Global and European setting

Global economic developments

Outlook for global economy severely clouded by the war in Ukraine

Russia's invasion of Ukraine, which began at the end of February 2022, has been a drag on the global economy. Activity is being throttled in particular by the surge in the prices of numerous commodities, which is driving up enterprises' production costs and eroding households' purchasing power. Heightened uncertainty about the availability of key commodities and intermediate inputs is adding to the gloom surrounding the business climate. The impact of the conflict on global economic activity is only likely to become fully apparent as the year unfolds. Nevertheless, economic dynamics were already quite weak in the first quarter of 2022. One factor in this was the spread of the Omicron variant of the coronavirus, which was a temporary drag on economic activity in many places. Against this backdrop, gross domestic product (GDP) in the euro area continued to only see muted growth. In the United States and Japan, economic output even declined slightly. The United Kingdom, by contrast, saw a marked expansion of GDP. In China, economic activity also continued to increase quite strongly, as the Omicron wave did not reach large parts of the country until the end of the quarter.

Increasing burdens on global industrial production

The strict measures taken in China against the spread of the Omicron variant and the Russian war against Ukraine are jeopardising the upswing in global industry. March already saw disruptions to international supply chains flare up again, after having previously faded into the background somewhat. The European automotive industry suffered production stoppages due to a lack of intermediate inputs from Ukraine. There were also signs of shortages in some of those industrial raw materials which are mainly produced in Russia and Ukraine. Owing to China's central position in cross-border value chains, business closures and logistical problems there could cause major disruptions worldwide.[1] According to the latest surveys of purchasing managers, price pressures at upstream stages of production have intensified. These pressures are themselves being caused by the already significant increases in the prices of a large number of commodities at the beginning of the war.

Sharp rise in commodity prices since the start of the war

Following the Russian invasion of Ukraine, the prices of fossil fuels as well as of some industrial metals and those foods of which Russia and Ukraine are among the world's most sig-

Global economic indicators*

Q4 2019 = 100, seasonally adjusted, log scale

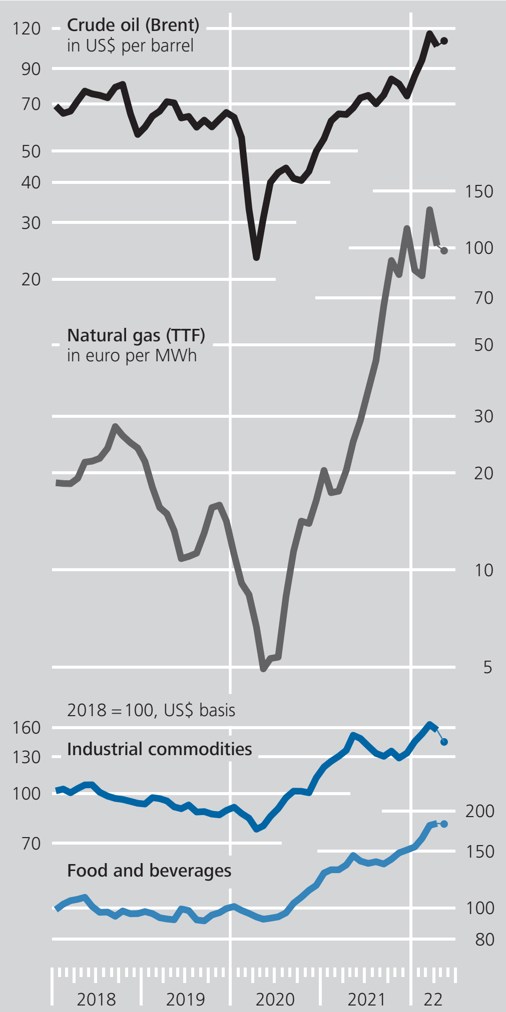
Sources: CPB, national data, Haver Analytics and Bundesbank calculations. * Groups of countries vary due to differences in data availability. **1** Bundesbank aggregate of national data, based on the number of units.

Deutsche Bundesbank

1 Empirical studies on the role of China in the slump in production observed in the EU and the United States in spring 2020 suggest that production in industries highly dependent on Chinese supplies fell significantly more sharply in March and April 2020 than in other industries. See Deutsche Bundesbank (2021) as well as Khalil and Weber (2022).

