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BETTER POLICIES FOR BETTER LIVES

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Editorial

The price of war

The world is set to pay a hefty price for Russia's war against Ukraine. A humanitarian crisis is unfolding before our eyes, leaving thousands dead, forcing millions of refugees to flee their homes and threatening an economic recovery that was underway after two years of the pandemic. As Russia and Ukraine are large commodity exporters, the war has sent energy and food prices soaring, making life much harder for many people across the world.

The extent to which growth will be lower and inflation higher will depend on how the war evolves, but it is clear the poorest will be hit hardest. The price of this war is high and will need to be shared.

The global economy is set to weaken sharply in our projections. We estimate world growth to be 3% in 2022 – down from the 4½ per cent we projected last December - and 2¾ per cent in 2023. Inflation projections now stand at nearly 9% in OECD countries in 2022, twice what we were previously projecting. Elevated inflation across the globe is eroding households' real disposable income and living standards, and in turn lowering consumption. Uncertainty is deterring business investment and threatening to curb supply for years to come. At the same time, China's zero-Covid policy continues to weigh on the global outlook, lowering domestic growth and disrupting global supply chains.

With risks biased to the downside, the price of war could be even higher. The conflict is disrupting the distribution of basic food and energy, fuelling higher inflation everywhere and threatening low-income countries in particular. European economies are struggling to wean themselves off Russian fuel. but because alternative energy sources may not be easy to ramp up quickly, there is a risk of higher prices or even shortages. If the war escalates or becomes more protracted, the outlook would worsen, particularly for low-income countries and Europe.

Limiting Russia's ability to finance the war, as is intended by an embargo on Russian oil exports, is essential for speeding up an end to this devastating conflict.

Meanwhile, we must minimise the humanitarian, economic and social consequences.

The first urgency is to avoid a food crisis. Today, the world is producing enough cereals to feed everyone, but prices are very high and the risk is that this production will not reach those who need it most. Global cooperation is needed to ensure that food reaches consumers at affordable prices, in particular in low-income and emerging-market economies. This may require more international aid as well as cooperation in the logistics of shipping and distributing to countries in need. The flaws of global vaccine distribution are still fresh in our memory. Let's not repeat them.

Second, inflation has strong distributional effects. It will help drive down debt, including public debt, but it is also eroding real income, savings and purchasing power. At the same time, it may affect firms' profits and capacity to invest and create jobs. Inflation is a burden, which must be shared fairly among people and firms, between profit and wages. Governments also have to play a role through support targeted to those most vulnerable to rising food and energy inflation.

Next, monetary and fiscal policy need to adjust to these extraordinary circumstances.

Globally, the elevated levels of inflation and employment *today* suggest there is no longer a need for monetary policy accommodation. However, in many regions inflation is driven by food and energy. If monetary policy cannot address such supply shocks, it can send signals that it will not allow inflation to rise or spread further. Removing accommodation is therefore warranted across the globe, but with particular caution in Europe where supply-driven inflation dominates. Conversely, wherever inflation is driven by over-buoyant demand, as in the United States, monetary policy can tighten faster to reduce such excess.

Fiscal policy management is particularly complex. Because of the current levels of growth, employment and inflation, the need for economy-wide income support has disappeared and should be replaced by better targeted measures. The war in Ukraine has raised the need for higher public investment in defence and for greater urgency in the transition to greener energy. This comes on top of other investment needs like health, digitalisation, ageing and education, and as public debts remain high. This conundrum can only be resolved with a stronger focus on prioritisation from governments. In Europe, the integration of the region and high exposure to the war calls for more solidarity in defence and energy spending.

The war has exposed how energy security and climate mitigation are intertwined. Governments need to shift gear to accelerate the energy transition. The emergency response to a possible energy crisis has turned out to be a stark scramble for alternative sources of fossil fuels and to increase coal use. This can only be temporary as it is the opposite of what the world needs, which is a rapid increase in investment in, and consumption of, cleaner energy. But clean energy requires inputs, minerals and intermediate materials which come from all over the planet. Put simply, the cleaner the energy, the larger and the more geographically diverse the value chains will have to be. There will be no climate mitigation without open trade and resilient global value chains.

The world is already paying the price for Russia’s aggression. The choices made by policymakers and citizens will be crucial to determining how that price will be distributed across people and countries.

8 June 2022

Laurence Boone

OECD Chief Economist and Deputy Secretary-General

1 General assessment of the macroeconomic situation

Introduction

The war in Ukraine has generated a major humanitarian crisis affecting millions of people. The associated economic shocks, and their impact on global commodity, trade and financial markets, will also have a material impact on economic outcomes and livelihoods. Prior to the outbreak of the war the outlook appeared broadly favourable over 2022-23, with growth and inflation returning to normality as the COVID-19 pandemic and supply-side constraints waned. The invasion of Ukraine, along with shutdowns in major cities and ports in China due to the zero-COVID policy, has generated a new set of adverse shocks. Global GDP growth is now projected to slow sharply this year to 3%, around 1½ percentage points weaker than projected in the December 2021 OECD Economic Outlook, and to remain at a similar subdued pace in 2023 (Table 1.1). In part, this reflects deep downturns in Russia and Ukraine, but growth is set to be considerably weaker than expected in most economies, especially in Europe, where an embargo on oil and coal imports from Russia is incorporated in the projections for 2023. Commodity prices have risen substantially, reflecting the importance of supply from Russia and Ukraine in many markets, adding to inflationary pressures and hitting real incomes and spending, particularly for the most vulnerable households. In many emerging-market economies the risks of food shortages are high given the reliance on agricultural exports from Russia and Ukraine. Supply-side pressures have also intensified as a result of the conflict, as well as the shutdowns in China. Consumer price inflation is projected to remain elevated, averaging around 5½ per cent in the major advanced economies in 2022, and 8½ per cent in the OECD as a whole, before receding in 2023 as supply-chain and commodity price pressures wane and the impact of tighter monetary conditions begins to be felt. Core inflation, though slowing, is nonetheless projected to remain at or above medium-term objectives in many major economies at the end of 2023.

The uncertainty around this outlook is high, and there are a number of prominent risks. The effects of the war in Ukraine may be even greater than assumed, for example because of an abrupt Europe-wide interruption of flows of gas from Russia, further increases in commodity prices, or stronger disruptions to global supply chains. Inflationary pressures could also prove stronger than expected, with risks that higher inflation expectations move away from central bank objectives and become reflected in faster wage growth amidst tight labour markets. Sharp increases in policy interest rates could also slow growth by more than projected. Financial markets have so far adjusted smoothly to tighter global financial conditions, but there are significant potential vulnerabilities from high debt levels and elevated asset prices. Challenges also remain for many emerging-market economies, from rising food and energy prices, the slow recovery from the pandemic, high debt, and the potential for capital outflows as interest rates rise in the advanced countries. Risks also remain from the evolution of the COVID-19 pandemic: new more aggressive or contagious variants may emerge, while the application of zero-COVID policies in large economies like China has the potential to sap global demand and disrupt supply for some time to come.

The substantial economic costs of the war, elevated uncertainty, and the forthcoming embargo on coal and seaborne oil imports from Russia in Europe add to the challenges already facing policymakers from rising inflationary pressures and the imbalanced recovery from the pandemic:

- Faced with an adverse supply shock of uncertain duration and magnitude from higher commodity prices, monetary policy should remain focused on ensuring well-anchored inflation expectations. This calls for a differentiated response across the major advanced economies. The case for a relatively quick normalisation is particularly strong in the United States, Canada and many smaller European countries, where the recovery in demand from the pandemic is well advanced and broad-based inflation pressures were already apparent ahead of the recent commodity price surge. Removing accommodation more gradually is appropriate in economies where core inflation is lower, wage pressures remain modest and the impact of the conflict and the future embargo on growth is greatest. Further policy rate increases are likely to be needed in many emerging-market economies to help anchor inflation expectations and avoid destabilising capital outflows.

- Temporary, timely and well-targeted fiscal measures, where feasible, provide the best policy option to cushion the immediate impact of the commodity and food price shocks on vulnerable households and companies and provide support for refugees from the war. Many countries have appropriately slowed plans for gradual fiscal consolidation in the aftermath of the pandemic, at least until 2023, but consolidation should not be delayed where demand pressures are clearly apparent in inflation. Over the medium and long term, the conflict in Ukraine is raising new fiscal priorities, including accelerated investment in clean energy and higher defence spending, reinforcing the need for a thorough reassessment of the composition of the public finances. Credible fiscal frameworks with strong national ownership can help to provide clear guidance about the medium-term trajectory of the public finances and mitigate concerns about debt sustainability.

- The pandemic and the war in Ukraine have exposed many longstanding structural weaknesses, which have been felt unequally across households, firms and countries. Effective and well-targeted reforms are needed to boost resilience, revive productivity growth, address persisting inequality and accelerate reductions in carbon emissions. International co-operation will need to be preserved to improve prospects for sustainable and equitable longer-term growth by keeping markets open to trade, helping developing countries overcome the COVID-19 pandemic and reduce debt burdens, and enabling more ambitious and effective collective actions on climate change.

The war has underlined the vulnerability of energy and food security given the dependence of many countries on exports from Russia or Ukraine. Substantial, but not complete, diversification of energy sources can be achieved relatively quickly in some countries, as highlighted by the plans for oil and gas imports set out by the International Energy Agency. Providing regulatory and fiscal incentives to move towards alternative energy sources and invest in innovation and infrastructures are both important steps to help develop clean energy supply and spur energy efficiency. Some progress in this direction has been made in recent public investment plans but more needs to be done to meet the commitments made at COP26. Food security has also become a more pressing concern given the acute risk of economic crises in some developing economies and sharp increases in poverty and hunger. To monitor and mitigate such risks, all countries must provide the assistance necessary to facilitate the planting of new crops, including in Ukraine, tackle logistical barriers limiting the supply of food to countries most at risk, and refrain from export restrictions on food and other agricultural products.

Table 1.1. Global growth is projected to be subdued

	Average 2013-2019	2020	2021	2022	2023	2021 Q4	2022 Q4	2023 Q4
				Per cent				
Real GDP growth[1]								
World[2]	3.3	-3.4	5.8	3.0	2.8	4.3	1.9	3.0
G20[2]	3.5	-3.0	6.2	2.9	2.8	4.3	1.9	2.9
OECD[2]	2.2	-4.6	5.5	2.7	1.6	4.8	1.5	1.6
United States	2.4	-3.4	5.7	2.5	1.2	5.5	1.2	0.7
Euro area	1.9	-6.5	5.3	2.6	1.6	4.6	1.2	1.8
Japan	0.8	-4.5	1.7	1.7	1.8	0.3	2.5	0.9
Non-OECD[2]	4.3	-2.3	6.1	3.3	3.8	3.8	2.3	4.2
China	6.8	2.2	8.1	4.4	4.9	3.9	4.9	4.5
India[3]	6.8	-6.6	8.7	6.9	6.2			
Brazil	-0.4	-4.2	5.0	0.6	1.2			
OECD unemployment rate[4]	6.5	7.1	6.2	5.2	5.3	5.5	5.3	5.3
Inflation[1]								
G20[2,5]	3.0	2.8	3.8	7.6	6.3	5.0	7.8	5.8
OECD[6,7]	1.7	1.5	3.7	8.5	6.0	5.2	8.9	5.2
United States[6]	1.4	1.2	3.9	5.9	3.5	5.5	5.1	2.8
Euro area[8]	0.9	0.3	2.6	7.0	4.6	4.6	6.8	3.9
Japan[9]	0.9	0.0	-0.2	1.9	1.9	0.5	2.4	1.6
OECD fiscal balance[10]	-3.2	-10.4	-7.4	-5.0	-3.8			
World real trade growth[1]	3.4	-8.1	10.0	4.9	3.9	8.5	2.6	4.1

1. Percentage changes; last three columns show the change over a year earlier.
2. Moving nominal GDP weights, using purchasing power parities.
3. Fiscal year.
4. Per cent of labour force.
5. Headline inflation.
6. Private consumption deflator.
7. Moving nominal private consumption weights, using purchasing power parities.
8. Harmonised consumer price index.
9. National consumer price index.
10. Per cent of GDP.

Source: OECD Economic Outlook 111 database.

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The war in Ukraine is a major economic and social shock

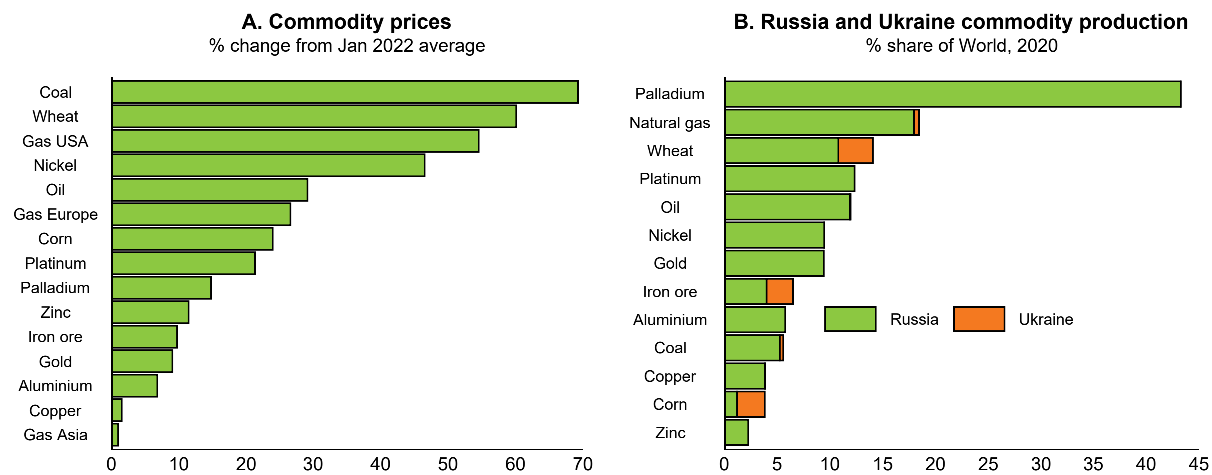
The Russian invasion of Ukraine is a humanitarian crisis affecting millions of people. Beyond the tens of thousands of deaths and injuries, close to 7 million people have already been forced to flee Ukraine to other countries in Europe, and an even greater number have been displaced within the country. The war is also a severe economic shock, above all in Ukraine itself, but also in Russia, the neighbouring region, and even in more distant parts of the world (OECD, 2022a).

The effects of the war are being felt through many channels. Large output declines in Russia and Ukraine directly shrink global economic activity and reduce demand for output from other countries. This effect is relatively modest, given the limited direct role of Russia and Ukraine in global activity and trade, but could still reduce global growth this year by over ¼ percentage point at market prices and by close to ½ percentage point in PPP terms.[1]

The major influence of Russia and Ukraine on the global economy is via their role as important suppliers in a number of commodity markets. Together they account for about 30% of global exports of wheat, 15% for corn, 20% for mineral fertilisers and natural gas, and 11% for oil. In addition, global supply chains are dependent on Russian and Ukrainian exports of metals (see below) and inert gases. The prices of many of these commodities increased sharply after the onset of the war, even in the immediate absence of any significant disruption to production or export volumes (Figure 1.1).

The surge in commodity prices and the possible disruptions to production will have significant consequences for many economies, particularly emerging-market and developing economies (Box 1.1). A particular concern is that a cessation of wheat exports from Russia and Ukraine could result in serious food shortages in many developing economies. There would be an acute risk not only of economic crises in some countries but also humanitarian disasters, with a sharp increase in poverty and hunger. The food supply shock could be compounded by fertiliser shortages and price rises, with Russia and Belarus major suppliers in many countries, putting agricultural output next year and perhaps beyond under stress.

Figure 1.1. Commodity prices have risen sharply since the invasion of Ukraine



Note: Data in Panel A are based on an average of daily prices between February 24 2022 and June 1 2022 for all commodities apart from wheat and corn, which are based on average prices over March-May 2022.
Source: Refinitiv; International Energy Agency; OECD Agricultural Outlook database; World Bank; and OECD calculations.

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[1] Prior to the war, Russia and Ukraine collectively accounted for only about 2% of global GDP at market prices (3½ per cent of global GDP in PPP terms) and a similar proportion of total global trade.

The war and the sanctions on Russia are also causing disruptions through financial and business linkages.[2] Sanctions placed on Russia have targeted selected individuals and banks, reduced access to foreign capital and frozen access to the foreign exchange reserves held by the Central Bank of Russia (CBR) in Western economies. Bans have also been imposed on some exports to Russia. As a result, the CBR has tightened monetary policy and imposed capital controls, and risk premia on Russian sovereign debt have widened. Selective export bans and delays and difficulties in making international payments are disrupting trade – Russian imports have plummeted since the start of the war – and could result in formal defaults on dollar-denominated Russian debts, with US banks now prohibited from handling US dollar payments from Russia. Financial market conditions around the world have also tightened, including in many economies in Central and Eastern Europe with relatively strong business ties with Russia. Air and sea traffic have been disrupted (see below) and many multinational companies have suspended operations in Russia.

The refugee flows caused by the war will result in additional public expenditure in the short term in host countries, although this will be offset over time as refugees enter the labour force, helping to alleviate some labour market pressures. The number of people who have already fled Ukraine since the start of the war is several times greater than the annual flow of asylum-seekers into Europe at the height of the Syrian refugee crisis in 2015-16. Supporting the refugees from Ukraine involves upfront spending on housing, food, medical assistance and childcare and schooling, along with assistance to help those who stay to enter the labour market. The scale of the spending challenge is difficult to predict due to uncertainty about the number of refugees, the length of time they will stay, and which country they may move to. An illustrative estimate, using current support for refugees, points to a minimum expenditure in European Union (EU) countries of around 0.2% of EU GDP (Box 1.2). This spending could be covered by the resources already made available in various EU funds.

Energy imports by the European economies from Russia are set to fall sharply in 2023. The EU has agreed an embargo on coal imports from Russia, to take effect in August, and an embargo on seaborne oil imports from Russia to begin in 2023. In addition, some countries have, or will, bilaterally end imports of gas and pipeline imports of oil from Russia this year, and Russia has halted gas exports to a few EU member states. These changes are incorporated in the baseline projections. A Europe-wide end to most oil imports from Russia brings challenges, with petroleum products (including crude oil) accounting for over one-third of total energy use in the EU. Even if alternative supplies can be found on world markets at higher prices and shortages avoided, as assumed in the baseline projections, the embargo is projected to push up inflation and weaken growth, particularly in Europe. The challenges in adjusting to the embargo, the risks of possible adverse supply-side effects and the impact of an additional EU embargo on gas imports from Russia are discussed further below.

Box 1.1. The implications of commodity price changes and disruptions to agricultural trade for emerging-market economies

The disruptions in commodity markets brought about by the war in Ukraine will likely have strong economic and social impacts on emerging-market economies. Current accounts, and through them the income of the private and public sectors, are being affected by soaring commodity prices, to the benefit of net commodity exporters and the detriment of net importers. In addition, the available quantities of certain commodities are also under strain. Agricultural commodities are of particular concern on this count, since Russia and Ukraine are two major suppliers of cereals and fertilisers.

[2] Financial linkages between Russia and other countries are generally modest. Stocks of foreign direct investment in Russia account for just 1-1½ per cent of the global total, while consolidated cross-border bank claims by BIS reporting banks on residents of Russia and Ukraine represented less than 0.5% of the global total as of the third quarter of 2021.

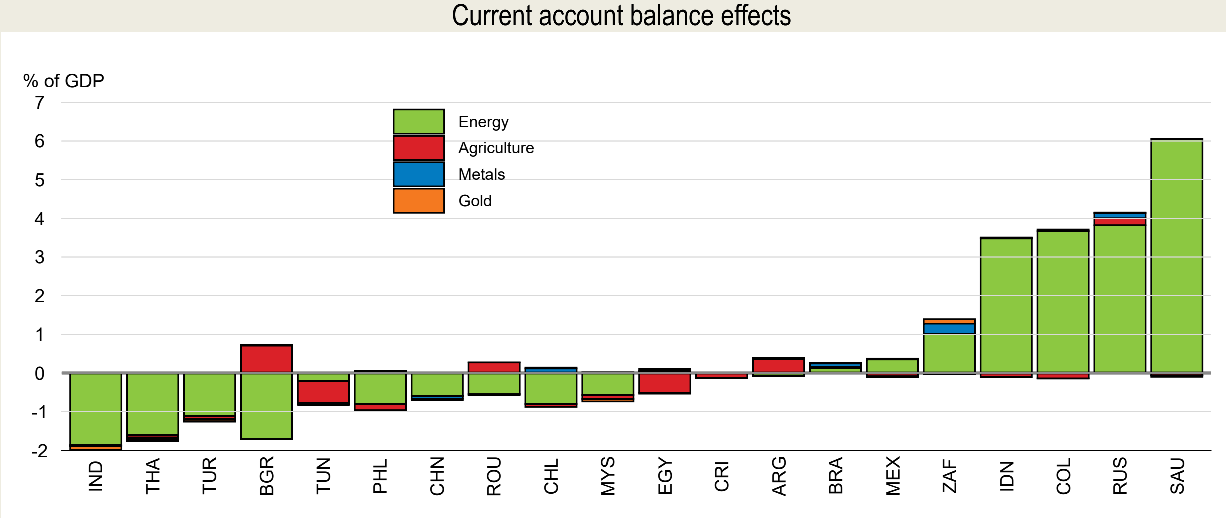
Current account effects

The current account effects of the commodity price shock depend on countries' net export positions and the size of the price shocks for individual commodities. Both aspects – variation in net exports and the magnitude of the price shock – tend to be larger for energy commodities than for food or metals. An illustrative estimate of the potential annual gains (or losses) from the abrupt price changes that have been observed since the outbreak of the war in Ukraine is shown in Figure 1.2. For each country and commodity, the average net exports-to-GDP ratio over 2015-19 is multiplied by the respective price shock since the invasion of Ukraine, with the effects aggregated by broad commodity categories.[1] The use of a five-year period helps to minimise the potential sensitivity of the results to exceptional events, such as droughts or strikes.[2] These calculations isolate the impact of trade of selected commodities and do not incorporate possible changes in consumption patterns in response to price changes, or in non-commodity trade that could affect aggregate saving-investment balances. Hence, the depicted gains or losses should not be regarded as estimates of expected changes in overall current account balances.

Colombia, Indonesia, Russia and Saudi Arabia, all large energy exporters, gain from improvements in their terms of trade. In contrast, Bulgaria, India, Thailand and Turkey could suffer significant losses.[3] Bulgaria and Romania benefit from the sharp rise in wheat and maize prices, and Chile from higher metals prices, but these fall short of the costs from rising energy prices. Rising food prices are likely to yield moderate gains to Argentina, but sizeable income losses in Egypt and Tunisia.

Figure 1.2. The impact of commodity price shocks varies across emerging-market economies

Current account balance effects



Note: The illustrative effects reflect the impact of the sharp rise in commodity prices following the war in Ukraine applied to the average commodity-level net exports-to-GDP ratio during 2015-19. The commodity price shock used in the analysis is the percentage difference in the average price of selected commodities over the period from February 24 to June 1 relative to the average price in January 2022. The selected commodities include natural gas, oil, coal, wheat, maize, nickel, platinum, palladium, iron ore, aluminium, zinc, copper and gold. Net energy exports are computed using IEA volume estimates converted to values using world prices. Oil and coal prices are based on Brent spot prices and Australian steam coal spot prices, respectively. For natural gas, regional prices – for Europe, Asia and America – are used. Europe covers Bulgaria, Romania, Russia, Turkey, Egypt and Tunisia; Asia covers China, India, Indonesia, Malaysia, the Philippines and Thailand, plus South Africa; and America covers Argentina, Brazil, Chile, Colombia and Costa Rica. Net export values of agricultural commodities and metal commodities (in USD) are taken from FAO statistics and from UN Comtrade, respectively. These calculations exclude the impact of commodity price changes on consumption and non-commodity trade that also affect annual changes in the current account balance.
Source: OECD Economic Outlook 111 database; FAO; IEA; Refinitiv; UN Comtrade; World Bank; and OECD calculations.

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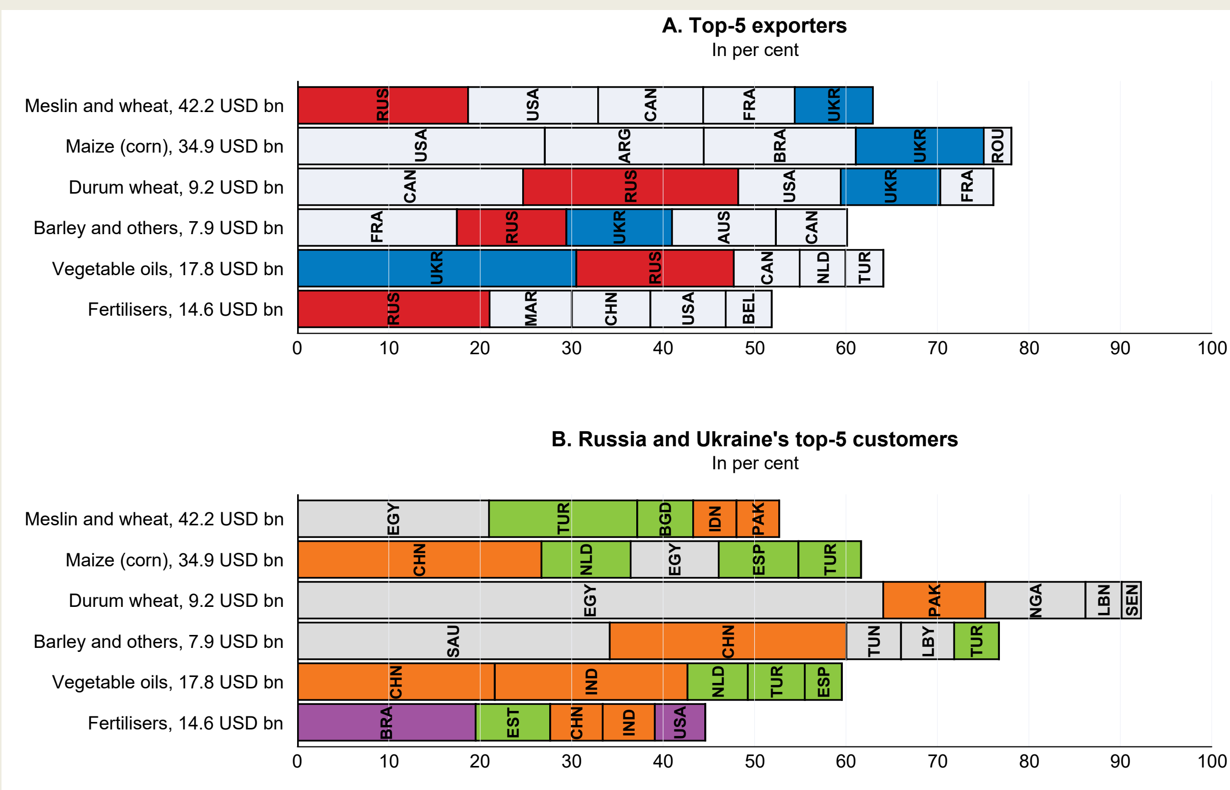
Emerging-market economies face risks of significant disruptions in agricultural trade

In addition to price effects, the war can also reduce the quantities available on world markets. Russia and Ukraine are two major suppliers of agricultural commodities, especially cereals and fertilisers. Highly disaggregated customs data, covering nearly 5 000 distinct products, help to show which particular markets are most at risk of disruption, and which customers are most exposed to a reduction in production in Russia and Ukraine.

War-related disruptions are particularly likely for cereals and vegetable oils. Russia and Ukraine accounted for about 30% of global exports of durum wheat and meslin and wheat in 2020, 15% of maize, and one-quarter of barley and other cereals (Figure 1.3). Ukraine is also the world's biggest exporter of vegetable oils (sunflower seed and safflower) and, together with Russia, supplies half of the global market. Russia also provides more than a fifth of global imports of sugar. Overall, the supply of these agricultural commodities is remarkably concentrated, with the five biggest suppliers covering more than half of the world export market, and almost to 80% in some cases. Such a high degree of concentration limits the scope for substitution to other producers in the short run, making these products particularly vulnerable to shocks.

Figure 1.3. Russia and Ukraine are important suppliers of many agricultural products

Market shares as percentage of total trade flows recorded in 2020 for each commodity



Note: Panel A shows the share of the largest 5 exporting countries as a proportion of total world exports of each commodity. Panel B shows the proportion of Russian and Ukrainian exports bought by the five largest customers for each commodity. The colour indicates the region to which the country buying the Russian or Ukrainian exports belongs: green for Europe, orange for Asia, purple for Americas and grey for Africa and Middle East. The value in USD bn represents global export flows recorded in 2020 for each item (i.e. the size of the market).
Source: BACI database from CEPII; and OECD calculations.

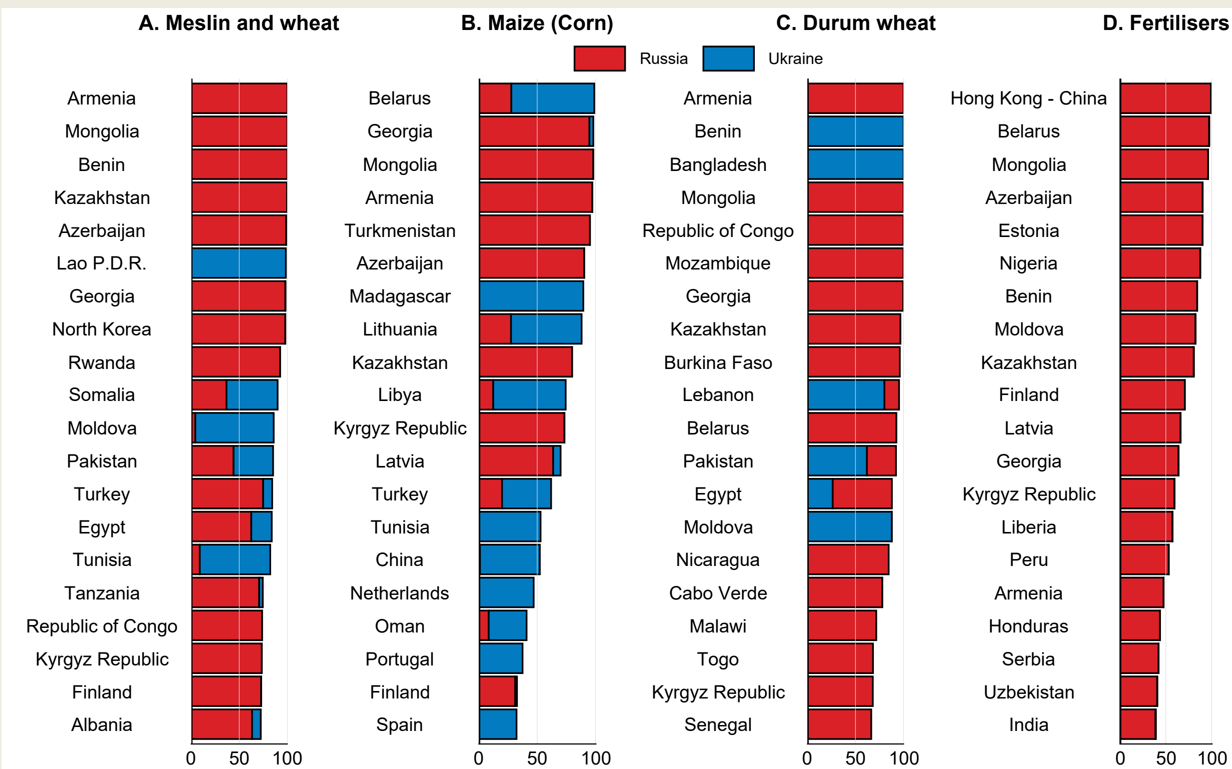
StatLink https://stat.link/t7wyjv

Some countries in Africa and the Middle East, and Central Asia are relatively exposed, particularly if they have low domestic production. Egypt buys two-thirds of the durum wheat exported by Russia and Ukraine, Turkey one-fifth of the meslin and Saudi Arabia one-third of barley and other cereals. Lower-income countries that are the most dependent on Russian and Ukrainian supply will be the hardest hit and disruptions could threaten food security in those countries (Figure 1.4).

Possible disruptions in the supply of fertilisers could add further pressures (Figure 1.4, Panel D). Russia is a major supplier of fertilisers, as natural gas is a key input in this industry, and accounted for 20% of world exports for some fertilisers in 2020, with a global trade market of USD 15 billion.[4] Russia is also one of the five biggest exporters of ammonia and natural calcium phosphates, two components mainly used in the production of fertilisers. Many countries from Central Asia as well as some advanced economies in Northern Europe, are among those most reliant on Russia for their imports of fertilisers. A few African countries are also highly exposed. Shortages of crops and fertilisers would put serious strain on agriculture worldwide.

Figure 1.4. Many lower-income countries rely heavily on cereal and fertiliser imports from Russia and Ukraine

Share of imports from Russia and Ukraine in total imports for selected commodities



Note: Fertilisers correspond to the aggregation of five products defined at the HS 6-digit level as follows: nitrogenous fertilisers (HS310280), fertilisers containing nitrogen, phosphorus and potassium (HS310520), fertilisers containing mono-ammonium phosphate and di-ammonium phosphate (HS310540), fertilisers containing nitrates and phosphates (HS310551) and fertilisers, mineral or chemical (HS310230).
Source: BACI database (CEPII); and OECD calculations.

StatLink https://stat.link/qecg6r

1. Potential shifts in countries' net exporting positions at the level of each commodity in response to the price shock or to changes in external demand could alter these illustrative results, but are not taken into account. For natural gas, the prices in the region a country belongs to are used to compute the effects on the current account balance.
2. More recent years have not been considered due to the impact of the pandemic (2020-21) or incomplete data (2021).
3. The estimated current account gains for Russia should be regarded as an upper bound as Russian oil has been traded at a discount – implied by the positive spread between Brent and Urals spot prices for oil – since the outbreak of the war.
4. The group of fertilisers plotted on Figure 1.4 aggregates five separate categories of fertilisers.

Box 1.2. The refugee crisis in Europe following the war in Ukraine

There has been an unprecedented outflow of refugees from Ukraine

The war in Ukraine has generated a historic outflow of people fleeing the conflict, unseen in Europe since World War II. The Syrian conflict raged for two years before the number of refugees abroad reached three million in 2015-16, whilst this number was reached in less than 3 weeks for the war in Ukraine. By May 18, according to data from the UNHCR, more than 6.2 million people had fled Ukraine and an additional estimated 8 million were internally displaced. About 5.3 million Ukrainian refugees have reached the European Union. Close to 3.4 million Ukrainians crossed into Poland, almost 930 000 into Romania, 615 000 into Hungary and 427 000 into the Slovak Republic.

This humanitarian crisis cannot be compared easily with previous ones, notably the 2015-16 humanitarian crisis in Europe. Key differences include the large pre-conflict Ukrainian diaspora and its role in the immediate reception of Ukrainian refugees; the pre-existing visa facilitations for Ukrainian nationals in Europe which greatly expedite orderly cross border movements; and the different socio-demographic characteristics of the current refugee inflow, which overwhelmingly consists of children and women with relatively high formal education levels. There has also been an exceptional mobilisation of institutions and host communities in OECD countries.

Daily outflows from Ukraine increased rapidly in the first days of the conflict, peaking at 200 000 in early March, but have now stabilised at around 50 thousand per day. The State Border Guard Service of Ukraine has reported that more than 1.8 million Ukrainians have returned to the country since the start of the war, although this figure may include short-term cross-border movements.

A growing number of refugees are now moving to other OECD countries. OECD estimates suggest that, by May 13, EU countries not bordering Ukraine have already received more than 2 million Ukrainians since February 24. In particular, Germany registered about 610 000 Ukrainians, the Czech Republic 335 000, Spain 135 000 and Italy 113 000. Beyond Europe, more than 28 000 Ukrainians arrived in Israel, 25 000 in Canada and about 37 000 in the United States.

The general mobilisation in Ukraine prevents most men aged 18 to 60 from leaving the country. As a result, very few working age men have left the country so far. Available data for Poland, according to the Office of Foreigners, show for example that out of the one million registrations by end-April, 48% of arrivals were minor children and 92% of the adults were women. Similar numbers are observed in Lithuania. Countries further from the Ukrainian border report a slightly lower share of children, between 32% (France and Greece) and 40% (the Czech Republic and Belgium).

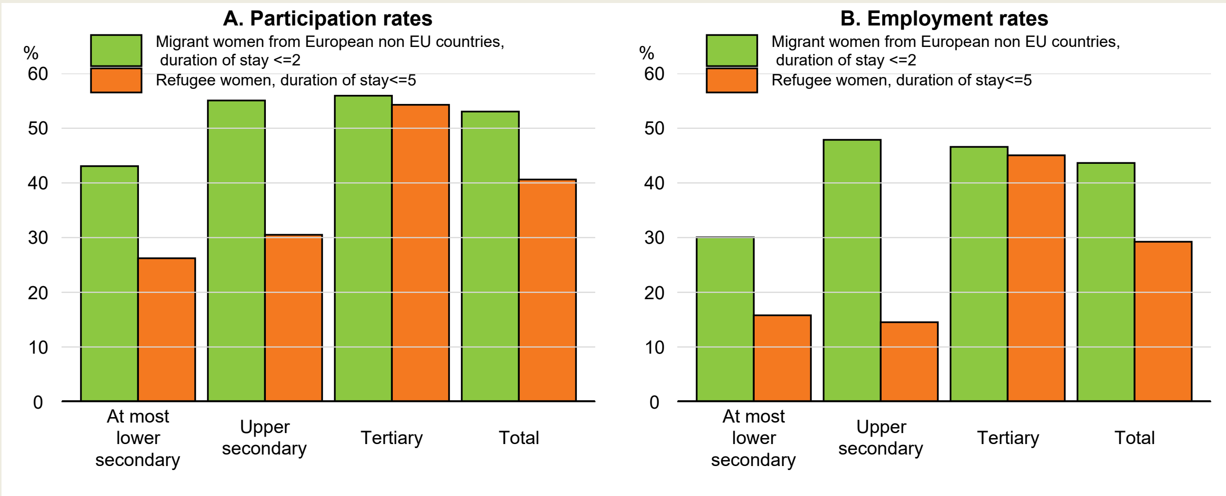
Available information from host countries suggests that a relatively high share of Ukrainian refugees are tertiary educated, in contrast to other refugee groups. Overall, they also have higher levels of education than the general Ukrainian active population (34% of whom were tertiary educated in 2019). In Spain for example, 60% of registered Ukrainians above 16 years old have a tertiary diploma, 25% have a professional qualification, 11% have upper secondary education, and less than 1% are without any education.

A first assessment of the labour market impact of the Ukrainian refugee inflow in Europe

The Ukrainian refugees may make a sizeable contribution to the EU labour market. Their socio-demographic profile, the support they are receiving from the Ukrainian diaspora and host communities and the relatively modest monthly income support available in most countries (see below) all encourage labour force participation. The EU has also provided Ukrainian refugees with immediate and unrestricted access to the labour market.

OECD estimates suggest that as of end-April, there could be 2.3 million Ukrainian refugees aged 20 to 64 in Europe.[1] Estimates of possible employment and participation rates by the end of 2022 can be derived using the educational structure observed in Spain, and observed employment and participation rates for refugee women in Europe with less than 5 years of duration of stay, or European third-country migrant women with less than 2 years of duration of stay (Figure 1.5). These point to between 850 thousand and 1.1 million entries to the EU labour market of Ukrainian migrant women aged 20-64, with between 602 and 917 thousand in employment.

Figure 1.5. Observed participation and employment rates for refugee women and for European migrant women



Note: Calculations based on the observed employment and participation rates of migrant women in the EU from non-EU European countries aged 20-64 who have remained for two years or less, and female refugees in EU countries aged 20-64 who have remained for five years or less. Based on data for 2014 and 2019 respectively.
Source: OECD calculations.

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These numbers may seem large but should be put in the perspective of the size of the EU labour market (327 million working age population and 240 million employed workers) as well as of regular permanent migration flows (1.3 million new permanent immigrants from non-EU countries in 2019). They can also be compared to temporary migration flows from third countries. For instance, before the COVID-19 pandemic, Poland alone was receiving annually more than one million seasonal and temporary foreign workers, most of whom were from Ukraine. Much of this annual flow will probably be replaced by Ukrainian refugees.

The labour market integration of Ukrainian women may be slower than anticipated due to language barriers, uncertainty about their length of stay and delays in integrating Ukrainian children in the education system. Currently, many children are maintaining some links with the Ukrainian education system via online solutions. This may prevent their single mothers or guardians from immediately seeking work.

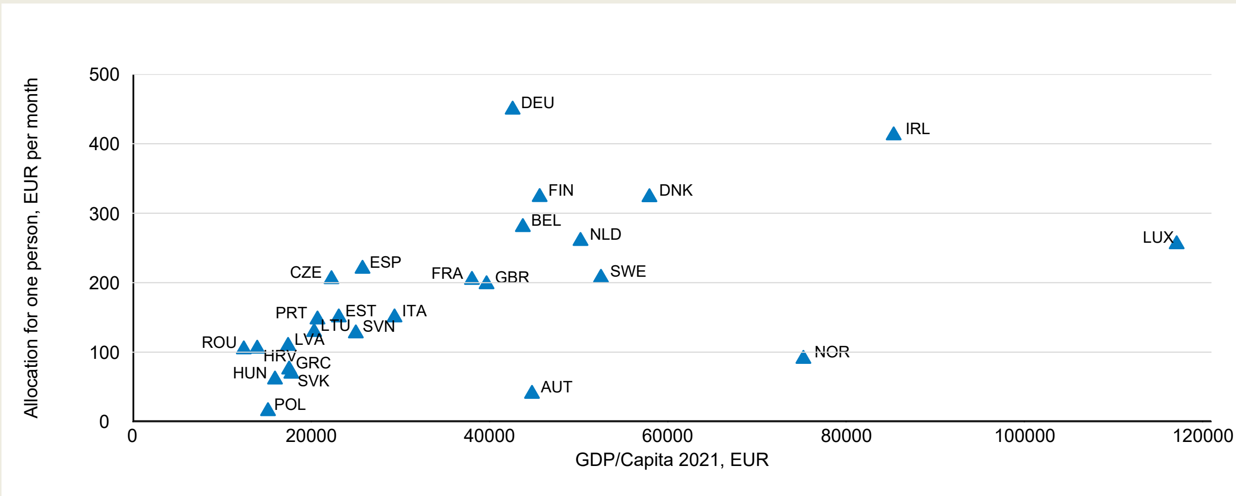
How much might the reception of Ukrainian refugees cost in Europe?

All EU countries provide financial support to beneficiaries of temporary protection to cover basic needs, but levels and mechanisms vary widely across countries. Monthly financial allowances also vary within countries, depending on whether refugees are hosted in a reception centre or not, whether they have access to food on site or not and, most importantly, depending on the family composition of the household. Differences in the monthly allocation for single refugees in accommodation provide an indication of the scope of cross-country differences (Figure 1.6). The total per capita cost might also be lower than in 2015-16 because there are no costs from asylum applications, because Ukrainian refugees are mostly concentrated in host countries with a cost of living below the EU average, because access to integration services is more limited and because of the higher proportion of minor children.

A provisional calculation based on the refugee population from Ukraine at the end of April, indicates that the cost for the direct financial support provided to Ukrainian refugees in the EU, including for housing, could be around EUR 17 billion in 2022. This does not include the broader costs for education, health and integration measures. Based on the age structure of the refugee population, these could collectively be just over an additional EUR 9 billion in the ten months of 2022. The reception cost can be compared to the funds made available by the decision of the EU Council in early April. This made it possible for Member States to redirect up to EUR 17 billion from European Structural and Investment Funds (ESIF), the Fund for European Aid for the Most Deprived (FEAD) and the 2022 tranche of the EU recovery plan (EU-REACT) to assist the refugees.

Figure 1.6. Monthly financial support for a single Ukrainian refugee in accommodation

Selected European countries



Note: For Ireland, the amount has been estimated at half the amount provided to people who do not benefit from publicly funded accommodation. Data for Austria, Hungary, Italy and Norway are for people in centres with meals provided.
Source: OECD calculations.

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1. These calculations assume that only one third of the re-entries in Ukraine are durable returns, that the demographic composition of the refugee population varies slightly between bordering countries (50% children) and the rest of the EU (33% children) and that 94% of the adult refugee population is working age.

Recent indicators point to moderating growth, high inflation and tighter financial conditions

Activity indicators have moderated and confidence has been hit

Most economies experienced strong economic growth in 2021, as rising vaccination coverage and improved treatments mitigated the severity of the pandemic, and policy support and favourable financial conditions helped demand to rebound. Labour market slack was steadily reduced in all the major OECD economies, in some cases taking employment rates above pre-pandemic peaks. The economic disruptions from the wave of infections brought by the Omicron variant in late 2021 and the early months of 2022 generally proved mild in most countries, but global GDP growth more than halved in the first quarter of 2022, with output declining in several advanced economies.

High-frequency data are now showing some of the adverse effects of the war on activity and prices. Global mobility has continued to improve, but global industrial production, retail sales and car sales all declined in March and April (Figure 1.7, Panels A and B). Survey evidence also suggests that the war and the health-related restrictions in China are having a sizeable impact on business activity and confidence (Figure 1.7, Panels C and D). Indicators of business confidence and output have fallen sharply in China, reflecting the lockdowns in many cities and ports, and declines have also occurred in Russia and a number of major European economies, including Germany. Consumer confidence indicators had already begun to weaken ahead of the war, especially in the United States, but tumbled further in March, particularly in Europe, and declined further in April and May. In Russia, air traffic has slowed considerably, with around one-third fewer commercial flights from major airports since the war began, and prices have risen sharply. By late April, consumer prices were around 11% higher than at the start of February. Taken together, these indicators suggest that global GDP growth could be very weak in the second quarter of 2022.

The downturn in consumer confidence is likely to be related to the squeeze on real household incomes coming from the acceleration in inflation as well as higher uncertainty. In most OECD economies, real household disposable income was already declining on a year-on-year basis in the last quarter of 2021, despite strong employment growth, and in many that decline is estimated to have continued in the first quarter of 2022. This partly reflects the phasing out of transfers associated with the pandemic, especially in countries like the United States and Canada where such payments were large, as well as the erosion of real wages. Economy-wide real hourly wage growth is now negative in most OECD economies (Figure 1.8).[3] The additional increases in energy prices seen since the start of the war in Ukraine are pushing headline year-on-year inflation well ahead of the inflation rates expected at the time of collective bargaining to set wage rates in 2022.

The impact of rising inflation on real incomes has not been uniform across households (Brainard, 2022).[4] The increase in expenditure resulting from recent food and energy price changes represents a larger proportion of total spending for lower-income households (Figure 1.9), and those households have limited scope to offset this by drawing on savings or reducing discretionary expenditures.[5] This is one reason why governments in many OECD countries have taken action to cushion recent rises in energy prices (see below).

The difference between the degree of inflation experienced by many households and the official measure may be one explanation for the persistent difference between household survey measures of inflation and actual inflation in the euro area (Figure 1.10), with perceived and expected inflation highest amongst the lowest income quartile. Over and above the actual budget shares of different items, perceived inflation is also influenced by those prices which are most salient for consumers, such as electricity bills in Europe, gasoline in the United States, or common food items (Georganas *et al.*, 2014; D'Acunto *et al.*, 2021). These items are encountered regularly, relatively homogeneous (facilitating price comparisons over time) and make up a significant share of household expenditure. With such prices being among those registering the largest increases over the past eighteen months, perceptions of inflation have risen sharply since 2020 and run ahead of the measured rate for many people. This increase could place upward pressure on wage bargains over the coming year.

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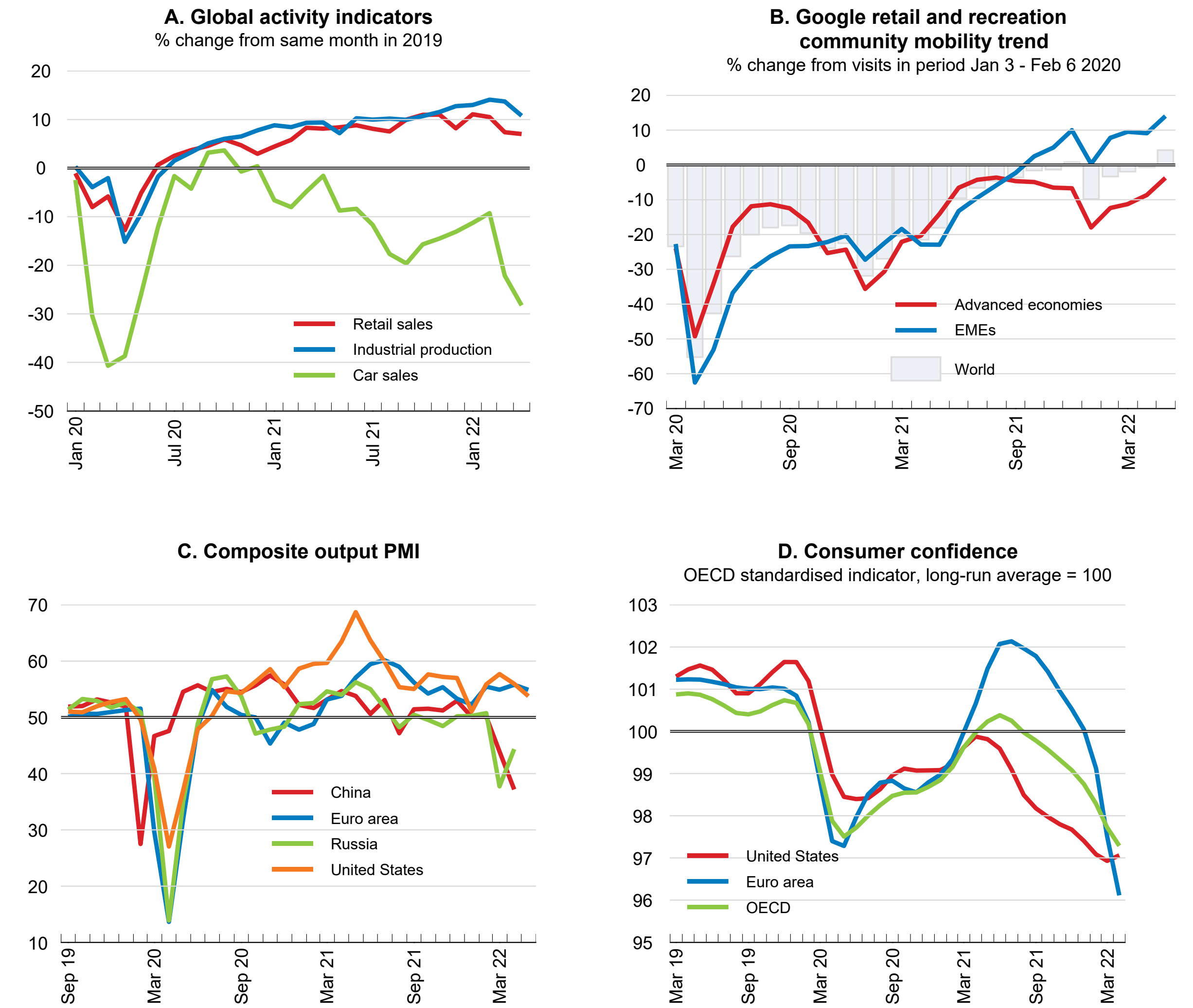
[3] Compositional effects have affected the growth of real wages in 2020 and 2021 in some countries, with many low-wage earners in contact-intensive service sectors dropping out of employment in 2020 and re-entering the labour force as the pandemic moderated. But even on a quarterly basis, real hourly wage growth was negative in the latter half of 2021.

[4] There is some evidence in the United States that inflation for households in the lowest income quintile has moderately outpaced that for the highest-income quintile over the period from 2003-19 (Klick and Stockburger, 2021). In the United Kingdom, annual consumer price inflation for the lowest income decile is estimated to be have been 3 percentage points higher than for the top income decile in April 2022 (Karjalainen and Levell, 2022).

[5] Within each expenditure category for which prices are collected by statistical offices there could also be unmeasured differences between the type or quality of goods and services purchased by higher and lower-income households, contributing to the perceived differences in inflation by different households.

Figure 1.7. Many activity indicators have recently weakened



Note: Data in Panel A are PPP-weighted aggregates. The retail sales measure uses monthly household consumption for the United States and the monthly synthetic consumption indicator for Japan.
Source: Google LLC, Google COVID-19 Community Mobility Reports, https://www.google.com/covid19/mobility; Markit; OECD Main Economic Indicators database; Refinitiv; and OECD calculations.

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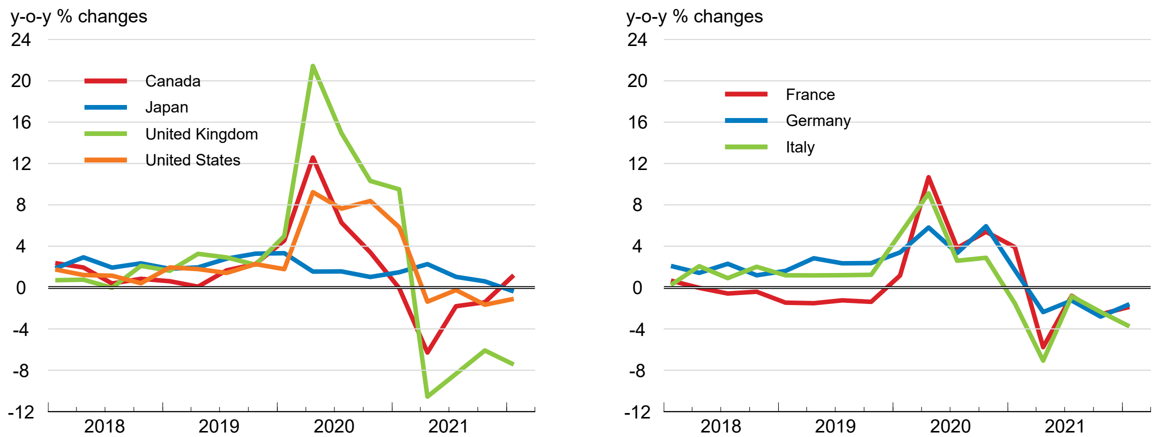
Figure 1.8. Higher inflation is hitting real wage growth

Real compensation per employee per hour worked.



Source: OECD Economic Outlook 111 database; and OECD calculations.

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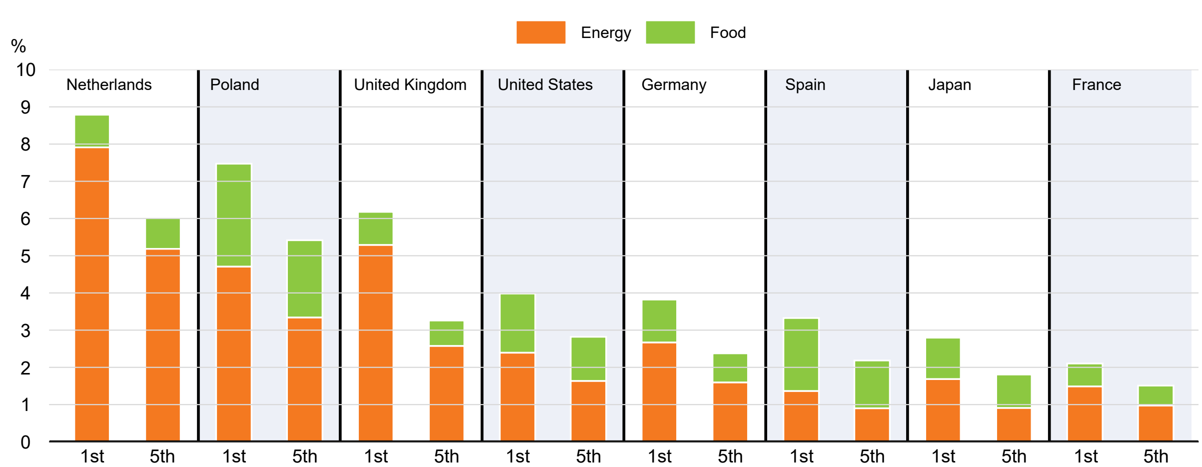
The COVID-19 pandemic has complicated the interpretation of labour market conditions, but it has become increasingly clear that labour markets in most OECD economies are now relatively tight. The OECD-wide unemployment rate is back to the lowest level in the past two decades and nominal wage growth has

Figure 1.9. The surge in food and energy prices has disproportionately affected lower-income households

Percentage increase in household expenditures for the lowest and highest income quintiles



Note: Estimated impact of the year-on-year increases in energy and food prices in April 2022, using consumer basket weights in 2019 for the United States and Japan, and 2015 for other countries. Data are ranked according to the first quintile (20% of households with the lowest income). Energy corresponds to natural gas, electricity and other fuels, and includes motor fuels as well for the United States. Food corresponds to food products and non-alcoholic beverages.
Source: Bureau of Economic Analysis; Statistics Bureau of Japan; Eurostat; and OECD calculations.

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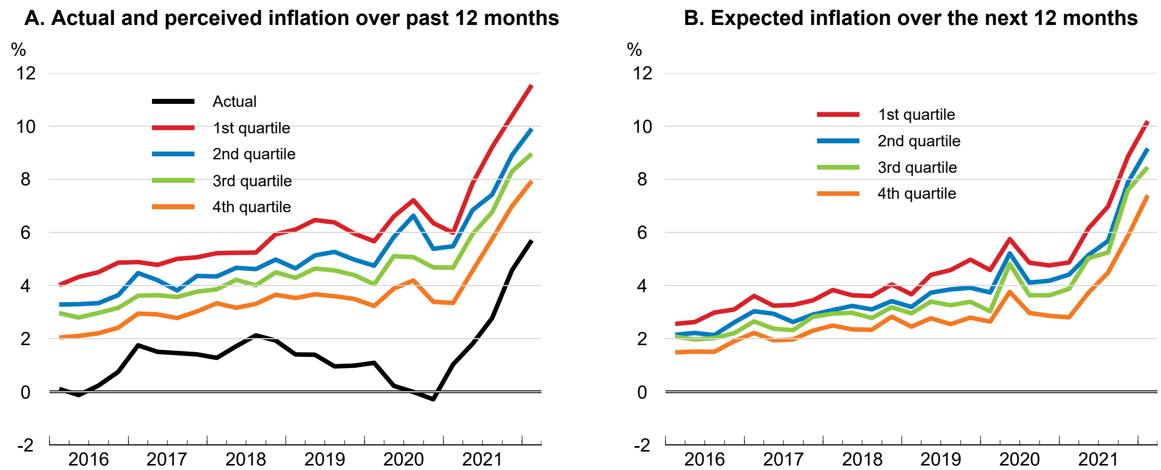
picked up in the United States and a few other countries to levels that are high by pre-pandemic standards. Most OECD economies are now experiencing labour shortages (Causa *et al.*, 2022), with sharp increases in vacancies even in countries that favoured job retention schemes (Figure 1.11). Large declines in international migration since the onset of the pandemic have also contributed to labour shortages in some countries.

Figure 1.10. Perceptions and expectations of euro area consumer price inflation by income quartile



Note: Actual inflation corresponds to headline harmonised consumer price inflation.
Source: OECD Economic Outlook 111 database; European Commission; and OECD calculations.

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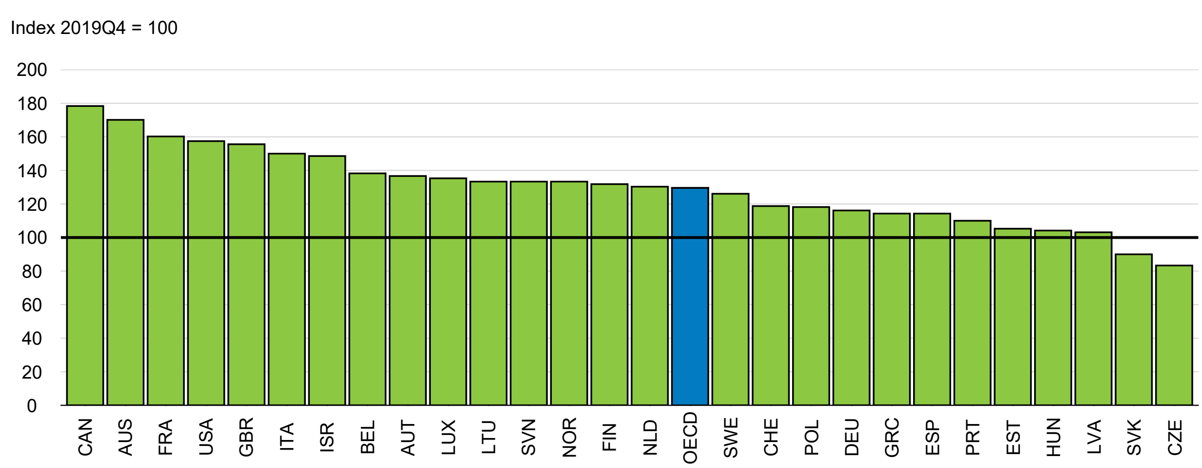
Figure 1.11. Most OECD countries are experiencing labour shortages

Job vacancy rates, 2022Q1 or latest



Note: Job vacancy rates (i.e. vacancies as a share of employment) are on a quarterly basis and seasonally adjusted, with the exception of Canada.
Source: Australian Bureau of Statistics (AUS); Statistics Canada (CAN); DARES (FRA); Office for National Statistics (GBR); Central Bureau of Statistics (ISR); US Bureau of Labor Statistics (USA); and Eurostat (OECD-EU).

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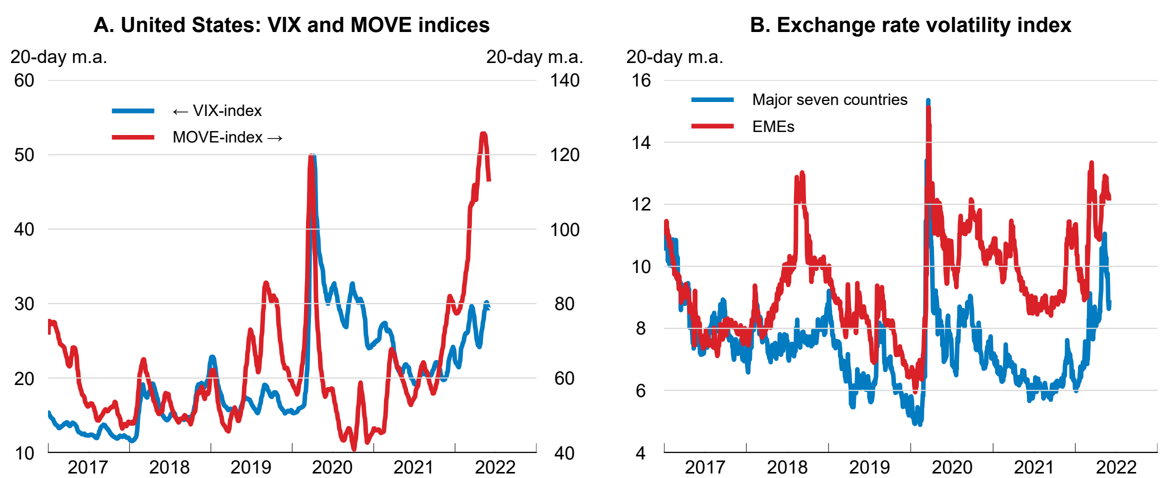
Financial market conditions have tightened significantly

Faster and more extensive policy interest rate rises in advanced and emerging-market economies and the war in Ukraine have led to a substantial tightening of global financial conditions. In particular, volatility has increased significantly in equity, bond and foreign exchange markets (Figure 1.12), equity prices have declined, government bond yields have risen and most currencies have depreciated against the US dollar.

- Weaker growth prospects and higher bond yields have weighed on equity markets in most advanced countries, including the United States. Strong exposure to the conflict region has added to downward repricing in the euro area and most Eastern European economies (Figure 1.13, Panel A). Equity prices have risen in a few commodity-exporting economies, as well as in Turkey, but recent COVID-19 outbreaks and continuing vulnerabilities of highly leveraged real estate companies have hit equity markets in China.
- Government bond yields have increased in most countries since January (Figure 1.13, Panel B). In the United States, the yields on 10-year nominal and inflation-adjusted government bonds have risen by around 1 percentage point over this period. The rise in 10-year nominal yields has been somewhat higher in the euro area, and sovereign bond spreads have widened within the area. Nominal yields have also risen in the major emerging-market economies.[6] In contrast, yields have hardly increased in Japan, reflecting lower inflationary pressures, yield curve control and no immediate sign of policy tightening.
- Corporate bond spreads (relative to government benchmark bonds) have increased since early 2022 but remain moderate by historical standards in the major advanced economies, reflecting generally healthy corporate balance sheets. However, bank credit default swap spreads have risen markedly, likely reflecting concerns about weakening growth prospects.

Figure 1.12. Financial market volatility has risen



Note: Implied volatility as measured by the VIX index can be interpreted as the market expectation of risk (future volatility) and is derived from at-the-money call option prices (interpolated) using the Black-Scholes formula. For more recent data, the Cox-Rubinstein binomial method is used for American-style options. The MOVE index is a yield curve weighted index of the normalised implied volatility on 1-month Treasury options which are weighted on the 2, 5, 10 and 30 year contracts.
Source: Refinitiv; and OECD calculations.

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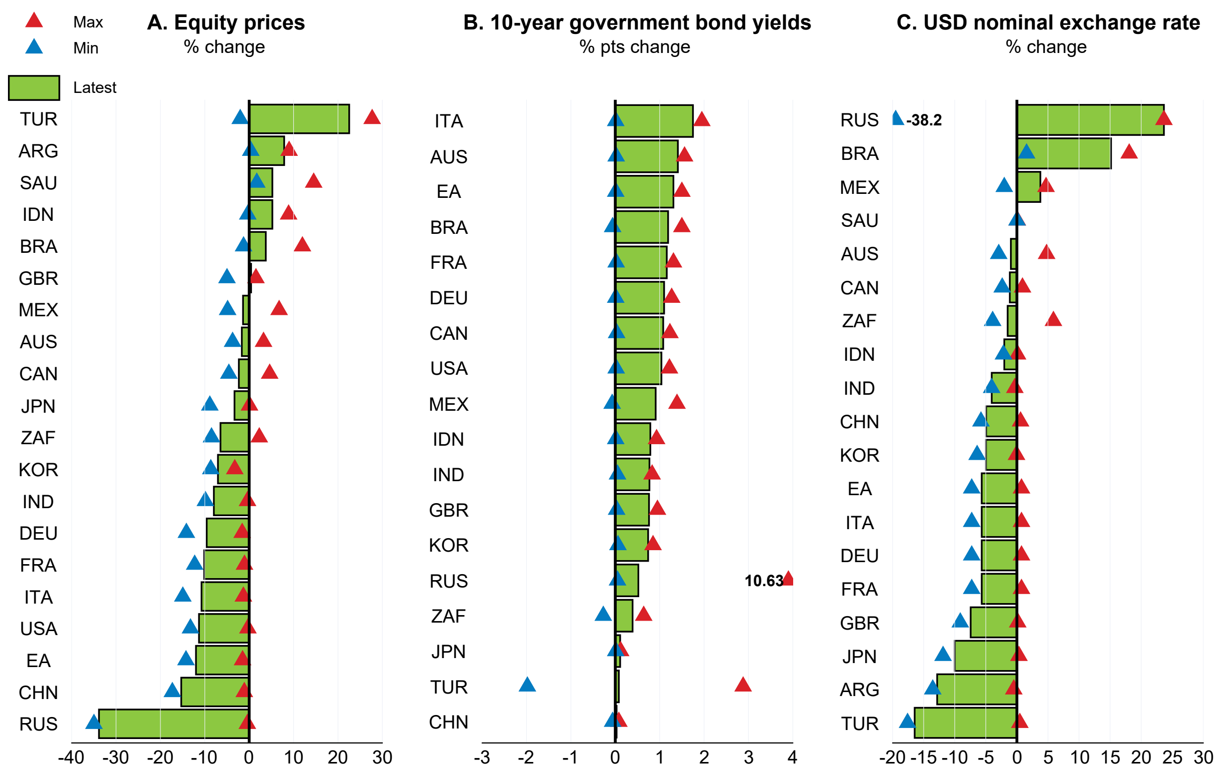
[6] Foreign-currency bond spreads for the major emerging-market economies have risen since January, albeit to a different extent, with a sizeable surge in Eastern European countries, signalling significant rises in risk premia.

- The US dollar has appreciated since the onset of the war in Ukraine, partly reflecting the faster anticipated pace of policy interest rate increases in the United States relative to most other advanced economies, especially Japan (Figure 1.13, Panel C). With a few exceptions due to idiosyncratic factors, such as Argentina, the currencies of most major commodity-producing emerging-market economies have either appreciated or depreciated only slightly against the US dollar since January.

Figure 1.13. Financial market conditions have tightened



Note: "Latest" refers to the change between the average of January 2022 and the latest available data up to June 1. "Maximum" and "Minimum" refer to the largest increases or falls relative to the average of January 2022. Based on a 10-day average of daily observations.
Source: Refinitiv; and OECD calculations.

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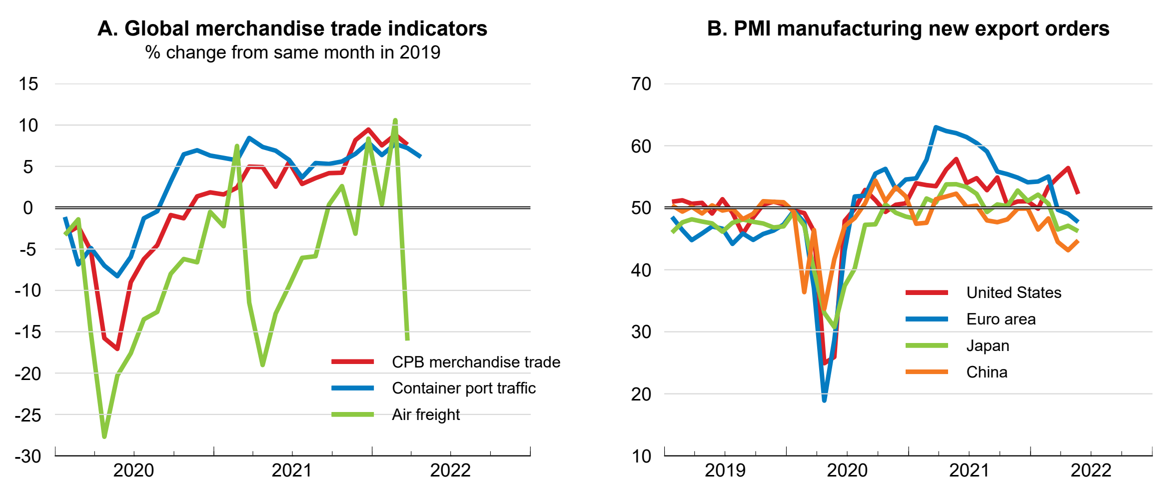
Trade momentum is easing and supply chain pressures remain acute

Global merchandise trade, container port traffic and air freight traffic indicators were all expanding in early 2022 (Figure 1.14, Panel A), prior to the war. International travel was also gradually recovering, other than in the Asia Pacific region where widespread border closures and restrictions remained. War-related disruptions curbed this trend in March, with a particularly sharp downturn for air freight. Global new export orders have also weakened, with declines in China, the euro area and Japan (Figure 1.14, Panel B).

Bottlenecks in international freight remain high, and are being accentuated by the Ukraine war and the shutdowns in China. Supplier delivery times rose in many countries in March and April but eased slightly in May. Indicators of freight waiting times and shortages of intermediate goods have also increased (Figures 1.15 and 1.16). The easing of pandemic lockdowns and sanitary restrictions, combined with the normalisation of demand in many regions, is helping to reduce demand-supply mismatch in maritime transport, with shipping costs down from their peaks in late-2021. However, the war has resulted in the diversion of freight from routes that have become non-viable towards others which are already over-stretched and very expensive. With parts of the Black Sea and Sea of Azov unpassable, maritime companies have closed lanes and suspended shipping services. Rail and airspace over Ukraine and Russia have also been shut off, limiting capacity. Commercial air travel and freight traffic by air and sea are being rerouted to avoid Russian air space and ports, becoming more expensive (due to higher insurance rates and longer routes) or ceasing altogether. Container loads in major Russian ports have also declined by 50% compared to a year ago and have stopped in the Ukrainian port of Odessa since early March. The war also risks exacerbating crew shortages, as nearly 15% of international freight crews in 2021 were Russian or Ukrainian.

Figure 1.14. Trade in goods is decelerating and new export orders have declined



Source: CPB Netherlands Bureau for Economic Policy Analysis; Institute of Shipping Economics and Logistics; IATA; Markit; and OECD calculations.

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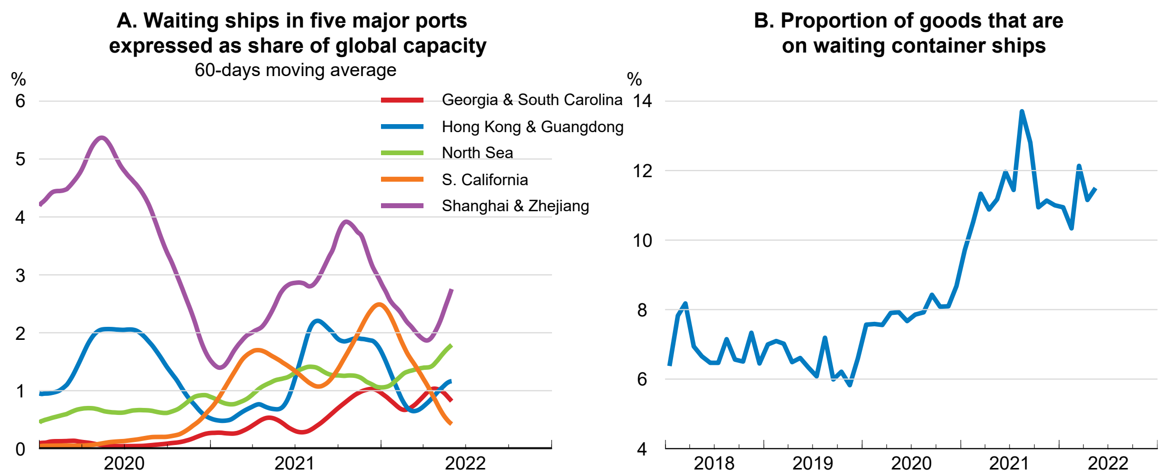
Additional disruptions have arisen as a result of the impact of the strict zero-COVID strategy in China. Though air and ocean ports are being kept operational (with workers often remaining on site), lockdowns in Shanghai and other big cities have created labour shortages that affect truck companies, reduce ground handling capacities, and ultimately slow operations in ports. Air traffic has also declined sharply.

Figure 1.15. Renewed supply chain disruptions and delays are starting to appear



Note: Calculations are made using real-time vessel position data and take into account the technically possible maximum capacity of each container ship.
Source: Kiel Institute; and OECD calculations.

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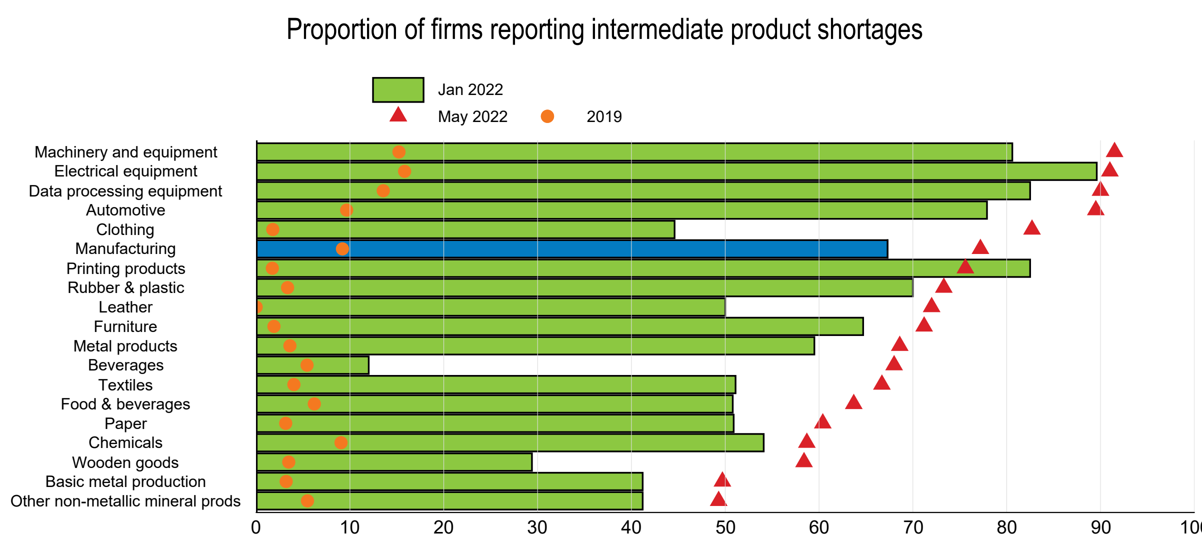
Figure 1.16. Shortages of intermediate products have risen in Germany after the onset of the war in Ukraine



Source: IFO; and OECD calculations.

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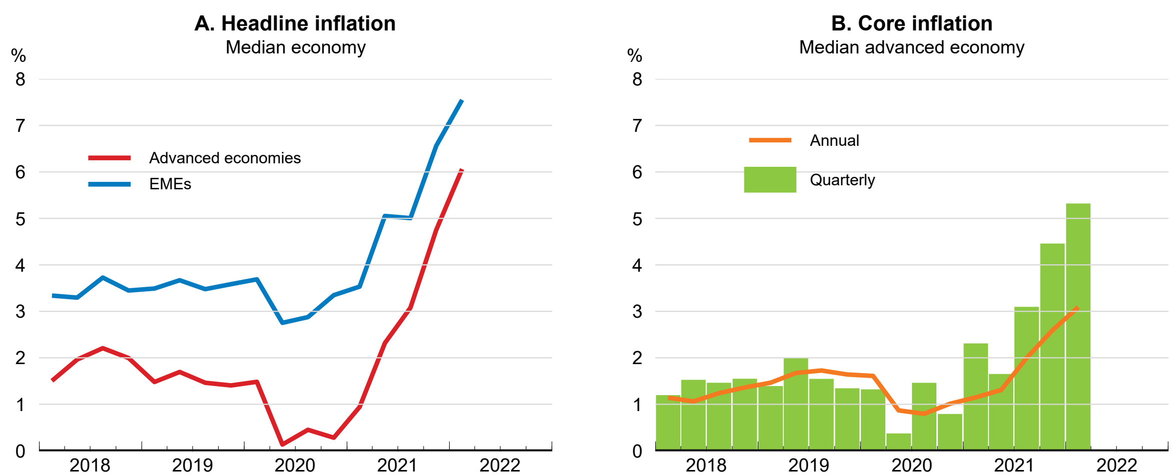
Inflation pressures have broadened further

Inflation has been increasing worldwide for more than a year (Figure 1.17, Panel A), with the headline measure of inflation currently above central bank objectives in most economies, particularly outside Asia. Apart from special cases of very high inflation, such as Turkey and Argentina, headline inflation has increased particularly rapidly in Central and Eastern Europe, Latin America, the United States and the United Kingdom.

Large increases in food and energy prices since mid-2020 have pushed up headline inflation in all economies, even though the increases have not been uniform.7 More recently, the increase in inflation has gone well beyond energy and food in most countries. Core inflation (excluding food and energy) has increased in almost all advanced economies (Figure 1.17, Panel B), even where the recovery from the pandemic is not complete. As with headline inflation, core inflation has increased particularly sharply in Central and Eastern Europe. The distribution of price changes has also shifted considerably. In the United States, the euro area and the United Kingdom, the prices of at least half the items in the inflation basket rose at annual rates above 4% over the year to April (Figure 1.18).

Figure 1.17. Headline and core inflation have risen sharply over the past year



Note: Headline and core inflation based on the personal consumption deflator in the United States, harmonised consumer prices in the euro area economies and the United Kingdom, and national consumer prices in other countries. In Panel B, the quarterly numbers are quarter-on-quarter percentage changes at an annualised rate.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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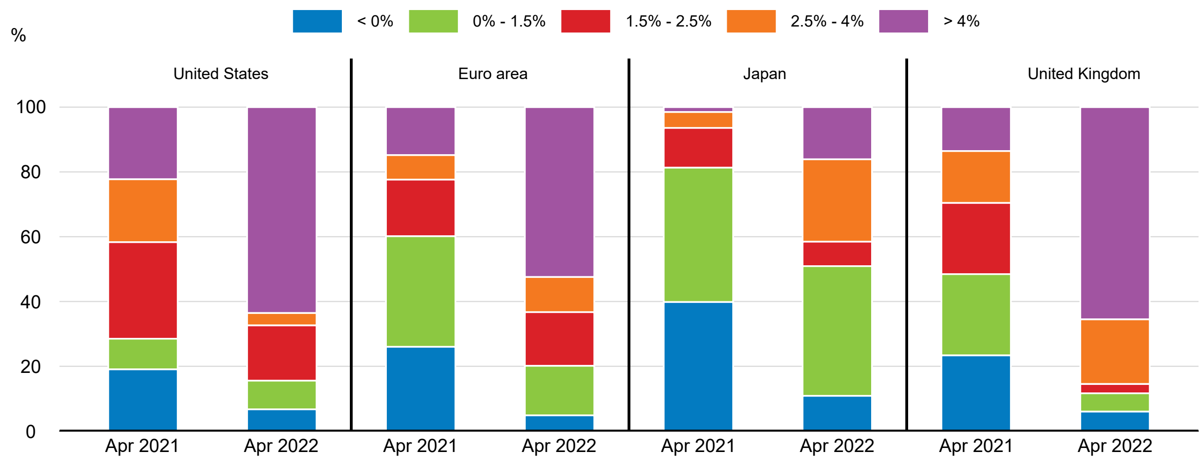
[7] Food price inflation was strong in most economies even before the Ukraine war, reflecting both poor crop outcomes and more expensive energy. The war has added to these effects, with the FAO Food Price Index in March to May 2022 at the highest level since its inception in 1990 and 29% higher than a year earlier.

