Table 1 / OVERVIEW 2016-2017 AND OUTLOOK 2018-2020

		GDP real change in % against prev. year					Consumer prices change in % against prev. year				
				Forecast					Forecast		
		2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
BG	Bulgaria	3.9	3.8	3.3	3.2	3.0	-1.3	1.2	2.5	2.5	2.5
CZ	Czech Republic	2.5	4.3	3.3	3.2	3.1	0.6	2.4	2.3	2.3	2.0
EE	Estonia	3.5	4.9	3.5	3.1	2.7	0.8	3.7	3.3	2.8	2.7
HR	Croatia	3.5	2.9	2.5	2.6	2.7	-0.6	1.3	1.6	2.0	2.0
HU	Hungary	2.3	4.1	4.3	3.0	2.3	0.4	2.4	3.1	3.0	3.0
LT	Lithuania	2.4	4.1	3.5	3.0	2.6	0.7	3.7	2.6	2.7	2.5
LV	Latvia	2.1	4.6	4.1	3.3	3.0	0.1	2.9	2.4	2.5	2.5
PL	Poland	3.1	4.8	5.0	3.5	3.3	-0.2	1.6	2.0	2.1	1.9
RO	Romania	4.8	7.3	3.8	3.6	3.7	-1.1	1.1	4.0	3.0	3.0
SI	Slovenia	3.1	4.9	4.5	3.6	3.5	-0.2	1.6	1.8	2.0	2.0
SK	Slovakia	3.1	3.2	3.8	4.1	3.3	-0.5	1.4	2.8	2.5	2.2
	EU-CEE [1)2)]	*3.2*	*4.9*	*4.2*	*3.4*	*3.2*	*-0.2*	*1.8*	*2.6*	*2.4*	*2.3*
	EA-19 [3)]	*1.9*	*2.4*	*2.0*	*1.7*	*1.6*	*0.2*	*1.5*	*1.6*	*1.6*	*1.6*
	EU-28 [3)]	*2.0*	*2.4*	*2.0*	*1.9*	*1.8*	*0.3*	*1.7*	*1.7*	*1.8*	*1.9*
AL	Albania	3.4	3.8	4.1	4.0	4.0	1.3	2.0	2.1	2.5	2.9
BA	Bosnia and Herzegovina	3.1	3.1	3.0	3.4	3.4	-1.1	1.2	1.2	1.9	1.9
ME	Montenegro	2.9	4.7	4.2	3.1	3.1	0.1	2.8	3.5	2.0	2.0
MK	Macedonia	2.9	0.0	2.9	2.8	3.1	-0.2	1.4	1.5	2.0	2.0
RS	Serbia	3.3	2.0	4.3	3.4	2.8	1.1	3.0	2.3	2.7	3.0
XK	Kosovo	4.1	3.7	4.2	4.0	4.2	0.3	1.5	0.7	1.6	2.0
	WB [1)2)]	*3.3*	*2.5*	*3.8*	*3.5*	*3.2*	*0.5*	*2.2*	*1.9*	*2.3*	*2.6*
TR	Turkey	3.2	7.4	2.5	1.0	4.0	7.7	11.1	16.5	17.0	12.0
BY	Belarus	-2.5	2.4	3.7	3.0	2.8	11.8	6.0	5.0	7.0	8.0
KZ	Kazakhstan	1.1	4.1	4.0	3.1	3.0	14.6	7.4	6.5	6.0	5.0
RU	Russia	-0.2	1.5	1.7	1.6	1.8	7.1	3.6	3.5	5.5	4.0
UA	Ukraine	2.4	2.5	3.3	2.7	2.0	13.9	14.4	10.8	8.9	5.2
	CIS + Ukraine [1)2)]	*0.1*	*1.9*	*2.2*	*1.9*	*2.0*	*8.5*	*4.9*	*4.4*	*5.9*	*4.3*
	V-4 [1)2)]	*2.8*	*4.5*	*4.4*	*3.4*	*3.1*	*0.0*	*1.9*	*2.3*	*2.3*	*2.1*
	BALT-3 [1)2)]	*2.5*	*4.4*	*3.7*	*3.1*	*2.7*	*0.6*	*3.5*	*2.7*	*2.7*	*2.5*
	SEE-9 [1)2)]	*4.1*	*5.1*	*3.6*	*3.4*	*3.4*	*-0.7*	*1.4*	*3.0*	*2.6*	*2.7*
	NON-EU-11 [1)2)]	*1.1*	*3.6*	*2.3*	*1.7*	*2.6*	*8.0*	*6.7*	*7.9*	*9.1*	*6.6*
	CESEE-22 [1)2)]	*1.7*	*3.9*	*2.8*	*2.2*	*2.8*	*5.6*	*5.2*	*6.4*	*7.1*	*5.3*

Table 1 / (ctd.)

		Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
				Forecast					Forecast		
		2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
BG	Bulgaria	7.6	6.2	5.5	5.3	5.0	2.6	6.5	2.9	1.0	0.8
CZ	Czech Republic	4.0	2.9	2.3	2.2	2.2	1.6	1.0	0.6	0.8	0.7
EE	Estonia	6.8	5.8	5.5	5.0	4.5	2.0	3.2	1.0	0.2	-0.7
HR	Croatia	13.1	11.2	9.8	9.0	8.8	2.6	4.0	2.7	1.5	1.3
HU	Hungary	5.1	4.2	3.6	3.5	3.5	6.2	3.2	2.5	2.7	2.8
LT	Lithuania	7.9	7.1	6.5	6.0	5.8	-0.8	0.9	-1.2	-1.3	-1.4
LV	Latvia	9.6	8.7	7.7	7.2	6.7	1.6	0.7	1.8	1.0	0.5
PL	Poland	6.2	4.9	3.8	3.7	3.6	-0.5	0.2	-0.4	-1.4	-1.5
RO	Romania	5.9	4.9	4.5	4.5	4.7	-2.1	-3.4	-4.4	-4.5	-4.3
SI	Slovenia	8.0	6.6	5.0	4.5	4.0	5.5	7.2	7.3	6.0	5.1
SK	Slovakia	9.7	8.1	6.6	6.3	6.0	-2.2	-2.0	-1.4	-0.6	-0.5
	EU-CEE 1)2)	*6.5*	*5.3*	*4.5*	*4.3*	*4.2*	*0.6*	*0.6*	*-0.1*	*-0.5*	*-0.6*
	EA-19 3)	*10.0*	*9.1*	*8.4*	*7.9*	*7.7*	*3.4*	*3.8*	*3.4*	*3.2*	*2.9*
	EU-28 3)	*8.6*	*7.6*	*6.9*	*6.4*	*6.2*	*2.0*	*2.5*	*2.1*	*1.9*	*1.6*
AL	Albania	15.2	13.7	12.4	12.2	12.0	-7.6	-7.5	-8.0	-7.2	-6.7
BA	Bosnia and Herzegovina	25.4	20.5	18.2	17.6	17.1	-4.7	-4.7	-4.6	-4.6	-4.5
ME	Montenegro	17.4	16.1	15.0	15.0	15.0	-16.2	-16.1	-16.1	-17.1	-17.2
MK	Macedonia	23.7	22.4	21.0	20.0	20.0	-2.8	-1.0	-0.8	-1.0	-1.0
RS	Serbia	15.2	13.6	13.3	13.0	12.0	-2.9	-5.3	-5.1	-4.8	-4.6
XK	Kosovo	27.5	30.5	28.0	26.0	24.0	-7.9	-6.1	-6.2	-6.3	-6.9
	WB 1)2)	*18.7*	*16.9*	*15.7*	*15.3*	*14.7*	*-4.8*	*-5.6*	*-5.5*	*-5.4*	*-5.3*
TR	Turkey	10.9	10.9	10.2	10.5	10.0	-3.8	-5.5	-4.8	-3.2	-3.2
BY	Belarus	5.8	5.6	4.7	4.5	4.5	-3.4	-1.6	-2.5	-2.8	-3.1
KZ	Kazakhstan	5.0	4.9	5.0	5.0	5.0	-6.5	-3.3	-0.9	-0.7	-1.2
RU	Russia	5.5	5.2	5.0	4.9	4.9	1.9	2.1	5.9	4.3	3.3
UA	Ukraine	9.3	9.5	8.9	8.5	8.3	-1.4	-2.2	-2.7	-3.1	-4.4
	CIS + Ukraine 1)2)	*6.1*	*5.9*	*5.6*	*5.5*	*5.4*	*0.8*	*1.3*	*4.6*	*3.2*	*2.2*
	V-4 1)2)	*5.9*	*4.7*	*3.7*	*3.6*	*3.5*	*0.7*	*0.6*	*0.1*	*-0.2*	*-0.3*
	BALT-3 1)2)	*8.2*	*7.3*	*6.7*	*6.1*	*5.8*	*0.6*	*1.4*	*0.2*	*-0.3*	*-0.7*
	SEE-9 1)2)	*11.2*	*9.7*	*8.9*	*8.7*	*8.5*	*-1.4*	*-1.6*	*-2.7*	*-3.2*	*-3.1*
	NON-EU-11 1)2)	*7.8*	*7.5*	*7.1*	*7.1*	*6.9*	*-1.0*	*-1.0*	*1.7*	*1.3*	*0.6*
	CESEE-22 1)2)	*7.4*	*7.0*	*6.5*	*6.4*	*6.3*	*-0.4*	*-0.4*	*1.0*	*0.6*	*0.1*