Commodity prices

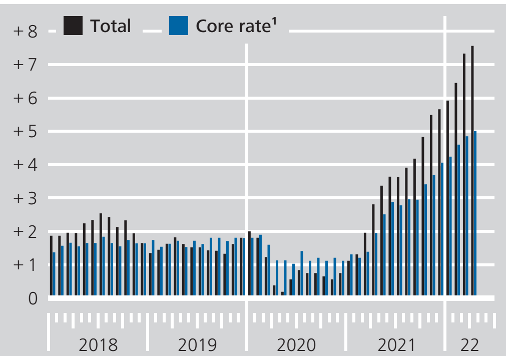
Monthly averages, log scale



Sources: Bloomberg Finance L.P., Haver Analytics and HWWI. • Latest figures: Average of 1 to 13 May 2022, or 1 to 19 May 2022 for crude oil and natural gas.
Deutsche Bundesbank

Consumer prices in industrial countries*

Year-on-year percentage change



Sources: Bundesbank calculations based on national data. * EU, Japan, Canada, Norway, Switzerland, the United States and the United Kingdom. **1** Consumer prices excluding energy and food; additionally excluding alcoholic beverages and tobacco products for the EU, Norway, Switzerland and the United Kingdom.
Deutsche Bundesbank

nificant producers surged.[2] This was mainly on account of concerns about future delivery stoppages and embargo measures. With the supply situation already strained, the price of Brent crude oil climbed by more than one-third in the space of a few days to just under US$134 per barrel, its highest level in 14 years. European natural gas prices, which had already risen very sharply in the months before, almost tripled temporarily in comparison to pre-war levels. Much the same thing happened with coal prices. After it became clear, however, that energy commodities would initially be largely exempt from western sanctions, and with Russian commodity exports falling only moderately to date, most prices came back down again significantly. Growing concerns about Chinese demand in relation to their zero-COVID policy also played a role in the decline in prices.[3] So far, in May, prices for crude oil (at US$110 per barrel) and European natural gas had exceeded their levels before the war by around 13% and 9%, respectively. Prices for industrial raw materials such as palladium, nickel and aluminium also rose, in some cases significantly, at the beginning of the war, before more recently falling below their pre-war levels on balance. By contrast, food prices, particularly those for wheat and corn, continued to rise until recently and were, on the whole, close to their all-time high at the time this report went to press.

Increased consumer price inflation

High energy and food prices were a driving force behind the renewed sharp rise in consumer price inflation around the world. In the advanced economies, annual consumer price inflation reached 7.6% by April, its highest level in more than 40 years. The narrower core definition of inflation, which strips out energy and food, continued to climb as well, reaching 5.0%. In view of persistently high prices for commodities, transport services and other

2 For information on the importance of Russia as a commodity exporter, see Deutsche Bundesbank (2022) pp. 18 f.
3 The release of record high quantities of strategic oil reserves in some producing countries, especially the United States, also dampened crude oil prices. See International Energy Agency (2022).

intermediate goods, consumer prices are likely to keep rising sharply in the coming months.

IMF raises its inflation forecast for 2022 significantly

Against this background, the International Monetary Fund (IMF) significantly raised its inflation forecast for advanced economies for the current year and again stressed the upside risks to this outlook.[4] At the same time, the IMF lowered its global growth forecast for 2022 by 0.8 percentage point to 3.6%. This was mainly due to the war in Ukraine and the western sanctions against Russia, which are likely to plunge the Russian economy into a severe recession. Moreover, the outlook deteriorated particularly sharply for those European countries that are closely economically interconnected with Russia or Ukraine owing to their geographical proximity or are heavily dependent on Russian energy supplies. For the United States and China, the IMF reduced its GDP forecasts only slightly, despite country-specific factors such as the expected tightening of monetary policy in the United States and the strict zero-COVID strategy in China.

Composite Purchasing Managers' Indices in selected large emerging market economies

Seasonally adjusted, monthly data

Source: S&P Global.
Deutsche Bundesbank

China

Economy suffering from strict anti-coronavirus measures for several weeks

For several weeks now, the Chinese economy has been severely affected by strict anti-coronavirus measures. The cities of Shenzhen and Shanghai, with 18 and 26 million inhabitants, respectively, have been in a hard lockdown for weeks. The containment measures had only a tentative impact on economic output in the first quarter. According to official data, real GDP growth even accelerated markedly to 4.8% on the year.[5]

Marked dampening effect on economic output in the second quarter likely

However, as the Chinese government continues to pursue its rigorous zero-COVID policy in the fight against the virus, a strong dampening effect on economic output in the second quarter is to be expected. Private consumption, in particular, is set to decline significantly. Chinese exports are also likely to feel the effects. Although the authorities have tried to allow industrial and port facilities to continue to operate, there have already been considerable production and transport disruptions. This is also likely to impair global supply chains over the next few months. In view of the severe strain the economy is under, the authorities have announced economic stimulus measures. No major monetary policy stimuli have been used so far, however, although China was one of the few countries in which the rise in consumer prices has not accelerated in recent months. In April, the year-on-year rate of inflation was

4 See International Monetary Fund (2022).
5 Compared with the previous period, real GDP rose by a seasonally adjusted 1.3%, which was slightly less than in the final quarter of 2021.

2.1%; excluding energy and food, it was as little as 0.9%.

