5.2. BUSINESS CYCLE MONITOR: DOMINATED BY HIGH INFLATION

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The average value of our headline Business Cycle Index for the CESEE region as a whole in Q2 2022 has risen to 0.6; this is above the pre-pandemic level of Q4 2019 and is up where it was at the end of 2007 – one of the highest values on record. Still, one should be cautious about interpreting this as overheating of the economy, since the high value of the index largely reflects the high level of inflation (which is mainly being driven by supply, rather than demand) and the low real interest rates (caused by the high inflation). Nevertheless, the index does also reflect the strong post-pandemic recovery that is evident in solid GDP growth and low unemployment.

The highest value to be observed is in Czechia (1.4), followed by Lithuania and Estonia (1.0). This would normally mean that those three economies are the closest to overheating. At the other side of the spectrum are Russia, Ukraine and Belarus, which have negative values for the index, suggesting that those three economies are the closest to underheating (Figure 5.2).

The high overall values of the index are driven by domestic economy and domestic finance indicators. Among the **domestic economy indicators**, it is unemployment and inflation that stand out. Unemployment is lower than the historical mean in all but two countries (Ukraine and Turkey), reflecting the positive labour market trends that have been visible in the region for some time now. Inflation is above the historical average in all but three countries (Serbia, Romania and Belarus), for reasons that require no explanation. The GDP growth indicator is also positive in most of the countries, thanks to their solid post-pandemic recovery; that said, it does not deviate that much more from the historical average (Table 5.3 and Figure 5.3).

Among the **domestic finance indicators**, the highest scores are observed for the real interest rate indicator, which is positive for all countries, except Kazakhstan. This means that the countries are facing real interest rates that are lower than the historical average. This is because most of the countries have negative real interest rates, due to the high inflation. The property prices indicator is also higher than the average in all the countries for which data are available, with the exception of Serbia. This is because property prices have continued to rise sharply in the region, bolstered by the recent high inflation (Table 5.3).

The **external finance indicators** are much more subdued. The current account indicator is positive in many of the countries, since they have elevated current account deficits on account of high energy and food prices. However, its values are not radically different from the historical average. Interestingly, the external debt indicator is negative in many of the countries, reflecting a declining external debt/GDP ratio, due to the increase in nominal GDP caused by inflation (Table 5.3).

When the CESEE countries are compared against one another, two stand out as potentially at risk of overheating: Turkey and Montenegro (Table 5.4). In Turkey, the domestic finance indicators are pronounced – there is high nominal growth in credit activity, money supply and property prices, while the real interest rate is profoundly negative. Still, this is largely a consequence of the very high inflation, which is affecting all those indicators. In Montenegro, the external finance sector stands out, since the current account deficit is very high and the external debt is the highest in the region (over 170% of

GDP). On the other hand, Russia and Belarus are the two economies that are potentially at risk of underheating.