Figure 1.18. Large price increases are more widespread in the United States than the euro area

Inflation ranges



Note: The figure shows the distribution of the annual percentage change in the prices of the different goods and services in headline consumer price inflation. Headline inflation based on the personal consumption deflator in the United States, harmonised consumer prices in the euro area and the United Kingdom, and national consumer prices in Japan.
Source: Bureau of Economic Analysis; Statistics Bureau of Japan; Eurostat; Office for National Statistics; and OECD calculations.

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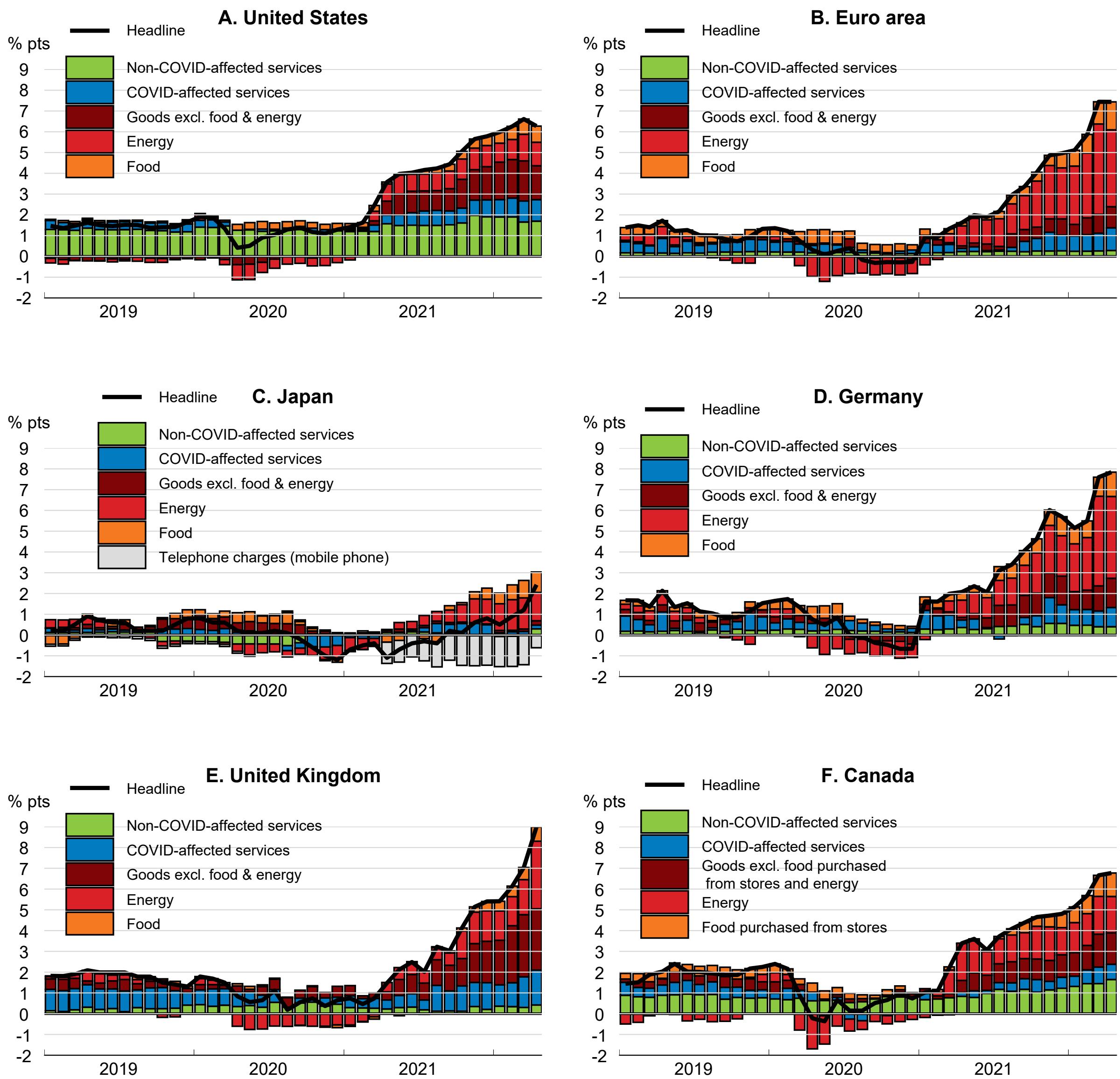
Differences in the severity of the pandemic, the structure of economic activity, the extent of labour shortages and policy responses to the pandemic all help to account for cross-country differences in inflation. Particularly strong fiscal measures in response to the pandemic in the United States helped produce a strong cyclical recovery by pushing household incomes well above their pre-pandemic level. With expenditure on some services constrained by the pandemic and the associated restrictions, more of the rebound in consumption was directed to goods, where supply-chain constraints have been strongest, and was reflected in rapidly rising goods prices (OECD, 2021a; Boone, 2022; Jordà *et al.*, 2022). In contrast, policies in many European economies focused on job preservation, with disposable incomes largely kept at their pre-pandemic level. This led to a slower recovery in consumption with smaller differences between goods and services spending. In Japan, large reductions in mobile phone price plans have helped to keep inflation low.

The patterns of price increases over the past two years suggest that pandemic-related effects account for a sizeable share of the recent increase in headline inflation (Figure 1.19). Prices declined in some of the service sectors most impacted by public health containment measures in the first phase of the pandemic, followed by large price increases as economies reopened. Similarly, the deep recessions in the spring of 2020 triggered sharp falls in the prices of oil and gas, which led many producers to shut down production and curb exploration. The rapid rebound in economic activity thus quickly met supply constraints in energy, contributing to the sharp increases in energy prices since that time.[8] A variety of supply constraints associated with the pandemic also meant that goods production could not keep pace with the rebound in demand for goods. As a result, inflation for goods excluding food and energy was generally weak in the first half of 2020 but unusually strong over the past 18 months. In contrast to energy, goods and

[8] Natural gas prices (and therefore electricity prices) have risen by much more in Europe than in North America since mid-2020. In contrast, the rise in petrol prices has been stronger in the United States than in Europe, as taxes account for a larger share of petrol prices in Europe and cushion the impact of oil price fluctuations.

COVID-affected services, categories of services like financial services or communications, less obviously directly affected by the pandemic, have experienced relatively stable rates of inflation, but with some upward drift, especially in North America (Figure 1.19).

Figure 1.19. The profile and composition of inflation has reflected the effects of the pandemic



Note: Data are for the personal consumption expenditures deflator for the United States; the consumer price index for Canada and Japan; and the harmonised consumer price index for the euro area, Germany and the United Kingdom. The attribution of different service activities to "COVID-affected" or "non-COVID-affected" depends on the categorisation of services within each jurisdiction's index, but follows a number of general principles, including the notion that services involving travel by the service receiver and/or requiring that the provider and the receiver of the service both be physically present would be classified as "COVID-affected". Thus, for example, passenger transport, package holidays, hotel accommodation, restaurants, cinemas, concerts, personal care services and dental services would all be included in "COVID-affected services", while financial services, communications and most education and health services would be categorised as "non-COVID-affected services".

Source: Bureau of Economic Analysis; Statistics Bureau of Japan; Eurostat; Office for National Statistics; Statistics Canada; and OECD calculations.

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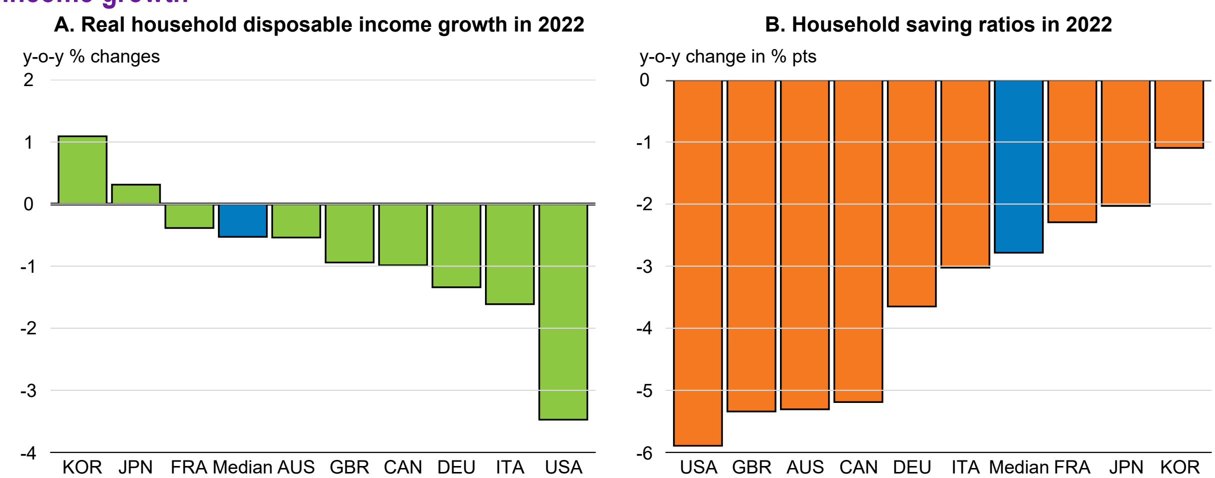
A continued recovery but at a slower pace with higher inflation

There have been several significant changes in the global economic environment in recent months, including the worldwide spread of the Omicron variant of the SARS-COV2 virus and the greater-than-expected persistence of inflationary pressures, entailing a faster adjustment of monetary policy in a number of major economies than previously expected. The single greatest change, however, is the economic impact of the war in Ukraine.

The Ukraine conflict is a significant negative shock to the global economy, although the impact on growth this year and next is partially mitigated by some of the factors already expected to support the recovery. In particular, the impact of the pandemic on economic activity is still assumed to wane through 2022, and household saving ratios, which in many countries surged in the first phase of the pandemic, are assumed to continue to decline, helping to offset much of the drag on real disposable incomes from elevated inflation (Figure 1.20). On the other hand, global financial conditions have tightened and fiscal consolidation is continuing in most OECD economies during 2022-23, though at a somewhat slower pace than previously expected, especially in Europe this year. Higher spending to offset the impact of higher energy prices on households and firms and to provide humanitarian assistance to refugees are among the reasons for this.

The war in Ukraine has quashed hopes that the inflationary surge experienced in much of the global economy in 2021 and early 2022 would subside quickly. The additional impetus to food and energy prices, and the aggravation of supply-chain issues, imply that consumer price inflation will peak later and at higher levels than previously foreseen. As this additional negative supply shock was not anticipated, household incomes are rising more slowly than prices, worsening the deterioration in real household disposable incomes that was already underway in many OECD economies. The forthcoming EU embargoes on coal and seaborne oil imports from Russia are likely to push up global energy prices further over the next year, keeping headline inflation higher for longer.

Figure 1.20. Lower household saving ratios will be needed to support consumption given weak income growth



Note: In Panels A and B, median denotes the median OECD economy.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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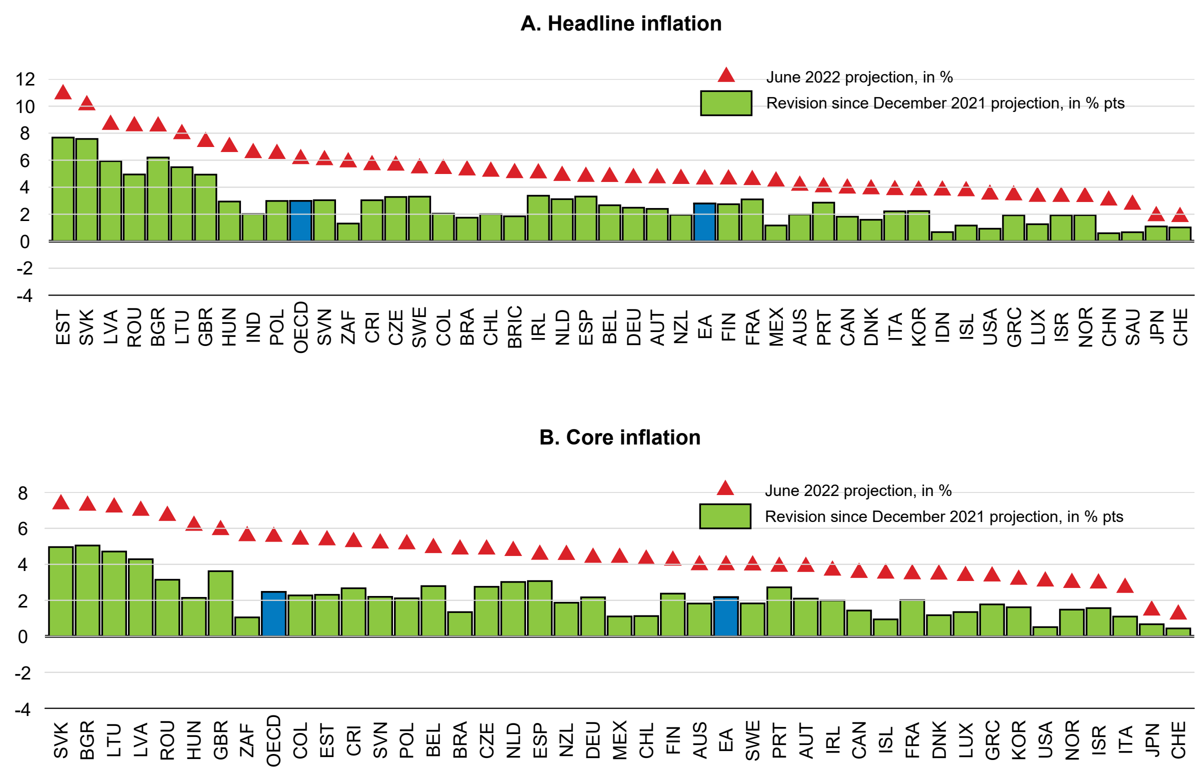
Consumer price inflation in the G20 economies is now projected to peak at 7.6% in 2022, before slowing to around 6¼ per cent in 2023 (Table 1.1). Inflation is still projected to moderate next year in most countries, provided that the peak in global energy prices is passed, as assumed, in early 2023 (Annex 1.A.) and supply-chain constraints wane gradually. Moderating demand growth will also help to ease inflation pressures. Even so, headline and core inflation are projected to remain higher in 2023 than previously foreseen, and in many cases above central bank policy objectives (Figure 1.21). With inflation now seen as staying higher for longer in most OECD economies, many central banks are now expected to raise interest rates more quickly than previously assumed. On average across the OECD, policy interest rates are projected to be around 2½ percentage points higher in 2023 than in 2021; the impact of this on the growth outlook is expected to take effect gradually through the projection period.

Figure 1.21. Inflation projections have been revised up in most countries

Inflation rate for 2023



Note: Data for Argentina and Turkey (50.6% and 38.9% for headline inflation, respectively) are not presented.
Source: OECD Economic Outlook 111 database; OECD Economic Outlook 110 database; and OECD calculations.

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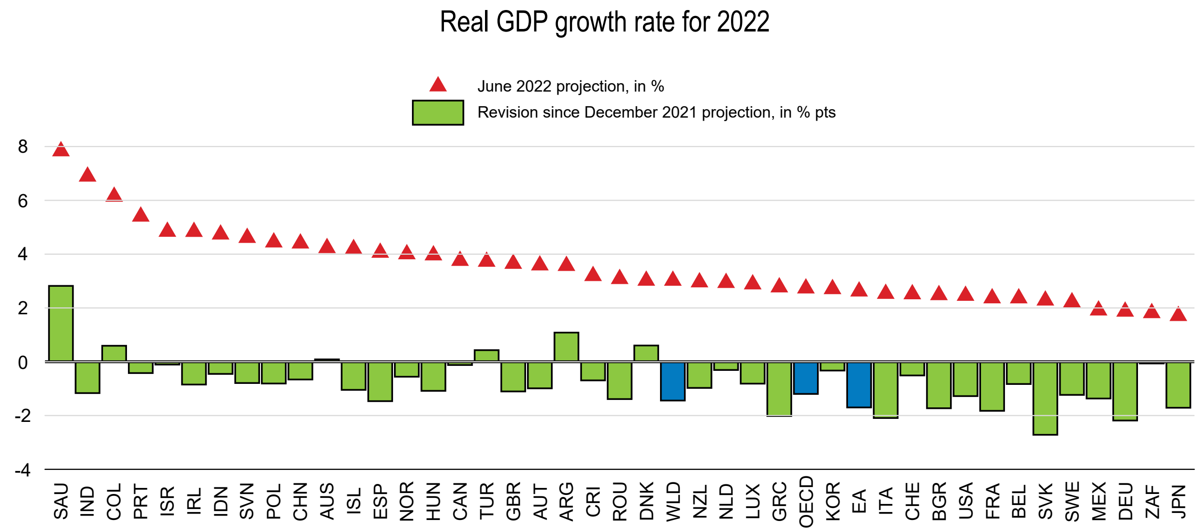
Global GDP growth is now projected to slow to 3% in 2022 and between 2¾-3 per cent in 2023, with output rising by only around 2% over the year to the fourth quarter of 2022. In the OECD economies, growth is now projected to moderate to 2.7% in 2022 and 1.6% in 2023, with the level of output in 2023 around 2% weaker than previously projected. Almost all countries are now expected to grow more slowly in 2022-23 than was foreseen before the war (Figure 1.22). Business investment and private consumption growth have both been revised down. OECD-wide private consumption is still projected to rise on average by between 2¼-2½ per cent over 2022-23, with lower saving ratios and solid, albeit slowing, employment growth offsetting the drag from real wage declines in many countries. In many countries, GDP growth over the two years is still projected to be fast enough to allow the output gap to narrow, although in some economies, including the United States and the United Kingdom, growth is projected to drop below potential rates in 2023.

Figure 1.22. GDP growth in most countries has been revised down in 2022



Note: Fiscal year for India.
Source: OECD Economic Outlook 111 database; OECD Economic Outlook 110 database; and OECD calculations.

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European economies, particularly those bordering Russia or Ukraine, are expected to be the hardest hit by recent developments. This reflects larger gas price rises in Europe than elsewhere and stronger pre-war business and energy linkages with Russia. In 2023, the oil embargo is likely to further weaken growth and prolong upward pressures on inflation in Europe, with adverse effects also being felt elsewhere. Advanced economies in the Asia-Pacific region and the Americas have weaker trade and investment links with Russia, and some are commodity producers who benefit from higher commodity prices. Even so, growth in these cases is still hit by weaker global demand and the impact of higher energy prices on household incomes and spending. Growth outcomes in the emerging-market economies reflect a balance between positive effects for some commodity-producing economies, particularly the major oil-producing economies other than Russia, and negative ones in the major commodity-importing economies.

Prospects in the major economies are as follows (Table 1.1):

- In the United States, GDP growth is anticipated to weaken from 5.7% in 2021 to 2.5% in 2022 and 1.2% in 2023. Supply shortages, exacerbated by the war in Ukraine and COVID-related lockdowns in China, higher oil prices and a faster pace of monetary policy normalisation will hold back growth to a greater extent than previously foreseen. The expiry of pandemic-related fiscal measures will result in a marked fiscal consolidation this year, exerting a drag on growth, though this is expected to be partially mitigated by the lagged effects of past government spending. Growth will also be supported by continued employment gains this year and rising real wages in 2023. Labour markets remain tight, although unemployment is projected to bottom out in late 2022 and begin to edge up during 2023. Annual inflation (as measured by the personal consumption expenditures price index) is projected to decline from a peak of 6.3% in the second quarter of 2022 to 2.8% by the last quarter of 2023 – both the headline and core measures of inflation would remain above the Federal Reserve's 2% target at end-2023.
- Near-term growth in Japan has been dented by the Omicron wave, with public health restrictions applied to much of the country in early 2022, as well as by weak external demand and the increase in the prices of key commodity imports. Helped by a bounce-back in private consumption following the lifting of confinement measures, GDP growth is projected to pick up through 2022 to be 1.7%

for the year as a whole, and 1.8% in 2023. Higher commodity prices will push headline inflation up to nearly 2½ per cent by late 2022, tempered by government subsidies to mute surging fuel prices, but core inflation is projected to remain low, partly reflecting weak wage growth.

- In the euro area, the war in Ukraine and the lockdowns in China add to supply-side bottlenecks giving additional impetus to inflationary pressures and further denting real household incomes and business sentiment. The slowdown in growth, while sharp, is being cushioned by tight labour market conditions, the implementation of the Next Generation EU recovery plan and fiscal support for households and firms affected by higher energy costs. GDP growth is projected to slow from 5.3% in 2021 to 2.6% in 2022 and 1.6% in 2023. Headline inflation is projected to reach 7% in 2022 before falling to 4.6% in 2023 – annual inflation at the end of 2023, at 3.9% for the headline measure and 3.7% excluding food and energy, would still be well above the central bank's objective.
- After a fast recovery from the first wave of COVID-19, China's economy has cooled, partly reflecting the stringent measures that remain in place to eradicate the spread of the virus as well as weak real estate investment due to tighter regulations and the failure of some major developers. However, additional monetary policy easing and fiscal support worth up to 2% of GDP this year should help to stabilise demand: GDP growth is projected to slip to 4.4% in 2022 before rebounding to 4.9% in 2023. China is potentially exposed to significant upward price pressures coming from energy and food, but large reserves are likely to contain these pressures. Headline inflation is projected to be 2% in 2022 and 3% in 2023.
- India recorded the strongest rebound from the COVID-related downturn of any G20 economy, but momentum is dissipating owing to weaker external conditions, rising global food and energy prices and the tightening of monetary policy. As an importer of energy, fertilisers and edible oils, India is adversely affected by the war in Ukraine. GDP growth, which reached 8.7% in FY 2021, is projected to slow to 6.9% in FY 2022 and 6.2% in FY 2023, with weaker external demand growth and tighter monetary conditions being mitigated by strong government spending and an ambitious set of measures to simplify the business environment. Headline inflation is projected to ease gradually, though remaining above the central bank's upper tolerance limit of 6% throughout 2022 and 2023.
- A range of factors, including rising inflation, the war in Ukraine, unfavourable weather conditions, political uncertainty and the spread of the Omicron variant in early 2022 have eroded sentiment and dented growth in Brazil. Commodity exports are likely to strengthen, but higher inflation is expected to hit households' purchasing power and hinder consumption growth, as well as triggering additional monetary policy tightening. GDP growth is projected to slow sharply to 0.6% in 2022 before picking up to 1.2% in 2023. Inflation is seen as remaining high in 2022, averaging 9.7%, before declining to 5.3% in 2023 as the impact of monetary policy tightening and currency appreciation is felt.

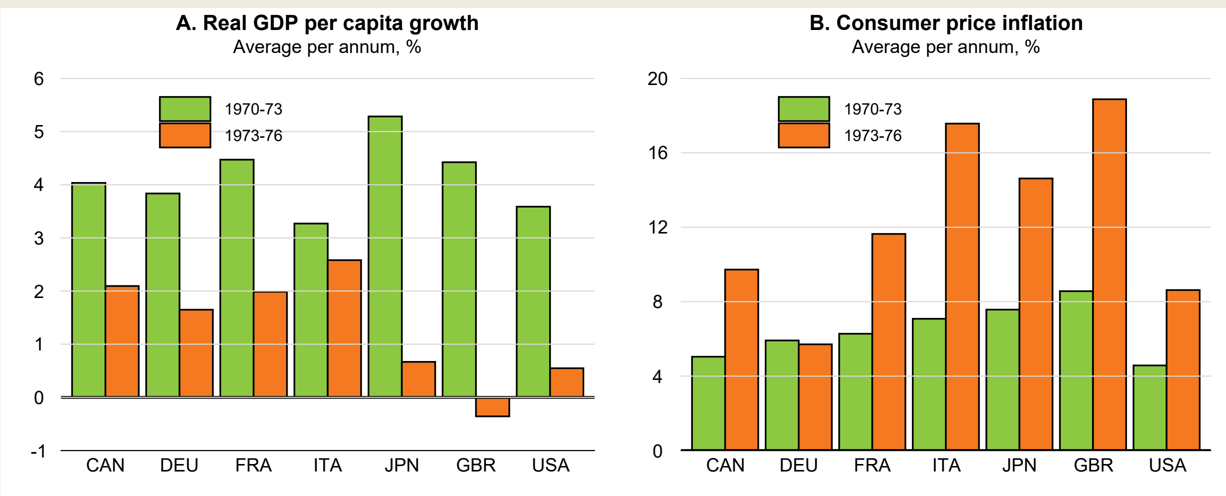
The normalisation of labour markets is projected to continue during 2022-23, despite the new negative shock of the war in Ukraine. As the public health situation improves further, based on rising vaccination rates and improved COVID-19 treatments, labour force participation is projected to increase in almost all economies. Stronger international migration flows and the gradual entry of Ukrainian refugees into host country labour markets should also help to ease some labour shortages. OECD-wide employment growth is projected to slow from around 2¾ per cent this year to under 1% in 2023, with unemployment rates starting to rise slightly in some countries. In most OECD economies, real wage growth over 2022-23 as a whole is projected to be negative, and for the OECD as a whole the pace of wage increases in nominal terms is projected to decline from around 4¾ per cent in 2022 to close to 4% in 2023.

The conjunction of soaring energy prices and growing worries about a sharp slowdown in growth has spurred talk of the global economy experiencing a new period of stagflation, a term redolent of the oil shocks of the 1970s. While there are indeed increasing similarities between the current situation and the mid-1970s after the first major oil price shock late in 1973, there are also differences that could mean that growth is more resilient now than on that occasion, and that inflationary pressures wane more quickly and durably (Box 1.3; Igan *et al*., 2022). Nonetheless, as discussed in the next section, there are clear risks that growth could slow more sharply than expected and inflationary pressures could intensify further.

Box 1.3. Differences between the current situation and the aftermath of the 1970s oil price shocks

The combination of rapidly rising prices and slowing economic growth has given rise to fears that the global economy may be entering a period of stagflation. There is no single definition of stagflation but it is generally understood to denote a combination of slow or zero growth and high inflation. The turbulence experienced after the global oil price shock in late 1973 – with oil prices tripling over the year to the first quarter of 1974 – is widely seen as a period of stagflation, with inflation and unemployment rates rising steadily in the aftermath of the oil price increase, and real income growth slowing sharply (Figure 1.23). In late 1974 and early 1975, GDP per capita declined in all G7 economies and labour market conditions deteriorated: the average unemployment rate in the G7 economies over 1974-76 was 1 percentage point higher than over 1971-73, and 1.8 percentage points higher in the United States.

Figure 1.23. Growth slowed and inflation surged following the 1973 oil price shock



Note: National consumer price indices are used in Panel B.
Source: OECD Economic Outlook 111 database; OECD Database on Consumer Price Indices; and OECD calculations.

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There were some other features of this episode also seen in the current economic situation. World food prices rose sharply, with the FAO food price index doubling between 1972 and 1974, and labour markets were generally tight ahead of the increase in oil and food prices, with strong wage growth. OECD potential output estimates suggest that the major advanced economies generally had large positive output gaps when the oil price shock hit in 1973, after a period of rapid growth. Cost-push inflation took root following the energy price shock, with successive wage rounds trying to restore real incomes, and inflation expectations rose over time. Ex-post real interest rates also turned negative, with monetary policy placing too much emphasis on maintaining low unemployment and too little on addressing rising inflation expectations (Meltzer, 2005; Powell, 2018).

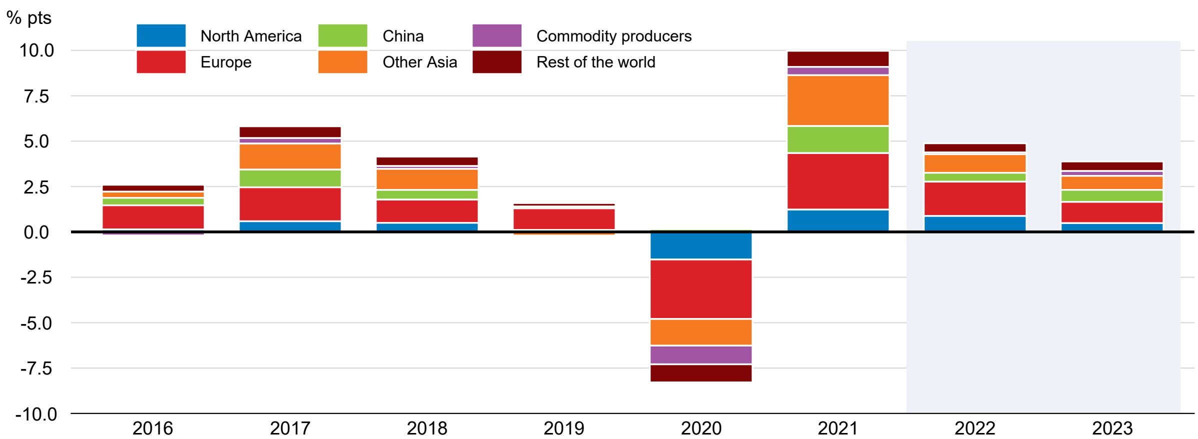
Although the current situation shares some similarities with that in the early 1970s, economic policy frameworks are very different, and structural changes have reduced the impact of commodity price shocks on economic activity and wage growth. Thus, a negative supply shock induced by oil prices should have less of a stagflationary impact than in the mid-1970s:

- The advanced economies have become far less energy-intensive after the big oil-price shocks of the 1970s and early 1980s, potentially reducing the impact of an oil shock by half in the United States (Blinder and Rudd, 2008). The share of industrial output in total economic activity has also declined. To some extent this is offset by the increasing importance of less energy-efficient emerging-market economies in global economic activity, but global oil and energy intensity has also declined (Rühl and Erker, 2021).
- Central banks' monetary policy frameworks have evolved and become more robust, with a stronger focus and understanding of the importance of maintaining well-anchored inflation expectations than was the case in the 1970s. Most central banks are now independent, and they have an explicit focus on price stability and an inflation target, even in countries in which they formally retain a dual mandate.
- The advanced economies are more flexible, and hence better able to handle oil shocks, than they were in the 1970s. Changes in labour market institutions since the 1970s have reduced the risk that an oil price shock (or other negative supply shock) results in a wage-price spiral. The coverage of collective bargaining agreements has declined, many automatic wage indexation mechanisms have been removed, and lower union membership has reduced employees' bargaining power (OECD, 2021a).
- There are particular circumstances at the current juncture that may buffer some of the potential adverse effects of higher energy prices. For instance, many consumers have excess savings accumulated during the pandemic that can be used to offset income shortfalls, some spare capacity still exists on OECD estimates in many countries, and supply shortage pressures should moderate as borders reopen and more people join the labour force.

The Ukraine war is primarily a negative global supply shock, reducing output and raising prices relative to what might otherwise have been expected. In this sense, it is qualitatively similar to the effects of the oil shocks in the 1970s and shares some characteristics with periods of stagflation. However, the current baseline projections are for continued, but mild growth in most economies, with inflationary pressures that are projected to moderate slowly over the coming year and a half. Downside risks remain of more severe effects that would further harm growth prospects and add to inflation, such as an abrupt shut-off of gas imports from Russia to Europe. Nonetheless, sustained high inflation for several years could still be avoided provided monetary policy acts to maintain well anchored long-term inflation expectations close to central bank objectives.

Global trade prospects have weakened. The surge in trade at the end of 2021 has strong positive carryover effects for annual growth this year, but on a quarterly basis trade growth is projected to be weaker than previously thought over 2022. World trade growth is projected to moderate from 10% in 2021 to about 5% in 2022 and 4% in 2023 (Figure 1.24). Key factors slowing trade growth in 2022 include prolonged regional lockdowns in China, weaker demand in Europe due to the Russia-Ukraine war and the transition of US consumer demand from goods to services. The recent rise in prices and tensions across commodity markets are projected to lower the trade growth of commodity exporters this year, with Russian trade expected to contract by over one-quarter in 2022 and 9% in 2023. In Europe, the slowdown in import growth is particularly pronounced in the Baltic and the East European economies, where supply-chain linkages with Russia and Ukraine are constraining key economic sectors.

Figure 1.24. Trade growth is set to moderate



Note: The North America aggregate includes the United States and Canada; Europe includes the OECD European countries; Other Asia includes Japan, Korea, the Dynamic Asia Economies (Hong Kong - China, Malaysia, Chinese Taipei, the Philippines, Singapore, Thailand and Vietnam), India and Indonesia; Commodity producers include Argentina, Brazil, Chile, Colombia, Russia, Saudi Arabia, South Africa and other non-OECD oil-exporting economies.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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Key risks and vulnerabilities

The adverse effects from the war could be much larger

A key potential risk to the projections is that all energy exports from Russia to Europe could cease completely. The impact of such a shock is difficult to quantify, but could be severe if it were to occur through a sudden stop in imports from Russia at a time when stock levels had yet to be rebuilt and there were limited possibilities to switch quickly to alternative sources of supply. The forthcoming EU embargos on imports of coal and seaborne oil from Russia also raise challenges, and could be more disruptive than projected if there are prolonged supply shortages.

Oil and gas represent sizeable shares of EU total energy use.[9] A Europe-wide embargo, or a sudden stop to exports by Russia, thus brings a sizeable risk of energy supply disruption as well as rising prices.[10] There are large differences across member states, both in terms of the energy mix and the share of energy inputs that originate in Russia. An end to imports of Russian energy is likely to affect sectors in different ways according to their dependency on energy imports from Russia and scope to obtain alternative energy

[9] In 2020, petroleum products, gas and coal accounted for approximately 35%, 24% and 12% of total EU energy use respectively.

[10] In 2019, Russia supplied around 40% of the oil and gas collectively used by EU producers and households, and around 30% of coal and peat products. The use of crude oil and other hydrocarbons was predominantly concentrated in the transport sector (accounting for 60% of oil consumption) and in industries such as the production of rubber and plastic products. In contrast, the consumption of natural gas was used more broadly by households for domestic lighting, heating and cooking (26% of gas consumption), manufacturing industry (20%) and energy-related sectors (36%). Around four-fifths of coal and peat in Europe was used as inputs in the energy industry, with the rest destined mainly for the production of chemicals and metals.

supplies or reduce demand. As energy is a critical input across several industries, the short-run impact on output could be amplified by cascading effects propagating along international and domestic input-output linkages. At the same time, sharp rises in energy prices might also have hefty repercussions on household incomes and demand.

Illustrative assessments of the direct effects on output in manufacturing and market services sectors that might result from an embargo of all of energy products from Russia can be made by combining input-output tables with information on energy use in 2019 from the International Energy Agency (IEA).[11] The IEA data provide economy-wide dependency ratios on Russian imports for each of the three different fossil fuels (coal, gas and petroleum products). These can be used to calculate the dependence on Russian energy imports in each sector by using the consumption shares of each respective fuel product in different sectors and assuming that the share of each fuel product imported from Russia is the same across all sectors. The impact on gross output from an energy embargo on Russia is then derived by applying input-output multipliers of energy-related industries.[12] After taking into account all direct and indirect linkages, the input-output multipliers quantify the change in each sector's output that results from the complete cut in Russian energy inputs in trade partners' industries and domestic sectors.

This approach, based on the pattern of energy use seen prior to the pandemic, suggests that a sudden stop in all imports of fossil fuels from Russia would affect all sectors of the economy, particularly energy-producing sectors, transport, minerals and metals manufacturing (Figure 1.25). Aggregating across sectors, the estimates imply a reduction in European output in manufacturing and market service sectors of between 2¾-3 per cent, if not offset by drawing down stocks or by substituting other energy inputs. Around one-half of this output decline would be due to shortfalls of petroleum and petroleum products, with the majority of the remainder from shortfalls of natural gas. These estimates highlight the risks of possible supply disruptions following an oil embargo, and the additional potential risks of a gas embargo.

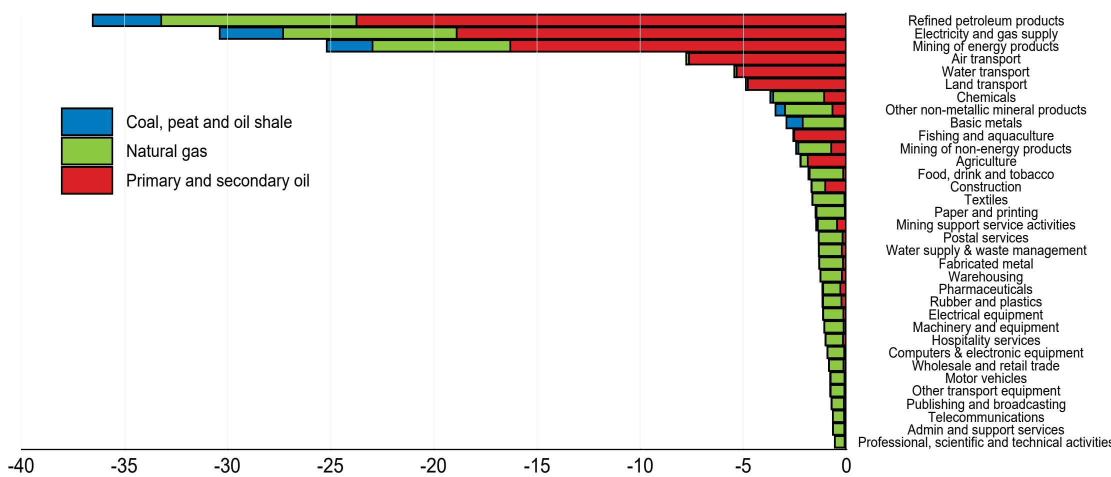
These illustrative input-output estimates are highly uncertain, particularly given ongoing efforts to diversify sources of energy supply in Europe. The output effects could easily be understated, as supply disruptions could force companies to shut down production completely rather than reduce it proportionally. The near-term impact of a simultaneous sharp contraction in production across many sectors and countries is also likely to be larger than if only one country is affected. On the other hand, the input-output structure used cannot account for possible substitution effects with foregone Russian imports replaced by imports from elsewhere, or by drawing down reserves, using additional domestic supplies from alternative energy sources, such as nuclear energy or renewables, or improved energy efficiency. Such adjustments would mitigate the output costs.

[11] Information is also available for 2020, but the structure of activities that year was heavily affected by the pandemic and related containment measures.

[12] Following Acemoglu et al. (2015), the overall impact of a supply shock originating in sector i on industry j's output is the sum of the direct effect and indirect downstream propagation from i to j. It is measured by sector j's total requirement from i, which is reported in the inverse Leontief matrix.

Figure 1.25. Sizeable output declines could occur in some sectors in Europe if energy inputs from Russia were suddenly stopped

Percentage decline in manufacturing plus market services output



Note: See text for details of the calculations. Primary and secondary oil includes crude, natural gas liquids, refinery feedstock and other processed oil products.
Source: OECD IOTs 2021 database; IEA World Energy Balances database; and OECD calculations.

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A few similar studies report comparable output costs for Germany of between 0.3 and 2.2% (depending on the scenario considered) and slightly lower costs for France (Baqaee *et al*., 2022; Bachmann *et al*., 2022). Earlier estimates using input-output linkages also pointed to relatively small output costs in Europe if imports of natural gas from Russia were ended (Bouwmeester and Oosterhaven, 2017). In contrast, estimates by Holtemöller *et al*. (2022) and Deutsche Bundesbank (2022) for Germany highlight the risk of a large and immediate drop in output in the event of a sudden stop in energy imports from Russia.[13]

The extent to which the loss of imported fossil fuels from Russia can be offset will depend in part on the timing and circumstances of such a change.

- Strong drives to reduce Europe's dependency on Russia over the course of this year have already begun. In early March, the IEA set out a plan to reduce use of gas from Russia by at least one-third in 2022. Shortly thereafter, the European Commission released its RePower EU plan, raising the ambition to a two-thirds cut within a year. Plans include improved storage levels ahead of the winter season, joint purchases from alternative suppliers, greater use of renewables and other existing

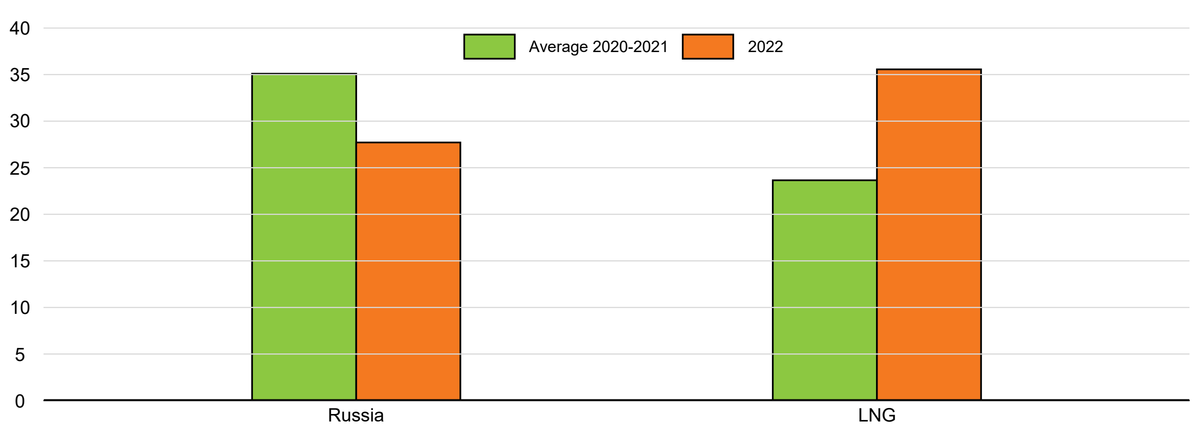
[13] One example of the need for a substantial adjustment in energy supplies, albeit in very different circumstances, is the aftermath of the nuclear meltdown at the Fukushima plant in Japan in 2011 triggered by the Great East Japan earthquake and tsunami. Operations at all of Japan's remaining 50 nuclear power plants were then suspended, removing almost one-third of electricity supply (OECD, 2013). Reductions in electricity consumption by businesses and households were requested by the government in the summer of 2011 and again in 2012 to avoid shortages. Many manufacturers reduced energy consumption during peak periods by shifting production to weekends and off-peak hours, raising costs but avoiding the need for blackouts. Imports of fossil fuels rose significantly to help overcome the domestic supply shortfall. Collectively, these adjustments helped to prevent a large contraction in output from energy shortages beyond the immediate adverse impact in the first half of 2011 (Carvalho et al., 2021).

domestic energy sources, and improved energy-saving measures (such as lower residential heating temperatures).

- There has already been a substantial shift in the composition of European gas imports this year. In the first 21 weeks of 2022, EU imports of Russian gas via pipeline were down by more than 30% compared to the corresponding period in 2021, and more than offset by a 54% increase in liquefied natural gas (LNG) imports from other sources. As a result, the share of Russian gas in total gas imports fell from 35% on average in the first 21 weeks of 2020 and 2021 to 24% in the same period of 2022 (Figure 1.26).
- The IEA has also produced a 10-point plan to reduce oil use. In addition to finding alternative suppliers, a key need is to change behaviour and reduce demand. Actions to lower the amount of oil consumed by cars are particularly important. These changes will take time to put into full effect, raising potential risks to the projections of a sudden stop in oil supplies in the absence of adequate storage levels.
- More generally, global energy markets are tight, although there is scope to obtain additional oil output from some OPEC and non-OPEC producers and further coordinated inventory releases by IEA members. Increased LNG deliveries can also help to mitigate any potential supply disruptions of pipeline gas to European markets, although additional investment in this sector will be necessary (G7, 2022). Significant logistical challenges also need to be overcome, including the transportation by sea of fuels from more distant non-European suppliers, the specialised platforms needed to store LNG offshore, and the infrastructure required to ensure that additional supplies can be moved within Europe to inland markets previously supplied by gas pipelines from Russia. Refineries currently designed to process oil from Russia also need to be reconfigured, unless a close substitute can be found. The difficulties that Russia would face in diverting all of its energy exports to Europe to non-European markets, particularly gas, would also be likely to hit global energy supply, at least in the short term. Strong additional competition from Europe for scarce energy supplies would therefore be likely to drive up prices in global markets.

Figure 1.26. The share of Russian gas in total European gas imports has already declined sharply

Share of EU gas imports, weeks 1-21



Source: McWilliams et al. (2021), based on data from ENTSO-G.

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Illustrative simulations, using the NiGEM global macroeconomic model, highlight the risk of potential adverse effects from an end to Russian gas imports in the European economies. A full gas embargo is modelled as a negative supply shock, with potential output in the average European economy lowered by close to 1½ per cent via a combination of reduced technical efficiency and a fall in average hours worked. The embargo is also assumed to push up global gas prices by 50%, reflecting the need for the European economies to source additional supplies on world markets and reduced supply from Russia.[14] Higher gas prices are expected to also push up fertiliser prices, which are assumed to rise by 25%, and increased demand for energy supplies is expected to spill over into oil markets, with oil prices assumed to rise by 10%. Given the uncertainty that is likely to accompany energy supply disruptions, additional effects are likely to arise in the European economies from a decline in confidence and higher financing costs for companies. These effects are modelled by an ex-ante increase of 1 percentage point in the household saving rate and a 1 percentage point rise in the user cost of capital. The commodity price shocks are assumed to last for at least one full calendar year, before fading slowly as markets start to adjust. All other shocks are assumed to persist for three years before fading. Policy interest rates are endogenous and adjust according to the balance of the shocks to growth and consumer price inflation.[15]

- Taken together, these shocks could reduce growth in the European economies by over 1¼ percentage points in 2023, relative to baseline, and raise inflation by over 1 percentage point (Figure 1.27). A growth decline of this magnitude could potentially leave many countries close to, or in, recession in 2023. Growth would also be weakened in 2024 if the shocks persist, with demand gradually being brought into line with the reduction in supply. Real household disposable incomes would be hard hit, declining by more than 2% in the euro area economies, reflecting the drag exerted by higher prices and lower hours worked. Business investment would also be severely affected, with lower potential output, higher gas costs and the higher user cost of capital leading to declines of around 5% or more in many European economies in 2023.
- Outside Europe, the impact of the shocks would be smaller, especially in other gas-producing economies, but there would still be impacts from higher inflation on real incomes and weaker demand from Europe. For the world as a whole, inflation is pushed up by over ½ percentage point in 2023, with growth reduced by just under ½ percentage point.
- Monetary policy reacts to the upturn in inflation, with policy interest rates initially raised by around 50 basis points in the euro area in the first year of the shock, and 25 basis points in many other advanced economies, before returning towards baseline as inflationary pressures subside.

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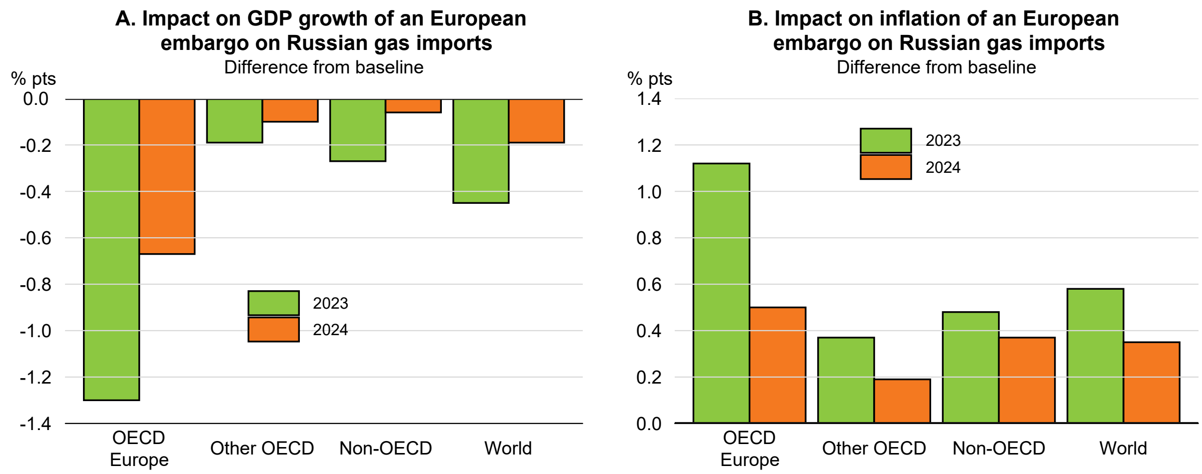
[14] The simulation assumes that 75% of Russian gas exports to Europe cannot be diverted to other markets due to logistical difficulties and a lack of ready infrastructure such as pipelines. This is broadly equivalent to a decline of 5% in total Russian exports of goods and services. In turn this generates an ex-ante gap between effective world supply and consumption of between 4½-5 per cent in global gas markets. The assumed gas price adjustment reflects a short-term price elasticity of demand of -0.1, at the low end of the estimates reported by Labandeira *et al*. (2017). The implied increase in gas spot prices would still leave them at a level below the daily market peak observed since the invasion of Ukraine.

[15] The simulation begins in the first quarter of 2023 and is run with households, companies and financial markets having forward-looking behaviour, so consumers and companies make their current spending choices with an expectation that the shocks will fade eventually.

Figure 1.27. An embargo on gas supplies from Russia would hit growth and raise inflation in Europe



Note: Illustrative scenario of the impact of ending imports of gas from Russia in Europe. See text for details of the shocks considered.
Source: OECD calculations using the NiGEM macroeconomic model.

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In addition to energy, the risks of stronger costs from the war in Ukraine also arise from shortages of critical raw materials, and disruptions to transportation and trade finance.

- As Russia and Ukraine are important suppliers of many critical raw materials, the risks of disruption are also high for some supply chains relying heavily on these inputs (e.g. automobile, aeronautics or electronics). Substituting towards alternative sources of supply is particularly difficult for some critical raw materials provided by Russia and Ukraine as these inputs are highly specialised and the market is very concentrated (Box 1.4; Grzegorczyk *et al*., 2022).

Box 1.4. Potential disruptions in raw materials trade due to the war in Ukraine

The products most at risk of disruptions in supply from Russia and Ukraine can be identified using granular customs data. For the purposes of this analysis, a traded good is characterised as *vulnerable* to disruption if Russia or Ukraine is one of the top five world exporters and if their combined market share represents at least 15% of the global export market. Out of more than 4500 products traded in 2020, 92 are identified as vulnerable on this basis. Collectively, they represent 2.7% of the total value of trade in 2020 (Table 1.2). The vulnerable products are concentrated in metals, chemicals, food and agriculture.

This snapshot of potential vulnerabilities suggests that beyond the impact on agriculture (Box 1.1) and energy, there are risks that the war hits trade in raw materials and triggers ripple effects in critical industries. European gross exports of basic metals and fabricated metal products contain almost 10% of value added from raw materials that originate from Russia. This high degree of backward integration to Russian metals makes production throughout Europe sensitive to disruptions.

Table 1.2. The products from Russia or Ukraine most vulnerable to disruption

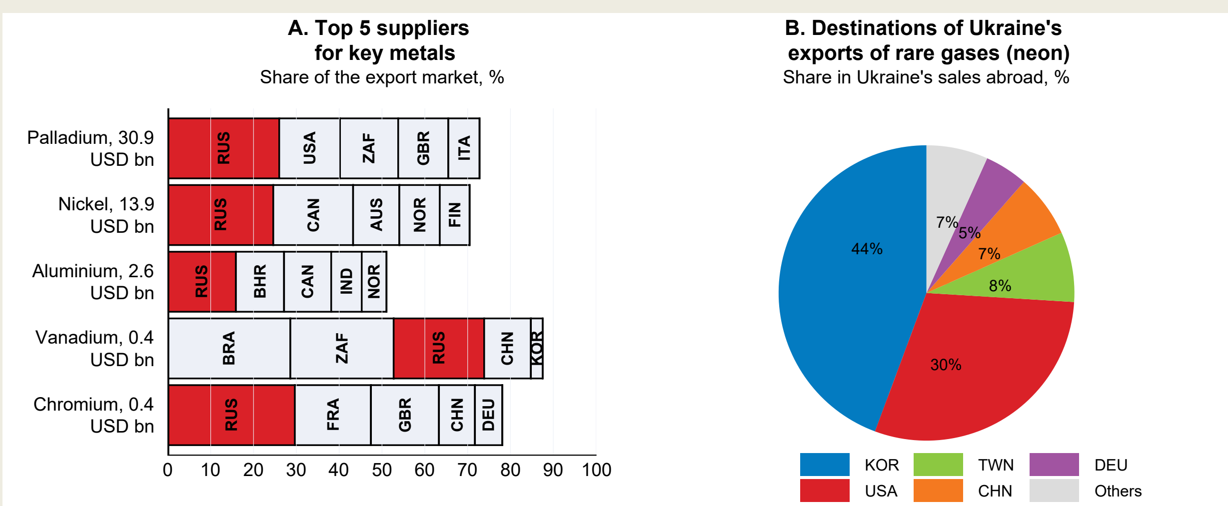
	Number of traded products	Total value (bn USD)	Number of products where Russia or Ukraine is a top-5 exporter	Number of vulnerable products	Share of vulnerable goods in % of total value of exports
Total	4528	16736	277	92	2.7
Agriculture	239	566	24	11	17.3
Food	424	1105	36	18	3.0
Chemicals	719	1420	59	18	3.0
Metals	577	1740	72	26	5.2
Mining and petroleum	106	1746	29	10	9.0
Others	2463	10158	57	9	0.4

Source: BACI database from CEPII; and OECD calculations.

Palladium and nickel matter for green technologies

Within metals products, Russia accounted for one-quarter of global palladium exports in 2020 (Figure 1.28, Panel A). This material is important for many green energy technologies. Its catalytic properties make palladium a central input for the production of emission-control systems in vehicles, with car manufacturers using it to remove toxic emissions from exhaust fumes. Global exports of nickel are also highly concentrated, and Russia together with Ukraine account for one-third of the world export market. Its uses include production of batteries powering electric vehicles. Ukraine is also a key exporter of neon gas, a by-product of steel manufacturing used in the lithography of semiconductors, which is sold to Korea, the United States, China and Chinese Taipei (Figure 1.28, Panel B). This collection of potential supply chain disruptions could pose significant risks for the vehicle industry, and especially the production of electric vehicles.

Figure 1.28. Russia and Ukraine are major suppliers of many metals



Note: Panel A shows the share of the top five exporters in global exports recorded in 2020 for each commodity. Panel B shows the destinations of Ukraine's exports of rare gases (i.e. neon gas).
Source: BACI database from CEPII; and OECD calculations.

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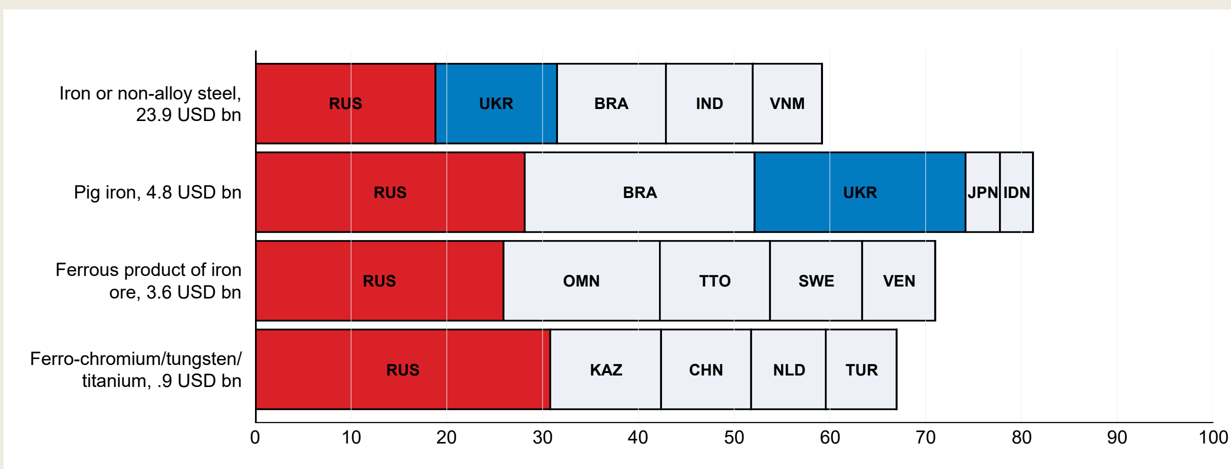
Steel value chains are also at risk, with potentially widespread downstream propagation

War-related disruptions could also weigh on iron and steel trade. Many products belonging to the broad iron and steel category are dependent on Russian and Ukrainian exports (Figure 1.29). Russia and Ukraine account for one-quarter of global exports of iron and non-alloy steel semi-finished products, and half of world exports of pig iron. While iron and steel are more easily substitutable than rare metals (such as palladium), their widespread use in multiple downstream industries could trigger cascading consequences in the event of supply disruptions.

Russia is also a major exporter of ferro-alloys, supplying 30% of the global export market for ferro-tungsten, ferro-chromium and ferro-titanium. Stainless steel makers use these ferro-alloys as a stabiliser in the production of low-carbon steels. Chromium and vanadium are also two important inputs in steel production: a small quantity is enough to harden steel and make it very resistant. The stainless steel is then used in construction or automotive industries. Stainless steel is also an input in transportation, including ship containers for the transportation of chemicals, liquids and food products. Many renewable energy technologies also use stainless steel components as they can withstand corrosive environments.

Figure 1.29. Several iron and steel products from Russia and Ukraine are particularly vulnerable to disruption

Share of the export market, in percentage



Note: The product “iron or non-alloy steel” corresponds to “iron or non-alloy steel, semi-finished products thereof”.
Source: BACI database from CEPII; and OECD calculations.

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- Disruptions to transportation could also have long-lasting and deeper costs, and increase congestion in international shipping. Regional blockages arising from Russia and Ukraine could also have stronger ripple effects on freight traffic than seen so far. European firms relying on manufacturing goods produced and assembled in Asia are particularly under pressure, since this merchandise is usually shipped through Russia. Bypassing Russian airspace or ports increases costs and the time taken for deliveries.

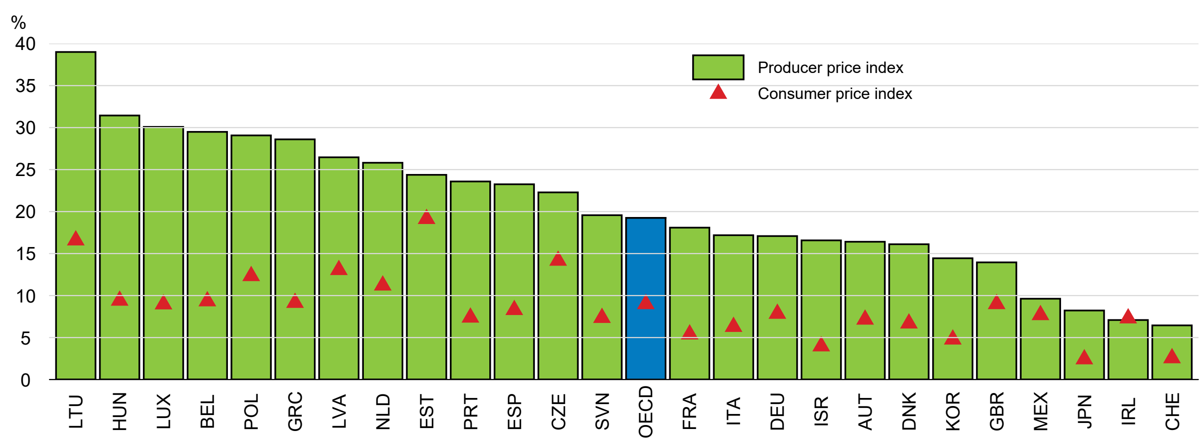
- Financial sanctions on Russia could also magnify the trade fall by more than assumed in the projections, as has happened in the past. During the 2008-09 global financial crisis the collapse in exports in many countries was disproportionate to that of output, in part due to disruptions to trade credits. Exporting generally involves higher default risks and working capital requirements than domestic activity (Amiti and Weinstein, 2011), reducing the incentives of lenders to provide credit during crises. In the 2014 sanctions on Russia, the financial disruption to the provision of trade finance is also thought to have reduced trade (Crozet and Hinz, 2016).

Inflationary pressures could be stronger and longer lasting than expected

The prices of energy, metals and food commodities are relatively heavily weighted in producer price indices (PPIs). As a result, across the OECD the PPI has risen much more sharply than consumer prices, although there is considerable cross-country variation (Figure 1.30). This is a common pattern, as the other cost components of consumer prices (especially labour costs) tend to be much less variable than commodity prices. Changes in producer selling prices are then passed through into retail prices, potentially with a lag, with the prices charged to consumers also reflecting distribution costs and retailers' margins. Empirical estimates suggest that if PPIs were to continue rising in the coming months at a pace similar to that seen over the past year, consumer price inflation would be expected to rise further through 2022 in many economies (Box 1.5). Given the potential of the war in Ukraine to result in further upward pressure on a range of commodity prices, together with the possibility of additional supply chain disruptions arising from both the war and China's zero-COVID policy, a continuation of inflationary pressure coming via producer prices is a clear risk.

Figure 1.30. Producer prices have risen more sharply than consumer prices

Change from April 2021 to April 2022



Note: Manufacturing producer prices in domestic markets. The consumer price index for euro countries and the euro area refers to harmonised price indices. Turkey's figures are 112.1 (PPI) and 70 (headline inflation). The OECD aggregate producer price index is for March.
Source: OECD Database on Consumer Price Indices; OECD Database on Producer Price Indices; and OECD calculations.

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Box 1.5. The pass-through from producer to consumer prices

The rapid rise of producer prices, especially for energy, has opened up an unusually large gap between producer price inflation and consumer price inflation (Figure 1.30). A key question is whether this presages continued upward pressure on the latter. The analysis in this box (developed in more detail in Ollivaud, 2022) suggests that changes in producer price indices (PPIs) explain much of the recent annual increase in consumer prices. Different scenarios for how PPIs may evolve in the coming months suggest that if they continue to rise at a similar pace to the past year, headline consumer price inflation in advanced economies would be expected to continue rising through the end of 2022 (except in the United States, where it would remain broadly flat). If, however, the increases in the PPI were to decline and turn negative, as has been the case after past inflation spikes, there would be a quick slowdown in headline inflation.

Empirical estimates, using seasonally-adjusted monthly data, suggest that consumer price inflation has typically reacted relatively quickly to PPI inflation: nearly a third of the deflation/inflation that producers face is passed through in two months to consumers, with most of the change happening in the same month. The relationship between producer and consumer prices is less robust using core rather than headline consumer price inflation, i.e. excluding energy and food products. In the United States, the euro area and the United Kingdom producer prices are found to have a much smaller effect on core inflation than on the headline measure, with Japan a notable exception. This suggests that much of the association between the PPI and consumer prices comes from the impact of fluctuations in food and energy prices – which are typically reflected relatively quickly in both price series.

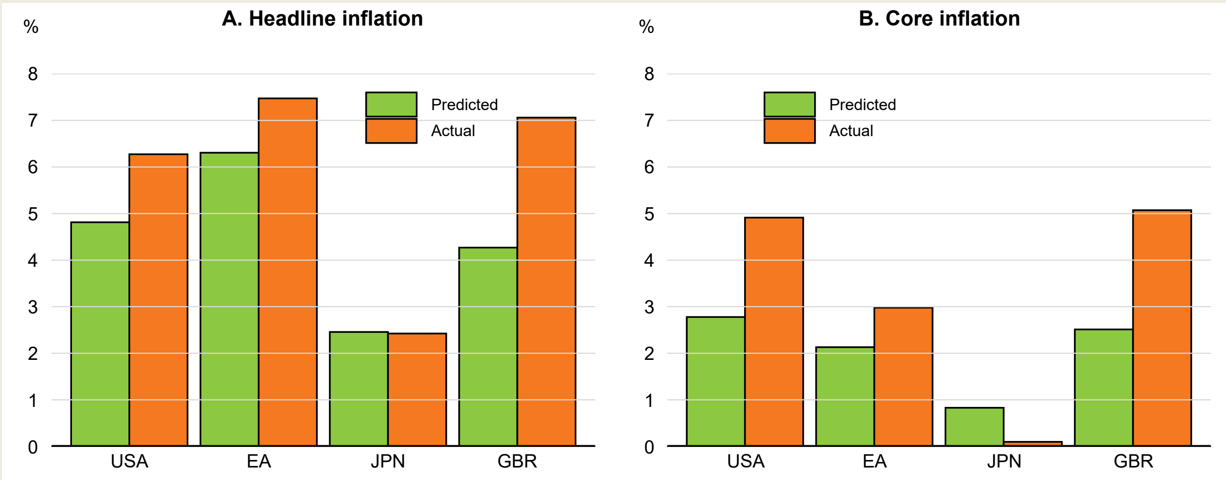
An assessment of the recent performance of the estimated equations suggests that consumer price inflation over the past year has typically been somewhat stronger than would have been predicted from producer prices alone (using actual PPI data) (Figure 1.31). The gaps between actual and predicted inflation over the past year are relatively small in Japan and the euro area, but larger for the United States and the United Kingdom. This suggests that additional factors have been important in the latter countries. This could be for instance an increase in employment costs or services prices, with broader consumer price pressures than just those reflected in producer prices.

The estimated equations can also be used to illustrate the possible outcomes for consumer price inflation depending on two different scenarios for near-term PPI developments. First, in a continued-high-inflation scenario, the average month-on-month increase in the PPI is assumed to be equal to the average seen over the past 12 months. This corresponds to an annualised month-on-month increase of 18.5%, 17.4%, 8.2% and 11.7% for the United States, the euro area, Japan and the United Kingdom, respectively. In an alternative scenario, it is assumed that PPI increases will slow and then turn quickly negative, as has been the case when prices have spiked in the past.

- If producer prices continue to rise rapidly, as they have over the past year, the analysis suggests that in most cases headline consumer price inflation would continue its upward trend – towards 11½ per cent for the United Kingdom, 10¼ per cent for the euro area and 3½ per cent for Japan – though not in the United States, where it would hover around 6% (Figure 1.32, Panel A).
- The alternative scenario where PPI inflation slows and then turns is characterised by a declining consumer price inflation rate (Figure 1.32, Panel B). Nonetheless, inflation would still remain above central bank target rates by the end of 2022, except in Japan.

Figure 1.31. The behaviour of the PPI over the past year explains much of current headline inflation

Year-on-year percentage changes in consumer prices



Note: Inflation for April 2022 for the United States and Japan, and March for the euro area and the United Kingdom. Predicted inflation comes from dynamic forecasts from April 2021 using estimated equations for consumer price inflation that relate month-on-month price changes to month-on-month producer price changes, using seasonally-adjusted series. Further details are provided in Ollivaud (2022). Consumer prices correspond to the personal consumption deflator for the United States, the harmonised consumer price index for both the euro area and United Kingdom, and the consumer price index for Japan.
Source: OECD Database on Consumer Price Indices; OECD Database on Producer Price Indices; and OECD calculations.

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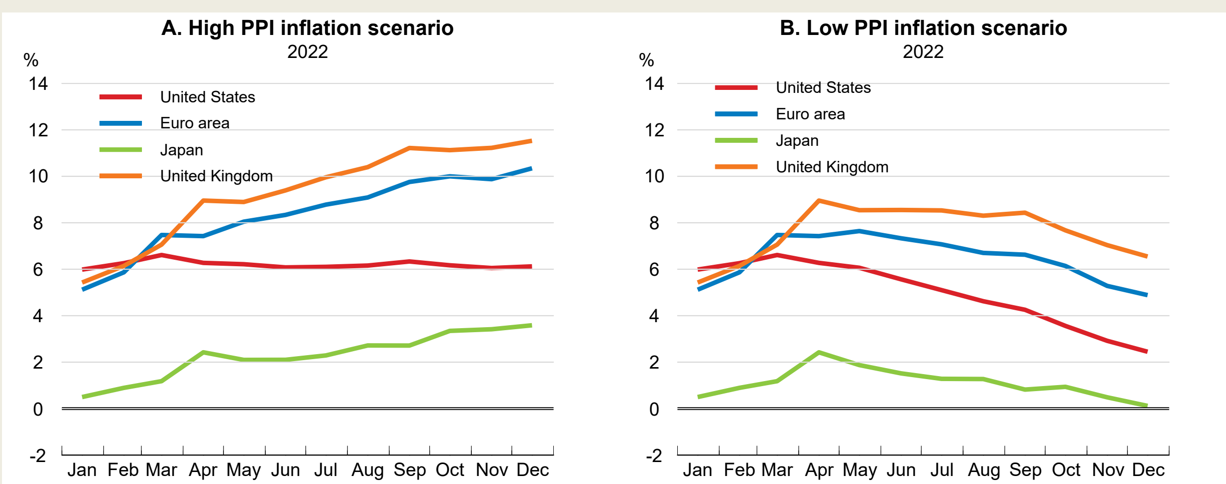
Figure 1.32. The outlook for consumer price inflation depends on the evolution of producer prices

Year-on-year percentage changes in consumer prices



Note: Paths for consumer price inflation based on dynamic forecasts from estimated equations using monthly seasonally adjusted data; see Ollivaud (2022). The "High PPI inflation scenario" assumes that the monthly increase in PPI inflation until December 2022 remains at the average over the last 12-months of historical data. The "Low PPI inflation scenario" assumes that the monthly increase in PPI inflation converges gradually to -1% (monthly rate) from its current rate. On a monthly basis, PPI inflation would then become negative from June in the United States and the euro area, and from May in Japan and the United Kingdom. The producer price index is for manufacturing: total producer prices for the United States; domestic producer prices for the euro area, Japan and the United Kingdom. See Figure 1.31 for definition of consumer prices.
Source: OECD Database on Consumer Price Indices; OECD Database on Producer Price Indices; and OECD calculations.

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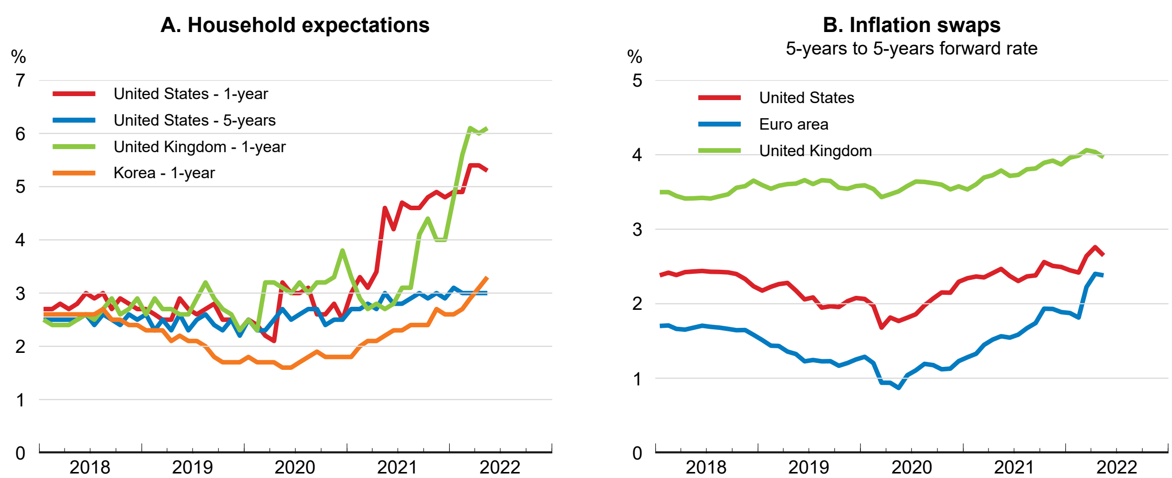
A further key area of uncertainty for the macroeconomic projections, as well as for policymakers, is the extent to which the burst of inflation that has already occurred gives rise to second-round effects, via expectations and labour markets, such that inflation becomes entrenched at above-target levels. Households' near-term inflation expectations have moved up in many economies, although other measures of expectations are more mixed (Figure 1.33). In most OECD economies with available survey measures, the inflation expectations of professional forecasters have remained close to central bank objectives (including the euro area and Canada) or below (Japan), but there has been some sign of upward drift in the United Kingdom and the United States. Financial market measures of inflation expectations (5-year, 5-year forward inflation swaps or long-term differentials between nominal bond yields and yields on inflation-linked bonds) began to drift up in 2021 and have continued to rise slowly (Figure 1.33, Panel B).

Tight labour markets could generate stronger wage growth than anticipated, especially for workers willing to change jobs and in sectors most affected by the pandemic. The risks of strong wage growth are acute in the United States (Domash and Summers, 2022), with median annual wage growth as measured by the Federal Reserve Bank of Atlanta having already risen to above 6% in April. With the current surge in inflation having resulted in a sharp and unanticipated decline in real wages, attempts to recoup these losses can be expected in wage bargains. Wage growth has started to pick up in the euro area, with area-wide negotiated wages rising by 2.8% over the year to the first quarter of 2022, and by 4% in Germany (incorporating one-off adjustments). Corporate surveys also point to a gradual pick-up as demand tightens (ECB, 2022), although household survey indicators of wage expectations have yet to show a marked acceleration in expected wage increases. Minimum wage increases are adding to aggregate wage growth, especially in Europe, with rises over over 6% likely in the EU in 2022, and particularly large increases in Germany, Greece, Hungary and the Baltic States (Eurofound, 2022).

Figure 1.33. Household inflation expectations have risen but financial market measures generally remain better anchored



Source: Refinitiv; and OECD calculations.

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Potential vulnerabilities in financial markets and emerging-market economies during policy normalisation

Higher policy interest rates, along with global inflationary pressures and a deteriorating growth outlook, could expose the vulnerabilities that have built up from higher debt and elevated asset prices. Rising financing costs, in particular, could affect the repayment capacity of firms and households in the medium term. Tighter global financial conditions and higher risk aversion, in tandem with the impacts of the war in Ukraine, also aggravate potential vulnerabilities in emerging-market economies from rising interest rates and capital flow reversals. Among the latter, commodity-importing economies face heightened fiscal and current account risks from higher global commodity prices.

Corporate indebtedness continued to rise in 2021 in many countries. In the median OECD economy, the debt of non-financial firms reached 106% of GDP in the third quarter of 2021, 15 percentage points above the 1999-2019 average. Tightening financing conditions and the progressive removal of many pandemic-related support measures, such as credit guarantees, raise concerns about corporate debt sustainability even though vulnerabilities have so far been contained. Financing costs for most companies in the largest economies have increased recently but are still moderate (Figure 1.34, Panel A), and debt service ratios remain close to, or below, their historical averages (Figure 1.34, Panel B). Healthy balance sheets and a substantial slowdown in financing needs in 2021 (after a record year in corporate loan and bond issuance in 2020) also limit immediate default risks. Firm-level data show that non-financial companies have started unwinding the very large cash buffers accumulated during the pandemic, but the amount of liquidity on large corporates' balance sheets is still substantially higher than in the fourth quarter of 2019.[16] Many large corporations also took advantage of low rates and quantitative easing during the pandemic to refinance their debt and lengthen its maturity, which will delay the speed at which higher market interest rates are reflected in debt service burdens. In the United States and Europe, the bulk of non-financial companies' debt is currently set to mature between 2026 and 2028.[17]

The risk of default for the most fragile firms currently appears contained, but concerns remain. As of the fourth quarter of 2021, the corporate default rate among speculative issuers in the United States – firms with the lowest rating – was still historically low (1.5%), and the median interest coverage ratio (ICR) among firms in this category remained higher than before the pandemic (S&P Global, 2022b). However, the resilience of the most vulnerable firms will ultimately depend on the growth and inflation outlook. Declines in household purchasing power or new COVID-19 variants could hurt sectors such as media and entertainment and consumer products disproportionately.[18] Larger-than-expected increases in interest rates could also hamper the ability of financially-stressed firms – those with ICR ratios close to or below one – to service their debt.[19] The conflict in Ukraine is also likely to weigh on firms' access to finance.[20]

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[16] For instance, the median cash ratio of all publicly listed US companies, measured as the amount of cash and equivalent as a percentage of total current liabilities, is still 7 percentage points higher (as of April 2022) than it was at the end of 2019 (S&P Global, 2022a).

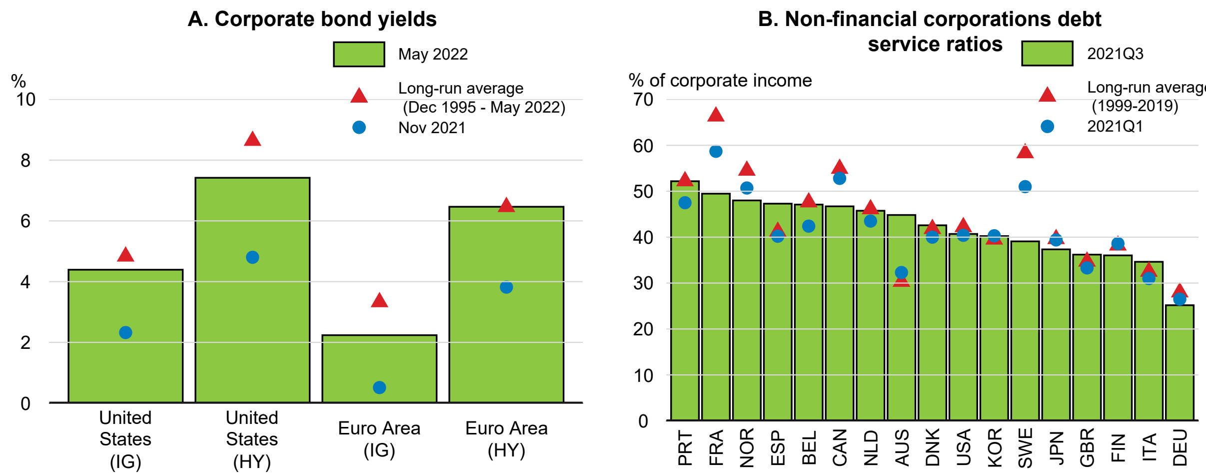
[17] Based on data based for all corporate bonds, loans, and revolving credit facilities in the United States and Europe that are rated by S&P Global Ratings as of the first quarter of 2022, with a value of around USD 9 trillion.

[18] These sectors currently contain most of the firms at risk of default in the United States.

[19] The share of firms currently reporting an ICR below one in a sample of mostly large public and private firms monitored by S&P Capital IQ in advanced and emerging-market economies is still relatively low and stable (6%).

[20] In the euro area, bank credit standards were already tightened in the first quarter of 2022 as a result of the war in Ukraine and the related uncertainty, even for small and medium-sized enterprises with no direct corporate or logistical exposure to Russia or Ukraine.

Figure 1.34. Corporate debt sustainability metrics are still favourable



Note: IG and HY refer to Investment Grade and High Yield bonds, respectively.
Source: BIS Credit Database; ICE BofA Indices database; and OECD calculations.

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There are also risks that debt service burdens could rise sharply for households. Household debt rose during the pandemic in most OECD countries (Figure 1.37, Panel A), but aggregate household balance sheets are generally healthier than they were before the pandemic, partly due to the savings accumulated in 2020 and 2021 (Figure 1.37, Panel B). Between 2019 and the third quarter of 2021, the aggregate financial net worth of households, measured relative to gross disposable income (GDI), rose by roughly 20 percentage points in the median OECD country. The sensitivity of debt service burdens to interest rates is also limited by the high share of fixed interest rates mortgages in many markets (Box 1.6). However, rising mortgage rates still carry a risk, especially for low-income borrowers in countries where monetary policy could be tightened more aggressively. With housing demand slowing due to the rise in longer-term financing costs, house prices are more likely to stabilise and could even adjust downwards. In this context, further steps could be taken to strengthen macroprudential tools to address risks to households and banks in the housing market (Box 1.6).

