Creditreform Economic Briefs: When it Rains it Pours – Risks to Economic Growth Rising Visibly

Since our last 'Economic Briefs' (Feb-22) the global economic outlook has markedly deteriorated on the back of the adverse repercussions from Russia's invasion in Ukraine, in particular as prices for key commodities have continued to rise, exacerbating famine in parts of the developing world and shrinking disposable income via soaring consumer price inflation. Shortages of material and equipment are re-intensifying, compounded by rigorous zero-Covid-policies in China, causing new disruption in global supply chains and slowing global activity, thus prompting governments especially in advanced economies to again resort to relief measures to cushion the blow to private households and companies.

Russia's aggression and re-intensifying supply-side shortages cloud global prospects materially

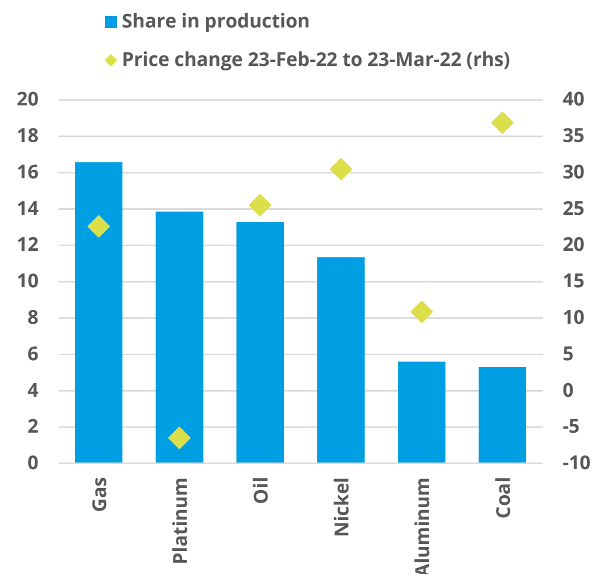
To this day, the current course of the military conflict shows yet no sign of a peaceful resolution in the near future. As a corollary, overall risks to economic prospects remain firmly skewed to the downside, having increased significantly over recent months. Even prior to the war, inflation had surged in many economies, largely driven by pandemic-induced supply-demand imbalances, also visible in rising labor shortages lately, and years of extremely accommodative monetary policy in advanced economies. The supply shortages associated with the war and stark increases in energy and raw materials have substantially amplified the price pressures, which have become more broad-based in a number of countries (see Figure **1**).

The IMF currently (Apr-22) expects global GDP growth to slow from an estimated 6.1% in 2021 to 3.6% in 2022 and 2023, slashing its forecast by 0.8 p.p. for 2022 and by 0.2 p.p. for 2023 as compared to this January. Uncertainty around these forecasts appears particularly high at this stage.

While threats relating to the Covid-19 pandemic seem to have ebbed further amid vaccination progress and adaptation to life with the coronavirus, it appears too early to declare victory, not least due to significant differences in the pace of vaccine rollouts and virus mutations. The pace of recovery also continues to differ due to divergence as regards the extent of fiscal and monetary policy support and the economic structure, in particular the importance of contact-intensive services.

Figure 1: Russia is a global key supplier of energy and other pivotal raw materials

Russian share in global production in %, change in commodity price since Russian invasion of Ukraine



Sources: IMF, Creditreform Rating

Multi-decade high inflation rates put central banks under pressure…

Price increases have been stronger, broader, and more persistent, prompting a tightening cycle of monetary policy in many countries. With the onset of the military aggression against Ukraine, the trade-off for monetary policy between containing price pressures on the one hand and safeguarding economic growth on the other has become even more challenging. Although some supply bottlenecks are expected to gradually ease over time, we expect the

shortages in some sectors to last into 2023, adding to already tight labor markets in a number of countries. With that, inflation is likely to remain on higher levels than previously expected.

While longer-term inflation expectations still appeared relatively well-anchored of late, there is a risk that a protracted phase of high inflation could push longer-term expectations to uncomfortable levels as seen from the viewpoint of central banks. More aggressive monetary policy tightening, in turn, could carry a risk of central banks' overdoing it and causing a recession.

...raising market concern over a too aggressive tightening cycle

Long-term bond yields have increased globally as inflationary pressures have fueled expectations of significantly tighter monetary policy stance. Since the beginning of the Russian invasion, ten-year government bond yields had risen by around 78bp in the UK (25-Feb to 8-Jul), and 112bp in the US and Germany respectively. We note that increasing global interest rates may further reduce fiscal policy space in many countries, especially oil- and food-importing emerging markets.

On the other hand, many countries have been left with the debt ratios significantly exceeding their pre-pandemic figures, exposing some of them to higher interest rate risk. As the recovery following the pandemic-induced decline progressed, and labor market conditions started to normalize prior to Russia's attack on Ukraine, targeted fiscal support was about to being scaled back.

Since the outbreak of the war in Eastern Europe, most governments in industrial countries are implementing fiscal measures to bring some relief to households and companies burdened by high energy costs, including new loan guarantees potentially adding to contingent liabilities. The need for governments to support the vulnerable parts of society from the fallout of soaring food and energy prices, and protect key industries, as well as imminent significant increases to defense spending will make it more difficult to ensure sustainable fiscal trends.

