KEY MESSAGES

+3.1%

expected euro area real GDP growth in 2022 in the ECB baseline

-0.9%

expected euro area real GDP growth in 2023 in the ECB “downside” scenario (vs +0.9% in the baseline)

+8.1%

expected euro area inflation in 2022 in the ECB baseline

+14.3%

EU consumer prices for food in August 2022, year-on-year

MACROECONOMIC OUTLOOK

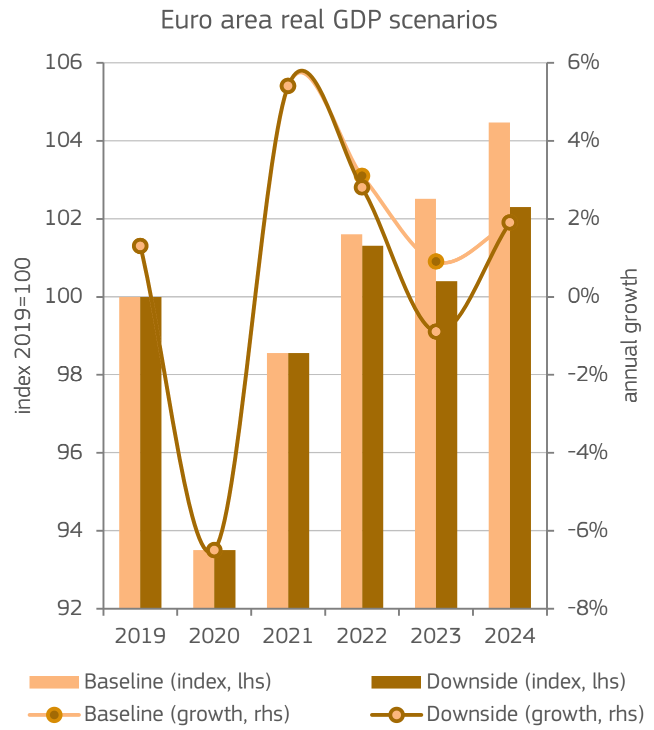
HIGHLIGHTS

Sustained adverse risks call for a further reduction of euro area's real GDP growth projection, especially if the war continues in 2023 and/or gas supplies need to be rationed.

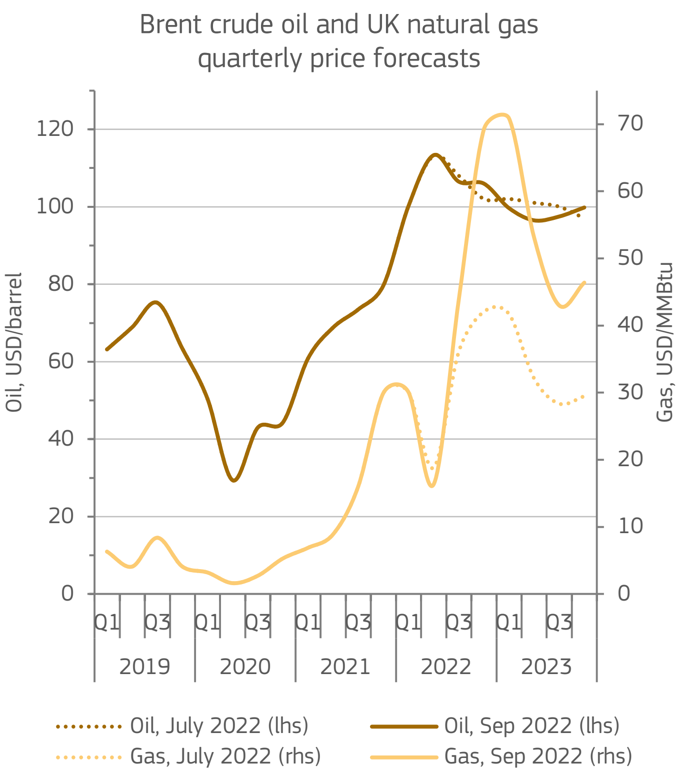
Fossil fuel markets are due to remain very tight and prices are expected to stay high and volatile. Marginal crude oil production increases become harder and harder while, with post-COVID-19, the demand has recovered. EU natural gas prices will also remain high and volatile especially due to uncertainties in Russian supplies, pending implementation of the RePowerEU strategy to reduce dependency on fossil fuels. This could also create further price pressure on electricity prices, being an important input for farmers and the food supply chain as a whole.