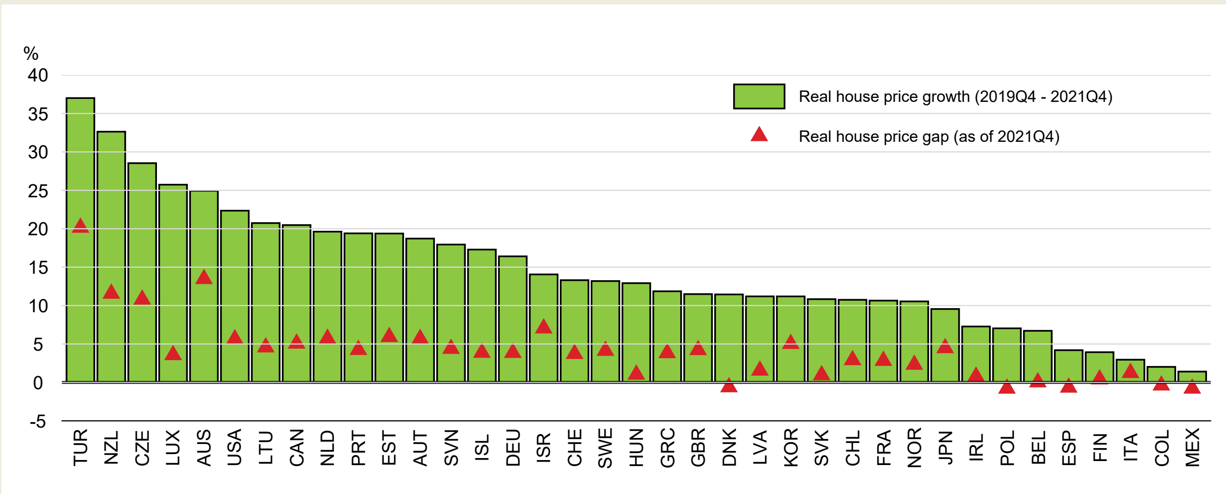
Box 1.6. Vulnerabilities in the housing sector from rising mortgage rates

House prices, along with household debt, rose steadily throughout the pandemic, even in countries in which valuations were already stretched and debt levels already high. With monetary policy now beginning to normalise, mortgage rates are increasing in many OECD countries, raising solvency concerns. However, vulnerabilities appear contained at present due to households' relatively strong balance sheets and the limited use of adjustable-rate mortgages (ARM). Still, fragile borrowers could be at risk in economies where ARM dominate, debt-service ratios are high and monetary policy is likely to tighten substantially. The potential adverse consequences for households and financial system resilience of a sharper-than-expected house price reversal also need to be prevented, primarily by macroprudential policy tools.

The pandemic pushed house prices to new heights in many countries

House prices rose strongly and quickly in most OECD countries during the pandemic. Between the fourth quarter of 2019 and the fourth quarter of 2021, real house prices rose by 13% in the median OECD economy (Figure 1.35). On average across countries, real house prices in the fourth quarter of 2021 were about 4% higher than expected based on the underlying trend prevailing before the COVID-19 pandemic, suggesting that the pandemic has exacerbated pre-existing tensions in many housing markets.[1] A range of factors can explain this strong and synchronised response of house prices. Exceptionally accommodative monetary conditions, a surge in household savings and unprecedented fiscal support all boosted housing demand during the pandemic, with housing supply temporarily curtailed by mobility restrictions and logistical bottlenecks. Higher financing costs should moderate future housing demand, helping the rise in house prices to abate. A slowdown is already taking place in several key markets, such as the United States, with home sales and prices stabilising or even declining in some large cities, due to rising mortgage rates.[2]

Figure 1.35. Real house prices rose strongly in OECD countries during the pandemic



Note: The real house price gap represented the percentage gap between house prices in 2021 Q4 and the country-specific trend estimated for each country by an HP filter. The latter is a proxy of the level house prices would have reached had the pandemic not happened. The real house price index is the ratio of the nominal house price index to the deflator of private consumption in each country. A related measure is proposed as an early warning indicator of financial vulnerabilities by Hermansen and Röhn (2016).
Source: OECD Analytical House Price database; and OECD calculations.

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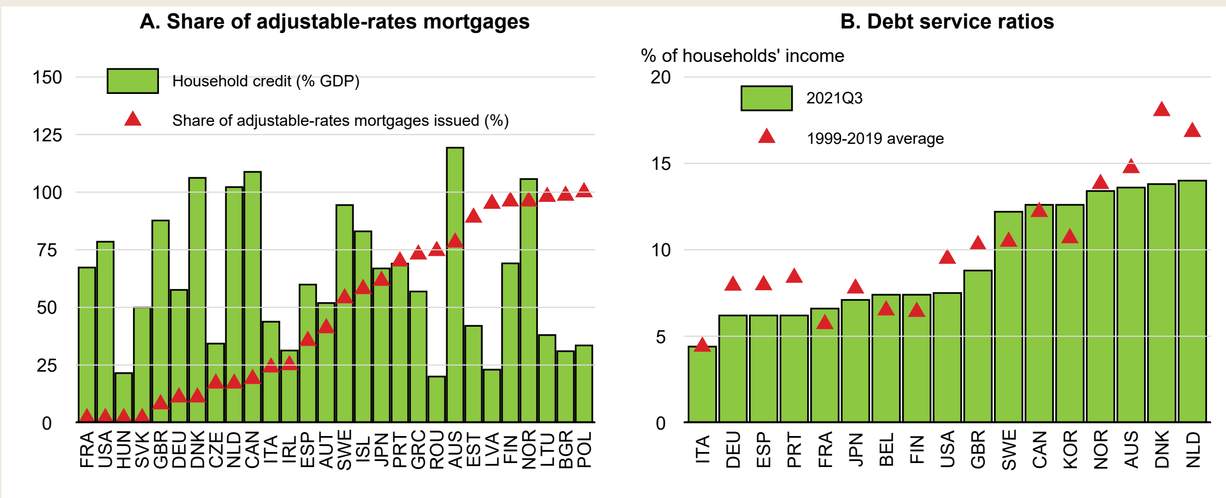
Fixed-rate loans dominate the mortgage landscape

The exposure of households to rising mortgage rates will be damped by the limited use of flexible or adjustable rate mortgages (ARM) in many OECD countries (Figure 1.36, Panel A), although there are also differences across countries in the typical period for which interest rates are fixed (van Hoenselaar *et al.*, 2021). With the exception of Japan and, to some extent, Spain, the largest mortgage markets in advanced economies are heavily dominated by fixed-rate mortgages. In contrast, ARM contracts, which have been shown to be associated with a higher probability of default on mortgages when interest rate rise (Gross et al., 2022),[3] are prevalent in several countries in Southern (Portugal and Greece), Eastern (Poland, Bulgaria, Romania and the Baltics) and Northern Europe (Sweden, Finland and Norway). If monetary policy normalisation proceeds gradually, borrowers should be protected from a sharp increase in financing costs over the medium term. Financially fragile borrowers in countries with independent monetary policies and rising inflation pressures could nonetheless experience a substantial rise in their debt servicing costs, particularly in countries where the ratio of mortgage costs to disposable income is already high for the lowest income quintile (van Hoenselaar *et al.*, 2021).

Households' savings are high and debt service ratios are still low

Household balance sheets are currently stronger than before the global financial crisis (GFC) in many countries. Stronger regulation in the aftermath of the GFC has limited the amount of risk-taking in the household sector over the last decade. In addition, the recent rise in household debt has been matched by a significant rise in household savings during the pandemic. These savings should support the repayment capacity of many households exposed to adjustable rates, especially if interest rates were to increase more rapidly than expected. Moreover, the low interest rate environment is still keeping average debt service ratios (DSR) in the household sector close or even below their long-term norms (Figure 1.36, Panel B), and significantly below what is considered a stressed DSR.[4] However, aggregate numbers might conceal important heterogeneity, and risks remain that the repayment capacity of low-income borrowers could deteriorate, given the withdrawal of pandemic income support measures and higher inflation.[5]

Figure 1.36. Fixed-rate mortgages and moderate debt service ratios limit risks in housing markets



Note: The level of household credit is measured as of 2021 Q3, and the average share of ARM at issuance in 2019 and 2020 is used to proxy for the importance of each type of mortgage in each country.
Source: European Mortgage Federation; Australian Bureau of Statistics; Mortgage Professionals Canada; Japan Housing Finance Agency; US FHFA, National Mortgage database; BIS Credit Database; and OECD calculations.

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Macroprudential policies could be strengthened further

Real estate prices might adjust more abruptly. A sharp deterioration in the growth outlook, or a sudden increase in inflationary pressures, could accelerate a correction in housing markets, with potentially damaging consequences for households’ and banks’ balance sheets. Given the large uncertainty surrounding the outlook, it is critical that there are adequate buffers in the banking sector to ensure resilience to unexpected fluctuations in property markets.

Most countries already have policies in place to limit over-indebtedness and associated risks. Following ESRB recommendations (ESRB, 2022), many European countries have recently announced increases in their countercyclical buffer (CCyB) after some relaxation during the pandemic, including some measures explicitly targeting risks in the real estate sector. For instance, Germany’s financial regulator, BaFin, proposed in January 2022 to (i) raise the countercyclical buffer on banks’ domestic exposures to 0.75% of risk-weighted assets (RWAs) from 0% and (ii) to apply an additional systemic risk buffer of 2% of RWAs specifically targeted at residential real estate mortgage loans

Preventive measures to limit further price increases, such as additional steps to lower LTVs or DSTI ratios, might also be welcome to moderate risks. Some countries have already taken steps to tighten existing tools to moderate new housing loans, while others could consider implementing those tools.[6] In addition to these macroprudential instruments, reforms in rental regulation and property taxation may also be effective means of addressing housing pressures over time. Those tools, along with stronger public investment in social housing and potential land use reforms, especially in job-rich urban areas, could ease the tensions that are still likely to prevail in the medium term (OECD, 2021b). Although the supply of new construction slowed down only moderately during the pandemic, new housing permits and starts dropped significantly in many OECD countries.[7] This gap, along with ongoing supply bottlenecks and labour shortages, is likely to amplify the structural housing shortages affecting many countries.

1. Price-to-rent and price-to-income ratios were already pointing to stretched housing valuations in many OECD countries before the pandemic and reached historic highs in almost all countries in early 2021.

2. In the United States, the Mortgage Bankers Association's Purchase Index, which tracks mortgage applications, fell 15% year on year during the week ending May 13, with mortgage interest rates having risen by 2 percentage points over the same period. In most countries, the rise in mortgage rates is not yet visible in official statistics because of reporting lags. House price growth also moderated in the first quarter of 2022 in Australia, and the Reserve Bank of Australia (2022) has estimated that a 200 basis point increase in interest rates would result in real house prices falling by around 15% over a two-year period. In Canada, mortage rates are expected to have an immediate impact on new homebuyers and only a gradual one on existing homeowners (Kozicki, 2022).

3. Gross et al. (2022) assess the sensitivity of household mortgage probabilities of default (PD) and loss given default (LGD) to changes in unemployment, house prices and interest rates using data from 21 EU countries and the United States, and find that the PDs are much more sensitive to changes in short-term interest rates in countries with a high share of ARMs.

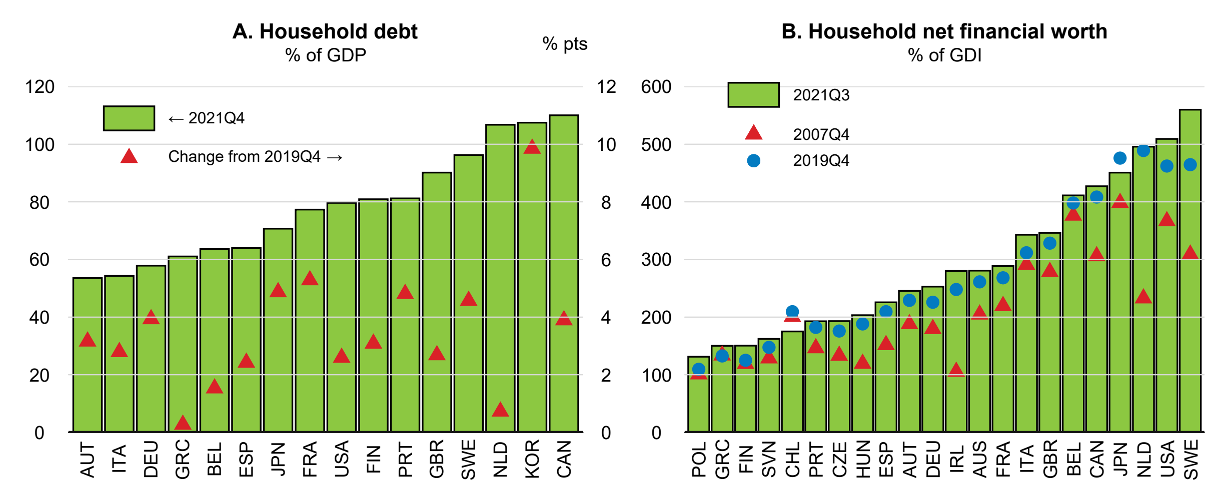
4. The notion of a stressed DSR varies across countries, but a debt service ratio above 40-50% is often considered as stressed (ESRB, 2022). The DSR data provided by the BIS (Figure 1.36) cover all types of household debt and should therefore be interpreted as an upper bound of the true mortgage repayment burden.

5. Emerging-market economies face tighter fiscal constraints than advanced economies, making it more difficult to put in place fiscal measures to mitigate the economic impact of the COVID-19 pandemic. This has led to a further increase in household debt. With household debt standing at 50% of GDP, emerging-market economies now have about the same levels of leverage as advanced economies had in 2001, just a few years before the global financial crisis, and substantial interest rate increases to address inflation are being implemented.

6. Austria's Financial Market Stability Board (FMSG) asked the country's bank supervisor and central bank in December 2021 to make its sustainable mortgage lending guidance legally binding by mid-2022. The guidance was issued in 2018 and includes a minimum down payment of 20% (equivalent to an 80% loan-to-value (LTV) cap), a debt-service-to-income (DSTI) ratio of no more than 40% and a maximum loan term of 35 years, except in exceptional circumstances. Germany could also consider formally implementing LTV and DSTI ratios, which are still missing despite the establishment of a legal framework for borrower-based instruments in 2017 (ESRB, 2022).

7. Housing permits in 2020 dropped by roughly 15%, on average, compared to 2019 in a sample of the largest OECD economies. Although in most countries permits bounced back to pre-pandemic levels in 2021, the gap in new constructions has not yet been fully offset. This will negatively affect the total supply of new homes available over the next few years.

Figure 1.37. Household debt and net financial worth in selected OECD countries



Note: In Panel A, the latest available observation for Korea is 2021 Q3.
Source: OECD National accounts database; OECD Household Dashboard; and OECD calculations.

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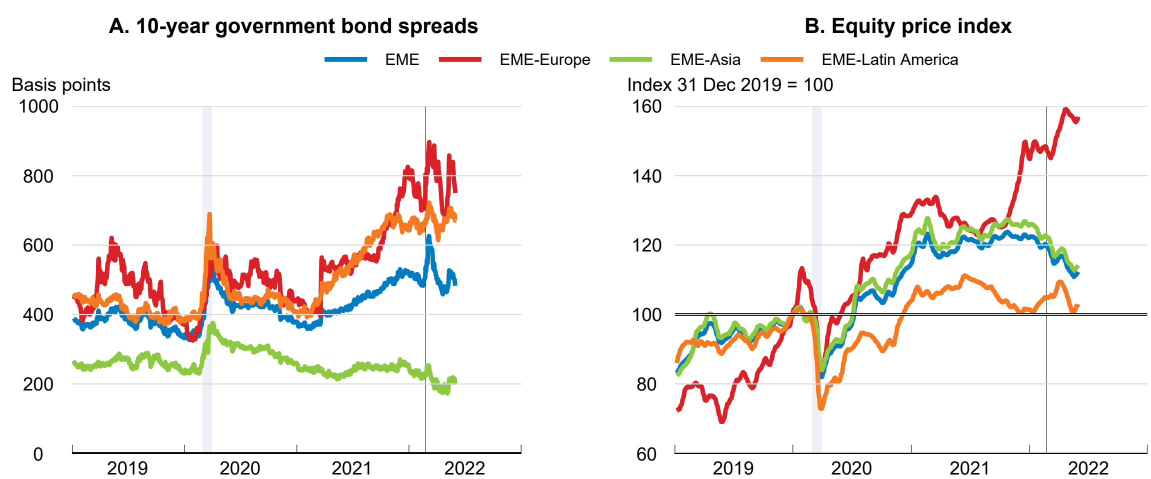
The war in Ukraine exacerbates vulnerabilities in many emerging-market economies

The Russian invasion of Ukraine has further tightened financial market conditions for commodity-importing economies and heightened concerns about emerging-market economy vulnerabilities to scarcer and more expensive financing. Higher commodity prices also compound the challenges from pre-existing inflationary pressures and put further pressure on fiscal and current account balances in commodity-importing economies (Box 1.1). Pandemic risks also linger, amidst an uneven pace of vaccination across countries and regional COVID-19 outbreaks. Emerging-market economies also remain vulnerable to capital outflows from faster and more extensive policy interest rate rises in advanced economies.

When the war in Ukraine broke out, local-currency government bond yields surged in all regions accompanied by an abrupt repricing in equity markets, reflecting a generalised increase in risk aversion. Tighter global financial conditions have also increased financial market volatility in emerging-market economies. In particular, local-currency government bond spreads have remained high in many countries, except in Asia, amid currency depreciation pressures (Figure 1.38, Panel A). Foreign-currency bond spreads have recently exceeded 10 percentage points in almost a quarter of a larger set of emerging-market and developing economies (IMF, 2022a), indicating significant sovereign borrowing difficulties. Equity prices have declined sharply in Asia, reflecting concerns about China, and been volatile in other major emerging-market economies (Figure 1.38, Panel B).

Figure 1.38. Bond and equity markets reflect substantial repricing across emerging-market economies



Note: Panel A shows the yield differential between 10-year local-currency government bonds in emerging-market economies and 10-year US Treasuries. Aggregate spreads correspond to unweighted cross-country averages. The regional equity indexes shown in Panel B are obtained by first converting individual local-currency indices to dollars and then aggregating them based on their market capitalisation weight. The shaded area in both panels denotes March 2020. The vertical line in both panels denotes 24 February 2022. “EME – Europe” covers Bulgaria, Romania and Turkey. “EME – Asia” covers China, Indonesia, India, Malaysia, the Philippines, Thailand and Vietnam. “EME – Latin America” covers Brazil, Chile, Colombia and Mexico. The “EME” aggregate covers all these countries plus Russia and South Africa. Both panels show 10-day moving averages.
Source: Refinitiv; and OECD calculations.

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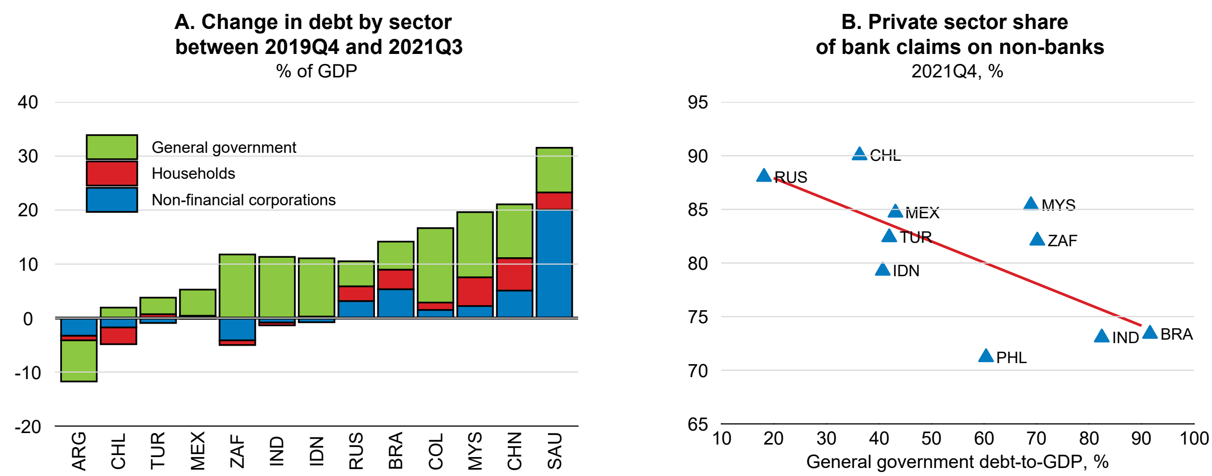
Elevated public and private debt levels and a high share of foreign-currency liabilities aggravate vulnerabilities to rising interest rates and capital flow reversals. Prior to the war in Ukraine, total debt as a share of GDP was gradually declining in the major emerging-market economies, helped by the larger-than-anticipated increase in inflation.[21] Nonetheless, the ratio of total debt to GDP, and in particular government debt to GDP, often remains well above pre-pandemic levels (Figure 1.39, Panel A). Emerging-market and developing economies issued around USD 3.5 trillion of sovereign debt in 2021, almost 40% higher than the average annual amount issued in 2017-19 (OECD, 2022b).[22] The share of foreign-currency debt in new issuance has declined considerably in Latin America and the Middle East-North Africa region, suggesting that governments have focused on domestic markets amid rising external borrowing costs. However, with high government debt typically associated with a larger share of the government in total banking sector claims, this could hamper the access of private sector borrowers to credit (Figure 1.39, Panel B). The overall share of central government debt denominated in foreign currency also remains high in Argentina, Bulgaria, Romania and Turkey, ranging between 50 and 70%. Should capital outflows from emerging-market and developing economies intensify, resulting in further currency depreciation, the debt burdens of those countries could increase significantly. Sovereign default risks, which have already materialised in Lebanon and Sri Lanka, are heightened by the sizeable (one third) share of variable-rate debt in the total external debt of the poorest countries (Estevão, 2022).

Figure 1.39. High public debt in emerging-market economies restrains lending to the private sector



Note: In Panel A, debt comprises loans and debt securities, and GDP takes the sum of the four quarters finishing in the quarter debt referred to. In Panel B, for Russia, local-currency claims on all sectors in 2021Q3 are used in the denominator due to missing data; for the remaining countries, claims on non-banks denominated in all currencies are used. Bank claims on the private sector in Panel B are calculated by subtracting bank claims on general government (collected from the IMF Sovereign Debt Investor Base database) from all claims on non-banks (collected from the BIS credit statistics except for Turkey). General government debt in Panel B follows the definition in the IMF Sovereign Debt Investor Base database and excludes intergovernmental debt.
Source: OECD Economic Outlook 111 database; BIS credit statistics; IMF Sovereign Debt Investor Base for Emerging Markets database; Banking Regulation and Supervision Agency in Turkey; and OECD calculations.

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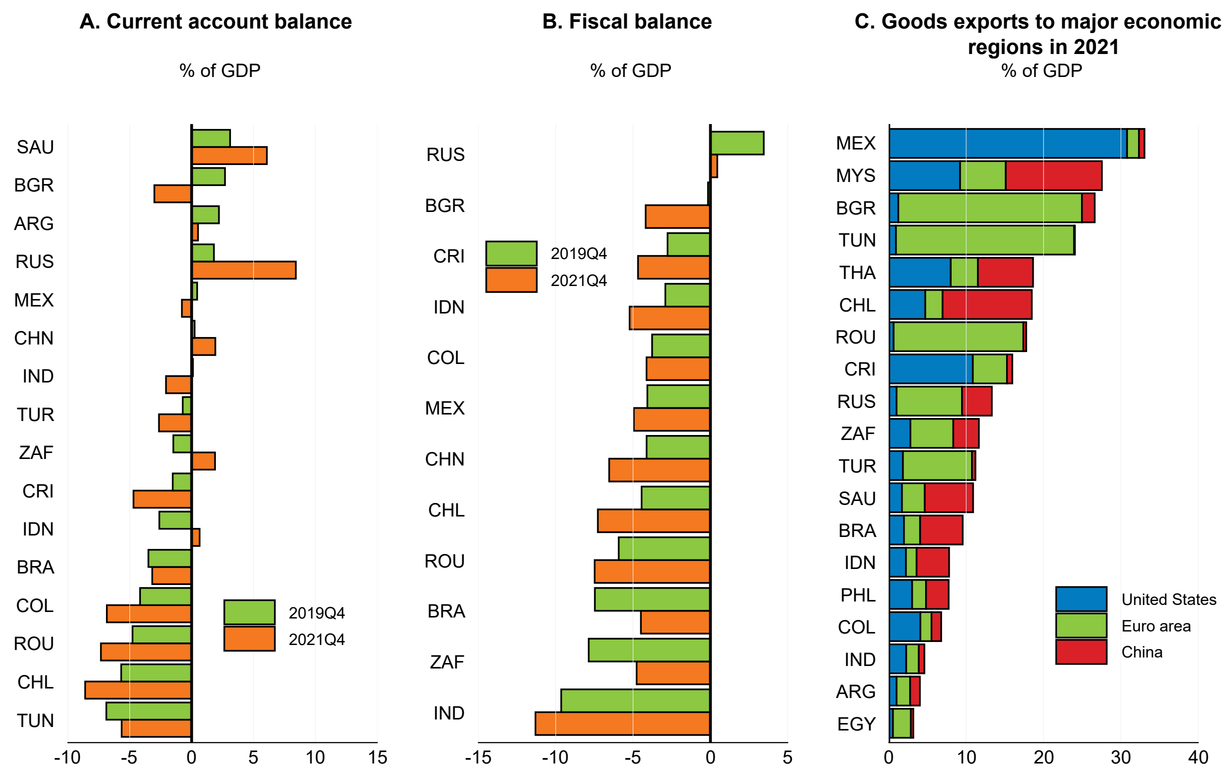
[21] If inflationary pressures persist, this mechanical effect on the debt-to-GDP ratio could rapidly reverse due to the increased cost of issuing new debt that incorporates higher expected inflation rates.

[22] Emerging Asia and China continued to account for more than half of the total issuance, and the share of Latin America issuance picked up, reflecting increasing borrowing needs.

Broad-based commodity price increases and weaker growth in major export markets add to existing macroeconomic vulnerabilities in many emerging-market economies (Figure 1.40). Higher food and energy prices raise external deficits in many countries, and disruptions to agricultural exports from Russia and Ukraine heighten food security risks if alternative suppliers cannot be found (Box 1.1). Weaker growth in the euro area – a major export market – is adding to the immediate costs from exposure to Russia in countries like Bulgaria, Egypt, Romania and Turkey (Figure 1.40, Panel C). Similarly, the gradual slowdown in the United States creates headwinds for growth in Mexico and other Latin American economies.

Figure 1.40. Commodity price shocks may worsen imbalances in some emerging-market economies



Note: Fiscal balance refers to central government net lending for Chile and general government net lending for the remaining countries.
Source: OECD Economic Outlook 111 database; IMF Direction of Trade statistics; IMF World Economic Outlook database; and OECD calculations.

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Policy requirements

Elevated uncertainty, and the implications of the war in Ukraine for growth, inflation and commodity markets add to the challenges already facing policymakers from rising inflationary pressures and the imbalanced recovery from the pandemic. Multilateral action remains vital to secure the recovery, provide the assistance needed to refugees and developing economies and durably improve prospects for sustainable and equitable growth. Monetary policy should remain focused on ensuring well-anchored inflation expectations, with normalisation proceeding at a different pace across the major economies. Temporary fiscal measures are appropriately being used to cushion the immediate impact of higher food and energy costs for consumers and businesses, but the medium-term consolidation path planned prior to the war will need to be resumed to help fund the energy transition and new priorities such as higher defence spending, especially where demand pressures are contributing to inflation.

Preserving international co-operation would help overcome the pandemic and global challenges from the war

The COVID-19 pandemic is not yet over, with risks remaining that further variants of concern could emerge. Vaccination efforts are continuing around the world, but remain limited in many countries. Only 11% of the population in low-income countries are fully vaccinated, compared with over 70% in high-income countries (WHO-World Bank, 2022). The recovery will remain precarious in all countries until vaccination levels can be raised and test and treatment capacities are improved. Global vaccine supply shortages have now largely been addressed, but effective multilateral actions are required to help overcome domestic logistical hurdles to vaccine deployment by providing technical and financial assistance, reducing regulatory barriers on vaccines and other medical products, and by keeping borders open.

Cross-country engagement and actions also remain vital to address the challenges arising from the war in Ukraine, including overcoming disruptions and supply constraints in energy and food markets, and providing humanitarian assistance to those displaced by the war. Developing economies are particularly exposed to these challenges, which come on top of the persisting scars from the pandemic in many of them. Open and accessible markets, provision of financial assistance to the most vulnerable countries and populations, and multilateral measures to maintain liquidity in global financial markets and provide effective debt relief to lower-income countries are essential to help promote a sustainable recovery in all countries. Preserving and strengthening international co-operation would also help countries progress faster towards national COP26 objectives to mitigate climate change. The Inclusive Forum on Carbon Mitigation Approaches proposed by the OECD would provide a comprehensive inventory of policy actions and best practices worldwide, and help to compare the effectiveness of policies in different country circumstances.

The war in Ukraine is also adding significantly to pre-existing food security issues. Prior to the war, over 800 million people worldwide were already estimated to be facing hunger (FAO, 2021), with the numbers rising due to the impact of other conflicts, climate change and the pandemic. Ongoing disruptions to agricultural exports from Russia and Ukraine could result in serious shortages in many developing economies, especially in Africa and the Middle East and Central Asia, and exacerbate food price increases that are already weighing on vulnerable social groups. The food supply shock could be further compounded by fertiliser shortages (Box 1.1). To monitor and mitigate such risks, co-ordinated actions are needed urgently to provide emergency food supplies and the assistance necessary to facilitate crop planting and transportation, including in Ukraine, tackle logistical barriers limiting the supply of food to importing economies, and refrain from export restrictions of food and other agricultural products.

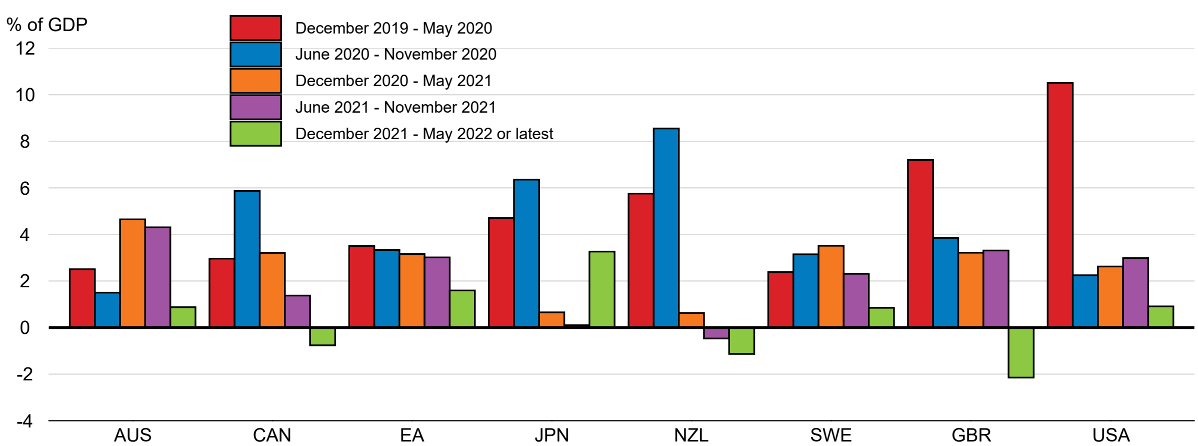
The pace of monetary policy normalisation should vary across economies

The impact of the war in Ukraine has added to the difficult choices already facing monetary policymakers. Ahead of the invasion, inflationary pressures were already proving stronger and more persistent than anticipated, albeit to a different extent and for different reasons across the major advanced economies. Recent months have thus seen steps towards monetary policy normalisation by many central banks. Policy interest rates are now being increased in a growing number of major economies, and net asset purchases have been halted or further reduced in most jurisdictions (Figure 1.41). Several central banks have also started to discuss or implement strategies for balance sheet reduction, either passively (by not reinvesting the proceeds of maturing bonds) or actively (through asset sales). In most jurisdictions, these changes could proceed more rapidly than expected in the event of further upside inflation surprises or stronger signs of a durable rise in underlying cost and price pressures.

- In the United States, the Federal Reserve began to increase the target for the federal funds rate in March. As of June, the Federal Reserve is also starting to reduce its holdings of Treasury securities, agency debt and agency mortgage-backed securities by reinvesting principal payments only if they exceed a monthly cap.[23]
- The ECB ended net asset purchases under the Pandemic Emergency Purchase Programme in March, and has signalled that it expects those under the remaining Asset Purchase Programme (APP) to be concluded early in the third quarter of 2022.
- The Bank of England, the Bank of Canada and the Reserve Bank of Australia have ceased to reinvest the proceeds of maturing bonds in recent months and have all raised their main policy rates.

Figure 1.41. Quantitative tightening has started in some countries

Central banks' net bond purchases in advanced economies



Note: For Canada and New Zealand latest available data is for April 2022. Data covers both private and public assets. Private assets include corporate bonds, commercial paper, asset-backed securities and exchange traded funds. General government bonds are treasury bills and municipal, state and central government bonds.
Source: Reserve Bank of Australia; Bank of Canada; Bank of England; European Central Bank; Bank of Japan; Reserve Bank of New Zealand; Sveriges Riksbank; US Federal Reserve; and OECD calculations.

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[23] For Treasury securities, monthly caps for balance sheet reduction are set at USD30 billion for the first three months of quantitative tightening and then at USD60 billion. For agency debt and mortgage-backed securities, the corresponding caps are set at USD17.5 billion and USD35 billion.

Given the uncertain duration and magnitude of the adverse supply shock from the war, and above-target inflation, monetary policy should remain focused on ensuring well-anchored inflation expectations and intervene if necessary to ensure the smooth functioning of financial markets and transmission of monetary policy. Central banks will have to conduct a delicate balancing act between keeping inflation under control and maintaining the post-pandemic economic rebound, especially where the recovery is not yet complete. The case for a steady policy tightening is stronger in those economies, such as the United States or some central European countries, where the recovery from the pandemic is essentially complete and signs of excess demand and durable inflation pressures were already apparent before the most recent commodity price surge. In contrast, removing accommodation more gradually is appropriate in countries where core inflation is moderate, wage pressures have yet to pick up and the growth outlook has deteriorated considerably because of the Ukraine conflict. Transparency and clarity in central bank communication will be critical. Increases in policy interest rates should remain data-dependent so that central banks can respond to unexpected developments in activity and labour markets, financial conditions and the broader inflation outlook without endangering financial stability. The importance of data-dependence is greatest in the economies most affected by the war in Ukraine.

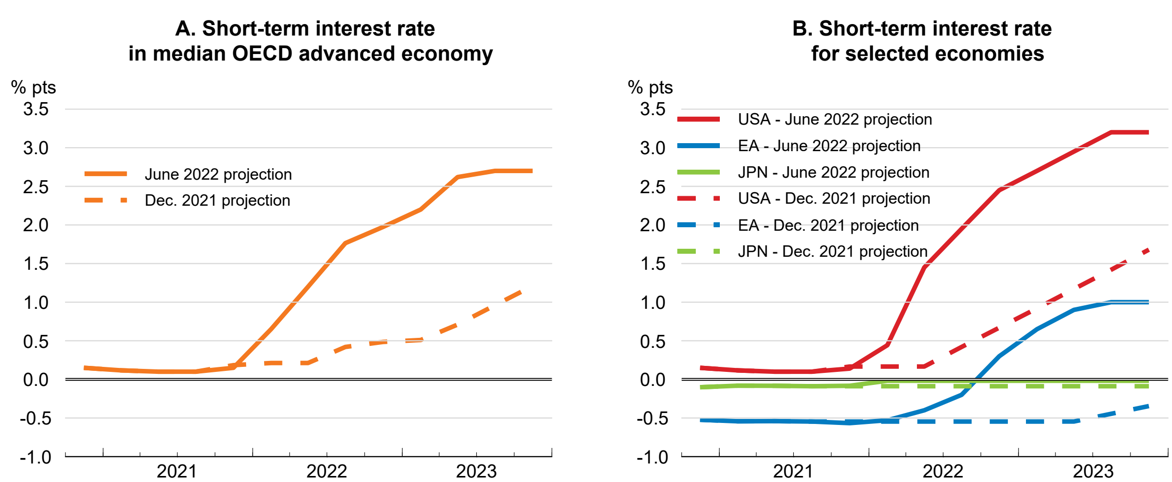
Monetary policy normalisation is projected to continue over the next 18 months in most jurisdictions, at a faster pace than anticipated in late 2021 (Figure 1.42). However, its speed and strength are expected to vary widely across regions, given the different prospects for inflation and growth. The advanced economies differ substantially in terms of domestic underlying macro-economic conditions and exposure to external shocks such as the war in Ukraine. This heterogeneity, combined with exceptionally large uncertainty surrounding the growth and inflation outlook, translates into very different paths for monetary policy:

- In the United States, where the recovery is well advanced, and core inflation is over 5%, the federal funds rate is projected to be raised swiftly to 2¼-2½ per cent by end-2022 and to 3-3¼ per cent by end-2023. The reduction in asset holdings is expected to proceed steadily over the projection horizon by reinvesting payments from maturing securities only partially. Long-term interest rates on government bonds are also projected to tighten, reaching 3.8% by end-2023.
- In the euro area, net asset purchases are projected to end early in the third quarter of 2022, with the deposit rate raised from -0.5% to 1% by the second quarter of 2023 and the main refinancing rate raised from 0% to 1.5%. Maturing bonds are expected to be fully reinvested over the projection period, keeping the size of the ECB’s balance sheet unchanged. The ECB should make use of all margins of flexibility when reinvesting the proceeds of maturing bonds, particularly assets acquired under the pandemic emergency purchase programme, to limit financial fragmentation in the euro area.
- With Japan facing still-mild underlying inflationary pressures and only a small direct exposure to the Ukrainian conflict, the Bank of Japan is projected to maintain its current accommodative stance focused on yield curve control over the projection horizon, with no change in policy rates being assumed.
- Other major central banks are expected to tighten their policy stance further over the projection horizon, albeit at a different pace and with different end-points. The Bank of England is projected to increase its policy rate to 2.5% by mid-2023 and to continue to reduce the size of its balance sheet. The Bank of Canada is assumed to raise its policy rate steadily to 2.5% by early 2023, and to continue passive quantitative tightening throughout the projection period.

The scale and impact of quantitative tightening (QT) plans remain uncertain. Most central banks have, or will soon have, ended asset purchases, and many have begun to stop reinvesting the proceeds of maturing assets, but few have yet indicated whether assets will be sold actively or communicated the terminal size of their balance sheets. The main economic impact of quantitative easing has occurred through reductions in bond yields and increases in asset prices. Quantitative tightening is likely to reverse this, with some upward pressure on bond yields and downward pressure on asset prices, particularly if active asset sales take place. The extent of such adjustments will depend on whether asset disposals occur in a gradual and predictable manner, as planned by the major central banks, and the overall scale of balance sheet reduction.

Nonetheless, the impact of reductions in the balance sheet may be smaller than the past impact of asset purchases (Pill, 2022). Discretionary asset reductions imply that financial markets are functioning well (as they would not occur otherwise), whereas the benefits of QE have arisen partially from improvements in market liquidity at times when financial markets were not functioning smoothly. QE policies also had significant effects by signalling the implementation of a more accommodative monetary policy stance at a time when policy interest rates were at or close to their effective lower bound. This signalling channel is likely to be less important during QT, with increases in policy interest rates and their future expected path used as a timely and clear signal of a change in the monetary policy stance. Normalisation strategies may however still vary across economies. In contrast to the United States, monetary policy in the euro area will have to be mindful of fragmentation risks, and take steps to address these if necessary, since QT announcements might tighten the monetary stance disproportionately in some economies.[24]

Figure 1.42. Monetary policy normalisation is gathering pace



Note: In Panel A, lines report the rate for the median advanced economy (AE). AEs include Australia, Canada, the Czech Republic, Denmark, the euro area, Hungary, Iceland, Israel, Japan, Korea, New Zealand, Norway, Poland, Sweden, Switzerland, the United Kingdom, and the United States. Short-term interest rates refer either to the 3-month money market rate or the 3-month treasury bill rate, depending on the country.
Source: OECD Economic Outlook 111 database; OECD Economic Outlook 110 database; and OECD calculations.

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[24] Asset purchases have also been shown to affect perceived credit risk in the euro area (Motto and Ozen, 2022). In this context, QT announcements could be interpreted by market participants as signalling a withdrawal of insurance against fragmentation risk, inducing wider spreads across countries in the euro area.

Fiscal policy support should be contingent on the state of the economy

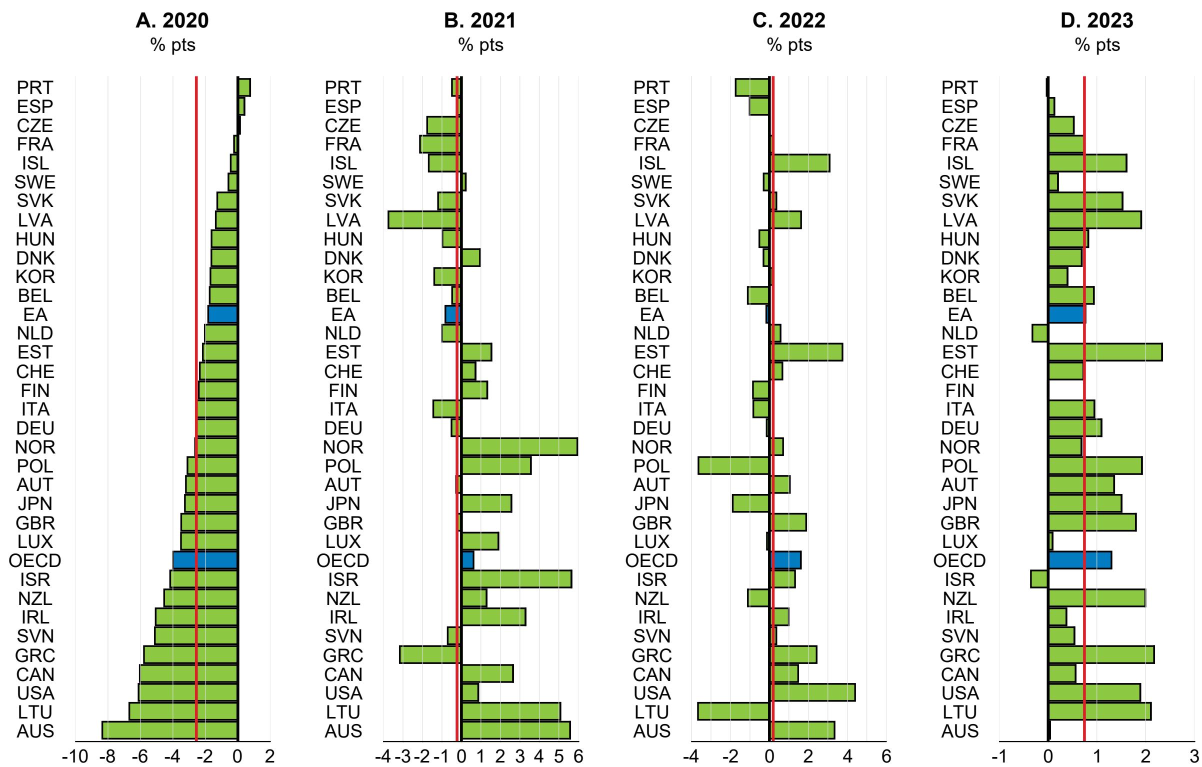
Fiscal consolidation plans for the current year have been reconsidered in many countries due to the war in Ukraine and soaring energy prices. Countries have continued to withdraw pandemic-related support measures, but also are addressing new immediate budget priorities. These tend to be more acute in Europe, including the costs of shielding households and companies from surging energy and food prices (discussed below) and of providing for Ukrainian refugees. The latter costs are highly uncertain, but available estimates point to amounts of around 0.2% of EU GDP in 2022 (Box 1.2), largely financed by EU funds. With a few exceptions, such as Poland and some Baltic countries, national Stability or Convergence Programmes suggest similar or even smaller estimated costs.

Fiscal projections for 2022-23 are conditional on announced government measures and OECD assessments of current plans (Annex 1.A.). In the median OECD economy, the fiscal stance is estimated to be broadly neutral in 2022, with the underlying primary balance increasing by 0.2% of potential GDP in 2022, before rising by 0.7% in 2023 (Figure 1.43). Relative to expectations in late 2021, this implies a considerable slowdown in the pace of consolidation in the current year:

- In the United States, fiscal policy assumptions are based on legislated measures only and imply substantial fiscal tightening, with the underlying primary balance projected to improve by over 6% of potential GDP over 2022-23. The withdrawal of pandemic-related support measures, many of which expired in the course of 2021, is expected to outweigh the additional public investment in 2022-23 under the Infrastructure Investment and Jobs Act.
- In the euro area, the fiscal stance is projected to remain broadly neutral in 2022. The unwinding of measures introduced during the pandemic is expected to be offset by support for energy consumers and refugees and stimulus from the implementation of Next Generation EU (NGEU) plans. The projected overall absorption of NGEU grants until the end of 2023 remains in line with expectations in late 2021, exceeding 0.5% of euro area GDP in 2022-23. In 2023, fiscal consolidation of 0.8% of potential GDP is expected, mainly driven by the withdrawal of support to energy consumers and the full termination of COVID-19-related measures (which sometimes were still in force in early 2022).
- In Japan, the fiscal projections reflect the economic package announced in late 2021 and legislated in the FY2021 supplementary budget and the FY2022 initial budget, complemented by more recent temporary measures to support vulnerable households and businesses. The ensuing discretionary fiscal expansion, estimated at close to 2% of potential GDP in 2022, is expected to be largely reversed in 2023 as the stimulus measures expire.

Figure 1.43. New budget priorities have often moderated consolidation efforts

Change in the underlying primary balance, in per cent of potential GDP



Note: Vertical lines indicate the median for the available OECD economies.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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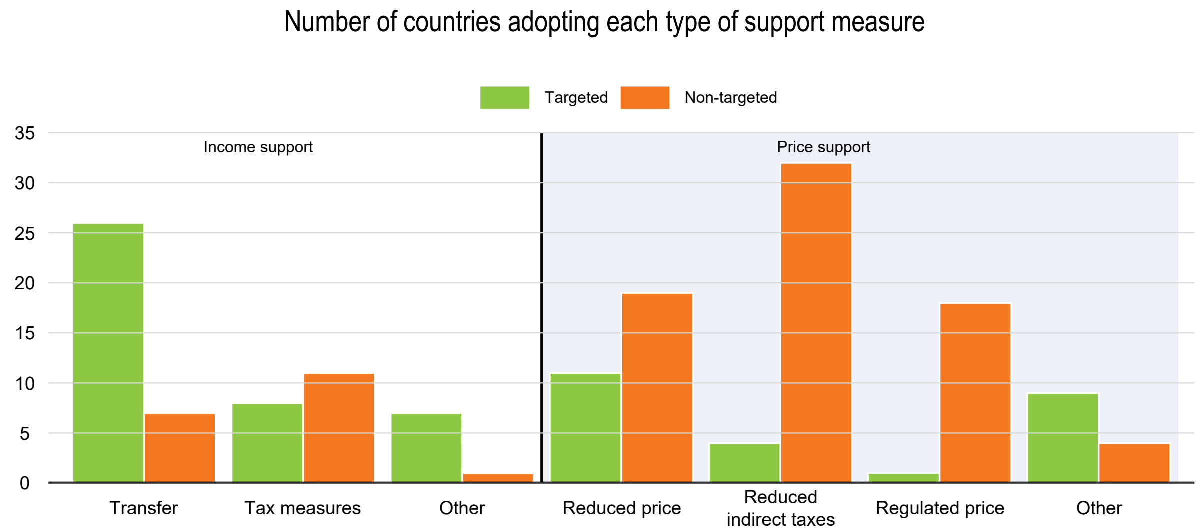
In the short term, fiscal policy should tackle the adverse distributional impacts of higher energy prices whilst avoiding adverse effects on the sustainability of the public finances or the transition to carbon neutrality. Given the acceleration of energy prices this year, countries, especially in Europe, have put in place a wide range of measures to support energy consumers (Figure 1.44), with budget costs in 2022 projected to exceed 1% of GDP in France, Germany and Italy. To help finance those costs, a number of European countries have enacted windfall profit taxes on energy companies. Policy action to help cushion the impact of higher energy prices should be well-targeted, not outlast the period of exceptional price pressures and avoid weakening price signals. Additional means-tested transfers to households while high prices persist generally meet these criteria, though finer targeting mechanisms that go beyond income, should be developed (OECD, 2022c). In contrast, lower taxes on energy or price controls, which have been the most widely used forms of support, tend to be untargeted. These measures are often administratively simpler and faster to implement, and help preserve aggregate household disposable income, an appropriate policy goal in economies where demand is still recovering from the pandemic. However, untargeted price support should not stay in place for more than some months due to the high fiscal costs involved and the need to avoid damaging incentives to reduce energy consumption and undertake the investments required to improve energy efficiency and develop alternative sources of energy.

Figure 1.44. Support to energy consumers has been widespread and diverse



Note: The figure is based on data collected for 35 OECD member states plus Bulgaria, China, India and Romania up to 30 May 2022. Support measures fall under two categories: income support (including lump-sum transfers to consumers) and price support measures, which lower energy prices paid by consumers. For income support, 'Other' includes loan guarantees for energy companies. For price support, 'Other' includes energy market regulatory changes. Targeted measures resort to means-testing or benefit only certain categories of consumers based on their energy consumption and other criteria. Non-targeted measures apply to all consumers with no eligibility conditions.
Source: OECD calculations.

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Fiscal policy should also take account of potential interactions with monetary policy and help, when appropriate, to moderate inflation pressures. Price support measures for energy consumers decrease inflation in the short run and may thus help anchor inflation expectations, but their necessary withdrawal after a limited time span could rekindle price pressures. In countries where inflation is particularly high and there are signs of excess demand, such as the Baltic countries or Central and Eastern European economies, a tighter fiscal stance should play a role in countering demand pressures, especially in the absence of an autonomous monetary policy. Given that those countries are often welcoming large numbers of Ukrainian refugees and, in some cases, plan to increase defence spending soon, tighter fiscal policy calls for expenditure restraint elsewhere or for higher taxes.

Over the medium and long term, the conflict in Ukraine is raising new fiscal priorities and thus reinforcing the need to change the composition of the public finances. In Europe, many countries are planning to increase expenditure on defence. Higher spending targets have often been set for well beyond the end of the projection horizon, but in a few countries, such as Germany and Poland, a large increase (in the range of 0.5 to 1% of GDP per year) has been announced already for 2022-23. In addition, the goal of reducing reliance on fossil fuel supplies from Russia has lent new urgency to investments in clean energy and energy efficiency, whose budgetary costs go clearly beyond NGEU grants (OECD, 2021a).[25] As an alternative to increasing tax burdens, countries will need to revisit the allocation of public spending across budget items and functional areas, and seek to reduce outlays which tend to be detrimental to growth,

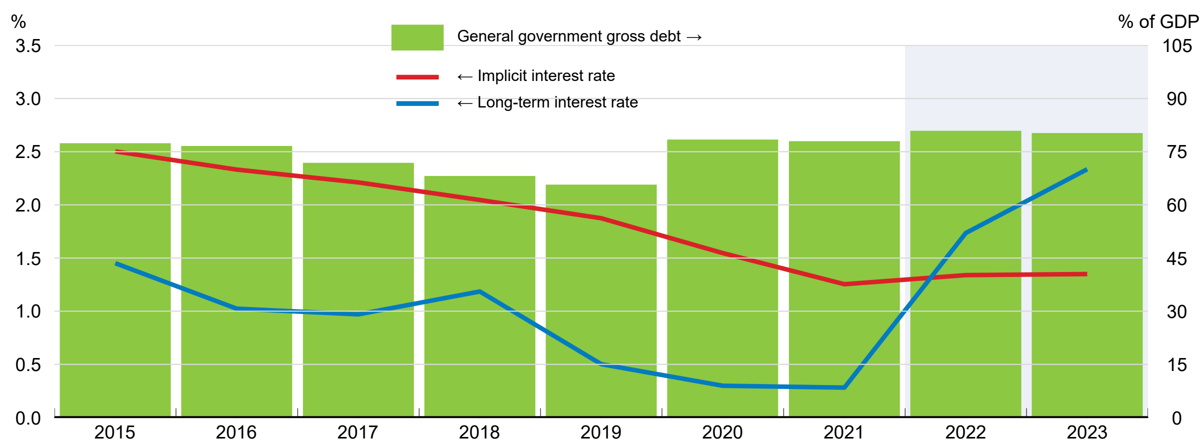
[25] Encouragingly, spending on environmentally positive measures rose to around 33% of total COVID-19 recovery spending by end-2021 (from 21% by mid-July) in OECD member countries, the European Union and selected large economies, though the share of spending with mixed or negative environmental impacts also increased somewhat (OECD, 2022d).

such as subsidies, while ensuring compensating measures to prevent adverse impacts on inequality. Achieving efficiency gains in spending should also be a priority, which for both defence and clean energy spending may require coordination across countries, be it within military alliances and procurement programmes, or as regards grid and recharging infrastructure.

Beyond 2023, rising debt service burdens are also likely to compound challenges for the public finances. After declining for several years, implicit interest rates on public debt are now levelling out over the projection horizon, as ongoing and expected monetary policy normalisation pushes up long-term interest rates (Figure 1.45). The eventual upward pressure on debt service burdens in the medium term will ultimately be heightened by elevated public debt levels (Rawdanowicz *et al.*, 2021). Credible fiscal frameworks with strong national ownership can provide clear guidance to citizens and markets about the medium-term trajectory of the public finances and help implement reforms to public expenditure.

Figure 1.45. The implicit interest rate on public debt is bottoming out

Interest rates and public debt in the median OECD advanced economy



Note: The implicit interest rate is defined as general government interest payments divided by general government gross financial liabilities at the end of the preceding year.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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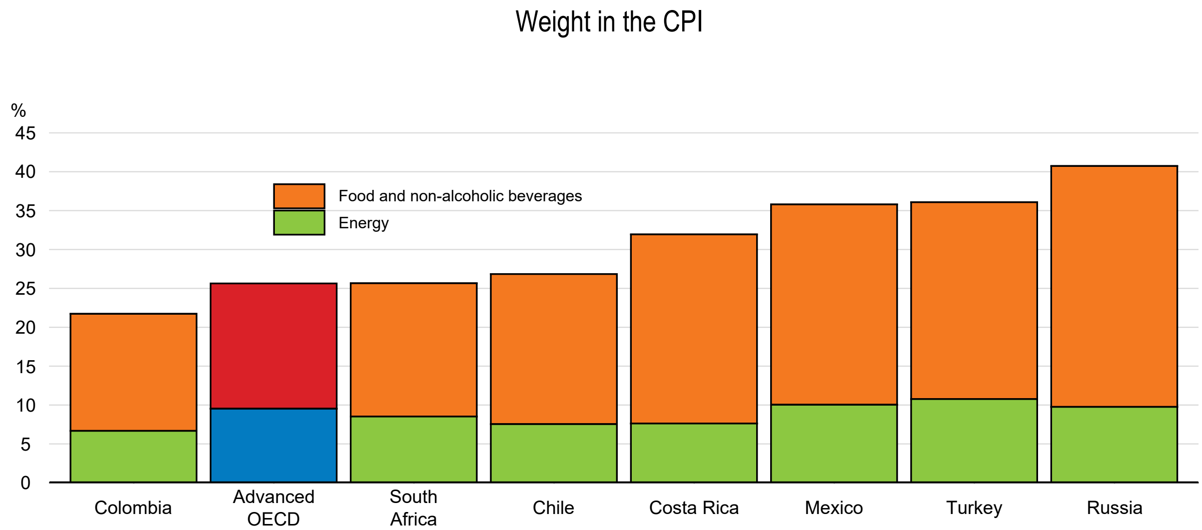
Emerging-market economies have limited scope for additional policy support

Persistent inflation pressures in many emerging-market economies, where food has a large weight in spending and consumer prices (Figure 1.46), and the ongoing policy normalisation in advanced economies have led to multiple policy rate increases in recent months despite continued economic slack. These factors will likely prompt further monetary policy tightening in the remainder of 2022. In 2023, rate increases are projected in some emerging-market economies, with policy rates remaining at high levels in many others. Inflation expectations in many emerging-market economies are often more sensitive to inflation shocks, and thus less well-anchored, than in advanced economies (Ha *et al.*, 2022). Given the large potential impact of food and energy price increases on wage demands and inflation expectations, central banks in emerging-market economies have tightened policy in response to surging headline inflation, even if core inflation developments have been more moderate. Additional monetary policy tightening should be accompanied by clear communication and careful adjustment of the pace of the tightening to re-anchor inflation expectations. Countries with low public debt-to-GDP ratios should ensure that the pace of policy tightening is strong enough and frontloaded to contain inflation expectations, with rising interest rates less likely to put public debt sustainability at risk.

Figure 1.46. Food and energy shares in consumption are large in emerging-market economies



Note: CPI weights follow the 2018 COICOP classification for Costa Rica and the 1999 COICOP classification for the remaining countries. Data as of 2017 for Russia, and as of 2021 for the remaining countries. "Advanced OECD" refers to an unweighted average across OECD member countries, excluding Chile, Colombia, Costa Rica, Mexico and Turkey.
Source: OECD Database on Consumer Price Indices.

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The pace and extent of policy rate increases is expected to continue to vary widely across major emerging market economies. In Latin America, policy tightening has been frontloaded, given the inflationary effects of supply-chain disruptions in Mexico, the need to strengthen the macroeconomic policy framework and offset very high inflation in Argentina, and inflationary pressures in Brazil stemming from an acceleration in energy and food price increases. In India, after an initial rise in May 2022, policy rates are projected to increase further amid persisting inflationary pressures. In contrast, monetary policy tightening in Indonesia is projected to be only limited, helped by milder inflation pressures. Reductions in reserve requirement ratios and benchmark interest rates have recently taken place in China to address the slowdown in growth, but no additional monetary policy easing is projected. In Turkey, policy rates are projected to stay unchanged given the authorities' commitment to an accommodative monetary policy stance, even though negative real policy rates could increase currency volatility and add to inflationary pressures.

The scope for additional fiscal support to protect vulnerable consumers from more expensive food and energy is limited in many emerging-market economies, with fiscal deficits often still considerably above their pre-pandemic levels (Figure 1.40, Panel B). Rising financing costs also decrease the room for manoeuvre in commodity-importing countries. For instance, sizeable social transfers and VAT reductions introduced to offset the effects of rising commodity prices may put fiscal sustainability at risk in Turkey.[26]

Commodity-exporting countries, whose budgets often benefit from higher commodity prices, need to strike a balance between restoring sound public finances and using windfall revenues to complete the recovery from the pandemic and support vulnerable citizens. For example, in South Africa, financing the prolongation of social programmes created during the pandemic with the surge in fiscal revenues is projected to support household incomes while preserving debt sustainability. In contrast, fiscal policy is

[26] The exchange-rate guarantee scheme, created in December 2021 to protect local-currency deposits from possible currency depreciation, may also give rise to large fiscal liabilities.

projected to be expansionary in Brazil, with spending pressures from forthcoming presidential elections going beyond windfall revenues.

Potential medium-term implications of the war

There are also some possible longer-term consequences from the war, including pressures for higher spending on defence in Europe and elsewhere, changes to the structure of energy markets, potential fragmentation of payment systems, reformulation of supply chains, and shifts in the composition of foreign exchange reserves. A re-division of the world into blocs separated by barriers would sacrifice some of the gains from specialisation, economies of scale and the diffusion of information and know-how. These changes would diminish the efficiency gains from having a global trade and financial system with a single dominant reserve currency.

Enhancing energy security via new sources of supply and a stronger push to low-carbon sources

The current crisis has highlighted the issue of energy security in the longer term, with many OECD countries still heavily reliant on fossil fuel energy and supply from Russia, as well as the need to hasten the transition to net zero emissions by 2050 (IEA, 2021a). Energy security concerns many aspects: energy system disruptions (extreme weather conditions or accidents), short-term balancing of demand and supply in electricity markets, regulatory failures and the reliability of supply from producers of fossil fuel resources. Energy systems have also become more interconnected across the world. This brings new opportunities but also challenges.

There is an inextricable link between energy security and climate change, as energy represents between half and two-thirds of total greenhouse gas emissions. The efforts needed to carry through on the pledge to net-zero emissions by 2050 are important (IEA, 2021b), notably to address future emissions of existing energy-related infrastructure – power and industrial plants, buildings and vehicles. In the longer term, OECD countries should reduce their overall reliance on fossil fuel imports by providing appropriate incentives to move away from fossil fuels and investing significantly in clean energy and energy efficiency. In Europe, improving the interconnection among domestic electricity grids can reduce energy costs and improve security. Improved storage capacity and diversification of energy sources will be necessary to limit volatility in oil and gas markets during the energy transition.[27]

There is no single policy mix to successfully achieve decarbonisation, given differences across countries in industrial structure, preferences and fiscal constraints. A mix of policy actions including effective carbon pricing, changes in standards and regulation, and structural reforms will be needed to reduce emissions at a minimum cost and facilitate the reallocation of resources towards low-carbon activities (D’Arcangelo et al., 2022). More generally, a strategic clean energy transition should aim to reduce vulnerabilities along the way, and be coupled with investment in innovation to develop the technologies needed for net-zero. Public acceptance of such policies will also be vital, as many poorer households face hard consumer choices when prices surge. Steps to improve funding for green infrastructure and low-carbon policies would help to improve public acceptance, together with appropriate redistributive policies that provide help to the most affected households.

[27] In Europe it may also be necessary in the short run to use more nuclear and carbon-intensive energy sources than planned to offset the reliance on supplies from Russia.

Restructuring global-value chains could have costs

The COVID-19 crisis has put global value chains (GVCs) under high pressure and the war in Ukraine is adding further stress, testing the resilience of a production model grounded on international fragmentation and just-in-time logistics. This raises questions about a possible reconfiguration of supply chains, and the use of suppliers at less distant locations in order to shift the balance between the security of supply and efficiency considerations. Global value chains can be an effective means of expanding supply quickly when needed, as seen during the pandemic with the production of vaccines and personal protection equipment. At the same time, global production sometimes relies on critical raw materials or components sourced from just a few countries – an arrangement that can quickly become a vulnerability if geopolitical tensions rise and key suppliers are based in countries that have very different geopolitical priorities.

Improving security by adjusting the configuration of GVCs could reverse some of the efficiency gains from globalisation. Specialisation and economies of scale have brought productivity gains as well as lower production prices (Andrews *et al*, 2018; Pain *et a*l., 2008). Such gains could dissipate if production is moved to more secure but costlier locations. Model simulations (Arriola *et al*., 2020; IMF, 2022b) show that less diversified supply chains and greater economic fragmentation would harm efficiency, and also economic stability when shocks are primarily domestic rather than global.

Governments still need to ensure that trade operates as efficiently as possible within supply chains, wherever they are located. Investment policies to modernise digital and physical infrastructures would improve trade logistics and reduce bottlenecks along production chains. Enhanced regulatory flexibility can facilitate innovation and supply diversification, and support resilience. More broadly, reducing unnecessary heterogeneity of technical standards that underlie regulations and non-tariff measures can facilitate easier substitution between alternative suppliers and help in cushioning shocks (Arriola *et al*., 2020).

Financial sanctions could lead to the development of alternative payment systems

The US dollar remains the dominant currency used in international trade, financial markets and in official foreign exchange reserve holdings (OECD, 2018; Bertaut *et al*., 2021). However, the financial sanctions now placed on Russia by the major advanced economies, which come on top of earlier sanctions imposed on Iran and Russia in 2014, raise the risk of greater fragmentation over time in cross-border payments and payment systems. In the short term, the exclusion of many Russian banks from the SWIFT payment messaging system will make financial transactions slower and more expensive for Russian institutions, and ultimately for their customers (firms and households). Although banks affected by sanctions can still request other banks to settle in US dollars on their behalf, doing so would significantly reduce the efficiency of cross-border payments (Berner *et al*., 2022). Banks may also be reluctant to undertake such transactions if there are risks of US secondary sanctions on banks in third countries undertaking dollar transactions.

In this context, an acceleration of the existing separate efforts by Russia and China to develop alternative payment systems is to be expected, especially for renminbi-denominated transactions.[28] To date, these systems do not have the same global reach as SWIFT. Nonetheless, their development could diminish the efficiency gains from having a single global system, and potentially reduce the dominant role of the US dollar in financial markets and cross-border payments (Arslanalp et al., 2022). However, important technical and political constraints remain. Although China's Cross-border Interbank Payment System (CIPS) can settle and clear cross-border payments, unlike SWIFT, it does so only for

[28] The financial committee in Russia's lower house of parliament already announced in March 2022 that the central banks of the two nations, Russia and China, were "establishing cooperation" between their respective financial messaging systems, the Russian System for Transfer of Financial Messages (SPFS) and the Chinese Cross-Border Interbank Payment System (CIPS).

renminbi-denominated transactions.[29] At present the renminbi accounts for only a small share of global transactions, and less than 4% of official foreign exchange holdings, although its use is growing due to China's greater size and the rising importance in global trade. However, the current scope and size of CIPS is not sufficient to replace Russia's lost access to the international financial system and incentives to hold renminbi in official reserves are limited by the lack of full convertibility.

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[29] The use of the renminbi in global payment systems is currently limited. As of January 2022, the renminbi represented only 3.2% of global payments reported in SWIFT and less than 2% in global trade finance (S&P Global, 2022).

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Annex 1.A. Policy and other assumptions underlying the projections

Fiscal policy settings for 2022-23 are based as closely as possible on legislated tax and spending provisions and are consistent with the growth, inflation and wage projections. Where government plans have been announced but not legislated, they are incorporated if it is deemed clear that they will be implemented in a shape close to that announced.

Projections for the EU countries account for spending financed by the Next Generation EU (NGEU) grants and loans, based on expert judgments about the distribution across years and different expenditure categories and informed by officially announced plans where available. NGEU grants are assumed to be budget neutral, i.e. they increase both capital tax and transfers receipts and government expenditure. In addition, positive net one-offs are added in order to reflect the discretionary stimulus associated with those grants, as measured by changes in underlying primary balances.

Regarding monetary policy, the assumed path of policy interest rates and unconventional measures represents the most likely outcome, conditional upon the OECD projections of activity and inflation. This may differ from the stated path of the monetary authorities.

The projections assume that the impacts of the war in Ukraine persist for one year, but do not spread or escalate, and that all war-related sanctions remain in place throughout the projection period. The projections also incorporate the impacts of the EU embargo of coal imports from Russia, beginning later in 2022, and the EU embargo on seaborne oil imports from Russia, assumed to take effect at the start of 2023.

The projections assume unchanged exchange rates from those prevailing on 10 May 2022: one US dollar equals JPY 130.3, EUR 0.95 (or equivalently one euro equals USD 1.05) and 6.74 renminbi.

The price of a barrel of Brent crude oil is assumed to average USD 107 in 2022 and USD 122 in 2023, with a peak of USD 131 in the first quarter of 2023. Metals prices are held flat at their estimated level in April 2022 until the end of the year. In 2023, prices are assumed to decline by 1% per month. Food, tropical beverages and agricultural commodity prices are assumed to be constant over the projection period at their average levels from April 2022.

The cut-off date for information used in the projections is 1 June 2022.

OECD quarterly projections are on a seasonal and working-day-adjusted basis for selected key variables. This implies that differences between adjusted and unadjusted annual data may occur, though these in general are quite small. In some countries, official forecasts of annual figures do not include working-day adjustments. Even when official forecasts do adjust for working days, the size of the adjustment may in some cases differ from that used by the OECD.

2 Developments in individual OECD and selected non-member economies

Argentina

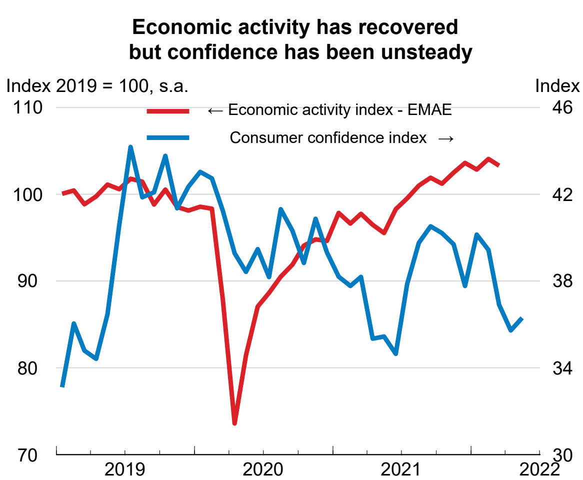
After a strong rebound in the second half of 2021, GDP is expected to rise by 3.6% in 2022 and 1.9% in 2023. A recent agreement with external creditors will lower policy uncertainty and help to reduce long-standing macroeconomic imbalances gradually. Annual inflation has risen to 58% and is largely related to domestic factors, as key domestic prices are delinked from global developments. In addition, currency controls, low international reserves and limited fiscal space keep risks elevated, which will weigh on investment in 2022 and 2023.

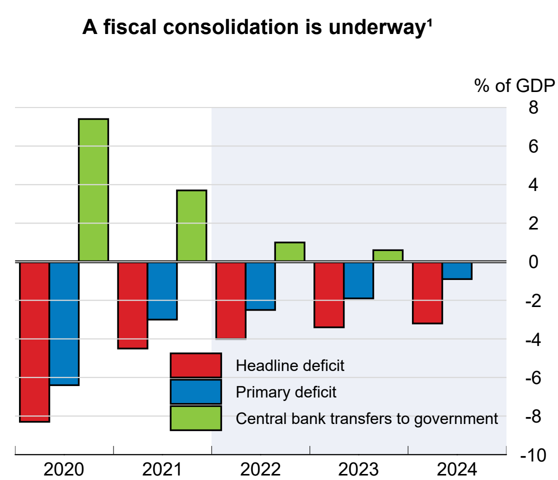
An ongoing gradual fiscal adjustment aims to close the primary deficit by 2025. Limits on monetary financing will reduce inflationary pressures, while higher domestic interest rates help to expand financing from the domestic capital market and reduce the gap between the official and the parallel exchange rates. There is ample scope to improve public spending efficiency, including by reviewing poorly-targeted energy subsidies and tax exemptions.

The economy has recovered well

After a strong recovery, activity surpassed pre-pandemic levels in mid-2021. Growth weakened in early 2022 amid rising COVID-19 cases and a decline in consumer confidence, although other short-term indicators have shown mixed signals. Employment has recovered fully from the pandemic and unemployment is falling, but real wages are still below 2019 levels. Inflation has risen to 58% amid unanchored inflation expectations, and weighs on consumer spending. Trade links with Russia and Ukraine are minimal, but global price changes are affecting Argentina. While food exports are temporarily benefiting from rising global prices, higher costs of energy imports including natural gas are adding to higher energy subsidy costs, as key energy prices are regulated and delinked from market prices.

Argentina





1. Data as of 2022 are agreed targets of the IMF Extended Fund Facility for Argentina.
Source: CEIC; Di Tella University; INDEC; and IMF Article IV Staff Report on Argentina, March 2022.

StatLink https://stat.link/jbizp9

Argentina: Demand, output and prices

Argentina	2018	2019	2020	2021	2022	2023
	Current prices ARS billion	Percentage changes, volume (2004 prices)				
GDP at market prices	14 744.8	-2.0	-9.9	10.3	3.6	1.9
Private consumption	10 243.2	-7.3	-13.8	10.2	4.1	2.1
Government consumption	2 330.4	-1.2	-3.3	7.8	3.6	-0.4
Gross fixed capital formation	2 248.7	-15.9	-12.9	32.9	4.5	1.8
Final domestic demand	14 822.4	-7.7	-12.2	12.9	4.1	1.6
Stockbuilding[1]	200.9	-0.7	1.8	0.4	0.3	0.0
Total domestic demand	15 023.4	-8.7	-10.1	13.0	4.2	1.7
Exports of goods and services	2 128.7	9.1	-17.3	9.0	7.4	4.1
Imports of goods and services	2 407.2	-19.0	-17.9	21.5	9.8	2.9
Net exports[1]	- 278.6	4.4	-0.5	-1.4	-0.1	0.2
Memorandum items						
GDP deflator	_	50.9	39.9	54.1	51.4	43.1
Consumer price index	_	54.4	40.4	48.8	60.1	50.6
Current account balance (% of GDP)	_	-0.6	0.7	1.4	1.0	1.0

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/uvf7e5

Gradual policy tightening will ease macroeconomic imbalances

The recent agreement with the International Monetary Fund has reduced uncertainty about near-term macroeconomic policies. The headline fiscal deficit is set to decline by 0.5% of GDP in 2022, as part of an overall consolidation of 2.1% of GDP during 2022-24. Transfers from the central bank to the Treasury are set to decline by 2.7% of GDP in 2022, reducing one key source of inflationary pressures. Compliance with fiscal targets hinges on scaling back the 2.3% of GDP spent on energy subsidies in the Greater Buenos Aires area, where regulated retail prices paid by many households and small enterprises cover less than half of costs. As adjustments of most regulated prices have fallen short of inflation, rising import prices for natural gas are adding to subsidy expenditures. The monetary policy rate was raised five times in early 2022 and is set to rise further to ensure positive real interest rates, as shallow domestic financial markets will play an increasing role for financing the fiscal deficit. In the short run, ensuring continuous roll-over of domestic-currency debt will require the maintenance of strict currency controls, implying collateral damage for growth. Implementing the crawling peg exchange rate regime faces a difficult trade-off between preserving export competitiveness to ensure continuous trade surpluses and support reserve accumulation, and limiting inflationary pressures.

Growth is slowing in the near term amid significant risks

The challenging domestic macroeconomic scenario will limit growth prospects in the short term without more ambitious reforms. High inflation weighs heavily on consumption and investment, and an escalation of inflation is a key risk as expectations lack a nominal anchor. Likely forthcoming adjustments of administered prices will add to inflationary pressures during 2022. Wage negotiations in key sectors are currently ongoing, but point to rising wage pressures and more-frequent adjustments in the future. Private consumption will remain subdued during 2022, before accelerating in 2023 as confidence in the macroeconomic stabilisation programme improves. Investment is likely to remain weak throughout both years as the macroeconomic backdrop remains fragile. Exports will remain solid amid high commodity prices, while currency restrictions continue to place severe limits on imports. Potential external shocks, including ones related to higher global prices and interest rates, could trigger a disorderly adjustment process involving stronger currency depreciation, spiralling inflation and a failure to comply with current fiscal targets. On the upside, stronger demand for Argentina’s exports could lead to stronger growth and currency inflows, reducing pressure on the exchange rate.

More ambitious reforms could reduce risks and strengthen growth

A more front-loaded fiscal adjustment, mostly through improvements in public spending efficiency, would ease macroeconomic tensions and imbalances and reduce risks. By contrast, well-targeted social expenditures, in particular cash transfers to poor and vulnerable households, should be safeguarded or even expanded. Broadening tax bases, including in personal income taxes, and reviewing special tax and pension regimes could also improve fiscal outcomes and enhance fairness. Strengthening domestic and external competition and entrepreneurship through lower regulatory and trade barriers holds the key for raising productivity and innovation. Ongoing investments in oil and gas production will enhance energy security. Moreover, the dependence on fossil fuels could be reduced through more investment in hydroelectric sources, where only 20% of the generation potential is used, while wind and solar energy also hold strong potential in Argentina.

Australia

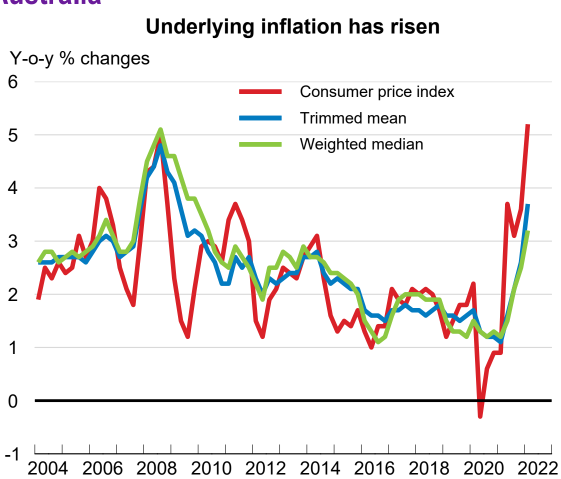
Real GDP is projected to grow by 4.2% in 2022 and 2.5% in 2023. The Australian economy is set to continue its solid recovery from the pandemic after having withstood the recent resurgence of COVID-19 cases as well as severe flooding in the states of Queensland and New South Wales. Wage and price pressures will rise given the already tight labour market and the strains on global supply chains, before moderating in 2023.

Monetary policy has started normalising, with the Reserve Bank of Australia raising its cash interest rate in May for the first time in a decade. Further tightening will be necessary in order to contain rising price pressures and bring inflation back to target. The temporary reduction in the fuel excise tax, prompted by concerns for cost-of-living pressures, is legislated to end on 28 September 2022. The global energy security risks posed by the war in Ukraine highlight the need to continue the transition towards greater renewable energy generation. In the medium-term, tax reform to reduce Australia's heavy reliance on taxation of personal incomes would help decrease the vulnerability of public finances to an ageing population.

Economic activity has been resilient but inflation has picked up

The recovery from the pandemic has continued despite the increase in COVID-19 cases in the first quarter of 2022 as well as the severe flooding that occurred in Queensland and New South Wales in February and March. Despite COVID-19 cases rising to levels not yet seen in Australia during the pandemic, indicators of private consumption and manufacturing activity have held up well over recent months. The labour market has tightened considerably, with the unemployment rate reaching 3.9% in April, its lowest level since 1974, reflecting the robust economic recovery and reduced immigration during the pandemic. In response, there are signs of wage growth picking up and inflation has risen, with the latter exacerbated by supply chain disruptions. Consumer prices rose by 5.1% year-on-year in the first quarter of 2022, with underlying inflation reaching 3.7%. This is the highest level since before the global financial crisis.

Australia



1. The underemployment rate counts part-time workers who would prefer to work additional hours and people who usually work full time, but are currently working part-time hours.

Source: Australian Bureau of Statistics.

StatLink https://stat.link/ldhk2e

Australia: Demand, output and prices

Australia	2018	2019	2020	2021	2022	2023
	Current prices AUD billion	Percentage changes, volume (2019/2020 prices)				
GDP at market prices	1 895.3	2.0	-2.2	4.8	4.2	2.5
Private consumption	1 051.4	0.8	-5.8	5.0	5.7	2.6
Government consumption	364.4	6.4	7.3	5.1	6.9	2.2
Gross fixed capital formation	455.4	-2.6	-2.9	9.6	6.8	3.0
Final domestic demand	1 871.3	1.1	-2.4	6.1	6.2	2.6
Stockbuilding[1]	3.0	-0.3	-0.2	0.7	0.2	0.0
Total domestic demand	1 874.3	0.8	-2.7	6.8	6.4	2.6
Exports of goods and services	438.1	3.1	-9.5	-2.1	-0.3	3.9
Imports of goods and services	417.1	-1.8	-12.9	6.4	10.2	4.8
Net exports[1]	21.0	1.1	0.4	-1.6	-1.9	0.0
Memorandum items						
GDP deflator	_	3.2	0.9	5.4	5.4	2.7
Consumer price index	_	1.6	0.9	2.8	5.2	4.1
Core inflation index[2]	_	1.6	1.3	2.4	4.4	4.0
Unemployment rate (% of labour force)	_	5.2	6.5	5.1	4.1	4.0
Household saving ratio, net (% of disposable income)	_	6.8	17.3	15.0	9.6	7.6
General government financial balance (% of GDP)	_	-1.2	-12.6	-5.1	-1.1	-1.1
General government gross debt (% of GDP)	_	47.0	66.4	63.4	64.0	64.9
Current account balance (% of GDP)	_	0.6	2.6	3.4	0.9	0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/ydq02b

While the direct impact of the war in Ukraine on the Australian economy has been limited, both the war and the recent stringent lockdowns in China have exacerbated the supply-chain issues faced by Australia. High global energy prices have already affected Australian consumers and resulted in a rise in inflation, although inflation expectations remain at moderate levels. However, higher commodity prices have boosted Australia's terms of trade, and strong global demand for grains will support exports following the war-related disruptions to output in Ukraine.

Monetary policy will tighten

In response to inflationary pressures, the Reserve Bank of Australia raised its cash target rate by 25 basis points to 0.35% in May, the first rate rise in over a decade. Further increases will be necessary to bring inflation back to the target range of 2-3%, with the OECD projections assuming that the cash rate will reach 2.5% by the end of 2023. The central bank has also ended its purchases of government bonds, which will lead to a significant but gradual decline of its balance sheet as bond holdings reach maturity. Pandemic-related fiscal support has largely unwound. However, this will be partly offset by a series of new spending measures announced with the Federal Budget following large revenue windfalls due to a stronger than anticipated recovery and high commodity prices. While windfalls will be partly used to reduce the federal deficit, the government also announced several measures aimed at easing cost of living pressures, including a cost of living tax offset and a temporary 6-month reduction in the fuel excise duty. Overall, the fiscal stance is assumed to be slightly contractionary in 2022 before being broadly neutral in 2023.

The economic recovery will continue amid rising inflation pressures

The economic recovery is projected to continue, with real GDP growth reaching 4.2% in 2022 and 2.5% in 2023. In the short run, growth will be supported by high commodity prices and improved terms of trade. Personal consumption growth will be supported by a strong labour market and a gradual decline in household saving rates. Inflation is projected to remain elevated in the near term as global supply chain issues, high energy prices and rising wages due to a tight labour market exert pressure on prices, before easing in 2023 as supply chain issues are gradually resolved and less accommodative monetary and fiscal policy weakens domestic demand. However, the recent embargo on Russian oil agreed by the European Union will exert upward pressure on inflation in 2023. Higher global oil prices will feed through to fuels and other items in the consumption basket, partially offsetting some of the easing in inflation that will result from waning supply chain issues. Skilled immigration will rise following the reopening of international borders in February, but is not expected to be sufficient to materially alleviate the tightness in the labour market. Strong global inflationary pressures and the tight labour market pose further upside risk to inflation in Australia, which could lead the Reserve Bank of Australia to tighten monetary policy more aggressively, with potential negative implications for consumption, investment and economic growth more generally. Finally, the pandemic also continues to pose a downside risk to the recovery as the emergence of a new, highly-infectious or virulent COVID-19 variant could prompt the re-imposition of restrictions, although it is unlikely that the country will return to restrictions as severe as those seen in 2020 and 2021.