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 (October 2018).

2. CESEE economic outlook

2.1. CESEE OVERVIEW: ROBUST GROWTH IN THE FACE OF INCREASED NEGATIVE RISKS

by Olga Pindyuk

› *Across most of the region, growth will still be quite strong by post-crisis standards during the forecast period. Private consumption will remain the key growth driver as tight labour markets will further push up wages. High levels of capacity utilisation will spur increases in investment.*

› *However, 2018 has brought a slowdown in the GDP dynamics of most of the countries, with Turkey standing out as the worst-performing country. All the EU-CEE economies, apart from Hungary, Poland and Slovakia, started on the path of deceleration, with the biggest adjustment in the growth rate – 3 percentage points – taking place in Romania.*

› *A loss of momentum in the eurozone and other advanced economies presents a challenge to growth in CESEE– especially in those that are strongly integrated into the regional production chains and rely on exports in their growth models. This will become particularly apparent by the end of our forecast period: we have revised down our forecasts for 2020 for many countries, in particular for the EU-CEE sub-region.*

› *Domestic factors will also contribute to lower growth rates in the CESEE region, as the currently strong (for most) cyclical upswing fades. Only a few Western Balkan economies will keep up their current pace of growth, though that will remain rather moderate and not enough for significant convergence with wealthier parts of EU-CEE or Western Europe. Turkey will also bounce back from its current difficulties by 2020.*

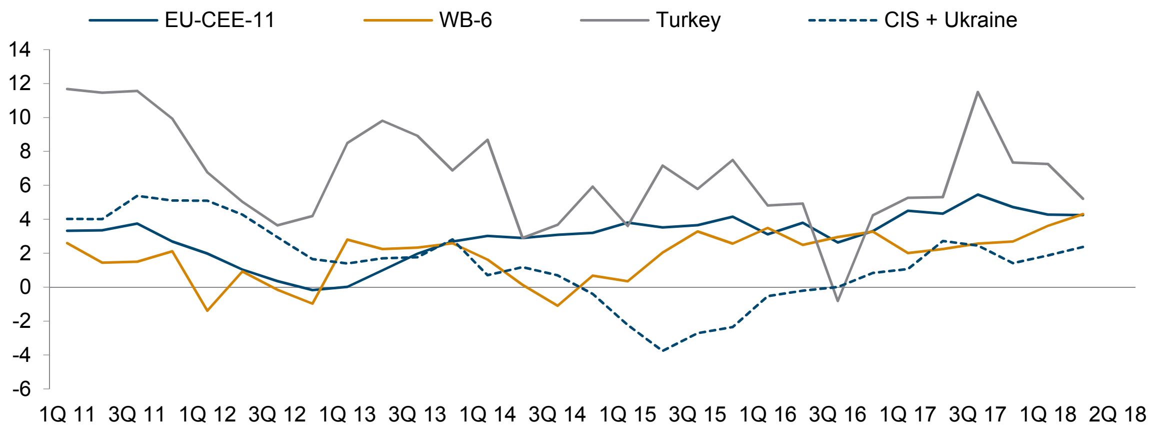
› *Russia will remain the economy facing the biggest challenges, and will continue to post very disappointing growth rates during the forecast period. In part, this will reflect the impact of international sanctions, although the main reasons for Russia's weak growth performance are domestic and structural in nature. Its problems will have negative spill-over effects for the rest of the CIS region as well.*

2.1.1. Still generally positive short-term trends, but regional growth will gradually tail off during the forecast period

The recent economic dynamics have been quite robust in almost all the countries of the region. In H1 2018, GDP growth either accelerated or remained steady across CESEE, except for Turkey. Among the EU-CEE countries, Hungary, Poland and Slovenia grew the fastest, with annual rates exceeding 4%. Croatia was an underperformer, as the only country in the group where GDP growth was below 3%. In the CIS + Ukraine group, Russia is an outlier, with persistently anaemic growth of below 2%, while the other three countries have been growing more dynamically. In most countries of the Western Balkans, growth in H1 2018 accelerated to above 4% year on year. The Serbian economy is the leader in the regional group, having expanded by around 5% year on year.

