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World economic outlook in autumn 2022: The economy is bruised, but not broken

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- The world economy is expected to grow by 3.3% in 2022 despite record increases in commodity prices, exacerbated by Russia's invasion of Ukraine. 2023 is also likely to be a resilient year, with projected growth of 3.1%.

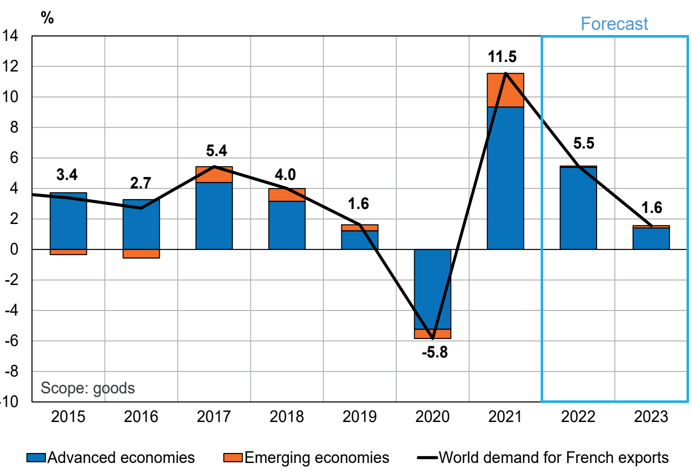
- Advanced economies are expected to slow amid monetary tightening and high energy prices. Still, moderate growth is forecast thanks to fiscal support measures such as the European recovery plan, room for catch-up in some countries and the gradual easing of supply chain disruptions. The United Kingdom stands out as an exception: it is projected to enter a recession in 2023, with the Bank of England abruptly raising rates in an attempt to tame particularly high inflation, a result of Brexit-related supply challenges and a lack of energy price regulation measures.

- A sharp slowdown is projected for the Chinese economy, with the country's zero-COVID policy and real estate crisis weighing on activity and government support measures doing little to help with pandemic-related uncertainty. In Russia, although capital controls and fiscal support measures helped to mitigate the immediate impact of sanctions, it looks as though the economy will enter a deep recession in 2022 and 2023.

- After a powerful rebound in 2021, world trade in goods will likely remain strong in 2022 before slowing more sharply in 2023 (see chart on this page). Growth in foreign demand for French goods is expected to outpace world trade growth in 2022 – as European countries catch up on trade – but lag behind in 2023.

- The main risks to this international scenario are geopolitical uncertainty, energy supply, the risk of de-anchored inflation expectations, policy-mix developments and climate risks.

Projected growth in world demand for French exports



Source: DG Trésor.

1. Many economies are in the midst of monetary tightening and high energy inflation

Our international projections rely in part on assumptions about future financial conditions, fiscal policy, commodity prices and the public health situation. The cut-off date for these assumptions is 22 August 2022.

Faced with rising inflation, the central banks in the United States (the Fed), the United Kingdom (BoE) and Europe (ECB) all swiftly pivoted to monetary tightening. July and August saw key rate hikes of 75 basis points (bps) from the Fed and 50 bps from both the ECB and BoE, with more likely to follow at a steady pace into early 2023.[1] At the same time, central banks are expected to speed up their balance sheet reductions, limiting reinvestments of principal payments from the bonds they hold. In the wake of key rate increases and the end of quantitative easing,[2] long-term sovereign yields should continue to rise. Similar increases are underway in some emerging economies, including India, where monetary tightening is expected to continue through to the end of the year, and Brazil. In contrast, China is expected to maintain an accommodative monetary policy to support investment and mortgage lending. Turkey's central bank announced another interest rate cut,[3] stoking already extremely high inflation (80% in August) and heightening uncertainty as to the direction of monetary policy. In Russia, after raising rates from 8.5% to 20% to mitigate the effects of the war, the central bank progressively reduced its key rate, bringing it down to 8% at the end of July, as inflation began to subside after peaking at 17.1% in May.

