2. CESEE Overview: Sailing through rough waters

BY OLGA PINDYUK

- **Although inflation in CESEE has mostly slowed down over the past few months, along with the falling global energy prices, it remains uncomfortably high and continues to weigh on real incomes and depress confidence.**

- **Regardless of falling real wages, household consumption has been increasing, boosted by fiscal support programmes. EU-CEE has been able to benefit from access to the resources of the EU Recovery and Resilience Facility: this has been especially important to Croatia and Romania, where the funds accounted for 3.8% and 2.6%, respectively, of 2021 GDP.**

- **CESEE countries have managed to drastically reduce their natural gas consumption and wean themselves off their dependency on Russian fossil fuels. However, many of them have slid back into increased coal use as an emergency solution.**

- **We expect inflation to take longer than previously thought to slow down, and we are revising our 2023 forecast upwards for most CESEE countries. However, the region will largely avoid recession – apart from Hungary, which is struggling with rampant inflation, as well as difficulties in accessing EU funds.**

- **Southeast Europe, including EU and non-EU members, is expected to put in a better economic performance than the Visegrád group over the forecast period. The CESEE region overall will further outperform the euro area, indicating that economic the catch-up process is still going on, albeit at a slower pace.**

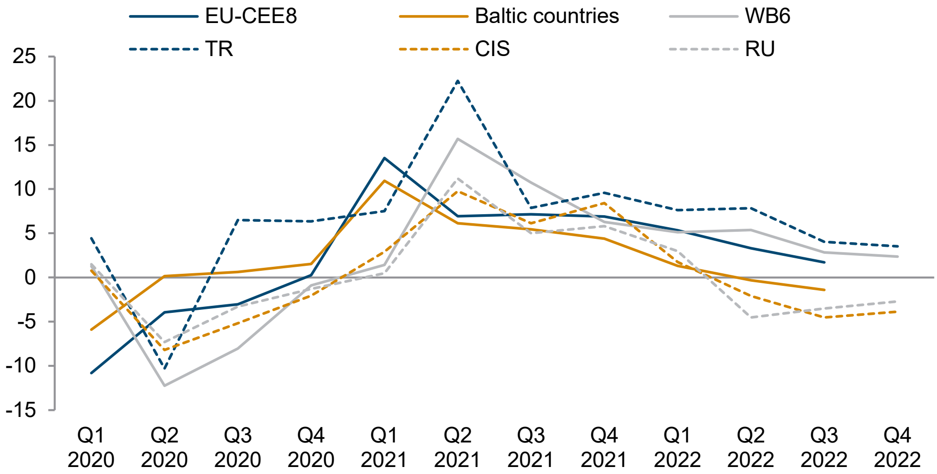
- **Negative risks to the forecast remain strong. One of the major risks to the forecast is that persistently high inflation will lead to harder lending conditions in the economies. A sharp tightening of financial conditions could exacerbate potential structural vulnerabilities in the banking sector, which must undergo a major rebalancing of its balance sheets. CESEE countries with high debt levels are particularly vulnerable to the rising costs of debt servicing and capital outflows. There could be a deterioration in the security situation in the region if Ukraine has problems in securing support from its allies after the US presidential election in November 2024.**

2.1. ECONOMIC PERFORMANCE IN Q4 2022 WORSENS FURTHER AS HIGH INFLATION DAMPENS ECONOMIC ACTIVITY

In Q4 2022, economic growth weakened in most of CESEE, as soaring inflation continued to weigh on real incomes and depress confidence (Figure 2.1). Ukraine had the steepest economic fall in the region in Q4 – 31.4% year on year – following the Russian missile attacks on the country's energy infrastructure (see Ukraine report). Russia managed to slow its economic fall in Q4, as high energy prices boosted government revenues and spending; but this was a temporary phenomenon, and the situation worsened at the beginning of 2023, when the EU's oil sanctions came into force (see Russia report). The repercussions of Russia's war in Ukraine on economic activity are particularly visible in those countries with historically close economic links to Russia – the Baltic countries and the CIS, where economic performance has been the weakest in the region.

Figure 2.1 / Quarterly real GDP

change against preceding year in %



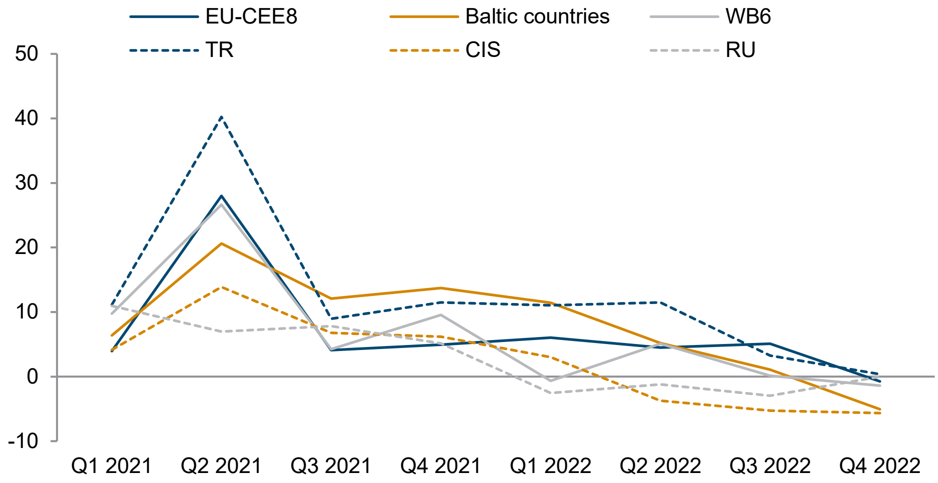
Note: simple average, EU-CEE8 includes the CEE members of the EU minus the Baltic countries.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Southeast European countries have put in the most resilient performance in the region. In Turkey, household consumption has been the primary driver of growth, despite high inflation (see Turkey report). The Western Balkan economies have been supported by a still strong growth in exports (especially tourism services), and domestic consumption has benefited from the relatively low inflation rate in some countries – achieved partly through administrative price controls (Jovanović, 2023). The Central European manufacturing core has been particularly affected by the high energy prices afflicting industry and by low growth in Germany, its main export market.

Industrial output suffered a sharp decline in Q4 2022, as industry struggled with rising input prices. The CIS and Western Balkans registered the biggest contractions of industrial output in real terms – of 5.7% and 5.1%, respectively, year on year (Figure 2.2). Only Turkey managed to avoid a decline in industrial output – but only narrowly (it increased by 0.4% year on year). EU-CEE countries showed uneven performance: some of them (Bulgaria, Czechia, Hungary and Poland) still achieved positive (albeit decelerating) growth in industrial production; others suffered a big decline – most notably Estonia (-11.2% year on year) and Slovakia (-7.1%), where the automotive sector was affected by a shortage of semiconductors and by supply-chain problems related to the Russian war in Ukraine (see Slovakia report). But given that gas demand in industry fell by 20-30% last year, these drops in industrial production can be seen as evidence of relative resilience.

