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Monthly Report

## Summer Forecast Update

# Impressive Resilience is Unlikely to Last

## Economic Forecasts for Eastern Europe for 2022-24

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

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## Economic Forecasts for Eastern Europe for 2022-24


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**Cut-off date for historical data and forecasts: 29 June 2022. Most data are taken from the wiiw Databases. Direct access is available at: https://data.wiiw.ac.at/.**

## ABBREVIATIONS

| | |
|---|---|
| EUR | euro |
| USD | US dollar |
| | |
| AMS | Austrian Public Employment Service |
| BIS | Bank for International Settlements |
| CIS | Commonwealth of Independent States |
| COMTRADE | UN Commodity trade statistics database |
| COVID-19 | coronavirus disease |
| CPC | Caspian Pipeline Consortium |
| CPI | consumer price index |
| ECB | European Central Bank |
| EU | European Union |
| GDP | gross domestic product |
| ICT | information and communications technology |
| NATO | North Atlantic Treaty Organisation |
| OECD | Organisation for Economic Cooperation and Development |
| OPEC+ | Organisation of the Petroleum Exporting Countries (OPEC) plus 10 of the biggest non-OPEC oil-exporting countries |
| PMI | purchasing managers' index |
| pp | percentage points |
| REPowerEU | EU plan to rapidly reduce dependence on Russian fossil fuels and fast forward the green transition |
| RRF | Recovery and Resilience Facility |
| SITC | Standard International Trade Classification |
| WIFO | Austrian Institute of Economic Research |
| wiiw | The Vienna Institute for International Economic Studies |
| WITS | World Integrated Trade Solution database of the World Bank |
| | |
| . | not available (in tables) |
| bn | billion |
| eop | end of period |
| m | million |
| p.a. | per annum |
| Q1 2021 | first quarter of 2021 |
| y-o-y | year on year |

Keywords: CESEE, economic forecast, Central and Eastern Europe, Western Balkans, EU, euro area, CIS, Austria, war in Ukraine, Ukrainian refugees, energy dependence, EU accession, COVID-19, EU Recovery and Resilience Facility, economic growth, labour markets, inflation, stagflation, monetary policy, fiscal policy

JEL classification: E20, E21, E22, E23, E24, E31, E32, E5, E62, F21, F31, H60, I18, J20, J30, O47, O52, O57, P24, P27, P33, P52

## wiiw COUNTRY GROUPS

### CESEE23 Central, East and Southeast Europe

| | | | |
|---|---|---|---|
| AL | Albania | ME | Montenegro |
| BA | Bosnia and Herzegovina | MK | North Macedonia |
| BG | Bulgaria | PL | Poland |
| BY | Belarus | RO | Romania |
| CZ | Czechia | RS | Serbia |
| EE | Estonia | RU | Russia |
| HR | Croatia | SI | Slovenia |
| HU | Hungary | SK | Slovakia |
| KZ | Kazakhstan | TR | Turkey |
| LT | Lithuania | UA | Ukraine |
| LV | Latvia | XK | Kosovo |
| MD | Moldova | | |

### EU-CEE11 Central and East European EU members

| | | | |
|---|---|---|---|
| BG | Bulgaria | LV | Latvia |
| CZ | Czechia | PL | Poland |
| EE | Estonia | RO | Romania |
| HR | Croatia | SI | Slovenia |
| HU | Hungary | SK | Slovakia |
| LT | Lithuania | | |

| **V4** | **Visegrád countries** | **BALT3** | **Baltic countries** |
|---|---|---|---|
| CZ | Czechia | EE | Estonia |
| HU | Hungary | LT | Lithuania |
| PL | Poland | LV | Latvia |
| SK | Slovakia | | |

### SEE9 Southeast Europe

| | | | |
|---|---|---|---|
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RO | Romania |
| BG | Bulgaria | RS | Serbia |
| HR | Croatia | XK | Kosovo |
| ME | Montenegro | | |

### non-EU12 Non-European Union CESEE countries

| | | | |
|---|---|---|---|
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RS | Serbia |
| BY | Belarus | RU | Russia |
| KZ | Kazakhstan | TR | Turkey |
| MD | Moldova | UA | Ukraine |
| ME | Montenegro | XK | Kosovo |

| | | | |
|---|---|---|---|
| **WB6** | **Western Balkans** | | |
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RS | Serbia |
| ME | Montenegro | XK | Kosovo |
| **CIS3+UA** | **Commonwealth of Independent States-3 and Ukraine** | | |
| BY | Belarus | MD | Moldova |
| KZ | Kazakhstan | UA | Ukraine |
| **CIS4+UA** | **Commonwealth of Independent States-4 and Ukraine** | | |
| BY | Belarus | RU | Russia |
| KZ | Kazakhstan | UA | Ukraine |
| MD | Moldova | | |
| **EU27** | **European Union** | | |
| AT | Austria | IE | Ireland |
| BE | Belgium | IT | Italy |
| BG | Bulgaria | LT | Lithuania |
| CY | Cyprus | LU | Luxembourg |
| CZ | Czechia | LV | Latvia |
| DE | Germany | MT | Malta |
| DK | Denmark | NL | Netherlands |
| EE | Estonia | PL | Poland |
| EL | Greece | PT | Portugal |
| ES | Spain | RO | Romania |
| FI | Finland | SE | Sweden |
| FR | France | SI | Slovenia |
| HR | Croatia | SK | Slovakia |
| HU | Hungary | | |
| **EA19** | **Euro area** | | |
| AT | Austria | IT | Italy |
| BE | Belgium | LT | Lithuania |
| CY | Cyprus | LU | Luxembourg |
| DE | Germany | LV | Latvia |
| EE | Estonia | MT | Malta |
| EL | Greece | NL | Netherlands |
| ES | Spain | PT | Portugal |
| FI | Finland | SI | Slovenia |
| FR | France | SK | Slovakia |
| IE | Ireland | | |

# Summer 2022 interim forecast update

## Table 1 / OVERVIEW 2020-2021 AND OUTLOOK 2022-2024

| | | GDP real change in % against prev. year | | | | | Consumer prices average change in % against prev. year | | | | | Unemployment (LFS) rate in %, annual average | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | | | | Forecast | | |
| | | 2020 | 2021 | 2022 | 2023 | 2024 | 2020 | 2021 | 2022 | 2023 | 2024 | 2020 | 2021 | 2022 | 2023 | 2024 |
| BG | Bulgaria | -4.4 | 4.2 | 2.5 | 3.7 | 3.5 | 1.2 | 2.8 | 14.0 | 8.0 | 5.0 | 5.1 | 5.3 | 4.8 | 4.5 | 4.0 |
| CZ | Czechia | -5.8 | 3.3 | 1.8 | 2.9 | 3.7 | 3.3 | 3.3 | 12.2 | 5.8 | 2.3 | 2.6 | 2.8 | 2.5 | 2.5 | 2.2 |
| EE | Estonia | -3.0 | 8.3 | 2.1 | 3.4 | 3.1 | -0.6 | 4.5 | 14.5 | 7.5 | 4.0 | 6.8 | 6.2 | 6.7 | 5.5 | 4.0 |
| HR | Croatia | -8.1 | 10.2 | 3.3 | 3.5 | 3.6 | 0.0 | 2.7 | 8.2 | 3.5 | 3.0 | 7.5 | 7.6 | 7.2 | 7.0 | 6.9 |
| HU | Hungary | -4.5 | 7.1 | 3.1 | 1.5 | 2.7 | 3.4 | 5.2 | 11.0 | 6.0 | 4.0 | 4.3 | 4.1 | 3.6 | 3.6 | 3.6 |
| LT | Lithuania | -0.1 | 5.0 | 1.9 | 2.8 | 2.6 | 1.1 | 4.6 | 14.5 | 6.5 | 4.0 | 8.5 | 7.1 | 6.8 | 7.0 | 6.0 |
| LV | Latvia | -3.8 | 4.5 | 2.1 | 2.4 | 2.6 | 0.1 | 3.2 | 13.0 | 6.5 | 3.0 | 8.1 | 7.6 | 7.0 | 5.8 | 6.0 |
| PL | Poland | -2.2 | 5.9 | 4.2 | 3.6 | 3.8 | 3.7 | 5.2 | 10.5 | 8.0 | 4.5 | 3.2 | 3.4 | 3.2 | 3.1 | 3.0 |
| RO | Romania | -3.7 | 5.9 | 3.5 | 3.5 | 4.5 | 2.3 | 4.1 | 12.0 | 7.0 | 4.0 | 5.0 | 5.6 | 5.5 | 5.3 | 5.0 |
| SI | Slovenia | -4.2 | 8.1 | 4.5 | 3.0 | 2.8 | -0.3 | 2.0 | 8.1 | 4.3 | 2.3 | 5.0 | 4.8 | 4.1 | 4.0 | 3.9 |
| SK | Slovakia | -4.4 | 3.0 | 2.2 | 2.8 | 3.4 | 2.0 | 2.8 | 10.5 | 6.5 | 2.5 | 6.7 | 6.8 | 6.5 | 5.9 | 5.7 |
| | *EU-CEE11 1)2)* | *-3.6* | *5.7* | *3.3* | *3.2* | *3.7* | *2.7* | *4.3* | *11.3* | *7.0* | *3.9* | *4.4* | *4.5* | *4.3* | *4.1* | *3.9* |
| | *EA19 3)* | *-6.3* | *5.4* | *2.2* | *2.5* | *2.1* | *0.3* | *2.6* | *7.5* | *3.5* | *2.0* | *7.9* | *7.7* | *7.0* | *6.8* | *6.6* |
| | *EU27 3)* | *-5.9* | *5.4* | *2.4* | *2.7* | *2.3* | *0.7* | *2.9* | *7.7* | *3.7* | *2.2* | *7.1* | *7.0* | *6.2* | *6.0* | *5.8* |
| AL | Albania | -3.5 | 8.5 | 3.5 | 3.5 | 3.7 | 1.6 | 2.0 | 6.1 | 3.5 | 2.5 | 11.7 | 11.5 | 11.2 | 11.0 | 10.6 |
| BA | Bosnia and Herzegovina | -3.1 | 7.1 | 1.4 | 1.8 | 2.3 | -1.1 | 2.0 | 10.0 | 4.0 | 3.0 | 15.9 | 17.4 | 16.8 | 16.3 | 15.7 |
| ME | Montenegro | -15.3 | 12.4 | 3.6 | 3.7 | 3.3 | -0.3 | 2.4 | 10.0 | 4.0 | 2.0 | 17.9 | 16.6 | 15.3 | 14.8 | 14.0 |
| MK | North Macedonia | -6.1 | 4.0 | 1.0 | 2.5 | 2.5 | 1.2 | 3.2 | 11.0 | 6.0 | 4.0 | 16.4 | 15.7 | 15.0 | 14.5 | 14.0 |
| RS | Serbia | -0.9 | 7.4 | 3.6 | 3.4 | 3.4 | 1.6 | 4.1 | 10.0 | 6.0 | 4.0 | 9.0 | 11.0 | 10.5 | 10.0 | 9.5 |
| XK | Kosovo | -5.3 | 10.5 | 3.3 | 3.7 | 3.9 | 0.2 | 3.4 | 8.5 | 4.3 | 2.0 | 25.9 | 24.5 | 24.3 | 23.8 | 23.5 |
| | *WB6 1)2)* | *-3.2* | *7.6* | *2.9* | *3.1* | *3.2* | *0.9* | *3.2* | *9.5* | *5.1* | *3.4* | *13.0* | *13.9* | *13.4* | *12.9* | *12.4* |
| TR | Turkey | 1.8 | 11.0 | 2.7 | 2.8 | 3.2 | 12.3 | 19.6 | 67.7 | 22.6 | 19.6 | 13.2 | 12.0 | 10.8 | 10.5 | 9.5 |
| BY | Belarus | -0.7 | 2.3 | -4.5 | 1.0 | 2.0 | 5.5 | 9.5 | 15.0 | 12.0 | 11.0 | 4.0 | 3.9 | 4.0 | 4.0 | 4.0 |
| KZ | Kazakhstan | -2.5 | 4.1 | 2.8 | 3.9 | 4.2 | 6.8 | 8.0 | 13.0 | 9.0 | 6.0 | 4.9 | 4.9 | 4.9 | 4.8 | 4.8 |
| MD | Moldova | -8.3 | 13.9 | -1.0 | 3.0 | 4.0 | 3.8 | 5.1 | 25.0 | 13.0 | 8.0 | 3.8 | 3.2 | 3.5 | 3.5 | 3.5 |
| RU | Russia | -2.7 | 4.7 | -7.0 | -3.0 | 1.0 | 3.4 | 6.7 | 15.6 | 9.7 | 3.7 | 5.8 | 4.8 | 6.0 | 6.0 | 5.5 |
| UA | Ukraine | -3.8 | 3.4 | -38.0 | 5.0 | 13.0 | 2.7 | 9.4 | 20.0 | 12.0 | 6.0 | 9.5 | 9.9 | 25.0 | 15.0 | 10.0 |
| | *CIS4+UA 1)2)* | *-2.7* | *4.5* | *-8.9* | *-1.5* | *2.4* | *3.7* | *7.1* | *15.8* | *9.9* | *4.4* | *6.2* | *5.6* | *8.9* | *7.1* | *6.0* |
| | *V4 1)2)* | *-3.4* | *5.4* | *3.4* | *3.1* | *3.6* | *3.4* | *4.7* | *10.9* | *7.2* | *3.9* | *3.5* | *3.7* | *3.4* | *3.3* | *3.2* |
| | *BALT3 1)2)* | *-1.8* | *5.6* | *2.0* | *2.8* | *2.7* | *0.4* | *4.2* | *14.1* | *6.7* | *3.7* | *8.0* | *7.0* | *6.8* | *6.3* | *5.5* |
| | *SEE9 1)2)* | *-4.1* | *6.5* | *3.2* | *3.4* | *3.9* | *1.6* | *3.6* | *11.3* | *6.3* | *3.9* | *8.1* | *8.7* | *8.4* | *8.1* | *7.7* |
| | *CIS3+UA 1)2)* | *-2.9* | *3.8* | *-15.8* | *3.9* | *7.6* | *4.8* | *8.8* | *16.6* | *10.8* | *6.8* | *7.2* | *7.3* | *15.5* | *9.9* | *7.3* |
| | *non-EU12 1)2)* | *-1.4* | *6.5* | *-5.9* | *-0.9* | *1.7* | *6.1* | *10.7* | *11.0* | *6.9* | *3.1* | *8.0* | *7.4* | *7.1* | *5.8* | *4.9* |
| | *CESEE23 1)2)* | *-2.1* | *6.3* | *-3.2* | *0.3* | *2.3* | *5.1* | *8.8* | *11.1* | *6.9* | *3.3* | *7.1* | *6.7* | *6.3* | *5.3* | *4.6* |