High energy prices and agri-food trade disruptions caused by Russia's invasion of Ukraine exacerbate inflationary pressures throughout the supply chains, although in some sectors and some EU countries effects might be witnessed with time-lag.

MACROECONOMIC OUTLOOK



*Note: **Baseline include higher interest rates, somewhat lower oil prices owing to weaker demand and rising supply, significantly higher wholesale gas and electricity prices and depreciation of the euro.** Downside: complete cut-off of Russian gas and seaborne oil flows, with little scope for alternative sources, higher commodity prices, elevated uncertainty, weaker trade and deterioration in financing conditions. Source: European Central Bank.*



Note: 1 MMBtu is 1 million British thermal units, approximately 293.1 kilowatt hours. Source: IHS Markit.

2023 GROWTH OUTLOOK REVISED DOWNWARDS AS WINTER APPROACHES

As the invasion of Ukraine by Russia continues to negatively affect the world economy, forecasters revised downwards their real GDP growth projections for the euro area from 2023 onwards, while for 2022 a solid growth is expected despite the high energy prices, due to easing of supply bottlenecks and push from services and tourism sectors. The preliminary September forecast by IHS Markit appoints to a real GDP growth of 3.1% for euro area in 2022, but much weaker economic growth in 2023 of 0.4% only, to return to a 2% increase in 2024. In the same interval, ECB's baseline[1] was revised upwards by 0.3 pp in 2022, but downwards by 1.2 pp in 2023 and 0.3 pp in 2024, confirming uncertainties about future economic growth.

Inflation in the euro area is expected to reach 8.1% in 2022 and subsequently fall to 5.5% in 2023 and to 2.4% in 2024.

However, in ECB "downside" scenario with worse impacts from the war on energy and commodity prices, the ECB foresees a much grimmer outlook, where euro area's real GDP could drop by 1.8 pp in 2023 compared to the baseline, returning a decline of 0.9%.

[1] *ECB projections based on information up to 22 August 2022.*

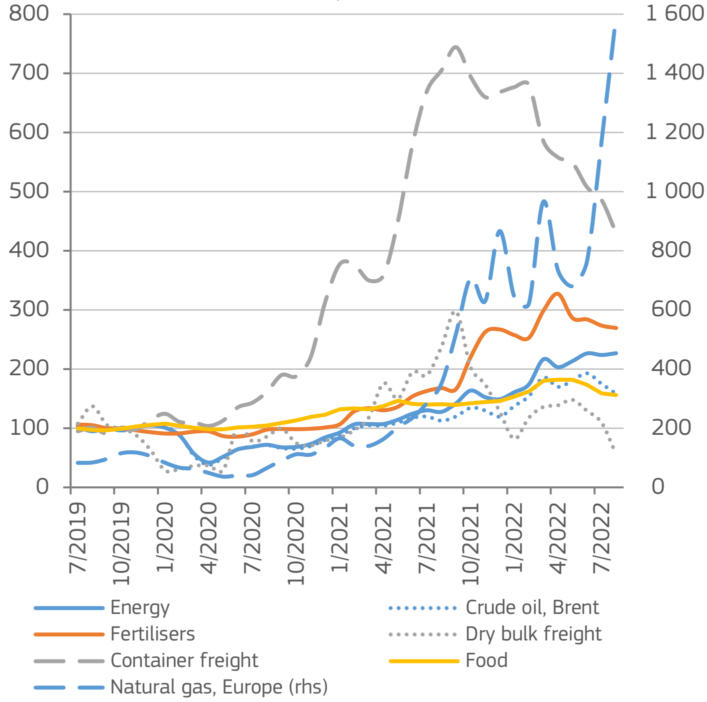
NATURAL GAS PRICES INCREASING MASSIVELY IN WINTER

IHS Markit expects the Brent crude oil price to fluctuate around USD 100/bbl after the peak of USD 113/bbl in Q2 2022, reaching USD 99/bbl in Q4 2023. According to IHS Markit, the stabilisation of crude oil prices reflects weaker demand, slowing economic activity and fear of global recession, although OPEC+ has agreed in cutting oil production to keep prices at the level of USD 100/bbl.

