

PRESS RELEASE

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Ten things to watch in CESEE this year. The region is set for a more difficult 2019, thanks to rising economic and political headwinds

EU politics, a packed election calendar, Brexit, migration battles, the US-China trade war and slower global growth will combine to make 2019 a challenging one for CESEE economies. After a strong 2017-18 for most of the region, a combination of negative external and domestic factors will test policymakers in the region this year. These are the main conclusions of a new report by the Vienna Institute for International Economic Studies (wiiw).

wiiw produces an annual report looking at the ten themes likely to define the economic fortunes of CESEE countries in the upcoming year. For 2019, the themes are as follows:

1. **A big year for the EU and CESEE's place within it:** This year will see European Parliament elections, a new Commission, the Romanian presidency of the EU and Brexit. All will create particular challenges for EU CESEE countries in particular, and the region will have to fight hard to make sure its interests are taken into account.
2. **Domestic political risk will remain high on the agenda:** CESEE will host a large number of elections this year, at both the national and local level. Among the most important and potential consequential will be those in Poland and Ukraine. The outcome of elections in the region will be key to determine whether the deterioration in the quality and independence of institutions seen in many countries in recent years continues.
3. **Potential for further instability in the Western Balkans:** Political risk in many parts of the Western Balkans is already high, but there are signs that it could be increasing. Further downplaying of EU accession prospects, Serbia-Kosovo tensions, internal disputes in Bosnia, the role of outside actors, and a weaker role for the US and EU are all sources of concern.
4. **Brexit is a blow to EU pride, and bad news for CESEE:** Brexit will mostly harm the UK and Ireland, and the former has certainly made a fool of itself. Nevertheless, Brexit is a blow to the EU. The economic fallout should be limited for CESEE, but the political implications could be bigger. As a supporter of enlargement, Russia hawk and barrier to further integration, the UK will be missed in the EU by at least some CESEE countries.

5. **EU-CEE will have to take a pay cut with the next EU budget:** After Brexit, the budget is likely to shrink. Net inflows from the budget into EU-CEE countries—generally 2-5 percentage points of GDP—will therefore likely be reduced. Meanwhile for the candidate countries in the Western Balkans, hopes of a significant increase in IPA are unlikely to be fulfilled.
6. **More fights over migration, with CESEE countries playing a prominent role:** 2019 will be another frustrating year for those hoping for a proper joint EU policy on migration. Broadly, EU-CEE countries are opposed to taking large numbers (or in some cases any) of successful asylum seekers, and these governments generally have the support of their populations. Further conflict on this issue between Western and Eastern EU member states appears to be almost inevitable.
7. **Euro reform will be incremental at best, leaving the single currency area exposed to the next downturn:** It is clear that Germany and some allies are not willing to take major steps towards further eurozone financial and fiscal integration, meaning that the single currency area remains vulnerable. CESEE countries—both members and non-members of the euro—have much to lose from a renewed outbreak of the eurozone crisis.
8. **Slowdown in Germany (and China) means CESEE growth rates unlikely to be sustained:** Most countries in CESEE had a good 2018 in terms of growth, despite a marked weakening of eurozone economic activity in the second half of the year. With growth in Western Europe and China both set to slow this year, CESEE is unlikely to remain unscathed. The region is full of small, open economies reliant on exports for growth. Meanwhile the region's two big economies—Russia and Turkey—will have another tough year as they struggle with internal problems.
9. **Inflation will remain relatively subdued:** Aside from a few special cases such as Turkey, inflation remains surprisingly weak in CESEE, particularly considering the increased tightness of labour markets and notable wage increases in many countries. There are several possible explanations for this, including higher savings rates, remittance outflows, and the knock-on effects of technological change. With oil unlikely to make a strong positive contribution to inflation this year, price growth will remain subdued across most of CESEE.
10. **Potential risks building in the financial sector:** Ten years after the global financial crisis, there are plenty of reasons to feel better about the financial sector in CESEE. Capital levels and asset quality have improved. However, there are still reasons to worry. One area of concern is FX borrowing by corporates, which has become challenging to roll over as US rates rise. So far Turkey is the only CESEE country caught up in this, but others in the CIS and the Balkans could face challenges in 2019.

Further reading

wiiw News 'Ten themes for CESEE in 2019, - 25 January 2019

Link: <https://wiiw.ac.at/n-362.html>

Comments, interviews, statistics

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