Figure 2.2 / Quarterly industrial output

real change against preceding year in %

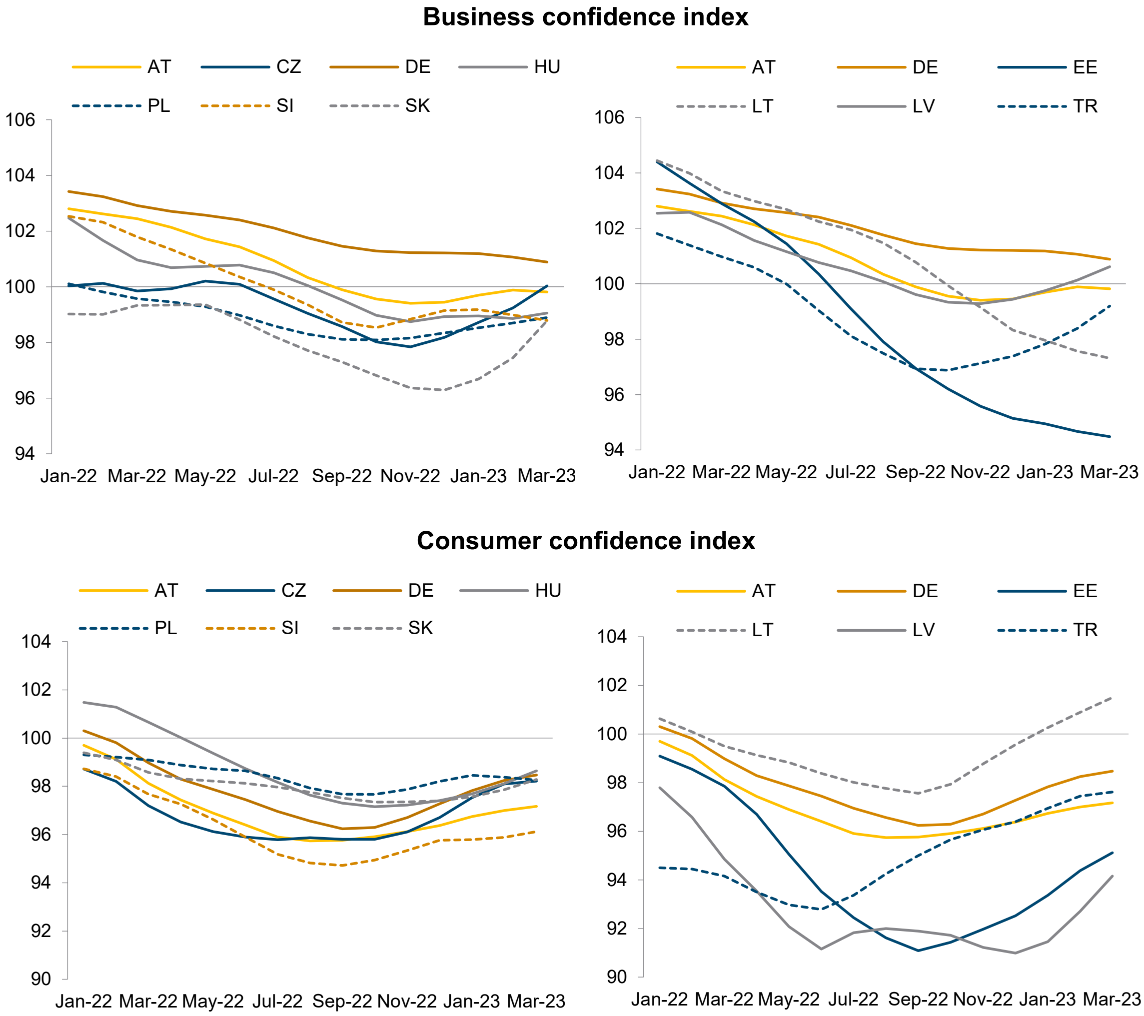


Note: simple average. EU-CEE8 includes the CEE members of the EU minus the Baltic countries.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Business and consumers both remain generally pessimistic, though sentiment appears to have started improving in some countries (Figure 2.3).[2] In 2022, all the countries in the region that are covered by OECD indices showed business confidence falling below the level for Germany; only in Latvia were companies on average mildly optimistic about their prospects (their index values rose above 100). In all the Visegrád countries (apart from Hungary), as well as in Latvia and Turkey, the business confidence indices appear to have bottomed out at the end of 2022 and have been picking up since – likely reflecting the improving prospects of the euro area and the German economy, in particular (see Global assumptions overview), and the fact that inflation appears to have peaked in some countries. The consumer confidence index shows a somewhat different pattern: even though consumers in all countries (apart from Lithuania) have on average been pessimistic, their confidence has grown over the past two quarters in all countries – apart from Poland, where it has stabilised. This probably points to consumers noticing the slowdown in inflation and hoping that the worst of the crisis is now behind them.

[2] According to the methodology of consumer and business confidence indices, numbers above 100 suggest optimism about future business performance and economic performance, respectively.

Figure 2.3 / Business and consumer confidence indices



Source: OECD, own calculation.

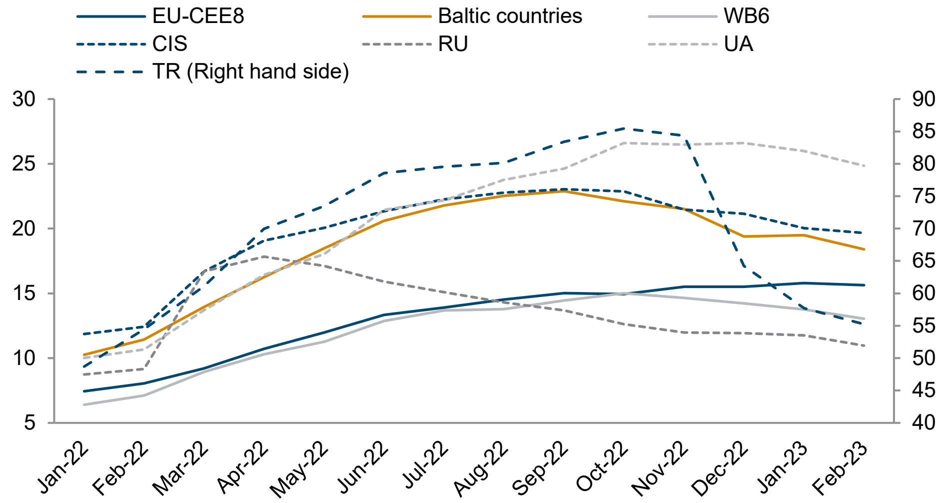
2.2. INFLATION REMAINS STUBBORNLY HIGH ACROSS VARIOUS COMPONENTS

Although inflation in CESEE has generally slowed over the past few months, as global energy prices have fallen (Figure 2.4)**, it remains uncomfortably high.** Inflation started to decelerate in Q4 2023 throughout the region, except for the EU-CEE8 countries[3] where it has been trending upwards, driven by the price dynamics in the Visegrád countries. Turkey still has the fastest-growing consumer prices in the region (55.2% year on year in February 2023), but inflation there has slowed dramatically – by 30 percentage points (pp) from the peak of October 2022. War-torn Ukraine has the second-highest inflation in the region, but there too it has started decelerating, along with global commodity prices. Russia and the Western Balkans have on average the lowest rates of inflation.

3 EU-CEE8 includes the CEE members of the EU minus the Baltic countries.

Figure 2.4 / Consumer price index

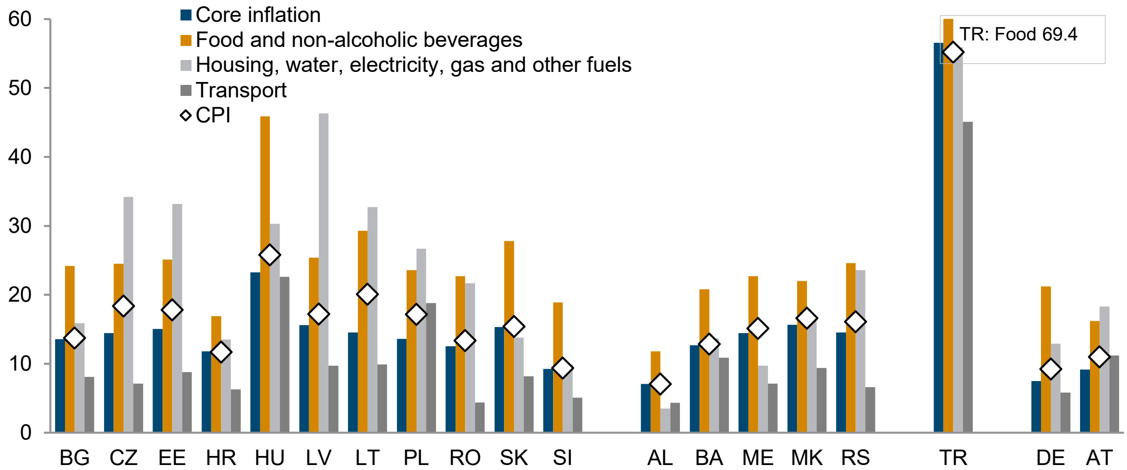
% change year on year, monthly



Note: simple average. Harmonised index of consumer prices (HICP) for EU-CEE.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 2.5 / Consumer price inflation sub-components in February 2023

percentage change year on year



Source: National sources, Eurostat, wiiw.

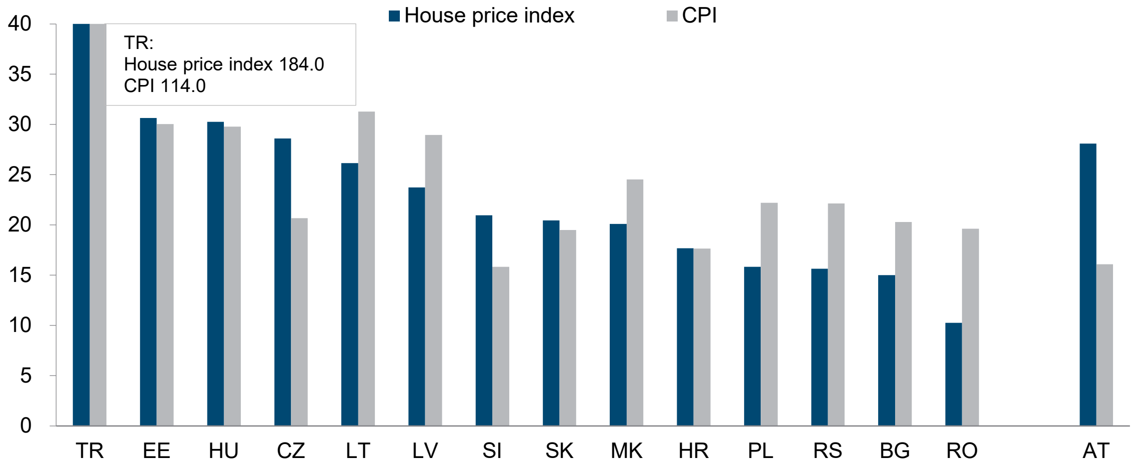
Food prices have kept growing at double-digit rates almost throughout the region, with only a marginal deceleration in the last four months (Figure 2.5). Turkey continues to have the highest food inflation in the region, followed by Hungary, where prices increased in February by a striking 46% year on year. In addition to the common inflationary factors, these countries also had major currency depreciations, which contributed to inflation. Although global commodity prices have been falling – especially after the Black Sea Grain Initiative enabled grain exports from Ukraine from August 2022 – this has so far not been reflected in retail food prices. According to the European Central Bank (ECB), this indicates that prices may, to a large extent, be driven by the opportunistic behaviour of firms – as evidenced by the rapid profit growth in many sectors, including agriculture, manufacturing and trade, which has significantly outpaced nominal wage growth.[4]

Core inflation is still in double digits in all the countries, apart from Albania and Slovenia, indicating that the pass-through of higher costs to prices remains robust. This reinforces the concerns of monetary authorities that inflation is becoming more entrenched and could take a long time to subside.

The growth in transportation prices slowed significantly on the back of falling energy costs, but in housing the deceleration has been far more moderate. After Turkey, the most rapid growth in housing costs (in those countries for which data are available) has been seen in the Baltic states, Czechia and Hungary (Figure 2.6). Both rental and house prices in those countries have been rising rapidly on account of the high demand for housing, which has been driven by low interest rates on mortgage loans (prior to the start of aggressive monetary tightening), the COVID-triggered shift to remote working and (in the case of Estonia and Latvia) an influx of refugees – as well as by an inadequate supply of housing.[5]

Figure 2.6 / House price index and CPI, cumulative, Q1 2021 - Q4 2022

percentage change year on year



Source: wiiw Monthly Database incorporating national and Eurostat statistics and Eurostat, Bank for International Settlements.

