MAY 2020

Monthly Report: Special Forecast Update

Looking for Shelter from the Storm

Economic Forecasts for Eastern Europe for 2020-21

The Vienna Institute for International Economic Studies
Wiener Institut für Internationale Wirtschaftsvergleiche

Looking for Shelter from the Storm

Economic Forecasts for Eastern Europe for 2020-21

RICHARD GRIEVESON

et al. (including Vasily Astrov, Alexandra Bykova, Rumen Dobrinsky, Doris Hanzl-Weiss, Gábor Hunya, Sebastian Leitner, Isilda Mara, Olga Pindyuk, Leon Podkaminer, Sándor Richter, Bernd Christoph Ströhm and Hermine Vidovic)

The authors of this report wish to thank Nadya Heger, Beate Muck, Monika Schwarzhappel, Galina Vasaros and David Zenz for statistical assistance, as well as Clive Liddiard for language editing and Michaela Bönisch for formatting.

Press date: 6 May 2020

Executive summary

The International Monetary Fund (IMF) projects that the current crisis will be the worst for the global economy in peacetime since the 1930s. All of CESEE's main trading partners and all its sources of tourism and capital inflows will suffer severe recessions.

The economic downturn caused by the Coronavirus in CESEE will be worse than the aftermath of the 2008 global financial crisis. wiiw projects a weighted average real GDP decline for CESEE in 2020 of 6.1%, compared with 5.6% in 2009. The biggest real GDP contractions in 2020 are expected to be in Croatia, Slovakia, Slovenia and Montenegro. This reflects either a high degree of vulnerability to global trade disruption and/or a particular reliance on tourism. All CESEE countries will record real GDP contractions of at least 3% this year.

CESEE countries have generally had far fewer cases of Coronavirus and far fewer deaths from it than Western Europe. However, the weakness of their healthcare systems means that they have almost all introduced strict lockdown measures, which will have severe knock-on consequences for economic life. Some will be able to loosen fiscal policy considerably to mitigate the downturn, but most CESEE economies have quite limited external financing options. As fiscal deficits widen and nominal growth collapses, public debt/GDP ratios will rise sharply.

The most likely scenario for CESEE economies is a deep contraction now, followed by a gradual easing of restrictions on economic life in the second half of 2020 and 2021. Nevertheless, this recovery will be bumpy (potentially including a reintroduction of some lockdown measures, if infection rates start to rise again), and a full return to normal economic life will have to wait until a mass vaccine is rolled out (probably mid- to late 2021). The politics and economics of restarting economic life are likely to be much more challenging than the imposition of the initial lockdowns.

The key global central banks have reacted strongly, effectively backstopping the global financial system and ensuring a degree of stability. However, the reliance of Ukraine, Moldova and many Western Balkan countries on large-scale capital inflows will cause particular stresses in those countries. Here, the role of the International Monetary Fund, the European Bank for Reconstruction and Development, the EU and Western parent banks will be key to avoiding worst-case scenarios.

Many Western countries have also announced big fiscal plans; but a serious, coordinated response from the euro area would appear to present something of a challenge. Those CESEE economies with particularly close links to Italy (those in Southeast Europe) will suffer because of it.

This is a crisis without precedent in the post-transition period, and our forecasts are subject to an unusually high degree of uncertainty. A far more negative scenario than our baseline is, unfortunately, possible. This would include a mixture of second/third waves of the virus, a longer-than-expected wait for a vaccine, and serious policy missteps in the US or Europe.

Over the medium term, the crisis will fundamentally change many aspects of the economies of CESEE, with both positive and negative implications. Consumers are likely to remain cautious and save more long after the acute phase of the crisis has passed. Demographic decline, persistently weak oil prices, competition from online retail and higher debt will combine to keep inflation (and therefore interest rates) lower for longer. Tax rates are likely to rise in CESEE to finance higher public debt, and in general the state will play a bigger role in economic life. Many parts of CESEE could benefit from 'near-shoring' of production by Western firms, while the sharp increase in online activity as a result of the crisis could also prompt more outsourcing of services to the region. With the EU focused on internal issues, and Russia's fiscal resources limited, China is likely to continue to play an important economic role in CESEE.

COUNTRY SUMMARIES

ALBANIA

The Albanian economy contracted in the last quarter of last year, due to a devastating earthquake on 26 November 2019. The COVID-19 crisis has thus affected an economy with limited liquidity buffers. There will be a negative impact on the current account, as tourism – a driver of growth over the past two years – becomes a drag on the economy. Foreign direct investment (FDI) and remittance flows will likely shrink. The economy will contract by 5% in 2020, due to a fall in domestic and external demand, but will rebound by 4% in 2021.

BELARUS

Defying the COVID-19 threat, Belarus has not yet declared a formal lockdown. The economic fallout from the pandemic has been increasing through both internal and external transmission channels. Rather late in the day, the authorities have launched a series of policy support measures, but their funding will depend on the government's ability to raise additional external finance. A notable downturn seems inevitable in 2020, with GDP falling by more than 5%.

BOSNIA AND HERZEGOVINA

The shutdown caused by the COVID-19 pandemic is severely jeopardising business in the tourism, hospitality, manufacturing and transport sectors throughout BiH. The country's structure means it has limited fiscal scope to mitigate the economic fallout and is reliant on foreign aid and loans. It also needs to cope with plummeting demand for products and services. The repercussions of the pandemic will be evident in 2020, with GDP contracting by 5%. The economy will recover somewhat in 2021, by 3%.

BULGARIA

The spread of the COVID-19 infection in Bulgaria has been relatively limited, but the country has been under lockdown since mid-March. The economic fallout from the pandemic is widespread, affecting a large number of sectors. The government launched a package of fiscal support measures, but their effectiveness is in doubt, especially as regards employment protection. Overall, we expect GDP to drop by more than 6% in 2020; this will be coupled with a surge in unemployment.

CROATIA

Croatia's authorities responded quickly to the pandemic and launched comprehensive stimulus packages to mitigate its effects. Given the serious decline in earnings from tourism, a major pillar of the country's economy, wiiw estimates that GDP will contract by about 11% in 2020. A moderate upswing of 4% is expected in 2021. Despite the challenging conditions, the Croatian authorities are continuing their preparations to enter ERM II as a precondition for adoption of the euro.

CZECH REPUBLIC

Fiscal and monetary policy moves cannot neutralise the effects of the slump in external demand for the products of the automotive industry, the economy's most important sector. Progressive easing of the epidemic-related restrictions will limit the damage to those sectors dependent on domestic sales. The deep recession – inevitable in 2020 – will be moderated by the strong devaluation of the domestic currency. The economic fundamentals will remain strong, enabling a recovery in 2021.

ESTONIA

The restrictions imposed in Estonia have been relatively light, and the government announced a rescue package worth 7% of GDP back in mid-March. However, the initial figures show that also in Estonia not only export-oriented production is contracting sharply, but also domestic demand. Apart from catering and tourism, transport and many manufacturing sectors are also likely to suffer. We expect Estonian GDP to decline by 7% in 2020, and forecast an upswing of 4% in 2021.

HUNGARY

The country's crisis management efforts consist primarily of a big reshuffle of budgetary expenditure and revenue, but the real fiscal stimulus will be only 1-2% of GDP. The government is introducing a limited version of income replacement subsidy. There is a moratorium on the repayment of both household and business loans. wiiw expects a decline in GDP of 5.5% in 2020, with 2% growth in 2021. The fiscal deficit will amount to at least 5% relative to GDP. The HUF will remain volatile and weak.

KAZAKHSTAN

A large part of the deterioration in Kazakhstan's economic performance will be due to the trade sector and the disruption it has faced in the wake of the Coronavirus restrictions. The low oil prices also mean that export earnings will plunge, draining budget revenues and putting pressure on the tenge. A large government support package, coupled with administrative measures, will go some way towards mitigating the shocks to the economy and the labour market. Because of a good performance in the first quarter, we expect GDP to decline by only 3% in 2020. The recovery next year is anticipated to be weak, at 2%, with low consumption growth and only a partial rebound in exports.

KOSOVO

The political unrest continues unabated, despite the COVID-19 emergency. Given the high exposure of Kosovo to Germany and Switzerland – especially as concerns remittances, foreign direct investment and exports – the downside effect of the lockdown will be felt strongly. International financial support will, in part, come to the rescue. Still the economy is expected to contract by more than 4% in 2020.

LATVIA

Government restrictions on shopping and restaurants have been relatively liberal in Latvia, but that will not prevent economic activity from declining sharply in 2020, compared to last year. We expect GDP to drop by 8.5% this year. The substantial government support package – amounting to 7% of GDP – will help the revival of domestic demand. Thus, we forecast GDP to grow again in 2021, by 4.5%.

LITHUANIA

Figures for the first quarter of 2020 show that the Lithuanian economy was in a high gear before foreign and domestic demand collapsed. The Lithuanian government reacted in tandem with the Lithuanian national bank to provide liquidity, income support and funding for infrastructure projects, through a rescue package worth almost 10% of GDP. We forecast the Lithuanian economy to shrink by 6.5% in 2020. The predicted revival of 4.3% in 2021 will depend upon the speed of recovery in manufacturing among the country's European trading partners.

MOLDOVA

While Moldova's exposure to COVID-19 has been relatively modest, its health system is underdeveloped and the fiscal resources it has at its disposal to deal with the consequences are equally modest. The World Bank, EU and WHO are all providing technical and financial support. GDP is expected to drop by 3% in 2020, and unemployment to jump to 9%. Government actions have mainly come in the form of tax allowances; handouts to business are few and far between. Preferential loans from international institutions and from Russia will cover the country's external financial needs.

MONTENEGRO

The COVID-19 pandemic is taking its toll on Montenegro, with reduced economic activity leading to lower investment and fewer exports. Personal consumption is expected to slow in 2020. Meanwhile, government consumption will increase, in order to mitigate the fallout from the pandemic. This will alter the government's planned path of debt reduction in 2020. Particularly in light of the imminent deep downturn in Montenegro's over-dominant tourist industry, the country's economy is expected to contract by 8% in 2020, to be followed in 2021 by 5% GDP growth.

NORTH MACEDONIA

North Macedonia's foreign trade market will likely underperform in 2020, as output is closely linked to the crisis-hit European car industry. GDP is expected to decline by 5% this year, due to lack of demand – both domestic and external. The expected recovery in 2021 will depend greatly on whether public investment picks up. Weak imports will lead to a reduction in North Macedonia's current account deficit in 2020 and 2021.

POLAND

The fiscal measures actually implemented are proving untimely and inadequate, in view of the strain felt throughout the private sector. However, the determined monetary-policy response to the Coronavirus epidemic, combined with a sharp currency devaluation, should limit the damage to the economy. But managing the ongoing crisis in health care and the economy is not the top priority for the government: its primary concern is to secure the president's re-election, by fair means or foul.

ROMANIA

The health system was ill-prepared to deal with the Coronavirus pandemic, and the government responded with strict lockdown measures that are unlikely to be lifted much before July. The economic impact will be a GDP decline of about 7% and a fiscal deficit of some 9% of GDP. The rising cost of external financing limits the government's scope for supporting economic recovery.

RUSSIA

The Russian economy is facing a double shock, with the Coronavirus crisis and collapsing oil prices. As a result, budget and current account surpluses are likely to be things of the past. Real GDP is expected to drop by 7% in 2020 and to recover only modestly next year. The fiscal stimulus enacted so far is only 2.8% of GDP, while monetary policy easing is unlikely to have much effect, given the anaemic demand for credit.

SERBIA

The economy will suffer badly this year from the Coronavirus fallout, and we expect a full-year decline in real GDP of 4%. This will be less severe than in many other CESEE countries, reflecting in part the government's quite ambitious fiscal stimulus plans, and a much lower reliance on tourism in Serbia than in some of its regional peers. Foreign direct investment (FDI) and exports will suffer badly this year and next, but thereafter could benefit from 'near-shoring' by Western European investors.

SLOVAKIA

The outlook for Slovakia is grim, with GDP forecast to drop by about 9% in 2020 (recovering somewhat in 2021, by 4.6%). Worldwide, the automotive industry is particularly badly affected by the COVID-19 crisis, and that goes for Slovakia, too – all four car companies have been closed since mid-March. A new government took over in the midst of the crisis, and is now focusing on fighting it.

SLOVENIA

The Coronavirus pandemic will probably hit the Slovenian economy even harder than the financial crisis did. Tourism, transport, retail trade and the export-oriented sectors will be most affected. Despite the adoption of two stimulus packages, GDP is expected to decline by 9.5% in 2020; this will be coupled with rising public debt and increased unemployment. In 2021, we expect a modest improvement, as foreign and domestic demand picks up slowly.

TURKEY

Having only just recovered from the 2018 lira collapse, Turkey finds itself back in the midst of yet another crisis. The Coronavirus will present huge challenges for the economy, and we expect real GDP to decline by 6% this year. Capital flight from emerging markets is at an all-time high, and this presents serious risks for Turkey's ability to meet its external debt commitments. However, if the immediate crisis is weathered, the recovery in Turkey should be strong.

UKRAINE

The Ukrainian economy will be hit quite hard by the Coronavirus crisis – in 2020, GDP will fall by 6%, due to plummeting private consumption and investment. The government needs International Monetary Fund (IMF) assistance to finance the large budget deficit and debt repayments, which will peak in 2020. Inflation will be moderate during 2020-2021, and only a slight depreciation of the hryvnia is expected. One major risk to the forecast is that the government may not be able to secure the IMF loan.

Keywords: CESEE, economic forecast, Europe, Central and Eastern Europe, Southeast Europe, Western Balkans, new EU Member States, EU, CEE, SEE, CIS, Russia, Ukraine, Romania, Czech Republic, Hungary, Turkey, Serbia, China, US, convergence, business cycle, coronavirus, external risks, trade war, EU funds, private consumption, credit, investment, digitalisation, servitisation, exports, FDI, labour markets, unemployment, employment, wage growth, migration, inflation, central banks, monetary policy, fiscal policy

JEL classification: E20, E31, E32, F15, F21, F22, F32, F51, G21, H60, J20, J30, J61, O47, O52, O57, P24, P27, P33, P52

CONTENTS

TABLES AND FIGURES

The statistical data until 2019 presented in this Report are as of 27 April 2020, forecasts as of March 2020. Most data are taken from the wiiw Databases. Direct access is available at: https://data.wiiw.ac.at/.

ABBREVIATIONS

ALL	Albanian lek
BAM	convertible mark of Bosnia and Herzegovina
BGN	Bulgarian lev
BYR	Belarusian rouble
CZK	Czech koruna
EUR	euro
HRK	Croatian kuna
HUF	Hungarian forint
KZT	Kazakh tenge
MDL	Moldovan leu
MKD	North Macedonian denar
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
TRY	Turkish lira
UAH	Ukrainian hryvnia
USD	US dollar

BiH	Bosnia and Herzegovina
BIS	Bank for International Settlements
BOP	balance of payments
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
BRI	Belt and Road Initiative
CET	Central European Time
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
COVID-19	Corona Virus Disease 2019
CPI	consumer price index
DB	district of Brčko
DCFTA	Deep and Comprehensive Free Trade Area
EA	euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EFSI	European Fund for Strategic Investment
EFTA	European Free Trade Association
EIA	Energy Information Administration
ER	exchange rate
ERM	Exchange Rate Mechanism
ESA'95	European system of national and regional accounts, ESA 1995
ESA 2010	European system of accounts, ESA 2010
ESIF	European Structural Investment Funds

EU	European Union
EU15	European Union – 15 countries
FBiH	Federation of Bosnia and Herzegovina
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GDP	Gross Domestic Product
GNP	Gross National Product
GVA	Gross Value Added
HICP	harmonised consumer price index
ICP	International Comparison Project
IFR	International Federation of Robotics
IMF	International Monetary Fund
LFS	Labour Force Survey
MFF	Multiannual financial framework
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
NMS	new EU Member States
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PMI	purchasing managers' index
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
PPS	purchasing power standard
RER	Real exchange rate
RIR	Real interest rate
RS	Republika Srpska
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
US	United States
VAT	value added tax
WEO	World Economic Outlook
WHO	World Health Organisation
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

.	not available (in tables)
2015q1	first quarter of 2015
2015h1	first half of 2015
bn	billion
mn	million
mom	month-over-month
lhs	left-hand side axis/panel
p.a.	per annum
rhs	right-hand side axis/panel
sa	seasonally adjusted
saar	seasonally adjusted annualised rate
qoq	quarter-over-quarter
yoy	year-over-year

May 2020 interim forecast update

Real GDP forecasts and revisions

		Forecast, %			Revisions, pp	
		2019	2020	2021	2020	2021
EU-CEE11	BG	3.4	-6.3	1.7	-9.1	-0.6
	CZ	2.6	-4.8	2.5	-7.0	0.1
	EE	4.3	-7.0	4.0	-9.7	1.4
	HR	2.9	-11.0	4.0	-13.7	1.3
	HU	4.9	-5.5	2.0	-8.8	-0.6
	LT	3.9	-6.5	4.3	-9.3	1.7
	LV	2.2	-8.0	4.5	-10.0	2.2
	PL	4.1	-4.0	3.0	-7.6	-0.3
	RO	4.1	-7.0	3.0	-10.2	0.2
	SI	2.4	-9.5	4.0	-12.1	1.3
	SK	2.3	-9.0	4.6	-11.0	2.2
WB6	AL	2.2	-5.0	3.8	-8.2	0.4
	BA	2.6	-5.0	3.0	-7.5	0.2
	ME	3.6	-8.0	5.0	-10.8	2.1
	MK	3.6	-5.0	4.0	-8.3	0.7
	RS	4.2	-4.0	4.0	-7.7	0.5
	XK	4.2	-4.4	4.0	-8.7	-0.2
Turkey	TR	0.9	-6.0	5.5	-9.9	1.4
CIS4+UA	BY	1.2	-5.3	-0.7	-6.3	-2.0
	KZ	4.5	-3.0	2.0	-6.7	-1.8
	MD	3.6	-3.0	3.0	-7.0	-1.0
	RU	1.3	-7.0	1.5	-9.1	-0.8
	UA	3.2	-6.0	2.5	-9.6	-1.7

Notes: Current forecast and revisions relative to the wiiw Spring forecast 2020. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw forecast.

OVERVIEW 2018-2019 AND OUTLOOK 2020-2021

		GDP real change in % against prev. year				Consumer prices average change in % against prev. year			
				Forecast				Forecast	
		2018	2019	2020	2021	2018	2019	2020	2021
BG	Bulgaria	3.1	3.4	-6.3	1.7	2.6	2.5	1.5	2.0
CZ	Czech Republic	2.8	2.6	-4.8	2.5	2.0	2.6	3.3	2.0
EE	Estonia	4.8	4.3	-7.0	4.0	3.4	2.3	1.0	1.5
HR	Croatia	2.7	2.9	-11.0	4.0	1.6	0.8	1.0	1.0
HU	Hungary	5.1	4.9	-5.5	2.0	2.9	3.4	4.0	3.0
LT	Lithuania	3.6	3.9	-6.5	4.3	2.5	2.2	0.3	1.4
LV	Latvia	4.3	2.2	-8.0	4.5	2.6	2.7	0.5	1.5
PL	Poland	5.3	4.1	-4.0	3.0	1.2	2.1	3.8	2.0
RO	Romania	4.4	4.1	-7.0	3.0	4.1	3.9	3.0	4.0
SI	Slovenia	4.1	2.4	-9.5	4.0	1.9	1.7	0.5	1.0
SK	Slovakia	4.0	2.3	-9.0	4.6	2.5	2.8	2.0	1.8
	EU-CEE11 1)2)	*4.4*	*3.7*	*-5.7*	*3.0*	*2.2*	*2.6*	*3.0*	*2.3*
	EA19 3)	*1.9*	*1.2*	*-7.5*	*4.7*	*1.8*	*1.2*	*0.2*	*1.0*
	EU27 3)	*2.1*	*1.5*	*-7.3*	*5.0*	*1.8*	*1.4*	*0.5*	*1.4*
AL	Albania	4.1	2.2	-5.0	3.8	2.0	1.4	2.3	2.5
BA	Bosnia and Herzegovina	3.7	2.6	-5.0	3.0	1.4	0.6	-0.5	1.2
ME	Montenegro	5.1	3.6	-8.0	5.0	2.6	0.4	0.5	0.9
MK	North Macedonia	2.7	3.6	-5.0	4.0	1.5	0.8	-1.0	0.4
RS	Serbia	4.4	4.2	-4.0	4.0	2.0	1.7	1.1	1.6
XK	Kosovo	3.8	4.2	-4.4	4.0	1.1	2.7	1.5	1.7
	WB6 1)2)	*4.0*	*3.5*	*-4.7*	*3.8*	*1.8*	*1.4*	*0.7*	*1.5*
TR	Turkey	2.8	0.9	-6.0	5.5	16.3	15.2	12.0	11.0
BY	Belarus	3.1	1.2	-5.3	-0.7	4.9	5.6	8.0	7.0
KZ	Kazakhstan	4.1	4.5	-3.0	2.0	6.0	5.3	7.0	5.0
MD	Moldova	4.3	3.6	-3.0	3.0	2.9	4.8	4.5	5.0
RU	Russia	2.5	1.3	-7.0	1.5	2.9	4.5	4.1	3.6
UA	Ukraine	3.4	3.2	-6.0	2.5	10.9	7.9	4.5	6.0
	CIS4+UA 1)2)	*2.8*	*1.8*	*-6.4*	*1.6*	*3.9*	*4.9*	*4.6*	*4.0*
	V4 1)2)	*4.7*	*3.8*	*-4.8*	*2.9*	*1.7*	*2.4*	*3.6*	*2.1*
	BALT3 1)2)	*4.1*	*3.5*	*-7.0*	*4.3*	*2.7*	*2.4*	*0.5*	*1.5*
	SEE9 1)2)	*4.0*	*3.7*	*-6.7*	*3.1*	*3.1*	*2.8*	*2.0*	*2.8*
	CIS3+UA 1)2)	*3.7*	*3.5*	*-4.4*	*1.8*	*7.4*	*6.2*	*6.3*	*5.7*
	non-EU12 1)2)	*2.8*	*1.6*	*-6.2*	*2.8*	*7.4*	*7.7*	*6.6*	*5.9*
	CESEE23 1)2)	*3.3*	*2.2*	*-6.1*	*2.8*	*5.9*	*6.2*	*5.5*	*4.9*

OVERVIEW 2018-2019 AND OUTLOOK 2020-2021 (ctd.)

		Unemployment (LFS) rate in %, annual average				Current account in % of GDP			
				Forecast				Forecast	
		2018	2019	2020	2021	2018	2019	2020	2021
BG	Bulgaria	5.2	4.2	10.0	9.0	1.4	4.0	1.9	1.7
CZ	Czech Republic	2.2	2.0	3.5	4.0	0.4	-0.4	0.3	0.3
EE	Estonia	5.4	4.4	8.0	7.0	2.0	2.2	3.0	2.0
HR	Croatia	8.5	6.6	11.0	10.0	1.9	2.5	-5.0	-1.0
HU	Hungary	3.7	3.4	10.0	7.0	0.0	-0.8	0.0	0.0
LT	Lithuania	6.2	6.3	9.0	8.0	0.3	4.3	5.0	4.0
LV	Latvia	7.4	6.3	8.0	8.5	-0.7	-0.5	4.0	2.0
PL	Poland	3.9	3.3	7.0	7.0	-1.0	0.5	0.2	0.3
RO	Romania	4.2	3.9	10.0	7.0	-4.4	-4.6	5.0	-4.5
SI	Slovenia	5.1	4.5	9.0	8.0	6.1	6.6	2.0	3.0
SK	Slovakia	6.5	5.8	8.2	8.7	-2.6	-2.9	-3.1	-1.8
	EU-CEE11 [1)2)]	*4.3*	*3.8*	*9.6*	*8.7*	*-0.8*	*-0.2*	*0.9*	*-0.3*
	EA19 [3)]	*8.1*	*7.5*	*10.4*	*8.9*	*3.6*	*3.0*	*2.8*	*2.8*
	EU27 [3)]	*7.2*	*6.7*	*9.7*	*8.2*	*3.2*	*2.9*	*2.9*	*3.0*
AL	Albania	12.3	11.5	13.6	11.5	-6.8	-7.6	-9.5	-9.0
BA	Bosnia and Herzegovina	18.4	15.7	19.0	17.0	-3.7	-3.5	-8.0	-6.0
ME	Montenegro	15.2	15.1	21.0	19.0	-17.0	-15.2	-20.0	-16.0
MK	North Macedonia	20.7	17.3	21.0	19.0	-0.1	-2.8	-2.5	-1.5
RS	Serbia	12.7	10.4	13.4	12.7	-4.8	-6.9	-7.5	-7.0
XK	Kosovo	29.6	25.7	27.0	26.0	-7.6	-5.8	-7.5	-6.0
	WB6 [1)2)]	*15.7*	*13.4*	*16.4*	*15.0*	*-5.2*	*-6.3*	*-7.9*	*-6.8*
TR	Turkey	10.9	13.7	17.2	15.6	-3.4	0.5	0.4	-0.2
BY	Belarus	4.8	4.2	6.0	5.5	0.0	-1.8	-2.7	-3.5
KZ	Kazakhstan	4.9	4.8	6.0	5.0	-0.1	-3.6	-6.0	-4.0
MD	Moldova	3.0	5.1	9.0	6.0	-10.6	-9.7	-9.0	-9.0
RU	Russia	4.8	4.6	7.0	6.5	6.8	3.8	0.0	1.0
UA	Ukraine	8.8	8.2	12.0	10.0	-3.3	-0.9	-2.0	-3.5
	CIS4+UA [1)2)]	*5.4*	*5.2*	*7.7*	*6.9*	*5.3*	*2.6*	*-0.8*	*0.1*
	V4 [1)2)]	*3.8*	*3.3*	*6.9*	*6.6*	*-0.7*	*-0.2*	*-0.1*	*0.1*
	BALT3 [1)2)]	*6.4*	*5.9*	*8.5*	*7.9*	*0.4*	*2.4*	*4.2*	*2.9*
	SEE9 [1)2)]	*8.6*	*7.4*	*12.3*	*10.3*	*-3.0*	*-2.9*	*0.4*	*-3.8*
	CIS3+UA [1)2)]	*6.9*	*6.6*	*7.7*	*6.9*	*-1.5*	*-2.5*	*-0.7*	*0.1*
	non-EU12 [1)2)]	*7.1*	*7.5*	*10.2*	*9.2*	*2.6*	*1.7*	*-0.8*	*-0.3*
	CESEE23 [1)2)]	*6.4*	*6.6*	*9.6*	*8.6*	*1.4*	*1.0*	*-0.2*	*-0.3*

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 (May 2020).

1. Global overview

by Richard Grieveson

- **The International Monetary Fund (IMF) projects that the current crisis will be the worst for the global economy since the 1930s. All of CESEE's main trading partners and all its sources of tourism and capital inflows will suffer severe recessions.**
- **All projections at present are subject to a huge degree of uncertainty. The most likely scenario is a deep contraction now, followed by a gradual easing of restrictions on economic life in the second half of 2020 and 2021.**
- **Nevertheless, this recovery will be bumpy (potentially including a reintroduction of some lockdown measures, if infection rates start to rise again), and a full return to anything like normal economic life will have to wait until a mass vaccine is rolled out (probably mid- to late 2021). The politics and economics of restarting economic life are likely to be much more challenging than the imposition of the initial lockdowns.**
- **The key global central banks have reacted strongly, effectively backstopping the global financial system and ensuring a degree of stability. Many Western countries have also announced big fiscal plans; but a serious, coordinated response from the euro area would appear to present something of a challenge. Those CESEE economies with particularly close links to Italy (those in Southeast Europe) will suffer because of it.**
- **A far more negative scenario than our baseline is, unfortunately, possible. This would include a mixture of second/third waves of the virus, a longer-than-expected wait for a vaccine, and serious policy missteps in the US or Europe.**

The economic crisis caused by the spread of the Coronavirus and the resulting lockdown will deal the global economy one of the worst shocks in recorded history. Elements of the crisis are comparable to previous setbacks, but taken as a whole the crisis is unprecedented. At the outset of this analysis, therefore, we need to state plainly that there is a huge amount that we simply do not know. Below, we separate out what we think we can say with a reasonable degree of certainty from those areas where there is still huge uncertainty.

1.1. WHAT WE KNOW AND WHAT WE DON'T

What we think we know

- In most countries, the most severe lockdowns and restrictions on economic life will last for 2-3 months.
- Thereafter, they will gradually be eased; but there will be no return to normal economic life until a vaccine is tested and is widely available. A realistic timeframe for that would seem to be mid- to late 2021.