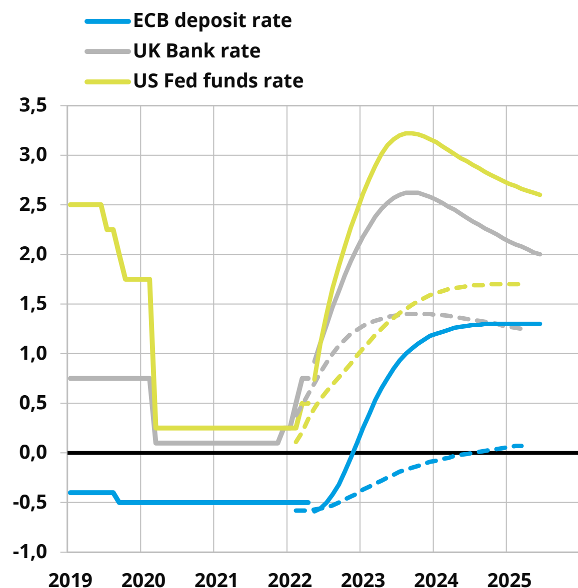
Likely stronger policy tightening ahead for the US

While real GDP rose by 5.7% last year, we assume growth dynamics to soften in the United States, as the US will presumably not be able to decouple from the global supply-chain disruptions and the Federal Reserve's monetary policy is about to become significantly less accommodative going forward.

US headline inflation (All Urban Consumers, CPI-U) hit 9.1% in June 2022. The core rate (excluding food and energy) remained more or less stable at a high 5.9%, falling somewhat from a peak earlier this year, but remaining high and fueling expectations that the Federal Reserve will opt for a stronger rise than assumed in our last Briefs (see Figure **2**).

Figure 2: Market expectations of key policy rates have increased sharply

Policy rates in %, curves are based on Bank of England estimates using forward overnight index swap rates, solid lines: May-22 and dashed lines: Feb-22



Sources: Bank of England, Creditreform Rating

The Fed funds rate was raised by 0.75 pp – the biggest increase since 1994 – to a range of 1.5-1.75% at the monetary policy meeting ending on15 June. We expect further hikes to more than 3.0% until the end of 2022, in a bid to move to a more neutral monetary

policy stance – or, if deemed necessary, a more restrictive stance – in order to restore price stability, whilst aiming to preserve the strength of the labor market.

After a weak Q1-22 that saw real GDP growth contract by 0.4% q-o-q, dragged down by negative contributions from net exports and the change in inventories, overall economic activity appears to have picked up pace again more recently. This is also suggested by the ISM index, which hints at a return to positive, albeit moderate growth rates amid substantial monetary policy tightening and diminishing fiscal impulses. The Federal Open Market Committee's latest economic projections from June 2022 are centered around an annual growth rate of 1.7% for both 2022 and 2023.

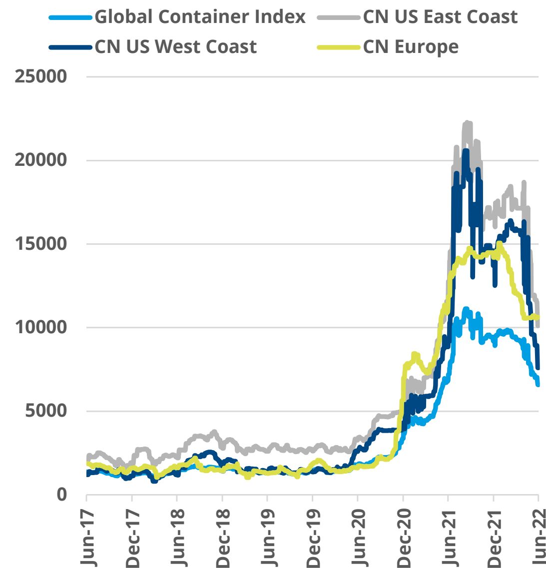
The unemployment rate has fallen to 3.6% as of Jun-22 in the meantime, close to historical lows, and has reached this level much faster than was broadly anticipated. Employment growth even powered through the difficult Omicron wave, with over 9 million jobs added since January 2021. Underscoring increasingly tight labor market conditions, there are far more job openings remaining unfilled than prior to the outbreak of the pandemic, despite the unemployment rate still being slightly higher by comparison. A diminished participation rate, which has not fully recovered yet from the pandemic, contributes to this.

Chinese growth to moderate markedly this year amid rigorous Covid-19 policy

Looking towards China, its economic growth is expected to slow to 4.4% this year (IMF forecast, Apr-22), from 8.1% in 2021, on account of a tight anti-Covid regime. While real GDP continued to expand in the first quarter of 2022, it experienced the first quarter-on-quarter contraction (-2.6%) since Q1-20 in the second quarter of 2022, due to strict lockdowns in major cities, taking a heavy toll on economic activity. Apart from that, ongoing weakness in the Chinese property sector continues to weigh on economic developments.

