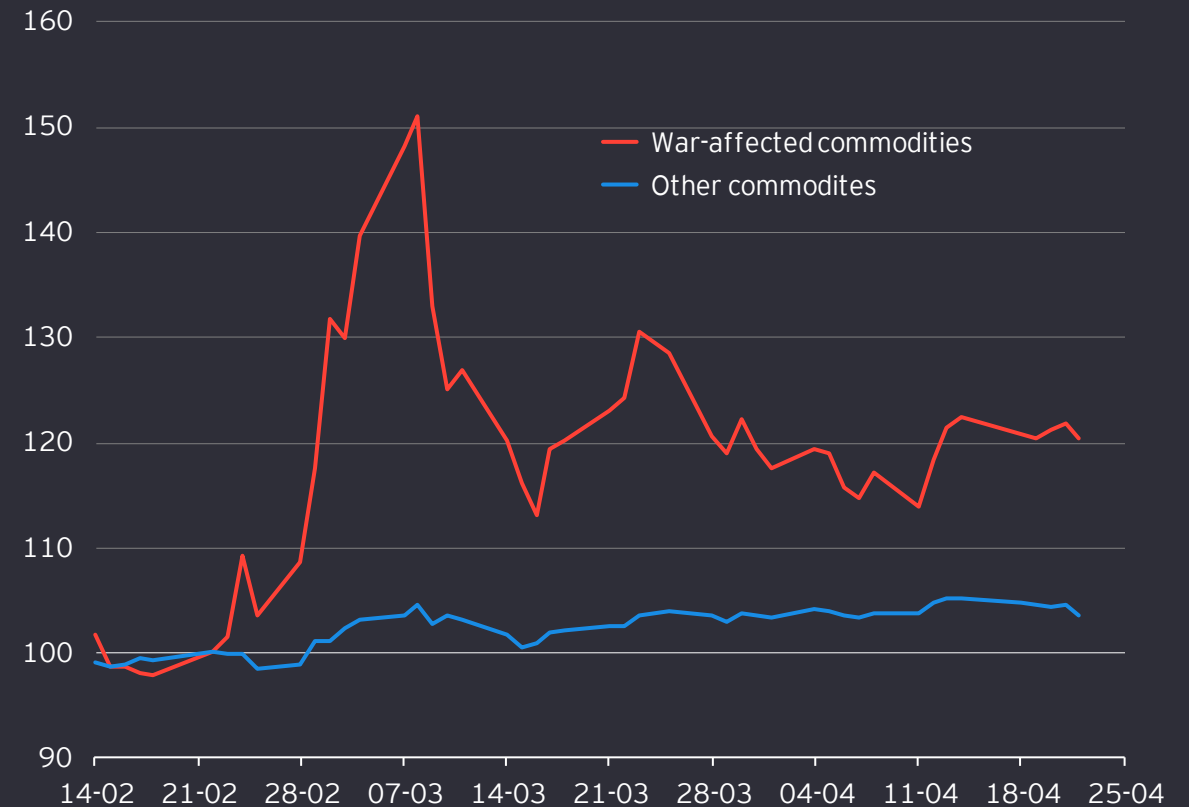
# Commodity (esp. natural gas) prices are surging, and the war in Ukraine has only made things worse

- ▶ The war has driven up particularly the prices of coal, natural gas, wheat and steel

**Global commodity prices** (index, 2016 = 100)



**Commodity prices** (Index, 22-02 = 100)



Source: stooq.pl, WITS, own calculations.

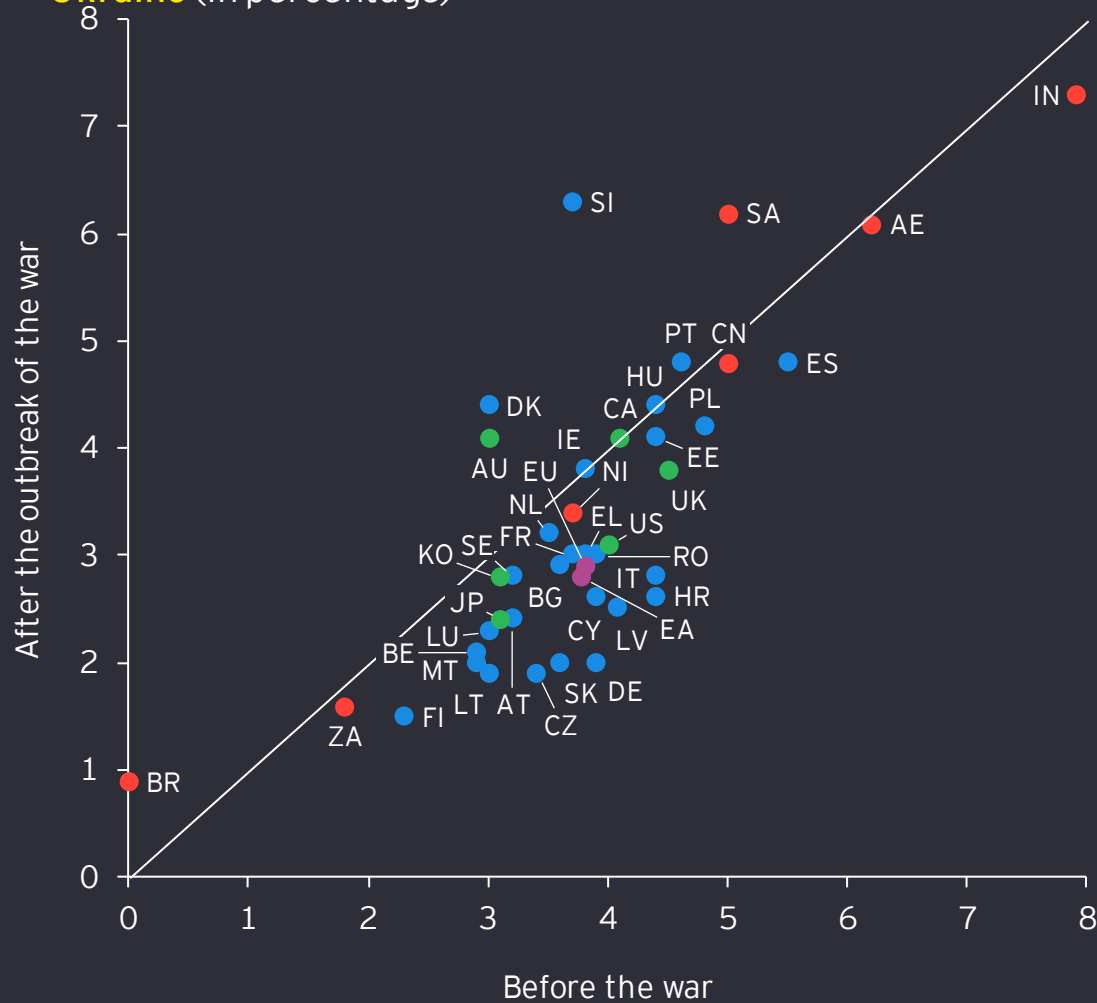
War-affected commodities: European natural gas, Brent oil, diesel, gasoline, coal, palladium, platinum, nickel, steel, aluminium, corn, wheat, rapeseed, lumber, urea.

Other commodities: silver, copper, iron ore, gold, zinc, rice, soybean, soybean oil, soybean meal, beef, pork, milk, cocoa, coffee, orange juice, sugar, cotton, palm oil.