While monetary policy is being used to slow activity, fiscal policy is set to keep demand high in the major advanced economies. In Europe, public spending – such as expenditure funded by the NextGenerationEU Recovery and Resilience Facility (€312.5bn in grants and €360bn in loans) – is expected to support economic growth, particularly in Spain and Italy. Additionally, household and business support measures introduced in Europe (see Box 1) should help cushion inflation shocks.

As for commodities, natural gas prices remain extremely high on the European market, with no recent signs of easing. In contrast, oil prices, which shot up after the invasion of Ukraine, have begun falling back down, ending August at close to February 2022 levels. The same downward trend has been seen in agricultural prices, and to an even greater degree in industrial metal prices (see Box 2). This is due to the anticipated impact of monetary tightening on demand, the slowdown in China in the wake of fresh lockdowns and the gradual easing of supply chain disruptions, with ocean freight in particular.

In our forecast, we set the price of a barrel of oil at a level consistent with market expectations, coming in at $95.60 per barrel for the final four months of 2022 and $89.50 in 2023. As for other commodities, we assumed they will continue their recent downtrend, with the exception of gas. We kept the exchange rate for the euro steady at $1.02.

We expect the pandemic to have less of an influence on global economic activity than in previous years. Of the world's large economies, only China's is expected to remain noticeably affected, as a result of its government's commitment to a zero-Covid strategy. Thanks to widespread vaccine coverage, tourism is expected to bounce back strongly in most major economies.

(1) The Fed funds rate is expected to hit 4.7% in April 2023 (up from 2.75% in early September) and the BoE's 3.4% in May 2023 (up from 1.75%); the ECB's deposit facility rate (the interest rate banks receive for depositing money with the central bank overnight) is projected to end 2023 at 2.25% (up from 0%).

(2) The ECB discontinued net asset purchases under the APP as of 1 July 2022 but does not plan to end reinvestments of principal payments until well after the start of its rate increases (late 2024 for assets purchased under the Pandemic Emergency Purchase Programme, or PEPP). The Fed confirmed it was ending net asset purchases in March 2022, after starting to taper them off in November 2021, and began gradually reducing its balance sheet in early June. The Bank of England discontinued its net asset purchases in December 2021 and announced a partial end to reinvestments in February 2022.

(3) On 18 August 2022, the central bank lowered its key rate by 100 bps, bringing it to 13.0%.

2. International scenario: a sharp slowdown in economic activity

Table 1: Growth forecasts

	2015-2019 average	2019	2020	2021	2022	2023	Cumulative since 2019 [a]		
					(forecasts, working-day adjusted)		2021	2022	2023
World growth	**3.4**	**2.9**	**–3.1**	**6.1**	**3.3**	**3.1**	**2.9**	**6.2**	**9.5**
Advanced economies[b]	**2.1**	**1.7**	**–4.5**	**5.2**	**2.4**	**1.5**	**0.5**	**2.8**	**4.4**
Euro area[c]	**2.0**	**1.6**	**–6.4**	**5.4**	**3.1**	**1.5**	**–1.3**	**1.8**	**3.4**
Germany	*1.7*	*1.1*	*–4.6*	*2.9*	*1.6*	*0.8*	*–1.8*	*–0.2*	*0.5*
Spain	*2.8*	*2.1*	*–10.8*	*5.1*	*4.6*	*2.0*	*–6.3*	*–2.0*	*0.0*
Italy	*1.0*	*0.5*	*–9.0*	*6.6*	*3.7*	*1.1*	*–3.0*	*0.5*	*1.7*
United Kingdom[d]	2.1	1.7	–9.3	7.4	3.2	–0.8	–2.6	0.6	–0.2
United States	2.4	2.3	–3.4	5.7	1.6	1.2	2.1	3.8	5.0
Japan	0.9	–0.2	–4.5	1.7	1.3	1.8	–2.9	–1.6	0.1
Emerging economies[b]	**4.4**	**3.7**	**–2.0**	**6.8**	**3.9**	**4.1**	**4.6**	**8.7**	**13.2**
Brazil	–0.5	1.2	–3.9	4.6	1.8	0.7	0.5	2.4	3.1
China	6.7	6.0	2.2	8.1	4.0	5.5	10.5	14.9	21.3
India[e]	6.6	3.7	–6.6	8.7	7.3	5.9	1.5	8.9	15.4
Russia	1.0	2.2	–2.7	4.7	–5.0	–4.0	1.9	–3.2	–7.1
Turkey	4.2	0.9	1.8	11.0	4.9	3.0	13.0	18.5	22.0