Figure 7 / Quarterly real GDP growth of the CESEE countries

change in % against preceding year



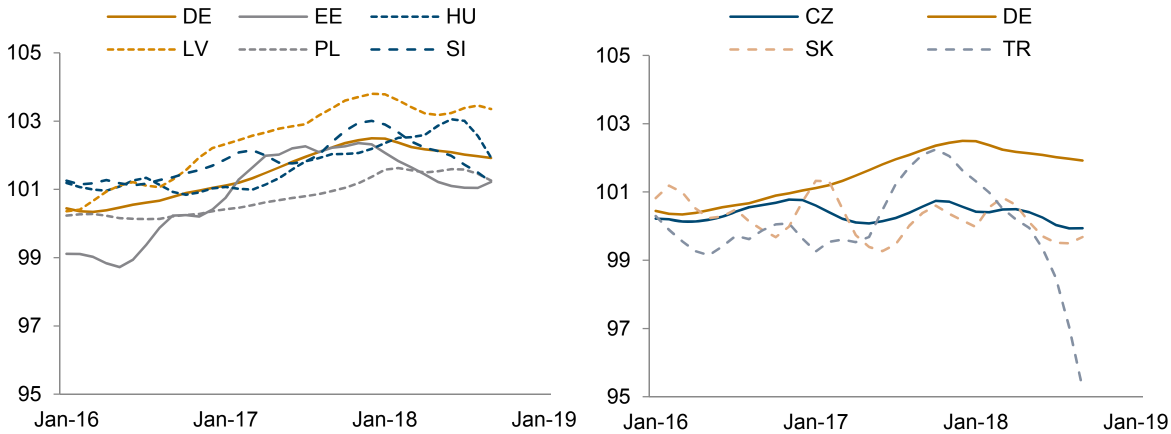
Source: wiiw Monthly Database incorporating national and Eurostat statistics, own calculation.

Though consumers and businesses remain optimistic overall,[9] their confidence has been dwindling. Both consumer and business confidence declined in Q2 2018, with businesses becoming on average more pessimistic than consumers about economic developments in the next 12 months. Most of the countries in our region that are covered by the OECD indices have business confidence falling below the level for Germany; moreover, companies in the Czech Republic, Slovakia and Turkey have become on average pessimistic about their prospects (their index values fell below 100). The consumer confidence index shows a different pattern – here all the countries apart from Turkey have more optimistic consumers than Germany. This probably reflects a robust growth in wages in most countries of CESEE.

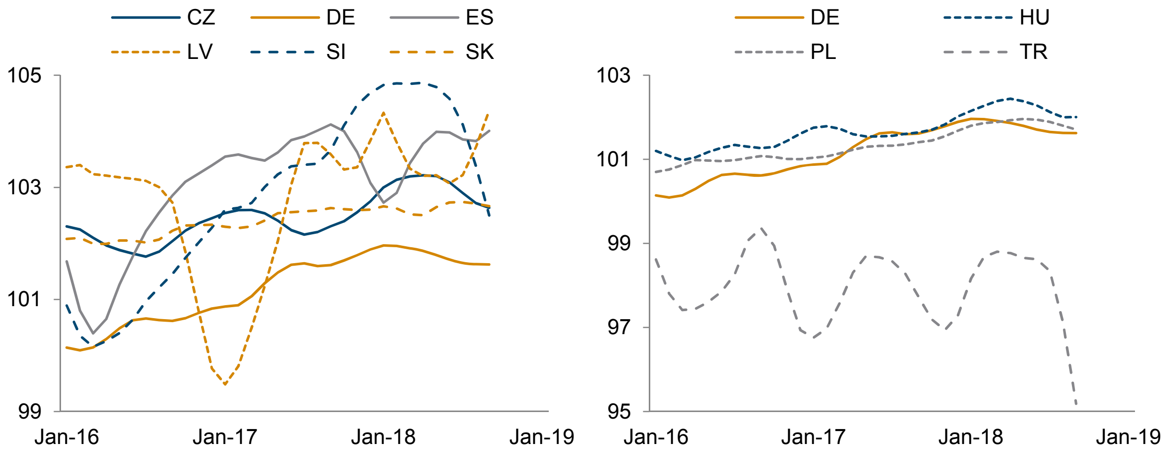
[9] According to the methodology of consumer and business confidence indices, numbers above 100 suggest optimism about future business performance / economic performance, respectively.

Figure 8 / Business and consumer confidence indices

Business confidence index



Consumer confidence index



Source: OECD, own calculation.

A less favourable external environment will exert negative pressure on the region's economies during the forecast period, and the current cyclical upswing will fade, but overall growth will remain robust in the medium run (see Table 2). The EU-CEE countries appear to be the most susceptible to a weakening of global growth, as for most of them the forecasts of 2020 GDP growth were revised downwards. Still, the average growth rate of that country group will stay above 3% during 2019-2020. Economies of the Western Balkans will grow at a similar rate during this period. We expect Turkey to recover from recession by the end of 2019 and to post 4% growth in 2020. Only the CIS + Ukraine region will lag behind, with an average growth rate of about 2% in 2019–2020, although it should be noted that this is heavily influenced by Russia: Belarus and Kazakhstan in particular are set to perform reasonably well.

Table 2 / Real GDP forecasts and revisions

		Forecast, %				Revisions, pp		
		2017	2018	2019	2020	2018	2019	2020
EU-CEE	BG	3.8	3.3	3.2	3.0	-0.2	-0.2	-0.1
	CZ	4.3	3.3	3.2	3.1	-0.4	-0.1	-0.1
	EE	4.9	3.5	3.1	2.7	0.0	0.0	-0.3
	HR	2.9	2.5	2.6	2.7	0.0	-0.1	-0.1
	HU	4.1	4.3	3.0	2.3	0.3	0.2	-0.1
	LT	4.1	3.5	3.0	2.6	0.2	0.0	0.0
	LV	4.6	4.1	3.3	3.0	0.2	-0.3	-0.1
	PL	4.8	5.0	3.5	3.3	1.2	0.0	0.0
	RO	7.3	3.8	3.6	3.7	-0.4	0.1	-0.1
	SI	4.9	4.5	3.6	3.5	-0.3	-0.1	-0.1
	SK	3.2	3.8	4.1	3.3	0.0	-0.1	0.0
Western Balkan	AL	3.8	4.1	4.0	4.0	0.3	-0.1	0.0
	BA	3.1	3.0	3.4	3.4	-0.3	0.1	0.1
	ME	4.7	4.2	3.1	3.1	1.0	-0.1	0.1
	MK	0.0	2.9	2.8	3.1	-0.6	-0.3	-0.2
	RS	2.0	4.3	3.4	2.8	0.7	0.4	0.0
	XK	3.7	4.2	4.0	4.2	0.3	0.2	0.4
Turkey	TR	7.4	2.5	1.0	4.0	-2.0	-3.1	0.0
CIS+UA	BY	2.4	3.7	3.0	2.8	-0.3	-0.7	-0.6
	KZ	4.1	4.0	3.1	3.0	0.0	0.1	0.0
	RU	1.5	1.7	1.6	1.8	0.2	0.0	0.1
	UA	2.5	3.3	2.7	2.0	0.0	-0.4	0.0

Remark: Current forecast and revisions relative to the wiiw Summer Forecast 2018. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