Tax reform should be a medium-term priority

Significant further monetary policy tightening is needed in order to limit the rise in inflation. The reduction in the fuel excise duty is legislated to end on 28 September 2022. Any further cost of living support needed beyond this date should be better targeted to low income households and delivered in a way that does not distort price signals. Given the risks to energy security highlighted by the war in Ukraine, the transition towards renewable energy generation should be further encouraged, accompanied with further investments in the transmission network. The current recovery would also be a good time to reduce Australia's heavy reliance on taxation of personal incomes, which adds to the vulnerability of public finances to an ageing population. Furthermore, consideration should be given to increasing or broadening the base of the Goods and Services Tax, reducing private pension tax breaks, reducing the capital gains tax discount and further replacing stamp duty with a recurrent land tax. Such reforms would result in a more sustainable tax base. As in other OECD countries, Australia would benefit from a review of its monetary policy framework. The review process should be transparent, involve consultation with relevant stakeholders, and should be broad in scope, potentially including a review of the central bank mandate, policy tools, methods of public communication, hiring processes and internal structures.

Austria

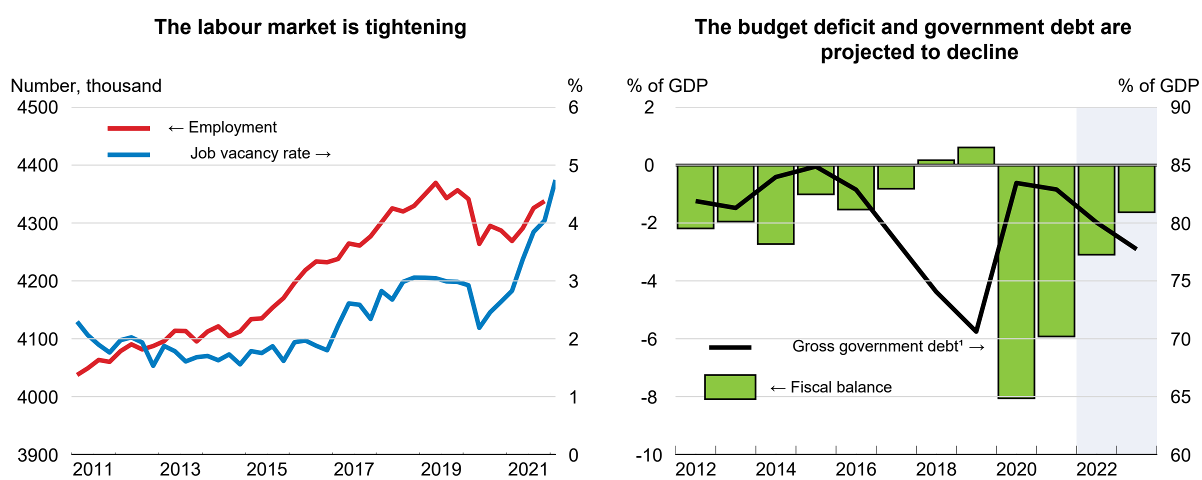
The Austrian economy is projected to expand by 3.6% in 2022 and 1.4% in 2023 though Russia's invasion of Ukraine has lowered growth prospects. The labour market is tightening, reflecting strong employment growth and rising job vacancies. Private consumption is set to be the main growth driver. Elevated uncertainty, higher energy prices, labour shortages and supply-chain disruptions are weighing on business investment and export growth. Headline inflation is expected to increase sharply to 6.7% in 2022 but ease modestly over 2023.

Fiscal policy is expected to tighten gradually over the projection horizon, reflecting the withdrawal of pandemic support packages. The government has introduced support measures to mitigate the impact of rising energy prices on households and firms, which should be targeted to avoid weakening price signals and to limit fiscal costs. While the eco-social tax reform is a welcome step in greening the economy, more action is necessary to progress towards net zero emissions by 2040 and enhance energy security.

Inflation is high and continues to rise

Economic activity rebounded strongly in the first quarter of 2022. The labour market has fully recovered from the pandemic, underpinning strong growth of private consumption. Consumer price inflation has increased to levels not seen since September 1975. Initially driven by energy prices, consumer price inflation is now relatively broad-based. Producer price inflation stands at its highest level since the mid-1970s and is expected to exert further pressure on consumer price inflation over 2022.

Austria



1. Maastricht definition.
Source: Statistik Austria; and OECD Economic Outlook 111 database.

StatLink https://stat.link/mlz91q

Austria: Demand, output and prices

Austria	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices*	385.4	1.5	-6.8	4.6	3.6	1.4
Private consumption	200.1	0.7	-8.4	3.2	4.0	1.1
Government consumption	74.5	1.5	-0.4	6.8	-1.2	0.6
Gross fixed capital formation	92.7	4.8	-4.9	4.0	4.2	2.0
Final domestic demand	367.3	1.9	-5.9	4.2	3.0	1.2
Stockbuilding¹	6.0	-1.2	0.1	0.5	0.0	0.0
Total domestic demand	373.3	0.6	-5.8	4.5	2.9	1.2
Exports of goods and services	214.3	3.3	-11.5	13.3	8.5	4.4
Imports of goods and services	202.2	1.8	-9.4	13.8	7.4	4.1
Net exports¹	12.1	0.9	-1.5	0.1	0.7	0.2
Memorandum items						
GDP deflator	_	1.6	2.3	1.7	3.5	3.4
Harmonised index of consumer prices	_	1.5	1.4	2.8	6.7	4.7
Harmonised index of core inflation²	_	1.7	2.0	2.3	3.6	3.9
Unemployment rate (% of labour force)	_	4.5	5.4	6.2	5.2	5.0
Household saving ratio, net (% of disposable income)	_	8.5	14.4	11.8	7.4	6.5
General government financial balance (% of GDP)	_	0.6	-8.1	-5.9	-3.1	-1.6
General government gross debt (% of GDP)	_	93.5	112.3	106.4	103.5	101.2
General government debt, Maastricht definition³ (% of GDP)	_	70.6	83.5	82.9	80.0	77.7
Current account balance (% of GDP)	_	2.1	1.9	-0.5	-0.3	-0.9

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/golc9b

Austria is highly dependent on gas imports from Russia. Prior to the invasion of Ukraine, Austria imported 80% of its gas consumption from Russia. Imports of crude oil from Russia were only around 8% of total crude oil imports and, to a large extent, have already been substituted with imports from other sources. Other trade links with Russia, including tourism, are relatively modest. The amount of outstanding loans of Austrian banks to Russia is one of the highest across the European Union. However, the risk to the Austrian banking sector is manageable given that these loans only account for around 4% of the total stock of outstanding credit to foreigners. Ukrainian refugees continue to move to Austria and numbered around 70 000 in May. Refugees have equal access to the labour market. The authorities have rolled out a refugee support package worth around 0.12% of GDP.

Fiscal policy will tighten

The primary budget deficit is expected to close in 2022 and turn positive in 2024, mainly due to the withdrawal of pandemic support. While the overall stance of fiscal policy is tightening, grants from the Recovery and Resilience Facility will support public investments with an aggregate amount of around 0.8% of GDP until 2026. The authorities have also rolled out new discretionary measures to cushion some of the impact of energy price inflation with a total amount of 0.8% of GDP in 2022 and 0.2% of GDP in 2023. The package also includes the acquisition of a national strategic gas reserve. Moreover, the eco-social tax reform - a combination of several measures including gradual increases in carbon prices and personal and corporate income tax cuts - will apply from July 2022.

Downside risks to the projection are high

Economic activity continues to expand due to significant private consumption growth. High energy prices and supply bottlenecks due to Russia's invasion of Ukraine and the subsequent sanctions will weigh on business investment and exports. Shortages of skilled labour are constraining growth in many sectors. Headline inflation is set to increase to 6.7% in 2022 and ease only modestly over 2023, as the EU embargo of Russian oil will keep oil prices at elevated levels. Wage negotiations, usually guided by inflation rates over the last 12 months, may add pressure on prices in 2022 and 2023. Real wages will decline in 2022 but strong wage growth in 2023 will help to keep real disposable incomes flat. The growth projections are subject to considerable downside risks. A new pandemic outbreak with renewed sanitary measures that impede activity in service sectors would jeopardise growth in 2022. Potential disruptions in the supply of gas would have severe consequences on economic activity as gas imports from Russia cannot be substituted from other sources in the short-term.

Expanding renewables to raise energy security and a better activation of labour reserves are key priorities

Policy action should aim at a better diversification of the supply of gas and fully leverage the domestic energy potential of renewables. This would complement recent efforts to build a gas storage facility and help to outweigh at least some of the adverse effects of a potential sudden stop of gas imports. Labour and skill shortages are holding back growth. Austria needs to better activate its labour reserves to counteract these shortages. Stepping up efforts to promote female employment, for example by bolstering the availability and quality of early childcare services throughout the entire country, should be a priority. Enhancing incentives to continue in the labour force at an older age while ensuring good working conditions for elderly workers would help to boost the supply of skilled labour.

Belgium

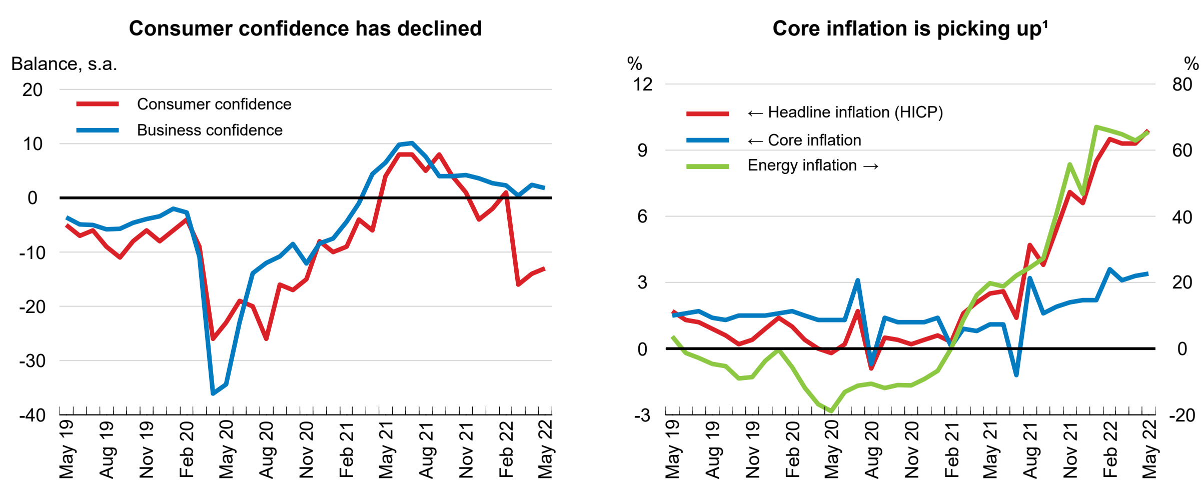
Growth will continue to slow due to heightened uncertainty, but will remain robust at 2.4% in 2022, before falling to 1% in 2023. Domestic demand will be supported by automatic wage indexation, energy support measures and continued growth in employment. The unemployment rate is projected to stay above 6%. Headline inflation will start subsiding through the second half of 2022, but core inflation will remain high over the projection period.

Fiscal policy will be expansionary in 2022 and contractionary in 2023. Support measures should be well targeted and temporary to maintain and deepen the recovery without compromising fiscal sustainability. Increasing certainty for investments and promoting alternative energies is key to ensure the security of electricity supply and promote the green transition. Continuing to raise employment and implementing productivity-enhancing reforms is necessary to prepare for future shocks and enable the digital transformation.

Growth has slowed and risks have intensified

The Omicron wave, high energy prices and supply constraints, including high vacancy rates, started to weigh on growth from late 2021, with 0.5% GDP growth in the first quarter of 2022. Heightened uncertainty and global commodity and energy market disruptions are adding to the slowdown, with a collapse in consumer confidence in March. Inflation was 9.9% in May, mainly driven by high energy price pass-through, and core inflation has been picking up. The automatic indexation mechanism, which is expected to increase public and private wages and social benefits by about 6% in 2022 and further in 2023, is supporting consumption, but weighing on competitiveness in the near term.

Belgium



1. Data for headline, core and energy inflation in May 2022 are provisional.
Source: National bank of Belgium.

StatLink https://stat.link/0ido3t

Belgium: Demand, output and prices

Belgium	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	460.1	2.1	-5.7	6.2	2.4	1.0
Private consumption	238.2	1.8	-8.2	6.4	3.6	0.9
Government consumption	106.5	2.0	-0.4	4.4	1.3	0.9
Gross fixed capital formation	108.5	4.4	-6.1	7.8	-0.4	2.6
Final domestic demand	453.2	2.5	-5.9	6.2	2.1	1.3
Stockbuilding[1]	8.0	-0.6	-0.3	-0.5	0.8	0.0
Total domestic demand	461.2	1.8	-6.1	5.6	2.9	1.3
Exports of goods and services	382.0	2.0	-5.5	9.6	0.8	0.5
Imports of goods and services	383.1	1.6	-5.9	9.1	1.3	0.8
Net exports[1]	- 1.1	0.3	0.4	0.6	-0.4	-0.2
Memorandum items						
GDP deflator	_	1.8	1.3	4.3	7.2	3.4
Harmonised index of consumer prices	_	1.2	0.4	3.2	9.0	4.8
Harmonised index of core inflation[2]	_	1.5	1.4	1.3	3.9	4.9
Unemployment rate (% of labour force)	_	5.4	5.8	6.3	6.0	6.4
Household saving ratio, net (% of disposable income)	_	5.5	13.7	9.9	10.0	10.6
General government financial balance (% of GDP)	_	-2.0	-9.0	-5.5	-5.6	-4.8
General government gross debt (% of GDP)	_	120.4	141.6	128.6	126.3	127.5
General government debt, Maastricht definition[3] (% of GDP)	_	97.7	112.8	108.4	106.1	107.2
Current account balance (% of GDP)	_	0.2	0.8	-0.4	-1.4	-0.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/9nf0w4

The direct impact of the war is small, but indirect effects via confidence, trade and supply chains are significant. Natural gas accounts for about one quarter of final energy consumption, with a significant share indirectly coming from Russia. The petrochemical sector will face a disproportionate impact, as about 30% of oil imports are sourced from Russia. About 45 000 Ukrainian refugees had arrived as of late May and 100-200 000 (0.8-1.6% of the population) are expected by the end of the year.

The war is accentuating medium-term fiscal sustainability challenges

The budget deficit narrowed in 2021 to 5.5% of GDP, helped by the phasing-out of COVID-19-related spending. The fiscal stance is expected to be supportive in 2022, as the energy crisis requires continued support measures, but restrictive in 2023, with budget deficits of 5.6% and 4.8% of GDP, respectively. Easier access to the temporary unemployment scheme was extended until June 2022 due to the war. Moreover, the extension of the social energy tariff has been prolonged and targeted lump-sum payments, one-off rebates on electricity and heating oil bills, reduced excise duties on gasoline, and reduced VAT on electricity and natural gas have been introduced. Automatic stabilisers, support measures and war-related expenses, such as refugee assistance and defence spending (EUR 1.25 billion budgeted), are expected to add almost EUR 4.5 billion (0.8% of GDP) in 2022 to the already high Maastricht public debt (108.4% of GDP in 2021). The labour market package adopted in February will promote employment by reducing social security contributions for low-wage workers, improving training opportunities and facilitating the return to work from disability leave.

Growth is set to slow

GDP is projected to expand by 2.4% in 2022, before slowing to 1% in 2023 as the consequences of the embargo on Russian oil materialise. High energy and commodity prices, supply chain disruptions and heightened uncertainty will drag on private consumption, investment and exports. Domestic demand will be the main driver of growth, as high household savings, automatic wage indexation and energy support measures mitigate the adverse effects of high inflation. Headline inflation is projected to subside due to base effects, a moderation in energy prices and monetary policy normalisation. Core inflation will remain elevated, as wage costs grow quickly due to automatic wage indexation. Geopolitical tensions and continued energy price pressures could lead to persistently high inflation and a wage-price spiral, while lower demand from main trading partners in Europe could dent growth. Supply bottlenecks, and especially labour shortages, could disrupt investment. An export boost from a faster-than-expected resolution of the war is an upside risk.

Targeting support measures and securing electricity supply are key

Fiscal support to attenuate the near-term effects of the energy shock on vulnerable households and firms should be temporary and means-tested. A medium-term consolidation strategy based on spending reviews is needed to start lowering public spending and the debt to GDP ratio gradually. Contingency planning and clarity on the energy policy stance is key to ensuring electricity supply and promoting private investment in alternative energy sources, given heightened energy supply uncertainty and the planned phasing out of nuclear energy generation. Reaching the government's employment targets requires better tailoring of active labour market policies to vulnerable groups. Further reforms to continue removing barriers to competition and ensure training quality within the planned individual training account are required to boost productivity growth and facilitate the digital and green transitions.

Brazil

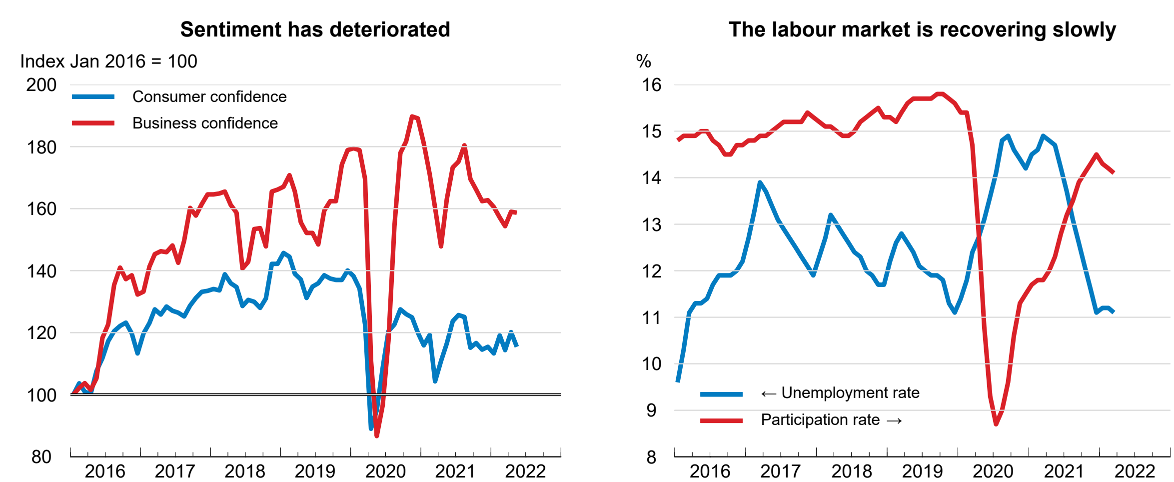
After a strong recovery by 5% in 2021, GDP growth is expected to slow significantly in 2022, to 0.6%, before picking up to 1.2% in 2023. Rising inflation, the war in Ukraine, and tighter financial conditions have eroded economic sentiment and purchasing power, which is expected to strongly dent domestic demand in the first half of 2022. The 2022 presidential election is adding uncertainty, helping to keep investment subdued until 2023. The labour market recovery has been slow; the participation rate and real labour incomes remain below pre-pandemic levels.

As the war in Ukraine has led to a further steep rise in food and energy prices, ramping up support through well-targeted social protection programmes is key to protect the most vulnerable. Additional efforts are needed to improve targeting and public spending efficiency, to remain consistent with sound fiscal management. Active labour market policies need to be strengthened to facilitate the reintegration of the long-term unemployed. The central bank should continue monetary policy tightening if pro-inflationary factors persist. Wind and solar energy sources should be exploited to complement hydropower.

Economic sentiment has deteriorated

After a successful vaccination campaign, economic activity recovered strongly in the second half of 2021, driven mostly by services. However, higher inflation, tighter financial conditions and the spread of Omicron, contributed to lower consumer confidence and business sentiments in early 2022. In April, annual inflation reached almost 12%, its highest value in eighteen years. Increasing food, fuel and energy prices significantly eroded households' purchasing power. Weather conditions were particularly unfavourable until recently, affecting agriculture and hydro-electricity production, while shortages and higher production costs weighted on industrial production. The manufacturing PMI index fell further in April 2022. Although employment has recovered fully and unemployment is falling, labour force participation, the share of formal workers and real wages are still below pre-pandemic levels. Nominal wages were not growing fast enough to compensate for higher inflation and real wages fell in early 2022. In February, the average real income for newly hired workers fell 1.1% year-on-year.

Brazil 1



Source: CEIC; IBGE; and OECD calculations.

StatLink https://stat.link/75lhfz

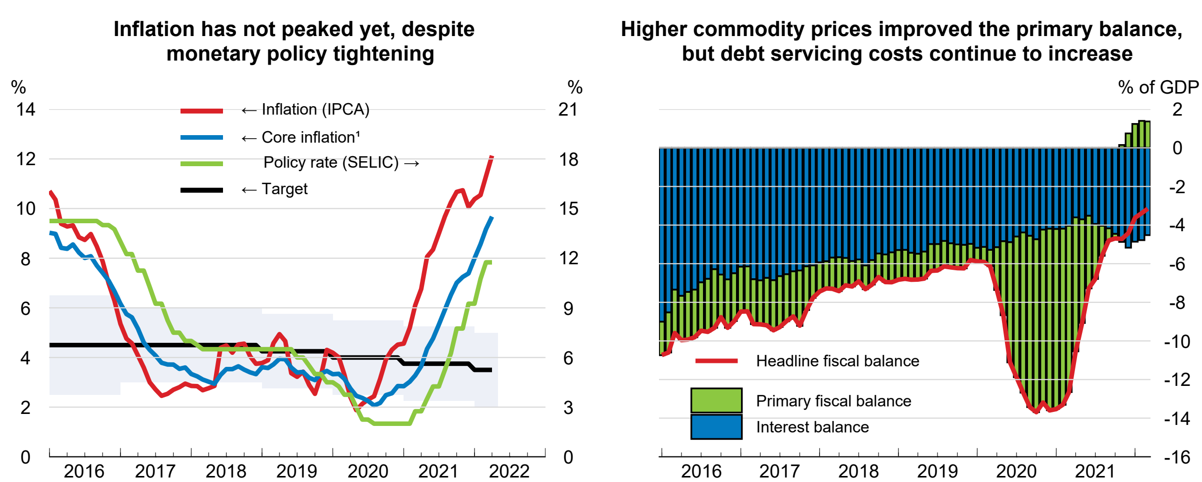
Brazil: Demand, output and prices

Brazil	2018	2019	2020	2021	2022	2023
	Current prices BRL billion	Percentage changes, volume (2000 prices)				
GDP at market prices	7 004.1	1.2	-4.2	5.0	0.6	1.2
Private consumption	4 525.8	2.6	-5.7	3.9	0.8	0.8
Government consumption	1 393.5	-0.5	-4.5	2.0	2.2	1.5
Gross fixed capital formation	1 057.4	4.0	-0.5	17.3	-0.8	1.4
Final domestic demand	6 976.7	2.2	-4.7	5.7	0.8	1.1
Stockbuilding[1]	- 0.1	-0.5	-0.6	0.5	0.0	0.0
Total domestic demand	6 976.6	1.6	-5.4	6.1	0.7	1.1
Exports of goods and services	1 025.1	-2.5	-2.2	6.3	-1.9	2.6
Imports of goods and services	997.5	1.4	-10.2	12.9	-1.6	1.7
Net exports[1]	27.6	-0.6	1.2	-1.0	-0.1	0.2
Memorandum items						
GDP deflator	_	4.2	5.5	10.7	7.2	5.0
Consumer price index	_	3.7	3.2	8.3	9.7	5.3
Private consumption deflator	_	3.7	3.5	8.4	9.4	5.3
General government financial balance (% of GDP)	_	-5.8	-13.6	-4.0	-6.4	-5.9
Current account balance (% of GDP)	_	-3.5	-1.6	-1.8	-1.0	-0.9

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/7jrge3

Brazil 2



1. Core inflation excludes energy and food products. The shaded area corresponds to the inflation tolerance band.
Source: OECD Economic Outlook 111 database; Central Bank of Brazil; and OECD calculations.

StatLink https://stat.link/9d5oql

The war in Ukraine has raised international commodity prices, further escalating inflation. To cushion the impact of higher international energy prices on households and firms, the exceptional tariff on electricity, introduced in September 2021 during the hydric crisis, has been withdrawn earlier than expected. Brazil is particularly dependent on fertilisers imported from Russia. Trade disruptions and economic sanctions are pushing farming input and output prices up, feeding food inflation. As a response, the government has eliminated the import tax rate for some food products and chemicals used in the production of fertilisers.

Monetary policy continues to tighten, while fiscal policy expands

In early May, the Brazilian central bank increased the reference rate by another 100 basis points, making monetary policy more restrictive. The Selic rate has reached 12.75% and is expected to rise to 13.25% in the next central bank meeting, since market inflation expectations continue to increase. The Selic rate is projected to remain at 13.25% until early 2023 and then decrease slowly during the year, as the lagged effects from recent increases are finally felt.

Strong commodity prices are supporting fiscal outcomes in the short term. Oil revenues, coming from royalties and dividends, are benefiting both the central government and regional governments, which posted robust budget results in 2021 and early 2022. Inflation is also boosting Federal and regional tax collection. However, public expenditure is expected to increase in 2022, driven by higher social transfers with the new *Auxílio Brasil* programme, adjustments in civil servant wages, and higher discretionary expenses, resulting in an expansionary fiscal stance in 2022. Permanent increases in public expenditures pose a threat to the fiscal outlook in the longer term, especially given the weaker spending cap rule. In addition, debt-servicing costs continue to increase given tighter monetary policy.

Growth is slowing amid significant downside risks

Due to deteriorating economic sentiment and the challenging domestic and global environment, growth prospects are limited in 2022 and 2023. GDP growth is expected to slow considerably this year, to 0.6%, before picking up to 1.2% in 2023. Inflation, tight financial conditions and uncertainty are restricting domestic and external demand. In addition, labour incomes are not recovering fast enough to compensate for the withdrawal of pandemic-related emergency support and rising inflation. Inflation should start easing in the second quarter of 2022, with tighter monetary policy and reduced uncertainty after the presidential elections, but rise again in early 2023 as the European oil embargo on Russia takes effect. Inflation will remain high in 2023, and is not expected to reach the inflation target in the projection horizon.

The 2022 presidential election adds considerable uncertainty, which could dampen private consumption and investment even further. Prolonged conflict in Europe could continue to raise the cost of farming inputs, such as fertilisers, severely constraining agriculture production and exports. An abrupt tightening of monetary policy in advanced economies could lead to capital outflows and currency depreciation, adding pressure to imported inflation. Mounting pressure on the spending cap rule in the coming years poses a threat to fiscal and financial stability. On the upside, if commodity prices remained high for longer than expected fiscal pressures would ease in the short term and the terms of trade would improve.

Ambitious reforms are needed to enhance growth and preserve public finances

To safeguard fiscal sustainability and prevent poverty rates from increasing, Brazil needs to continue the ambitious reforms it has started to simultaneously boost productivity and employment. Improving public spending efficiency and strengthening the medium-term fiscal framework would create fiscal space for productive public investment and well-targeted social support, and strengthen investors' confidence.

Conditional cash transfers that fade out only as workers regain employment, would strengthen incentives for job search in the formal sector. Boosting professional training opportunities would facilitate the re-integration of long-term unemployed and discouraged workers into the labour market. Finally, laws that prevent illegal deforestation need to be properly enforced, to protect natural resources, such as the Amazon rain forest, that can provide sustainable livelihood to vulnerable segments of the populations and is associated with higher levels of rainfall. The strong reliance on hydroelectric energy has shown its limits and, as demand for electricity continues to increase, alternative renewable sources will need to be exploited. Wind and solar sources present significant untapped potential in Brazil. Scaling up investments in urban public transport systems would benefit low-income workers, while also reducing car dependency and air pollution.

Bulgaria

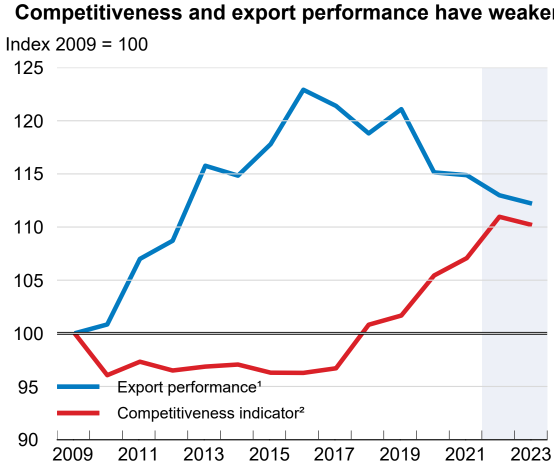
After a rebound of 4.2% in 2021, growth is expected to weaken to 2½ per cent in 2022 and 2¼ per cent in 2023 and be accompanied by a surge in inflation mainly because of the war in Ukraine. Soaring energy and food prices, growing uncertainty and supply difficulties for certain raw materials will weigh on activity and only be partly offset by the expected increase in public investment and the measures taken by the government to protect households from rising prices.

The reinforcement of infrastructure financed with European funds and the support measures in the face of rising energy prices are welcome to limit the economic impact of the conflict. However, targeted and temporary aid for low-income households would be preferable to freezing energy prices. More investment in renewable energies would also be beneficial for the country's energy security and transition.

Bulgaria faces an inflationary surge

The economy was rebounding and inflation surging when the war in Ukraine started. Growth weakened in the first quarter 2022 with the increase in prices. National CPI inflation reached 14.4% year-on-year in April 2022 due to the rise in food and energy prices and the tightness of the labour market, with unemployment declining below 5%. High inflation, together with the depreciation of the Turkish currency, has weakened competitiveness. A further pick-up in inflation is expected in the short term by the business sector. However, wage increases remained moderate in the first quarter of 2022 due to limited rises in the public sector. With the pandemic slowing, COVID-related restrictions were lifted in end-March 2022.

Bulgaria



1. Export performance index (based 100 in 2009) is measured as actual growth in exports relative to the growth of the country's export market. A decrease of the index indicates a loss of export market share.
2. Indicator (based 100 in 2009) of relative consumer prices. An increase in the index indicates a real effective appreciation and a corresponding deterioration of the competitive position.
3. Average balance of opinions in the business surveys in industry, construction, retail trade and services concerning selling prices expectations.
Source: OECD Economic Outlook 111 database; and National Statistical Institute.

StatLink https://stat.link/jpad8m

Bulgaria: Demand, output and prices

Bulgaria	2018	2019	2020	2021	2022	2023
	Current prices BGN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	110.0	4.0	-4.4	4.2	2.5	2.3
Private consumption	65.8	6.0	-0.4	8.0	2.0	1.8
Government consumption	18.0	2.0	8.3	4.0	5.2	1.7
Gross fixed capital formation	20.6	4.5	0.6	-11.0	1.1	9.8
Final domestic demand	104.5	5.0	1.4	3.1	2.5	3.1
Stockbuilding[1]	2.7	0.0	-1.2	1.9	0.5	0.0
Total domestic demand	107.2	4.8	0.0	4.7	2.9	3.0
Exports of goods and services	72.2	4.0	-12.1	9.9	3.5	3.1
Imports of goods and services	69.4	5.2	-5.4	12.2	4.3	4.2
Net exports[1]	2.8	-0.7	-4.4	-1.1	-0.4	-0.7
Memorandum items						
GDP deflator	_	5.2	4.2	6.2	10.8	7.8
Consumer price index	_	3.1	1.7	3.3	14.1	8.5
Core consumer price index[2]	_	1.8	1.2	1.4	8.0	7.3
Unemployment rate (% of labour force)	_	4.2	5.1	5.3	4.7	5.1
Household saving ratio, net (% of disposable income)	_	2.7	9.2	8.3	3.9	3.1
General government financial balance (% of GDP)	_	2.1	-4.1	-4.1	-5.6	-3.2
General government gross debt (% of GDP)	_	30.3	36.2	36.6	41.5	43.8
General government debt, Maastricht definition[3] (% of GDP)	_	20.0	24.7	25.1	30.0	32.2
Current account balance (% of GDP)	_	1.9	-0.1	-0.4	-2.2	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/5np6jm

Since the outbreak of the war, Bulgaria has taken in more than 100 000 refugees, inflation pressures have intensified, and uncertainty has increased. This uncertainty affects several sectors including construction, which is facing supply difficulties; tourism, where fewer Ukrainian and Russian visitors are expected; and the energy sector given the country's dependence on Russia, which has suspended its gas supplies to Bulgaria since April 27, 2022. Although a gas shortage will likely be avoided due to the supply of liquefied natural gas by the United States and EU partners and a new pipeline allowing greater gas imports from Azerbaijan and possibly other producers in the future, this situation will likely exacerbate inflationary tensions. The European oil embargo on Russian oil will also add to these price pressures, even if Bulgaria is exempt from this embargo until 2024. Faced with these tensions, companies were granted a partial compensation for their electricity bills. Household electricity, heating and water tariffs have also been frozen since December 2021.

Fiscal policy will moderate the economic consequences of the war

The budget deficit remained stable at 4.1% of GDP in 2021 and the 2022 budget, which foresees a deficit increase by 1 point of GDP, will be reviewed during the summer. This strongly expansionary policy involves a sharp increase in public investment due to EU subsidies of the Recovery and Resilience plan, which will total around 10% of GDP between 2022 and 2026. The deficit is expected to decline in 2023 due to lower

COVID-related expenditure and the expiry of measures to offset rising energy prices. Although rising to around 32% of GDP (Maastricht definition) in 2023, public debt will remain moderate by international comparison. Despite the strong acceleration of inflation in recent months, short-term interest rates remain low, reflecting the hard peg of the lev to the euro and euro area monetary conditions. Market rates are expected to increase gradually alongside those in the euro area.

The recovery is expected to weaken and inflation to rise

The negative impact of inflation on household income, heightened uncertainty and the weaker external environment and competitiveness will hamper the recovery. The slowdown in growth to around 2½ per cent in 2022 and 2¼ per cent in 2023 should however be moderated by the measures taken to protect households from the surge in energy prices and the increase in public investment. Private consumption will also be supported by a decline in the savings rate as the pandemic wanes. Inflation, which could average nearly 14% in 2022, is expected to decline in 2023, and unemployment to remain relatively low. With fiscal policy tightening next year, energy price increase expected to moderate and lower pressures on other commodities, inflation could slow to around 6% by the end of 2023 if wage outcomes are moderate. However, risks are significant and tilted to the downside. Higher-than-expected inflation in the event of a wage-price spiral or a sharper increase in energy or food prices would weaken exports and/or private consumption. The increase in public investment could also be weaker than expected due to the late adoption, in April 2022, of Bulgaria's Recovery and Resilience plan.

Promoting the energy transition will help energy security

Protecting low-income households against rising energy and food prices with targeted aid, such as cash transfers, would be more effective than freezing tariffs, generalised subsidies or a VAT reduction, and also avoid distorting price signals. A tightening of the fiscal stance in 2022, stemming from the summer budget review, could help ease inflationary pressures. Promoting the energy transition and renewable energies through effective use of EU aid is also important to improve the country's energy security.

Canada

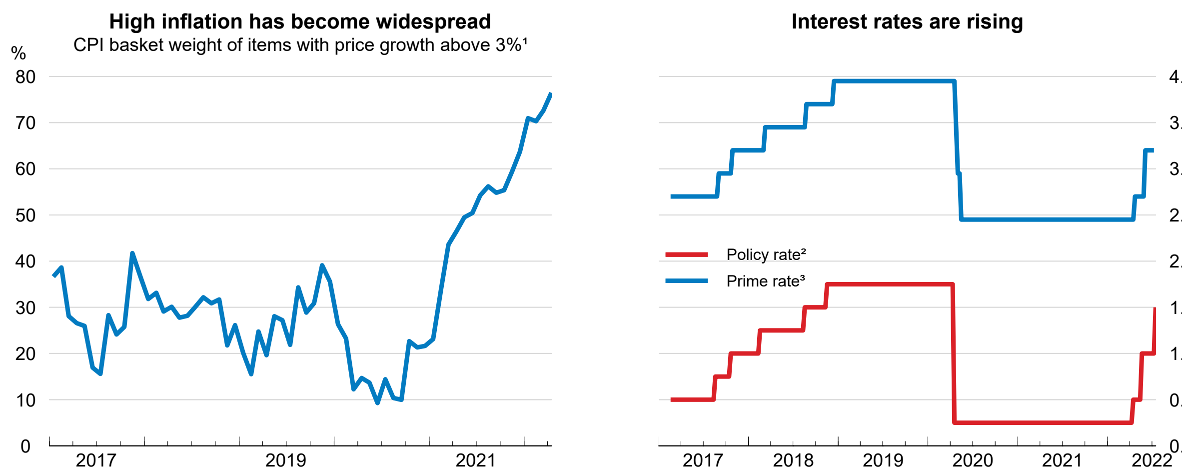
Canada's economy has largely recovered from the COVID-19 crisis. Domestic demand is picking up following the easing of containment measures. Exports are expected to strengthen, demand for commodities buoying trade amid shocks to world growth. Limited trade ties to economies hard-hit by the war in Ukraine, and income from high resources prices, shield Canada from larger economic impacts. Real GDP is projected to grow by 3.8% in 2022 and 2.6% in 2023. Unemployment will remain low as output rises slightly above potential. Global supply tensions will keep price growth high this year, compounding underlying inflationary pressures.

The Bank of Canada should continue raising its policy rate and shrinking its balance sheet to return inflation to target and contain financial imbalances. Signs that resurgent demand is straining domestic productive capacity could require faster policy tightening. To avoid fuelling excess demand, federal and provincial governments should channel strong resources revenues to public-debt reduction while targeting temporary income support to households facing living-cost pressures. Greater support for green technologies, including clean electricity, would advance Canada's climate policy goals and free up energy for export.

Price pressures have increased in a strong economy

The Omicron wave only briefly slowed growth in economic activity. Real GDP grew by 0.8% (non-annualised) in the first quarter of 2022. Large output gains in contact-intensive services followed the relaxation of containment measures from late January. Solid growth in recent months also reflects contributions from resources sectors, construction and manufacturing. Higher energy prices are boosting merchandise export values, which are also benefiting from increased demand for metals and fertilisers. Slowing home sales and price growth suggest housing-market activity is cooling in the wake of interest rate rises. Housing-related spending continues, however, to buoy core retail sales. Recent data

Canada 1



1. The chart shows the share of products experiencing year-on-year price growth above the top of the central bank's 1-3% control range for inflation. Basket weights are aggregated from level four product group data.
2. Policy rate is the Bank of Canada's target average rate for overnight money market financing.
3. Prime rate is the typical benchmark set by Canada's six major chartered banks to determine interest rates for variable-rate mortgages and other loan products.
Source: Statistics Canada; Bank of Canada; and OECD calculations.

StatLink https://stat.link/neo8p4

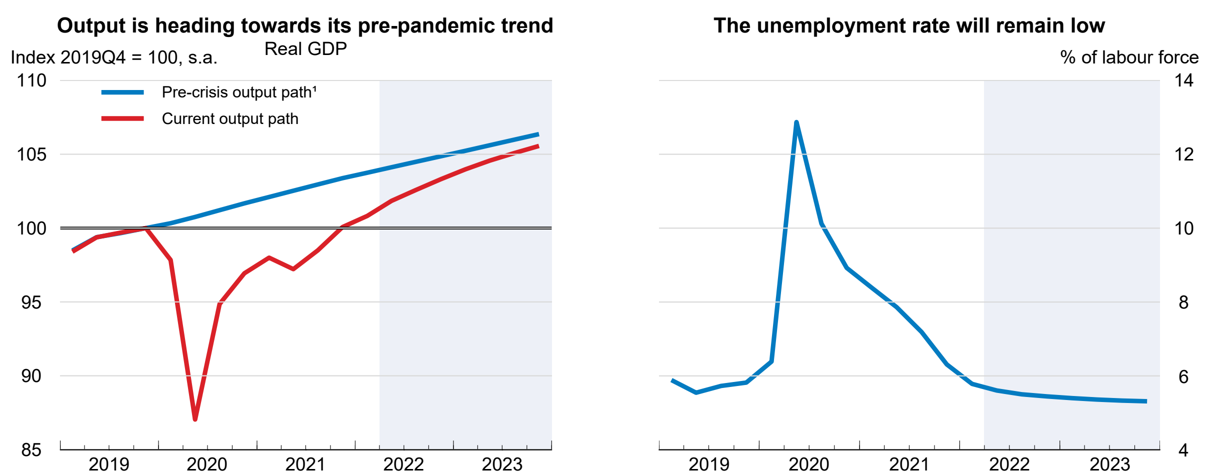
Canada: Demand, output and prices

Canada	2018	2019	2020	2021	2022	2023
	Current prices CAD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	2 235.7	1.9	-5.2	4.5	3.8	2.6
Private consumption	1 294.2	1.4	-6.1	4.9	4.7	3.0
Government consumption	462.4	1.7	0.0	5.8	1.8	1.3
Gross fixed capital formation	507.0	0.0	-2.8	7.1	2.9	1.7
Final domestic demand	2 263.5	1.2	-4.2	5.6	3.7	2.3
Stockbuilding[1]	15.8	0.1	-1.7	0.9	0.5	0.0
Total domestic demand	2 279.3	1.2	-5.8	6.5	4.3	2.3
Exports of goods and services	722.7	2.3	-9.7	1.4	2.5	4.1
Imports of goods and services	766.3	0.4	-10.8	7.7	4.0	3.3
Net exports[1]	- 43.6	0.6	0.5	-2.0	-0.5	0.3
Memorandum items						
GDP deflator	_	1.5	0.7	8.1	8.3	4.3
Consumer price index	_	2.0	0.7	3.4	6.0	3.9
Core consumer price index[2]	_	2.1	1.1	2.3	4.3	3.5
Unemployment rate (% of labour force)	_	5.7	9.5	7.4	5.6	5.4
Household saving ratio, net (% of disposable income)	_	2.0	14.4	10.8	5.6	2.9
General government financial balance (% of GDP)	_	0.0	-11.4	-5.0	-2.4	-1.3
General government gross debt (% of GDP)	_	92.9	126.9	117.3	117.0	116.8
Current account balance (% of GDP)	_	-2.0	-1.8	0.0	1.7	2.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/hsoq20

Canada 2



1. The pre-crisis output path is based on the November 2019 OECD Economic Outlook projection, with linear extrapolation for 2022 and 2023 based on trend growth in 2021.
Source: OECD Economic Outlook 106 and 111 databases.

StatLink https://stat.link/zqp1yf

show households spending more of their disposable incomes and saving less than in 2021. This is allowing many to maintain consumption in the face of rising prices. Firms' investment plans are strong, in line with sales growth and capacity pressures. Supply challenges have been exacerbated by labour shortages. Increased competition for workers and rising wage growth point to an economy operating near full employment. Firms facing strong demand are passing on higher input costs to customers. Large price increases are now widespread and threaten to become self-sustaining.

Food and energy price rises following Russia's invasion of Ukraine are contributing to high inflation. Despite terms of trade gains, the value of the Canadian dollar is little changed against the US dollar, leaving import price pressures strong. Higher resource revenues are, however, boosting incomes and helping offset foreign demand shocks. Domestic production of wheat, energy and metals protects Canada from acute supply shortages.

Macroeconomic policy support is being withdrawn

The Bank of Canada has stepped up monetary policy tightening. A 50 basis point increase in June brought the benchmark interest rate to 1.5%. The Bank has also announced that it will stop replacing maturing government bonds on its balance sheet. The resulting quantitative tightening will further increase long-term borrowing costs. More rate rises will be needed to tame price pressures and bring monetary policy to neutral settings, where it neither stimulates nor weighs on the economy. The projections assume the policy rate will increase to 2.5% by early-2023. Additional increases may be required if high inflation expectations become entrenched at a time when spare capacity is limited.

The federal government sensibly allowed pandemic support to businesses and households to expire in May. Reduced expenditure on wage and rent-bill subsidies and strong tax revenues, due partly to high commodity prices, will contribute to declining fiscal deficits in 2022 and 2023, even after accounting for new spending. To reduce the burden of rising consumer prices this year, provincial governments have deployed measures ranging from fuel-tax cuts to one-off transfers to lower-income households. The federal government is focusing on alleviating housing costs, using supply-side interventions and support to first-time buyers. On top of higher skilled-migration targets, a fee-exempt immigration stream has been set up for people fleeing Ukraine. Over 240 000 applications had been received as of late May (equivalent to 0.6% of Canada's population). The federal budget proposes additional funding for military and financial aid to Ukraine. Despite the new funding for these and other measures such as climate action, the public debt burden is projected to decline over the projections, tighter fiscal policy complementing withdrawal of monetary stimulus.

Strong growth will continue amid external shocks

Real GDP is projected to grow by 3.8% in 2022. As a commodity exporter with limited trade links to hard-hit economies, Canada is well placed to withstand economic shocks from the war in Ukraine. The major impact will come from higher price growth. Food and energy price rises will squeeze household purchasing power, with quarterly consumer price inflation peaking at an annualised rate of 7.2% in mid-2022. This will weigh on private spending, even as saving rates return to more normal levels. Weaker foreign demand, due in part to withdrawal of stimulus in the United States, will temper recovery in exports of non-resource goods. Demand for home-buying will soften with higher borrowing costs, causing price rises and construction to moderate. These growth drags will be offset in 2022 by strong investment in the public and private sectors and higher commodity exports. Oil and gas producers are expected to increase production this year and expand capacity in response to high prices. Trade surpluses will widen in the near term and then narrow from mid next year amid export price moderation and ongoing recovery in travel services, in which Canada is usually a net importer. Real GDP is projected to grow by 2.6% in 2023. Output will rise above potential, with the unemployment rate remaining at historically low levels. Tight labour-market conditions are projected to drive up wage growth. This will keep core inflation above target next year even as energy price adjustments reduce headline inflation.

A prolonged conflict in Ukraine would weaken foreign demand and bring stronger price rises, but also larger commodity revenues. Elevated uncertainty could damp businesses' investment plans and encourage more precautionary saving among households. Large housing market corrections could weigh on credit markets and consumer finances, particularly if labour market conditions also deteriorate. This would further dent consumption. Economic activity has proved resilient to recent waves of COVID-19. Yet new variants and virus outbreaks remain a risk. In contrast, higher immigration could alleviate labour shortages and wage pressures in supply-constrained industries.

Current challenges must not derail long-term priorities

Living-cost support should be temporary and targeted at lower-income households. Fuel-tax cuts – as introduced in some provinces – in contrast assist well-off households as well as those in need. Such measures also distort carbon-pricing signals. Support for clean electricity will help cut greenhouse gas emissions while freeing up energy for export. Rising interest rates should temper housing price growth in the near term. Other measures are needed to durably improve housing affordability, including relaxing local land-use rules to expand housing supply. Progress continues in social policy. Access to affordable childcare will support workforce participation. Such efforts should be matched with action to boost productivity. Lowering barriers to trade between provinces would remove an important obstacle to growth.

Chile

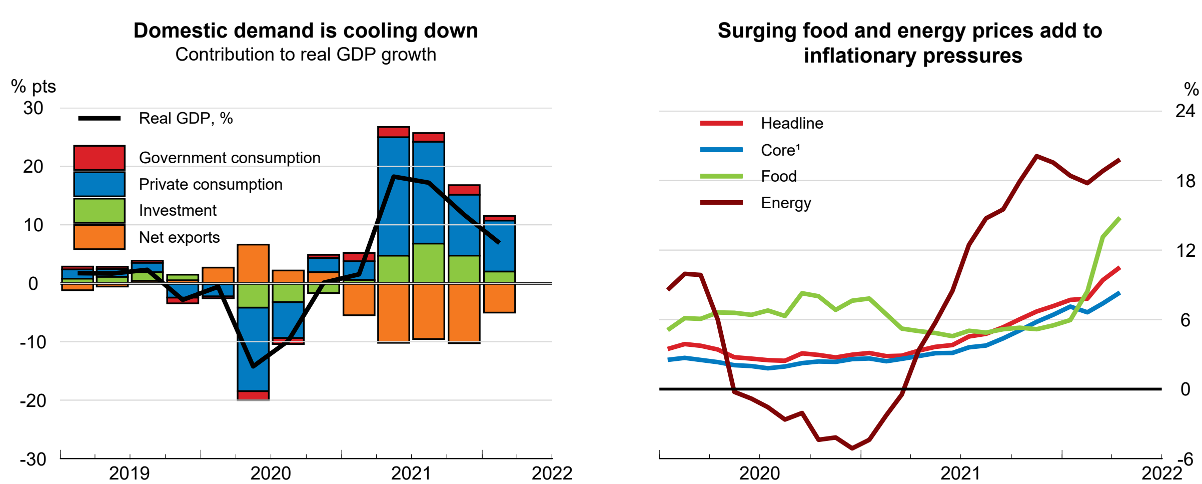
Growth is projected to slow sharply to around 1.4% in 2022 and 0.1% in 2023. Elevated inflation, tighter financial conditions and the withdrawal of extraordinary fiscal measures will constrain household consumption. Tighter financial conditions and uncertainty surrounding the new constitution will likely damp firms' investment. Headline inflation will moderate in 2023, but will remain high due to the impact on energy prices of the EU oil embargo on Russia.

Preserving fiscal sustainability will hinge on implementing the envisaged ambitious consolidation path. A lagging job recovery and higher global food and energy prices will require targeted and temporary fiscal support to the most vulnerable households. A fiscal reform addressing Chile's structurally low public revenues and low tax progressivity is needed to address pressing infrastructure and social needs. More investment in renewables, coupled with an accelerated coal phase-out, can help to reduce energy dependence and costs. The central bank should continue tightening to ensure that inflation returns to target, but at a slower pace, given the economic slowdown.

The economy has slowed after a fast recovery

After surpassing pre-pandemic levels by 8% in 2021, driven by strong household consumption, economic activity contracted in the first quarter of 2022. Retail sales and economic sentiment declined in the first months of the year, with services contributing positively to activity, as the economy reopened. The labour market has been recovering although employment and participation levels remain below pre-pandemic levels. The unemployment rate has increased this year, reaching 7.7% in April, with more people returning to the labour force.

Chile



1. Consumer Price Index (CPI) excluding energy and food products.
Source: OECD Economic Outlook 111 database; CEIC; and INE.

StatLink https://stat.link/m8sd45

Chile: Demand, output and prices

Chile	2018	2019	2020	2021	2022	2023
	Current prices CLP billion	Percentage changes, volume (2018 prices)				
GDP at market prices*	189 611.1	0.7	-6.2	11.9	1.4	0.1
Private consumption	117 576.3	0.8	-8.2	20.5	1.2	-1.5
Government consumption	28 144.8	0.5	-4.1	10.4	7.2	0.2
Gross fixed capital formation	43 456.1	4.7	-9.7	18.0	-1.0	-0.4
Final domestic demand	189 177.3	1.7	-8.0	18.3	1.4	-1.0
Stockbuilding[1]	2 693.2	-0.7	-1.6	3.1	1.2	0.0
Total domestic demand	191 870.5	0.9	-9.4	21.8	2.5	-1.0
Exports of goods and services	53 881.8	-2.5	-1.2	-1.5	1.3	1.8
Imports of goods and services	56 141.2	-1.7	-12.8	31.2	5.7	-1.3
Net exports[1]	-2 259.4	-0.2	3.5	-8.9	-1.4	1.1
Memorandum items						
GDP deflator	_	2.6	8.7	7.6	8.3	4.8
Consumer price index	_	2.6	3.0	4.5	9.0	5.2
Private consumption deflator	_	1.8	4.3	5.3	9.4	5.4
Unemployment rate (% of labour force)	_	7.2	10.7	8.8	8.2	8.1
Central government financial balance (% of GDP)	_	-2.9	-7.3	-7.6	-2.8	-1.7
Current account balance (% of GDP)	_	-5.2	-1.7	-6.5	-7.8	-5.7

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/z5fbe3

Indirect effects of the war in Ukraine are already being felt through higher energy and food prices. These add to inflationary pressures from strong consumption demand, fuelled by extraordinary pension fund withdrawals and pandemic-related income support to households. In addition, the currency has depreciated amid domestic political uncertainty, pushing inflation expectations over the next two years above the central bank inflation target of 3%. Wages have increased to 7.4% annually in March driven by labour market mismatches, although real wages decreased by 2% annually. While higher copper prices could spur mining production and investment, these effects are outweighed by higher energy prices, leading to a deterioration of the terms of trade.

Monetary and fiscal policy are becoming more restrictive

The government has appropriately committed to an ambitious fiscal consolidation and is phasing out COVID-19 fiscal stimulus measures. The government intends to reduce the structural deficit of the public sector from 11% of GDP in 2021 to 3.3% of GDP in 2022 and by 0.75% of GDP per year until 2026, in line with the fiscal rule, in order to stabilise debt around 44% of GDP. The government has recently approved a fiscal package to mitigate high oil prices through higher subsidies to households and firms and to support employment and SMEs in lagging sectors. Targeted cash transfers have been increased to alleviate the impact of inflation on vulnerable households. Monetary policy has become restrictive after authorities implemented successive policy rate increases to 8.25% in May. Further but smaller increases in policy rates to 9.4% are expected during this year, with rates then remaining stable until late 2023.

Economic growth will remain weak given the uncertain environment

The unwinding of fiscal stimulus, a decline in real wages driven by strong inflationary pressures, and monetary tightening will weigh on economic growth during 2022 and 2023. Private investment is projected to remain weak, due to uncertainty surrounding the new constitution and higher interest rates. Pre-pandemic employment levels will be reached gradually, supported by ongoing hiring subsidies, but labour informality remains a concern. Inflation is projected to ease driven by the slowdown of the economy but will remain elevated due to high energy prices following the EU embargo on Russian oil. Downside risks include sudden sentiment changes in global financial markets that could increase financing costs, widen the current account deficit and weaken the currency further. A depreciated currency could push up inflation, but more severe effects will be mitigated by large foreign-exchange reserves. Inflation could be higher than expected if inflationary pressures from energy and food prices last longer. A sharper slowdown in China, the main trading partner, would hurt investment and growth. Upside risks to growth are sustained higher copper prices and a faster resolution of global supply bottlenecks.

Enhancing energy security and boosting productivity should be priorities

Chile’s rich endowments in renewable energy sources provide strong export potential. More investment in renewables, coupled with an accelerated coal phase-out, can help to diversify the economy and boost productivity, while reducing energy dependence and costs. A recent National Green Hydrogen Strategy has the potential to decarbonise the economy, particularly the mining industry. Ensuring adequate funding for social and infrastructure spending will require raising tax revenues by further reducing tax evasion, increasing property and CO2-emission-related taxes and broadening the personal income tax base. Strengthening competition, encouraging the adoption of digital technologies and reducing the complexity of regulatory procedures would drive needed productivity gains and boost potential growth. Improving the quality of public education and professional training would mitigate the consequences of the pandemic and reduce inequalities. Reinforcing unemployment benefits and expanding coverage of cash transfer programmes for the vulnerable, while reducing their segmentation would strengthen the labour market recovery and enhance fairness.

China

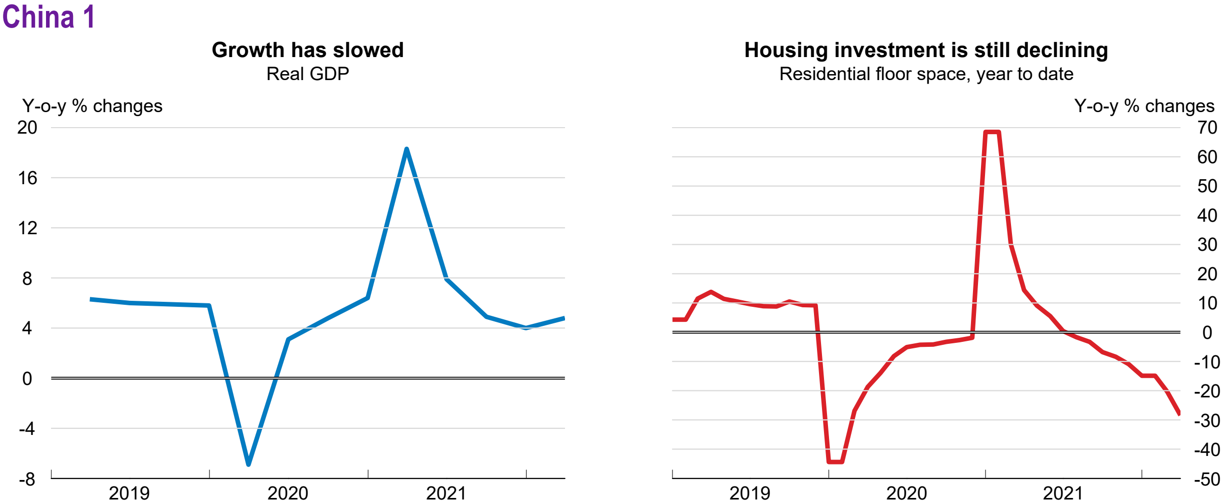
Economic growth will slide to 4.4% in 2022 and rebound to 4.9% in 2023. Amid mounting headwinds, growth will be supported by investment in the climate transition and the frontloading of infrastructure projects. Real estate investment will remain weak due to the continuing defaults across developers and falling price expectations. Exports will remain relatively strong as companies continue to raise their market shares. Adverse confidence effects related to continuing lockdowns coupled with inadequate social protection will weigh on consumption. China's large oil and grain reserves will mitigate the impact of rising global energy and food prices.

Monetary policy has become more supportive with a series of interest rate and reserve requirement rate cuts, but will refrain from significant easing. Fiscal policy will become more supportive as the composition of spending shifts towards infrastructure, though the use of fiscal reserves will mean the headline deficit will shrink. Fiscal measures should focus more on renewables investment and the energy transition to achieve climate mitigation objectives. Recent measures to create a single domestic market are welcome and the phasing out of administrative monopolies should be accelerated.

The zero-COVID policy has been maintained

GDP growth slowed to 1.3% quarter-on-quarter in the first quarter of 2022 from 1.5% in the fourth quarter of 2021. This partly reflected the stringent measures that remain in place to eradicate the spread of COVID-19, resulting in strict lockdowns in key economic centres such as Shanghai and Beijing. These have continued in the second quarter of 2022, disrupting economic activity. Nearly 90% of the population is vaccinated by domestically-made vaccines, which are considered less effective than the ones used in OECD countries. Moreover, the share of the elderly is high among the unvaccinated. All the infected continue to be obliged to isolate collectively and millions are being put into lockdown. These policies create demand for new isolation facilities, new jobs at local neighbourhood centres and delivery companies, but

China 1



Source: CEIC.

StatLink https://stat.link/r4oej0

China: Demand, output and prices

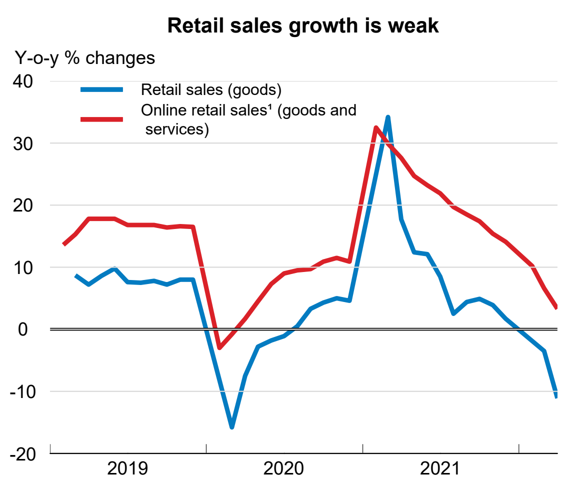
China	2018	2019	2020	2021	2022	2023
	Current prices CNY trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	91.9	6.0	2.2	8.1	4.4	4.9
Total domestic demand	91.3	5.9	1.6	6.3	2.9	4.9
Exports of goods and services	17.5	1.3	3.0	16.2	7.3	5.5
Imports of goods and services	17.0	0.4	-0.3	7.7	-0.3	5.3
Net exports[1]	0.6	0.2	0.6	2.0	1.6	0.4
Memorandum items						
GDP deflator	_	1.3	0.5	4.4	3.1	1.4
Consumer price index	_	2.9	2.5	0.8	2.0	3.0
General government financial balance[2] (% of GDP)	_	-3.7	-6.9	-6.6	-6.5	-6.6
Headline government financial balance[3] (% of GDP)	_	-2.8	-3.7	-3.1	-2.8	-3.0
Current account balance (% of GDP)	_	0.7	1.7	1.8	3.0	3.1

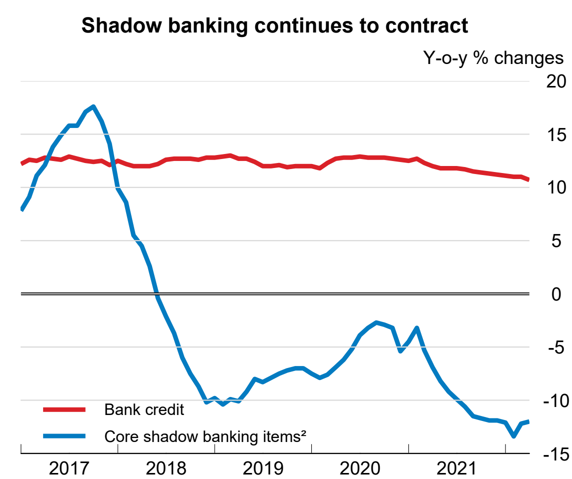
1. Contributions to changes in real GDP, actual amount in the first column.
2. Encompasses the balances of all four budget accounts (general account, government managed funds, social security funds and the state-owned capital management account).
3. The headline fiscal balance is the official balance defined as the difference between revenues and outlays. Revenues include: general budget revenue, revenue from the central stabilisation fund and sub-national budget adjustment. Outlays include: general budget spending, replenishment of the central stabilisation fund and repayment of principal on sub-national debt.

Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/codpmb

China 2





1. Year-to-date data.
2. Core shadow banking items include entrusted loans, trusted loans and undiscounted bankers' acceptance.
Source: CEIC.

StatLink https://stat.link/dbzlie

such investments are less productive than those, for instance, in much needed infrastructure. The services sector and consumption have been particularly impacted. Automobile supply chains have experienced disruptions, contributing to weaker export growth. Investment growth is slowing as some components such as real estate investment have weakened. Stringent regulations to rein in real estate investment (the so-called three red lines related to financial ratios as well as caps on real estate lending by bank type) and prices have tightened liquidity conditions for property companies and even pushed some large ones to default.

The impacts of the war in Ukraine have mostly been felt through the impact on global markets as neither Ukraine nor Russia is an important economic partner for China (unlike vice versa). Imported energy and raw material prices have surged, but the pass-through to consumer price inflation is limited due to the structure of consumption, with a large share of food that has limited import content. The release of edible oils reserves has helped keep food inflation under control, despite price rises in international markets due to the war in Ukraine. China's large grain reserves and export restrictions in the form of quotas will mitigate the impact of rising global grain prices on domestic inflation and reduce the risk of shortages. However, lockdown-induced supply-side constraints on fresh food have started to push CPI inflation higher, with headline inflation reaching 2.1% year-on-year in April (though core inflation remained low at 0.9%). Replacing part of crude oil imports by discounted Urals from Russia also helps contain inflationary pressure.

Monetary policy will be more supportive and fiscal policy more expansionary

Monetary policy is assumed to become more supportive. The required reserves ratio and the benchmark interest rate have been cut twice since November 2021, and further moderate cuts are assumed to follow, though the room is quite limited. Financial risks have declined, though vulnerabilities remain. Credit events in the property market have tightened borrowing conditions for companies in the sector and other high-risk borrowers, and shadow banking has been further reined in. This led to a slight increase in informal interest rates, reflecting credit risk for smaller private companies. As the share of unsold properties reached the highest level in thirteen years, many cities adopted stimulus measures such as lump sum or per square-metre subsidies for first-time buyers, tax reductions, or broadening the definition of eligible home buyers. In May, the floor of mortgage rates for first-time buyers was cut nationwide. Recent guidelines foreshadow some relaxation of financing restrictions for property developers and local government investment vehicles. Orderly bond defaults will help sharpen risk pricing and gradually remove implicit guarantees. Corporate debt has stabilised at a very high level of around 155% of GDP. Deleveraging should thus continue.

Fiscal policy will provide support in the form of cuts in taxes and charges and spending of reserve funds. There is also a sizeable carry-over effect stemming from unspent proceeds from specialised local bond issues in 2021. Furthermore, ad hoc submission of dividends by the state-owned financial sector to the government as its owner equivalent to 0.8% of GDP will partly be spent on infrastructure investment. The recent requirement for local government investment vehicles to secure the budget prior to carrying out infrastructure projects helps contain contingent liabilities, though it has constrained their activities. To better mobilise them in the infrastructure drive, they will have easier access to funding.

Growth is returning to its pre-pandemic path

GDP growth will moderate significantly in 2022, reflecting a slowdown from the strong rebound in 2021 and the impact of pandemic-related shutdowns, before returning to its gradually slowing pre-pandemic path in 2023. Infrastructure investment will pick up, financed by bonds issued last year and as the authorities frontload projects. This will partly offset weaker real estate investment. An expected further rise in corporate defaults will improve risk pricing, but may adversely affect banks, trust companies, as well as other private and institutional investors. Further virus outbreaks are likely, constraining consumption, though to a lesser extent than in early 2022 assuming case numbers further decline. CPI inflation will be somewhat higher due to lockdown-related supply-side constraints lifting fresh food prices and some pass-through from higher energy and food prices, but will remain moderate. A stable supply of energy and grains will play a key role in containing price increases.

The sanitary situation remains a key downside risk as outbreaks continue and are addressed by stringent isolation measures. The lack of mutual recognition of vaccination certificates prevents the reopening of borders. Continued credit events and disorderly deleveraging in the overstretched property sector may trigger failures of smaller banks and shadow banking institutions. In contrast, relaxing prudential measures and encouraging investment in real estate may fuel the bubble and subsequently cause greater disruptions. Relaxing environmental regulations to address electricity shortages would boost production in the short run, but would make it more difficult to meet longer-term environmental objectives.

Turning crisis into an opportunity to initiate key reforms

Fundamental reforms to enhance competition would sustain the economic recovery from the pandemic. This includes easing restrictions on the entry and conduct of private and foreign enterprises as well as phasing out privileges of state-owned firms and public entities, in particular implicit government guarantees. Administrative monopolies, often with exclusive rights to provide certain goods and services, should be dismantled. Recent measures aiming at creating a single domestic market are a welcome step. Stronger consumer protection could also boost competitive pressures. The creation of a level playing field and adherence to competitive neutrality should be done in a coherent and systematic way to avoid uncertainty and adverse confidence effects stemming from ad hoc implementation of regulations. Better preparation for future outbreaks, which will likely happen, including vaccinating the unvaccinated and increasing the effectiveness of boosters would cause fewer disruptions to economic activity. The current growth target of around 5.5% is rather ambitious and available funding should target new technologies to decarbonise industrial processes, which would work towards also achieving climate goals. Furthermore, occasional power shortages should prompt an acceleration of the transition to renewables. As renewables production has become sustainable and subsidies are being phased out, more funds should be channelled to support the transition to zero net emissions.

Colombia

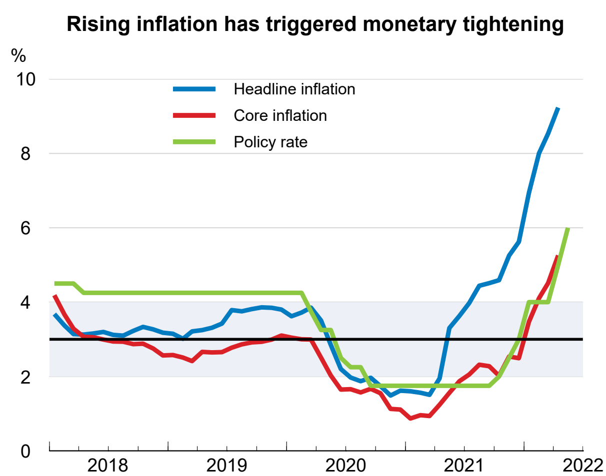
GDP is projected to grow by 6.1% in 2022 and 2.1% in 2023. Private consumption is the main driver of the recovery, driven by a gradual pick-up of employment. Strong commodity prices have improved the terms of trade and are supporting fiscal outcomes, against the background of rising external demand. Inflation has risen well above target, initially driven by food and energy prices, which have particularly affected low-income households. More recently, however, inflationary pressures have become increasingly widespread.

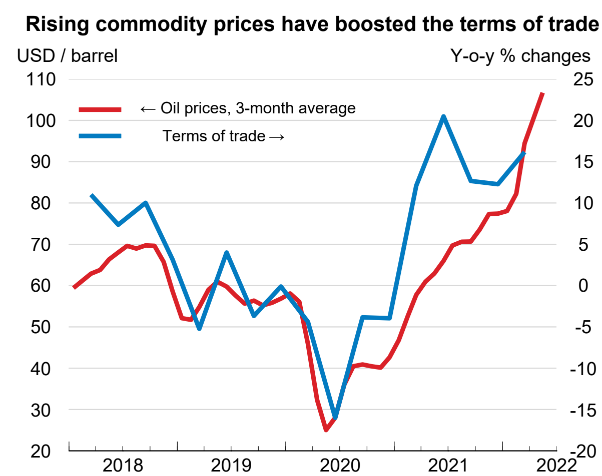
Monetary policy tightening has accelerated substantially and financial conditions are expected to remain tight until end-2023. Fiscal policy will provide continuous support to vulnerable households during 2022, while spending reductions in other areas will usher in a gradual fiscal adjustment that is set to intensify in 2023. A recent fiscal reform has laid the grounds for this adjustment, but stabilising public debt will require additional efforts. Addressing long-standing challenges like low tax revenues, low tax progressivity and low coverage of social benefits could ensure a more inclusive recovery.

Rising commodity prices are supporting exports and public revenues

A strong rebound of activity during the second half of 2021 brought GDP almost back to the levels projected prior to the pandemic. In early 2022, the recovery slowed amid a sharp decline in consumer confidence, although unemployment continues to fall while employment remains on a rising trend. Rising female employment has narrowed the gender employment gap. Annual inflation has reached 9.2% and is weighing on consumer spending, especially for low-income households, as food prices have risen by 26% year-on-year. Recent negotiations have resulted in a 10% increase of the minimum wage, while wage growth in manufacturing and retail sectors have been strong. While Colombia has only a small direct trade and financial exposure to Russia and Ukraine, it is a major commodity exporter and higher oil and mineral prices have buttressed exports and fiscal outcomes.

Colombia





Source: DANE; BRC; Refinitiv; and OECD Economic Outlook 111 database.

StatLink https://stat.link/fbeh9q

Colombia: Demand, output and prices

Colombia	2018	2019	2020	2021	2022	2023
	Current prices COP trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	987.8	3.2	-7.0	10.7	6.1	2.1
Private consumption	672.9	4.1	-5.0	14.8	8.3	3.1
Government consumption	152.3	5.3	-0.6	10.3	4.1	-0.9
Gross fixed capital formation	209.7	2.2	-23.3	11.2	8.6	2.9
Final domestic demand	1 034.9	3.9	-8.1	13.4	7.7	2.5
Stockbuilding[1]	- 0.3	0.2	0.6	0.3	1.5	0.0
Total domestic demand	1 034.6	4.0	-7.5	13.6	9.3	2.3
Exports of goods and services	157.1	3.1	-22.7	14.8	12.5	7.1
Imports of goods and services	203.8	7.3	-20.5	28.7	25.1	5.9
Net exports[1]	- 46.8	-1.0	0.8	-3.9	-4.1	-0.2
Memorandum items						
GDP deflator	_	4.0	1.4	6.5	12.3	6.2
Consumer price index	_	3.5	2.5	3.5	8.4	5.4
Core inflation index[2]	_	2.8	2.0	1.8	5.2	5.4
Unemployment rate (% of labour force)	_	10.4	15.7	13.8	11.6	9.9
Current account balance (% of GDP)	_	-4.6	-3.4	-5.7	-6.5	-6.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding primary food, utilities and fuels.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/zr0p14

Monetary and fiscal policies are tightening over 2022 and 2023

The monetary policy rate has risen by 425 basis points since 2021, and tightening has accelerated this year. Broad-based inflationary pressures will likely require maintaining this accelerated pace to restrictive levels of 8%, and then keeping interest rates stable until late 2023. Fiscal policy has moved from unprecedented support to a gradual consolidation as the recovery gained pace. Exceptional income support to vulnerable households will be maintained until the end of 2022, while other spending areas are set for a significant consolidation, including public investment and general public services expenditures. Fiscal consolidation is meant to accelerate in 2023, if the incoming administration honours current fiscal plans. Improving fiscal outcomes will shore up confidence, after gross public debt has risen to 62% of GDP in 2021, up from 50% in 2019.

Despite a slowdown, growth will nonetheless remain solid

Moderate growth will resume in 2022, with a slight acceleration through 2023. Private consumption will gather steam in 2023 as high inflation abates and unemployment recedes. Investment will be driven by a strong construction sector attenuated by tighter financial conditions. Primary exports from oil and mining will benefit from high global prices, at least temporarily, which will also support investment in these sectors. Potential risks surround the adherence to fiscal plans, given that a significant part of the planned fiscal adjustment will have to be implemented by the next administration. Sudden sentiment changes in global financial markets, possibly related to changes in global interest rates, could increase financing costs and affect portfolio capital flows. These have been volatile in the recent past, although the impact has been cushioned by sizeable reserves and continuous access to multilateral financing.

Ambitious reform could address structural bottlenecks and improve equity

The pandemic has exacerbated previous challenges in poverty, inequality and labour market informality, while interrupting many children's education for up to 18 months. Healing these scars will require additional spending on social protection, health and education. This requires mobilising additional public revenues, as does maintaining adequate levels of public investment. It also provides an opportunity for a progressive reform of the tax system and its widespread exemptions and special rates, most of which favour the better off. Replacing social security charges on formal-sector wages with general tax revenues would reduce high non-wage labour costs and curb labour informality, which currently affects 60% of the workforce. A significant overhaul of the fragmented pension system could increase its currently narrow coverage and reduce old-age poverty, while fragmented cash benefit programmes could be merged into a universal social safety net, building on recent advances in social registries. Steps to reduce trade barriers and strengthen competition could facilitate necessary reallocation processes and bolster productivity. A majority of electricity is already generated from renewable, mostly hydroelectric, sources, ensuring energy security, but there is scope to expand the use of wind and solar energy to reduce the reliance on fossil fuels. Defining a timeline for raising and expanding the carbon tax could support these efforts.

Costa Rica

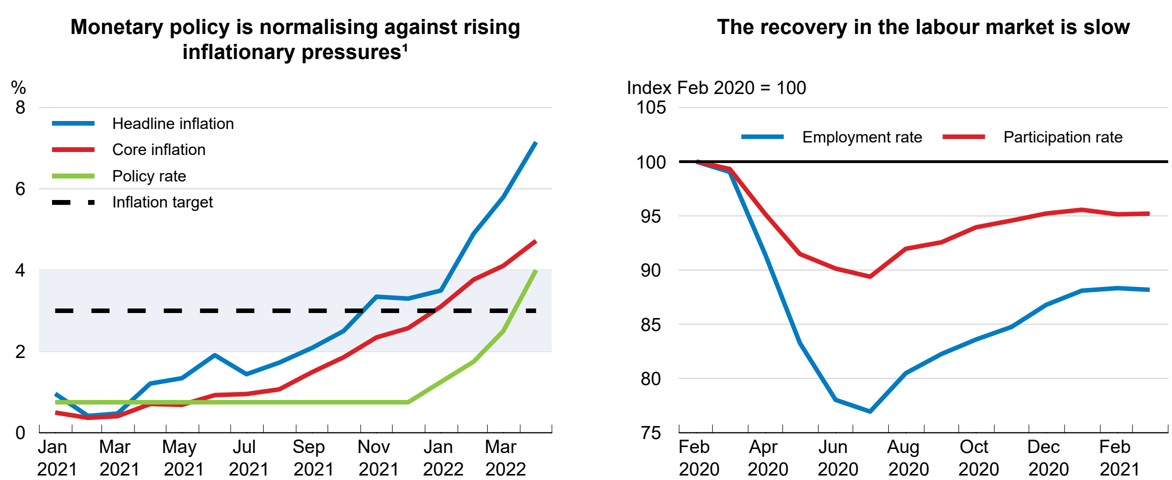
GDP will grow by 3.2% in 2022 and 2.6% in 2023. Domestic demand will strengthen moderately in 2022 and exports will benefit from the reactivation of the tourism sector in the last quarter of 2022 and 2023. Geopolitical tensions will affect Costa Rica through weaker external demand and increased inflationary pressures from higher commodity prices (food, energy and transportation). Inflation will hit 5.7% in 2022 and 5.6% in 2023, due to persistent external inflationary pressures and the reduction in domestic spare capacity.

The approval of the public employment bill in March and better than expected fiscal results in 2021 improved Costa Rica's fiscal outlook. The fiscal stance will remain restrictive over the projection period, as the fiscal rule contains public spending. Monetary policy will continue to normalise as inflationary pressures persist and the improvement in economic activity reduces the output gap. Reinforcing the childcare network would support female participation in the labour force and reduce educational inequalities. Shifting part of the tax burden from social security contributions to general taxation, in particular property taxes, and reducing the cost to set up firms would boost formal job creation.

The recovery has further progressed amid high inflationary pressures

Economic activity continued to progress in the first months of 2022, but at a slower pace, with all sectors operating above their pre-pandemic level except for those related to tourism (hotels and restaurants). In April, most economic restrictions were relaxed. The vaccination campaign has been rolled out successfully, with 81% of the total population having received at least a second dose in May.

Costa Rica



1. The horizontal dashed black line indicates the target inflation rate of monetary policy. The shaded area reports the tolerance band around the inflation target (+2% to +4%). Headline and core inflation indicate, respectively, the headline consumer price inflation rate and the core consumer price inflation rate. The core consumer price inflation rate measures consumer price inflation excluding food and energy components.
Source: Banco Central de Costa Rica.

StatLink https://stat.link/c874ow

Costa Rica: Demand, output and prices

Costa Rica	2018	2019	2020	2021	2022	2023
	Current prices CRC trillion	Percentage changes, volume (2017 prices)				
GDP at market prices	36.0	2.4	-4.1	7.8	3.2	2.6
Private consumption	23.4	1.7	-5.0	6.4	4.7	2.7
Government consumption	5.8	5.9	0.6	1.4	1.0	-0.2
Gross fixed capital formation	6.6	-8.2	-1.7	8.7	11.9	3.9
Final domestic demand	35.8	0.6	-3.5	5.9	5.4	2.5
Stockbuilding[1]	0.1	-0.3	-0.1	1.7	0.7	0.1
Total domestic demand	35.8	0.2	-3.6	7.6	5.3	2.3
Exports of goods and services	12.2	4.3	-10.9	15.9	8.2	9.3
Imports of goods and services	12.0	-2.3	-10.2	16.2	15.2	8.8
Net exports[1]	0.2	2.2	-0.6	0.3	-1.9	0.3
Memorandum items						
GDP deflator	_	2.6	0.2	2.1	5.8	5.6
Consumer price index	_	2.1	0.7	1.7	5.7	5.6
Core inflation index[2]	_	2.7	1.3	0.9	3.4	5.2
Unemployment rate (% of labour force)	_	11.8	19.5	16.4	13.2	12.0
Current account balance (% of GDP)	_	-1.2	-1.3	-3.2	-5.8	-5.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/eugvra

The war in Ukraine has strengthened inflationary pressures from logistics costs and imported commodity prices, especially of energy and food, which were rising already in 2021. Annual headline and core inflation hit 7.1% and 4.7%, respectively, in April, and the average wage in the formal sector increased by 5.7% in March. One-year ahead survey-based inflation expectations have reached 5.3%, above the upper end of the inflation target range of 2-4%. Trade linkages with Russia and Ukraine are negligible, but for imports of metals (construction) and fertilisers, finding alternative suppliers may imply higher costs in the short run. Fiscal measures to reduce the impact of the increase in energy prices on retail fuel are being discussed, but remain unlegislated.

Fiscal prudence will continue and monetary policy will normalise

Fiscal projections assume that current government spending is contained by the fiscal rule and government fiscal targets are met during 2022 and 2023. Net government lending is projected to fall to 4.4% in 2022 and 3.3% in 2023. Under these assumptions, public debt will peak at around 69% in 2022 before starting to decline. A swift and full implementation of the public employment bill would further support Costa Rica's fiscal sustainability via substantial savings in public spending. In reaction to increasing inflationary pressures and improved domestic conditions, the central bank started normalising monetary policy in December 2021 to avoid the de-anchoring of inflation expectations and the depreciation of the exchange rate. Since then, the target rate has increased from the historically low level of 0.75%, to 4% in April 2022. The monetary policy target rate is assumed to increase by 50 basis points in both the third and fourth quarters of 2022 and the first quarter of 2023, and then by 25 basis points each quarter from the second quarter of 2023, reaching 6.25% by end-2023.

