3. CESEE overview: Beneath the Veneer of Calm

BY BRANIMIR JOVANOVIĆ[15]

- **The economy of the CESEE region grew by 1.5% in Q2 2023, outperforming the EU and the euro area. However, this overall benign picture conceals many nuances.**
- **There were notable differences between the various regions. The EU-CEE countries performed worse than expected, due to the recession in Germany. The Western Balkan countries performed better than expected, thanks to tourism, remittances and FDI. And the CIS countries and Ukraine also did better than anticipated, as they adapted to the new reality.**
- **Inflation is proving far more persistent than previously imagined; it is driven not just by global energy prices, but also by company profits, price rises in other sectors and, most recently, higher wages.**
- **The price increases are having a serious adverse effect on people's living standards and poverty, and some indicators have worsened dramatically.**
- **Growth in 2024 and 2025 will be lower than previously expected, on account of the global slowdown, the weak EU economy, the more persistent inflation, the tighter monetary conditions and less-supportive fiscal policy.**
- **Inflation will also be higher and will not return to 2% any time soon, as its dynamics have become far more complex and are no longer driven just by higher global energy prices.**

3.1. SOLID GROWTH OVERALL, BUT WITH MANY QUESTION MARKS

Economic growth in the CESEE region in Q2 2023 was notably resilient. Despite the stagnation of the EU economy, two thirds of CESEE countries saw their economies expand, sometimes quite robustly. Montenegro led the pack, growing by 6.9% on the back of strong tourism and foreign direct investment (FDI); this continues a streak that has already lasted for some time. The CIS countries also grew strongly, owing to a weak base effect from the previous year, increased military production in Russia and the reorientation of the Russian economy towards countries that have not imposed sanctions. On the other hand, the Baltic and Visegrád countries performed relatively poorly, with the former suffering from their geographical proximity to Russia and the latter from the recession in Germany (Figure 3.1).

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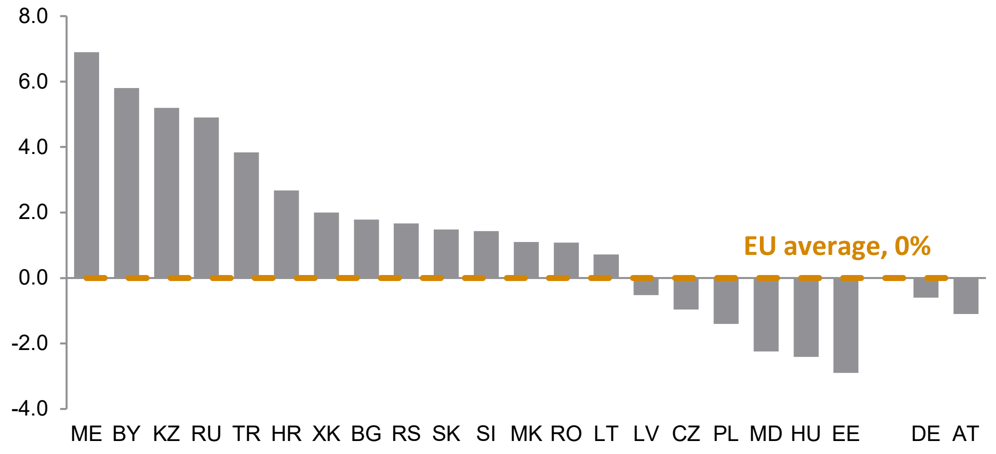
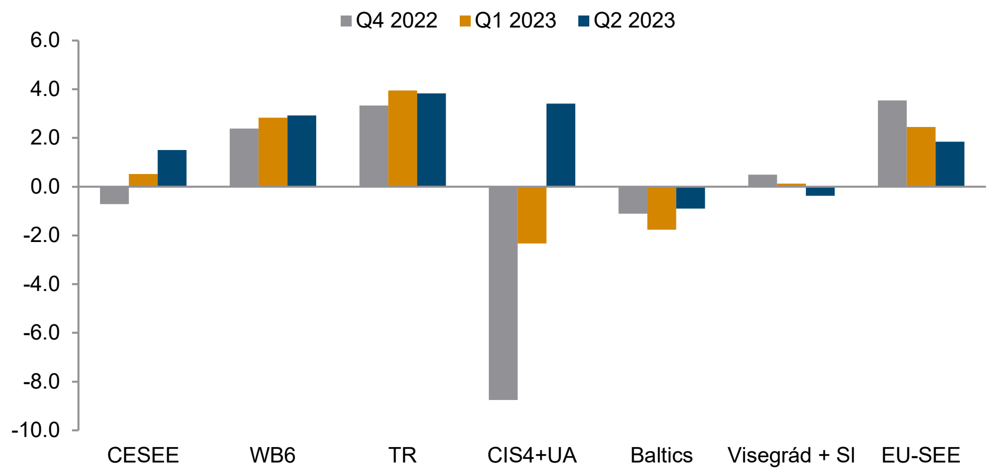
Figure 3.1 / Real GDP growth in CESEE in Q2 2023, %, year on year



Note: Countries which have not published data on Q2 not shown.
Source: Eurostat and wiiw Monthly Database.

Economic growth in the CESEE region in Q2 2023 was generally better than in the previous two quarters, but there was significant variation across the countries. Overall, in the second quarter the region expanded by 1.5% year on year, a clear improvement over the 0.5% growth of Q1 (simple averages). This was also significantly better than the growth in the EU during this period, which was 0%. The sub-region with the highest rate of growth was the CIS plus Ukraine, which saw an expansion of 3.4% in Q2 (compared to a decline of 2.3% in the previous quarter). The Baltic countries also saw their decline moderate from -1.8% in Q1 to -0.9% in Q2. Growth in Western Balkans and Turkey was almost unchanged, while the EU countries of Southeast Europe (EU-SEE) experienced a major slowdown, from 2.5% to 1.8%. The Visegrád countries and Slovenia saw their economies decline by 0.4% in Q2, after growth of 0.1% in the previous period (Figure 3.2).

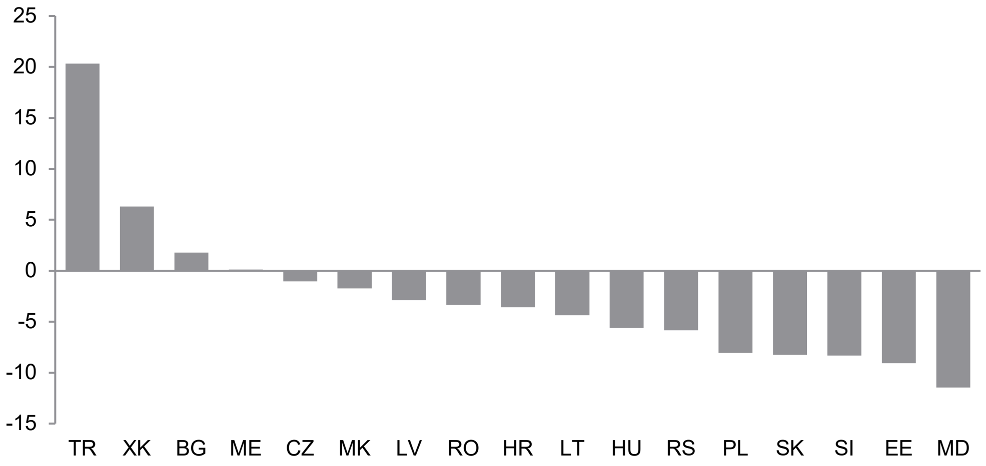
Figure 3.2 / Real GDP growth in the last three quarters, by sub-region of CESEE, %, year on year



Note: Simple averages. No data for Albania, Bosnia and Herzegovina or Ukraine.
Source: Eurostat and wiiw Monthly Database.

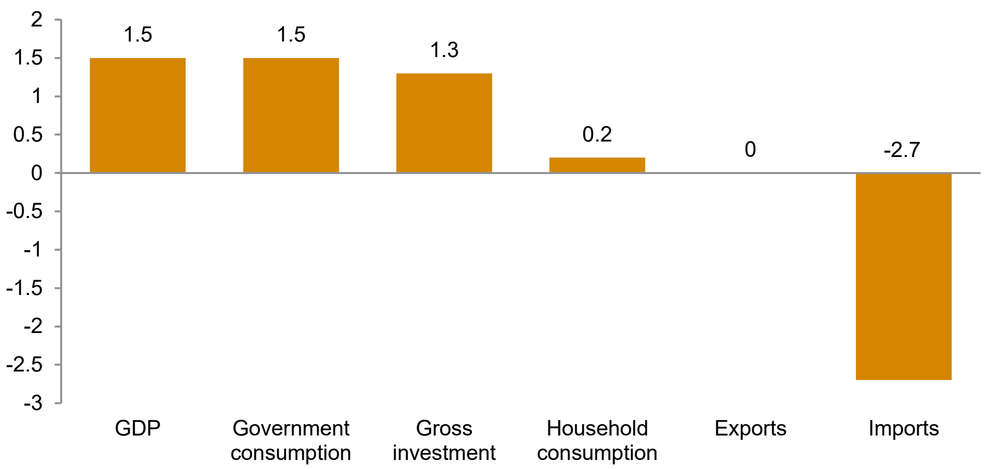
The main driver of growth in the CESEE region in Q2 was, perhaps somewhat surprisingly, the decline in imports. Imports declined in 13 of the 17 CESEE countries that published data on this, by an average of 2.7% for the whole region (simple average). This was due primarily to the big imports of energy in Q2 2022, when there was major uncertainty surrounding the availability and price of energy, leading governments and businesses to rush to import energy. A notable exception was Turkey, where imports of goods and services increased by 20% in real terms (Figure 3.3).

Figure 3.3 / Real growth in imports of goods and services in CESEE in Q2 2023, %, year on year



Note: Countries which have not published data on Q2 not shown.
Source: Eurostat and wiiw Monthly Database.