2.1.2. 2018: Poland leading the region, Turkey heading into recession

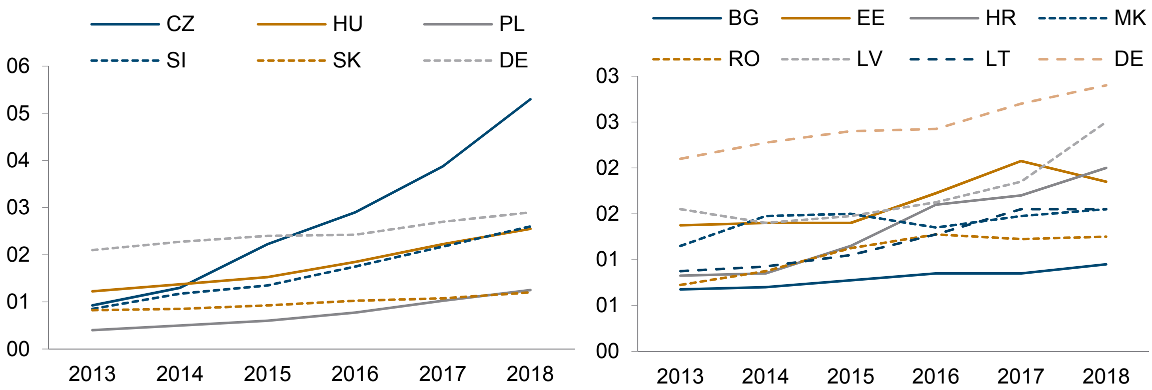
Although aggregate growth rates will dip a bit relative to 2017, the EU-CEE countries in particular are having another good year in 2018. We expect Poland to significantly outperform its peers in terms of economic growth in 2018. Its GDP growth rate is going to reach 5%, the best result since 2011. EU-CEE as a whole will achieve economic growth of 4.2% in 2018, closely followed by the Western Balkans with 3.8% growth. CIS + Ukraine show more modest performance, with an average growth rate of 2.2%. However, this is largely due to Russia's continuously disappointing dynamics: Belarus, Kazakhstan and Ukraine are all growing at rates of between 3% and 4%.

Turkey is undergoing its worst crisis in a decade, reflecting long-standing structural vulnerabilities. It was triggered by higher US interest rates and the subsequent withdrawal of investors from the risky emerging markets. Big external imbalances made Turkey highly vulnerable to capital flow reversals, and the Turkish lira has depreciated sharply. Growth in 2018 is going to be only modestly positive, as the economy will experience a significant drop in output in H2 2018.

Russia and Kazakhstan are continuing to benefit from higher global oil prices, reflecting lower output in some parts of the world and still-buoyant global economic growth (see Global and eurozone outlook). Oil output in both countries will rise to new record highs, in particular helped by an agreement between Russia and OPEC to increase oil production. Rising export revenues are helping Russia to offset somewhat the negative effect of the newly introduced US sanctions.

Labour shortages will be felt in many CESEE countries. Although this is starting to feed through into quite strong wage growth, the difficulty of finding workers is an increasingly important barrier to growth. In H1 2018, job vacancy rates[10] increased in all countries for which data are available, apart from Estonia. Even in Macedonia, which suffers from extremely high unemployment, there was a slight increase in the job vacancy rate. The Czech Republic, which has moved close to full employment, had an unprecedentedly high job vacancy rate of 5.3%. Although labour shortages are not new, vacancy rates in some of the EU-CEE countries suggest a highly unusual situation that is increasingly acute. In the Western Balkans, which are characterised by extreme unemployment, a lack of skilled labour has become more prominent – largely a result of the significant emigration of high-skilled workers. Ukraine is another country that suffers from the effects of massive labour emigration.

Figure 9 / Job vacancy rate, in %



Remark: Data for 2018 are an average of two quarters.
Source: Eurostat.

Increasing demand for labour, in particular for skilled labour, will continue to push real wages upward in most countries (Astrov et al., 2016). We expect the highest real wage growth in 2018 to take place in Belarus (where the government has hiked public sector wages) and Ukraine (where the official minimum wage has been raised). In EU-CEE, real wage growth will range from 2% in Slovenia to 8.5% in Hungary, and in many countries it will be even higher than in 2017. The only exceptions to this trend are Montenegro and Turkey. Falling wages in the former country are caused primarily by the fiscal consolidation policy needed to afford an ambitious highway construction project. In Turkey, the double-digit inflation rate accompanying lira depreciation is to blame.

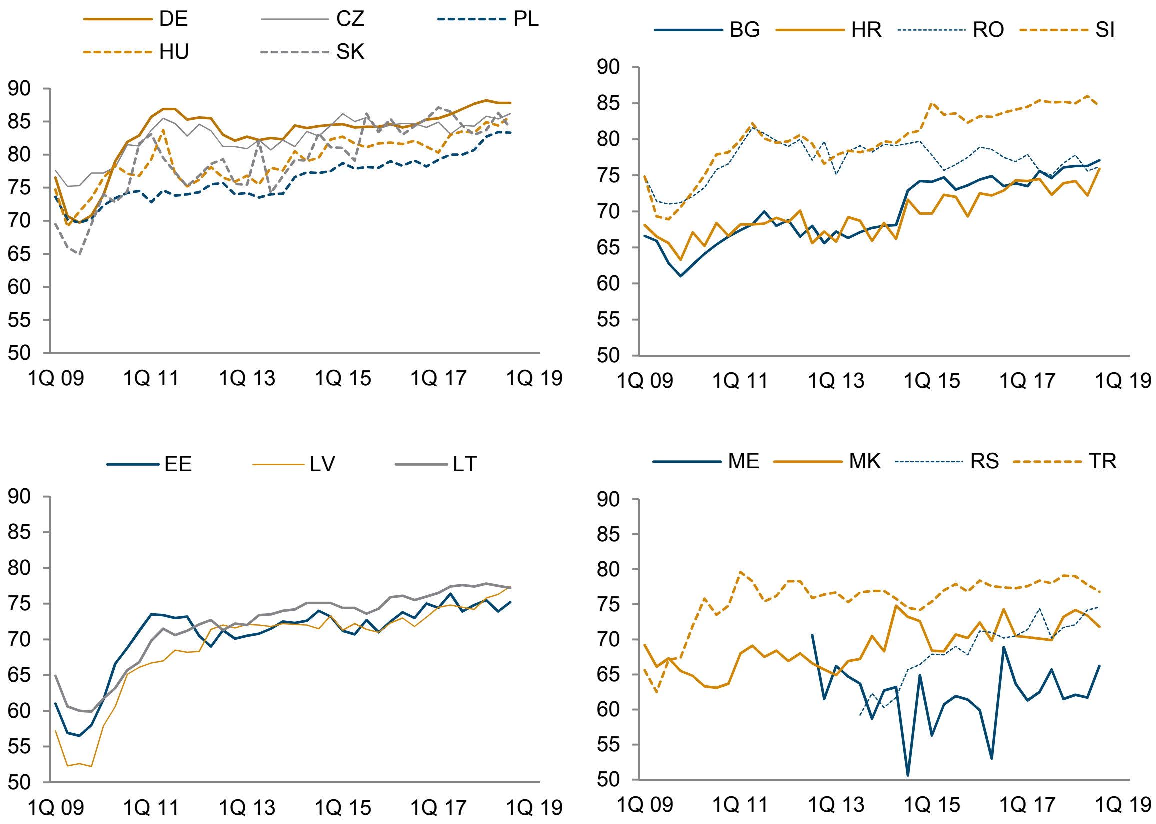
The high level of capacity utilisation and the tight labour markets in EU-CEE are pushing companies to increase investment in capital-intensive technologies, and we are cautiously optimistic that this trend will continue (Grieveson, 2018). Capacity utilisation has been on the rise in

[10] The job vacancy rate measures the proportion of total posts that are vacant, expressed as a percentage; it can be interpreted as an indication of unmet labour demand. Comparison of job vacancy rates across countries can be misleading, due to country-specific definitions of a job vacancy; nevertheless the within-country dynamics of the indicator is quite informative.

most of the countries and has almost reached the pre-crisis levels, with the Czech Republic nearly catching Germany up in this regard. Gross fixed capital formation has grown rapidly in 2018, supported in addition by resources from the EU Cohesion Fund – particularly important for Poland and Hungary, where the unfavourable political climate and escalating conflicts with the EU Commission are discouraging private investment; the governments have been front-loading EU fund disbursements in anticipation of future cuts (for more details, see the respective country reports).

