# Inflation dictates the agenda of central banks around the world

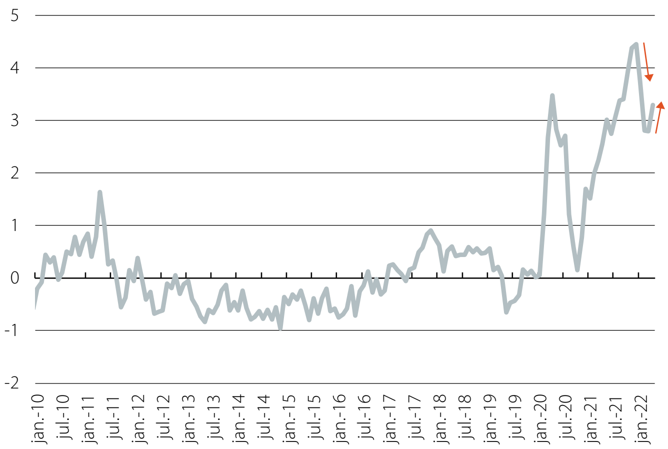
**The war in Ukraine remains the key factor in the global scenario**. Developments in the war in Ukraine and the persistence of China's zero-COVID policy remain the main factors determining the current scenario. Both events are further aggravating the problems in global supply chains, pushing up the price of key inputs for industry, as well as that of many industrial and agricultural commodities. As a result, inflation rates are at record highs in most developed and emerging economies, forcing central banks to take action to keep medium-term inflation expectations in check, despite the deterioration in economic activity and in the outlook in some cases. Only China, Russia, Japan and Turkey are not currently following this widespread monetary trend.

**The ECB is ready to act**. To date, it is the only central bank in the G7 (except Japan) that has not yet raised official interest rates, but in an entry on the ECB's blog, Lagarde made it clear that this could change at the July meeting. Some may question whether now is a good time to raise rates, given the growing uncertainty and the deteriorating growth outlook for the region. However, with inflation in May at 8.1% and with no signs that it has peaked yet, medium-term inflation expectations need to be kept under control, as the consequences of failing to act now could be more damaging in the future (see the Focus «Rate hikes in the euro area, under the microscope» in this same report).

**The risks to euro area growth in the coming months increase**. Confidence among economic agents collapsed in March, with the outbreak of the war in Ukraine, before stabilising in April and May at these low levels. The most pronounced deterioration is seen in industry, the sector hardest hit by the bottlenecks in global supply chains and by the sharp rise in production costs, as well as among households, which are very concerned about their loss of purchasing power due to rising inflation. Confidence in the services sector, meanwhile, seems to be holding up better for now, having benefited the most from the end of the COVID-related restrictions. On balance, after a moderately positive start to the year (euro area GDP grew by 0.2% quarter-on-quarter in Q1 2021), there is no guarantee that euro area GDP will maintain this good tone in Q2 2022. Moreover, there is an increase in the downside risks for the second half of the year: after Russia cut off its gas supplies to Poland, Bulgaria, Finland and the Netherlands, the threat that it could extend these cuts to the rest of Europe is more real than ever. Indeed, the European Commission has presented a series of alternative forecast scenarios in its spring economic outlook report: in one of them, it estimates that if Russia were to cut its gas supplies, then the euro area's average economic growth in 2022 would be virtually zero, and inflation could reach almost 9.0% on average for the year.

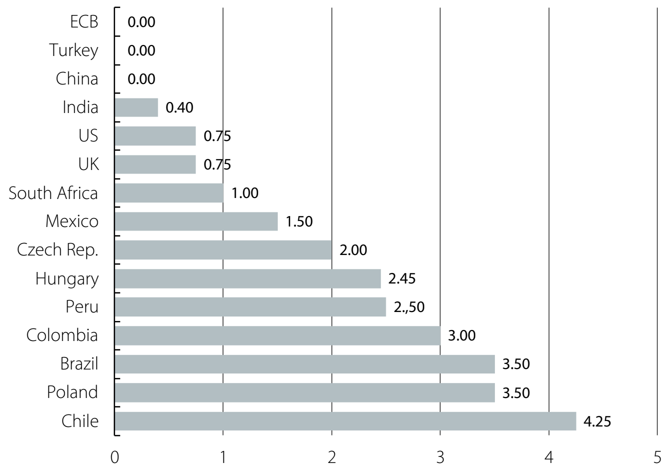
**The weakness of US GDP in Q1 2022 will not alter the Fed's roadmap**. It is true that the US economy performed worse than expected in Q1 2022, shrinking 0.4% quarter-on-quarter. However, the analysis by component paints a more nuanced picture: domestic demand remained buoyant thanks to the

