1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

During 2022, economic activity in the United States (US) and the United Kingdom (UK) continued to recover from the effects of the pandemic, but economic growth slowed down from the high rates regstered in 2021. Unemployment declined in both economies. Price pressures rose markedly, largely reflecting developments in energy and food prices due to lingering supply and demand imbalances which were amplified by the effects of the war in Ukraine. The annual rate of consumer price inflation averaged 8.0% in the United States and 9.1% in the United Kingdom.

Throughout the year, both the Federal Reserve and the Bank of England raised their key policy rates on several occasions in order to address high inflation. Both central banks also started to unwind the stock of assets held on their balance sheets.

In the euro area, real GDP slowed down to 3.5% in 2022. Employment increased and stood above the level registered before the onset of the pandemic. Meanwhile, the unemployment rate continued to decline throughout 2022, and stood at 6.7% from 7.7% in 2021. Consumer price inflation, measured on the basis of the HICP, rose notably during 2022, with the average for the year standing at 8.4%, up from 2.6% in 2021.

During 2022, the ECB started to unwind its accommodative monetary policy stance in the context of heightened inflation. The Governing Council raised the interest rates on the deposit facility, the MROs, and the marginal lending facility first in July, and then again in September, October and December, such that by December these rates stood 250 basis points above their level at the end of 2021. Further increases were announced in the first quarter of 2023.

At its March meeting, the Governing Council revised the purchase schedule for its APP, and reduced the amount purchased, before ending them as of 1 July 2022. As regards the PEPP, net purchases ended in March 2022. TLTRO III conditions were also revised during the year, to align them with the normalising monetary stance.

During 2022, the price of oil generally increased, amid concerns about oil supplies following the Russian invasion of Ukraine. Towards the end of the year, oil prices subsided somewhat, as weaker economic growth prospects increased the possibility of lower demand for oil. The price of Brent crude oil ended 2022 at USD 83.3 per barrel, 6.0% above its level at end-2021.

Key advanced economies

US economy remains resilient

During 2022, the US economy remained resilient, but economic growth slowed down. Real GDP rose by 2.1% in 2022, following a rise of 5.9% in the previous year (see Table 1.1). In 2022, GDP stood 5.1% above its 2019 level.

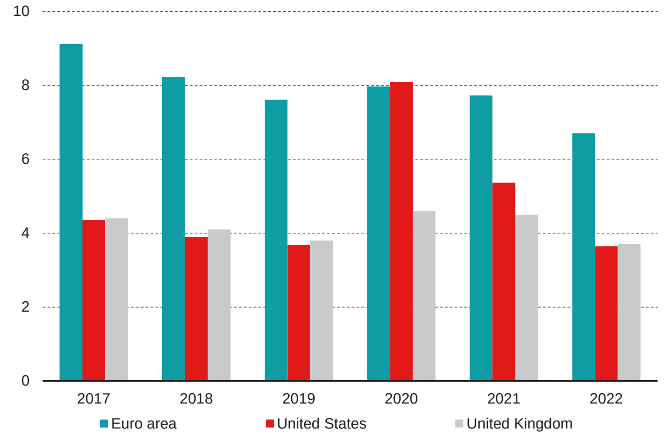
The deceleration in real GDP growth was driven by domestic demand. While personal consumption expenditure and gross private domestic investment grew further, they did so at a slower pace. Furthermore, growth in government expenditure turned negative. These developments offset an increase in the contribution of inventories. Meanwhile, net exports had a smaller negative effect on GDP growth compared with 2021.

Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES
Percentage changes over preceding period

	2017	2018	2019	2020	2021	2022
United States	2.2	2.9	2.3	-2.8	5.9	2.1
Euro area	2.6	1.8	1.6	-6.1	5.3	3.5
United Kingdom	2.4	1.7	1.6	-11.0	7.6	4.0

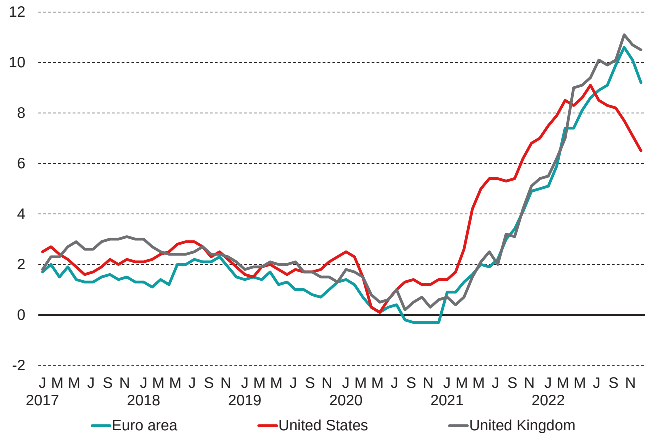
Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

Chart 1.1
UNEMPLOYMENT RATE
(percentage of the labour force; seasonally adjusted)



Sources: Eurostat; US Bureau of Labor Statistics; Office for National Statistics, UK.