## Table 1 / OVERVIEW 2020-2021 AND OUTLOOK 2022-2024 (contd.)

| | | Current account in % of GDP | | | | | Fiscal balance in % of GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2020 | 2021 | 2022 | 2023 | 2024 | 2020 | 2021 | 2022 | 2023 | 2024 |
| BG | Bulgaria | -0.1 | -0.4 | -1.8 | -1.5 | -1.0 | -4.0 | -4.1 | -5.0 | -4.0 | -3.0 |
| CZ | Czechia | 2.0 | -0.9 | -3.5 | -2.2 | 0.0 | -5.8 | -5.9 | -5.0 | -2.7 | -0.5 |
| EE | Estonia | -0.3 | -1.1 | -0.2 | -0.4 | -0.3 | -5.6 | -2.4 | -4.5 | -3.0 | -1.8 |
| HR | Croatia | -0.1 | 3.2 | 0.6 | 0.8 | 1.0 | -7.3 | -2.9 | -3.3 | -2.5 | -2.3 |
| HU | Hungary | -1.1 | -3.1 | -4.5 | -2.5 | -1.5 | -7.8 | -6.8 | -5.5 | -4.3 | -3.7 |
| LT | Lithuania | 7.3 | 1.4 | 0.4 | 0.4 | 0.5 | -7.3 | -1.0 | -4.5 | -3.5 | -2.0 |
| LV | Latvia | 2.9 | -2.9 | -3.8 | -1.9 | -2.0 | -4.5 | -7.3 | -5.5 | -3.5 | -2.0 |
| PL | Poland | 2.9 | -0.6 | -2.1 | -2.0 | -1.5 | -6.9 | -1.9 | -3.8 | -3.5 | -3.0 |
| RO | Romania | -5.0 | -7.0 | -7.0 | -6.5 | -6.0 | -9.3 | -7.1 | -6.5 | -5.0 | -4.0 |
| SI | Slovenia | 7.4 | 3.3 | 0.6 | 1.1 | 1.8 | -7.8 | -5.2 | -3.7 | -3.4 | -2.2 |
| SK | Slovakia | 0.4 | -2.0 | -4.4 | -4.5 | -4.2 | -5.5 | -6.2 | -5.1 | -4.1 | -3.4 |
| | *EU-CEE11 1)2)* | *1.1* | *-1.6* | *-3.1* | *-2.5* | *-1.8* | *-7.0* | *-4.3* | *-4.7* | *-3.7* | *-2.7* |
| | *EA19 3)* | *2.8* | *3.5* | *1.5* | *1.5* | *1.5* | *-7.1* | *-5.1* | *-4.3* | *-3.1* | *-1.8* |
| | *EU27 3)* | *2.8* | *3.2* | *1.5* | *1.5* | *1.5* | *-6.8* | *-4.7* | *-3.9* | *-2.7* | *-1.4* |
| AL | Albania | -8.7 | -7.7 | -8.1 | -7.5 | -6.7 | -6.7 | -4.5 | -4.0 | -3.0 | -2.0 |
| BA | Bosnia and Herzegovina | -3.8 | -2.1 | -2.8 | -3.1 | -4.0 | -5.3 | 3.5 | -1.0 | 0.5 | 1.0 |
| ME | Montenegro | -26.1 | -9.3 | -12.0 | -12.7 | -12.2 | -11.1 | -1.8 | -3.1 | -2.9 | -2.1 |
| MK | North Macedonia | -3.4 | -3.5 | -10.0 | -7.0 | -7.0 | -8.3 | -5.4 | -4.0 | -3.0 | -2.0 |
| RS | Serbia | -4.1 | -4.4 | -10.0 | -7.0 | -7.0 | -8.0 | -4.1 | -4.0 | -3.5 | -3.0 |
| XK | Kosovo | -7.0 | -8.6 | -9.9 | -9.8 | -9.4 | -7.6 | -1.3 | -2.0 | -2.0 | -1.0 |
| | *WB6 1)2)* | *-5.7* | *-4.9* | *-8.6* | *-6.9* | *-6.9* | *-7.5* | *-2.7* | *-3.3* | *-2.6* | *-2.0* |
| TR | Turkey | -5.0 | -1.8 | -6.3 | -5.8 | -5.5 | -2.9 | -2.3 | -3.2 | -2.4 | -2.0 |
| BY | Belarus | -0.4 | 2.7 | 1.1 | 0.9 | 0.7 | -1.7 | 0.2 | -4.0 | -2.0 | -2.0 |
| KZ | Kazakhstan | -3.8 | -3.0 | 2.0 | 0.0 | -1.0 | -4.0 | -3.1 | -3.0 | -2.5 | -2.0 |
| MD | Moldova | -7.7 | -11.6 | -13.0 | -10.0 | -8.0 | -5.3 | -1.9 | -6.5 | -4.5 | -3.5 |
| RU | Russia | 2.4 | 6.9 | 12.5 | 9.0 | 8.0 | -4.0 | 0.8 | 0.0 | -3.0 | -2.0 |
| UA | Ukraine | 3.4 | -1.3 | -3.0 | -4.0 | -6.0 | -5.3 | -3.4 | -20.0 | -15.0 | -8.0 |
| | *CIS4+UA 1)2)* | *1.8* | *5.1* | *10.0* | *6.9* | *5.6* | *-4.0* | *0.1* | *-2.0* | *-3.9* | *-2.5* |
| | *V4 1)2)* | *1.9* | *-1.2* | *-3.0* | *-2.3* | *-1.4* | *-6.6* | *-3.9* | *-4.4* | *-3.5* | *-2.6* |
| | *BALT3 1)2)* | *4.2* | *-0.4* | *-0.9* | *-0.4* | *-0.4* | *-6.1* | *-3.1* | *-4.8* | *-3.4* | *-1.9* |
| | *SEE9 1)2)* | *-3.9* | *-4.3* | *-5.7* | *-5.0* | *-4.6* | *-7.9* | *-5.1* | *-5.2* | *-4.0* | *-3.2* |
| | *CIS3+UA 1)2)* | *-0.6* | *-1.7* | *-0.3* | *-1.6* | *-2.7* | *-4.2* | *-2.7* | *-9.7* | *-7.2* | *-4.3* |
| | *non-EU12 1)2)* | *-0.3* | *2.9* | *6.8* | *4.5* | *3.5* | *-3.9* | *-0.7* | *-1.5* | *-2.7* | *-1.8* |
| | *CESEE23 1)2)* | *0.2* | *1.2* | *2.7* | *1.5* | *1.2* | *-5.0* | *-2.0* | *-2.7* | *-3.1* | *-2.1* |

1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Forecasts estimated by wiiw.
Source: wiiw, Eurostat. Forecasts by wiiw. Cut-off date for historical data and forecasts: 29 June 2022.

**Table 2 / Policy rate and exchange rate for selected CESEE countries: overview 2020-2021 and outlook 2022-2024**

| | | Policy rate eop, p.a. | | | | | Exchange rate NCU/EUR average | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2020 | 2021 | 2022 | 2023 | 2024 | 2020 | 2021 | 2022 | 2023 | 2024 |
| AL | Albania | 0.50 | 0.50 | 1.00 | 1.25 | 1.25 | 123.8 | 122.5 | 121.0 | 122.0 | 121.0 |
| BY | Belarus | 7.75 | 9.25 | 12.00 | 10.00 | 8.00 | 2.789 | 2.992 | 2.8 | 3.0 | 3.2 |
| CZ | Czechia | 0.25 | 3.75 | 7.00 | 4.00 | 3.00 | 26.5 | 25.6 | 24.7 | 24.4 | 24.4 |
| HR | Croatia | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 7.538 | 7.528 | 7.51 | 7.52 | 7.50 |
| HU | Hungary | 0.60 | 2.40 | 7.50 | 5.50 | 4.50 | 351.3 | 358.5 | 385.0 | 380.0 | 380.0 |
| KZ | Kazakhstan | 9.00 | 9.75 | 14.00 | 10.00 | 9.00 | 471.4 | 503.9 | 490.0 | 500.0 | 510.0 |
| MD | Moldova | 2.65 | 6.50 | 20.00 | 10.00 | 6.00 | 19.7 | 20.9 | 21.0 | 21.5 | 22.0 |
| MK | North Macedonia | 1.50 | 1.25 | 2.00 | 2.50 | 2.50 | 61.7 | 61.6 | 61.7 | 61.7 | 61.7 |
| PL | Poland | 0.10 | 1.75 | 7.50 | 6.00 | 3.50 | 4.443 | 4.565 | 4.60 | 4.55 | 4.50 |
| RO | Romania | 1.50 | 1.75 | 5.50 | 4.50 | 3.00 | 4.838 | 4.922 | 4.96 | 5.02 | 5.05 |
| RS | Serbia | 1.00 | 1.00 | 2.50 | 2.50 | 3.00 | 117.6 | 117.6 | 118.0 | 118.5 | 119.0 |
| RU | Russia | 4.25 | 8.50 | 8.00 | 6.00 | 5.00 | 82.4 | 87.2 | 70.0 | 75.0 | 80.0 |
| TR | Turkey | 17.00 | 14.00 | 14.00 | 14.00 | 12.00 | 8.055 | 10.512 | 19.5 | 22.0 | 23.8 |
| UA | Ukraine | 6.00 | 9.00 | 25.00 | 15.00 | 8.00 | 30.8 | 32.3 | 36.0 | 37.0 | 38.0 |

Source: wiiw, forecasts by wiiw. Cut-off date for historical data and forecasts: 29 June 2022.

# 1. CESEE Overview: Impressive resilience is unlikely to last

BY OLGA PINDYUK

- **The performance of the CESEE economies was robust in Q1 2022, but intensifying supply-chain bottlenecks and soaring commodity prices due to Russia's war in Ukraine as well as a decrease in external demand are putting their resilience to the test. The confidence of both consumers and businesses is declining in most of the region, with consumers more pessimistic than firms.**
- **High inflation will hinder economic activity in the region as it eats into real household incomes and pushes many households into poverty. Accelerating core inflation indicates that price rises are becoming increasingly broad-based.**
- **Policy responses to counteract soaring inflation are constrained by macro-financial vulnerabilities in many countries. The EU-CEE economies are better placed to provide fiscal stimulus than their regional peers, not least because they can benefit from their access to the resources of the EU Recovery and Resilience Facility (RRF).**
- **With the exception of the CIS and Ukraine, CESEE is expected to avoid a recession in 2022 primarily on the back of resilient domestic demand. In the CIS and Ukraine subgroup Ukraine will record the steepest economic decline in 2022 due to the devastating effects of Russia's invasion on its economy, while other relatively weak performers will be Russia and Belarus. Russia appears to be more resilient in 2022 than we had previously expected, but this is mainly because the full impact of the oil embargo will mainly be felt in 2023.**
- **For Ukraine and Moldova, being granted EU candidate status represents a decisive step towards their EU integration, signalling that they are now accepted by the European community. Although the accession process may last a long time, the status will provide a stronger anchor for the reform process in the two countries than previous bilateral institutional arrangements.**
- **The slowdown in growth is likely to be short-lived, and most CESEE countries (apart from Hungary, Poland and Slovenia) are expected to accelerate their economic growth in 2023. In 2024 the dynamics will be mixed owing to structural issues in many of the region's economies. However, this forecast is subject to a very high degree of uncertainty, reflecting the unpredictability of the future course of the war and mounting negative risks.**
- **The major risk to macro-financial stabilisation is persistently high inflation. This would require stronger monetary tightening, which could trigger stagflation and a hard landing.**
- **Reducing dependency on Russia's fuel has become a priority, as the country is increasingly using energy to put pressure on its perceived rivals. Short-term risks along the way are energy rationing in winter, which could push the region into a recession, as well as backsliding into increased use of coal in the energy mix, which would be detrimental for the environment.**

## 1.1 GLOBAL ASSUMPTIONS

**Table 3 / wiiw summer 2022 global assumptions**

| | Summer 2022 | | | Changes since spring | | |
|---|---|---|---|---|---|---|
| | **2022** | **2023** | **2024** | **2022** | **2023** | **2024** |
| Euro area real GDP growth, % | 2.2 | 2.5 | 2.1 | -0.3 | -0.2 | 0.0 |
| Euro area CPI, % | 7.5 | 3.5 | 2.0 | 1.5 | 0.5 | 0.0 |
| USD/EUR exchange rate, average | 1.08 | 1.08 | 1.08 | -0.04 | -0.04 | -0.04 |
| USD per barrel Brent oil, average | 110.0 | 90.0 | 90.0 | 5.0 | 0.0 | 0.0 |

Source: forecasts by wiiw. Cut-off date: 29 June 2022.

## 1.2 ECONOMIC GROWTH IN Q1 2022 WAS STILL ROBUST, BUT SENTIMENT IS DETERIORATING

**In Q1 2022 most of CESEE recorded robust economic growth, indicating that the region's impressive ability to bounce back from the pandemic was fully on course before Russia invaded Ukraine** (Figure 1). The region was able to benefit from the low statistical base of comparison (as many countries still had negative growth in Q1 2021) and strong consumer demand. However, this strong performance is unlikely to continue given the multiple shocks hitting the economies, above all Russia's war in Ukraine and soaring global commodity prices.

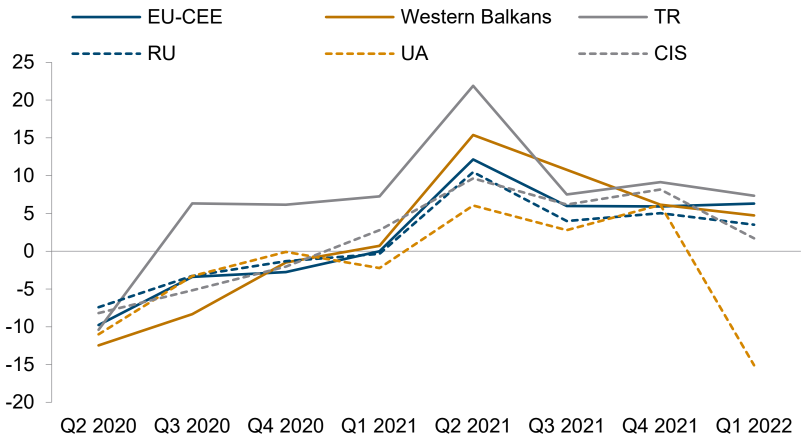
**In EU-CEE annual real GDP growth accelerated in Q1 2022 compared with Q4 2021.** This was achieved primarily on the back of strong private consumption driven by pent-up demand and panic buying in the expectation of rising inflation. Slovenia, Poland and Hungary achieved the highest annual growth rates among their peers, at 9.8%, 9.2% and 8.2%, respectively. Slovakia recorded the lowest growth rate in the subregion, at 3.1% year on year, reflecting mostly a decline in production in its automotive sector. Strong reliance on exports in the economic models of EU-CEE will limit their growth potential as momentum in the global economy fades, and together with skyrocketing inflation this will cause a marked deceleration of growth as the year progresses.

**The Western Balkans also registered a strong performance in Q1 2022, growing by almost 5% in annual terms.** Montenegro outperformed its peers by reaching 7.2% real GDP growth, while North Macedonia was the worst performer in the subregion as it suffered from a decline in industrial production and stagnating real wages. Although the region is expected to benefit from a strong tourism season this year, this will not be enough to sustain the momentum of Q1 in the face of the fallout from the war.