4 https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230322_2~af38beedf3.en.html

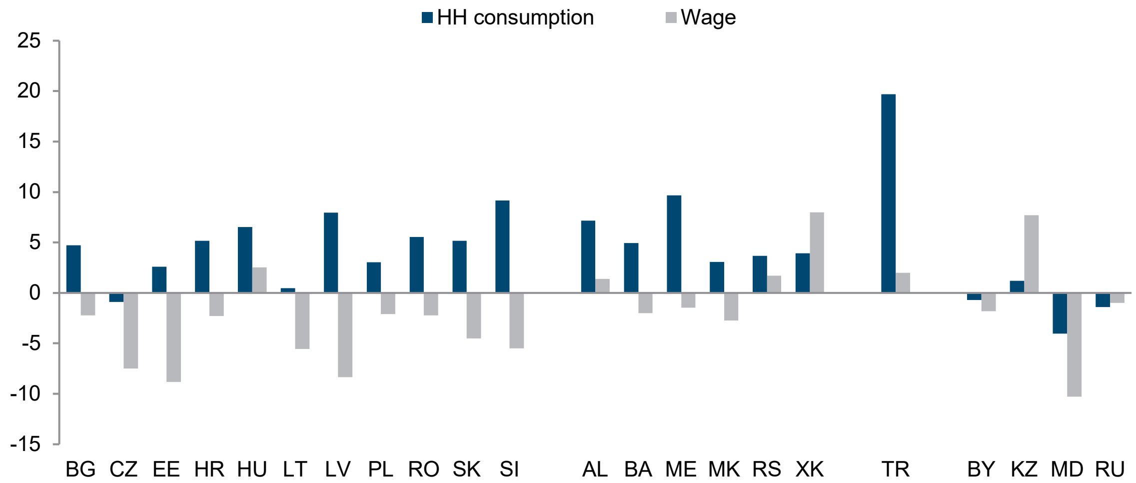
5 https://www.euronews.com/next/2022/10/10/europes-cost-of-living-crisis-this-is-how-much-more-rent-you-are-paying-in-your-country

2.3. HOUSEHOLDS ARE INCREASINGLY RELYING ON NON-WAGE SOURCES OF INCOME

The purchasing power of households in CESEE has been eroding, with real wages decreasing (Figure 2.7). In 2022, real gross wages fell in all the countries in most of the region, apart from Hungary, Albania, Serbia, Kosovo, Turkey and Kazakhstan. The sharpest year-on-year declines were recorded in Moldova (10.3%), Estonia (8.8%), Latvia (8.3%) and Czechia (7.5%). In Montenegro, although gross wages did not increase, net wages did, as the tax reform abolished health insurance contributions.

Nonetheless, households managed to increase their consumption in most countries of the region, indicating the availability of additional sources of income, along with the possible use of savings. Countries with sufficient fiscal space were able to introduce fiscal support programmes to shield the most vulnerable households from rising prices. In poorer countries of the region, households had to rely more on remittances or consumer loans to finance their consumption.

Figure 2.7 / Household consumption and gross monthly wages in 2022, real, % change year on year, annual



Source: wiiw Annual Database incorporating national and Eurostat statistics.

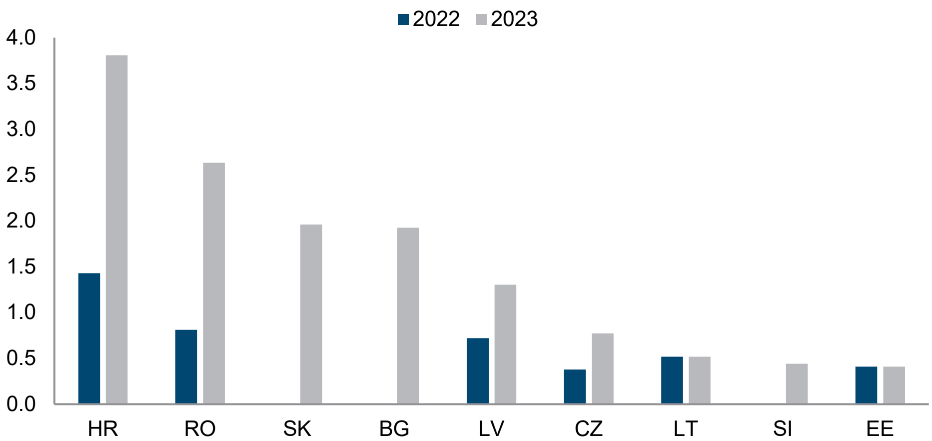
In order to cushion the blow of higher prices, CESEE governments introduced fiscal packages to subsidise household incomes (Figure 2.8). These measures included energy price caps, energy subsidies and social assistance programmes. The countries worst affected by the energy price hikes were those that had previously depended most on imports of Russian gas (Slovakia, Czechia and the Baltic countries), while soaring food prices had the greatest impact on those countries with the highest shares of the population at risk of poverty – Ukraine, Moldova, Bulgaria, Romania, Turkey and the countries of the Western Balkans (Moshammer, Pindyuk et al., 2022). Overall fiscal support programmes in the region accounted for as much as 8-9% of annual household consumption in Bulgaria, Lithuania and Czechia; meanwhile, they accounted for less than 2% in Moldova and Montenegro, which are constrained by their tight fiscal space.

Figure 2.8 / Government funding to shield households and firms from the rising energy prices, percentage shares in 2021 household consumption

Source: WB (2023); G. Sgaravatti, S. Tagliapietra, C. Trasi and G. Zachmann (2021) 'National policies to shield consumers from rising energy prices', Bruegel Datasets, first published 4 November 2021, available at https://www.bruegel.org/dataset/national-policies-shield-consumers-rising-energy-prices; wiiw Annual Database incorporating national and Eurostat statistics, own calculations

The countries of EU-CEE have been able to benefit from access to the resources of the EU Recovery and Resilience Facility (RRF) to finance their fiscal packages, but the speed of drawdown of these funds has varied widely across the region. By the end of March 2023, there had been a noticeable increase in disbursements under RRF, compared to June 2022, in seven of the 11 EU-CEE countries (Figure 2.9). RRF funds have played the most important role in Croatia and Romania, where they accounted for 3.8% and 2.6%, respectively, of 2021 GDP. Over the forecast period, the mobilisation of EU transfers will continue to be crucial for all eligible countries, in order to counteract the cost-of-living crisis.

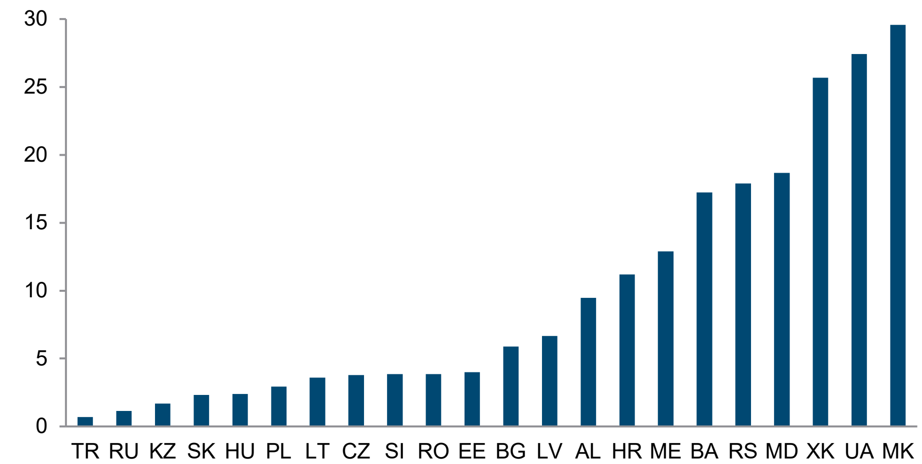
Figure 2.9 / Disbursements made under RRF by mid-June 2022 and by end-March 2023, percentage shares in 2021 GDP



Note: Hungary and Poland are not included because they have not yet drawn down any funds.
Source: European Commission.

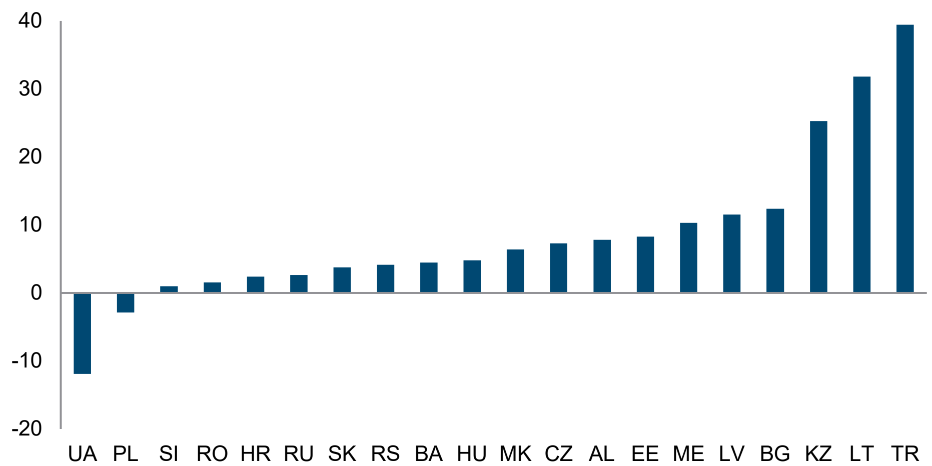
Households in the Western Balkans, Ukraine and Moldova have instead relied on remittances to finance a large share of their expenditure (Figure 2.10). In North Macedonia and Kosovo, remittances (proxied by received secondary income from the balance of payments) accounted for more than a quarter of household consumption in 2022. In Moldova and Serbia, remittances financed 18% of annual household consumption.