› Even then, it is likely that certain effects of the crisis will last much longer. Tourism, aviation, business travel, global goods trade and retail are all sectors that could be fundamentally and permanently reshaped by this crisis.

› The big central banks—including the Fed and the ECB--will do whatever it takes for as long as it takes, and this matters a lot. Fiscal responses in non-euro area Western countries and Germany are also set to be huge. These big monetary and fiscal moves by rich countries will have important, positive spill-over effects for CESEE countries.

› Oil prices are going to stay very low for a long time. This will exert serious additional pressure on those countries (mostly emerging markets) that rely heavily on oil exports, but will be positive (albeit with a lag) for oil importers.

› Many emerging markets are already under severe pressure, due to a combination of collapsing commodity prices and sharp capital outflows.

What we don't know

› This is an unprecedented crisis, and there is no usable model on which to base our projections.

› Nobody knows whether there will be a second or a third wave of the virus, and whether it will mutate.

› It is unclear how people will react as measures are eased. There may be a confidence shock that is much harder to deal with than the lockdown measures themselves, and many people may be very cautious about returning to normal life in terms of retail, travel and socialising.

› Perhaps the most shocking indicator of the crisis so far has been the spike in US initial jobless claims, which went from 282,000 in mid-March to almost 7 million by the end of the same month. The labour market dynamics will play a crucial role in recovery, but given the unprecedented nature of the current shock, we have very little idea of how this will proceed. Both the economic and the social implications are likely to be profound.

› It remains to be seen how the politics of the crisis will develop, both within and between countries. We expect the politics of reopening economies to be much harder than the imposition of the initial lockdowns.[1] And as the US election approaches, the incentives for US President Donald Trump to ramp up tension with China (and possibly the EU) in order to deflect attention from his administration's handling of the crisis are potentially quite great.

1.2. GLOBAL ASSUMPTIONS

As ever, we start with the IMF's most recent World Economic Outlook (WEO) as the baseline for our global assumptions.

› The IMF believes it is 'very likely' that this downturn will exceed the one that followed the global financial crisis, and will be the worst since the 1930s.

› The IMF expects global real GDP to contract by 3% this year. It expects a downturn in 2020 of 5.9% in the US, 7.5% in the euro area and 5.2% in Japan – and growth of 1.2% in China.

1 https://medium.com/@tomaspueyo/coronavirus-learning-how-to-dance-b8420170203e

› Apart from China, substantial declines are expected in all CESEE's main trading partners and in all its sources of foreign direct investment (FDI), remittances and tourism.

› We take our Brent crude forecasts from the US Energy Information Administration (EIA). Based on latest developments, the risks to these projections are clearly to the downside.

› With both the Fed and the European Central Bank (ECB) engaging in substantial monetary easing, the euro is likely to stay roughly where it currently stands against the dollar for the next 18 months. The risks are of a weaker euro.

Table 1.1 / May 2020 global assumptions

		2020	2021
Real GDP growth, %			
Euro area	IMF	-7.5	4.7
Germany	IMF	-7.0	5.2
Italy	IMF	-9.1	4.8
US	IMF	-5.9	4.7
China	IMF	1.2	9.2
Emerging markets	IMF	-1.0	6.6
Exchange rates			
USD/EUR	wiiw	1.08	1.08
Commodity prices			
Non-fuel commodity prices, % change yoy	IMF	-1.1	-0.6
Fuel prices, % change yoy	IMF	-42.0	6.3
Brent crude, USD per barrel	EIA	33.04	45.62

1.3. SCENARIOS

Projections in the current environment are particularly uncertain. The economic fallout will depend on the spread/containment of the virus, the speed with which mass testing and eventually a vaccine for all can be rolled out, and policy responses.

A more **positive scenario** than currently projected would require mass testing and a vaccine to be introduced more quickly than currently expected. This scenario could also include a bigger-than-expected coordinated fiscal response in the EU.

However, a more **negative scenario** is also certainly possible – and unfortunately, probably more likely. Several things could make this happen.

1. **A second or even a third wave of the virus, as lockdown measures are eased.**

2. **A longer-than-expected wait for a mass vaccine.**

3. **Greater limits on the Fed and/or the US fiscal response after the November presidential election.** So far, the US fiscal and monetary response has been solid. However, this has relied on a

certain amount of bipartisan cooperation. If the Democrats were to win the next presidential election, the willingness of Republicans in Congress to compromise may be sharply reduced; that would constrain the capacity of US policy makers to act.

4. **Bad policy decisions in key economies that prolong the crisis.** The US seems to be the most likely candidate for this. In his book *The Fifth Risk*, Michael Lewis details how state capacity in the US has been undermined under the current president, and points to some of the implications that are already visible.[2] However, the real test will come with the easing of lockdown measures. With the presidential election approaching, it is not inconceivable that easing could proceed too quickly, leading to a resurgence of the virus in the world's most important economy, with knock-on effects for everyone else.

› Social unrest in one or more systemically important countries, or directly in CESEE.

› **Food shortages and sharply rising prices** (there are already food production problems in key parts of CESEE, such as Ukraine, Romania and Poland).[3]

› **A new euro area crisis centred on Italy.** This has long been one of our main concerns, but is much more serious now, in light of recent developments.

In this negative scenario, the severity of the economic downturn could be considerably greater and the time it takes to return to something like normality could be significantly longer than current consensus projections anticipate.

2 https://www.vox.com/2020/4/7/21209887/coronavirus-covid-19-michael-lewis-the-fifth-risk-trump-administration-catastrophe

3 https://emerging-europe.com/news/exit-virus-followed-by-drought/

2. Regional overview

by Richard Grieveson

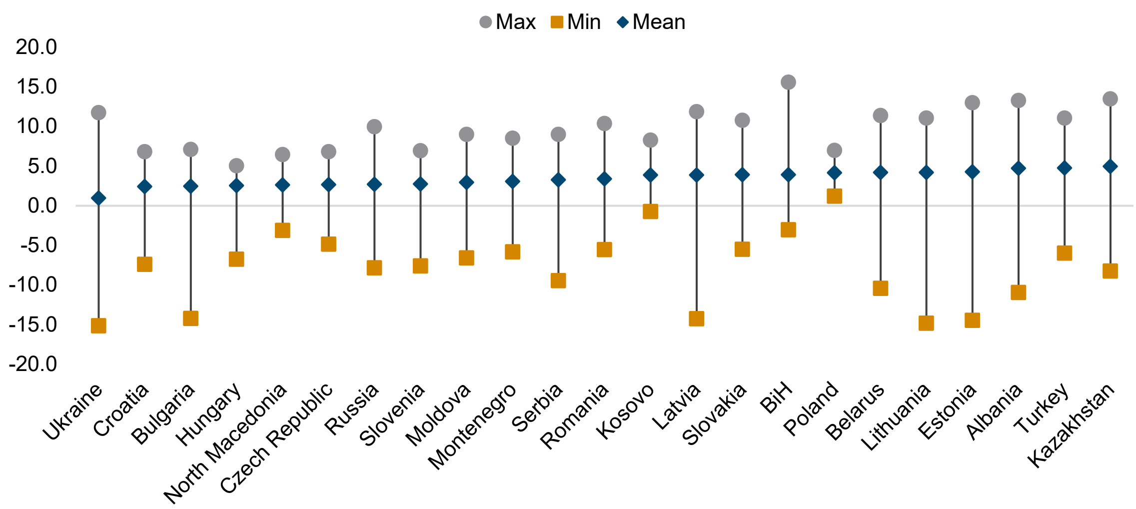
- **The economic downturn caused by the Coronavirus in CESEE will be worse than the aftermath of the 2008 global financial crisis. wiiw projects a weighted average real GDP decline for CESEE in 2020 of 6.1%, compared with 5.6% in 2009.**
- **This is a crisis without precedent in the post-transition period, and our forecasts are subject to an unusually high degree of uncertainty. A much more negative scenario than we currently project is, unfortunately, quite possible.**
- **We expect the biggest real GDP contractions in 2020 to be in Slovakia, Slovenia, Croatia and Montenegro. This reflects either a high degree of vulnerability to global trade disruption or a particular reliance on tourism. All CESEE countries will record real GDP contractions of at least 3% this year.**
- **CESEE countries have generally had far fewer cases of Coronavirus and far fewer deaths from it than Western Europe. However, the weakness of their healthcare systems means that they have almost all introduced strict lockdown measures, which will have severe knock-on consequences for economic life.**
- **Some will be able to loosen fiscal policy considerably to mitigate the downturn, but most CESEE economies have quite limited external financing options. As fiscal deficits widen and nominal growth collapses, so public debt/GDP ratios will rise sharply.**
- **The reliance of Ukraine, Moldova and many Western Balkan countries on large-scale capital inflows will cause particular stresses in those countries. Here, the role of the International Monetary Fund, the European Bank for Reconstruction and Development, the EU and Western parent banks will be key to avoiding worst-case scenarios.**
- **Over the medium term, the crisis will fundamentally change many aspects of the economies of CESEE, but not all the impacts will be negative.**

2.1. WHAT WE KNOW AND WHAT WE DON’T

It is well nigh impossible to pin any figure at all on the impact of the Coronavirus – whether for real GDP growth, inflation, unemployment, the current account or any other economic indicator. There are far too many things that we simply don’t know – including more than a few of Donald Rumsfeld’s ‘unknown unknowns’. History is always a guide, no matter how imperfect; and one element or another of all the big crises to have hit CESEE will be relevant here: the early 1990s transition shock, the late 1990s financial crisis, various exchange rate crises – and the global crisis of 2008. However, none offers a comprehensive guide to current events.

In thinking through the most likely and the worst-case scenarios for the Coronavirus shock, we started by looking back at the impact of these previous crises in the region. Starting from 1995 (data before that are problematic), we identify the maximum, minimum and mean full-year real GDP contractions for all CESEE economies (Figure 2.1). The countries with the lowest lows are Ukraine, Bulgaria and the Baltic states. This may reveal a particular exposure in times of global economic and financial stress – for example, an inability to adjust, due to fixed exchange rates, or a general weakness on a host of fundamental factors. Meanwhile, the countries where the historical lows have not been especially low are Poland, Kosovo, the Czech Republic, Bosnia and North Macedonia (all less than 5%). This probably reflects either strong fundamentals and resilience (Poland and the Czech Republic) or very closed economies with limited exposure to the global business cycle and increases in risk premia (especially Kosovo and Bosnia).

Figure 2.1 / Real GDP growth, %, range and mean, annual data, 1995 (or earliest available) to 2019



Source: wiiw.

We absorb these lessons into our thinking about the current crisis. However, we also note that not only are there important differences between the COVID-19 crisis and these previous episodes, but also that the fundamentals of many of the countries considered have changed.

2.2. OVERVIEW OF NEW WIIW FORECASTS

wiiw's new forecasts for CESEE show that all 23 economies will experience a deep recession this year:

› The weighted average real GDP decline for the CESEE23 in 2020 will be 6.1%, worse than 2009 (5.6%).

› The recovery will then be much weaker: 2.8% in 2021, compared with 4.4% in 2010.

› We expect those with the biggest contractions in 2020 to be those with a particularly heavy reliance on external trade or tourism (e.g. Slovakia, Slovenia, Montenegro and Croatia).

- Those less badly affected could include especially closed economies (Kosovo, Moldova); those that can and will throw a lot of money at the problem (Serbia, Poland, Kazakhstan); and those that seem to have got the lockdown/easing timing right, such as the Czech Republic (there is some evidence that, contrary to the notion of a trade-off between health and the economy, quicker lockdowns are better for the economy).[4]
- The crisis will wipe out more than two full years' worth of real growth in CESEE, taking GDP back to 2017 levels. Trade- or tourism-dependent economies, like Croatia or Slovakia, will lose 3-4 years of GDP in just a couple of quarters.
- Even by 2021, no country will have got back to 2019 levels. The economies of Croatia, Slovenia, Russia and Belarus will be at least 5% smaller in 2021 than in 2019.

2.3. TRACKING THE CASES: WHY SO MUCH LOWER IN CESEE?

One of the interesting features of this crisis is that the number of cases of the Coronavirus and the number of deaths in CESEE have both been so much lower than in most of Western Europe (see Figure 2.2). As pointed out by Branko Milanovic[5] and others,[6] the share of the population that has died differs dramatically between Western and Eastern Europe (with very few exceptions, see Figure 2.3).

We see two main explanations for this. First, CESEE countries are not integrated into the global business-travel and winter-tourism industries in the same way as Western Europe, and domestic transport infrastructure is often weak (limiting internal mobility). This appears to have been a key factor at the start.

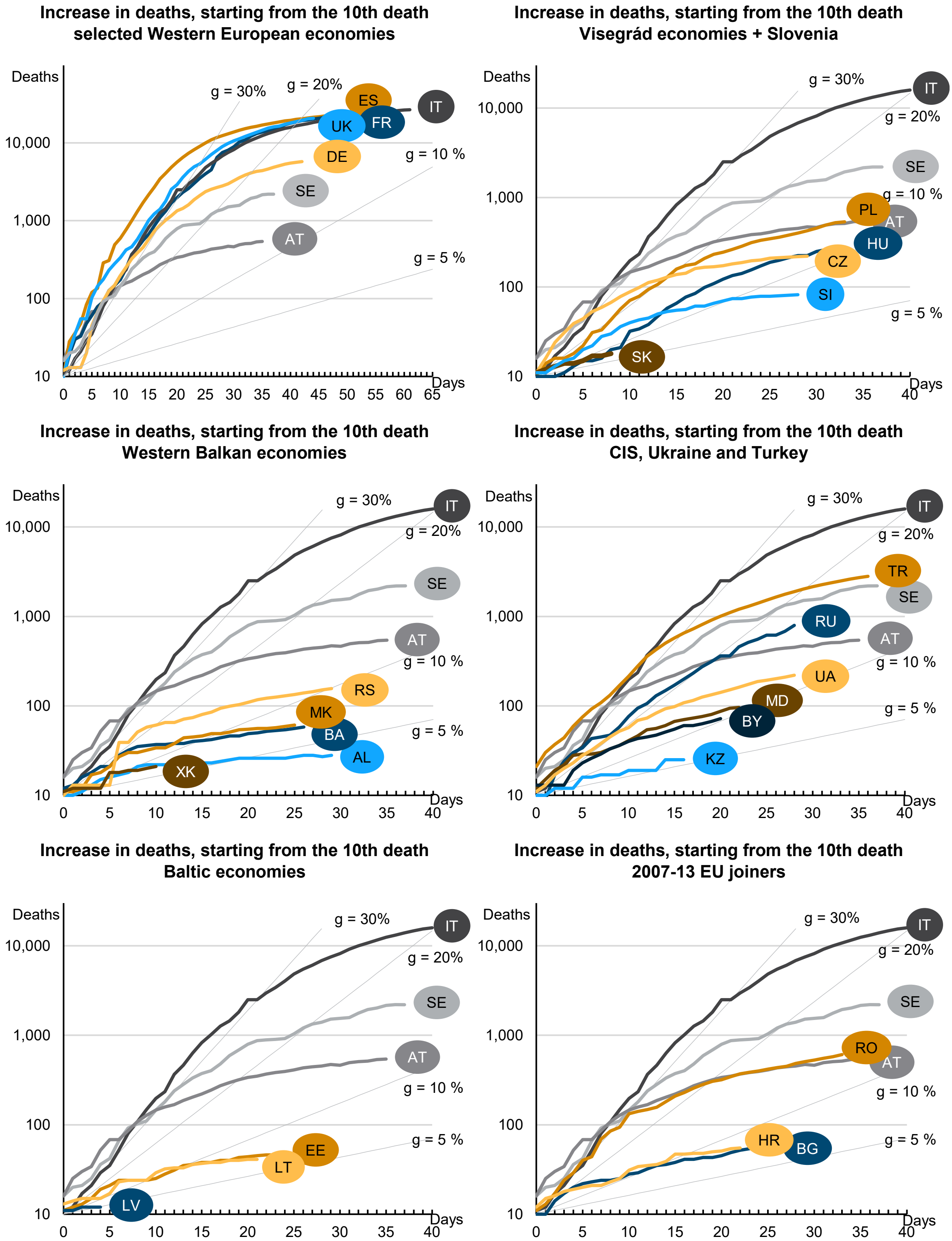
Second, because the outbreak began later in CESEE countries, governments had a head start in introducing lockdown measures. By mid-March, most CESEE countries scored very highly on the Stringency Index produced by Oxford University's Blavatnik School of Government, despite having very few cases, compared to Western Europe or the US (Figure 2.4). Their decision to introduce lockdown measures at an earlier stage also likely reflects their awareness of the weakness of their healthcare systems. As the chart shows, by 15 March, most had more restrictive measures in place than the UK, US and France, despite having far fewer cases. Some were even already at or close to Spanish/Italian levels of stringency by this point.

4 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561560

5 https://twitter.com/BrankoMilan/status/1252812420357083137

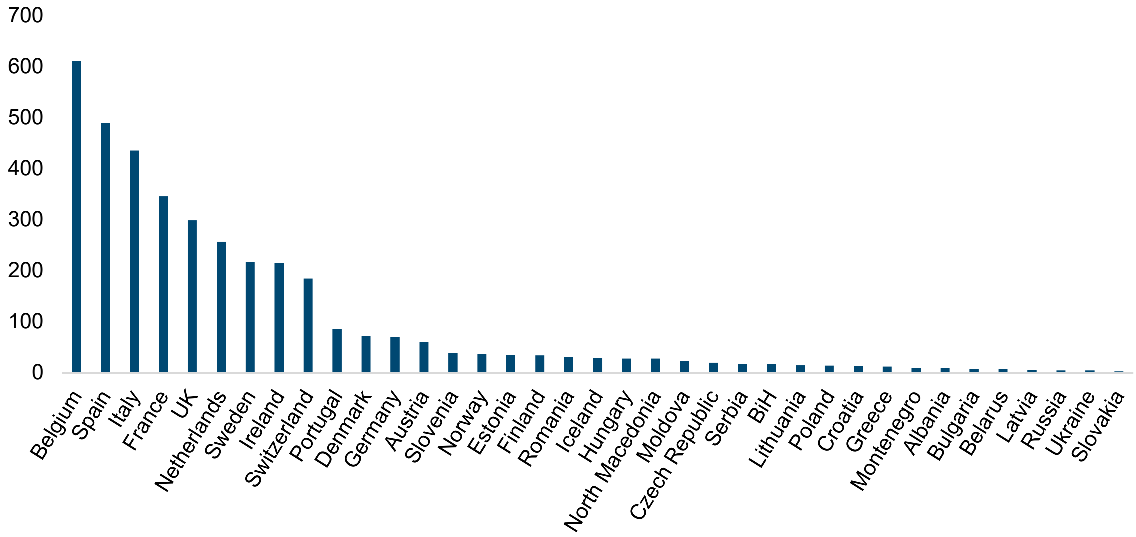
6 https://www.wsj.com/articles/poorer-eastern-european-nations-could-teach-the-west-a-lesson-on-coronavirus-11586718779

Figure 2.2 / Evolution of the number of official COVID-19 deaths in CESEE and selected countries for comparison as reported to the World Health Organization



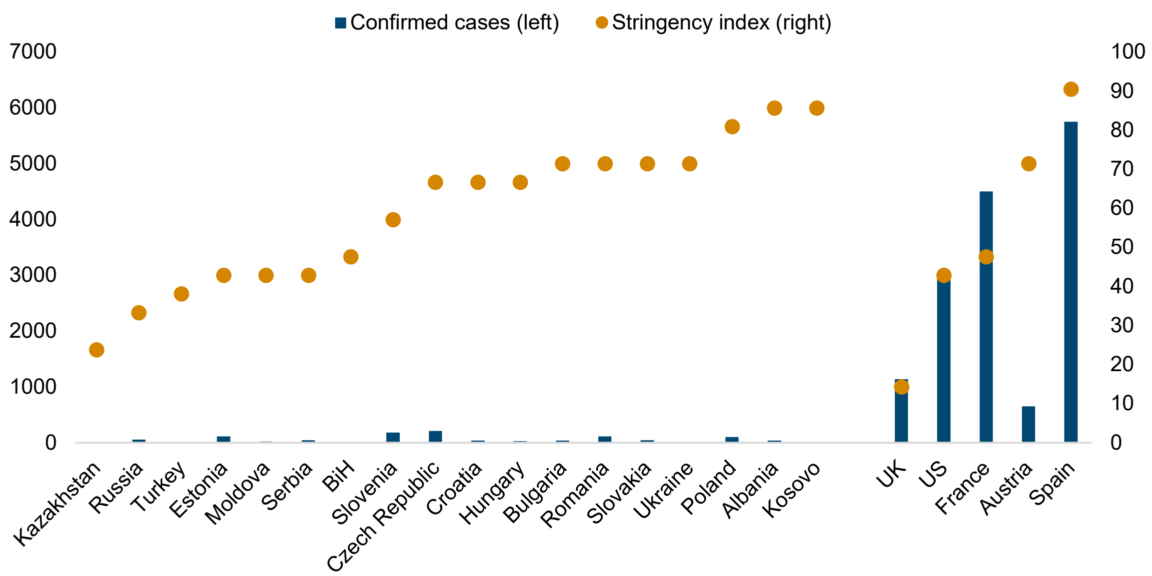
Notes: Numbers shown on a log scale to emphasise changes in growth rates. A shorter time period is chosen for CESEE for better readability of the chart. Montenegro does not feature in the graph as it has reported fewer than 10 COVID-19-related deaths
Data source: WHO Situation Reports (latest report: No. 98 - data as reported by national authorities by 10:00 CET, 27 April 2020).

Figure 2.3 / Deaths per 1 million population from Coronavirus, data updated as of 27 April



Source: Worldometer.

Figure 2.4 / Relationship between number of confirmed cases and restrictive measures, 15 March



Note: Stringency Index is a composite of seven indicators: school closures; workplace closures; cancellation of public events; closure of public transport; public information campaigns; restrictions on internal movement; and international travel controls.
Source: Blavatnik School of Government, Oxford University.

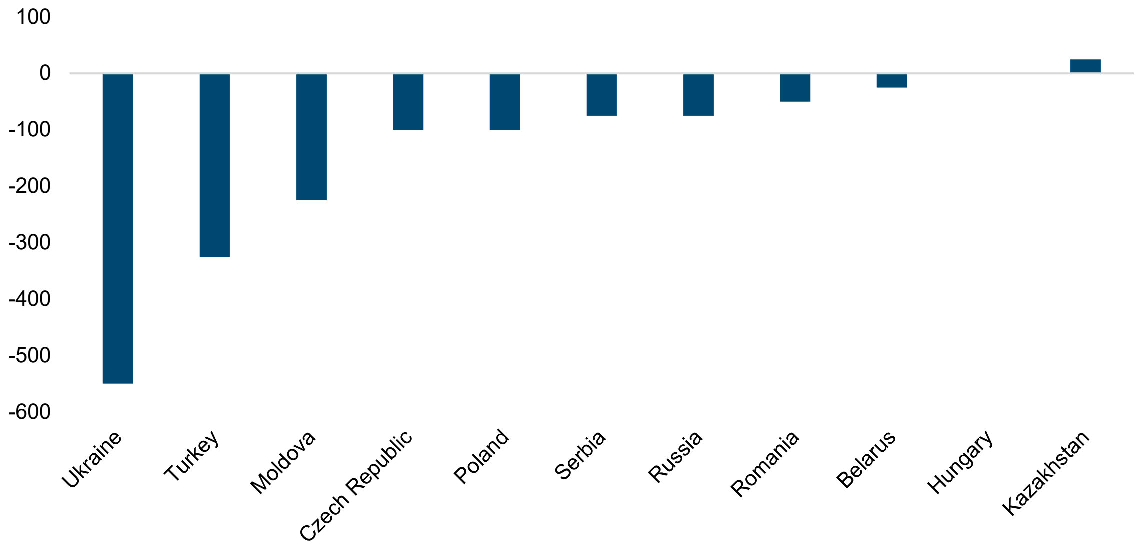
2.4. MEASURING THE POLICY RESPONSES

A full list of policy responses is provided in an annex at the end of this report. Here, we summarise the main monetary and fiscal measures.

Monetary

Most countries with independent monetary policies have now reacted strongly to stimulate their economies. Central banks in Ukraine and Turkey have been particularly aggressive so far (Figure 2.5). With interest rates so low (or negative) around the world, there is less need than in normal times to offer a high, positive interest rate differential versus developed states in order to attract capital inflows (or try to prevent outflows). As a result, we think that at least some countries in CESEE will cut policy rates further, and that in general nominal (and in most cases real) rates will stay low across the region over the next two years.

Figure 2.5 / Cumulative change in policy rate, nominal, between end 2019 and 27 April 2020, basis points

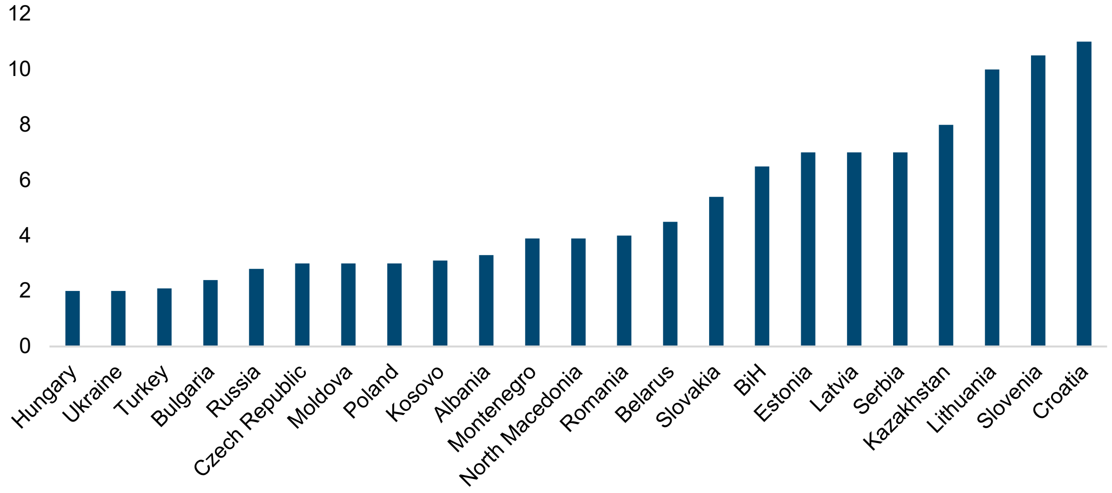


Source: National central banks, wiiw

Fiscal

The range of fiscal responses is quite wide, and largely reflects the different scale of options open to governments. Some will be able to finance quite a large stimulus to prop up demand, whereas others are much more limited in what they can do. The range of planned fiscal responses is roughly between 2% and 11% of GDP, but whether or not this will really materialise is another matter, and all estimates are subject to a high degree of uncertainty. Broadly, the CIS, Ukraine and the Western Balkans (with the exception of Serbia) will not be able to raise huge sums (as a share of GDP) on international capital markets, and so will have to rely on (often limited) domestic resources. This will exacerbate the scale of the downturn in economies that often already face particular difficulties.

Figure 2.6 / Planned fiscal response, % of GDP, 2020 (update on 30.4)



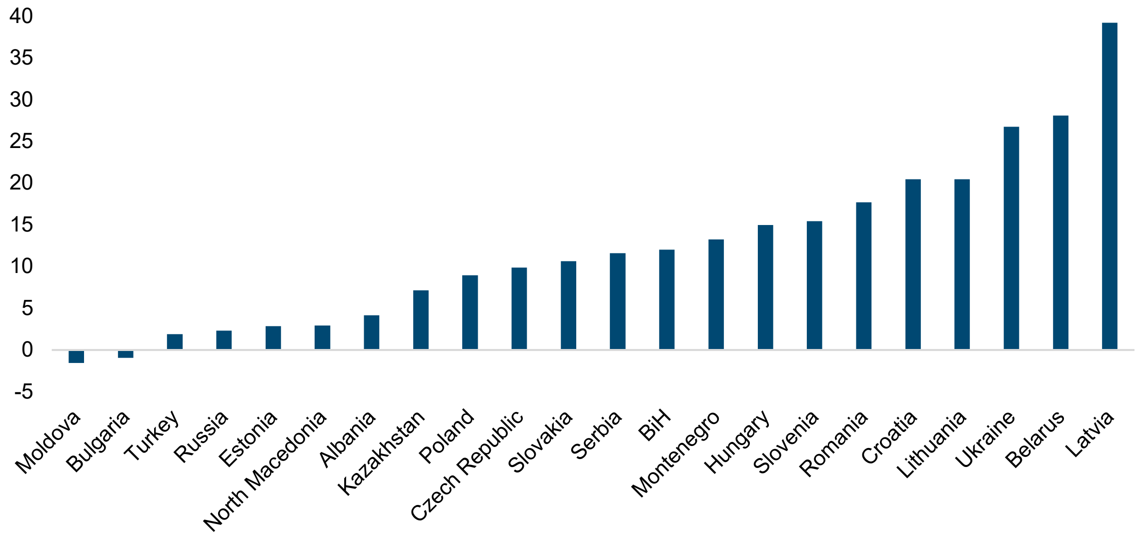
Source: National sources, wiiw estimates.