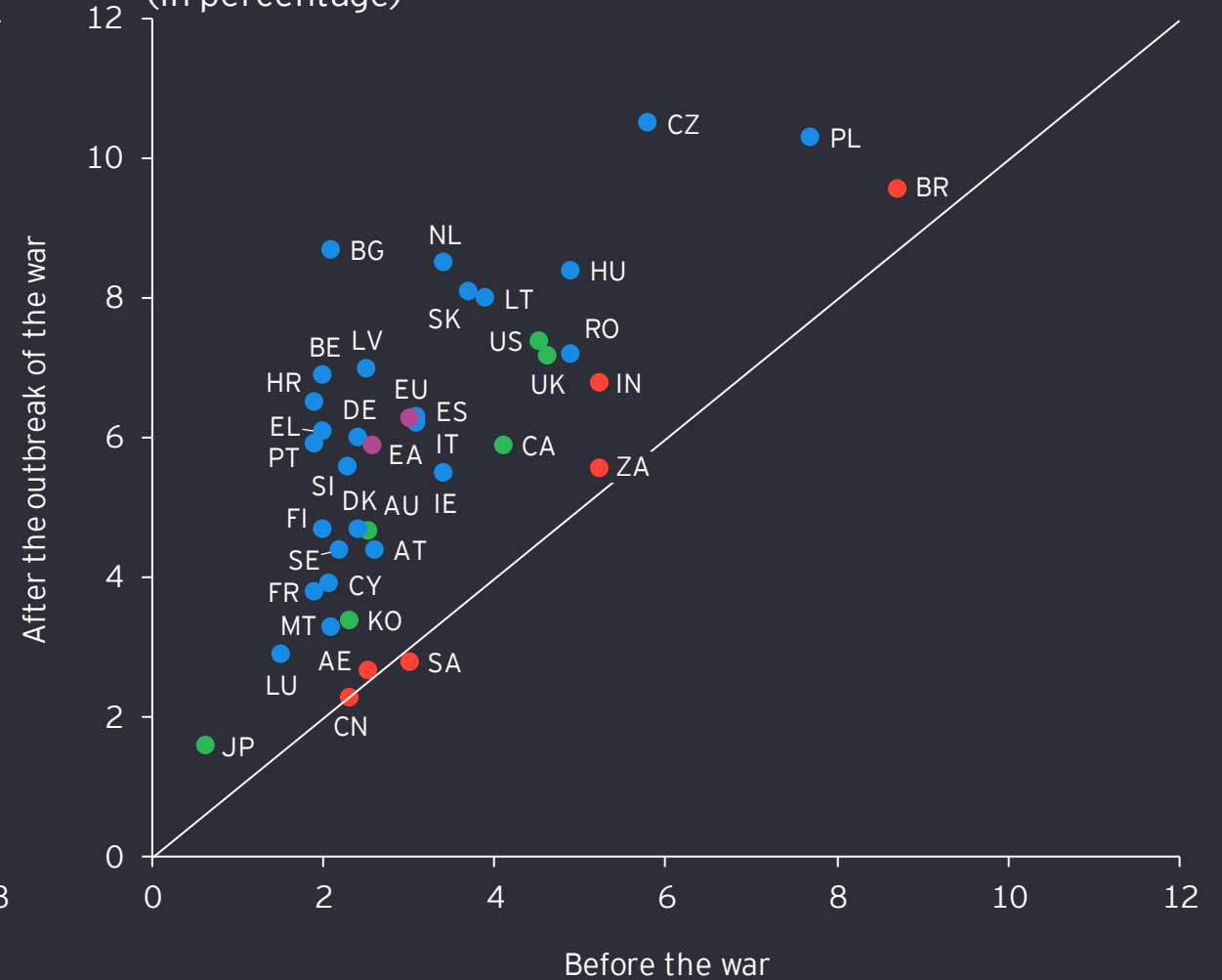
Averages weighted with shares in global trade in 2019.

# The war in Ukraine not only raises inflation, but also puts a drag on GDP growth

**GDP 2022 forecast before and after outbreak of war in Ukraine** (In percentage)

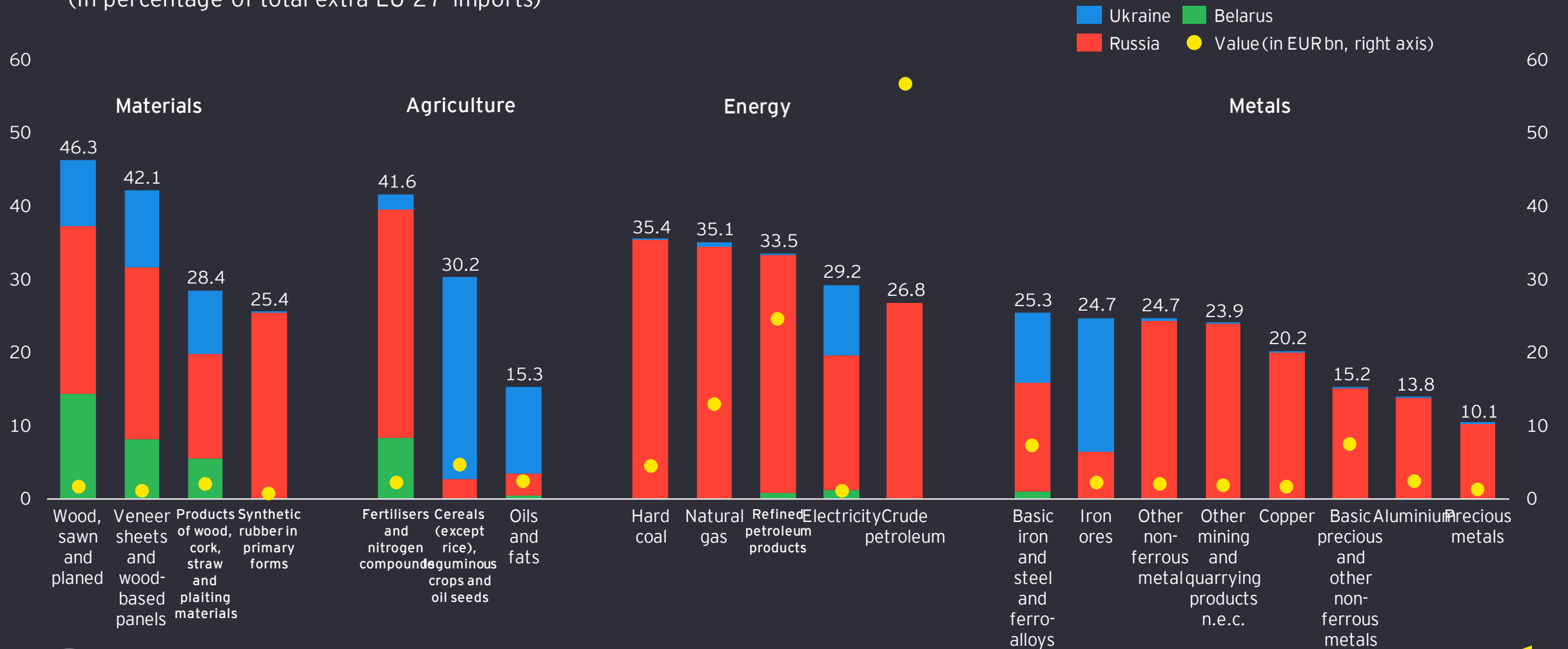


**Inflation 2022 forecast before and after outbreak of war in Ukraine** (In percentage)



European economies are quite dependent on imports of wood, fertilisers, energy commodities, cereals, rubber and metals from Russia, Ukraine and Belarus

**EU-27 commodity imports from Russia, Belarus and Ukraine in 2019 by product**  
(In percentage of total extra-EU-27 imports)

