Overview

The outlook for euro area activity and inflation has become very uncertain and depends crucially on how the Russian war in Ukraine unfolds, on the impact of current sanctions and on possible further measures.[1] *The baseline includes an initial assessment of the impact of the war on the euro area economy based on the information available up to 2 March 2022. Soaring energy prices and negative confidence effects imply significant headwinds to domestic demand in the near term, while the announced sanctions and sharp deterioration in the prospects for the Russian economy will weaken euro area trade growth. The baseline projections are built on the assumptions that current disruptions to energy supplies and negative impacts on confidence linked to the conflict are temporary and that global supply chains are not significantly affected. Based on these assumptions, the baseline projections foresee a significant negative impact on euro area growth in 2022, from the conflict. Nevertheless, given the starting point for the euro area economy, with a strong labour market and headwinds related to the pandemic and supply bottlenecks assumed to fade, economic activity is still projected to expand at a relatively strong pace in the coming quarters. Over the medium term, growth is projected to converge towards historical average rates, despite a less supportive fiscal stance and an increase in interest rates in line with the technical assumptions based on financial market expectations. Overall, real GDP growth is projected to average 3.7% in 2022, 2.8% in 2023 and 1.6% in 2024. Compared with the December 2021 Eurosystem staff projections, the outlook for growth has been revised down by 0.5 percentage points for 2022 owing mainly to the impact of the Ukraine crisis on energy prices, confidence and trade. This downward revision is partly offset by a positive carry-over effect from upward data revisions for 2021. Growth in 2023 has been revised down by 0.1 percentage points, while in 2024 it is unchanged.*

Following a series of exceptional energy price shocks, the conflict in Ukraine implies that headline inflation in the baseline is projected to remain at very high levels in the coming months, before easing slowly towards target. It is set to average 5.1% in 2022, 2.1% in 2023 and 1.9% in 2024. Near-term price pressures have risen significantly, in particular those related to oil and gas commodities. These pressures are assessed to be more lasting than previously expected and to be only partly offset by dampening effects on growth from lower confidence and by weaker trade growth related to the conflict. Nevertheless, in the absence of further upward shocks to commodity prices, energy inflation is projected to drop significantly over the projection horizon. In the short term, this decline relates to base effects, while the technical assumptions based on futures prices embed a decline in oil and wholesale

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1 The cut-off date for technical assumptions, such as those for oil prices and exchange rates, was 28 February 2022. The macroeconomic projections for the euro area were finalised on 2 March 2022. The current projection exercise covers the period 2022-24. Projections over such a long horizon are subject to very high uncertainty, and this should be borne in mind when interpreting them. See the article entitled "An assessment of Eurosystem staff macroeconomic projections" in the May 2013 issue of the ECB's Monthly Bulletin. See http://www.ecb.europa.eu/pub/projections/html/index.en.html for an accessible version of the data underlying selected tables and charts. A full database of past ECB and Eurosystem staff macroeconomic projections is available at https://sdw.ecb.europa.eu/browseSelection.do?node=5275746.

gas prices resulting in a negligible contribution from the energy component to headline inflation in 2024. HICP inflation excluding energy and food remains high in 2022, at 2.6%, reflecting stronger price dynamics for contact-intensive services, indirect effects from higher energy prices and upward impacts from ongoing supply bottlenecks. As these pressures ease, this measure of underlying inflation is expected to decrease to 1.8% in 2023 and then to rise to 1.9% in 2024, on account of strengthening demand, tightening labour markets and some second-round effects on wages, in line with historical regularities. Compared with the December 2021 Eurosystem staff projections, in cumulative terms over the projection horizon, headline inflation has been revised upwards substantially, especially in 2022. This upward revision reflects recent data surprises, higher energy commodity prices, more persistent upward pressures from supply disruptions and stronger wage growth, also related to the planned increase in the minimum wage in Germany. The upward revision also takes into account the recent return of survey-based indicators of medium-term inflation expectations to levels consistent with the ECB's inflation target. These effects more than offset the negative impact on inflation of a significant upward revision to the market-based assumptions on interest rates and the negative demand-related effects of the conflict in Ukraine.