Figure 3.4 / Real growth of the different GDP components in Q2 2023, %, year on year (simple averages for whole CESEE)

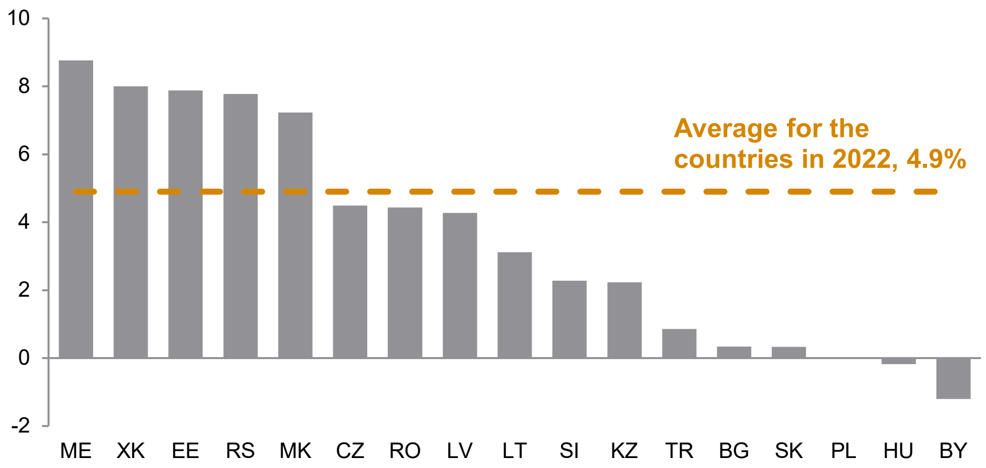


Note: No data on Albania, Bosnia and Herzegovina, Belarus, Kazakhstan, Russia or Ukraine.
Source: Eurostat and wiiw Monthly Database.

Household consumption remained weak in Q2 2023, due to high inflation and the erosion of real incomes. It grew by just 0.2% on average for the whole region (simple average). In 10 of the 17 countries that published data on this, household consumption declined compared to the same period of 2022. Exports were also weak, owing to the recession in Germany and weak activity in China. They stagnated on average for the whole region, declining in nine of the 17 countries for which data are available. Government consumption, on the other hand, was supportive, though only mildly: it grew by 1.5% on average, with 12 of the 17 countries recording a positive change. Gross investment grew similarly, at 1.3% on average for the whole region, with 12 countries seeing an expansion, thanks to strong FDI inflows (Figure 3.4).

FDI inflows remained relatively robust in Q2 2023, although noticeably lower than in 2022. Across the entire region, they averaged 3.6% of GDP – down on both the previous quarter (5.8%) and 2022 (4.9%). This moderation can be attributed to the global economic slowdown, stagnation within the EU and Germany's recession. Nevertheless, some countries continued to attract substantial FDI inflows, primarily the Western Balkan nations, the Baltic countries and a few select Central European countries, such as Czechia and Romania (Figure 3.5). Conversely, some traditionally attractive destinations for FDI – like Slovakia, Hungary and Poland – underperformed in the second quarter, potentially influenced by the recession in Germany. Belarus stood out as a notable outlier (as has often been the case recently): it experienced negative FDI inflows, implying that international companies have been leaving the country. One also has to bear in mind that FDI inflows can be very volatile and are driven by many factors, so they could change a lot by the end of the year.

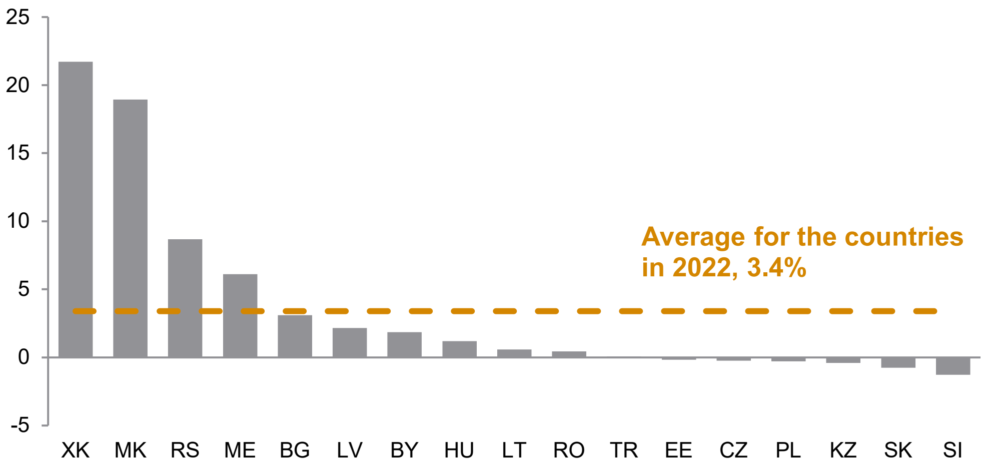
Figure 3.5 / FDI inflows into CESEE countries in Q2 2023, % of GDP



Note: The data refer to FDI inflows (liabilities) from Balance of Payments statistics. Countries which have not published data on Q2 not shown.
Source: Central banks, wiiw calculations.

Remittance inflows, represented by secondary income in the Balance of Payments, remained strong, particularly in countries with significant diasporas. In Q2 they averaged 3.6% of GDP for the entire region – slightly up on the previous year's inflows of 3.4%. The Western Balkan countries saw the strongest inflows, with Kosovo and North Macedonia receiving transfers of around 20% of GDP, and Serbia and Montenegro around 6-9% of GDP. On the other hand, countries that have attracted workers from abroad in recent years, such as Slovenia, Slovakia, Poland and Czechia, had outflows in the secondary income category (Figure 3.6). Strong remittances explain a significant portion of the resilience that some CESEE countries have been demonstrating during this crisis. Evidence from this and past crises, including the pandemic, suggests that remittances in the region do not decline during economic downturns, implying that they are likely to remain robust in the coming period.

Figure 3.6 / Secondary income inflows into CESEE countries in Q2 2023, % of GDP



Source: Central banks, wiiw calculations.

Table 3.1 / OVERVIEW 2021-2022 AND OUTLOOK 2023-2025

	GDP real change in % against prev. year					Consumer prices average change in % against prev. year					Unemployment (LFS) rate in %, annual average				
			Forecast					Forecast					Forecast		
	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
BG Bulgaria	7.6	3.4	1.0	1.5	2.5	2.8	13.0	9.0	7.0	5.0	5.3	4.3	4.2	4.1	4.0
CZ Czechia	3.6	2.4	0.1	2.0	2.7	3.3	14.8	11.0	4.0	2.8	2.8	2.2	2.8	2.6	2.6
EE Estonia	7.2	-0.5	-1.3	1.7	3.0	4.5	19.4	9.5	3.4	2.5	6.2	5.6	6.7	7.0	6.1
HR Croatia	13.1	6.2	2.5	2.9	3.1	2.7	10.7	7.5	4.0	3.0	7.6	7.0	6.8	6.7	6.6
HU Hungary	7.2	4.6	-0.5	1.8	2.4	5.2	15.3	17.5	6.0	4.0	4.1	3.6	4.0	3.8	3.6
LT Lithuania	6.0	1.9	-0.1	1.7	2.4	4.6	18.9	8.0	2.8	2.0	7.1	6.0	7.1	6.5	6.0
LV Latvia	4.3	2.8	0.3	1.8	2.3	3.2	17.2	9.5	3.0	3.2	7.6	6.9	6.6	6.3	6.0
PL Poland	6.9	5.1	0.0	2.8	3.8	5.2	13.2	11.5	5.2	3.6	3.4	2.9	3.0	3.6	3.8
RO Romania	5.8	4.7	2.5	3.2	3.5	4.1	12.0	10.5	7.5	5.0	5.6	5.6	5.7	5.8	5.7
SI Slovenia	8.2	2.5	1.3	2.7	2.5	2.0	9.3	7.2	3.6	2.4	4.8	4.0	3.7	3.7	3.6
SK Slovakia	4.9	1.7	0.8	1.9	2.4	2.8	12.1	11.0	5.0	3.0	6.8	6.1	6.0	6.0	5.8
EU-CEE11 [1)2)]	*6.4*	*4.2*	*0.6*	*2.5*	*3.2*	*4.3*	*13.5*	*11.2*	*5.4*	*3.7*	*4.5*	*4.0*	*4.2*	*4.4*	*4.4*
EA20 [3)]	*5.6*	*3.3*	*0.5*	*1.2*	*1.6*	*2.6*	*8.4*	*5.7*	*3.2*	*2.5*	*7.7*	*6.8*	*6.6*	*6.6*	*6.6*
EU27 [3)]	*5.7*	*3.4*	*0.7*	*1.4*	*1.8*	*2.9*	*9.2*	*5.9*	*3.4*	*2.7*	*7.1*	*6.2*	*5.8*	*5.8*	*5.8*
AL Albania	8.9	4.9	3.5	3.6	3.7	2.0	6.7	4.6	3.0	2.5	11.5	10.9	10.5	10.0	9.5
BA Bosnia and Herzegovina	7.4	3.9	1.7	1.9	2.1	2.0	14.0	7.5	3.0	2.5	17.4	15.4	13.8	13.5	13.2
ME Montenegro	13.0	6.4	4.5	2.9	3.0	2.4	13.0	9.1	5.0	2.8	16.6	14.7	13.8	13.1	12.0
MK North Macedonia	3.9	2.1	1.6	2.0	2.5	3.2	14.2	10.0	5.0	3.0	15.7	14.4	13.0	12.5	12.0
RS Serbia	7.5	2.3	1.5	2.0	2.5	4.1	11.9	12.5	5.5	3.5	11.0	9.4	9.5	9.0	8.5
XK Kosovo	10.7	3.5	3.2	3.3	3.7	3.4	11.6	5.5	4.0	2.5	20.7	12.5	12.4	12.3	12.0
WB6 [1)2)]	*7.8*	*3.2*	*2.1*	*2.4*	*2.7*	*3.2*	*11.8*	*9.5*	*4.5*	*3.0*	*13.6*	*11.7*	*11.3*	*10.9*	*10.4*
TR Turkey	11.4	5.5	3.2	2.7	3.6	19.6	72.3	54.9	54.0	35.0	12.0	10.5	9.5	10.5	10.0
BY Belarus	2.4	-4.7	3.0	2.2	2.5	9.5	15.2	9.0	8.0	8.0	3.9	3.6	3.4	3.4	3.4
KZ Kazakhstan	4.3	3.2	4.7	4.0	4.2	8.0	15.0	14.5	9.0	6.0	4.9	4.9	4.8	4.8	4.8
MD Moldova	13.9	-5.0	0.0	3.5	3.5	5.1	28.7	14.0	6.0	5.0	3.2	3.1	4.5	4.0	4.0
RU Russia	5.6	-2.1	2.3	1.9	1.7	6.7	13.8	5.6	4.9	3.4	4.8	3.9	3.3	3.2	3.1
UA Ukraine	3.4	-29.1	3.6	4.2	5.3	9.4	20.2	14.0	8.0	6.0	9.9	25.0	20.0	15.0	10.0
CIS4+UA [1)2)]	*5.3*	*-3.5*	*2.6*	*2.3*	*2.2*	*7.1*	*14.4*	*7.2*	*5.6*	*4.0*	*5.6*	*7.4*	*6.0*	*5.1*	*4.2*
V4 [1)2)]	*6.2*	*4.3*	*0.0*	*2.4*	*3.3*	*4.6*	*13.7*	*12.2*	*5.1*	*3.5*	*3.7*	*3.2*	*3.4*	*3.7*	*3.8*
BALT3 [1)2)]	*5.8*	*1.6*	*-0.2*	*1.7*	*2.5*	*4.2*	*18.5*	*8.8*	*3.0*	*2.4*	*7.0*	*6.1*	*6.9*	*6.6*	*6.0*
SEE9 [1)2)]	*7.3*	*4.3*	*2.2*	*2.7*	*3.1*	*3.6*	*12.0*	*9.8*	*6.4*	*4.3*	*8.7*	*7.7*	*7.6*	*7.5*	*7.3*
CIS3+UA [1)2)]	*3.9*	*-9.3*	*3.9*	*3.8*	*4.3*	*8.7*	*17.2*	*13.4*	*8.4*	*6.3*	*7.3*	*15.3*	*12.5*	*9.8*	*7.2*
non-EU12 [1)2)]	*7.1*	*-0.4*	*2.8*	*2.4*	*2.7*	*10.5*	*32.4*	*22.2*	*20.7*	*13.6*	*7.4*	*8.3*	*7.1*	*6.7*	*5.9*
CESEE23 [1)2)]	*6.9*	*0.9*	*2.1*	*2.4*	*2.8*	*8.7*	*26.8*	*18.9*	*16.1*	*10.7*	*6.7*	*7.3*	*6.4*	*6.1*	*5.6*