Figure 5.2 / Business Cycle Index
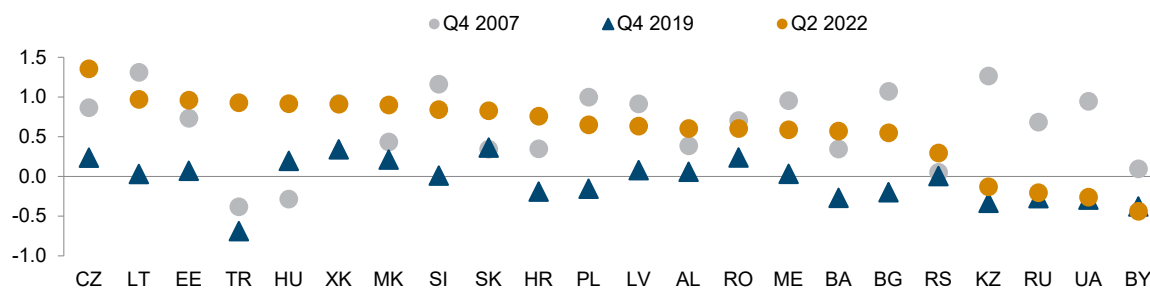
Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those shown in Table 5.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.
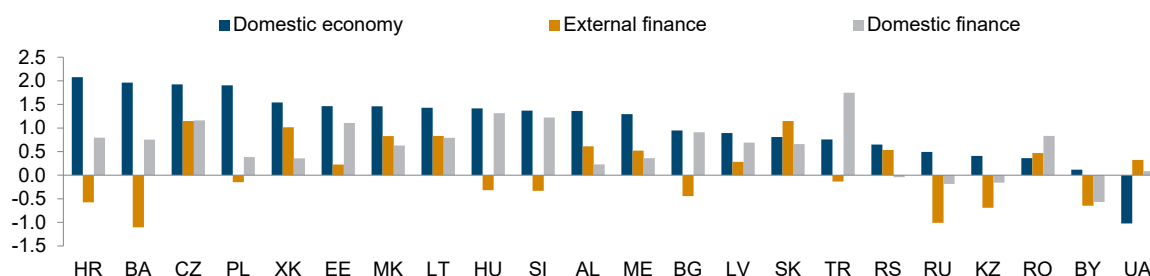
Table 5.3 / Number of standard deviations from historical mean, Q2 2022

	Domestic economy			External finance				Domestic finance			
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
BG	0.49	1.22	1.14	-0.64	0.68	-1.39	2.37	-0.17	-0.35	2.27	0.43
CZ	0.45	1.53	3.79	0.79	1.71	0.84	2.40	-0.18	-0.18	0.89	2.88
EE	0.26	0.91	3.22	-0.74	1.68	-0.28	4.10	-0.22	0.42	0.62	0.62
HR	2.08	1.63	2.47	-0.69	-0.63	-0.46	2.86	-0.07	0.34	-0.98	1.82
HU	1.47	1.35	1.43	0.95	-1.26	-0.41	1.98	0.56	1.34	0.92	1.77
LT	0.02	1.00	3.27	0.40	1.92	0.11	3.54	0.04	-0.15	-0.65	1.18
LV	0.17	1.04	1.48	0.00	1.17	-0.33	2.67	-0.24	-0.53	0.94	0.62
PL	1.68	1.32	2.72	0.48	-0.72	-0.23	2.33	-0.58	-0.42	-1.10	1.71
RO	0.40	0.73	-0.05	1.31	0.02	0.09	2.45	-0.06	-0.42	1.12	1.07
SI	1.74	1.36	1.01	0.12	-1.15	0.07	4.04	0.12	0.01	-0.06	2.01
SK	-0.48	1.45	1.46	0.50	0.87	2.01	3.15	-0.36	-0.27	0.25	0.52
AL	0.47	1.43	1.87	-0.94	1.84	0.63	2.29	-0.29	0.07	-1.31	
BA	1.53	1.64	2.71	-1.08	-1.54	-0.59	4.21	-0.48	-0.35	-0.35	
ME	2.41	1.13	0.35	-0.88	0.61	0.72	2.87	-0.38	0.04	-0.98	
MK	0.03	2.02	2.32	0.80	0.28	1.32	2.33	-0.38	-0.94	0.69	1.43
RS	0.72	1.49	-0.26	0.19	1.06	0.28	0.65	-0.37	-0.65	0.42	-0.27
XK	1.04	1.51	2.07	1.05	1.04	0.98	2.39	-0.08	-0.29	-0.60	
TR	0.68	-0.23	1.82	0.16	-2.48	1.53	2.46	0.59	2.07	-0.54	4.16
BY	-1.34	1.59	-0.39	-1.59	-1.13	0.78	0.20	-1.20	-0.90	-0.37	
KZ	-0.33	0.83	0.76	-0.82	-1.03	-0.06	-0.28	0.22	-0.57	0.01	
RU	-0.34	1.58	0.23	-1.56	-0.06	-1.50	0.60	-0.41	-0.97	-0.25	0.44
UA	-2.07	-1.07	0.07	-0.37	0.15	0.36	0.00	-0.49	-0.75	1.57	

overheating ▨ / underheating ▨
> 1 SD above historical average / > 1 SD below historical average