Domestic demand will slow but remain solid

Growth is projected to slow to 3.2% in 2022 and 2.6% in 2023. The elimination of the remaining economic restrictions in the first half of 2022 and a successful vaccination campaign will support domestic demand despite the negative impact on private consumption and investment of high inflation and faster monetary policy tightening. The gradual reactivation of tourism will reinforce the recovery of labour intensive sectors and improve employment. Export growth in 2022 will slow due to lower global growth, especially in the United States. The flow of foreign direct investment will continue over the projection period. Inflation is projected to reach 5.7% in 2022, hitting household real disposable incomes, and to remain high at 5.6% in 2023, as external inflationary pressures continue. Higher interest rates will contain domestic inflationary pressures. The high degree of dollarisation exposes Costa Rica to risks associated with sharp exchange rate movements due to an unexpected tightening of global financial conditions. A higher-than-expected recovery in the tourism sector would boost exports and the recovery in the labour market.

Continuing with structural reforms would increase growth and economic resilience

Continuing the implementation of the structural reforms initiated during the OECD accession process would increase growth and economic resilience and reduce large income inequalities. Strengthening the governance and performance of state-owned enterprises would benefit the economy as a whole, as they play a dominant role in many key sectors, such as electricity and banking. The high administrative burden to start a company could be reduced by establishing virtual one-stop shops. Phasing out remaining exemptions to the competition law would boost productivity and lower prices. Costa Rica continues to implement the National Decarbonisation Plan as to achieve net-zero emissions by 2050 through actions such as increasing the share of zero-emission vehicles in the public transport fleet and maintaining the 100% share of electricity produced from renewable sources at a competitive price.

Czech Republic

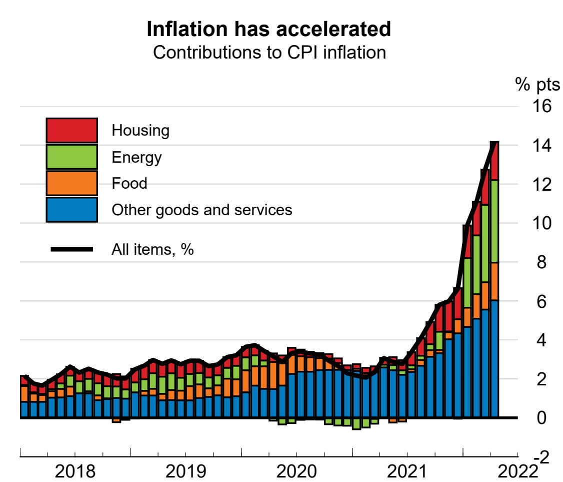
The Czech economy is projected to grow by 1.8% in 2022 and 2% in 2023. The recovery is facing headwinds from further supply disruptions, rising prices and overall uncertainty related to the war in Ukraine. Trade and manufacturing output will slow. A tight labour market will buttress private incomes, but weaker sentiment and rising prices will weigh on domestic demand. Inflation is expected to increase further, before gradually returning towards the tolerance band around the 2% target.

Since June 2021, the Czech National Bank has cumulatively raised its policy interest rate by 550 basis points, to 5.75% in May 2022 and further rate rises are assumed until the summer of 2022. A gradual fiscal consolidation in structural terms is planned from this year onwards. Targeted income-support measures are appropriate to protect the vulnerable from rising energy prices. A stronger framework for immigration policy and programmes to support the integration of refugees into the labour market would help ease recurring labour shortages.

The recovery is slowing

Adverse impacts on global trade and supply chains and upward pressures on energy and commodity prices from the war in Ukraine have slowed the recovery. The growth of manufacturing activity and exports has eased. Economic sentiment has deteriorated in some sectors, notably for households who face steep rises in consumer prices. Consumer price inflation reached 14.2% in April and exchange rate volatility rose. The labour market remains tight, with the unemployment rate at 2.4% in the first quarter of 2022. Yet, nominal wages have grown more slowly than consumer prices, and real wages are falling.

Czech Republic



Source: Refinitiv; and OECD Consumer Prices Indices database.

StatLink https://stat.link/4wsbiz

Czech Republic: Demand, output and prices

Czech Republic	2018	2019	2020	2021	2022	2023
	Current prices CZK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	5 416.2	3.0	-5.8	3.3	1.8	2.0
Private consumption	2 569.9	2.6	-6.8	4.3	1.3	1.9
Government consumption	1 048.9	2.5	3.4	3.0	0.8	1.0
Gross fixed capital formation	1 424.6	5.9	-7.5	0.6	1.3	3.5
Final domestic demand	5 043.4	3.5	-4.9	3.0	1.3	2.1
Stockbuilding[1]	48.2	-0.3	-0.8	4.3	0.7	0.0
Total domestic demand	5 091.6	3.1	-5.6	7.6	1.9	2.0
Exports of goods and services	4 172.9	1.4	-7.0	5.0	1.8	3.7
Imports of goods and services	3 848.3	1.5	-6.9	11.4	1.9	3.7
Net exports[1]	324.6	0.0	-0.5	-3.8	0.0	0.1
Memorandum items						
GDP deflator	_	3.9	4.4	4.0	7.5	3.4
Consumer price index	_	2.8	3.2	3.8	13.0	5.6
Core inflation index[2]	_	2.5	3.6	5.0	10.7	4.8
Unemployment rate (% of labour force)	_	2.0	2.5	2.8	2.5	2.6
Household saving ratio, net (% of disposable income)	_	8.5	16.8	15.6	8.9	8.4
General government financial balance (% of GDP)	_	0.3	-5.8	-5.9	-5.1	-4.5
General government gross debt (% of GDP)	_	37.8	47.1	48.4	52.4	56.0
General government debt, Maastricht definition[3] (% of GDP)	_	30.0	37.7	41.9	46.0	49.5
Current account balance (% of GDP)	_	0.3	2.0	-0.8	-3.9	-4.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/fszr7u

Due to its specialisation in manufacturing – the automotive sector in particular – the Czech Republic is highly vulnerable to disruptions in global supply chains and rising prices of raw materials. It also relies heavily on energy imports from Russia. Moreover, in its efforts to phase out coal, the Czech Republic planned to rely increasingly on natural gas. Until end-May 2022, the Czech Republic issued the status of temporary protection to around 350 000 Ukrainian refugees (3% of the total population). The authorities have introduced a “humanitarian benefit” targeted on the refugees, and made their employment administratively easier. Around 50 000 refugees have already found employment.

Fiscal policy has room to protect the most vulnerable

Given accelerating inflation and signs of de-anchoring of inflation expectations, the Czech National Bank (CNB) raised the policy interest rate from 0.25% to 5.75% between June 2021 and May 2022. The CNB has also intervened in the foreign exchange market to stave off depreciation pressures. The projections assume that the policy interest rate will rise further, to 6.25% in June. In addition, the CNB decided to increase the countercyclical capital buffer rate for exposures located in the Czech Republic in incremental steps from 0.5% to 1% (effective from 1 July 2022), with subsequent intermediate steps to 2.5% from April 2023. The CNB also reintroduced limits on new mortgage loans (based on debt-to-income and debt service-to-income ratios) to limit risks accumulating in the housing market. To protect households and firms from rising prices, and energy costs in particular, a variety of fiscal measures have been introduced. These include a temporary reduction in the excise duty on diesel and petrol, state guarantees for loans to the

SMEs affected by rising energy costs, a delay of VAT payments for firms in the transport sector, and increased and extended housing allowances. Moreover, the necessary public support services for refugees also require additional expenses. Overall, however, the government has set out to tighten fiscal policy over the medium term, and fiscal consolidation in structural terms is projected for 2022 and 2023, as budgeted.

Growth will remain moderate in 2023

GDP growth will slow in 2022. Trade and private investment will weaken due to global supply disruptions. Weaker sentiment and rising prices will damp private consumption, although still elevated savings and a tight labour market will support it. After rising further in 2022, inflation will start to subside in the second half of 2022. The decline in inflation will be only gradual due to further oil price increases – in early 2023 – related to the oil embargo. GDP growth will remain moderate in 2023. The impact of the Ukraine crisis on global supply chains and prices will fade and exports and investment will pick up, but rising prices will continue to hinder domestic demand. Uncertainty is very high. Prolonged pressures on global supply chains would raise inflation further and depreciate the exchange rate, which could force the CNB to tighten monetary policy even more forcefully. A prolonged energy crisis – even higher energy prices or a disruption to energy supplies – and additional large influx of refugees could result in higher pressures on public spending.

Unleashing labour supply and greening the economy would support growth

The CNB has appropriately tightened monetary policy to counter the rapid pick-up in consumer prices and concerns about inflation expectations. On the fiscal side, support measures to cushion rising energy prices should balance the immediate need for energy security and protection of disposable incomes with getting on the path towards a decarbonised economy. Moreover, it is important that public debt be put on a sustainable path in the long-term, notably by reforming the pension system. Boosting domestic labour supply (through increased employment of mothers and older workers), better matching skills provision with skills needs and using immigration policy more effectively would help attract and retain a productive and skilled labour force. Investment into renewable energy and electro mobility would decrease reliance on the gas and oil markets and help the recovery.

Denmark

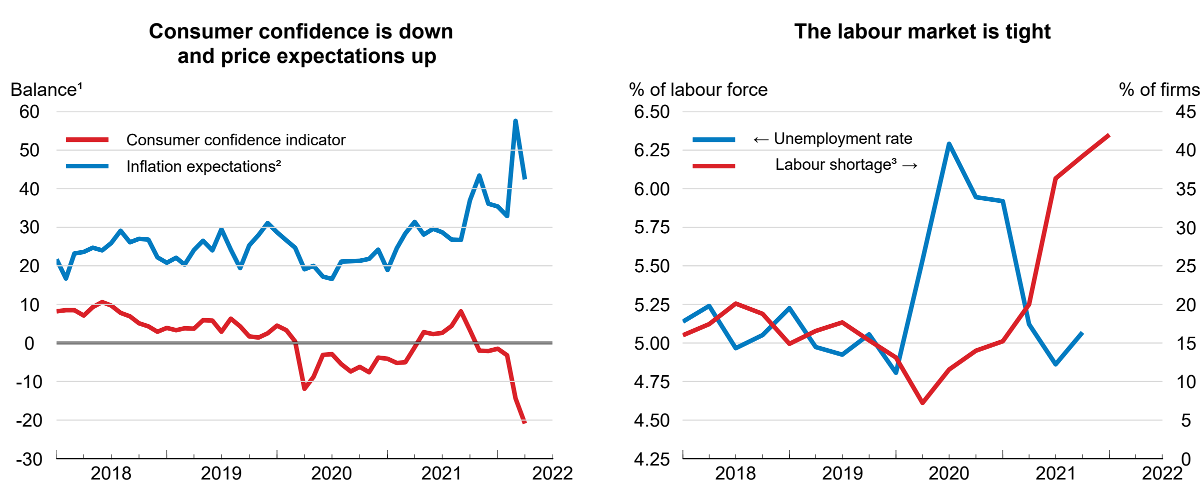
Growth has slowed due to the Russia-Ukraine war, with GDP forecast to expand by 3% in 2022 and 1.4% in 2023. The resilience of the Danish economy is underpinned by its low reliance on fossil fuel imports and strong household, corporate and government balance sheets. However, consumer and business confidence have fallen considerably and inflation has increased to over 6%. Further energy market disruption could reduce growth and push prices higher again, while the tight labour market could trigger more sustained inflation if it leads to rapid wage growth.

Fiscal policy is tightening as exceptional COVID-19 measures are removed. Budgetary support may need to be redirected if the geopolitical and economic situation worsens, for example through further support for the integration of refugees. Denmark should continue steps to reduce greenhouse gas emissions in manufacturing, transport and agriculture, building on its success in reducing fossil fuel dependence in the energy sector.

The rapid recovery has eased as price pressures mount

A rapid recovery from the COVID-19 crisis saw output exceed its pre-crisis trajectory in the second half of 2021. Strong export growth (28% in nominal terms in the year to March 2022) has been a key driver of the recovery. Private consumption eased over the winter as COVID cases rose, while GDP and retail trade declined in the first quarter of 2022 as consumer confidence fell with the outbreak of war in Ukraine. The rapid recovery has led to a tight labour market. The unemployment rate has fallen below its pre-crisis level and labour shortages are widespread across manufacturing, construction and services.

Denmark



1. Balance of positive and negative answers.
2. Balance of expectations of consumer prices in the next 12 months, by comparison with the past 12 months.
3. Simple average of the share of firms reporting labour shortages in manufacturing, construction and services.
Source: OECD Economic Outlook 111 database; and Statistics Denmark, Statbank tables FORV1, BAR03, KBYG33 and KBS2.

StatLink https://stat.link/q6kmn4

Denmark: Demand, output and prices

Denmark	2018	2019	2020	2021	2022	2023
	Current prices DKK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	2 253.3	2.1	-2.1	4.7	3.0	1.4
Private consumption	1 058.6	1.2	-1.3	4.2	1.3	1.2
Government consumption	547.0	1.5	-1.7	3.7	-2.4	0.9
Gross fixed capital formation	489.6	0.1	5.1	5.6	4.8	4.3
Final domestic demand	2 095.2	1.0	0.1	4.4	1.2	1.9
Stockbuilding[1]	19.6	-0.2	-0.1	0.3	0.6	0.0
Total domestic demand	2 114.9	0.9	-0.1	4.7	1.7	1.8
Exports of goods and services	1 274.5	5.0	-7.0	7.8	3.5	2.9
Imports of goods and services	1 136.0	3.0	-4.1	8.2	1.1	3.8
Net exports[1]	138.5	1.4	-2.0	0.3	1.5	-0.3
Memorandum items						
GDP deflator	_	0.7	2.6	2.4	5.8	3.1
Consumer price index	_	0.8	0.4	1.9	5.2	3.9
Core inflation index[2]	_	0.8	1.0	1.2	3.0	3.4
Unemployment rate (% of labour force)	_	5.0	5.6	5.2	5.1	5.5
Household saving ratio, net (% of disposable income)	_	3.6	5.8	4.9	4.5	3.3
General government financial balance (% of GDP)	_	4.1	-0.2	2.3	3.7	4.3
General government gross debt (% of GDP)	_	48.4	58.7	50.3	46.0	42.4
General government debt, Maastricht definition[3] (% of GDP)	_	33.6	42.1	36.7	32.5	28.8
Current account balance (% of GDP)	_	8.8	8.1	8.3	9.6	9.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/os1drh

The war in Ukraine has exacerbated accelerating price growth, with consumer prices rising by 6.7% in the year to April. Annual energy price growth exceeding 30% is a key driver, though Denmark is somewhat insulated from the effect of energy price growth due to domestic production of North Sea oil and gas and relatively low fossil fuel consumption. Asset price growth, notably housing, has eased, but asset price levels remain elevated following rapid growth during the crisis. Over 20 000 people (0.3% of the Danish population) have applied for residency under the Danish special law for Ukrainian refugees.

Macroeconomic policy is normalising gradually

Fiscal policy is set to be moderately contractionary in 2022 and 2023. Exceptional support during the COVID-19 crisis (around 1.5% of GDP) has largely been withdrawn, more than offsetting additional spending on refugees (0.1% of GDP, financed primarily from the existing development aid budget) and on defence (0.15% of GDP in 2022 and 2023). Increases in the statutory retirement age will improve the fiscal position while increasing the labour force by around 30 000 people (1% of the labour force) over 2022 and 2023. Policy interest rates are expected to increase gradually from the current low level as euro area rates rise, in order to maintain the strong peg to the euro.

Output and price growth will ease

Growth is forecast to slow to 3% in 2022 and 1.4% in 2023 due to weaker business and consumer confidence, erosion of household real incomes and wealth with rapid price growth, and weakening export demand as European growth slows with the war in Ukraine. Labour shortages and increased inflation expectations are nonetheless expected to drive an acceleration of wage growth from around 3% to over 4%. Inflation is expected to moderate in 2023 once energy prices and supply constraints gradually ease, but strong wage growth will keep core inflation above 3%. There is a risk that higher inflation could become entrenched if there are further energy market disruptions or if wage growth exceeds expectations. There are important downside risks to growth from an escalation of the war in Ukraine or further COVID-19 outbreaks, while more complete spending of household savings accrued during the crisis could drive higher growth.

The energy transition and integrating refugees should continue to be priorities

More may need to be done to integrate Ukrainian refugees if a large number remain in Denmark, as there are large gaps in employment outcomes between immigrants and native Danes as well as regional variation in the quality and implementation of integration programmes. Denmark's successful transition to an energy sector dominated by renewables has increased resilience to the impacts of the war by reducing its dependence on fossil fuels for electricity and heating. Policy steps to broaden progress to other sectors should continue, such as exploiting low-cost abatement opportunities in agriculture and encouraging the shift to low carbon vehicles by incentivising expansion of the charging network to remote areas. The high share of renewables in electricity generation (over 80%) provides an opportunity to cushion the effect of high energy prices on vulnerable households by reducing high electricity taxes as greenhouse gas pricing ramps up.

Estonia

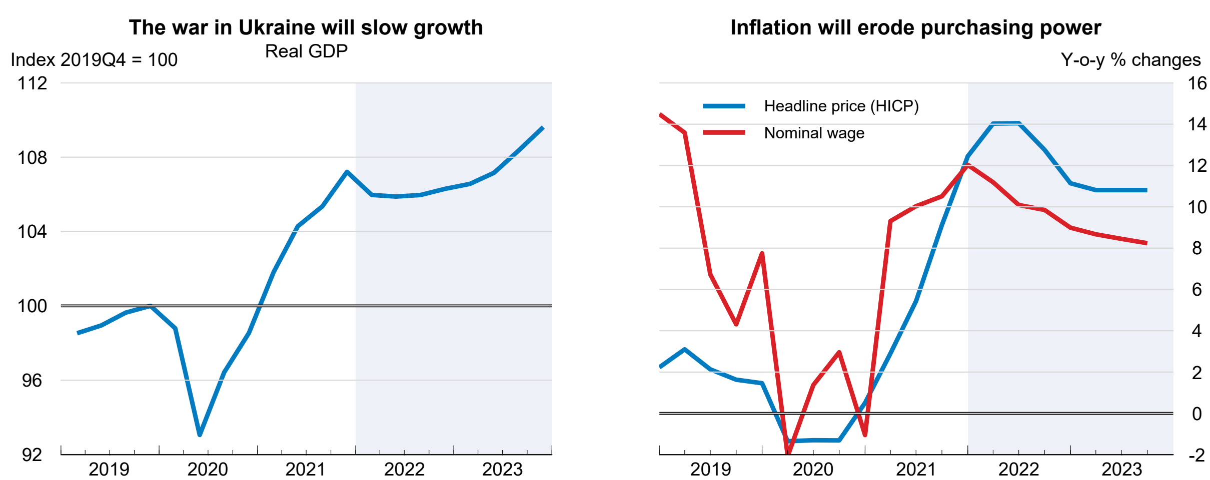
After a very robust expansion in 2021, GDP growth is expected to slow to 1.3% in 2022 and 1.8% in 2023, owing to the war in Ukraine. Household purchasing power is suffering as inflation far outpasses nominal wage growth. Export opportunities are expected to shrink, which, together with reduced confidence, will weaken investment. The gradual drawdown of savings accumulated during the pandemic and in individual pension funds, as well as the inflow of EU funds, will support the economy. Unemployment is expected to increase, as a large number of refugees are entering the country and not all of them are likely to find jobs immediately.

Given already high inflation, additional public spending should be focused only on assistance to refugees, defence and infrastructure developments that increase energy security. Support for low-income households to mitigate the negative impact of inflation on essential consumption needs should remain narrowly targeted. The influx of refugees can benefit Estonia's tight labour market and alleviate long-standing skills shortages issues, but this will require stepping-up activation policies and making language courses more widely available.

The war in Ukraine is fuelling already high inflation

Harmonised consumer price inflation has risen at double-digit rates since the end of 2021, and reached a record high of 19% year-on year in April. Upward price pressures came mainly from the cost of food (14.6% vs 13.8% in March) and energy (38% vs 44% in March). Producer prices also rose by 31.8% over the year to April. While nominal wages continue to grow strongly, wage growth remains below inflation and household purchasing power is being eroded. However, consumption continued to grow in March, as households accumulated fewer savings and withdrew pension funds from the second pension pillar.

Estonia



Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/iybu78

Estonia: Demand, output and prices

Estonia	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	25.8	4.0	-2.6	8.2	1.3	1.8
Private consumption	12.9	3.9	-2.5	6.5	4.4	2.6
Government consumption	5.0	3.1	3.1	4.0	1.4	0.6
Gross fixed capital formation	6.4	6.0	17.0	7.3	-21.8	3.7
Final domestic demand	24.2	4.4	4.1	6.8	-4.1	2.5
Stockbuilding[1]	0.8	-1.2	-0.8	2.3	-2.2	0.0
Total domestic demand	25.1	3.0	2.5	8.4	-6.4	2.4
Exports of goods and services	19.2	6.4	-4.9	19.9	14.1	6.3
Imports of goods and services	18.5	3.9	0.6	20.9	3.4	7.3
Net exports[1]	0.7	2.0	-4.1	-0.6	8.6	-0.5
Memorandum items						
GDP deflator	_	3.3	-0.6	5.4	6.5	2.8
Harmonised index of consumer prices	_	2.3	-0.6	4.5	14.5	10.9
Harmonised index of core inflation[2]	_	2.4	0.0	2.8	7.3	5.3
Unemployment rate (% of labour force)	_	4.4	6.8	6.2	7.1	8.3
Household saving ratio, net (% of disposable income)	_	8.7	11.9	6.2	0.4	-2.9
General government financial balance (% of GDP)	_	0.1	-5.6	-2.4	1.0	2.3
General government gross debt (% of GDP)	_	13.5	25.4	25.4	25.4	23.7
General government debt, Maastricht definition[3] (% of GDP)	_	8.6	19.0	18.1	19.8	21.9
Current account balance (% of GDP)	_	2.5	-0.2	-1.6	3.9	3.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/qrweto

Economic links with Russia have weakened considerably since 2014 and Russia's share in Estonian exports is now below 2%. Estonia is the least energy-dependent country in the European Union. Disruption to imports could still have an adverse impact on specific sectors such as agriculture and construction, due to foreseen shortages in wood products and fertilisers, which will necessitate seeking new sources of supply. Refugees will also likely have a substantial impact on the labour market. So far, Estonia has received 30 000 refugees from Ukraine (2.3% of the total Estonian population), two thirds of whom are adults, and 10 000 of whom are expected to join the labour market, increasing unemployment in the short term.

Fiscal support will strengthen security and help the most vulnerable

With ample fiscal room, notably fiscal reserves accumulated from unspent funds during the COVID crisis, a supplementary budget has been passed, amounting to almost 3% of GDP. As such, fiscal policy is anticipated to have a broadly neutral impact on growth in 2022. The budget includes EUR 257 million for strengthening energy security, notably establishing gas reserves and investing in liquefied natural gas capacity, EUR 247 million for strengthening defence and EUR 243 million for initial expenses related to integrating refugees. There are also plans to raise the subsistence level from EUR 150 to EUR 200, while one-off payments will be made to cushion high energy prices for families with children and pensioners.

The war in Ukraine will reduce growth

Growth is expected to slow considerably in 2022, to 1.3%, as a sustained fall in real wages will hamper consumption. In 2023, as price pressures on energy will remain elevated, due to the recently announced EU embargo on Russian oil imports, nominal wage growth will remain below inflation and GDP is projected to grow at 1.8%. An expected pick-up in EU fund absorption will underpin activity, with rising spending as the previous 2014-2020 financing cycle approaches its end in 2023 and through the EU Recovery and Resilience Facility. The use of savings accumulated during the pandemic and in individual pension funds will sustain private consumption. Nonetheless, risks are skewed to the downside. Additional disruptions to supply chains, more persistent inflation or prolonged weakness in growth in major trading partners could all further weaken the outlook.

Further public spending should avoid stoking inflationary pressures

Core inflation will remain high in 2023 and the outlook remains highly uncertain. Thus, further spending should avoid stoking inflationary pressures by remaining tightly targeted to refugees and the most vulnerable, building defence capacity and investing in energy infrastructures. Regarding the latter, the leasing of the floating liquified natural gas terminal should be expedited in order to become fully independent of Russian gas and enhance energy security. Inflation pressures could be eased by addressing entrenched skills shortages. The influx of refugees may help, but it will be important to conduct a rapid assessment to identify the newly unemployed that could quickly join the labour market, and expand training and active labour market policies for the others. Moreover, as language skills are a key factor for integration into the Estonian labour market, the availability of language training should be increased.

Euro area

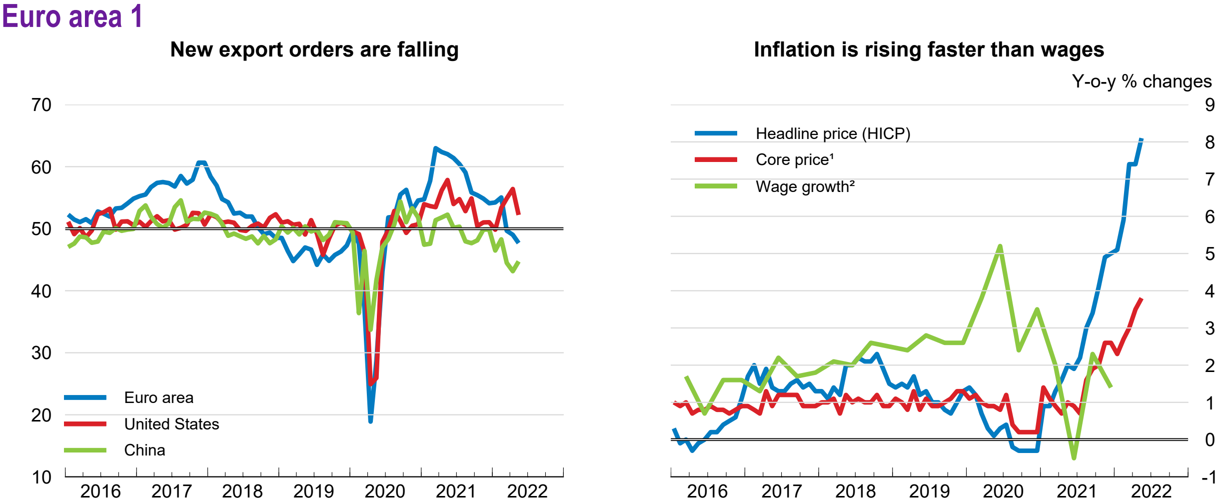
After a strong rebound in 2021, real GDP is projected to grow by 2.6% in 2022 and 1.6% in 2023. Growth is set to be significantly damped in the first half of 2022 by the war in Ukraine and the lockdowns in China. These factors are also pushing inflation up further, to a projected 7% this year. This is weighing on households' consumption and increasing uncertainty. With the Russian oil embargo from 2023 pushing oil prices up, growth is expected to remain subdued in 2023, while inflation is set to decline only gradually. Risks to economic activity remain tilted to the downside: severe disruptions in energy, notably gas, supply would hit growth in Europe while pushing inflation further up.

High uncertainty around the evolution of the war and its economic ramifications requires careful policy actions. Recovery and Resilience Facility funds need to be used effectively to support growth. Support to limit the effects of rising energy and food prices on consumers and businesses, while welcome, should be well targeted and avoid distorting price signals. As enacted during the pandemic, some common borrowing to strengthen energy security in Europe could be considered. While the case for removing monetary policy accommodation is strong given inflationary developments, this should be done carefully and be mindful of the evolution of the war to reduce risks of financial fragmentation.

Supply-side and energy shocks are weighing on the outlook

The euro area economy is showing signs of weakening. GDP growth stagnated at 0.3% (non-annualised) in the first quarter of 2022, with considerable cross-country divergence. High-frequency indicators point to ongoing weakness in the second quarter of 2022, notably due to the war in Ukraine. There has been a record drop in business sentiment, notably in Germany, and the euro area PMI reached a 15-month low in April. Meanwhile, inflation has continued to strengthen, to 8.1% in May, and also become more broad-based and widespread across the euro area, though to a very diverse extent. Inflation expectations have also started to pick up. However, negotiated wage growth has remained contained so far. The sharp slowdown in growth has been cushioned by elevated levels of household and corporate savings and fiscal policy measures to soften the blow of higher energy prices on households. Unemployment has continued to decline: in April 2022, the euro area seasonally-adjusted unemployment rate was 6.8%, down from 8.6% at its recent peak in September 2020.

Euro area 1



1. Excludes energy, food, alcohol and tobacco.
2. Average hourly wages and salaries of industry, construction and services (except activities of households as employers and extra-territorial organisations and bodies).
Source: S&P Global; Eurostat; and OECD calculations.

StatLink https://stat.link/lrboet

Euro area: Demand, output and prices

Euro area	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	11 571.0	1.6	-6.5	5.3	2.6	1.6
Private consumption	6 204.7	1.4	-7.9	3.6	2.6	1.5
Government consumption	2 364.8	1.8	0.8	3.9	0.8	0.4
Gross fixed capital formation	2 426.5	6.8	-7.2	4.1	4.8	3.2
Final domestic demand	10 996.0	2.7	-5.9	3.8	2.7	1.7
Stockbuilding[1]	108.4	-0.2	-0.4	0.4	0.4	0.0
Total domestic demand	11 104.4	2.4	-6.2	4.2	3.1	1.6
Net exports[1]	466.7	-0.8	-0.4	1.3	-0.3	0.1
Memorandum items						
GDP deflator	_	1.7	1.7	2.1	4.4	3.8
Harmonised index of consumer prices	_	1.2	0.3	2.6	7.0	4.6
Harmonised index of core inflation[2]	_	1.0	0.7	1.4	3.8	4.0
Unemployment rate (% of labour force)	_	7.6	8.0	7.7	7.1	7.4
Household saving ratio, net (% of disposable income)	_	7.1	13.6	11.5	8.7	7.8
General government financial balance (% of GDP)	_	-0.7	-7.1	-5.1	-4.1	-3.0
General government gross debt (% of GDP)	_	103.1	121.1	115.7	115.0	114.0
General government debt, Maastricht definition[3] (% of GDP)	_	85.7	99.3	97.5	96.9	95.9
Current account balance (% of GDP)	_	3.0	2.8	3.6	2.2	2.0

Note: Aggregation based on euro area countries that are members of the OECD, and on seasonally-adjusted and calendar-days-adjusted basis.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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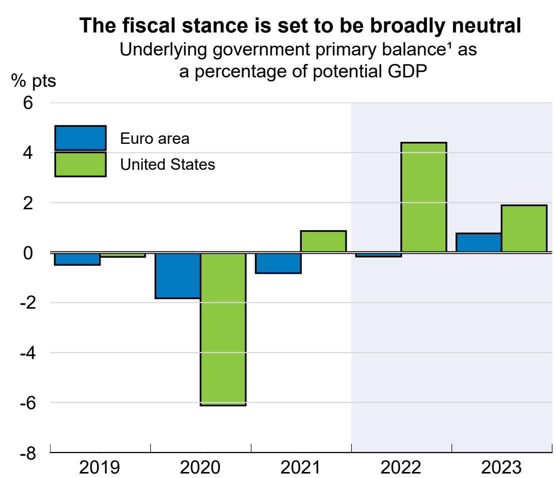
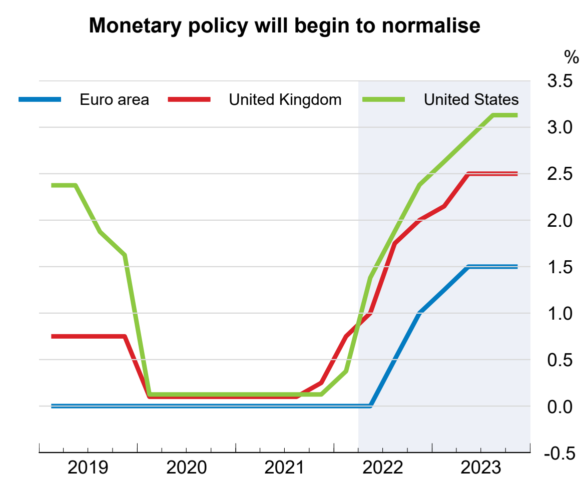
Euro area 2





1. The underlying government primary balance is cyclically-adjusted government net lending excluding net interest paid and net one-off operations.
Source: OECD Economic Outlook 111 database; and OECD calculations.

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The war is having significant effects on the euro area economy and spending to support Ukrainian refugees (over 5 million within the European Union) will add to pressures on public finances in the short term until refugees gradually join the labour force or return home. The war is also affecting imports of critical base metals and agricultural commodities as well as their global prices. The escalation of sanctions on fossil fuels (coal, oil and possibly natural gas in the future) could also have profound adverse macroeconomic effects in Europe, notably in the countries that are the most dependant on Russian energy.

Fiscal measures are supporting businesses and consumers from rises in energy prices

While starkly different within the euro area, the fiscal stance is projected to be broadly neutral in 2022, with a moderate consolidation in 2023. Measures to minimise the impact of the pandemic are being phased out, but member states are introducing additional fiscal support to help shelter vulnerable consumers and businesses from the rapid rise in energy prices. However, in the absence of common European guidelines, the measures taken are not equally well designed and targeted across the euro area, which might reduce their effectiveness and possibly create distortions in competition. In addition, the ongoing conflict in Ukraine has triggered a rise in military spending in many countries, and a rise in energy-related investment to strengthen the diversity of energy sources. This strengthened energy independence will require significant national and European investments in energy infrastructure. Eventually, and noting the consequences of the war for public finances and investment, an ambitious reform of the European fiscal framework will be needed.

The ECB had signalled the gradual removal of monetary policy accommodation before the war erupted, and recent communication from the ECB governing council has pointed to further progress given upward surprises to prices. Net asset purchases are now planned to end early in the third quarter of 2022. However, it is expected that maturing bonds will be fully reinvested over the projection period, keeping the size of the ECB's balance sheet unchanged. A first rise in policy rates is assumed to take place shortly after the end of net asset purchases in July, followed by additional increases, before stabilising by mid-2023 as inflationary pressures progressively wane. Further rises in policy rates in 2023 will depend on data developments and the evolution of the war in Ukraine, as well as on the evolution of long-term interest rates and the need to avoid financial fragmentation.

After a soft patch in the first half of 2022, growth will resume but risks are to the downside

Quarterly growth is projected to slow in the first half of 2022, although strong carryover effects from 2021 mean that annual GDP growth of 2.6% is projected. The increase in oil prices from the embargo on Russian oil will weaken the pace of the recovery in 2023. Despite relatively robust wage growth, consumer price inflation of 7% in 2022 and 4.6% in 2023 will lead to a contraction of real disposable income in 2022 and only modest growth in 2023. This will weigh on private consumption but be partially offset by further declines in household saving rates. Inflation is projected to moderate only very slowly through 2023, with progressively lower global energy prices, waning supply chain bottlenecks, and subdued domestic growth helping to contain price and cost pressures.

The risks to the projections are to the downside. The ongoing energy price shock and disruptions to supply chains could worsen, either through an additional round of sanctions or a worsening of the COVID-19 outbreak in China. Empirical studies suggest that a complete or partial gas embargo in Europe would reduce output in different countries significantly, although to a varying extent depending on each country's energy dependency. The risks to inflation are to the upside, especially in case of a severe disruption in gas supply or through stronger wage growth. This could lead to a more rapid tightening of monetary policy than assumed.

Supporting the recovery and long-term resilience to shocks

Ensuring a rapid and effective disbursement of Next Generation EU funds would continue to support the recovery. In case member states need to further increase economic support measures to shelter businesses and the most vulnerable citizens from the energy and food price shock, they should ensure that they remain temporary and better targeted. Common EU guidelines would help to maximise their effectiveness and ensure a level playing field. It is also important to ensure that price signals keep operating, for example by protecting vulnerable households through financial support and offering cleaner alternatives to current energy sources, rather than price freezes or tax cuts.

In addition to national fiscal policy, this crisis might also warrant some common spending and borrowing, as implemented during the pandemic crisis, for example to invest in critical common energy infrastructure. The European Commission should accelerate proposals for reforming the European fiscal framework. Finally, while the case for gradually removing monetary policy accommodation is strong given inflationary developments, high economic uncertainty calls for maintaining a cautious and flexible approach. In particular, flexibility in the reinvestment of maturing asset purchases will be critical to avoid financial fragmentation.

Finland

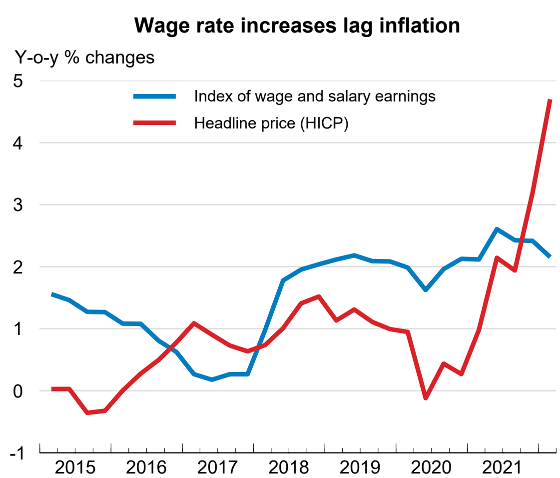
Economic growth will slow sharply to 1.1% in 2022 and 0.6% in 2023 owing to the waning of the COVID-19 rebound and to the war in Ukraine. Private consumption will be depressed by falling real household incomes but should slowly recover from late 2023 as they begin to rise again. Headline inflation will fall slowly from a peak of 7% in late 2022. After dropping sharply this year, exports should accelerate next year as exporters find new markets and world trade picks up. The main downside risk is that a wage-price spiral develops, increasing inflation and reducing competitiveness and growth.

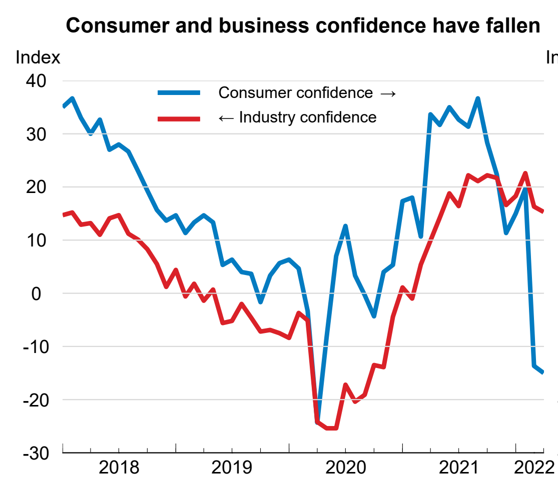
Reforms to reduce transport emissions would help Finland to meet its abatement targets and increase energy security. Reducing the structural budget deficit to the 0.5% of GDP Medium-Term Objective would alleviate inflationary pressures and make public finances more sustainable. A comprehensive expenditure review should be undertaken to identify savings and tax loopholes should be closed. Reforms underway and planned to increase employment and reduce skills shortages will help but need to be taken further.

The war in Ukraine has stalled the recovery

Finland was enjoying a solid recovery from the COVID-19 shock before the Russian invasion of Ukraine. The war boosted energy and food prices, which account for most of the increase in inflation, to 7.1% in the year to May 2022. This has reduced household real incomes and spending. Consumer confidence and, to a lesser extent, business confidence have fallen. The strong recovery in the labour market in 2021 was interrupted in the first quarter of 2022, with the employment rate declining and the unemployment rate rising to 7%. Wage growth has remained subdued, with the index of wage and salary earnings rising by 2.1% in the year to the first quarter of 2022. There was an upsurge in serious COVID-19 cases in early 2022 but it had only minor economic effects and receded swiftly in April.

Finland





Source: Statistics Finland; and European Commission.

StatLink https://stat.link/u3pc0t

Finland: Demand, output and prices

Finland	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	233.5	1.2	-2.3	3.5	1.1	0.6
Private consumption	123.9	0.7	-4.1	3.1	0.8	-0.2
Government consumption	53.5	2.0	0.4	3.2	1.4	-0.8
Gross fixed capital formation	56.2	-1.5	-0.3	1.2	3.3	1.4
Final domestic demand	233.6	0.5	-2.1	2.7	1.5	0.0
Stockbuilding[1,2]	2.8	-1.0	0.1	0.8	0.2	0.0
Total domestic demand	236.4	-0.3	-1.2	4.0	1.7	0.0
Exports of goods and services	89.8	6.7	-6.8	4.2	-2.0	3.0
Imports of goods and services	92.7	2.4	-5.8	4.6	3.3	1.6
Net exports[1]	- 2.9	1.6	-0.4	-0.2	-2.1	0.6
Memorandum items						
GDP deflator	_	1.5	1.6	2.7	5.7	3.7
Harmonised index of consumer prices	_	1.1	0.4	2.1	6.2	4.6
Harmonised index of core inflation[3]	_	0.7	0.5	1.2	3.8	4.2
Unemployment rate (% of labour force)	_	6.7	7.8	7.6	7.2	7.7
Household saving ratio, net (% of disposable income)	_	0.4	4.7	1.0	-0.3	0.0
General government financial balance (% of GDP)	_	-0.9	-5.5	-2.6	-3.1	-3.2
General government gross debt (% of GDP)	_	73.1	85.0	78.6	86.3	92.2
General government debt, Maastricht definition[4] (% of GDP)	_	59.6	69.0	65.8	73.5	79.4
Current account balance (% of GDP)	_	-0.3	0.7	0.7	-0.4	0.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/c8w4on

Goods exports to Russia (5.5% of 2021 goods exports) will shrink drastically this year and remain low. Oil imports from Russia have fallen sharply since the beginning of the war and are likely to end in July. Following Finland's application in May to join NATO, Russia terminated gas and electricity exports to Finland. While most gas was imported from Russia, gas only represents 5% of total energy consumption and plans are advanced for sourcing it elsewhere, in LNG form. Additional electricity from local sources and from Sweden and Baltic countries has replaced imports of electricity from Russia, which represented 10% of electricity consumption. The new nuclear power plant that will come on stream in July will supply 14% of Finland's electricity. The government estimates that there will be 60 000 (1.1% of the total population) applications for temporary protection in 2022 from people fleeing Ukraine.

The war is slowing fiscal consolidation

Following marked consolidation in 2021, fiscal policy will be expansionary in 2022 despite a further reduction (by 1.5% of GDP) in COVID-19 support measures, and neutral in 2023. Measures in response to the war in Ukraine contribute 0.8% of GDP to the structural deficit this year and next. These include a large increase in defence expenditure and in refugee-related expenditures (0.1-0.3% of GDP annually). Modest budget measures have been announced to cushion the impact of higher energy prices, including a temporary increase in the maximum income tax deduction for commuting expenses and in net social security benefits. The government is committed to reducing the structural budget deficit over time by implementing reforms to increase employment, which will reduce transfers expenditure and increase government revenue. Reforms that will increase employment include a progressive increase in the pension eligibility age, the phasing out of the unemployment tunnel to early retirement and measures to incentivise job search and strengthen municipalities' incentives to reduce unemployment.

Economic growth will be low

GDP growth will slow sharply to 1.1% in 2022, despite substantial carryover from the COVID-19 rebound in late 2021, and 0.6% in 2023. Private consumption expenditure will be dragged down by weak growth in real household incomes, reflecting both an increase in inflation to a peak of around 7% and lower employment, but will begin to recover towards the end of 2023 as the direct and indirect contributions of higher energy and food prices to inflation diminish and employment expands. The unemployment rate will increase to a peak of 7.9% in early 2023 and decline slowly thereafter. Wage growth will increase to 4% in 2023 as unions seek to claw back part of the real wage losses endured since late 2021. Export growth will be down sharply this year as exports to Russia plummet and exports to other European countries fall, but should rise in 2023 as exporters find new markets and export markets strengthen. A key downside risk is that wage increases are significantly higher than projected, increasing inflation and reducing cost competitiveness, employment and growth. On the upside, private investments catalysed by the Recovery and Resilience Facility could be higher than projected.

Reforms are needed to support a stronger and more sustainable recovery

The programmed investments to reduce greenhouse gas emissions will support the recovery and make it more sustainable, including by enhancing energy security. The government should go further in supporting retrofits to make buildings more energy efficient, reducing demand for car use, supporting the deployment of electric vehicles and, if necessary, should introduce an emissions trading scheme for the transport sector. Reforms to increase employment will also strengthen the eventual recovery but need to be taken further if the government's objective of increasing employment by 80 000 by the end of the decade and thereby reducing the structural budget deficit by 0.4-0.8% of GDP are to be realised. It will also be vital to reduce the severe skills shortages Finland faces by facilitating skilled immigration and increasing the tertiary attainment rate.

France

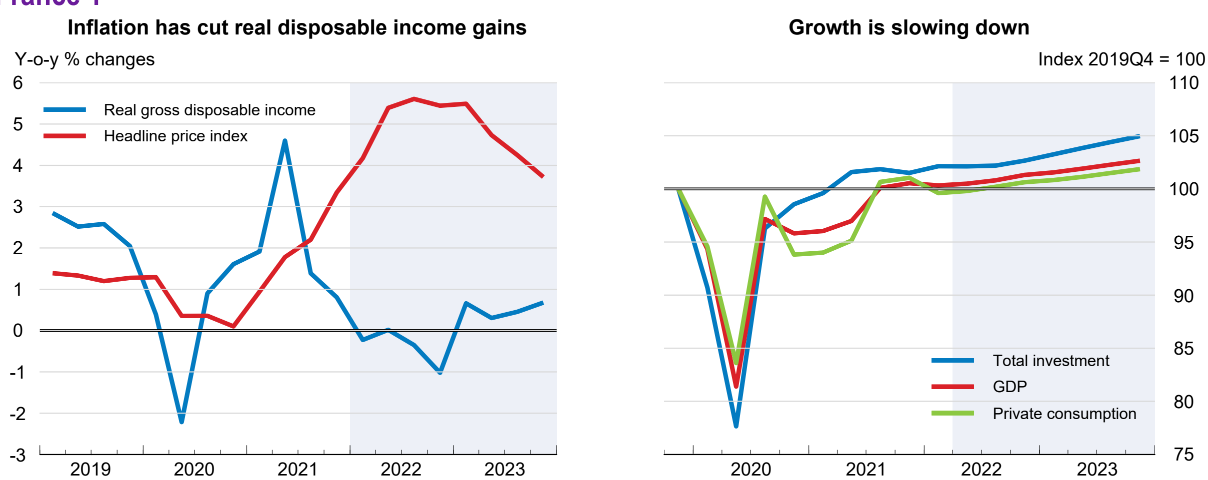
After a strong rebound in 2021, real GDP is projected to grow by 2.4% in 2022 and 1.4% in 2023. The early 2022 COVID-19 wave, the war in Ukraine, supply chain disruptions and elevated energy prices have dented economic prospects. Headline inflation is expected to reach 5.2% in 2022 and 4.5% in 2023, lowering household purchasing power and consumption growth. The decline in business and household confidence, weaker global economic conditions and high uncertainty will hold back investment and exports. Wages will accelerate, owing to high labour-market shortages and minimum-wage indexation. With slowing employment gains, the unemployment rate will progressively rise to 8%.

Fiscal policy will gradually become less supportive. The temporary freeze in regulated energy prices, subsidies and cash transfers have smoothed the initial energy price shock, but unconditional energy price cuts should end as expected by end-2022 and fiscal support should become more targeted. A swift and efficient implementation of the ambitious recovery and investment plans would support more sustainable growth and green investments. It should help raise the employment rate, whose level is persistently low. Putting in place a credible medium-term consolidation strategy with clear prioritisation is key to ensure fiscal sustainability and spending efficiency in a context of rising debt service payments.

The recovery has lost steam

The high incidence of COVID-19 cases, rising energy prices and the war in Ukraine halted the rapid rebound in GDP in early 2022. Despite historically-high employment rates, large accumulated savings and the lifting of COVID-19 sanitary restrictions, surging energy prices, declining real wages and consumer confidence have dented households' consumption and investment. Consumer prices were up by 5.8% in the year to May, as energy price growth reached 29% and price pressures are broadening to food, manufacturing products and services sectors. Yet, the pass-through of inflation to wages remains limited so far.

France 1



Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/am1byf

France: Demand, output and prices

France	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2014 prices)				
GDP at market prices	2 364.5	1.9	-7.9	6.8	2.4	1.4
Private consumption	1 273.9	1.8	-6.8	5.3	2.4	1.3
Government consumption	550.1	1.0	-4.0	6.4	2.2	0.3
Gross fixed capital formation	541.4	4.1	-8.4	11.4	1.1	1.8
Final domestic demand	2 365.5	2.2	-6.6	6.9	2.0	1.2
Stockbuilding[1]	23.2	0.0	-0.2	-0.3	-0.1	0.0
Total domestic demand	2 388.6	2.1	-6.7	6.6	1.9	1.1
Exports of goods and services	750.7	1.6	-17.0	8.6	7.7	5.7
Imports of goods and services	774.8	2.4	-13.0	7.8	5.9	4.4
Net exports[1]	- 24.1	-0.3	-1.1	0.1	0.4	0.3
Memorandum items						
GDP deflator	_	1.3	2.8	1.3	2.2	3.2
Harmonised index of consumer prices	_	1.3	0.5	2.1	5.2	4.5
Harmonised index of core inflation[2]	_	0.6	0.6	1.3	3.4	3.5
Unemployment rate[3] (% of labour force)	_	8.5	8.1	7.9	7.5	7.8
Household saving ratio, gross (% of disposable income)	_	14.7	20.6	18.2	15.9	15.2
General government financial balance (% of GDP)	_	-3.1	-8.9	-6.4	-5.4	-4.7
General government gross debt (% of GDP)	_	123.4	145.8	137.9	139.5	140.3
General government debt, Maastricht definition[4] (% of GDP)	_	97.3	114.7	112.6	114.1	114.9
Current account balance (% of GDP)	_	-0.3	-1.9	-0.6	-2.1	-2.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. National unemployment rate, includes overseas departments.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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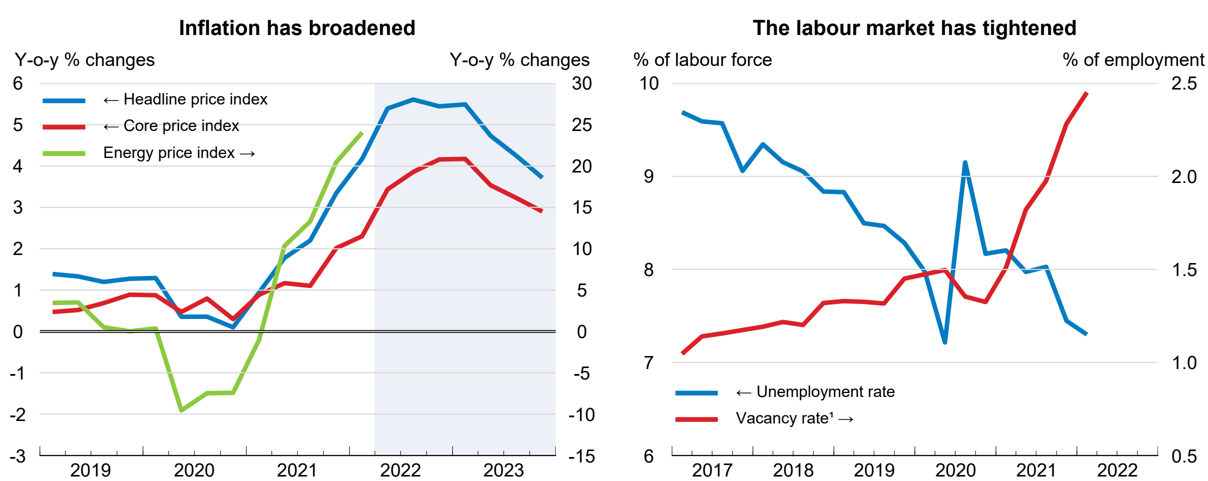
France 2



1. Missing data for 2020Q1.
Source: OECD Economic Outlook 111 database; Insee; and Ministry of labour (Dares).

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The war in Ukraine has exacerbated increases in commodity and food price growth and renewed manufacturing supply disruptions. Though France's direct exposure to shortages of energy supplies from Russia is limited, wholesale energy prices have increased further since the onset of the war. Business surveys point at historically high supply constraints in industrial and construction sectors, further rises in producers' prices, and high uncertainty. By end-April, 70 000 refugees from Ukraine received a living allowance in France and the authorities expect 30 000 additional refugees to come.

The resilience and recovery plans are supporting growth

Fiscal policy is assumed to remain supportive in 2022 and shift to consolidation in 2023. The budget deficit narrowed to 6.4% of GDP in 2021 due to strong revenue growth and the phasing-out of most COVID-19-related spending. To respond to the current commodity and energy price spikes, gas and electricity charges have been temporarily capped, vouchers for poorer households' energy consumption increased and an additional one-off means-tested transfer has reached 38 million people. The government also temporarily cut road fuel taxes, increased targeted conditional subsidies for businesses and extended state-guaranteed loans through its resilience plan. The direct support measures amount to EUR 27 billion (1.1% of GDP) and are set to be phased out in early 2023. In addition, the already-planned EUR 10.5 billion business tax cut and hiring subsidies are supporting firms and jobs. Housing and corporate income tax cuts, as well as higher funding for the health and education sectors, are also supporting household income and business profit margins.

Monetary and financial conditions remain favourable, supporting domestic demand, though monetary policy is assumed to become less accommodative over 2022-23. The implementation of the Next Generation EU plan is supporting growth in France (France will receive EUR 40 billion of European grants) and in its main trading partners. The 2022 resilience plan has pushed forward funding for housing renovation and insulation. Government guaranteed loans and subsidies for highly-affected firms will limit the impact of the war in Ukraine and the energy crisis on business liquidity. Car and energy investment subsidies for households are targeted on green alternatives, and will raise durable goods consumption and housing investment. Higher public investment in infrastructure and digitalisation, as well as additional financing for training programmes, are expected to improve productivity and more durable growth.

Domestic demand growth will slow

Growth is projected to slow to 2.4% in 2022 and 1.4% in 2023. Inflation will weigh on household's purchasing power and pent-up demand will decelerate, despite the lifting of COVID-19 sanitary restrictions, a tight labour market and the temporary freeze of regulated energy prices. The pass-through of high energy prices, with renewed pressures due to the impact of European embargo on Russian oil in 2023, high labour shortages and the indexation of the minimum wage will push upwards core inflation and wages. As demand in trading partners softens and supply bottlenecks persist, exports will rise only slowly from their current low levels. Yet, business investment is set to remain resilient, as accommodative financing conditions and the support from the recovery and resilience plans will partly compensate reduced profit margins, high uncertainty and softer global demand. The budget deficit and public debt are projected to remain high relative to GDP, with debt (Maastricht definition) remaining close to 115% of GDP in 2023.

Worsening geopolitical tensions, supply bottlenecks and labour shortages could lead to higher-than-expected inflation and lower domestic demand and growth in France and her main trading partners. Activity in some sectors, such as transport equipment, travel and tourism services, would be particularly affected. On the upside, further fiscal support could raise domestic demand, as the authorities envisage increases in pension and public wages, a new subsidised food scheme and prolonged energy-related measures in 2022-23. Stronger-than-expected pent-up domestic demand and spending of large accumulated savings, a swift use of European recovery funds and a faster-than-projected recovery in the international tourism sector could also raise growth.

Supporting more sustainable and long-term growth

Unconditional energy price support measures, notably tax cuts, should be phased out by end-2022, as planned, as they have high fiscal costs and create economic distortions. To dampen the effects of persistently high geopolitical tensions and energy price pressures, additional support to the most vulnerable households and firms should be contemplated instead, provided they are well targeted and temporary. As geopolitical and price tensions dissipate and growth becomes more entrenched, a medium-term fiscal strategy to gradually lower public expenditures and increase their efficiency should be firmly implemented to raise growth and improve medium-term fiscal sustainability. It should build on a strengthened fiscal framework, ensuring a more efficient and transparent public spending allocation through spending reviews. Policy steps to broaden progress towards green alternatives and energy savings and ensure a fair transition should also continue. Speeding up housing renovation and energy savings would help the longer-term energy transition and should build on regular evaluations of the related support schemes. Ensuring broad access to lifelong learning for low-skilled and long-term unemployed people, as well as an efficient implementation of quality standards for these programmes, is also needed to support growth and help bring about longer working lives, as foreseen in the planned pension reform. In particular, continuing to strengthen initial education from an early age will be key to ensure more equity.

Germany

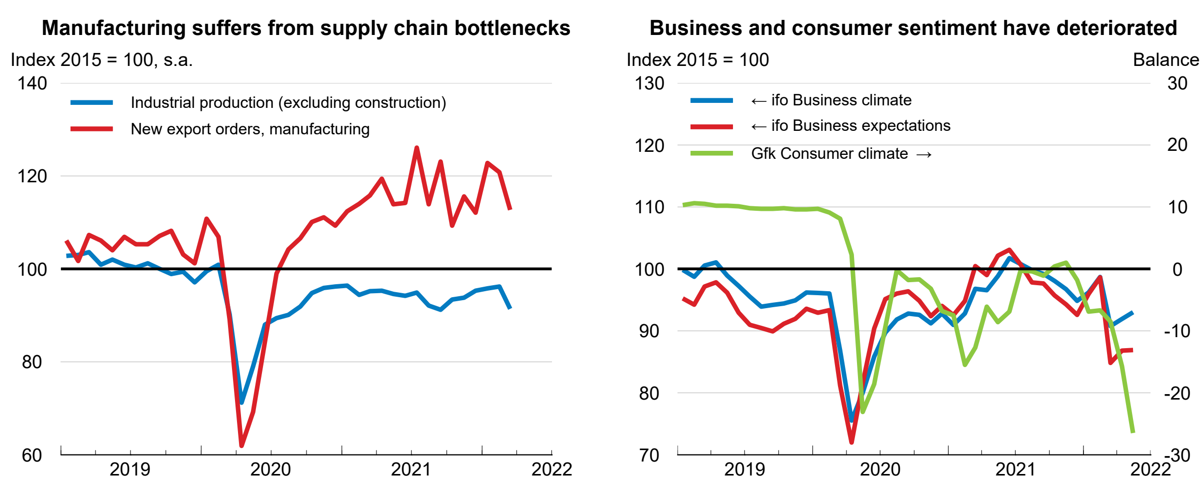
The economy is projected to grow by 1.9% in 2022 and 1.7% in 2023, with the recovery hampered by the war in Ukraine, and an embargo on Russian oil. Rising inflation is reducing household purchasing power, damping the rebound of private consumption. Investor and consumer confidence have collapsed and supply chain bottlenecks have worsened, postponing the recovery of industrial production and exports towards the end of 2022, despite a large order backlog. The recovery could be further derailed by a sudden stop of gas imports from Russia or more persistent lockdowns in China.

Fiscal support programmes to mitigate the effects of rising energy and food prices need to be well targeted to vulnerable households and firms. Boosting infrastructure investment and improving planning and approval procedures and capacity, particularly at the municipal level, would accelerate digitalisation and the energy transition, which is crucial to lower dependency on energy imports. Skilled labour shortages will need to be addressed by raising the labour supply of women, elderly and low-skilled workers, improving training and adult learning, and lowering occupational licensing requirements to ease transitions to jobs in high demand. This should be complemented by facilitating the recognition of the qualifications of migrants and refugees.

Uncertainty, supply chain bottlenecks and high inflation weigh on the economy

In the first quarter of 2022, real GDP grew by 0.2% (at seasonally adjusted quarterly rates). In January and February, the easing of supply chain bottlenecks and mild weather conditions led to a rebound in manufacturing and construction, private investment and exports. Retail and hospitality spending started to recover due to high excess savings and the lifting of containment measures from March. However, the war has changed this positive outlook. High inflation and plummeting consumer confidence hit private consumption. Heightened uncertainty, a surge in energy prices and new material shortages hurt manufacturing and construction, private investment and exports. The ifo business climate plunged in March by more than 13%, but stabilised in April and May. Industrial production and goods exports decreased by

Germany 1



Source: Refinitiv.

StatLink https://stat.link/pctlx1

Germany: Demand, output and prices

Germany	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	3 372.3	1.1	-4.9	2.9	1.9	1.7
Private consumption	1 753.2	1.6	-6.1	0.3	3.4	1.9
Government consumption	670.4	3.0	3.5	2.9	-0.1	-0.7
Gross fixed capital formation	711.6	1.9	-3.0	1.0	3.4	4.5
Final domestic demand	3 135.2	2.0	-3.3	1.1	2.6	1.9
Stockbuilding[1]	27.6	-0.1	-0.9	1.1	1.2	0.0
Total domestic demand	3 162.8	1.8	-4.2	2.3	3.9	1.9
Exports of goods and services	1 598.9	1.1	-10.1	9.5	1.4	4.9
Imports of goods and services	1 389.3	2.9	-9.2	9.0	5.4	4.7
Net exports[1]	209.6	-0.7	-1.0	0.7	-1.6	0.2
Memorandum items						
GDP without working day adjustments	3367.9	1.1	-4.6	2.9	1.8	1.6
GDP deflator	_	2.1	1.6	3.0	6.1	4.4
Harmonised index of consumer prices	_	1.4	0.4	3.2	7.2	4.7
Harmonised index of core inflation[2]	_	1.3	0.7	2.2	4.0	4.4
Unemployment rate (% of labour force)	_	3.2	3.9	3.6	3.1	3.4
Household saving ratio, net (% of disposable income)	_	11.1	16.3	15.9	12.2	10.5
General government financial balance (% of GDP)	_	1.5	-4.3	-3.8	-3.4	-1.8
General government gross debt (% of GDP)	_	67.5	79.1	78.0	79.0	78.1
General government debt, Maastricht definition[3] (% of GDP)	_	58.8	68.9	69.5	70.5	69.6
Current account balance (% of GDP)	_	7.7	6.9	7.6	6.2	6.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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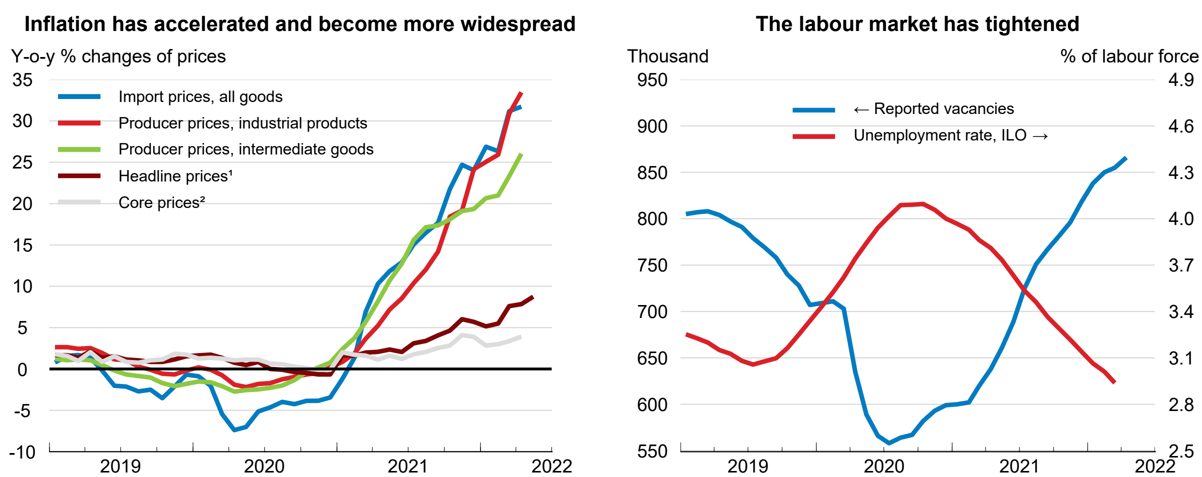
Germany 2



1. Harmonised index of consumer prices.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: Refinitiv; and Destatis.

StatLink https://stat.link/sijext

3.9% and 3.3% (m/m), respectively, in March. Moreover, the annual rate of headline inflation rose to 8.7% in May, with more than 40% of the price increase resulting from non-energy components following the pass through of high producer prices, which rose by 33.5% over the year to April. Wholesale prices have increased by 23.8% over the year to April, and by 2.1% compared to March 2022. With employment growth of 0.2%, the labour market remained robust in March amid intensifying labour shortages. After moderate wage growth during the pandemic, negotiated pay rose firmly at 4% (y/y) in the first quarter of 2022.

Before the start of the war in Ukraine, Germany was highly dependent on Russian gas, oil and coal, with around one-third of primary energy supply coming from Russia. A rapid diversification of energy suppliers has led to a significant reduction in the share of Russian energy imports, with the oil import share from Russia falling from 35% to 12% and the coal import share from 50% to 8% by late April. Gas imports from Russia have only fallen from 55% to 35% of total gas supply, making the German economy highly vulnerable to a possible stop of gas imports. To prepare for such a scenario, the government has taken several measures, including filling up gas storage tanks, accelerating the construction of LNG terminals and negotiating trade deals with LNG exporters. Measures to raise energy savings could be further improved. Russia's overall share in Germany's foreign trade was only 2.3% in 2021. While imports from Russia fell by only 2.4% in March, exports to Russia fell sharply by 62%. So far, Germany has received 610 000 refugees from Ukraine (0.7% of the population), the largest inflow among the non-neighbouring countries.

Fiscal policy faces new challenges

The underlying budget deficit will remain higher than before the pandemic. Pandemic-related support programmes including short-term work and grants for firms are to be phased out at the end of June, but new measures to mitigate the energy price surge are included in the supplementary budget for 2022 (additional spending of EUR 39 billion or 1.1% of GDP). These comprise the permanent abolishment of the renewable energy surcharge from July, a three-month decrease in fuel taxes, an increase of the commuting subsidy, public transport subsidies, as well as several one-off cash transfers and income tax relief for households. While some of these measures are well targeted at vulnerable households, others disburse considerable amounts of scarce public resources to all households, reducing incentives to save energy and lower carbon emissions. The government is also providing liquidity support to firms severely impacted by the war in Ukraine through loan guarantees, credit lines, energy cost subsidies and equity. It is crucial that these programmes are well targeted and maintain strong incentives for capital and labour reallocation towards booming sectors with rising labour shortages. Additional social spending of EUR 4 billion (0.1% of GDP) is planned to manage the inflow of refugees from Ukraine.

To reach its ambitious climate targets, the government plans to invest around EUR 200 billion until 2026, with fiscal incentives to crowd in private investments playing a major role. It also envisions a significant increase in military spending of EUR 100 billion over the next years to upgrade military equipment. Most of these debt financed investments will be conducted using shadow budgets, the spending of which is excluded from the debt brake that will be reinstated from 2023. Exact spending plans for the shadow budgets are currently missing, but capacity constraints in the construction sector and long and complex planning and approval procedures will likely cause slow disbursement of funds this year.

A strong recovery is hampered by the war in Ukraine

Heightened uncertainty, a surge in energy prices and additional material shortages due to lock-down measures in China will hurt manufacturing and hold back private investment and exports despite a large order backlog, postponing the pickup of the recovery to the second half of this year. The easing of containment measures and accumulated excess savings will lead to a stronger recovery in services activity. However, falling consumer confidence due to the war and rising inflation rates will damp the recovery of private consumption. Fiscal policy will remain supportive. Inflation will stay high due to supply chain bottlenecks and high producer prices, which will be passed on to consumers during the coming months. Energy prices will further increase in 2023 due to the embargo on Russian oil. The depreciation of the euro and intensifying labour shortages will contribute to inflationary pressures. Wages will grow significantly due to a minimum wage increase from 48% to 60% of the median wage in October and pressure from unions to preserve the purchasing power of workers.

A severe downside risk to the projection arises from a potential stop of gas imports from Russia, which would hit the economy through higher import prices, heightened uncertainty and direct gas rationing. A worsening of the pandemic in China could exacerbate supply chain bottlenecks. On the upside, a quicker end of the war or faster substitution of energy imports from Russia would restore investor and consumer confidence. A stronger rise in tax revenues due to high inflation and repayments of pandemic related firm support could create additional fiscal space for public investments.

Expanding renewables to raise energy security

To expand renewable energy supply, it is crucial to continue accelerating complex planning and approval procedures at the municipal and Laender level. Speeding up the digitalisation of the economy requires more investments in digital infrastructure, a more rapid modernisation of the state and better coordination of policies and administrative procedures across levels of government. Increasing efficiency of public spending through effective use of spending reviews, reducing regressive and environmentally harmful subsidies and tax exemptions and improving tax enforcement could free up additional resources for necessary public investment. To address rising labour shortages, which also risk derailing private and public renewable energy investment, the labour market participation of women, low-skilled and elderly workers needs to be raised by setting the right tax incentives and improving training and adult learning policies. Boosting skilled migration and facilitating the labour market participation of Ukrainian refugees, such as through better supply of childcare facilities, is also key.

Greece

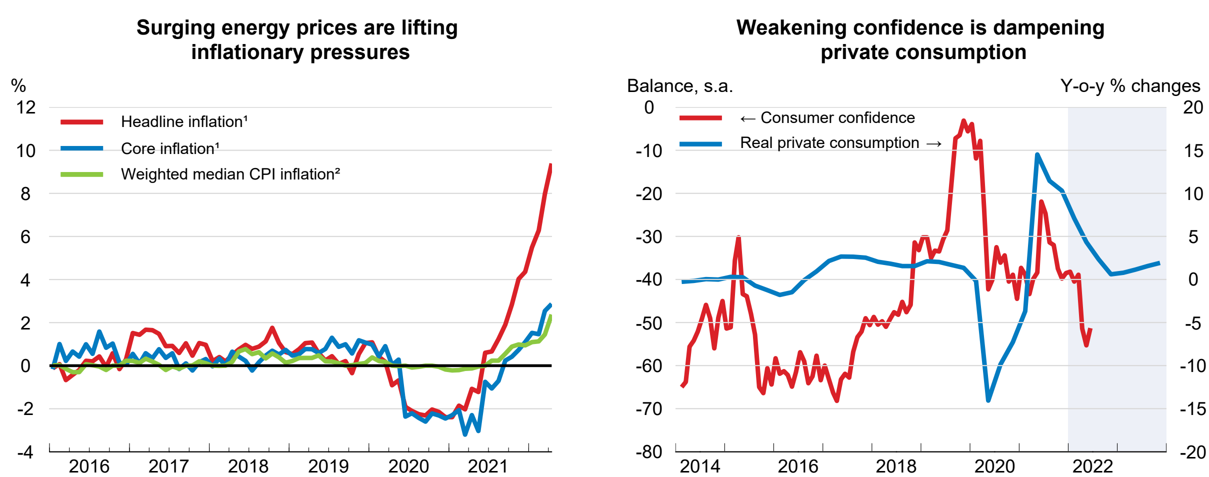
The recovery is expected to slow in 2022. Surging global prices, heightened uncertainty and tightening monetary conditions will be partly offset by disbursements of Greece's recovery and resilience plan, fiscal support to households and firms, and rising exports and investment. Employment growth is expected to pause temporarily as employers face higher uncertainty, difficulties in hiring workers with relevant skills and rising wages. While supply pressures have risen, remaining spare capacity will dampen price pressures.

Revenues buoyed by rising prices and the recovery will help the government return the budget to a primary surplus in 2023. Using unplanned revenues and savings to rebuild the fiscal surplus, and ensuring support measures are temporary and targeted towards vulnerable households' income rather than subsidising prices, would further improve fiscal sustainability. Greater fiscal sustainability, along with resolving banks' remaining non-performing loans, would support Greece achieving an investment-grade sovereign debt rating, improving access to finance. While Greece is shifting its energy supply from Russia, improving energy efficiency and developing renewable sources would support long-term energy security and sustainability.

Surging prices are slowing Greece's recovery

Greece's economy recovered strongly from the COVID crisis in 2021 and most remaining COVID-related health restrictions were lifted from 1 May 2022. Rising exports and investment, and the end of short-time work schemes contributed to job growth. Employers reported growing difficulties filling vacancies. These trends slowed with the surge in energy prices and the war in Ukraine. Consumer price inflation has reached a 25-year high, and price pressures are broadening, lifting underlying inflation. The government increased the minimum wage by 2% in January and 7% in May 2022, ahead of the rise in prices.

Greece



1. Headline and core inflation are based harmonised consumer prices. Core inflation excludes food, energy, alcohol and tobacco.
2. The median inflation is the price change of the item at the middle of the distribution of price changes, accounting for the items' expenditure weights.
Source: OECD Economic Outlook 111 database; Eurostat; and OECD calculations.

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Greece: Demand, output and prices

Greece	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	179.6	1.8	-9.0	8.3	2.8	2.5
Private consumption	124.3	1.8	-7.9	7.8	3.5	1.4
Government consumption	35.5	1.7	2.6	3.7	-1.5	-0.2
Gross fixed capital formation	20.0	-3.3	-0.3	19.6	9.0	12.4
Final domestic demand	179.8	1.3	-5.0	8.2	3.2	2.5
Stockbuilding[1,2]	3.6	0.0	1.4	-0.9	0.0	0.0
Total domestic demand	183.4	1.5	-3.4	7.0	3.3	2.4
Exports of goods and services	70.0	4.9	-21.5	21.9	16.5	5.8
Imports of goods and services	73.9	3.1	-7.6	16.1	13.2	5.1
Net exports[1]	- 3.9	0.6	-5.5	0.7	0.3	-0.1
Memorandum items						
GDP deflator	_	0.2	-0.8	2.1	5.4	3.8
Harmonised index of consumer prices	_	0.5	-1.3	0.6	8.8	3.4
Harmonised index of core inflation[3]	_	0.8	-1.2	-1.1	3.4	3.3
Unemployment rate (% of labour force)	_	17.3	16.3	14.7	12.4	12.6
General government financial balance[4] (% of GDP)	_	1.1	-10.2	-7.4	-4.1	-1.1
General government gross debt (% of GDP)	_	204.9	242.3	225.2	213.5	202.8
General government debt, Maastricht definition[5] (% of GDP)	_	180.7	206.3	193.3	181.6	170.9
Current account balance[6] (% of GDP)	_	-1.5	-6.6	-5.9	-7.7	-7.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. National Accounts basis. Data also include Eurosystem profits on Greek government bonds remitted back to Greece, and the estimated government support to financial institutions and privatisation proceeds.
5. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
6. On settlement basis.

Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/5cvy3b

Greece is primarily exposed to the war in Ukraine through its energy imports from Russia, equivalent to 30% of its total energy consumption. Higher international prices are being passed into domestic energy prices, such as the 79% increase in retail electricity prices in the year to April 2022. Russia and Ukraine are otherwise minor trade partners. Russian tourists generated 1.1% of Greece's tourism receipts in 2021. The maritime services sector, which made up 20% of total exports in 2019, is benefiting from high global shipping demand and prices. Greece is also providing dedicated support for approximately 20 000 Ukrainians, adding to the 32 000 refugees from before the war started.

Fiscal support is continuing despite overall consolidation

The government plans to achieve a modest budget primary surplus in 2023, although it projects a slower fiscal consolidation than it did in late 2021. It has cut tax and social security contribution rates and recurrent property taxes. It is announcing expanding measures responding to the energy price surge. The total cost for 2022 was EUR 5.4 billion (2.7% of GDP) in May 2022, with higher spending planned, in part financed through Emission Trade Scheme receipts. These broaden access and increase the level of electricity and fuel price subsidies for households and businesses, provide a rebate on fuel costs with generous eligibility criteria, and top-up social transfers for low-income households. Partly offsetting these measures, monetary conditions are tightening in Greece more than elsewhere in the euro area, through widening spreads on government and corporate bond yields as Greece's sub-investment grade sovereign rating excludes it from the ECB's standard asset purchase programmes. The ECB has undertaken to provide exceptional support to ensure that monetary conditions in Greece do not materially diverge from elsewhere in the euro area in the event of renewed market fragmentation related to the pandemic.

Higher prices are likely to slow the recovery

Surging energy prices, likely to extend into 2023 following the embargo on oil imports from Russia, tighter monetary conditions and disruptions in global trade are projected to slow the recovery considerably. Inflation pressures and renewed uncertainty are weakening private consumption and softening business confidence, investment and job creation. Government support and implementation of the Recovery and Resilience Plan, worth 1.6% of GDP annually, will provide some offsetting support. Energy subsidies and, from later in 2023, the expected retreat of energy and other international prices will allow headline and, more gradually, core inflation to moderate. Greater stability in the global security situation and energy prices will reduce uncertainty and allow stronger investment and consumer demand to lift growth.

Additional disruptions to energy supply, especially of gas, would amplify current high energy prices, and setback improvements in activity, exports and well-being. Wages rising by more than expected would risk entrenching higher inflation, partially unwinding improved competitiveness and weakening investment and exports. Rising materials costs and scarce skills may drag on the delivery of public investments. Poorly targeted energy price support measures and subsidies may weaken fiscal credibility and the return to an investment-grade sovereign debt rating. Deteriorating economic conditions and rising interest rates risk stalling the improvements to banks' health by creating new non-performing loans and making it more challenging to securitise existing non-performing loans or to raise capital.

Fiscal policy will need to balance support with fiscal sustainability

Ending current fiscal measures as scheduled, and limiting any further measures to well-targeted temporary support for vulnerable households would allow the government to rebuild its primary budget surplus. This would maintain Greece's reserves to cover contingent liabilities, build fiscal buffers, and support efforts to achieve an investment-grade sovereign rating. Developing the wage-setting system so that social partners negotiate broad agreements on working conditions that reflect workers' productivity and market conditions, rather than relying on administered adjustments to the minimum wage, would improve labour market performance. Expanding building renovation plans would accelerate inroads into high rates of energy poverty and low energy efficiency, improving energy security and reducing greenhouse gas emissions in the long term.

Hungary

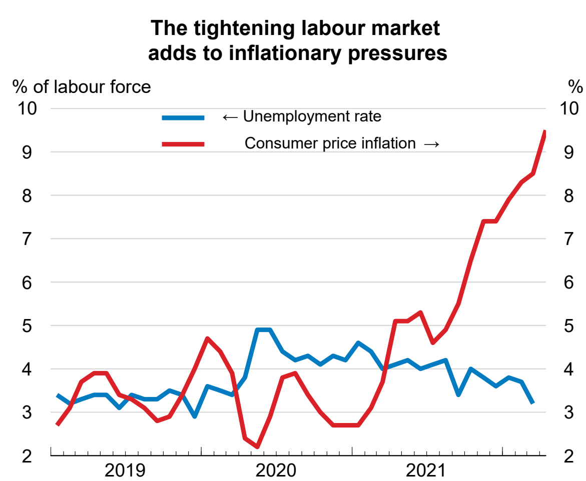
GDP growth is projected to slow to 4% in 2022 and 2.5% in 2023. Domestic demand will be the main growth driver. The labour market is expected to remain tight, continuing to put upward pressure on real wages. Together with high food and energy prices, this will keep headline inflation elevated until the end of 2022. Thereafter, inflation is projected to recede slowly, reflecting a slowdown in domestic demand growth as fiscal and monetary policy tighten. A major risk is that a combination of stronger wage growth and continued high energy prices could further de-anchor inflation expectations.

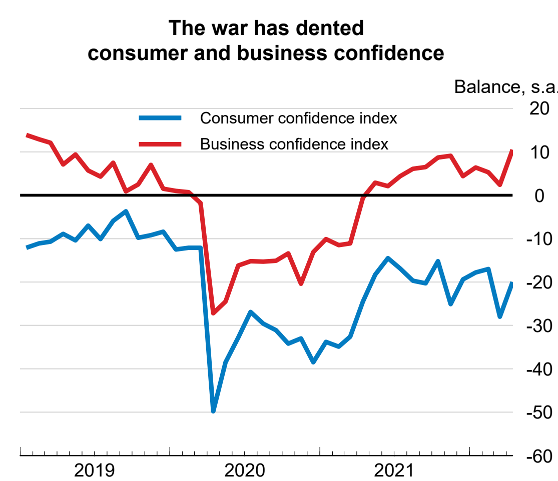
Further monetary tightening would help to contain inflation expectations. This should happen in coordination with faster fiscal consolidation. In addition, structural reforms are needed to raise productivity growth. Additional reductions in labour taxes can help address labour shortages but need to be financed by lower spending and an increased reliance on consumption and property taxation.

Economic headwinds are growing

Buoyant domestic demand drove a strong recovery, which is now threatened by the war in Ukraine. Labour market performance has improved significantly, with the employment rate reaching a historic high of 74.2%, the unemployment rate falling to 3.6% and signs of labour shortages in April 2022. Wages in the private sector have risen strongly, driven by a 20% increase in the minimum wage in January 2022. Headline inflation reached a 20-year high of 9.6% in April 2022. In addition to international factors such as supply-side disruptions and rising food and energy prices, domestic price pressures have been rising since mid-2021. This has resulted in inflation becoming broad-based, as reflected in core inflation of 8.2% in April. The impact of the strong minimum wage rise on overall wage costs, and indirectly on price inflation, was offset partly by the reduction of employers' social security contributions. In addition to regulated prices below market prices for gas and electricity supply, the government has also introduced price caps for fuel and food prices. Nevertheless, one-year inflation expectations have risen by 3 percentage points to 7%, and long-term interest rates by 4.4 percentage points to 6.6%, since early 2021.

Hungary





Source: OECD Labour Statistics database; Refinitiv; and GKI.