Chart 1.2
CONSUMER PRICE INFLATION
(annual percentage changes)



Sources: Eurostat; US Bureau of Labor Statistics; UK Office for National Statistics.

In the labour market, the participation rate averaged 62.2% in 2022, as against 61.7% registered in 2021. Employment increased by 3.7%, after increasing by 3.2% in 2021. Compared to 2019, there were 0.5% more persons in employment. Nevertheless, the participation rate remains below pre-pandemic levels.

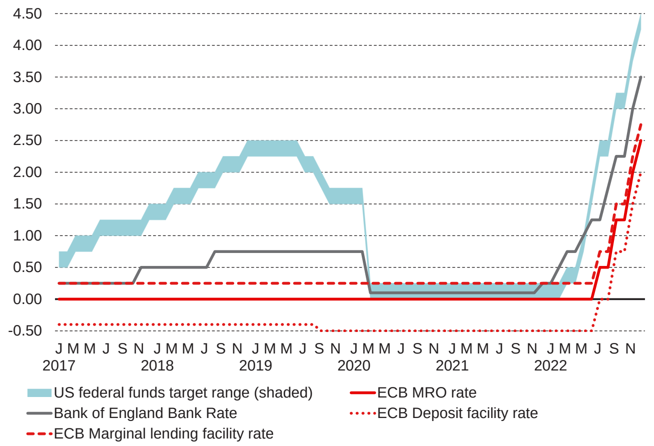
Non-farm payroll data suggest that during 2022 employment was higher across all main economic sectors, with the strongest level increases recorded in the leisure and hospitality, and in the professional and business services.

The unemployment rate stood well below the rates seen in the preceding two years, and was more in line with pre-pandemic rates. In 2022, the unemployment rate averaged 3.6%, down from 5.4% in 2021, and was also 0.1 percentage point lower compared with 2019 (see Chart 1.1).

Inflationary pressures increased substantially during 2022, with the annual inflation based on the consumer price index (CPI) averaging 8.0%, up from 4.7% in 2021 (see Chart 1.2). US inflation exceeded 8.0% in March and rose further to reach a 40-year peak of 9.1% in June. Thereafter, inflationary pressures subsided, although at 6.5% it remained well above the monetary policy target of 2%.

High inflation reflected mainly higher energy and food prices, as well as supply and demand imbalances arising from supply bottlenecks. In fact, energy prices rose by 25.2%, after increasing by 21.0% in 2021. Food price inflation rose to 9.9% from 3.9%. Meanwhile, prices of commodities excluding food and energy grew at a faster pace, though by December, the rate of increase was much more muted. Services inflation also increased at a faster rate of 6.2%. As a result, inflation excluding food and energy accelerated to 6.2% in 2022, from 3.6% in 2021.

Chart 1.3
OFFICIAL INTEREST RATES
(percentages per annum; end of month)



Sources: ECB; Federal Reserve; Bank of England.

After holding the federal funds rate near zero since the onset of the pandemic, in March 2022, the Federal Open Market Committee (FOMC) raised the target range for that rate, in response to persistent inflationary pressures and a tight labour market (see Chart 1.3). Further six increases followed throughout the year, as the FOMC sought to achieve its goals of maximum employment and lower inflation to 2.0% over the longer term. By the end of 2022, the target range stood between 4.25% and 4.50%. The Committee also signalled that further increases would be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2% over time.

At the beginning of 2022, the Committee decided to continue to reduce the monthly pace of its net asset purchases, bringing them to an end in early March, and issued a set of principles regarding its planned approach for significantly reducing the size of the Federal Reserve's balance sheet. According to these principles, the federal funds rate remains the primary means of adjusting the stance of monetary policy.

In March, the Committee announced that it expected to begin reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities at a coming meeting. In June, the FOMC began reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities and continued doing so throughout the year as the Committee emphasised that it remained strongly committed to returning inflation to its objective.