**Turkey recorded the strongest performance in the region in Q1, but this was a temporary phenomenon,** and economic growth in the country is bound to slow down drastically towards the end of the year as the effects of macroeconomic instability become more pronounced. War-torn Ukraine was the only country in the region to record negative economic growth in Q1 2022, contracting by 15.1% year on year. The recession in the country is expected to become significantly worse towards the end of the year as the war is causing the destruction of a major part of the economy. Belarus, Moldova and Russia are expected to follow suit and enter into a recession later in 2022, as they are the most affected by the economic fallout from Russia's war against Ukraine.

**Figure 1 / Quarterly real GDP growth**

real change against preceding year in %



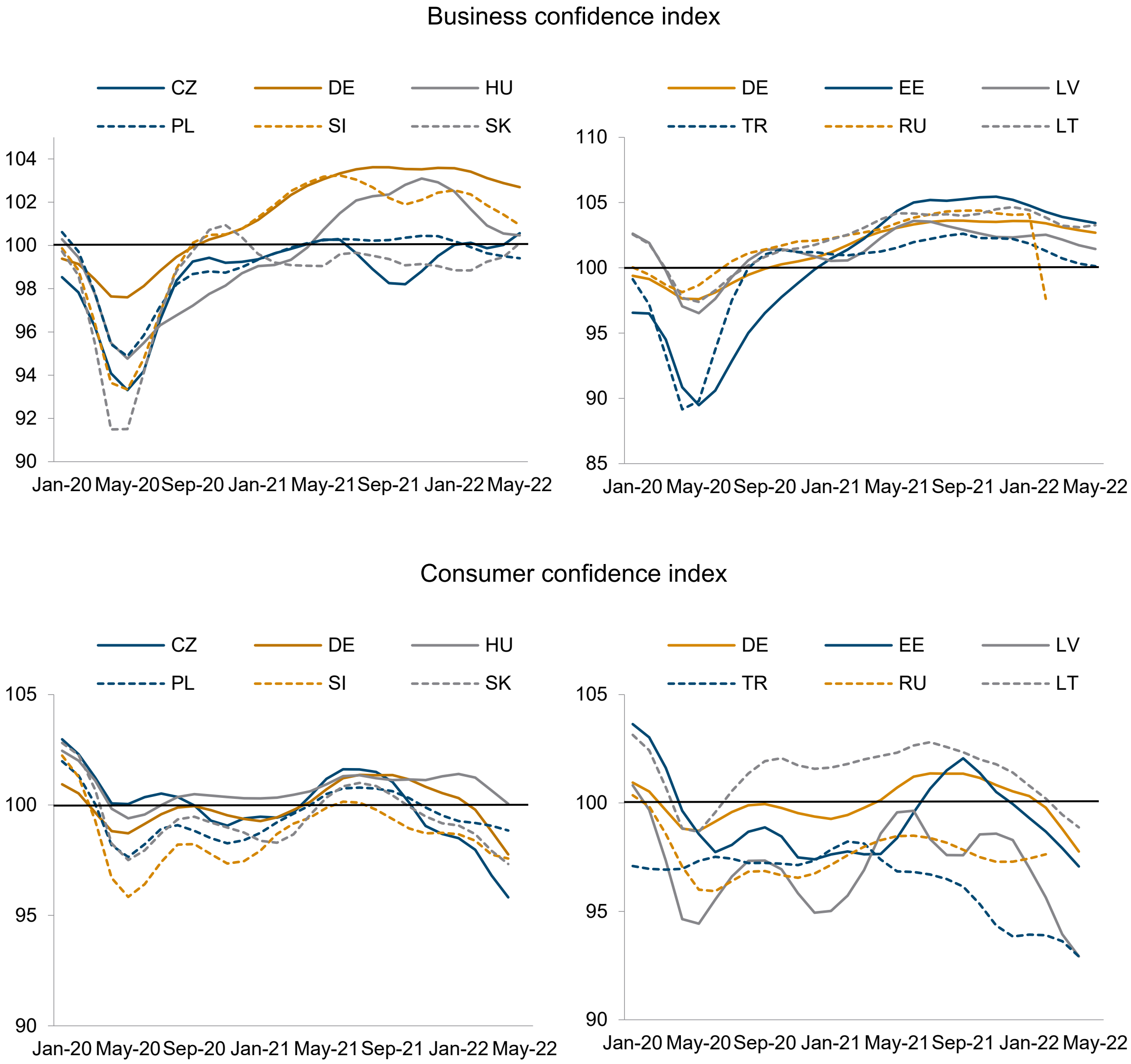

Note: CIS includes Belarus, Kazakhstan and Moldova.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**The confidence of both businesses and consumers has started to dwindle, although there is an interesting divergence in that the impact of the headwinds to growth have so far been much more visible among consumers than businesses (Figure 2)[1].** Most of the countries in the region that are covered by OECD indices show business confidence falling below the level for Germany; however, only in Poland and Russia have companies on average become pessimistic about their prospects (their index values fell below 100). In Czechia and Slovakia business confidence indices have even picked up recently, but given the developments in Germany, this is not likely to last.[2] The consumer confidence index shows a different pattern – here consumers in all the countries apart from Hungary have on average been pessimistic. Latvia and Turkey have the lowest values of consumer confidence indices, with consumers being more pessimistic than during the toughest phase of the COVID-19 pandemic.

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

[2] According to freshly released data from Slovak Statistics, in June 2022 confidence in the economy recorded double-digit declines in the services and industrial sectors.

**Figure 2 / Business and consumer confidence indices**




Source: OECD, own calculation.

**The relative optimism of firms could be linked to the recovery of the services sectors,** benefitting from high accumulated pent-up demand, which had been strongly suppressed during the acute phase of the COVID-19 pandemic in 2020-2021. Higher resilience of sentiment in the services sectors also points to this. As Figure 3 shows, companies in the services sector remain optimistic in most CESEE countries with the exception of Poland, the Baltic states and Russia. The strongest confidence indicators are recorded in Czechia, Slovakia, Croatia and Turkey.

**Figure 3 / Service confidence indicator, seasonally adjusted**

Balance of positive over negative survey results

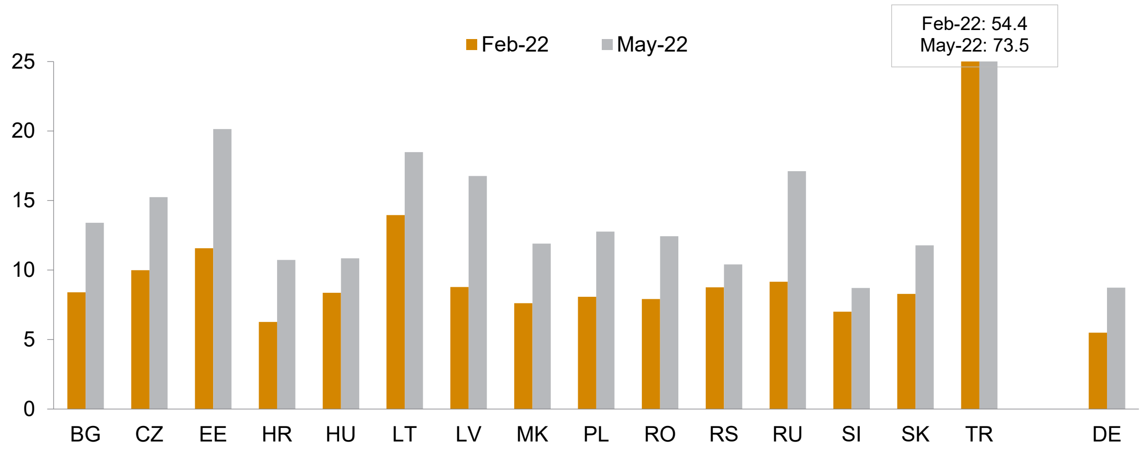

Source: Eurostat and national statistics.

## 1.3 RESILIENCE LIKELY TO BE SHORT-LIVED AS INFLATION WILL HINDER ECONOMIC ACTIVITY

**Inflation in CESEE accelerated further during March-May 2022 (Figure 4), as Russia's war in Ukraine caused new supply-chain bottlenecks and soaring commodity prices**. Pent-up demand for services has also contributed to the rise in prices. The most striking increase in inflation is taking place in Turkey, where the annual CPI increased in May 2022 by 19 percentage points (pp) compared with February 2022. The country is suffering from the highest inflation in the region due to its ultra-negative real interest rates, which have caused a collapse in the lira and massive imported inflation; its strong exposure to the Russian economy and reliance on commodity imports are aggravating the situation further. In May 2022 consumer prices in all the countries in the region apart from Slovenia were growing at double-digit rates, with the Baltic states and Russia recording the highest values of CPI (after Turkey).

**Figure 4 / Consumer price index in February 2022 and May 2022**

percentage change year on year




Source: National sources, Eurostat, wiiw.

**Food prices are growing at double-digit rates throughout almost the entire region, regardless of price regulation efforts in some countries (Figure 4).** Russia's war in Ukraine is the main reason for the skyrocketing food prices, as both countries are important global suppliers of many agricultural commodities such as wheat, corn and sunflower oil (Astrov et al., 2022). The supply of fertiliser is also being affected, which is likely to limit crop production in many countries. As the war is expected to last at some level for a prolonged period and there appears to be little chance of the blockade of the Black Sea ports in Ukraine being lifted any time soon, Ukraine will continue to face difficulties in exporting its agricultural commodities. The upward pressure on global food prices is therefore likely to continue.

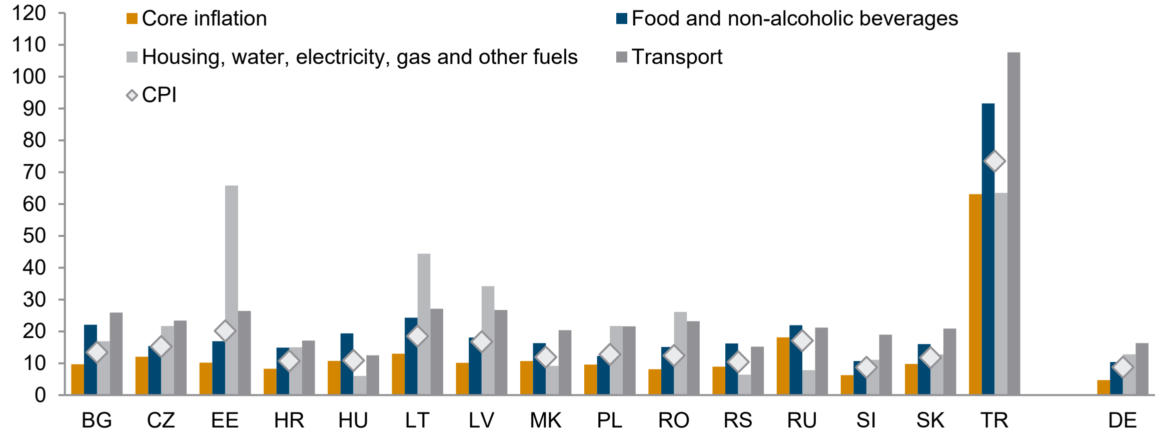
**New sanctions on Russia have driven energy prices further upwards.** On 31 May 2022 the EU adopted a ban on imports of most Russian oil, with a temporary exception for oil transported via pipelines, which accounts for about 10% of total oil imports from Russia. The ban will come into effect at the end of 2022. Its delayed implementation is leading to a temporary tightening of global oil markets, which is pushing oil prices higher. On the bright side, energy inflation is likely to run out of steam next year, constrained by shrinking global demand, a higher base period, and the possible introduction of price caps on Russian fuel that is being considered by G7 leaders.

**Compared with food prices, housing and energy prices in CESEE are showing more heterogeneity**. In Estonia they grew by 65.8% in May 2022 compared with the same month of the previous year, while in Hungary and Serbia they grew by 6% and 6.4%, respectively. This indicates that the full impact of high global energy prices has yet to be felt in many countries.

**Core inflation is accelerating as well, signalling that inflation is no longer driven only by supply bottlenecks but is becoming increasingly broad-based.** As Figure 5 shows, core inflation reached double digits in many CESEE economies in May 2022. This points to firms passing higher input costs on to consumers.

**Figure 5 / Consumer price index sub-components in May 2022**

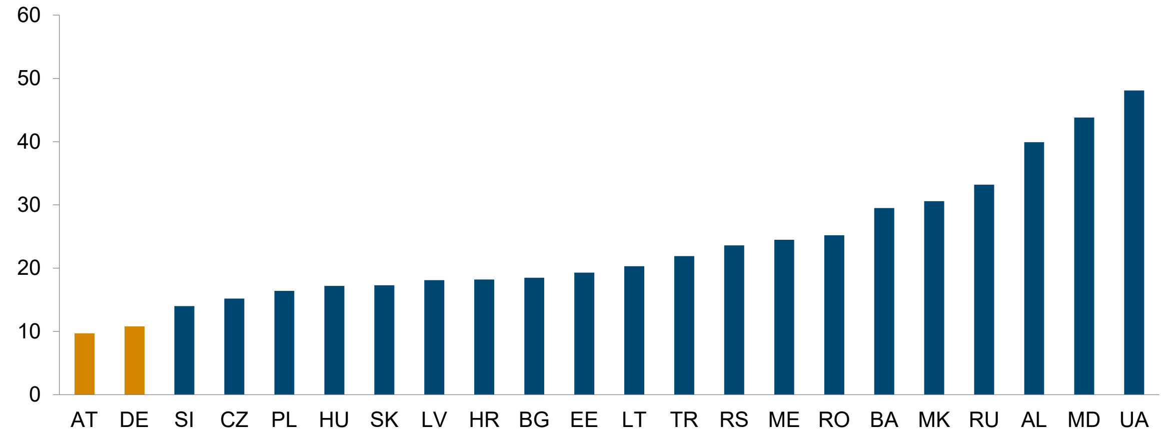
percentage change year on year




Source: National sources, Eurostat, wiiw.

**Households in the Western Balkans, the CIS and Ukraine are the most vulnerable to food price increases.** As Figure 6 shows, in 2019 food accounted for a much higher share of household expenditure in the CESEE countries than in Austria or Germany, for example – in half of the countries the share was at least twice as high. In Ukraine, Moldova and Russia more than one third of household expenditure was allocated to food (with Ukraine standing out with a share of almost 50%). As food demand is relatively inelastic, the share of food in household expenditure is likely to increase significantly in many countries, putting a brake on their demand for services and durable goods.

**Figure 6 / Share of food and non-alcoholic beverages in household expenditures in 2019, %**




Source: Eurostat, National sources.