Table 3.1 / (contd.)

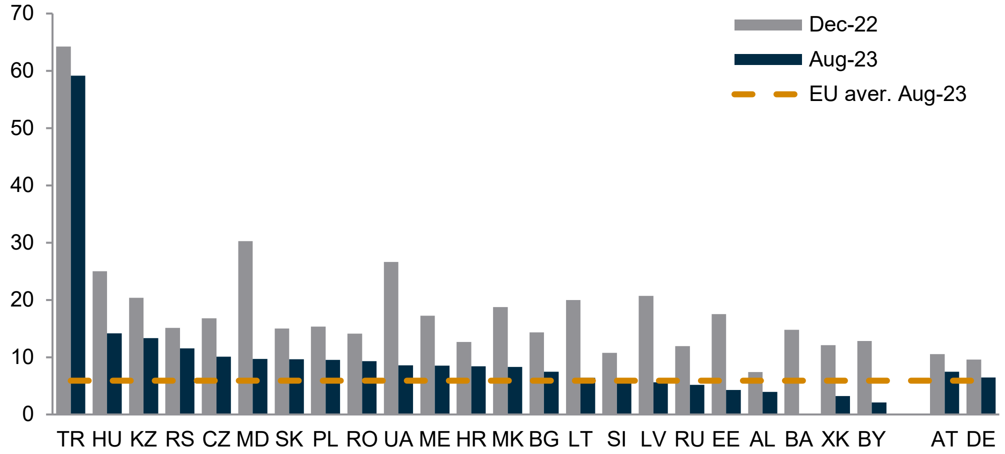
	Current account in % of GDP					Fiscal balance in % of GDP				
			Forecast					Forecast		
	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
BG Bulgaria	-1.9	-0.7	-0.5	-0.3	0.3	-3.9	-2.8	-5.0	-4.0	-3.0
CZ Czechia	-2.8	-6.1	-1.2	-0.6	-0.1	-5.1	-3.6	-4.2	-1.9	-1.0
EE Estonia	-1.8	-2.9	0.9	1.1	1.7	-2.4	-0.9	-3.5	-3.3	-2.7
HR Croatia	1.8	-1.6	-0.4	0.2	1.7	-2.5	0.4	-2.4	-2.0	-1.8
HU Hungary	-4.1	-8.1	-2.3	-0.6	0.0	-7.1	-6.2	-4.8	-4.2	-3.3
LT Lithuania	1.1	-5.1	-1.1	-0.8	-0.9	-1.2	-0.6	-2.0	-1.8	-1.5
LV Latvia	-4.2	-6.4	-2.1	-2.0	-1.9	-7.1	-4.4	-3.5	-2.8	-2.3
PL Poland	-1.4	-3.0	1.2	0.6	0.7	-1.8	-3.7	-4.8	-4.0	-3.5
RO Romania	-7.2	-9.3	-7.0	-5.6	-5.2	-7.1	-6.2	-5.7	-4.5	-4.0
SI Slovenia	3.3	-1.0	1.3	2.2	2.3	-4.6	-3.1	-4.2	-3.5	-2.1
SK Slovakia	-2.5	-8.2	-1.8	-1.3	-0.4	-5.4	-2.0	-6.0	-4.4	-4.5
EU-CEE11 1)2)	*-2.5*	*-5.1*	*-1.3*	*-0.9*	*-0.5*	*-4.1*	*-3.9*	*-4.7*	*-3.6*	*-3.0*
EA20 3)	*4.1*	*1.2*	*1.0*	*1.5*	*2.5*	*-5.3*	*-3.6*	*-3.7*	*-2.7*	*-2.6*
EU27 3)	*3.7*	*1.0*	*1.0*	*1.5*	*2.5*	*-4.8*	*-3.4*	*-3.3*	*-2.3*	*-2.2*
AL Albania	-7.7	-5.9	-3.6	-3.5	-3.4	-4.6	-3.7	-2.2	-1.5	-1.0
BA Bosnia and Herzegovina	-2.4	-4.5	-3.9	-3.6	-4.0	-0.3	-0.4	-0.5	0.5	0.3
ME Montenegro	-9.2	-12.9	-11.8	-10.8	-10.2	-1.9	-5.1	-4.9	-4.8	-4.5
MK North Macedonia	-3.1	-6.0	-2.2	-2.5	-3.1	-5.4	-4.5	-4.0	-3.0	-2.5
RS Serbia	-4.2	-6.9	-3.5	-4.3	-4.4	-4.1	-3.2	-2.0	-2.0	-1.5
XK Kosovo	-8.7	-10.5	-8.9	-7.9	-7.6	-1.3	-0.5	-0.5	-1.4	-2.0
WB6 1)2)	*-4.8*	*-6.7*	*-4.2*	*-4.4*	*-4.6*	*-3.4*	*-2.8*	*-2.0*	*-1.7*	*-1.4*
TR Turkey	-0.9	-5.3	-5.3	-4.1	-3.7	-2.4	-1.1	-4.0	-3.0	-3.0
BY Belarus	3.1	3.5	0.1	-0.1	-0.7	0.2	-1.5	-2.0	-1.0	0.0
KZ Kazakhstan	-1.3	3.5	-3.3	-3.2	-1.7	-3.0	-2.1	-2.7	-2.6	-2.4
MD Moldova	-12.4	-15.7	-10.3	-8.2	-7.1	-1.9	-3.2	-5.0	-4.0	-3.0
RU Russia	6.6	10.5	2.6	3.4	3.7	0.8	-1.4	-2.5	-2.0	-1.5
UA Ukraine	-1.9	5.0	-0.7	-3.1	-4.5	-3.4	-16.3	-27.0	-15.0	-10.0
CIS4+UA 1)2)	*5.0*	*9.3*	*1.6*	*2.0*	*2.2*	*0.1*	*-2.3*	*-4.2*	*-3.0*	*-2.2*
V4 1)2)	*-2.2*	*-4.9*	*-0.1*	*0.0*	*0.4*	*-3.7*	*-3.9*	*-4.8*	*-3.6*	*-3.0*
BALT3 1)2)	*-1.1*	*-4.9*	*-0.9*	*-0.6*	*-0.5*	*-3.1*	*-1.7*	*-2.8*	*-2.5*	*-2.0*
SEE9 1)2)	*-4.8*	*-6.5*	*-4.7*	*-3.9*	*-3.5*	*-5.2*	*-4.1*	*-4.4*	*-3.5*	*-3.0*
CIS3+UA 1)2)	*-1.2*	*3.4*	*-2.2*	*-2.9*	*-2.7*	*-2.7*	*-6.9*	*-10.4*	*-6.4*	*-4.6*
non-EU12 1)2)	*3.1*	*5.2*	*-0.6*	*-0.1*	*0.0*	*-0.7*	*-2.1*	*-4.0*	*-2.9*	*-2.4*
CESEE23 1)2)	*1.0*	*1.6*	*-0.9*	*-0.4*	*-0.2*	*-2.0*	*-2.7*	*-4.3*	*-3.2*	*-2.7*

1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Forecasts estimated by wiiw.
Source: wiiw, Eurostat. Forecasts by wiiw. Cut-off date for historical data and forecasts: 21 September 2023.