Implications for public debt

There is no obvious immediate problem with public debt in CESEE. Most countries that had a problem after the 2008 crisis have significantly reduced their debt/GDP ratios in recent years. None have ratios comparable with many Western European countries (although neither should they, given their lower level of development). At the global level, the International Monetary Fund (IMF) predicts an increase in the public debt/GDP ratio of 13.1 percentage points, although with a more limited increase of 7.3 percentage points for emerging Europe.

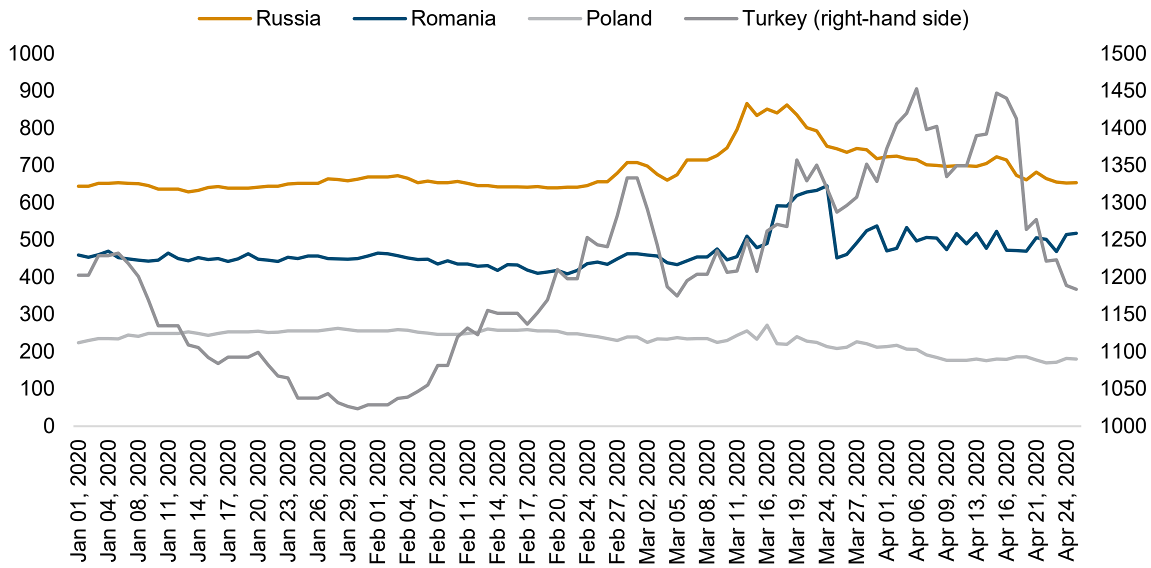
However, a narrow focus on public debt/GDP ratios can obscure much of what is important. The cost of debt, rather than the debt level, is the real issue. Although in recent years all countries in CESEE for which data are available have had significantly higher nominal GDP growth than long-term bond yields, this could quickly change in the current crisis, as nominal growth plummets and borrowing costs rise (at least for some), leading to a sharp increase in the public debt/GDP ratio and financing problems. The last crisis is instructive: between 2007 and 2010, public debt/GDP ratios increased by over 20 percentage points in many CESEE countries (including by almost 40 percentage points in Latvia, see Figure 2.7). In mid-March, as financial markets fretted about how strongly central banks would react, stress was visible on many CESEE bond markets, including Romania, Russia and Turkey (see Figure 2.8). Although spreads have since tightened again, these stresses could easily return.

Figure 2.7 / Change in public debt/GDP ratio, 2007-2010, percentage points



Source: wiiw.

Figure 2.8 / Spread of 10-year government bond yield over German equivalent, basis points



Source: Investing.com.

2.5. SHORT-TERM MEASURABLE IMPACTS

Since the end of March, wiiw has been tracking and collecting relevant high-frequency data to measure the economic fallout from the Coronavirus in CESEE. A huge collection of trackers (including ours) has been collected by economist Lukas Lehner.[7]

Labour markets

The most obvious (and shocking) impact of the crisis is likely to be on employment (see global overview). Data for CESEE are not yet available, but this is likely to be a huge and lasting issue. A study by the European Bank for Reconstruction and Development (EBRD) found that the prevalence of small and medium-sized enterprises (SMEs) could make job displacement particularly acute in much of CESEE.[8]

Purchasing managers' indices

Purchasing managers' indices (PMIs) are often the most reliable high-frequency indicators of economic activity. The latest available suggest a fairly severe impact, with data for April showing activity in both manufacturing and services (where available) plunging to the lowest levels ever recorded in the euro area and parts of CESEE.

Table 2.1 / Purchasing managers' indices (PMIs)

	Composite			Manufacturing			Services		
	Period	**Data**	***Monthly change***	**Period**	**Data**	***Monthly change***	**Period**	**Data**	***Monthly change***
Turkey				April	33.4	*-14.7*			
Russia				April	31.3	*-16.2*	March	37.1	*-14.9*
Kazakhstan				April	39.3	*-9.5*	March	40.6	*-6.0*
Euro area	April	13.5	*-16.2*	April	33.4	*-11.1*	April	11.7	*-14.7*
Czech Republic				April	35.1	*-6.2*			
Poland				April	31.9	*-10.5*			

Note: Figures above 50 = expansion; below 50 = contraction.
Source: IHS Markit.

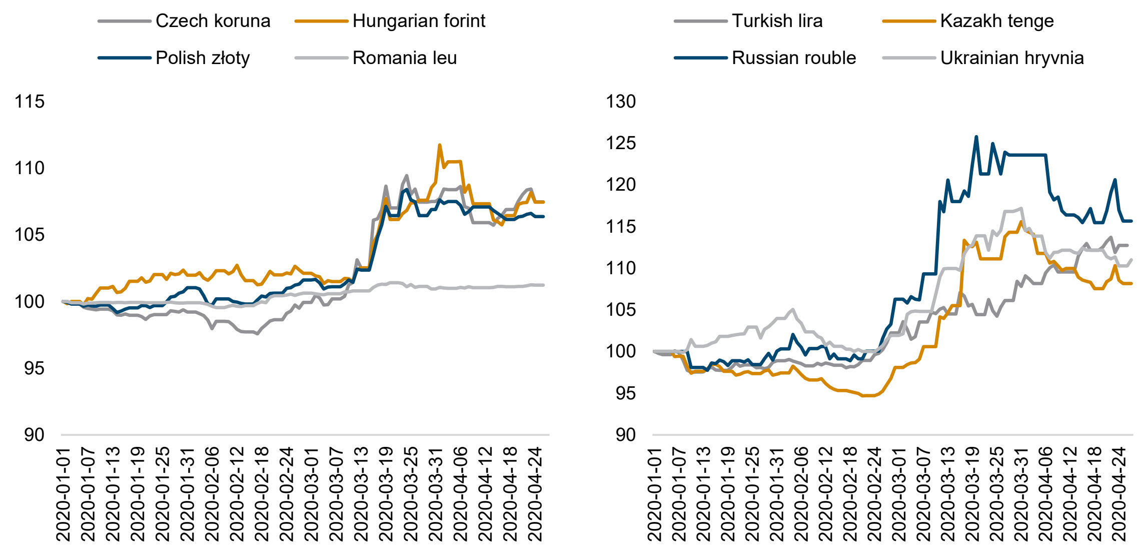
Currency impact

Many currencies across CESEE have weakened considerably in the early part of 2020, with markets anticipating problems (Figure 2.9). The biggest year-to-date depreciation has been experienced by the Russian rouble, although it has recovered some of its lost value since March. The Turkish lira has also weakened steadily during the year so far. In EU-CEE, the Czech, Hungarian and Polish currencies have recorded relatively similar sell-offs, implying a rather general increase in risk aversion towards the region, rather than an approach based on the fundamentals of individual countries. The impact of currency depreciation on net exports could mitigate the downturn somewhat, although this is unlikely to be decisive, given the huge drop in demand everywhere and the fact that global value chain integration limits the importance of exchange rates in general.

7 https://lukaslehner.github.io/covid19policytrackers/

8 https://voxeu.org/article/covid-19-job-displacement-emerging-markets

Figure 2.9 / Exchange rate versus euro, 1 January 2020 = 100, value > 100 = depreciation

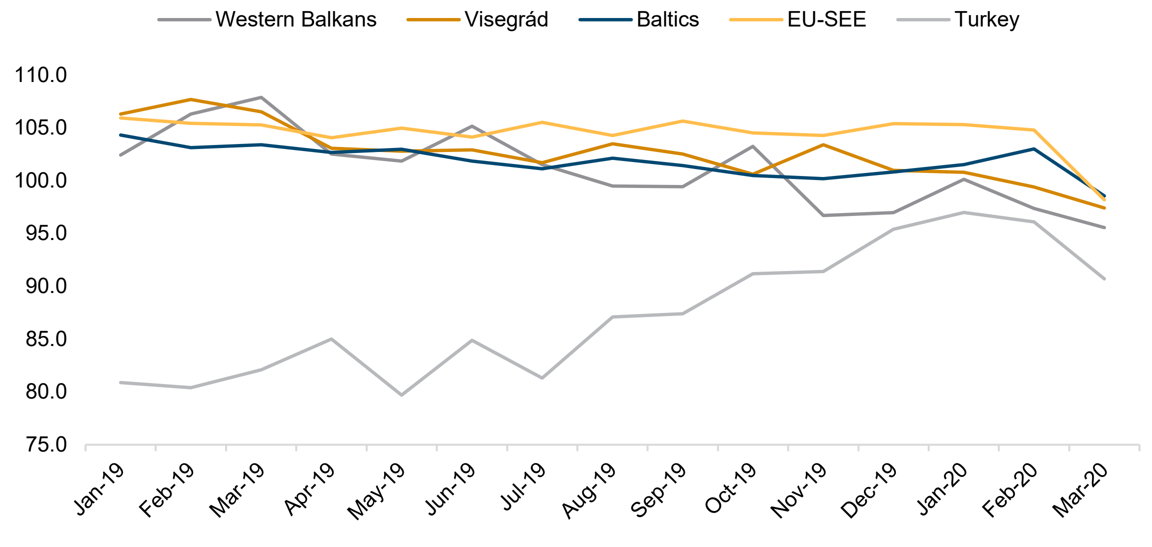


Source: National central banks, wiiw.

Sentiment

The true impact on economic sentiment will only become clear in future data releases, but the European Commission's economic sentiment indicator, available up to March, already shows a clear deterioration everywhere (Figure 2.10).

Figure 2.10 / European Commission economic sentiment indicator, long-term average = 100



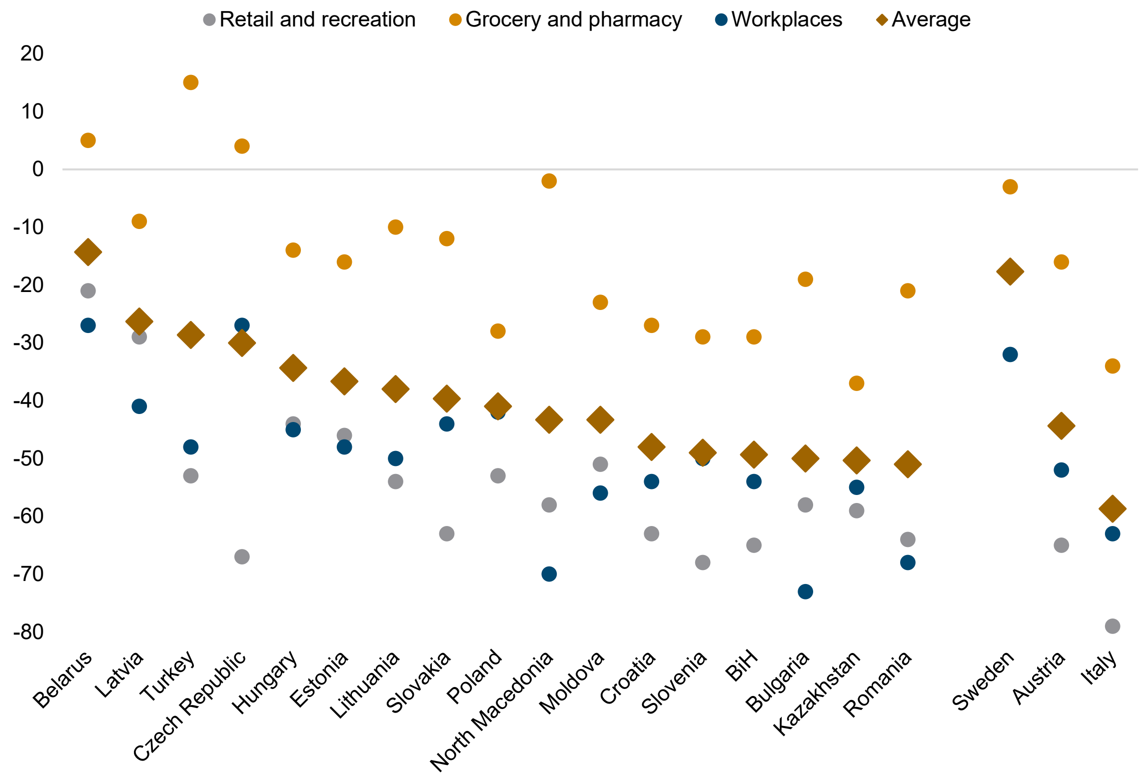
Note: Simple averages of each country group. EU-SEE = Slovenia, Croatia, Romania, Bulgaria.
Source: European Commission.

Google mobility

One-day snapshots of data can be tricky to interpret, but Google mobility data offer us the most up-to-date guide to how economic life is being affected (Figure 2.11). We use three comparators from Western Europe: Sweden (limited restrictions), Italy (severe lockdown) and Austria (somewhere in between):

- Belarus looks most like Sweden, followed by Latvia, Turkey and the Czech Republic.
- Romania, Bulgaria, Kazakhstan, Bosnia, Slovenia and Croatia seem to have the most severe disruption to normal economic life.
- Almost everywhere, the biggest impact is on retail and recreation, with grocery and pharmacy businesses much less affected (and actually above the baseline in Belarus, Turkey and the Czech Republic). This is roughly what one would expect to see.
- We also observe a big impact on workplace activity. Although many can work from home, this is unlikely to be as easy in much of CESEE as it is in Western Europe. Recent data released by Eurostat showed only Estonia and Slovenia above the EU average for working from home in EU-CEE countries.[9] A separate study released in April showed that only around one fifth of people in some parts of CESEE could work from home (Figure 2.12), compared to around 37% in Austria and Germany, and over 40% in the US. Here again, Estonia and Slovenia look much better positioned than the rest of CESEE.

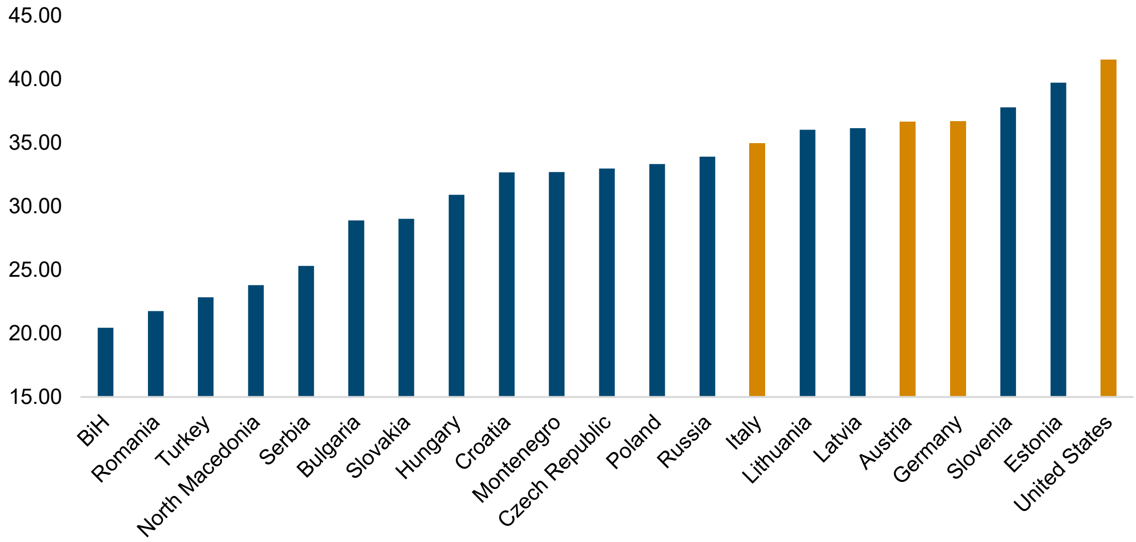
Figure 2.11 / Google mobility tracker, % activity versus baseline, 17 April



Source: Google.

[9] https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20200424-1?inheritRedirect=true&redirect=%2Feurostat%2Fnews%2Fwhats-new

Figure 2.12 / Share of population that can work from home, %



Source: https://bfi.uchicago.edu/wp-content/uploads/BFI_White-Paper_Dingel_Neiman_3.2020.pdf.

2.6. FUNDAMENTAL FACTORS OF ECONOMIC RESILIENCE AND VULNERABILITY

In trying to understand the fundamental factors of resilience and vulnerability for CESEE countries, we split them into three broad areas: demographic and health; fiscal capacity; and sectoral impact. Below, we present and discuss tables for each. In each case, we use four comparator countries from Western Europe: Italy and Spain (where lockdowns have been most severe), Sweden (the loosest restrictions in Western Europe) and Austria (somewhere in between).

Demographics and health

Countries with stronger healthcare systems will – all else being equal – require less-stringent restrictions on economic life. The relative weakness of public healthcare systems in CESEE in general, versus Western Europe, is one major reason why lockdowns were originally introduced there more quickly, relative to the number of cases. Separately, research shows that countries with older populations are likely to struggle more.[10] Below, we show data on the age structure and domestic public healthcare spending. This suggests the following conclusions:

› The share of the population aged 65 and over is around one fifth in the EU member states of CESEE, which is similar to the Western European comparator countries. In most of the rest of CESEE, the age structure is more advantageous.

› Even adjusted for local costs, public healthcare spending in CESEE is dramatically lower than in Western Europe, and especially the wealthier parts. On this metric, spending ranges from 47% of the Swedish level in the Czech Republic to just 5% in Moldova and Ukraine.

[10] https://www.pnas.org/content/early/2020/04/15/2004911117

Table 2.2 / Demographic and health factors

	Over 65 share of total population, %	Domestic govt healthcare spending, USD per capita, PPP
Source	**UN**	**World Bank**
Year	**2020 (est)**	**2017**
Albania	15	542
Belarus	16	790
BiH	18	826
Bulgaria	21	876
Croatia	21	1468
Czech Republic	20	2251
Estonia	20	1608
Hungary	20	1361
Kazakhstan	8	509
Latvia	21	961
Lithuania	21	1396
Moldova	12	241
Montenegro	16	
North Macedonia	14	624
Poland	19	1350
Romania	19	1075
Russia	16	802
Serbia	19	784
Slovakia	17	1728
Slovenia	21	2126
Turkey	9	917
Ukraine	17	257
Austria	19	4067
Sweden	20	4770
Italy	23	2675
Spain	20	2449

Note: Red = worst, green = best.
Sources: UN, World Bank, wiiw.

Fiscal space

Many Western countries will be able to expand their fiscal deficits significantly, in order to support workers and firms through much of the worst of the crisis. We do not expect this to be an option to anything like the same extent in most of CESEE. Even some of the countries that have made big fiscal promises (see annex table) may not be able to deliver. The data collected here (Table 2.3) suggest the following conclusions:

- Five countries go into this crisis with relatively high public debt/GDP ratios: Slovenia, Hungary, Albania, Montenegro and Croatia. The fact that the latter three are also heavily exposed to the tourism sector (see below) is a concern.
- Only Romania is going into this crisis with a significant budget deficit. The generally loose fiscal policy of the last few years could impact Romania's ability to respond to the crisis.

› The 2004 EU joiners generally have the best credit ratings, and so should be able to borrow externally to fund their deficits to a much greater extent than the rest of CESEE. The other countries will have to rely on either official creditors (where the amounts available appear to be quite limited) or their domestic resources.

Table 2.3 / Fiscal factors

	Credit rating	Budget balance, % of GDP	Public debt, % of GDP*
Source	*Moody's, S&P, Fitch*	*wiiw*	*wiiw*
Year	*2020*	*2019*	*2019*
Albania	6.0	-1.9	67.5
Belarus	6.0	4.0	42.0
BiH	6.0	1.0	31.7
Bulgaria	4.0	2.1	20.4
Croatia	4.7	0.4	73.2
Czech Republic	2.0	0.3	30.8
Estonia	2.3	-0.3	8.4
Hungary	4.0	-2.0	66.3
Kazakhstan	4.0	-1.9	25.2
Kosovo		0.7	17.2
Latvia	3.0	-0.2	36.9
Lithuania	3.0	0.3	36.3
Moldova	6.0	-1.4	26.3
Montenegro	6.0	-2.3	69.0
North Macedonia	5.0	-2.1	48.8
Poland	3.0	-0.7	46.0
Romania	4.0	-4.3	35.2
Russia	4.0	2.0	12.4
Serbia	5.0	0.7	52.0
Slovakia	3.0	-1.2	48.0
Slovenia	3.0	0.5	66.1
Turkey	5.7	3.0	32.0
Ukraine	6.3	-2.1	50.3
Austria	2.0	0.7	70.4
Sweden	1.0	0.5	35.1
Italy	4.0	-1.6	134.8
Spain	3.3	-2.8	95.5

Note: Credit rating scores calculated as follows: 1 = prime, 2 = high grade, 3 = upper medium, 4 = lower medium, 5 = non-investment grade speculative, 6 = highly speculative, 7 = substantial risks. Scores represent averages of assessments by Moody's, S&P and Fitch.
Red = worst, green = best.
Sources: Moody's, S&P, Fitch, wiiw.

Key sectors

It is clear that not all sectors are going to be affected in the same way by this crisis, and that some could even benefit. Here, we highlight two that will certainly suffer (external trade and tourism); one area that will see benefits for some, but will be a challenge for others (energy); and one that should certainly benefit (the digital economy). Our conclusions are as follows:

- **Countries with the greatest exposure to external trade (Slovakia) or tourism (Croatia, Albania and Montenegro) are particularly exposed to the crisis.** However, while the former could recover reasonably quickly (especially if the rebound in Asia continues), the latter group is likely to suffer for longer. This summer's tourist season will be extremely tough, and it is not unreasonable to think that the impact on international tourism will last well beyond 2020. Tourism is a fairly important sector in many CESEE countries.
- **Although the sharp decline in energy prices should, in theory, have symmetrical effects (oil importers gain whatever oil exporters lose), various studies indicate that this is not generally the case.** Oil exporters (Russia and Kazakhstan in our region) will register a big decline in earnings, but this will not necessarily translate into a big gain for importers. The huge hit to confidence stemming from the current crisis will mean that any real income gains are saved, rather than spent. However, with oil prices likely to stay low for some while (see global overview), over time this will generate a positive boost to consumption and investment in the rest of the region.
- **The digital economy will certainly get a boost from this crisis.** The best-positioned countries seem to be the Baltics states, the Czech Republic and Slovenia. We dealt extensively with the opportunities for CESEE in the new digital economy in our previous forecast report.[11]

Table 2.4 / Key sectors

	External trade, % of GDP	Travel/tourism total contribution to GDP, %	Net energy trade balance, % of GDP	Networked readiness index
Source	*wiiw*	*World Bank*	*wiiw*	*WEF*
Year	*2019*	*2016*	*2019*	*2016*
Albania	77.1	26.3	-1.4	3.9
Belarus	139.4	6.2	-4.3	
BiH	99.2	9.9	-5.0	3.6
Bulgaria	129.2	11.3	-3.4	4.1
Croatia	101.8	25.1	-3.2	4.3
Czech Republic	150.6	7.6	-2.9	4.7
Estonia	145.0	15.5	-1.0	5.4
Hungary	165.5	8.0	-3.8	4.4
Kazakhstan	63.5	6.0	22.4	4.6
Kosovo	82.0		-6.4	
Latvia	122.8	9.4	-3.4	4.8
Lithuania	149.3	4.9	-4.0	4.9
Moldova	85.8	3.3	-8.5	4.4
Montenegro	109.6	25.1	-4.1	4.0
North Macedonia	133.8	6.8	-6.4	4.3
Poland	107.8	4.5	-2.8	4.5
Romania	86.2	5.4	-1.6	4.1
Russia	51.3	4.9	14.1	4.5
Serbia	110.1	6.7	-4.8	4.0
Slovakia	190.2	6.4	-4.1	4.4
Slovenia	160.8	12.3	-2.9	4.7
Turkey	60.1	11.7	-5.0	4.4
Ukraine	99.0	6.0	-9.4	4.2

Note: Red = worst, green = best.
Sources: World Bank, World Economic Forum (WEF), wiiw.

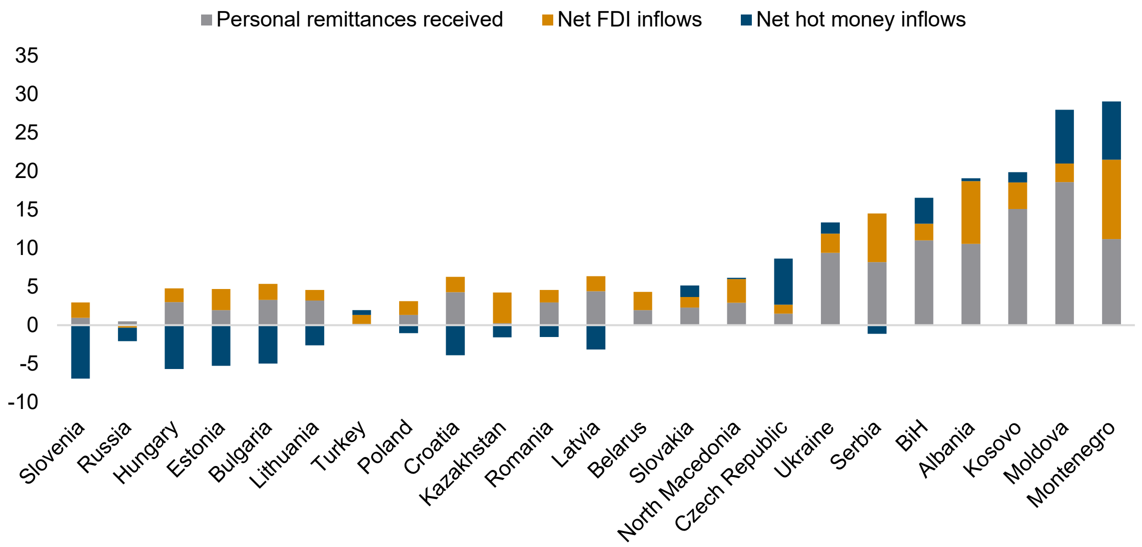
[11] https://wiiw.ac.at/uncertainty-in-turbulent-times-p-5237.html

2.7. FINANCIAL FALLOUT

This is not (yet) a financial crisis in the same way as 2008 was. After an initial squeeze,[12] dollar liquidity – always a big issue in any crisis, given the US currency's prevalence in global trade and finance – has been underpinned by a strong Fed response. Nevertheless, capital flight is a huge potential challenge for the CESEE region. Data produced by the Institute of International Finance (IIF) show that Q1 2020 saw the biggest ever capital outflows from emerging markets.[13] A new emerging markets crisis is far from unthinkable, not least because China is unlikely to provide the backstop to global demand that it did after 2008.[14]

Looking across different types of capital flows (remittances, foreign direct investment and hot money), the CESEE countries most exposed to a sharp reduction are the Western Balkans, Moldova and Ukraine (Figure 2.13). Remittances are important for all the countries mentioned, while foreign direct investment (FDI) has also been a key aspect of external financing for Montenegro, Serbia and Albania in recent years. As capital flows fall this year, so there will be an additional financing squeeze on these countries. In this context, the rolling over of external debt is also going to be a challenge (as just one example, Turkey has external debt falling due in the next 12 months that is equivalent to over 20% of its 2019 GDP). Most countries have higher external debt as a share of GDP than they did in 2007, on the eve of the global financial crisis (Figure 2.14), and the current strength of the dollar adds to their difficulties.