Figure 2.10 / Share of secondary income, credit, in household consumption in 2022, %



Note: Remittances account for the bulk of secondary income inflows in the region. In Ukraine, grants and humanitarian aid accounted for about a half of secondary income inflows in 2022.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Figure 2.11 / Change in stock of consumer loans in 2022, year on year, %



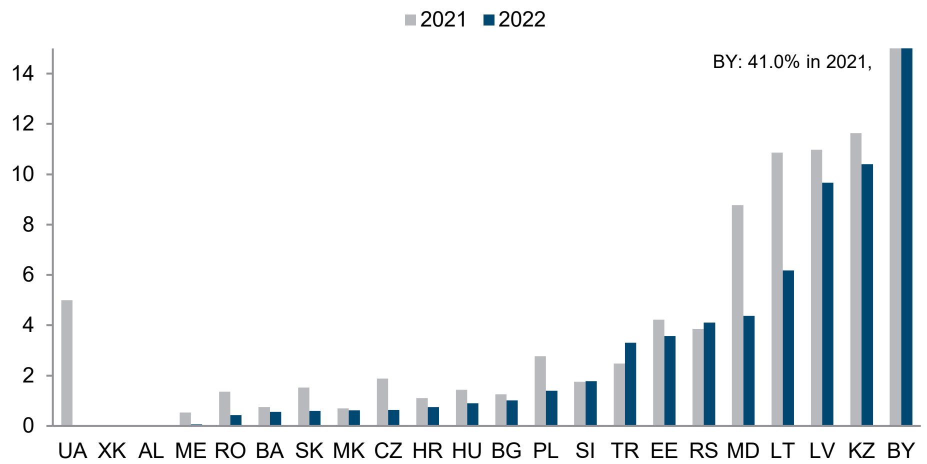
Note: In Hungary loans are defined as loans to households excluding overdraft and housing; in Russia – loans to households excluding housing.
Source: National statistical offices, own calculations.

Consumer lending continued to expand in 2022 in all CESEE countries, apart from Ukraine and Poland (Figure 2.11). It grew particularly strongly in Turkey, Lithuania and Kazakhstan – by 39%, 32% and 25%, respectively, compared to 2021. This source of consumption financing is hardly sustainable in the longer run, especially with rising interest rates on loans making it harder for cash-strapped borrowers to repay their debts. Also, in all CESEE countries apart from Albania, Kazakhstan and Lithuania, high inflation meant that real credit growth was negative; so it is not the growth driver that it would seem to be, based on the nominal figures.

2.4. CESEE HAS CONTINUED TO DECOUPLE FROM RUSSIA, BUT THE GREEN TRANSITION HAS NOT ADVANCED FAR YET

Russia's share of countries' exports decreased further in 2022 in all CESEE economies, apart from Belarus, Serbia, Slovenia and Turkey (Figure 2.12). New sectoral sanctions on Belarus's economy – which saw it completely decoupled from the Western markets – forced the country into heavier dependence on Russia (see Belarus report). The most significant export reorientation away from Russia was observed in Lithuania and Moldova: in 2022, Russia's share of Lithuanian exports fell by 5 pp, while Moldovan exports to Russia were down 4 pp. In Slovenia, Serbia and Turkey, by contrast, the share of exports to Russia increased; in the case of the latter two countries, this is largely attributable to the re-export of sanctioned goods from the EU.

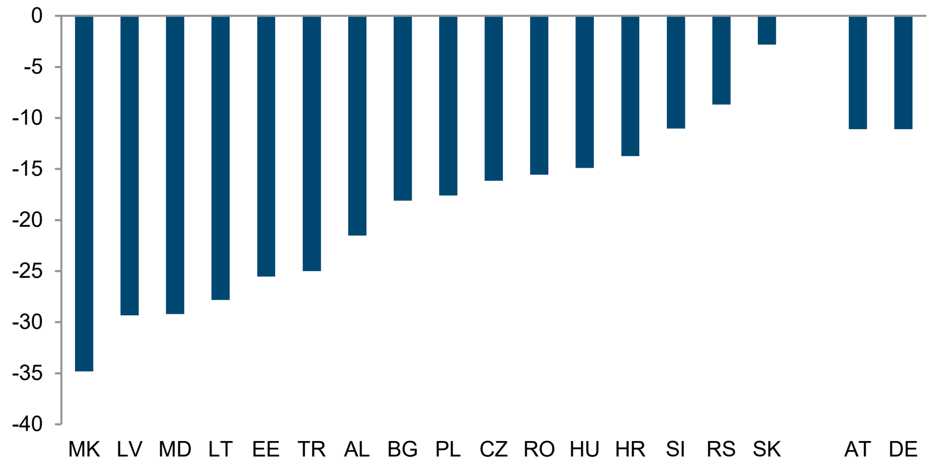
Figure 2.12 / Share of exports to Russia in total exports, %



Note: 2022 data for Belarus are for January-June; 2022 data for Ukraine are not available.
Source: National statistical offices, wiiw Annual Database, wiiw calculations.

CESEE countries also managed to drastically reduce their natural gas consumption and wean themselves off their dependency on Russian fossil fuels. Fast action by governments and industry – in addition to luck with the weather – allowed the CESEE countries to avoid the looming catastrophe as Russia weaponised its energy exports. Most countries in the region managed to reduce their natural gas consumption more rapidly than either Austria or Germany. The biggest year-on-year declines in gas consumption were achieved in North Macedonia (35%), Latvia (and Moldova (29% each) (Figure 2.13). Slovakia was the least successful in this respect, as it managed to cut its gas consumption by only 3% compared to the previous year.

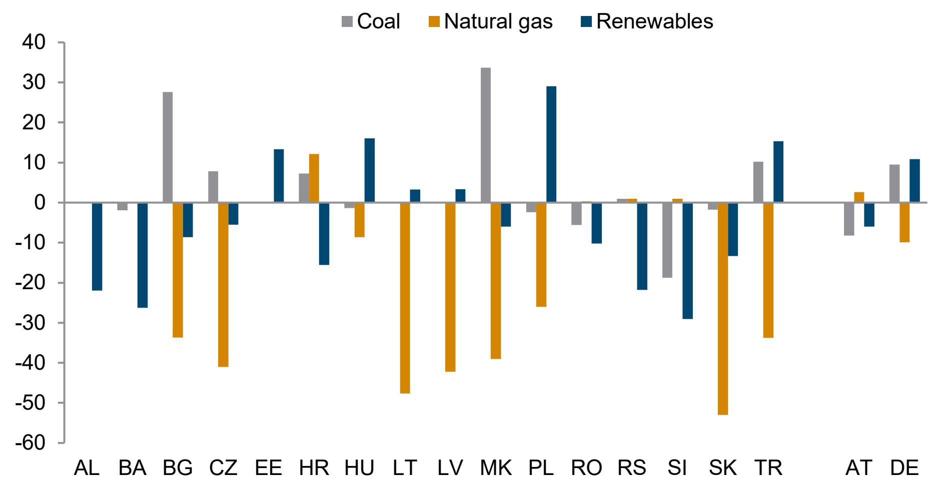
Figure 2.13 / Observed inland consumption of natural gas in 2022, percentage change year on year



Source: Eurostat, own calculations.

However, many CESEE countries reverted to increased coal use in order to compensate for the decline in natural gas consumption. As many feared, cutting dependency on Russia in an environmentally friendly way has proved difficult to achieve in the short run, regardless of the various green transition support schemes, such as the REPowerEU Plan. The most striking year-on-year increase in the use of coal in electricity generation in 2022 was recorded in North Macedonia (33.7%) and Bulgaria (27.6%) (Figure 2.14). Germany also increased its coal use by 10% last year. Only Slovenia and Romania were able to significantly reduce the use of coal in their electricity generating activities – by 19% and 6%, respectively, year on year.

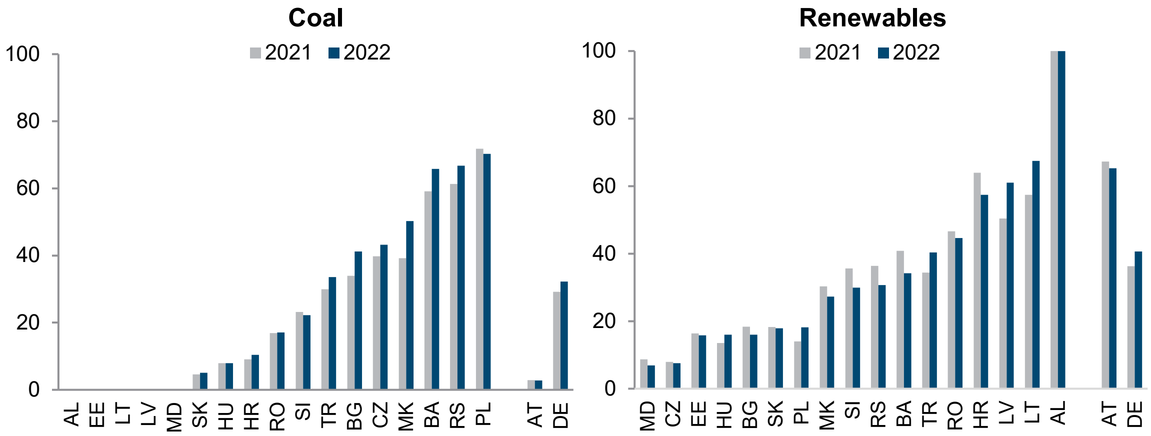
Figure 2.14 / Net electricity generation by type of fuel in 2022, percentage change year on year



Source: Eurostat, own calculations.