3.2. INFLATION MODERATING, BUT NOT ABOUT TO REACH TOLERABLE LEVELS

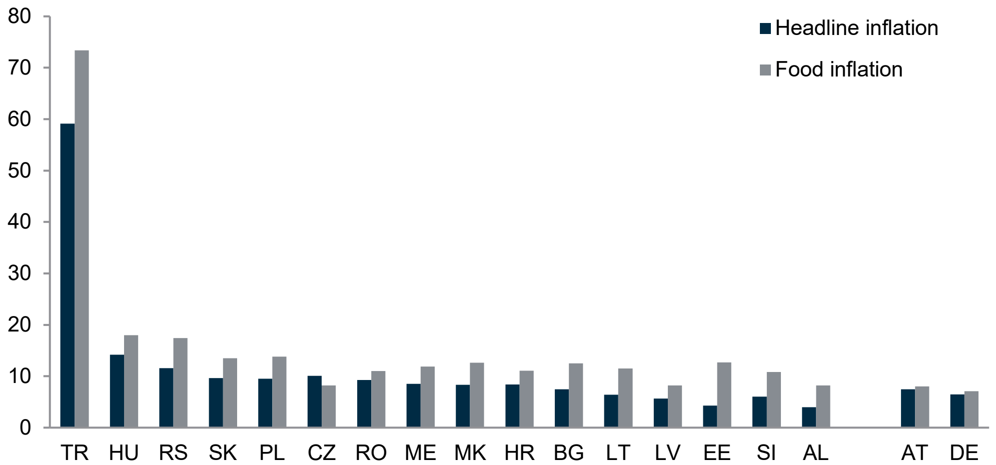
Inflation is moderating everywhere – but only slowly, so that it remains very high. In August 2023, it was below the level at the end of 2022 in all the countries. However, it was under 3% only in Belarus; and it was below the EU average of 5.9% in just six countries. Turkey continues to have the highest inflation – 59% in August – and it has actually increased in recent months, from 38% in June, due to depreciation of the lira. Hungary and Kazakhstan likewise continue to have double-digit inflation rates, again due to the depreciation of their currencies (Figure 3.7).

Figure 3.7 / Headline inflation in CESEE in December 2022 and August 2023, %, year on year



Source: Eurostat and wiiw Monthly Database.

Figure 3.8 / Headline and food inflation in CESEE in August 2023, %, year on year

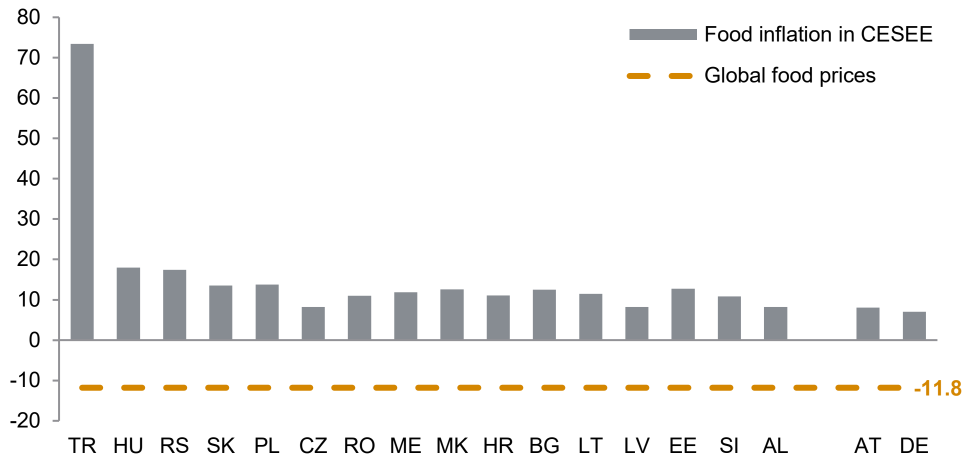


Source: wiiw calculations, using data from Eurostat and wiiw Monthly Database. Some CESEE countries are omitted, due to unavailability of data on inflation by sub-component in the Eurostat database.

Food prices stand out as the main component that has been driving inflation in recent months. In all CESEE countries with data on inflation by component, food inflation exceeds headline inflation, often by a significant margin. The only exception is Czechia, where food inflation in August was below headline inflation (Figure 3.8), and where energy (housing, water, electricity, gas and other fuels) has been the main component driving inflation. Falling global energy prices have meant that the cost of energy has been stable (or has declined) in most countries, apart from Czechia, Slovakia, Poland, Serbia, North Macedonia and Turkey, where it has increased significantly in 2023.

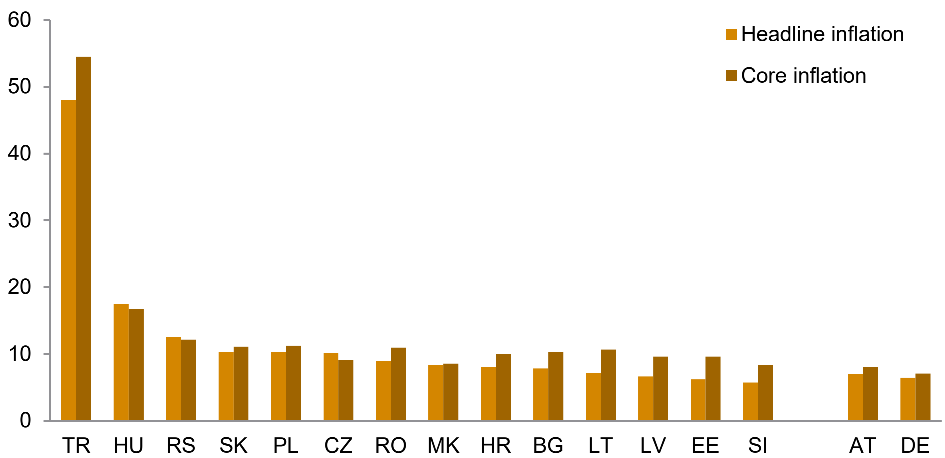
Food inflation in CESEE has been driven mainly by domestic factors, such as firm profits, as global food prices have continued to decline. In August 2023, the food price index of the Food and Agriculture Organization (FAO) was 11.8% lower than in the same period the year before (Figure 3.9). Of the components of the index, almost all – meat, dairy products, cereals and oils – declined year on year (by figures ranging from 5% to 23%). Only sugar increased (by 34%).

Figure 3.9 / Food inflation in CESEE and global food prices in August 2023, %, year on year



Source: Eurostat, wiiw Monthly Database and FAO.

Figure 3.10 / Headline and core inflation in CESEE in August 2023, %, year on year

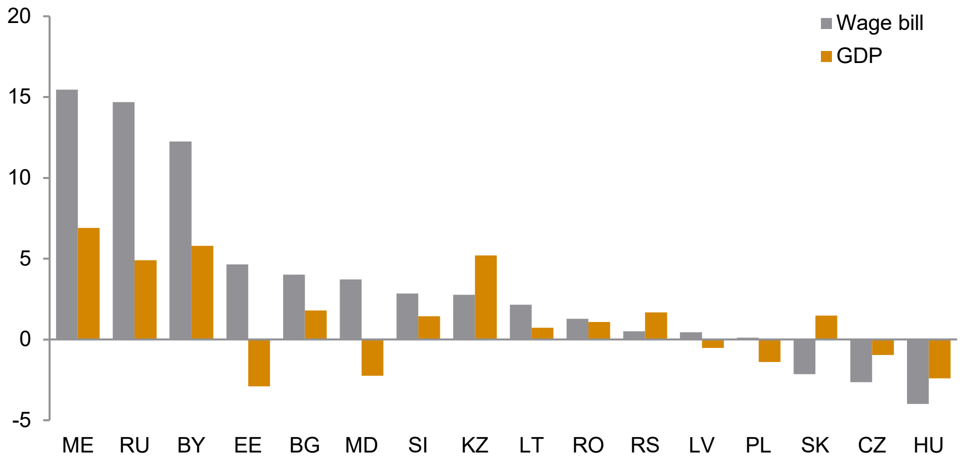


Source: wiiw calculations, using data from Eurostat and wiiw Monthly Database. Some CESEE countries are omitted, due to unavailability of data on inflation by sub-component in the Eurostat database.

Still, it would be wrong to attribute the ongoing inflation solely to food prices, since core inflation has also been increasing everywhere in CESEE. So far this year, core inflation (i.e. inflation excluding food and energy prices) has exceeded headline inflation in all but three countries of the region: Serbia, Czechia and Hungary are the only exceptions (Figure 3.10). This indicates that price pressures have spilled over to other components, making inflation more difficult to tame and likely to stay elevated for some time.

Wages have become more important for the dynamics of inflation in CESEE. In 2022 and Q1 2023, corporate profits grew much faster than wages, and the profit share of income increased in most countries of the region. However, in Q2 2023, the real growth in the wage bill (i.e. the combined growth of real wages and employment) exceeded real GDP growth in most CESEE countries, suggesting that labour may be regaining some of the income share it lost in the previous year (Figure 3.11). This could lead to a fresh bout of inflation, if businesses respond to rising labour costs by raising prices, in order to maintain their profit margins. This would make inflation more persistent and long-lasting than previously thought.

Figure 3.11 / Real growth in the wage bill and real growth in GDP in CESEE in Q2 2023, %, year on year

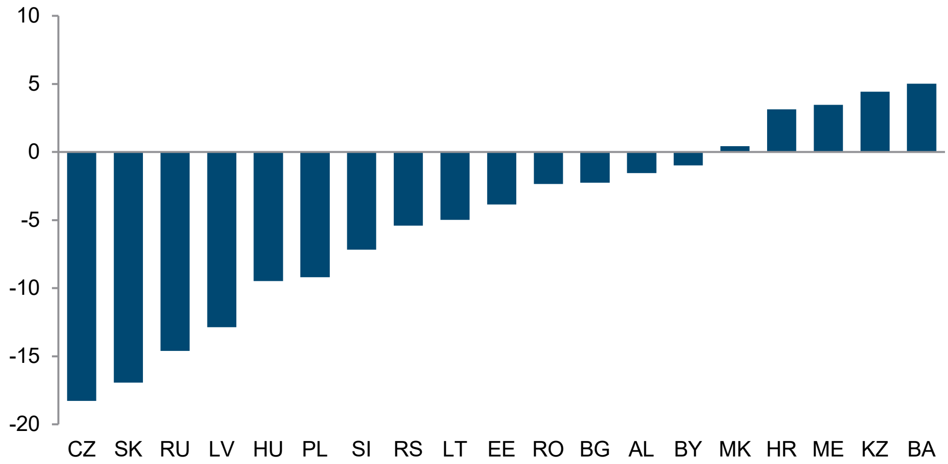


Note: The growth in the wage bill is calculated as combined growth in real wages and the number of employed persons. For countries that have had methodological changes or new censuses, the data used here have been adjusted to take account of these changes.
Source: wiiw calculations, using data from Eurostat and wiiw Monthly Database.