Figure 3: Softening demand is translating into normalizing freight rates

Freightos daily freight container indices measuring global container freight rates, spot rates in USD per 40-foot container, for trade lines coming from China



Sources: Refinitiv, Creditreform Rating

Judging by the Purchasing Manager Indices in June, activity both in the service sector and in manufacturing is about to bounce back, amid some easing of restrictions, added to by some indications of waning supply constraints, with Shanghai's major port reportedly operating closer to capacity (see **Figure 3**). More generally, a more accommodative policy stance should moderate the impact of lockdowns on economic growth. Key interest rates were lowered in January and May 2022. With regard to 2023, the IMF expects Chinese growth to accelerate somewhat, to 5.1%.

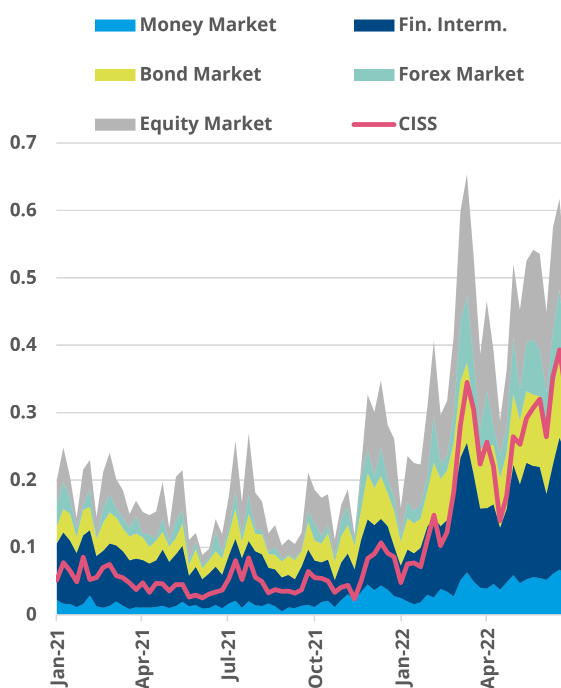
Downside risks for euro area GDP growth start to materialize, albeit with some regional and cross-sectoral differences

Continuing its recovery, the euro area economy grew by 0.6% in the first quarter of 2022, leaving it 0.8% above its pre-pandemic level (Q4-29), with positive contributions from domestic demand and net exports, although partly very high coronavirus infection rates at the beginning of the year affected private consumption negatively.

The Russian invasion and its implications have contributed to increasingly tight financial conditions (see Figure 4), and should, together with pandemic measures in China, weigh on trade in the near term, although to various extents, depending on economic structures and trade links to Russia. As also indicated by a vulnerability matrix compiled by the European Commission (May 2022), in particular the Baltic countries and other CEE countries tend to be more exposed in terms of energy dependence and more closely intertwined trade and value chains. This said, Germany exhibits a high dependency on Russia when it comes to gas imports, which proves very difficult to reduce in the short time (see below).

Figure 4: The war has prompted further tightening financial conditions in Europe

ECB CISS, unit-free composite indicator of systemic stress in the interval (0, 1), aggregation of five market-specific subindices and cross-correlations between subindices



Sources: ECB, Creditreform Rating

European countries with less closer ties to Russia are mainly affected by a higher burden on their economy from the price shocks, posing downside risks to private consumption and investment plans which might be delayed as a consequence. What is more, we expect to see pronounced cross-sectoral differences as regards the negative impact from the geopolitical developments.

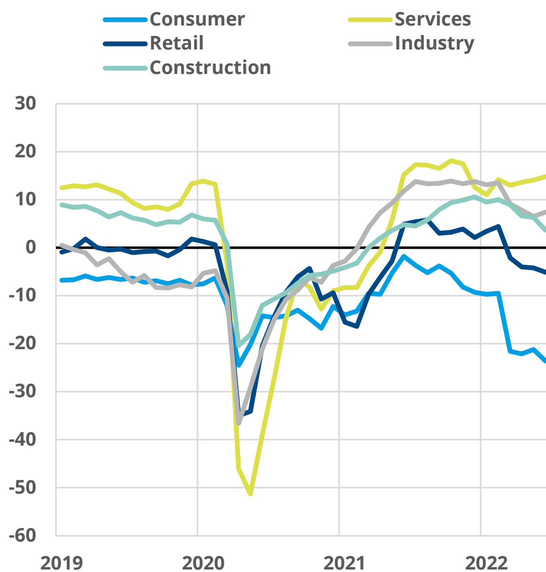
So far, we understand that Russia has halted gas deliveries to Bulgaria, Finland, Poland, and the Netherlands, as they refused to comply with Russian demands to settle gas payments in ruble. Gas deliveries to Germany were lowered over the last weeks, and expectations are for more severe cuts once the scheduled maintenance of the Nord Stream 1 pipeline is over. The risk of broader gas supply shortages in the EU is thus materializing and might see further escalation, given Russian threats of 'penalizing' measures in response to Finland's and Sweden's imminent NATO accession.

Despite higher energy and food prices weighing on consumer sentiment, demand for contact-intensive services is recovering as pandemic-related restrictions are eased, partly offsetting negative effects from manufacturing output affected by bottlenecks regarding supply of certain materials and equipment. Contrary to consumer confidence, the European Commission's sentiment indicators gauging the mood in the industry, the service and construction sectors remained at least well above their long-term averages in April and May (see Figure 5). Overall, high-frequency indicators point to continued positive, albeit slowing, growth in the second quarter of 2022.