StatLink https://stat.link/wi3aro

Hungary: Demand, output and prices

Hungary	2018	2019	2020	2021	2022	2023
	Current prices HUF billion	Percentage changes, volume (2015 prices)				
GDP at market prices	43 392.4	4.6	-4.7	7.1	4.0	2.5
Private consumption	21 373.1	5.0	-1.2	4.6	3.9	1.5
Government consumption	8 543.1	4.3	-0.9	3.7	2.1	1.0
Gross fixed capital formation	10 729.9	12.8	-7.0	5.9	4.1	2.8
Final domestic demand	40 646.2	6.9	-2.7	4.7	3.6	1.8
Stockbuilding[1]	902.3	0.1	0.0	1.1	0.0	0.0
Total domestic demand	41 548.4	6.8	-2.7	5.8	3.4	1.7
Exports of goods and services	36 338.7	5.4	-6.1	10.3	3.0	3.1
Imports of goods and services	34 494.7	8.2	-4.0	8.7	2.3	2.1
Net exports[1]	1 844.0	-2.0	-1.8	1.4	0.5	0.8
Memorandum items						
GDP deflator	_	4.8	6.6	6.9	7.9	7.0
Consumer price index	_	3.3	3.3	5.1	10.3	7.0
Core inflation index[2]	_	3.4	3.3	4.5	9.3	6.1
Unemployment rate (% of labour force)	_	3.3	4.1	4.0	3.8	3.7
Household saving ratio, net (% of disposable income)	_	9.2	10.5	9.6	7.1	8.3
General government financial balance (% of GDP)	_	-2.1	-7.8	-6.8	-5.5	-5.4
General government gross debt (% of GDP)	_	84.1	97.5	88.7	88.1	86.7
General government debt, Maastricht definition[3] (% of GDP)	_	65.5	79.6	76.8	76.3	75.1
Current account balance (% of GDP)	_	-0.7	-1.6	-3.1	-5.0	-3.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/yegpk0

The war in Ukraine is a major headwind to economic growth. Direct trade with Russia and Ukraine is low (accounting for only 3% of all exports) but the war has caused heavy disruptions to global supply-chains, prolonging supply-side bottlenecks in the automotive sector. The forint has depreciated by 10% against the euro since the start of the war. Moreover, Hungary is highly reliant on energy imports from Russia, including about 95% of its gas and 45% of its oil and petroleum. Consumer and business confidence fell at the onset of the war, but recovered partly in April. The conflict has also led to the arrival of over half a million refugees from Ukraine (about 5% of the population) by the end of April. In addition to propping up the hospitality sector, this will have an impact on the labour market as about one tenth of the new arrivals (or 50 000 people) are expected to take up jobs in sectors with labour shortages, notably agriculture and health.

Fiscal policy has been supportive

Fiscal policy remained expansionary in early 2022 with another four percentage point reduction in employers' social security contributions. In addition, families with dependent children received a personal income tax refund and pensioners a 13th-month pension in early 2022. The announced fiscal measures will contribute to an expected budget deficit of 5.5% of GDP in 2022, implying a fiscal expansion of 0.5% of GDP. The fiscal stance is adding to the pressures on the central bank to contain inflation expectations. Since June 2021, the central bank has raised its base policy rate by 5.3 percentage points to 5.9%. It announced it would continue with monthly base rate increases as long as the headline inflation forecast remains above the target of 3% with a tolerance band of +/- 1%. The projections assume further increases in the interest rate over the projection horizon as announced by the central bank.

Domestic demand will be the main growth driver

The strong post-pandemic recovery is set to slow due to the impact of the war in Ukraine. In the near term, the conflict will add to already high inflation through higher fuel and food prices, putting pressure on private consumption and investment. Nonetheless, private consumption will benefit from further increases in real incomes due to the tight labour market. Private and public investment will grow, helped by generous home building subsidies, domestic and foreign direct investment and stronger inflows of EU funds. Higher food and energy prices together with strong wage growth are expected to feed into headline inflation in 2022 and 2023. Nonetheless, inflation is projected to fall in 2023 as tighter fiscal and monetary policies slow domestic demand growth. Downside risks include even stronger wage growth, which could raise demand pressures and, along with high food and energy prices, fuel rising inflation expectations. Another important risk is an embargo on Russian gas imports. On the upside, a shorter-than-expected war in Ukraine could ease price pressures and accelerate growth.

Policy needs to contain inflation expectations

Further monetary tightening is needed to contain inflation expectations. This should be implemented alongside faster fiscal consolidation. Price caps on energy prices could boost contingent liabilities of the state by around 1% of GDP in 2022. A better-targeted measure would be direct income support to households most exposed to high energy costs. Such support should be financed by cutting government spending elsewhere.

Iceland

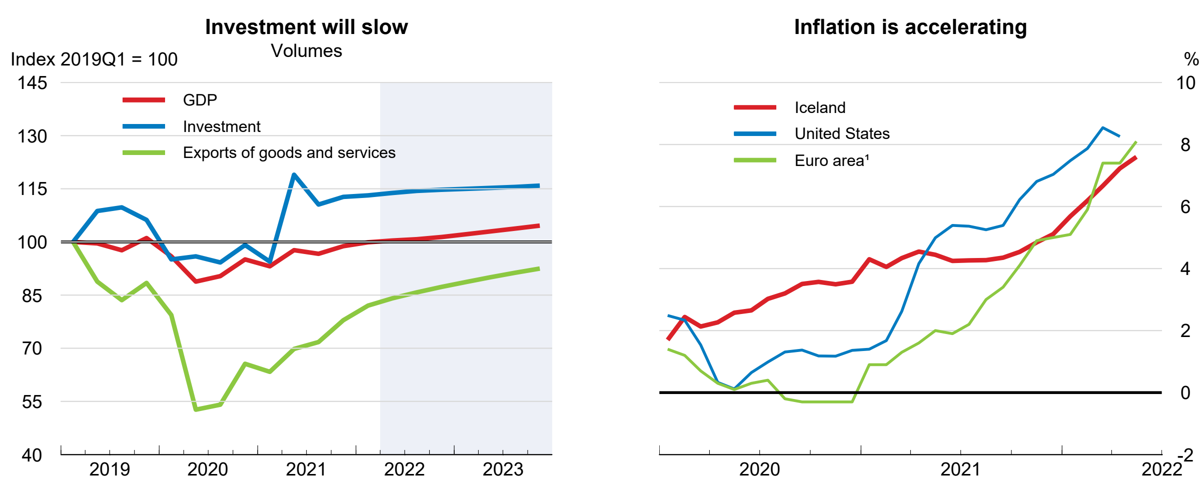
The economy is projected to grow by 4.2% in 2022 and 2.8% in 2023, driven by buoyant goods and services exports. Household consumption will slow in the course of 2023 as real wage growth is set to cool. Worsening financial conditions and uncertainty related to the consequences of the war in Ukraine is expected to weigh on business investment, but investment in residential housing will remain solid. Unemployment will continue to decline slightly, to around 4.5% at the end of 2023.

In early May, the central bank lifted the policy rate to 3.75%, the sixth rate increase within a year as inflation is accelerating and long-term expectations are rising. The central bank should increase interest rates further should inflationary pressure persist. Fiscal policy will be contractionary as planned by the government, which is welcome. Regulatory reform in the energy sector could make energy supply more sustainable, reliable and resilient.

The economy has exited crisis mode

The economy has successfully exited the COVID-19 crisis but the impact of the war in Ukraine is looming, although trade with Russia and Ukraine is negligible. Exports of goods and services remain strong, especially tourism which is benefitting from the removal of almost all restrictions. Business investment is slowing as uncertainty is rising, confidence declining and financial conditions worsening. Household consumption remains solid after significant wage increases. The unemployment rate stands at around 5%, and labour shortages have become more apparent. By the end of April, around 2 000 Ukrainian refugees (equivalent to around 0.7% of Iceland's population) had received asylum, including immediate access to the labour market, public services and free health care.

Iceland



1. Inflation data for May 2022 are preliminary.
Source: OECD Economic Outlook 111 database; Statistics Iceland; European Central Bank; and OECD Database on Consumer Price Indices.

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Iceland: Demand, output and prices

Iceland	2018	2019	2020	2021	2022	2023
	Current prices ISK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	2 844.4	2.4	-7.1	4.3	4.2	2.8
Private consumption	1 429.9	1.9	-2.9	7.6	5.4	2.4
Government consumption	686.8	3.9	4.2	1.8	1.4	1.0
Gross fixed capital formation	625.8	-2.4	-9.5	13.6	4.5	1.2
Final domestic demand	2 742.6	1.5	-2.6	7.2	4.1	1.8
Stockbuilding[1]	7.7	-0.6	0.9	-0.1	0.1	0.0
Total domestic demand	2 750.3	0.8	-1.7	7.2	4.3	1.7
Exports of goods and services	1 326.5	-4.7	-30.2	12.3	19.9	6.9
Imports of goods and services	1 232.4	-8.5	-21.6	20.3	19.0	4.0
Net exports[1]	94.1	1.5	-4.8	-2.9	-0.1	1.3
Memorandum items						
GDP deflator	_	4.5	3.6	5.8	7.0	2.6
Consumer price index	_	3.0	2.8	4.4	6.5	3.7
Core inflation index[2]	_	2.9	2.9	4.4	6.0	3.5
Unemployment rate (% of labour force)	_	3.9	6.4	6.0	4.5	4.5
General government financial balance (% of GDP)	_	-1.5	-8.6	-8.8	-4.8	-3.1
General government gross debt[3]	_	61.2	70.0	77.5	80.0	81.9
Current account balance (% of GDP)	_	5.8	0.8	-2.8	-4.1	-3.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Includes unfunded liabilities of government employee pension plans.
Source: OECD Economic Outlook 111 database.

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Macroeconomic policies are restrictive

Monetary policy continues to tighten. In early May, the central bank raised the interest rate by 100 basis points to 3.75%, the sixth increase since normalisation started in May 2021. Headline inflation has accelerated to 7.6% in May, driven by rising housing, food and commodity prices. Long-term inflation expectations are also drifting up. The króna has appreciated slightly over the past few months. The policy rate is projected to climb to almost 5% by the end of 2023, with inflation expected to subside to around 3%. The structural balance is improving by around 3 percentage points of GDP per year until 2023 according to the fiscal plan published in April, which is appropriate, subject to additional public spending for reception and integration of Ukrainian refugees.

The economy is set to cool

The economy is projected to grow by 4.2% in 2022 and 2.8% in 2023, driven by strong goods and services exports. Economic slack will continue to diminish. Household consumption will remain solid in 2022 but slow in 2023 as wages decelerate. Business investment will decline due to deteriorating financial conditions, rising uncertainty and the completion of pent-up projects, although spending on ships and aircraft will provide some support. Residential investment should remain robust thanks to solid housing demand. The unemployment rate is expected to fall to around 4.5% by the end of 2023. Despite fiscal tightening, public debt will rise from around 78% of GDP in 2021 to around 82% in 2023.

The projections are subject to considerable uncertainty and risks. Consumption and investment could suffer because of extended uncertainty about the war's impact as well as rising food and commodity prices. Inflation could become persistent. Foreign tourism might decline again if economic conditions are weaker than projected in the home countries of visitors. Domestic shocks such as a very strong volcanic eruption could interrupt transport links.

Policies to strengthen energy sustainability

With geothermal and hydropower covering around 90% of energy demand, Iceland relies overwhelmingly on domestic, renewable and reliable energy sources. The low share of fossil fuels in energy consumption and the lack of a physical connection to the European electricity grid shelter Iceland largely from the fallout of energy market imbalances. To maintain energy independence and ensure that the recovery remains resilient and sustainable, the government should continue to support energy diversification, notably by supporting investment in wind energy and by reforming the regulatory framework for energy generation, transmission and distribution, to ensure fair competition among providers.

India

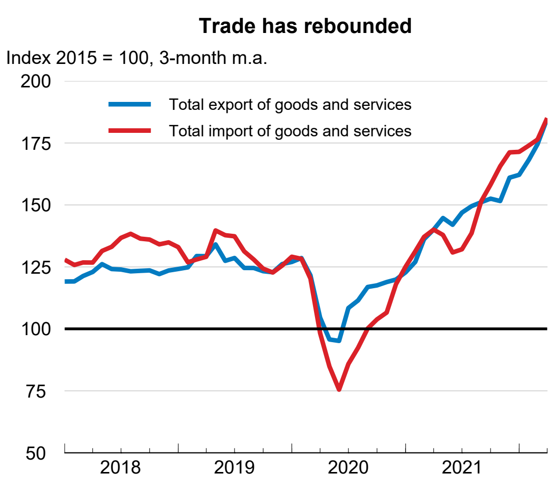
After recording the strongest GDP rebound in the G20 in 2021, the Indian economy is progressively losing momentum as inflationary expectations remain elevated due to rising global energy and food prices, monetary policy normalises and global conditions deteriorate. Real GDP is projected to grow by 6.9% in fiscal year (FY) 2022-23 and 6.2% in FY 2023-24, despite a pick-up of corporate investment facilitated by the Production-Linked Incentive (PLI) Scheme. While inflation will gradually decline, the current account deficit will widen due to the surge in energy import costs.

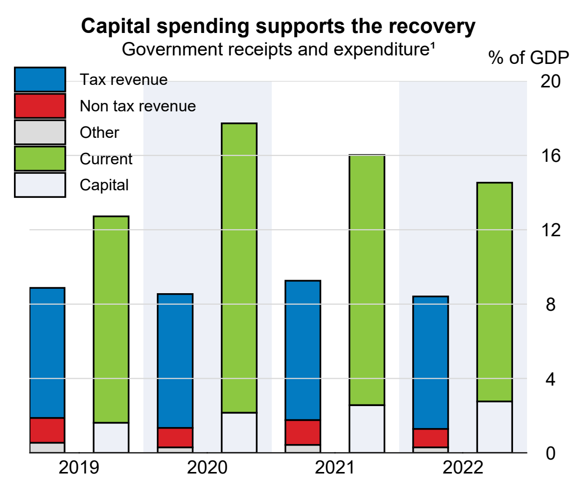
The Reserve Bank of India (RBI) began monetary policy tightening in May, intending to anchor inflation expectations and limit second-round effects. Given the financial and social costs of high inflation, the RBI should gradually move towards a more neutral monetary stance. The government should counter signs of a rapid deterioration in living standards with income support for vulnerable households. Risks include the appearance of a new COVID variant, failure to tame inflation, a reversal of capital flows to emerging markets, and a significant widening of the current account deficit.

Improved sanitary conditions underpinned a strong recovery, which is now slowing

The waning scale of the COVID-19 shock, the elimination of containment measures, the ability of exporters to take advantage of favourable external conditions, and government support to vulnerable households combined to produce remarkably high GDP growth in FY 2021-22. Merchandise exports rose to a record level, exceeding official government targets and validating India's strategy of managed liberalisation through preferential trade agreements with major partners. However, consumption growth has slowed, with

India 1





1. The first bar for each year represents revenue and capital receipts excluding borrowings and other liabilities. The second bar for each year represents total expenditure excluding interest payments and grants in aid for creation of capital assets. 2019 refers to the average of data over the fiscal year 2017-18, 2018-19 and 2019-20. Other years are fiscal years ending on 31 March of the following calendar year.
Source: OECD Economic Outlook 111 database; Ministry of Finance; Budget Union; Reserve Bank of India; and Ministry of Commerce and Industry.

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India: Demand, output and prices

India	2018	2019	2020	2021	2022	2023
	Current prices INR trillion	Percentage changes, volume (2011/2012 prices)				
GDP at market prices	189.0	3.7	-6.6	8.7	6.9	6.2
Private consumption	112.1	5.2	-6.0	8.7	0.0	4.2
Government consumption	20.5	3.4	3.6	2.2	9.6	5.8
Gross fixed capital formation	55.7	1.6	-10.4	15.5	7.8	9.6
Final domestic demand	188.2	4.1	-6.5	9.5	3.2	6.0
Stockbuilding[1,2]	7.9	-1.1	-0.8	-1.7	0.0	0.0
Total domestic demand	196.1	4.1	-7.7	11.5	8.2	6.3
Exports of goods and services	37.7	-3.4	-9.2	23.0	4.2	1.8
Imports of goods and services	44.8	-0.8	-13.8	34.7	10.0	2.9
Net exports[1]	- 7.1	-0.5	1.4	-3.0	-1.7	-0.4
Memorandum items						
GDP deflator	_	2.4	5.6	9.3	7.9	6.0
Consumer price index	_	4.8	6.2	5.6	6.7	6.5
Wholesale price index[3]	_	1.7	1.3	13.7	12.2	8.9
General government financial balance[4] (% of GDP)	_	-7.2	-13.3	-9.4	-8.3	-7.6
Current account balance (% of GDP)	_	-0.8	1.0	-1.2	-2.2	-1.8

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Actual amount in first column includes statistical discrepancies and valuables.
3. WPI, all commodities index.
4. Gross fiscal balance for central and state governments.
Source: OECD Economic Outlook 111 database.

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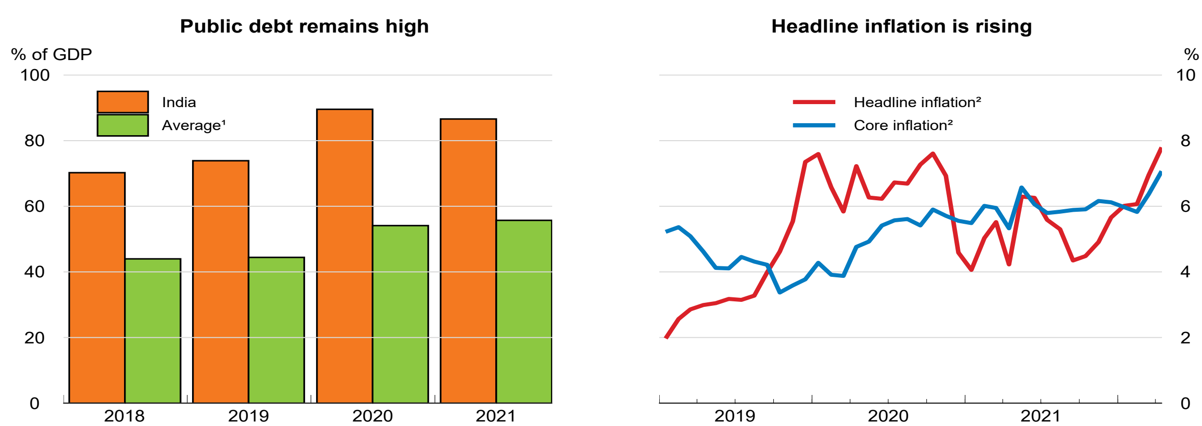
India 2



1. The unweighted average of general government debt ratio for similarly-rated countries (Bulgaria, Costa Rica, Indonesia, Hungary, Kazakhstan, Mexico, Malaysia, Peru, the Philippines, Romania, Thailand and Uruguay).
2. Headline inflation refers to the change in price of all goods in the basket. Seasonally adjusted and based on the monthly consumer price index and core CPI (index 2012 = 100) provided by the Central Statistics Office.
Source: IMF World Economic Outlook; and CEIC.

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sales of two-wheelers falling to a 10-year minimum, subdued private sector credit growth, and contracting employment, although companies report difficulties in filling vacancies. Consumer price inflation forenergy-related items and edible oils started trending up even before the Ukraine war and has accelerated afterwards. Inflation has also risen and become wide-ranging: almost 75% of the CPI sub-components exceed the 4% inflation target. Despite uncertainty, reflected in the higher yield on 10-year government bonds, equity markets have been boosted by the initial public offer (IPO) of state-owned Life Insurance Corp., India's largest ever IPO. Meanwhile, the import coverage of foreign exchange reserves, which exceeded 18 months in March 2021, declined to 12 months in March 2022.

The direct impact of the war in Ukraine is relatively limited, as trade between India and both Russia and Ukraine is small. Russia accounts for less than 1% of India's crude oil consumption in 2015-21 and 1% of 2020 coal consumption. Nonetheless, for selected industries, notably pharmaceuticals and weapons, Russia is an important destination and source, respectively. The indirect impact, through global commodity and energy market shifts, is much larger. In the 2015-21 period, India imported 88% of its annual consumption of oil and 29% for coal in 2020. It is also the world's largest nitrogen fertiliser importer, with Ukraine and Russia accounting for 9% of imports. These forces, together with the lockdowns in China and the EU embargo, are contributing to high inflation, although pressures may subside in coming months. Potential opportunities for Indian grain exporters to take the place of Ukrainian suppliers in third markets, in particular for wheat, have been prevented, at least temporarily, by the export-restrictive measures introduced in May.

Monetary policy is becoming less supportive

Facing increasing inflationary pressures, the RBI signalled its shift from an accommodative to a neutral stance in May, with an off-cycle increase of the repo rate by 40 basis points. The cash reserve ratio was also raised to drain liquidity from the inter-bank market. The policy rate is projected to rise to 5.3% by the end of 2022 and remain there in 2023. With food and energy accounting for 53% of the consumer price index basket, measures have also been taken to contain domestically-generated inflation, such as cutting central excise duties on petrol and diesel and import duties on edible oils and coal, as well as restricting exports of selected agricultural produces. Such interventions should be supplemented by policy actions to reduce excess margins in high-concentration and/or low-competition sectors.

The central government financial deficit will decline, despite an increase in capital expenditure, in the expectation that private investment will be crowded in. The strategic emphasis is on improving logistics, with challenges due to execution capabilities. Railways and roads will also receive a considerable boost through 50-year interest-free loans (Scheme of Financial Assistance to States for Capital Investment). Income support to vulnerable groups is set to remain contained, with fewer funds allocated to the National Rural Employment Guarantee scheme (MGNREGA) and housing spending unchanged. A growing gender gap in terms of labour participation and employment, as well as time spent on household chores, is a cause of concern, as it affects social mobility and poverty reduction. Welfare spending ought to be prioritised in the budget allocation process, and resources can be found by reducing non-targeted subsidies.

Growth will moderate in 2022 and 2023

Monetary policy normalisation and weaker external demand will weigh on GDP growth in FY 2022-23 and FY 2023-24, though strong government spending will continue to support activity. An ambitious set of measures to simplify the business environment, create a 'bad bank' (National Asset Reconstruction Company) tasked with cleaning up balance sheets, and improve logistics is expected to mitigate the impact of higher credit costs on private investment. However, households maintain cautious views regarding short- and medium-term prospects, amid signs of labour market softening, deteriorating purchasing power and flattening real incomes.

Major risks continue to surround the outlook. The COVID-19 pandemic may not subside as fast and broadly as expected and the booster vaccine campaign may stall at far from universal coverage levels. A significant deterioration in investors' risk appetite for emerging economy assets may ignite a negative feedback loop between the financial sector and real economy, which in turn may weaken banks' capital positions. Private business, including large enterprises and business groups that were largely immune from the worst consequences of the COVID-19 crisis, may revisit investment plans if interest rates keep increasing. Rising food inflation is an upside risk to the overall inflation outlook, as it may lead to more food protectionism and prompt retaliatory measures. Failure to contain the increase in the cost of living may also exacerbate food security risks, especially among children, and further aggravate the social costs of school closures during the pandemic.

Energy transformations are needed on a scale no country has achieved in history

India is set to see the largest increase in energy demand of any country over next 20 years. The combination of a growing and industrialising economy and an expanding and increasingly urban population will drive energy use higher, raising the question of how best to meet the swelling demand without exacerbating issues like costly energy imports, air pollution and greenhouse gas emissions. Climate action was framed as one of the pillars of the budget, including plans for low-carbon and climate-resilient development. Based on India's current policy settings, nearly 60% of its CO_2 emissions in the late 2030s will be coming from infrastructure and machines that do not exist today. This represents a huge opportunity for policies to steer India onto a more secure and sustainable energy path and requires efforts to electrify processes, enhance material and energy efficiency, use carbon capture technologies, and switch to lower-carbon fuels. Continued reliance on imported fuels – which the International Energy Agency expects to rise above 90% by 2040, up from 75% today – creates vulnerabilities to price cycles and volatility, as well as possible disruptions to supply. Reinforcing energy security in the electricity sector requires significant increases in system flexibility, improvements to the financial health of many distribution companies, and further efforts to develop renewable energy and storage capacities.

Indonesia

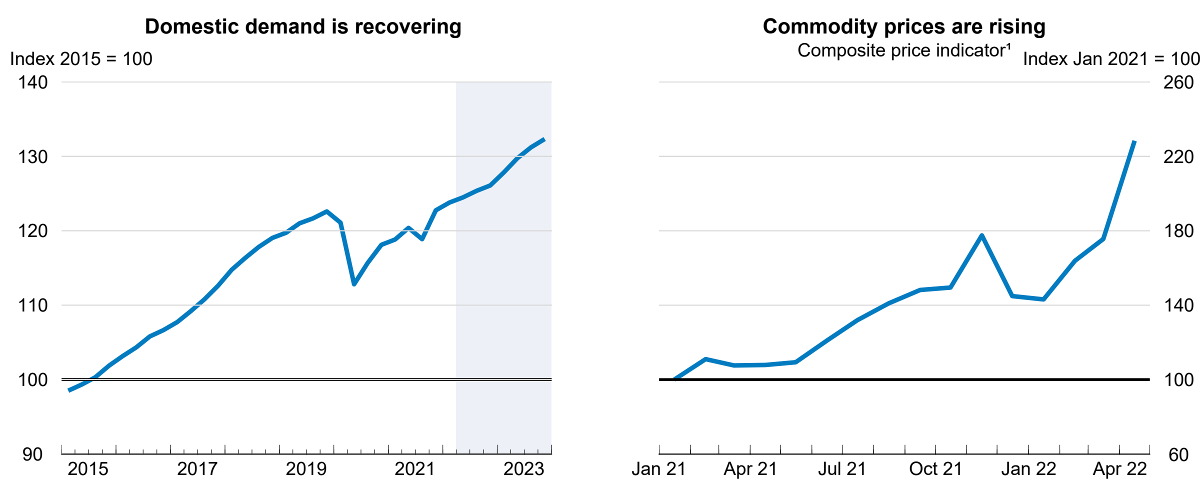
GDP growth is projected to strengthen to 4.7% in 2022 and 2023, as the improving health situation underpins the rebound of domestic demand, exports of raw materials increase and tourism slowly restarts. The rise in inflation, however, is already damping consumers' purchasing power and demand for durable goods. The output gap will remain considerable, limiting at least initially the pass-through of higher global commodity prices to consumer prices. However, the current account deficit will rise.

The government plans to reduce the budget deficit progressively in order to comply with the 3% of GDP constitutional ceiling by 2024. The normalisation of monetary policy will be gradual and geared towards currency stability. Following the enactment of major investment and tax administration reforms, it is important to complete the process with coherent implementation measures. Geopolitical tensions highlight the urgency of improving energy security through investment in renewables and higher energy efficiency.

The recovery is taking hold

Mobility restrictions introduced to contain successive waves of COVID-19 infections have been largely lifted, although a shortage of vaccines, logistical challenges and vaccine hesitancy are still impeding quasi-universal coverage. Real GDP grew by 3.7% in 2021 and accelerated to 5% (year-on-year) in the first quarter of 2022: nonetheless output remains well below the path expected before the pandemic. Household consumption, corporate investment, and net exports each accounted for a third of 2021 growth. Sentiment indicators, such as the Mandiri Spending Index and the manufacturing PMI, suggest the rebound is taking hold, and the April stock market debut for Indonesia's biggest start-up bucked a global decline in technology stocks. The pass-through of higher global prices into consumer prices was initially limited, although headline inflation has accelerated this year and core inflation has reached a level last seen at end-2017. Transport services and food and beverages are the fastest-growing CPI items. The unemployment rate declined in 2021, but almost half of household primary breadwinners report earning less than before COVID-19. Sales of consumer durables such as scooters have slowed in the first quarter of 2022.

Indonesia 1



1. The price indices for individual commodities (palm oil, coal, iron ore and gold) are aggregated by using weights based on the share of each commodity in the total 2020 exports of these commodities.
Source: OECD Economic Outlook 111 database; Ministry of Energy and Mineral Resources; and World Bank Commodity Markets Outlook.

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Indonesia: Demand, output and prices

Indonesia	2018	2019	2020	2021	2022	2023
	Current prices IDR trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	14 838.8	5.0	-2.1	3.7	4.7	4.7
Private consumption	8 455.1	5.2	-2.7	2.0	5.3	4.4
Government consumption	1 338.6	3.3	2.0	4.2	-6.3	1.4
Gross fixed capital formation	4 791.2	4.5	-5.0	3.8	3.8	4.9
Final domestic demand	14 585.0	4.8	-3.1	2.8	3.8	4.3
Stockbuilding[1]	412.4	-1.0	-0.5	0.1	0.2	0.0
Total domestic demand	14 997.4	3.6	-3.6	2.8	3.9	4.3
Exports of goods and services	3 116.5	-0.5	-8.1	24.0	13.1	9.5
Imports of goods and services	3 275.1	-7.1	-16.7	23.3	11.0	8.7
Net exports[1]	- 158.6	1.4	1.4	1.0	1.0	0.6
Memorandum items						
GDP deflator	_	1.6	-0.4	6.0	6.1	3.1
Consumer price index	_	3.0	1.9	1.6	3.8	3.8
Private consumption deflator	_	3.2	1.9	1.7	4.2	4.5
General government financial balance (% of GDP)	_	-1.7	-5.4	-5.8	-4.4	-3.4
Current account balance (% of GDP)	_	-2.7	-0.4	0.3	-0.6	-0.9

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 111 database.

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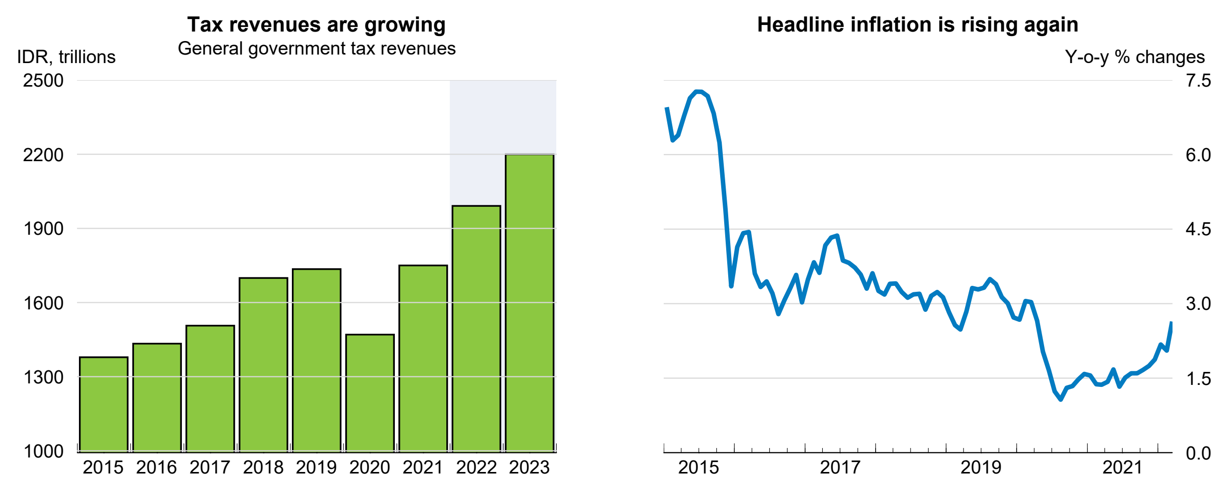
Indonesia imports a considerable share of its energy needs and is also far from self-sufficient in selected food staples such as wheat (a quarter of domestic needs is sourced from Ukraine). This is making the country vulnerable to war-related supply disruptions and weighting on households' purchasing power. Russian visitors also accounted for a considerable share of foreign tourists. On the other hand, Indonesia is among the largest global suppliers of commodities such as palm oil, thermal coal, nickel, gold and ferroalloys that have recorded considerable global price surges since mid-February.

Indonesia 2



Source: OECD Main Economic Indicators database; and IMF World Economic Outlook, April 2022.

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Policy normalisation will reflect global developments

Fiscal and monetary policies have supported activity through the COVID-19 crisis and are now set to normalise gradually in parallel with the recovery. Bank Indonesia is projected to bring the policy rate to 4½ per cent by late 2022, thus moving from an accommodative towards a neutral stance before accelerating inflation expectations take root. The financial system is in better shape than during previous episodes of global turbulence and uncertainty: sovereign and corporate exposure to external financing is now relatively small, the current account deficit is low and manageable, the rupiah's fluctuation has been relatively mild and international reserves are ample. Indonesia has resorted to export bans on commodities for which it ranks among the world's largest producers, palm oil in particular. This approach should be very limited in time and coverage, as the potential short-term benefits (securing supply in the domestic market and limiting price increases) are likely to be offset by the proven medium-term costs of distortions. These include lower hard currency earnings, currency depreciation and therefore higher import costs, damage to reputation in global markets, and disincentives to farmers.

The 2021 fiscal performance was driven by improved tax revenue collection, supported by high commodity prices and tax reforms. In this context, there is space to protect the purchasing power of the most vulnerable groups through direct income support without jeopardising fiscal consolidation plans. Spending performance also improved, focusing mainly on healthcare and social programmes. The carbon tax, initially planned for April 2022 and postponed to July, includes a floor rate of IDR 30 000 (EUR 1.9) per tonne that will initially apply to coal power plants. This would be an important step to containing greenhouse gas emissions, which are currently the highest relative to GDP among G20 countries after accounting for land use.

Growth is set to return to its medium-term trend

Real GDP growth for 2022 and 2023 is projected to be 4.7%. Forces driving the return to the growth pattern that prevailed before the pandemic include a release of pent-up demand for consumer goods and personal services, a cash transfer programme for cooking oil, job creation, new investments made possible by recent reforms and trade agreements, the return of foreign tourism and strong, albeit decelerating, world demand for Indonesian raw materials. Annual headline inflation will be close to the 4% ceiling during 2022 and 2023. The current account is projected to record a modest deficit.

The forecast is subject to both idiosyncratic risks weighing on investors' confidence, such as continuing uncertainty surrounding the date of the next presidential elections, and a broad-based deterioration of financial conditions in emerging markets. Enduring increases in global energy and food prices would pose additional risks, including for public finances due to the large size of subsidies, as well as to food security and livelihoods. On the upside, the benefits of the 2020-21 reforms of labour markets and tax administration will be felt through a better business and investment climate, increased employment, and improved private physical and human capital.

Structural reforms can steer Indonesia towards energy security

Through Vision 2045, the government has set the goal of making Indonesia one of the world's five largest economies by the time of the 100th anniversary of independence. Achieving this ambition must be consistent with the target of reducing emissions by 29% with its own efforts, and 41% with international support, by 2030. The 2014 National Energy Plan targeted a 2025 energy mix where oil and coal account for 55% (against 72% in 2019), gas for 22% (19%), and new and renewable energy for 23% (9%). The government is working to cut subsidies that encourage the use of coal. Indonesia has an abundance of renewable energy resources, but complex procurement and project implementation inhibit greater uptake. To attract the necessary investment, the reliability of official energy data should be enhanced, the regulatory review process strengthened to ensure regulatory consistency, and policies that have made fossil fuels more financially attractive than less emission-intensive energy sources withdrawn. Fiscal and non-fiscal incentives should be considered to accelerate the shift to electric vehicles and the necessary infrastructure should be expanded.

Ireland

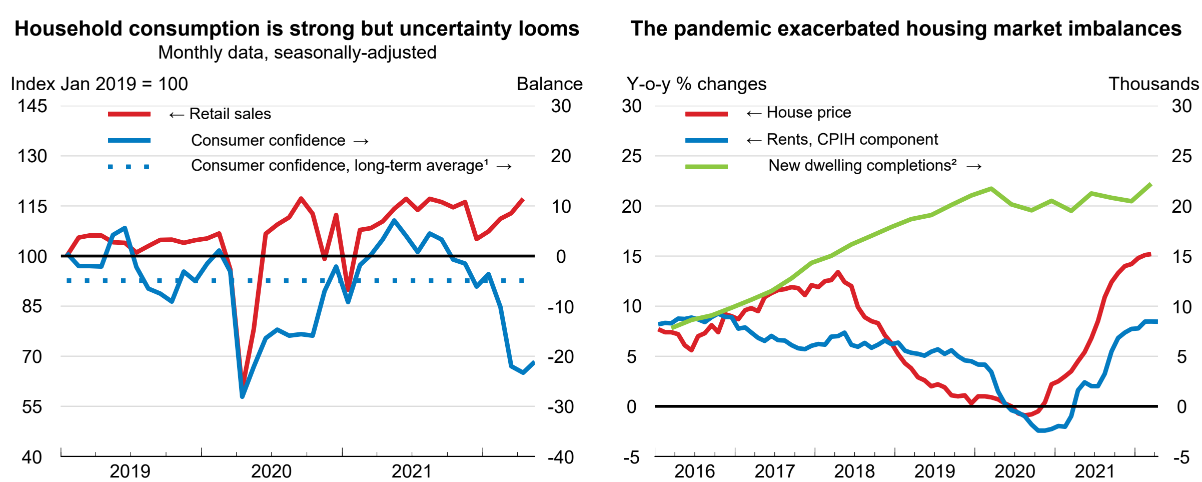
Against the backdrop of high COVID-19 vaccination rates, the full reopening of the economy is boosting a broad-based recovery, with GDP projected to increase by 4.8% in 2022 and 2.7% in 2023. Business conditions underpin sizeable employment gains, while household excess savings and wage increases support consumer spending. However, surging inflationary pressures, caused by disruptions in global supply chains and geopolitical concerns, will cut households' real income and dampen consumption growth.

Amidst current headwinds, the government acted to cushion households from high energy prices and ensure assistance to refugees. Additional fiscal measures should better target poorer households, particularly in the event of further food price increases. At the same time, allocating windfall corporate tax receipts to specific contingency funds would help support fiscal sustainability.

Business activity is solid but inflationary pressures are growing

Supported by an improved epidemiological situation, reflecting high vaccination rates, economic growth was solid in early 2022. Industrial production and retail sales were well above pre-pandemic levels, as was consumer spending, sustained by growing wages and household excess savings. Due to high job vacancy rates, labour market conditions have remained relatively tight, despite the winding down of the emergency Pandemic Unemployment Payments and the Employment Wage Subsidy schemes. However, steadily rising consumer prices, combined with concerns around the war in Ukraine, have fuelled uncertainty, triggering a marked deterioration in consumer sentiment. Surging energy and transport prices have driven inflationary pressures. These recently spilled over to the hospitality and communication sectors and, partly, to food products, with harmonised headline inflation estimated to have reached 8.2% in May.

Ireland



1. The long-term average of consumer confidence index is computed based on monthly values between January 1985 and May 2022.
2. Four-quarter cumulated sums.
Source: Central Statistics Office; and Eurostat.

StatLink https://stat.link/q8d72h

Ireland: Demand, output and prices

Ireland	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2019 prices)				
GDP at market prices	325.5	5.1	5.9	13.4	4.8	2.7
Private consumption	99.2	3.2	-11.1	5.6	5.8	3.0
Government consumption	38.8	6.8	9.4	5.4	-0.3	2.1
Gross fixed capital formation	91.9	100.5	-22.9	-37.7	27.9	3.3
Final domestic demand	229.9	42.8	-14.9	-16.8	13.0	3.0
Stockbuilding[1]	3.1	1.6	0.0	-0.1	-1.5	0.0
Total domestic demand	233.0	42.5	-14.5	-17.0	10.1	2.9
Exports of goods and services	399.6	10.5	9.5	16.6	5.1	3.5
Imports of goods and services	307.1	42.5	-7.5	-3.6	11.0	4.0
Net exports[1]	92.5	-27.2	21.4	25.7	-3.6	0.8
Memorandum items						
GVA[2], excluding sectors dominated by foreign-owned multinational enterprises	_	3.7	-8.6	4.9	4.6	3.0
GDP deflator	_	4.1	-1.3	-0.3	4.5	2.9
Harmonised index of consumer prices	_	0.9	-0.5	2.4	6.6	5.0
Harmonised index of core inflation[3]	_	0.9	-0.1	1.7	3.7	3.7
Unemployment rate (% of labour force)	_	5.0	5.8	6.2	4.8	5.0
Household saving ratio, net (% of disposable income)	_	5.2	21.4	17.9	12.5	8.3
General government financial balance[4] (% of GDP)	_	0.5	-5.1	-1.9	-0.5	-0.1
General government gross debt (% of GDP)	_	69.5	72.3	65.0	62.0	60.1
General government debt, Maastricht definition[5] (% of GDP)	_	57.3	58.6	56.1	53.1	51.2
Current account balance (% of GDP)	_	-19.9	-2.7	14.0	11.2	11.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Gross value added.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. Includes the one-off impact of recapitalisations in the banking sector.
5. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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Direct macroeconomic risks from the war in Ukraine are limited, as Ireland's goods trade with Russia, Ukraine and Belarus is modest. However, specific shocks could hit agriculture and some industries dependent on specialised energy inputs, particularly as the oil embargo takes effect. As for trade in services, the aircraft leasing industry could be affected, although the impact on the domestic economy would be negligible. Following the Government's commitment not to cap their number, Ireland has so far welcomed more than 33 000 Ukrainian refugees, with state accommodation provided to about two thirds of them. A new Cabinet subcommittee was recently established to oversee the all-government response to the crisis.

Targeted fiscal support should be prioritised

To mitigate the adverse impact of rapidly rising energy bills on household income, the government took support measures worth about 0.5% of 2021 GDP. Largely made up of untargeted electricity credits and reductions in energy-related indirect taxes and levies, such measures have provided only limited protection to poorer households. Any new initiatives should focus on temporary assistance to the most vulnerable and productivity-enhancing public investment. In addition, the costs of the refugee crisis, so far financed via unspent COVID-19 contingency funds, will weigh on public spending in 2023. The recently introduced fiscal rule, limiting annual permanent expenditure increases to around 5%, should keep spending in check, while buoyant tax receipts will continue to improve public finances.

Growing uncertainties will dent the pace of the recovery

The full reopening of the economy and the prospects of a relatively normal summer tourist season, combined with high household excess savings, will support consumer spending in 2022. However, mounting uncertainties, fuelled by geopolitical tensions and still impaired global supply chains, will work in the opposite direction. Due to a tight labour market, wages will grow strongly in 2022, but moderate somewhat thereafter, as growth subsides. Even so, high inflation will cut real household disposable income and weigh on firms' investment decisions, especially in 2023, as the embargo on Russian oil takes effect.

If funding costs were to rise faster than assumed, more domestic firms might downsize or ditch their investment plans. Similarly, higher interest rates could make housing less affordable. Additionally, protracted uncertainties around the full implementation of Brexit agreements may further weaken firms' competitiveness. Persistently high input price inflation, while weighing on firms' profitability, could also hamper the fiscal sustainability of the ambitious government agenda to subsidise residential construction and retrofitting, in a bid to boost housing supply and ease pressure from high house prices and rents. On the upside, GDP growth may turn out stronger, as multinational-dominated exports of pharmaceutical and medical goods, as well as ICT services, could again surprise on the upside.

Sustaining growth will require structural reforms

Ireland faces important challenges in order to sustain growth and improve wellbeing in the medium to long term. These include ambitious and investment-intensive objectives to ensure affordable housing, to overhaul the health system to improve quality of care and value for money, and to achieve a just carbon transition by 2050. Regarding the latter, the government recently committed to maintain the schedule of carbon price increases as planned, whilst vowing to protect those more at risk of fuel poverty. This would preserve the carbon tax price signal and help strengthen energy saving incentives. In addition, measures fostering the acquisition of digital and green construction skills, particularly among displaced workers, and improving access to finance for innovative SMEs, would boost participation and productivity in the domestic-oriented economy.

Israel

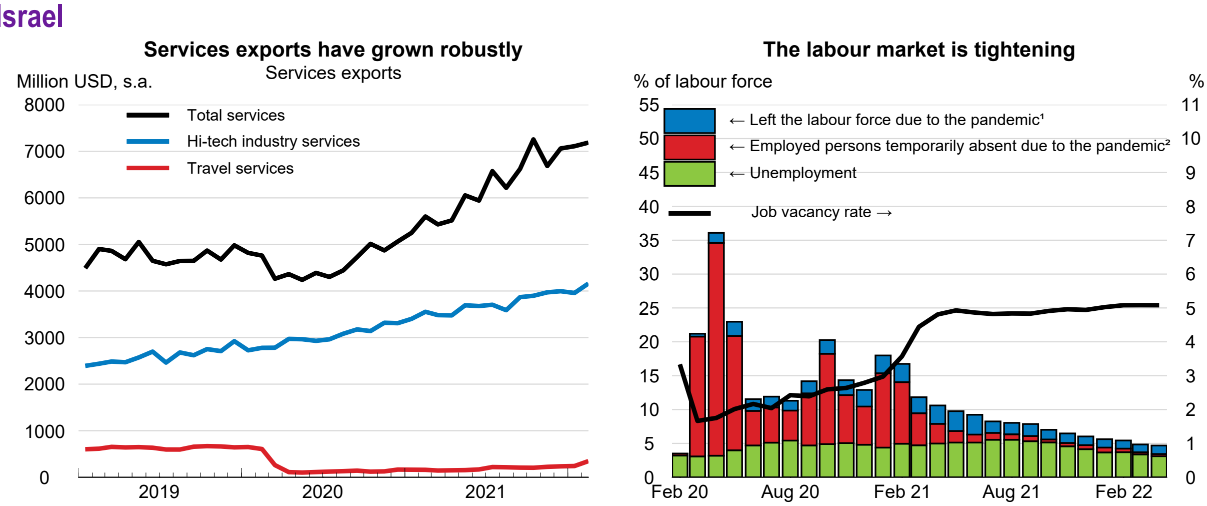
GDP is projected to grow by 4.8% in 2022 and 3.4% in 2023. The strength of the high-tech sector will continue, with exports and investment growing at a robust, albeit more moderate, pace. The strong labour market recovery will support consumption growth. Inflation should gradually slow but slightly exceed the upper bound of central bank's target range in 2023. Risks are skewed to the downside, related to a prolonged war in Ukraine, new strains of the corona virus, internal political uncertainty and an intensification of security incidents.

The advanced stage of the recovery and consumer price inflation exceeding the central bank's target range, call for a continuation of the gradual tightening of monetary policy. Fiscal policy support should be temporary and well targeted to households and firms most affected by the increase in the cost of living, so as not to add to inflationary pressures. In the medium term, putting public debt on a downward trajectory while allowing for productivity-enhancing investment calls for further efforts to enhance spending efficiency and increase tax revenue.

The economic recovery is well-advanced

After exceptionally strong growth in the fourth quarter of 2021, GDP contracted by 0.4% (non-annualised) in the first quarter of 2022. Credit card data and service exports suggest robust underlying growth momentum. The labour market has largely recovered with unemployment and employment rates close to pre-pandemic levels. A high vacancy rate suggests continued strong labour demand with some labour shortages evident in particular in the high-tech sector. Consumer price inflation, at 4% in April, exceeded the central bank's target range (1-3%), due to rising energy and food prices and price increases of other components (notably housing). Inflation has been mitigated by the trend currency appreciation, but more recently the shekel has depreciated. Wage increases in the public sector have been moderate so far.

Israel



1. Series includes persons not in the labour force who stopped working due to dismissal or closure of the workplace since March 2020. Data not available before March 2020.
2. This includes employees on unpaid leave, employees who were absent during the week due to reduced workload, work stoppage or other reasons related to the pandemic and excludes quarantined persons.
Source: Israel Central Bureau of Statistics; and OECD calculations.

StatLink https://stat.link/lf0w1d

Israel: Demand, output and prices

Israel	2018	2019	2020	2021	2022	2023
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 341.6	3.7	-2.1	7.9	4.8	3.4
Private consumption	731.2	4.0	-9.2	11.6	6.7	4.2
Government consumption	305.3	2.7	2.5	2.9	1.2	0.5
Gross fixed capital formation	286.1	3.0	-4.0	10.9	7.3	4.7
Final domestic demand	1 322.6	3.5	-5.3	9.3	5.5	3.4
Stockbuilding[1]	7.8	0.2	1.1	0.3	0.2	-0.2
Total domestic demand	1 330.4	3.7	-4.2	9.4	5.7	3.1
Exports of goods and services	402.4	3.7	-1.9	12.8	5.2	3.9
Imports of goods and services	391.3	3.3	-9.4	19.6	10.9	3.2
Net exports[1]	11.2	0.1	2.0	-1.0	-1.2	0.3
Memorandum items						
GDP deflator	_	1.9	0.9	3.0	3.1	2.2
Consumer price index	_	0.8	-0.6	1.5	4.0	3.3
Core inflation index[2]	_	0.7	-0.1	1.2	3.0	2.9
Unemployment rate (% of labour force)	_	3.8	4.3	5.0	3.7	3.6
Household saving ratio, gross (% of disposable income)	_	3.8	12.9	6.9	2.5	1.9
General government financial balance (% of GDP)	_	-3.9	-10.8	-3.8	-1.9	-2.2
General government gross debt (% of GDP)	_	59.5	71.7	68.7	65.8	64.7
Current account balance (% of GDP)	_	3.4	5.4	4.6	3.3	3.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/985mar

The impact of the war in Ukraine on the Israeli economy is likely limited to indirect effects via higher world energy and food inflation and lower demand from trading partners. Direct trade volumes with Russia and Ukraine only account for around 1% of total trade. Israel is also largely self-sufficient in natural gas, which accounts for around 40% of total energy supply. In contrast, the conflict may boost defence exports.

Macroeconomic policy normalisation is underway

The central bank raised the policy rate twice in April and May 2022 from 0.1% to 0.75%, after having ended its quantitative easing programmes at the end of 2021. The projections assume a continuation of the gradual monetary policy normalisation cycle with additional increases of the policy rate projected until the end of 2023. With strong revenue growth and the phasing-out of COVID-19-related spending, the budget deficit narrowed significantly in 2021. Revenue growth is likely to moderate in the coming years as some exceptional factors related to high financial and real estate valuations, strong import growth as well as increased profits in the high-tech sector dissipate. The government recently adopted a programme to mitigate the increase in the cost of living, including by expanding the earned income tax credit and child tax allowances, the suspension of the coal excise tax in 2022, and some reductions in custom tariffs. The estimated fiscal costs of the programme is around NIS 5.2 billion in 2022 (0.3% of GDP). A budget for 2023 has not yet been adopted and the projections assume a broadly neutral fiscal policy stance in 2023.

GDP will continue to grow robustly

After a very strong rebound in 2021, GDP is projected to grow at a more moderate pace in 2022 and 2023. Strong investment in the high-tech sector is projected to continue and, together with increasing tourist inflows will support service exports. Government support will mitigate the impact of inflation on households' disposable income. Inflation should gradually slow as monetary policy is tightening, but energy prices will remain elevated due to the EU embargo on Russian oil. A prolonged conflict in Ukraine could adversely affect the economy through more persistent inflation and lower demand from trading partners. New strains of the coronavirus, internal political instability and an increase in security incidents could heighten uncertainty, weighing on consumption and investment. On the upside, growth could be stronger if the high-tech boom continues unabated.

Macroeconomic policy should remain flexible

The gradual and data-driven normalisation of monetary policy should continue in order to bring inflation back into the target range. Fiscal policy should remain flexible, and additional targeted and temporary support to the most vulnerable households may be needed if inflation proves persistent. The abolition of the coal excise tax and reduction of transport fuel excise taxes are not well targeted and should be temporary as planned, so as not to compromise environmental goals. Expanding renewable energy would support energy security. Ensuring timely and effective implementation of the government's plans to boost infrastructure investment and investment in Israeli-Arab communities, and streamline regulations can boost productivity and lower socio-economic gaps. With extraordinary tax revenues dissipating, putting public debt on a downward trajectory while making these investments requires additional efforts to enhance spending efficiency, including by further digitising government services, and to increase tax revenues, including by broadening tax bases and reducing tax expenditures.

Italy

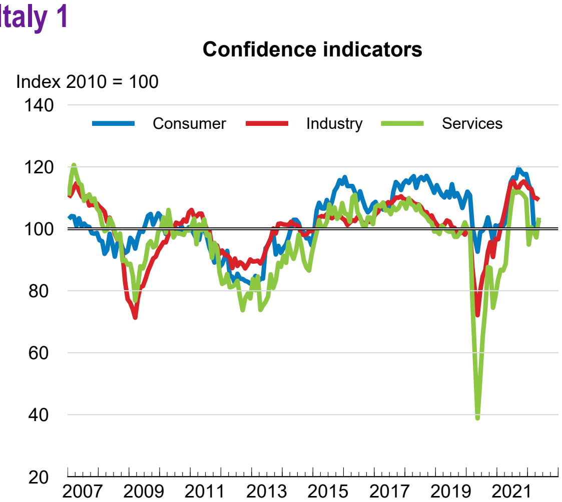
After a sharp 6.6% rebound in 2021, Italy's GDP growth will be hit by the war. Growth is expected to be 2.5% in 2022, supported by strong base effects, and 1.2% in 2023. Persistent war-related inflationary pressures and uncertainty will hold back household consumption, slowing the recovery in services. New incentives for the private sector and the National Recovery and Resilience Plan will mitigate some of the negative impact of supply disruptions and uncertainty on investment. With gas constituting 42% of total energy consumption, the main risks to the outlook are energy prices and supplies. Sharply higher bond yields could also lower growth.

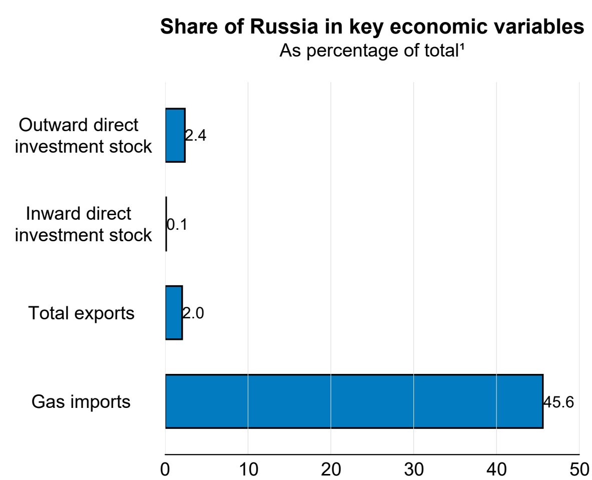
Authorities secured energy supplies close to two thirds of Russian gas imports. Accelerating investments in renewable energy and energy efficiency would further increase energy security. Fiscal stimulus, undertaken in response to the crisis, should be gradually withdrawn. Better targeted policies would support purchasing power of the most vulnerable from high inflation without blunting green transition incentives. Decisive implementation of the National Recovery and Resilience Plan reforms, including digitised civil justice and bankruptcy processes, would raise resilience and confidence.

The war has induced a sharp slowdown in growth

Growth momentum slowed further in the first half of 2022. The economy slowed to 0.1% in the first quarter as the impact of COVID restrictions in January compounded war-related inflation and supply chain and confidence shocks. Headline inflation rose to 7.3% in May, driven by higher energy and food prices. Core inflation reached 3.4%, reflecting producer cost pressures and price normalisation in services after COVID-related stagnation. Although inflation expectations continue to rise, wage inflation is currently subdued. The services sector has increasingly contributed to job creation. Confidence declined sharply at the war's onset, but stabilised in April. Firms continue to have comfortable cash positions, thanks in part to past and ongoing State guarantees.

Italy 1





1. Average of 2018 to 2020.
Source: Istat; Italian Trade Agency; Banca d'Italia; and OECD calculations.

StatLink https://stat.link/3julah

Italy: Demand, output and prices

Italy	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 771.3	0.5	-9.1	6.6	2.5	1.2
Private consumption	1 066.3	0.2	-10.6	5.2	1.6	0.7
Government consumption	334.5	-0.5	0.5	0.6	0.6	0.7
Gross fixed capital formation	316.2	1.2	-9.2	17.0	8.6	1.5
Final domestic demand	1 716.9	0.3	-8.2	6.4	2.8	0.9
Stockbuilding[1]	11.5	-0.5	-0.3	0.2	0.5	0.0
Total domestic demand	1 728.5	-0.2	-8.5	6.6	3.3	0.8
Exports of goods and services	555.5	1.8	-14.2	13.4	7.9	3.2
Imports of goods and services	512.6	-0.5	-12.7	14.3	10.5	2.3
Net exports[1]	42.8	0.7	-0.9	0.2	-0.6	0.3
Memorandum items						
GDP deflator	_	0.9	1.4	0.5	2.9	3.3
Harmonised index of consumer prices	_	0.6	-0.1	1.9	6.3	3.8
Harmonised index of core inflation[2]	_	0.5	0.5	0.8	2.8	2.7
Unemployment rate (% of labour force)	_	9.9	9.3	9.5	9.0	9.3
Household saving ratio, net (% of disposable income)	_	2.4	10.2	7.5	4.5	4.3
General government financial balance (% of GDP)	_	-1.5	-9.6	-7.2	-6.1	-4.2
General government gross debt (% of GDP)	_	155.6	185.5	175.0	174.4	172.4
General government debt, Maastricht definition[3] (% of GDP)	_	134.1	155.4	151.0	150.4	148.3
Current account balance (% of GDP)	_	3.2	3.8	2.4	-0.5	-0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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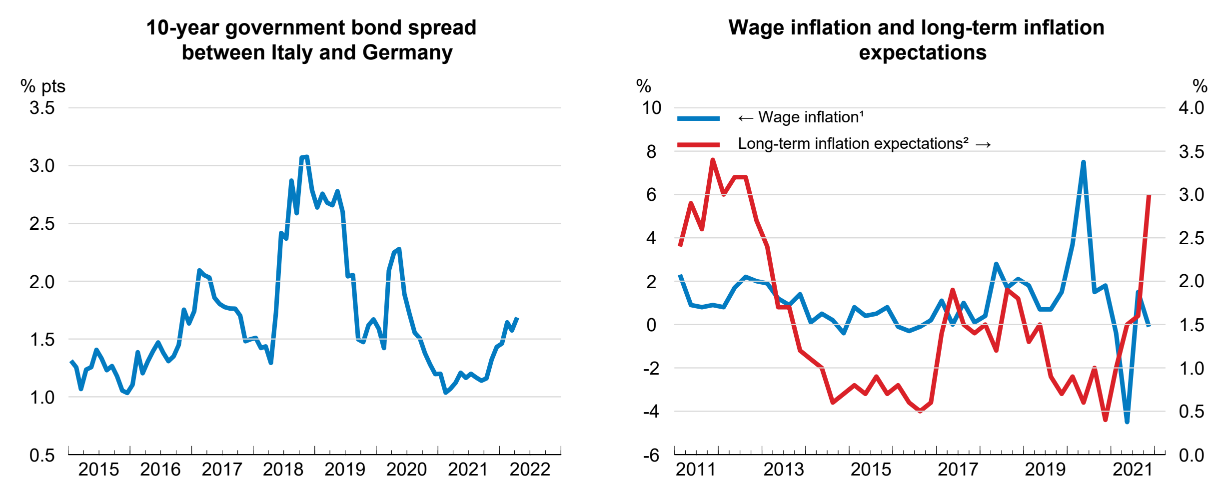
Italy 2



1. Average hourly wages and salaries of industry, construction and services (except activities of households as employers and extra-territorial organisations and bodies).
2. Firms' expectations for consumer price inflation in 2 years time.
Source: OECD Economic Outlook 111 Database; Eurostat; Banca d'Italia; and OECD calculations.

StatLink https://stat.link/ynats0

The war will impact growth as higher prices erode spending power and confidence. Natural gas supplies 42% of Italy's energy needs. The government has introduced substantial policy supports, including reduced energy price surcharges and VAT rates, tax credits for energy intensive users and a one-off cash and public transport bonus for lower-income workers. State guarantees for firms' credit and short-time work schemes have been expanded alongside green energy investment incentives. The government estimates Italy can be completely independent of Russian gas by the end of 2024. Alternative gas sources have been negotiated and regulations to raise gas reserves are in place, providing important shock absorbers, but lower energy consumption will also be required in the event of a possible decrease in gas supplies. Over the longer term, accelerated renewable energy supply would support energy security. Some administrative hurdles to renewable energy supply have been removed. The authorities expect 175 000 Ukrainian refugees will arrive in 2022, mostly women and children, support to whom is budgeted to cost 0.1% of GDP.

Policy is supportive but reforms must continue to be implemented

Government policy remains focused on raising growth and gradually reducing fiscal support so that by 2030 total debt returns to 2019 levels. The fiscal stance is set to remain expansionary in 2022, with a deficit of 6.1% declining to 4.2% in 2023. Higher spending on energy price support and other stimulus to offset the impact of the war, and unanticipated payments for inflation-linked bonds, were partially offset by higher tax revenues and a windfall tax on energy companies. Gross debt (Maastricht definition) is projected to reach 148.3% of GDP in 2023. A spending review will identify funds for new spending commitments, including gradually higher military spending by 2030. Better targeted energy price support could generate savings. Whilst interest payments from higher government bond spreads will not rise significantly in the short term due to the longer duration of bonds, the risks from sharply higher interest rates could be substantial by 2025.

Implementing additional reforms will send an important signal and support confidence and growth. The single child allowance and initial changes to personal income tax rates were introduced in December 2021 to support labour force participation and consumption. The National Recovery and Resilience Plan is being implemented. Public investment reached 2.9% of GDP in 2021 and will grow at double-digit rates in 2022 and 2023. The government allocated almost EUR 6 billion between 2022 and 2023 to counteract the impact of high construction inflation on investment projects. Nonetheless, the Plan's very ambitious investment targets have been affected by delays. Planned investments of about EUR 9.5 bn were moved beyond 2026, although these sums were not financed by the Recovery and Resilience Fund.

A consumption driven slowdown in 2022 before a gradual recovery in 2023

Growth momentum will slow in 2022, as inflation lowers households' purchasing power and willingness to spend, before gradually recovering in 2023. Growth is forecast to reach 2.5% in 2022 and 1.2% in 2023, with strong carry-over effects contributing 2.2 percentage points to 2022 growth. Although energy price moderation is expected to reduce headline inflation through 2023, core inflation is forecast to remain persistent, due to lasting effects from energy and trade supply disruptions. Food inflation is projected to remain elevated throughout the forecast. Wage rises will not fully compensate households for the higher cost of living. Uncertainty and high construction prices will delay investment somewhat, but this will be offset to an extent by increased investment incentives and strong public investment. International trade frictions will weigh on exports throughout the forecast, although competiveness will be supported by euro weakness and relatively lower inflation.

Downside risks to growth dominate. A possible restriction in the supply of natural gas could further lower growth and increase inflation. Higher interest rates could lower growth, and through this channel raise public debt levels. If growth does not recover quickly, confidence and profitability could be damaged, raising bankruptcies, reducing bank profitability and lowering growth further. On the upside, the fiscal impact of tax reforms may have a larger effect, allowing wages, employment and household confidence to recover faster than forecast.

Supporting viable, greener firms will raise long-term resilience to shocks

To mitigate the impacts of a drawn-out Ukraine conflict, policy should increasingly target temporary assistance to the most vulnerable, rather than lower energy prices. De-linking this support from future energy consumption and phasing out environmentally harmful subsidies accelerates the green transition. Energy security would be boosted by supporting investments in energy efficiency and renewable energy supply; long-term energy pricing contracts can help manage fiscal costs whilst providing certainty to investors. The measured fiscal consolidation strategy should be implemented to reduce the public debt-to-GDP ratio gradually. Social safety nets and training should be the main instruments to protect workers affected by firm closures, rather than policies that may inadvertently reduce willingness to hire or lengthen bankruptcy procedures. Implementing bankruptcy and public administration reforms, alongside the digitisation of civil justice, will support a faster, more predictable and more resilient recovery from the most recent crisis. Continued effective implementation of the National Recovery and Resilience Plan reforms will raise growth, and demonstrate political commitment to help offset war-related uncertainty.

Japan

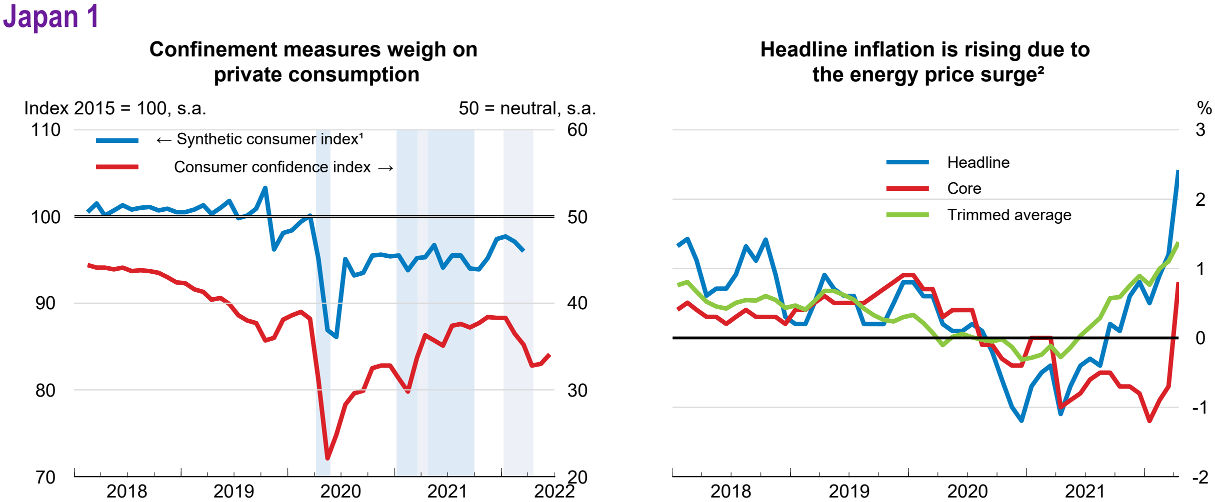
Confinement measures, weak external demand and surging prices for energy, materials and commodities in the context of COVID-19 and the Russia-Ukraine war weighed on domestic demand early in the year. In these conditions, pent-up demand has risen, further boosted by substantial policy support. As a result, the economy will pick up from the slow start to the year, with GDP growth projected to be 1.7% in 2022, and 1.8% in 2023.

In the face of the Omicron wave and energy price surge, the Japanese government supported vulnerable households and affected businesses. The government has also acted to address supply bottlenecks, including by supporting investment in semiconductor capacity. Structural reforms are required to ensure sustainable and resilient growth. Monetary policy will remain accommodative until the inflation rate has reached its target sustainably.

The Omicron shock and supply constraints slow Japan's recovery

While Japan had comparatively very low infection numbers until the end of 2021, the arrival of the Omicron variant caused a surge in the number of cases. The Japanese government applied state-of-emergency type measures ("Priority Preventive Measures") during the first quarter of 2022 in most prefectures. These measures limited the operation of restaurants, bars and events. While the confinement measures have been lifted, the conflict in Ukraine and lockdowns in China have affected trade and prices. Headline inflation

Japan 1



1. The synthetic consumer index is calculated by the Cabinet Office to show monthly macro-level private consumption trends by using both demand and supply-side statistics. The consumer confidence index is the average of four sub-indicators for overall livelihood, income growth, employment, and willingness to buy durable goods, on a scale of 1-100. Shaded areas show the periods when confinement measures were applied (blue for states of emergency, grey for Priority Preventive Measures).
2. The core price index excludes energy and fresh food related items from headline CPI. The trimmed average is calculated by excluding the top and bottom decile of the price changes (measured by items' weight in the CPI).
Source: Cabinet Office; Ministry of Internal Affairs and Communications; and Bank of Japan.

StatLink https://stat.link/owgl7c

Japan: Demand, output and prices

Japan	2018	2019	2020	2021	2022	2023
	Current prices YEN trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	556.3	-0.2	-4.5	1.7	1.7	1.8
Private consumption	304.9	-0.5	-5.2	1.3	2.6	2.2
Government consumption	108.9	1.9	2.3	2.1	1.7	-1.6
Gross fixed capital formation	140.3	1.0	-4.6	-1.6	-0.2	3.6
Final domestic demand	554.1	0.3	-3.6	0.7	1.7	1.7
Stockbuilding[1]	2.1	-0.1	-0.1	-0.1	0.2	0.0
Total domestic demand	556.2	0.2	-3.7	0.6	1.9	1.7
Exports of goods and services	101.9	-1.5	-11.7	11.8	1.9	3.2
Imports of goods and services	101.8	1.0	-6.9	5.1	3.0	2.6
Net exports[1]	0.1	-0.4	-0.8	1.0	-0.2	0.1
Memorandum items						
GDP deflator	_	0.6	0.9	-0.9	0.4	1.7
Consumer price index[2]	_	0.5	0.0	-0.2	1.9	1.9
Core consumer price index[3]	_	0.4	0.1	-0.7	-0.1	1.4
Unemployment rate (% of labour force)	_	2.4	2.8	2.8	2.6	2.5
Household saving ratio, net (% of disposable income)	_	3.2	12.1	8.5	6.5	3.2
General government financial balance (% of GDP)	_	-3.0	-9.0	-5.7	-6.9	-4.6
General government gross debt (% of GDP)	_	223.5	240.9	240.5	244.7	244.7
Current account balance (% of GDP)	_	3.4	2.9	2.8	1.5	1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Calculated as the sum of the seasonally adjusted quarterly indices for each year.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

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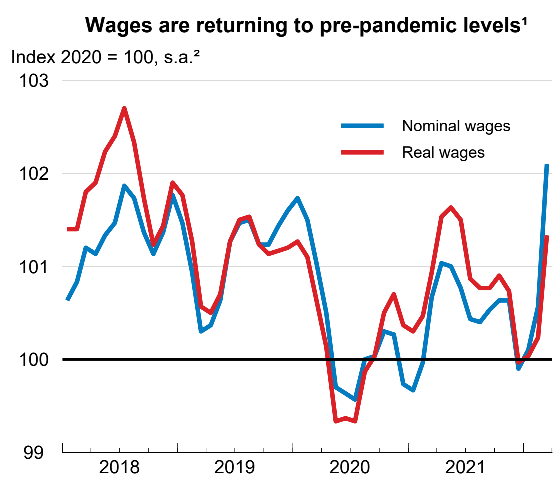
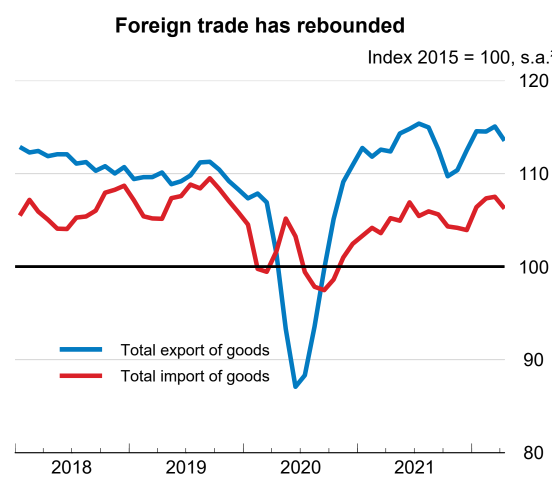
Japan 2





1. Nominal wages are total cash earnings per employee. Real wages are nominal wages deflated by the consumer price index excluding imputed rent.
2. Three-month moving average.
Source: Ministry of Health, Labour and Welfare; and Bank of Japan.

StatLink https://stat.link/magf7x

has risen largely due to high energy prices. In addition, price rises have been announced for utility fees including electricity and water supply, and some food products. The recent depreciation of the yen intensifies inflationary pressures. Core inflation has remained very sluggish until recently due to the impact of declines in mobile phone fees since March 2021 (cumulatively 1.5 percentage points). However, as the impacts of these price declines wear off, core inflation is strengthening.

The direct effect on the Japanese economy of the Ukraine war is limited in the short term, but the economic damage could be more serious in the longer term. The share of goods imports from Russia is only 1.8%, and the share of exports to Russia 1%. Dependence on Russia for fossil fuels is modest (at 11%, 9% and 4% respectively for coal, natural gas and oil in 2021). The government will gradually reduce it and eventually aims to stop importing coal from Russia. Japan also imports some non-ferrous metals from Russia including palladium, which is used in catalytic converters for cars. While disruptions to trade in these metals could be covered by using stocks or recycling in the short term, Japan would have to find other suppliers or substitute resources for energy and materials over the longer term.

Fiscal and monetary policies continue to be supportive

The Japanese government has reacted to both the sanitary and the energy price shocks. On 25 March, it decided to spend 0.3% of 2021 GDP to secure COVID vaccines, therapeutic medicines and testing tools, and to provide a special cash benefit for low-income households. To address high energy prices, the government introduced a new subsidy from January for fuel wholesalers to moderate fuel price increases. In addition to the expansion of this subsidy in March, the authorities announced a new policy package to counter surging prices on 26 April, whose total scale (including private sector spending) will be around 2.4% of GDP. In the process, the government debt-to-GDP ratio continues to increase to unprecedented levels.

Monetary policy has remained supportive with yield curve control maintaining 10-year Japanese government bond yields at around zero within a range of plus or minus 0.25 percentage point and with no limit on bond purchases. The Bank of Japan extended the terms of their current measures to support private bank lending, especially for SMEs. The stance of monetary policy is assumed to remain accommodative in the projection period, consistent with the Bank of Japan’s longstanding statements that this will remain the case until the inflation rate reaches its 2% target sustainably.

The economic recovery will be sluggish, and risks are rising

Oil prices will rise in 2022 and early 2023 because of the oil embargo in EU countries, but the government subsidy for fuel will continue to damp the price increases faced by consumers, so that inflation is expected to be around 2%. The subsidy is assumed to be extended beyond its current expiry date at the end of September. Private consumption will bounce back following the lifting of the confinement measures, but be slowed by higher inflation. While weak external demand, especially in large trade partners, and high import prices will weigh on trade in the near term, both exports and imports will grow as energy prices stabilise and domestic and external demand recover. Investment will accompany the recovery of exports and production, supported by government subsidies, especially in the green and digital areas. The labour market will continue improving, but overall wage growth will remain subdued as more lower-wage workers are hired and corporate profits are squeezed by the high prices of energy and other commodities.

A prolonged war in Ukraine and higher-than-foreseen import prices are downside risks. Supply chain disruptions due to further COVID-19 shocks or geopolitical instability could depress trade, production and investment. Continued monetary policy tightening in other countries may accelerate the depreciation of the yen. This would push up import prices and inflation but would also strengthen Japan’s goods and services exports including inbound tourism – insofar as the sanitary situation permits. The cost pass-through to consumer prices is currently stronger than before and may help support higher wage and price growth by changing the deep-rooted deflationary mindset.

Further reforms should be implemented for sustainable and resilient growth

While the Japanese government reacted forcefully to recent shocks, current policy settings are not enough to meet global and structural challenges. In this regard, normalising and reopening economic activities including inbound tourism is again possible as prevention and treatment of COVID-19 infections is enhanced and should not be further delayed. Lowering hurdles for incoming foreign direct investment could not only support investment but also raise productivity. To avoid scarring effects and offset the effects of an ageing population, continuing "work-style" reform and enhanced vocational training and education are essential. Developing and implementing support programmes for skills and training would help in this regard. In addition, support for the digital and green transformation should be intensified to improve productivity, resilience and sustainability. Securing and reallocating employment, global supply chains and energy sources are current priorities. If downturn risks emerge, further fiscal measures should be taken, but they should be more targeted and consider inclusiveness and sustainability. As economic growth regains momentum, fiscal consolidation efforts should resume on both the expenditure and the revenue side, including social security and tax system reforms, to ensure longer-term sustainability in the face of demographic headwinds.

Korea

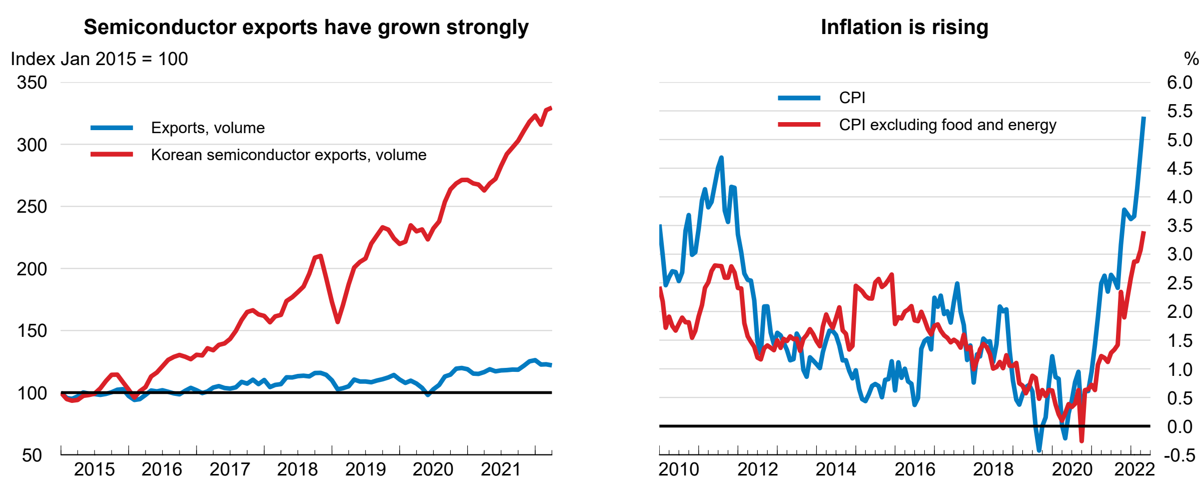
Growth will moderate to 2.7% in 2022 and 2.5% in 2023. Consumption is set to strengthen, though with a drag from high inflation. From early 2023, growth will pick up due to strong investment and exports, as current uncertainties are assumed to abate. Elevated household debt and housing prices, and stronger-than-expected interest rate increases pose downside risks to domestic demand. A potential shortage of rare gases sourced from Russia and Ukraine could weaken semiconductor exports.

Monetary policy should aim to keep inflation expectations anchored. Fiscal support should be deployed in ways that avoid exacerbating ongoing price pressures, delivering maximum relief to the most vulnerable at a lower cost. Structural reforms should facilitate a reallocation of labour and capital to expanding sectors and address high social protection gaps. Measures are also needed to bolster the resilience of essential supply chains and energy security.

The recovery has slowed

After a strong rebound in 2021, real GDP growth slowed to 2.9% (q-o-q seasonally adjusted annualised rate) in the first quarter of 2022. While exports grew robustly, driven by demand for semiconductors, private consumption lagged, as contact-intensive services faced restrictions. The gradual easing of distancing measures should help consumption to recover. However, the exports orders index recorded its biggest drop in two years in April reflecting the war in Ukraine and lockdowns in China. Headline consumer price inflation reached 5.4% in May 2022, the highest rate in more than a decade, mainly due to surging commodity prices. Core inflation reached 3.4%, reflecting a broadening of price pressures to some categories of goods and services, including furnishings and restaurants. Employment and labour underutilisation have recovered to pre-crisis levels.

Korea



Source: Bank of Korea.

StatLink https://stat.link/4brquz

Korea: Demand, output and prices

Korea	2018	2019	2020	2021	2022	2023
	Current prices KRW trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 898.2	2.2	-0.9	4.0	2.7	2.5
Private consumption	911.6	2.1	-5.0	3.6	2.3	2.9
Government consumption	304.7	6.4	5.0	5.6	3.7	3.0
Gross fixed capital formation	576.6	-2.1	2.6	2.5	0.5	2.8
Final domestic demand	1 792.9	1.5	-0.8	3.6	2.0	2.9
Stockbuilding[1]	21.1	0.0	-0.6	-0.4	-0.2	0.0
Total domestic demand	1 814.0	1.5	-1.5	3.2	1.8	2.9
Exports of goods and services	791.8	0.2	-1.8	9.9	9.2	4.1
Imports of goods and services	707.6	-1.9	-3.3	8.6	7.3	4.9
Net exports[1]	84.2	0.8	0.5	0.8	1.1	-0.3
Memorandum items						
GDP deflator	_	-0.8	1.3	2.3	3.0	2.3
Consumer price index	_	0.4	0.5	2.5	4.8	3.8
Core inflation index[2]	_	0.7	0.4	1.4	3.4	3.1
Unemployment rate (% of labour force)	_	3.8	3.9	3.6	3.2	3.1
Household saving ratio, net (% of disposable income)	_	8.1	14.1	11.8	10.7	9.0
General government financial balance (% of GDP)	_	1.0	-2.3	-3.0	-2.5	-1.9
General government gross debt (% of GDP)	_	44.2	45.4	47.9	49.9	51.1
Current account balance (% of GDP)	_	3.6	4.6	4.9	5.3	5.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/mgi9zt

The direct economic consequences of the war in Ukraine and sanctions on Russia have been relatively modest, given limited direct trade and financial links as well as low energy dependence on Russia. However, energy and commodity prices have risen markedly, driving up inflation. The price of neon gas, which is essential for Korean semiconductor production, tripled in early 2022 compared to a year earlier, although the impact on semiconductor production has been limited so far thanks to raw material stockpiling, diversifying imports, and localising neon gas production. The government is also investing in R&D to homeshore the production of other inputs such as krypton and xenon.

Some temporary supports have been extended

Pandemic-related employment retention subsidies have been extended until the end of 2022, and a supplementary budget of KRW 16.9 trillion (0.8% of GDP) was passed in February 2022 to help small businesses. The National Assembly recently approved the largest-ever supplementary budget, amounting to KRW 62 trillion (2.9% of GDP), which is to be financed mostly by excess tax revenue. In addition, the temporary 20% fuel tax cut on gasoline, diesel and liquefied petroleum gas was increased to 30% and extended until the end of July 2022. However, the fiscal stance is projected to turn to slightly contractionary in 2023, with the assumed withdrawal of temporary measures. The Bank of Korea has embarked on monetary policy normalisation, raising the key policy rate in five steps from 0.5% to 1.75%, and has signalled further tightening. The projections assume that the key policy rate will reach 2.5% by the end of 2023.

