Wiener Institut für Internationale Wirtschaftsvergleiche
The Vienna Institute for International Economic Studies

PRESS RELEASE: NOT TO BE RELEASED BEFORE 6th July 2012, 12:00 a.m.

wiiw Forecast for Central, East and Southeast Europe, 2012-2014: Fasting or feasting? Europe – Old and New – at the Crossroads

For the CESEE countries, wiiw expects 2012 to be a rather disappointing year. GDP growth will be rather slow – at least when judged by the past standards and the ambitions harboured only a few years ago. Some countries (Czech Republic, Hungary, Slovenia, Bosnia and Herzegovina, Serbia) will suffer a mild recession or come close to it (Bulgaria, Romania, Montenegro). 2013 will be characterized by external imbalances developing anew in some countries, although these are not expected to culminate in a repetition of precipitate and disorderly rebalancing crises. The imbalances, if allowed to widen, may come to a sticky end later. The fiscal consolidation in many CESEE countries is pursued despite the revealed weakness of private consumption and investment, amid signs of flagging demand for CESEE exports.

***External determinants**:* Two key factors currently affect the economic prospects of CESEE: the crisis in the euro area and movements in the commodity prices. For Russia, Kazakhstan and Ukraine declining world market prices of energy carriers, steel and other basic commodities are vital. For most of the countries in Central and Southeast Europe, the strength of external demand for their manufacturing exports and their competitiveness are much more important. The European Union constitutes a natural external environment not only through mutual trade, capital and labour flows, but also through 'intangible links': regulations/directives enacted 'in Brussels'. The *economic* crisis in the euro area is perceived as being primarily about possible insolvencies of peripheral euro area countries. The range of possibilities opened up by sovereign insolvencies is vast. However, a muddling-through scenario still seems the most realistic prospect. Insistence that the 'problematic' euro area countries – but possibly also others in the EU (including the new member states) – should enact the austerity measures in order to reduce public debt levels continues to set the tone throughout Europe, as epitomized by the Fiscal Compact. But, were the Fiscal Compact to be actually obeyed, the euro area – and the EU as a whole, including the new member states – would plunge into an era of permanent stagnation with high and rising unemployment.

Euro area enters recession, CESEE to follow? Given the prevailing fiscal consolidation policy mix it is not surprising that while the world economy recovers, the euro area returns to recession. Consolidation fever has spread to the new member states – including those that formally refused to subscribe to the Fiscal Compact such as the Czech Republic. Given the trend towards fiscal consolidation, it is natural to expect that the new member states will also slow down in 2012. Chances of faster growth in 2013 remain uncertain – both in the new and old member states. The EU Spring forecast is cautiously optimistic. Our forecasts for the new member states in 2013 and afterwards are also cautiously optimistic. That optimism, however, is based on the assumption that the fiscal consolidation fever will abate – both within the euro area and outside. After the deep recession that beset almost all CESEE countries in 2009, most of them recorded a moderate recovery in 2010. However, on a quarterly basis, growth has been generally slowing down since the third quarter of 2011. In a number of countries (e.g. Croatia, Czech Republic, Hungary, Serbia, Slovenia) the most recent quarterly GDP growth rates are already negative. The recent output contractions do not appear to be exceptions, but point to the possibility of more protracted periods of recession occurring in the CESEE region. Among the star-performers of 2011 (Turkey, the three Baltic countries and Kazakhstan), growth will also slow down. Poland, Slovakia, Ukraine and Russia, all of which displayed steady growth in the biennium 2010-2011, are gradually losing steam as well.

External rebalancing is proving temporary: Merchandise exports are expected to rise in 2012. This view reflects an assumption of a shallow and short-lived recession in the euro area. In the Baltic countries, as well as in Romania, Bulgaria, Bosnia and Herzegovina and Ukraine, even with relatively slow growth in domestic demand, foreign trade will not be in a position to support overall GDP growth in 2012. The frailty of a proper industrial base capable of supplying higher value-added exports may be one reason for this. Furthermore, those countries' real exchange rates have also started moving in the wrong direction once again, adding to the deterioration in cost competitiveness. The return of a rise in trade deficits in the Baltic countries (and some other countries) indicates that the 'rebalancing' of 2009 may have been a temporary phenomenon.