As a result, the share of renewable energy in electricity generation mostly decreased in CESEE, while the share of coal increased (Figure 2.15). In most countries of the region – except for Albania, Lithuania, Latvia and Croatia – renewable sources of energy account for less than half of the fuel mix in electricity generation; moreover, the share of renewables fell in 2022 in all countries, apart from Latvia, Lithuania, Turkey, Hungary and Poland. Opposite trends were observed with respect to coal use, the share of which in the fuel mix in electricity generation generally increased – with the exception of those countries with zero use of coal (Albania, Moldova and the Baltic countries), plus Poland and Slovenia. In many CESEE countries, the share of coal remains much higher than in Germany and accounts for as much as 70% of the fuel mix in electricity generation in Poland, 67% in Serbia and 66% in Bosnia and Herzegovina.

Figure 2.15 / Shares of coal and renewable energy in net electricity generation, %



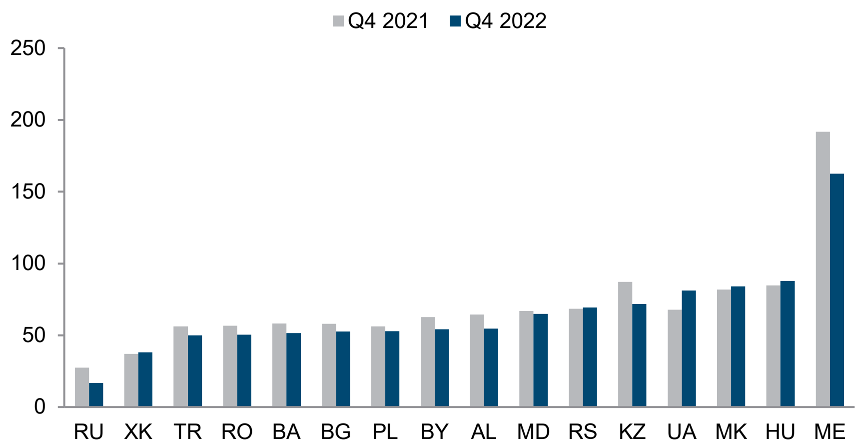
Note: Renewables consist of solar, wind, hydropower and geothermal energy.
Source: Eurostat, own calculations.

2.5. TIGHTER FINANCIAL CONDITIONS POSE RISKS FOR COUNTRIES WITH FINANCIAL VULNERABILITIES

A sharp tightening of financial conditions after the era of ultra-low interest rates poses a risk for CESEE countries with high levels of debt. Though the external-debt-to-GDP ratio dropped in 2022 in most of the region (Figure 2.16) owing to the rise in prices inflating nominal GDP and higher interest rates causing a downward revaluation of the stock of bonds, countries need to deal with the surging costs of debt servicing. External debt as a share of GDP increased in only a few countries – most notably Ukraine (by 13.3 pp in Q4 2022 compared to Q4 2021), as it has to rely heavily on external financing to keep its economy afloat under wartime conditions (see Ukraine report). Apart from Ukraine, the share of external debt increased slightly in Hungary, North Macedonia, Kosovo and Serbia. All other countries saw their external debt fall last year, relative to the size of their economies – most dramatically in Montenegro, by 29 pp. Still, the stock of external debt in that country remains the highest in the region as a proportion of GDP (163%). Hungary and North Macedonia have accumulated gross external debt above 80% of GDP. High levels of debt, accompanied by weak anticipated economic growth, could herald problems with debt servicing in the future.

The banking sector in CESEE has so far held up well, but the adjustment to rapid increases in policy and lending rates might prove painful. The collapse of several banks in the United States and Credit Suisse in Switzerland in March 2023 has raised concerns about the health of the banking sector. Although these cases are believed to be isolated and are attributable to the maturity mismatch on the balance sheets, aggravated by the rapid interest rate rises, the events also point to potential structural vulnerabilities in the banking sector, which must undergo a major rebalancing of its balance sheets. The rates of non-performing loans remain low across CESEE, with the exception of Ukraine, and a big difference between deposit rates and loan interest rates has allowed banks to make record profits. However, they have likely accumulated substantial unrealised losses on their balance sheets, as fixed-rate government bonds and loans have been losing value due to rising interest rates. Banks with a higher share of loans at variable rates, on the other hand, risk a wave of defaults from borrowers who can no longer afford to service their debts. Mortgage loans are especially at risk now, as there appears to be a reversal of an almost decade-long boom in residential property markets, and the inflated real estate prices have started to fall in some countries. Deposit withdrawals by clients in search of better returns could threaten the liquidity of banks and bring to the fore possible issues with maturity mismatch. According to the ECB,[6] depositors withdrew EUR 214bn from euro area banks in the period October 2022 to February 2023, with outflows hitting a record level in February.

Figure 2.16 / Gross external debt, nominal, % of GDP



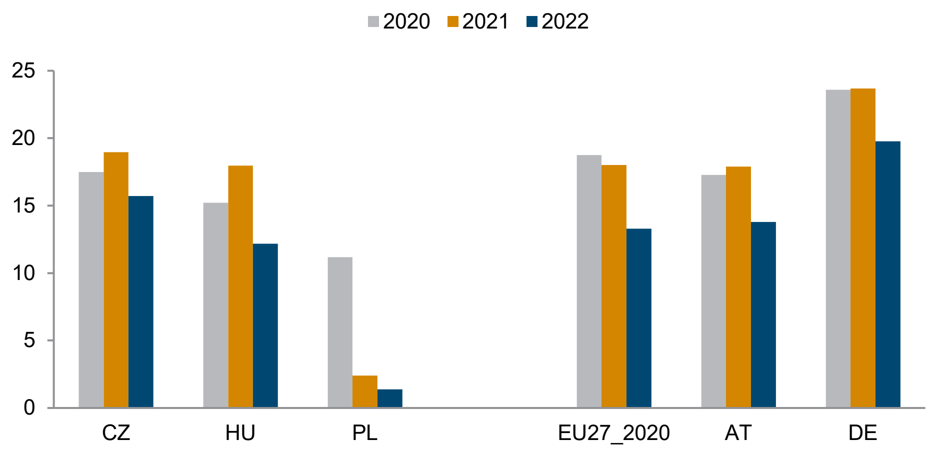
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

There are some indications that aggregate savings built up early in the pandemic – which may have provided a buffer for households and firms struggling to cope with higher prices and interest rates – have been declining. Available quarterly data show that gross household savings rates declined in 2022 on average in the EU, with the most dramatic fall observed in Poland (Figure 2.17), where it reached 1.4% on average during Q1-Q3 2022, down almost 10 pp on the same period of 2020. Hungarian and Czech households also had to decrease their savings, arriving at savings rates of 12.2% and 15.7%, respectively – markedly lower than the rate of German households (19.8%). The current savings rates roughly correspond to the pre-pandemic levels for these countries; only in

6 https://www.ecb.europa.eu/press/pr/stats/md/html/ecb.md2302~952f671d72.en.html

Czechia and Germany do they remain elevated (by about 3-4 pp). Thus, we can conclude that pandemic-enforced savings are likely to have been largely spent in many countries.

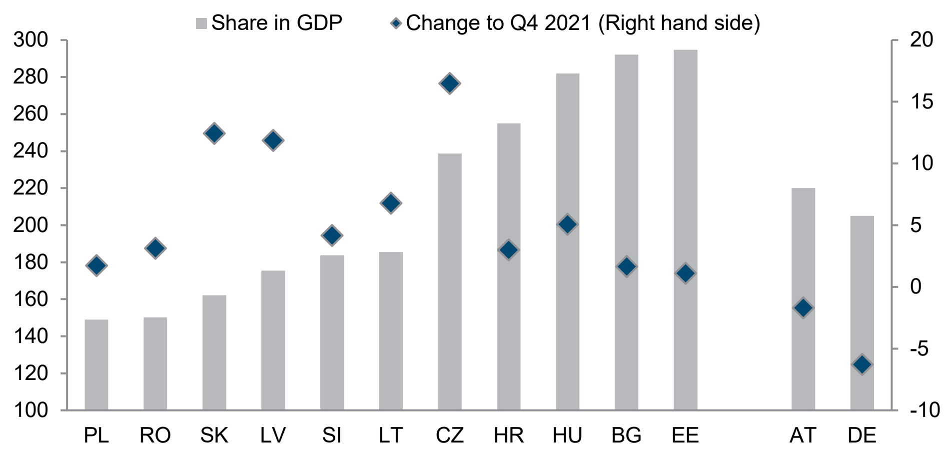
Figure 2.17 / Gross household savings rate, average in Q1-Q3 of respective year, %



Source: Eurostat, own calculations.

Companies in many CESEE countries emerged from the pandemic with high financial liabilities, but raising funding could prove hard under tighter financial conditions. This is most relevant for the corporate sector in Estonia, Bulgaria, Hungary, Croatia and Czechia, where the total financial liabilities of non-financial corporations in Q3 2022 exceeded 230% of GDP, noticeably outpacing levels in the corporate sector of Austria and Germany. De Haas and Bircan (2022) estimate that around 20-25% of all firms in the emerging Europe are currently financially vulnerable – and about a quarter of those can be classified as 'zombies': firms that are in distress, but avoid default thanks to their continued access to cheap funding. This suggests that the adjustment to tighter financing conditions could turn out to be quite painful in some countries of the region.