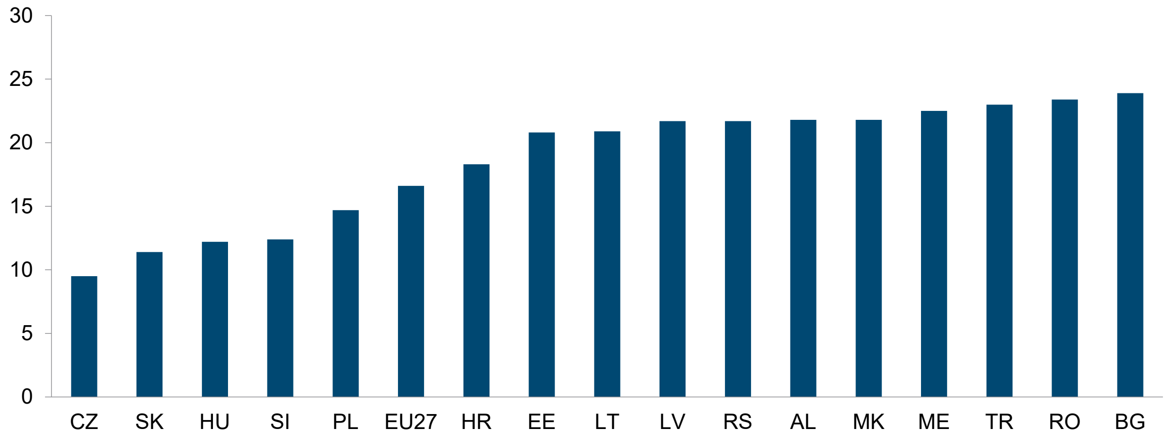
**High inflation is eating into real household incomes.** In March 2022 real wages were already decreasing in annual terms in six countries in the region (Figure 7), with the sharpest declines recorded in Slovenia (-5.7%), Moldova (-5.2%) and Estonia (-3.9%). Only in Kazakhstan and Hungary did real wages grow at a speed above 5% year on year. The March data are only the beginning. Real incomes are likely to be further squeezed because CESEE countries have relatively weaker collective wage bargaining systems (Astrov et al., 2020; Müller, 2021), while fiscal support will be limited by inflation concerns and shrinking fiscal space.

**Figure 7 / Average gross monthly wages in March 2022, real growth, % change year on year**


Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**More and more households in CESEE will be pushed into poverty**. Most of countries in the region have at-risk-of-poverty rates significantly above the average level of the EU (Figure 8). The CIS and Ukraine are not covered by the Eurostat survey, but the available data show that in Ukraine in 2020 the actual poverty rate was above 40% (Cherenko et al., 2020); in Moldova the poverty rate was above 30%. It will be necessary to offer targeted financial assistance to the most vulnerable household groups in the region, especially in the Western Balkans, the CIS and Ukraine, to avoid devastating, long-term effects of poverty.

**Figure 8 / At-risk-of-poverty rate by poverty threshold, %**



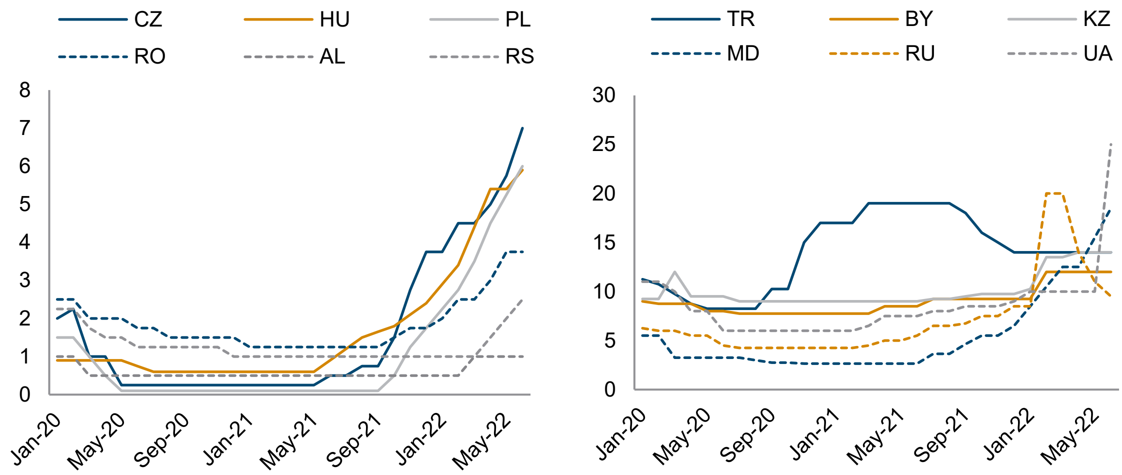

Note: The at-risk-of-poverty rate is the percentage of persons living in households where the equivalised total disposable household income is below the at-risk-of-poverty threshold, defined as 60% of median equivalised disposable income of all households.
Source: Eurostat.

## 1.4 POLICY RESPONSES TO COUNTERACT INFLATION CONSTRAINED BY MACRO-FINANCIAL VULNERABILITIES

**During the recent decade of ultra-loose monetary policy many CESEE countries, similar to their counterparts in the West, got used to assigning a low probability to inflation risks.** They benefited from access to cheap liquidity, which did not seem to have a significant impact on inflation, despite rapid wage growth. Now they are faced with the very challenging task of fighting skyrocketing prices in a recessionary environment.

**Central banks have continued to tighten their monetary policy sharply in response to soaring inflation (Figure 9).** Russia is the only country where the strengthening current account has allowed the central bank to roll back its February 2022 increase in the policy rate, which is now only 1 pp higher than in January 2022. Ukraine, which has the harshest macro-financial conditions due to the war, has introduced the steepest interest rate hike in the region – by 15pp to 25%. Still, real interest rates remain negative in most countries (Figure 10), which points to the limited effect that monetary policy has in the fight against inflation.

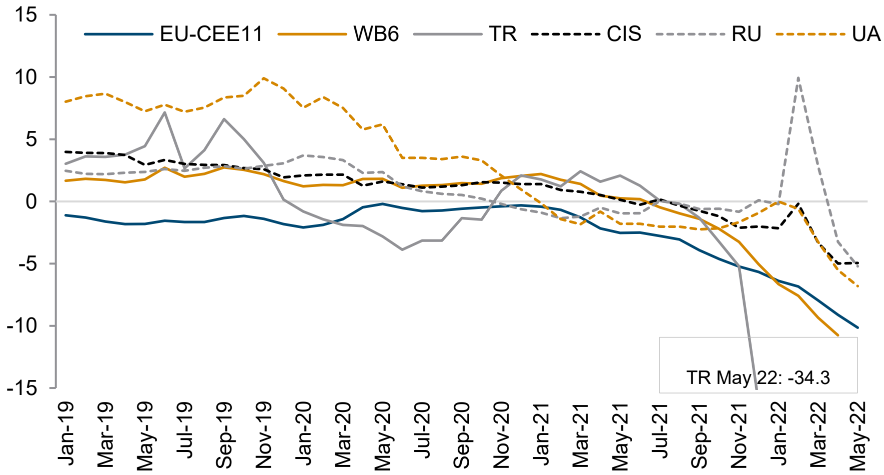
**Figure 9 / Central bank nominal policy rate, end of month, %**




Note: June 2002 data end on June 23.
Source: wiiw Monthly Database incorporating national statistics.

**Fiscal policy contributes to alleviating the inflationary burden on the economy, but its room for manoeuvre is shrinking.** The governments of most CESEE countries continue to use different fiscal policy tools to cushion the blow of soaring inflation to the most vulnerable households and companies (see Forecast Report / Spring 2022). However, as interest rates are rising, so are the costs of borrowing for the governments, which can make liquidity scarcer and more expensive. As Figure 11 shows, government bond yield spreads have widened significantly compared with February 2022 and have almost reached the peak values recorded during the global financial crisis in all the sampled CESEE countries apart from Turkey. (In the latter the yield spread – at almost 20% – remains the highest in the region, which makes the country highly exposed to external funding stress). Among the EU-CEE economies, Romania, Hungary and Poland have recorded the sharpest increases in the cost of borrowing. However, as the long-term interest rates in these countries are still negative, the average financing costs of government debt is likely to remain low by historical standards, and the fiscal sector is unlikely to suffer from a significant squeeze any time soon.

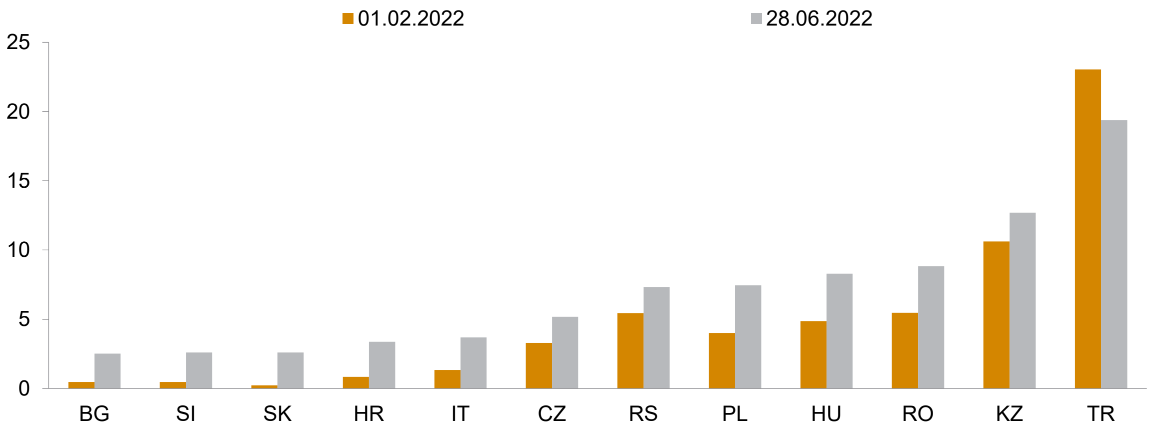
**Figure 10 / Real policy rate, CPI deflated, %**




Note: Simple averages for country aggregates. CIS includes Belarus, Kazakhstan and Moldova.
Source: wiiw Monthly Database incorporating national statistics.

**Figure 11 / Government 10-year bond yield spreads versus Germany**

percentage point change




Source: [www.investing.com](http://www.investing.com).

**EU-CEE can benefit from access to the resources of the EU Recovery and Resilience Facility (RRF).** As of mid-June 2022 the Baltic states, Croatia, Czechia and Romania had their recovery plans endorsed and received disbursements under the RRF programme (Table 4). During the forecast period the mobilisation of EU transfers may become crucial for all the eligible countries to compensate for shrinking aggregate demand.

**Table 4 / Disbursements made under the RRF to selected CESEE countries by mid-June 2022**

| | Amount, EUR m | Share in 2021 GDP, % |
|---|---|---|
| Croatia | 818.4 | 1.43 |
| Czechia | 914.6 | 0.38 |
| Estonia | 126.0 | 0.41 |
| Latvia | 237.4 | 0.72 |
| Lithuania | 289.1 | 0.52 |
| Romania | 1942.5 | 0.81 |

Source: European Commission.

**We have revised our inflation forecasts for 2022 in most CESEE countries upwards (see Table 5).** Our inflation forecast is cut only for Russia, where currency appreciation, coupled with the cooling of private consumption, has brought about rapid disinflation. Excluding Turkey, which is an outlier with a forecast inflation rate of 67.7%, as well as war-torn Ukraine, the CIS countries registered the highest price increases in 2022 among their peers. Their economies are the most exposed to Russia's war in Ukraine and lack the fiscal space to mitigate the effects of the rise in global commodity prices.

**Table 5 / CPI growth forecasts and revisions**

| | | Forecast, % | | | Revisions, pp | | |
|---|---|---|---|---|---|---|---|
| | | 2022 | 2023 | 2024 | 2022 | 2023 | 2024 |
| EU-CEE | BG | 14.0 | 8.0 | 5.0 | 0.0 | 0.0 | 0.0 |
| | CZ | 12.2 | 5.8 | 2.3 | 3.5 | 2.0 | 0.0 |
| | EE | 14.5 | 7.5 | 4.0 | 3.5 | 4.0 | 1.2 |
| | HR | 8.2 | 3.5 | 3.0 | 1.7 | 0.6 | 0.7 |
| | HU | 11.0 | 6.0 | 4.0 | 2.0 | 1.0 | 0.5 |
| | LT | 14.5 | 6.5 | 4.0 | 2.5 | 0.0 | 0.0 |
| | LV | 13.0 | 6.5 | 3.0 | 3.0 | 0.0 | -0.5 |
| | PL | 10.5 | 8.0 | 4.5 | 0.5 | 1.5 | 1.0 |
| | RO | 12.0 | 7.0 | 4.0 | 3.0 | 2.0 | 1.0 |
| | SI | 8.1 | 4.3 | 2.3 | 3.3 | 2.6 | 0.9 |
| | SK | 10.5 | 6.5 | 2.5 | 2.5 | 2.0 | 0.5 |
| Western Balkans | AL | 6.1 | 3.5 | 2.5 | 0.1 | 0.1 | 0.0 |
| | BA | 10.0 | 4.0 | 3.0 | 2.0 | 0.0 | 0.0 |
| | ME | 10.0 | 4.0 | 2.0 | 3.6 | 1.0 | 0.0 |
| | MK | 11.0 | 6.0 | 4.0 | 3.0 | 1.0 | 0.0 |
| | RS | 10.0 | 6.0 | 4.0 | 0.0 | 0.0 | 0.0 |
| | XK | 8.5 | 4.3 | 2.0 | 1.5 | 0.3 | 0.0 |
| Turkey | TR | 67.7 | 22.6 | 19.6 | 12.7 | 2.6 | 9.6 |
| CIS+UA | BY | 15.0 | 12.0 | 11.0 | 0.0 | 0.0 | 0.0 |
| | KZ | 13.0 | 9.0 | 6.0 | 2.0 | 1.0 | 0.0 |
| | MD | 25.0 | 13.0 | 8.0 | 5.0 | 3.0 | 4.0 |
| | RU | 15.6 | 9.7 | 3.7 | -4.4 | -4.3 | -0.3 |
| | UA | 20.0 | 12.0 | 6.0 | 5.0 | 2.0 | 0.0 |

Note: Current forecast and revisions relative to the wiiw spring forecast 2022. Colour scale variation is from the minimum (green) to the maximum (red), excluding Turkey.
Source: wiiw.