Figure 2.13 / Selected capital flows, % of GDP



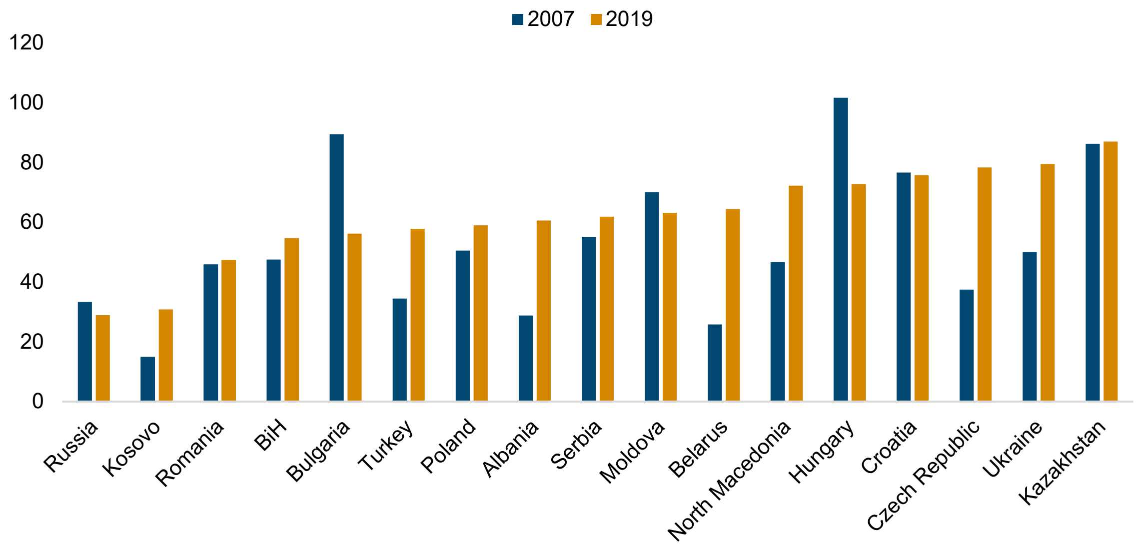
Note: average of last five years for which data are available. Positive value = net inflow.
Sources: World Bank, wiiw.

[12] https://adamtooze.com/2020/03/22/crashed-to-corona-1-the-dollar-shortage/

[13] https://www.iif.com/Publications/ID/3841/Capital-Flows-Report-Sudden-Stop-in-Emerging-Markets

[14] https://foreignpolicy.com/2020/03/28/coronavirus-biggest-emerging-markets-crisis-ever/

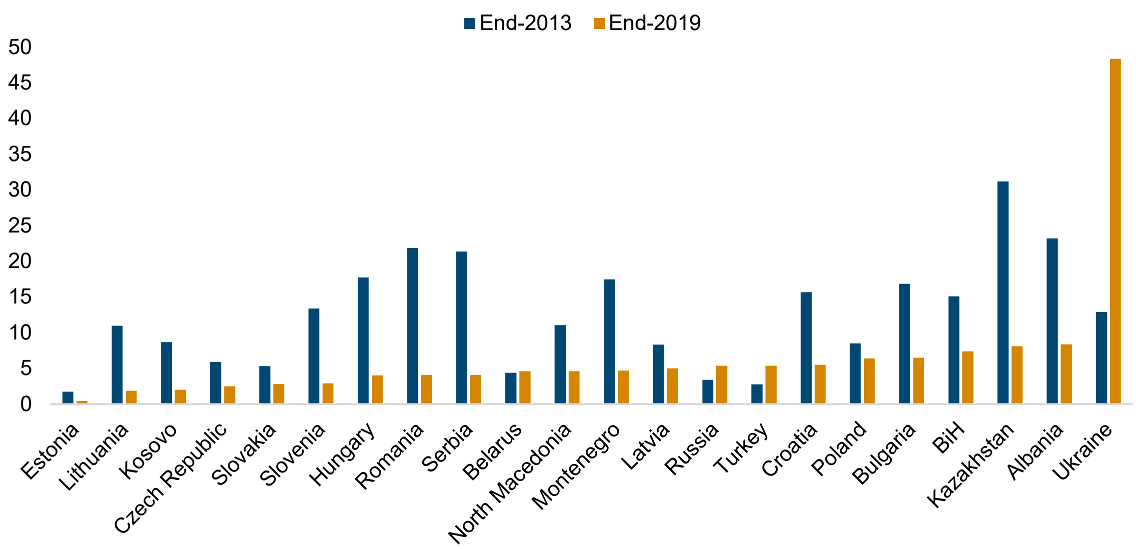
Figure 2.14 / Gross external debt, % of GDP



Note: euro area countries not shown.
Source: wiiw.

A key aspect of financial resilience will be the banking sector. Here, there are grounds for moderate optimism, given the clear improvement in asset quality in recent years (Figure 2.15). Nevertheless, the headline improvement in asset quality may mask some particular areas of stress or vulnerability. Moreover, as the aftermath of the 2008 crisis showed, asset quality ratios can change very quickly, and a strong increase in non-performing loans over the coming two years looks very likely.

Figure 2.15 / Non-performing loan ratio, % of total loans

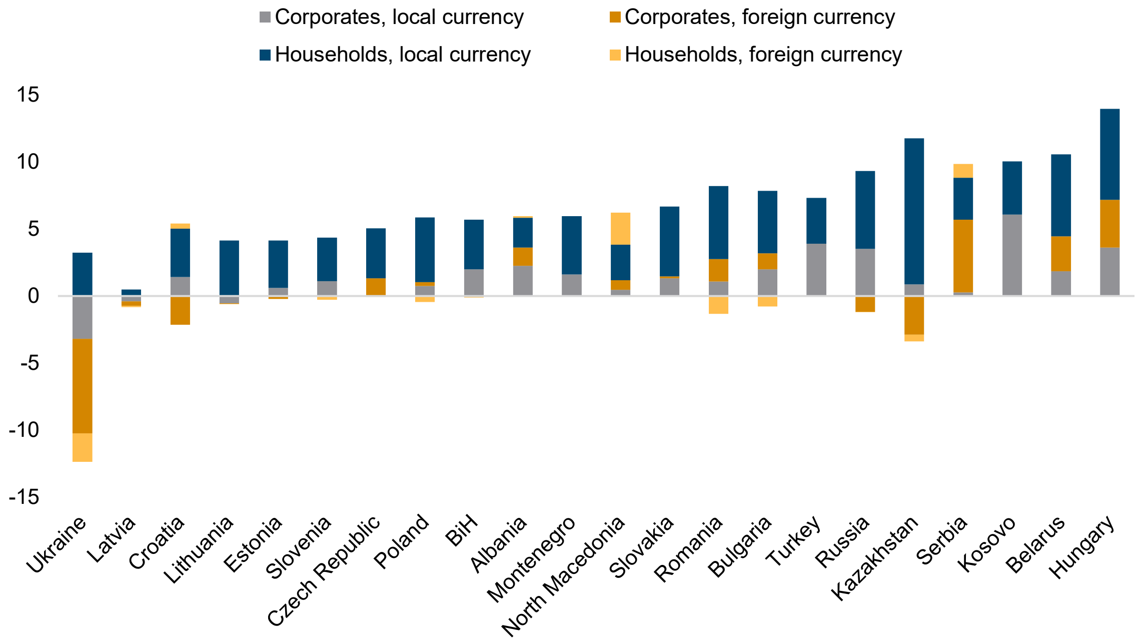


Source: wiiw.

This time, international organisations, banks and interested Western governments appear to be responding quickly, having learned the lessons of 2008. The risk of capital flight, especially in the Western Balkans, has already prompted a response from the Vienna Initiative, which was initially set up under EBRD leadership to support the financial sector in CESEE after the 2008 crisis.[15] In addition, Albania, Bosnia, Kosovo, Moldova and North Macedonia have already agreed to so-called Rapid Financing Instruments (RFIs) with the IMF, ranging from 41.3 million Special Drawing Rights (SDR) for Kosovo to SDR 265.2 million for Bosnia.[16]

It is probably safe to assume that credit growth will collapse everywhere. This will have the biggest economic implications for countries that have until now relied most heavily on credit growth to drive overall economic expansion. Over the most recent six months, credit growth was particularly strong in the CIS, parts of the Western Balkans, Hungary and Turkey (Figure 2.16). In most of these countries, the key demand for credit has been from households and firms in local currency. However, in Serbia (and to an extent in Hungary and Belarus), there have been quite notable increases in foreign-exchange borrowing by firms.

Figure 2.16 / Credit, percentage-point contributions to year-on-year growth, six-month moving average, March 2020 or latest available



Source: wiiw.

15 https://www.ft.com/content/162bfc8d-603d-415d-938e-f940eadd3aaf?emailId=5ea5e199ea83a3000415efdb&segmentId=488e9a50-190e-700c-cc1c-6a339da99cab

16 https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#EUR

2.8. THE MEDIUM AND LONG TERM

This crisis is likely to have far-reaching implications for the economies of CESEE. It is already possible to imagine what at least some of them will be. Below, we outline a few:

1. **A different kind of consumer economy and a higher level of caution.** It is very difficult to imagine that, even in the long run, the normal methods and patterns of consumption will return to exactly what they were before. Many people who previously did not shop online have started to do so extensively, and most will probably not go back entirely once the virus has finally passed. For a long time to come, many people will be cautious about eating and drinking out; and in the meantime, many firms in the hospitality sector will go bust. The leisure and entertainment industry in general will look different in the future. Consumption patterns will, at least for some time, be defined by a new level of caution. Even as economic conditions improve, consumers will probably be more careful and allocate a greater share of their income to saving than before. This will be exacerbated by lower levels of employment (at least initially), greater uncertainty about real income growth prospects, and possibly also higher household debt.

2. **An even longer period of ultra-low global interest rates.** As central banks found out after 2008, cutting interest rates is much easier than raising them again. That is even more the case now. After the last crisis, a key barrier to raising rates was the fact that stock and bond markets panicked every time even a small increase was mooted. Now that a much greater range of financial assets has been included in central bank purchase programmes, the path back towards 'normal' rates will be even more fraught and prolonged (if it is ever attempted at all).

3. **Re-shoring, but also near-shoring, which could benefit the four Visegrád countries, Slovenia, the Baltic states and possibly parts of the Western Balkans.** The Coronavirus crisis will prompt at least some unwinding of the complex supply chains that span the globe. Firms will sacrifice cost advantages in return for greater security of supply. Nevertheless, the incentive for companies in rich countries to outsource some production to lower-cost locations will remain. The Western part of CESEE (and possibly also Serbia and North Macedonia) is likely to benefit from this, and could in the coming years attract new investment from Western Europe. The Visegrád states in particular should be able to benefit from their proximity to Western Europe, as well as their EU membership, their relatively good infrastructure and their high quality of labour. One of the implications of this could be a return to – or even a speeding up of – migration from the poorer parts of CESEE to the region's EU member states.

4. **More outsourcing of services to CESEE.** Firms have so far generally been much quicker to outsource goods than services.[17] Given that the current crisis has shown how many service jobs can be done remotely, and given that companies will face big additional costs related to the crisis and potentially weaker demand for some time to come, firms in Western Europe may also now take greater advantage of CESEE's lower labour costs in services. Although, in theory, this could benefit the even cheaper Asian locations more, there is evidence that gravity also applies in services trade (for example, because of the importance of time zones).

---

[17] https://wiiw.ac.at/testing-the-smile-curve-functional-specialisation-in-gvcs-and-value-creation-p-4807.html

5. **The gulf between the 'two Eastern Europes' will grow.** On the one hand, the more developed part of the region – and especially the 2004 EU joiners – will integrate ever more with Western Europe. On the other hand, the rest of the region may struggle to improve much on the current (generally relatively low) levels of economic integration with richer parts of Europe. Russia, for example, has been preparing for a less-globalised world for some time. What this means for the Western Balkans is highly uncertain. It is fully in the EU's interests to integrate the Western Balkans as far as possible; but whether it will do so is questionable.

6. **A still-important role for China in CESEE.** In the short term, the three big blocs of the global economy – the US, China and the EU – are all in defensive mode. However, while this is a temporary state of affairs for the US and China, the EU has been primarily focused on internal challenges for over a decade now. As a result, even as the crisis fades, the EU is unlikely to take decisive steps to secure its geo-economic interests in the Western Balkans and its Eastern Neighbourhood. With countries in this region set to face persistent funding constraints, and with Russia more cash-strapped than ever due to the low oil prices, China is likely to continue to play an important economic and political role in the non-EU countries of CESEE. Its role in helping Serbia to manage the Coronavirus crisis provides a clear example of this.

7. **A more positive outcome for younger people.** The narrative of the post-2008 crisis has often focused on the suffering of younger people (especially in Southern and Southeast Europe) and the relatively better outcomes for 'baby boomers' and the generation below them who have secure jobs, fixed pensions and high savings. The current crisis and its aftermath are likely to create more advantages for those most capable of capitalising on the digital economy, i.e. young people.

8. **Higher (and possibly more progressive) taxes in CESEE.** Countries in CESEE tend to have much lower tax rates than in Western Europe, and in many cases also less-progressive ones. Given the likely huge increase in public debt as a result of this crisis, taxes will have to rise, and more progressive options may be considered.

9. **An expanded role for the state in economic life.** Higher taxes will accompany (and reinforce) an expanded role for the state, which will outlast the current crisis. This will be an important step for many CESEE countries, where governments have often adopted a fairly hands-off approach to the economy, at least by Western European standards. For countries like Russia and Turkey, and also to a lesser extent Poland and Hungary, this will be less of a change. However, for most other EU member states in CESEE, the change could be more significant, including a marked (and much-needed) increase in public health expenditure.

10. **Still very low inflation for most.** The lack of price growth has been a constant theme of our analysis in recent years. Although the exact causes of persistently low inflation remain disputed, it is likely that demographic trends, the increased competition of online retail and the deflationary impact of high debt have all played a role. All three of these factors are here to stay, and the effect of the latter two will be even stronger now than before. Persistently low oil prices will provide an additional factor. There will, of course, be exceptions to this – especially countries with persistently negative real interest rates and ever-weakening currencies, such as Turkey.

11. **After a brief lull, labour shortages and automation will return as prominent themes in CESEE.** For a while, the crisis will alleviate the labour shortages by increasing unemployment. However, the pressure towards automation will likely remain strong, and firms will look for cost savings to offset the higher costs of re- and near-shoring. Moreover, such is the scale of the negative demographic trend in CESEE that it is unlikely to be more than a couple of years before the theme of labour shortages returns.

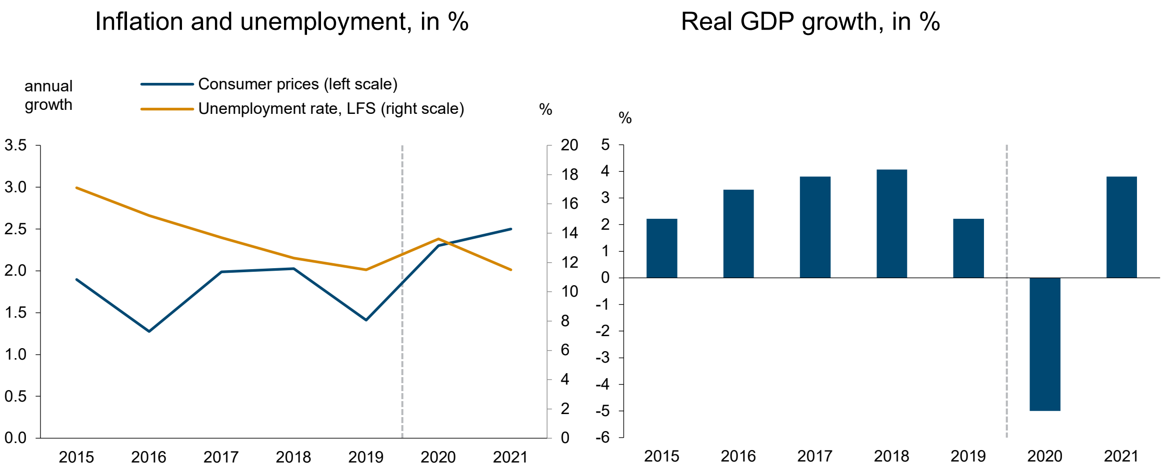
3. Country reports

ALBANIA: Double whammy lays the economy low

ISILDA MARA

The Albanian economy contracted in the last quarter of last year, due to a devastating earthquake on 26 November 2019. The COVID-19 crisis has thus affected an economy with limited liquidity buffers. There will be a negative impact on the current account, as tourism – a driver of growth over the past two years – becomes a drag on the economy. Foreign direct investment (FDI) and remittance flows will likely shrink. The economy will contract by 5% in 2020, due to a fall in domestic and external demand, but will rebound by 4% in 2021.

Figure 3.1 / Albania: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.1 / Albania: Selected economic indicators

	2018	2019 [1)]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	4.1	2.2	-5.0	3.8
Unemployment rate, LFS, in %, average	12.3	11.5	13.6	11.5
Consumer prices, % p.a.	2.0	1.4	2.3	2.5
Current account, % of GDP	-6.8	-7.6	-9.5	-9.0
Central bank policy rate, % p.a., eop [2)]	1.0	1.0	0.5	0.5
Average exchange rate ALL/EUR	127.6	123.0	124.0	123.0

1) Preliminary. - 2) One-week repo rate.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

COVID-19 has hit the Albanian economy hard, following on from the blow it received from last November's earthquake. A devastating earthquake on 26 November led to the economy contracting by 0.15% in the fourth quarter of 2019. A donor conference in Brussels on 17 February 2020 succeeded in securing EUR 1.15 billion funding for the country, through donations, grants and soft loans from the international community. But the arrival of the COVID-19 pandemic brought further woe for the Albanian economy.

A state of emergency was announced on 23 March, to extend at least until 23 June. The financial package allocated by the government to the COVID-19 emergency amounts to 2% of GDP. The International Monetary Fund's Rapid Financing Instrument support amounts to EUR 175 million, while macro-financial assistance from the EU is expected to be EUR 185 million. Already, the first month of lockdown has devastated government finances. Public debt will rise further and a fiscal deficit of 5% is expected in 2020. Meanwhile, the government has brought forward a package that promises a tax amnesty to Albanian companies and citizens (including emigrants). Given the country's large informal economy, such an amnesty will certainly help place things on a more formal footing and raise revenue for the general government budget. Despite the difficulties at home, solidarity with Italy has been offered: even though in per capita terms it has the lowest number of health personnel of all the CESEE countries, on 28 March and 20 April Albania sent 30 and 60 doctors and nurses, respectively, to assist its neighbour.

Unemployment is expected to rise to 14%. Some 44% of workers in Albania are employed in the private sector, and more than 80% of that sector consists of small and medium-sized enterprises that are engaged in the trade (41%) and service (22%) sectors, which are quite badly affected by the lockdown. Firms that are export oriented are particularly badly hit: companies in the garment sector, for instance, have continued with production and have built up their stocks, but there is concern about the import of raw materials and the cancellation of contracts from Italy – that sector's main trading and investment partner – if the lockdown is extended for several months. Another emerging concern is that a number of companies operating in the sector are turning into hotspots for spreading the virus. Overall, more than 60,000 people in the country have registered as unemployed. It is very likely that unemployment will rise above 14%, but the high level of informal employment means that many of them will not be recorded in the official statistics.

The banking sector is well capitalised, but lending is being tightened. Non-performing loans have dropped to 10% and the demand for credit recovered during the first months of the year. But with the arrival of COVID-19, the banks have been tightening up on their lending conditions. The central bank has cut the interest rate further to 0.5%. The domestic currency depreciated by 4% in March and fluctuated quite a lot throughout April. In March, inflation rose above 2.1%, driven mainly by food prices, but also by a rise in rents on apartments in the wake of the earthquake.

The negative effects on the current account will expand. In March, exports of goods contracted by 36%, while imports of goods dropped by 26% – except for food imports, which have been rising. The tourism sector has helped drive the economy over the past two years – in 2019, it accounted for 26% of Albanian GDP. But the earthquake and COVID-19 could devastate the sector. In 2019, Albanians spent almost EUR 1.6 billion on tourism abroad. There is thus some glimmer of hope that domestic tourism may come to the rescue of the sector. Remittances may also contract: the Albanian community living and working in Italy – close to 500,000 – is expected to be adversely affected by the contraction of the

Italian economy. Thousands of seasonal workers from Albania who go to Greece for the harvest are also expected to be affected by closure of the border. Foreign direct investment is also likely to suffer, as Italy accounts for 27% of Albania's FDI stocks.

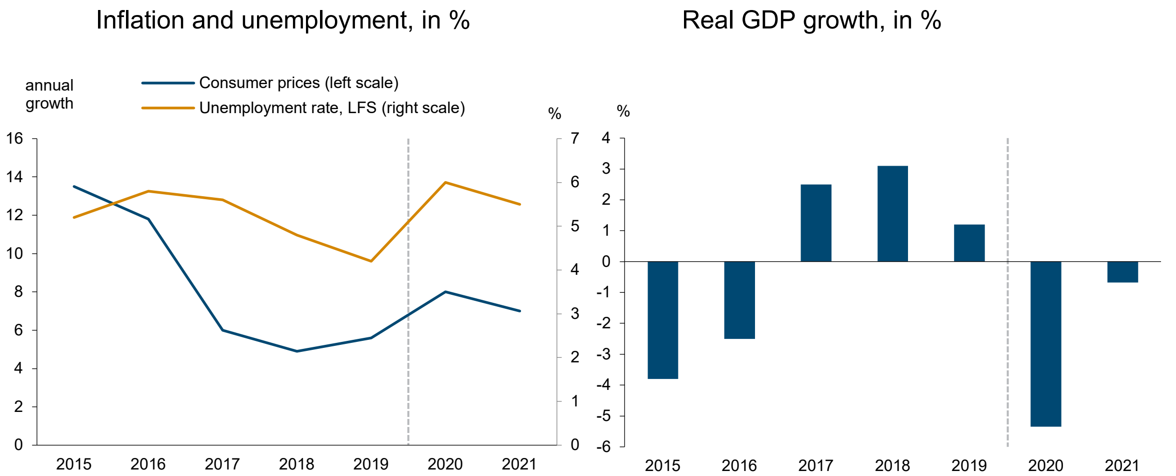
It is to be expected that the economic breakdown in Italy will have a domino effect on Albania's economy. In 2019, Italy was one of the main sending countries of FDI to Albania. Italian enterprises operating in Albania represent 47% of the foreign enterprises in Albania. Trade volume with Italy amounted to 48% of exports and 25% of imports in 2019. The textile and garment industry is the sector where Italian-Albanian cooperation is most intensive.

BELARUS: Risky strategy with uncertain outcomes

RUMEN DOBRINSKY

Defying the COVID-19 threat, Belarus has not yet declared a formal lockdown. The economic fallout from the pandemic has been increasing through both internal and external transmission channels. Rather late in the day, the authorities have launched a series of policy support measures, but their funding will depend on the government's ability to raise additional external finance. A notable downturn seems inevitable in 2020, with GDP falling by more than 5%.

Figure 3.2 / Belarus: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.2 / Belarus: Selected economic indicators

	2018	2019 [1]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	3.1	1.2	-5.3	-0.7
Unemployment rate, LFS, in %, average	4.8	4.2	6.0	5.5
Consumer prices, % p.a.	4.9	5.6	8.0	7.0
Current account, % of GDP	0.0	-1.8	-2.7	-3.5
Central bank policy rate, % p.a., eop [2]	10.0	9.0	10.0	9.0
Average exchange rate BYN/EUR	2.40	2.33	3.0	3.3

1) Preliminary. - 2) Refinancing rate of NB.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

At the time of writing, Belarus and Sweden are the only European countries not to have declared a formal lockdown. After a late start, the infection has been spreading rapidly throughout Belarus, and – again at the time of writing – the number of daily reports of new cases is among the highest in Europe. At the same time, the reported mortality rate attributed to COVID-19 remains quite low.

The healthcare system in Belarus is, in principle, well prepared to cope with infectious diseases. The country has more hospital beds per capita than most European countries, and there is a functioning vertical structure of sanitary epidemiological reconnaissance and control. This is largely a legacy of the Soviet era, and although there has been some degradation in recent years, the system is still very much intact. However, the country's approach to dealing with COVID-19 may turn out to have simply delayed the introduction of life-saving health protection measures. And it may well be that future events – such as a sharp rise in the mortality rate – force the authorities to take more stringent measures.

The economic fallout from the pandemic is already visible, although its magnitude will only become apparent with some delay. The population has gradually began to adopt self-imposed protective and social distancing restrictions, which have had an impact on economic activity. While hotels and restaurants have remained open, occupancy rates have plummeted. Meanwhile, passenger traffic in April was 40% down on the same month last year. Exports both to Russia and to other important markets are falling. And the plunge in oil prices is having a negative effect, as Belarus exports large quantities of refined oil. The Belarusian currency – which is closely linked to the Russian rouble – has seen a similar depreciation as the rouble, suggesting a possible resurgence of higher inflation.

After almost a month of deliberation, on 24 April the authorities finally launched their first package of policy support measures. These focus on immediate support for the worst-affected economic sectors, such as retail trade and transport, but also manufacturing and some service industries. The instruments in the package include tax holidays, relief on rental payments owed to the state, and more flexible tax regimes. A second package, targeting social protection, is due to be launched soon. According to preliminary information, it will envisage a significant rise in unemployment benefits and an increase in budgetary allocations to the healthcare system. In addition, the central bank has made changes to the banking regulations, allowing a relaxation of banks' capital adequacy requirements for the release of liquidity for additional lending.

The two fiscal packages are estimated to be worth BYN 5-6 billion. The authorities hope to be able to fund them mostly through new foreign borrowing from international financial institutions: negotiations for new loans amounting to USD 2-2.5 billion are under way. However, the outcome of these negotiations – especially those with the International Monetary Fund – is difficult to predict.

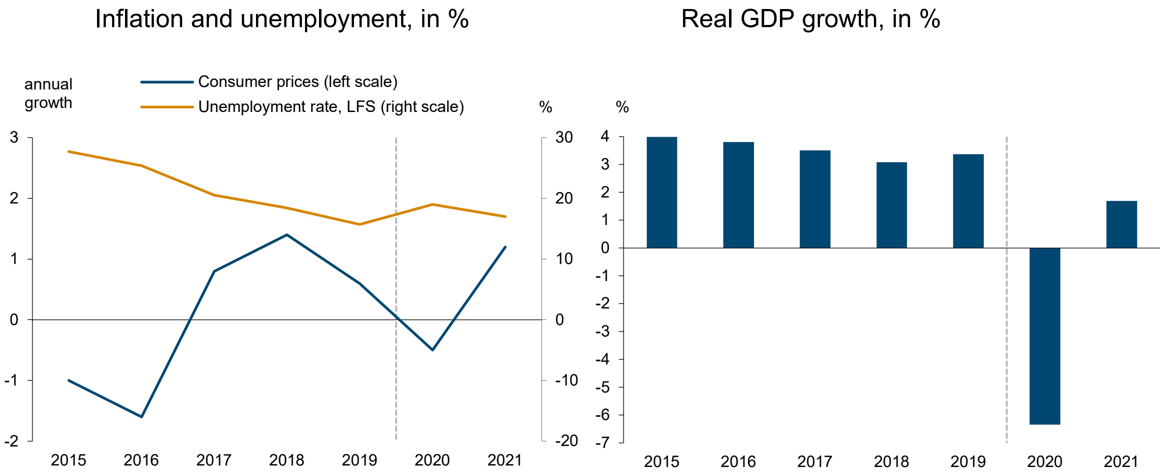
A notable GDP contraction in 2020 seems inevitable, although the authorities have been reluctant to acknowledge this. The stakes are high, as 2020 will see presidential elections, which are due in August. Unless the elections are cancelled or postponed, some further populist moves can be expected in the run-up to them. In the absence of a radical departure from the present course, we expect GDP to drop by more than 5% in 2020. However, the downturn may be steeper if there is any sharp deterioration in the healthcare situation. The negative implications are likely to be lasting, and it may take years before the economy recovers fully from the current crisis.

BOSNIA AND HERZEGOVINA: Complex governance structure contributing to foreign dependence

BERND CHRISTOPH STRÖHM

The shutdown caused by the COVID-19 pandemic is severely jeopardising business in the tourism, hospitality, manufacturing and transport sectors throughout BiH. The country's structure means it has limited fiscal scope to mitigate the economic fallout and is reliant on foreign aid and loans. It also needs to cope with plummeting demand for products and services. The repercussions of the pandemic will be evident in 2020, with GDP contracting by 5%. The economy will recover somewhat in 2021, by 3%.