On account of the significant uncertainty surrounding the impact of the conflict in Ukraine on the euro area economy, in addition to the baseline, two scenarios have been prepared. Compared with the baseline, an "adverse" scenario assumes that stricter sanctions are imposed on Russia, leading to some disruptions in global value chains. Persistent cuts in Russian gas supplies would lead to higher energy costs and to cuts in euro area production, but this would be only temporary as substitution into other energy sources takes place. In addition, geopolitical tensions would be more sustained than in the baseline, leading to additional financial disruptions and more persistent uncertainty. Under such a scenario, euro area GDP growth would be 1.2 percentage points lower than the baseline in 2022, while inflation would be 0.8 percentage points higher. Differences would be more limited in 2023. In 2024, growth would be somewhat stronger than the baseline as the economy catches up after the larger negative impact on economic activity in 2022 and 2023. As oil and gas markets rebalance, the large spikes in energy prices would gradually unwind, causing inflation to decline below the baseline, especially in 2024. A more "severe" scenario includes, in addition to the features of the adverse scenario, a stronger reaction of energy prices to more stringent cuts in supply, stronger repricing in financial markets and larger second-round effects from rising energy prices. This scenario would imply GDP growth in 2022 that is 1.4 percentage points below the baseline, while inflation would be 2.0 percentage points higher. Significantly lower growth and higher inflation, compared with the baseline, would also be seen in 2023. Higher persistence of the disruptions tiggered by the war imply that, in 2024, the catch-up effects on growth would be relatively modest whereas stronger second-round effects would offset the negative impact on inflation from declining energy prices.

Owing to the exceptional circumstances related to the Russian invasion of Ukraine, the March 2022 ECB staff macroeconomic projections were finalised later than usual to allow for the inclusion of a first assessment of the impact of the war as well as the *production of scenarios. The publication of the full report on the March 2022 projections has therefore been postponed to Friday, 11 March 2022.*

Growth and inflation projections for the euro area

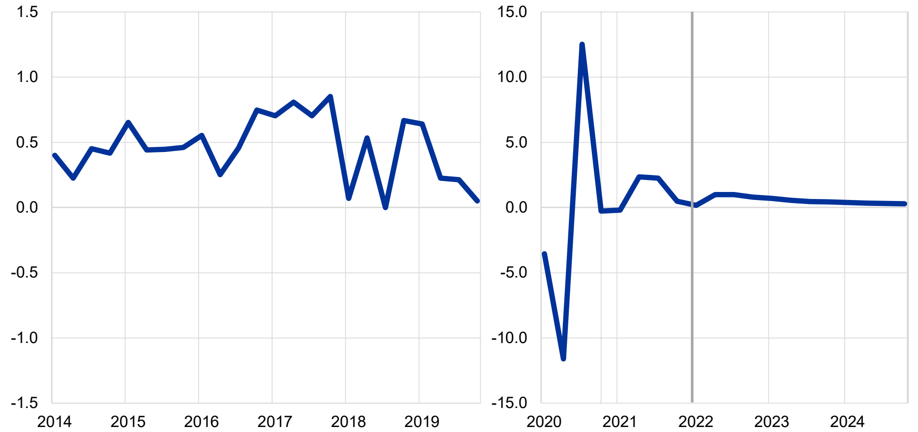
(annual percentage changes)

	March 2022 projections				Adverse scenario				Severe scenario			
	2021	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**
Real GDP	5.4	3.7	2.8	1.6	5.4	2.5	2.7	2.1	5.4	2.3	2.3	1.9
HICP inflation	2.6	5.1	2.1	1.9	2.6	5.9	2.0	1.6	2.6	7.1	2.7	1.9

Notes: Real GDP figures refer to seasonally and working day-adjusted data. Historical data may differ from the latest Eurostat publications due to data releases after the cut-off date for the projections.