a. Cumulative growth rates between 2019 and 2021, 2019 and 2022, and 2019 and 2023.
b. Aggregate forecast figures for advanced economies and emerging economies are based on IMF projections adjusted using *DG Trésor* projections covering the countries in the table above, with past figures adjusted for revisions to national accounts.
c. Aggregate figures for the euro area are calculated using quarterly accounts, adjusted for working days. Forecast figures are estimated based on European Commission projections adjusted using *DG Trésor* projections for Germany, France, Italy and Spain. The ECB published new projections on 8 September, after the *DG Trésor's* forecast cut-off date, and now projects +3.1% in 2022 and +0.9% in 2023.
d. The forecast cut-off date was prior to the publication of the ONS Blue Book, which revised 2020 growth downward from –9.3% to –11%.
e. India's fiscal year growth is 8.7% for 2021/2022, 7.3% for 2022/2023 and 5.9% for 2023/2024.

Source: IMF July 2022 World Economic Outlook; European Commission Summer 2022 Economic Forecast; DG Trésor calculations and projections.

2.1. Slowdown in global economic growth and trade

After bouncing back strongly in 2021 (6.1%), global economic growth is expected to come in at 3.3% in 2022, despite tightening financial conditions, the economic impact of the war in Ukraine and a COVID-19 resurgence in China. Emerging economy growth should be close to its pre-crisis average (3.9%), thanks in large part to strong economic activity in India, whereas China can expect a steep slowdown and Russia a recession. For advanced economies, 2022 is expected to deliver growth at above pre-pandemic levels (2.4%) as European economies continue to catch-up to their pre-pandemic GDP levels. In 2023, the global economy is expected to grow at a rate approaching its pre-pandemic trend (3.1%), with a slight acceleration in emerging economies (4.1%) almost fully offsetting a slowdown in advanced countries (1.5%).

World trade in goods returned to its pre-Covid trend in 2021, posting growth of 12.6%. Although expected to slow in 2022, it should remain strong (4.6%). In 2023, we foresee slowing economic activity causing trade growth to fall to 2.1% from its pre-crisis level of 3.2% for the 2015-2019 period.

Growth in foreign demand for French goods is expected to outpace world trade growth in 2022 (5.5%) – as France's main trading partners continue catching-up to their pre-crisis trade levels – but then drop off in 2023 (1.6%) due to a slowdown in Europe.

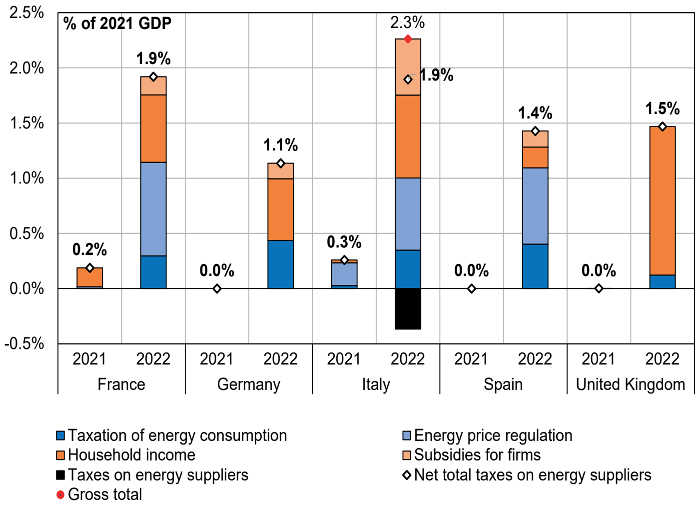
Box 1: Massive fiscal policy measures in Europe in response to rising inflation