In assessing the appropriate stance of monetary policy, the Committee said that it would continue to monitor the implications of incoming information for the economic outlook. Furthermore, the monetary stance would be adjusted as appropriate, if risks emerge that could impede the attainment of its goals.[1]

UK economy continues to recover

During 2022, the UK economy continued to recover from the effects of the pandemic, though growth in real GDP slowed down to 4.0% in 2022, from 7.6% in 2021 (see Table 1.1). Household expenditure increased at a slower pace as high consumer price inflation, rising mortgage costs and tight financial conditions weighed on consumption. Government consumption also increased less rapidly. On the other hand, gross fixed capital formation (GFCF) increased at a faster pace. Meanwhile, the contribution of net trade was less negative. In 2022, the GDP level stood just 0.4% below its level in 2019.

In 2022, on average, employment increased by 1.0% compared with 2021, when employment had contracted. The employment level was around 0.2% below its pre-pandemic level. The average unemployment rate stood at 3.7%, down from 4.5% a year earlier (see Chart 1.1).

Consumer price inflation in the United Kingdom surged to new highs during 2022. Annual Inflation based on the CPI rose above 9.0% in May, before peaking at 11.1% in October (see Chart 1.2). It ended the year

[1] In its meeting held between end-January 2023 and beginning of February 2023, the Committee decided to raise the target range for the federal funds rate to between 4.50% and 4.75% and confirmed that further rate hikes would be required to bring inflation closer to 2%.

at 10.5%. For 2022 as a whole, inflation averaged 9.1%, up from 2.6% in 2021. Energy inflation increased markedly to 47.6% in 2022, from 8.9% in 2021. Prices for NEIG, services and food also grew at a faster pace. The average annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco, rose to 5.9% in 2022 from 2.4% in 2021.

The Bank of England Monetary Policy Committee (MPC) started increasing its Bank Rate in February, and did so on eight occasions during the year, to end 2022 at 3.5% (see Chart 1.3). In December, the MPC said that while the labour market was beginning to ease, it remained tight, and there was evidence of inflationary pressures in domestic prices and wages that could justify a more forceful response. The MPC added that it will take the actions necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit. The Committee will, as always, consider and decide the appropriate level of Bank Rate at each meeting.

In early 2022 the MPC decided to begin reducing the stock of UK government bond purchases and the stock of sterling non-financial investment-grade corporate bond purchases financed by the issuance of central bank reserves, by stopping reinvestments. Furthermore, in the case of corporate bonds, a sales programme is expected to be completed no earlier than towards the end of 2023, with a view to fully unwind the stock of these purchases.

In August the Committee stated that it was provisionally minded to start gilt sales shortly after its September meeting. In September, the MPC considered that the conditions to start gilt sales were met and agreed to reduce the stock of purchased UK government bonds, financed by the issuance of central bank reserves, by GBP 80 billion over the next 12 months, to a total of GBP 758 billion. However, on 28 September 2022, the Bank of England also announced that gilt sales would be postponed, in light of a significant repricing of UK and global financial assets, which could undermine financial stability and the flow of credit to the economy. To address this issue, the Bank carried out temporary purchases of long-dated UK government bonds. The GBP 80 billion reduction target was not affected. Temporary gilt purchases were conducted between 28 September and 14 October, with a view to restore orderly market conditions and limit the risk of contagion to broader credit conditions in the economy. On 29 November, the Bank begun to unwind, in a timely but orderly way, the specific gilt purchases resulting from the financial stability operations. As of 13 December 2022, around 40% of the gilts purchased during those operations had been sold.[2]

Economic and financial developments in the euro area

Euro area GDP growth slows down[3]

Real GDP growth in the euro area slowed down to 3.5% in 2022, compared to 5.3% in 2021 (see Table 1.2). After having gathered momentum in the first half of the year, economic growth retraced notably in the second half. In early 2022, strong net exports, a rebound in tourism, and reasonably robust domestic demand outweighed negative repercussions emanating from increasing energy costs, renewed supply-chain disruptions, and uncertainty in light of the Russian invasion of Ukraine. In the second half of the year, however, elevated geopolitical uncertainty related to the war in Ukraine, record-high inflation, disruptions in the energy and food commodity markets, tightening financial conditions and weakening global demand dampened economic growth.

The expansion in real GDP was largely driven by domestic demand. Private consumption was the main domestic demand component pushing up economic activity as it rose by 4.3% over the previous year and contributed 2.2 percentage points to GDP growth. Consumption kept the strong momentum started in 2021, following the easing of pandemic-related restrictions, while consumers' upbeat sentiment was supported by a robust labour market. This was followed by an increase in investment spending, which contributed 0.8 percentage point to GDP growth as GFCF grew by 3.7%, in part reflecting a notable increase in investment in

[2] In its meeting held in February 2023, the MPC increased the Bank Rate by 0.5 percentage point to 4.0%. The MPC said that while headline CPI inflation has begun to ease and is likely to fall sharply over the rest of 2023, the labour market remains tight and domestic price and wage pressures have been stronger than expected, suggesting risks of greater persistence in underlying inflation.