Figure 3.3 / Bosnia and Herzegovina: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.3 / Bosnia and Herzegovina: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	3.7	2.6	-5.0	3.0
Unemployment rate, LFS, in %, average	18.4	15.7	19.0	17.0
Consumer prices, % p.a.	1.4	0.6	-0.5	1.2
Current account, % of GDP	-3.7	-3.5	-8.0	-6.0

1) Preliminary.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

The complex state structure of BiH – with the two entities of the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpksa (RS), plus the district of Brčko (DB) – is hampering effective action to cope with the pandemic at a political and fiscal level. The economic downturn for BiH began in mid-March, when economic activity ceased, unemployment rose and public revenues fell. The overall adverse effects of COVID-19 on BiH will be felt particularly in 2020, with GDP contracting by 5%. In 2021, the economy will improve, but only by 3%.

The shutdown is endangering business, especially in the tourism, hospitality, manufacturing and transport sectors. The FBiH entity, with the capital Sarajevo, will suffer particularly badly, as it relies on the service sector. BiH declared a state of emergency on 17 March, whereupon public life came to a standstill. The country's 'brain drain' means that the health sector suffers from a lack of trained medical personnel. Fearing that the health system may be overwhelmed, in an attempt to contain the pandemic, the governments of FBiH and RS imposed draconian measures, including a strict curfew. Schools, restaurants and shops were closed, apart from pharmacies and supermarkets (though delivery services were allowed to continue). BiH's multi-entity state structure means that the country has very limited fiscal scope to mitigate the economic fallout by itself, so that RS and FBiH are reliant on foreign aid and loans, which are largely being provided by the IMF and the EU. In April, the IMF agreed to provide BiH with a EUR 330 million loan as a measure to mitigate the adverse economic consequences of the pandemic.

The impact on the labour market will be enormous. RS announced that it would pay a minimum wage to all employees in those sectors most affected by the pandemic, while the FBiH entity wants to subsidise contributions and taxes and pay a minimum wage to all employees of companies that have been affected by the lockdown. As a result of the pandemic, unemployment will probably rise to 19% in 2020. As the economy recovers, however, this figure will drop in 2021. A reduction in private consumption means that consumer prices are projected to fall by 0.5% in 2020, before rising again in 2021.

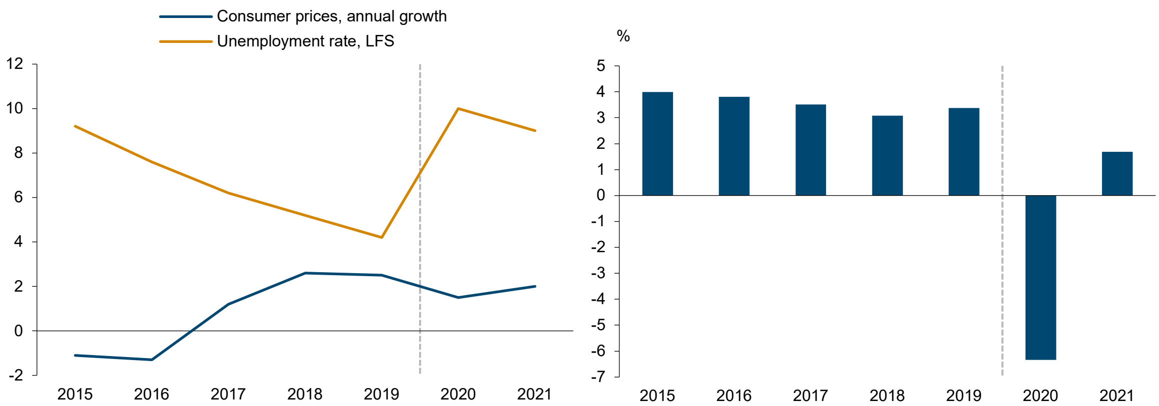
External trade is badly affected by COVID-19, since companies are not able to maintain supply chains properly. This applies to exports to the EU, but possibly even more importantly (from the perspective of fiscal revenue) it also has an impact on imports required by the country's manufacturers. BiH also needs to manage the dramatic decline in external demand for products and services. Bosnia's close ties to Italy, in particular, will adversely affect the overall output of the economy: Italy's total lockdown has virtually removed an essential trade destination for at least the first and second quarters of 2020. Overall, BiH's current account deficit will likely rise to 8% in 2020, before narrowing to 6% in 2021, spurred by remittances from the diaspora.

BULGARIA: The shock will likely be passed on to the labour market

RUMEN DOBRINSKY

The spread of the COVID-19 infection in Bulgaria has been relatively limited, but the country has been under lockdown since mid-March. The economic fallout from the pandemic is widespread, affecting a large number of sectors. The government launched a package of fiscal support measures, but their effectiveness is in doubt, especially as regards employment protection. Overall, we expect GDP to drop by more than 6% in 2020; this will be coupled with a surge in unemployment.

Figure 3.4 / Bulgaria: Main macroeconomic indicators



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

Table 3.4 / Bulgaria: Selected economic indicators

	2018	2019 [1]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	3.1	3.4	-6.3	1.7
Unemployment rate, LFS, in %, average	5.2	4.2	10.0	9.0
Consumer prices (HICP), % p.a.	2.6	2.5	1.5	2.0
Current account, % of GDP	1.4	4.0	1.9	1.7

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

On 13 March, Bulgaria declared a state of emergency, which was later extended until 13 May. Since then, the country has been in partial lockdown, with all public activities suspended. However, businesses that can ensure social distancing (including manufacturing firms and small shops) have been allowed to continue operating. As in other countries, the lockdown itself has created a domestic shock in sectors such as tourism, catering, transport and the retail trade. In addition, all export-oriented manufacturing sectors have been suffering from the reduced global demand.

Probably thanks to the early imposition of restrictions, the spread of COVID-19 in Bulgaria has been relatively limited. The healthcare system was fully mobilised to deal with the infection, and as of the end of April it was still operating at far below capacity (in terms of both available hospital beds and medical personnel).

As a policy response, the Bulgarian government announced relatively early on a fiscal package amounting to BGN 2.8 billion. It included, among other things, credit guarantees and employment protection measures for affected businesses; incentives for healthcare workers; and deferred payments to the budget of taxes and other dues. While the package appears to be adequate in size and scope, in fact it has turned out to be poorly designed in terms of implementation of the measures: one month on, bureaucratic bottlenecks mean that many of the measures are still not up and running.

Under the currency board system, the Bulgarian authorities cannot resort to monetary measures to complement the fiscal response. The only monetary response has been the easing of banks' capital adequacy requirements for the release of liquidity for additional lending.

Within the agreed fiscal package, direct and indirect employment protection measures alone are estimated to account for BGN 1.5 billion. However, these do not include grants to affected employees and households, and that is considered to be a major flaw. The most important instrument envisaged within the measures is the government's pledge to contribute 60% of the wage bill of firms affected, provided they keep their employees on; the businesses still have to contribute the remaining 40%. However, it has turned out that only a few large and relatively unaffected firms can comply with this provision; small and medium-sized enterprises (SMEs) have been forced to close, as cashflow problems mean they simply cannot afford to keep on their workforce.

Therefore, despite these measures, the Bulgarian labour market will probably suffer a greater shock than other CESEE countries. In general, the labour market in Bulgaria is quite flexible, since the employment protection offered under labour contracts is relatively poor. On the other hand, as the newly adopted employment protection measures impose a number of cumbersome conditionalities, many of those businesses affected, and especially SMEs, have opted out and have resorted to layoffs. In consequence, massive redundancies were a fact of life even back in March – and this has continued in April.

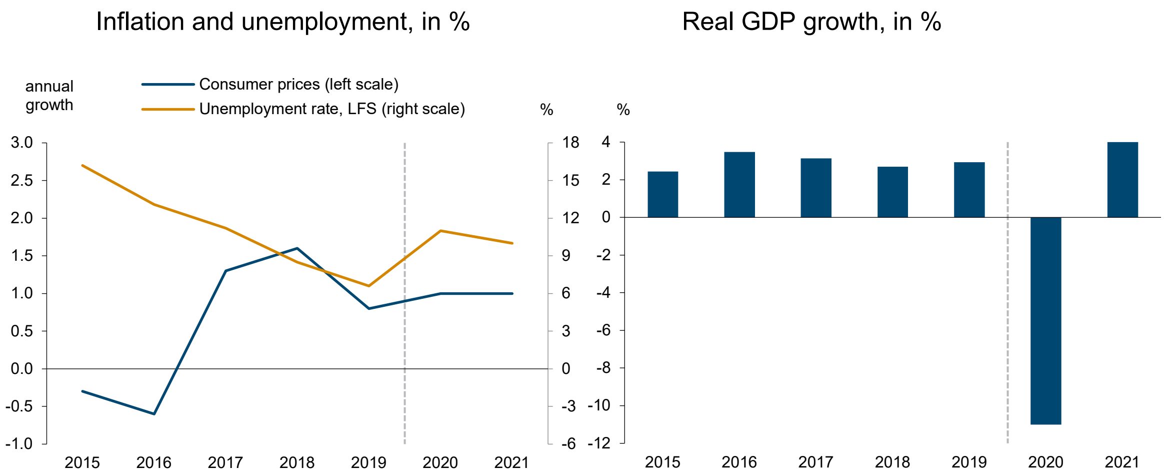
Overall, we expect GDP to drop by more than 6% in 2020; this will be coupled with a surge in unemployment, which could reach 10%. As for 2021, we anticipate only a modest recovery, as both domestic and external demand is expected to remain depressed.

CROATIA: Rebound in GDP will require recovery in tourism

HERMINE VIDOVIC

Croatia's authorities responded quickly to the pandemic and launched comprehensive stimulus packages to mitigate its effects. Given the serious decline in earnings from tourism, a major pillar of the country's economy, wiiw estimates that GDP will contract by about 11% in 2020. A moderate upswing of 4% is expected in 2021. Despite the challenging conditions, the Croatian authorities are continuing their preparations to enter ERM II as a precondition for adoption of the euro.

Figure 3.5 / Croatia: Main macroeconomic indicators



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

Table 3.5 / Croatia: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	2.7	2.9	-11.0	4.0
Unemployment rate, LFS, in %, average	8.5	6.6	11.0	10.0
Consumer prices (HICP), % p.a.	1.6	0.8	1.0	1.0
Current account, % of GDP	1.9	2.5	-5.0	-1.0
Central bank policy rate, % p.a., eop 2)	3.0	3.0	3.0	3.0
Average exchange rate HRK/EUR	7.4	7.4	7.6	7.5

1) Preliminary. - 2) Discount rate of NB.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Croatia's economy, which is heavily dependent on tourism, is among those countries particularly affected by the COVID-19 pandemic. To mitigate these effects, the Croatian government has launched stimulus packages worth around EUR 6.1 billion, or 11% of GDP. Measures include a temporary increase in the net minimum wage to HRK 4,000 (EUR 725); partial (or total) exemption of some businesses from taxation for April, May and June, and deferral of VAT payments; and support for tourism and agriculture. The massive state interventions will drive up both the general government deficit and the public debt (which has fallen continuously in recent years) to at least 85% of GDP.

State support will help to keep workers in employment and mitigate the risk of job loss in the coming 3-4 months, but will not be sufficient to prevent unemployment from almost doubling (to 11%), compared to 2019. Inflation will remain low due to the falling cost of energy and services. After six years of running a surplus, the current account will show a deficit of close to 5% of GDP in 2020 as a result of a massive drop in earnings from tourism (which in the past has helped to offset the traditional deficit in goods trade). In response to the increased pressure on the exchange rate from late February, the Croatian National Bank intervened continuously in March to keep the rate stable at HRK 7.6/EUR, by selling EUR 2.25 billion to banks. In contrast to Bulgaria, which has suspended its preparations for introduction of the euro, the Croatian National Bank is continuing the measures it has committed itself to, in order to enter ERM II as a precondition for adoption of the euro.

On top of the Coronavirus pandemic, Croatia will have to cope with the impact of a powerful earthquake that struck the capital Zagreb and its surroundings on 22 March, causing about EUR 5.7 billion worth of damage. But assuming that repairs are carried out this year, that would entail a rise in GDP. As regards construction, large infrastructure projects – such as work on the Peljesac Bridge and the Istrian Y motorway – are continuing, and an agreement on construction of the Beli Manastir–Halasica bridge, a section of the Vc transport corridor, was signed recently.

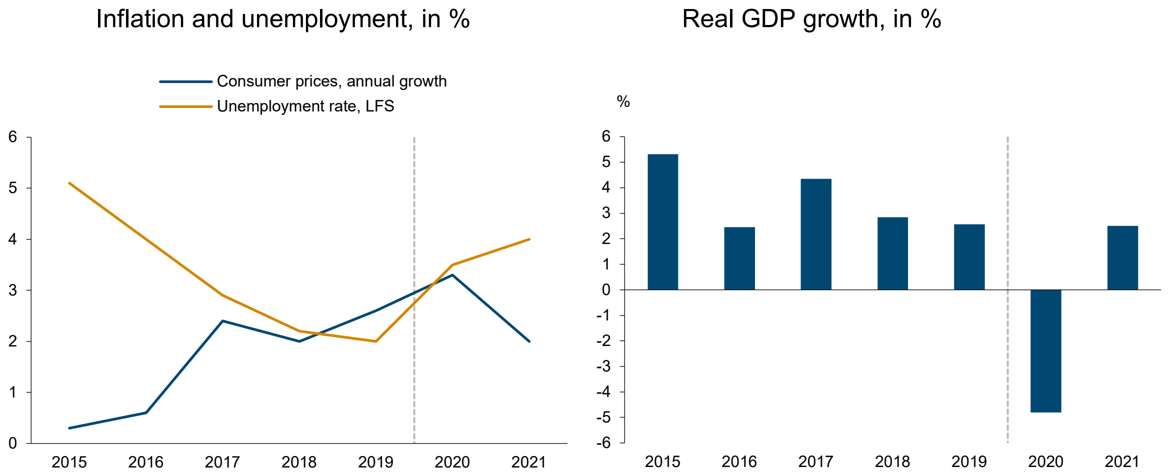
wiiw expects GDP to contract by about 11% in 2020, due to the sharp decline in tourism – particularly from the main source countries of Italy and Germany, but also from Slovenia and Austria. Income losses from tourism will also translate into a drop in household consumption. GDP is likely to recover somewhat in 2021, by about 4%.

CZECH REPUBLIC: Paying a high price for its skewed production structure

LEON PODKAMINER

Fiscal and monetary policy moves cannot neutralise the effects of the slump in external demand for the products of the automotive industry, the economy's most important sector. Progressive easing of the epidemic-related restrictions will limit the damage to those sectors dependent on domestic sales. The deep recession – inevitable in 2020 – will be moderated by the strong devaluation of the domestic currency. The economic fundamentals will remain strong, enabling a recovery in 2021.

Figure 3.6 / Czech Republic: Main macroeconomic indicators



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

Table 3.6 / Czech Republic: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	2.8	2.6	-4.8	2.5
Unemployment rate, LFS, in %, average	2.2	2.0	3.5	4.0
Consumer prices (HICP), % p.a.	2.0	2.6	3.3	2.0
Current account, % of GDP	0.4	-0.4	0.3	0.3
Central bank policy rate, % p.a., eop 2)	1.75	2.00	0.25	0.50
Average exchange rate CZK/EUR	25.65	25.67	26.8	26.0

1) Preliminary. - 2) Two-week repo rate.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Fiscal measures to aid firms and employees hit by the epidemic-related restrictions were introduced relatively early on. The scale of additional public spending envisaged (up to 4% of GDP) is significant, but is still fairly modest given the very low level of public debt. The contribution made by the National Bank, which has lowered its policy rates quite aggressively, has already pushed down interbank interest rates (and also the yield on treasury bonds). Low interest rates may be important – not so much by way of promoting greater lending (or making the domestic public debt cheaper to service), but rather through their impact on the depreciated exchange rate of the domestic currency. The strong devaluation during the first quarter of 2020 may be attributed to the indiscriminate treatment of all 'emerging markets'. But the Czech Republic's economic fundamentals differ from those of typical emerging economies: the level of its foreign exchange reserves is very high and the country's trade balance is normally in surplus. Moreover, neither the level nor the structure of the country's foreign debt is a cause for concern. It may be assumed that the domestic currency's depreciation is likely to be reversed (though not necessarily totally) as soon as the initial dust settles. For some time to come, the devalued currency will act as a buffer, moderating the GDP decline through differential impacts on exports and imports.

The epidemic has probably passed its peak – possibly thanks to both the early introduction of restrictions and the relatively good quality of the public health service. A progressive easing of the restrictions has already started and will limit the impact on those sectors that depend on domestic sales. However, the Czech Republic is paying a high price for its external openness, its intensive participation in global value chains and its highly skewed production structure. Its main industrial sector (automotive) depends inordinately on external demand, which may not be forthcoming. A recession in Germany will have grave repercussions for the Czech Republic. Moreover, foreign tourism – quite important for the country – is likely to suffer heavy losses. Restrictions on cross-border mobility may limit the employment opportunities of foreign workers (e.g. from Ukraine). But the demand for labour will weaken in 2020 without producing mass unemployment. At the same time, wage growth will slacken. Consumer demand will be additionally depressed by households saving more as a precaution. That the business sector's demand for investment goods and services will nosedive in 2020 is more than certain.

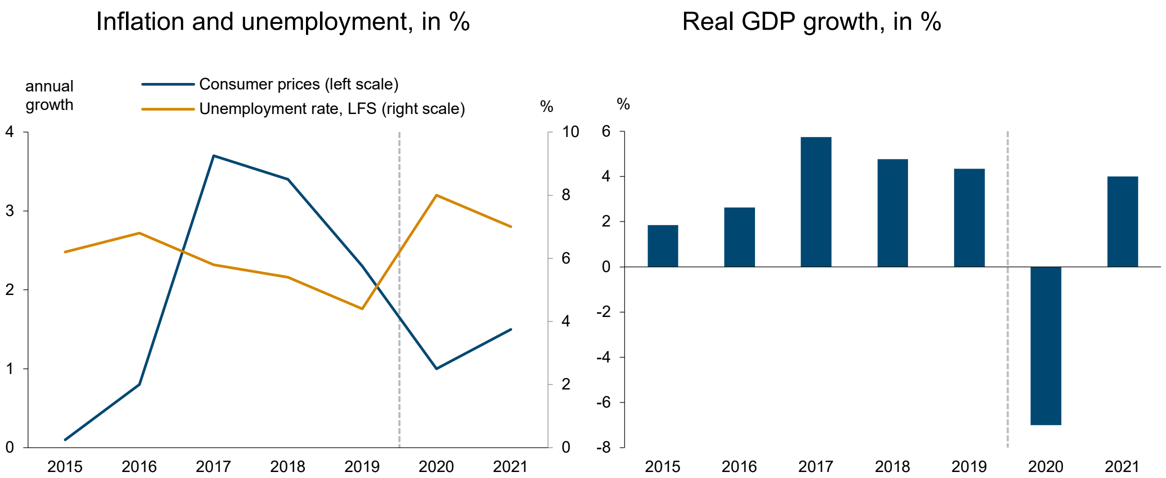
All in all, a deep recession in 2020 is now inevitable. But the economic fundamentals are not going to be substantially eroded. Assuming that the epidemic in Europe peters out in 2020, the Czech economy will experience a recovery in 2021.

ESTONIA: Enough fiscal space to weather the crisis

SEBASTIAN LEITNER

The restrictions imposed in Estonia have been relatively light, and the government announced a rescue package worth 7% of GDP back in mid-March. However, the initial figures show that also in Estonia not only export-oriented production is contracting sharply, but also domestic demand. Apart from catering and tourism, transport and many manufacturing sectors are also likely to suffer. We expect Estonian GDP to decline by 7% in 2020, and forecast an upswing of 4% in 2021.

Figure 3.7 / Estonia: Main macroeconomic indicators



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

Table 3.7 / Estonia: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	4.8	4.3	-7.0	4.0
Unemployment rate, LFS, in %, average	5.4	4.4	8.0	7.0
Consumer prices (HICP), % p.a.	3.4	2.3	1.0	1.5
Current account, % of GDP	2.0	2.2	3.0	2.0

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The restrictions introduced by the Estonian government in mid-March to mitigate the effects of the COVID-19 pandemic have been somewhat laxer than in many Central and Western European countries. Even non-essential shops (except for those in shopping malls) have been allowed to remain open, as have restaurants and bars. However, certain measures to enforce social distancing – including the closure of schools and universities – have been taken. On 22 April, the government published its exit strategy, with restrictions on outlets in shopping malls, cultural and sports facilities being lifted in the first half of May and schools gradually reopening from 15 May.

Initial figures suggest, however, that despite this rather more hands-off approach by the Estonian government, the decline in domestic economic activity has probably been no less than in other countries: for example, the figures show about 80% lower turnover in the hospitality sector in recent weeks than in the corresponding period of 2019. The danger of infection has put many people off dining out, so that restaurants have had to close.

Several country-specific features suggest that economic activity in the country will decline sharply. Estonia is a small, open economy, and 37% of its manufacturing enterprises are exporting firms. The strong drop in demand from trade partners and the disruption to the value chains will deal a severe blow to its economy. Moreover, sectors like transport (transit trade) and construction are very export oriented, which amplifies the downside impact in this situation. Tourism income, particularly from neighbouring Finland and other Northern European countries, accounts for a comparatively large proportion of the country’s value added. The summer season will see only very few foreign tourists, and only in autumn is there likely to be a gradual recovery. However, a possible second wave of COVID-19 may dash those hopes.

Although we have seen only a very slight increase in registered unemployment, we expect the Labour Force Survey unemployment rate to grow to 8% on average in 2020. Those who are unemployed will suffer badly, since adequate benefits are paid for only a short period.

Back in mid-March, the government launched a support package worth 7% of GDP. This comprises state guarantees for commercial business loans, direct state loans to businesses and downtime payments covering 70% of workers’ income for two months. Limited support is also provided to the self-employed and to cultural and sports institutions, with a special support package for the tourism industry and tax deferrals. Additional public investment in infrastructure and housing should help companies in the construction sector to stay afloat. The government deficit is expected to amount to 11% in 2020, and a supplementary budget also envisages a reduction in charges for fuel and electricity. At the same time, the public’s contributions to the funded pension scheme have been suspended. The Estonian government enjoys enormous fiscal space: even with the rescue package and economic decline, public debt is expected to increase to only 22% in 2021.

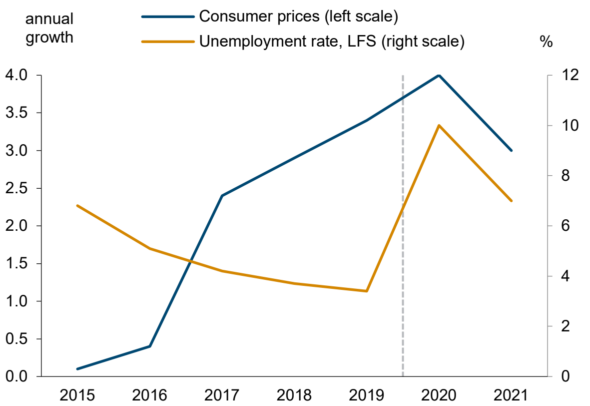
For 2020, we expect a decline in GDP of 7%, with risks on the downside. The GDP upswing of 4% forecast for 2021 depends greatly on the recovery of industrial production in the neighbouring Nordic countries of Sweden and Finland. Tourism is forecast to recover gradually. We should also mention that Estonia is likely to be one of the countries that benefit most from the increased digitalisation induced by the COVID-19 crisis. The production of mobile hardware – and particularly of software – has soared in the past years and will continue to do so, given the increased demand for remote-working environments.

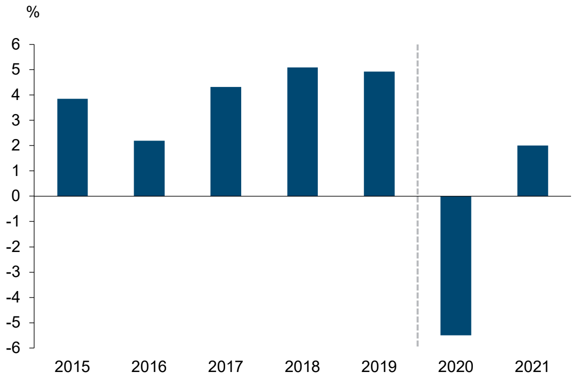
HUNGARY: Crisis management: a zigzag course from day to day

SÁNDOR RICHTER

The country's crisis management efforts consist primarily of a big reshuffle of budgetary expenditure and revenue, but the real fiscal stimulus will be only 1-2% of GDP. The government is introducing a limited version of income replacement subsidy. There is a moratorium on the repayment of both household and business loans. wiiw expects a decline in GDP of 5.5% in 2020, with 2% growth in 2021. The fiscal deficit will amount to at least 5% relative to GDP. The HUF will remain volatile and weak.

Figure 3.8 / Hungary: Main macroeconomic indicators





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

Table 3.8 / Hungary: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	5.1	4.9	-5.5	2.0
Unemployment rate, LFS, in %, average	3.7	3.4	10.0	7.0
Consumer prices (HICP), % p.a.	2.9	3.4	4.0	3.0
Current account, % of GDP 2)	0.0	-0.8	0.0	0.0
Central bank policy rate, % p.a., eop 3)	0.9	0.9	1.5	1.5
Average exchange rate HUF/EUR	318.9	325.3	355.0	365.0

1) Preliminary. - 2) Excluding SPE. - 3) Base rate (two-week NB bill).
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The government's treatment of the COVID-19 crisis has been chaotic in both the healthcare sector and the economy, characterised by uncoordinated and inconsistent decisions and improvisation. The mortality rate relative to confirmed cases has been over 10%, one of the worst in the region.

The crisis management effort has consisted primarily of a big reshuffle of budgetary expenditure and revenue, to the tune of 18% of GDP; however, the real fiscal stimulus will be only minimal – around 1-2% of GDP. The fiscal deficit should remain at below 3% of GDP this year, although there is no obligation to follow this rule now, and well-regarded Hungarian economists have proposed proactive expansive demand management to avoid a deep recession. The resources to support the central government's spending on crisis management come partly from the municipalities and partly – in the form of a special tax – from the banks and large multinational retail companies. After an initial reluctance, the government has now declared itself ready to introduce a Hungarian version of short-time working, with an income-replacement subsidy, in order to curb the rapid spread of unemployment. A key point of the crisis management is to sustain the financial health of enterprises and households. This is coupled with a moratorium on the repayment of both household and business loans.

The Cohesion Policy funds mobilised by the EU are actually much less (EUR 0.9 billion) than the sum theoretically allocated (EUR 5.6 billion), as Hungary's strategy of frontloading spending means that it has already spent (or allocated) the bulk of the funds due under the 2014-2020 MFF. As the fiscal deficit will grow to about 5% of GDP (mainly due to evaporating tax revenue), public debt will start to increase again from the figure of 64.5% of GDP at the end of 2019. Domestic financing of the public debt may prove insufficient, so that a EUR 3-4 billion issue of foreign currency denominated bonds is again on the cards. Although the central bank has for years maintained that it has no exchange rate target, after the recent volatility of the HUF/EUR rate and the persistently weak HUF it has declared that it will deploy the full arsenal of instruments available to it to preserve the stability of the economy. Ahead of this, the effective official interest rate was raised, putting an end to a period of extremely loose monetary policy.

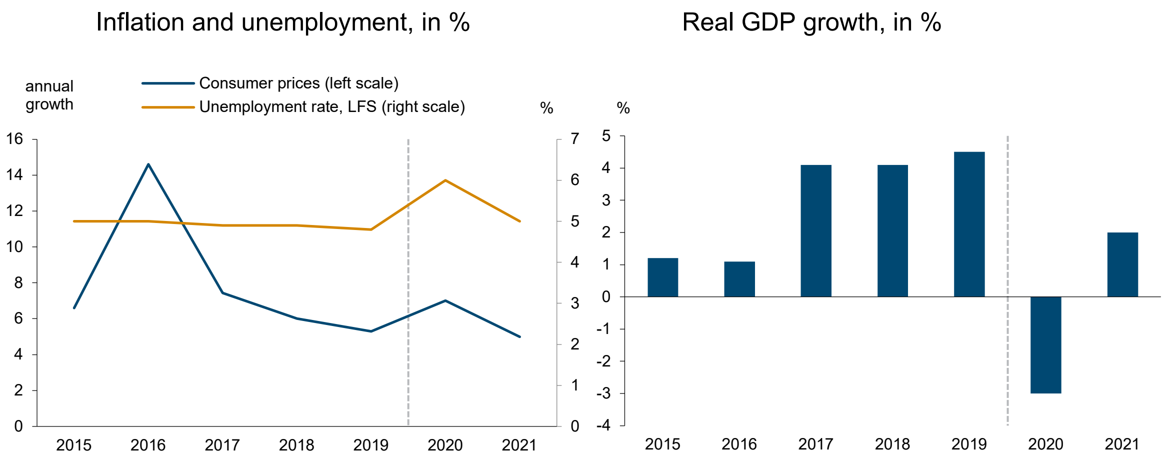
For 2020, wiiw forecasts a 5.5% decline in GDP, followed by a bounce-back in 2021, with growth of 2%. This implies a larger fiscal stimulus and a bigger fall in tax revenue than is currently envisaged by the government, leading to a general government deficit of 5% relative to GDP. The Hungarian forint will remain volatile and weak. Sectors that will see the biggest decline are tourism, catering, the automotive industry, selected personal services and culture. Due to the array of uncertainties, our pessimistic scenario for GDP change in 2020 is -10%, while the optimistic scenario is -3%.