We sought to compare the policy measures introduced by major European countries to address the elevated pace of price increases beginning in autumn 2021, particularly energy prices and more recently food prices. We limited our analysis to government measures taken in response to the sharp rise in inflation since mid-2021, announced up to 26 August 2022. Our calculations are somewhat uncertain as the cost of some measures will depend on price developments and actual disbursement figures; the measures announced by each country may have changed after these estimates were finalised. Measures adopted to mitigate the effects of rising prices on households and firms take the form of either (1) a reduction in sale prices (taxation of energy consumption[a] and energy price regulation[b]), with a downward effect on inflation, or (2) an increase in the income of households[c] and firms. We also included taxes on energy sector firms, but only if they were specifically introduced in reaction to rising energy prices to fund support measures for households and firms.

Among the major European countries, France has one of the largest fiscal packages for 2021-2022 combined, coming in at 2.1% of GDP, compared to 1.1% in Germany,[d] 1.5% in the United Kingdom[e] 1.4% in Spain and 2.5% in Italy (see Chart 1). The measures introduced in France (€5bn in 2021 and €48bn in 2022) include a cap on increases in gas and electricity prices and a fuel price rebate. According to France's national institute of statistics and economic studies (INSEE), these measures appear to have reduced inflation by 3 points in Q2 2022 compared to Q2 2021[f] significantly containing inflation in France compared to its main neighbours. Germany's fiscal package, valued at €41bn, contains direct household income support (including a €300 lump sum for energy price relief) and energy tax cuts, but less generous support for firms (targeted subsidies totalling €5bn).

Italy has earmarked €40bn in support measures for 2022, which includes €13bn in household income support, €9bn in subsidies for firms and €18bn in tax cuts. Of particular note is a reduction in general system charges on electricity bills, at a cost of €12bn. Spain's package of measures should cost €17bn, the majority of which have a direct impact on consumer prices (via fuel price rebates costing €5bn in 2022). In the United Kingdom, fiscal support measures are valued at €34bn for 2022, consisting mainly of direct payments for the most vulnerable households, with payments of £650 for low-income earners, £300 for retirees, £150 for people with disabilities and £400 for energy price relief.

Chart 1: Fiscal packages to protect households



Source: DG Trésor.

a. Measures used to lower energy prices (fuel, electricity, gas) via tax relief, such as France's decision to lower the domestic consumption tax on electricity for end-users (TICFE).
b. Measures used to lower energy prices directly or indirectly without touching taxation. This includes price caps, which are measured on the basis of compensation paid to suppliers.
c. For households, this includes all measures that directly support household incomes, via transfers (cheques) or income tax cuts.
d. A new €65bn package of measures was announced on 4 September. This amount includes previously announced measures, with most new measures set to take effect in 2023. The additional amount for 2022 is roughly 0.2 points of GDP.
e. On 8 September, Liz Truss announced a support plan, estimated at £150bn by the media, whose main measures include a cap on gas and electricity prices for households (for 2 years) and firms (for 6 months).
f. See the INSEE statistical study of 1 September 2022, "La flambée des prix de l'énergie".

2.2. Advanced economies to remain resilient despite imported inflation shocks

In 2022 and 2023, advanced economies can expect a pronounced slowdown in activity, in response to high inflation and monetary tightening. Factors expected to contribute to different rates of growth between major countries include differences in catch-up potential, exposure to impacts from the war in Ukraine, the size of rate hikes and fiscal support measures. In all countries, inflation should start to come down.

In the United States, which swiftly returned to its pre-COVID level of activity in 2021, GDP contracted in the first half of 2022. It is not expected to last: the US economy is projected to rebound in the second half, ending the year with an annual GDP increase of 1.6%. In 2023, the Fed's rate hikes should help curb inflation, but at the expense of limited growth (1.2%). Residential investment is expected to decline due to monetary tightening. However, the US economy should be able to count on a continued strong labour market and an improved trade balance: consumer spending will likely shift back toward services, following the rise in import-heavy durable goods spending (such as used cars) after households received stimulus cheques.