The recovery will continue at a slower pace, but uncertainties are high

Real GDP is projected to grow by 2.7% in 2022 and 2.5% in 2023. Private consumption will recover from late spring due to high immunity, the lifting of restrictions, the latest supplementary budget, and a continued normalisation of the household saving ratio. The recovery in consumption is nonetheless expected to be gradual, as inflationary pressures from commodity prices and supply chain disruptions are being passed on to consumers. Inflation is set to remain elevated, based on the assumption that the embargo on Russian oil pushes up global oil prices in 2023. Business investment is set for solid growth, with substantial planned investments in some key industries. The underlying primary balance is expected to narrow slightly. A faster-than-expected increase in interest rates could hold back household consumption, given elevated household debt mostly at floating rates. A prolonged war in Ukraine could harm Korean semiconductor production as stocks of rare gases run out and the local supply of raw materials falls short of demand.

Further policy action is needed for a resilient recovery

Scaling back and better targeting fiscal support to those most in need would help contain inflation and address structural weaknesses. The temporary fossil fuel price cut should be replaced in due course by transfers to vulnerable households. Stepping up training and activation policies for those who lose their jobs, and strengthening the social safety net are crucial to facilitate workforce reallocation. Policies are also needed to enhance the resilience of essential supply chains. The government plans to establish an Economic Security Supply Chain Management Committee. This should be complemented by developing consistent and evidence-based policy tools to help make informed choices and improve transparency and trust from the private sector. In addition to the new government's plan to revive nuclear plants, further policy actions that accelerate green transitions, such as aligning the K-ETS with the net-zero emission target for 2050, will be required to enhance energy security.

Latvia

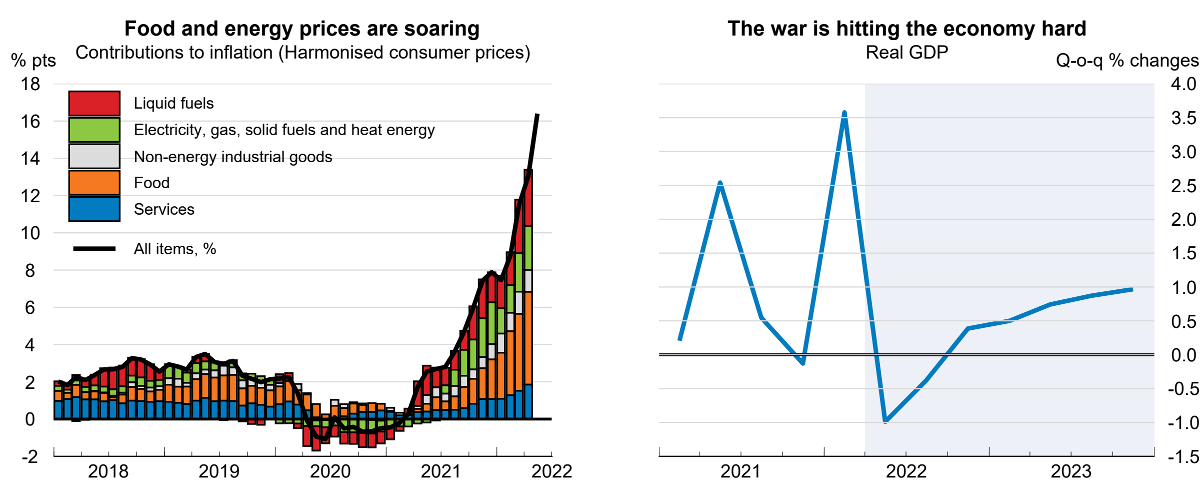
The economy is projected to grow by 3.5% in 2022 and 1.6% in 2023. Export growth will slow due to the repercussions of the war in Ukraine, material shortages, and weaker economic activity in the EU, although strong demand for some of Latvia's main export products, such as wood and food products, will soften the downturn. Inflation will stay high, reducing real wages and curbing private consumption. Shifts in external demand will lead to a moderate rise in unemployment.

Fiscal policy will become less supportive as pandemic-related measures are phased out. Support measuresto mitigate the adverse effects of rising energy and food prices should become more targeted and maintain incentives to save energy and lower carbon emissions. Accelerating investment in renewables and completing the integration of regional power and gas markets would promote energy security. Continuing to facilitate the labour market participation of Ukrainian refugees through better access to childcare and schooling and recognition of qualifications will help to reduce skills shortages.

The war is halting the recovery and fuelling inflation

The easing of COVID-19 related restrictions since January has led to a strong rebound in private consumption, particularly in services. GDP increased by 3.6% (seasonally adjusted quarterly rate) in the first quarter of 2022. Nonetheless, the labour market has not yet fully recovered, since unemployment remains about 1% higher and the participation rate about 1.2% lower than before the pandemic. Skills mismatch as well as mandatory vaccination in some sectors have limited the labour market recovery. Inflation has been rising rapidly since the second half of 2021 and accelerated to 16.4% in May 2022, driven mainly by rising heating, fuel and food prices. Nonetheless, the increase in prices has started to be more broad-based since early 2022, and core inflation (excluding food, energy, alcohol and tobacco) reached 6% in April 2022.

Latvia



Source: OECD calculations based on Eurostat database; and OECD Economic Outlook 111 database.

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Latvia: Demand, output and prices

Latvia	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	29.2	2.5	-3.8	4.7	3.5	1.6
Private consumption	17.3	0.2	-7.4	4.8	7.8	0.5
Government consumption	5.3	3.4	2.6	4.4	2.5	2.1
Gross fixed capital formation	6.4	6.9	0.2	2.9	2.1	3.4
Final domestic demand	29.0	2.3	-3.8	4.2	5.3	1.4
Stockbuilding[1]	0.3	1.0	0.0	5.1	1.0	0.0
Total domestic demand	29.4	3.1	-3.9	9.1	6.1	1.3
Exports of goods and services	17.9	2.1	-2.2	6.2	3.8	1.0
Imports of goods and services	18.1	3.0	-2.5	13.5	7.7	0.6
Net exports[1]	- 0.2	-0.6	0.2	-4.3	-2.7	0.2
Memorandum items						
GDP deflator	_	2.6	-0.1	6.8	12.8	6.5
Harmonised index of consumer prices	_	2.7	0.1	3.2	13.3	8.6
Harmonised index of core inflation[2]	_	2.2	0.9	1.9	7.0	7.0
Unemployment rate (% of labour force)	_	6.3	8.1	7.5	7.2	7.4
Household saving ratio, net (% of disposable income)	_	0.1	9.1	8.0	-3.2	-6.0
General government financial balance (% of GDP)	_	-0.6	-4.5	-7.3	-4.4	-2.5
General government gross debt (% of GDP)	_	48.1	56.0	58.8	60.2	61.0
General government debt, Maastricht definition[3] (% of GDP)	_	36.7	43.3	44.8	46.2	47.0
Current account balance (% of GDP)	_	-0.7	2.9	-2.9	-3.2	-2.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/vizpde

Latvian firms have reduced their exposure to Russia over the past decade, especially since the annexation of Crimea in 2014. Nonetheless, Russia is still Latvia's fifth largest trade partner and an important supplier of natural gas (accounting for all of Latvia's imports), oil, fertilisers and raw materials. Heating bills and fuel prices have strongly increased over the past few months despite a government compensation for service fees, while electricity costs fell due to government support, which was phased out at the end of April. Business confidence has dropped sharply, as the economic sentiment indicator fell significantly in March and slightly dropped again in April. About 28 500 Ukrainian refugees have entered Latvia since the invasion (about 1.5% of the population), mainly women and children.

Targeted fiscal policy measures are key to support vulnerable households

The COVID-19 income-support measures expired in February 2022. However, the government introduced new measures to compensate households and firms for the rise in energy prices. It reduced electricity bills and covered additional heating costs in regions that experienced a rapid increase in heating tariffs, but these measures ended in April 2022. A monthly allowance of about EUR 20 is given to 150 000 vulnerable households until the end of 2022 and a rise in the means-tested allowance for low-income households is envisioned. However, more is needed, as the social safety net in Latvia is limited, poverty rates are high compared to the EU average and poor households suffer the most from rising energy and food prices. The government expects the implemented measures to amount to about 1.3% of GDP. It also plans to raise general government employees' salaries and defence spending (from 2.2% to 2.5% of GDP by 2025). Nonetheless, there is likely to be substantial fiscal consolidation due to the phase-out of COVID-19 support measures and increasing tax revenue, with the government deficit projected to decrease from 7.3% of GDP in 2021 to 2.5% in 2023. Latvia will receive about 6.7% of 2020 GDP in grants from Next Generation EU by 2026, 35% of which is expected to be spent by 2023. The government plans to stop natural gas imports from Russia from early 2023 and substitute them by liquefied natural gas imports, mainly from neighbouring countries.

Economic growth will slow and downside risks remain high

The need to replace imports of raw materials and energy from Russia and Belarus will reduce production and raise prices, and will affect private investment. EU-funded investments will rise, but high uncertainty and rising construction costs due to labour shortages and supply bottlenecks will mitigate investment growth. Nominal wage growth will be moderate, despite existing labour shortages, as the economic shock limits employment growth and the wave of refugee inflows increases the labour force by about 0.75%. The recovery of private consumption will be moderate due to high uncertainty and inflation. Headline inflation will ease somewhat in 2023, but will remain high due to the embargo on Russian oil. The annual rate of core inflation will still exceed 5% at the end of 2023. GDP growth could drop, and inflation could rise further due to supply-chain disruptions and difficulties in substituting Russian energy supply. A lack of construction materials could further slow investment. On the upside, the refugee inflow might ease labour shortages by more than expected and increase output growth.

Addressing skills shortages could help to ease inflationary pressures

To support an inclusive recovery and avoid amplifying inflationary pressures, fiscal policy measures should remain targeted at vulnerable households. Support measures should maintain price incentives for firms and households to transition towards less-carbon intensive energy sources. Providing students with greater financial support, establishing training funds to raise access to training, and improving public transport services would help to boost labour productivity and ease labour shortages. Continuing to facilitate the recognition of qualifications, including VET and education degrees, enhance access to childcare, ease language restrictions and provide financial support are key for the labour market integration of refugees.

Lithuania

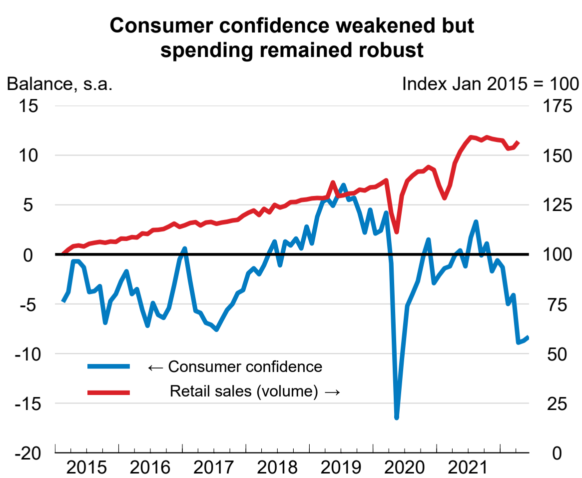
Growth is projected to slow to 1.8% in 2022 and 1.6% in 2023, as the war in Ukraine takes its toll on confidence, weakens external markets and intensifies supply bottlenecks. Domestic activity will continue to be supported by solid wage growth, pent-up demand and EU-fund inflows, but high energy prices and increased uncertainty will weigh on private spending. Labour market conditions will remain tight, despite the slowdown in activity, as a result of large skills shortages.

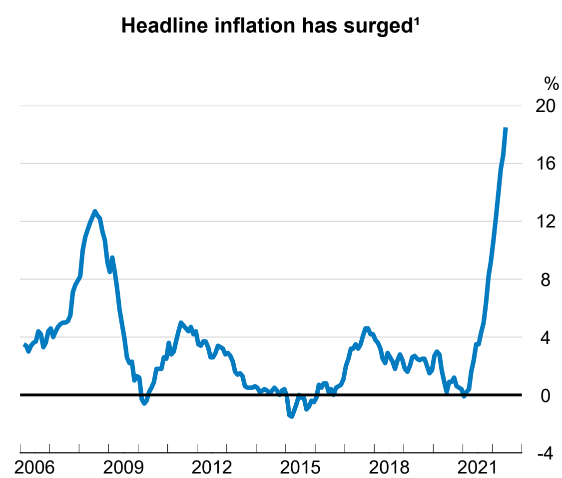
Fiscal policy support cushions households and firms from the impact of rising energy prices. Rebalancing support toward measures targeted to low-income households, while unwinding energy price caps, would enhance policy effectiveness. Structural reforms that promote digitalisation by fostering relevant skills and encouraging a wider adoption of advanced technologies by smaller firms are essential for higher productivity growth. Further increasing energy independence is crucial for economic resilience and sustainable growth.

Economic activity remained solid despite headwinds

Economic activity grew at a solid pace in the first quarter of 2022, led by exports and investment and despite waning business confidence and the outbreak of the war in Ukraine. Consumer confidence tumbled amid a resurgence of COVID-19 cases in early 2022 and surging energy prices. Fast wage growth and some unwinding of savings accumulated since the onset of the pandemic limited the contraction of private consumption. Headline inflation, which was already high, rose further in early 2022, reaching 18.5% in May, owing largely to the rise in energy and food prices. Underlying price pressures also intensified, as service prices grew rapidly, driven by buoyant domestic demand.

Lithuania





1. Inflation data for May 2022 are preliminary.
Source: OECD Main Economic Indicators database; and European Central Bank.

StatLink https://stat.link/8gci69

Lithuania: Demand, output and prices

Lithuania	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	45.5	4.6	-0.1	5.0	1.8	1.6
Private consumption	28.0	3.1	-2.1	7.3	2.1	1.6
Government consumption	7.5	-0.3	-0.4	0.5	0.3	0.2
Gross fixed capital formation	9.5	6.6	-1.8	7.0	3.9	4.4
Final domestic demand	45.0	3.3	-1.7	5.9	2.1	1.9
Stockbuilding[1]	- 0.3	-1.7	-1.9	-0.6	-1.2	0.0
Total domestic demand	44.7	1.6	-3.7	5.8	1.1	1.8
Exports of goods and services	34.2	9.9	0.4	15.9	-1.9	0.5
Imports of goods and services	33.4	6.1	-4.4	18.7	-2.7	0.8
Net exports[1]	0.8	3.0	3.5	-0.3	0.5	-0.2
Memorandum items						
GDP deflator	_	2.7	1.5	6.5	12.7	7.5
Harmonised index of consumer prices	_	2.2	1.1	4.6	15.6	7.9
Harmonised index of core inflation[2]	_	2.3	2.6	3.4	8.6	7.2
Unemployment rate (% of labour force)	_	6.3	8.5	7.1	7.2	7.4
Household saving ratio, net (% of disposable income)	_	-0.2	9.0	4.4	-0.8	-1.7
General government financial balance (% of GDP)	_	0.5	-7.3	-1.0	-4.7	-2.9
General government gross debt (% of GDP)	_	44.5	55.5	51.4	50.5	51.0
General government debt, Maastricht definition[3] (% of GDP)	_	35.9	46.6	44.3	43.4	43.9
Current account balance (% of GDP)	_	3.5	7.3	1.3	-2.9	-2.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/b0m85r

The war in Ukraine, and concomitant sanctions against Russia, weigh on Lithuania's exports, especially transport services. Despite a gradual decoupling over the past decade, Russia accounted for 11% of Lithuania's goods exports in 2021 (mainly consisting of re-exported goods) and 12% of imports, remaining one of Lithuania's main trading partners. Moreover, Lithuania is highly dependent on imported energy and therefore remains vulnerable to supply shocks, even though it stopped importing gas and oil from Russia in early April 2022. Lithuania currently uses liquefied natural gas from the terminal in Klaipeda and has diversified its oil import sources. By late May 2022, Lithuania had received over 54 000 Ukrainian refugees (equivalent to 2% of the total Lithuanian population). The government has promptly taken measures to provide them with social support and access to the labour market.

Fiscal policy helps mitigate the economic consequences of the war

The revised draft budget for 2022 incorporates measures to mitigate the impact of rising energy prices on households and firms, equivalent to around 1.2% of GDP. These are part of a comprehensive fiscal package announced in early April 2022 to alleviate inflationary pressures (including through energy price caps), increase energy efficiency and strengthen energy independence. The revised draft budget further provides assistance for the Ukrainian refugees (amounting to 0.6% of GDP) and envisages increased defence spending. Businesses and households will receive compensation for the portion of energy price increases above 40%. Support for vulnerable households to cope with surging energy prices includes an increase in non-taxable income, an extension of means-tested heating compensation and higher pensions. As a result of these initiatives, the fiscal stance is expected to be highly expansionary this year, before tightening in 2023 as temporary measures expire. The tightening of fiscal policy, subject to additional support to vulnerable households and firms, is appropriate to reduce risks of prolonged inflationary pressures. Rebalancing temporary support toward measures targeted on low-income households, while unwinding energy price caps, would enhance policy effectiveness.

Growth will remain moderate

Growth will slow as the war in Ukraine takes its toll on domestic demand through increased geopolitical uncertainty and intensified supply bottlenecks, as well as by adding to already high inflation. Output growth will remain subdued in 2023, even though investment will gather pace with the absorption of EU funds and implementation of the government's multi-year investment programme. Headline inflation will decline but remain high due the EU embargo on Russian oil to take effect in 2023. Real wages will continue falling, albeit at a slower pace. A decline in the household saving ratio will support consumption. The unemployment rate will rise as a consequence of the slowdown, although large skills shortages will keep labour market conditions tight. The risks surrounding the projections relate mainly to the evolution of the war in Ukraine and sanctions against Russia, given trade links. Upside risks include a swifter-than expected use of EU recovery funds and a faster-than-foreseen integration of Ukrainian refugees into the labour market, which could alleviate skills shortages and wage pressures.

Ensuring strong and sustainable growth

Measures to strengthen energy independence are crucial for economic resilience and sustainable growth. The focus of the comprehensive April 2022 fiscal package on energy efficiency through the renovation of multi-apartment buildings and on the production of solar and wind energy and electricity storage is appropriate. Achieving long-term growth also hinges on higher productivity. Promoting digitalisation is key in this regard. There is scope to further increase investment in innovation and encourage the digital take-up of smaller firms, including by reducing remaining gaps in digital infrastructure and improving access to finance for young innovative firms. Education reforms need to continue to ensure strong and relevant skills for the digital era. This is also essential to ensure that the benefits arising from digitalisation are shared widely.

Luxembourg

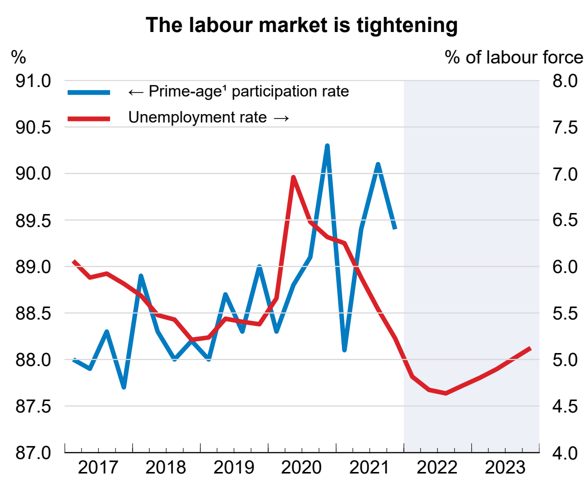
Growth in Luxembourg is set to slow in 2022 to around 2.9%, and will slow further in 2023 to 2.1%. The war in Ukraine will weigh on consumer confidence and consumption but investment, including residential construction, will support growth alongside government spending. Employment and wage growth will remain robust. Rising prices of intermediary goods will push up core inflation. Downside risks include a prolonged war or lingering high inflation, eroding confidence.

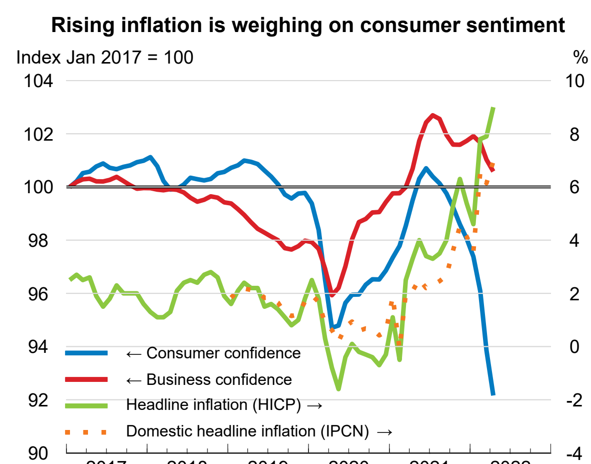
Measures to target support to low-income households affected by energy prices should be encouraged instead of wage indexation, and bankruptcy reform should be prioritised to support restructuring. To embed resilience, economic diversification will require investments in ICT and continued green policy reforms, alongside an acceleration in the transition to a low-carbon economy.

Growth will slow in 2022

Business confidence is robust, and 70% of industry report full order books. Residential construction activity is rising and house prices are high, with the quarterly price of new dwellings increasing by 16% in the fourth quarter of 2021, although the market is slowing as interest rates are expected to rise. Private consumption remained robust in the first quarter of 2022, despite COVID-19 restrictions which affected retail trade. Most restrictions were revoked in March. However, high inflation and the war in Ukraine are weighing on consumer confidence indicators, which have dropped to their lowest point since April 2020. The labour market recovery is strong, with unemployment at 4.7%, and rising vacancies. Inflation is rising sharply and has become broad-based, with the harmonised consumer price inflation index (HICP) reaching an estimated 9.1% in May. This is above the national inflation index (ICPN) which has a lower weight of energy. Wages and social benefits were raised by 2.5% on 1 April owing to automatic price indexation.

Luxembourg





1. Defined as 25-54 year olds.

Source: OECD Economic Outlook 111 database; OECD Main Economic Indicators database; OECD Database on Consumer Price Indices; Eurostat; STATEC; and OECD calculations.

StatLink https://stat.link/xf09o6

Luxembourg: Demand, output and prices

Luxembourg	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	60.3	3.3	-1.8	6.9	2.9	2.1
Private consumption	20.2	2.5	-6.9	7.4	3.4	2.2
Government consumption	10.1	3.8	6.8	4.7	3.6	3.5
Gross fixed capital formation	9.8	10.0	-4.3	11.8	4.2	4.1
Final domestic demand	40.1	4.6	-2.7	7.8	3.7	3.0
Stockbuilding[1]	0.5	0.0	0.2	-0.2	-0.5	0.0
Total domestic demand	40.6	4.7	-2.8	7.2	2.7	3.0
Exports of goods and services	118.5	5.8	1.2	9.8	0.8	2.3
Imports of goods and services	98.8	6.9	1.6	10.5	0.7	2.6
Net exports[1]	19.7	0.2	-0.3	2.1	0.5	0.1
Memorandum items						
GDP deflator	_	0.6	4.3	6.8	5.8	1.9
Harmonised index of consumer prices	_	1.6	0.0	3.5	8.0	3.3
Harmonised index of core inflation[2]	_	1.8	1.2	1.5	4.3	3.4
Unemployment rate (% of labour force)	_	5.4	6.4	5.7	4.7	5.0
Household saving ratio, net (% of disposable income)	_	7.9	18.1	17.1	15.3	15.3
General government financial balance (% of GDP)	_	2.3	-3.4	0.9	0.9	0.9
General government gross debt (% of GDP)	_	29.9	32.3	30.6	33.7	34.6
General government debt, Maastricht definition[3] (% of GDP)	_	22.3	24.8	24.4	27.5	28.4
Current account balance (% of GDP)	_	4.6	4.1	4.8	3.4	3.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/scdr3q

Luxembourg’s economy is relatively sheltered from direct negative consequences from the war in Ukraine or the sanctions imposed on Russia, as total trade exposure is minimal. Most gas imports are from LNG facilities in Belgium and the Netherlands, with a large share of Norwegian gas. Total energy imports are roughly 12% of total trade, with Russian oil accounting for less than 5% of direct oil imports. The authorities have taken steps to diversify supply by sourcing oil from the Middle East. However, the EU oil embargo on Russia in 2023 will further increase energy prices, which will spill over into electricity, transport and food prices, as well as intermediary goods. Luxembourg has taken in almost 5 000 Ukrainian refugees, around 1% of the population, mostly women and minors. They have been granted exceptional status, which allows them to seek work. Affordable accommodation is scarce, and temporary hosting facilities have reached full occupancy, putting the housing market further under strain.

Fiscal policy will remain supportive

In response to the energy price shock, the government has implemented several measures, including a cash allowance to disadvantaged households, and reduced network costs for gas and electricity. The total support to mitigate rising energy prices is around EUR 830 million with an additional EUR 500 million in business loan guarantees (around 1.7% of GDP in total). Public investment of over 4% of GDP in 2022 and 2023 will be implemented in order to support infrastructure and innovation. The government is implementing the carbon tax, which was introduced in 2021, with a EUR 5 increase in 2022 to EUR 25 per tonne and EUR 30 per tonne in 2023. The government has announced its intention to accelerate the switch to renewable energy.

Economic growth will return closer to potential over the next two years

GDP growth recovered strongly to 6.9% in 2021 and is expected to moderate to 2.9% in 2022, and 2.1% in 2023. Revised data point to robust household consumption in recent quarters, but it is expected to slow in the second quarter of 2022. High inflation is eroding confidence as well as disposable incomes. Public sector investment will support growth in 2022-23, and residential construction will gradually pick up. Incentives to accelerate the green transition will increase private investment, particularly in 2022. Export growth will moderate in 2022 and 2023 following strong financial market services activity in 2021. Supply-chain restrictions will also weigh on the export outlook this year. Core inflation is projected to rise on the back of rising wages, a still tight labour market, and persistent supply-side bottlenecks, and is likely to linger in 2023. Risks to the outlook are mainly on the downside. A prolonged war in Ukraine will weigh on business and consumer sentiment, as will an extended period of high inflation. Increasing financial market volatility, against a backdrop of rising insecurity linked to the war, would negatively affect activity, exports and financial sector earnings.

To embed resilience, policy should focus on productivity and investment

Vulnerable households affected by rising energy prices could benefit more from means-tested income support rather than automatic wage indexation, which kicks in when the six-month moving average of inflation is 2.5% higher than its level at the time of the previous wage indexation. Private investment and faster firm growth would boost productive capacity. Draft bankruptcy reforms should be enacted quickly to help restructure failing firms, and allow exit of non-viable ones. Additional macro-prudential measures to manage the pace of house price growth and its inflationary impact should be considered. To reinforce the behavioural change expected from carbon pricing, public investment in infrastructure, smart grids and cross-border rail systems can be complemented with measures to reduce the incentive to drive, such as congestion charges. The fiscal balance can be improved in the long term by absorbing older workers into the workforce. This can happen through upskilling, more flexible working conditions, and pension reforms to allow phased retirement.

Mexico

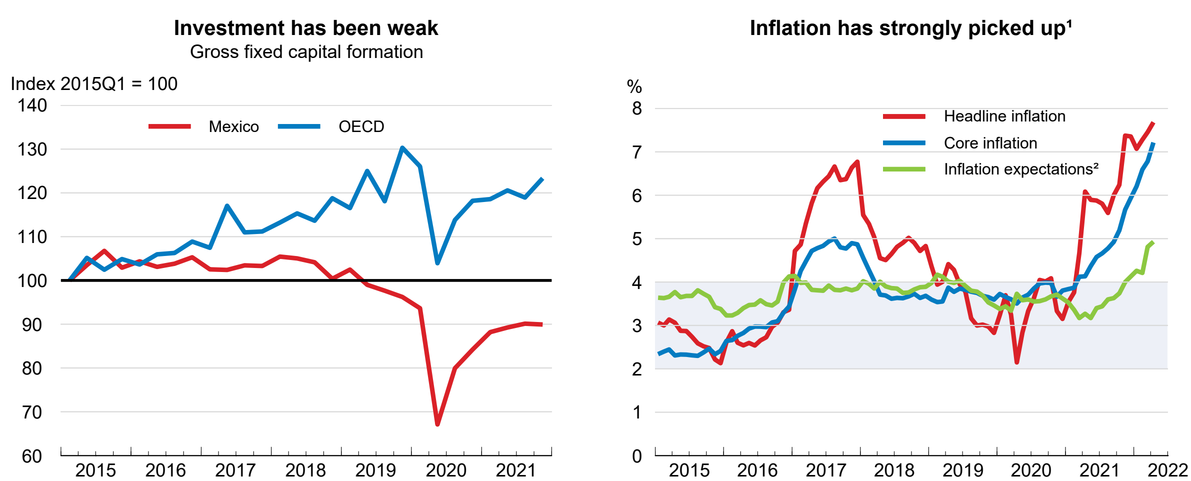
The economy is projected to expand by 1.9% in 2022 and 2.1% in 2023. Consumption will be supported by the gradual improvement in the labour market, remittances, and the increasing share of the population vaccinated. Exports will continue to benefit from deep integration in global value chains and a gradual recovery in tourism. Planned public infrastructure projects will benefit investment. Inflation will stand at 6.9% in 2022 and edge down to 4.4% in 2023.

Boosting public investment and social spending further would deepen the recovery. Measures to respond to increases in energy prices should be temporary and targeted at the most affected households and SMEs. Monetary policy should continue to tighten to keep inflation expectations anchored. Providing investors, both domestic and foreign, with certainty about existing contracts and with regulatory stability would help to boost investment. Improving access and the quality of childcare would support female labour force participation and reduce educational inequalities.

An uneven recovery has resumed and inflation has strongly picked up

After the weak outcomes in the second half of 2021, real GDP grew by 1% (at seasonally adjusted quarterly rates) in the first quarter of 2022. Automobile production continues to be constrained by supply chain problems. Consumption of non-durable goods is well above pre-pandemic levels while services consumption and private investment lag. Unemployment and underemployment have decreased but remain above pre-pandemic levels. Global inflation, supply-chain disruptions and domestic factors continue to exert significant pressure both on headline and core inflation. Consumer prices rose by 7.7% year-on-year in April 2022, with underlying inflation reaching 7.2%. Inflation expectations 12-month ahead have continued to increase, but longer-term inflation expectations remain stable.

Mexico



1. The blue shaded area represents the Central Bank of Mexico's inflation target range.
2. Inflation expectations for the next 12 months by specialists in the economy of the private sector.
Source: OECD Economic Outlook 111 database; and Bank of Mexico.

StatLink https://stat.link/lfxnh4

Mexico: Demand, output and prices

Mexico	2018	2019	2020	2021	2022	2023
	Current prices MXN billion	Percentage changes, volume (2013 prices)				
GDP at market prices	23 524.4	-0.2	-8.2	4.8	1.9	2.1
Private consumption	15 238.4	0.4	-10.5	7.4	4.1	2.7
Government consumption	2 721.8	-1.8	0.1	1.0	3.2	2.2
Gross fixed capital formation	5 179.0	-4.7	-17.8	10.0	2.3	2.7
Final domestic demand	23 139.3	-1.0	-10.7	7.2	3.6	2.7
Stockbuilding[1]	866.0	-0.2	-0.4	0.2	0.0	0.0
Total domestic demand	24 005.3	-1.3	-11.3	7.6	3.5	2.7
Exports of goods and services	9 235.1	1.5	-7.3	6.9	6.3	5.1
Imports of goods and services	9 716.0	-0.7	-13.7	13.7	4.3	6.2
Net exports[1]	- 480.9	0.8	2.4	-2.2	0.8	-0.4
Memorandum items						
GDP deflator	_	4.1	4.0	7.1	7.0	4.3
Consumer price index	_	3.6	3.4	5.7	6.9	4.4
Core inflation index[2]	_	3.7	3.8	4.7	6.7	4.4
Unemployment rate[3] (% of labour force)	_	3.5	4.4	4.1	3.6	3.8
Current account balance (% of GDP)	_	-0.3	2.3	-0.4	-0.5	-0.7

1. Contributions to changes in real GDP, actual amount in the first column.

2. Consumer price index excluding volatile items: agricultural, energy and tariffs approved by various levels of government.

3. Based on National Employment Survey.

Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/ozg4nr

The geopolitical turmoil resulting from war in Ukraine has generated a new source of uncertainty for the Mexican economy. While trade and financial ties with the countries in conflict are weak, Mexican exports would be impacted indirectly, mainly through the US economy. Global increases in commodity prices are also adding to existing inflationary pressures. Tax relief measures and generalised tax credits are cushioning the impact of higher energy prices. Higher interest rates in global financial markets will increase Mexico’s sovereign financing costs.

Fiscal policy can foster growth prospects

The budget deficit is expected to increase to 3.1% of GDP in 2022, from 2.9% of GDP in 2021, and to decrease to 2.8% of GDP in 2023. The official measure of public debt is expected to stabilise around 50% of GDP. The ongoing recovery and medium-term growth prospects could be strengthened by increasing public investment, based on cost-benefit analysis, and targeted spending on social programmes. The commitment to debt sustainability could be maintained by gradually broadening tax bases, phasing out inefficient and regressive exemptions, and strengthening the property tax.

To respond to mounting inflationary pressures, the central bank has increased interest rates in its last eight board meetings, leaving the rate at 7%. With widespread price pressures expected to persist, further interest rate increases are warranted. The interest rate is assumed to increase to 9% by the first quarter of 2023 and remain at that level in the rest of 2023. The government has taken steps to mitigate pressures in basic goods prices, including the elimination of tariffs for basic goods, cooperation with the private sector to freeze the prices of 24 key products (mainly food) for six months, measures to increase production of basic grains and the reduction of customs fees for basic goods.

Growth will be moderate

The economy is projected to expand by 1.9% in 2022 and 2.1% in 2023. Domestic consumption will be a key growth driver while services related to tourism will gradually recover. Exports will continue to benefit from deep integration into value chains. Inflation is expected to increase in 2022 and gradually slowdown in 2023, as the impact of higher interest rates take effect and ample spare capacity limits wage pressures. However, the inflation outlook remains very uncertain. Inflation may be higher for longer, eroding purchasing power, particularly of vulnerable households, and requiring a larger tightening of monetary policy. If infections increase, mobility could decrease, hampering economic activity. Episodes of financial volatility may trigger greater risk aversion, reduce net financial inflows and increase financing costs. On the upside, near-shoring opportunities could imply stronger exports. The recovery in tourism could be quicker than anticipated.

Restarting investment and boosting productivity are key priorities

Improving business regulations at sub-national level, by lowering administrative burdens and monetary costs for starting and formalising companies, would help to raise investment and formal job creation. Ensuring independent competition authorities and regulators, with sufficient budget to carry out their functions, would also boost competition and productivity. Allocating more resources towards primary education would mitigate the adverse effects the pandemic had on educational outcomes. Transitioning towards massive urban and interurban transport and promoting renewables energies could reduce emissions and the use of fossil fuels.

Netherlands

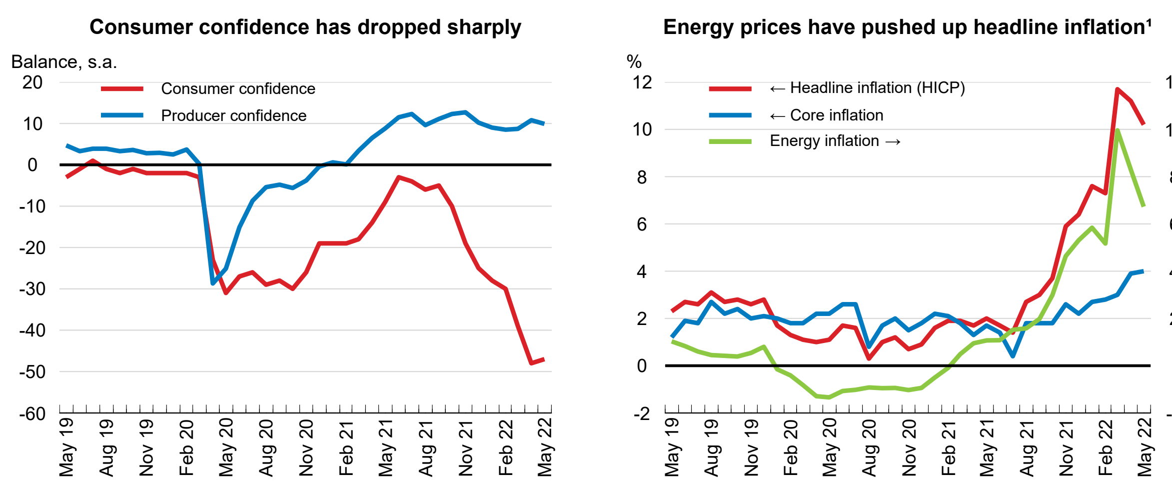
The Dutch economy is projected to grow by 2.9% in 2022 and 1.1% in 2023. Inflation will remain high throughout 2022 averaging 9.2% due to continuing supply shortages and high energy prices, before falling back to 4.8% on average in 2023. Private consumption will continue to support growth, but will be subdued as the rising cost of living erodes households' income. A tight labour market will help to keep unemployment low.

Well-targeted and temporary fiscal policy should continue to protect vulnerable households from high costs of living. The fiscal position remains strong despite the impact of the COVID-19 crisis and gives the new government room to implement its agenda and refocus public spending to help tackle structural challenges, including the green transition, address high nitrogen pollution, a housing shortage and low productivity growth. Ensuring energy security and reducing dependence on fossil fuels by accelerating the green transition should be a key priority.

Growth halted in the first quarter of 2022

After strong GDP growth of 5.0% in 2021, quarterly GDP was flat in the first quarter of 2022. Producer confidence remains well above pre-pandemic levels, but consumer confidence has plummeted reflecting concerns over rising cost of living. Inflation started surging in mid-2021 due to global supply pressures and rising energy prices, and has been pushed up further by the Ukraine war, with the annual rate reaching 10.2% in May. Hourly contractual wages rose by 2.3% in the first quarter of 2022, far below inflation despite a tightening labour market and a historically low unemployment rate of 3.2% in April.

Netherlands



1. Data for headline, core and energy inflation in May 2022 are provisional.
Source: CBS; and Eurostat.

StatLink https://stat.link/0dp3h6

Netherlands: Demand, output and prices

Netherlands	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	774.4	1.9	-3.8	5.0	2.9	1.1
Private consumption	341.6	0.9	-6.6	3.5	3.7	1.0
Government consumption	188.7	2.8	1.0	5.5	0.4	2.7
Gross fixed capital formation	158.2	6.1	-4.2	3.5	2.5	1.7
Final domestic demand	688.5	2.6	-3.9	4.1	2.5	1.6
Stockbuilding[1]	4.3	0.3	-0.3	-0.3	0.4	0.0
Total domestic demand	692.8	2.9	-4.3	3.8	2.9	1.6
Exports of goods and services	655.5	1.9	-4.8	6.6	1.6	2.4
Imports of goods and services	573.9	3.1	-5.5	5.1	1.3	3.1
Net exports[1]	81.6	-0.7	0.1	1.7	0.4	-0.3
Memorandum items						
GDP deflator	_	3.0	2.3	2.4	4.5	3.7
Harmonised index of consumer prices	_	2.7	1.1	2.8	9.2	4.8
Harmonised index of core inflation[2]	_	1.9	1.9	1.8	4.2	4.7
Unemployment rate (% of labour force)	_	4.4	4.9	4.2	3.8	4.4
Household saving ratio, net[3] (% of disposable income)	_	11.4	17.8	17.3	13.9	12.5
General government financial balance (% of GDP)	_	1.7	-3.7	-2.5	-0.9	-1.2
General government gross debt (% of GDP)	_	62.4	69.8	66.3	64.6	64.3
General government debt, Maastricht definition[4] (% of GDP)	_	48.5	54.4	52.1	50.4	50.1
Current account balance (% of GDP)	_	9.4	7.0	9.5	8.8	8.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Including savings in life insurance and pension schemes.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/ht93q1

The Netherlands has limited direct trade and financial linkages with Russia and Ukraine, but has some dependence on Russian energy imports. About 15% of the gas consumed and 18% of oil product imports come directly from Russia. The Dutch economy is also vulnerable to spill-over effects from sanctions on Russia through rising global energy and food prices and supply chain disruptions. By late May, more than 59 000 (0.34% of population) Ukrainian refugees had arrived in the Netherlands who are entitled to health care, education for minor children and permission to work under the EU Temporary Protection Directive.

Fiscal policy will tighten moderately over the projection period

The fiscal deficit is projected to fall over the projection period from 2.5% of GDP in 2021 to 1.2% of GDP in 2023 supported by the phasing out of COVID-19 support measures and continuous, albeit slowing, economic growth. The new government plans to increase public expenditure to reduce nitrogen pollution, support the energy transition, research & development, education, housing and childcare. However, there is significant uncertainty around the timeline for the implementation of budgetary plans owing to persistent supply chain issues, a tight labour market and procedural delays. In March, the government extended the support package to cushion the impact of energy prices on households to a total of EUR 6.1 billion (0.71% of GDP). The VAT rate on energy will be lowered from 21% to 9% in July and the excise duty on petrol and diesel has been cut by 21%. The package also includes measures that support vulnerable households, including a one off EUR 800 energy discount, and EUR 300 million to help with the insulation of their home.

Economic growth will continue to slow

Output is projected to grow by 2.9% in 2022 and 1.1% in 2023. Headline inflation will start to moderate from end-2022 due to base effects but higher energy prices due to the oil embargo, as well as high core inflation, will keep inflation at elevated levels throughout 2023. Wages will grow more moderately than inflation over 2022, as automatic indexation is not widespread, but will catch up with inflation over 2023. Private consumption will continue to support growth but be subdued as rising prices erode households' income. Following some improvement due to the better health situation early 2022, growth in business investment will remain subdued. The outlook is surrounded by significant downside risks. Lower consumption and business investment could weigh on growth if disruptions of energy supply due to the Ukraine war translate into even higher prices or if new COVID strains lead to a resurgence of cases. A worsening economic outlook in the Netherlands' main trading partners (Germany, Belgium, United Kingdom and France) could also further weigh on the economy. Higher spending than assumed in the forecast is an upside risk, if wealthier households spend more excess savings than projected.

Long-standing structural challenges need to be addressed to sustain the recovery

Well-targeted fiscal policy support to protect vulnerable households from high living costs is needed as long as high energy costs persist. The new government should address long-standing structural challenges and accelerate progress towards net zero to enhance energy security and reduce dependence on fossil fuels. The government is planning to take steps in this direction by stimulating the supply of renewable energy, the use of electric cars, improved insulation of houses, and making preparations for new nuclear power plants. Other important policy objectives are to reduce the high level of nitrogen pollution, increase housing supply, reduce childcare expenditure for parents to narrow the gap in working hours between women and men, and ensure equal opportunities for all in education.

New Zealand

After reaching 5% in 2021, real GDP growth will ease to 3% in 2022 and 2% in 2023. High inflation and rising interest rates will weigh on private consumption. Economic growth will slow but remain solid as pent-up demand during the surge in COVID-19 infections in early 2022 is unleashed and gradual reopening of the border allows the tourism sector to recover. Inflation will decline in 2023 but remain high, as firms pass on global commodity price inflation and workers demand higher wages.

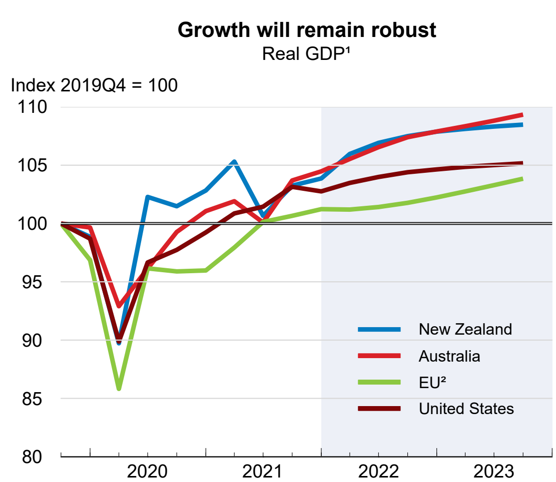
Monetary policy should be tightened further to reduce inflation to within the 1-3% target band. Fiscal policy should avoid concentrating the burden of macroeconomic stabilisation on monetary policy, and support for households and businesses should be tightly targeted to those most vulnerable to high inflation.

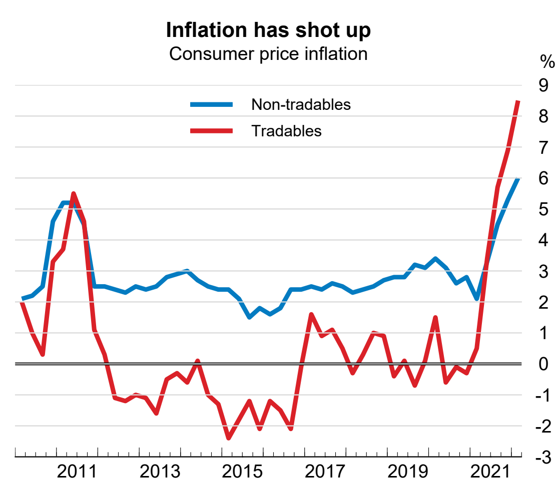
The economy is under pressure from high inflation

New Zealand's economy has been subject to large fluctuations caused by COVID-19. The surge of the Omicron variant in early 2022 reduced mobility and private consumption despite the new COVID-19 response framework sparing any lockdown. Inflation surged to its highest levels since 1990, driven by a very tight labour market, as well as persisting global supply chain disruptions and rising global energy prices. wage growth is strengthening as the unemployment rate hit a historic low (3.2%) and skills shortages are widespread, but falls short of inflation. After a record surge, house prices have fallen by 4% since November 2021. The gradual reopening of the border since March 2022 has so far resulted in a net outflow of migrants, partly because migrant workers who need new work visas can only enter from July 2022.

Although the direct impacts of the war on Ukraine on economic growth are limited given the small shares of Russia and Ukraine in New Zealand's trade, the indirect impacts through higher fuel and commodity prices have rapidly increased costs of inputs and living, weighing on business and consumer confidence.

New Zealand





1. Expenditure-based. 2. EU countries that are members of the OECD.
Source: OECD Economic Outlook 111 database; and Statistics New Zealand.

StatLink https://stat.link/rw0p67

New Zealand: Demand, output and prices

New Zealand	2018	2019	2020	2021	2022	2023
	Current prices NZD billion	Percentage changes, volume (2009/2010 prices)				
GDP at market prices	302.6	3.3	-0.9	5.0	3.0	2.0
Private consumption	174.9	3.1	-1.1	6.2	0.8	1.1
Government consumption	54.8	5.1	6.8	10.2	7.5	1.4
Gross fixed capital formation	70.8	4.4	-7.0	9.6	6.7	3.6
Final domestic demand	300.4	3.8	-1.0	7.8	3.5	1.7
Stockbuilding[1]	2.6	-0.5	-0.8	1.6	0.0	0.0
Total domestic demand	303.1	3.2	-1.8	9.5	3.5	1.7
Exports of goods and services	84.0	2.4	-12.7	-3.0	6.4	5.5
Imports of goods and services	84.5	2.1	-16.1	15.7	8.2	3.7
Net exports[1]	- 0.5	0.1	0.9	-4.3	-0.7	0.3
Memorandum items						
GDP deflator	_	2.4	2.2	2.8	3.6	3.4
Consumer price index	_	1.6	1.7	3.9	6.6	4.6
Core inflation index[2]	_	1.8	2.2	3.7	5.3	4.5
Unemployment rate (% of labour force)	_	4.1	4.6	3.8	3.2	3.5
Household saving ratio, net (% of disposable income)	_	2.9	5.8	5.2	3.9	2.9
General government financial balance (% of GDP)	_	-0.6	-7.3	-4.2	-5.1	-3.6
General government gross debt (% of GDP)	_	36.3	42.4	42.6	47.4	50.5
Current account balance (% of GDP)	_	-2.9	-1.1	-5.6	-6.5	-6.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/n6tisp

Macroeconomic policies should be better coordinated to contain inflationary pressures

The fiscal stance will be expansionary in 2022 due to the fiscal outlays to compensate for higher living costs but will turn contractionary in 2023, as the temporary support expires and the government phases out the large pandemic fiscal stimulus, such as the “shovel-ready” infrastructure investment (1% of GDP) to be implemented by end-2022. As a response to large increases in fuel prices, the government cut fuel taxes and road user charges for diesel vehicles by 25 cents per litre and halved the cost of public transport for three months starting from mid-March. Budget 2022 extended both of these measures for a further two months and introduced a temporary income support of NZD 350 to individuals earning less than NZD 70 000 per year and who are not eligible for the Winter Energy Payment. In order to avoid fuelling inflationary pressure in the near term, any additional fiscal support against higher living costs should be more targeted. The government should also consider deferring some of its infrastructure investment. The Reserve Bank of New Zealand (RBNZ) initiated monetary tightening in October 2021, increasing its Official Cash Rate (OCR) to 2% by May 2022. The OCR is assumed to rise to 3.9% by mid-2023 with some frontloading to anchor inflation expectations. From July 2022, the RBNZ will start selling its large holdings of government bonds. The faster increase in the OCR in the near term and the start of quantitative tightening are adequate and signal a strong commitment to price stability.

Economic growth will moderate

Private consumption will recover from the second quarter of 2022 but will be held back by high inflation, a negative wealth effect from declining house prices, and higher mortgage interest rates. 78% of mortgage rates will be reset within one year. Border reopening paves the way for a gradual recovery of tourism exports, which comprised 18% of exports on the eve of the pandemic, and inflows of migrant workers, which will alleviate skills shortages. Resumed international business travel and migrant workers inflows will encourage business and residential investment, despite falling house prices. Inflation will decline moderately in 2023, as fiscal and monetary policy tightening will slow growth, alleviating capacity constraints.

Risks are tilted to the downside. An outbreak of a more virulent COVID-19 variant could stifle the recovery of private consumption. A further escalation in the war in Ukraine and sanctions against Russia could bring about higher and more persistent inflation and weaker external demand. Prolonged lockdowns in large cities in China, New Zealand's largest export market, would also reduce exports and add to inflationary pressure by exacerbating disruptions in global supply chains. Conversely, China's shift toward a less stringent COVID-19 policy would boost exports and alleviate supply chain disruptions.

Structural reforms can pave the way to more resilient growth

To ease inflationary pressure and skills shortages in the near term, the government should facilitate the inflow of migrant workers after the full border opening in July 2022 by ensuring the smooth implementation of the new work visa and employer accreditation system. Swift and concrete policy actions to enhance competition in the retail grocery sector are warranted, given the Commerce Commission's conclusion that imperfect competition is resulting in high grocery prices and profit margins of major grocery retailers by international comparison. Strengthening the domestic pipeline of digital skills, letting regulations evolve with technological change and promoting exports by firms exploiting digital technologies would support the digital transformation and productivity. The fiscal rule announced in May 2022, which aims to maintain a small budget surplus and caps the net debt level at 30% of GDP will underpin long-run fiscal sustainability in the face of population ageing and rising healthcare expenditure. The government has unveiled greenhouse gas emissions budgets through 2035 that are consistent with achieving net zero emissions by 2050. Rising carbon prices and complementary measures will be needed for New Zealand to meet its abatement objectives. The Climate Emergency Response Fund amounting to 1.4% of GDP established with Emissions Trading Scheme revenue will finance investments in transport sector decarbonisation, energy transition, agriculture emission mitigation and long-term carbon sinks.

Norway

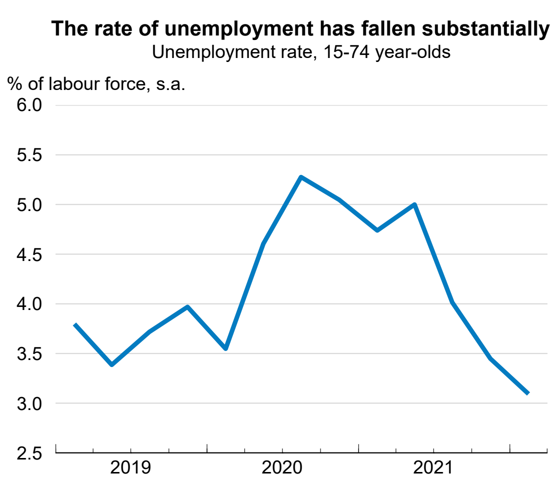
Mainland GDP growth of 3.5% is projected for 2022, reflecting the final phase of recovery in the wake of the pandemic. In 2023, economic growth will have declined towards its long-term potential rate, at 1.7%. Risks to inflation are pronounced, given the broadening of large price increases and elevated uncertainties around commodity prices. The labour market, already tight, will add to pressures on wage inflation. House prices and household indebtedness remain high.

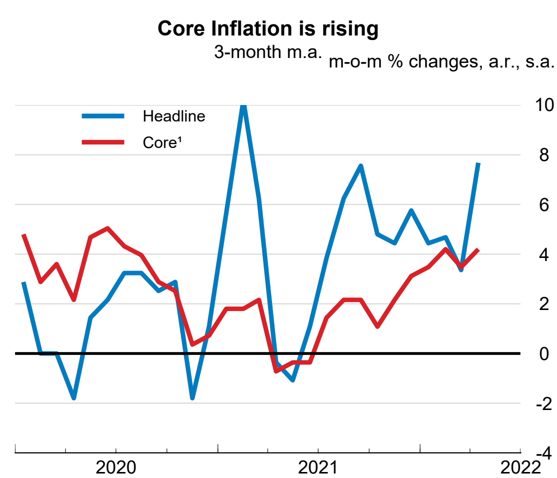
Monetary policy normalisation should continue given the strength of demand and price inflation. A prudent approach to government budgeting is needed. Policies shielding households from sharp increases in energy bills should, in the longer term, aim to transition away from direct government support and should not distort incentives to energy saving. Further structural policy measures that facilitate housing supply and temper demand for home ownership are needed.

Output growth remains strong

The Omicron wave of COVID-19 only briefly paused strong growth in mainland output. Energy price increases have been the dominant influence on headline consumer price inflation, although these are partly offset by electricity price subsidies. Core inflation, which excludes energy, is picking up, reflecting a broadening of inflation to more goods and services, including travel-related services. The unemployment rate recorded in labour-force survey data has declined sharply. This reflects strong demand but also that inflows of temporary foreign workers have not yet returned to pre-pandemic levels. The tight labour market is creating upward pressure on wages. The negotiated benchmark wage increase for 2022 in the centralised wage bargaining system has been set at 3.7% and there is a risk wage increases may be higher than this, including in industries facing skill shortages.

Norway





1. Core inflation is Statistics Norway's CPI-ATE measure which adjusts for tax changes and excludes energy products.
Source: OECD Economic Outlook 111 database; and Statistics Norway.

StatLink https://stat.link/6nesbz

Norway: Demand, output and prices

Norway	2018	2019	2020	2021	2022	2023
	Current prices NOK billion	Percentage changes, volume (2019 prices)				
Mainland GDP at market prices[1]	2 935.4	2.0	-2.3	4.1	3.5	1.7
Total GDP at market prices	3 553.9	0.7	-0.7	3.9	4.0	2.3
Private consumption	1 526.9	1.1	-6.6	4.9	5.8	1.5
Government consumption	826.1	1.3	1.8	3.8	0.1	1.2
Gross fixed capital formation	850.3	9.5	-5.6	-0.9	3.9	2.3
Final domestic demand	3 203.3	3.4	-4.2	2.9	3.7	1.6
Stockbuilding[2]	146.8	-1.1	-0.4	0.2	0.2	-0.3
Total domestic demand	3 350.1	2.1	-4.5	3.0	3.9	1.2
Exports of goods and services	1 349.5	1.1	-1.2	4.7	3.3	3.5
Imports of goods and services	1 145.7	5.1	-11.9	2.3	5.4	1.5
Net exports[2]	203.8	-1.2	3.7	0.8	-0.2	1.4
Memorandum items						
GDP deflator	_	-0.5	-3.6	16.9	20.6	1.5
Consumer price index	_	2.2	1.3	3.5	4.6	3.3
Core inflation index[3]	_	2.3	2.7	1.7	3.3	3.0
Unemployment rate (% of labour force)	_	3.7	4.6	4.3	2.8	2.8
Household saving ratio, net (% of disposable income)	_	7.0	14.2	13.1	10.3	8.9
General government financial balance (% of GDP)	_	6.6	-2.6	9.1	10.6	10.9
General government gross debt (% of GDP)	_	47.0	53.8	49.6	..	..
Current account balance (% of GDP)	_	2.9	0.7	15.3	27.0	26.8

1. GDP excluding oil and shipping.
2. Contributions to changes in real GDP, actual amount in the first column.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/o2z5rw

The war in Ukraine is principally affecting the economy via its impact on global commodity and energy prices; direct trade links with Russia and Ukraine are not substantial. There is only limited capacity to ramp up oil and gas production in the near term to address shortages in Europe arising from the phase-out of Russian imports. Norway plans on taking in around 40 000 - 50 000 refugees from Ukraine (equivalent to about 1% of Norway's population). Public spending of about 0.5% of mainland GDP has been allocated to accommodating refugees and strengthening civil and military preparedness. Norway is also providing military and other aid to Ukraine.

Fiscal and monetary support is being withdrawn

The mainland fiscal deficit is projected to decline over the projections reflecting government adherence to the fiscal rule. The fiscal space generated by phasing out COVID-19 support plus strong revenue growth (in part linked to energy-price increases) will outweigh costs associated with the Ukraine crisis and outlays on electricity-bill subsidies. The latter are scheduled to terminate in March 2023 and to cost around 0.8% of mainland GDP. In recent months, the krone value of Norway's wealth fund has been boosted by greater inflows from high oil and gas prices but adversely impacted by falls in global equity prices; the net effect is so far negative. Norges Bank is appropriately continuing to tighten monetary policy. The Bank's policy rate is expected to reach 2.5% by the end of 2023, a rate which is estimated to be broadly neutral, where it neither stimulates nor weighs on the economy. This pace of tightening should help control inflation while limiting risks of straining borrowers, especially households.

Growth and inflation will moderate

Moderating real income growth and dwindling reserves of spare capacity will see mainland output growth decline from 3.5% in 2022 towards potential at 1.7% in 2023. Growth in the volumes of household consumption and business investment will be strong in the second quarter of 2022, due to a bounce back from a weak first quarter, but then diminish partly due to inflation. Easing demand will reduce consumer price inflation, along with modest decline in commodity prices. Nevertheless, core inflation will still be above the central bank's 2% target by the end of 2023 and there is a risk of more substantial price and wage pressures. Commodity price risks tied to the war in Ukraine add uncertainty to the economic outlook. As an oil and gas producer with considerable hydropower capacity, Norway faces comparatively small energy security risks. New waves of Covid-19 infections or more virulent variants remain a risk. In the absence of renewed constraints on movement, recovering migrant worker inflows may alleviate labour market tensions, reducing pressures on wage growth.

Carbon-price increases are key for green transition

Progress in green transition needs to continue, including follow-through on planned carbon-price increases. As regards green investment, a recently announced plan for a large expansion of offshore wind power capacity is encouraging. Meanwhile, energy-bill subsidies to help households cope with the cost-of-living should remain temporary. Government plans to facilitate more fixed-price contracting in the energy supply chain, in order to reduce the frequency and volatility of price changes for households, could be an effective solution. In addition, more action to make housing more affordable is needed, such as lighter land-use restrictions. Steps to reduce the tax concessions that boost demand for home ownership and put upward pressure on prices are also needed.

Poland

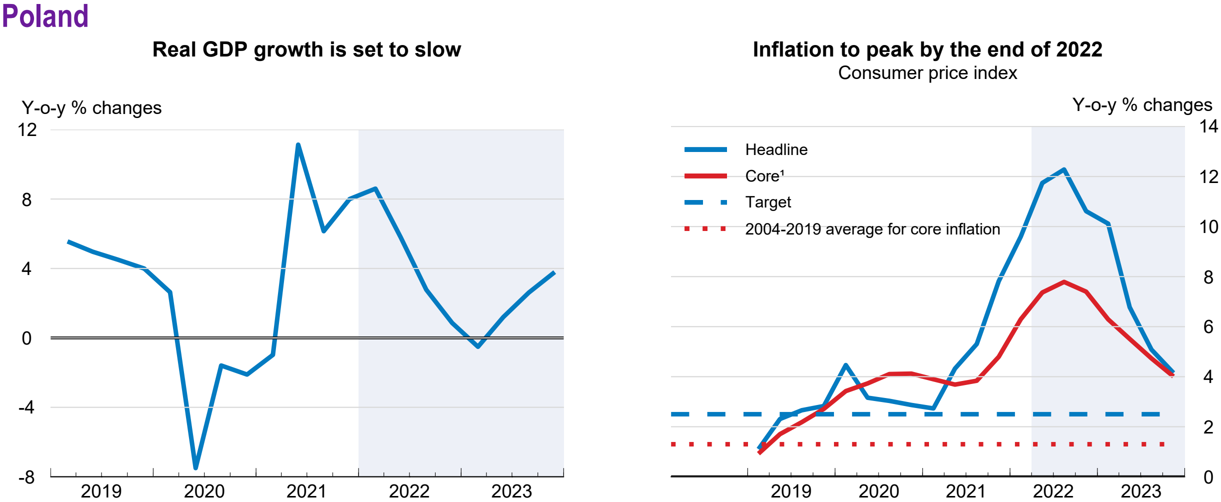
After strong GDP growth in the second half of 2021, the war in Ukraine will take a toll. Real GDP is projected to expand by 4.4% in 2022 and by 1.8% in 2023. Consumption and, to a lesser extent, investment growth is expected to slow considerably, partly offset by fiscal policy. Inflation is expected to peak by the end of the year as the rise in energy prices slows and monetary policy tightens. Core inflation is projected to decrease but is likely to remain elevated at the end of 2023.

Monetary policy should continue tightening to reduce inflation and stabilise inflation expectations. Fiscal policy should be targeted towards vulnerable households and supporting refugees, but should be broadly neutral in aggregate. In the medium-term, greater decarbonisation and digitalisation, supported by labour market policies, could lead to more energy security and greener and higher economic growth.

The war in Ukraine will slow the recovery

The economy expanded strongly in the first quarter of 2022 with industrial production and retail sales growing at a solid pace, accompanied by robust wage growth and low unemployment. High energy and food price growth and supply chain disruptions persisted into 2022, exacerbated by the war in Ukraine. Annual headline inflation rose further to 11.4% in April 2022, while core inflation reached 8.6%.

Poland



1. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/njgodq

Poland: Demand, output and prices

Poland	2018	2019	2020	2021	2022	2023
	Current prices PLN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	2 121.6	4.7	-2.2	5.9	4.4	1.8
Private consumption	1 239.8	3.9	-2.8	6.0	4.4	1.0
Government consumption	376.3	6.5	4.9	3.4	1.3	2.4
Gross fixed capital formation	386.4	6.1	-4.9	3.8	3.3	3.5
Final domestic demand	2 002.5	4.8	-1.7	5.1	3.6	1.7
Stockbuilding[1]	54.1	-1.0	-1.1	2.4	1.4	0.0
Total domestic demand	2 056.6	3.6	-2.9	7.5	4.9	1.6
Exports of goods and services	1 172.0	5.2	0.0	11.8	3.5	1.8
Imports of goods and services	1 107.0	3.0	-1.1	15.9	6.9	1.4
Net exports[1]	65.0	1.3	0.6	-1.2	-1.7	0.2
Memorandum items						
GDP deflator	_	3.2	4.2	5.8	11.5	8.8
Consumer price index	_	2.2	3.4	5.1	11.1	6.5
Core inflation index[2]	_	1.9	3.8	4.1	7.2	5.1
Unemployment rate (% of labour force)	_	3.3	3.2	3.4	2.9	2.9
Household saving ratio, net (% of disposable income)	_	0.7	6.9	1.4	1.4	2.2
General government financial balance (% of GDP)	_	-0.7	-6.9	-1.9	-4.4	-3.1
General government debt, Maastricht definition[3] (% of GDP)	_	45.6	57.1	53.8	52.9	52.5
Current account balance (% of GDP)	_	0.5	2.9	-0.6	-5.1	-3.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/m1dt3o

The war in Ukraine will significantly affect the Polish economy. Inflation has been pushed up by a surge in energy and food prices and the zloty's depreciation. Returning Ukrainian men have exacerbated skill shortages in construction and transport. Meanwhile, more than three million Ukrainian refugees, mostly women and children, have entered Poland. Having been granted access to the labour market and social benefits, the projections assume an additional 350 000 workers will join the labour force, alleviating skills shortages in some sectors. Direct trade with Russia, Belarus and Ukraine, which represents 3-5% of GDP and 6-8% of total trade, will fall as exports drop while energy imports are diverted as planned, minimising the impact of the recent end to Russian natural gas imports. Higher uncertainty and lower consumer and business confidence should also damp consumption and investment growth. Nonetheless, refugee spending in Poland should bolster consumption growth.

Expansionary fiscal policy will be accompanied by tighter monetary policy

Fiscal spending will rise to shield the economy against the impact of the war. The Polish New Deal, introduced in January, has been expanded. The government has also set aside an 11 billion zloty special fund for Ukrainian refugees. The Anti-Inflation Shield, introduced at the turn of the year and originally set to expire in mid-2022, is assumed to be extended until the end of 2022 to cushion households against high energy and food prices. Moreover, national defence spending is set to increase from 2.2% of GDP in 2022 to 3% by 2023. Given rising headline inflation, growing domestic inflationary pressures and an expansionary fiscal policy, the National Bank of Poland has continued raising key short-term interest rates from 1.25% in November to 5.25% in May. Interest rates are assumed to rise further and reach 8.5% by the end of 2023.

The economy is expected to slow amid high inflation and uncertainty

Economic growth is set to slow considerably over the next two years. In 2022, inflation is expected to remain high but is likely to peak by the end of the year. Weaker real incomes and high uncertainty should lead to significantly slower consumption growth with investment and trade growth also dampened. A rise in fiscal spending will partly offset these shocks over 2022, with real GDP set to expand by 4.4%. In 2023, the effects of higher uncertainty should dissipate and, while the announced EU embargo on Russian oil will exert additional upward pressure on energy prices, headline inflation should slow as monetary policy tightens further. Core inflation should also ease but is likely to remain elevated. Fiscal policy will support activity, boosted by spending from the EU Recovery and Resilience Facility funds, but monetary policy tightening will reduce growth. Overall, real GDP is expected to slow to 1.8% in 2023.

There is considerable uncertainty around this outlook and the balance of risks lies to the downside. Further escalation of the war would increase uncertainty, exacerbate inflation, and strain public finances. Additional disruptions to energy supplies would hit growth. A persistently tight labour market and continued consumption growth could further push up inflation. On the upside, a quick resolution of the war would increase GDP growth and reduce inflation.

Policies should be coordinated and facilitate a green and digital transition

Aggregate fiscal policy should have a broadly neutral stance to complement monetary policy, while continuing to shield the most vulnerable households from inflation. Diversifying energy imports as planned while increasing investment in renewables would improve energy security and ensure greener growth. Policies should encourage greater use of digital technology among firms to raise productivity. Labour market policies can support this by upgrading weak basic skills, notably among older adults, improving access to lifelong training, especially for the unemployed and the low-skilled, with a focus on skills relevant for the digital and green transitions. Better childcare support and language training could facilitate the successful integration of refugees in the labour market.

Portugal

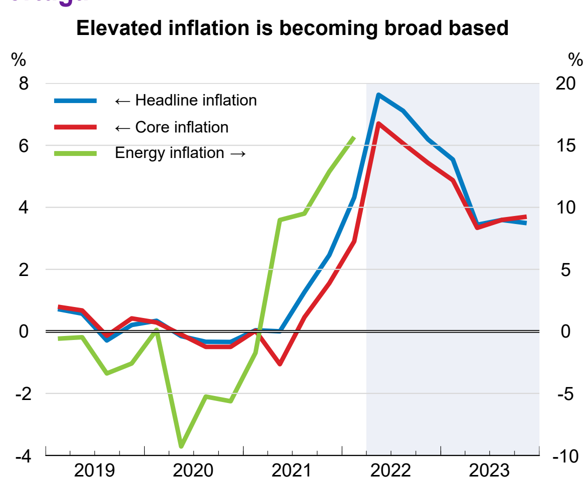
Real GDP is projected to grow by 5.4% in 2022 and 1.7% in 2023. Robust public investment, boosted by EU funds, and the return of tourism exports are set to support the recovery. Yet, the war in Ukraine, supply-chain disruptions and increases in energy and commodity prices will weigh on activity, lowering confidence and purchasing power. Although spare capacity remains, increases in energy and food prices are expected to push inflation to 6.3% in 2022 and 4% in 2023. Wages will accelerate as hours worked reach pre-pandemic levels, but not enough to protect households' purchasing power against rising inflation.

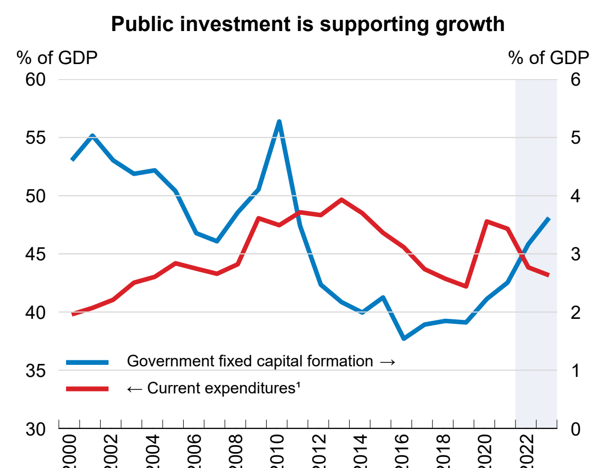
Given the high levels of public debt, maintaining prudent fiscal policy and defining a credible medium-term fiscal consolidation plan will be key to secure favourable financing conditions. To limit the effects of rapid inflation at minimal cost, fiscal support should be temporary and targeted on the most vulnerable. Accelerating green investment can support the recovery while reducing dependence on fossil fuels. Fostering the adoption of digital technologies through greater access to digital training and advisory services would boost firms' competitiveness and support productivity.

The economic recovery is easing

Strong private consumption growth and a rebound in tourism supported GDP growth in early 2022. Yet, the pace of the recovery is easing, with elevated uncertainty, surging commodity and energy prices and declining real wages. Consumer prices increased by 8.1% in the year to May and price pressures became more broad-based. Consumer confidence has fallen sharply and retail sales have moderated. Strong rises in production costs have negatively affected sentiment in construction and industry, while the rebound in tourism has sustained sentiment in the services sector. While the unemployment rate has declined, hours worked remain below pre-pandemic levels and wage pressures so far remain limited.

Portugal





1. Current expenditures includes government final consumption, social security benefits, property income and other outlays.
Source: OECD Economic Outlook 111 database; OECD Database on Consumer Price Indices; OECD Main Economic Indicators database; and OECD calculations.

StatLink https://stat.link/78ia6z

Portugal: Demand, output and prices

Portugal	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2016 prices)				
GDP at market prices	205.2	2.7	-8.4	4.9	5.4	1.7
Private consumption	131.9	3.3	-7.1	4.5	3.6	0.5
Government consumption	34.8	2.1	0.4	4.1	1.3	0.9
Gross fixed capital formation	36.0	5.4	-2.7	6.5	7.7	5.1
Final domestic demand	202.7	3.4	-5.0	4.8	4.0	1.5
Stockbuilding[1]	1.6	-0.3	-0.6	0.2	-0.1	0.0
Total domestic demand	204.2	3.1	-5.5	5.0	4.0	1.5
Exports of goods and services	89.1	4.1	-18.6	13.1	13.2	3.2
Imports of goods and services	88.2	4.9	-12.1	13.1	9.3	2.6
Net exports[1]	0.9	-0.4	-2.9	-0.3	1.3	0.2
Memorandum items						
GDP deflator	_	1.7	1.9	0.7	3.7	2.9
Harmonised index of consumer prices	_	0.3	-0.1	0.9	6.3	4.0
Harmonised index of core inflation[2]	_	0.4	-0.2	0.2	5.3	3.9
Unemployment rate (% of labour force)	_	6.6	7.0	6.6	5.8	5.7
Household saving ratio, net (% of disposable income)	_	-2.2	3.3	1.3	-0.9	0.4
General government financial balance[3] (% of GDP)	_	0.1	-5.8	-2.8	-1.5	-1.1
General government gross debt (% of GDP)	_	136.1	157.6	145.6	138.1	134.9
General government debt, Maastricht definition[4] (% of GDP)	_	116.6	135.2	127.4	120.0	116.7
Current account balance (% of GDP)	_	0.4	-1.1	-1.1	-2.2	-2.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Based on national accounts definition.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

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While Portugal has few direct trade links with Russia and Ukraine, the war is perpetuating increases in energy and food prices, increasing uncertainty and weighing on activity. 10-year government bond yields have increased by around 150 basis points since the start of January. The measures to cushion the effects of higher energy costs are on net impacting the 2022 government budget by EUR 1.1 billion (0.5% of GDP). An estimated EUR 780 million will reduce fuel prices by temporarily decreasing the petrol and energy tax (ISP), suspending the increase in the carbon tax and increasing subsidies through the Autovoucher programme. There is EUR 450 million of grants for companies and EUR 105 million of social benefits for refugees and vulnerable families.

Policy will remain supportive in 2022, boosted by EU funds

Fiscal policy is expected to be supportive in 2022. Although pandemic-related measures will ease to 0.8% of GDP in 2022, spending of Next Generation EU funds (grants and loans) is assumed to jump from zero in 2021 to 1.4% of GDP in 2022 and 1.8% in 2023, boosting government investment. The first stage of this spending is already fully contracted, although there are risks of delays given the significant amount. Fiscal policy is expected to be broadly neutral in 2023 as pandemic-related measures are eliminated.

The recovery is slowing

Real GDP is projected to grow by 5.4% in 2022 and 1.7% in 2023. Diminishing pent-up demand and elevated inflation will weigh on consumption. Investment growth will remain solid, supported by government spending, which is being boosted by EU funds. Tourism exports should rebound further. Although spare capacity remains, inflation is projected to increase to 6.3% in 2022 before moderating to 4% in 2023, as elevated energy and food prices ease somewhat through the year. As employment and hours worked increase, wage growth is expected to increase, although elevated inflation will lower real wages. Strong nominal GDP growth will lower public debt (Maastricht definition) to 117% of GDP in 2023. Risks to the recovery include the delayed spending of EU funds or their erosion in real terms due to higher inflation, and an increase in interest rates which may reduce bank lending and gradually limit the government's ability to spend. Tourism could rebound more strongly than expected. Alternatively higher-than-expected oil prices could weigh on demand for international travel.

Policy can support sustainable growth

Temporary fiscal support against high energy prices should target the most-impacted households and firms. For instance, means-tested financial support should replace reductions in fuel taxes. Increasing the share of renewables in energy supply, combined with reducing energy demand would support energy security and the achievement of carbon neutrality. Faster development of public transport, shared transport solutions and electric-vehicle infrastructure would support investment and lower fossil-fuel dependence. To reduce energy demand, technical and financial support to low-income households and vulnerable (but viable) firms, such as for building insulation, should intensify. Fostering the adoption of digital technologies, such as through expanding access to training and advisory services, can boost productivity. Maintaining the government's commitment to fiscal prudence should help reassure financial markets and limit increases in borrowing costs as euro-area monetary policy normalises. A clear and credible medium-term fiscal consolidation strategy would further help support external credibility.

Romania

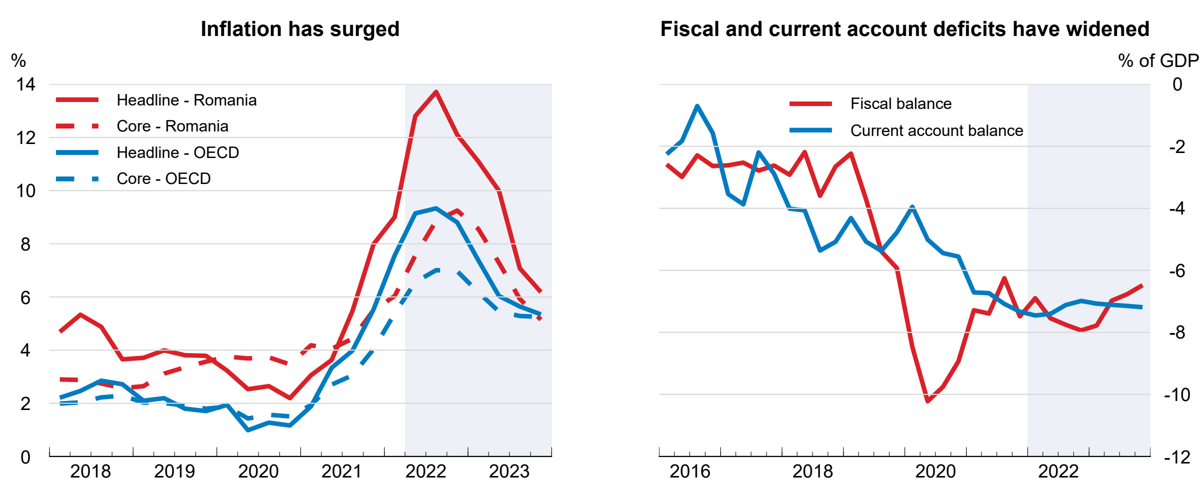
Following a 5.9% rebound in 2021, GDP growth is projected to decelerate to 3.1% in 2022 and 2.6% in 2023 due to high uncertainty, commodity prices and supply shortages. Domestic demand will remain the main growth driver supported by the absorption of EU funds and a resilient labour market. By contrast, the trade deficit is set to remain large, contributing to relatively high risk premia in financial markets. Inflation is expected to reach 11.9% in 2022 and 8.5% in 2023, despite tightening monetary policy and a cap on electricity and gas prices.

Monetary policy should ensure inflation expectations remain anchored. Fiscal support should target the most vulnerable households and firms, as fiscal space is limited. If the recovery resumes as projected from end-2022, fiscal consolidation should start in 2023. Expanding the tax base will be key, as room to reduce public spending is low. Greening the energy mix and achieving energy savings, notably in housing, is a priority for sustainable growth.

Growth has lost momentum

The declining incidence of COVID-19 cases after a peak in early February and the lift of containment measures has supported domestic demand. Business confidence has remained robust, but supply chain disruptions and soaring energy and food prices exacerbated by the war in Ukraine have damped activity, especially in manufacturing, transport, and agriculture. Double-digit inflation has become increasingly broad-based, but wage pressures have remained limited so far. While labour shortages have worsened in some sectors, the unemployment rate has stabilised above its 2019 level.

Romania



Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/q3nswa

Romania: Demand, output and prices

Romania	2018	2019	2020	2021	2022	2023
	Current prices RON billion	Percentage changes, volume (2010 prices)				
GDP at market prices	951.7	4.2	-3.7	5.9	3.1	2.6
Private consumption	607.3	3.9	-5.1	7.9	2.2	2.1
Government consumption	160.1	7.3	1.8	0.4	1.2	1.7
Gross fixed capital formation	200.4	12.9	4.1	2.3	2.4	7.1
Final domestic demand	967.8	6.4	-1.7	5.3	2.3	3.2
Stockbuilding[1]	16.4	-0.6	-0.7	1.3	-0.3	-0.2
Total domestic demand	984.2	5.6	-2.4	6.8	3.0	2.9
Exports of goods and services	398.4	5.4	-9.4	12.5	4.9	3.9
Imports of goods and services	430.9	8.6	-5.2	14.6	4.6	4.3
Net exports[1]	- 32.5	-1.6	-1.5	-1.4	-0.1	-0.4
Memorandum items						
GDP deflator	_	6.8	3.9	5.4	7.9	8.1
Consumer price index	_	3.8	2.6	5.0	11.9	8.5
Core consumer price index[2]	_	3.2	3.7	4.5	7.9	6.7
Unemployment rate (% of labour force)	_	4.9	6.1	5.6	5.8	5.7
General government financial balance (% of GDP)	_	-4.3	-9.3	-7.1	-7.5	-7.0
General government gross debt (% of GDP)	_	44.5	59.2	57.3	61.7	65.1
General government debt, Maastricht definition[3] (% of GDP)	_	35.3	47.2	48.8	53.2	56.6
Current account balance (% of GDP)	_	-4.9	-5.0	-7.0	-7.2	-7.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/5gofbe

Direct trade and financial links to Russia and Ukraine are limited. Around 70% of energy demand is covered by domestic production. However, spillovers from the war, including through supply shortages (such as components imported from Ukraine in the automotive sector), have hit activity. In addition, reliance on Russia for energy imports, especially of crude oil, is high. Romania has received one of the largest inflows of Ukrainian refugees in Europe. The impact on the labour market should be limited as most of them are expected to leave the country. Only around 4 300 (0.5%) have asked for asylum in the country as of early May. Sovereign bond spreads have widened, reaching their highest level since the global financial crisis, signalling significant rises in risk premia.

Policies will remain accommodative

In response to inflationary pressures and tightening monetary policies in the region, the central bank is set to continue raising its policy rate from 3.75% to 6% by the end of 2022. The fiscal deficit is projected to widen in 2022, due to slowing activity, additional spending on defence and temporary measures to cushion the adverse effects of the war in Ukraine. A cap on electricity and gas prices is in place until March 2023 to shield consumers' purchasing power. Support measures, amounting to around 1.5% of GDP, also include vouchers for low-income households and grants for most affected sectors. Public investment financed with EU funds will pick up at the end of 2022. The implementation of the Next Generation EU Plan is expected to be delayed, with only around 20% of the total allocation absorbed by 2023. Fiscal consolidation will start slowly in 2023, as support measures are phased out.