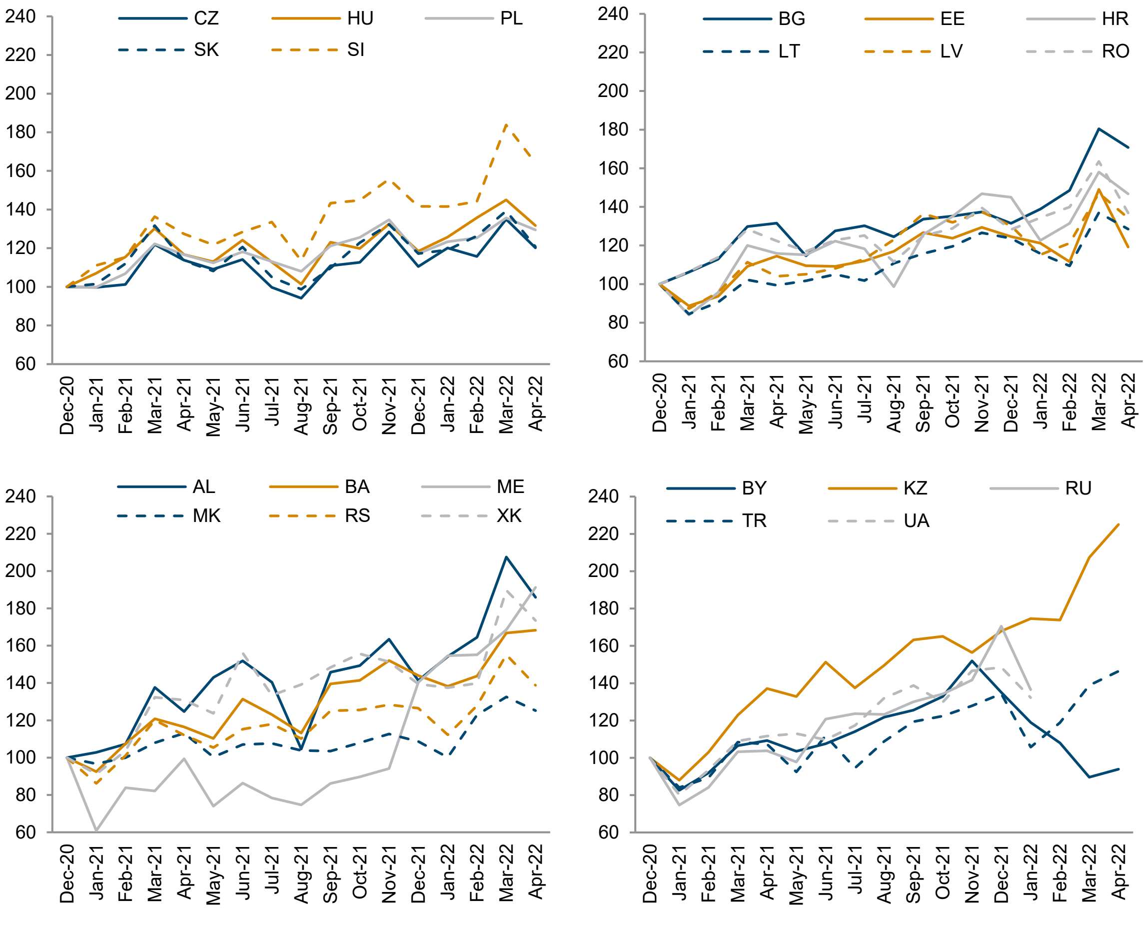
**Our inflation forecast for 2023 has also been revised upwards for most of the countries**. Inflation is expected to moderate in 2024 and reach average levels below 4% in annual terms both in EU-CEE and the Western Balkans. Only in CIS and Turkey will the inflation trajectory be more protracted, reflecting the pre-existing macro-financial imbalances.

## 1.5 INDUSTRIAL PRODUCTION LOSING MOMENTUM WITH SUPPLY-CHAIN DISRUPTIONS AND FALLING EXTERNAL DEMAND

**Global supply-chain disruptions and decreasing external demand due to the war and lockdowns in China are having a negative effect on the industrial sector of CESEE.** Especially exposed are Slovakia, Czechia, Hungary and Romania, which are tightly integrated into regional automotive production chains. They are strongly affected by the continuing shortage of semiconductors and the disruption of supply chains caused by the Russian invasion of Ukraine. Other countries, such as Lithuania, Bulgaria and Poland, are maintaining a strong industrial performance, but we think that this points to a delay in the reaction of these economies to the external shocks.

**Figure 12 / Exports of goods (customs statistics, EUR-based)**

December 2020=100




Note: data for Russia and Ukraine unavailable starting from February 2022.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**Export growth showed first signs of a slowdown in April 2022 in most countries of CESEE (Figure 12).** The EU-CEE countries appear to be the most susceptible to a weakening of global demand, reflecting their high degree of trade openness. Commodity exporters in the region, by contrast, are positively affected by soaring global prices and are seeing their exports grow.

## 1.6 FORECASTS FOR 2022-2024: ECONOMIC GROWTH SLOWS DOWN, BUT RECESSION MOSTLY AVOIDED

**With the exception of the CIS and Ukraine subregion, CESEE is expected to avoid a recession in 2022.** Given the almost unprecedented level of uncertainty, in our spring 2022 forecast we identified an adverse scenario in addition to a baseline one. In the adverse scenario, Russia's war in Ukraine is expected to continue beyond the summer and Russian energy imports are fully banned by the EU, rather than being gradually phased out. Some CESEE countries are forecast to fall into recession in that scenario. We are already finding ourselves hovering between these two scenarios, as the probability of a ceasefire any time soon is very low and the EU has introduced an almost comprehensive oil embargo. However, the region's domestic demand appears to be sufficiently resilient to achieve positive growth this year. We forecast that EU-CEE and the Western Balkans will have annual real GDP growth rates of about 3% in 2022, with Turkey lagging only slightly behind with 2.7% growth. Among the EU-CEE countries, Slovenia and Poland are expected to grow the fastest – by 4.5% and 4.2% year on year, respectively. The two countries appear to have the most resilient economies, shielded from the negative external shocks by robust domestic demand, lower exposure to the Russian and Ukrainian economies and, in the case of Slovenia, buoyant services exports. The impact of Russia's war in Ukraine will affect these two countries with a delay in 2023, when their economic growth is expected to decelerate.

**Ukraine will experience the steepest economic decline in 2022, reflecting the devastating effects of Russia's invasion on its economy**. The Russian economy will record a smaller decline than we forecasted in April because the crisis is unfolding more slowly than initially expected. This is attributable to the strength of the rouble, which has made a full recovery from its slump in the first few weeks of the war. Kazakhstan is the only country in the group that will achieve positive growth this year on the back of strong oil exports.

**The economic growth of the majority of the CESEE countries (apart from Hungary, Poland and Slovenia) is forecast to accelerate in 2023. However, in 2024 the dynamics will be mixed**, with growth in some countries accelerating and in others decelerating, reflecting structural issues in many of the region's economies. On average, EU-CEE will grow slightly faster than the Western Balkans or Turkey, with Romania becoming the leader in terms of real GDP growth. Accelerating economic growth in Ukraine assumes that the hot phase of the war will be over and that a Marshall Fund-type international agency will have been established to provide sufficient financing for the reconstruction of Ukraine's economy. The Russian economy, by contrast, is expected to grow anaemically, as the impact of trade sanctions in a wide range of industries will be unfolding with a delay and will exacerbate long-term structural weaknesses.

### Table 6 / Real GDP growth forecasts

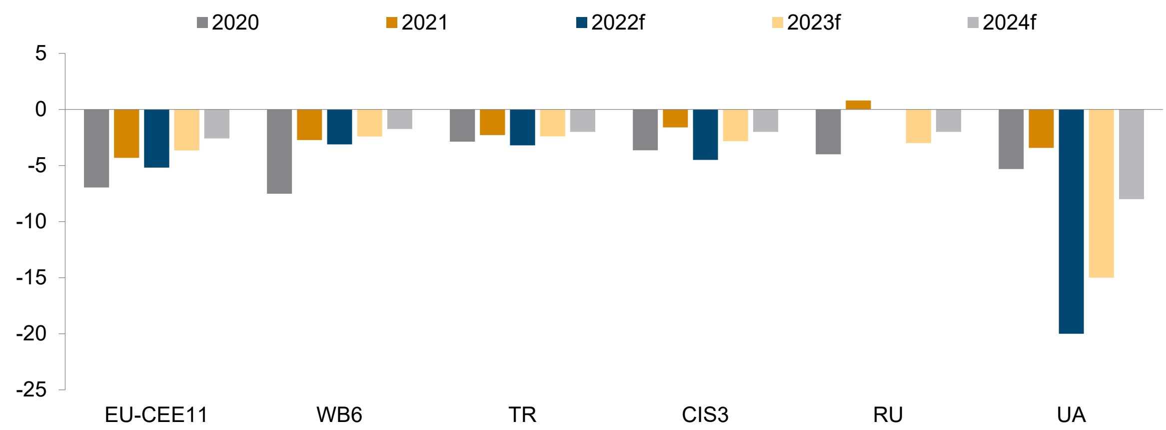
| | | Forecast, % | | |
|---|---|---|---|---|
| | | 2022 | 2023 | 2024 |
| EU-CEE | BG | 2.5 | 3.7 | 3.5 |
| | CZ | 1.8 | 2.9 | 3.7 |
| | EE | 2.1 | 3.4 | 3.1 |
| | HR | 3.3 | 3.5 | 3.6 |
| | HU | 3.1 | 1.5 | 2.7 |
| | LT | 1.9 | 2.8 | 2.6 |
| | LV | 2.1 | 2.4 | 2.6 |
| | PL | 4.2 | 3.6 | 3.8 |
| | RO | 3.5 | 3.5 | 4.5 |
| | SI | 4.5 | 3.0 | 2.8 |
| | SK | 2.2 | 2.8 | 3.4 |
| Western Balkans | AL | 3.5 | 3.5 | 3.7 |
| | BA | 1.4 | 1.8 | 2.3 |
| | ME | 3.6 | 3.7 | 3.3 |
| | MK | 1.0 | 2.5 | 2.5 |
| | RS | 3.6 | 3.4 | 3.4 |
| | XK | 3.3 | 3.7 | 3.9 |
| Turkey | TR | 2.7 | 2.8 | 3.2 |
| CIS+UA | BY | -4.5 | 1.0 | 2.0 |
| | KZ | 2.8 | 3.9 | 4.2 |
| | MD | -1.0 | 3.0 | 4.0 |
| | RU | -7.0 | -3.0 | 1.0 |
| | UA | -38.0 | 5.0 | 13.0 |

Note: Current forecast and revisions relative to the wiiw spring forecast 2022. Colour scale variation from the minimum (red) to the maximum (green) excluding UA.
Source: wiiw.

**Economic growth in the region will be backed by lax fiscal policy in 2022 to the extent that the fiscal space will allow.** Increased public spending on energy and food subsidies to the most vulnerable households and firms will result in a renewed widening of the budget deficits in many countries of CESEE. Average budget deficits will increase in all the country groups (Figure 13), with EU-CEE having on average the highest level (above 5% of GDP). The widest budget deficit in the region is expected in Ukraine, where the government finances have been ruined by the war and the bulk of the deficit will be financed through official Western assistance. We expect the deficit to widen this year in Bulgaria, Estonia, Lithuania, Poland, Bosnia and Herzegovina, Montenegro, Turkey, Belarus and Moldova. Fiscal consolidation is expected from 2023 onwards. In 2024 only five countries in CESEE are expected to have a fiscal deficit above 3% of GDP, while Bosnia and Herzegovina will be the only country in the region to run a fiscal surplus.

**Being awarded EU candidate status is a very positive development for the future of Ukraine and Moldova.** It is a decisive step towards their EU integration, signalling that they have now been embraced by the European community. Although the accession process may last a long time, as demonstrated by the Western Balkans, the status will provide a stronger anchor for the reform process in the two countries.

**Figure 13 / Fiscal balance in % of GDP**



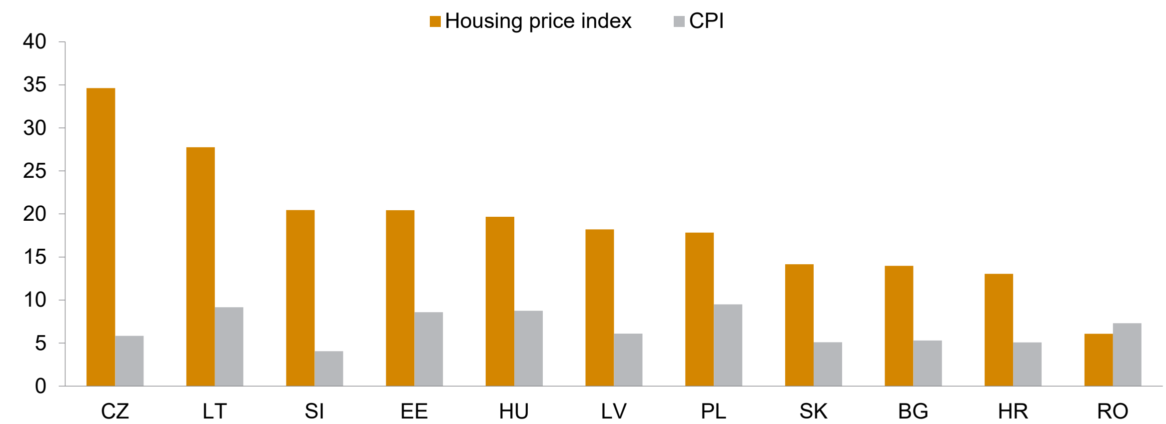

Source: wiiw Annual Database incorporating national statistics and Eurostat; wiiw forecasts.

## 1.7 NEGATIVE RISKS ARE MOUNTING

**A major risk to macro-financial stability is persistently high inflation,** which could push the countries into a high-inflation world, where rapid price rises are considered normal, dominate daily life and are difficult to subdue (BIS, 2022). Stronger monetary tightening, which would be required in this case, could be detrimental for growth. It could trigger a larger slowdown or even a recession – in short, a stagflationary hard landing.

**Figure 14 / Housing price index and CPI, cumulative % change, Q1 2020 - Q4 2021**

percentage change year on year



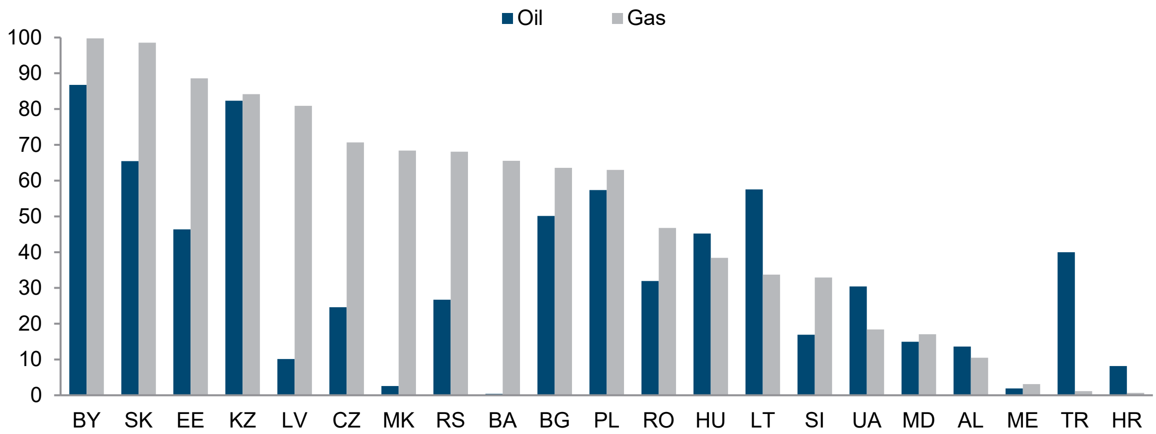

Source: wiiw Monthly Database incorporating national and Eurostat statistics and Eurostat.

**Inflated asset prices are yet another growing concern for policy makers.** As Figure 14 shows, in 2021 average nominal housing prices increased at double-digit rates – well above inflation – in all the countries in the sample apart from Romania. The fastest growth in housing prices, at 35% in annual terms, was recorded in Czechia. The tighter monetary conditions could make mortgages unaffordable for those households that have variable interest rates on their housing loans, while real income decline could make highly priced residential properties prohibitively expensive for an increasing share of consumers. All this could lead to abrupt house price corrections, with potentially adverse implications for macro-financial stability and negative spill-over effects on the wider economy (ECB, 2022).

**The effects of higher policy rates in the banking sector would also be felt through higher debt repayments** in countries where floating rate loans are more common (BIS, 2022). The aggregate savings built up early in the pandemic could provide some buffers for households and firms to cope with higher rates. However, the level of savings is unlikely to match the burdens of debt.