Germany is expected to post moderate growth in 2022 (1.6%) and lower growth in 2023 (0.8%), due to weak performance in exports and investment. Supply chain disruptions are likely to weigh on manufacturing investment and exports amid softening demand, particularly from China. The increased price of gas, which makes up more than a quarter of the country's primary energy consumption, is expected to put a drag on private consumption and export competitiveness.

The United Kingdom should still see healthy growth in 2022 (3.2%) before entering a recession in 2023 (−0.8%). Inflation is particularly high in the UK, driven by a tight labour market conducive to wage-price spirals, and because the government opted to send cheques to low-income households instead of introducing price caps to fight inflation. Over our forecast horizon, we expect private consumer spending to slow due to energy price surges, and investment to be curbed by rate hikes from the Bank of England.

Strong growth is also forecast for Italy in 2022 (3.7%). The economy is being supported by a sizeable recovery plan (totalling €235bn between 2021 and 2026, or 13.1% of 2019 GDP) that is 87% funded by the NextGenerationEU recovery plan. Private investment is particularly strong, thanks to an energy-efficiency building renovation bonus.[4] Growth is expected to be more limited in 2023 (1.1%), partly due to an anticipated delay in the disbursement of funds from the national recovery and resilience plan.

Spain, where activity remains far below Q4 2019 levels (−2.5% in Q2 2022), is expected to post the highest growth rate among developed economies in 2022 (4.6%). Drivers of activity include public investment funded by the NextGenerationEU plan (with the funds to be received by Spain representing 11.3% of 2019 GDP over the 2021-2026 period) and exports, with the recovery of its tourism sector (in June 2022, Spain saw tourist arrivals return to 85% of 2019 volume). Growth in 2023 (2.0%) will see the country return to its pre-pandemic level of activity by the end of the year.

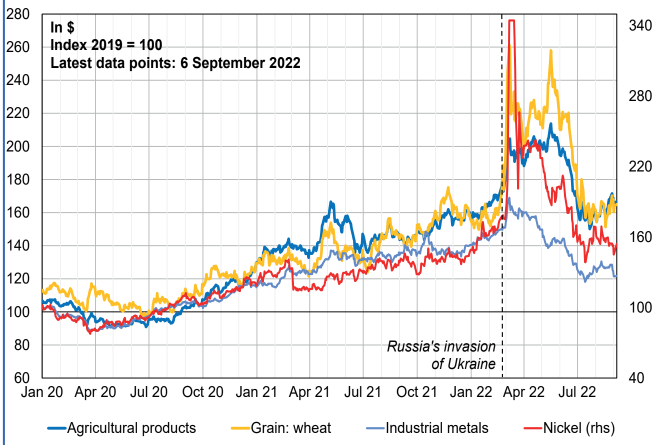
Although Japan was not as hard hit by the COVID crisis in 2020, its recovery has been slower than in other major advanced economies. Growth is expected to come in at 1.3% in 2022 and 1.8% in 2023. Thanks to exports spurred by a weak yen, the Japanese economy should return to its pre-crisis level by the end of 2023.

(4) Under what is known as the *Superbonus* 110% scheme, homeowners are entitled to a tax credit equal to 110% of the cost of work done to improve a building's energy efficiency or earthquake resilience. A total of €47bn is earmarked for the scheme.

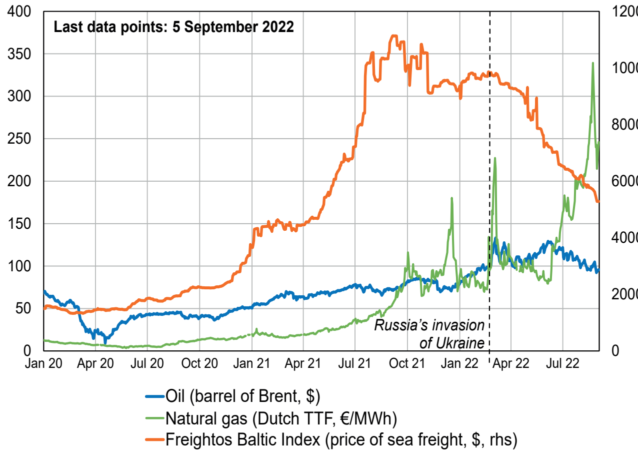
Box 2: Supply chain disruptions to remain high but show signs of easing