3.3. THE HARROWING SOCIAL IMPACTS OF THE PRICE INCREASES

While there was year-on-year growth in real wages during Q2, this cannot conceal the fact that most of the CESEE region had seen a persistent decline in real wages over the previous year and a half. When comparing Q2 2023 to Q4 2021, one can see that real wages in the second quarter of this year were below the level of a year and a half previously in 14 of the 19 CESEE countries with available data (Figure 3.9). Notably, only Bosnia and Herzegovina, Kazakhstan, Montenegro and Croatia experienced increases of 3% or more in the previous 18 months. Conversely, countries like Czechia, Slovakia, Russia and Latvia witnessed double-digit declines (Figure 3.12). This points to the fact that people’s living standards have deteriorated significantly during the cost-of-living crisis, and that real wages have a chasm to bridge if they are to return to pre-crisis levels. This may in turn exert further pressure on prices to rise.

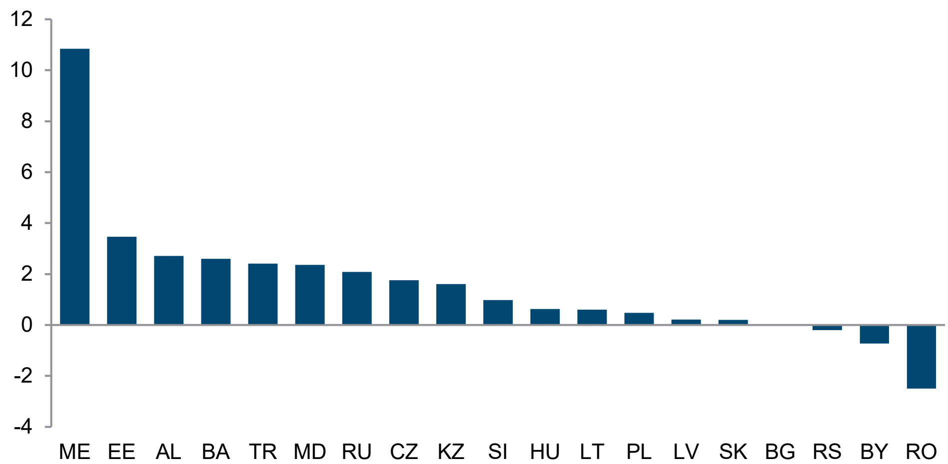
Figure 3.12 / Real gross wages in CESEE economies in Q2 2023, compared to Q4 2021, % change



Note: For Czechia, Slovakia, Lithuania and Albania, the latest data point is Q1 of 2023, not Q2.
Source: wiiw Monthly Database.

On the flip side, employment remains remarkably stable, and there are no visible signs of crisis-induced job losses. Only three countries of the region – Romania, Belarus and Serbia – saw a reduction in the number of employed individuals during Q2 2023, compared to the same period the previous year. Montenegro again stands out: it experienced impressive 11% year-on-year growth in the number of employed individuals, mirroring its robust GDP expansion (Figure 3.13). The strong employment trend has been consistent for some time and may be attributed to heightened corporate profits: as many firms continue to reap substantial profits from their price hikes, they find it unnecessary to lay off employees and, in fact, have the capacity to take on more workers.

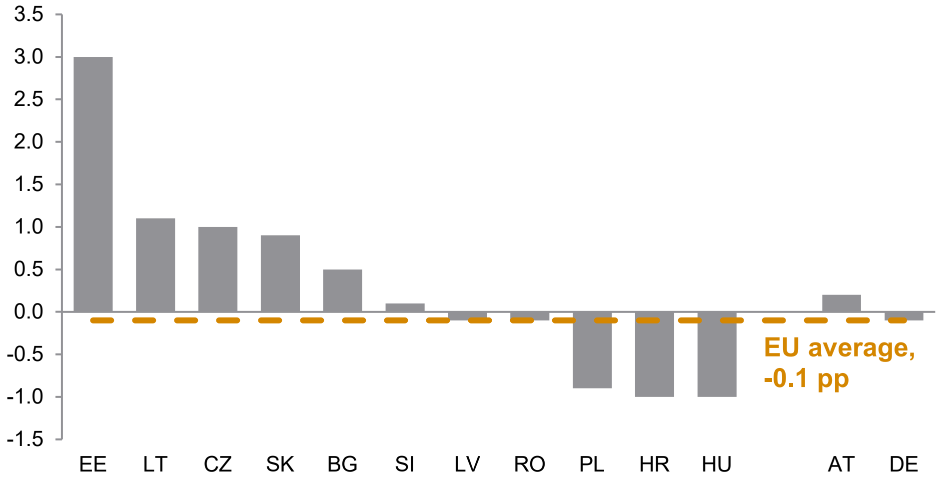
Figure 3.13 / Change in the number of employed persons in Q2 2023, %, year on year



Note: For countries that have had methodological changes or new censuses, the data shown here have been adjusted to take account of these changes. Some countries omitted, due to a lack of data, or methodological breaks.
Source: wiiw Monthly Database.

The crisis has also swelled the number of people at risk of poverty or social exclusion, at least in some CESEE countries. This indicator – which measures how many people are either at risk of poverty, or are severely materially and socially deprived, or are living in a household with very low work intensity – increased in 2022 in six of the 11 CESEE countries that have published such data. Estonia saw the largest increase, of 3 percentage points (pp) in a year, while Lithuania, Czechia and Slovakia witnessed rises of around 1pp. Only Poland, Croatia and Hungary saw sizeable declines in this indicator in 2022, of around 1pp (Figure 3.14). One must also bear in mind that this indicator could underestimate the impact of the crisis, since the risk of poverty is calculated as relative poverty (i.e. as the percentage of people who have income lower than 60% of the median) – thus, if everyone has experienced a same deterioration in real income, the percentage will not change.

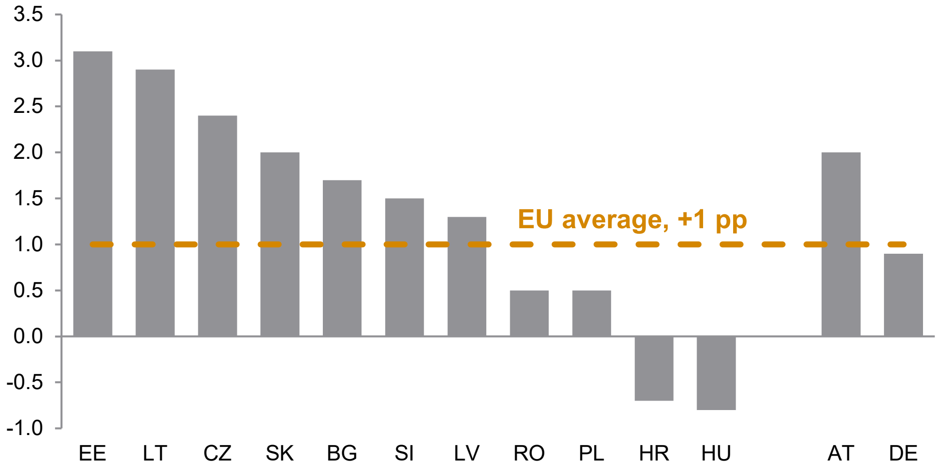
Figure 3.14 / Change in the share of people at risk of poverty or social exclusion in 2022 with respect to 2021, pp, year on year



Source: Eurostat.

The adverse social consequences of inflation become more evident when one looks at some more granular indicators. For example, the share of people who cannot afford a meal with meat, chicken, fish (or vegetarian equivalent) every other day increased in all but two countries of the CESEE region in 2022 (Croatia and Hungary being the exceptions). In some countries the figure rose quite substantially, by almost 3pp (Estonia and Lithuania). The proportion also increased quite a lot in the EU overall, as well as separately in Austria and Germany (though the figure there is still generally lower than in CESEE) (Figure 3.15). One also has to bear in mind that this deterioration in social indicators comes at a time when some CESEE governments have implemented fiscal packages to protect the most vulnerable from the impact of higher prices. These packages are likely to be phased out in the coming years, suggesting that the adverse social impact of price increases is likely to worsen in the coming period.

Figure 3.15 / Change in the share of people who cannot afford a meal with meat, chicken, fish (or vegetarian equivalent) every other day in 2022, pp, year on year



Source: Eurostat.