[3] The cut-off date for data on GDP and the labour market in this chapter is 8 March 2023.

Table 1.2
REAL GDP GROWTH IN THE EURO AREA
Chain-linked volumes

	2017	2018	2019	2020	2021	2022
			Annual percentage changes			
Private consumption	1.8	1.5	1.4	-7.7	3.7	4.3
Government consumption	1.1	1.0	1.7	1.0	4.3	1.1
GFCF	3.9	3.1	6.9	-6.2	3.8	3.7
Exports	5.6	3.6	2.8	-8.9	10.6	7.0
Imports	5.2	3.9	4.8	-8.5	8.4	7.9
GDP	2.6	1.8	1.6	-6.1	5.3	3.5
			Percentage point contributions			
Private consumption	1.0	0.8	0.7	-4.1	1.9	2.2
Government consumption	0.2	0.2	0.4	0.2	1.0	0.2
GFCF	0.8	0.6	1.4	-1.4	0.8	0.8
Changes in inventories	0.2	0.1	-0.2	-0.3	0.3	0.3
Exports	2.6	1.7	1.4	-4.3	4.8	3.5
Imports	-2.1	-1.7	-2.1	3.8	-3.5	-3.6
GDP	2.6	1.8	1.6	-6.1	5.3	3.5

Source: Eurostat.

intangible assets in Ireland. Changes in inventories also had a positive impact on GDP growth during 2022, as did government consumption, which increased by 1.1% over the previous year. By contrast, net exports pushed down GDP growth by 0.1 percentage point, as a 7.0% rise in exports was outweighed by a 7.9% increase in imports that also reflected the increase in domestic demand.

From a sectoral perspective, the services sector, notably high-contact services that include travel and tourism, extended its robust positive performance following the relaxation of pandemic-related containment measures. Activity also expanded in most other economic sectors, although contributions to overall growth were smaller. By contrast, activity was stagnant in the sector comprising agriculture and fisheries, in construction and in the financial and insurance sector.

Labour market conditions improve further

Labour market conditions in the euro area improved further during the year under review. The labour market was mainly supported by strong demand, which amply compensated for the phasing out of supporting policy measures implemented at the height of the pandemic.

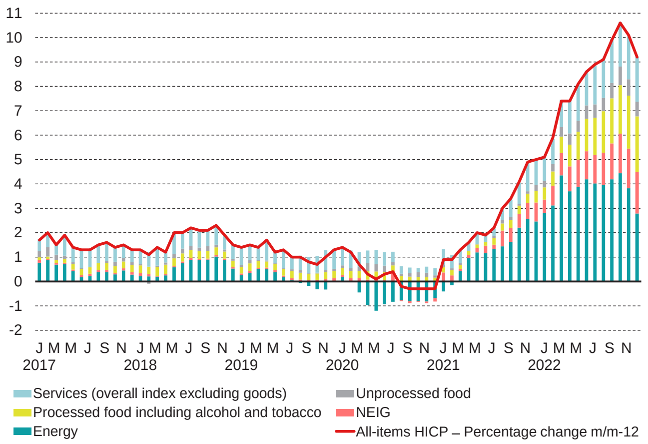
Employment increased by 2.2% in 2022, up from 1.4% in 2021. Seasonally-adjusted data show that the rebound in employment which started in the second half of 2020 continued steadily during the year and imply that, during the final quarter of 2022, the number of people in employment was 2.3% higher than that registered in the final quarter of 2019, just before the onset of the pandemic.

Meanwhile, unemployment continued to decline throughout 2022, with the seasonally-adjusted unemployment rate averaging 6.7% during the year, down from 7.7% in 2021 (see Chart 1.1). In December 2022, the unemployment rate stood at 6.7%, as against 7.0% a year earlier. Cross-country data show that the unemployment rate fell in most euro area countries. However, wide disparities across countries persist, with the unemployment rate at the end of the year standing at 13.0% in Spain but only 2.9% in Malta.