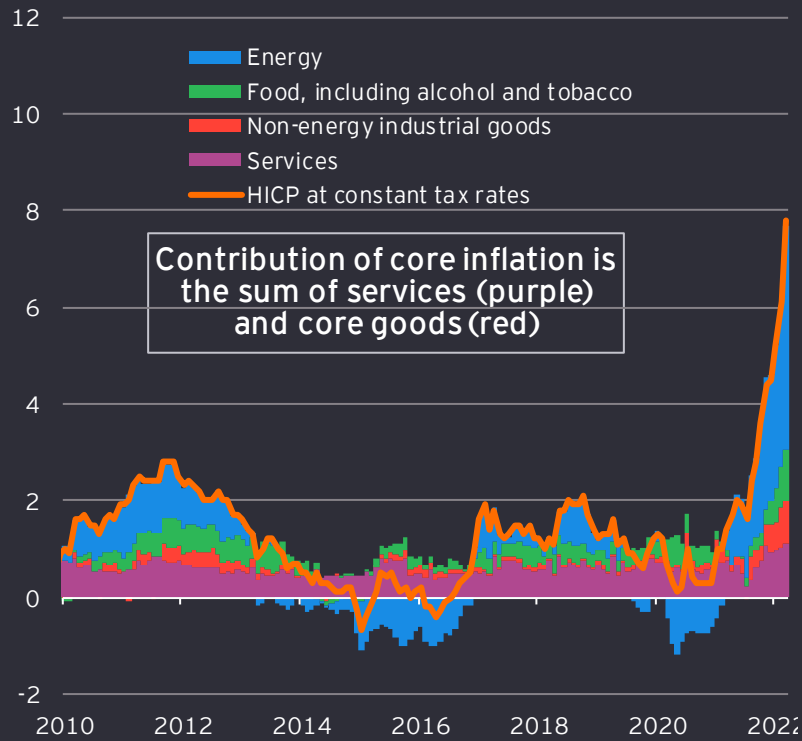


# Inflation is on the rise across the world, but its drivers differ across countries

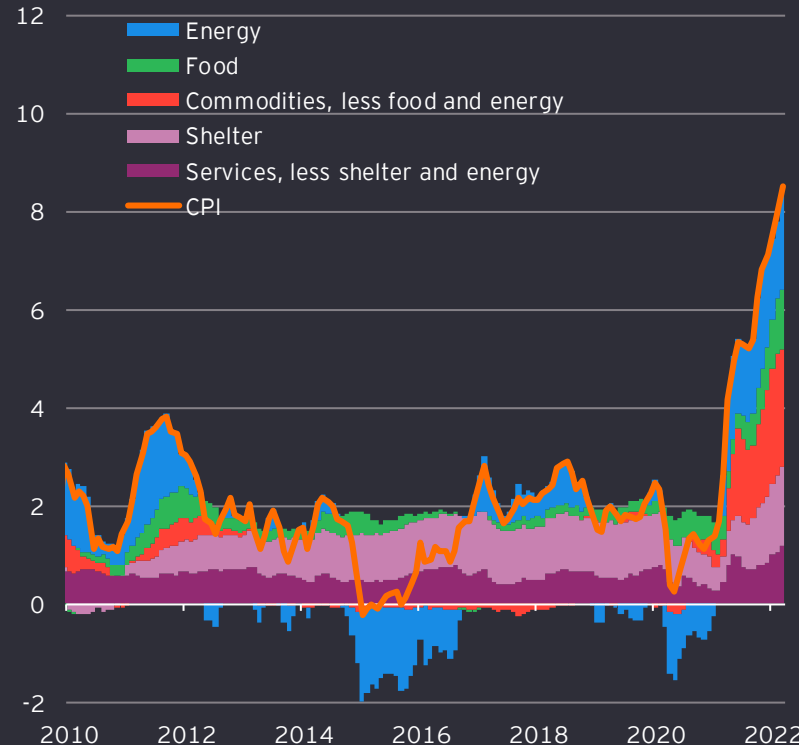
- Price pressures are stronger and more broad-based in CEE and the US than in Western Europe, where inflation is driven predominantly by energy prices

## Statistical decomposition of year-over-year inflation (In percentage)

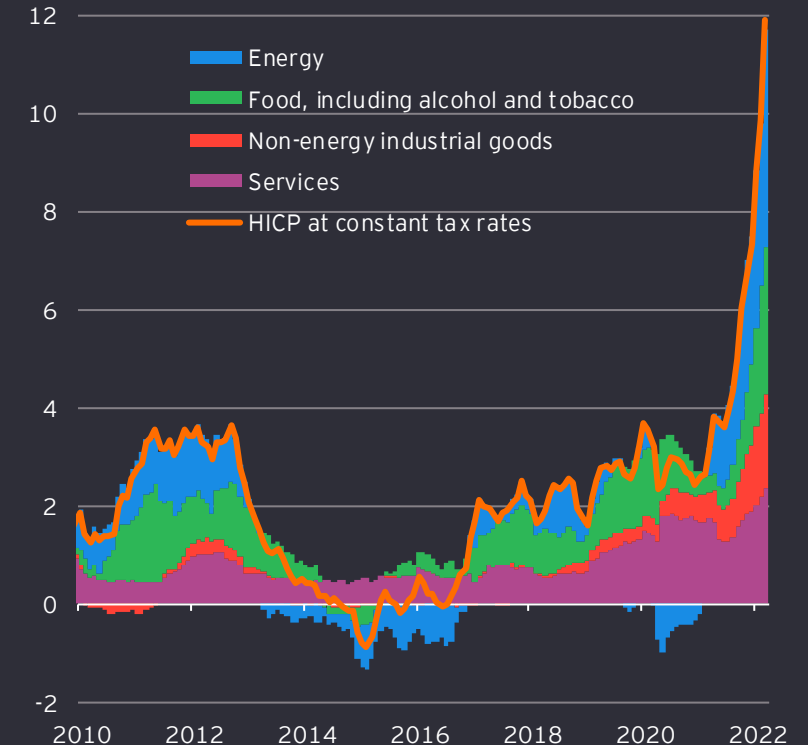
a) Euro area



b) US



c) CEE plus Baltics

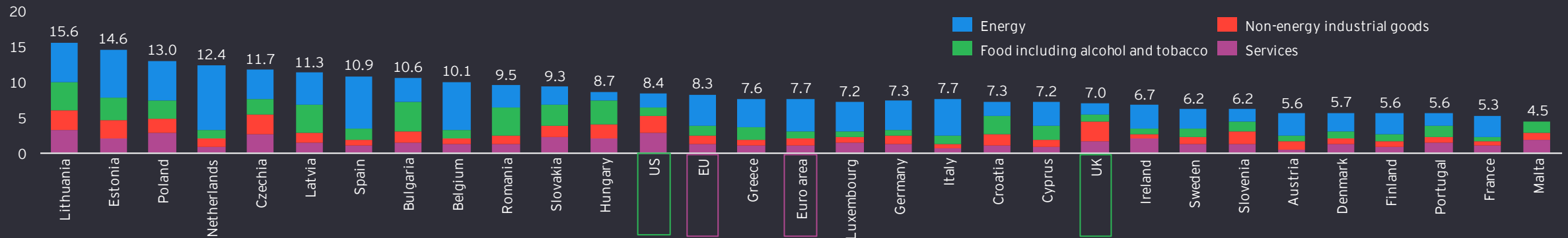




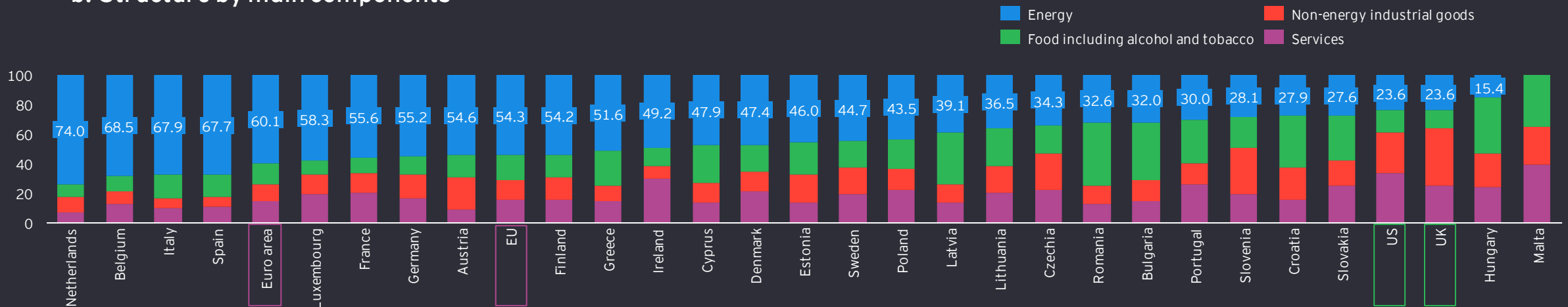
While inflation has reached double digits in some euro area countries (Netherlands, Spain, Belgium), it is predominantly driven by (larger than elsewhere) energy price hikes. In the CEE, US or UK inflation is much more broad-based