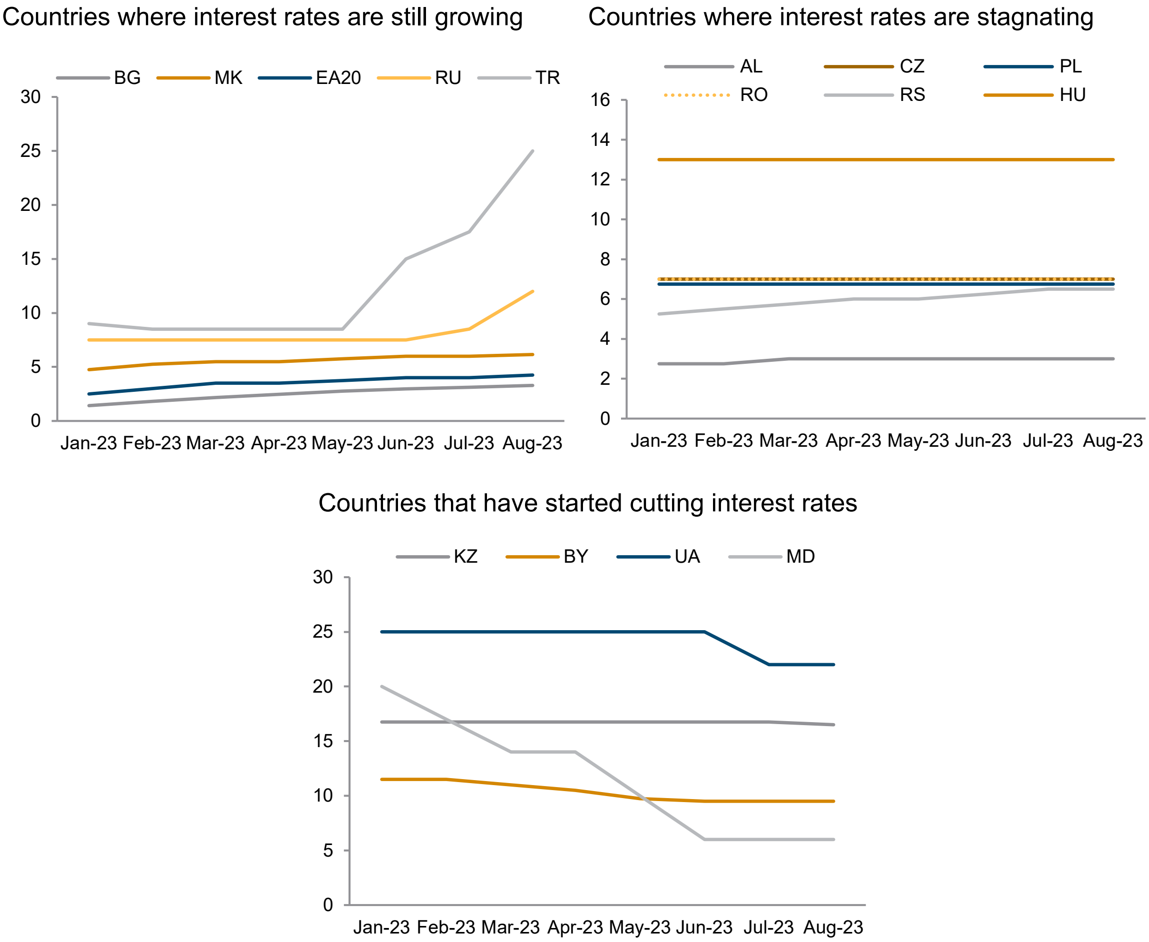
3.4. THE HIKING CYCLE IS COMING TO AN END, FISCAL SUPPORT WILL DECLINE

Monetary policy in CESEE has remained restrictive throughout 2023, though in recent months some central banks have begun easing. As of the end of August, four countries with independent monetary policy – Bulgaria, North Macedonia, Russia and Turkey, plus the euro-area countries – had not yet stopped raising interest rates. Six countries – Albania, Czechia, Poland, Romania, Serbia and Hungary – had probably ended their hiking cycles, as their central banks did not increase their interest rate on their last meeting. Four countries – Kazakhstan, Belarus, Ukraine and Moldova – had even begun an easing cycle, cutting their interest rates at least once in recent months (Figure 3.16). It is likely that more countries will start easing (or at any rate stop hiking) in the coming months, as inflation moderates and economic activity struggles[16]. However, drastic interest rate cuts are unlikely, as inflation will probably remain elevated for some time.

Particularly interesting developments have been seen in the base interest rates of the Turkish and Russian central banks. After more than a year of unorthodox monetary policy, the Turkish central bank finally raised its base rate after the election – from 8.5% in May to 25% in August – in an effort to stabilise the exchange rate and cool inflation. The Russian central bank was also forced to raise its rate from 7.5% in July to 12% in August, due to the depreciation of the rouble. On the other hand, Moldova has seen the most aggressive cut to its base rate – from 20% in January to 6% in August – thanks to the rapid moderation of inflation.

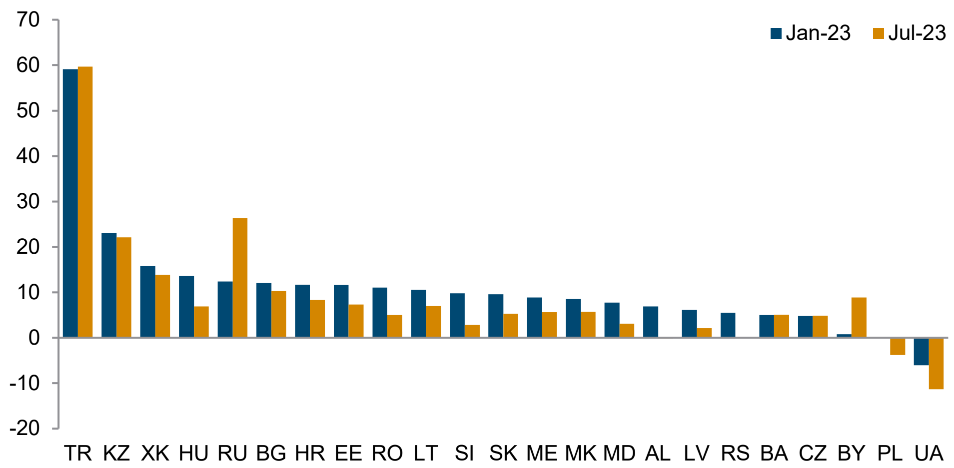
[16] The data presented here ends with August. Developments in September are not reflected. For instance, in September, the Polish central bank reduced its interest rate by 75 basis points.

Figure 3.16 / Central bank policy rate in CESEE countries in 2023, end of period, %



Source: wiiw Monthly Database.

Figure 3.17 / Nominal growth in loans to non-financial private sector in January and July 2023, %, year on year

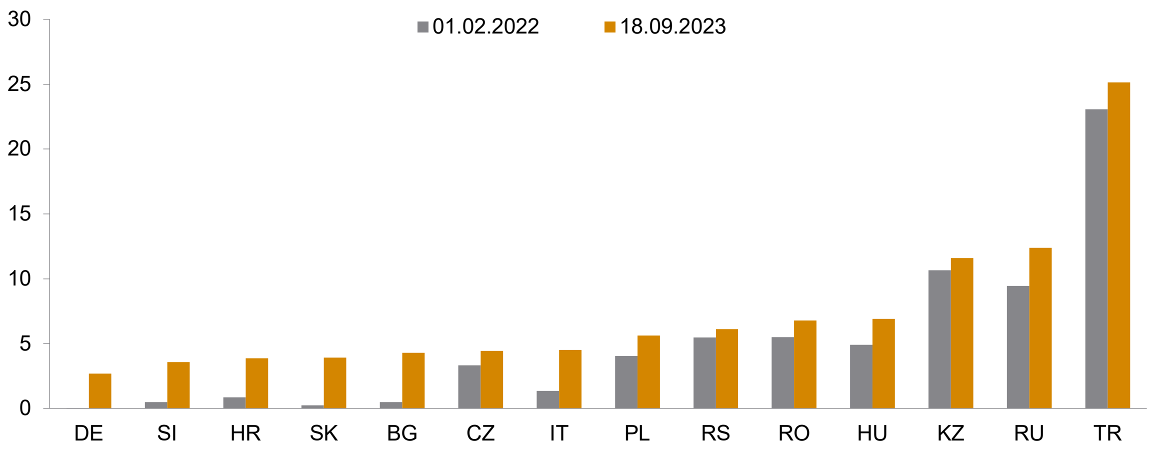


Source: wiiw Monthly Database.

Although it is still unclear whether monetary tightening has contributed to the slowdown in inflation (given that the inflation does not seem to be caused by higher demand), the tightening has certainly slowed credit activity in the region. In August, credit growth decelerated compared to January in 18 of the 23 CESEE countries (in nominal terms). Only Russia and Belarus saw a significant acceleration in credit growth (Figure 3.17). The slowdown in credit activity has certainly dampened demand in the economy and, through it, economic activity; but on the positive side, it seems that it has not yet had any adverse effect on the banking sectors in the region, as the share of non-performing loans remains low in all countries.

Higher interest rates have also increased borrowing costs for governments. This has been the case even in developed EU countries like Germany, whose 10-year government bond yield increased from virtually zero in February 2022 (before the European Central Bank started its hiking cycle) to 2.7% in September 2023. CESEE countries have seen a similar increase in yields, but they were already facing higher rates than Germany before the hiking cycle, on account of their country risk premia (Figure 3.18). For example, Bulgaria's yield is now 4.3%, up from 0.5% in February 2022. This significantly raises borrowing costs for CESEE governments and makes it more difficult for them to borrow on international financial markets, limiting in turn the fiscal support they can provide to their economies.

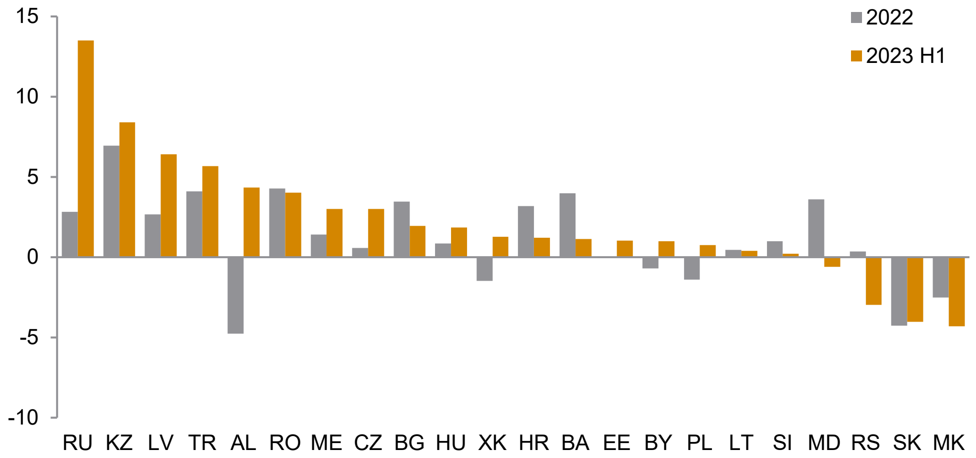
Figure 3.18 / 10-year government bond yields in February 2022 and September 2023, %



Source: wiiw calculations using data from www.investing.com

Despite the increase in borrowing costs, fiscal policy remained moderately supportive in H1 2023. Government consumption increased in real terms in 18 of the 22 CESEE countries with available data (Figure 3.19), although in only four of them by more than 5% (Russia, Kazakhstan, Turkey and Latvia). The simple average increase for the region as a whole was 2.1% year on year, which is not particularly strong – but not weak either. In 13 of the 22 countries, fiscal support in H1 2023 exceeded that for the whole of 2022. The still-solid fiscal support in 2023 was primarily due to the support packages that many governments adopted to protect households from the adverse effects of the cost-of-living crisis. From a revenue point of view, such support was possible because of the positive effect that inflation has had on fiscal revenues. To some extent, and especially in some of the EU member states, fiscal support was also made possible by the funds that those countries have received from the EU budget. Looking ahead, though, fiscal policy is likely to be much less supportive, as the support packages will be phased out and the positive impact of higher prices on government revenues will decline.