HICP inflation rises sharply

The annual rate of HICP inflation in the euro area rose markedly during 2022, with the average for the year as a whole standing at 8.4%, up from 2.6% in 2021 (see Chart 1.4). This increase mainly reflected a very strong rise in energy inflation, which shot up to 37.0% from 13.0% in 2021, reflecting sharp increases in the prices of fuels, gas and electricity following Russia's invasion of Ukraine. Thus, the contribution of energy to overall inflation rose to 3.8 percentage points, from 1.2 percentage points in the previous year. To a lesser extent, unprocessed food inflation also rose on average, to 10.4%, so that its contribution to overall inflation rose to 0.5 percentage point, from 0.1 percentage point in 2021. Processed food (including alcohol and tobacco) inflation rose to 8.6%, on average, and its contribution to overall inflation increased to 1.4 percentage points, from 0.3 percentage point a year before. Meanwhile, NEIG inflation picked up to 4.6%, pushing up its contribution to overall inflation to 1.2 percentage points, from 0.4 percentage point in 2021. Services inflation rose to 3.5%, on average, contributing 1.5 percentage points to overall inflation, up from 0.6 percentage point in the previous year.

Chart 1.4
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION IN THE EURO AREA
(percentage points; annual percentage change)



Source: Eurostat.

Inflation went up almost consistently as the year progressed but eased somewhat in the last two months of the year. The annual rate of HICP inflation rose from 5.0% in December 2021 to 10.6% in October 2022, which was the highest inflation rate ever recorded for the euro area. It eased to 10.1% in November and ended the year at 9.2%. Besides energy-price dynamics, other factors contributed to the significant rise in headline inflation. Most importantly, recovering demand after the COVID-19 pandemic outpaced supply, which remained restricted by various bottlenecks. The latter were reinforced by disruptive effects stemming from the war in Ukraine. Supply shortfalls exerted upward pressure on the prices of food and some categories of NEIG, while the recovery in demand contributed to the increase in prices of services, especially those for high-contact services such as restaurants and hotels.

HICP inflation excluding energy and food averaged 3.9% during 2022, 2.4 percentage points higher than that recorded in 2021. This measure of inflation increased steadily as the year progressed, rising to 5.2% in December.

ECB projects weaker economic activity, while inflation is set to ease

According to the ECB staff macroeconomic projections published in March 2023, economic growth is set to weaken in the near term, before picking up as of mid-2023 as uncertainty diminishes, real incomes rise, and foreign demand strengthens. On the other hand, tighter financing conditions will dampen growth. Inflation is projected to ease, largely due to developments in energy prices. A tighter monetary policy stance is also expected to restrain upward price pressures, countering the impact of faster growth in wages. However, uncertainty remains high and has increased following recent financial market tensions.

Real GDP growth in the euro area is expected to slow down to 1.0% in 2023, but pick up in 2024 and 2025, with economic activity expanding by 1.6% in both years (see Table 1.3). Following stagnant real GDP growth at the turn of the year, economic activity in the euro area is expected to improve in the short term, as a result of lower energy prices, dissipation of global supply bottlenecks, improving real incomes and lower uncertainty related to energy bills. However, the ECB's tightening policy stance and further interest rate hikes expected by markets are likely to increasingly feed through to the real economy, with some additional dampening effects stemming from the recent tightening in credit supply conditions. These factors, together

Table 1.3

MACROECONOMIC PROJECTIONS FOR THE EURO AREA[1]

Annual percentage changes

	2022	2023	2024	2025
GDP	**3.6**	**1.0**	**1.6**	**1.6**
Private consumption	4.3	0.7	1.3	1.4
Government consumption	1.4	-0.2	1.4	1.4
GFCF	3.7	0.3	1.4	1.8
Exports	7.5	3.4	3.5	3.3
Imports	8.3	3.0	3.0	3.2
HICP	**8.4**	**5.3**	**2.9**	**2.1**
HICP excluding energy and food	3.9	4.6	2.5	2.2

Source: ECB.

[1] ECB staff macroeconomic projections (March 2023).

with the expected gradual withdrawal of fiscal stimulus measures and persisting concerns about the energy supply-demand balance, are likely to weigh on economic growth in the medium term.

Compared to the December 2022 projections, real GDP growth has been revised upwards by 0.5 percentage point for 2023. By contrast, growth projections were revised downwards by 0.3 and 0.2 percentage point for 2024 and 2025, respectively. The revision for 2023 reflects carry-over effects from a better than expected performance in the second half of 2022 and significantly lower energy prices. On the other hand, the tightening of financing conditions and the appreciation of the euro are expected to outweigh the positive effects of lower inflation and act as a drag on economic growth in 2024 and in 2025.