In the near term, the growth outlook remains negatively affected by elevated uncertainty, high and rising energy prices, ongoing supply bottlenecks, and less favorable financing conditions in light of the turning tide in monetary policy. While investment plans may be delayed in some cases in such an environment, the improving outlook for services activity and broader support from NextGenerationEU funds for the ongoing green and digital transition remain supportive pillars.

Figure 5: Services continue to hold up well in the euro area, while consumer sentiment plunges

Confidence indicators for sectors surveyed in the euro area, balance



Sources: European Commission, Creditreform Rating

Euro area governments providing ample fiscal support

Moreover, in light of more pronounced downside risks to growth, governments have resorted to opening the fiscal taps again to cushion adverse repercussions from the war in Ukraine and strengthen defense capacities. Fiscal support measures are in particular aimed at countering the rising cost of living for households and limiting energy costs for companies. Support of refugees from the war in Ukraine also adds to government expenditure.

Labor markets have continued to improve throughout the recovery from the most acute phase of the pandemic. The euro area unemployment rate has recently stabilized at its historical low of 6.8% reached in February 2022. Job vacancies across many sectors show that there is robust demand for labor, and wage growth has accelerated slightly, overall adding to expectations of expanding private consumption despite marked downside risks via consumer prices. Domestic demand should thus ultimately contribute positively to GDP growth this year. We currently expect annual real GDP growth to be at 2.5% in 2022 and 1.5% in 2023.

Medium-term growth prospects remain buttressed by progressing implementation of initiatives and measures set out in the respective national Recovery and Resilience Plans and largely funded by the EU's Recovery and Resilience Facility (RRF). In case of a longer duration of the war in Ukraine and related price developments and a possible further escalation of the tensions with Russia, the medium-term outlook could quickly worsen. Risks from perceived higher political fragmentation in many euro area economies are not to be underestimated either, among other things with a view to an effective roll-out of the measures in the Recovery and Resilience Plans, but also wider policy decisions. As a case in point, we would highlight current political developments in Italy, where Prime Minister Draghi wishes to resign as he sees no longer sufficient support for his government of national unity.

Inflation further on the rise, increasing pressure on the ECB to act sooner

In light of continuously increasing inflation, reaching 8.6% in June 2022 (HICP), the ECB has been under immense pressure to act sooner, having had to revise upward its inflation projections substantially (see Figure **6**). The inflation pressures have also broadened, with prices for many goods and services significantly above 2% by now. Core inflation, here excluding energy, food, alcohol and tobacco, posted at 3.7% in June.

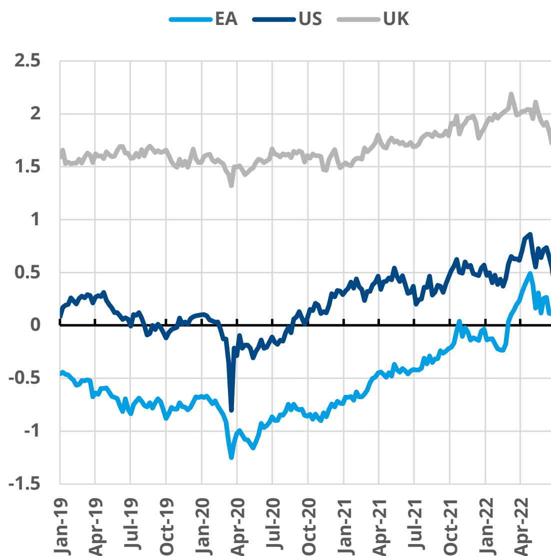
According to its June macroeconomic projections, the ECB expects the HICP inflation to average 6.8% in 2022, before moderating to 3.5% in 2023 and converging to the ECB's inflation target in the second half of 2024. In 2024, the average annual HICP inflation is expected to be 2.1%, which should mainly reflect an assumed moderation in energy and food prices.

At its June meeting, the ECB Governing Council left its key policy interest rates unchanged and decided to end net asset purchases under its asset purchase program as of 1 July 2022. It will continue to reinvest,

in full, the principal payments from maturing securities purchased under the APP for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance.

Figure 6: Inflation expectations have increased since the start of the war

Difference between average inflation rate over a five-year period starting in five years' time as implied by inflation-linked swaps and assumed inflation target [2.0%], in %



Sources: Refinitiv, Creditreform Rating

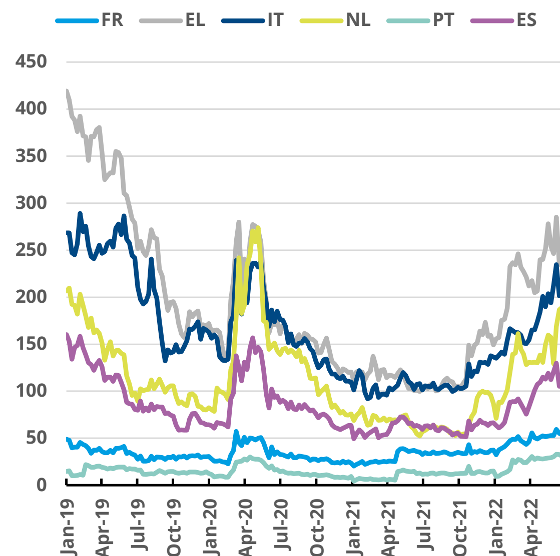
The principal payments from maturing securities purchased under pandemic emergency purchase program (PEPP), for which net asset purchases were terminated in March 2022, will be reinvested until at least the end of 2024.