Figure 3.19 / Real growth in government consumption in CESEE in 2022 and H1 2023, %, year on year



Note: Ukraine omitted due to data unavailability. For Albania, Belarus, Bosnia and Herzegovina, Kazakhstan and Russia, the 2023 data refer only to Q1.
Source: wiiw Monthly Database.

Support for some CESEE EU member states through the NextGenerationEU plan has been significant; for others it has been limited. Poland and Hungary, facing rule-of-law issues, have yet to receive any disbursements. Slovenia, Estonia and Czechia have received only marginal support, amounting to less than 1% of their GDP. Slovakia, Bulgaria, Lithuania and Latvia have obtained support ranging from 1% to 2% of their GDP. Notably, Romania and Croatia have emerged as the front-runners, securing the greatest support, amounting to 2.6% and 3.8% of GDP, respectively (Table 3.2). Disbursements are expected to speed up over time, meaning that most of these countries will benefit from their EU membership and could outperform their CESEE peers. However, for some countries (such as Hungary) there are serious doubts about whether any disbursements will be made at all, meaning that their economies could slow down in the coming period, compared to previous years.

Table 3.2 / Disbursements made under the Recovery and Resilience Facility to EU member states from CESEE by mid-September 2023

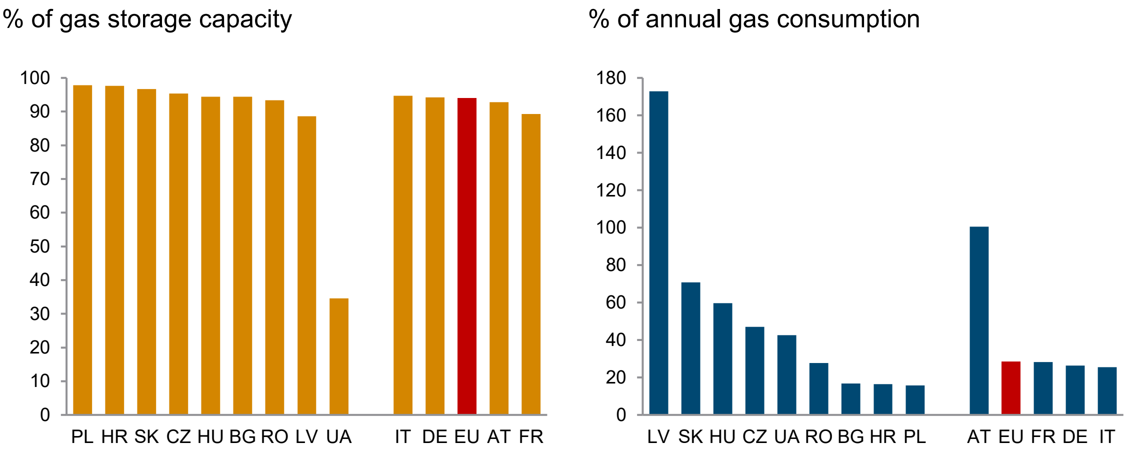
Country	Amount, EUR m	Share in 2021 GDP, %
Romania	6,355.6	2.63
Croatia	2,218.4	3.81
Slovakia	1,930.2	1.92
Czechia	1,842.8	0.77
Bulgaria	1,368.9	1.90
Lithuania	831.5	1.48
Latvia	438.4	1.30
Slovenia	280.6	0.54
Estonia	126.0	0.40
Hungary	n/a	n/a
Poland	n/a	n/a

Source: European Commission.

3.5. THE ENERGY SITUATION IS BETTER THAN LAST YEAR, BUT THERE ARE STILL SOME RISKS

The energy situation in the region this autumn is much more positive than last year, when there were concerns about energy shortages and possible temporary facility closures. All CESEE countries have reduced their use of natural gas, making them less vulnerable to gas-related shocks. Many of them have also diversified their gas sources by replacing Russian pipeline gas with liquefied natural gas (LNG) imports from other countries, reducing the risk of sudden gas supply disruptions. Additionally, in mid-September European gas storage facilities were already almost completely full (Figure 3.20, left panel). However, it is important to note that the stored gas volume is only sufficient for a short period. In the EU as a whole, gas storage covers 28% of annual consumption, though certain CESEE countries have slightly better figures (Figure 3.20, right panel). Although some countries may face challenges in securing enough gas supplies if the winter is severe, the chances of this happening are not very high, considering last year's experience.

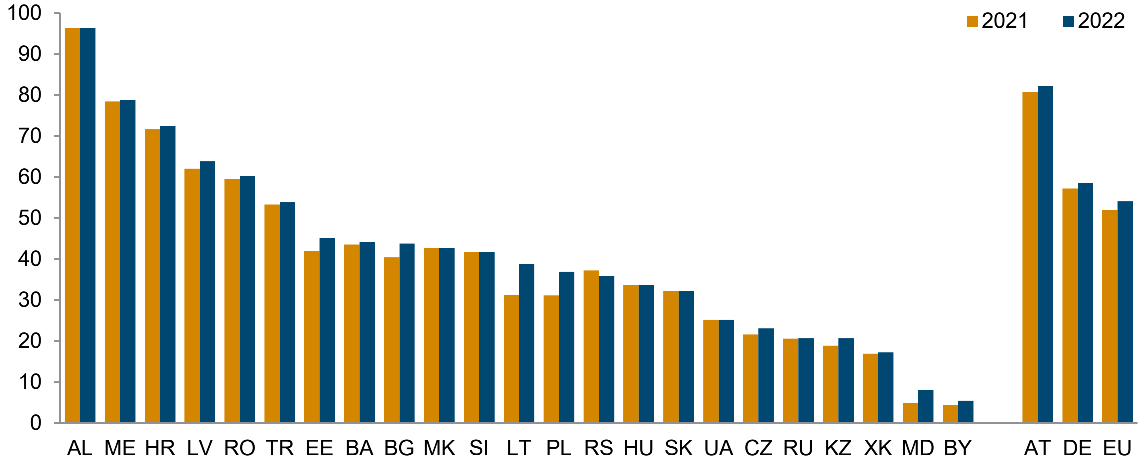
Figure 3.20 / Gas stored in storage facilities in CESEE and EU in mid-September 2023, %



Source: Gas Infrastructure Europe website.

On the flip side, the region has made limited progress in addressing its structural energy-sector challenges, particularly the low adoption of renewable energy sources. While there are notable exceptions – like Albania, Montenegro, Croatia and Latvia, where renewable energy capacities account for most of the total installed electricity generation capacity – the majority of the countries in the region still rely heavily on non-renewable sources (Figure 3.21). Moreover, investment in new renewable energy infrastructure has been inadequate, with only a handful of countries significantly increasing their share of renewable energy capacity in 2022: Lithuania increased its share by 8pp, Poland by 6pp, and Bulgaria, Estonia and Moldova by approximately 3pp. For comparison, the EU as a whole saw a 2pp increase in 2022. Some countries – Serbia, Hungary and Slovenia – even witnessed a decline in the share of installed renewable capacities, indicating a greater investment in non-renewable sources.

Figure 3.21 / Renewable energy share of electricity capacity in 2021 and 2022, %



Source: International Renewable Energy Agency.

3.6. LOWER GROWTH AND HIGHER INFLATION OVER THE MEDIUM TERM

Our GDP growth revisions for this year are mixed. For the EU-CEE countries, most of the revisions are on the downside, due to the German recession and weak economic activity in the EU. Slovakia is the only exception within this group: it sees an upward revision, due to the good performance of its automotive industry. In the Western Balkans plus Turkey group, by contrast, most of the revisions are on the upside, thanks to robust tourism, FDI inflows and remittances. Kosovo stands out here as the only economy with a downward revision, on account of the EU sanctions. In the CIS plus Ukraine group, similarly, most of the revisions are on the upside, thanks to stronger growth from the first half of the year, increased military production, the reorientation of the Russian economy towards CIS markets, and the resilience of the Ukrainian economy. Moldova is the only exception here, owing to the poor results from the first half of the year (Table 3.3).

On the contrary, the GDP growth revisions for 2024 and 2025 are on the downside for most of the countries, in all the sub-regions. There are several reasons for this: the global slowdown, the worsening outlook for the EU economy, the more persistent inflation, the tighter monetary conditions, and the less-supportive fiscal policy in coming years. There are some individual exceptions here as well, such as Poland, Ukraine and Russia, for which our expectations over the next two years are more bullish than before (for reasons outlined in the country reports).