Chart 1
Euro area real GDP growth

(quarter-on-quarter percentage changes, seasonally and working day-adjusted quarterly data)



Notes: Data are seasonally and working day-adjusted. Historical data may differ from the latest Eurostat publications due to data releases after the cut-off date for the projections. The vertical line indicates the start of the projection horizon.

Chart 2
Euro area HICP

(annual percentage changes)

Note: The vertical line indicates the start of the projection horizon.

Table 1
Macroeconomic projections for the euro area

(annual percentage changes)

	March 2022					December 2021			
	2020	2021	2022	2023	2024	2021	2022	2023	2024
Real GDP	-6.5	5.4	3.7	2.8	1.6	5.1	4.2	2.9	1.6
Private consumption	-8.0	3.4	4.6	2.6	0.9	3.3	5.9	2.8	1.0
Government consumption	1.2	3.8	0.1	0.3	1.1	3.9	0.2	0.5	1.3
Gross fixed capital formation	-7.3	3.5	3.0	3.8	2.5	3.7	3.9	4.3	2.4
Exports[1)]	-9.4	10.6	7.8	6.3	3.1	9.3	6.4	6.4	3.1
Imports[1)]	-9.3	7.8	7.0	5.8	2.8	7.0	6.1	6.4	2.9
Employment	-1.5	1.1	1.4	0.7	0.6	1.1	1.3	1.0	0.6
Unemployment rate (percentage of labour force)	7.9	7.7	7.3	7.2	7.0	7.7	7.3	6.9	6.6
HICP	0.3	2.6	5.1	2.1	1.9	2.6	3.2	1.8	1.8
HICP excluding energy	1.0	1.5	2.9	2.0	2.0	1.5	2.1	1.9	1.9
HICP excluding energy and food	0.7	1.5	2.6	1.8	1.9	1.4	1.9	1.7	1.8
HICP excluding energy, food and changes in indirect taxes[2)]	0.8	1.3	2.5	1.8	1.9	1.3	1.9	1.7	1.8
Unit labour costs	4.6	-0.2	1.3	1.3	1.9	0.3	0.9	1.0	1.9
Compensation per employee	-0.7	4.0	3.6	3.4	2.9	4.2	3.8	2.9	2.9
Labour productivity	-5.1	4.2	2.3	2.1	1.0	3.9	2.9	1.9	1.0
General government budget balance (percentage of GDP)	-7.2	-5.5	-3.1	-2.1	-2.0	-5.9	-3.2	-2.1	-1.8
Structural budget balance (percentage of GDP)[3)]	-4.8	-3.6	-2.5	-2.3	-2.3	-4.0	-2.6	-2.3	-2.1
General government gross debt (percentage of GDP)	97.3	95.8	92.0	89.6	88.7	96.6	93.2	90.7	89.7
Fiscal stance (adjusted for NGEU grants)[4)]	-4.2	0.5	0.9	0.2	0.1	0.2	1.1	0.3	0.3
Current account balance (percentage of GDP)	1.9	2.5	1.7	2.2	2.5	2.0	1.8	1.9	2.1

Notes: Real GDP and components, unit labour costs, compensation per employee and labour productivity refer to seasonally and working day-adjusted data. Historical data may differ from the latest Eurostat publications due to data releases after the cut-off date for the projections.
1) This includes intra-euro area trade.
2) The sub-index is based on estimates of actual impacts of indirect taxes. This may differ from Eurostat data, which assume a full and immediate pass-through of indirect tax impacts to the HICP.
3) Calculated as the government balance net of transitory effects of the economic cycle and measures classified under the European System of Central Banks definition as temporary.
4) The fiscal policy stance is measured as the change in the cyclically adjusted primary balance net of government support to the financial sector. The figures shown are also adjusted for expected Next Generation EU (NGEU) grants on the revenue side. A negative figure implies a loosening of the fiscal stance.

Further tables are available in the Annex to the ECB staff macroeconomic projections**.**