After COVID-19 triggered a collapse in prices of commodities and freight transport by sea, the post-lockdown surge in global demand led to supply-chain disruptions in 2021. Pandemic restrictions disrupted industrial value chains and caused consumer spending to plummet, sapping global demand for commodities. As a result, prices hit record lows, with natural gas dropping below €4/MWh in May 2020. When lockdowns were lifted in 2021, consumption picked up again, particularly in durable goods, as did manufacturing activity, causing a surge in energy demand (see Chart 2). The Brent crude oil price[a] hit its 2021 high of $85 in October, and Dutch TTF gas[b] peaked at €180/MWh in December. Delivery lead times and freight prices also skyrocketed, with the Freightos Baltic Index hitting $11,000[c] in September 2021 (compared to $1,350 in February 2020).

Chart 2: Benchmark commodity prices (left) and natural gas, oil and ocean freight prices (right)



Source: GSCI, DG Trésor calculations.



Source: ICE Futures Europe, Freightos Baltic Index, DG Trésor calculations.

By late 2021 commodity prices had started to go down, but then Russia's invasion of Ukraine compromised the medium-term security of supply, sending the prices of oil, gas, agricultural products and industrial metals soaring. In March 2022, oil prices hit their highest levels since 2008 (with a barrel of Brent trading at $133 on 8 March), and the price of gas hit its first peak of €227 on 7 March. Since Russia is a major exporter of rare metals used in manufacturing (accounting for 30% of global exports for chromium and ferrotitanium, and 25% for palladium and nickel), the invasion of Ukraine caused precious metal prices to spike, with nickel in particular doubling in price between late February and mid-March. With Ukraine also accounting for 30% of world sunflower exports and 12% of wheat, the war also put upward pressure on agricultural prices, with the price of wheat jumping 60% between February and May 2022.

Prices have since come down from their spring 2022 peaks, with commodity prices (excluding gas) back to pre-Ukraine war levels and freight rates continuing to ease. In August, the Brent oil price climbed down to around its pre-war level ($98) in response to an anticipated drop in demand and, to a lesser degree, an increase in supply from producing countries. Agricultural commodity prices stand, as of late August, slightly below pre-invasion levels, despite the impact of droughts on crops. Industrial metals saw an even more dramatic drop in prices, plummeting by a third between early March and July to end up at H1 2021 levels. The price of gas in Europe (TTF), on the other hand, remains high and volatile amid a sharp reduction in Russian supply. The price shot up in the summer, peaking at €339/MWh in late August. As for sea freight, the Freightos Baltic Index declined ($6,000 in August 2022) due to: (1) a short-term rate freeze by two major carriers (CMA CGM and Hapag-Lloyd); (2) the flattening of US demand for durable goods; and (3) round-the-clock operations at some US ports. The Global Supply Chain Pressure Index, calculated by the New York Fed,[d] has been on the decline since April, hitting its lowest level since February 2021, a sign of easing supply chain tensions.

a. The price of a barrel of Brent, Europe's crude oil benchmark, fluctuated between $40 and $80 between 2015 and 2019.
b. The Dutch TTF (Title Transfer Facility) gas price, Europe's natural gas benchmark, fluctuated between €10 and €30/MWh between 2015 and 2019.
c. The Freightos Baltic Index, which is calculated from a large worldwide sample of freight rates, measures the average price of shipping a 40-foot container on the world's 12 main trade routes.
d. The Global Supply Chain Pressure Index (GSCPI) is a composite index designed to measure the level of tension on global supply chains, based on shipping cost indicators (air and sea freight) and supply-related data from purchasing manager surveys.