Figure 10 / Current level of capacity utilisation, %

Seasonally adjusted

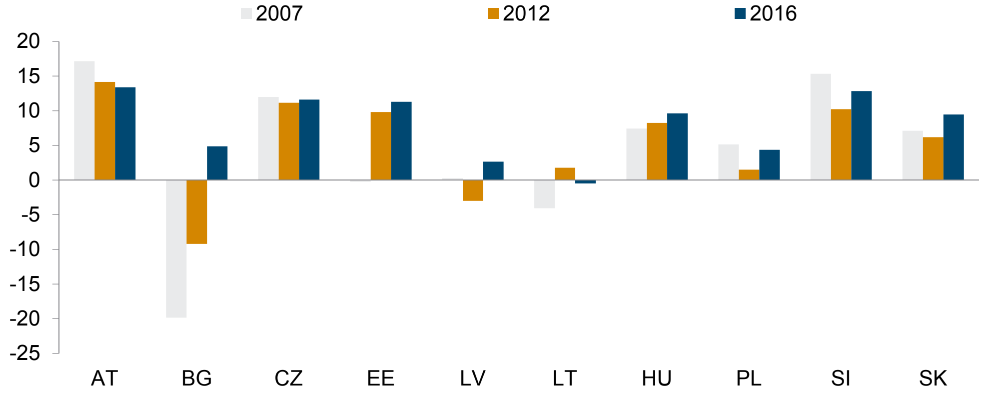


Source: Eurostat statistics.

As has been the case in recent years, in 2018 rising wages in EU-CEE have fed through into inflation only to a limited extent. The precise reasons for this are not fully clear, but one factor is likely to be rising household saving rates across EU-CEE (see Figure 11). In 2016, saving rates increased compared to 2012 in all EU-CEE countries apart from Lithuania, and we think that this trend has probably continued or even intensified since. Slovenia, the Czech Republic and Estonia topped the household saving rates in the regional group, reaching almost the level of Austria (which tends to have quite a high savings rate). Another contributory factor could be outflows of remittances from the countries that have large proportions of immigrant workers (who often send a significant share of their wages to their relatives back home). In addition to rising numbers of Ukrainian workers in Poland and the Czech Republic, there has been quite a big increase in intra-CESEE migration in the last few years: Serbs migrating to work in Slovakia, Bosnians to Slovenia, and so on (Podkaminer, 2018).

Figure 11 / Gross household saving rate, %

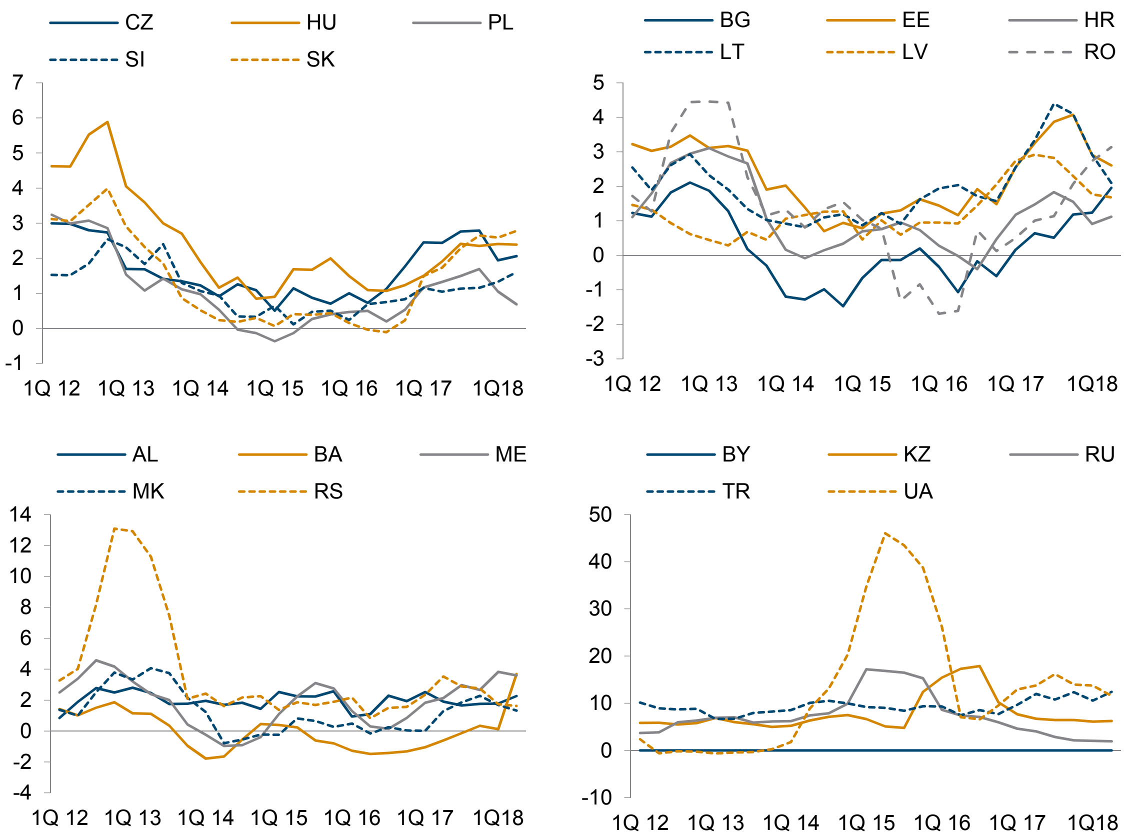
Households and non-profit institutions serving households



Source: Eurostat.