On the natural gas side, this unprecedented increase in prices is driven by the shutdown of Russia's Nord Stream I pipeline, which was already running at only 20% capacity at the time of the announcement. The risk of shortages has grown considerably, despite EU countries being well on track to fill their natural gas storages according to the REPowerEU objectives for this autumn, as well as the first signs of demand reduction in the EU. The price for natural gas is expected to reach the level of USD 70/MMBtu (around €238/MWh) in Q1 2023 and remain above USD 40/MMBtu for the entirety of next year. The price for natural gas in the US and in Asia remains a lot lower than in Europe, and this leads to a high risk for EU competitiveness, especially for energy intensive products.

MACROECONOMIC OUTLOOK

Monthly price indices
(USD-based, July-Dec 2019 = 100)



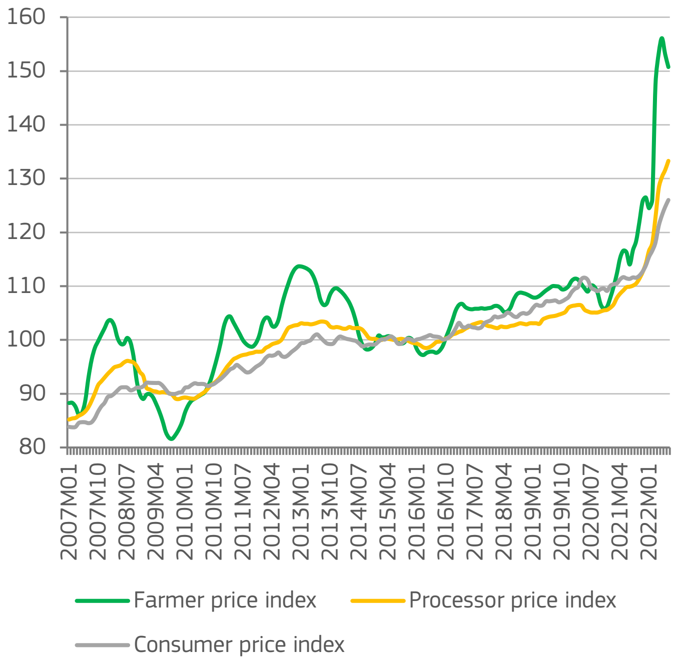
Sources: World Bank (fertilisers, energy, natural gas), Drewry (global container freight), Baltic Exchange (Dry Bulk Freight).
Note: Energy index includes oil, natural gas and coal.

EASING LOGISTICAL COSTS WHILE PRESSURE OF SOARING GAS PRICES REMAINS

While it is clear how the increasing price of natural gas can be a significant driver of input costs for businesses and of inflation for consumers, the prices of fertilisers remain 110% above 2019 levels, despite a reduction observed during summer on international markets, small for P and K, more substantial for nitrogen. The situation in the EU is different with nitrogen fertilisers prices increasing again since summer. With fertilisers companies being an energy intensive industry, the massive surge of the price of natural gas also led to a reduction in the production of ammonia and nitrogen-based fertilisers, as well as its by-products such as CO2, used by the food processing sector. In this context of very high prices, a relief comes from the logistics sector, as costs for container and dry bulk transport are on a downward trend, due to the easing of supply bottlenecks. Container prices are still 330% above 2019 level, but significantly below the peak of +644% seen in September last year. Similarly, dry bulk transport prices are even 44% lower than the 2019 level.

Regarding agricultural commodities, while in August prices were still 36% above the same month last year, expectations about a global recession, as well as the gradual resumption of international trade, in particular in the Black Sea, have brought international prices down from their earlier peaks.

Price transmission along the food chain
(2015=100)



Source: DG Agriculture and Rural Development, based on Eurostat.

PRODUCER PRICE INCREASES PUSHED FURTHER DOWN THE FOOD CHAIN

Since May, the EU farmer price index declined by 6 points, driven by a drop of soft wheat, maize and feed barley prices while the price of durum wheat remains high, as well as meat prices. Meanwhile, EU raw milk price continued increasing and reached more than EUR 50/100 kg. Therefore, the index remains historically high. Considering the high price of energy, together with fall in crop harvest due to drought, and related renewals of some feed and energy supply contracts by the end of the year, producer prices are likely to remain high in 2023.

At the same time, producers are under pressure from processors, and further down the food chain by distributors and consumers, which are facing continuously increasing food prices. While processor and consumer price index changes are delayed and usually not symmetrical to the change in producer prices, these are likely to continue to increase, to compensate for high producer prices but also for their own energy cost of processing, storage, and logistics, even if many EU countries will try to ease the impact of inflation on food purchases, consumer price index is likely to rise as well.