Turning to the outlook for prices, according to the March 2023 projections, HICP inflation is envisaged to moderate to 5.3% in 2023, and ease further to 2.9% and 2.1% in 2024 and 2025, respectively. Such developments are expected to take place on the back of the sharp adjustment in energy markets, strong base effects, and the appreciation of the euro exchange rate. Since pipeline pressures related to cost pass-through are still being felt, food inflation is expected to start declining later. The expected decline of headline inflation in the medium-term also reflects the gradual impact of monetary policy normalisation. In contrast to headline inflation, HICP inflation excluding energy and food is expected to increase in 2023 compared to 2022, reflecting lagged effects related to past high energy prices and from the past strong depreciation of the euro. The effects of the recent energy price declines and euro appreciation on core inflation will be felt only later in the horizon. In addition, the tight labour markets and inflation compensation effects imply that wages are likely to grow at rates well above historical averages, putting upward pressure on inflation.

Compared to the December 2022 projections, HICP inflation has been revised downwards by 1.0 percentage point for 2023, and by 0.5 and 0.2 percentage point for 2024 and 2025 respectively. The notable downward revision in 2023 is driven by the energy component, partially offset by upward surprises in HICP inflation excluding energy and food. As to 2024 and 2025, the HICP inflation rate projections were revised downwards on account of a lower impact from fiscal measures on energy inflation, more strongly dissipating indirect inflationary effects and an increasing pass-through of the recent appreciation in the euro exchange rate.

ECB raises key interest rates as monetary policy normalises

The ECB's Governing Council started to unwind its highly accommodative monetary policy stance in 2022 in the context of heightened inflationary pressures. The Governing Council took firm decisions to achieve its inflation objective of 2% over the medium term. Thus, the interest rates on the deposit facility, the MROs and the marginal lending facility were raised during the second half of the year, ending the year at 2.00%, 2.50% and 2.75%, respectively, compared to -0.50%, 0.00% and 0.25% at the beginning of 2022 (see Chart 1.3).

At the beginning of the year, the Governing Council confirmed the monetary policy stance adopted in December 2021. At its March meeting, the Governing Council revised the purchase schedule for its APP for the ensuing months. It reduced the amounts to be purchased and stated that if incoming data supported the expectation that the medium-term inflation outlook would not weaken, even after the end of its net asset purchases, the Governing Council would conclude net purchases under the APP in the third quarter of 2022. The Council restated its intention to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it started raising the key ECB interest rates and, in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. As regards the PEPP, the Governing Council ended net purchases at the end of March 2022. It decided that the reinvestment period for the principal payments from maturing securities purchased under the PEPP would be until at least the end of 2024, and in any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. The Council also announced that net purchases under the PEPP could be resumed, if necessary, to counter negative shocks related to the pandemic.

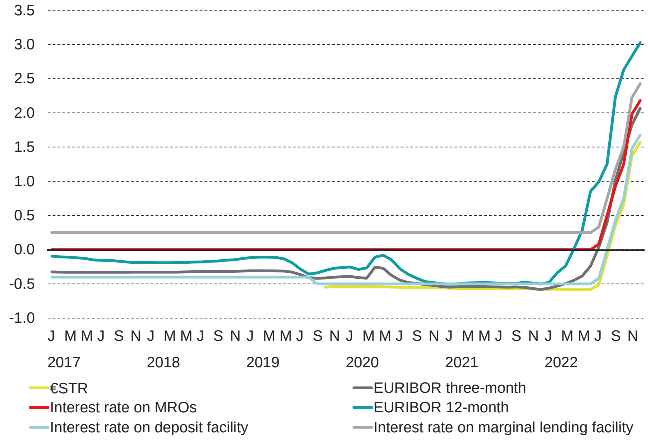
On 9 June, the Governing Council announced its intention to raise the key interest rates by 25 basis points at its July monetary policy meeting and to increase rates again in September and gradually thereafter depending on incoming economic data and inflation developments. This announcement was made as previously specified conditions necessary for the Council to start raising rates were satisfied. Also, at its June meeting, the Governing Council decided to end net asset purchases under its APP as of 1 July 2022. As to the PEPP, while net purchases under the programme ended in March, the Governing Council reiterated its intention to reinvest the principal payments from maturing securities purchased under this programme until at least the end of 2024. The Council reaffirmed that net purchases under the PEPP could be restarted, if necessary, to neutralise negative shocks related to the pandemic.

Following its earlier announcement, the Governing Council decided to increase interest rates for the first time since 2011 in July. On 21 July, the Council raised the three key interest rates by 50 basis points.

At its July meeting, the Governing Council also approved the TPI to help prevent disorderly market dynamics that pose a serious threat to the transmission of monetary policy. Whereas net asset purchases under the APP ended as of 1 July 2022, the Council reaffirmed its intention to continue fully reinvesting the principal payments from maturing securities purchased under the APP for an extended period of time and for as long as necessary to maintain favourable liquidity conditions and an appropriate monetary policy stance. Regarding the PEPP, the Governing Council reiterated its intention to reinvest the principal payments from maturing securities purchased until at least the end of 2024. Redemptions coming due in the PEPP portfolio were being reinvested flexibly to prevent risks to the monetary policy transmission mechanism related to the pandemic. As was previously announced, the special conditions applicable under TLTRO III ended on 23 June 2022.