Other selected emerging market economies

Further recovery in India

India's economic upturn continued in the first quarter of 2022, although the new coronavirus wave at the beginning of the year is likely to have slowed growth somewhat. In the final quarter of 2021, real GDP had already once again clearly exceeded its pre-pandemic level. The export industry has become an important driver of growth in recent quarters, having benefited from, among other things, some large multinational enterprises relocating to India. In the first quarter of 2022, goods exports (in US dollar terms) exceeded the level at the start of the pandemic by just under one-half. Consumer price inflation increased markedly to 7.8% in April against the backdrop of higher food prices. The central bank therefore raised its policy rate at the beginning of May for the first time since 2018, by 40 basis points to 4.4%.

Economic activity in Brazil remains listless

Economic activity in Brazil is likely to have remained anaemic in the first quarter of 2022. Real GDP has been more or less stagnant since as early as the beginning of 2021. Economic output has recently slightly exceeded pre-crisis levels, yet private consumption is still lagging significantly behind. This is also due to the fact that real disposable income fell significantly last year, owing to the sharp rise in prices. Consumer price inflation has continued to accelerate in recent months, reaching 12.1% in April. The central bank has therefore continued to tighten its monetary policy. Since February 2021, it has already raised its policy rate by a total of almost 11 percentage points to 12.75% at the end of the period under review.

Russia facing severe economic crisis as a result of western sanctions

Russia's economy is facing a severe recession owing to the consequences of the Russian invasion of Ukraine. Economic sanctions imposed by western countries, such as the exclusion of Russian banks from the international payment system SWIFT or restrictions on the export of high-tech goods to Russia, have had a particularly significant impact. Russian industry has thus been cut off from important foreign intermediate goods.[6] In addition, many foreign enterprises have ceased business with Russia on their own initiative. Oil and gas exports, the main pillar of the Russian economy, have so far only been partially affected by sanctions and voluntary boycotts. The sharp rise in energy prices is actually gifting Russia with exceptionally high foreign exchange revenue at present. This is another reason why the rouble has more than made up for its initially sharp losses in value. In the future, however, Russian energy exports are also likely to suffer considerable losses, especially if sanctions are expanded. All in all, Russia is thus at risk of large welfare losses over the longer term (see the box on pp. 15 f.). Consumer price inflation surged in the first weeks of the war. Given the subsequent stabilisation of the rouble, however, the inflation rate increased only slightly to 17.8% in April. This allowed the central bank to lower its policy rate, which it had raised substantially to 20% at the beginning of the war, to 14% at the end of the period under review.

United States

Q1 decline in GDP likely only temporary

In the first quarter of 2022, the economic upturn in the United States halted for the first time since the end of the pandemic-induced recession. According to initial estimates, GDP fell by 0.4% on the quarter after price and seasonal adjustment. Nevertheless, the underlying cyclical trend would appear to be intact. Private domestic final demand, often used as a yardstick for said trend, expanded rapidly. Households increased their consumption again, despite considerable losses in purchasing power as a result of the sharp rise in prices. In fact, after

6 According to official Russian data, industrial production was still fairly robust in March. However, major difficulties in the production process are likely to arise once inventories of intermediate goods have been exhausted.

The possible longer-term impact of the Ukraine war on the Russian economy

Russia's economy faces a severe crisis owing to the far-reaching sanctions imposed by western countries and decisions by many foreign enterprises to sever their trading relationships with Russia or cease doing business in the Russian market. The International Monetary Fund (IMF), writing in the April 2022 edition of its World Economic Outlook, forecasts that real gross domestic product (GDP) will shrink by 8.5% this year. Other institutions are predicting that the decline will be significantly heavier still.[1] For the coming year, the IMF is expecting the downward movement to continue, albeit at a much slower pace. The scale of the looming recession is thus likely to far eclipse even the sharp decline in GDP seen during the global financial crisis of 2009.

While the economic downturn back then came in the wake of a protracted and robust upswing, Russia's economy was already lethargic before the current crisis occurred, with real GDP growing by a meagre 0.9% per year on average between 2013 and 2021. Measured in terms of US dollars and current prices, economic output per capita even declined markedly, shrinking from US$15,900 to US$12,200. One notable factor behind this loss of income was the significant drop in the price of oil, and thus in Russia's export revenues, during this period.[2]

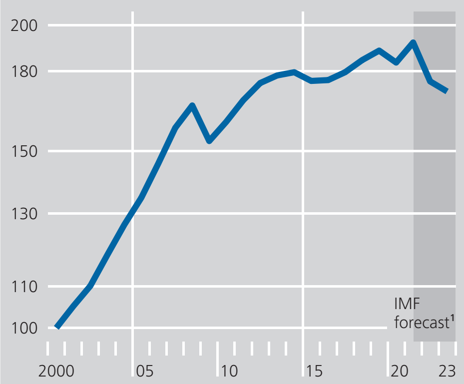
To reduce its reliance on energy exports, the Russian government has been striving for several years to promote industry and other non-commodity sectors. One measure saw the government pursue an import substitution policy, partly also in response to the economic sanctions imposed by western countries in connection with the annexation of Crimea in 2014. This strategy met with little success overall, however. In particular, Russia failed to build up domestic production operations in the high-tech sector that meet western quality standards.

