Europe: return to growth, but the crisis is not over yet

*Strong rebound in the first half of 2021, powerful headwinds in the second, mixed outlook*

**New York, 13 January** – The economies of Europe returned to growth in 2021, with the gradual easing of containment measures introduced to prevent the spread of the Covid-19 pandemic, continuation of accommodative macroeconomic policies, and a sharp rebound in the leading export destinations, according to the latest report "World Economic Situation and Prospects".

The report notes that the global economic recovery is facing significant headwinds amid new waves of COVID-19 infections, persistent labour market challenges, lingering supply-chain challenges and rising inflationary pressures. After expanding by 5.5 per cent in 2021, the global output is projected to grow by only 4.0 per cent in 2022 and 3.5 per cent in 2023.

"Without a coordinated and sustained global approach to contain COVID-19 that includes universal access to vaccines, the pandemic will continue to pose the greatest risk to an inclusive and sustainable recovery of the world economy," noted Liu Zhenmin, Under-Secretary-General of the United Nations Department of Economic and Social Affairs.

**Following the economic rebound in early 2021, Europe faced serious challenges**

During the first half of 2021, the economic performance of the European region exceeded earlier expectations. Private consumption surged, as households started to spend savings accumulated during 2020. Reopening of the services sector and lifting of intra-EU mobility restrictions stimulated recovery, especially in Greece, Italy, and Spain that have large tourism sectors. However, in the second half of 2021 the region faced significant headwinds. The manufacturing sector was severely impacted by supply chain disruptions, in part caused by shortages of shipping containers and constrained capacities in the Asian ports. The automotive industry – crucially important for the leading economy, Germany – had been forced to scale back production because of the global semiconductor shortage. On top of that, many industries and services confronted large-scale shortage of workers.

**Another surge in Covid-19 cases towards the end of the year**

Although most countries in the region have relatively high vaccination rates against the Covid-19 Europe experienced another surge in the number of cases in the fall, again becoming an epicentre
of the pandemic. This has led to the re-introduction of containment measures. Those measures are disrupting the service sectors, including leisure and tourism.

**From battling deflation to dealing with inflation**

Consumer price inflation that turned negative in many European countries in 2020, has accelerated markedly in the second half of 2021, far exceeding the European Central Bank’s (ECB) 2 per cent target. Skyrocketing costs of raw materials and energy and persistent supply-chain disruptions largely explain the surge in inflation. In Eastern European countries with flexible exchange rates, depreciations added to inflationary pressure. While some of these factors are considered transitory; there is a risk of a longer-than-anticipated period of above-target inflation in the region.

**Gradual shift to fiscal consolidation and scaling down of ECB’s asset purchases**

The massive stimulus spending sharply increased public debt in a number of European countries, far beyond the limits set by the Stability and Growth Pact (SGP) for the EU members. Fiscal consolidation is expected to start in 2022. On the monetary policy side, following the enactment of massive liquidity support schemes, central banks in Europe are expected to start gradual monetary policy normalization. Asset purchases – the main policy tool of the ECB since 2020 – is expected to taper, starting 2022. The Bank of England has announced that it would begin slowing its asset purchases once interest rates reach 0.5 per cent. In Eastern Europe, inflation rates not seen for over a decade prompted series of interest rate hikes.

**Massive recovery plan to improve long-term growth prospects**

The outlook for European economies for 2022 is mixed. Growth may slow due the weaker base effects and the start of the gradual unwinding of the stimulus spending. On the positive side, the EU will start benefiting from the combination of the multi-annual budget running from 2021 to 2027 and the massive Recovery and Resilience Facility of over €800 billion. After shrinking by 6 per cent in 2020, the aggregate GDP of the EU-27 is estimated to have grown by 4.7 per cent in 2021. A further 3.9 expansion is projected in 2022, according to the baseline scenario, which does not assume prolonged lockdowns. Among the non-EU Europe, the economy of the United Kingdom is expected to expand by 6.2 per cent in 2021 and further 4 per cent in 2022.

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