Figure 12 / Core inflation (HICP/COICOP), overall index excluding energy

change in % against preceding year

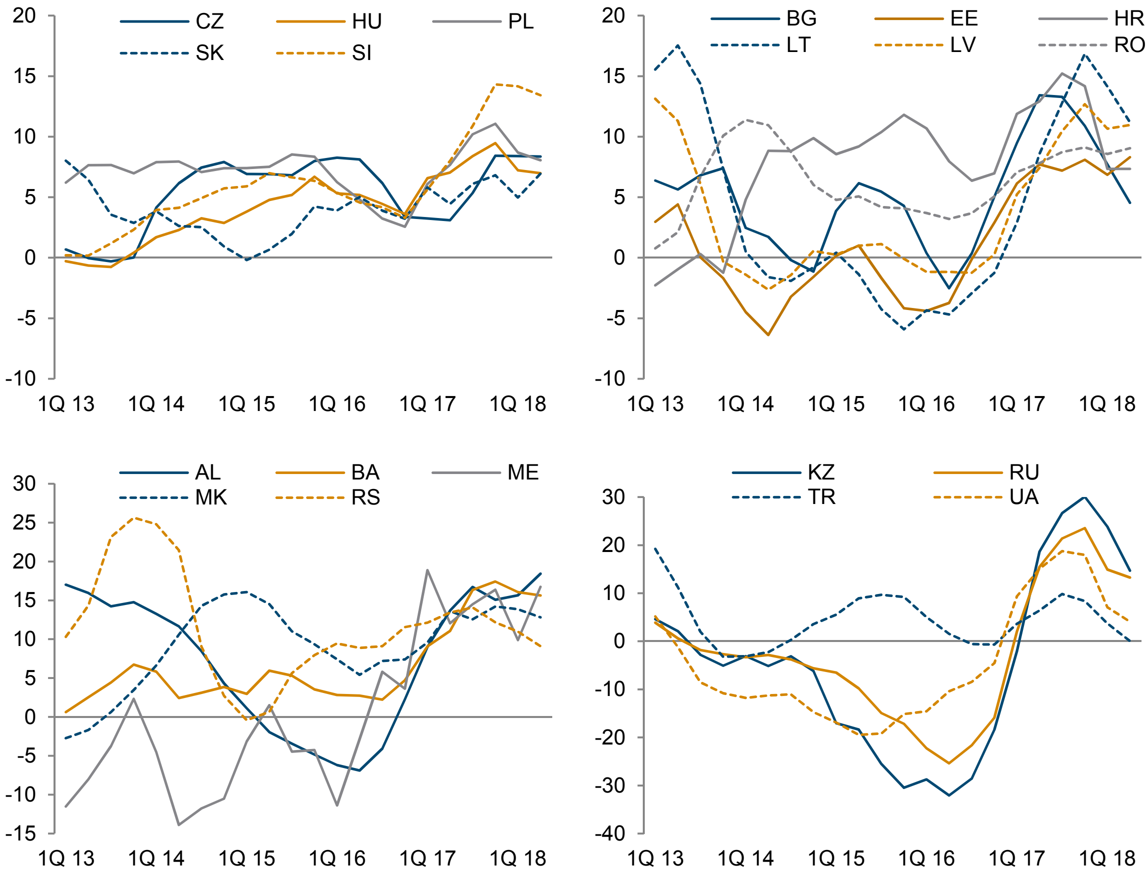


Remark: Core inflation: refers to the overall Harmonised Index of Consumer Prices (HICP), excluding energy; according to the UN Classification of Individual Consumption by Purpose (COICOP), energy comprises: 045 Electricity, gas and other fuels and 0722 Fuels and lubricants for personal transport.
Source: Eurostat and national statistics.

Core inflation (headline inflation minus energy) remains rather low in most countries, except for Kazakhstan, Ukraine and Turkey, which have experienced depreciation of their currencies (see Figure 12). However, energy prices have been rising strongly in a year-on-year comparison, pushing up inflation rates across much of the region. Turkey and Ukraine are expected to have double-digit annual consumer price index (CPI) growth in 2018. Romania stands out in the EU-CEE sub-region as a country with the highest inflation, the main cause being excess demand under rather loose fiscal and monetary conditions. Over the past two years, inflation-targeting central banks in EU-CEE (the Czech Republic, Hungary, Poland and Romania) have allowed real interest rates (CPI-adjusted) to trend generally downwards and into negative territory, which signals that they are not expecting inflationary pressures to rise significantly.

Figure 13 / Exports of goods (custom statistics) growth, %

4 quarters moving average



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

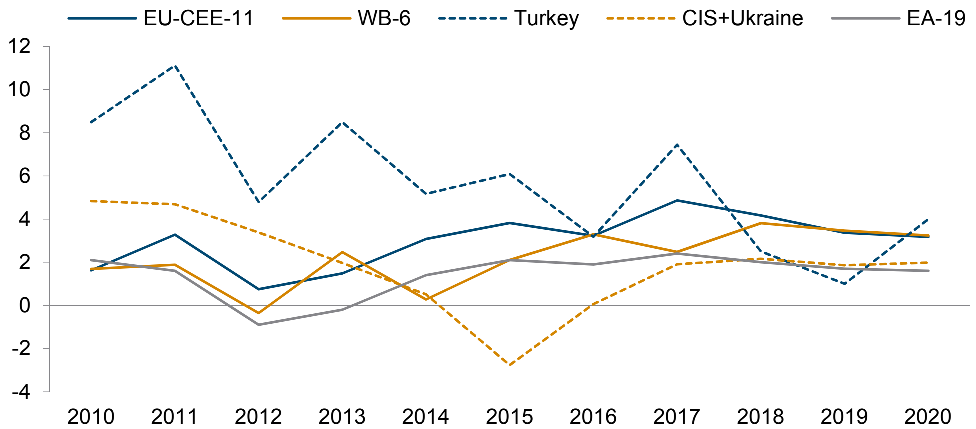
Household consumption will again make the biggest contribution to GDP growth in 2018, while net exports will contribute negatively in most countries, reflecting strong domestic demand (both consumption and investment) and some slackening of external demand. In EU-CEE, only two countries – Slovakia and Slovenia – will have positive contributions of net exports. Still, all the countries in our region apart from Bulgaria and Kosovo will expand their exports in nominal euro terms. The most dynamic growth will be achieved in oil exporters Russia and Kazakhstan, as well as in Albania, Macedonia, Montenegro and Serbia. Albania and Montenegro have benefited from a booming tourism season, while in Serbia and Macedonia increased integration into European supply chains has played the biggest role. However, the nominal growth of imports will exceed that of exports in most of the countries, on the back of expanding consumer and investment demand.

2.1.3. Medium-term outlook: settling down with moderate growth

In 2019–2020, most economies of the region will grow at a robust rate, but will gradually lose the impetus to growth. Both the EU-CEE sub-region and the Western Balkans will mirror the decelerating trend of the eurozone and will grow on average at about 3% per year (see Figure 14). This is a healthy growth rate in the post-crisis context, as it exceeds the average growth rates in 2010–2017 – 2.8% for EU-CEE and 1.7% for WB; but it is significantly lower than before the global economic crisis, reflecting generally disappointing productivity growth trends over the past decade (at least partly linked to the post-crisis collapse in investment across much of the region). Growth in CIS + Ukraine will be lower than in the rest of the region, barely reaching 2% per year during 2019–2020; this will mostly be due to disappointing performance by the Russian and Ukrainian economies. Only Turkey will see its GDP grow faster in 2020 than in 2019, but this will represent a bounce-back from a short-lived crisis. Over the medium term, Turkey is also unlikely to repeat the bumper growth rates of recent years.