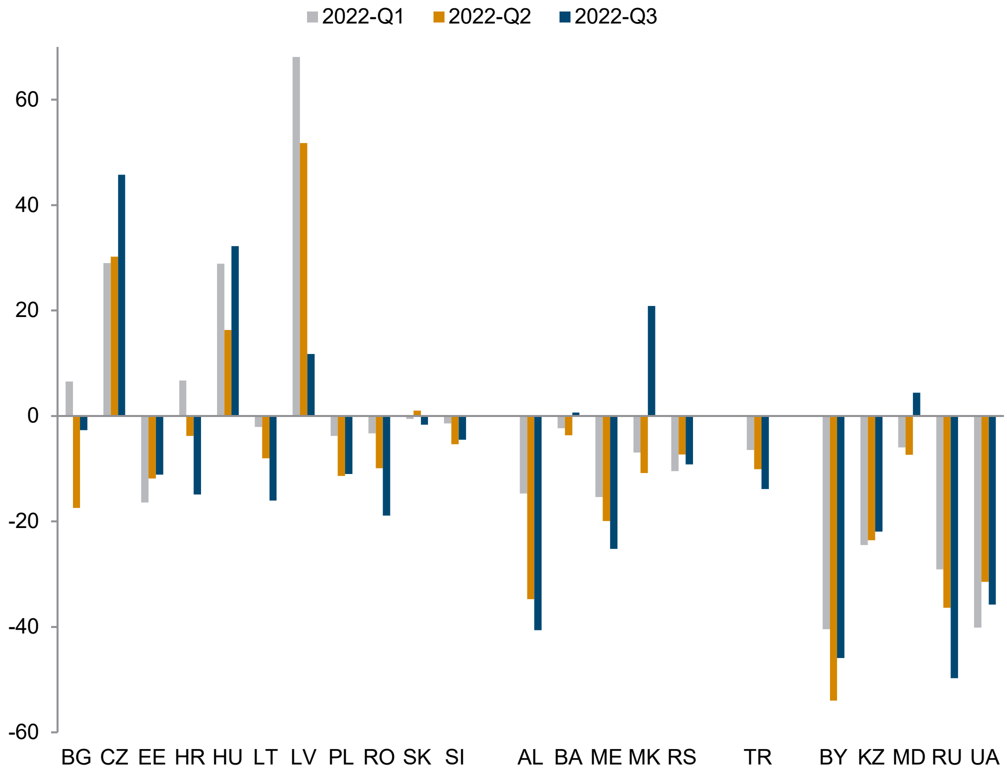
Figure 2.18 / Total financial liabilities of non-financial corporations in Q3 2022, % share of GDP and change to Q4 2021, pp



Source: Eurostat, own calculations.

The access of banks to funding worsened with decreasing cross-border bank credit. The decline in cross-border bank claims has been sharpest in the CIS and Ukraine; particularly affected have been Russia and Belarus (due to the international sanctions), as well as the Western Balkans (Figure 2.19). Among the EU-CEE countries, only Czechia, Hungary and Latvia had positive cross-border bank claims in Q3 2022; in other countries, parent bank groups appear to have been reducing their exposure to the region. In Russia, the situation has been exacerbated by the international sanctions on banks.

Figure 2.19 / Cross-border consolidated bank claims on guarantor basis in nominal USD terms, change year on year, %



Source: Bank for International Settlements, own calculations.

2.6. FORECASTS FOR 2023-2025: INFLATION TO PERSIST, BUT THE ECONOMIES WILL START RECOVERING

We expect inflation to take longer to slow down than we previously thought, and so have revised our 2023 forecast for it upwards in most CESEE countries (Table 2.1). In many countries, it will remain in double digits, with Turkey continuing to have the most rapid price growth in the region. The Western Balkan countries on average are expected to have the lowest CPI growth, while the CIS countries and Ukraine will have the highest inflation (after Turkey). Hungary stands out among EU-CEE members as having the second-highest inflation rate in CESEE, after Turkey.

Inflation is expected to subside across the region in 2024-2025, but it will still exceed 2% in all countries, apart from Estonia. The Western Balkans will continue to have the lowest CPI growth among CESEE countries, with inflation rates being practically uniform in all six countries. Turkey will still have uncomfortably high inflation of 30% even in 2025. Belarus will be the only other country in the region with double-digit CPI growth in 2025. In EU-CEE, Bulgaria and Hungary will be the least successful in bringing inflation down.

Table 2.1 / CPI growth forecasts and direction of revisions since wiiw winter forecast 2023

Region	2023		2024		2025	
EU-CEE						
BG Bulgaria	10.0		7.0		5.0	
CZ Czechia	10.4	▲	4.0		3.0	
EE Estonia	9.5	▲	2.5	▼	1.8	▼
HR Croatia	6.5	▲	4.0	▲	3.0	▲
HU Hungary	18.5	▲	8.0	▼	5.0	▼
LT Lithuania	10.0	▲	4.0	▲	2.8	
LV Latvia	11.0	▲	4.0	▼	3.2	▼
PL Poland	12.5	▼	6.0		4.0	
RO Romania	9.0	▼	5.0	▼	4.0	
SI Slovenia	6.4	▼	3.2	▼	2.4	▲
SK Slovakia	10.2	▲	5.0		3.0	
Western Balkans						
AL Albania	4.0		3.0		2.5	▼
BA Bosnia and Herzegovina	9.0	▲	4.0	▲	2.5	▲
ME Montenegro	10.0	▲	4.0	▲	2.8	▲
MK North Macedonia	9.0	▼	4.0		3.0	
RS Serbia	10.0	▲	4.0		3.0	
XK Kosovo	7.0		4.0	▲	2.5	▲
Turkey						
TR Turkey	47.7	▲	38.2	▲	30.0	▲
CIS+UA						
BY Belarus	12.0		11.0		10.0	
KZ Kazakhstan	14.0	▲	9.0		6.0	
MD Moldova	14.0		6.0		5.0	▼
RU Russia	5.4		4.6	▲	3.4	▲
UA Ukraine	17.0	▲	9.0		7.0	

Note: Colour scale variation from the maximum (dark grey) to the minimum (dark orange).
Source: wiiw.

Table 2.2 / Real GDP growth forecasts

Region	2023		2024		2025	
EU-CEE						
BG Bulgaria	1.7	▲	2.2	▼	2.7	▼
CZ Czechia	0.2	▼	2.4		2.7	
EE Estonia	0.4	▼	2.6	▼	3.1	▼
HR Croatia	2.5		2.9	▲	3.1	▲
HU Hungary	-0.5	▲	1.5	▼	1.7	▼
LT Lithuania	0.9	▼	2.6	▼	2.5	▼
LV Latvia	0.3	▲	2.5	▼	2.3	▼
PL Poland	1.0		2.4		3.2	▲
RO Romania	3.0	▲	4.0		4.3	▲
SI Slovenia	1.4	▲	2.5	▼	2.7	▼
SK Slovakia	0.6		2.5	▲	2.2	▼
Western Balkans						
AL Albania	3.3	▲	3.8	▲	4.0	▲
BA Bosnia and Herzegovina	1.7	▲	1.9	▼	2.5	
ME Montenegro	2.9	▲	3.2	▼	3.0	
MK North Macedonia	1.6	▲	2.5		3.0	▲
RS Serbia	1.5		2.6		3.0	
XK Kosovo	3.6	▲	3.9	▲	4.1	▲
Turkey						
TR Turkey	2.6	▼	3.4	▲	3.8	▼
CIS+UA						
BY Belarus	1.3	▲	1.6	▲	2.0	▲
KZ Kazakhstan	3.5		4.0		4.0	
MD Moldova	3.0	▲	4.0		4.0	▼
RU Russia	0.0	▲	1.0		1.5	
UA Ukraine	1.6	▼	3.4	▼	5.0	▼

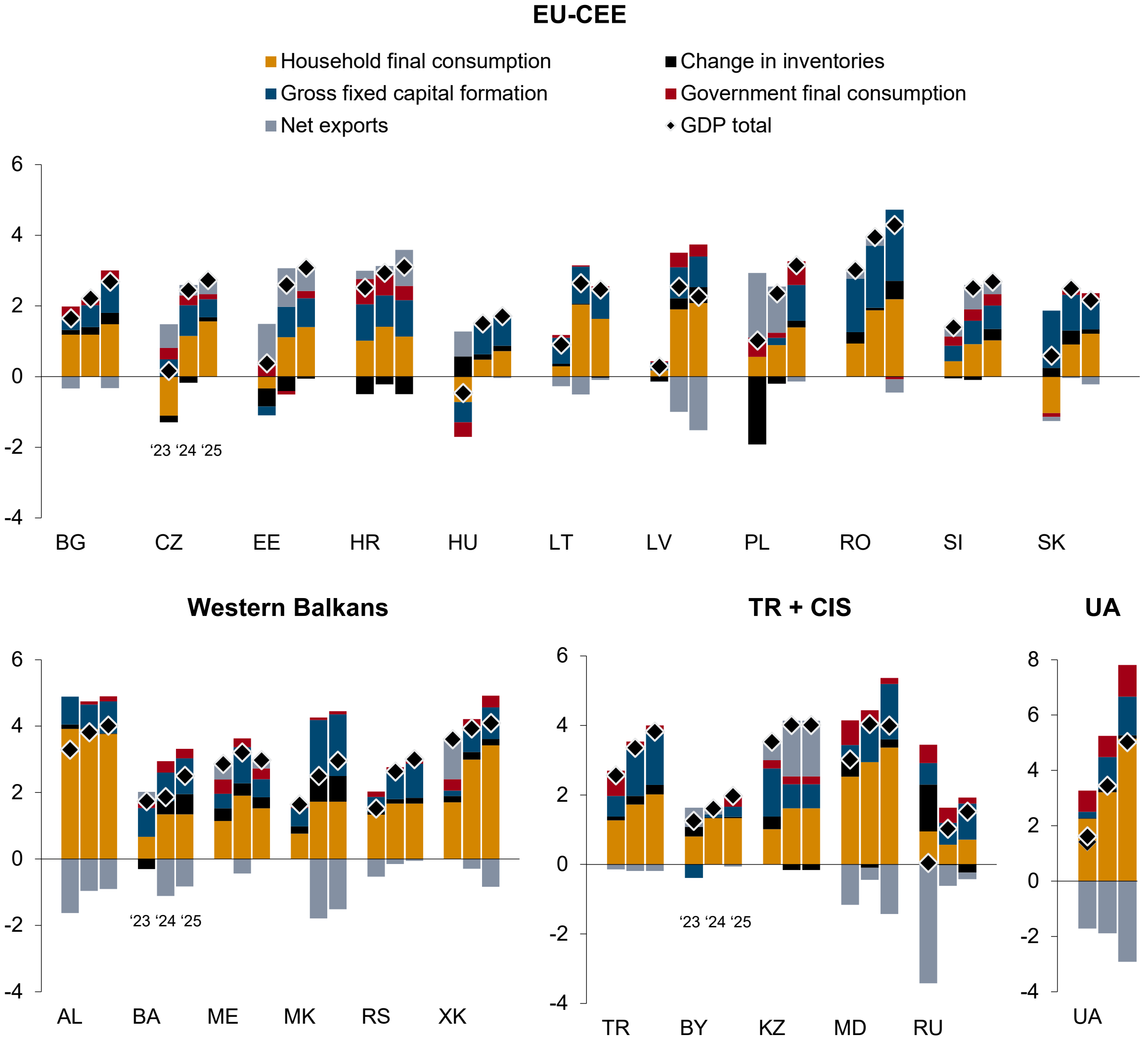
Note: Colour scale variation from the minimum (dark grey) to the maximum (dark orange).
Source: wiiw.