Inflationary pressures will continue to weigh on growth

After a strong rebound in the first quarter, GDP growth is expected to decelerate to 3.1% in 2022, and 2.6% in 2023. Slowing activity in Europe and high uncertainty will weigh on exports, business investment and job creation. The absence of major tensions on the labour market will keep wage growth moderate. Households’ purchasing power will decline, holding back consumption. Inflation is projected to remain well above the upper bound of the central bank target, due to the end of the capping scheme on electricity and gas and the EU embargo on Russian oil imports in 2023. The main risks to the recovery relate to stronger and persistent increases in commodity prices and to possible disruptions in energy supply that would undermine firms’ capacity to operate and invest. Capital outflows and tightening financing conditions could jeopardise access to credit and reduce fiscal space. Other risks include the emergence of new virus variants that would require restrictions, as Romania is among the EU countries with the lowest vaccination rates. Conversely, the faster use of EU funds would support activity, especially if directed to infrastructure projects.

Targeted policies can support sustainable growth

A prudent policy mix will be key to avoiding an inflationary spiral and unsustainable increases in borrowing costs. Fiscal consolidation would help to reduce demand pressures and maintain external credibility. Expanding the tax base, notably by removing special tax regimes and exemptions would improve public finance sustainability and make the tax system more equitable. At the same time, improving the coverage and adequacy of the social assistance system would reinforce support to vulnerable households. The high reliance on fossil fuels calls for accelerating investment in renewable energy sources by extending support to new installations and developing adequate grid infrastructure. Accelerating building refurbishment in deprived areas can achieve large efficiency gains and help to reduce energy poverty. Such measures, which can both improve energy security and help to meet decarbonisation targets, require increasing administrative capacity to absorb EU funds.

Slovak Republic

The Slovak economy is projected to grow by 2.3% in 2022 and 3.4% in 2023. High inflation as well as uncertainty due to the war in neighbouring Ukraine will weigh on domestic demand well into 2023. The war is also aggravating industrial supply chain shortages and weakening exports. Growth will partly strengthen in 2023 due to strong EU-funded investment and a gradual upturn in exports. Key downside risks include a prolonged war in Ukraine and disruptions in energy supply, which would have strong adverse effects on growth and inflation.

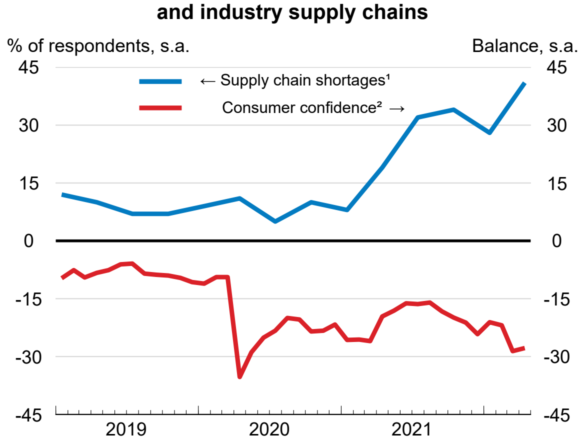
Measures to help vulnerable households cope with high energy and food prices should be temporary and targeted. Accelerating public investment into energy-related projects would reduce the dependence on Russian oil and gas and support the green transition. The recent adoption of public expenditure ceilings will help ensure fiscal sustainability in view of rapid population ageing.

The economy is facing strong headwinds

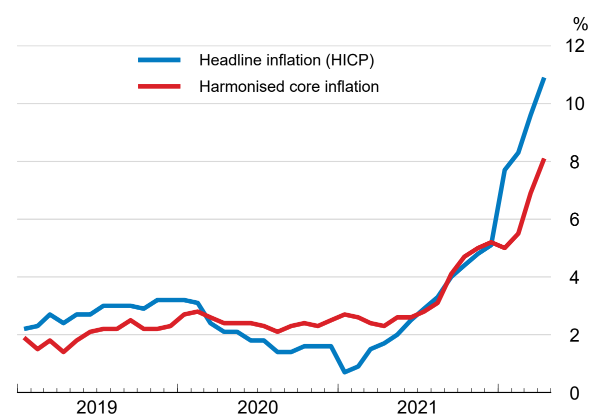
The economic disruptions of the Omicron wave were mild despite surging infection rates, and remaining restrictions were lifted in March. Harmonised consumer price inflation has been increasing for more than a year and stood at 11.8% in May. While food and energy inflation are particularly high, inflationary pressures have become increasingly broad-based, with core inflation at 8.1% in April. Consumer confidence, already declining with increasing inflation, dipped further after the start of the war in Ukraine. Continued supply chain shortages in export industries coupled with strong import price growth turned the annual trade balance negative in March. Monthly registered unemployment has been mostly flat for half a year and remains almost 2 percentage points above the pre-pandemic level.

Slovak Republic

The war in Ukraine weighs on consumer confidence and industry supply chains



Inflation is accelerating



1. Economic Sentiment Indicator, confidence in industry, quarterly questions, factors limiting the production: equipment shortages.
2. Economic Sentiment Indicator, consumer confidence.
Source: Central Bank of the Slovak Republic; European Commission; and OECD Main Economic Indicators database.

StatLink https://stat.link/qygsc2

Slovak Republic: Demand, output and prices

Slovak Republic	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	89.4	2.6	-4.4	3.0	2.3	3.4
Private consumption	50.4	2.7	-1.5	1.4	1.7	0.5
Government consumption	16.7	4.6	0.9	1.9	-0.2	0.1
Gross fixed capital formation	18.8	6.7	-11.6	0.6	13.9	15.0
Final domestic demand	85.9	3.9	-3.2	1.3	3.6	3.5
Stockbuilding[1]	2.0	0.0	-2.2	2.4	-0.6	0.0
Total domestic demand	87.8	3.9	-5.1	3.8	2.9	3.4
Exports of goods and services	86.0	0.8	-7.4	10.2	1.0	4.3
Imports of goods and services	84.5	2.1	-8.4	11.1	1.7	4.3
Net exports[1]	1.6	-1.2	0.9	-0.6	-0.6	-0.2
Memorandum items						
GDP deflator	_	2.5	2.4	2.4	7.9	8.4
Harmonised index of consumer prices	_	2.8	2.0	2.8	10.8	10.1
Harmonised index of core inflation[2]	_	2.0	2.4	3.3	7.1	7.3
Unemployment rate (% of labour force)	_	5.8	6.7	6.8	6.7	6.4
Household saving ratio, net (% of disposable income)	_	4.1	5.1	5.4	3.4	2.4
General government financial balance (% of GDP)	_	-1.3	-5.5	-6.2	-4.5	-2.4
General government gross debt (% of GDP)	_	63.4	79.3	81.7	81.3	78.2
General government debt, Maastricht definition[3] (% of GDP)	_	48.1	59.7	63.1	62.7	59.6
Current account balance (% of GDP)	_	-3.4	0.1	-2.0	-4.7	-4.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/sporbg

The war has reinforced pre-existing headwinds. Industrial production contracted already in February. At least two car plants had to temporarily suspend production in March and April due to shortages in components from Ukraine in addition to continued disruptions in global semi-conductor supply chains. The Slovak Republic is highly dependent on Russian supply for oil and gas, with the main pipelines for both commodities coming from Russia via Ukraine. Around 78 000 refugees from Ukraine (equivalent to 1.5% of the Slovak population) have applied for temporary protection status in the Slovak Republic, and about 10% have become employed, as of late May 2022. The influx of refugees temporarily increased accommodation revenues especially in eastern regions. A majority of refugees are children and women.

Fiscal measures are being taken in response to the war and the increase in the cost of living

A nominal freeze of household electricity prices until 2024 was negotiated with the main utility provider. Parliament approved a package to mitigate the increase in costs of living with estimated fiscal costs of around 0.3% of GDP in 2022 and 1% of GDP in 2023. While some (0.1% of GDP) are targeted one-off payments, the bulk of the package consists of permanent increases in family benefits, such as child benefits and child tax credits. Pandemic measures are being phased out further in 2022. The projections assume a mildly restrictive fiscal stance in 2022 and, in line with the latest stability programme, that structural consolidation gathers pace in 2023. Costs associated with hosting refugees (0.4% of GDP) are largely covered by the European Commission. Funds from the EU Recovery and Resilience Facility of about 1.4% of GDP per year over 2022-25 will boost public investment. In addition, Slovakia has until end-2023 to draw on its remaining 2014-2020 EU cohesion policy funds, of which around half (worth about 7% of GDP) are still unused.

The war weighs on the recovery

Growth is projected to slow in 2022, as the war in Ukraine adds to already high inflation through higher energy and food prices, weighing on household disposable income and private consumption. Export growth will slow, due to weaker external demand and intensified supply-chain disruptions in export-intensive manufacturing industries, especially the automotive sector. Growth will strengthen in 2023 mainly due to strong investment, driven by the absorption of EU funds. Inflation will stay in double-digits throughout 2022 and will recede only slightly in 2023, as external price pressures wane but delayed pass-through of the current high energy prices to regulated heating and gas prices keeps inflation high. The main downside risk is a prolonged war in Ukraine, which would jeopardise the gradual recovery of consumption and exports in 2023. While oil imports from Russia are currently exempt from the EU embargo, disruptions in Russian oil and gas supply would lead to energy shortages. Moreover, the Slovak Republic is vulnerable to future waves of COVID-19 given the low vaccination rate of its population. A prolonged shutdown in China could also intensify supply disruptions. On the upside, a stronger integration of Ukrainian refugees into the labour market would lead to higher growth.

Fiscal support should be targeted on vulnerable households and investments to support the green transition

Fiscal support for households should be better targeted to the most vulnerable households, to avoid adding to existing price pressures. Most of the recently approved measures are permanent and need to be sustainably financed to avoid jeopardising long-term fiscal sustainability. Labour market integration of Ukrainian refugees who are willing and able to work should be facilitated, for example by offering language training and childcare. The recovery plan allocates substantial investments for the energy transition, enhancing energy security and reducing carbon intensity. Investment in these areas should be accelerated. Strengthening the governance of public investment and procurement would help accelerate Slovakia’s chronically slow absorption of EU funds and support the timely implementation of investment projects. Structural reforms to training and other active labour market policies would support labour reallocation during the green transition.

Slovenia

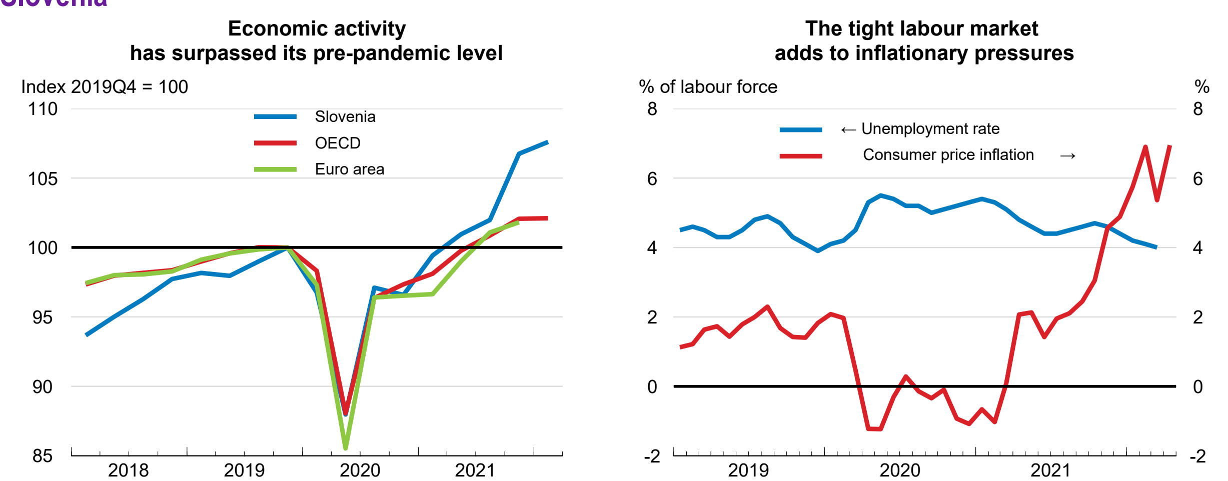
GDP growth is projected to moderate to 4.6% in 2022 and 2.5% in 2023, in part reflecting the negative impact from the war in Ukraine. Domestic demand will be the main growth driver. The labour market is expected to remain tight, with historically high employment and low unemployment rates continuing to put pressure on wages. Together with high and rising fuel and food prices, this will lead to higher headline inflation. A major risk is that stronger wage growth could further raise inflation expectations and lead to a wage-price spiral.

Fiscal policy is expected to tighten moderately in 2022. Temporary subsidies and tax measures aim to mitigate the effects of increasing electricity prices for most affected households. Additional support to households should be financed by spending cuts as the current fiscal stance risks prolonging inflationary pressures. Moreover, making the tax system more growth-friendly by further reducing labour taxes, financed by higher consumption and property taxes, could address labour shortages and raise potential growth.

The recovery is facing headwinds

Until the outbreak of the war in Ukraine, the economy had experienced a strong recovery, raising economic activity above its pre-pandemic level by mid-2021. The recovery benefitted from strong private consumption, reflecting fiscal support to households such as pandemic-related wage bonuses in the public sector and the government's short-time work and furlough schemes. Unemployment returned to pre-pandemic levels and the employment rate reached a historic high in early 2022. Headline inflation has increased since mid-2021 and reached a 20-year high of 8.7% in May 2022. In addition to international factors such as supply-side disruptions and the energy crisis, domestic price pressures have been rising sharply since mid-2021. As a result, inflation has become broad-based, reflected in core inflation of 5.3% in April. The war in Ukraine has further added to inflationary pressures through higher food and energy prices. Nonetheless, industrial production and retail sales continued to grow month-on-month in March. Fuel price increases were moderated by a temporary cut to excise duties for fuel, heating oil and gas and the waiving of network fees from February, and the introduction of a temporary fuel price cap from mid-March.

Slovenia



Source: OECD Economic Outlook 111 database; OECD Labour Statistics database; OECD Main Economic Indicators database; and OECD calculations.

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Slovenia: Demand, output and prices

Slovenia	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	45.9	3.3	-4.2	8.1	4.6	2.5
Private consumption	23.9	4.8	-6.6	11.6	10.5	2.1
Government consumption	8.4	2.0	4.2	3.9	2.2	1.1
Gross fixed capital formation	8.8	5.5	-8.2	12.3	11.8	4.3
Final domestic demand	41.1	4.4	-4.7	10.0	9.0	2.4
Stockbuilding[1]	0.9	-0.9	0.1	0.8	0.0	0.0
Total domestic demand	42.0	3.3	-4.6	10.8	7.0	2.4
Exports of goods and services	38.9	4.5	-8.7	13.2	5.4	3.4
Imports of goods and services	35.0	4.7	-9.6	17.4	10.5	3.3
Net exports[1]	3.9	0.3	-0.1	-1.6	-3.7	0.2
Memorandum items						
GDP deflator	_	2.2	1.2	2.6	5.4	6.0
Harmonised index of consumer prices	_	1.7	-0.3	2.0	7.6	6.0
Harmonised index of core inflation[2]	_	1.9	0.8	0.9	6.4	5.2
Unemployment rate (% of labour force)	_	4.4	5.0	4.8	3.9	3.7
Household saving ratio, net (% of disposable income)	_	6.5	16.3	11.0	5.2	7.2
General government financial balance (% of GDP)	_	0.4	-7.8	-5.2	-3.7	-3.6
General government gross debt (% of GDP)	_	86.6	109.7	94.6	93.0	92.8
General government debt, Maastricht definition[3] (% of GDP)	_	65.6	79.8	74.7	73.5	73.3
Current account balance (% of GDP)	_	6.0	7.4	3.3	-1.5	-1.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/pxnlao

The war in Ukraine is a key source of uncertainty. Direct trade with Russia and Ukraine is low, although nearly all gas and 13% of oil and petroleum imports, or about 18% of total energy use, come from Russia. Higher energy prices and disruptions to supply chains are already weighing on consumer and business confidence. To ensure gas supplies in event of a Russian gas embargo, the government is in contact with other foreign suppliers and is taking steps to secure LNG capacity in other countries. The war in Ukraine has also led to an inflow of about 18 000 Ukrainian refugees in Slovenia by early May 2022.

Fiscal policy has been supportive

The fiscal stance remained expansionary in early 2022. This reflected larger pension benefits due to higher pension indexation and replacement rates. Additional temporary public transfers included subsidies to households and businesses to mitigate the effects of increasing energy prices. These measures are expected to contribute to an expected budget deficit of 3.7% of GDP in 2022, implying a fiscal consolidation of about ½ per cent of GDP. Additional money from the Recovery and Resilience Facility funds will finance investment in the green and digitalisation transformations, boosting the inflow of total EU funds to an average of 2.2% per year over 2021-26. The fiscal stance has added to demand pressures at a time when monetary conditions are very accommodative in Slovenia.

Growth will be driven by domestic demand

GDP growth is projected to moderate, in part reflecting the negative impact from the war in Ukraine. The conflict will add to the already high inflation through higher energy and food prices, putting pressure on private consumption and investment. Nonetheless, economic activity will continue to expand, with the output gap projected to close in 2022. Economic growth will mostly be driven by private demand. Private consumption will benefit from real income increases due to a tight labour market. Investment will continue to expand, supported by inflows of EU funds. The labour market is expected to remain tight, with historically high employment and low unemployment rates continuing to put pressure on wages. Together with high and rising fuel and food prices, this will lead to high headline and core inflation in both 2022 and 2023. One major downside risk is stronger-than-expected wage growth, which together with high food and energy prices could fuel rising inflation expectations. Another important risk is an embargo on Russian gas supply. On the upside, a faster mobilisation of underutilised labour resources, as reflected in the low labour force participation of people older than 60, and increased immigration could help to reduce wage pressures.

Fiscal policy needs to manage demand pressures

A faster fiscal consolidation is needed to reduce demand pressures. Additional support for the households most affected by the energy crisis should be financed by cuts to other government spending. Such efforts should be implemented alongside structural reforms to raise potential growth and prepare public finances for the fiscal challenges associated with population ageing. This includes a growth-friendly tax reform with lower labour taxes, financed by higher consumption and property taxation, as well as measures to promote later retirement and longer working lives.

South Africa

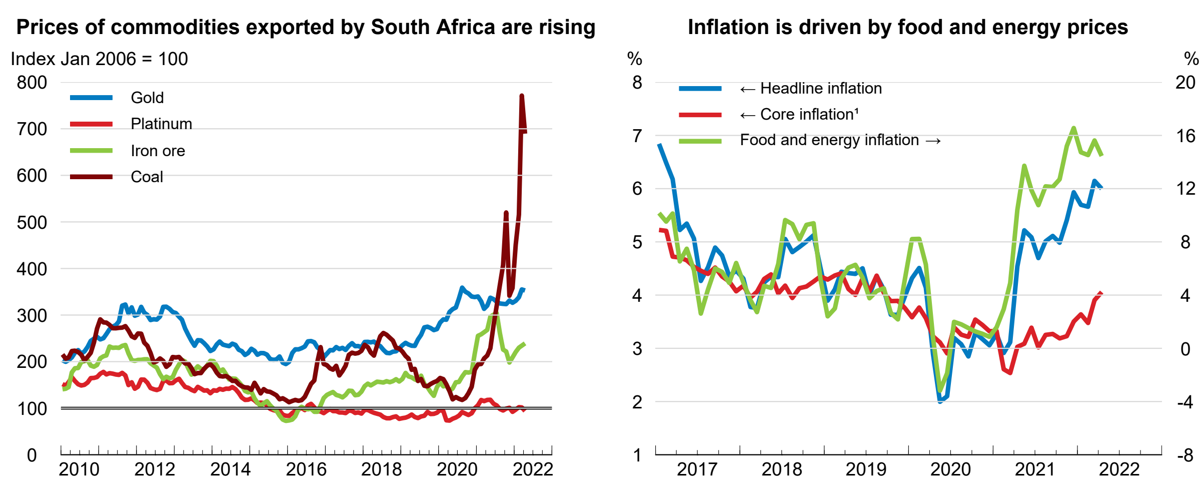
After a strong rebound in 2021, GDP is projected to grow by 1.8% and 1.3% in 2022 and 2023 respectively. Household consumption and investment will remain the main drivers of growth. Household income will benefit from the continuation of the COVID-relief grant. The commodity prices boom will support exports. Investment will continue to strengthen over the projection horizon. Inflation reached close to 6% in early 2022, and is projected to increase further due to higher energy prices before starting to fall.

The budget situation has improved, underpinned by the government revenue recovery and commodity price windfalls. Nonetheless, the government should maintain a solid consolidation policy to put debt on a more sustainable path and target spending increases on lifting potential growth and preserving social stability. In particular, spending on electricity generation, infrastructure and social grants remains essential. Further interest rate rises may be required to prevent inflation drifting away from the target band.

The recovery is under way but risks are on the downside

Quarterly sub-indicators point to a relatively strong growth in the first quarter of 2022. Manufacturing production rose by 4.6% in the first quarter of 2022. Retail trade sales remained robust, growing by 1.9% quarter-on-quarter. Electricity generation increased by 2% in the first quarter of 2022 contributing slightly to improving production conditions. Mining is expected to subtract from GDP in the first quarter of 2022, following a contraction in production of 1.5% quarter-on-quarter. Headline inflation reached 5.9% in March and April, well above the Reserve Bank midpoint objective in the target band of 3-6%.

South Africa



1. Core inflation excludes energy and food products.
Source: OECD Database on Consumer Price Indices; Refinitiv; Statistics South Africa; and OECD calculations.

StatLink https://stat.link/nqjeba

South Africa: Demand, output and prices

South Africa	2018	2019	2020	2021	2022	2023
	Current prices ZAR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	5 357.6	0.1	-6.4	4.9	1.8	1.3
Private consumption	3 408.4	1.1	-6.5	5.7	2.8	1.9
Government consumption	1 037.9	2.7	1.3	0.0	0.5	1.1
Gross fixed capital formation	849.2	-2.4	-14.9	2.0	5.0	6.0
Final domestic demand	5 295.5	0.8	-6.2	4.0	2.6	2.3
Stockbuilding[1]	37.0	0.4	-1.7	0.7	-0.2	0.0
Total domestic demand	5 332.5	1.2	-8.0	4.8	2.4	2.3
Exports of goods and services	1 472.7	-3.4	-12.0	9.9	6.3	3.1
Imports of goods and services	1 447.6	0.5	-17.4	9.4	8.6	6.6
Net exports[1]	25.2	-1.1	1.8	0.1	-0.6	-1.0
Memorandum items						
GDP deflator	_	4.5	5.3	7.1	4.8	4.0
Consumer price index	_	4.1	3.3	4.6	6.0	5.8
Core inflation index[2]	_	4.1	3.4	3.1	4.2	5.6
General government financial balance (% of GDP)	_	-5.7	-11.6	-6.4	-5.2	-4.3
Current account balance (% of GDP)	_	-2.6	2.0	3.7	2.8	1.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/fg5ah3

South Africa has a low direct exposure to Russia and Ukraine, trading less than 1% of its total exports and imports with these countries. Nonetheless, food prices are rising at 6.6% in March and 6.3% in April, outstripping headline inflation. In addition to the war and logistical bottlenecks, the recent flooding in KwaZulu-Natal may lead to further increases in food prices. Exports will benefit from rising prices for commodities exported by South Africa.

The fiscal and monetary policy mix remains accommodative

Inflation is at the upper limit of the target band, but the relatively strong currency is helping cushion the transmission of external pressures to domestic prices. In this context, the central bank should be ready to raise interest rates again to prevent inflation from drifting away from the target band. The key policy rate is expected to rise to 5.75% by the end of the year and to 6% by mid-2023 before declining gradually thereafter. The fiscal stance is still accommodative, as windfall commodity revenues have allowed the government to maintain a high level of spending while reducing the deficit. In particular, the COVID-relief grant covering 10 million beneficiaries is now prolonged until March 2023. Fiscal policy should become more targeted, with support focused on vulnerable households particularly exposed to food price increases and firms in sectors affected by lingering effects of the pandemic and the war. To cushion the impact of higher energy prices on households and companies, the government introduced a reduction in the general fuel levy for two months, starting in April. The reduction is being renewed for another two months but it will be halved for the last month.

Growth prospects have improved

GDP growth is projected to reach 1.8% and 1.3% in 2022 and 2023 respectively. Growth will remain supported by household consumption, investment and commodity exports. Household incomes and consumption will be boosted by government social transfers and higher wages. Private investment will continue to rise as electricity generation improves, given the need for capital replacement. The war in Ukraine has pushed up commodity prices, prolonging the commodity boom cycle for longer than expected. Consequently, inflation, driven by energy and food prices, is projected above the upper limit of the target band in 2022 and only start to start declining by the end of 2023. Core inflation will rise in 2022 and 2023, as second-round effects from higher headline inflation spread in the economy. Domestic near-term risks to growth include increased rolling blackouts by the power utility and renewed mobility and gathering restrictions due to a new wave of COVID-19, as only around 50% of the adult population is vaccinated. Also, if global prices do not decline as assumed in 2023, inflation would remain around the upper limit of the target band, delaying the reduction of policy rates and lowering GDP growth. On the upside, if the recovery in the tourism sector continues, it will provide additional support to household consumption.

Boosting infrastructure investment is key for productivity growth

In the short term, boosting electricity generation remains key to improving production conditions for firms. To help cushion the impact of rising energy prices, administrative bottlenecks delaying the implementation of the decision to allow private companies to self-generate up to 100 MW should be lifted rapidly, and the purchase of renewable energy from independent power producers accelerated. Reviving productivity growth is essential to lift living standards. Key measures include improving transport infrastructure, fostering the quality and affordability of telecommunication networks, broadening access to higher education and reducing competition barriers. More fiscal space is needed to finance these spending needs. Increasing government tax revenues and improving public spending efficiency through better procurement and contracting would increase fiscal space.

Spain

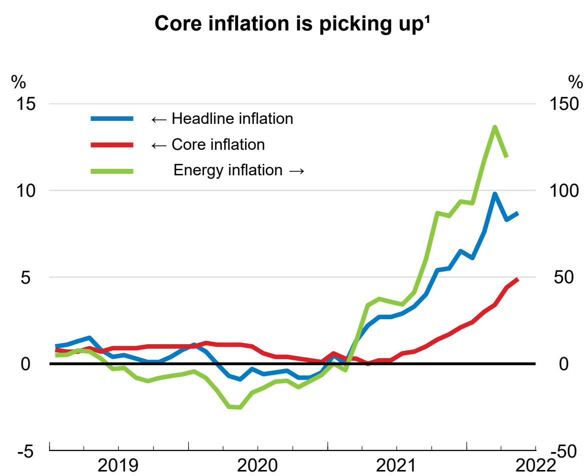
Growth is set to slow to 4.1% in 2022 and 2.2% in 2023 due to heightened uncertainty, high inflation and slower external demand. Household savings accumulated during the pandemic, the fiscal package to mitigate the effects of the war, continued recovery in employment and the Next Generation EU funds will support domestic demand. The ongoing recovery in tourism will also support growth. Headline inflation will moderate in 2023, but remain high.

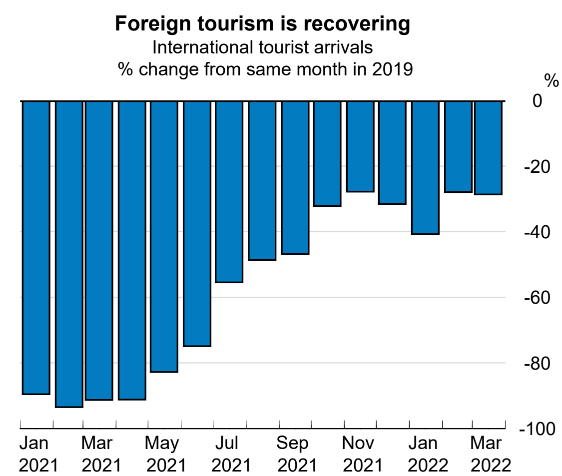
Fiscal policy, which is set to remain supportive in 2022-23, should balance gradual fiscal tightening with well-targeted and temporary support to protect vulnerable households and firms from high inflation. Steps to lower greenhouse gas emissions in transport and buildings and accelerate reducing dependence on fossil fuels should be continued to meet the ambitious targets for decarbonisation and increase energy security.

Growth has slowed

The Omicron variant, high inflation and the war in Ukraine led to a moderation of GDP growth to 0.3% in the first quarter of 2022, with GDP remaining 3.5% below pre-pandemic levels. After reaching 9.8% in March, headline inflation fell to 8.5% in May, while core inflation increased to 4.9%. Due to the multi-year nature of collective bargaining and the low share of wage indexation clauses, wage growth remains moderate. The wage rate increased by 1.3% over the year to the first quarter of 2022. Consumer and business confidence have deteriorated, and manufacturing and services activity indicators slowed since March. Job creation gained momentum in April and permanent contracts as a share of new contracts have risen from around 10% in 2021 to 48%. The recovery in tourism has picked up, with foreign tourist expenditures in March reaching 84% of those in March 2019.

Spain





1. Data for energy inflation in 2022 and for headline and core inflation in May 2022 are provisional.
Source: Instituto Nacional de Estadística.

StatLink https://stat.link/t7wacg

Spain: Demand, output and prices

Spain	2018	2019	2020	2021	2022	2023
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 203.3	2.1	-10.8	5.1	4.1	2.2
Private consumption	699.5	1.0	-12.0	4.6	0.1	3.2
Government consumption	224.7	2.0	3.3	3.1	1.2	1.3
Gross fixed capital formation	234.0	4.5	-9.5	4.3	7.4	4.7
Final domestic demand	1 158.2	1.9	-8.5	4.2	1.9	3.1
Stockbuilding[1]	12.4	-0.2	-0.5	0.5	0.0	0.0
Total domestic demand	1 170.6	1.6	-8.9	4.8	1.9	3.1
Exports of goods and services	423.1	2.5	-20.1	14.7	13.7	2.5
Imports of goods and services	390.4	1.2	-15.2	13.9	7.5	4.8
Net exports[1]	32.7	0.5	-2.2	0.5	2.3	-0.9
Memorandum items						
GDP deflator	_	1.3	1.1	2.2	3.9	4.6
Harmonised index of consumer prices	_	0.8	-0.3	3.0	8.1	4.8
Harmonised index of core inflation[2]	_	1.1	0.5	0.6	4.5	4.5
Unemployment rate (% of labour force)	_	14.1	15.5	14.8	13.6	13.9
Household saving ratio, net (% of disposable income)	_	4.2	10.8	7.0	6.4	5.5
General government financial balance (% of GDP)	_	-3.1	-10.3	-6.9	-5.0	-4.2
General government gross debt (% of GDP)	_	117.7	147.6	146.3	143.3	140.8
General government debt, Maastricht definition[3] (% of GDP)	_	98.3	120.0	118.6	115.6	113.1
Current account balance (% of GDP)	_	2.1	0.8	0.9	1.0	0.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/i0689p

The war in Ukraine is affecting the Spanish economy via increased energy prices, disruptions in production chains and higher uncertainty, as direct trade and financial exposures to Russia and Ukraine are limited. Lower confidence and real disposable incomes led to a decline in private consumption in the first quarter of 2022. The agreement with Brussels to limit the price of gas entering the electricity market in the Iberian peninsula, expected to come into effect in June, can help contain headline inflation. At the end of May, 59 000 Ukrainian refugees had been processed by the authorities.

Fiscal policy remains supportive

Fiscal policy is set to remain accommodative in 2022-23. Due to strong revenue growth and the phasing-out of COVID-19-related spending, the budget deficit narrowed to 6.9% of GDP in 2021 and is projected to be 4.2% of GDP by 2023. To counter the negative impact of the war, the government approved a plan in March that included a subsidy on fuel retail sales, the extension of existing energy tax rebates, direct aid to the transport sector and electricity-intensive industries, a refugee reception programme, and a new credit line for vulnerable firms (EUR 10 billion, 0.6% of GDP). The direct support measures to soften the impact of higher energy costs (EUR 6 billion, 0.4% of GDP), due to expire in June, are expected to be extended until September. The introduction of the mechanism to offset the loss of pension purchasing power will support household incomes, but also increase public spending in the projection period. The execution of Next Generation EU funds has picked up in the first quarter of 2022, and is expected to be frontloaded in 2022-2023.

The pace of growth will moderate

GDP is projected to expand by 4.1% in 2022 and 2.2% in 2023. High inflation and uncertainty will lower household spending. Supply bottlenecks in semiconductors will also constrain private investment and merchandise exports. The adverse effects of the war will partly be mitigated by the boost provided by the March fiscal package, the rollout of the Next Generation EU investment projects, lower uncertainty surrounding the pandemic and the recovery of tourism. Inflation is projected to moderate in 2023, helped by continued slack in labour markets, and assuming moderate pass-through of inflation to wages, but will remain high due to the impact of the EU oil embargo on Russia. There is a risk that higher inflation could become entrenched if there are further energy market disruptions or greater pass-through to final prices and wages. Escalation of the war in Ukraine or further COVID-19 outbreaks create downside risks to growth, while a higher-than-assumed use of EU funds and their impact on economic activity could boost growth further.

Reforms and investments to promote the green transition are crucial

Fiscal support to address the near-term effects of the energy shock on vulnerable households and firms should be well targeted and temporary. A medium-term consolidation strategy based on spending reviews is needed to start lowering the fiscal deficit and public debt-to-GDP ratio gradually. The share of wage agreements with indexation clauses remains moderate, but is rising, highlighting the importance of an agreement of social partners to burden share and prevent a wage-price spiral. Increasing certainty for investment, cooperating closely with European partners to increase interconnectivity with the rest of Europe, and improving energy efficiency are key to ensure energy security and promote the green transition. The ambitious climate targets will require a predictable, long-term regulatory framework, sufficient incentives to mobilise private investment, and improved storage, demand-side management and digitalisation to use renewable energies effectively. Ensuring timely and effective implementation of the recovery plan can support the digital and green transition and boost productivity growth.

Sweden

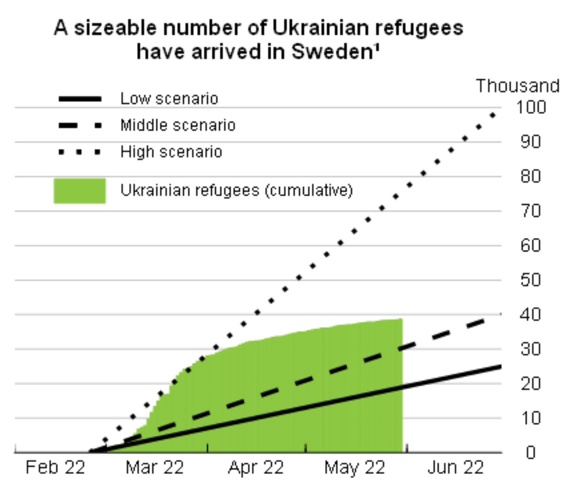
Growth is set to slow to 2.2% this year and 1% in 2023. Heightened global uncertainty will weigh on business investment and exports. Household consumption is backed by a strong labour market, high savings and fiscal support, but will slow as higher inflation and interest rates start to bite. The unemployment rate will continue to fall this year but will level off in 2023, as skills in high demand become increasingly scarce.

Inflation has taken off, fuelled by lingering supply chain disruptions and soaring commodity prices. Monetary policy should aim to keep expectations anchored. Fiscal policy remains expansionary this year, and additional spending may be needed in the future to accommodate Ukrainian refugees and boost defence. Investment in energy infrastructure will be needed to support ongoing electrification and enhance energy security.

Growth is slowing amid increasing uncertainties

The level of GDP was 4% above its pre-pandemic peak by the fourth quarter of 2021, but declined in the first quarter of 2022. Household consumption edged down in March and consumer confidence has plummeted, reaching the lowest level since 2008. In contrast, business sentiment remains relatively upbeat. Unemployment is almost back at pre-pandemic levels and will continue to decrease, albeit at a slower pace, as an increasing share of jobseekers lack the skills demanded by employers. Inflation rose to 6.4% in April, the highest rate in three decades, and is broadening beyond energy prices, with food and services prices shooting up.

Sweden



1. Scenarios published by the Migration Agency on 27 April. The original scenarios run to the end of 2022. The truncated scenarios shown here assume that half of the number for the whole year is reached by the end of June.
Source: Statistics Sweden; and the Swedish National Mediation Office; Migration Agency.

StatLink https://stat.link/b9swtf

Sweden: Demand, output and prices

Sweden	2018	2019	2020	2021	2022	2023
	Current prices SEK billion	Percentage changes, volume (2021 prices)				
GDP at market prices	4 830.1	2.0	-2.3	4.9	2.2	1.0
Private consumption	2 205.5	0.7	-3.2	6.1	3.2	0.5
Government consumption	1 258.1	0.3	-2.0	2.6	1.6	1.6
Gross fixed capital formation	1 217.5	-0.3	1.5	5.9	1.9	1.8
Final domestic demand	4 681.1	0.3	-1.7	5.1	2.4	1.1
Stockbuilding[1]	40.4	-0.1	-0.7	0.4	0.0	0.0
Total domestic demand	4 721.5	0.2	-2.4	5.5	2.5	1.1
Exports of goods and services	2 209.7	6.1	-5.8	7.6	4.8	1.9
Imports of goods and services	2 101.1	2.2	-6.4	9.3	5.7	2.2
Net exports[1]	108.7	1.8	0.0	-0.4	-0.2	0.0
Memorandum items						
GDP deflator	_	2.5	2.0	3.1	6.0	4.4
Consumer price index[2]	_	1.8	0.5	2.2	6.5	5.4
Core inflation index[3]	_	1.7	0.5	2.4	6.1	3.9
Unemployment rate (% of labour force)	_	7.0	8.5	8.8	7.4	7.4
Household saving ratio, net (% of disposable income)	_	15.7	17.0	15.4	12.0	10.3
General government financial balance (% of GDP)	_	0.6	-2.6	-0.2	0.0	-0.1
General government debt, Maastricht definition[4] (% of GDP)	_	34.9	39.3	36.3	33.0	31.0
Current account balance (% of GDP)	_	5.5	6.0	5.4	5.5	5.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Consumer price index with fixed interest rates.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/9c21pa

The direct economic consequences of the war in Ukraine have so far been small, as trade with Ukraine and Russia is limited and financial exposure to Russia low. Sweden has been hit by higher prices of energy and other commodities and is set to suffer from lower growth in important trading partners, notably Germany. As of late May, close to 39 000 Ukrainian refugees (0.37% of the population) had arrived in Sweden but the number could grow considerably, depending on the course of the war. The government is compensating car owners for mounting fuel prices, and has set aside an extra SEK 10 billion (0.2% of GDP) to accommodate Ukrainian refugees.

Fiscal policy remains supportive but monetary policy has begun to normalise

In response to surging energy prices and the deteriorating security situation, the government has proposed to add discretionary spending amounting to 1.2% of GDP to an already expansionary budget. Public spending is set to remain high by pre-pandemic comparison, as Ukrainian refugees need accommodation, and the government has vowed to expand defence spending from today's 1.3% of GDP to 2% over the coming years, against the backdrop of Sweden's application to NATO. Moreover, energy infrastructure is being strengthened to support decarbonisation and enhance energy security. Tax revenues have surprised on the upside and are expected to remain strong with an improved labour market and the phasing out of pandemic-related support measures. Fiscal policy will remain supportive despite tightening somewhat in 2023. The Riksbank has started to normalise monetary policy, raising the repo rate from 0 to 0.25% and tapering asset purchases, in an attempt to curb soaring inflation expectations before the upcoming central wage negotiations. The Riksbank is expected to raise the repo rate three times in 2022, by a cumulative 100 basis points, and by a further 0.5 percentage point in 2023.

Growth will edge down as inflation lingers

Growth will abate, albeit from a high pace, to 2.2% this year and 1% in 2023. Households will react to declining purchasing power and rising interest rates by reducing spending growth. Public consumption and investment will continue to support the economy, but strong tax revenues are bolstering the public finances and the public debt-to-GDP ratio is likely to fall below its pre-pandemic level in 2022. Inflation will remain high throughout the projection period, as increasing commodity and energy prices are gradually passed on to customers. Elevated energy prices could de-anchor inflation expectations, resulting in greater wage pressures and more entrenched inflation. Rising interest rates will quickly increase households' debt servicing costs on floating-rate mortgages. There is a risk that this could trigger a house price correction, with consumption easing further. Firms indicate that lack of material and equipment, not demand, continues to be the main factor constraining industrial production. A quick easing of supply bottlenecks would improve growth prospects.

Labour market and energy infrastructure challenges remain

The labour market suffers from structural problems, as manifested in a still relatively high unemployment rate. Improving activation policies and raising the skills of the long-term unemployed and inactive individuals should remain top policy priorities. The government has taken welcome first steps to prevent tax avoidance, the exploitation of low-skilled foreign labour, and welfare fraud in low-skill segments of the labour market. The government should follow through to ensure that resident low-skilled workers compete on a level playing field. Investments in existing energy infrastructure as well as in new, plannable energy sources will be needed to facilitate the green transition and reduce reliance on energy imports.

Switzerland

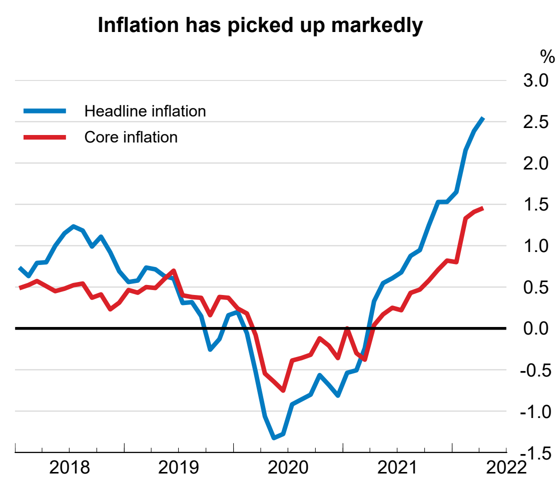
GDP is projected to grow by 2.5% in 2022 and 1.3% in 2023. Slower demand due to the war in Ukraine will moderate the growth of exports and investment. Continued improvements in the labour market and a reduction of the high savings rate will underpin consumption. Rising prices of energy and goods affected by supply bottlenecks will be a headwind to growth and push headline inflation above the Swiss central bank's target range to 2.5% in 2022, before slowing to 1.8% in 2023.

The monetary policy stance is appropriate as long-term inflation expectations remain anchored and safe-haven inflows support the Swiss franc. Strengthening of macroprudential policy should continue. Fiscal consolidation should proceed, but targeted measures to tackle the influx of refugees are warranted. Structural reforms should accelerate to foster labour market integration, remove barriers to competition, improve environmental sustainability and enhance energy security.

Growth has slowed

Real GDP exceeded pre-pandemic levels by the third quarter of 2021 and growth has continued, albeit at a slower pace. Consumer confidence dropped significantly in April, while the manufacturing PMI remains elevated and capacity utilisation is high. The labour market has continued to improve, as the number of unemployed workers has fallen and the number of vacancies increased. After more than a decade of low inflation, headline inflation rose to 2.5% in April 2022, driven primarily by higher energy prices and imported goods affected by supply bottlenecks. Core inflation also rose to 1.5% in April, although services inflation slowed to 1.2%. Medium-term inflation expectations are around 1.6%, within the target-range of the Swiss central bank.

Switzerland



1. GDP adjusted for the effects of major international sporting events as such events can have a sizable impact on Swiss GDP but do not occur every year complicating business cycle analysis.
Source: Secrétariat d'État à l'économie (SECO); and Refinitiv.

StatLink https://stat.link/gnxu1w

Switzerland: Demand, output and prices

Switzerland	2018	2019	2020	2021	2022	2023
	Current prices CHF billion	Percentage changes, volume (2015 prices)				
GDP at market prices	719.7	1.2	-2.5	3.7	2.5	1.3
Private consumption	372.2	1.4	-3.7	2.6	3.1	0.8
Government consumption	79.9	0.7	3.5	4.0	2.7	0.8
Gross fixed capital formation	184.0	0.6	-1.7	3.4	0.2	1.1
Final domestic demand	636.1	1.0	-2.3	3.0	2.2	0.9
Stockbuilding[1]	- 6.0	0.7	1.3	-3.8	0.7	0.0
Total domestic demand	630.1	1.9	-0.8	-1.2	3.0	0.9
Exports of goods and services	476.6	-0.8	-6.4	12.8	6.0	2.0
Imports of goods and services	387.0	-0.2	-4.4	5.8	7.7	1.6
Net exports[1]	89.6	-0.4	-1.8	4.9	-0.1	0.6
Memorandum items						
GDP deflator	_	-0.1	-0.5	1.4	2.4	1.4
Consumer price index	_	0.4	-0.7	0.6	2.5	1.8
Core inflation index[2]	_	0.4	-0.3	0.3	1.7	1.2
Unemployment rate (% of labour force)	_	4.4	4.8	5.1	4.7	4.6
Household saving ratio, net (% of disposable income)	_	17.4	23.1	21.5	18.7	17.9
General government financial balance (% of GDP)	_	1.3	-2.8	-0.8	0.4	1.2
General government gross debt (% of GDP)	_	39.5	43.1	40.7	41.2	40.6
Current account balance (% of GDP)	_	5.4	2.8	9.3	7.1	7.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/yp7lqo

Switzerland has limited direct economic ties with Russia and Ukraine, but the economy is affected by lower global growth and uncertainty, which have triggered an appreciation of the Swiss franc. Natural gas imports make up 15% of Switzerland's final energy consumption. To safeguard supplies for the next year, the Federal Council has created conditions for the Swiss gas industry to quickly procure additional natural gas, liquefied natural gas (LNG) and storage capabilities. Roughly 51 000 Ukrainian refugees (0.6% of the population) have arrived in Switzerland since the onset of the war. The Swiss government has invoked a special residential status for refugees, which includes access to accommodation, social benefits and medical care.

Monetary policy remains accommodative, but fiscal policy is tightening

The Swiss central bank kept interest rates unchanged at -0.75% at its meeting in March 2022 and remains willing to intervene in the foreign exchange market to stave off unwanted currency appreciation. As core inflation is within the target-band and the Swiss franc faces appreciation pressures, policy interest rates are projected to remain unchanged. However, the Swiss central bank should closely monitor inflation prospects and begin normalising interest rates if warranted. Due to strong momentum in the real estate market, the Federal Council has reactivated the sectoral countercyclical capital buffer, at 2.5% of risk-weighted exposures secured by residential property in Switzerland, effective from September 2022. The government has continued to scale back COVID-19-related fiscal support as the pandemic and economic situation has improved. A fiscal surplus is expected for 2022 with further consolidation in 2023 of 1.2% of GDP.

Growth prospects are damped by the war

Real GDP growth is projected to moderate to 2.5% in 2022 and 1.3% in 2023, reflecting slowing domestic demand and the negative impact on global growth from the war in Ukraine. While lower, manufacturing export growth is projected to remain positive over the projection horizon and should, together with a low cost of capital, raise investment. A progressive reduction of the high household savings rate is projected to support private consumption over the next two years. Higher prices on energy and supply bottlenecks will be a headwind to growth, and are projected to push headline inflation to 2.5% in 2022 and 1.8% in 2023, within the central bank's target range. However, prolonged disruptions in global supply chains could increase inflation more markedly and lower activity.

Fiscal policy should continue to support inclusive growth and the green transition

Ample fiscal capacity allows for continued government support to people and firms hardest-hit by the COVID-19 crisis. Due to the significant uncertainties relating to the war in Ukraine, the government should be ready to scale up expenses related to the influx of refugees while the planned consolidation progresses. Fostering labour market integration of under-represented groups would help sustain the recovery and improve inclusiveness. Close monitoring of financial risks related to real estate is warranted. Improving the environmental sustainability of consumption and production would accelerate the transition towards a net-zero economy. Further investment into renewable energy and mobility would decrease reliance on the gas and oil markets and enhance energy security.

Turkey

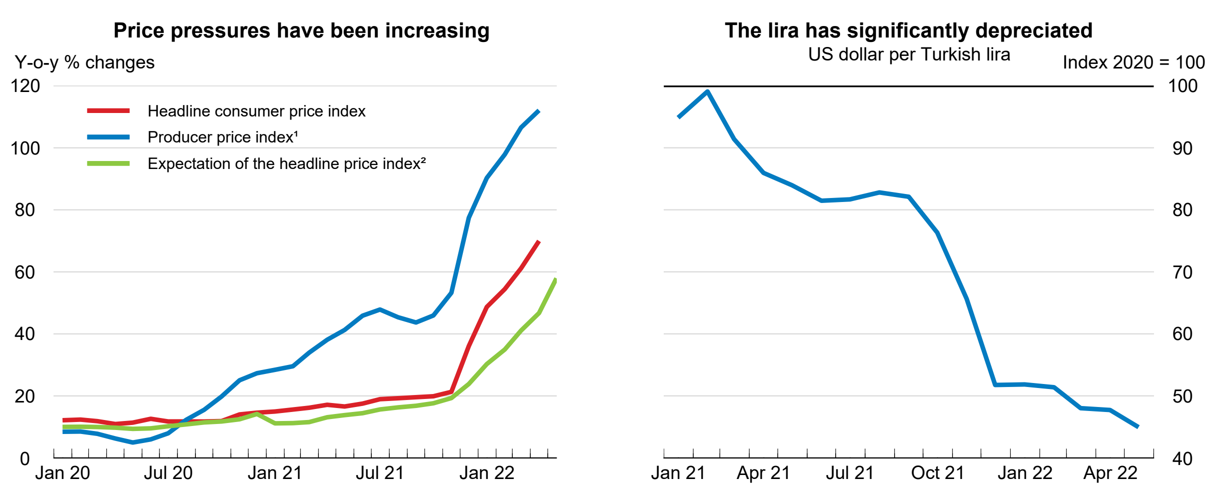
After a strong recovery in 2021, growth will moderate over the projection period. Very high inflation and declining consumer confidence will limit consumer spending. Investment will be held back by uncertainty about geopolitical factors and financial conditions. While exports will continue to benefit from the reallocation of global supply chains, the war in Ukraine will adversely affect external demand and commodity prices. Accommodative monetary policy coupled with high commodity and food prices will keep consumer inflation above 70% in 2022.

Strengthening the independence of the central bank and tightening monetary policy will be key to shore up confidence and anchor inflation expectations. Fiscal policy is expected to remain supportive over the projection period, including support to lower-income households that are facing high commodity prices. Structural reforms to enhance skills and the quality of training for workers and the unemployed are key to facilitate a move to higher paying jobs. Given its heavy dependence on oil and gas imports, Turkey should continue to diversify supply sources and improve energy efficiency.

Economic activity is moderating after the strong recovery in 2021

The economy grew by 11% in 2021, boosted by strong exports and high consumer spending. Exports of goods reached a record high in 2021 supported by strong external demand, with Turkey benefitting from supply chain disruption in Asia and the lira depreciation. Domestic demand has been supported by strong credit growth and facilitated by expansionary monetary policy, in spite of high inflation. Employment has recovered to pre-pandemic levels, helped by the rebound in economic activity, and income has been boosted by a minimum wage increase of 50%. However, leading indicators – such as consumer confidence and the PMI – signal a gradual moderation of economic momentum. At the same time, prices are increasing significantly further, due to accommodative monetary policy, higher commodity prices and the exchange rate depreciation, and have begun to erode real incomes and limit consumer spending.

Turkey



1. Domestic producer price index refers to manufacturing.
2. Expectation of monthly consumer price index for the end of the current year.
Source: OECD, Main Economic Indicators database; the Central Bank of the Republic of Turkey; and Refinitiv.

StatLink https://stat.link/d9nuax

Turkey: Demand, output and prices

Turkey	2018	2019	2020	2021	2022	2023
	Current prices TRY billion	Percentage changes, volume (2009 prices)				
GDP at market prices	3 758.8	0.9	1.8	11.0	3.7	3.0
Private consumption	2 111.9	1.6	3.0	15.5	5.1	1.8
Government consumption	552.0	4.0	2.1	2.2	1.8	3.2
Gross fixed capital formation	1 115.0	-12.4	7.2	6.4	1.6	4.7
Final domestic demand	3 778.9	-2.2	3.9	10.8	3.8	2.8
Stockbuilding[1]	- 10.7	0.2	4.7	-6.0	-3.2	0.0
Total domestic demand	3 768.1	-2.0	9.0	3.8	1.0	2.6
Exports of goods and services	1 171.0	4.6	-14.8	24.9	9.9	5.5
Imports of goods and services	1 180.3	-5.4	7.6	2.0	2.6	4.5
Net exports[1]	- 9.3	3.1	-7.1	6.5	2.6	0.3
Memorandum items						
GDP deflator	_	13.9	14.8	28.7	72.3	35.1
Potential GDP, volume	_	4.1	3.8	3.9	3.7	3.6
Consumer price index[2]	_	15.2	12.3	19.6	72.0	38.9
Core inflation index[3]	_	13.4	11.2	18.3	58.9	38.0
Unemployment rate (% of labour force)	_	13.7	13.1	12.0	11.8	11.8
Current account balance (% of GDP)	_	0.9	-5.0	-1.9	-4.8	-4.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Based on yearly averages.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/21zfkb

The war in Ukraine has been reflected in soaring commodity prices. This has added to cost and price increases, given Turkey's heavy dependence on imported oil and gas. Gas imports from Russia account to almost half of all gas imports to Turkey, while oil imports are around 30%. More than 70% of Turkey's imported grains come from Russia and Ukraine. Moreover, Russian and Ukrainian tourists are important for Turkish hospitality sectors, accounting for about 15% of the overall tourism revenues.

Monetary and fiscal policy will remain supportive

The central bank has reduced its base rate by 5 percentage points since September 2021 and is expected to hold its policy rate at 14% over the projection period. Negative real interest rates have weighed on investors' confidence and resulted in a large depreciation of the lira. This has prompted the population to protect their savings by changing lira deposits into dollars and other hard currency. As a result, bond yields have risen sharply and inflationary pressures have increased further. Central bank interventions and administrative measures, including obligations for exporters to convert 40% of their foreign currency revenue into lira and an exchange-rate protection for lira-denominated bank deposits introduced at the end of 2021, have helped to stabilise the exchange rate during the opening months of 2022, but has weakened again in May. Fiscal policy will remain supportive over the projection period, with increases in public sector wages and support for energy consumers. To mitigate higher energy prices, the government has reduced the value-added tax on electricity used in residences and agricultural irrigation and has granted subsidies to 4 million households.

Economic growth will slow

Economic growth will moderate over the next two years. The reopening of the economy after the pandemic and expansionary monetary and fiscal policy will support economic activity. However, persistent very high inflation will limit the purchasing power of households and uncertainty will moderate investment. Exports will remain solid as the relocation of global supply chains from Asia will help absorb some downward pressures from weaker global demand growth. The EU embargo of Russian oil will keep oil prices at high levels adding to high consumer price inflation, which will remain significantly elevated over the projection period.

The risks are on the downside as the adverse effects from the war could become much larger, particularly via commodity prices. A complete cessation of energy exports from Russia to Europe, stronger costs arising from shortages of critical raw materials, or further disruptions to transportation and trade could have sizable negative effects on the economy. Further pressures on the Lira could turn the exchange rate protection on deposits into an additional liability for public finances, with adverse effects on inflation and confidence. These risks are aggravated by the increase in contingent liabilities accumulated over the past years, despite the relatively low public debt-to-GDP ratio compared to other OECD countries and a sound banking sector.

The macroeconomic policy framework should be strengthened

Strengthening the credibility of monetary policy and increasing the policy rate will be key to ensure well-anchored inflation expectations and shore up confidence. Fiscal policy should tackle the adverse distributional impacts of higher energy prices. In order to avoid weakening price signals and keep fiscal costs manageable, the measures should be well targeted and temporary. Besides the stabilisation of the macroeconomic framework, a new reform package will be needed to make the economy more inclusive and resilient to future shocks. Labour market reforms that encourage more formal job creation, promote women's labour force participation, reduce employment costs and encourage more flexible employment forms are vital to promote social cohesion. Given its heavy dependence on oil and gas imports, Turkey should continue with efforts to boost domestic oil and gas exploration, diversify supply sources and improve energy efficiency.

United Kingdom

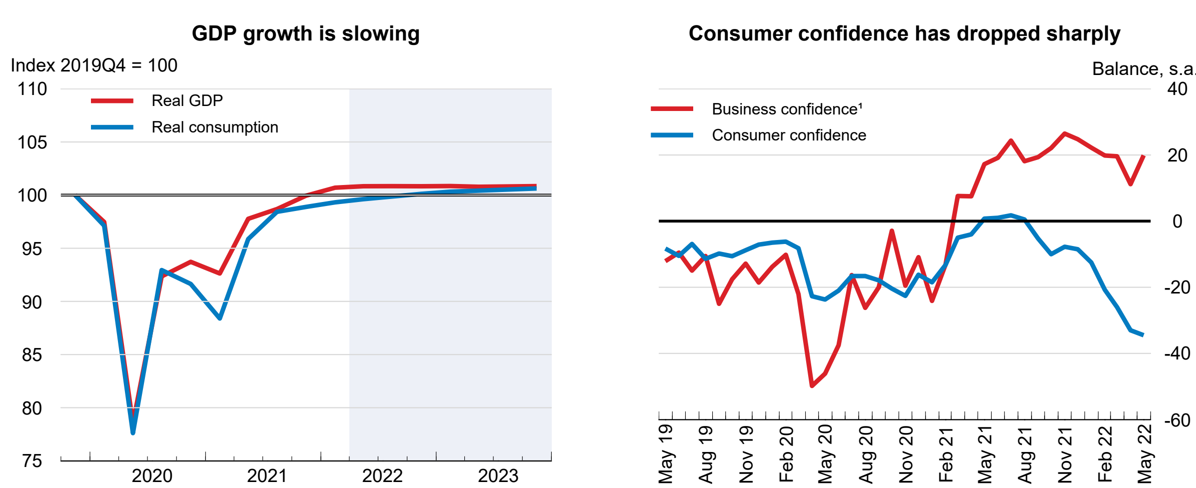
GDP is projected to increase by 3.6% in 2022, before stagnating in 2023. Inflation will keep rising and peak at over 10% at the end of 2022 due to continuing labour and supply shortages and high energy prices, before gradually declining to 4.7% by the end of 2023. Private consumption is expected to slow as rising prices erode households' income. Public investment will weaken in 2022 as supply bottlenecks hamper the implementation of planned investment, but is set to rise again in 2023 as these effects subside. A tight labour market will help to keep unemployment low.

Monetary policy should continue to normalise gradually to help bring inflation to target. Fiscal policy has to balance gradual fiscal tightening with well-targeted support to protect vulnerable households from the rising cost of living and significant spending and investment needs to support productivity. Government programmes should focus on providing certainty about the transition to net zero to support investment and accelerate the reduction of fossil fuel dependence.

Growth is slowing amid persisting supply shortages and rising inflation

Output exceeded pre-pandemic levels in November 2021, but high frequency data indicate a slowing of the economy. Monthly GDP declined by 0.1% in March 2022, down from 0.7% in January and no growth in February. The easing of COVID travel restrictions early 2022 led to a sharp recovery in holiday bookings, but manufacturing slumped due to global supply chain disruptions. The labour market continues to tighten, with the number of vacancies rising to about 1.3 million in March 2022. The unemployment rate fell to 3.7% in the first quarter of 2022, below its pre-pandemic lows, but the inactivity rate remains above pre-pandemic levels. Inflation continues to rise, reflecting elevated energy and goods prices due to global supply shortages and strong pent-up demand for goods. Average weekly earnings have increased steadily since mid-2020, but real wages in January-March 2022 were 1.2% weaker than a year earlier. Inflation pressures have been aggravated by surging energy prices following Russia's invasion of Ukraine, hitting confidence. Business confidence remains well above pre-pandemic levels, but consumer confidence remains subdued, reflecting concerns related to the rising cost of living.

United Kingdom 1



1. Business confidence refers to the manufacturing sector.
Source: Economic Outlook 111 database; and OECD Main Indicators database.

StatLink https://stat.link/tcx50w

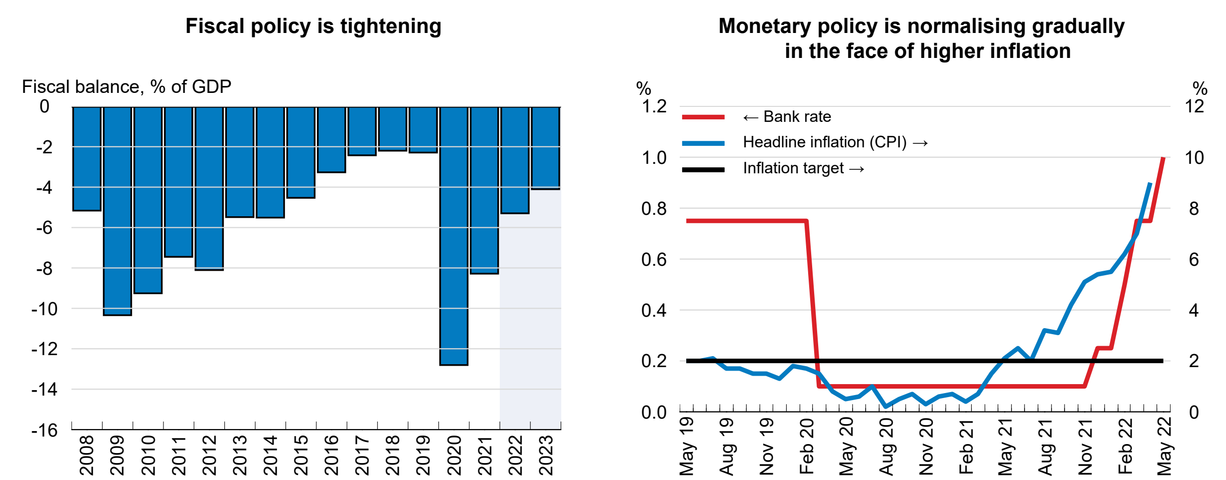
United Kingdom: Demand, output and prices

United Kingdom	2018	2019	2020	2021	2022	2023
	Current prices GBP billion	Percentage changes, volume (2019 prices)				
GDP at market prices	2 174.4	1.7	-9.3	7.4	3.6	0.0
Private consumption	1 412.3	1.3	-10.6	6.2	4.5	0.7
Government consumption	399.0	4.2	-5.9	14.3	1.4	0.8
Gross fixed capital formation	386.5	0.5	-9.5	5.9	8.0	2.1
Final domestic demand	2 197.8	1.7	-9.5	7.9	4.5	1.0
Stockbuilding[1]	4.9	-0.1	-0.6	0.6	3.5	0.0
Total domestic demand	2 202.7	1.6	-10.2	8.3	8.0	0.9
Exports of goods and services	663.3	3.4	-13.0	-1.3	0.9	1.5
Imports of goods and services	691.6	2.9	-15.8	3.8	15.7	3.6
Net exports[1]	- 28.3	0.1	1.0	-1.4	-4.2	-0.7
Memorandum items						
GDP deflator	_	2.0	5.1	0.3	5.7	4.9
Harmonised index of consumer prices	_	1.8	0.9	2.6	8.8	7.4
Harmonised index of core inflation[2]	_	1.7	1.4	2.4	6.4	5.9
Unemployment rate (% of labour force)	_	3.8	4.5	4.5	3.8	4.3
Household saving ratio, gross (% of disposable income)	_	4.6	14.0	10.4	5.1	1.7
General government financial balance (% of GDP)	_	-2.3	-12.8	-8.3	-5.3	-4.1
General government gross debt (% of GDP)	_	118.5	149.1	143.1	139.2	138.6
Current account balance (% of GDP)	_	-2.7	-2.5	-2.6	-7.2	-7.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/uawbc0

United Kingdom 2



Source: Economic Outlook 111 database; and Bank of England.

StatLink https://stat.link/vfsoue

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The UK economy is susceptible to economic spill-over effects from Russia's invasion into Ukraine through rising energy prices and supply chain disruptions. The United Kingdom has limited direct trade and financial linkages with Russia and Ukraine, but higher global energy prices add to the squeeze on household incomes, which are now declining in real terms. Special visa schemes for Ukrainian refugees have been introduced allowing Ukrainian nationals to either stay with a sponsor in the United Kingdom, or be brought in by an immediate family member that is of British nationality or is settled in the United Kingdom.

Monetary and fiscal policy are becoming restrictive

The Bank of England has responded to rising inflationary pressures by increasing its policy rate four times since December 2022 from 0.1% to 1% and by starting 'quantitative tightening' of its balance sheet by no longer reinvesting the proceeds of gilt redemptions into new gilt purchases. As announced in February 2022, its holdings of sterling corporate bonds are also being reduced gradually, including through sales up to the end of 2023. As the policy rate reached 1% in May, the Bank announced that it would discuss a strategy for active gilt sales at the August 2022 monetary policy meeting. Monetary policy is expected to continue normalising, with the bank rate set to increase to 2.5% by 2023.

Fiscal policy has started to tighten, with the main pandemic support measures phased out at the end of 2021. Other measures, such as the temporary reduced VAT rates on hospitality and recreational services, ended on 31 March 2022. To return to a sustainable fiscal path, the government has committed to a gradual medium-term fiscal consolidation plan, with planned increases in tax revenues and increased investment. From April 2022, national-insurance contributions increased by 1.25 percentage points to fund health and social care spending while tax-free allowances and higher rate thresholds for income tax are frozen until 2025-26, a policy that now has a bigger positive impact on revenues than anticipated when introduced in early 2021 due to high inflation. From April 2023, the corporate income tax rate will increase from 19% to 25%. Due to rising energy prices, the UK government introduced a support package worth GBP 9.1 billion (0.4% of 2022-23 GDP) for 2022-23 before Russia's invasion of Ukraine, to help households with rising cost of living. Measures include a non-repayable council tax rebate, a repayable energy discount and discretionary funding for Local Authorities to support households who need support but are not eligible for the Council Tax Rebate. Following Russia's invasion into Ukraine, additional measures were taken, such as a 12-month cut in fuel duty. To reduce the burden on lower income households in face of increasing cost of living, the national insurance threshold is being raised in July from GBP 9 880 to GBP 12 570. An additional support package of GBP 15 billion (0.7% of GDP) was announced at the end of May, including a one-off GBP 600 payment to households on means-tested benefits, and one-off payments of GBP 300 to pensioner households and GBP 150 to individuals receiving disability benefits. Moreover, the energy discount was doubled to GBP 400 and turned into a grant. To help pay for the extra support, the government announced a new and temporary 25% energy profit levy for oil and gas companies, while also introducing an investment allowance of 80% to incentivise the oil and gas sector to invest in UK extraction. Overall, the fiscal stance will be contractionary and the underlying primary balance is set to improve by 1.8 percentage points of potential GDP between 2022 and 2023.

Economic growth is set to slow

Output is projected to grow by 3.6% in 2022 before stagnating in 2023 due to depressed demand. Private consumption will slow as rising prices erode households' incomes. Household savings will decline to below pre-pandemic levels, with some households taking on more debt to keep up with the rising cost of living. Inflation will continue to rise, peaking at just over 10% in the fourth quarter of 2022, driven by increasing global prices of tradable goods and services due to supply bottlenecks, transportation costs and energy prices. Inflation will moderate gradually through 2023 due to base effects, but will remain elevated due to the impact of the EU oil embargo on global energy prices. Continued tightness of the labour market is expected to feed through to higher wage growth over the projection period, but with wage growth remaining below inflation. Tighter monetary policy and easing supply constraints over 2023 are expected to help inflation to decline to 4.7% by the end of 2023. Unemployment is set to remain low, but will increase gradually to 4.5% by the end of 2023 due to weaker demand. Business investment will be damped by rising interest rates and lingering uncertainties. Public investment will be weakened by supply shortages in 2022, hindering planned investment, but is expected to pick up in 2023 with planned spending increases on infrastructure and climate. The general government deficit is projected to decline gradually to 5.3% of GDP in 2022 and 4.1% of GDP in 2023.

Risks to the outlook are considerable. Spill-overs from economic sanctions and higher than expected energy prices as the Ukraine war drags on, and a deterioration in the public health situation due to new COVID strains are significant downside risks. Higher than expected goods and energy prices could weigh on consumption and further lower growth. A prolonged period of acute supply and labour shortages could force firms into a more permanent reduction in their operating capacity or push up wage inflation further. A progress in trade deals could support trade and improve the outlook.

Supporting investment to raise productivity and advance the green transition

The government should consider slowing fiscal consolidation to support growth. The ambitious government “Plan for Growth” to support structural transformation towards greener and more inclusive growth through large scale public investment in infrastructure, skills and innovation should continue as planned, and be well targeted, with a special focus on improving productivity in lagging regions. Accelerating progress towards net zero is fundamental to enhance energy security and reduce dependence on fossil fuels. Policies in place are not yet sufficient to deliver the Net Zero target. The government can stimulate the necessary investment by being clearer about its approach to the transition to a net zero economy and developing an economy-wide plan with concrete deadlines, policies and priorities in line with a target-consistent emission pricing trajectory.

United States

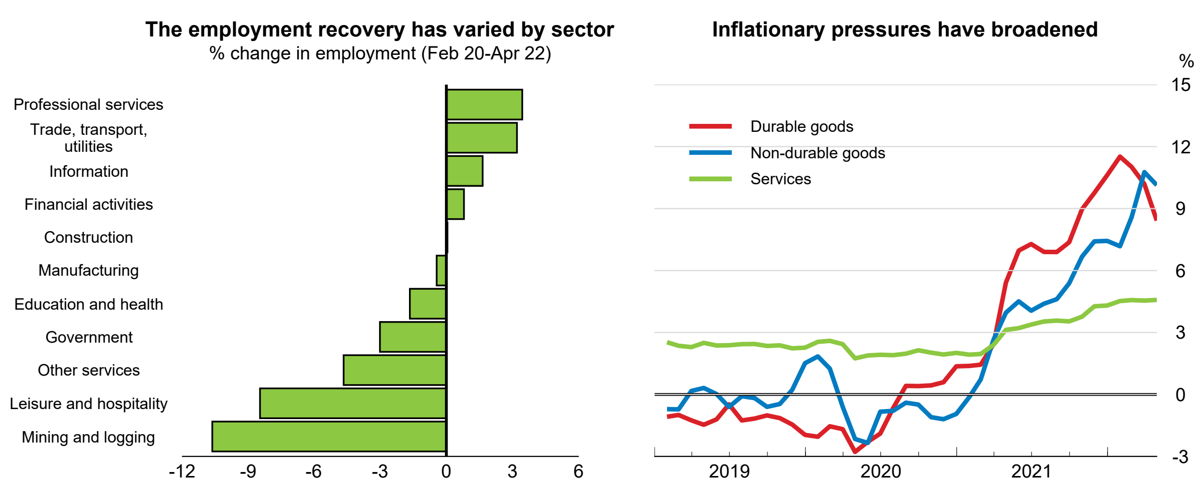
The pace of GDP growth is anticipated to weaken from its recent very high levels to 2.5% in 2022 and 1.2% in 2023. Supply disruptions may take some time to fully ease, especially given the impacts of the war in Ukraine and COVID-related lockdowns in China. Wage growth will stay strong, as the labour market is expected to remain tight, despite an increase in labour force participation as receding health risks and higher wages prompt workers to return to the labour force. Inflation will remain above the Federal Reserve's 2% target at the end of 2023.

A further significant normalisation of monetary policy will weigh on economic growth. The expiration of pandemic-related support measures means fiscal policy will also have a contractionary influence, although the spending of accumulated fiscal transfers by households and subnational governments could partially offset this effect. The authorities should be ready to provide temporary fiscal support for vulnerable groups in the event of an unexpectedly sharp slowdown. Despite limited direct trade linkages with Russia, the further decarbonisation of the United States energy system has become more pressing given the rise in global energy prices. Looking further ahead, building fiscal pressures will require improved public spending efficiency, in areas such as health, and broadening the tax base.

Demand continues to rise but inflationary pressures are intense

Real GDP growth contracted in the first quarter of 2022, but domestic demand growth continued to hold up. Private consumption rose by an annualised rate of 3.1%, a slight acceleration from the previous quarter. The share of goods consumption remains high by historical levels, but there has been a gradual reorientation of spending back towards services as the economy has further reopened and the population has adjusted to living with COVID-19. Stronger domestic demand has boosted imports, particularly of goods, pushing the current account deficit higher. Labour market demand continues to be very strong and

United States 1



Source: Refinitiv; and OECD Economic Outlook 111 database.

StatLink https://stat.link/skr2cm

United States: Demand, output and prices

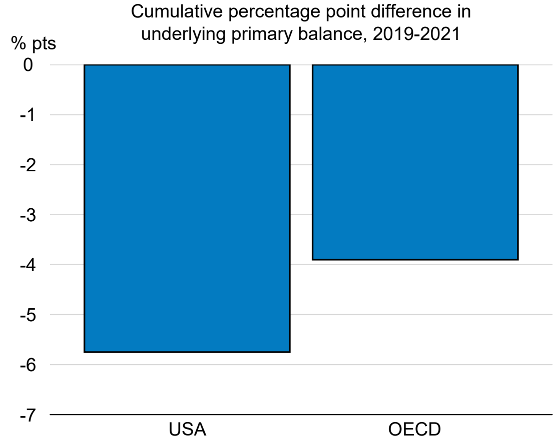
United States	2018	2019	2020	2021	2022	2023
	Current prices USD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	20 527.2	2.3	-3.4	5.7	2.5	1.2
Private consumption	13 913.5	2.2	-3.8	7.9	3.1	1.1
Government consumption	2 869.4	2.0	2.0	1.0	-0.1	1.8
Gross fixed capital formation	4 281.7	3.1	-1.5	6.1	2.8	2.6
Final domestic demand	21 064.6	2.4	-2.5	6.5	2.6	1.5
Stockbuilding[1]	58.7	0.1	-0.5	0.3	1.0	0.0
Total domestic demand	21 123.3	2.4	-3.0	6.9	3.5	1.5
Exports of goods and services	2 533.5	-0.1	-13.6	4.5	3.6	3.9
Imports of goods and services	3 129.7	1.2	-8.9	14.0	9.6	3.2
Net exports[1]	- 596.2	-0.2	-0.3	-1.4	-1.0	-0.1
Memorandum items						
GDP deflator	_	1.8	1.2	4.2	6.4	3.6
Personal consumption expenditures deflator	_	1.5	1.2	3.9	5.9	3.5
Core personal consumption expenditures deflator[2]	_	1.7	1.4	3.3	4.7	3.1
Unemployment rate (% of labour force)	_	3.7	8.1	5.4	3.6	3.8
Household saving ratio, net (% of disposable income)	_	7.6	16.6	12.3	6.4	7.0
General government financial balance (% of GDP)	_	-6.4	-15.4	-11.8	-6.7	-5.3
General government gross debt (% of GDP)	_	108.6	134.1	127.6	126.1	126.8
Current account balance (% of GDP)	_	-2.2	-2.9	-3.6	-4.2	-4.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Deflator for private consumption excluding food and energy.
Source: OECD Economic Outlook 111 database.

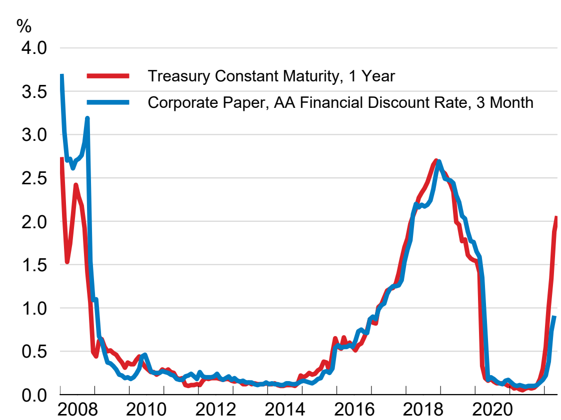
StatLink https://stat.link/fpz9rj

United States 2

The fiscal expansion was large
Cumulative percentage point difference in underlying primary balance, 2019-2021



Interest rates have risen sharply



Source: Refinitiv; and OECD Economic Outlook 111 database.

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a depressed participation rate that still remains over 1 percentage point below its pre-pandemic level has contributed to acute labour shortages in some sectors and rising nominal wages. As in other countries, energy and food prices have spiked, eroding the purchasing power of households. However, underlying inflationary pressures have also risen markedly as strong demand continues to run up against supply constraints, with price pressures having broadened from goods to services components.

The direct trade implications on the United States of the war in Ukraine and sanctions on Russia are limited. Just 3% of crude oil imports and 1% of total crude oil processed by US refineries derive from Russia. Furthermore, the United States is a net exporter of natural gas and is the second largest exporter of wheat in the world. Even so, there is a greater reliance on Russia for some other energy commodities, such as uranium, and there have been material indirect effects through global markets. The rise in oil prices has prompted the administration to release an additional one million barrels per day on average from strategic reserves over the next six months. The recently announced embargo on Russian oil imports by the European Union is expected to push global oil prices even higher in 2023. The S&P500 has also fallen markedly so far this year. Furthermore, disruptions to key inputs for semiconductors and transport equipment produced in Ukraine and Russia (e.g. palladium, argon, neon) and lockdowns in China could also create supply disruptions that impact production in the United States.

Fiscal and monetary policy support is unwinding rapidly

The major pandemic-related fiscal programmes have now expired. The fiscal deficit is anticipated to fall substantially in 2022, suggesting a strong contractionary influence on real GDP growth. Nonetheless, this may be partially offset by the lagged effects of previous government spending. Discretionary fiscal stimulus during the pandemic was among the largest across the OECD and some support measures, such as transfers to households and state and local governments, are yet to be fully spent.

Monetary policy normalisation has now begun. The Federal Open Market Committee has now lifted the Federal Funds Rate from its pandemic low by 75 basis points to 0.75-1% and communicated that further increases are likely to be forthcoming. OECD projections assume that the policy rate will be raised through the projection period in pursuit of the Federal Reserve's objectives of maintaining price stability and full employment, with the Federal Funds Rate reaching 3-3.25% by the end of 2023. A reduction in central bank holdings of Treasury securities, agency debt and agency mortgage-backed securities also began on 1 June 2022. Balance sheet reduction will primarily be achieved by only reinvesting principal payments from securities to the extent that they exceed monthly caps. For Treasury securities, the cap will be set at USD 30 billion per month for the first three months before increasing to USD 60 billion per month. For agency debt and mortgage-backed securities, the cap will initially be set at USD 17.5 billion per month and will rise to USD 35 billion per month after three months. The tightening of monetary policy is already having a notable impact on market interest rates: the rate on a 30 year fixed rate mortgage has risen by over 2% since the start of 2022.

Growth will slow and risks are to the downside

Real GDP growth is projected to slow to 2.5% in 2022 and 1.2% in 2023. A rapid normalisation of monetary policy, fiscal consolidation, ongoing supply disruptions and a rise in oil prices will weigh on growth. However, the further reorientation of domestic demand back towards the services sector should help to attenuate some supply shortages. Wage growth is expected to stay strong, as the labour market is expected to remain tight despite an increase in participation as receding health risks and higher wages prompt workers to return to the labour force. Price pressures may recede with a moderation in energy prices in 2023, but inflation is projected to remain above the Federal Reserve's 2% target.

Risks to the growth and inflation projections are substantial. The war in Ukraine could have a more significant negative impact on real GDP growth and could also push inflation notably higher. At the same time, further tightening in labour markets could cause nominal wages to accelerate substantially. To the extent that this contributes to more persistent inflationary pressures and a de-anchoring of inflation expectations, it could lead to a faster tightening of monetary policy, weakening economic growth. With fiscal support now having been wound back, signs of distress may become more visible on balance sheets of corporates in sectors that continue to be impacted by the pandemic or by supply chain issues. Another variant of COVID-19 that significantly disrupts economic activity would also weaken growth, especially in those parts of the country with more limited vaccine coverage. On the upside, healthy household balance sheets could fuel a stronger rebound in consumption and there is the potential for a larger rebound in labour supply than currently projected.

Building fiscal pressures necessitate reforms

A significant decline in monetary and fiscal policy support is appropriate given the rapid economic recovery and elevated inflation. There may be a need for new fiscal measures to cushion the impact of war in Ukraine or a broader economic slowdown. However, any such measures should be well targeted and temporary. This is especially the case given building fiscal pressures from an ageing population and much-needed spending initiatives to strengthen the social safety net and achieve the climate transition. Improved public spending efficiency in areas such as health should be a priority. Declining competition between healthcare providers has led to rising profit margins that could be combatted by giving consumers more control of their data, including by introducing clear national data portability policies. Very high pharmaceutical costs could also be addressed through expanding the number of pharmaceuticals subject to negotiation by Medicare. Facilitating the decarbonisation of the United States energy system has become more pressing given the rise in global energy prices and should continue to be a strong focus of the administration.

OECD Economic Outlook

The war in Ukraine is a major humanitarian crisis with associated economic shocks that threaten the post-pandemic recovery. The *OECD Economic Outlook, Volume 2022 Issue 1*, highlights the implications and risks for growth, inflation and living standards from higher commodity prices and potential disruptions to energy and food supplies, and discusses the associated policy challenges.

This issue includes a general assessment of the macroeconomic situation, and a chapter summarising developments and providing projections for each individual country. Coverage is provided for all OECD members as well as for selected partner economies.

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