Figure 14 / Real GDP growth in 2017–2020

change in % against preceding year

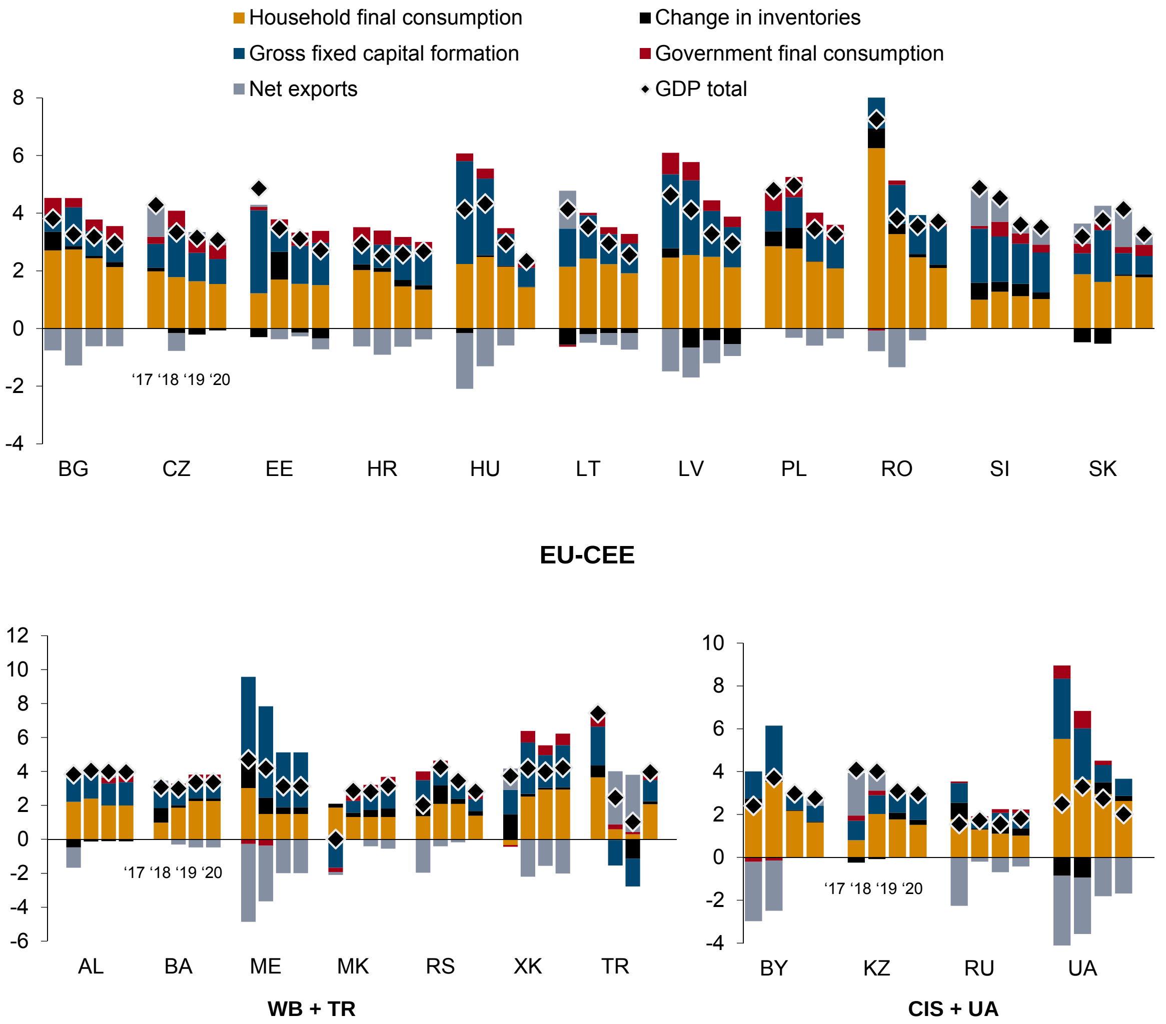


Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The region will grow more dynamically than the eurozone, though the growth rate differential will slowly decrease from 2.3 percentage points in 2017 to 1.6 percentage points by 2020. This will mean deceleration of convergence of the EU-CEE countries and the Western Balkans with the more affluent EU Member States (see CESEE convergence monitor). In case of the Western Balkans, growth of 3% per annum will mean that their catching-up process will be much slower than that of the EU-CEE countries when they had similar levels of GDP per capita. This reduces the prospects of their catching up even with EU-CEE, let alone with Western Europe. Thus, the push factors of emigration are likely to remain strong in the medium run.

Figure 15 / GDP growth in 2017–2020

and contribution of individual demand components in percentage points



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

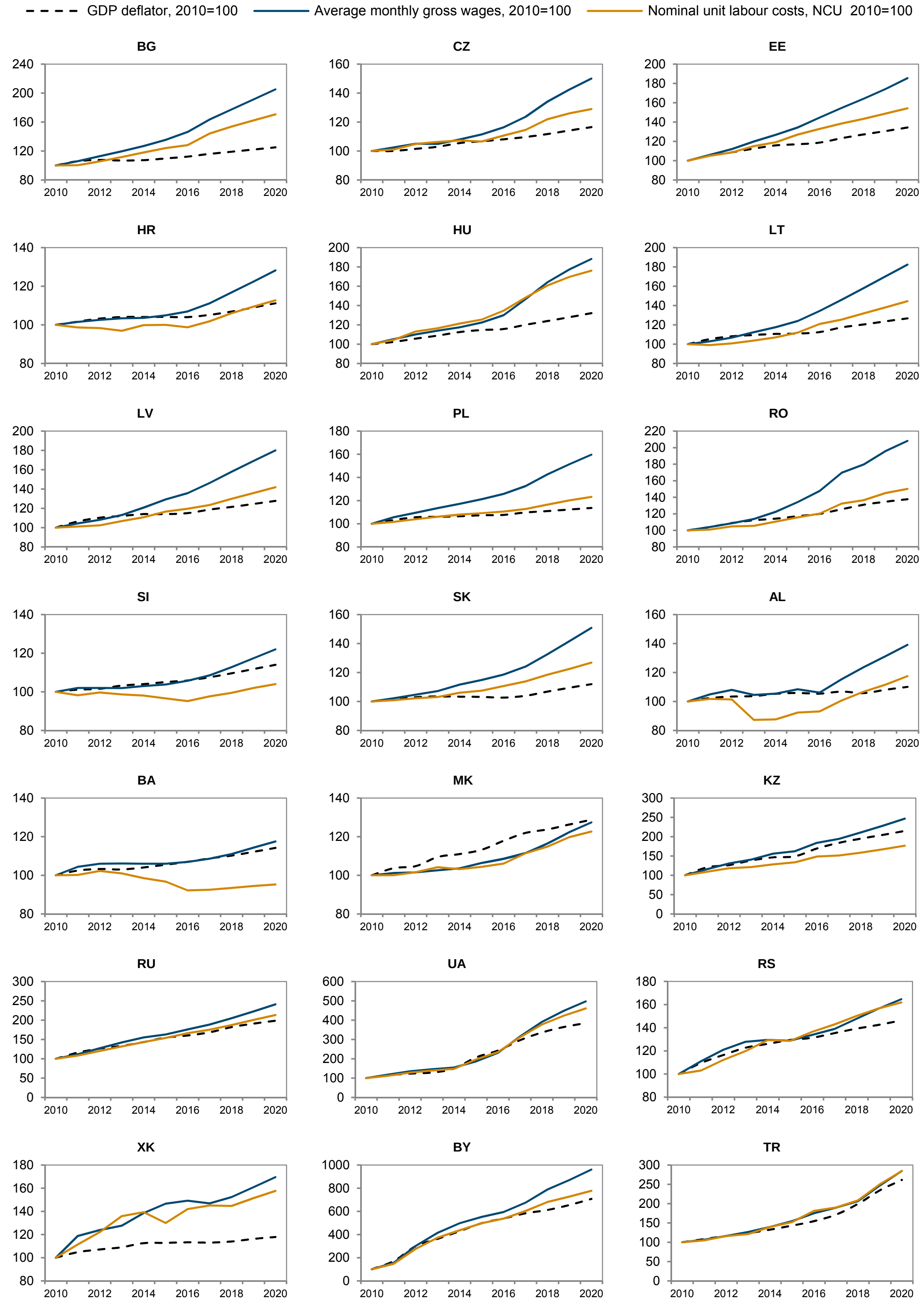
Both domestic and external factors will play a role in the slowdown of economic growth. Tight labour markets present a constraint on growth in EU-CEE, and judging by rising vacancy rates, an influx of immigrant workers will not be sufficient to solve the problem. The long-run impact of the effects of labour shortages depends on how strongly wages and investment in capital-intensive technologies grow in response. In the case of the Western Balkans, a skills mismatch in the labour market will become more prominent, aggravated by large-scale emigration by the most skilled workers. The positive effects of increased remittances on consumption will not compensate for the impact of structural issues. In the CIS + Ukraine, economic development is slowed by insufficient reforms, as well as by geopolitical tensions in the case of Russia. Apart from the controversial pension reform, so far there has been little progress in reforming institutions, infrastructure, innovation and the investment climate – the so-called 'four I's' – that were cornerstones of the reform programme announced 10 years ago by former President Medvedev. Growing popular dissatisfaction with economic conditions and the vested interests of the elites are likely to cause further postponement of the necessary reforms.