## HICP at constant tax rates\* in March 2022 (In percentage)

### a. Year-over-year



### b. Structure by main components

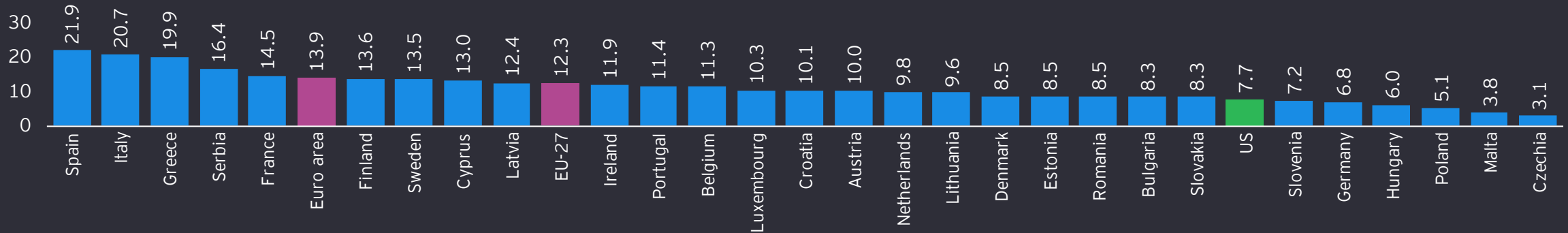




# The key differentiating factor is the labour market situation - labour market slack is much higher in Southern Europe than in the US or CEE

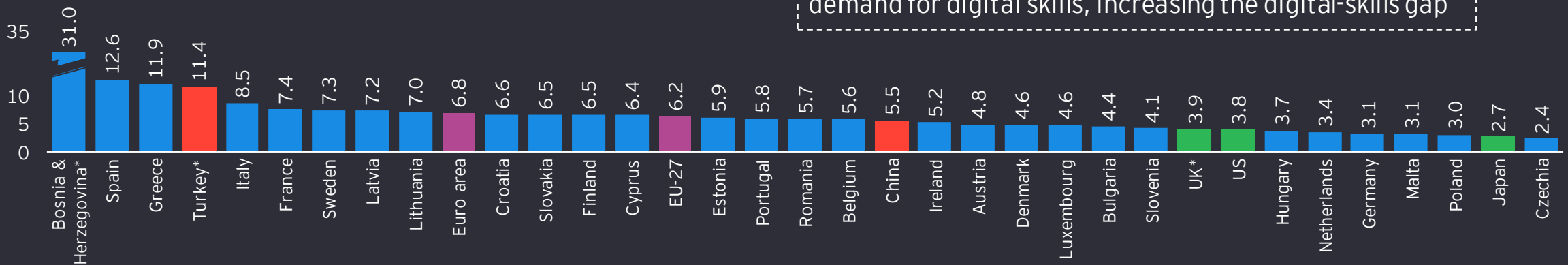
## Labor market slack in Q4 2021

In percentage of extended labor force, 20-64 years old



## Unemployment rate in February 2022

In percentage of population in the labor force



Global hunt for talent - pandemic has accelerated the demand for digital skills, increasing the digital-skills gap

Source: Eurostat; BLS; Trading Economics.

Note: Labor market slack refers to the total sum of all unmet employment demands and includes four groups:

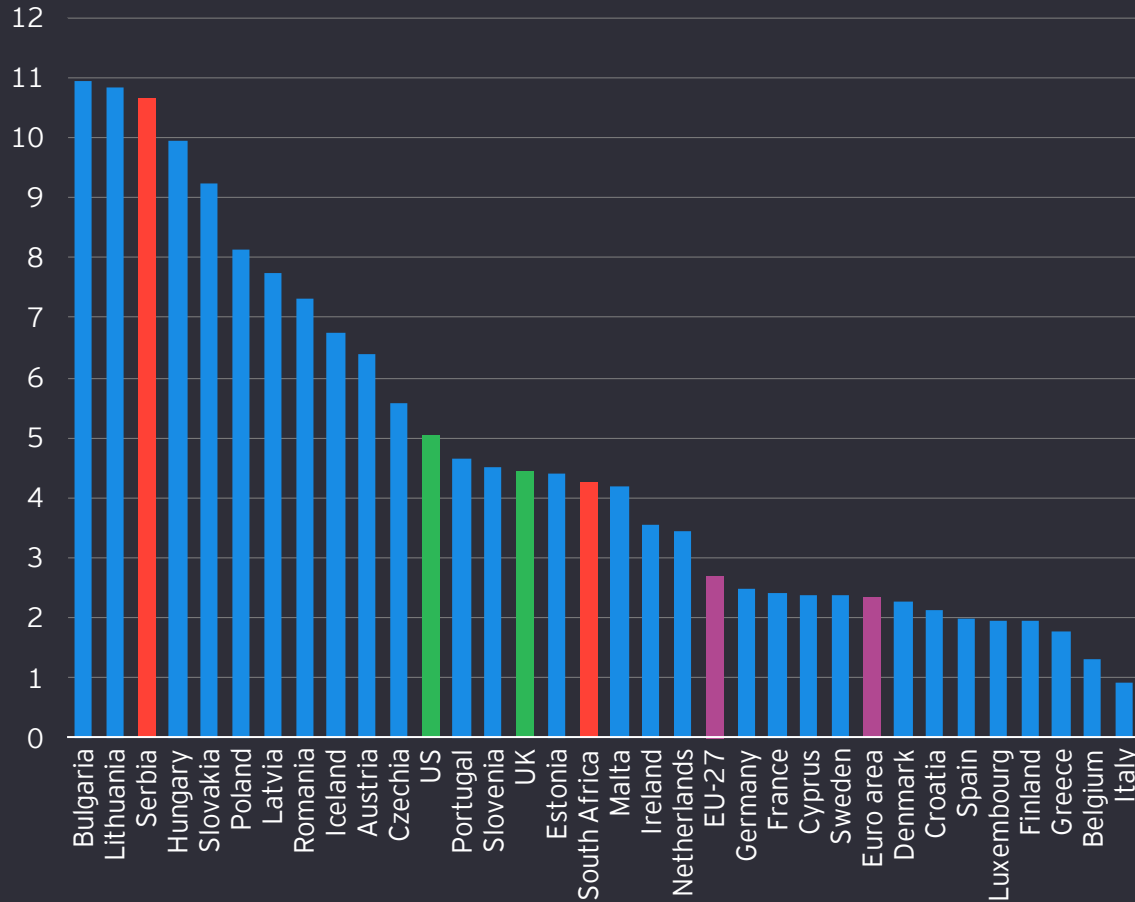
1. Unemployed people as defined by the ILO
2. Underemployed part-time workers (i.e., part-time workers who want to work more)
3. People who are available to work but are not looking for it
4. People who are looking for work but are not available for it

While the first two groups are in the labor force, the last two, also referred to as the potential additional labor force, are both outside the labor force. For this reason, the "extended labor force", composed of both the labor force and the potential additional labor force, is used in this analysis. For the US, labor market slack is the U-6 unemployment rate. For the US and the UK, unemployment rate is for unemployed persons aged between 16 and 64.