The Governing Council hiked rates by 75 basis points on 8 September. The Governing Council envisaged raising interest rates further to dampen demand and guard against the risk of a persistent upward shift in inflation expectations. It added, however, that future policy rate decisions would continue to be data-dependent and follow a meeting-by-meeting approach.

On 27 October 2022, the Governing Council raised the three key ECB interest rates by a further 75 basis points. Also, it adjusted the interest rates applicable to TLTRO III from 23 November 2022 and offered banks additional voluntary early repayment dates. Furthermore, the Council decided to set the remuneration of minimum reserves at the ECB's deposit facility rate. Subsequently, on 15 December 2022, the Council raised key interest rates again by 50 basis points and announced that from the beginning of March 2023 the Eurosystem would not reinvest all of the principal payments from maturing securities in the APP portfolio so that the portfolio would decline at a measured and predictable pace.[4]



Money market rates rebound and turn positive

In the context of the ECB's unwinding of its highly accommodative monetary policy stance and indications that it would implement further tightening steps in due course, money market rates in the euro area rebounded in 2022. The euro short-term rate (€STR) stood at -0.58% on average in December 2021 but, by mid-September, it turned positive and averaged 1.57% in December.[5] Reflecting changes in the key ECB interest rates, the €STR rose by 215 basis points during 2022. It remained slightly below the interest rate on the ECB's deposit facility throughout the year.

The three-month Euro Interbank Offered Rate (EURIBOR) averaged -0.58% in December 2021 but rose incrementally during the first half of 2022, turning positive in July. It increased further in the following months and averaged 2.07% in December. The 12-month EURIBOR rose from -0.50% to -0.24% between December 2021 and March 2022, turning positive in April and continued to rise during the rest of the year. It averaged 3.03% in December (see Chart 1.5).[6]

Euro area bond yields rise notably

Ten-year benchmark government bond yields in the euro area rose markedly further during 2022, against the background of rising inflation, increasing short-term interest rates and expectations that the monetary policy stance would continue to tighten. Overall, the euro area ten-year government benchmark bond yield increased from 0.28% at end-December 2021 to 3.00% one year later.

All sovereign bond yields in the euro area rose during 2022. German ten-year bond yields turned positive in early 2022 and continued to rise throughout the year, reaching 2.08% in December or 246 basis points higher than twelve months before. Italian bond yields went up by 321 basis points to average 4.26% in December, whereas French and Spanish yields rose to a lesser extent. Yields on Cypriot bonds recorded the strongest increase, gaining 356 basis points and averaging 4.20% in December, while Slovenian, Slovak and Latvian bond yields also gained considerably.

As a result, spreads between yields on ten-year German bonds and those on bonds issued by the other euro area governments widened over the year (see Chart 1.6). By the end of the year, spreads on Greek and Italian bonds widened to over 200 basis points, while those on Spanish and Portuguese bonds increased to slightly over 100 basis points. Spreads were more contained in France and Ireland, as well as in the Netherlands.

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4 In February 2023, the Governing Council raised the three key ECB interest rates by 50 basis points and stated that it expected to raise them further. In view of the underlying inflation pressures, the Governing Council expressed its intention to raise interest rates by another 50 basis points at its March monetary policy meeting and would then evaluate the subsequent path of its monetary policy. The Governing Council also decided on the modalities for reducing the Eurosystem's holdings of securities under the APP. In March 2023, the Governing Council hiked the three policy interest rates by 50 basis points so that the interest rates on the deposit facility, the MROs and the marginal lending facility reached 3.00%, 3.50% and 3.75%, respectively. The Council stated that it was monitoring current market tensions closely and stood ready to respond as necessary to preserve price stability and financial stability in the euro area.

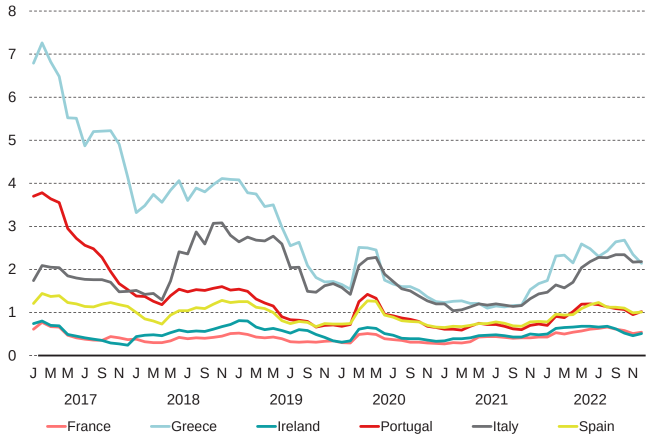
5 The €STR is a reference rate based on money market data collected by the Eurosystem, reflecting the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. The €STR has replaced the EONIA interest rate as from 4 January 2022.