Russia thus remains heavily dependent to this day on foreign intermediate goods, particularly from the EU and other advanced economies. The new export bans introduced by western countries and the supply restrictions imposed by many enterprises are therefore likely to hurt Russian industry in particular. In a recent central bank survey, almost 40% of industrial enterprises reported that they were finding it difficult to source alternative suppliers.[3] Surveys among purchasing managers, furthermore, indicate that delivery times for intermediate goods in manufacturing have increased sharply, which is a sign that firms are experiencing considerable supply chain problems. Russian exporters, meanwhile, need to scout for new sales markets and logistical opportunities. Overall, Russian industry faces the prospect of severe efficiency losses and technological regression now that the country has been largely ostracised from the international community.

1 The Bank of Russia, too, is expecting GDP to contract by between 8% and 10% this year. See Bank of Russia (2022).
2 The price of oil plummeted between mid-2014 and early 2016 as the United States stepped up the production of shale oil, and it did not make a full recovery. See Deutsche Bundesbank (2016) for the impact of the oil price slump on the Russian economy.
3 Russian firms are likely to step up their efforts to source supplies from Asia over the medium and long term. Whether and to what extent trading partners there are willing to do business with them is questionable, however. China, in particular, is unlikely to want to run the risk of undermining western sanctions. See Simola (2022).

Real GDP in Russia

2000 = 100, log scale



Sources: Rosstat and IMF. 1 World Economic Outlook, April 2022.
Deutsche Bundesbank

Services was home to a small number of up and coming business areas before the war broke out, such as the IT sector and finance. They, too, are likely to face stiff headwinds. Recent years have already seen an exodus of highly skilled workers from Russia,[4] and the brain drain looks set to increase further because of the war in Ukraine. Reports suggest that tens of thousands of IT specialists have turned their backs on Russia since the conflict erupted.

All these challenges would suggest that the Russian economy's reliance on oil and gas exports in the coming years will arguably be even greater than it is today. But with many buyers exercising restraint, Russia is currently having to grant hefty price discounts on its oil exports.[5] In addition, the subdued demand may soon leave Russia with no choice but to significantly cut its oil production. The latest forecast by the Oxford Institute for Energy Studies (2022) indicates that oil production is likely to decline from the pre-war level of 11 million barrels per day (mb/d) to around 9 mb/d by the end of 2022. The planned EU embargo could even push this figure down to less than 7 mb/d by year-end.[6]

Russia's gas deliveries are more focused than even its oil exports on Europe as a sales market. Only a very small fraction of Russian gas exports are currently routed via pipelines to China, and the major Western Siberian Yamal gas fields that supply Europe are not even linked up with Asia yet. That situation would only change when the proposed additional pipeline (Power of Siberia 2) goes into operation. However, the negotiations between China and Russia on the terms and conditions of construction are likely to last a few years yet. This contrasts with plans by Germany – currently Russia's most important gas customer – to wean itself off Russian gas by 2024 at the latest. Moreover, it is unclear whether Russia will even be able to shoulder this colossal infrastructure project, with all the sanctions in place.

All in all, the Russian economy not only faces sizeable drops in activity in the short term but also significant scarring in the longer term as a result of the war. The structural problems that already surfaced in recent years will probably become considerably more acute. Overall, Russia is heading towards a situation where it loses a considerable share of its welfare on a lasting basis.

4 Official figures indicate that overall, for every ten people who left Russia fifteen migrated to Russia between 2015 and 2020. However, these were mainly low-skilled workers from other CIS countries. Despite the positive migration balance, the number of people of working age has shrunk by around 8% since 2010. These demographic strains are likely to persist in the years ahead.
5 Russia's Urals brand of crude oil is currently trading at a discount of around US$35 per barrel to the North Sea Brent variety.
6 This forecast seems to be based on the assumption that Russia will probably find it difficult to ship oil originally destined for Europe to Asia by sea. That would call for the mobilisation of a significant fraction of the global fleet of oil tankers. In addition, western countries are looking to clamp down on sanctions-evading transactions of this kind.

price adjustment, expenditure on services exceeded pre-pandemic levels for the first time. Investment in private housing construction rose once again. Spending on new machinery and equipment in trade and industry even expanded very considerably. There was also a similarly steep rise in imports. At the same time, the weaker global economy was reflected in a decline in exports. In addition, the reduced build-up of inventories and the further decline in government demand were a drag on economic growth.

Monetary policy turnaround initiated

By contrast, the US labour market continued its recovery. The unemployment rate almost returned to pre-pandemic levels. At the same time, numerous job openings remained vacant. Given the high demand for labour, wage growth continued to accelerate, while nevertheless remaining below the rise in consumer prices. Consumer price index (CPI) inflation rose to 8.5% in March and fell only slightly in the past month. Against this background, the US Federal Reserve tightened its monetary policy stance, raising its policy rate by a total of 75 basis points in March and May.