Notwithstanding the persistent inflation, the region will mostly avoid recession in 2023 (Table 2.2). Only Hungary, which is struggling with rampant inflation and difficulties in accessing EU funds, is forecast to have negative GDP growth this year. The Western Balkans will have on average the strongest economic growth in the region, with average GDP growth of 2%. In EU-CEE, economic performance will be very uneven: Romania and Croatia are expected to grow by 3.0% and 2.5%, respectively (based on the weighted average growth rates), while the Baltic countries, Czechia and Slovakia will expand at below 1%. We have revised downwards our GDP forecast for Ukraine (to 1.6%), as the damage caused to the country's energy infrastructure by Russian missile attacks has raised costs for the economy and aggravated supply-chain issues. The forecast is subject to high downside risks related primarily to the intensity and duration of Russia's war in Ukraine and the continued willingness of Ukraine's international partners to support it (see Ukraine report). The forecast for the Russian economy, by contrast, has improved, and now the country is expected to avoid recession and merely stagnate this year, since the economy is believed to have stabilised, having adjusted to the Western sanctions (see Russia report).

In 2024-2025 we expect an overall acceleration of economic growth across the region, primarily on the back of a recovery in private consumption (Figure 2.20). Investment is also expected to recover, but its contribution to economic growth will be overall quite modest –except for in Croatia, Romania and North Macedonia: in those countries it will grow on a par with household final consumption, supported to a large extent by FDI inflows and (in the case of the first two countries) by EU funds.

Figure 2.20 / GDP growth forecast for 2023-2025

and contribution of individual demand components in percentage points

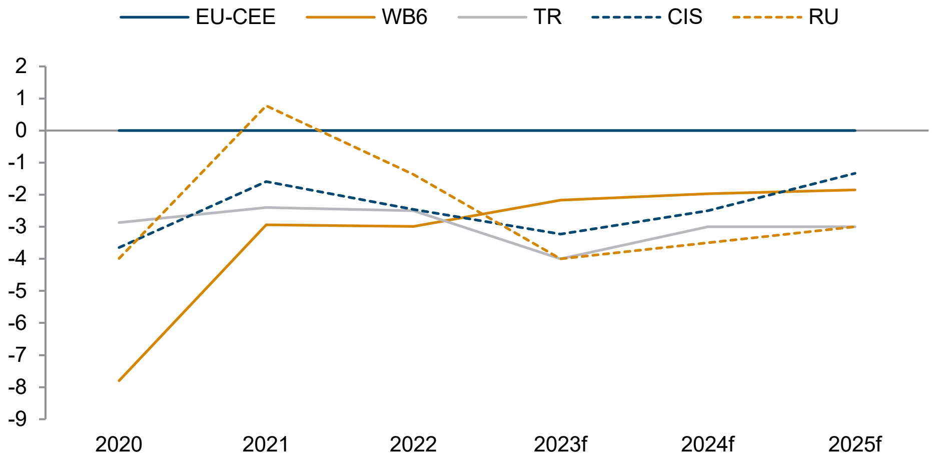


Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

Southeast Europe is expected to put in a better economic performance than the Visegrád group over the forecast period. The Visegrád countries have been struggling for some time with their economic model, based as it is on labour-cost advantages and participation in regional production chains (Pindyuk et al., 2020). Although growth rates in the CESEE countries will be mostly lower than they were before the global economic crisis, the region will still outperform the euro area, indicating that the economic catch-up process is still ongoing, albeit at a slower pace.

Fiscal consolidation will be very slow and fiscal balances will remain in the red. The widest budget deficit in the region is expected to be in Ukraine, where the bulk of the deficit will be further financed through official Western assistance. Aside from Ukraine, EU-CEE, Turkey and Russia are forecast to have the highest budget deficits in 2025, at around 3% of GDP on average. The countries of the Western Balkans will have to consolidate their public finances much faster than the rest, due to fiscal space constraints; Bosnia and Herzegovina will be the only country in the CESEE region to run a budget surplus during the forecast period.

Figure 2.21 / Fiscal balance in % of GDP



Note: simple average.
Source: wiiw Annual Database incorporating national statistics and Eurostat; wiiw forecasts.

Table 2.3 / 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	1.7	2.2	2.7	2.8	13.0	10.0	7.0	5.0	5.3	4.3	4.3	4.2	4.2
CZ	Czechia	3.6	2.5	0.2	2.4	2.7	3.3	14.8	10.4	4.0	3.0	2.8	2.3	2.7	2.6	2.6
EE	Estonia	8.0	-1.3	0.4	2.6	3.1	4.5	19.4	9.5	2.5	1.8	6.2	5.6	7.0	6.2	5.6
HR	Croatia	13.1	6.3	2.5	2.9	3.1	2.7	10.7	6.5	4.0	3.0	7.6	7.0	6.8	6.7	6.6
HU	Hungary	7.2	4.6	-0.5	1.5	1.7	5.2	15.3	18.5	8.0	5.0	4.1	3.6	4.5	4.0	3.6
LT	Lithuania	6.0	1.9	0.9	2.6	2.5	4.6	18.9	10.0	4.0	2.8	7.1	6.0	6.8	6.5	6.0
LV	Latvia	4.1	2.0	0.3	2.5	2.3	3.2	17.2	11.0	4.0	3.2	7.6	6.8	7.2	6.8	6.6
PL	Poland	6.8	4.9	1.0	2.4	3.2	5.2	13.2	12.5	6.0	4.0	3.4	2.9	3.4	3.6	3.8
RO	Romania	5.8	4.8	3.0	4.0	4.3	4.1	12.0	9.0	5.0	4.0	5.6	5.6	5.8	5.4	5.2
SI	Slovenia	8.2	5.4	1.4	2.5	2.7	2.0	9.3	6.4	3.2	2.4	4.8	4.0	4.0	3.9	3.9
SK	Slovakia	3.0	1.7	0.6	2.5	2.2	2.8	12.1	10.2	5.0	3.0	6.8	6.1	6.3	6.2	6.0
	EU-CEE11 1)2)	*6.3*	*4.1*	*1.2*	*2.6*	*3.1*	*4.3*	*13.5*	*11.4*	*5.5*	*3.8*	*4.5*	*4.0*	*4.4*	*4.4*	*4.3*
	EA20 3)	*5.4*	*3.5*	*0.5*	*1.8*	*1.7*	*2.6*	*8.5*	*5.7*	*3.0*	*2.3*	*7.7*	*6.8*	*6.6*	*6.6*	*6.6*
	EU27 3)	*5.4*	*3.5*	*0.7*	*2.0*	*1.9*	*2.9*	*9.0*	*5.9*	*3.2*	*2.5*	*7.0*	*6.0*	*5.8*	*5.8*	*5.8*
AL	Albania	8.9	4.8	3.3	3.8	4.0	2.0	6.7	4.0	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	2.5	2.0	14.0	9.0	4.0	2.5	17.4	15.4	15.0	14.7	14.4
ME	Montenegro	13.0	6.1	2.9	3.2	3.0	2.4	13.0	10.0	4.0	2.8	16.6	14.7	13.8	13.1	12.0
MK	North Macedonia	3.9	2.1	1.6	2.5	3.0	3.2	14.2	9.0	4.0	3.0	15.7	14.4	14.0	13.0	12.0
RS	Serbia	7.5	2.3	1.5	2.6	3.0	4.1	11.9	10.0	4.0	3.0	11.0	9.4	9.0	8.5	8.0
XK	Kosovo	10.7	3.5	3.6	3.9	4.1	3.4	11.6	7.0	4.0	2.5	20.7	18.0	17.0	16.5	16.0
	WB6 1)2)	*7.8*	*3.2*	*2.0*	*2.8*	*3.1*	*3.2*	*11.9*	*8.7*	*3.9*	*2.8*	*13.6*	*12.1*	*11.6*	*11.1*	*10.5*
TR	Turkey	11.4	5.6	2.6	3.4	3.8	19.6	72.3	47.7	38.2	30.0	12.0	10.5	10.0	9.5	9.0
BY	Belarus	2.4	-4.7	1.3	1.6	2.0	9.5	15.2	12.0	11.0	10.0	3.9	3.6	3.8	4.0	4.0
KZ	Kazakhstan	4.3	3.2	3.5	4.0	4.0	8.0	15.0	14.0	9.0	6.0	4.9	4.9	4.8	4.8	4.8
MD	Moldova	13.9	-5.9	3.0	4.0	4.0	5.1	28.7	14.0	6.0	5.0	3.2	3.1	3.5	3.2	3.0
RU	Russia	5.6	-2.1	0.0	1.0	1.5	6.7	13.8	5.4	4.6	3.4	4.8	3.9	4.0	4.0	3.8
UA	Ukraine	3.4	-29.1	1.6	3.4	5.0	9.4	20.2	17.0	9.0	7.0	9.9	25.0	20.0	15.0	10.0
	CIS4+UA 1)2)	*5.3*	*-3.7*	*0.5*	*1.5*	*2.0*	*7.1*	*14.5*	*7.3*	*5.6*	*4.1*	*5.6*	*7.4*	*6.5*	*5.7*	*4.7*
	V4 1)2)	*6.0*	*4.1*	*0.6*	*2.3*	*2.8*	*4.6*	*13.7*	*12.8*	*5.8*	*3.9*	*3.7*	*3.2*	*3.7*	*3.7*	*3.8*
	BALT3 1)2)	*5.9*	*1.2*	*0.6*	*2.6*	*2.6*	*4.2*	*18.5*	*10.2*	*3.7*	*2.7*	*7.0*	*6.1*	*7.0*	*6.5*	*6.1*
	SEE9 1)2)	*7.3*	*4.4*	*2.5*	*3.3*	*3.7*	*3.6*	*12.0*	*8.8*	*4.9*	*3.8*	*8.7*	*7.9*	*7.7*	*7.4*	*7.1*
	CIS3+UA 1)2)	*3.9*	*-10.2*	*2.4*	*3.4*	*4.1*	*8.7*	*17.4*	*14.8*	*9.2*	*7.0*	*7.3*	*15.3*	*12.6*	*9.9*	*7.3*
	non-EU12 1)2)	*7.0*	*-0.7*	*1.2*	*2.1*	*2.6*	*10.5*	*31.5*	*19.3*	*15.2*	*11.8*	*7.4*	*8.4*	*7.6*	*6.8*	*6.1*
	CESEE23 1)2)	*6.8*	*0.8*	*1.2*	*2.3*	*2.7*	*8.7*	*25.9*	*16.9*	*12.2*	*9.3*	*6.7*	*7.3*	*6.8*	*6.2*	*5.6*