2.3. Emerging economies to see a slowdown in China and a deep recession in Russia

Activity in China is being heavily impaired by the country's zero-Covid policy and its waves of local restrictions, as well as the real estate crisis that began in autumn 2021.[5] The government has stopped mentioning its growth target for 2022 (5.5%), with growth projected at only 4%, supported by a positive contribution from foreign trade and by the policy mix. The country's central bank has made several moves to loosen monetary policy, and the central and local governments have introduced more fiscal and tax measures to support business and investment. Although pandemic uncertainties may prevent the targets of this support policy from being reached, it is projected to yield results in the second half of the year, generating a rebound in activity that will carry over into 2023. This carry-over effect should lead to 5.5% growth in 2023, despite the medium-term effects of the country's zero-Covid policy (increased uncertainty, a deteriorating business environment and a declining job market).[6]

Turkey is expected to post strong growth in 2022 (4.9%), alongside inflationary pressures, driven by ultra-accommodative monetary policy and the return of tourist activity. Consumer spending is forecast to be strong despite extremely high inflation (above 80% in August), supported by lending and a healthy labour market. However, this growth trend is expected to lose momentum in 2023 and risks are tilted to the downside, in relation to unorthodox monetary policy and with general elections approaching in summer 2023. Growth is forecast to stand at 3% in 2023.

In Russia, GDP is expected to decline 5% in 2022 and 4% in 2023 (see Box 3). Preliminary figures show that international sanctions have had a significant and growing impact on the Russian economy. In 2022, the main impacts of the crisis are likely to be on exports, consumer spending and, to a lesser degree, investment. In 2023, with no new growth drivers, activity is likely to continue to deteriorate, with shrinking domestic demand and declining exports, particularly oil and gas exports, between the European oil embargo and the Russian government's moves to restrict exports to the EU.

India saw an 8.7% rebound in activity in 2021/2022,[7] exceeding its pre-pandemic level. Despite a highly countercyclical budget based on an infrastructure-focused recovery plan amounting to 3% of GDP, growth is expected to slow to 7.3% in 2022/2023 as the central bank raises its key rates to combat inflation (6.7% in July) and the external environment deteriorates. Declining global demand and increasing energy prices are likely to worsen India's trade deficit.[8] Growth is projected to come in at 5.9% in 2023/2024, due to a mild multiplier effect from public investment to private investment.

Growth in Brazil is forecast at 1.8% in 2022. Despite pressure from inflation (which hit 10% year-on-year in July) and ensuing monetary policy tightening, activity should be bolstered by strong exports and household support measures. As October's general elections approach and to support households most vulnerable to inflation, the federal government increased social transfers through to the end of the year. In 2023, the discontinuation of these measures and monetary tightening are expected to put a drag on activity, bringing growth down to 0.7%.

(5) See Carre T. et al. (2022), "China's Dependence on the Property Sector as an Engine of Growth", *Trésor-Economics* No. 311.
(6) The youth unemployment rate (aged 16-24), for example, hit a record high of 20% in July.
(7) The reference period is the fiscal year, which runs from April 1 to March 31.
(8) India imports 85% of its energy.

Box 3: The impact of sanctions on the Russian economy

Preliminary data confirms that sanctions have had a substantial impact on Russia's economy: a severe economic contraction was registered in Q2 2022 (−4% year-on-year). While the unemployment rate remains stable and contained (roughly 4%[a] in July), labour market adjustments are being seen in the cost of labour, with a decline in real wages (−3.2%[b] in June).

Moves by Russia's central bank, which recently announced five key rate cuts (ending up at 8% in July 2022, below its pre-invasion level) and introduced capital controls, have helped Russia contain the short-term effects of sanctions on its financial system. Inflation remains high, coming in at 15.1% in July, above its pre-war rate of 9.2% in February. It has been on the decline since May, however, as the rouble appreciates. Despite the rate cuts, capital controls (which have been gradually loosened) and a sanctions-related drop in Russian imports have put upward pressure on the rouble, which is further supported by favourable trends in commodity and oil and gas prices. While the rouble is currently above its pre-pandemic value, it appears to have become detached from economic fundamentals, due to the central bank's particularly interventionist policy, despite the de jure floating exchange rate regime.