Japan

Slight decline in GDP

The rebound in the Japanese economy stalled over the winter. According to the initial official estimate, real GDP in the first quarter fell by a seasonally adjusted 0.2% on the previous quarter. Private consumption stagnated as a result of the rapid spread of the Omicron variant at the beginning of the quarter. Although sickness-related losses of working hours and renewed supply bottlenecks weighed on Japanese firms at the beginning of the year, business investment increased slightly in the first quarter. Imports also picked up substantially. By contrast, there was only a slight increase in exports. Government demand was cut back once again. Labour market conditions continued to improve. The seasonally adjusted unemployment rate declined to 2.6% by March. Annual CPI inflation increased to 2.5% in April,[7] exceeding the Japanese central bank's inflation target for the first time since 2015. However, the central bank assessed the increase in price inflation as temporary and maintained its expansionary stance.

United Kingdom

Marked growth in GDP

The UK economy grew at a slower, but nonetheless solid pace in the first quarter of 2022. According to initial estimates, price and seasonally-adjusted GDP rose by 0.8% on the quarter. This was the first time that the pre-crisis level had been exceeded. The recovery was broadly based across sectors. In particular, high-contact services benefited from the ebbing of the Omicron wave. In the hotel and restaurant sector, real gross value added rose by more than 5%. Construction activity and the manufacturing sector also grew more buoyantly at the beginning of the year than in the previous quarter. However, many industrial enterprises are increasingly complaining about the persistently surging prices for intermediate inputs as well as about supply bottlenecks and labour shortages. The unemployment rate fell to 3.7%, below the low of December 2019. Against this backdrop, wages rose significantly. Annual Harmonised Index of Consumer Prices (HICP) inflation rose sharply, reaching 9% by April. The Bank of England subsequently raised its policy rate by a further 25 basis points to 1% in May and announced additional tightening over the next few months.

Poland

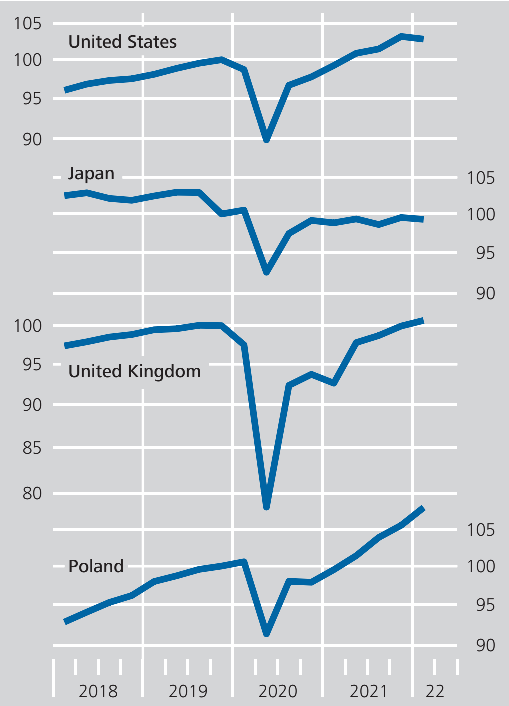
Upswing robust so far

Poland's economic upswing continued in the first quarter of 2022. Real GDP grew by 2.4% after seasonal adjustment. The renewed strong

7 In addition to the rise in energy prices, one reason for this was the expiry of a one-off effect. The substantial reduction in mobile phone charges triggered by a reform in April 2021 had pushed down annual CPI inflation by 1.4 percentage points in March. In April, the decline in mobile phone charges dampened the inflation rate by only 0.6 percentage point.

Real GDP in selected industrial countries

Q4 2019 = 100, seasonally and calendar adjusted, log scale



Sources: Bureau of Economic Analysis, Cabinet Office of Japan, Office for National Statistics, Statistics Poland and Bundesbank calculations.
Deutsche Bundesbank

GDP growth was mainly driven by the further expansion of industrial output. However, consumption activity was also buoyant, with the very favourable labour market situation likely to have been one reason for this. The unemployment rate stood at just 3% in March, and gross average wages in the corporate sector rose by 12.4% on the year. Russia's invasion of Ukraine also represents a turning point for Poland. At 3.7% of total exports, its share of exports to Russia is almost twice as high as that of Germany. In addition, Poland is the main destination for refugees from Ukraine.[8] However, the commodity crisis and the Russian gas embargo have not caught the country off guard. Poland has been in the process of reducing its energy dependency on Russia for years.[9] Despite price-dampening measures introduced by the government, consumer price inflation increased to 12.4% by April. Energy and food accounted for a considerable share of this, but the core rate excluding these components also rose to 7.7%. As a result, the Polish central bank raised its policy rate in four further increments between February and May by a total of 300 basis points to a current level of 5.25%.