Household consumption and investment: steady on the 'fringes', sagging in the 'core': Investment growth in 2012 is expected to remain quite sluggish throughout the 'core' countries (even declining in some of them). Only in the period 2013-2014 is investment growth expected to recover across the new EU member states and in the Balkans. Investment is forecast to remain steady throughout 2012-2014 in Kazakhstan, Russia and Ukraine. In 2012, consumption growth will sag still more in most new EU member states and across the Balkans. Even in the Baltic countries, consumption growth is expected to slow down.

Threats and opportunities: At present, the major and most realistic danger facing the majority of CESEE countries is that they will stick to their commitment to fiscal consolidation, even if investment, consumption and exports continue to weaken. For that threat to materialize, neither the euro area nor the EU as whole need necessarily plunge into some dramatic crisis. For that danger to become reality, it is sufficient for Europe to continue slowing down, while fiscal consolidation is still being demanded of its old, new or prospective members. Of course, some spectacular collapse of the euro area/EU (as we know it) could perhaps have truly devastating effects on most CESEE countries – via trade, capital flows, transfers and migration. Chaotic developments would then follow in its wake, with repercussions for the global economy at large. However, we may be unqualified to predict events, should chaos erupt. A scenario more optimistic than that possible under 'muddling through' may still be beyond the horizon. Muddling through is unlikely to yield satisfactory results, but desirable changes may still eventually come about. But those changes would have to start in 'high places' in the leading EU countries and leading European institutions. Should the political and economic elites of Europe start acknowledging the negative consequences of fiscal austerity and efficiently work for an overhaul of EU institutions (including the ECB), things might start looking more promising for Europe as a whole – and hence for the CESEE countries as well.

wiiw Current Analyses and Forecasts, No. 10, July 2012
'**Fasting or Feasting? Europe – Old and New – at the Crossroads**'
published by the Vienna Institute for International Economic Studies (wiiw).

The report provides a comprehensive analysis of the current situation in Central, East and Southeast Europe with

- an overview of developments in the new EU member states, in the countries of the Western Balkans and in Turkey as well as in selected CIS countries
- 20 brief country reports
- an assessment of the medium-term economic prospects in the period 2012-2014 (see Table)
- four special sections: (1) Should the European Union strive to achieve permanently balanced public finances? (2) Unit labour cost adjustments in times of crisis, (3) Labour market developments and prospects, (4) Structural distortions before and adjustments after the crisis: a GIIPS-NMS comparison
- a statistical appendix containing selected indicators of competitiveness.

wiiw, 6 July 2012

For questions please contact:

Leon Podkaminer (o*verview, special section 1*) tel. 533 66 10 – 34 podkaminer@wiiw.ac.at
Peter Havlik (*special section 2*) tel. 533 66 10 – 15 havlik@wiiw.ac.at
Hermine Vidovic (*special section 3*) tel. 533 66 10 -45 vidovic@wiiw.ac.at
Michael Landesmann/Doris Hanzl (*special section 4*) tel. 533 66 10 – 39 landesmann@wiiw.ac.at
hanzl@wiiw.ac.at

For ordering the report:

Ursula Köhrl, tel. 533 66 10 – 11 koehrl@wiiw.ac.at

Table I

Overview 2010-2011 and outlook 2012-2014

	GDP real change in % against previous year					Consumer prices change in % against previous year					Unemployment, based on LFS rate in %, annual average					Current account in % of GDP				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
			Forecast					Forecast					Forecast					Forecast		
NMS-10																				
Bulgaria	0.4	1.7	0.5	1.5	2	3.0	3.4	3	3	3	10.2	11.2	12	11	9	-1.0	0.9	-1.3	-2.4	-3.4
Czech Republic	2.7	1.7	-0.3	1.5	2.4	1.2	2.2	3.2	2	2	7.3	6.7	7.1	7	6.5	-3.9	-2.9	-2.4	-2.4	-2.1
Estonia	2.2	7.6	2.1	3.7	4.4	2.7	5.1	3.8	3.8	4	16.9	12.5	11	9.5	9	3.6	3.2	-4.7	-3.8	-4.0
Hungary	1.3	1.7	-1	1.5	2.5	4.7	3.9	5.5	4	3.7	11.2	10.9	11.5	10.5	10	1.2	1.4	1.8	1.6	1.0
Latvia	-0.3	5.4	2.7	3.3	3.8	-1.2	4.2	2.4	2.8	3.5	18.7	15.4	15.5	14.5	14	3.0	-1.2	-2.4	-2.7	-2.9
Lithuania	1.4	5.9	3	3.6	4	1.2	4.1	3	3	3.5	17.8	15.4	13.8	12.5	11.5	1.5	-1.6	-4.6	-4.3	-4.0
Poland	3.9	4.3	2.3	2.4	2.6	2.7	3.9	3.8	2.5	2.5	9.6	9.7	10	9.5	9	-4.6	-4.3	-4.0	-4.4	-4.3
Romania	-1.6	2.5	1	2.5	3	6.1	5.8	3.5	4	4	7.3	7.4	7.5	7	7	-4.4	-4.4	-4.6	-4.5	-4.9
Slovakia	4.2	3.4	2.2	3	4	0.7	4.1	3.5	3	3	14.4	13.5	14	13	12.5	-3.5	0.1	1.0	0.4	0.0
Slovenia	1.4	-0.2	-1.5	0.5	1.5	2.1	2.1	2	2	2	7.3	8.2	8.8	9	8.5	-0.8	-1.1	-0.6	-0.8	-1.1
NMS-10 1)	*2.2*	*3.2*	*1.2*	*2.2*	*2.7*	*3.0*	*3.9*	*3.7*	*2.9*	*2.9*	*9.9*	*9.7*	*9.9*	*9.4*	*8.8*	*-3.1*	*-2.6*	*-2.7*	*-2.9*	*-3.1*
EA-17 2)	*1.9*	*1.5*	*-0.3*	*1.0*	.	*1.6*	*2.7*	*2.4*	*1.8*	.	*10.1*	*10.2*	*11.0*	*11.0*	.	*0.4*	*0.5*	.	.	.
EU-27 2)	*2.0*	*1.5*	*0.0*	*1.3*	.	*2.1*	*3.1*	*2.6*	*1.9*	.	*9.7*	*9.7*	*10.3*	*10.3*	.	*-0.2*	*0.2*	.	.	.
Candidate countries																				
Croatia	-1.4	0.0	-1.5	1	2	1.1	2.3	2.5	2.4	2	11.8	13.5	14.5	14.5	13.5	-1.1	-1.0	-0.7	-1.1	-1.2
Macedonia	2.9	3.1	1.9	3	3.3	1.6	3.9	3	3	3	32.0	31.4	31	31	31	-2.1	-2.7	-5.7	-4.8	-4.5
Montenegro	2.5	2.0	1	2	3	0.5	3.1	3	3	3	19.6	19.7	20	20	19	-24.6	-19.2	-20.6	-22.2	-21.1
Turkey	9.0	8.5	3.5	5.0	5.0	8.6	6.5	9.1	9.0	8.0	10.7	8.8	10.1	10.2	9.9	-6.4	-10.0	-8.9	-9.1	-8.9
Potential candidate countries																				
Albania	3.0	2.9	2.3	2.8	3.3	3.5	3.5	1.5	4	4	13.7	14	15	14	13	-11.5	-12.5	-12.5	-13.8	-14.7
Bosnia and Herzegovina	0.7	2.2	-0.5	1.5	2.0	2.1	3.7	2	2	2	27.2	27.6	28	28	28	-5.7	-8.6	-8.9	-8.6	-8.3
Serbia	1.0	1.6	-1	1	2	6.8	11.0	6	5	5	19.2	23.0	27	27	26	-7.4	-9.6	-10.1	-11.2	-11.2
Kazakhstan	7.3	7.5	6	5	5.5	7.1	8.5	5.5	6	6	5.8	5.4	5.2	5	5	1.6	7.6	7.6	6.0	4.7
Russia	4.3	4.3	3.8	4.0	4.2	6.9	8.5	6	5	5	7.5	6.6	6.6	6.7	6.7	4.8	5.3	3.9	3.0	2.2
Ukraine	4.1	5.2	3.2	4	5	9.4	8.0	2	6	5	8.1	7.9	7.9	7.7	7.5	-2.2	-5.5	-4.7	-4.9	-4.8

Note: LFS: Labour Force Survey. NMS: The New EU Member States. EA-17: Euro area, 17 countries.
1) wiiw estimate. - 2) Current account data include transactions within the region.

Source: wiiw (June 2012), Eurostat. Forecasts by wiiw and European Commission (Spring Report, April 2012) for EU and euro area.