Alongside monetary policy support, the Russian government introduced a series of fiscal support measures: payments for families with children aged 8 to 16 and a 10% increase in the minimum wage, subsistence income and pensions. In combination with this increase in expenditure, public revenue is expected to fall, leading to a deterioration of Russia's fiscal balance. Because public revenue is particularly dependent on dollar-denominated revenue from oil and gas exports, a weaker dollar against the rouble means, after currency conversion, a contraction of this revenue – and an increase in the public deficit, which means dipping into the country's sovereign wealth fund.

In the medium term, sanctions will have a major impact on growth. They are likely to lastingly undermine the normal functioning of the banking sector and its ability to fund the economy, due to the near total decoupling of the Russian banking system from international financial markets. The effects on the real economy are already visible and supply chain disruptions will become more severe as current inventories are depleted. In its most recent July forecast, the IMF projects a 6% decline in Russia's GDP this year, followed by a 3.5% fall in 2023. For its part, the Bank of Russia, in its central (or baseline) scenario – which incorporates continued western sanctions affecting Russia's foreign trade, technology and investment – predicts a contraction of 4% to 6% in 2022 and 1% to 4% in 2023. Russia is likely to face significant challenges when rebuilding its supply chains. It will also be very difficult to reindustrialise the country and strengthen import substitution mechanisms (a strategy previously introduced in 2014, with limited effectiveness) due to a labour shortage and the need to import high-tech goods from "unfriendly" countries. Lastly, the war could also affect Russia's human capital. There appears to have been a flight of skilled labour since the start of the war, a change from its previously positive migration balance, which was helping to limit demographic decline.

a. Russia's Federal Service for State Statistics.
b. Ibid.

3. The main risk to the scenario relates to the geopolitical situation

The war in Ukraine, which could last, is heightening commodity supply risks, especially for natural gas, with further reductions in Russian supply to Europe exposing the manufacturing sector to potential rationing this winter. We could also see disruptions in imports of rare metals like palladium and nickel, which would affect Europe's automotive, steel and aerospace sectors. Moreover, a further escalation of hostilities could send agricultural product prices soaring again, with emerging and developing countries bearing the brunt of the impact.[9]

In addition to Russia's invasion of Ukraine, there is also the risk presented by the situation in the Strait of Taiwan. An escalation of tensions could threaten the supply of semi-conductors from Taiwan (the world's leading supplier) and further fuel the technology and trade war between the United States and China, potentially leading to a decoupling of their economies,[10] with an impact on global value chains.

In view of these supply disruptions, inflationary pressures are likely to remain high in the medium term, with a risk of de-anchoring expectations, which could force central banks to become even more hawkish. Additionally, a stronger dollar could increase the price of imports in emerging and advanced economies alike. Furthermore, we could see wage-price spirals in some activity sectors, particularly in the United States with its tight labour market.

Steeper than expected key rate hikes by central banks would increase risks to the debt sustainability of some countries and heavily indebted companies.

Conversely, a faster cooldown in inflation, potentially spurred by the recent fall in commodity prices, would allow for more gradual monetary tightening, which would support economic activity.

The size of fiscal support in advanced economies is another important factor in this scenario. In particular, our projections do not factor in the €65bn plan announced by Germany on 4 September, or the new UK government's measures, which are upside risks for both countries.

There are also political uncertainties at play in this international scenario, with upcoming legislative or general elections in Italy (September), Brazil (October) and the United States (November). A potential political crisis in Italy could derail the disbursement schedule for European funds connected with its national recovery and resilience plan and increase tensions surrounding Italy's sovereign debt.

More frequent extreme climate events are likely to exert new supply pressures, particularly on manufacturing output (which was disrupted by low Rhine levels in summer 2022 affecting freight transport in German) and agricultural output.

Lastly, pandemic-related uncertainties persist, particularly in China, where the government has been imposing more local measures (testing campaigns, close-contact quarantines and new lockdowns). While China shows no signs of deviating from its COVID policy in the near term, the arrival of broader and more restrictive measures would severely affect economic activity.

(9) See Coeln X. et al. (2022), "Impacts of the Russian Invasion of Ukraine on Emerging Economies", *Trésor-Economics* No. 306.
(10) See Beaujeu R. et al. (2022), "Decoupling of US and China Value Chains: Challenges for the EU", *Trésor-Economics* No. 308.

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