Table 2.3 / (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	-5.0	-5.0	-4.0	-3.0
CZ	Czechia	-2.8	-6.1	-2.8	-1.7	-0.5	-5.1	-3.9	-4.2	-2.5	-1.9
EE	Estonia	-1.8	-2.2	0.7	1.8	1.4	-2.4	-2.0	-4.0	-3.3	-3.0
HR	Croatia	3.1	-3.3	-2.6	-2.1	-0.6	-2.6	-1.9	-2.4	-2.0	-1.8
HU	Hungary	-4.1	-8.1	-4.0	-2.8	-2.0	-7.1	-6.1	-4.5	-4.0	-3.3
LT	Lithuania	1.1	-5.1	-4.9	-4.8	-4.7	-1.0	-2.0	-5.0	-3.0	-2.0
LV	Latvia	-4.2	-6.4	-4.1	-2.6	-1.6	-7.0	-4.8	-4.5	-3.0	-2.0
PL	Poland	-1.4	-3.0	-0.3	0.4	1.0	-1.8	-3.5	-4.8	-4.0	-3.5
RO	Romania	-7.2	-9.3	-7.0	-5.9	-4.9	-7.1	-6.0	-5.3	-4.5	-4.0
SI	Slovenia	3.8	-0.4	0.8	0.8	0.7	-4.7	-3.8	-4.2	-2.6	-2.2
SK	Slovakia	-2.5	-8.3	-5.0	-3.1	-2.6	-5.5	-3.5	-6.0	-4.4	-4.5
	EU-CEE11 1)2)	*-2.5*	*-5.2*	*-2.6*	*-1.7*	*-1.0*	*-4.1*	*-4.2*	*-4.7*	*-3.7*	*-3.2*
	EA20 3)	*3.8*	*0.5*	*1.0*	*1.5*	*2.5*	*-5.1*	*-4.3*	*-3.7*	*-2.7*	*-2.6*
	EU27 3)	*3.4*	*0.5*	*1.0*	*1.5*	*2.5*	*-4.6*	*-3.9*	*-3.3*	*-2.3*	*-2.2*
AL	Albania	-7.7	-6.0	-5.9	-5.8	-5.8	-4.6	-3.7	-2.5	-2.5	-2.5
BA	Bosnia and Herzegovina	-2.4	-4.5	-4.0	-4.1	-4.3	-0.3	-1.0	0.5	1.0	1.0
ME	Montenegro	-9.2	-13.3	-11.7	-10.7	-10.0	-1.9	-5.2	-5.0	-4.8	-4.6
MK	North Macedonia	-3.1	-6.0	-4.5	-4.5	-4.4	-5.4	-4.5	-3.0	-2.5	-2.5
RS	Serbia	-4.2	-6.9	-5.8	-4.9	-4.2	-4.1	-3.1	-2.5	-2.0	-1.5
XK	Kosovo	-8.7	-10.5	-9.7	-9.4	-9.3	-1.3	-0.5	-0.5	-1.0	-1.0
	WB6 1)2)	*-4.8*	*-6.8*	*-5.9*	*-5.4*	*-5.1*	*-3.4*	*-2.9*	*-2.0*	*-1.7*	*-1.4*
TR	Turkey	-0.9	-5.3	-4.0	-3.0	-2.5	-2.4	-2.5	-4.0	-3.0	-3.0
BY	Belarus	3.1	3.7	1.5	1.2	1.0	0.2	-2.0	-3.0	-2.0	-1.0
KZ	Kazakhstan	-1.3	3.9	-0.5	-1.0	-1.5	-3.0	-2.1	-2.7	-2.5	-2.0
MD	Moldova	-12.4	-15.8	-14.4	-12.2	-11.3	-1.9	-3.3	-4.0	-3.0	-1.0
RU	Russia	6.7	10.4	4.3	3.4	2.7	0.8	-1.4	-4.0	-3.5	-3.0
UA	Ukraine	-1.9	5.0	3.1	-1.4	-4.6	-3.4	-16.3	-27.0	-15.0	-10.0
	CIS4+UA 1)2)	*5.0*	*9.2*	*3.6*	*2.5*	*1.6*	*0.1*	*-2.4*	*-5.2*	*-4.1*	*-3.3*
	V4 1)2)	*-2.2*	*-4.9*	*-1.8*	*-0.8*	*0.0*	*-3.7*	*-4.0*	*-4.7*	*-3.7*	*-3.2*
	BALT3 1)2)	*-1.1*	*-4.7*	*-3.3*	*-2.5*	*-2.3*	*-3.0*	*-2.8*	*-4.6*	*-3.1*	*-2.2*
	SEE9 1)2)	*-4.6*	*-6.7*	*-5.3*	*-4.5*	*-3.7*	*-5.2*	*-4.6*	*-4.2*	*-3.5*	*-3.0*
	CIS3+UA 1)2)	*-1.2*	*3.6*	*0.5*	*-1.1*	*-2.5*	*-2.7*	*-7.0*	*-11.0*	*-6.7*	*-4.5*
	non-EU12 1)2)	*3.1*	*5.1*	*1.2*	*0.4*	*-0.1*	*-0.7*	*-2.4*	*-4.8*	*-3.7*	*-3.1*
	CESEE23 1)2)	*1.1*	*1.6*	*-0.1*	*-0.3*	*-0.4*	*-2.0*	*-3.0*	*-4.8*	*-3.7*	*-3.1*

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: 13 April 2023.

2.7. THE DOWNSIDE RISKS REMAIN VERY STRONG

One of the major risks to the forecast is that persistently high inflation will lead to harder lending conditions. Continuing monetary tightening could trigger painful adjustments in the global financial markets, and any vulnerabilities in the domestic banking sector could be aggravated. Sudden capital outflows from the region could disproportionately affect countries with high levels of external debt.

Further stresses could emerge in the real estate markets, where inflated property prices may see a rapid adjustment. Rising interest rates on mortgage loans have significantly increased the cost to variable-rate mortgage holders of servicing their debt, and in some countries there is already a rush to sell and very few buyers. This poses a risk both for the banks (which may face rising non-performing loans) and for the real economy, as households will have to spend an increased proportion of income on their monthly mortgage payments and accordingly will reduce their consumption.

Another significant downside risk is related to a possible deterioration in the security situation of the region. This could come about if Ukraine has problems in securing support from its allies in the event that Donald Trump (or some other candidate with similar views) wins the US presidential election in November 2024: that could mean a reversal of US foreign policy, which would be a blow to Ukraine's military capabilities and economy (see Ukraine report). The increased risk of geopolitical instability in those countries close to the Russian border places them at additional risk from tighter financial conditions. An aggravation of the US-China economic and political confrontation could also have repercussions for CESEE countries.

2.8. CONCLUSIONS

Inflation has proved more persistent than we previously thought it would and has become a drag on economic activity in CESEE countries. Core inflation is still in double digits in all countries, apart from Albania and Slovenia, which indicates that the pass-through of higher costs to prices remains robust. Economies are being hit by a double whammy of aggressive monetary tightening and soaring prices, which especially puts at risk those countries with high levels of indebtedness. EU members with access to RRF funds are in a better position to withstand the crisis.

Nevertheless, the region will mainly avoid recession in 2023, and GDP growth will accelerate in 2024-2025. Only Hungary, which is struggling with rampant inflation and difficulties in accessing EU funds, is forecast to have negative GDP growth in 2023. Southeast Europe will have, on average, faster economic growth than the countries of the Visegrád group over the forecast period, as the latter appear to be struggling with their economic model, based as it is on labour-cost advantages and participation in regional production chains.

The forecast is subject to major downside risks. Harder lending is possible in the economies, if a sharp tightening of financial conditions triggers financial instability. Highly indebted countries are particularly vulnerable to rising costs of debt servicing and to capital outflows. A deterioration in the security situation of the region could have significant negative spill-overs to economic activity.

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