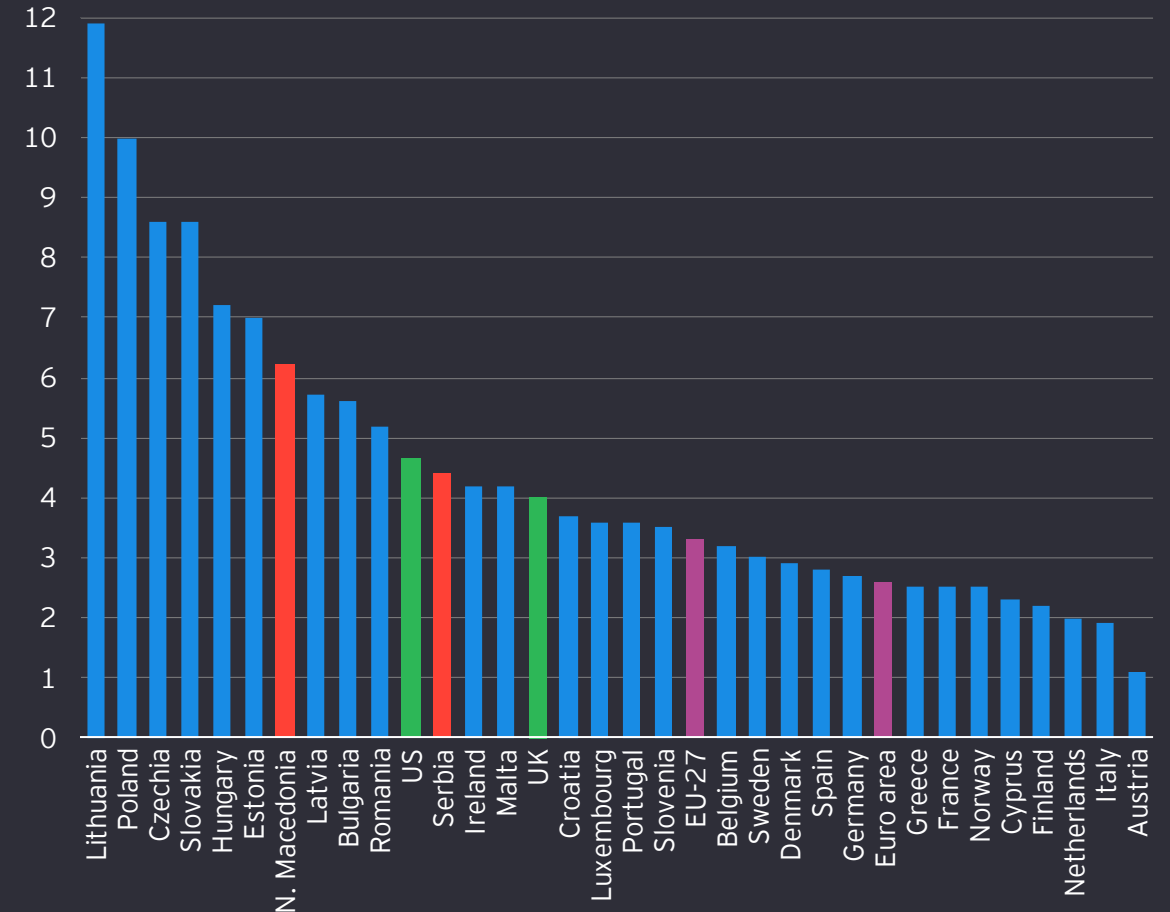
\* For Bosnia, Turkey and the UK; unemployment rate in January.

# This translates into differences in wage growth and inflation in (labour-intensive) services

Wage growth in the total economy by country, change from Q4 2019 to Q4 2021 CAGR (In percentage)



Services HICP at constant tax rates\* in March 2022 (year-over-year) (In percentage)



Source: Eurostat; FRED; ONS.

Seasonally and calendar adjusted data. For the US, average hourly earnings in the private sector; for the UK, total pay in the whole economy. CAGR - compound annual growth rate.

Source: Eurostat; FRED; ONS.

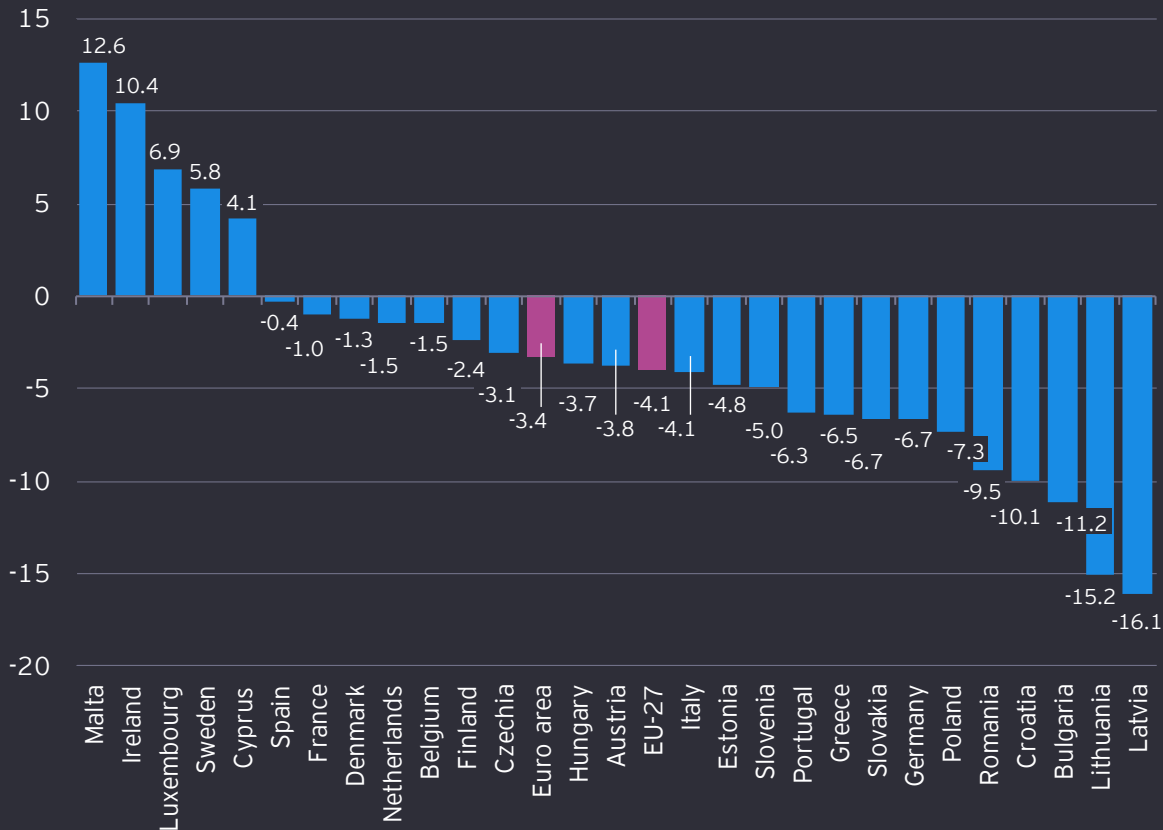
\* Services, less energy, CPI without any tax corrections for the US and the UK.