**As Russia is increasingly using energy to put pressure on countries that back Ukraine, many CESEE countries face the risk of winter energy rationing, which could push them into recession.** Gazprom has already cut off gas supplies to countries including Poland and Bulgaria for allegedly failing to comply with its demands to use a new rouble payment mechanism. In early June 2022 Russia restricted the volumes of its gas exports to Europe via Nord Stream 1, claiming technical issues as a pretext. Ten EU members, including Germany, Sweden and Italy, declared 'early warning' level for a potential gas supply emergency as a result. Many countries in CESEE are highly dependent on imports of Russian gas, especially Slovakia, Estonia, Latvia and Czechia (Figure 15).

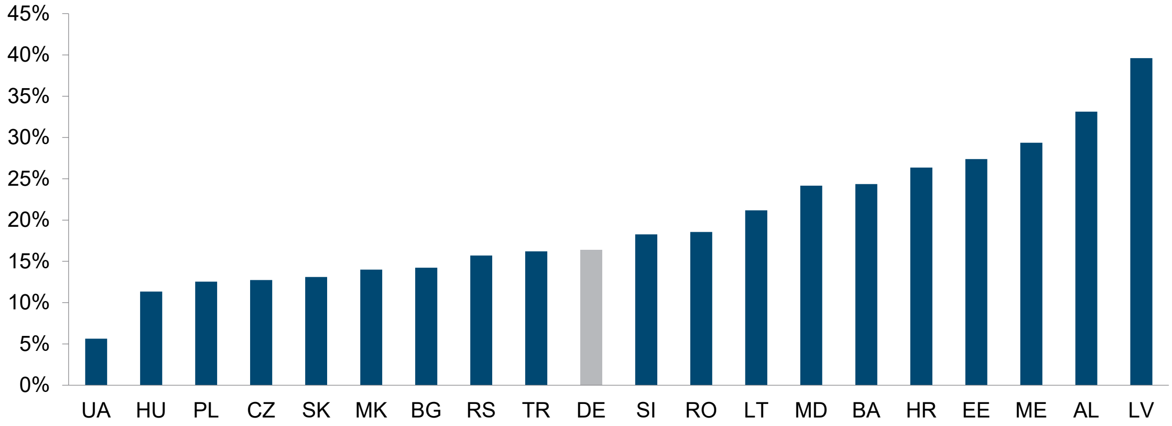
**Figure 15 / Dependence on Russian oil and gas, in % of total imports of oil and gas, 2020**




Notes: according to SITC 4 rev. classification, 2-digit level, oil corresponds to 33 (petroleum and products), gas to 34 (gas, natural and manufactured).
Source: WITS - UN COMTRADE, wiiw calculations.

**Backsliding into increased coal use is another risk in this situation.** Although the EU has adopted the Just Transition Mechanism, which is aimed at alleviating the consequences of a coal phase-out and the transition to climate neutrality, and recently the REPowerEU Plan, which is aimed at ending the EU's dependence on Russian fossil fuels through energy savings, the diversification of energy supplies and the accelerated roll-out of renewable energy to replace fossil fuels, it may not be feasible in the short run to cut the dependency in an environmentally friendly way. Germany, Austria and the Netherlands have already announced that they would fire up coal plants if Russia moved to limit gas supplies. Within CESEE, the best performers in terms of the share of renewables in the gross available energy mix are Latvia, Albania, Montenegro, Estonia and Croatia (Figure 16).

**Figure 16 / Share of renewables and biofuels in gross available energy mix in 2020**




Source: Eurostat.

**Increased risk of geopolitical instability in the countries located close to the Russian border puts them at risk of tightening financial conditions.** There is early evidence that Russia's invasion of Ukraine has deterred international investment in the Baltic states (and Finland) as fund managers seek to avoid geopolitical risks. A recent change in NATO's battle plans to offer better protection to the alliance's eastern flank may help to boost investors' confidence in the security of the region.

## 1.8 CONCLUSIONS

**Multiple external shocks are putting the resilience of the economies of CESEE to the test.** Although the performance of these countries in Q1 2022 was robust, later this year high inflation will be a significant obstacle to economic activity in the region as it eats into real household incomes and pushes many households into poverty. Intensifying supply-chain bottlenecks as a result of Russia's war in Ukraine as well as a decrease in external demand will also create barriers to growth.

**Still, the region's domestic demand appears to be sufficiently resilient to allow most of the countries to achieve positive growth this year.** We forecast that EU-CEE and the Western Balkans will record annual real GDP growth rates of about 3% in 2022, with Turkey lagging only slightly behind with 2.7% growth. Among the EU-CEE economies, Slovenia and Poland are expected to grow at the fastest rate – by 4.5% and 4.2% year on year, respectively – thanks to robust domestic demand, lower exposure to the Russian and Ukrainian economies and, in the case of Slovenia, buoyant services exports. Ukraine will suffer the steepest economic decline in 2022 in the CIS3+UA subregion because of the devastating effects of Russia's invasion on its economy. The Russian economy will experience a smaller decline this year than previously forecast because the biggest shock from oil embargo will not be felt until 2023.

**The slowdown in growth is likely to be short-lived, and most countries in CESEE (apart from Hungary, Poland and Slovenia) are forecast to experience a rebound in 2023.** In 2024 the dynamics will be mixed, reflecting structural issues in many of the region's economies. However, this forecast is subject to very high degree pf uncertainty owing to the unpredictability of the future course of the war and mounting negative risks. The major risk for macro-financial stabilisation is persistently high inflation. This would require stronger monetary tightening, which could trigger a stagflationary hard landing. A sudden stop of gas imports from Russia could bring energy rationing in winter and push the region into a recession.

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# 2. Challenges for Austria in light of the war in Ukraine

BY BERNHARD MOSHAMMER

› **Although efforts are under way to reduce Austria's reliance on Russian energy, it will remain high for some time and leave the country vulnerable to a winter gas shut-off.**

› **An additional area of potential vulnerability for Austria is its reliance on oil imports from Kazakhstan that transit via Russia.**

› **Ukrainian refugees have a fairly good chance of finding jobs in Austria, but they will face challenges such as avoiding qualification mismatches and organising childcare.**

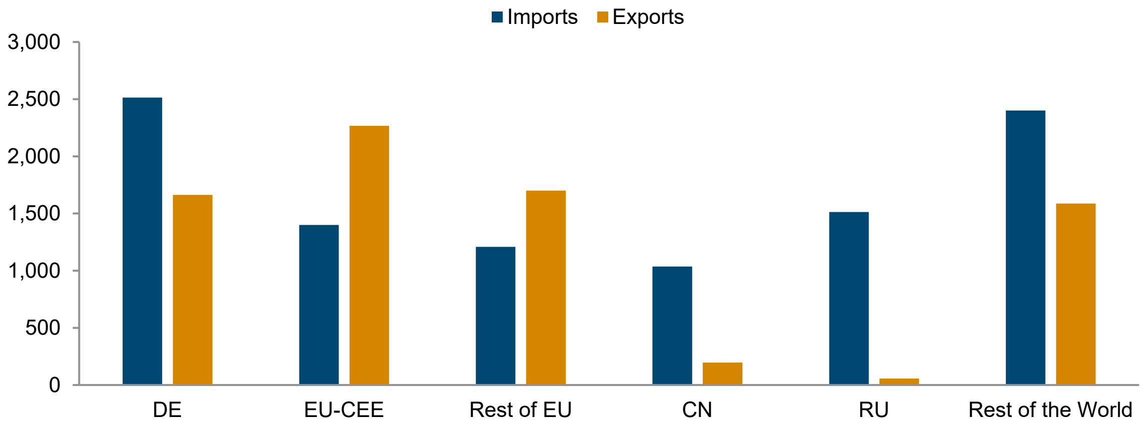
› **If the first tranches of the Polish Recovery and Resilience Plan are now approved by the European Commission, Austria will also benefit through its close economic and financial links with Poland and other Visegrád economies.**

**As a small, open economy with extensive economic and financial links to large parts of CESEE, Austria will be negatively impacted by the fallout from the Russian invasion of Ukraine.** Sharply increasing inflation, deteriorating business sentiment and the particular challenges faced by Austrian firms in Russia, Ukraine and Belarus already underscore this. As outlined in the regional overview, while much of the CESEE region has shown impressive resilience so far this year, it is hard to imagine that this will remain the case during the second half of the year. Given that the region includes some of Austria's most important trading partners, it is likely that negative external headwinds will intensify in the second half of the year. The increasingly negative outlook for the German economy, by far Austria's main trading partner, is a further indication of the progressively difficult external environment.

**In Q1 2022 trade rebounded strongly compared with Q1 2021, but this is unlikely to continue as the full effects of the war make themselves felt.** Sentiment indicators already point to a slackening of momentum in industry, driven by external factors. The Austrian Purchasing Managers Index (PMI) for May showed new orders in industry falling below 50 (the level separating expansion from contraction) for the first time in 20 months. According to the survey, the key driver of the fall in orders was demand from abroad.

**Along with a slackening of external demand, Austrian trade data also show clearly the impact of surging commodity prices, with the value of imports growing strongly in Q1.** Although the import volume from Russia declined, the nominal value of imports more than doubled in the same period, driven by buoyant gas prices. The value of exports to key EU markets also rose strongly in Q1, although the PMI data suggest that this will not last during the rest of the year (Figure 17).

**Figure 17 / Change in Austria's trade with selected economies, Q1 2022 year on year, in euro million**

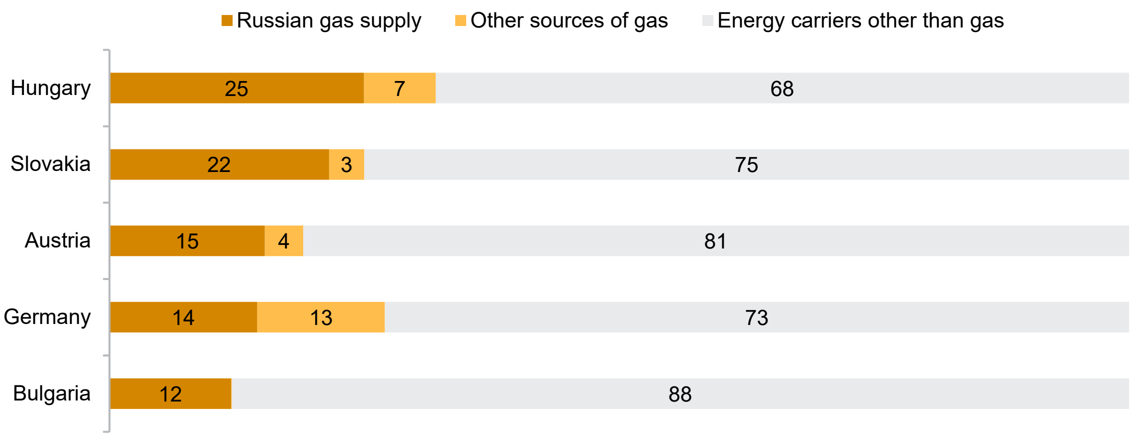



Source: Statistik Austria.

## 2.1 PHASING OUT OF RUSSIAN ENERGY UNLIKELY TO HAPPEN QUICKLY

**The biggest challenge for Austria in the near term is its high dependence on Russian energy, which will not be quickly unwound and remain a source of vulnerability, especially in the winter months.** Although Austrian oil imports from Russia will be embargoed by the end of the year (along with those of most of the rest of the EU), the transition away from Russian gas will take much longer. Austrian gas imports from Russia are only to be phased out by 2027, according to the federal government. [1] As illustrated in the wiiw spring forecast, Austria and its key EU trading partners are particularly dependent on Russian gas (Figure 18).

**Figure 18 / Top five EU members states most dependent on Russian gas as a share of overall energy consumption**




Source: McWilliams et al., 2022.

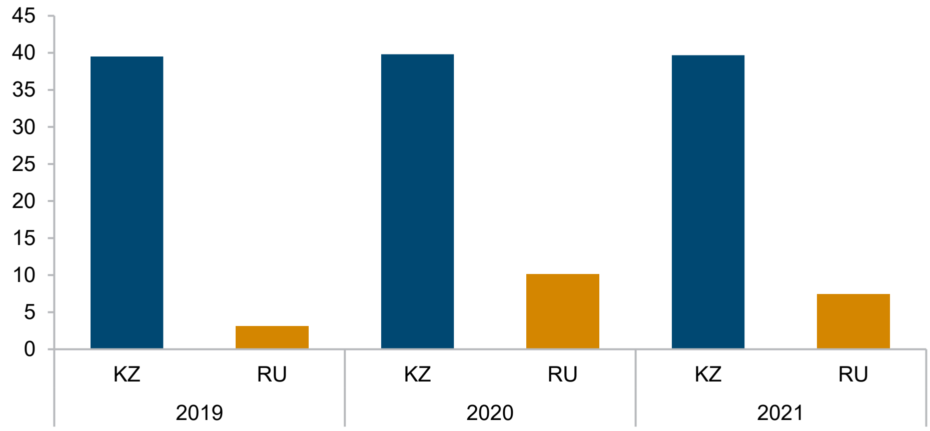
[1] https://www.wienerzeitung.at/nachrichten/wirtschaft/oesterreich/2148210-Gewessler-an-Autofahrer-Runter-vom-Gas.html

**In Austria gas plays a crucial role for large industrial firms, meaning that key parts of the economy are vulnerable to a gas shut-off or reduction by Russia.** The importance of gas for the production process increases with business size. According to the WIFO Business Cycle Survey 38% of Austrian manufacturers reported that gas plays an important role in their production process (including 24% of small businesses and 65% of large businesses). Among those, only 27% estimated that a 10% reduction of gas supplies would not cause a reduction in production, and only 6% estimated that a 50% reduction in gas supplies would not cause a reduction in production. WIFO estimates the negative impact of a 50% reduction of gas supply on production at 19.2%, which is likely to be a lower bound estimate.

## 2.2 UNCERTAINTIES OVER KAZAKHSTAN, AUSTRIA'S KEY OIL SUPPLIER

**Austria's reliance on oil from Kazakhstan could emerge as a further source of vulnerability, given the fact that Russia is a transit hub for all of this oil, and it appears willing to limit these flows for its own political ends.** Kazakhstan is Austria's key supplier of crude oil (Figure 19), but its current key transport route transits through Russia. The Caspian Pipeline Consortium (CPC) pipeline, which carries two thirds of Kazakhstan's oil exports, terminates in the Russian Black Sea town of Novorossiysk, from where the oil is then shipped. Since the outbreak of the war Kazakhstan has made considerable efforts to avoid being sanctioned along with Russia, but vulnerabilities remain in the short term, as demonstrated by recent operational suspensions. [2,3] Since the outbreak of the war operations at the terminal have been suspended twice, first in March and then again in June. The second closure came shortly after President Kassym-Jomart Tokayev stated at the St. Petersburg International Economic Forum that Kazakhstan would not recognise the Russian-controlled regions of Luhansk and Donetsk as independent. Days later the Russian authorities suspended operations, claiming that torpedoes and sea mines from the Second World War had been found and the harbour had to be cleared.

**Figure 19 / Share of Kazakh and Russian oil in Austrian oil imports, % of total**




Source: UN COMTRADE.