Macroeconomic trends in the euro area

Further slight increase in economic activity

The euro area economy also grew only slightly in the first quarter of 2022. According to Eurostat's flash estimate, GDP rose by 0.3% on the quarter after price and seasonal adjustment, thereby exceeding its pre-pandemic level by 0.5%. At the beginning of the quarter, the Omicron wave, in particular, weighed on services sector activity. Towards the end of the quarter, the impact of the war prevented a stronger recovery. As a result, parts of industry experienced production stoppages and private consumption suffered from the erosion of purchasing power caused by energy prices.

Ongoing strains caused by the war on Ukraine

In the medium term, too, the impact of the war on Ukraine is likely to weigh on the euro area economy, especially if the conflict escalates further and associated sanctions and retaliatory measures are expanded.[10] In addition to higher energy prices, the heightened uncertainty, for example regarding the reliability of the energy supply, and possible supply stoppages for other commodities, are the main constraining factors. Conversely, the export losses in the Russian sales market are likely to be of lesser importance. Russia accounted for merely 3% of euro area goods exports in 2021.

By contrast, the burdens caused by the coronavirus pandemic are likely to wane further. The

8 According to the Polish Border Guard, more than 3.2 million refugees from Ukraine have entered Poland to date, although they have by no means all remained there. In Poland, Ukrainians can take up work without a work permit for six months within one year. In the years prior to the war, there were already up to 1.7 million such employment contracts per year.
9 Poland has had an LNG terminal for importing liquefied gas since 2015. Moreover, the new Baltic Pipe system is scheduled to be completed this year, which will allow pipeline-based gas imports from Norway.
10 See Deutsche Bundesbank (2022).

Pandemic-related burdens waning

economic impact of the Omicron wave at the beginning of the year was already much smaller than previously expected. Although, for a time, a considerable number of working hours were lost due to illness, these absences were mostly short-lived and the health system was not overwhelmed as had been feared. As a result, containment measures were further eased, which benefited service providers in particular.

Subdued consumption activity …

Consumption activity in the euro area remained subdued in the first quarter of 2022. After the recovery phase in the final quarter of 2021, retail sales fell again in price-adjusted terms. New motor vehicle registrations even dropped quite substantially again and were down by one-third on their pre-pandemic level. This was probably partly due to supply difficulties for intermediate input products for motor vehicle production worsening again in connection with the Ukraine war. In any event, according to European Commission surveys, the propensity to purchase passenger cars decreased only slightly. The consumption of services is also likely to have barely increased on a quarterly average, although it made a clear recovery over the course of the quarter once various infection protection measures had been eased.

… also due to the pronounced losses in purchasing power

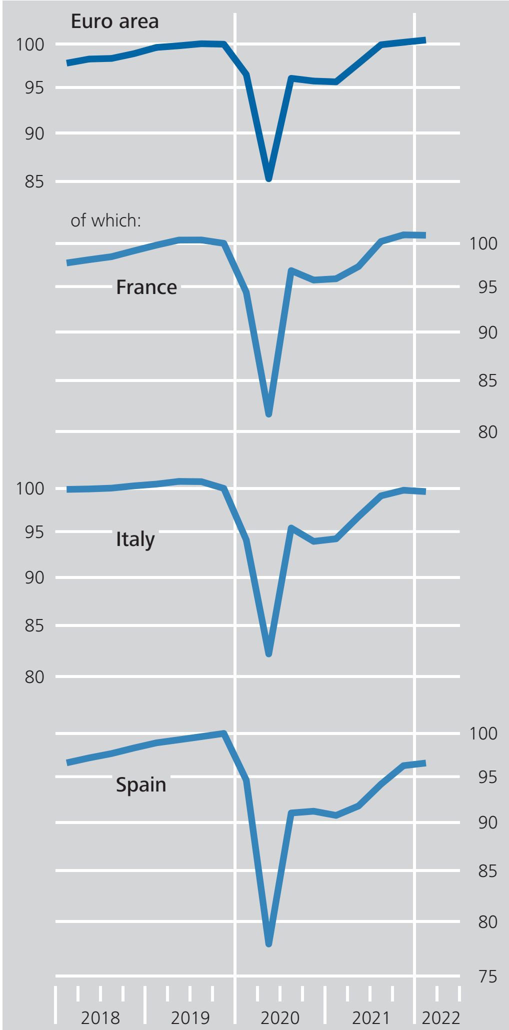
A major reason for the subdued development of private consumption is likely to have been the significant deterioration in households' financial situation. In the first quarter, consumer prices rose by no less than 6.1% on the year. The increase in the wage bill is expected to have lagged considerably behind this. The various fiscal relief measures are also unlikely to have made up for the losses in purchasing power.[11] As a result, consumer confidence fell distinctly below its long-term average until March, according to European Commission surveys.

