1. Global overview: Weak but resilient

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› **The euro area economy will only see very moderate growth this year, but the outlook has improved since our last forecast, and the single-currency area has shown an impressive degree of resilience to the fallout from the Russian invasion of Ukraine.**

› **Euro area inflation will stay high this year by historical standards, but is well past its peak, and European Central Bank (ECB) interest rates will end 2023 only moderately higher than the current levels, indicating limited additional monetary tightening.**

› **Growth in the US is slowing, but has proven to be more resilient than expected, while the Chinese economy will have a much better 2023 on the back of post-COVID reopening.**

› **The medium-term outlook for economic growth in the euro area and globally is solid, if unspectacular, which will be positive for CESEE economies. The major risks are to the downside, and are linked above all to the fallout from monetary tightening, as well as to the potential for a further escalation of the war in Ukraine.**

The euro area continues to struggle under the weight of the inflation shock, but has proven more resilient than anticipated; we have revised our forecast for this year upward by 0.3 percentage points, relative to our winter report. The reasons for the upgrade are 1) better-than-expected resilience, especially in industry; 2) the relatively mild winter (which capped demand for expensive gas); 3) the collapse in energy prices, which means that inflation will be lower than previously expected; 4) stronger external demand, especially with China reopening; and 5) a further easing of supply-chain bottlenecks. This year will be weak, and the euro area growth outlook remains subject to material downside risks related to the war and uncertainty about momentum in both the US and China; yet the worst-case scenarios of a year ago have proved overly pessimistic. The latest available data suggest continued resilience. German industrial output and new industrial orders both grew strongly and at above expectation in February.

Figure 1.1 wiiw spring 2023 global assumptions

	Spring 2023			Changes since winter		
	2023	2024	2025	2023	2024	2025
Euro area real GDP growth, %	0.5	1.8	1.7	0.3	-0.1	-0.1
Euro area CPI, %	5.7	3.0	2.3	-0.3	-0.4	0.0
Euro area unemployment rate, %	6.6	6.6	6.6	-0.3	-0.2	0.0
Euro area current account, % of GDP	1.0	1.5	2.5	2.4	2.5	3.3
USD/EUR exchange rate, average	1.08	1.08	1.08	0.05	0.05	0.05
ECB refinancing rate, %, eop	4.00	3.00	2.00	na	na	na
USD per barrel Brent oil, average	83.0	78.0	73.0	-2.0	-2.0	-2.0

Source: forecasts by wiiw. Cut-off date: 7 April 2023.

Beyond 2023, our outlook for the euro area remains largely unchanged, with the economy set to expand at a bit below 2% per year, roughly in line with historical norms. We have made very moderate downward revisions for growth in 2024-2025, as tightening financial conditions and a stronger euro outweigh the positive impact of lower inflation. Real growth of slightly below 2% is hardly a stellar rate of expansion, but nevertheless it should ensure a healthy level of export demand, remittance outflows, tourism and other financial flows for the economies of CESEE.

The other two main blocs of the global economy are currently on divergent paths, with growth slowing in the US, but improving in China as post-COVID reopening continues there. In the US, the lagged impact of strong monetary tightening is cooling the economy. In its Spring World Economic Outlook, released on 11 April, the International Monetary Fund (IMF) said it expected the US economy to expand by 1.6% this year, down from 2.2% in 2022.[1] Nevertheless, it revised its 2023 US forecast upward by 0.2 percentage points relative to the winter, thanks to better-than-expected resilience to monetary tightening and the continued strength of the labour market. For China, the IMF expects an expansion of 5.2% this year, a major improvement on last year's 3% outturn.

Set against our winter forecast, we have revised downward our projections for euro area inflation both this year and next. This has been driven, above all, by the collapse in energy prices due to price caps on Russian oil and impressive reductions in demand by European industry. Energy price inflation in the euro area is likely to be negative from mid-2023, due to base effects. We have made a downward revision to our oil price forecasts as well.

Given the relative economic resilience, the lower-than-expected inflation and the continued ECB monetary tightening, we have revised upward our forecasts for the euro versus the dollar during the forecast period. Despite inflation starting to trend down and problems in the US and Swiss banking sectors, the ECB is still hawkish, and plans to continue raising interest rates. We think, however, that the ECB is close to its terminal rate, and that the refinancing rate will end this year at 4%, indicating a further 50 basis points of hikes from the current level. The impact of this tightening will still take some time to work through the system, and we cannot rule out further stresses emerging in the financial sector or real estate markets in parts of the bloc. Should these stresses indeed emerge, they will have an additional negative impact on growth, over and above the general impact of monetary tightening.

Our forecasts are fairly benign in the context of a major war on the European continent and inflation at multi-decade highs, and are subject to material downside risks. While the risks emanating from the war itself are most likely limited, the impact of a major escalation – for example, the use of tactical nuclear weapons by Russia, or a direct Russia-NATO altercation – are difficult to predict. A bigger risk is probably posed by further problems in the financial sector, as sharp monetary tightening after a decade and a half of ultra-loose policy continues to cause stress in parts of the financial system. A potential faltering of China's post-COVID reopening would also have a significant negative impact on global and euro area economic growth this year, although so far there are few signs of this risk materialising.

1 https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023