In addition to terminating net asset purchases under the APP in Jul-22, the ECB envisaged hiking its key interest rates by 25bp in July, although we would not exclude a 50bp increase, as the ECB was in for hawkish surprises more recently. Judging by the ECB 's forward guidance, a further 50bp rise is likely to take place in September. Given protracted price pressure and broad continuation of labor markets becoming more tight, we think that it is increasingly likely that the refinancing rate will be raised further in this year's fourth quarter, up to 1.25% by the end of this year.

Moreover, with the announced intention to develop a new tool to address resurgent fragmentation risks in the euro area, referred to as Transmission Protection Mechanism, the Governing Council aims to counter any possible renewed market speculation over euro area cohesion in case of stronger rises in bond yields that could spell trouble for higher-indebted sovereigns (see Figure 7). Given the current political developments in Italy, the country might be a beneficiary of such a policy.

Figure 7: Bund spreads have moved up following the ECB's signals to normalize monetary policy

Spreads of 10y-government bond yields to German Bund, in basis points



Sources: Refinitiv, Creditreform Rating

As one of the largest beneficiaries of the RRF funds and as a country with comparatively low direct trade and financial ties with Russia, the Spanish economy has shown resilience lately, having been hit hard by the pandemic in the context of collapsing tourism. The recovery of the latter is well underway, currently proving to be a stabilizing pillar, along with recovering contact-intensive services and business services that support export growth. Adding to a more positive assessment in this case, Spain is showing revived reform momentum, despite challenges related to a fragmented political landscape. As a consequence, prospects for its currently high public debt ratio to

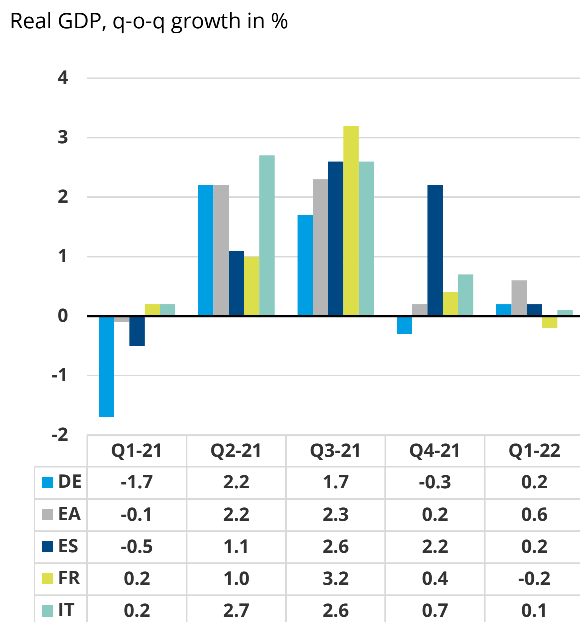
stabilize following an expected decline in 2022 and 2023 have improved in our opinion, prompting us to lift our long-term sovereign rating outlook for the Kingdom of Spain from 'negative' to 'stable' in July 2022.

The recovery in Germany is challenged by soaring prices and severe supply shortages

Economic prospects for the German economy remain dim. Annual real GDP growth in 2021 had posted at only 2.9%, following the decline by 4.6% in 2020, with economic activity decelerating significantly during winter. Total output decreased by 0.3% q-o-q and remained subdued in this year's first quarter (0.2% q-o-q), mainly due to contraction household spending coming on the back of the pandemic and related containment measures (see Figure 8).

Figure 8: Economic growth softened in light of Omicron and the geopolitical context

Real GDP, q-o-q growth in %



	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22
DE	-1.7	2.2	1.7	-0.3	0.2
EA	-0.1	2.2	2.3	0.2	0.6
ES	-0.5	1.1	2.6	2.2	0.2
FR	0.2	1.0	3.2	0.4	-0.2
IT	0.2	2.7	2.6	0.7	0.1

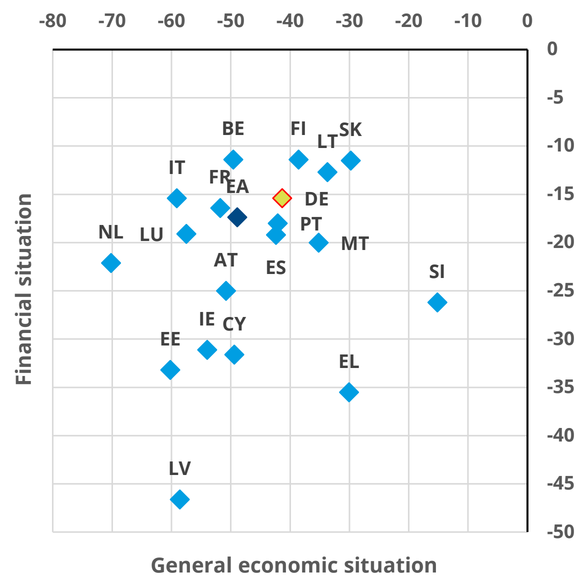
Sources: Eurostat, Creditreform Rating

Headwinds related to the Covid-19 pandemic have waned over the last months, essentially boding well for private consumption as the authorities' restrictive measures have been increasingly lifted. That said, the dramatic price increases for energy and other commodities are likely to pose a significant drag on the economy, as these are set to severely dampen households' purchasing power. According to Eurostat, the annual all-items HICP stood at a tremendously high 8.1% in May (Apr-22: 7.4%). Also, the annual core inflation rate accelerated to 3.8% in May (Dec-21: 2.6%, May-21: 1.0%).