### *Pressure on global supply chains*
*Index*



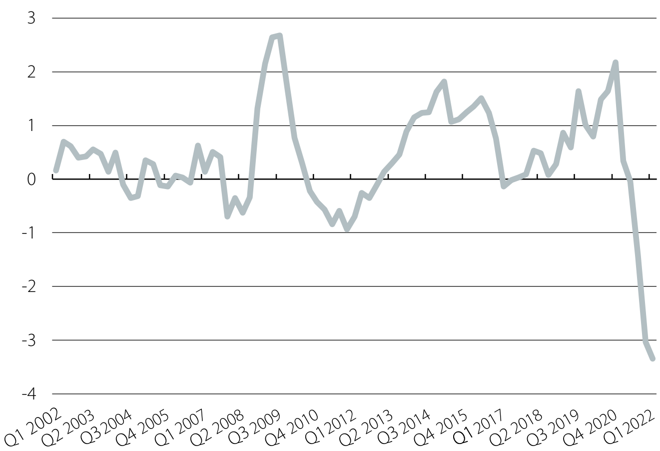

***Note:*** *The average of the Global Supply Chain Pressure Index is zero.*
***Source:*** *CaixaBank Research, based on data from the New York Fed.*

### *Global: interest rate hikes in 2022 **
*(bps)*




***Note:*** ** Between January and May.*
***Source:*** *CaixaBank Research, based on data from Bloomberg.*

### *Euro area: inflation-deflated negotiated wages*
*Year-on-year change (%)*




***Source:*** *CaixaBank Research, based on data from the ECB.*

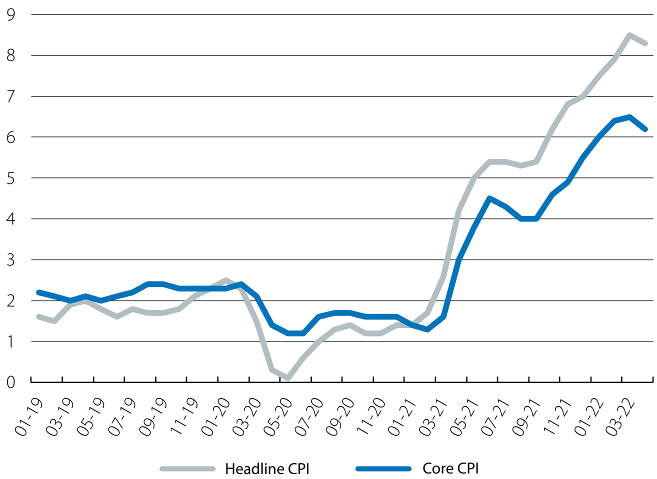
boost from private consumption and non-residential investment. Moreover, the labour market remains strong: in April, 428,000 new jobs were created, the unemployment rate remained stable at a low 3.6% and wages rose by 5.5% year-on-year. Against this backdrop of strong domestic demand, inflation fell in April after reaching a 40-year peak in the previous month, although it remains very high: headline inflation stands at 8.3% and core inflation at 6.2%. The coming months will see continued upward pressure on inflation due to the stress in the labour market, the effects of the war in Ukraine and closures in China due to its zero-COVID policy. Thus, although inflation will be declining, these factors will keep it high and prevent it from returning to the 2.0% benchmark until late 2023. This justifies the Fed's clearly hawkish tone, having stated its intention to raise interest rates above «neutral» levels if necessary. These more restrictive financial conditions, the lack of agreement on much of Biden's Build Back Better Plan and a weaker-than-expected start to the year lead us to cut our 2022 average growth forecast for the US by 0.75 pps, bringing it to 2.4%.