# Unfavorable demographic tendencies are and will be increasing tensions in the labour market in most European countries

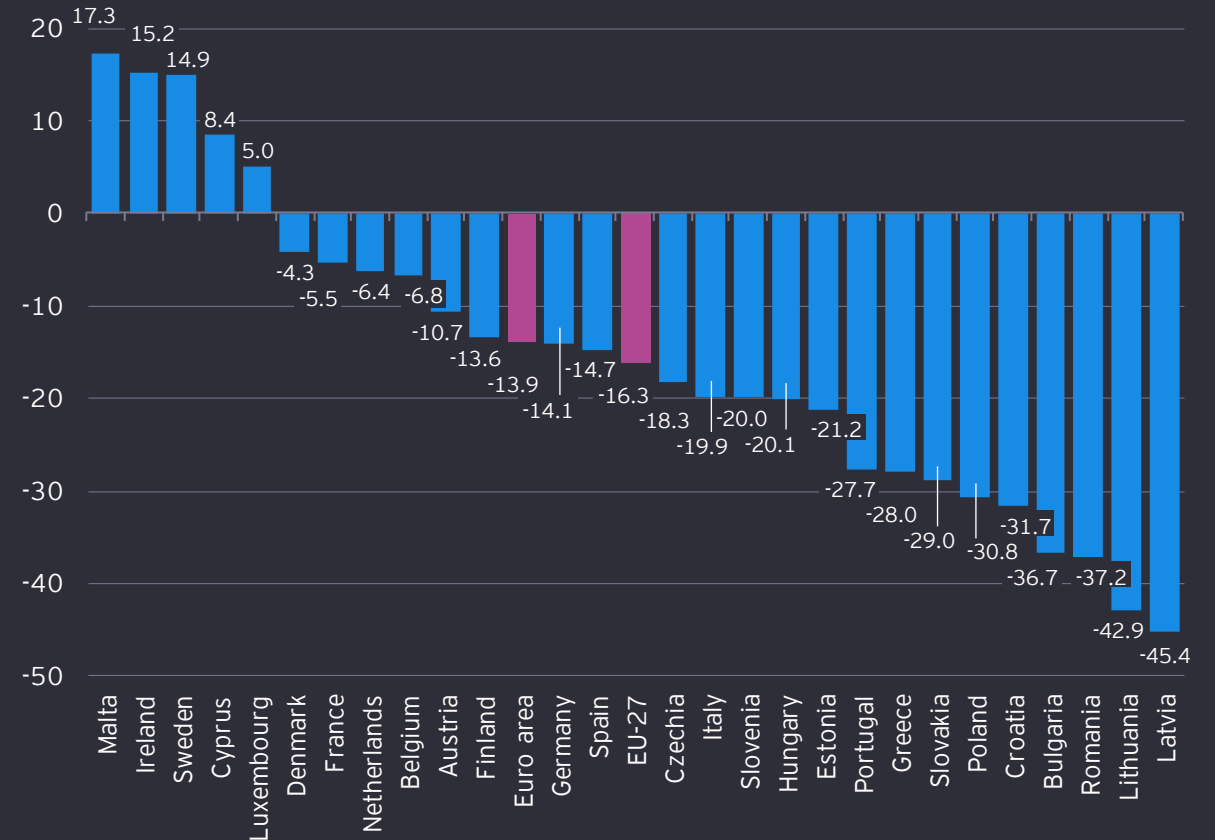
- Demographic challenges will be particularly acute in CEE countries.

## Change in population aged 20-64 in the EU countries (In percentage)

a) Between 2020 and 2030

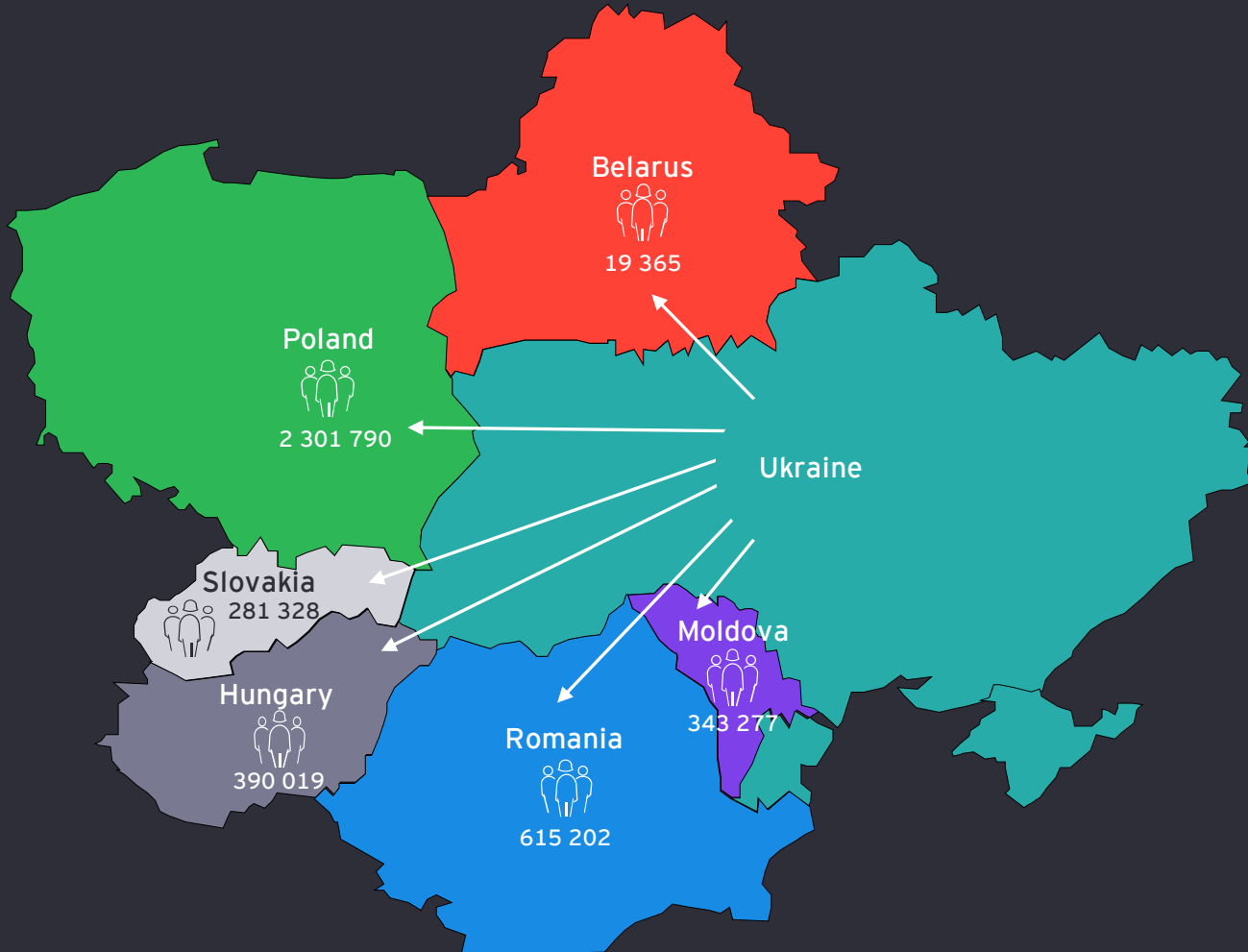


b) Between 2020 and 2060



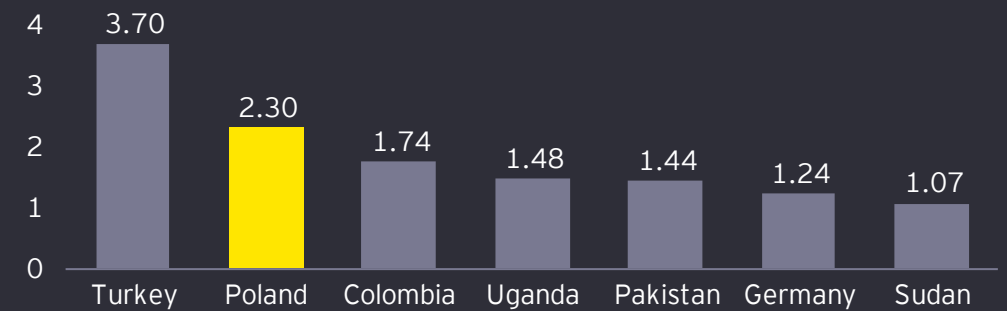
In the medium term influx of refugees may increase labour supply. In the short-term it will increase consumer demand, generate additional fiscal costs and fuel inflation

Net refugee influx\* from Ukraine as of 24 April

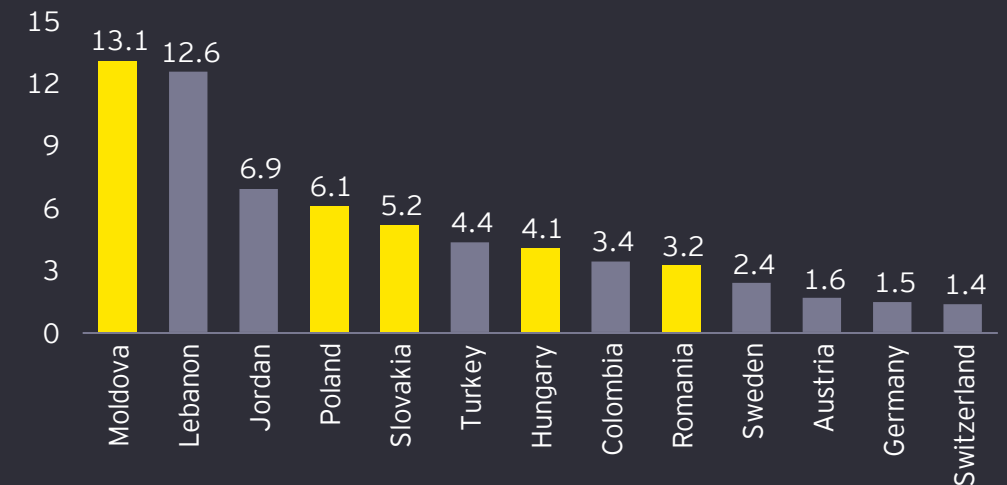


Net number of refugees\*\* (all countries of origin)

a) Absolute number (In millions)



b) Relative to population (In percentage)



Source: UNHCR, World Bank, own calculations.