Table 3.3 / Real GDP growth forecasts and revisions over previous forecast, October 2023

Region		2023		2024		2025	
EU-CEE							
BG	Bulgaria	1.0	▼	1.5	▼	2.5	
CZ	Czechia	0.1	▼	2.0	▼	2.7	
EE	Estonia	-1.3	▼	1.7	▼	3.0	▼
HR	Croatia	2.5		2.9		3.1	
HU	Hungary	-0.5		1.8	▼	2.4	▼
LT	Lithuania	-0.1	▼	1.7	▼	2.4	▼
LV	Latvia	0.3	▼	1.8	▼	2.3	▼
PL	Poland	0.0	▼	2.8	▲	3.8	▲
RO	Romania	2.5	▼	3.2	▼	3.5	▼
SI	Slovenia	1.3	▼	2.7	▲	2.5	▼
SK	Slovakia	0.8	▲	1.9	▼	2.4	
Western Balkans							
AL	Albania	3.5	▲	3.6	▼	3.7	▼
BA	Bosnia and Herzegovina	1.7	▲	1.9	▼	2.1	▼
ME	Montenegro	4.5	▲	2.9		3.0	
MK	North Macedonia	1.6		2.0	▼	2.5	▼
RS	Serbia	1.5	▲	2.0	▼	2.5	▼
XK	Kosovo	3.2	▼	3.3	▼	3.7	▼
Turkey							
TR	Turkey	3.2	▲	2.7	▼	3.6	▼
CIS+UA							
BY	Belarus	3.0	▲	2.2		2.5	
KZ	Kazakhstan	4.7	▲	4.0		4.2	▲
MD	Moldova	0.0	▼	3.5	▼	3.5	▼
RU	Russia	2.3	▲	1.9	▲	1.7	▲
UA	Ukraine	3.6	▲	4.2	▲	5.3	▼

Note: Current forecast and revisions relative to the wiiw Summer Forecast Update (wiiw, 2023). Colour scale variation from the minimum (dark grey) to the maximum (dark orange).
Source: wiiw.

The inflation forecasts for 2023 are again mixed. In the EU-CEE group, most of the forecasts have been revised downwards, as inflation seems to be receding faster than expected. However, some countries in this group – Croatia, Romania, Slovenia and Slovakia – have upward revisions. In the Western Balkans plus Turkey group, most of the revisions are upwards, as inflation there seems to be far more persistent. There are again some exceptions, such as Bosnia and Herzegovina, Montenegro and Kosovo, where inflation has recently slowed more than expected. In the CIS plus Ukraine group, most of the new forecasts are the same as the old ones; Russia is the only exception, due to the recent depreciation of the rouble.

Table 3.4 / Inflation forecasts and revisions over previous forecast, October 2023

Region		2023		2024		2025	
EU-CEE							
BG	Bulgaria	9.0	▼	7.0		5.0	
CZ	Czechia	11.0		4.0	▲	2.8	
EE	Estonia	9.5	▼	3.4	▲	2.5	▲
HR	Croatia	7.5	▲	4.0		3.0	
HU	Hungary	17.5	▼	6.0		4.0	▲
LT	Lithuania	8.0	▼	2.8		2.0	
LV	Latvia	9.5	▼	3.0	▲	3.2	▲
PL	Poland	11.5	▼	5.2	▼	3.6	▼
RO	Romania	10.5	▲	7.5	▲	5.0	▲
SI	Slovenia	7.2	▲	3.6		2.4	▼
SK	Slovakia	11.0	▲	5.0		3.0	
Western Balkans							
AL	Albania	4.6	▲	3.0		2.5	
BA	Bosnia and Herzegovina	7.5	▼	3.0	▼	2.5	
ME	Montenegro	9.1	▼	5.0	▲	2.8	
MK	North Macedonia	10.0	▲	5.0	▲	3.0	
RS	Serbia	12.5	▲	5.5	▲	3.5	▲
XK	Kosovo	5.5	▼	4.0		2.5	
Turkey							
TR	Turkey	54.9	▲	54.0	▲	35.0	▲
CIS+UA							
BY	Belarus	9.0		8.0		8.0	
KZ	Kazakhstan	14.5		9.0		6.0	
MD	Moldova	14.0		6.0		5.0	
RU	Russia	5.6	▲	4.9	▲	3.4	
UA	Ukraine	14.0		8.0	▼	6.0	▼

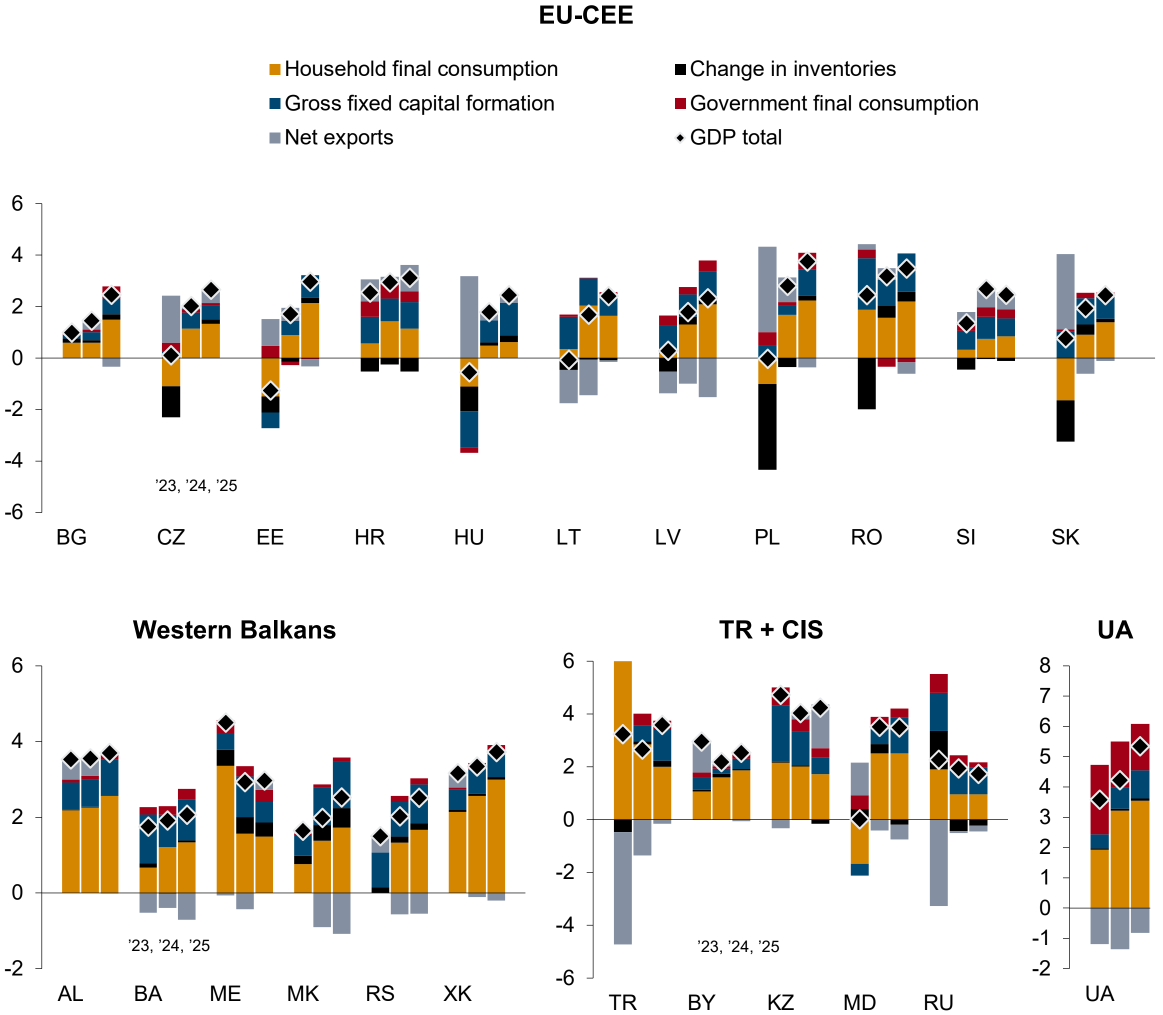
Note: Current forecast and revisions relative to the wiiw Summer Forecast Update (wiiw, 2023). Colour scale variation from the minimum (dark orange) to the maximum (dark grey).
Source: wiiw.

Our inflation forecasts for 2024 and 2025 are now slightly higher than before for most countries, with individual exceptions. This is because price pressures have turned out to be much more persistent and broad based, stemming not just from higher global energy prices, but also from higher company profits, higher prices in other sectors, and – in some cases – higher wages (Table 3.4).

Our new GDP and inflation forecasts suggest that the CESEE region is trending towards a new equilibrium, characterised by lower overall growth and higher inflation. While it is still too early to call the current situation ‘stagflation’, and while there are important differences between the ongoing crisis and that of the 1970s, the region does appear to be entering a new phase that will last for some time and that will have a profound impact on the economic dynamics and people’s living standards.

Figure 3.22 / GDP growth forecast for 2023-2025

and contribution of individual demand components in percentage points



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

3.7. CONCLUSIONS

The CESEE region grew by 1.5% in Q2 2023, outperforming the EU by a significant margin. However, there were notable differences across the various sub-regions of CESEE: EU-CEE countries performed worse than expected (due to the recession in Germany), while Western Balkan countries performed better than expected (thanks to tourism, remittances and FDI). The CIS countries and Ukraine also did better than expected, as they have adapted to the new reality.

Inflation was generally higher than expected, with some exceptions. Its dynamics have also changed, and it is now driven not only by global energy and food prices, but also by company profits, price rises in other sectors and, in some cases, higher wages.

The price increases are having serious repercussions for people's living standards and poverty. Real wages are still well below the level of a year and a half ago, and the number of people who cannot afford to eat the meal they want has increased significantly.

Monetary policy has been restrictive throughout 2023 in all CESEE countries. Some central banks have ended the hiking cycle, and some have even started an easing cycle; but monetary conditions are unlikely to change drastically in 2024 and are likely to remain tight.

Fiscal authorities in CESEE have faced higher borrowing costs, but have still managed to support their economies to some extent. This is partly due to the positive effects of inflation on public revenues – and in some countries also to EU funds.

The energy situation in the region is less worrying than last year, as countries have reduced their dependence on gas, replaced Russian pipeline gas with LNG from different sources and filled up their gas storage facilities. However, a severe winter could pose some problems for certain countries.

On a longer-term horizon, very little has been done to reduce dependence on fossil fuels or to invest in renewable energy.

Over the medium-term, the region seems to be heading towards a new equilibrium, characterised by lower growth and higher inflation.

Growth in 2024 and 2025 will be lower than previously expected, on account of the global slowdown, the weak EU economy, more persistent inflation, tighter monetary conditions and less-supportive fiscal policy.

Inflation will also be higher and will not return to 2% any time soon, as its dynamics have become much more complex and are no longer driven just by higher global energy prices.

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