Despite price pressures weight on real disposable income growth and weaker consumer sentiment, we still assume private consumption to buttress real GDP growth this year and next, reflecting the recovery in the services sector and still very favorable labor market conditions (see Figure 9). Unemployment continued to dwindle, posting at a historically low 2.8% in May, down from 3.7% a year before.

Figure 9: German households' expectations of their financial situation took a less severe hit, pointing to significant potential for pent-up consumption

Change in balance of households' expectations regarding the next 12 months, June 2022 vs. June 2021



Sources: European Commission, Creditreform Rating

We expect employment to expand moderately, whilst labor force participation should recover further from the dent caused by the pandemic. We witnessed revived employment growth after the peak of the Omicron wave had been passed in Feb-22 and remained vivid up to April (0.3% m-o-m). The number of employees in Germany in April 2022 stood only slightly below the pre-pandemic level of Dec-19.

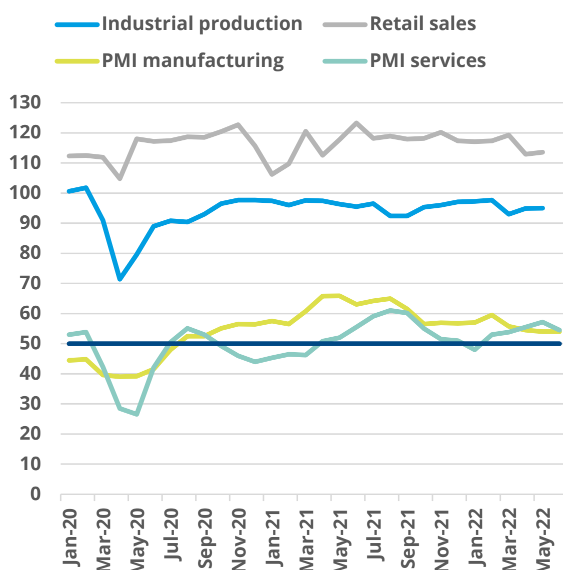
In addition, government support and minimum wage hikes will aid household spending growth. In order to ease the burden on private households, the government had announced a second relief package on 23-Mar-22, including a one-off bonus and lower energy tax on fuel for three months. An eventual rise of the minimum wage to EUR 12 per hour from Oct-22, which will come on top of staged increases to EUR 10.45 by Jul-22, should also help to lessen the pain for consumers.

Tremendous uncertainty and surging prices pushing back recovery in industrial production

Producer prices in Germany surged by 33.5% in May as compared to the corresponding month of 2021. The rapid and substantial increase in energy, as well as other raw material and interim goods prices will likely curb profit margins of domestic enterprises and corporate incentives to invest, more generally. In the same vein, the huge increase in economic uncertainty should induce companies to postpone their investment plans.

Figure 10: Germany: activity indicators reflect many cross-currents to economic expansion

Industrial production index (2015=100), retail sales index (2015=100), Purchasing Manager Indices (50 ⇔ economic stagnation)



Sources: Eurostat, Refinitiv, Creditreform Rating

Industrial production in May could only make up for a small fraction of output lost between February and April, while industry new orders indicate a marked slow-down going forward, having fallen three consecutive months since this March (-4.0% y-o-y-, -6.1%, -2.9%). Overall, industrial production volumes in May were still posted 2.9% below the pre-pandemic level at the end of 2019 (see Figure **10**).

Supply-chain disruptions had already weighed on the industry sector before the Russian invasion, but the geopolitical context and related developments in energy markets, together with the negative repercussions stemming from China's very stringent Covid-policies, will create severe obstacles to energy-intensive industrial sectors, and will dampen private investment activity.

Figure 11: Prospects for export growth becoming increasingly gloomy

Export expectations in the industry sector, balance, s.a.

Sources: ifo, Creditreform Rating

At the same time, sanctions and counter-sanctions as well as ultimately weaker global external demand against the geopolitical backdrop and disrupted supply-chains are set to slow export growth (see Figure **11**), which was already constrained by trade disrup-

tions prior to the outbreak of the war. Related shortages, in turn, could lead to further curtailed production in crucial sectors, such as chemicals, metals, and Germany's pivotal automotive industry, where the transformation to electric mobility is in full flow.

Energy-intensive production could well be impacted more severely as well, despite the government's efforts to soften the blow by diversifying away from Russia in terms of energy commodity imports as fast as possible and by preparing added financial support to companies. Among the production lines of the interim goods, the processing of glass, ceramics and stones experienced the steepest decline due to high degree of energy usage in its production processes.