Notes: CPI: consumer price index; CA: current account; RER: real exchange rate (EUR) CPI deflated, values more than 100 mean appreciation and vice versa; RIR: real interest rate CPI deflated. The data for unemployment, current account, real interest rate and fiscal balance are inverted (since for these indicators lower values would indicate overheating). The historical mean is calculated for Q4 2000 – Q2 2022. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Figure 5.3 / Sub-components of the Business Cycle Index, Q2 2022

Note: Number of standard deviations from the historical mean, average of indicators in each sub-component. Indicators are those shown in Table 5.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Table 5.4 / Over-/underheating in relation to regional peers, Q2 2022 (four-quarter trailing average)

	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
	%	%	% yoy	% of GDP	2015 = 100	% of GDP	%	% yoy	% yoy	% of GDP	% yoy
BG	4.6	4.7	7.8	0.3	101.6	56.5	-7.1	9.6	11.2	-6.1	9.9
CZ	3.9	2.5	8.4	-3.4	117.4	69.0	-4.0	8.0	6.2	-5.0	24.2
EE	5.2	5.6	11.9	0.8	109.1	80.4	-10.4	7.9	16.8	-1.3	19.6
HR	9.9	6.8	6.2	-0.6	98.4	74.3	-3.0	4.3	12.8	-1.6	10.5
HU	7.0	3.6	7.9	-6.6	92.9	82.8	-3.5	11.9	16.7	-6.9	20.2
LT	4.2	6.4	11.8	-5.2	110.0	67.6	-10.4	13.0	11.8	-0.5	19.3
LV	4.4	7.1	9.1	-4.8	105.0	104.8	-8.2	2.9	7.7	-5.0	15.3
PL	7.0	2.9	8.5	-3.9	96.2	53.6	-5.2	4.6	8.0	-1.6	11.5
RO	5.2	5.6	7.9	-9.9	95.9	51.9	-5.1	14.7	13.8	-6.6	6.6
SI	8.3	4.4	5.5	0.9	97.9	92.3	-5.2	6.6	7.4	-3.4	15.2
SK	1.9	6.5	7.1	-5.4	103.2	125.9	-6.6	8.3	6.4	-4.7	11.0
AL	5.3	11.3	4.2	-6.7	115.6	58.3	-3.3	10.3	8.5	-2.0	
BA	6.7	16.2	7.7	-3.4	95.0	54.9	-7.0	3.9	9.3	0.7	
ME	13.8	15.4	6.7	-12.1	99.2	174.1	-1.4	5.2	18.2	-0.1	
MK	2.6	15.1	7.0	-6.7	99.8	79.1	-5.1	8.5	4.8	-4.1	9.8
RS	5.7	10.0	7.8	-7.7	108.6	64.3	-5.9	10.6	10.1	-3.5	6.3
XK	7.0	23.5	7.9	-10.7	101.3	35.4	-1.8	15.8	11.6	0.8	
TR	8.1	11.1	43.5	-4.2	54.1	57.2	-17.8	36.4	50.6	-1.3	68.5
BY	-1.5	3.7	12.4	2.1	85.7	60.0	-1.5	7.3	7.1	1.3	
KZ	4.6	4.9	10.3	1.4	71.2	78.4	1.2	25.6	15.2	-1.5	
RU	2.1	4.2	10.9	12.1	101.4	23.4	0.3	14.7	9.7	2.3	20.7
UA	-10.8	10.0	12.8	1.5	127.4	78.5	0.2	5.9	12.1	-4.9	

potential overheating/instability relative to regional peers   underheating/stability relative to regional peers

Notes: CPI: consumer price index; CA: current account; RER: real exchange rate (EUR) CPI deflated, values more than 100 mean appreciation and vice versa; RIR: real interest rate CPI deflated.
For all indicators higher values indicate overheating, except unemployment, current account, real interest rate and fiscal balance.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.