[2] https://www.reuters.com/business/energy/exclusive-kazakhstan-renames-its-export-oil-avoid-russia-sanctions-risk-2022-06-03/

[3] https://www.reuters.com/article/oil-kazakhstan-cpc/update-1-russia-extends-search-for-explosive-mines-near-cpc-pipeline-sea-terminal-idUSL1N2YA14U

## 2.3 UKRAINIAN REFUGEES BOUND TO ENTER A BOOMING AUSTRIAN LABOUR MARKET

**The Austrian labour market has the capacity to absorb the current number of Ukrainian refugees willing to work, but they will face challenges.** The overall conditions on the Austrian labour market are fairly favourable: in May 2022 there were 237,818 unemployed and 73,725 in training reported, against 138,134 open positions. With fewer than three unemployed persons per open position, the Austrian labour market is tight. As of May 2022 more than 20,000 open positions were reported in the restaurant and hotel sector alone.[4] Given that around 7,600 work permits had been issued by the end of June, the current number of Ukrainian refugees who can access the labour market will have little impact on regional mismatches and sectoral asymmetries.[5]

**The overall educational attainment of Ukrainian refugees is high**. According to Austrian Public Employment Service (AMS) data, 31% of Ukrainian refugees registered in Austria hold a university degree.[6] Particular challenges for a successful labour market integration are avoiding qualification mismatches and organising childcare. Refugees often work below their educational attainment level due to lack of proof or verification of their previous training. For this they need bureaucratic assistance to obtain proof of their qualifications and verification of their certificates because the Ukrainian tertiary educational system is quite heterogeneous.

**Childcare duties will be a challenge for labour market integration.** First, the share of children among Ukrainian refugees is very high: according to EU-wide estimates, 39% of all Ukrainian refugees are under the age of 18.[7] Second, care and household duties were the main reason for Ukrainian women of working age not to become active on the Ukrainian labour market even before the outbreak of the war. In 2018, 61% of working-age women who were not working reported this as the reason for not becoming active.[8] The provision of sufficient childcare facilities will contribute to a swift labour market integration. Regional disparities in the provision of such services could play a role here: for instance, in Vienna the childcare participation rate of infants is highest with 43.1% of all children aged 0-2 years, while Upper Austria and Styria are at the lower end of the scale with only 17.8%.[9]

## 2.4 THE EUROPEAN COMMISSION'S GREEN LIGHT FOR THE FIRST TRANCHES OF THE POLISH RECOVERY FUNDS WOULD BE GOOD FOR AUSTRIA

**As long as the remaining issues are resolved between Warsaw and the European Commission, Austria will benefit from the Polish Recovery Plan both directly and indirectly.** The Polish government agreed a deal with the European Commission in early June to unlocks its share of the EU Recovery and Resilience Facility (RRF) funds. However, at the start of July it emerged that there was still one sticking point related to proposed judicial reforms. Assuming that a compromise is found and the

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4 AMIS Datenbank.

5 https://www.bmdw.gv.at/Themen/Aktuelles/PK-AL-Zahlen-und-AMS-Erhebung-Qualifikation-Ukraine.html

6 Ibid.

7 https://data.europa.eu/en/datastories/refugee-flows-ukraine

8 State Statistics Service of Ukraine (2019).

9 Statistik Austria.

issue resolved, Poland will start to receive the funds. The Commission's approval is highly relevant, as Poland's share of the RRF funds accounts for around 7% of its entire volume. The RRF with its more than EUR 700bn in grants and loans will not only facilitate the COVID-19-related recovery but also mitigate shocks inflicted by the Russian war of aggression against Ukraine. According to wiiw estimates made before the war, the annual growth impact of the entire RRF on the Austrian economy within a five-year period could reach 0.3 percentage points, which is more than the size of the funds Austria is to receive directly from the RRF plan.[10]

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# 3. Country updates

## ALBANIA: INFLATIONARY PRESSURE IS HOLDING BACK CONSUMPTION AND GROWTH

***by Isilda Mara***

Economic growth will be 3.5% in 2022. A weakening of consumption can be anticipated because wage rises will not fully compensate for surging consumer prices (nominal wages rose by 5.8% in Q1 2022, year on year, while consumer prices soared by 5.2% in January-May 2022, and are expected to reach 6.1% by the end of 2022). Still, we expect that rising employment and remittances inflows – the latter owing to persistent emigration – will in part cushion consumption. The central bank responded to the hike in inflation by raising interest rates, but the effect on credit demand will be moderate both among households and the private sector. Tourism looks promising, but the sector has not yet fully recovered from the pandemic and is strongly affected by labour market tightening. A new wave of emigration among Albania's youth is one of the main causes. Labour market tightening is also becoming evident in other sectors such as agriculture and ICT, sectors which have huge potential given the global food crisis and growing gig economy, respectively. The energy balance improved slightly in Q1 2022. The government has become more proactive with respect to renewables by promoting and supporting the country's potential regarding green energy.

## BELARUS: SLIDING INTO A DEEP RECESSION

***by Rumen Dobrinsky***

With Western sanctions applied in full, the recession in Belarus is deepening. In the period January-May 2022 gross aggregate output was 3.4% down year on year, while gross industrial production was down 4.2%. At the same time inflation picked up, with the 12-month consumer price index up by 17% year on year in May. The central bank has maintained a relatively loose monetary stance, keeping its policy rate (at 12% since March) well below expected inflation. After an initial dip in February-March the Belarusian rouble strengthened against the main Western currencies. In June the exchange rate against the US dollar stood at approximately the same level as before the start of the war in Ukraine. However, during the same period the Belarusian currency weakened by some 25% against the Russian rouble. These developments reflect the overall appreciation of the Russian currency and the reorientation of Belarusian trade flows to and from new markets, which has resulted in declining demand for the dollar and the euro. The short-term prospects for Belarus have deteriorated, and we now expect annual GDP to sink by 4.5% in 2022 which is 1 percentage point down from our spring forecast. The country's economic performance will remain sluggish in the coming years.

## BOSNIA AND HERZEGOVINA: POLITICAL TURBULENCE AND INFLATION TAKE THEIR TOLL ON THE ECONOMY

***by Selena Duraković***

Inflation, which was 9.6% in the first four months of 2022, reached 14.4% in May. We now project that it will average 10% in 2022 as a whole, which equates to an upward revision of 2 percentage points (pp) from our spring forecast because prices are expected to increase further. The economy is expected to grow by only 1.5% in 2022 – a downward revision of 0.3 pp from our spring forecast. This is largely a reflection of falling private consumption as a result of rising prices and unaligned increases in wages and pensions. Furthermore, growth in both public and private investments is expected to slow due to the uncertainties caused by higher domestic and foreign political risks and the non-adoption of the country's consolidated budget, which is holding back new public investments. Exports and imports will continue to rise, but this may well be at a slower rate than previously expected owing to lower disposable incomes and low EU growth projections. Moreover, funding for the country's October general election has still not been secured as the country's Croats insist on a change in the Election Law and no agreement has been reached so far. However, the date for the election has been announced and elections are expected to be held on 2$^{nd}$ of October.

## BULGARIA: A NEW POLITICAL CRISIS RAISES ECONOMIC UNCERTAINTY

***by Rumen Dobrinsky***

Bulgaria faced a new political crisis after the government lost a no confidence vote in parliament on 22 June. The motion followed the decision by one of the parties in the heterogeneous four-party coalition to pull out of the government due to disagreements over its policy course. On the economic front performance was better than previously expected, with GDP growing by 5% year on year in Q1, thanks to robust exports and private consumption in that period. However, high inflation remained a big headache for the authorities; apart from the effect of global factors, it accelerated as a result of loose budgetary and income policies. The June 2022 EC Convergence Report concluded that Bulgaria did not fulfil the conditions for the adoption of the euro, citing two problematic conditions: (i) failure to fulfil the criterion on price stability, and (ii) legislation which was not fully compatible with the euro zone requirements. Given such a conclusion, Bulgaria's target date to adopt the euro on 1 January 2024 now seems problematic. In Q2 economic activity slowed down considerably. However, thanks to the strong performance in the first months of the year, we now expect GDP to grow by 2.5% in 2022 as a whole, which is 0.5 percentage points higher than envisaged in our Spring Forecast. At the time of writing it was not clear how the political crisis would be resolved, and the uncertainties about the future policy course were rising.

## CROATIA: NO RESPITE IN SIGHT

***by Bernd Christoph Ströhm***

Croatia's economy grew by 7% year on year in Q1 2022, indicating a further recovery from the COVID-19 pandemic. Nevertheless, due to increases in energy and basic goods prices Croatia will see record levels of inflation in 2022, as seen in May, when inflation accelerated to 10.8% year on year. Persisting global supply-chain disruptions and higher energy prices will exert upward pressure on inflation to an average of 8.2% in 2022 as a whole. Soaring inflation will negatively affect household spending and tourist bookings from EU countries such as Germany, Austria or Italy for the country's vital summer season, which is why we have slightly revised Croatia's 2022 GDP growth forecast to 3.3%, down from 3.5% previously. Croatia's current account surplus is projected to rise to 0.6% of GDP and the unemployment rate will remain at some 7.2% – above pre-COVID levels. Surging inflation and energy prices will put pressure on the country's budget expenditure side. Nevertheless, the government has so far managed to contain public debt thanks to the country's improved fiscal position and stellar economic recovery in 2021. In June the European Commission also confirmed that Croatia had met all the criteria to adopt the euro in January 2023. We expect that this year's budget deficit will widen 3.3% of GDP, but that the public debt/GDP ratio will fall to around 78%.

## CZECHIA: HEADWINDS PROVING STRONG AND PERSISTENT

***by Zuzana Zavarská***

The Czech economy performed relatively well in Q1 2022, expanding by 4.8% in annual terms. Household consumption and gross fixed capital formation were the main drivers of this, contributing 3.4 percentage points and 3.1 percentage points, respectively. A similar pace of growth is unlikely to be maintained over the rest of the year, however, as the pandemic-related base effects subside, households become more prudent in their spending, and the impact of the ongoing war in Ukraine is fully reflected in the numbers. Inflation is anticipated to remain high for much of the year and, following a substantial revision upward, is now expected to be in double-digit territory in 2022. Amidst falling real incomes, consumer confidence has hit a 10-year low, denting the ability of household consumption to contribute to growth. At the same time, recovery from the supply-chain shock, further intensified by the war, is apparently going to take longer than anticipated. This will hurt export-oriented industrial economies like Czechia, where net exports will inevitably put a damper on growth. Industrial production already recorded a year-on-year decline of 3.8% in April, partially explained by the strong post-lockdown revival last year. On the other hand, the service sector is driving optimism, as life returns to 'normal' and pandemic concerns are packed away. Yet, as consumers tighten their belts, the revival could prove short lived. Given the rather strong and persistent headwinds, the outlook for Czechia has been revised downward, with real GDP expected to grow only modestly, by 1.8% in 2022, and with downside risks dominating.

## ESTONIA: CLOUDS ARE GATHERING AS AUTUMN APPROACHES

***by Maryna Tverdostup***

The first half of 2022 revealed just the tip of the economic setback iceberg, the second half will uncover the rest. With the first signs of the crisis only starting to appear at the end of spring, economic growth reached 4.3% year on year in Q1 of this year. This was largely due to active foreign trade, strong consumption both by the business and the private sector, and steadily growing income levels. However, our GDP forecast has been downgraded to 2.1% in 2022, as the full effect of the EU's economic sanctions and Russia's retaliation measures is expected to materialise in the second half of the year, both via a reduction in demand by foreign trade partners and upward price pressure. With inflation hitting a record 18.8% in April and continuing to climb, we have raised our inflation forecast for 2022 to 14.5%. Political tensions (the break-up and a likely 'on the fly' change of the coalition government) as well as above-budget spending by the government, including support to low-income households, are likely to leave a long-lasting mark on economic growth and inflation, respectively.

## HUNGARY: THE EMERGENCY BRAKE IS BEING APPLIED

***by Sándor Richter***

Hungary's GDP growth rose to 8% year on year in Q1 2022, driven by pre-election and pre-war spending, while the macroeconomic equilibrium deteriorated radically as a result of overheating. Close to 90% of the annual targeted budget deficit was accumulated in the first half of the year, and a large deficit emerged in foreign trade. The exchange rate remained weak despite policy rate rises, and consumer price inflation recorded double-digit growth despite price caps. In early June the government announced a consolidation package for the remainder of 2022 and in 2023, with measures accounting for 3-3.7% of GDP in each year. These include a considerable increase in existing specific sectoral taxes and the introduction of new taxes, which are primarily targeted at the large multinational firms in the services sector. The postponement of public investment projects has been announced and price caps on energy will be maintained for households only – a painful change for resource-deprived local governments and many businesses. Other, not yet specified expenditure cuts have been announced as well. In the wake of the consolidation package the mobilisation of suspended EU transfers may become crucial. Recovery and Resilience Facility funds and traditional transfers from the EU budget would compensate to a large extent for the shrinking aggregate demand due to the consolidation package. Since the beginning of the war in Ukraine political relations between the EU and Hungary have become even worse than before, leaving little chance of the country accessing the outstanding EU resources any time soon. This year the impact will still be cushioned by the strong growth recorded in the first quarter and a prolonged spending rush of households in reaction to growing inflation. The full negative impact of the consolidation measures on growth will be felt in 2023. This forecast assumes a lasting suspension of most EU transfers. Should a compromise emerge, inflows of EU transfers would allow a milder deceleration of economic growth.

## KAZAKHSTAN: HIGH OIL PRICE IS FAVOURABLE FOR GROWTH, BUT GEOPOLITICAL RISKS REMAIN

***by Alexandra Bykova***

Higher than expected oil prices have pushed up exports, and the recent OPEC+ decision to expand oil production starting from the third quarter of this year has caused an upward revision to our real GDP growth forecast for 2022 to 2.8%. However, the main oil shipment route via the Russian port of Novorossiysk remains exposed to geopolitical risks. Economic sentiment in the manufacturing sector in May indicated growing optimism based on an increase in new orders, despite rising input costs, problems with logistics and deteriorating access to finance following a policy rate hike to 14%. A government import substitution programme, estimated to account for around 1% of GDP in 2022, is likely to add to this optimism. Amid high global prices for food and energy our consumer price forecasts for 2022 and 2023 have been revised upwards. Nevertheless, an extension in June 2022 of fuel price controls for a further six months is likely to have a dampening effect on inflation. Despite high inflation, real wages posted double-digit annual growth in Q1 2022, driven partly by an increase in the minimum wage in January, which will have a positive impact on consumption. The constitutional amendments approved by 77% of voters in a June referendum are in line with the demands of January's protesters for political change because they curtail the privileges of the first president and slightly restrict presidential power in general. Protest potential is likely to decline, but no significant changes in the political system are likely in the near future.