6 The EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period.

The euro partly recovers lost ground versus the US dollar, appreciates against the British pound

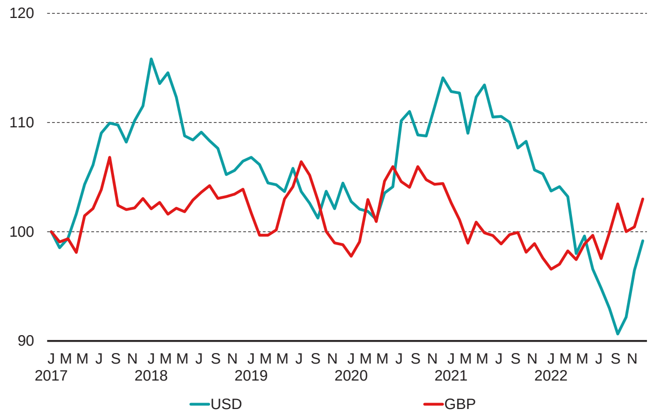
The euro exchange rate appreciated in nominal effective terms during 2022, with the NEER-19 gaining 0.4% from its end-2021 level.[7] This contrasted with a depreciation of 5.1% in 2021. The marginal increase in the external value of the euro during 2022 mainly reflected the monetary policy decisions taken by the ECB to address heightened inflationary pressures and reversal of flows into safe-haven currencies which had taken place in the context of the COVID-19 pandemic. Perceptions of a more hawkish tone by the Federal Reserve compared to the ECB, however, weighed on the euro during most of the year.

Chart 1.6
SELECTED EURO AREA GOVERNMENT BOND YIELD SPREADS
(difference vis-à-vis German ten-year government bond yields in percentage points)



Source: ECB.

Chart 1.7
EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES
(index of end of month rates; Jan. 2017=100; an increase in the index implies euro appreciation)



Source: Eurostat.

On a bilateral basis, the euro lost 5.8% against the US dollar. The depreciation of the euro versus the US currency took place during the first ten months of the year, mainly on account of the continued broad-based strength of the dollar, reflecting positive macroeconomic developments in the United States and investors' expectations of a tighter US monetary policy stance relative to the euro area (see Chart 1.7). Subsequently, however, the euro recovered substantially against the US unit, largely in the context of the ECB's rapid normalisation of its monetary policy stance and as risk aversion abated. By contrast, the single currency appreciated by 5.6% against the pound sterling, as the latter was weakened by political developments in the United Kingdom and persistent economic uncertainty that was also related to Brexit ramifications.

Over the year as a whole, the euro recorded a mixed performance against a number of other currencies. The euro strengthened against the Japanese yen, the Chinese renminbi, the Hungarian forint, the Swedish krona, the Norwegian krone, the Korean won and the Polish zloty. On the other hand, the single currency weakened versus the Singapore and the Hong Kong dollars, the Swiss franc, the Czech koruna and, to a much lesser extent, the Australian and the Canadian dollars and the Romanian leu.

[7] The nominal effective exchange rate (NEER) is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.

Commodities

Oil prices rise before subsiding

Chart 1.8
PRICE OF BRENT CRUDE OIL
(end of week; US dollars per barrel)

Source: Reuters.

Oil prices started 2022 on a high note and by early February the price of Brent crude oil crossed the threshold of USD 100 per barrel, as markets were optimistic that the new COVID-19 variant would not have a negative impact on global oil demand to the extent previously feared. Following the Russian invasion of Ukraine, oil prices rose further as fears about oil supplies increased. As the year progressed, ongoing risks associated with supplies coupled with embargoes on Russian oil continued to pose upward pressure on oil prices. However, demand concerns from the worsening global economic outlook offset some of this upward pressure. The price of Brent crude oil ended 2022 at USD 83.3 per barrel, 6.0% above the level prevailing at the end of 2021 (see Chart 1.8).

Non-energy commodity prices rose during 2022, with World Bank data showing an increase of 10.6%. The increase mainly reflected higher prices for fertilisers and to a lesser extent agricultural products.