KAZAKHSTAN: The state attempts to rescue the economy under a double burden

ALEXANDRA BYKOVA

A large part of the deterioration in Kazakhstan's economic performance will be due to the trade sector and the disruption it has faced in the wake of the Coronavirus restrictions. The low oil prices also mean that export earnings will plunge, draining budget revenues and putting pressure on the tenge. A large government support package, coupled with administrative measures, will go some way towards mitigating the shocks to the economy and the labour market. Because of a good performance in the first quarter, we expect GDP to decline by only 3% in 2020. The recovery next year is anticipated to be weak, at 2%, with low consumption growth and only a partial rebound in exports.

Figure 3.9 / Kazakhstan: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.9 / Kazakhstan: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	4.1	4.5	-3.0	2.0
Unemployment rate, LFS, in %, average	4.9	4.8	6.0	5.0
Consumer prices, % p.a.	6.0	5.3	7.0	5.0
Current account, % of GDP	-0.1	-3.6	-6.0	-4.0
Central bank policy rate, % p.a., eop 2)	9.25	9.25	9.5	9.0
Average exchange rate KZT/EUR	406.7	428.5	470.0	480.0

1) Preliminary. - 2) One-day (overnight) repo rate.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Only certain regions of Kazakhstan are currently under strict lockdown, and the restrictions are gradually being lifted from 27 April. Despite some disruption to economic activity in March, first-quarter real GDP growth reportedly reached 2.7%, on the back of an expansion in industry and construction of 5.8% and 11.7%, respectively. However, the recent decline in the sentiment indicator to 41.5 points (against the 50-point base level) suggests that an economic downturn is in prospect.

The oil market is presenting an additional challenge this year. Falling oil prices, full global storage capacities, low demand expectations and the OPEC+ cut in oil production of 23% in May-June 2020 will almost halve oil exports in dollar terms, thus reducing budget revenues and inflows into the National Oil Fund and putting the tenge under pressure. A full rebound of exports in 2021 is unlikely, as demand for oil and oil prices are both expected to remain low.

Retail trade fell by 4.5% year-on-year in March, and a further deterioration is expected, as those regions under lockdown generate half of the trade volume. We estimate that the trade sector will account for almost half of the GDP decline in 2020 – a result of the lockdown disruptions and future low demand caused by reduced incomes.

A large state support package of USD 13 billion (around 8% of GDP) includes monthly social payments of the minimum wage (42,500 tenge or around EUR 90) as partial compensation for loss of income during the state of emergency; food parcels for vulnerable households; a 10% hike in pensions; a cut in VAT to 8% for essential foodstuffs; an increase in salaries; and higher spending on equipment for the health sector.

The government has introduced a comprehensive anti-crisis package to support small and medium-sized enterprises (SMEs), which includes tax relief, USD 1.4 billion in subsidised loans to finance working capital, and credit holidays. SMEs account for around a third of value added and jobs, and have been badly affected by the restrictions, since many of them are located in Almaty and Nur-Sultan, which are currently under lockdown. However, this package will only go some way towards mitigating the negative impact on jobs and income in the SME sector.

Subsidised lending and state contracts for domestic producers in agriculture and industry seek to keep domestic production afloat and to reduce import dependence amid the risk of supply-chain disruption, and with a weak tenge making imports more expensive.

The budget deficit will reportedly reach 3.5% of GDP in 2020, and the non-oil deficit – 10.8%. Annual guaranteed transfers from the National Oil Fund to the budget have been increased by USD 4.7 billion and the budget deficit will grow by USD 1.9 billion over the pre-crisis plan for 2020. The National Oil Fund (36% of GDP) offers enough fiscal space for counter-cyclical measures.

In addition to fiscal stimuli, the government is resorting to administrative measures, introducing a price ceiling for essential foodstuffs, in an attempt to contain inflation and limit foreign currency purchases by legal entities so as to prevent depreciation of the tenge.

We anticipate only a moderate rise in unemployment, as the state 'Employment Roadmap' programme envisages the creation of about 250,000 new jobs.

Public investment in road, housing and hospital construction is expected to grow. There are downside risks to private investment, as large oil-field expansion projects are likely to be postponed.

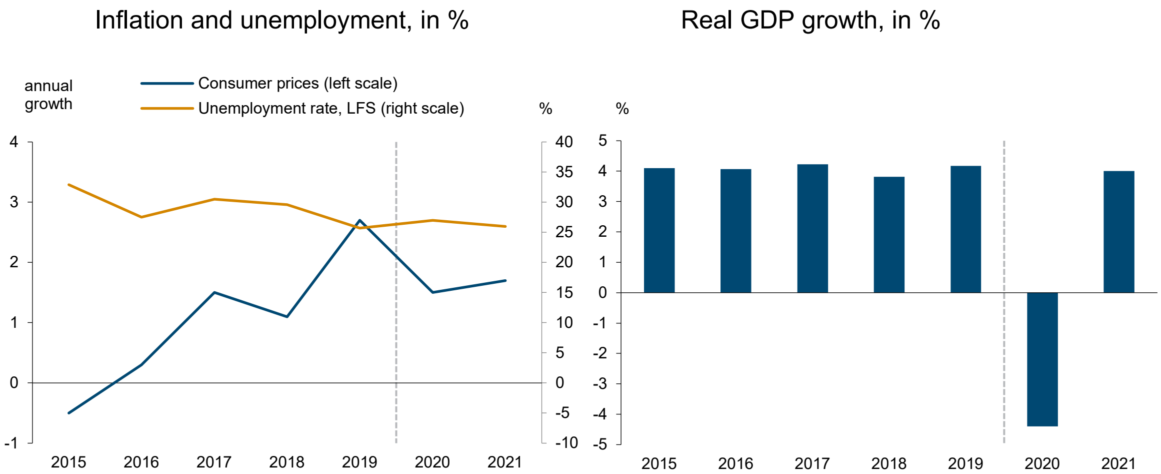
We expect an economic downturn of 3% in 2020 – not as marked as in some other countries, partly because of good performance in the first quarter of the year. We anticipate a weak recovery of 2% next year, with low private consumption growth and a slow recovery in exports.

KOSOVO: COVID-19 knocks out the government

ISILDA MARA

The political unrest continues unabated, despite the COVID-19 emergency. Given the high exposure of Kosovo to Germany and Switzerland – especially as concerns remittances, foreign direct investment and exports – the downside effect of the lockdown will be felt strongly. International financial support will, in part, come to the rescue. Still the economy is expected to contract by more than 4% in 2020.

Figure 3.10 / Kosovo: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.10 / Kosovo: Selected economic indicators

	2018	2019 [1)]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	3.8	4.2	-4.4	4.0
Unemployment rate, LFS, in %, average	29.6	25.7	27.0	26.0
Consumer prices, % p.a.	1.1	2.7	1.5	1.7
Current account, % of GDP	-7.6	-5.8	-7.5	-6.0

1) Preliminary.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

On 25 March, parliament passed a vote of no confidence in the Kurti government. The vote had been sought by the Democratic League of Kosovo (LDK), following continuous clashes with its leading partner in government, Kurti's Levizja Vetevendosje (LVV). Kurti favours fresh elections, but President Thaci has asked the LDK to nominate a candidate to take over as prime minister and form a new government. The LDK already holds the position of President of the Assembly (parliament) and looks set to lead the government, too. Kurti has announced that he will appeal against this decision in the Constitutional Court. Thus, the political clashes are continuing despite the COVID-19 emergency.

On 4 April, the Kurti government announced a package of EUR 170.6 million for the COVID-19 emergency. The International Monetary Fund has offered Kosovo assistance to the tune of EUR 52 million, in the form of a Rapid Financing Instrument. Also, EU macro-financial assistance to Kosovo amounts to EUR 100 million. Additional funding is being negotiated with other international institutions, e.g. the World Bank, for financial support of up to EUR 70 million. The financial package and the financial support from international donors will go some way to help reduce the liquidity pressure on small enterprises, the self-employed and households, as well as to shore up the fragile healthcare system in Kosovo.

The banking sector is solid and the level of non-performing loans is quite low. The central bank's interest rates have not changed; however, it has announced that borrowers who are unable to keep up with their repayments may take a loan payment holiday until the end of April 2020.

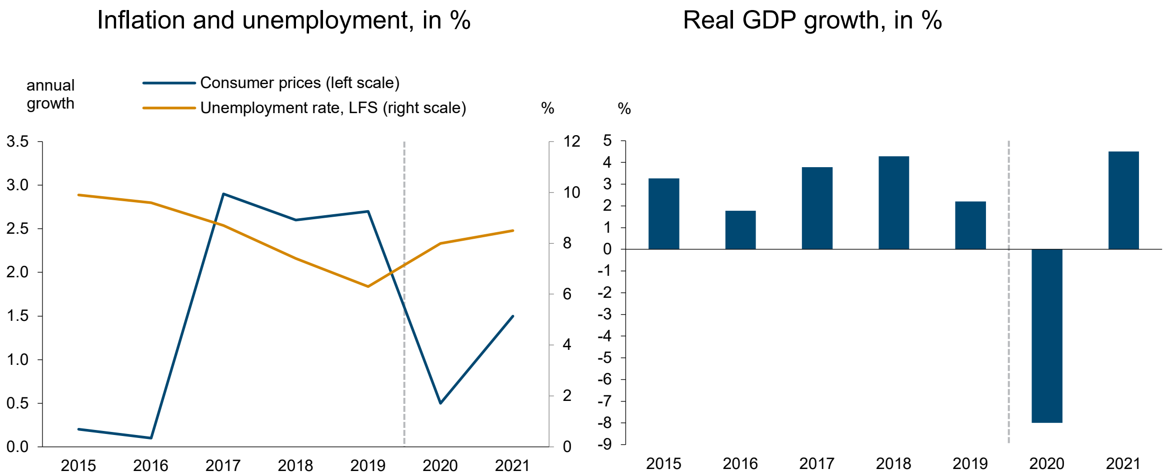
As of April 2020, the 100% tariff on imports from Serbia and Bosnia and Herzegovina has been lifted. According to the Kurti government, there will be reciprocity; but how that will work in practice remains unclear (and things might change if there is a new government). Moreover, the COVID-19 crisis is expected to have a negative effect on the current account. Exports of goods and services are likely to be adversely affected, as the main export destination tends to be the EU. Even though the country does not depend very much on tourists, the lockdown will hit diaspora tourism. The lockdown will also have a negative effect on remittances: in March, these fell by 6%. In particular, remittances sent through informal channels – i.e. other than bank transfers or money transfer operators – shrank by 50%. Kosovar emigrants, most of whom reside in Germany and Switzerland – work in the service sector, construction and manufacturing. Therefore, they are more vulnerable, because of the higher exposure of these sectors to the negative effects of COVID-19. In 2019, 50% of foreign direct investment (FDI) inflows into Kosovo came from Germany and Switzerland. Thus, FDI inflows will be negatively affected, given the current state of play.

LATVIA: Laxer restrictions cannot prevent a deep recession

SEBASTIAN LEITNER

Government restrictions on shopping and restaurants have been relatively liberal in Latvia, but that will not prevent economic activity from declining sharply in 2020, compared to last year. We expect GDP to drop by 8.5% this year. The substantial government support package – amounting to 7% of GDP – will help the revival of domestic demand. Thus, we forecast GDP to grow again in 2021, by 4.5%.

Figure 3.11 / Latvia: Main macroeconomic indicators



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

Table 3.11 / Latvia: Selected economic indicators

	2018	2019 [1)]	2020 Forecast	2021
Gross domestic product, real, annual change in %	4.3	2.2	-8.0	4.5
Unemployment rate, LFS, in %, average	7.4	6.3	8.0	8.5
Consumer prices (HICP), % p.a.	2.6	2.7	0.5	1.5
Current account, % of GDP	-0.7	-0.5	4.0	2.0

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

In Latvia – as in neighbouring Estonia – the restrictions introduced to deal with the emergency situation have been rather less stringent than in many Central and Western European countries. Non-essential shops have been allowed to stay open (except at the weekends), as have restaurants and bars. Hotels, too, can take in guests, so long as the required health regulations are observed. At the end of April, Latvia still had the lowest figure in the Baltics for the number of people confirmed as having COVID-19. However, the relative freedom has not translated into a higher level of economic activity: turnover in the hospitality sector is down by about 80% compared to the same period last year.

As in all countries, the trade channel in Latvia is the one that is hardest hit by the crisis. Aside from manufacturing, important service sectors are also affected by supply chain disruptions and a strong decline in external demand. Tourism is an important source of income for the country – and particularly for Riga and the Baltic Sea region; but foreign tourists will certainly shun the country this summer: even in March, the number of tourists was 60% down on last year. Only in autumn might an upswing in city tourism be expected. The transport sector will suffer from plummeting transit trade, which is an important activity for the Latvian economy.

The unemployment rate was already moving upwards, reaching 7.3% in March 2020. We expect the Labour Force Survey unemployment rate to rise to 8% in 2020 on average and to edge upwards in 2021, to 8.5%.

The immediate reaction of the government was to use the fiscal space available to it and enact a rescue package in mid-March that amounted to a full 7% of GDP. It consists of tax holidays for up to three years for companies and individuals affected; state guarantees for existing investment loans and financial leasing; additional state loans of up to EUR 1 million for each company; and a cut in interest rates on bank loans – of 50% for businesses engaged in tourism and of 15% for other companies. Employers can be compensated for up to 75% of the wages of furloughed employees (up to EUR 700 per month). On 28 April, the government proposed allowing enterprises to pay workers only 70% of their wages until the end of the year. Though this would help employers, it would reduce the purchasing power of households, and thus damage domestic demand.

The government deficit is likely to amount to about 8% in 2020 and another 4% in 2021; thus public debt is expected to increase from 35% in 2019 to about 50% in 2020, and then decline again to 45% in 2021.

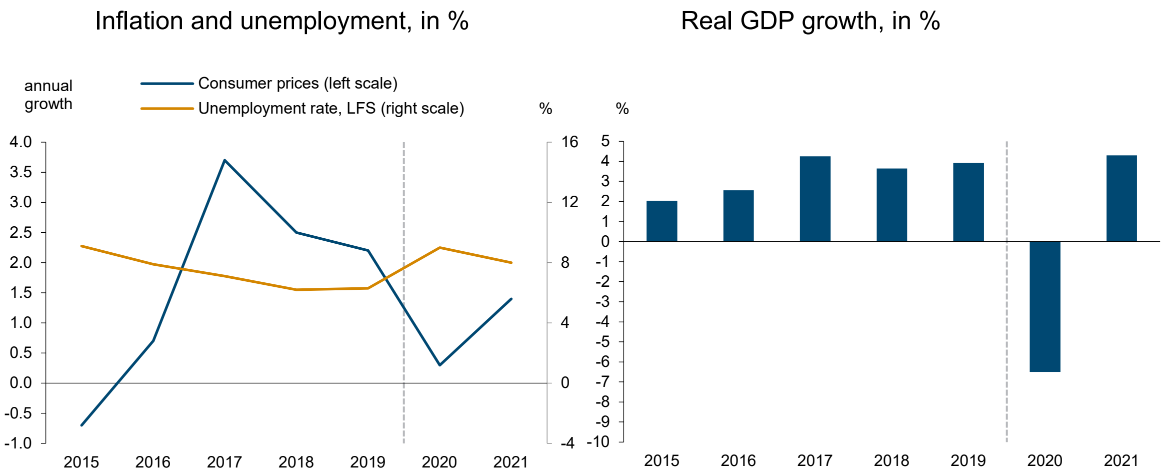
We expect Latvian GDP in 2020 to decline sharply, by 8.5%. Anticipating a gradual rise in foreign demand for goods and services, but particularly a revival of domestic demand, we expect a slow recovery of GDP in 2021, of 4.5%.

LITHUANIA: Substantial government support to boost the economy after recession

SEBASTIAN LEITNER

Figures for the first quarter of 2020 show that the Lithuanian economy was in a high gear before foreign and domestic demand collapsed. The Lithuanian government reacted in tandem with the Lithuanian national bank to provide liquidity, income support and funding for infrastructure projects, through a rescue package worth almost 10% of GDP. We forecast the Lithuanian economy to shrink by 6.5% in 2020. The predicted revival of 4.3% in 2021 will depend upon the speed of recovery in manufacturing among the country's European trading partners.

Figure 3.12 / Lithuania: Main macroeconomic indicators



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

Table 3.12 / Lithuania: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021
Gross domestic product, real, annual change in %	3.6	3.9	-6.5	4.3
Unemployment rate, LFS, in %, average	6.2	6.3	9.0	8.0
Consumer prices (HICP), % p.a.	2.5	2.2	0.3	1.4
Current account, % of GDP	0.3	4.3	5.0	4.0

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The Lithuanian government more or less followed the Western European governments by introducing restrictions quite early in March. Schools, universities, museums and public facilities were closed, and home-working was encouraged wherever possible. With the stabilisation of Coronavirus-related infections, an exit strategy was also announced by the government quite early on. From 27 April, there has been a gradual reopening of non-essential shops, hairdressers, outdoor cafes, cultural and outdoor sporting facilities.

The disruption to production chains and the slump in demand from the country's trading partners will hit export-oriented manufacturing firms particularly hard. Moreover, companies in the important transport sector are suffering from reduced east–west transit trade – something that the country has specialised in.

Registered unemployment rose considerably in March, compared to the same month last year. We expect an increase in the Labour Force Survey unemployment rate to 9% in 2020 on average, followed by a slight decline to 8% in 2021.

Parliament approved a COVID-19 rescue package on 20 March amounting to about 10% of GDP. It includes additional health and public security expenditure and income support for employees, comprising reduced-worktime subsidies of up to EUR 911 (gross) per employee per month. The self-employed are eligible for a monthly subsidy of EUR 257. Liquidity support for businesses includes tax loans, deferred payments for utility bills and 100% compensation of interest on deferred loans and finance lease payments. The banking sector is being supported by the Lithuanian national bank to provide additional loans to enterprises. In all, 2% of GDP is earmarked for extra private and public investment in, for example, infrastructure and housing construction and refurbishment. The government has enough fiscal space to drive a revival of the economy with higher deficits not only in 2020, but also in 2021. The public debt will increase substantially – by more than 15 percentage points – but will most likely not exceed 55%.

Figures for the first quarter of 2020 show that the Lithuanian economy was performing quite strongly in the first two months of the year. Although foreign and domestic demand collapsed in March, GDP growth still amounted to 2.6% in real terms year on year. We expect the Lithuanian GDP to decline by 6.5% on average in 2020, with domestic demand shrinking by about 10% in real terms. The forecast upswing of 4.3% in 2021 has considerable downside risk: it depends on the uncertain speed of recovery of industrial production in the EU, but also on demand developments in neighbouring Russia, which remains one of Lithuania's most important trading partners.

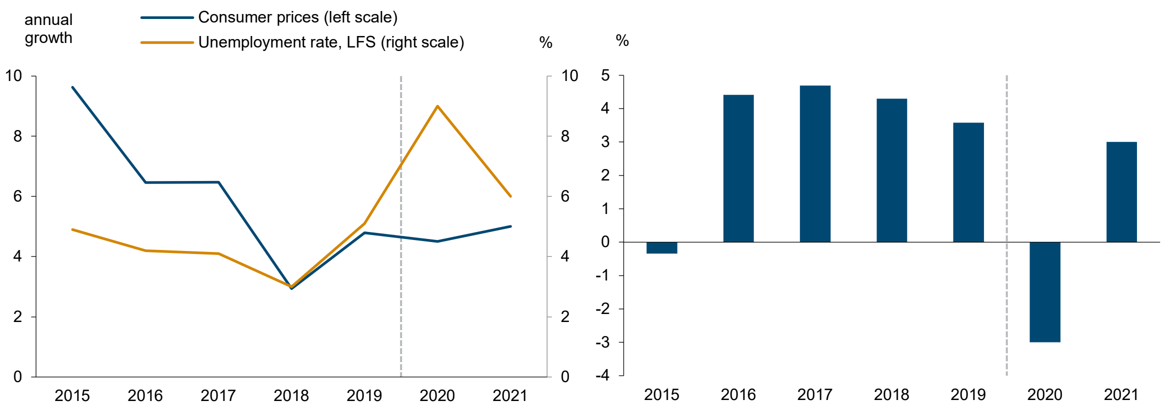
MOLDOVA: Keeping low key

GÁBOR HUNYA

While Moldova's exposure to COVID-19 has been relatively modest, its health system is underdeveloped and the fiscal resources it has at its disposal to deal with the consequences are equally modest. The World Bank, EU and WHO are all providing technical and financial support. GDP is expected to drop by 3% in 2020, and unemployment to jump to 9%. Government actions have mainly come in the form of tax allowances; handouts to business are few and far between. Preferential loans from international institutions and from Russia will cover the country's external financial needs.

Figure 3.13 / Moldova: Main macroeconomic indicators

Inflation and unemployment, in % — Real GDP growth, in %



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.13 / Moldova: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	4.3	3.6	-3.0	3.0
Unemployment rate, LFS, in %, average	3.0	5.1	9.0	6.0
Consumer prices, % p.a.	2.9	4.8	4.5	5.0
Current account, % of GDP	-10.6	-9.7	-9.0	-9.0
Central bank policy rate, % p.a., eop 2)	6.5	5.5	3.0	3.5
Average exchange rate MDL/EUR	19.84	19.67	19.7	20.0

Note: All series excluding data on districts from the left side of the river.
1) Preliminary. - 2) Overnight (refinancing) operations rate.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Moldova's healthcare system is the worst funded of all the countries observed by wiiw. Although the density of hospital beds and physicians is not particularly low, in the initial stages of the pandemic there was a major shortage of equipment and knowledge to combat COVID-19. Unsurprisingly, a fifth of all severe infections have been among medical personnel. Draconian restrictions imposed as part of a state of emergency have limited the spread of the virus; from the beginning of May, parks have reopened and public transport is again running. The country is receiving substantial support in the form of donations, expertise and loans – primarily from international organisations, including the WHO and the World Bank, which has approved a EUR 52.5 million emergency loan to deal with COVID-19.

The country's poor fiscal situation means that it is not able to give much away to the population or business. Unemployment benefit, the minimum wage and child allowance have all seen a moderate increase. Tax allowances are being offered on wages (reducing the wage bill by 44%) and on corporate income in the case of companies that have temporarily ceased their activities. A law designed to support the restarting of the economy promises subsidised interest rates on loans from the date on which the state of emergency is lifted until 31 December 2020.

Most of the fiscal deficit will be financed by multinational creditors. The loans pledged include EUR 100 million from the EU and EUR 210 million from the International Monetary Fund. An additional EUR 200 million offered by Russia has been accepted after some political controversy, since the move will strengthen the position of pro-Russian President Dodon, ahead of the presidential elections scheduled for the autumn. Sovereign loans will set the limit of the fiscal space at about 8% of GDP and will allow public debt to rise from 30% of GDP in 2019 to 35% in 2020. Earlier government plans to gain access to the international capital markets have had to be shelved.

The pandemic struck while the economy was in a period of growth, but we are lacking any indication of how severe the negative consequences have been. Industrial production and construction activities showed robust year-on-year growth in the first two months of 2020, except for the export-oriented production of automotive components. The number of unemployed increased by 40% between February and mid-April, and the figure is continuing to rise. We expect unemployment to reach 9% in 2020 on average, as many workers who have returned home from abroad will not be able to leave any time soon. The reduced remittances will suppress demand and will be a deficit on the current account.

Monetary measures have increased liquidity in the economy. The policy rate has been cut by 1.25 percentage points to 3.25%, and the reserve requirement for banks has also been reduced. Inflation moderated in early 2020, but will remain at around 4.5%, mainly on account of food prices.

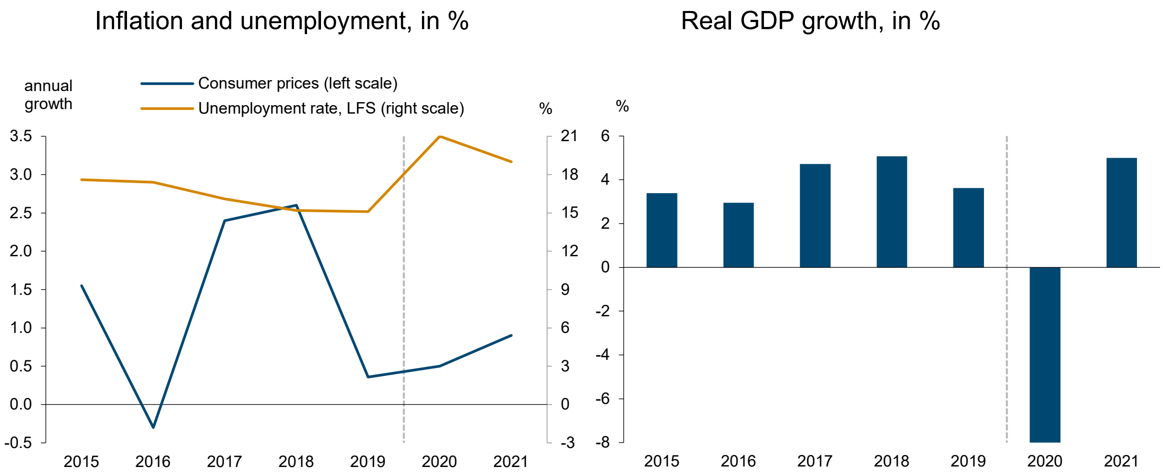
A drop in GDP of about 3% seems realistic in 2020, to be followed by a similar rate of recovery in 2021. Agricultural production and exports – which are of huge importance to Moldova's economy – constitute a major risk, with a drought looming.

MONTENEGRO: Tourism's over-dominance exacerbating economic downturn

BERND CHRISTOPH STRÖHM

The COVID-19 pandemic is taking its toll on Montenegro, with reduced economic activity leading to lower investment and fewer exports. Personal consumption is expected to slow in 2020. Meanwhile, government consumption will increase, in order to mitigate the fallout from the pandemic. This will alter the government's planned path of debt reduction in 2020. Particularly in light of the imminent deep downturn in Montenegro's over-dominant tourist industry, the country's economy is expected to contract by 8% in 2020, to be followed in 2021 by 5% GDP growth.

Figure 3.14 / Montenegro: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.14 / Montenegro: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	5.1	3.6	-8.0	5.0
Unemployment rate, LFS, in %, average	15.2	15.1	21.0	19.0
Consumer prices, % p.a.	2.6	0.4	0.5	0.9
Current account, % of GDP	-17.0	-15.2	-20.0	-16.0

1) Preliminary.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Montenegro's heavy economic reliance on the tourism sector will greatly exacerbate the economic downturn caused by the COVID-19 pandemic. More than 2.5 million tourists visited Montenegro in 2019, generating about EUR 1 billion. Last year, about 50% of visitors to the country came from outside the region – mainly Western Europe and Russia. The continuing travel restrictions mean that the economic outlook for Montenegro in 2020 is bleak. With tourism accounting for around a quarter of the country's GDP, it is likely that Montenegro's economy will contract by 8% this year. A 5% growth in GDP can be expected in 2021.

The COVID-19 pandemic is exacting a heavy toll on Montenegro, with reduced economic activity leading to lower investment and fewer exports. Personal consumption is expected to slow in 2020. Meanwhile, there will be an increase in government consumption to mitigate the fallout from the pandemic; while this move will provide a boost to the economy, it will also raise public debt. The pandemic has dealt a body-blow to the government's plan for debt reduction in 2020: Montenegro's public debt sustainability and its fiscal position may both be under threat in the period 2020-2021, especially considering its EUR 800 million debt for construction of the Bar–Boljare motorway.

Reacting to the impending economic downturn, the government announced that it will invest EUR 5 million to shore up the tourist industry: this will go on covering the salaries of employees in the tourism sector for two months, guaranteeing the minimum wage and offering 100% tax exemption. The government has also said that it is cooperating with the *Investment-Development Fund of Montenegro* to prepare a financial package of measures to mitigate the economic fallout from the COVID-19 pandemic. The package is designed to sustain investment in the tourism sector, while at the same time ensuring its liquidity. The government is further planning economic measures to strengthen the energy sector and limit Montenegro's dependence on tourism.