The potential for a slowdown in global growth (see Global and eurozone outlook) **will affect most strongly those economies with a high share of exports in their GDP.** In particular, this applies to the Visegrád countries, which – though heavily integrated into the German supply chain – depend mainly on global demand (Astrov et al., 2018: 12-13). Exports from these countries to Germany tend to be of intermediate goods, with the final demand being in places like China and the US. The Baltic States are also particularly open economies in the CESEE region. Russia and Kazakhstan will experience a significant decline in export growth rates, as the upward trend in world oil prices is interrupted.

Private consumption will decelerate following wage-growth slowdown across the region, but will remain the main growth determinant through the forecast period (to a large extent because of its high share in GDP almost everywhere). Though labour shortages will persist during 2019–2020, wage increases in EU-CEE will be constrained by increased labour market flexibility and creation of a two-tier labour market that reduces workers' bargaining power, especially among lower-skilled employees (Astrov, 2018). Labour productivity has increased as wages have risen more quickly than unit labour costs in most places (see Figure 16), especially in EU-CEE, where labour shortages are most acute. Investment in more capital-intensive technologies would help further raise productivity and might serve as a solution to the demographic trap.

Fiscal consolidation is less of a barrier to growth than in the immediate post-crisis period, but tightening undertaken in some of the countries will be another factor to have a dampening effect on private consumption. This will be the case in Bulgaria, Croatia, the Czech Republic, Slovakia, Slovenia and Montenegro, which are pursuing the goal of reducing the public debt. Given the relatively low shares of debt in GDP in Bulgaria, the Czech Republic and Slovakia, we consider contractionary fiscal policies to be inadvisable in a situation of economic growth slowdown.

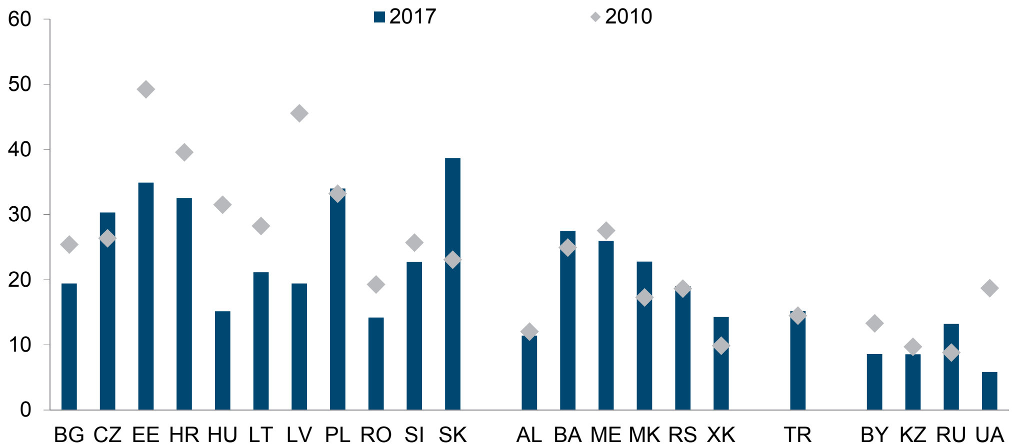
Figure 16 / Wages, unit labour costs and inflation, 2010–2020



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

Loans to households will expand only moderately in most of the countries and thus will not have a significant effect on consumption. Loan penetration remains quite low throughout the region after the post-crisis deleveraging, in particular in the Western Balkans and CIS + Ukraine. Among EU-CEE countries, only the Czech Republic, Poland and Slovakia have higher shares of loans to households in GDP than in 2010. Deleveraging in the Baltic states and Hungary has been dramatic, and their credit markets have not fully recovered yet. Only the CIS countries and Ukraine have experienced a significant increase in loans to households (see Credit monitor) – in these countries, loans are an important factor behind private consumption growth. This situation might pose risks to the sustainability of consumer-loan dynamics, especially in the case of Kazakhstan and Russia, where a rise in household consumption has largely been financed by credit.

Figure 17 / Stock of bank loans to households, as % of GDP



Notes: Data for BG, CZ, RO, SK, AL including non-profit institutions serving households.
Source: wiiw Monthly Database incorporating national and Eurostat statistics, own calculations.

Over the medium term, high capacity utilisation will create a stimulus for the continuation of investment growth in most of the countries. A particularly high contribution of gross fixed capital formation to growth will be seen in Poland, the Czech Republic, Slovenia and the Western Balkan states. Slovakia will see a marked slowdown in investment growth in 2020, as the Jaguar project is finalised. Hungary will undergo a dramatic trend reversal in 2020, as previous rapid investment growth took place primarily on the back of accelerated utilisation of EU funds, which will be exhausted by then.

Overall, according to our forecast most of the economies in the CESEE region will grow at healthy rates of 3–4% during 2018–2020. They will outperform the eurozone in terms of the pace of growth, but will lag behind emerging-market and developing economies, which are projected to grow at rates close to 5%.[11] The CIS + Ukraine will show the most disappointing growth dynamics, primarily due to slow progress with reforms, while Turkey will undergo a short-lived but significant economic slowdown.

[11] The forecast for emerging markets and developing economies is taken from the IMF World Economic Outlook, October 2018.

However, negative risks to economic growth are mounting, as the external environment deteriorates (see the CESEE risk matrix). In particular, the probability of a global trade war has been increasing, and there has been a lack of reforms in the eurozone. If those risks were to materialise, that would have a significant negative effect on the economic prospects of the CESEE region.

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