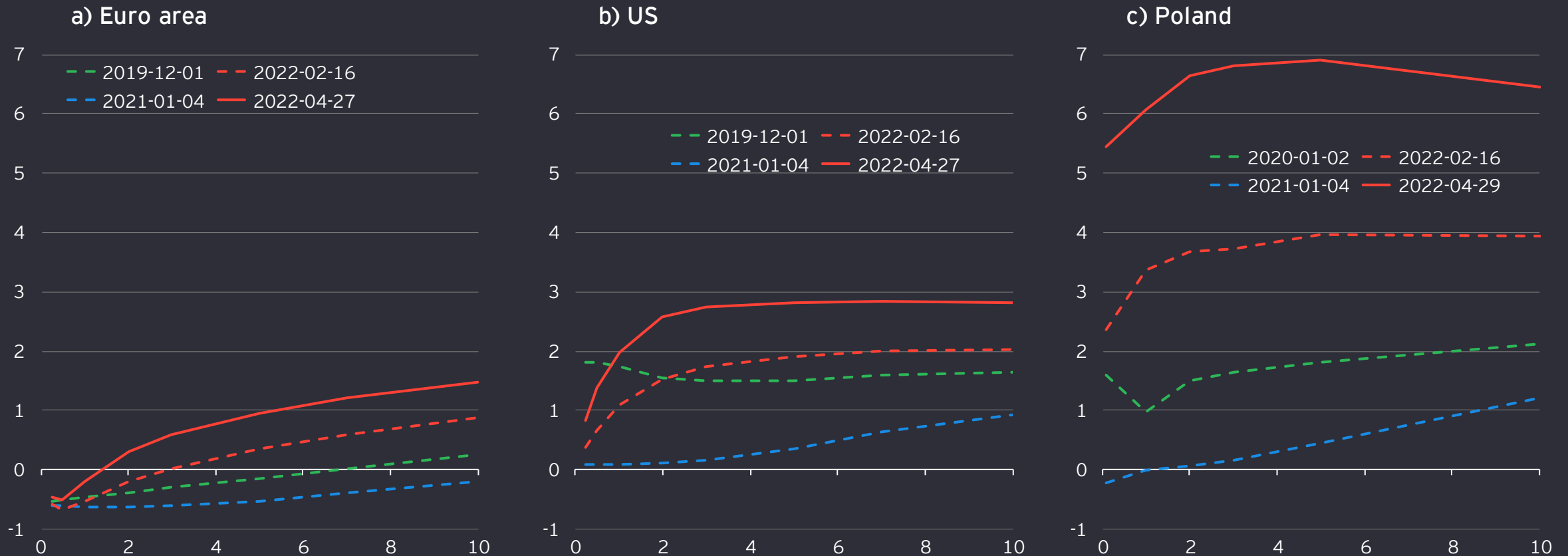
\* Total number of people crossing the border and leaving Ukraine less the estimate of people returning to the country. Some of the refugees do not stay in a given country, but move further to Western Europe.

\*\* Refugees and displaced Venezuelans as of mid 2021 and Ukrainians as of 24 April 2022.

# Despite downward revisions of GDP growth forecasts, in most cases the continued surge in inflation has led to a faster and stronger monetary policy tightening

- ▶ Having said that, the scale of tightening reflects the scale and broadness of inflationary pressures, and thus is larger in CEE and the US than in the euro area

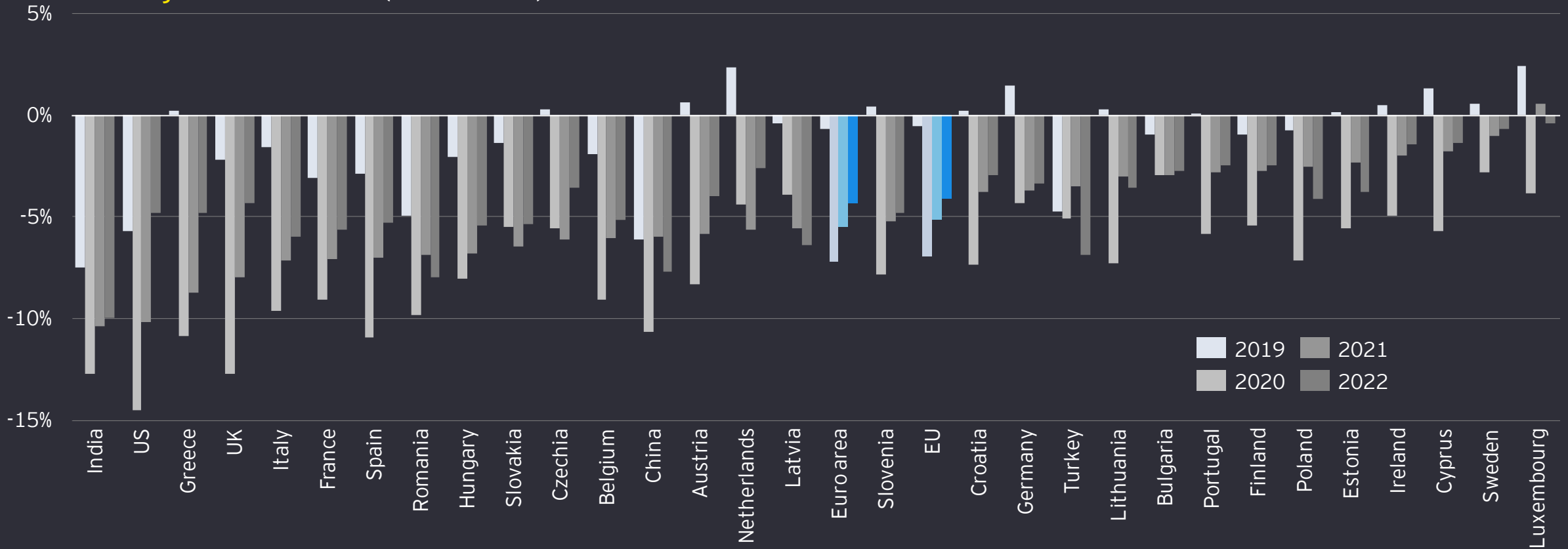
## Spot rate yield curves (In percentage)



The pandemic, energy transition and the war in Ukraine have generated new spending needs, driving up fiscal deficits. Expansionary fiscal policy in many countries continues to stimulate demand, thereby adding to inflation pressure