Reflecting the significantly worse outlook regarding investment and export growth, as well as the rapidly intensifying price pressures and the concurrent curbed post-pandemic rebound in household spending, we have materially cut our forecast for real GDP growth this and in particular, next year. The latter mirrors our belief that the tremendous headwinds will remain in place for longer and drag well into 2023. We thus project total output to expand by 1.5% in 2022, and only a minor pick-up in real GDP growth to 1.6% in 2023. Having said this, we cannot rule out the possibility that gas deliveries to Germany will be entirely stopped by Russia, which is likely to result in a technical recession in Q4-22 and Q1-23. In such a scenario, 2023 growth could come in below, but close to 1.0%.

Authorities take action in view of rising real estate risks

Prices and lending for residential real estate have developed very dynamically in recent years. Residential house prices have registered a slight acceleration of the annual increase to 7.7% in 2021. Mortgage lending has been posting annual growth rates of just over 7% for some time. According to Bundesbank calculations, there are now considerable overvaluations throughout the country. Against this backdrop, BaFin aims to counter the resulting increasing risks through the targeted use of the sectoral systemic risk buffer. The German watchdog thus ordered a sectoral systemic risk buffer of 2% for risk positions of loans secured by residential real estate as of 1 April 2022, in order to preventively strengthen the resilience of the German banking system against specific risks from the residential real estate market.

In January 2022, BaFin had already announced to increase the countercyclical capital buffer from 0% to 0.75% as of 1 February 2022, to be applied from February 2023. According to Bundesbank, debt service has continued to grow as a share of disposable income, recently reaching 29%. Given the ECB's imminent rate hike envisaged so far, and in light of our expectation of further rate hikes in this year's fourth quarter, we expect demand for housing loans to moderate. Going forward, risks related to this area might e.g. prompt a cap to the loan-to-value ratio.

More aggressive monetary policy tightening in the United Kingdom:

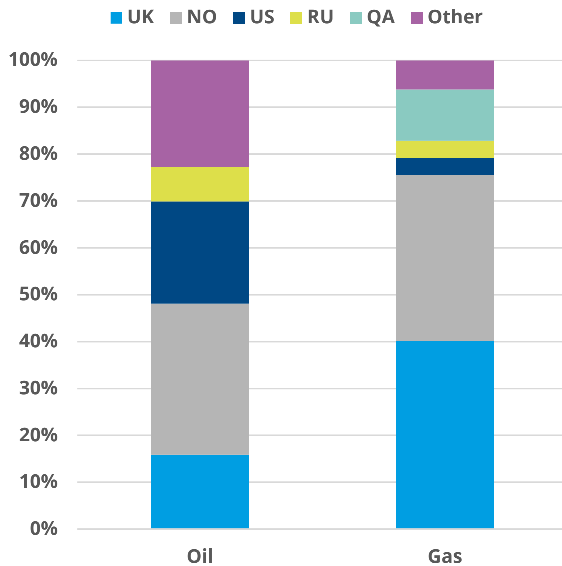
The UK's economic recovery form the pandemic has proved relatively strong, underscoring resilience in the face of the global health crisis. Structural challenges related to adjusting to the post-Brexit regime remain in place, and while direct dependency on Russian oil and gas is smaller than in many European countries, UK consumers are feeling the pain of higher energy and commodity prices (see Figure **12**). Shortages of certain materials as well as a tight labor market continue to pose some risks to growth.

The UK's economic output continued to expand at the beginning of the year, partly benefiting from the flattening of the Omicron infection wave. While in Q1-2022 GDP growth still came in at a quarter-on-quarter rate of 0.8%, the outcome masked a slower pace from February, with rising commodity prices and supply chain disruptions weighing on the economic performance (see Figure **13**). Moreover, total output in the second quarter was likely negatively affected by the public holidays related to the Queen's Platinum Jubilee.

The near-term outlook remains somewhat muted by falling consumer confidence in the face of the squeeze on real household disposable income. Some indicators of corporate sector sentiment have weakened of late, partly burdened by re-intensifying supply-side bottlenecks, although still appearing somewhat more upbeat than consumer confidence.

Figure 12: The UK is less dependent on Russian energy supply than most of its European peers

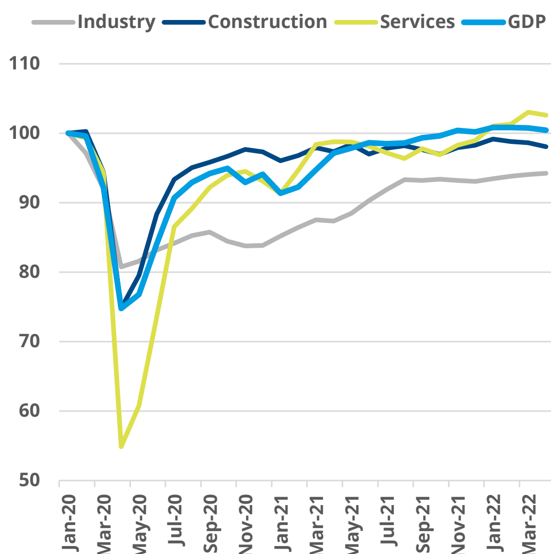
Supply of crude oil and natural gas by origin, 2019



Sources: Bank of England, Creditreform Rating

Figure 13: UK economy has lost momentum

Monthly GDP and main sectors, seasonally adjusted up to Apr-22 (2019=100)