**Uneven start to the year in the other two major G7 economies.** On the one hand, the United Kingdom surprised analysts by registering an impressive growth of 0.8% quarter-on-quarter in Q1 2022 (8.7% year-on-year), placing economic activity 0.7% above pre-COVID levels. However, this apparent good result conceals a deterioration during the course of the quarter, and this trend will continue in Q2 2022, as anticipated by the Bank of England's May forecasts. On the other hand, Japan registered a contraction of 0.2% quarter-on-quarter in Q1 2022 (+0.2% year-on-year), as a result of the strict restrictions imposed to contain the new outbreaks of COVID-19. Thus, over the last year, the Japanese economy has failed to register two consecutive quarters with positive growth.

**China's zero-COVID policy is having a clear impact on the country's economic activity, while the war in Ukraine is beginning to take its toll on the Russian economy.** In China, GDP growth exceeded our expectations in Q1 2022 (4.8% year-on-year). However, by March and April most of the economic activity and foreign trade indicators were already showing a sharp slowdown, compatible with a fall in GDP in Q2 2022. To alleviate the impact of its zero-COVID policy, both the government and the central bank have implemented a series of economic stimulus measures, although we believe that they will not be enough. Indeed, the deterioration we envisage for Q2 leads us to reduce our growth forecast for 2022 by 1 pp, to 3.7%, well below the government's target of 5.5%. In Russia, meanwhile, year-on-year growth in Q1 2022 moderated to 3.5%, down from the 5.0% registered in Q4 2021. This is a significant slowdown due to the sharp decline in economic activity in March as a result of the war in Ukraine. The outlook for Russia has deteriorated substantially in the wake of the conflict, given that, regardless of how long the conflict lasts, the economy will be severely damaged by the Western sanctions and the flight of foreign investment (for instance, more than 300 multinationals have already ceased or limited their activity in the country). As a result, we anticipate that Russia's GDP in 2022 will fall by 8.0%, although the risks are clearly skewed to the downside.

**US: CPI**

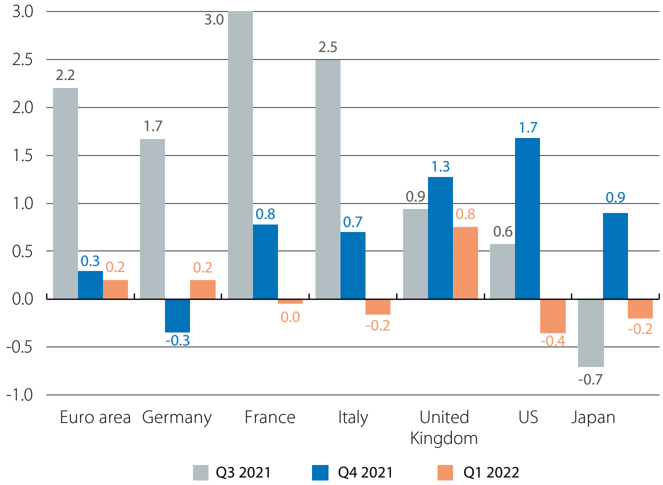
*Year-on-year change (%)*




**Source:** *CaixaBank Research, based on data from the BLS.*

**Global: GDP**

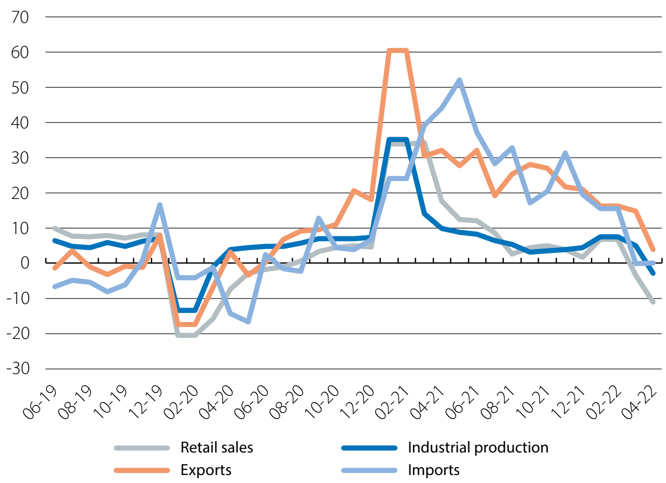
*Quarter-on-quarter change (%)*




**Source:** *CaixaBank Research, based on data from Eurostat, the BEA and Bloomberg.*

**China: economic activity indicators and foreign trade**

*Year-on-year change (%)*




**Source:** *CaixaBank Research, based on data from the National Statistics Office of China.*