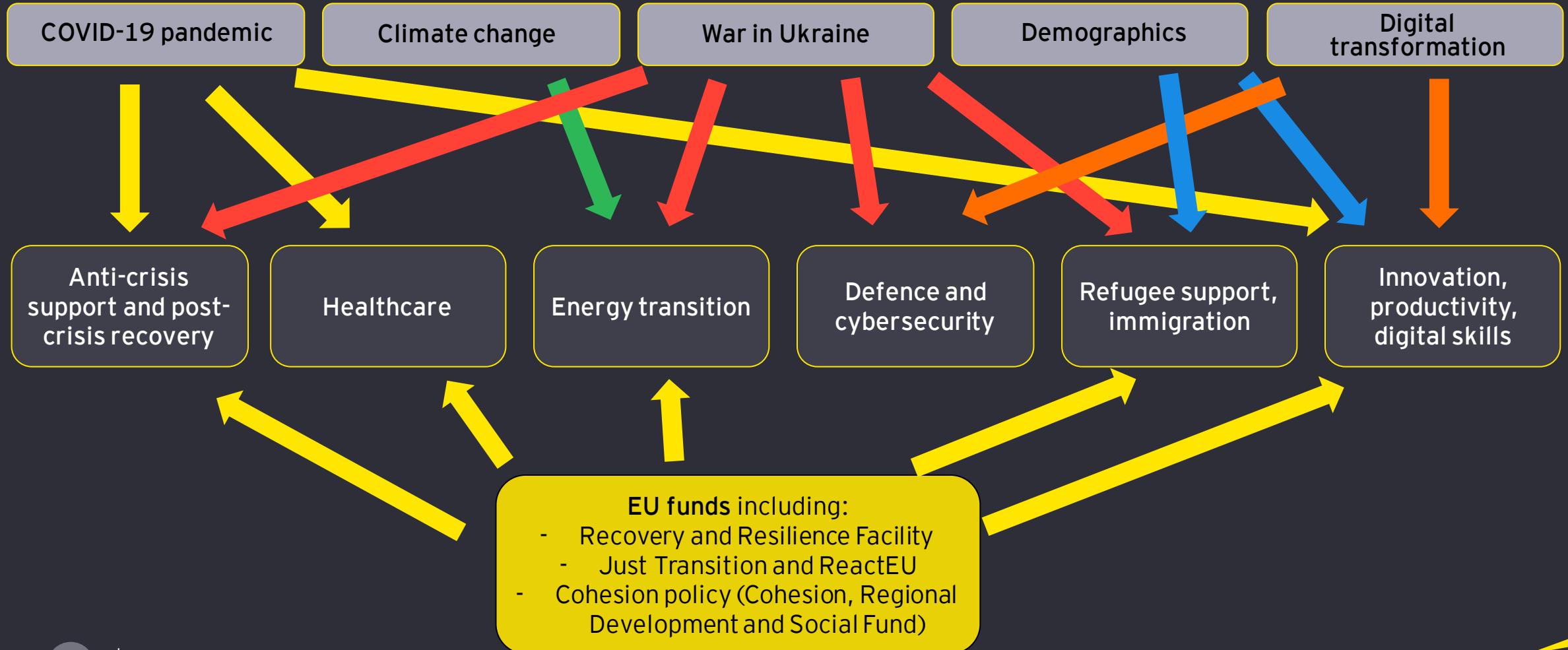
- ▶ At the same time recent disruptions (incl. pandemic, supply shortages, war in Ukraine) have increased the need to increase and accelerate public policy interventions in several key areas

**General government deficit** (as a % of GDP)



# Governments are facing multiple challenges, which require additional spending amid already high public debt and deficits. EU funds can help address that...

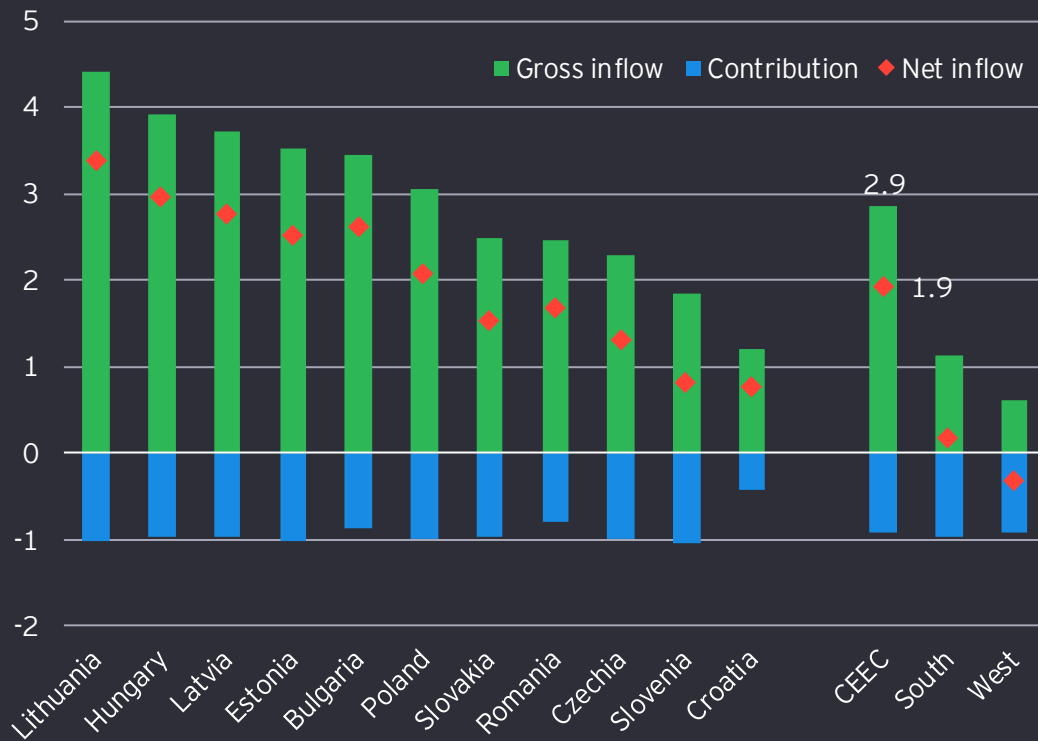
- ... but their efficient use is crucial, including the reallocation of spending from traditional aims towards the new priority areas





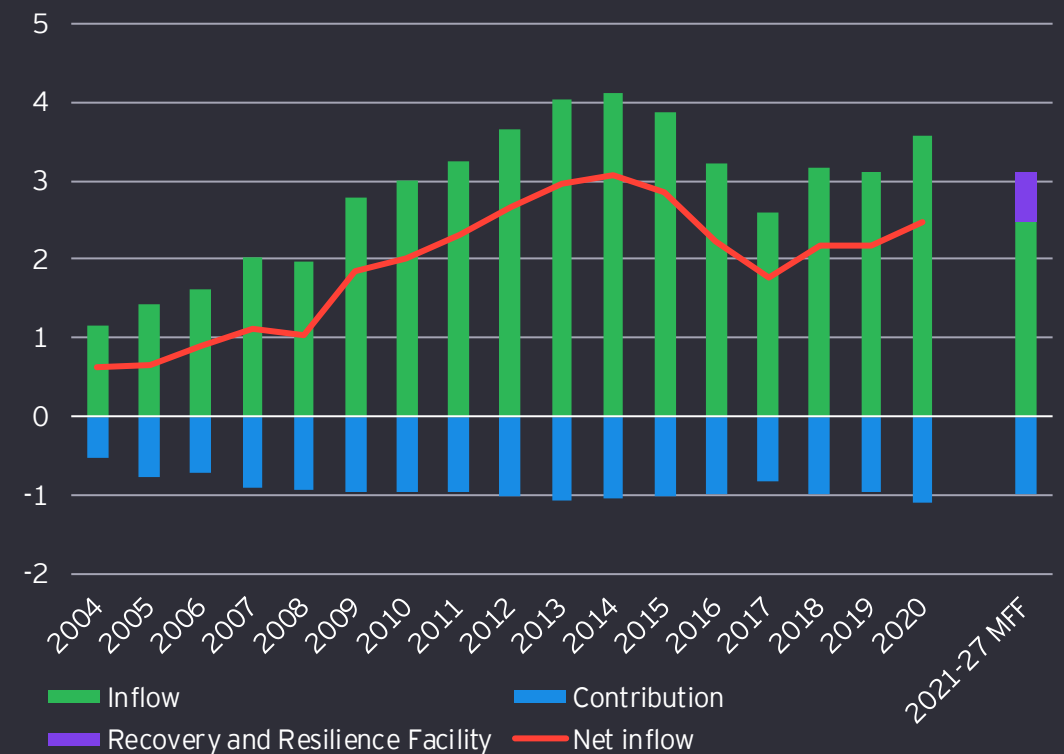
# CEE countries have been big net beneficiaries of the EU budget. RRF helps to make up for a decline in net inflow of EU funds in the 2021-27 MFF

**Inflow of EU funds and contributions to the EU budget by country and region (2004-2020 average, % of GNI)**



Source: European Commission.

**Inflow of EU funds and contributions to the EU budget in CEEC (% of GNI)**



Source: European Commission.

# EY Economic Analysis Team



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