Investment remains on an upward trajectory

Gross fixed capital formation is likely to have risen further in the first quarter.[12] Construction output rose very robustly. The upward trend in investment in information and communication technologies and intellectual property seems to have continued. By contrast, expenditure on transportation probably declined. In any case, the number of commercial vehicle registrations fell very steeply again, which is likely to have been partly due to supply bottlenecks. By comparison, investment in other machinery and equipment probably increased markedly. In January and February, capital goods producers'

Aggregate output in the euro area

Real GDP, Q4 2019 = 100, seasonally and calendar adjusted, log scale



Sources: Eurostat and Bundesbank calculations.
Deutsche Bundesbank

11 See Sgaravatti et al. (2022) for an overview of the fiscal measures taken to cushion the increase in energy prices.
12 Excluding Ireland. For several years now, the statistical recording of investment as a whole, and of investment in intellectual property in particular, has been strongly influenced by the strategic planning of multinational enterprises in that country. See Deutsche Bundesbank (2018).

Consumer sentiment in the euro area*

Balance of positive and negative responses as a percentage of all responses, seasonally adjusted, monthly data

Source: European Commission. * Deviations from the respective average since 2000. **1** Response to the question: "In view of the general economic situation, do you think that now it is the right moment for people to make major purchases?"
Deutsche Bundesbank

domestic sales significantly exceeded the previous quarter's level after price adjustment.

Goods trade with third countries sees strong growth given surging prices

Euro area countries' exports of goods to third countries continued to increase in the first quarter after price adjustment. This is likely to have been due, in particular, to favourable global industrial activity at the beginning of the year, but also to the depreciation of the euro in recent months. In terms of value, goods exports even rose by a very substantial degree again in the light of continued surging prices. This was particularly true of goods exports to the United States. Exports to China also expanded visibly. By comparison, exports to Russia declined significantly under the influence of the war on Ukraine. According to figures from the balance of payments, the recovery of services exports from the euro area to third countries slowed markedly. One reason for this was probably the pandemic-induced slump in tourism at the beginning of the year. Goods imports to the euro area from third countries increased only marginally in real terms in the first quarter. The largest increases were consistent with the robust investment activity in intermediate and capital goods, whilst imports of consumer goods declined. In terms of value, imports rose very sharply amidst the considerable price increases.

Situation in manufacturing strained again recently

The upward movement in manufacturing continued at the beginning of the year, mainly due to the at times marked easing of some supply bottlenecks coupled with well-filled order books. The outbreak of the war has directly hampered those sectors, in particular, whose supply chains extend to Ukraine and Russia. This includes, above all, motor vehicle manufacturers. Moreover, the sanctions prevented certain products from being delivered and orders were not placed. In addition, the costs for intermediate goods continued to rise. In view of the heightened uncertainty, the order situation deteriorated somewhat. All of this contributed to a significant decline in industrial production in March. Nevertheless, capacity utilisation picked up slightly between January and April, thus continuing to exceed the long-term average. Industrial producer prices rose at a faster pace. Price inflation was especially pronounced for intermediate goods but it also increasingly extended to capital and consumer goods.

Service providers see slight recovery at the end of the quarter

Economic output in various services sectors is likely to have recovered at the end of the quarter. Especially hotels and restaurants as well as art and cultural activities widened their services considerably following the easing of containment measures. As businesses were still subject to extensive restrictions at the beginning of the year, on a quarterly average the previous quarter's level was probably just maintained. By contrast, various business-related services are likely to have expanded further. Activity in the information and communications sector increased particularly significantly once more.

In most Member States, economic output increased in the first quarter of 2022. The main

Economic output rose in most Member States

factors behind the remaining growth disparities were the effects of the last wave of the pandemic, the impact of the war on Ukraine and sanctions on Russia.

French economy stagnates

In France, real GDP in the first quarter stagnated at the previous quarter's level. The decline in private consumption, in particular, was a drag. Especially at the beginning of the quarter, the consumption of services was restricted against the backdrop of the resurgent infection rates. The consumption of goods likewise declined significantly. This is likely to have been partly due to greater price pressures despite the energy price brake. Investment remained on a moderate upward trajectory, by contrast. Although services exports rose markedly once more, the pandemic is likely to have distinctly slowed business activity in the tourism sector. Growth in goods exports weakened significantly, as did growth in goods imports.

Decline in Italy's real GDP

In Italy, too, the recovery in macroeconomic activity came to a standstill at the beginning of the year. According to preliminary data, real GDP fell by as much as 0.2% in the first quarter, thus remaining slightly below its pre-crisis level. A key reason for this was a pronounced setback in industrial production, which was probably due in part initially to a shortage of intermediate input products and later to business with Russia coming to a halt and the steep rise in energy prices. The services sector, too, generated only very little stimulus. Domestic tourism collapsed at the beginning of the year, and the number of foreign tourists has not yet returned to pre-pandemic levels, either.

Activity in Spain continuing to rise, but significantly more slowly

According to preliminary estimates, in Spain aggregate output in the first quarter rose slightly by 0.3% on the quarter. At 3.5%, the gap compared with the pre-crisis level thus remained significantly larger than in the other euro area countries. Here, too, a decline in private consumption was the main reason for the slowdown in the recovery, with the pandemic likely to have played only a minor role. Losses in purchasing power as a result of the sharp rise in consumer prices, especially for energy, were a much more significant factor. The continued recovery of tourism had a counterbalancing effect.