Tourism is vital for Montenegro's labour market. The sector's dominant position in the economy means that the pandemic will have a devastating effect on the country's work force: with every fifth employee working in the tourist industry, unemployment will likely rise to 21% in 2020.

The absence of monetary policy increases Montenegro's vulnerability to external shocks, which are now amplified by the COVID-19 pandemic. Consumer prices may be expected to edge up by 0.5% in 2020, before rising by a further 0.9% in 2021.

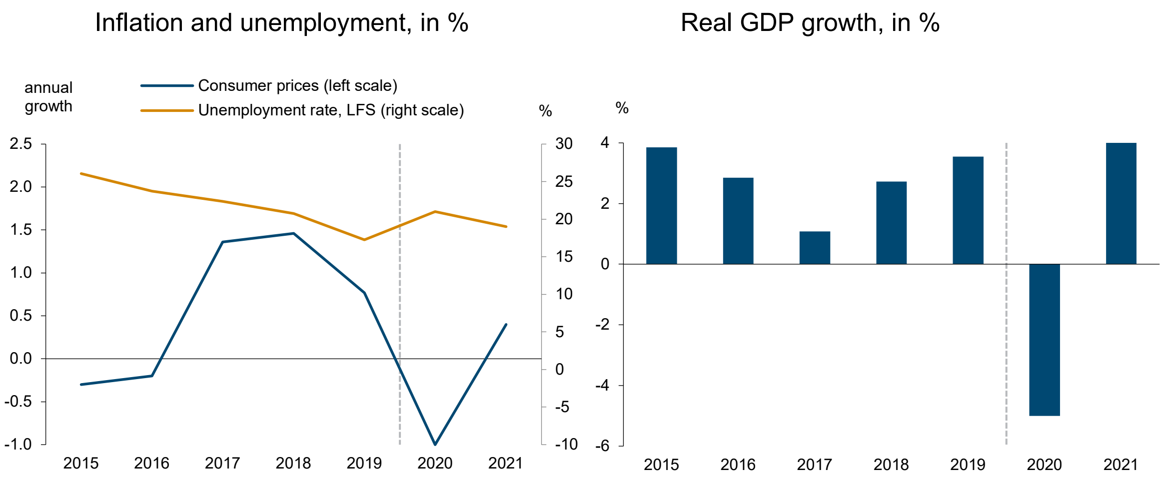
Inactivity in the energy and construction sectors and declining FDI are swelling the country's current account deficit. The temporary shutdown of large investment projects in the energy and construction sectors (such as the Bar–Boljare motorway project mentioned above), which are mostly funded by FDI, is having an adverse effect on the country's growth prospects and is causing the already sizeable current account deficit to rise to 20% in 2020 (narrowing to 16% in 2021).

NORTH MACEDONIA: Recession looms as pandemic dents vital car industry

BERND CHRISTOPH STRÖHM

North Macedonia's foreign trade market will likely underperform in 2020, as output is closely linked to the crisis-hit European car industry. GDP is expected to decline by 5% this year, due to lack of demand – both domestic and external. The expected recovery in 2021 will depend greatly on whether public investment picks up. Weak imports will lead to a reduction in North Macedonia's current account deficit in 2020 and 2021.

Figure 3.15 / North Macedonia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.15 / North Macedonia: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	2.7	3.6	-5.0	4.0
Unemployment rate, LFS, in %, average	20.7	17.3	21.0	19.0
Consumer prices, % p.a.	1.5	0.8	-1.0	0.4
Current account, % of GDP	-0.1	-2.8	-2.5	-1.5
Central bank policy rate, % p.a., eop 2)	2.50	2.25	1.75	1.75
Average exchange rate MKD/EUR	61.5	61.5	61.8	61.5

1) Preliminary. - 2) Central Bank bills (28-days).
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

The COVID-19 pandemic has had a considerable impact on North Macedonia's manufacturing, tourism and service sectors, which have all been badly hit by the nationwide lockdown. In March, the government imposed strict measures to contain the pandemic, declaring a 30-day state of emergency, imposing a curfew, limiting public life and closing the country's borders. GDP is expected to decline by 5% in 2020, due to lack of demand, both domestic and external. Though GDP is expected to recover by 4% in 2021, this does depend heavily on whether public investment picks up and on an increase in both exports and consumption. Meanwhile, the parliamentary elections scheduled for 12 April have been postponed indefinitely.

Exports – especially to the European automotive industry – have suffered as a result of the pandemic. North Macedonia is closely integrated into the supply chains of the car industry, which is set to experience a recession in 2020 due to the COVID-19 pandemic. European car sales generally tanked in March and April, following the strict lockdown enforced throughout Europe to contain the pandemic. Both Audi and VW further announced that they would be temporarily closing parts of their plants in Europe. The drop-off in production will lead to a decline in exports and export revenue.

The pandemic has also led to a big fall in foreign direct investment (FDI) and remittances. North Macedonia's exports depend heavily on foreign investment in its industrial zones, which account for around 30% of the country's foreign trade. Consequently, looking beyond the immediate future, the country's export performance will depend not only on the recovery in key markets, but also on how soon FDI returns. Despite the decline in exports and remittances this year, we expect the current account deficit to narrow, reflecting a concomitant collapse in imports (many of which are financed by remittances).

The COVID-19 pandemic is likely to bring a rise in unemployment in 2020 – again because of the country's reliance on its automotive supply sector. In general, tourism and the car industry are two sectors that are particularly affected by the pandemic. And in North Macedonia, taken together those sectors account for nearly 40% of total employment. The country's labour force will thus be badly affected (for example, around 30,000 people work directly in the automotive supply sector). We expect unemployment to rise to 21% in 2020.

To mitigate the effects of the COVID-19 pandemic, the central bank has cut its key interest rate to 1.75%. It has also made regulatory changes to encourage banks to restructure the debts of high-quality borrowers affected by the pandemic. All ongoing insolvency proceedings have been suspended. Low inflation means that the policy rate will likely remain at below 2019 levels, at 1.75% in 2020 and 2021.

POLAND: Making the best of the epidemic

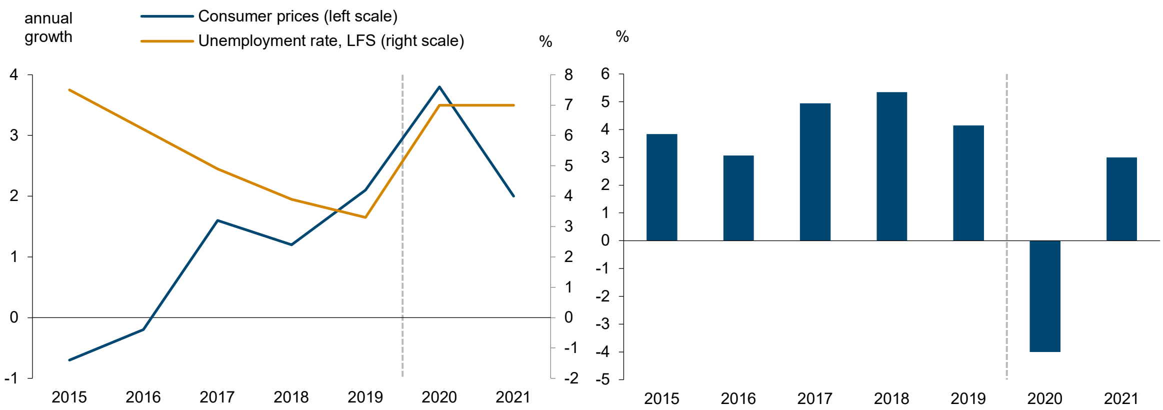
LEON PODKAMINER

The fiscal measures actually implemented are proving untimely and inadequate, in view of the strain felt throughout the private sector. However, the determined monetary-policy response to the Coronavirus epidemic, combined with a sharp currency devaluation, should limit the damage to the economy. But managing the ongoing crisis in health care and the economy is not the top priority for the government: its primary concern is to secure the president's re-election, by fair means or foul.

Figure 3.16 / Poland: Main macroeconomic indicators

Inflation and unemployment, in %

Real GDP growth, in %



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

Table 3.16 / Poland: Selected economic indicators

	2018	2019 [1)]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	5.3	4.1	-4.0	3.0
Unemployment rate, LFS, in %, average	3.9	3.3	7.0	7.0
Consumer prices (HICP), % p.a.	1.2	2.1	3.8	2.0
Current account, % of GDP [2)]	-1.0	0.5	0.2	0.3
Central bank policy rate, % p.a., eop [3)]	1.5	1.5	0.25	0.50
Average exchange rate PLN/EUR	4.26	4.30	4.45	4.35

1) Preliminary. - 2) Including SPE. - 3) Reference rate (7-day open market operation rate).
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Poland was the only EU member state to weather the global economic crisis (2008-2009) without suffering a recession. Its success owed much to a strong currency devaluation, the relatively low level of external openness, and a determined relaxation of fiscal and monetary policies. But the resilience of the private sector – dominated as it was by small and medium-sized firms – proved key.

The current situation is more complex. On the one hand, the present currency devaluation will again mitigate the recession (through its differential effects on exports and imports), at least for a time. The sharp depreciation cannot really be explained by the fundamentals: Poland's foreign exchange reserves are large; its foreign debt (and its shorter-term component, in particular) is moderate; and its trade balance tends to be in kilter. Depreciation is likely to represent the effect of 'contagion', or of the indiscriminate treatment of all 'emerging markets' as high-risk areas. It is likely to be reversed – though not necessarily completely – if domestic interest rates rise too far or too fast. Fortunately, although inflation is currently running at well above the National Bank's official tolerance range, monetary policy has been aggressively relaxed. This has already had some desirable effects, in the shape of dramatically declining interbank interest rates and yields on domestically traded treasury bonds. In due course, the lower policy rates will trickle down.

The large-scale packages to aid firms and their (now increasingly redundant) employees may look impressive. But in actual fact, the programmes are bureaucratic nightmares: they require constant correction, are hard to implement and tend to offer too little too late. Arguably, this attitude to the needs of private business could have been predicted. The ruling party styles itself as illiberal ('pro-social'), in contrast to the openly liberal ('pro-business') government that led the country through the 2008-2009 crisis. The government's priority has been to distribute – pretty indiscriminately – handouts to families with children and to retirees (an important segment of the electorate), rather than to entrepreneurs (who are generally suspected of mischief and tax machinations).

With the private sector suffering from falling sales and mounting fixed costs, a recession – the first since the big-bang recession of 1990-1991 – now seems inevitable. The material impoverishment of broad social strata (former employees, as well as the self-employed) goes hand in hand with increased day-to-day inconveniences, imposed to contain the spread of the epidemic. Healthcare policy is rightly perceived to be chaotic and inadequate.

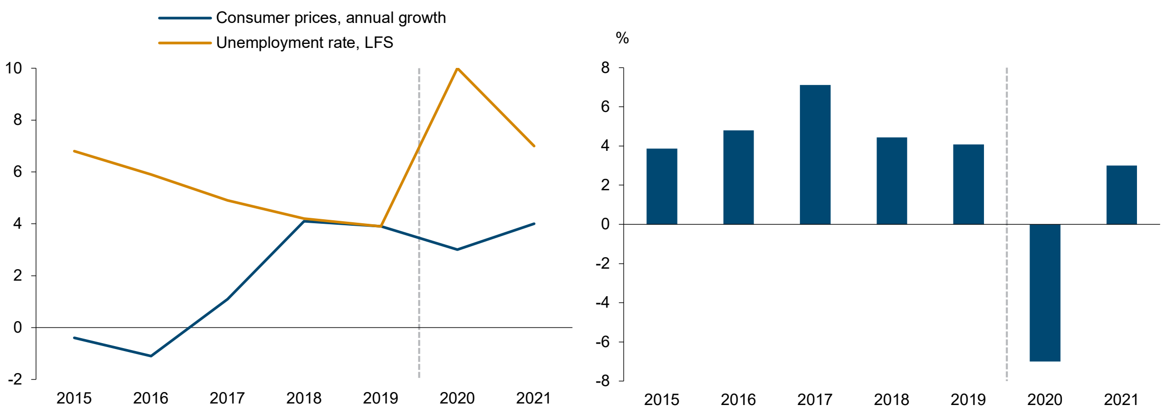
In the midst of the unprecedented combined economic-cum-health crisis (with a serious drought capping the country's misfortunes), the government is now busily engaged, at the last moment, in engineering fundamental changes to the electoral law. The goal is to hold the presidential election in May 2020 – i.e. before the electorate has had a chance to feel the full effects of the crisis. Given his access to the government-controlled ('public') media, the government-backed incumbent is likely to win. However, if it goes ahead, the government-supervised postal ballot will accord him little legitimacy – either internally or externally.

ROMANIA: Strict lockdown and soaring fiscal deficits

GÁBOR HUNYA

The health system was ill-prepared to deal with the Coronavirus pandemic, and the government responded with strict lockdown measures that are unlikely to be lifted much before July. The economic impact will be a GDP decline of about 7% and a fiscal deficit of some 9% of GDP. The rising cost of external financing limits the government's scope for supporting economic recovery.

Figure 3.17 / Romania: Main macroeconomic indicators



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

Table 3.17 / Romania: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	4.4	4.1	-7.0	3.0
Unemployment rate, LFS, in %, average	4.2	3.9	10.0	7.0
Consumer prices (HICP), % p.a.	4.1	3.9	3.0	4.0
Current account, % of GDP	-4.4	-4.6	5.0	-4.5
Central bank policy rate, % p.a., eop 2)	2.5	2.5	2.0	2.0
Average exchange rate RON/EUR	4.65	4.75	4.85	5.20

1) Preliminary. - 2) One-week repo rate.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Romania has the lowest spending on health care in the EU, and among the lowest densities of physicians. The country suffered a major exodus of health professionals up until 2018, at which point the government was forced to award health service workers a pay rise of 160%. Initially, there was a severe shortage of equipment and knowledge to fight COVID-19, and in the early days a fifth of all severe cases occurred among medical personnel; more recently, there has been an improvement, thanks to imports of equipment and better organisation.

The lockdown measures are very strict, with heavy fines imposed on those who go out without a written certificate. Many manufacturing companies – including the automotive industry – sent their employees home in March. Compared to February, the loss of production was estimated to be 30% in March and 40% in April. A further severe drop is expected in the second quarter of the year. However, the lockdown is due to be eased in May, and tentative steps to relaunch the economy may help put an end to the decline. The local infectious diseases institute believes that most of the lockdown measures could be lifted in July.

The unemployment rate rose from 3.9% in February to 6.6% in mid-April, and a further 11.5% of the workforce are on temporary leave of absence. In addition, about 250,000 people have returned to Romania from abroad since the outbreak of the crisis and are temporarily unemployed; about 80,000 are expected to leave the country again once the restrictions are eased.

The main government support for the population consists of a partial and capped wage guarantee for those on reduced worktime. The government has deferred tax payments and is prepared to guarantee loans for investment and working capital totalling EUR 3 billion between May and December this year. Altogether, the fiscal measures are expected to be worth up to 4% of GDP.

The public deficit more than tripled in the first quarter of 2020, compared to the same period last year, reaching 1.7% of GDP (mainly due to lower tax revenue). The budget deficit was already 4.5% in 2019 and may increase to 9% in 2020. EUR 1 billion worth of treasury bills were sold in January and February, and this has provided some cushioning. A lot more external financing will be needed, and the cost is only going to increase: 10-year government bond yields rose from 3.8% to 4.8% within a month, and more rises are on the cards as the rating agencies consider downgrading the country.

The current account deficit will remain at about 5% of GDP. Although imports will fall more than exports, foreign investors' earnings will rise, due to the high profits made in 2019. Remittances may have increased thanks to the funds brought back home by returning emigrants; but they will decline later on, due to the reduced income of those who have stayed abroad.

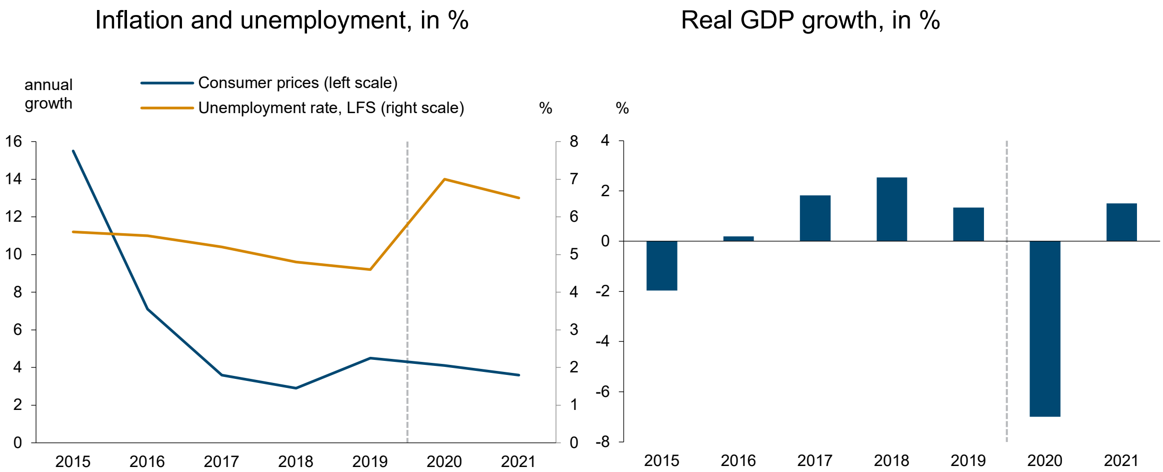
We expect a GDP decline of 7% in 2020 and a modest 3% recovery in 2021. It is not only external financing and demand constraints that constitute a downside risk in 2020: the extremely dry spring has also placed the harvest, exports and rural consumption in some jeopardy.

RUSSIA: Facing a double shock

VASILY ASTROV

The Russian economy is facing a double shock, with the Coronavirus crisis and collapsing oil prices. As a result, budget and current account surpluses are likely to be things of the past. Real GDP is expected to drop by 7% in 2020 and to recover only modestly next year. The fiscal stimulus enacted so far is only 2.8% of GDP, while monetary policy easing is unlikely to have much effect, given the anaemic demand for credit.

Figure 3.18 / Russia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.18 / Russia: Selected economic indicators

	2018	2019 [1)]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	2.5	1.3	-7.0	1.5
Unemployment rate, LFS, in %, average	4.8	4.6	7.0	6.5
Consumer prices, % p.a.	2.9	4.5	4.1	3.6
Current account, % of GDP	6.8	3.8	0.0	1.0
Central bank policy rate, % p.a., eop [2)]	7.75	6.25	5.0	4.5
Average exchange rate RUB/EUR	73.87	72.51	84.0	80.0

Note: Including Crimean Federal District.
1) Preliminary. - 2) One-week repo rate.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

The Russian economy is facing a double shock, with the Coronavirus crisis and collapsing oil prices. Restrictive measures, including strict lockdowns in many regions (notably Moscow), were introduced relatively early on. However, the population's compliance has often been poor, resulting in quite a rapid spread of the virus and implying that lockdowns may remain in place for some time to come. On top of that, the oil price has collapsed by 60-70%, to levels not seen since 1999, while the newly concluded OPEC++ agreement requires Russia to cut its production by around a quarter in the coming months.

Thanks to persistent Central Bank interventions, the rouble has depreciated by only about 20-25% – less than the recent collapse in the oil price would otherwise have suggested. On the one hand, this means that the impact of depreciation on inflation and real incomes should be relatively moderate. But on the other hand, it also means that the shortfall in government revenues from energy exports will be only partly offset by a weaker rouble, resulting in a ballooning budget deficit – possibly rising to 6% of GDP this year. Besides, the relative strength of the rouble will constrain the drop in imports, so that the long-standing current account surpluses will likely disappear, or may even turn negative this year.

In response to the crisis, the government has adopted two packages of fiscal stimuli with a combined volume of 2.8% of GDP, of which 0.5 pp represents subsidised credit. The measures target households (such as 50% higher unemployment benefit, extra child benefit and credit holidays in the event of steep loss of income), businesses (credit holidays and a moratorium on bankruptcies) and especially small and medium-sized enterprises (salary subsidies, tax holidays and lower social security contributions). However, the scope of the fiscal measures enacted so far is very modest, given Russia's ample fiscal space: public debt of just 13% of GDP and the sovereign National Wealth Fund standing at 12% of GDP (the latter can be tapped, so long as the oil price is below USD 42 per barrel).

Monetary policy, too, has been relaxed, with the policy rate slashed by 50 basis points on 24 April (to 5.5%) and further cuts likely in the coming months. The reduction was made possible by the recent financial stabilisation: initial capital outflows at the start of the crisis were reversed, and on 22 April the government successfully placed RUB 87 billion of sovereign bonds at 5.99% yield. However, the effectiveness of lower interest rates is questionable in the current climate, since the demand for credit appears to be very weak regardless.

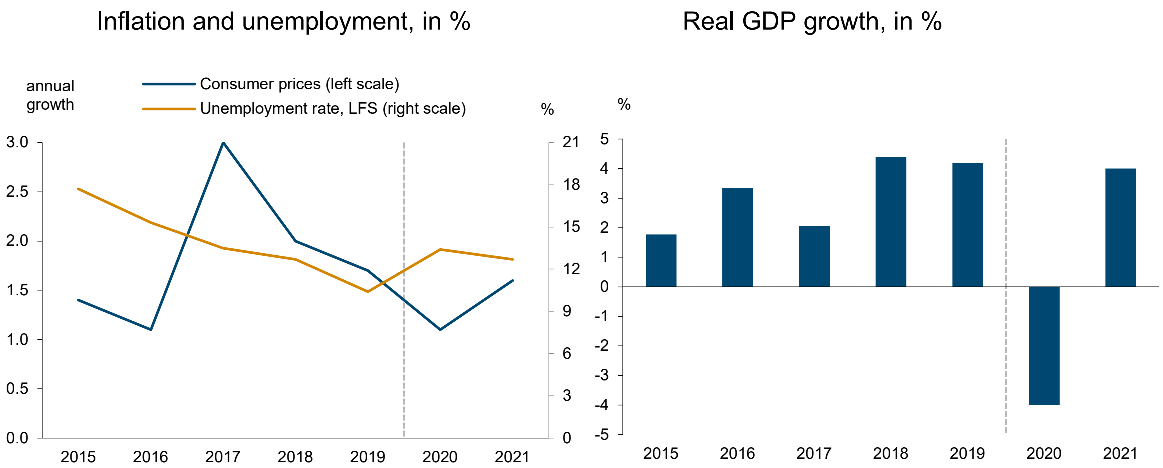
The economy is projected to contract by 7% this year, with a decline in private consumption of around 5% and a double-digit fall in investment; meanwhile real net exports are likely to contribute positively to growth (despite the deterioration in nominal terms). The rise in unemployment should not be dramatic: historically, labour market adjustment in Russia in time of crisis has tended to be primarily via wage cuts, rather than layoffs. However, unlike in most other CESEE countries, the peak of the epidemic is not yet in sight for Russia. Should the current lockdowns be extended beyond 11 May, the risks to the above forecasts are clearly on the downside.

SERBIA: Recent strong growth hits a wall

RICHARD GRIEVESON

The economy will suffer badly this year from the Coronavirus fallout, and we expect a full-year decline in real GDP of 4%. This will be less severe than in many other CESEE countries, reflecting in part the government's quite ambitious fiscal stimulus plans, and a much lower reliance on tourism in Serbia than in some of its regional peers. Foreign direct investment (FDI) and exports will suffer badly this year and next, but thereafter could benefit from 'near-shoring' by Western European investors.

Figure 3.19 / Serbia: Main macroeconomic indicators



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

Table 3.19 / Serbia: Selected economic indicators

	2018	2019 [1)]	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	4.4	4.2	-4.0	4.0
Unemployment rate, LFS, in %, average	12.7	10.4	13.4	12.7
Consumer prices, % p.a.	2.0	1.7	1.1	1.6
Current account, % of GDP	-4.8	-6.9	-7.5	-7.0
Central bank policy rate, % p.a., eop [2)]	3.00	2.25	1.0	1.5
Average exchange rate RSD/EUR	118.3	117.9	118.2	119.0

1) Preliminary. - 2) Two-week repo rate.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

After two years of good growth, economic activity in Serbia this year will contract sharply as a result of the Coronavirus shock. The economy is exposed via exports, remittances, transport and tourism, and has also been affected by the strict domestic lockdown measures introduced to stop the spread of the virus. However, the government is keen to restart the economy, and some easing of restrictions has already taken place.

Serbia's greater integration into regional value chains in recent years renders it exposed to the collapse in global trade and dislocation in the automotive industry. The important Fiat-Chrysler plant closed back in February, as it struggled to get parts from China – the first automotive production suspension in Europe related to the Coronavirus. Tourism has also been gaining in importance in recent years (as in most of the Western Balkans), but inflows are likely to drop massively this year.

We expect real GDP to contract by 4% this year – one of the better outturns in CESEE. Despite major challenges, Serbia may weather the downturn better than many other CESEE countries. It can probably pursue a looser fiscal policy than other Western Balkan countries, and its levels of dependence on external trade and tourism are not as high as many of its regional peers. If agricultural production is maintained at a decent level, food exports may also help the recovery from the second half of this year.

Serbia will certainly suffer badly from a reduction in capital flows. We calculate that over the last five years, personal remittance inflows have totalled around 8% of GDP per year, with the equivalent figure for FDI at over 6%. Both are likely to decline considerably in 2020, and may not bounce back very strongly next year. Nevertheless, as the crisis fades, it could be that Serbia benefits from 're-shoring' by Western European firms that still want to outsource, but wish to keep production closer to home.

So far, the impact on the (mostly fixed) exchange rate appears to be manageable, but this is not guaranteed to last. The central bank has cut the policy rate to 1.5%, and may go even further; massive global monetary easing means that Serbia does not need to offer the big interest rate differentials of the past. However, easing policy to support the economy, while also selling foreign currency to support the dinar may not be sustainable, and we expect the domestic currency to weaken over the next 18 months.

Domestic fiscal stimulus plans are quite ambitious, and – if enacted – would help to mitigate the extent of the downturn. Public investment has been a key driver of growth recently, and the government will try to maintain this as much as possible, in order to cushion the downturn in other parts of the economy. The government says that it has borrowed much of what it needs already to run a deficit of 7% of GDP this year. This would be a much more significant fiscal support for the economy than anywhere else in the Western Balkans, and may even be able to compensate for some of the lost FDI.

SLOVAKIA: Grim outlook ahead

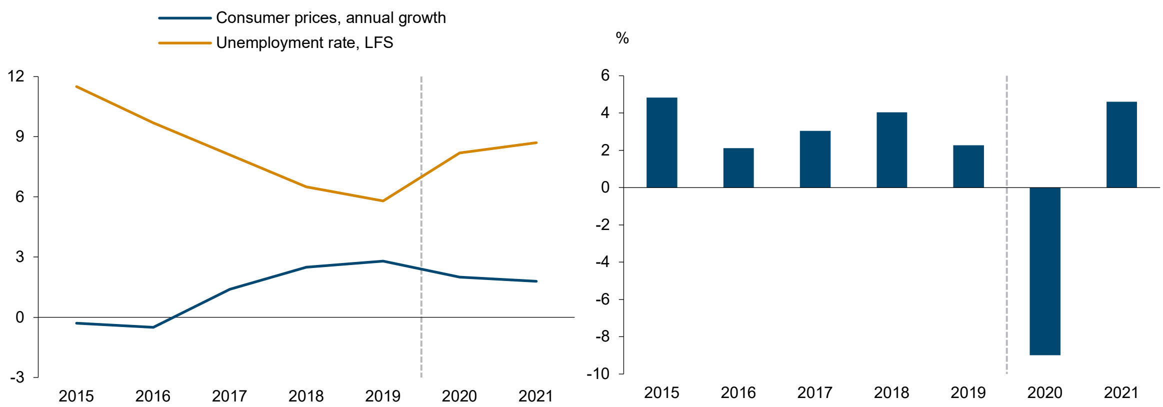
DORIS HANZL-WEISS

The outlook for Slovakia is grim, with GDP forecast to drop by about 9% in 2020 (recovering somewhat in 2021, by 4.6%). Worldwide, the automotive industry is particularly badly affected by the COVID-19 crisis, and that goes for Slovakia, too – all four car companies have been closed since mid-March. A new government took over in the midst of the crisis, and is now focusing on fighting it.