Sources: ONS, Creditreform Rating

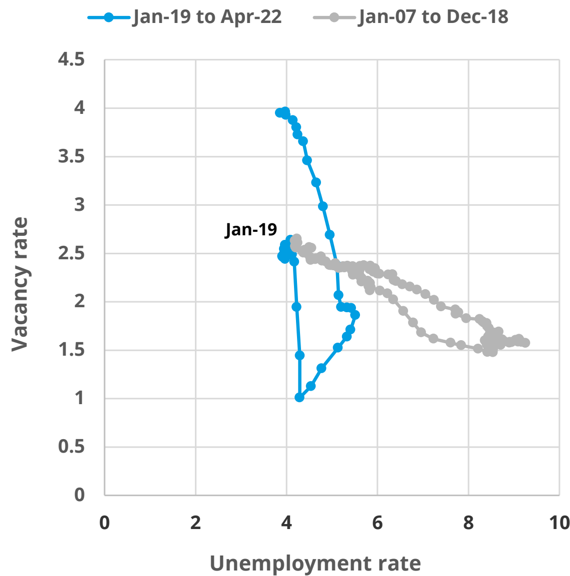
The recovery in previously subdued contact-intensive consumer services seems intact, and an ongoing tight labor market, with the unemployment rate continuing to decline despite the ending of the furlough scheme in September 2021, should remain supportive to private consumption. In the three months to March 2022, employment grew by 1.7% year-on-year, while the unemployment rate averaged 3.8% in the three months to April 2022. Nominal earnings growth has also remained comparatively strong against this backdrop, although remaining well below recent inflation rates.

At the end of May, the Chancellor of the Exchequer announced a GBP 15bn support package to ease the cost of living. The announced measures will kick in from July 2022 and should bolster economic developments in the second half of the year. For the whole year 2022, we currently project real GDP to expand by 3.6% and to moderate to about 1.0% in 2023%. Given that we now anticipate a somewhat more aggressive monetary policy tightening cycle, our forecast for 2023 is subject to some downside risk, alongside substantial uncertainty over how the geopolitical tensions will evolve.

The UK inflation rate spiked to 9.1% in May, with core inflation posting at higher levels than witnessed in the euro area, partly also reflecting Brexit effects and the tight labor market (see Figure **14**). Consumer services price inflation, which is more influenced by domestic costs than internationally traded goods price inflation, has strengthened in the UK in recent months, registering higher levels than in the euro area or the US. The Bank of England's Monetary Policy Committee (MPC) expects CPI inflation to exceed 9% over the next few months, with a possible peak at slightly above 11% in the autumn 2022. With regard to 2023, the upward pressure on CPI inflation should diminish amid the assumption that the prices of commodities and other tradable goods stabilize or start to reverse, also reflecting the combined impact of falling real incomes and tighter monetary policy on domestic demand.

Figure 14: Labor market is increasingly tight, as vacancies climb to all-time highs

3-month moving averages in %, unemployment rate does not include furloughed workers in 2020-22



Sources: ONS, Creditreform Rating

At the meeting ending on 15 June 2022, in view of continuing signs of robust price pressures, the MPC voted to increase the Bank Rate by 0.25 p.p. to 1.25%, the highest they have been since February 2009. With that, the MPC had raised interest rates for the fifth consecutive time, having begun the hiking cycle in December 2021. The MPC has also started to reduce the size of its asset purchase program from its peak value of £895bn. Not least given that three members of the 9-member committee favored a 50 basis point hike at the time, suggesting greater concern over inflationary developments than downside risks to economic growth, we consider three more hikes this year a likely scenario.

PM Boris Johnson finally steps down following wave of criticism

With regard to domestic politics, a successor for UK Prime Minister Johnson, who resigned in July following increasing criticism both among the public and Conservative Party members over a number of scandals including his conduct during the UK lockdown, is to be chosen by autumn. The field of candidates has been narrowed down to five at the time of writing, with former finance minister Rishi Sunak appearing to be a frontrunner.

Early elections are not our main scenario at this stage, and we assume broad continuation of post-Brexit policies, albeit the forthcoming prime minister may choose to strike a somewhat more conciliatory tone over the handling of the controversial Northern Ireland protocol in practice. Challenges regarding the political situation in Northern Ireland to have risen of late, as suggested by ongoing difficulties to agree on a new political leadership following nationalist Sinn Fein's winning the most seats, bearing a risk of rising tensions among the wider society in the region.

Figure 15: We have cut our real GDP forecast in light of the further deteriorating geopolitical backdrop

In %, IMF forecasts for World, China, FOMC for the US

	2010-19	2019	2020	2021	2022e	2023e
World	2,9	2,5	-3,5	5,8	3,5	3,1
Euro area	1,4	1,6	-6,3	5,4	2,5	1,5
Germany	2,0	1,1	-4,6	2,9	1,5	1,6
France	1,4	1,8	-7,8	6,8	2,9	1,8
Italy	0,3	0,5	-9,0	6,6	2,8	1,5
Spain	1,1	2,1	-10,8	5,1	4,1	2,9
UK	2,0	1,7	-9,3	7,4	3,6	1,0
US	2,3	2,3	-3,4	5,7	1,7	1,7
China	7,7	6,0	2,2	8,1	4,4	5,1

Sources: Creditreform Rating, FOMC, IMF

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