Marked differences in the smaller Member States

In Austria and Portugal, GDP increased considerably once most infection protection measures had been lifted, with tourism likely to have played a key role. In Belgium, real GDP rose moderately. Despite potentially considerable strains caused by the war on Ukraine, activity also increased in Finland, Slovakia, Lithuania and Latvia, probably mainly as a result of the good start to the year once the infection protection measures had been eased. GDP in the Netherlands was unchanged.

Further improvement in labour market situation at the beginning of the year

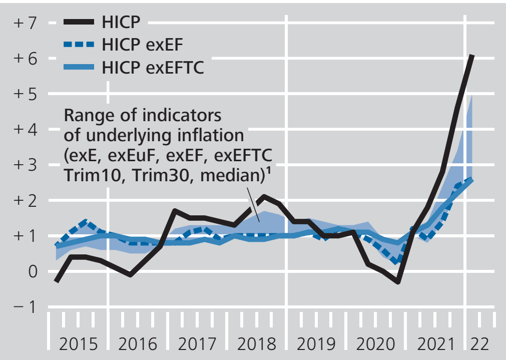
The labour market situation improved once again in the euro area. The unemployment rate fell to a new low of 6.8% in March 2022 and the number of persons in employment continued to rise in the first quarter. The employment outlook deteriorated markedly in industry and services over the course of the quarter. At the same time, surveys indicate that the shortage of labour was more pronounced than ever before. The rise in gross wages and salaries per employee is likely to have accelerated further in the first quarter, in part due to minimum wage hikes. However, the increases are not likely to have kept pace with inflation, meaning that real wages probably declined.

Surge in consumer prices in Q1 2022

Consumer price inflation intensified in the euro area in the first quarter of 2022. The HICP increased by a seasonally adjusted 2.7% on the quarter. Prices for energy and other industrial goods, in particular, rose more sharply than ever before. Food prices saw their steepest growth since 2007, and the rise in services prices also remained exceptionally strong. Annual headline HICP inflation subsequently jumped from 4.6% in the fourth quarter to 6.1%, with energy prices rising by 35%. The inflation rate excluding energy and food grew from 2.4% to 2.7%.

Underlying inflation in the euro area

Year-on-year percentage change, quarterly data



Sources: Eurostat and Bundesbank calculations. **1** exE = HICP excluding energy, exEuF = HICP excluding energy and unprocessed food, exEF = HICP excluding energy and food, exEFTC = HICP excluding energy, food, travel and clothing, Trim10 = mean trimmed by 10%, Trim30 = mean trimmed by 30%.

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Business sentiment in the euro area*

Balance of positive and negative responses as a percentage of all responses, seasonally adjusted, monthly data

Source: European Commission. * Deviations from the respective average since 2000.

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Persistent price pressures stemming from upstream stages

The main reason behind the accelerated consumer price inflation is the increase in cost pressures at upstream stages. Crude oil prices and wholesale prices for natural gas continued to rise as a result of the Ukraine war, as did other commodity prices, and supply bottlenecks intensified again. For example, European cereal prices rose by more than 10% on the quarter and by more than 50% on the year. The price of industrial inputs increased by a further 6% on the quarter and by more than 20% on the year. Although these broad-based cost pressures have already been clearly reflected in consumer prices, they are unlikely to have been passed through in full yet.

Inflation rate remained at all-time high in April

In April, the annual HICP rate remained at 7.4%, as in the previous month. Annual rates of change in prices of food, services and non-energy industrial goods reached their highest levels since the beginning of monetary union. The inflation rate excluding energy and food picked up robustly from 3.0% to 3.5%. According to market and survey-based inflation expectations, inflation rates are expected to normalise only very gradually. Inflation expectations for 2023 are still significantly elevated. At present, they are not moving towards the 2% mark again until 2024 (see p. 44).

Distinct negative effects in the current quarter due to rising costs and heightened uncertainty

In the current quarter, economic development is likely to be largely slowed by the impact of Russia's invasion of Ukraine and the resulting sanctions. High commodity prices, especially for energy, are a considerable drag, and there is a great deal of uncertainty about the stability of the supply of commodities. While industrial enterprises are increasingly trying to tap alternative delivery channels and safeguard value chains, this costs time. Supply bottlenecks are also likely to intensify in the face of pandemic-related restrictions in China. All of this is visibly weighing on business sentiment, especially in industry. Sentiment among service providers, who can hope to benefit from the easing of infection protection measures, remained more upbeat. However, they, too, might feel the effects of the restraint shown by households, who are suffering from the erosion of purchasing power as a result of the sharp rises in prices. According to European Commission surveys, consumer confidence, including, in particular, the propensity to make purchases and expectations with regard to the future financial situation, deteriorated again in April and fell clearly below the long-term average. This could significantly impair the robust recovery in private consumption expected before the outbreak of the war.

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