## KOSOVO: REMITTANCES COME TO THE RESCUE

***by Isilda Mara***

We expect economic growth to accelerate to 3.3% this year. Growth will be consumption-led, albeit at a slower pace than in 2022. Kosovo's high dependence on imports makes it quite exposed to international price dynamics. Inflation reached 9.7% year on year in January-May 2022, while price hikes in electricity, food products and transport reached 12%, 13% and 17%, respectively, over the same period. We expected consumer price inflation to hover at 8.5% this year. Remittances are coming to the rescue, and they will certainly help to smooth consumption, as they also did during the pandemic. In the first four months of the year remittances recorded a rise of 6% compared with the same period in 2021. In June 2022 the gross minimum wage rose to EUR 264, from EUR 150 previously, which will affect 27% of employees. In April 2020 the government offered a lump sum of EUR 100 to 800.000 citizens – 44% of the total population, mainly pensioners, public- and private-sector employees and students – to cope with the strong rise in prices. For the time being energy security challenges are being met. Imports of electricity declined slightly, while exports rose by 20% year on year in the first four months of 2022. The international energy turmoil has pushed many countries to go back to coal for their energy production. This is reflected in the strong rise of lignite exports from Kosovo, which in real terms rose tenfold in January-April 2022, year on year. Positive dynamics are also recorded for foreign direct investment inflows, which were up by 41% in Q1 2022, year on year, although the majority of this continues to be absorbed by the real estate sector.

## LATVIA: WAR-INDUCED SLUMP KEPT IN CHECK

***by Sebastian Leitner***

With the start of Russia's war against Ukraine both consumer and business sentiment in Latvia plunged in March of this year. Since then, however, short-term data show that overall growth is still being supported by both domestic and foreign demand. The enormous rise in the price for energy but also for food products has pushed up the consumer price index significantly. Industrial production and activity in the private service sector were still growing considerably in the first half of 2022, while escalating prices of inputs resulted in a substantial decline of construction output. We have raised our GDP forecast for 2022 slightly, to 2.1% (from 1.4%), on the back of stronger external and domestic demand, with the latter driven also by unemployment falling to 6.8% in Q1 of this year. In 2023 we expect GDP to grow more robustly, by 2.3%, given an increase in public investment. The general budget deficit in 2022, at 5.5% of GDP, will be somewhat higher than previously expected, driven by anti-inflationary measures introduced by the government and higher defence spending.

## LITHUANIA: REDUCED PURCHASING POWER OF HOUSEHOLDS AMID A TIGHTENING LABOUR MARKET

***by Sebastian Leitner***

The Lithuanian economy grew by 4.6% year on year in Q1, above expectations. Moreover, after a slump in March, business sentiment improved again slightly in the subsequent months of 2022. External demand has remained robust in the most recent months, and manufacturing also recorded good growth rates. However, rising prices, particularly of imported energy and food, will reduce the purchasing power of households substantially. In Q2 2022 Lithuania's decision to stop importing Russian gas and oil resulted in the second-highest inflation rate in the EU (after Estonia). As a result we expect private consumption to decline in real terms in the second half of this year. At the same time the situation on the labour market is getting tighter – the unemployment rate declined again to 6% in April 2022, and gross wages still grew by 14% year on year in Q1 2022. Given the higher-than-expected growth in household consumption and exports in Q1, we have raised our GDP growth forecast for 2022 slightly, from 1.7% to 1.9%. In 2023 investment will be driven by increased public spending, leading us to expect a more substantial upswing in GDP growth to 2.8%. Anti-inflationary measures (compensation to households for rising gas and electricity bills, additional pension increases etc.) will cause the public budget deficit to widen to 4.5% in 2022.

## MOLDOVA: RECESSION AHEAD

*by Gábor Hunya*

Economic growth was still positive in Q1 2022, supported by private and public consumption and driven also by the large number of temporary resident refugees from Ukraine. Severe trade disruptions and high inflation, coupled with the expected worsening of agricultural performance, will drive the economy into recession later this year. Sharp rises in electricity, oil and gas tariffs and skyrocketing food prices have prompted us to increase our inflation forecast from 20% to 25%. The Central bank has tried to alleviate inflationary pressure by raising the policy rate, which provides little help against imported inflation. The fiscal deficit is expected to expand to 6.5% from 2% to allow paying for energy subsidies and refugee-related expenditures. Generous foreign assistance, pledged mainly by multinational agencies, will provide the financing. Expanding government consumption and subsidies to private consumption will result in a milder recession than forecast earlier. Risks related to the energy supply have been factored in. Moldova produces no oil or gas and has no oil refineries. Low transport capacity is the main problem facing fuel imports and also Ukrainian exports through Moldova. The newly granted candidate status of EU membership has strengthened the position of the ruling coalition even if the country has a long and bumpy road of reforms ahead. Institutional adjustment to EU norms will widen the systemic gap between Moldova and the separatist region of Transnistria, which may lead to tensions. A further geopolitical risk is the Odesa region, which is located just across Moldova’s border with Ukraine, becoming a target for Russia’s invasion.

## MONTENEGRO: INFLATION WILL WEIGH ON GROWTH

*by Nina Vujanović*

The formation of a new government in Q2 2022 has brought about more political clarity and greater commitment to reforms as part of the EU accession process. Although the GDP growth rate in Q1 2022, at 7.2%, was very high, this was mainly from a low base in 2021 due to the lockdown, and somewhat increased private consumption. Inflation recorded double-digit growth in Q2 2022. The implementation of recent amendments to the laws on excise duty and value-added tax will limit the rise in fuel and food prices, but this will not be enough to tame inflation, which we expect to average 10% this year. The tourism sector is expecting a good season, based on improved airline connectivity with the EU market this year and the revival of demand globally. This will push up services exports. We forecast a current account deficit of 12% of GDP this year, 0.5 percentage points narrower than we projected in our spring forecast. Despite this, growth potential will be capped by high inflation, which will erode purchasing power. We forecast GDP growth at 3.6% in 2022, 0.1p higher than we had expected in the Spring.

## NORTH MACEDONIA: WHEN INFLATION RUNS OUT OF CONTROL

***by Branimir Jovanović***

Inflation in May reached 11.9%, after the government aborted the price freezes on basic foodstuff. Real wages are stagnating as a consequence, registering no growth in the first fourth months of the year, despite the 20% increase in the minimum wage from the beginning of the year. That slowed down consumption and made GDP grow by just 2.4% in Q1. The start of Q2 was even worse, with both industrial production and retail trade declining in April (in real terms). The government is refusing to raise wages in the public sector, which has led to numerous protests and strikes across the country. The central bank has hiked its interest rate three times since April, to 2% in June, from 1.25% before, which will hardly rein in inflation but may slow down the economy further. Because of all this, we are revising our inflation forecast for 2022 to 11%, from 8% previously, and our GDP growth forecast to 1%, from 2.5% previously.

## POLAND: SO FAR SO GOOD

***by Adam Żurawski***

Very strong GDP growth in Q1 2022 was driven by private consumption and rising inventories, although the latter are very likely mostly 'works in in progress'. Fixed investment rose moderately, and exports were less dynamic than imports. Gross value added is surging in the manufacturing and construction sectors, and the profitability of the corporate sector is at a record high. Wage costs are subdued amid high growth in productivity. Inflation is the key concern and is unlikely to cool down as long as external energy problems (supply and price) persist. Wages are following inflation sluggishly and have recently declined in real terms, which may augur a slowdown of output growth. Against this background the government's policy response is confused. While the central bank is tightening its policy, the government seems keen on 'compensating' for the inflation losses through the provision of subsidies to the most affected social groups. The conflict over the 'reforms' of the judicial system is temporarily less intense, but it is far from over. Because of this Poland has so far received no payments from the EU Recovery Funds. Further delays are possible.

## ROMANIA: ADVERSE IMPACTS OF INFLATION AND WAR COME WITH A DELAY

***by Gábor Hunya***

Romania is confronted with surging inflation and the adverse spillovers from the war in neighbouring Ukraine. These challenges are leading to high fiscal and current account deficits, narrowing the room for public policies. The economy is suffering from high energy prices and input bottlenecks. Despite this household consumption expanded in the first four months of 2022, driven by pent-up demand and hoarding in the expectation of rising inflation. Reflecting the delayed impact of the adverse external environment and the relatively modest effects of Russian sanctions, the wiiw growth forecast has been adjusted upwards, by 1.5pp to 3.5% in 2022. Dependence on Russian oil and gas is relatively modest, but rising prices can put a serious strain on fuel consumers, especially in agriculture and transport. Protection is provided to the population in the form of price caps on household energy supply, excise tax reliefs and cash compensation to the poorest. The resulting fiscal expenditures will be partly offset by taxes on windfall profits. The government is likely to give up some of its austerity plans, and the deficit to GDP ratio will hit 6.5% in 2022. The central bank has applied only modest rate hikes to keep the economy afloat, but interventions on the currency market are keeping the leu by and large stable against the euro, thereby curtailing imported inflation. Money from the EU Recovery and Resilience Facility has started to flow, albeit with delays due to institutional bottlenecks. More abundant disbursements of EU funds with a strong impact on investments in 2023 would counterbalance the expected faltering of household consumption.

## RUSSIA: CURRENCY REBOUND DELAYS THE PEAK OF THE CRISIS

***by Vasily Astrov***

Western sanctions on Russia have started to bite, and in April growth switched to negative (on a yearly basis). Private consumption has plunged on the back of declining incomes and increased saving propensity, partly reflecting tighter credit conditions, while many investment projects have reportedly been put on hold. However, the crisis is unfolding more slowly than initially expected, leading us to improve our growth forecast for 2022 by 2 percentage points compared with our spring forecast, to -7%. The main reason for this is the unexpected recovery of the Russian rouble on the back of high energy prices and the dramatic collapse of imports. The rouble is now trading at above pre-war levels, thereby depressing import prices and – last but not least – supporting overall public confidence in the resilience of the economy. However, the impact of trade sanctions and the mass withdrawal of foreign firms has yet to unfold fully, with a wide range of industries – from automotive to pharmaceuticals to aviation to food processing – already reporting shortages of imported inputs and inventories gradually being depleted. The EU oil embargo that will take effect at the end of 2022 will add to the economic pains, as will any further curtailment of gas exports by Russia. For these reasons the recession next year is likely to be deeper than previously expected. It is not until 2024 that the economy will finally settle on a new – and much lower – plateau, where it will probably stay for years to come.

## SERBIA: STILL STANDING

***by Branimir Jovanović***

Government price controls seem to be succeeding in partially taming inflation, which reached 10.4% in May, the second-lowest level in the Western Balkan region. Before the introduction of government controls, in November 2021, it had been 7.5%, the highest in the region. Despite the inflation real incomes are still growing, driven by the increases in the minimum wage and in public-sector wages introduced at the beginning of the year. This is keeping the economy afloat, and GDP grew by 4.4% year on year in Q1, which, although perhaps a slowdown vis-à-vis the previous year, is still decent. Q2 started on a similar note – both industrial production and retail trade grew in April (in real terms). The central bank raised its interest rate to 2.5% in June, for the third time in three months (until April it had been 1%), which may slow down the economy a bit, though not excessively, as real interest rates remain deeply negative. All in all, the economic situation in the country remains as projected in spring, so we keep our forecasts mostly unchanged, expecting GDP to grow by 3.6% for the whole year and inflation to average 10%.

## SLOVAKIA: NEGATIVE RISKS CLOUD THE OUTLOOK

***by Doris Hanzl-Weiss***

GDP grew by 3% year on year in Q1 2022 and finally reached pre-crisis levels. This was, however, one of the lowest growth rates in the EU and was affected by poor results in the industrial sector. Household consumption was the main driver with 9% growth, which was due to the low base compared with last year, when a COVID-19 lockdown was in place. Also, gross capital formation – which was about the same as gross fixed capital formation – contributed to growth and increased by 6%. Construction finally grew after three years of decline. Net exports had a negative impact: while exports declined by 4.5%, imports fell by just 1.3% (in real terms). The main Slovak industry, the automotive industry, is still in trouble. Overall, in the first four months of 2022 industrial production dropped by 4%, but the automotive sector contracted by a substantial 11%. The industry suffers particularly from the continuing shortage of semiconductors and the disruption of supply chains caused by the Russian invasion of Ukraine. Negative risks are rising and cloud the outlook: growth has been revised downward for both 2022 and the next year, to 2.2% and 2.8%, respectively. The main concern is high inflation, which risks dampening household consumption and investment. Overall, the harmonised index of consumer prices reached 9% for the first four months of 2022, while producer prices were up by 28%. Still, prospects are good for investment this year and next, as the EU budgeting period ends/starts and funds from the Recovery and Resilience Facility (RRF) will be distributed soon. Slovakia managed to fulfil the 14 milestones and on 29 April made the first payment request for a disbursement of EUR 398.7m. Trends in net exports are also negative and are also influenced by the strict zero-COVID policy in China (e.g. the lockdown in Shanghai in April and May) and the continuing war in Ukraine. Not included in this forecast is a full stop to the supply of gas, on which Slovakia is particularly dependent, but which has become increasingly probable.

## SLOVENIA: REGIONAL OUTPERFORMER

***by Niko Korpar***

Despite high inflation and mounting uncertainties on global markets, Slovenia's growth in Q1 2022 far exceeded the EU average, mainly as a result of strong private consumption. Growth in 2022 will benefit from the base effect and is forecasted to reach 4.5%. The primary drivers will be strong private demand and investments in fixed capital. The brunt of the negative impact of the Ukrainian crisis is expected to hit Slovenia only in 2023, when GDP growth will slow down to 3%. The inflation rate will reach 8.1% in 2022. The main cause for price hikes is still energy prices, although the prices of food and services have also grown considerably. The rising prices of industrial goods could have a negative effect on external trade and act as a suppressant on growth. The government has responded by capping the price of petrol and has announced measures to control the rising cost of living. The labour market is seeing historically high employment levels, and the unemployment rate is expected to settle at 4.1%. The new centre-left government led by newcomer Robert Golob was appointed at the beginning of June after a strong victory at the polls. The government will face numerous challenges, such as inflation, the need to rein in public spending, and delivering a long-delayed healthcare reform.

## TURKEY: FOOT TO THE FLOOR, HOPING FOR THE BEST

***by Richard Grieveson***

Economic and financial risks are extremely high owing to deeply negative real interest rates, skyrocketing inflation, an ever weaker lira and an expanding current account deficit. Turkey is also facing strong external headwinds, reflecting its high level of exposure to Russia, heavy reliance on commodity imports and the vulnerability of the lira in the face of rapid US monetary tightening. Real economic growth in 2022 and throughout the forecast period will be low by historical standards, as double-digit inflation continues to eat into real incomes and affects consumer and business confidence. Without a dramatic change of course by the central bank, the lira will continue to weaken in the coming years.

## UKRAINE: PERSEVERING IN TIME OF WAR

***by Olga Pindyuk***

Russia's war against Ukraine continues to have devastating effects on the country. With its Black Sea ports likely to remain blockaded in the coming months, Ukraine will be prevented from shipping the bulk of its exports. Consumer price inflation has continued to accelerate and is likely to reach 20% year on year on average in 2022. To slow soaring inflation, the central bank has increased its policy rate to 25% (by 15 pp) to the highest level for any European country. The budget deficit continues to widen, reflecting significant budget needs and a decrease in revenues. The bulk of this is being financed through borrowing, which poses risks to the sustainability of the country's public debt. As the war is expected to last for a prolonged period, we forecast a deep recession of the Ukrainian economy in 2022 and a gradual recovery beginning in 2023, subject to the end of the hot phase of the war. We forecast accelerating economic growth in 2024, which would depend on the establishment of a Marshall Fund-type international agency capable of providing sufficient financing for the reconstruction of Ukraine's economy.

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