Figure 3.20 / Slovakia: Main macroeconomic indicators

Inflation and unemployment, in %

Real GDP growth, in %



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

Table 3.20 / Slovakia: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	4.0	2.3	-9.0	4.6
Unemployment rate, LFS, in %, average	6.5	5.8	8.2	8.7
Consumer prices (HICP), % p.a.	2.5	2.8	2.0	1.8
Current account, % of GDP	-2.6	-2.9	-3.1	-1.8

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Fairly restrictive measures to deal with COVID-19 were introduced quite rapidly in Slovakia at a time when only a small number of cases had been detected. These have been in effect since 16 March. A four-phase plan was recently announced for the gradual reopening of the country. Overall, the number of deaths is very low (as of 27 April, 1,384 people had been infected, with just 20 deaths). However, it is feared that the disease could spread in Roma settlements (some localities have been placed in quarantine) and retirement homes. Measures to help the economy came rather late on, as a new government took over in the midst of the crisis. However, the rescue package encompasses EUR 1 billion in financial aid plus EUR 0.5 billion in loan guarantees each month for small and medium-sized enterprises. For large companies, short-time working is proposed. EU funds for the period 2014-2020 (which have been slow to be used) have been reallocated to fight the crisis.

The car industry worldwide has been particularly badly affected by COVID-19, and demand has collapsed. In Slovakia, all four main car manufacturing companies have been closed since mid-March for a combination of reasons: fear of Coronavirus spreading in large companies (VW Bratislava has 12,000 employees), pressure from trade unions (at Jaguar Land Rover) and problems with the supply chain. Most worrying is that industrial production in the first two months of the year had already declined generally (0.8%), and February’s performance was bad for the automotive industry particularly. Kia partially reopened its plant on 6 April; Volkswagen has gradually started production since 20 April; and Jaguar Land Rover is planning to resume on 18 May.

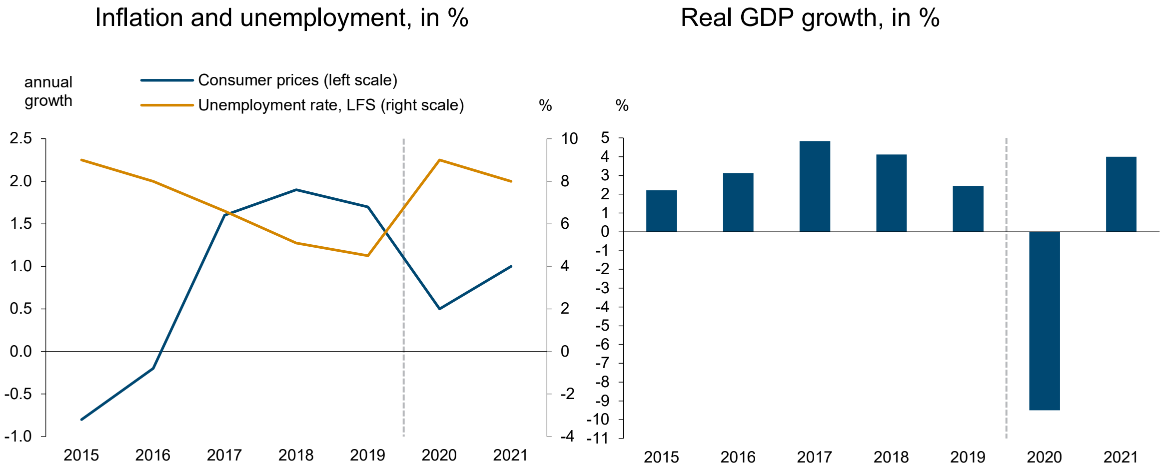
The outlook for the Slovak economy is grim. There is considerable uncertainty, and GDP estimates for this year range from -6% (the most optimistic) to -13%. However, we forecast GDP to drop by about 9% in 2020, with a 4.6% recovery in 2021. Not surprisingly, there will be a huge fall in both exports and investment, and household consumption will likewise be adversely affected. The base effect will help recovery in 2021 but consumers will be cautious. The new government’s main targets include the fight against corruption – but first it has to address the COVID-19 crisis.

SLOVENIA: Pandemic hits manufacturing and service sectors alike

HERMINE VIDOVIC

The Coronavirus pandemic will probably hit the Slovenian economy even harder than the financial crisis did. Tourism, transport, retail trade and the export-oriented sectors will be most affected. Despite the adoption of two stimulus packages, GDP is expected to decline by 9.5% in 2020; this will be coupled with rising public debt and increased unemployment. In 2021, we expect a modest improvement, as foreign and domestic demand picks up slowly.

Figure 3.21 / Slovenia: Main macroeconomic indicators



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

Table 3.21 / Slovenia: Selected economic indicators

	2018	2019 1)	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	4.1	2.4	-9.5	4.0
Unemployment rate, LFS, in %, average	5.1	4.5	9.0	8.0
Consumer prices (HICP), % p.a.	1.9	1.7	0.5	1.0
Current account, % of GDP	6.1	6.6	2.0	3.0

1) Preliminary.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The Slovenian parliament responded relatively quickly to the outbreak of the Coronavirus crisis and adopted two stimulus packages to combat the impact of the COVID-19 pandemic. The first – worth EUR 3 billion (6.3% of GDP) – was designed primarily to prevent layoffs and to support the self-employed, pensioners and students. The second package – worth over EUR 2 billion (4.2% of GDP) – is intended to preserve liquidity in companies (mainly via guarantees) and to relax conditions and expand the list of recipients of the first package's benefits. A third package is being considered to support economic recovery. In view of the rising expenditure, the general government deficit could end up at 8% relative to GDP in 2020 (after surpluses in recent years). In order to finance the stimulus packages, the Slovenian government issued bonds worth EUR 2.25 billion in March; since the beginning of the year it has borrowed a total of EUR 5.4 billion.

The negative economic consequences will be felt most strongly in sectors such as tourism, transport (e.g. the port of Koper), retail trade and export-oriented manufacturing. In this last sector, Revoz, the Renault-owned car producer, embarked on a gradual resumption of production at the end of April, having been shut since mid-March.

Unemployment, which reached an all-time low in 2019, is expected to rise to 9% in 2020, although the measures taken by parliament should help to cushion the effects of the crisis on the labour market. However, Chinese-owned Gorenje, the country's fourth most important export company, recently announced to lay off around 800 workers; if other companies were to follow suit and undertake long-overdue structural adjustments, unemployment could well be boosted.

wiiw expects GDP to decline by about 9.5% in 2020, mainly due to weaker foreign demand – both in goods and services trade (tourism and transport) – particularly from Germany and Italy, Slovenia's most important trading partners. On top of this, household consumption is expected to decline, as consumer sentiment has fallen further than at any time since the mid-1990s. We expect a slow recovery in 2021, with GDP up by 4% on the back of a moderate rise in foreign demand and a slight recovery in domestic demand.

TURKEY: Heading back into stormy weather

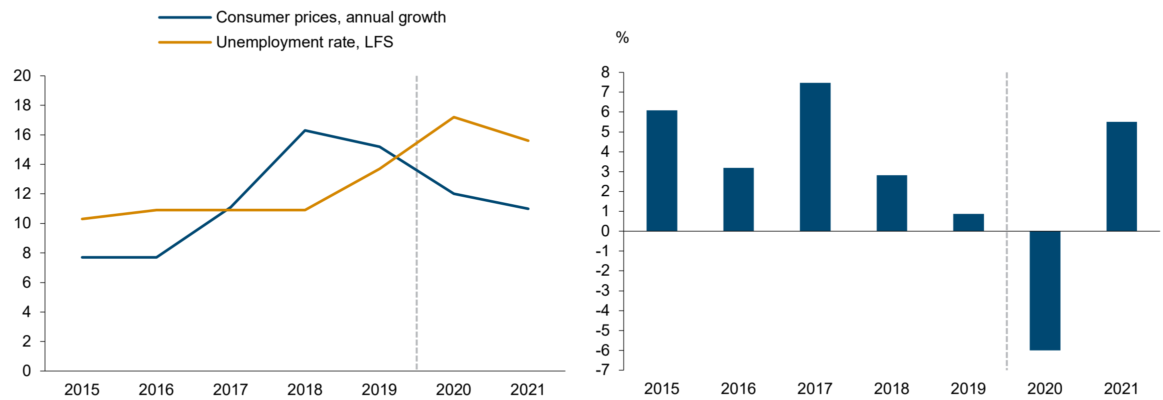
RICHARD GRIEVESON

Having only just recovered from the 2018 lira collapse, Turkey finds itself back in the midst of yet another crisis. The Coronavirus will present huge challenges for the economy, and we expect real GDP to decline by 6% this year. Capital flight from emerging markets is at an all-time high, and this presents serious risks for Turkey's ability to meet its external debt commitments. However, if the immediate crisis is weathered, the recovery in Turkey should be strong.

Figure 3.22 / Turkey: Main macroeconomic indicators

Inflation and unemployment, in %

Real GDP growth, in %



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

Table 3.22 / Turkey: Selected economic indicators

	2018	2019 [1)]	2020	2021
			Forecast	
Gross domestic product, real, annual change in %	2.8	0.9	-6.0	5.5
Unemployment rate, LFS, in %, average	10.9	13.7	17.2	15.6
Consumer prices (HICP), % p.a.	16.3	15.2	12.0	11.0
Current account, % of GDP	-3.4	0.5	0.4	-0.2
Central bank policy rate, % p.a., eop [2)]	24.0	12.0	8.75	10.00
Average exchange rate TRY/EUR	5.71	6.36	7.6	7.8

1) Preliminary. - 2) One-week repo rate.
Source: wiiw Annual Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The Coronavirus – the latest (and most severe) in a series of shocks that the economy has faced in recent years – presents an enormous challenge for Turkey. This crisis will lead to a sharp decline in tourism, trade and capital inflows, and a strong rise in unemployment. Turkey already faces a significant increase in risk premia, as well as pressure on its macroeconomic and financial stability. This adds to huge existing challenges, including the presence of over 3 million refugees, the conflict in Syria and the ongoing impact of the 2018 crisis and collapse of the lira.

In terms of Coronavirus cases and deaths, Turkey is one of the worst affected CESEE countries, which could mean that lockdown measures need to be kept in place for longer than in other parts of the region. Turkey has the seventh-highest number of cases in the world, behind only the five big Western European economies and the US. However, its death rate – at 35 per million population – is considerably lower than in those countries (the figure for Spain, for example, is 510 per million).

As usual, the actions of the big central banks, and especially the Fed, are crucial for Turkey. Since the big central banks flooded the financial system with liquidity in late March, the premium of Turkish 10-year government bonds over their German equivalent has fallen by around 275 basis points. Nevertheless, Turkish borrowing costs – for both the public and the private sector – are likely to remain extremely elevated during the forecast period. Turkey is vulnerable to a mass stampede by foreign investors from the emerging markets, although the sharp adjustment since 2018 has reduced somewhat its dependence on foreign capital inflows. Nevertheless, at the end of February, external debt due within one year amounted to almost USD 170 billion (over 20% of 2019 GDP). Around half of this is in US dollars.

A big recession is unavoidable in 2020, and we project a decline in real GDP of 6% this year. This forecast is subject to an unusually high degree of uncertainty, given the possible range of outcomes at the local and global level. A key risk is that the central bank has continued to cut interest rates, leaving the real policy rate firmly in negative territory and contributing to a sharp lira sell-off. At the time of writing, the lira is languishing at around 7.60 to the euro, close to the lows it touched during the 2018 crisis. This will put further pressure on foreign currency debt servicing costs, and push up already high inflation, eating further into real incomes.

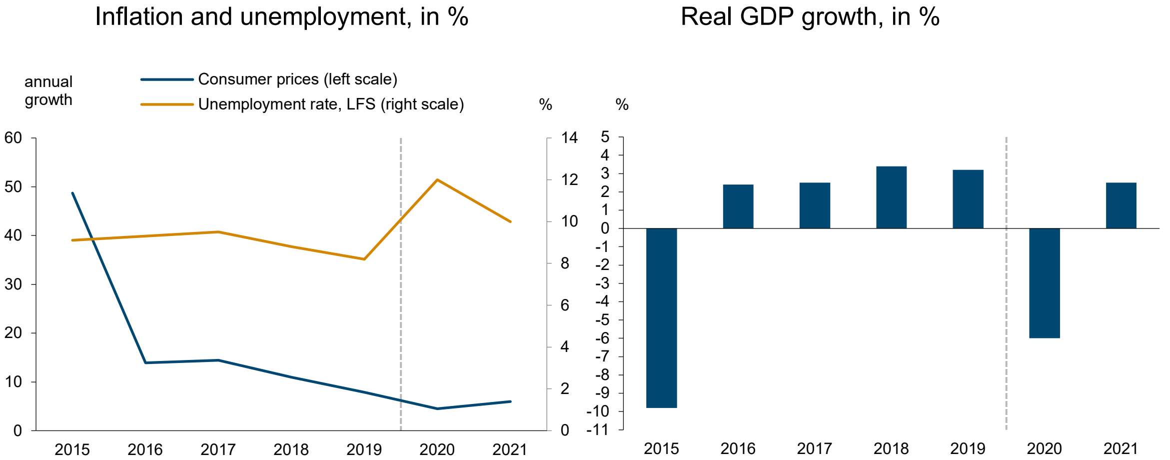
We expect the recovery to arrive by the second half of 2021, and we could see the Turkish economy growing by 5.5% next year. Assuming that Turkey can avoid serious financial meltdown in the meantime, when the recovery arrives the country will be able to benefit from its usual advantages, including a young population and a dynamic and adaptable private sector. The collapse in the oil price is a huge positive for Turkey: it will help to keep both the lid on inflation and the current account deficit under control.

UKRAINE: IMF assistance crucial to keep the economy afloat

OLGA PINDYUK

The Ukrainian economy will be hit quite hard by the Coronavirus crisis – in 2020, GDP will fall by 6%, due to plummeting private consumption and investment. The government needs International Monetary Fund (IMF) assistance to finance the large budget deficit and debt repayments, which will peak in 2020. Inflation will be moderate during 2020-2021, and only a slight depreciation of the hryvnia is expected. One major risk to the forecast is that the government may not be able to secure the IMF loan.

Figure 3.23 / Ukraine: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

Table 3.23 / Ukraine: Selected economic indicators

	2018	2019 1)	2020 Forecast	2021 Forecast
Gross domestic product, real, annual change in %	3.4	3.2	-6.0	2.5
Unemployment rate, LFS, in %, average	8.8	8.2	12.0	10.0
Consumer prices, % p.a.	10.9	7.9	4.5	6.0
Current account, % of GDP	-3.3	-0.9	-2.0	-3.5
Central bank policy rate, % p.a., eop 2)	18.0	13.5	7.0	7.0
Average exchange rate UAH/EUR	32.14	28.95	31.5	32.5

Note: Excluding the occupied territories of Crimea and Sevastopol and the temporarily occupied territories in the Donetsk and Luhansk regions.
1) Preliminary. - 2) Discount rate of NB.
Source: wiiw Annual Database incorporating national statistics. Forecasts by wiiw.

The quarantine has already significantly affected business activity, consumption and employment in Ukraine. About 700,000 small and medium-sized enterprises, employing an estimated 3.5-4 million people, have ceased operations.[18] In an attempt to keep going through the quarantine, Ukrainian businesses are opting to cut salaries and dismiss staff.[19]

A decline in global demand has also limited Ukraine's export opportunities, which has further aggravated the situation in the industrial sector. Exports of metals and chemicals are particularly badly affected by the deterioration in the situation on the external markets. At the same time, global demand for agricultural products is likely to remain strong, which will buoy up Ukraine's exports. Major risks to the increase in exports in this sector lie on the supply side – a bad harvest following extremely dry weather and a shortage of labour due to the spread of COVID-19.

We forecast a 6% fall in GDP in 2020, primarily because of a slump in private consumption and investment. Remittances, which have been an important source of household income, are expected to decline significantly in 2020, as many migrants have returned home. Record low energy prices, high global demand for agricultural commodities and a decrease in imports of goods and services (in particular foreign travel, which accounts for about half of services imports) will support the relative stability of prices and the exchange rate. The current account deficit is expected to be quite modest in 2020, but will widen in 2021 with the slow economic recovery.

The limited fiscal space prevents the introduction of fiscal stimuli on a level comparable to the EU-CEE. Only about UAH 65 billion (1.7% of GDP) has been allocated to the stabilisation fund to finance procurement in the healthcare sector and counteract the effects of the Coronavirus crisis. The national bank has tried to provide monetary stimulus, by cutting the policy rate on 13 March and 24 April 24 – by 100 basis points and 200 basis points, respectively, bringing it to 8%. However, this policy has limited effectiveness, as it is not likely to offset credit tightening in the banking sector.

The government needs to reach a deal with the IMF if it is going to be in a position to finance an increased budget deficit (about 7.5% of GDP) and meet its debt repayments (about USD 16 billion or 10% of GDP) this year. Initially, the government reached an agreement on a USD 5.5 billion three-year programme; and recently this amount was increased to USD 8 billion to deal with the pandemic effects. As a precondition for receiving the IMF loan, Ukraine must adopt a law on banks that would prevent the former owners of banks that are declared insolvent from regaining their assets. Adoption of the law has met with strong resistance from the former owner of the nationalised Privatbank, Ihor Kolomoisky. Failure to get the law passed remains a major risk to the above forecast.

---

18 According to President of the Chamber of Commerce and Industry of Ukraine, Gennady Chizhikov.

19 According to Factum Group Ukraine, 20% of Ukrainians have been forced to take unpaid sick leave during the quarantine. A poll of households by Info Sapiens, published on 31 March, showed that many households started to earn less after the restrictions were imposed: 16% of Ukrainians have temporarily lost their source of income, 38% are being paid less and 14% have lost their jobs outright.

4. Appendix

Table 4.1 / Summary of CESEE key measures regarding COVID-19 as of 30th April, 2020

	Fiscal measures		Monetary measures (where relevant)	Public order		
Country	Description	Size (% of GDP)		Closure of all non-essential shops?	Closure of offices and schools?	Border/travel restrictions
Albania	Total domestic financing of around US$ 300m. For medical equipment and health personnel support, tourism sector; sovereign guarantee fund to be provided to private companies to pay salaries; ongoing humanitarian operations. Additional US$ 191m from IMF.	3.3%	Central bank cut the policy rate by 50bps on March 26th.	Yes	Yes	Yes
Belarus	Two fiscal packages to support affected firms and employees including tax holidays, deferred payments to the budget, employment and social protection, increased budget allocations to the healthcarwe system	4.0%	Banks' capital adequacy requirements were eased to release liquidity for additional lending.	No	No	Yes
BiH	Up to EUR 50m from the EU; EUR 330m from the IMF (doubled original funds), EUR 205m guarantee fund from the FBiH govt for SMEs, EUR 10m from the EIB, fiscal package of EUR 64m from the RS government and EUR 500m from the FBiH government.	6.5%	Six-month loan repayment moratorium in some cases.	Yes	Yes	Yes
Bulgaria	BGN 2.8bn measures including credit guarantees; employment protection; incentives to health care workers; deferred payments to the budget.	2.4%	Banks' capital adequacy requirements were eased to release liquidity for additional lending.	Yes	Yes	Yes
Croatia	Measures worth around HRK 45bn. Temporary increase of the net minimum wage to HRK 4,000 (EUR 725) and partly or fully exempting some businesses from taxes for April, May, and June; deferral of VAT payments and support for tourism and agriculture.	11.0%	Reduction of reserve requirements to free additional liquidity; regular FX interventions to stabilise kuna and ensure liquidity; purchase of government bonds; as of March 16th regular operations to provide short- and long-term kuna liquidity.	Yes, but retail shops were re-opened on 27 April and shopping centres will be opened on 11 May	Opening of all retail entitites Yes, but restrictions to be eased for kindergartens and primary schools on 11 May	Yes
Czech Republic	CZK 100bn in direct support to firms, CZK 900bn loan guarantees. Plus direct payments to the employees, deferred taxes and contributions etc	3.0%	Central bank cut policy rate by 50 bps on March 17th and a further 75bps on March 26th. Lowered some reserve requrements.	Gradually re-opening	Gradually re-opening	Yes, but travel ban removed April 24th
Estonia	First rescue package worth EUR 2bn, including loan guarantees, additional lending for businesses, expansion unemployment insurance fund, support for self-employed. Additional supplementary budget to be presented by April 16th.	7.0%	na	No	Offices: no; schools/ universities: yes	Yes

ctd.

Table 4.1 / Summary of CESEE key measures regarding COVID-19 as of 30th April, 2020, ctd.

	Fiscal measures		Monetary measures (where relevant)	Public order		
Country	**Description**	**Size (% of GDP)**		**Closure of all non-essential shops?**	**Closure of offices and schools?**	**Border/travel restrictions**
Hungary	A reduction in certain taxes and social security contributions in exposed branches/sectors. The state will pay a portion of the wage bill of firms affected, launch of investments, assistance in kick-starting certain sectors hit by the pandemic, a gradual reintroduction of the thirteenth-month pension.	Uncertain, but up to 1-2 % of GDP.	Increase in the effective policy rate, widening of the interest rate corridor, launch of a government security purchase programme on the secondary market and a relaunch of a mortgage bond purchase programme. The central bank will undertake further steps to ensure affordable funding for businesses, in a package worth HUF 3 trillion (EUR 8.3 billion).	No, but restricted opening hours	Yes	Yes
Kazakhstan	Tax relief; support packages for health sector, agriculture, SMEs, domestic producers; job creation measures; indexation of pensions and benefits by 10%; monthly payments for affected 4m people; free food sets to 1m people; free medical care for uninsured citizens; price limits for essential food; import duties for essential food and medical goods lifted inside EAEU.	8.0%	The central bank cut policy rate by 250bps on April 6th. In response to tenge depreciation, FX controls were introduced for legal entities on March 24th. Relaxed risk provisions requirements for banks, 3-month credit holidays for affected SMEs and individuals, ban on extra charges for overdue loans.	Closed in several regions, partial restrictions in the rest of country.	Offices: closed in several regions; schools: yes	Yes
Kosovo	Emergency fund worth EUR 170.6m; negotiations with World Bank for funding (up to EUR 70m); request to IMF for EUR 52m (approved); request to EBRD for loan of EUR 35m; hope for EU support.	3.1%	Borrowers who are unable to pay loan instalment may choose not to pay their instalment from 16 March 2020 until 30 April 2020.	Yes	Offices: no; schools: yes	Yes
Latvia	Tax holidays for affected companies; state guarantees for existing investment loans and financial leasing; additional state loans of up to EUR 1m for each company; employers can be compensated for idle workers' wages up to 75% of the remuneration, but no more than EUR 700 per month. Cut in interest rates for bank loans by 50% in tourism for SME's and 15% for other companies also in related sectors.	7.0%	na	No: Only on weekends non-essential shops are closed	Offices: no; schools/ universities: yes	Yes
Lithuania	EUR 5 bn support package approved for additional health and public security expenditures; income support for employees and self-employed; liquidity support for businesses; additional public investments in infrastructure, housing etc.	10.0%	na	No, non-essential shops re-opened on 27 April	Yes	Yes

ctd.

Table 4.1 / Summary of CESEE key measures regarding COVID-19 as of 30th April, 2020, ctd.

	Fiscal measures		Monetary measures (where relevant)	Public order		
Country	**Description**	**Size (% of GDP)**		**Closure of all non-essential shops?**	**Closure of offices and schools?**	**Border/travel restrictions**
Moldova	Postponed income tax payments; reduced VAT for restaurant and hotels; bank guarantees to strategic economic entities. Enterprises which stop work but continue to pay salaries get a refunding of the income tax, the social contribution and medical contribution of employees (% of the salary fund); other enterprises get 60% of this amount. Interest subsidy to restart production.	3.0%	Central bank cut policy rate by 125bps and reduced reserve ratios.	Yes	Yes	Yes
Montenegro	EUR 18m for SMEs; EUR 50m from the EU; EUR 2.5m from the central bank, EUR 120m credit line by the Investment Development Fund.	3.9%	na	Yes (except outlets selling construction products, plant protection products, agricultural machinery and funeral equipment)	Yes	Yes
North Macedonia	EUR 62m from the EU; EUR 14m interest-free loans for SMEs and EUR 50m of low-intrest loans for commercail banks from the Development Bank of North Macedonia; EUR 176.5m Financial Support from the IMF, EUR 132m fiscal package	3.9%	Central bank cut policy rate by 25bps on March 16th.	Yes	Yes	Yes
Poland	PLN 70bn direct 'Economic Shield' mostly aimed at companies, including deferred tax and social security payments. Direct payments to the employees of business (SMEs in particular) etc. Tax and Social Security Bureaux to intermediate. Much larger loan guarantee scheme promised.	3.0%	Central bank cut policy rate by 50bps on March 18th and a further 50bps on April 8th. QE programme launched.	Yes	Yes	Yes
Romania	State guaranteed loans to firms, unemployment benefits paid from the state budget, deferral of tax payments. Income support to cover 75% of the wages up to 75% of the average wage for those temporarily layed off. Extra wage to medical personal, support care of the elderly. Direct aid to SMEs forthcoming.	4.0%	Central bank cut policy rate by 50bps and will provide liquidity to credit institutions via repo transactions and purchase leu-denominated government securities on the secondary market.	Yes	Yes	Yes

ctd.

Table 4.1 / Summary of CESEE key measures regarding COVID-19 as of 30th April, 2020, ctd.

	Fiscal measures		Monetary measures (where relevant)	Public order		
Country	Description	Size (% of GDP)		Closure of all non-essential shops?	Closure of offices and schools?	Border/travel restrictions
Russia	For households: unemployment benefits raised by 50%, extra child benefits, credit holidays in case of sharp income loss. For businesses: 6-month credit holidays and moratorium on bankruptcies. For SMEs: subsidies to cover salaries, tax holidays and lower social security contributions.	2.8%, of which 0.5 pp subsidised credit	Policy rate lowered on 24 April by 50 basis points, to 5.50% (despite acceleration in inflation); further cuts likely later this year. Ongoing forex sales by Central Bank to limit the extent of rouble depreciation.	Yes	Yes	Yes
Serbia	RSD 384bn including increased healthcare spending, payments to pensioners, cash transfers to citizens, new infrastructure investment, extra time to pay tax and social security contributions, wage subsidies.	7.0%	Central bank cut policy rate by 75bps cumulatively and is selling FX to support the dinar. Using FX swaps and repo operations to provide liquidity to banking sector.	Yes	Yes	Yes
Slovakia	Up to EUR 1 bn aid and EUR 0.5bn bank guarantees per month for SMEs; postponement of tax payments; 'kurzarbeit' also for large companies, relocation of EU funds (EUR 1.3 bn)	1.8% of GDP/month	na	Selected shops re-opened on March 30 and April 22	Offices: restricted hours; Schools: yes	Yes
Slovenia	EUR 3bn aimed at companies, including tax exemptions, co-financing of social security contributions, as well as temporary basic income for self-employed and vulnerable groups. Second package (EUR 2bn), focusing on guarantees to companies.	10.5%	na	Yes, but shops outside shopping centers will be re-opened on 4 May	Yes, but schools and kindergartens will be gradually re-opened from 18 May	Yes
Turkey	TRY 100bn 'Economic Security Shield' mostly aimed at companies, including deferred tax and social security payments, and loan repayments. Support via public banks for particularly affected sectors (e.g. tourism).	2.1%	Central bank cut policy rate by 200bps cumulatively. Various other measures to inject liquidity into banking sector, plus extended debt repayment periods for some firms.	No official mandate but many have closed	Schools closed, offices partly open	Yes
Ukraine	Increasing housing subsidies (by about EUR 10 per household), one-time payments to pensioners (about EUR 30), pensions indexation, tax holidays business. UAH 65 bn (EUR 2.2 bn) stabilization fund created	1.7%	Policy rate cut by 100 bps on March 13th and 200bps on April 24th. Delay in the introduction of capital buffers, launch of long-term refinancing loans, interventions at the FX market.	Yes	Yes	Yes

IMPRESSUM

Herausgeber, Verleger, Eigentümer und Hersteller:
Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),
Wien 6, Rahlgasse 3

ZVR-Zahl: 329995655

Postanschrift: A 1060 Wien, Rahlgasse 3, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50
Internet Homepage: www.wiiw.ac.at

Offenlegung nach § 25 Mediengesetz: Medieninhaber (Verleger): Verein "Wiener Institut für Internationale Wirtschaftsvergleiche", A 1060 Wien, Rahlgasse 3. Vereinszweck: Analyse der wirtschaftlichen Entwicklung der zentral- und osteuropäischen Länder sowie anderer Transformationswirtschaften sowohl mittels empirischer als auch theoretischer Studien und ihre Veröffentlichung; Erbringung von Beratungsleistungen für Regierungs- und Verwaltungsstellen, Firmen und Institutionen.

wiiw.ac.at

https://wiiw.ac.at/p-5302.html